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# Transcript

## RBC Capital Markets Canadian Automotive, Industrials & Transportation Conference

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**Webcast**

**Corporate Participants:**
Nadeem Velani – Executive Vice-President & Chief Financial Officer, Canadian Pacific

**Other Participants:**
Walter Spracklin – Analyst, RBC Capital Markets

# QUESTION AND ANSWER SECTION

**Walter Spracklin**

*Analyst, RBC Capital Markets*

Good afternoon, everyone. And move on to the next session today. And for those of you, I haven't met, my name is Walter Spracklin. I'm a transportation analyst here at RBC Capital Markets. And I'm very pleased to have Canadian Pacific here, and representing Canadian Pacific is Nadeem Velani, the EVP and Chief Financial Officer of CP. He's had that role and has been CFO of CP since October 2016. He joined CP in March of 2013 and served as VP Investor Relations prior to becoming the CFO. He also spent 15 years at CN where he worked in a variety of positions strategic and financial planning, investor relations, sales and marketing, and the office of the President, CEO.

So Nadeem welcome and it's great to have you here in-person. Live and in-person. It's great. So let's start by, a lot of these conversations that we've been having with companies start with kind of a macro overview to that extent that you're seeing any weakness in the overall – your webcast just kicked in. So the macro opportunity or the macro pressure and potential downturn. Secondly is on pricing and cost inflation and then self-help. What are you doing? I think there's something you might be doing that might insulate you from or create a new opportunity down the road that is significant in nature.

So those are the way we're approaching these sessions and feel free anyone, please, if you have any questions, this is the time to ask them so you can signal me or I'll pause for questions every now and then.

So perhaps, Nadeem, we'll start with the demand environment, talking about truckload rates and prices coming down as indication of a potential downturn in the economy. Anything you're seeing on the front line right now that would give you caution or cause for concern with regard to the demand environment?

**Nadeem Velani**

*Executive Vice-President and CFO, Canadian Pacific*

Sure. Thanks, Walter. And it is my pleasure to be here. It's been – been too long to see many of the investors in person and to see you and the Zoom only – only lasts so long and you can tolerate it for so long. There's nothing like connecting in person.

So as far as your question, I mean, we had a tough start to the year, there's no doubt about it. Q1 was challenged for a number of reasons, but the demand environment certainly wasn't an aspect of it. And we've come out of Q1 into April and here the first part of May with exceptionally strong demand. If we look at our volume numbers, RTMs and exclude grain for the moment, Canadian grain, given the drought, we're seeing weakness there. We're down about 65% this month. But if you strip out Canadian grain, volumes are up mid-single digits and it's pretty broad-based strength across the board.

So if you think about how we look at the business, break it down intermodal merchandise and then bulk, starting with bulk ex-grain potash is up double digits. Given the very unfortunate geopolitical events that have taken place, the demand for Canadian potash is exceptionally strong. And the food security and the importance of potash and inputs into the world markets has never been higher. We see that growing for a number of years. But in the meantime, we've seen double-digit growth and we see kind of double-digit growth in demand through the course of the year. So very strong kind of base for the bulk business.

Teck has been – had some challenges at the mines, but certainly expect that to recover. And so we haven't moved as much as we'd like. And I think they haven't moved as much as they'd like. But we see that closing the gap in through the back half of the quarter here. And so bulk, we feel very good about those two lines of business.

Our US grain is up 60% as we speak. So after years of seeing declines, I think, it shows the strength of the world markets and corn and beans. You look at intermodal on the domestic side, we had another month of record volumes. It's been month after month. We're seeing on the international side continued strength kind of double-digit growth on that front. Obviously, there's lockdowns in China that may impact the ships coming overseas over the next few months. But in the near term, we still have a lot of traffic to move. And I think that will just be a short period of maybe less ships.

But to your point about self-help, we have a few new contracts that are going to start ramping up. One is the second call by Hapag-Lloyd. Those ships are on their way to Saint John. That's a significant additional volume for us. It's going to be almost 1% of total revenues, annual run rate. That's going to start moving over the course of the next week. So very excited about their confidence in our service, confidence in Saint John working through with our partners there to create that product a few years ago and now expand on that.

So international intermodal, domestic intermodal will see significant strength as well on pricing, high single-digit type of pricing in the domestic intermodal space and as diesel prices continue to climb here, the truck alternative that gap between their costs – the cost of impact to them versus the impact on rail creates the opportunity for further growth in intermodal. Not to mention the ESG benefits, of course.

And then lastly, if you look at the merchandise business, its broad based strength even on the auto side, where chip shortages have kind of plagued volumes for the last few years, we're starting to see sequential improvement there. We're starting to see growth in automotive volumes. We've added some resources on the car side to support the movement of more lumber product. Paper is very strong. On the steel side, we're seeing strength as well.

So pretty broad based growth across the board. Once we get through this drought and we're optimistic that we'll see a more normal crop starting in August, I think our volume growth that we highlighted that we think we can deliver in the back half of the year of double-digit volume growth is certainly feasible. Then we kind of go into 2023 where we have the opportunity upon STB approval of combining our network with Kansas City Southern and layer on synergy potential that we've outlined, I think we have a very bright several years on the CP front, so very excited about the future.

**<Q – Walter Spracklin>:** That's is a great self-help opportunity for sure and we'll come back to that in a moment. Absolutely. You mentioned pricing high single-digit. It's coming through across all modes whether it's trucking or rail or and even on all goods and services, there's just a general price or cost inflation that is prompting higher pricing.

You have a regulatory framework around your ability to price. Do you find that that's being tested at all or do customers just know that, I'm not going to win a rate case in this environment and therefore not really trying to fight the price increase?

**<A – Nadeem Velani>:** I mean, at the end of the day, you have to have service, that's how you sell and get stickiness in your business. It's all premised around having service and driving value for the customer. So if you think about the Canpotexes of the world or many of our customers that have their own rail cars, our ability to service that customer, turn their assets, that's value to them.

Hapag-Lloyd, the ability to get containers turned around so that they can get another load on the ocean, that's a huge value to them. So, you've got to earn your price and you got to earn it every day and we don't take it for granted. Even when you look at the regulatory side, Walter, to your point, Canadian grain, we just got the decision end of April on the regulated grain pricing, and we're going to see a 12.7% price increase on Canadian grain with this new crop year.

So I think it's a great point to show when you're dealing with customers to say even in a regulated environment this is the pricing that's being set by the government. Now, granted, it's got a bit of fuel surcharge embedded in that number. So it's not completely apples to apples, but certainly indicative.

**<Q – Walter Spracklin>:** Yeah. I mean, 12.7%, like you said, from a government giving it to the firm is quite a significant bellwether for the type of price increases that that are generally going out there.

You talked about service and obviously there were some – supply chain is brought up in every session, whether you're a transportation company or you're a widget manufacturer, supply chain issues are so commonplace. Can you articulate that for us? And what you view the key issue as being in Canada and is it different from the US? And do you see line of sight? Is there any light at the end of the tunnel that you see that this is starting to alleviate and to improve?

**<A – Nadeem Velani>:** I wish I could answer for you, Walter. I mean, supply chain, everyone's got a view on it. And I think the only thing that wasn't blamed for the Leafs loss the other day was the supply chain.

**<Q – Walter Spracklin>:** Find a way to blame them.

**<A – Nadeem Velani>:** But I think it centers around a big part of it is labor across the supply chain. So it was a big part of our challenges in Q1 and in January, what we couldn't do for our customers. We had hundreds of employees out on because of Omicron, certainly we couldn't uphold our end of the supply chain when you take out employees out of the resource base and it takes – it directly impacts capacity. But then it has a knock on effect across the supply chain as well.

Each industry has had to deal with labor challenges. Each industry has had to deal with whether that's on the warehousing side, on the trucker side. And it doesn't look like that's going away here anytime soon. I mentioned earlier the lockdowns in China that that's going to have an impact on the supply chain as well. We focus on what we can control, ensuring that we have the right equipment, whether that's locomotives or the railcars we supply, ensuring that we have the labor to support our service. Ensure that we have the right communication line with our customers as far as loading, unloading and trying to do our part in the supply chain, and I think a big part of it is that is communication and getting aligned on – on expectations of demand and supply of railcars, et cetera.

So when we look at what's ahead of us and what we can control, right now, it really is the equipment and labor. We're hiring for the fall peak. We expect a significant volume increase, everything I talked about and then a new grain crop coming in. So the planning needs to be done now as far as hiring and training and getting the employees on the railroad to support those volumes.

We pride ourselves on not overselling our capacity. And so if we're going to do what we say we're going to do from a service point of view, we do need to ramp up our hiring. I think we're in a good spot there. And so we'll do our part for the supply chain and as volumes ramp up.

**<Q – Walter Spracklin>:** And as volumes ramp up, you mentioned double-digit in the back half. You talked about the capacity and you're preparing for it. And that was one of my questions. You've answered that in terms of the risk factor if grain comes up and it's going to be up, what, 40% year-over-year just from that.

So bringing on all this volume that is – has line of sight to come on, could you, I mean, it seems that you could do net-net for the full year or something up single – low-single digits. Is that something you're comfortable with? Or are you just waiting to see, okay, let's check where the economy is going, let's see where the supply chain, whether it improves or not or do you feel pretty comfortable that low-single-digit volume growth is in the cards?

**<A – Nadeem Velani>:** Yeah. No. I think we have a high level of confidence. Nothing is ever – nothing's crystal clear. In the last several years, there's been a lot of uncertainty. That being said, I mean the way we're insulated, if we look at our line of business we talked about the bulk – bit more bulk heavy than some of our peers. And that's insulated from kind of the macro environment for the most part.

So I do feel good about our view of low single-digits for the year and high single-digits in the back half. I think from a macro point of view and there's talk of freight recession, there is a lag, of course, with the impact of what the Fed does and then what Bank of Canada does and what that means as far as consumer and the overall economy. But I'm confident that through the rest of the year that we can deliver what we say we're going to do with that kind of forecast.

**<Q – Walter Spracklin>:** And one thing I want to come back to now is your resiliency, your operating model that the operations of your company in general and the ability to go through the first quarter that you went through, it hitting your bottom line through a high operating ratio and just under 70%. But then your communication that it's going to go down to 60% one quarter later and then 55%, the back half certainly demonstrates a high degree of resilience.

Do you still have confidence in that? Is there any risk to that forecast or you remain confident that you can snap back that quickly despite what happened in the first quarter?

**<A – Nadeem Velani>:** Sure. No, I'm extremely confident. I wouldn't have said it if I didn't have that level of confidence. I mean, Q1 not to make excuses, but whatever could go wrong did go wrong. And we certainly weren't proud of the results we delivered and that message was sent internally. We all kind of looked in the mirror and owned up to what we can do to improve and I think it's important to show the resiliency of our network to our customers.

We have a lot of pride at CP as far as our employees are and pride in what we do and what we deliver and so we're not taking this lightly to deliver a quarter like we did in Q1 and then just say forgive us. It's about accountability culture that we have internally and so, yeah, we'll deliver a sub-60% OR in Q1 – or Q2, sorry. April was very strong as far as our performance.

May, I'd argue that despite our volumes being down with the grain crop, as I mentioned, ex-grain volumes are up mid-single digits and I expect the operating leverage to be there to continue to drive our margin improvements from that 69.8% in Q1 to the sub-60% Q2. And then as the new crop comes in, there's no reason why mid-50s type of operating ratio in the back half of the year that we can't deliver that.

**<Q – Walter Spracklin>:** And does 12% pricing help you get there a lot faster? You couldn't have been – were you factoring that in when...

**<A – Nadeem Velani>:** No, we didn't – that was a bit higher than our expectations in terms of, but again, there's a bit of fuel in there. So I'm not complaining about the calculation. I will say that it is a bit higher. So there is upside there, there's upside in a few areas that we didn't factor in when we were reporting our results in January, certainly the volume has come on stronger. The network has responded better. It's an outdoor sport. There's always stuff that can happen. We had flooding in Manitoba last week. I think the main line was 5 feet below water. But our engineering team worked tirelessly to get – restore service. So there's things that you factor, things that you don't factor. But net-net, I think there's upside versus where we were in January.

**<Q – Walter Spracklin>:** I just want to ask one thing on grain before we move on. And I find myself following these drought monitors now, which I never thought I would do, these yellow and red colored maps. And it looks although the government has not moved off its formal forecast for an average crop year, it does look to be on the dry end. Now you mentioned flooding as well. So I'm not going to pretend I understand any of that. But is – are we – from what – I'm sure you have people that are following this as well. What's the latest in terms of the expectation for the crop for this year?

**<A – Nadeem Velani>:** Yeah. I think we're – we do follow it. We have third parties. And being Canadian, you watch the railroad, you watch hockey and you watch the weather. And look at my weather app. I've got some unique places in Saskatchewan that I've never had that my kids ask me, why do you have Estevan in your – in your Weather Network app? And there's a reason, following it closely, we've seen precipitation in the last few weeks are – were critical. I wouldn't say maybe critical is too strong a word – were very important in terms of getting the moisture levels for seeding and then getting the crop going.

So we've seen some good precipitation in southern parts of Saskatchewan that are important to our part of the network and our draw territory. There's part of southern Alberta that could be wetter, Lethbridge specifically and that area, but it's starting to come in as well. I can tell you that forecast for Friday. I think they've got some showers coming. So not that I'm hyper focused on it, but all in I think at this point there's reason for optimism that we'll have a normal crop in our draw territory.

**<Q – Walter Spracklin>:** I'm going to move on to the Kansas City Southern merger, but any questions from the floor before I move on to KC? So, I've been talking about it as a once in a generation type of event here with this acquisition, transformational. A glance at the map just shows what this acquisition will add to your network.

Let's start from the beginning. Now you're in the regulatory process. There were some data discrepancy issues that have put a pause on that. Have we got it back going again? And you – are we now looking more at an early 2023 versus late December 2022 as the most likely timeframe for that?

**<A – Nadeem Velani>:** Yeah. So late April, the STB asked for us to re-file some data. We filed it early. They put a deadline for May 27. We filed just this past Friday, Friday the 13th, so few weeks earlier. So that starts the process again, starts the timeline up and running. It provides interested parties 20 days to respond to our filing.

So we're back into the schedule advancing from there. It does – our view is still in early 2023, potential decision from the STB by statute, they're mandated for February 23, 2023 to supply a decision. So I think we're back on track. I'm not concerned. I think it was the right thing to do. We worked hard to provide the data. There wasn't a lot of change, to be honest with you. So we'll see where this goes. But we're back on track.

**<Q – Walter Spracklin>:** And now moving to the – let's move forward to the point where before we transact or close, what can you do in the meantime? Obviously, this is an arm's length organization. It's run separately, but it doesn't mean that you can't engage in planning. You can't speak to customers or presumably you've been doing that. Are you doing that, what are you – what's your sense of your early take up by the customers of the new service that you're going to ultimately provide?

**<A – Nadeem Velani>:** Yeah, you're exactly right. I mean, so we can't have any influence or control. We're very respectful of that. Honor the trust. That being said, there are integration, planning activities that occur. We've done some proof of concept, moving some traffic on an interline basis where we provide a rate. Kansas City Southern provides their rate to the customer and we move it on an interline basis. We've done some test moves from Lazaro Cardenas in Mexico into Chicago, effectively providing customers a competitive alternative to other ports, such as LA-Long Beach, for example. So we were able to move traffic from Lazaro to Chicago in seven days.

Again, as you go through this and show this proof of concept it takes something that to a customer instead of being on a map and talking about the art of the possible, showing, actually moving goods for them, I think puts you in a different position when you start thinking about the value of the CPKC for customers. We've done other type of interline movements as well. And then to your point, a lot of discussions with customers, John and Jonathan Wahba and their teams have engaged with customers to try to understand what value they want and what transportation solutions they're missing today and what – where we can play a role in the combined entity ultimately to give them competitive alternatives.

Certainly, service has not been the strength of the rail industry in the US the past year, and customers have loud voices. I'd argue that providing a single line service from Mexico to throughout North America, there's never a better time to provide that competitive alternative. And customers are really engaged in the process to understand what we can do and what we can offer. So it's exciting times.

**<Q – Walter Spracklin>:** So as you get that customer feedback and you have that $1 billion USD target for synergies out there, become more and more comfortable with those synergy targets, you feel like they're kind of a conservative forecast at this point based on the feedback you're getting from customers, particularly for the revenue target?

**<A – Nadeem Velani>:** Yeah, absolutely. I think, you only know what you know when you're doing the kind of that due diligence process. And there's a lot of customers that we haven't engaged with. There's lines of business that we didn't necessarily have a strong footing or knowledge of in areas and lanes that we didn't have as strong a knowledge. And we start engaging with the customers and start engaging as those conversations take place. It opens up both the pie – size of the pie gets much bigger.

And then you take kind of the macro environment that's constantly changing, the geopolitical environment that's constantly changing and creating additional kind of demands on the world stage. So, take, for example, potash, we talked about the strength of that and increased production from Nutrien and then the Mosaics of the world. Well, the demand for potash at the world level when Belarus is one of the biggest suppliers in the world. There's certain countries that going forward likely aren't going to purchase from them. And so, what does that mean for Canadian potash, what does that mean for Canpotex and we could look at the CPKC network and look at the art of the possible.

We can move potash down to the Gulf, we're moving DRU crude down to Port Arthur. That's the terminal Port Arthur, Texas, that has additional capacity. What if you want to look at that for moving export potash? And Brazil is the largest customer for Canpotex, surpassing China recently. So, you start looking at that as an outlet, that as a potential synergy, K+S, Canpotex. So, we're actively reviewing that as an opportunity. So, that's a synergy that we didn't factor in.

We looked at fertilizers, we looked at opportunities there, but did arise out of a geopolitical event, at a tragedy, but it does create other opportunities that you can't think of all of them when you – when you start going through the due diligence and you announced the deal. So, I have more confidence on the $1 billion every day.

**<Q – Walter Spracklin>:** I only have a couple more questions and we're running out of time, but Derek, over to you.

**<Audience Question>** [indescernable]

**<A – Nadeem Velani>:** Yeah. No, it's a great question. Our expectations, yeah. So the question was, are some of our rail competitors looking to lock up contracts in advance of the CPKC transaction getting approval and have they been successful?

So certainly that's what we've expected. It's a competitive environment. And there's going to be some of our rail peers that would look to do that and not give us the option to try to provide that service to some of these customers and not deliver our synergies. That being said, it's a high demand environment right now. I think some of our rail peers have a lot of growth ahead of them as well.

I think that customers are savvy enough to know that they've been wanting to have an alternative, have competitive option for some time, and they haven't had one other than maybe truck that's getting more and more expensive. And for them to see this generational opportunity, as Walter described, and have a competitive rail opportunity that arguably and has – using Walter's service survey, we have the strongest service in the industry. Why would you lock up that business and avoid yourself getting a chance to taste – to have a taste of that service?

So I would say that it's certainly something we are watching, we are expecting. We haven't seen that yet. Doesn't mean it's not occurring. Doesn't mean it won't occur. But that risk I think is smaller given just the fact that we continue to show the art of the possible and that some of these proof-of-concepts, I think, is getting a lot of traction in the marketplace with customers and they're going to keep their options open.

**<Q – Walter Spracklin>:** Go ahead.

**<Audience Question>** Do you have to wait for STB approval of the final deal before [indiscernible] (29:45-30:02)?

**<Q – Walter Spracklin>:** The question is whether you need STB approval before we could see the likes of the Lazaro Cardenas moves going forward?

**<A – Nadeem Velani>:** So I'd say that we can move on an interline basis. So KCS can provide their rates, we can provide our rate. Can you do a large contract on that basis? Yeah, there's absolutely – we do deals like that, take ConocoPhillips the DRU facility. We've – we move that from Hardisty, Alberta to Kansas City, interchange at Kansas City made to take it to the final destination. We started that a year ago or so, a little bit more than that. So there's a structure in place for that to occur.

I would argue that you're probably not going to see these large contracts like that set in stone until we get final approval. I think in some cases you're going to need a capital investment that will support the movements, that will support the long term contract, whether that's investment in terminals such as our Bensonville terminal in Chicago or investment in capital infrastructure along the right of way, either by KCS or by us.

So I think given we're potentially seven, eight months away from ultimate approval. I think there's reason to wait for that in both sides, both from a customer point of view and a rail point of view. But it doesn't mean that we're going to be waiting much longer after hopefully we get approval for those things to be coming into place. So it's – I think we're going to hit the ground running as far as synergies. I don't think it's going to be much of a delay post approval, but this is why some of that planning and those conversations are taking place now.

**<Q – Walter Spracklin>:** Any other final questions for Nadeem? No? Okay. Well, that takes us to our end of our time. And Nadeem thank you very much for your time. Much appreciated and look forward to hearing more about it.

**<A – Nadeem Velani>:** Thanks Walter.

**<Q – Walter Spracklin>:** Thank you.