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# Transcript

CP Fourth Quarter Earnings Call

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# MANAGEMENT DISCUSSION SECTION

## Operator

Good afternoon. My name is Mike, and I will be your conference operator today. At this time, I would like to welcome everyone to Canadian Pacific's Fourth Quarter 2016 Conference Call. The slides accompanying today's call are available at www.cpr.ca. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

I would now like to introduce Maeghan Albiston, AVP Investor Relations, to begin the conference.

## Maeghan Albiston

*AVP Investor Relations, Canadian Pacific*

Thank you, Mike. Good morning and thanks for joining us. I'm proud to have with me here today, Andrew Reardon, Chairman of the Board; Keith Creel, President and Chief Operating Officer; and Nadeem Velani, Vice President and Chief Financial Officer.

Before we begin, I want to remind you that this presentation may contain forward-looking information. Actual results may differ materially. The risks, uncertainties and other factors that could influence actual results are described on slide two in the press release and in the MD&A filed with Canadian and U.S. regulators. This presentation also contains non-GAAP measures which are outlined on slide 3.

Today's formal remarks will be followed by Q&A. In light of the announcement this afternoon of Hunter Harrison's retirement effective January 31, CP's Chairman has prepared the remarks he'd like to share. The details of Mr. Harrison's separation agreement will be filed with Securities Regulators over the next few days, and we respectfully ask that you focus your questions today on CP's results.

It is now my pleasure to introduce CP's Chairman of the Board, Mr. Andrew Reardon.

## Andrew Reardon

*Chairman of the Board, Canadian Pacific*

Thank you, Maeghan, and welcome everyone to CP's 2016 fourth quarter and full year earnings call. I fully understand that many of you may have questions regarding Hunter's decision to retire and Keith Creel's transition into the role of CEO a few months early. But it's important to remember that we have been preparing for the seamless leadership transition since Keith arrived in 2013.

Today's call, however, is about the CP's results, that is a strong year and a strong future ahead. From the very beginning of this remarkable transformation at CP what some have called the greatest corporate turnaround in history, Hunter and his team have been focused on implementing the operating plan, building a strong bench and preparing for the future. The future is now and that future is very, very bright.

I've been in this industry for 40 years and I have never seen such a textbook case of mentoring and leadership development from Hunter to Keith and now from Keith to his team. The fact is, I've been fortunate to serve on the CP board alongside the two most talented railroaders of their generations and perhaps in the history of the industry.

I wish my dear friend Hunter well in his future endeavors and both proud and happy to welcome Keith to his new role as CEO in two weeks' time. Again, I appreciate your interest but today's call is about CP successful learnings and about Keith Creel's leading CP into future. Keith?

## Keith Creel

*President & Chief Operating Officer, Canadian Pacific*

Okay. Thank you, Chairman. I really appreciate those very kind comments and certainly thank you and the board for your support, your vote of confidence. And I'm humbled and honored to lead this company as we go forward with mixed emotion as Hunter leaves. I've worked with Hunter for the last 20-plus years. He's been, like you, a close friend, a mentor. He's taught me the railroad business. But I can tell you this, if he's taught me anything, he's taught me how this operating model works and how to produce sustainable results. And this team is prepared for this transition.

Some people say it's an early transition. When I left the other railroad to come here to work with Hunter back in 2013, we'd actually planned this transition this past summer. So we're certainly prepared. This team is in place. The foundation is set and we will succeed.

So, let's focus our comments on a great fourth quarter result. Team effort certainly of operating and marketing. I'm proud of the performance of the operating team. Their ability to continue to improve productivity and service levels in light of what's been a very challenging operating environment [indiscernible] (04:24) pretty hard in December. In spite of that though, this quarter CP produced a fourth quarter operating ratio of 56.2%, which is a 360 basis points improvement and a full year operating ratio of 58.6%, 240 basis points better than last year's record.

Q4 adjusted EPS is up 12%, full year adjusted EPS up 2% and that's in spite of a 7% decline in revenues. Over half the revenue decline came from the lower crude volumes as the crude certainly was a huge headwind for us in the fourth quarter as it will still be in the first quarter of 2017, and then we can stop talking about it at least in those terms.

In the fourth quarter with tougher conditions than last year, the team was able to sustain or modestly improve upon a number of the key metrics which we're showing in our slides. For the full year of 2016, this team produced records across all major metrics, lengths, weight, speed, dwell, fuel, all while executing safely which is the most important part here, the proudest metric that we have setting record safety performance for the company with the lowest train accident frequency for CP in its history.

And this story is not over. We've got line of sight to additional opportunities. We're confident in our ability to improve margins in 2017. And as we mentioned in our release, the revenues on the revenue side down 3% this quarter which is slightly weaker than we originally planned. In fact, we had guided to flat. However of course, we had the headwind with the later start with the grain, as well as the weather we faced in the fourth quarter, specifically more so in December.

RTMs were down 3% - again, the grain volumes, headwinds from the decline in long-haul crude traffic. And it's also worth noting, I think this is critically important. If you exclude crude, RTMs are actually up 5% for the quarter which is pretty substantial growth. As expected, the impact of fuel surcharge and currency were negligible for the quarter. The impacts of positive price offset the impacts of negative commodity mix. Areas of strength such as Canadian coal and export potash have a lower RTM versus the corporate average which is the effect of the mix there.

Looking forward, we're expecting, as I said, RTM decline in the first quarter for the crude and the Canadian grain comps against record levels, the moderate conditions, the negative RTM trend will continue into the first quarter. That said, the underlying fundamentals are encouraging and similar to this quarter. If you strip out crude again, RTM growth would be slightly positive in the first quarter moving to positive the second, third and the fourth.

Beyond the first quarter, the growth prospects, the strong bulk fundamentals start to shine through, grain carryover is plentiful, coal pricing is supportive. Potash outlook is strong driven by export potash in the first half versus very little shipped this past year as a comp. And new K + S volumes coming online this summer. We're confident in our guidance, our ability to execute in 2017. The underlying volume trends are improving. We've got a low cost basis to grow from and we have a committed team of railroaders ready to produce.

So with that, I'm going to turn it over to Nadeem to provide some more color to the numbers.

## Nadeem Velani

*Vice President and Chief Financial Officer, Canadian Pacific*

Thanks, Keith and good afternoon, everyone. I'm pleased to be walking you through our fourth quarter results and 2017 outlook. In light of what's been a challenging year on the top line, we've worked hard to adapt our cost base. As Keith just noted, revenues were down 3% this quarter. Meanwhile, operating expenses were down 9% resulting in an operating ratio of 56.2%. Our operating ratio for the year came in at a record 58.6% and an improvement of 240 basis points when compared to last year's adjusted operating ratio.

I won't go through each line of the income statement in detail but there are a few key elements worth highlighting. Comp and benefits was down 15% or CAD 51 million versus last year as a result of the 9% smaller workforce and positive pension income. Labor inflation acted as a partial offset. We finished the year with a workforce of about 11,700.

Fuel expense was up 4% year-over-year as a result of higher fuel costs and an CAD 8 million one-time cost for the settlement of a reciprocal fueling contract paid to another railroad. Purchased services declined 21% to CAD 215 million, largely due to CAD 45 million in land sales during the quarter. Keep in mind, land sales were CAD 11 million last year so the year-over-year benefit was CAD 34 million. Lower crew hauling cost and lower contracted services also aided in the year-over-year expense decline.

The adjusted effective tax rate was 25.3% for the quarter and 26.2% for the full year, a reflection of some favorable year-end tax adjustments as a result of change in traffic mix as well as other tax planning initiatives. Adjusted diluted earnings per share grew 12% on the quarter, finishing the year at 2% adjusted EPS growth. A positive result in light of some of the challenging conditions we faced and a testimony to the cost management efforts of the CP team.

In terms of 2017 outlook, as noted in our press release, we expect to see positive volume growth this year. We also see opportunities to take out additional cost, which gives us a great deal of confidence that we will deliver high single-digit EPS growth.

A couple of key factors to consider as you start modeling 2017. We expect pension income of CAD 180 million in 2017 for our defined benefit and defined contribution plans, which is an incremental benefit of CAD 100 million from the income in 2016. This is driven by higher market related value of the plan assets. Head count should remain relatively flat in 2017, as any volume increases would be offset by further reductions for productivity.

We expect land sales of approximately CAD 60 million total for 2017. And as a reminder, land sales tend to be lumpy. Many of you will recall that we had CAD 53 million of land sales in the first quarter 2016.

The effective tax rate is expected to be approximately 26.5% without any assumption on potential tax reform benefits in the U.S.

Turning to the cash flow slide, consistent with our guidance at the beginning of the year, beginning of 2016, we generated free cash of CAD 1 billion. As many of you know, we increased our dividend 43% last May, completed a 5% share buyback program in September and we deployed roughly CAD 1.18 billion on CapEx this year.

Looking ahead to 2017, we plan to spend approximately CAD 1.25 billion on CapEx, a 6% increase over 2016. Roughly 70% of our CapEx will be spent on basic replacement with the balance going towards initiatives focused on improving productivity and service reliability.

With over 400 locomotives in storage, we don't see the need to acquire new units for the next several years. However, we do have some funds earmarked in 2017 to modernize and improve reliability of our existing fleet. With expected earnings growth and a disciplined capital plan, we'll have a strong free cash generation again this year.

We will continue to be good stewards of capital committed to maintaining our BBB+ debt rating and naturally de-levering, while maximizing the value return to our shareholders. I'd also point out that our guidance doesn't make any assumptions around share buybacks but consistent with past practices, we'll be looking to revisit our capital allocation decisions in the usual spring timeframe.

With volume fundamentals improving over the course of the year, combined with our ability to manage costs and find incremental productivity opportunities, we're confident in our ability to deliver high single-digit EPS growth this year.

And with that I'll pass it over to you, Keith.

**Keith Creel**
*President & Chief Operating Officer, Canadian Pacific*

All right. Thank you, Nadeem. So, with that we'll turn it over for questions.

# QUESTION AND ANSWER SECTION

**Operator -** Thank you. [Operator Instructions] Your first question comes from Fadi Chamoun from BMO Capital Markets. Please go ahead.

**<Q - Fadi Chamoun>:** Yes, thank you. Good afternoon and congratulations Keith on your early promotion I guess.

**<A - Keith Edward Creel>**: Thanks, Fadi.

**<Q - Fadi Chamoun>:** Can we dig a little deeper into the 2017 outlook that you just sort of gave us some color but what are you assuming for volume and sort of pricing and revenues for 2017? Where are the positives and where are the negatives in that?

**<A - Keith Edward Creel>**: Yeah. So right now it's a little bit early, so if I had to guesstimate, we're looking at slightly positive volume growth and then as far as pricing 2% to 3% would be a number I would put there. As far as the positives, it's really a bulk story, Fadi, except for obviously the crude, that's a headwind for us the first quarter but that fades away. We should have a very strong second quarter or I'd say strong relative to the last year's numbers, from a bulk standpoint, be it potash, be it grain, U.S. or Canadian.

**<Q - Fadi Chamoun>:** Okay. Also related, so it feels like coming into the fourth quarter and into this year, the grain was supposed to be a little bit stronger and I know there are some timing issues and some other issues. But is the overall crop size in your territory is what you feel you're going to end up moving. Is it a little smaller than you thought originally or is it the same, it's just that's going to move this year versus what happened I guess last year?

**<A - Keith Edward Creel>:** Yeah. It's actually the same or maybe slightly better, about 71 million metric tons is where our number came in and we're in a pretty good catchment area. The challenge with us is, number one, the comps. You've got to see what we're comparing to which was a record fourth quarter last year. So, going into the south shore, we also experienced number one, a late harvest with the wetness. October was a phenomenal, I think, a record rain month in Vancouver on the West Coast, followed up with December, another record snow month in Vancouver.

Vancouver just simply doesn't handle snow too well and the elevators that we serve are on the south shore of Vancouver.

So, I've spent quite a bit of my time, my personal time in Vancouver during December. I'm happy to say I was out there again last week and things have dramatically improved. We're working extremely well turning assets with our grain customers on the south shore. We actually had or came out there December 31, January 1 and 2 making some physical plan enhancements to allow us to turn those assets faster. So I went out last week to visit the team and to see that work and to visit with the customers and I'm very pleasantly surprised with the work that they were able to accomplish during the holiday.

**<Q - Fadi Chamoun>**: Okay. My second question is really just if we go back to I think a couple of years ago when you had the Analyst Day, one of the assumption or outlook was that, as the cost comes off and the service improve and remained consistently strong, there's going to be opportunities for CP to grow a little bit faster in some of the sort of, service sensitive markets. And we haven't really seen a lot of tangible evidences of that. I know we're coming out of a freight recession, but I was just wonder, if you have some color about, what do you think of that assumption? Do you see opportunities over the next couple of years to start onboarding new business that is really a function of that lower cost and service? Can we assume that there could be an above GDP growth for CP in the next couple of years or...?

**<A - Keith Edward Creel>**: Well, as I've said earlier, and it's probably shielded by this crude challenge, we're there now, Fadi. I mean, we're doing what we said we would do. Our intermodal growth 8% last year, we outpaced the entire industry. Our merchandise growth excluding crude 5%, RTM's up. So I mean, if it not were for the one-third, and if I take you back to when we did that multi-year plan, it was a third, a third, a third. And the assumption was about – correct me if I'm wrong James, 250,000 car loads of crude which was in that growth plan and I think this year, we finished at 35,000. So we missed that one. But if you exclude that and you take it out of the numbers and you look at everything else, we're hitting on all cylinders. So we're converting that story now. It's just being disguised by the crude numbers.

**Operator -** Your next question comes from Ravi Shanker from Morgan Stanley. Please go ahead.

**<Q - Ravi Shanker>**: Thanks. Good afternoon, everyone. Apologies if I missed this, but could you share your pricing growth number in the fourth quarter, both including and excluding ag? And also what are your inflation expectations for 2017 and kind of how do you think about pricing versus inflation going into next year?

**<A - Keith Edward Creel>**: Yeah. Including ag we were 3% and I would assume the same thing for 2017. Excluding ag, I'd have to do the math but probably

**<A - Maeghan Albiston>:** Around the same amount.

**<A - Keith Edward Creel>**: Okay. So that's the assumption I'd put in your model for 2017 is about 3%.

**<Q - Ravi Shanker>:** Got it. And inflation, how you're think about pricing versus inflation in 2017?

**<A - Keith Edward Creel>:** I'm guessing inflation's going to be 2%-1.5%. I mean, Nadeem, do you have any color on that or?

**<A - Nadeem Velani>:** Yeah, 1.8% is where we – when we looked at the planning for the year, about 1.8% so pricing above inflation. I'd just qualify the ag comment just the fact that it's kind of split between in terms of the Canadian crop versus the U.S. crop so the regulated Canadian grain is closer to 4%, 4.5%. But it's not necessarily a straight line with how you manage the crop and the outlook in terms of how you manage the MRE. It's not a flat line month-to-month the way we do it. So, that does change by quarter depending on how much we move and where you're moving at and so forth so, just be mindful of that.

**<Q - Ravi Shanker>**: Got it. And can you just give us some of the puts and takes on OR and how you think about that in 2017? Obviously you had a great year in 2016. What are your drivers of upside versus downside for OR in 2017 that you're kind of tracking?

**<A - Keith Edward Creel>**: You can assume an improvement and I'll let Nadeem speak to the drivers. But a lot of its operating synergies. It's talking about controlling what you can control, which is what we did this year in spades given the revenue was down and we've made the improvements that we made. So, it's more of the same. Several initiatives across the board. I mean we've got – we could take it offline but we have a list of initiatives that we go through with the operating team but we'll get a I'd say 1 point, 2 points just off of cost take out initiatives year-over-year.

I don't know if you want to add any more color, Nadeem, but...

**<A - Nadeem Velani>:** Ravi I'd just point out, we talked about a little bit about some of the one-time items being the lumpier items of land sales. We've got a bit of a headwind there of about CAD 50 million, CAD 55 million potentially and more than offsetting that is a benefit on pensions of CAD 100 million.

So, the net impact of those two is about a CAD 50 million or 0.75 point benefit on the OR. Above and beyond that, as Keith mentioned, is going to be some pure cost takeout with a slight positive volume outlook. We're not assuming a huge amount of operating leverage under that scenario but rather more pure cost takeout.

**<A - Keith Edward Creel>:** And let me point out to Fadi's point. That operating ratio being low is currency for us. It's leveraging the marketplace for us to grow the top line too and it's not talking about competing with revenue and with the rail share. I'm talking about competing with truck share and taking trucks off the road and putting them on the rail.

We've always said that we're going to do that. We've created that currency by having that low cost and that superior service and we're actually doing that today. So, we'll do more of that if it makes sense to drive EPS growth as we go forward in 2017.

**<Q - Ravi Shanker>:** Great. Thank you.

**Operator -** Your next question comes from Chris Wetherbee from Citi.

**<Q - Christian Wetherbee>**: Hey, great. Thanks. Good afternoon, guys.

**<A - Keith Edward Creel>:** Hey, Chris.

**<Q - Christian Wetherbee>**: Wanted to touch back on intermodal a little bit and sort of think about the 2017 outlook. From a competitive standpoint on the international side, how should we think about sort of the progress with volume this year? And just kind of get a sense also updating on the sort of the progress on domestic and whether from a modal standpoint we're going to see a better dynamic from a competitive standpoint with truck or is that going to still be in some markets a challenge?

**<A - Keith Edward Creel>:** Yeah, I would say its two stories, Chris. So on the international side, you'll see us down slightly. We lost the Yang Ming contract. We did not win the OOCL contract which we'd assumed, we put a pretty compelling value proposition in the marketplace but obviously it wasn't compelling enough and I think it showed some pricing discipline on our part. So looking forward, Yang Ming's gone so that's a headwind but we'll offset about CAD 40 million of that CAD 60 million loss with initiatives.

So we're still going to see some growth, it's just going to be muted by the Yang Ming loss and the lack of the OOCL win. But on the domestic side, which is where our network really thrives, the strength of our network is. We continue to grow and outpace the industry. You'll see more of that growth on the wholesale side as well working with our domestic partners cross-border in that Montreal, Toronto to Chicago lane. So expect to see more of that success in the marketplace.

**<Q - Christian Wetherbee>:** Okay, that's helpful. I appreciate the color. And then just to step back for a second, take a bigger picture stab at sort of border adjustment taxes and some of the trade dynamics that we've heard recently. I don't know if it's too early to have any feedback from your customer base and how they may be thinking about it or other potential contingencies, they're thinking about. Any perspective you can give us would be helpful from where you sit at CP.

**<A - Keith Edward Creel>:** I don't see anything. I mean, net, net we think it's going to be positive for us. I don't – with the currency as sort of a hedge naturally against border taxes, we don't know what's going to happen relative to lumber. We don't know what's going to happen relative to intermodal but I would point out our product mix 85% of our intermodal is actually domestic Canada, so it's not going to be exposed with that.

So at the end of the day, our book of business that might be potentially exposed is going to be minimized and we think the upside relative to maybe the tax implications as well as to the raw materials, they're going to move back and forth across the border regardless are net positives for this railway.

**<A - Nadeem Velani>:** Yeah. Chris, it seems like the focus seems to be on country of origin, which in our case, when we're hauling a lot of more of the raw goods, raw materials is not as impactful. And also, just the dynamics of how production is done in Canada, to us it shouldn't be as impactful as well.

**<A - Keith Edward Creel>**: Yeah. More gain and ag, Chris, for us on our profile as opposed to maybe some other folks. We're not as exposed to autos as exposed to lumber.

**<Q - Christian Wetherbee>:** Yeah. Okay. That makes sense. Thanks for the time guys. It's really appreciated.

**<A - Keith Edward Creel>**: Thanks, Chris.

**<A - Nadeem Velani>:** Thanks, Chris.

**Operator** - Your next question comes from Walter Spracklin from RBC. Please go ahead.

**<Q - Walter Spracklin>:** Thanks very much. Good afternoon everyone. So, I guess to start out on the volume side, I think I heard you say that you're expecting kind of slight volume growth there. Going back and understanding the commentary you mentioned on grain, is there anything else that has shifted between now and since your last call that has given you a little bit more concern or uncertainty with regards to any other of the product segments outside of crude – kind of crude, grain and the intermodal – the lack of gains that you got in the international intermodal that you mentioned?

**<A - Keith Edward Creel>:** Yeah. Grain would be it – Walter, the only thing I would point out there's a little bit of a lag. UP had a very large derailment with our U.S. grain franchise. They've been out for about eight days. They're just now coming back so that will maybe push some grain that we would have moved from the U.S. side to the second quarter. But in the absence of that, pushed fourth quarter in the first quarter, I don't see anything else that shifted.

**<A - Nadeem Velani>:** Walter, we've been pretty conservative in our view of the energy world which I think is appropriate. We've probably seen a little bit more optimism recently but we're not willing to bake that into our guidance at this stage. It's way too early and we've been burned in the past.

**<A - Keith Edward Creel>:** To put that in perspective, we moved about 35,000 car loads last year, 17,000 in the first quarter. And we're assuming about 5,000 or 6,000 this first quarter against the 17,000. That's a pretty strong number to go against.

**<Q - Walter Spracklin>:** Sure. Okay. And so as a follow up here, if I were to summarize some of the indications you gave behind your high single-digit earnings growth. You mentioned in productivity or expense improvements, 1 or 2 points of cost reduction alone in the OR and then perhaps another 0.75 points from some of the items, non-operating items that Nadeem mentioned.

So, all-in about 2 to 3 points on OR with 3% pricing, up slightly on volume. The high single-digit seems to be a little bit on the conservative side. Is there something I'm missing when I kind of look at each one of those main driving factors or...?

**<A - Keith Edward Creel>:** The 2 to 3 points would be quite a challenge with some of the headwinds we have on the OR side. 1 to 2 points I would say is very doable. We don't know what the revenue's going to do. It's so early to tell. I don't if you want to?

**<A - Nadeem Velani>:** Yeah. No, I think it's appropriate, Walter, at this stage and where we are to have a conservative view.

**<Q - Walter Spracklin>:** Okay.

**<A - Nadeem Velani>:** So, you want to call it conservative, that's fine. We're confident in our ability to achieve it.

**<Q - Walter Spracklin>:** Okay. No, fair enough. Thank you very much, everyone.

**<A - Keith Edward Creel>:** Thank you, Walter.

**Operator -** Your next question comes from Scott Group from Wolfe Research. Please go ahead.

**<Q - Scott H. Group>:** Hey, thanks. Afternoon, guys.

**<A - Keith Edward Creel>:** Hey, Scott.

**<Q - Scott H. Group>:** So, wanted to just ask maybe just for your thoughts on first quarter and kind of RTM and operating ratio outlook. Can we have slight RTM growth and margin improvement in first quarter or is that not first quarter, it starts in the second quarter?

**<A - Keith Edward Creel>:** It's going to be more a second quarter story, Scott, not first quarter. It's just too challenging with the compares versus last year on grain and crude that won't be here this year.

**<A - Nadeem Velani>:** And the headwind from land sales in Q1 is pretty significant. We had a very – I mean, it was non-existent winter last year in...

**<A - Keith Edward Creel>:** We're having winter.

**<A - Nadeem Velani>:** ...Canada. And believe you me, we've got a winter this year.

**<Q - Scott H. Group>:** Okay. So we should see some pressure on both RTM and margin in the first quarter?

**<A - Nadeem Velani>:** Yes.

**<A - Keith Edward Creel>**: Yes.

**<Q - Scott H. Group>:** Okay. Okay. On grain, so we've seen the other – so CN has been growing their grain volumes. How do we know that this is not just a market share shift in grain?

**<A - Keith Edward Creel>:** I would look at the total volume of grain that shipped. I mean, the compare versus what we moved last year was a record amount and we're almost up against it again this year. So I think if I go back and look at last year's numbers, we moved a little bit more grain, a little bit more share than our competitor did. But listen, every year it's plus or minus 2% or 3% and 1% or 2%, they serve their markets well, we serve our markets well. As long as we stay fluid and they stay fluid, we're going to move similar amounts of the crop harvest. It's about a 50/50 split normally.

**<A - Nadeem Velani>:** The actual grain markets aren't equivalent. They're not completely comparable and I don't think they split out their U.S. and Canada numbers like we do. So it's maybe not – you're comparing apples to oranges.

**<A - Keith Edward Creel>:** And I'd say this too, Scott. If you understand our grain network in Canada, I'm pretty proud of our network, our high throughput elevators as we continue to work with our partners to build new ones. 134 car unit trains that we're running this year which the margins are much better on, more efficient, moving more grain at a lower cost. So I'm pretty proud of our grain franchise.

**<Q - Scott H. Group>:** Okay. That's helpful. And then, just one last question. I know you want the focus to be on kind of the results but I just had one question about some of the language in the press release on Hunter. So it talked about a limited waiver of his non-compete. Can you just clarify what a limited waiver is?

**<A - Maeghan Albiston>:** Yeah. I don't think – we're not going to add any additional comments on that, Scott, but we will be filing a copy of the separation agreement with the securities regulators in the next few days.

**Operator** - Your next question comes from Tom Wadewitz from UBS. Please go ahead.

**<Q - Thomas Wadewitz>:** Yes, good afternoon and congratulations also to you Keith. You know we were expecting this, but still great news for you and congratulations.

**<A - Keith Edward Creel>:** Thank you, Tom.

**<Q - Thomas Wadewitz>:** Wanted to ask you a bit about the competitive dynamics. It seems like there was optimism that on the international intermodal contracts that some of the business over time could come back to you. And I think on the auto side, there's been some shift to CN over the past, I don't know year or so. And I just – do you think that's kind of – is that indicative of maybe just a challenging competitive environment for rail that may persist? Is that kind of a natural equilibrium now? Or how would you look at that because it just seems that that's not – some of the business we thought might go back to you, just hasn't and it's unclear how that should affect our outlook in terms of competitive pressures or opportunities?

**<A - Keith Edward Creel>**: Yeah. I would say there's a couple of stories there. When you talk about international intermodal, number one, the margins are pretty low. So you've got to be competitive for the business and we're competing with a very capable competitor that has a network with a bit more reach than what we have. So what we're doing to offset that, part of our strategy is extending our reach. And we're deciding where our network and what partners we should be partnering with, where our strengths are to their business model.

So these things come in waves. I'm not going to tell you a story. I was a bit disappointed that we didn't get an opportunity to earn some of OOCL's business but you know what, we made a decision, we're going to focus on the business we make money in. We're going to have pricing discipline. We're going to have our carriers, our steamship lines grow their business with the strength of our franchise and we're going to do well in that marketplace and make a buck or we're not going to do it.

On the automotive side, some of that is just a reset of business that never should have been on this railroad in the first place. And quite frankly a very valued customer, I'm not going to suggest they're not. But when you're not making a whole money and you're asked to do things that effectively don't recognize the strength of your networks, again we say we're not going to be a commodity, we're going to be a service and the contribution on that business that we walked away from was not that meaningful, not that significant to the point that it justifies compromising your principles.

**<Q - Thomas Wadewitz>**: Okay. So that makes sense. What do you think about the look forward, would you say you're pretty confident that we have stability now and we aren't going to see more of these competitive losses – I mean, it's hard to say that definitively but...

**<A - Keith Edward Creel>:** Yeah.

**<Q - Thomas Wadewitz>:** ...do you think we'll have stability or is that something where there still might be some share shift on the rail side and then you've got to make that up by taking share on the truck side?

**<A - Keith Edward Creel>:** I'd say this year on the international intermodal, we should be in a steady state. I mean there's no crystal ball, but what I know now, I feel pretty good about. I'd say that long term all these alliances realigning. There's a lot of question marks out there, different ship steam companies are consolidating. Where's the ball finally going to land, I'm not certain. But I'd say for now in 2017 we'll be fine, 2018 and 2019 maybe another wave of consolidation but also another wave of opportunity. In the meantime, we continue to invest in our physical plant. We're doing some things from a service enhancement standpoint, some things like a portal, North Dakota where we come through the border. That's an irritant for some customers having containers that customs sets off and effectively you might get 10 car loads of containers that are stranded because of one that needs to be inspected by customs.

We've not had a benefit or an ability in the past to be able to offload that one container, something that our competitor enjoys. I know a little bit about from when I was there so we're giving our team some of those same service enhancements this year. Our customers will get the same experience. If you look at our franchise, our length of haul from Vancouver to Chicago is faster, if we partner and extend our reach east of the Mississippi to reach into the Ohio Valley, to reach into Detroit, to reach into some of those markets. We've got a superior route if you partner with the right person. So, that's something we're looking at from a strategic standpoint for this next round of consolidations in 2018 and 2019.

**<Q - Thomas Wadewitz>**: Right. Okay. Make sense. Thank you for the perspective.

**<A - Keith Edward Creel>**: Thanks, Tom.

**Operator -** Your next question comes from Brandon Oglenski from Barclays. Please go ahead.

**<Q - Eric Morgan>**: Hi. This is Eric Morgan on for Brandon. Thanks for taking my question. And Keith, congrats on assuming the new role a bit earlier here.

**<A - Keith Edward Creel>:** Thank you.

**<Q - Eric Morgan>:** Keith, I wanted to ask, as you stepped into the new seat, obviously you've had the major role here for several years but just wondering if you could provide some color on kind of your vision for the company and the future and what your biggest opportunities are looking forward and anything you might do differently?

**<A - Keith Edward Creel>**: I would say it's a continuation of what we started four years ago. Hunter brought me here with a vision, with a plan to take this company. We had a mandate for change. It takes time to implement this precision railroading operating model which we've done. We fixed the engine. Next stage is to grow the top line which we're starting to do. You'll start to see the color of that much more vividly as this crude fades away and it's not disguising it all. So as we go into 2017 and 2018, you'll see top line growth, you're going to see bottom line control, you're going to see this team which the bench is extremely strong.

And a lot of some of the same players but essentially we've got a very young aggressive, progressive talented team. We look forward to competing, and we look forward to producing earnings for our shareholders as we go forward. So I would say that's the short-term vision. Long-term stay tuned. And certainly I'm going to work with the board closely and with our leadership team on our strategic vision as we go forward.

But as I've always said, eventually there's going to be consolidation in this industry. And I don't know if it's going to be two years, three years, five years but it's inevitable. Volume growth is going to come, railways are not going to be built, consolidation will occur and I can certainly see that happening within my career.

**<Q - Eric Morgan>:** All right. Appreciate that. And just wanted to ask one on the macro too. We've seen industry volumes come up a little bit recently. Just wondering if you could elaborate on how you're currently viewing the health of the economy. And then maybe somewhat related with how you're thinking about some of the risks and opportunities related to the new administration in the U.S.?

**<A - Keith Edward Creel>:** I would say we're cautiously optimistic on both those questions. So, we're starting to see positive signs like everyone else is. We're seeing things to recover both Canadian and U.S. and we think given that we're a North America network, we'll benefit from what I hope to be the Trump effect that continues, as he takes office in 2017 with the U.S. piece.

**<Q - Eric Morgan>:** All right. Thanks for the time.

**<A - Keith Edward Creel>:** Thank you.

**Operator -** Your next question comes from Turan Quettawala from Scotiabank. Please go ahead.

**<Q - Turan Quettawala>:** Yes, good afternoon. And Keith congratulations on the role.

**<A - Keith Edward Creel>:** Thank you.

**<Q - Turan Quettawala>:** I guess, I wanted to just ask firstly on whether you can comment a little on how you think about the future leadership team here at CP. Obviously you've got a strong CFO in the place now but just in terms of the other hats that you've been wearing, should we expect some additions here or you're comfortable with sort of adding the CEO hat?

**<A - Keith Edward Creel>:** Well, I would say that I handpicked – or had a part, a large part in handpicking everyone that's on this team. So I feel very comfortable and confident with the team that we have. You'll see some tweaks.

There's a few more pieces that we will adjust as I sort of take my COO, President hat off and put more of my CEO hat on. But stay tuned for that, as soon as we get those finalized over the next week or two and I've got a chance to brief my internal team, then we'll certainly come to the market and let you know about those.

**<Q - Turan Quettawala>:** Perfect, that's helpful. Thank you. And maybe just one more on the guidance on the volume side. Like RTMs are growing, I think, you said about 5% sort of ex of the crude. Crude will obviously tail off here after Q1. You've got some pent up grain. I understand there's intermodal. You've lost the Yang Ming contract but up slightly. Doesn't that sound a little too conservative just based on also the fact that the economy seems to be getting a little bit better?

**<A - Keith Edward Creel>:** You've got a pretty good handle on it.

**<Q - Turan Quettawala>:** Thank you.

**<A - Keith Edward Creel>:** Thank you.

**Operator** - Your next question comes from Ken Hoexter from Bank of America Merrill Lynch. Please go ahead.

**<Q - Kenneth S. Hoexter>:** Hey, Keith and Nadeem. Congratulations, Keith on the new role. Let me extend that as well.

**<A - Keith Edward Creel>:** Thanks, Ken.

**<Q - Kenneth S. Hoexter>**: But let's go back just a couple of years, as you talked about it over and over here. You've positioned for growth and yet you talk today about losing some of the share on international intermodal, autos. Yet you've built a network that obviously can handle a lot more room. Maybe your thoughts on CapEx but really how do you pivot back to that growth? Is there something you need to do to gain that back? Are we seeing a more competitive market in Canada that's going to keep that maybe a little more muted than otherwise could be?

**<A - Keith Edward Creel>:** Well as I said, Ken, we've got a very capable competitor, but I'd say, the thing you do, is you focus on growing, where you're going to make money and where you can win in the marketplace, to the strength of your network which is this franchise needs to grow more on the merchandise side. So that's where we're going to focus.

The other piece which we have been growing exponentially in, better than anyone else is domestic intermodal. You make money in domestic intermodal. Now certainly we're going to continue to participate in international intermodal but, as far it being part of our long-term growth, a big piece, we're not going to, I guess for the lack of a better term, bet the farm on it. There's still a tremendous amount of car load growth out in this railway that if we can provide service, we implemented a trip plan this past fall, we give our marketing team the tool to go into customers, so that they'll trust us with their assets, turning their assets. We can show them how to save money with the length or the short lengths of our lanes that we operate in, that's a pretty compelling value proposition. We'll continue to develop the marketing team to be able to do that, and you'll continue to see us win market share and grow with our existing customers, as well as, take stuff off the road with this low cost situation that we have with our operating ratio.

**<Q - Kenneth S. Hoexter>:** And I know you wanted – understand that you want to keep away from the discussion but I'm just being pinged so much. The Hunter discussion, has this been going on for a while? Did he come to the board with a particular end target or was it, I need to move on, any comments that you can care to give out?

**<A - Keith Edward Creel>:** Unfortunately, we really can't.

**<A - Andrew Fitzpatrick Reardon>:** Yeah. We really – this is Andy Reardon, Chairman. At this point, we really can't. We'd like to keep the focus on our earnings and on the future with Keith.

**Operator -** Your next question comes from David Vernon from Bernstein. Please go ahead.

**<Q - J. David Scott Vernon>**: That's kind of a hard one to follow-up on but, Nadeem, could you talk a little bit about where you expect kind of free cash flow to run for the rest of this year? And what we can expect on the share repurchase side of the house?

**<A - Nadeem Velani>:** Sure. So, we haven't assumed anything on the share repurchase. It's something we'll go to the board over the next several months. Our NCIB that we announced last year in May, we completed very quickly and the intent of it was to buy back stock at a cheap price which we think we did at CAD 175. So we think it worked well. I think that's something – a premise that we're going to have going forward as well.

We likely want to make consideration on the dividend and so forth but as far as a buyback, kind of wait and see. Our free cash of CAD 1 billion when operating earnings are coming down, it's a pretty strong testament of what we can generate, what this model can generate. So, we're talking about the OR going lower, we're talking about revenues going higher. We're not going to be in that same scenario from an operating cash flow point of view, so we'll have stronger operating cash flow, maintain relatively the same level of CapEx, up slightly CAD 50 million, CAD 60 million.

So, you can assume some pretty strong free cash generation, billion-plus is a very safe assumption. And we're not going to sit on cash. We talked about de-levering naturally but you can assume we're not going to sit on cash.

**<Q - J. David Scott Vernon>:** Do you have any expectation for where you want to take the dividend or what kind of growth rate you want to put in there as far as – I'm just trying to back into what sort of rate of repurchase we should assume? Or if you can give us any color on what kind of dividend growth expectations you have that would help?

**<A - Nadeem Velani>:** Yeah, we don't give you the number, so you want to back into it. I got it. I used to do IR too. I think, David, I think we're...

**<Q - J. David Scott Vernon>:** Transparent Nadeem.

**<A - Nadeem Velani>:** I think that's something that will – it's going to be somewhat dependent on the stock price too. We're not going to just buy back stock for the sake of it. I think we're in still in this growth stage. I think that we want to do something with the dividend, we want to balance our shareholders. It's something that we think is the appropriate thing to do. But it's certainly something – we'll have a recommendation to the board in the spring, work with Maeghan to model it out, but I don't want to say anything more than that to be fair.

**<Q - J. David Scott Vernon>:** All right. Thanks for the lack of color, I guess.

**<A - Nadeem Velani>**: Anytime, David.

**Operator -** Your next question comes from Justin Long from Stephens. Please go ahead.

**<Q - Justin Long>:** Thanks and good afternoon. So, first, you're guiding for slight volume growth this year. And it sounds like the philosophy is that demand has been tough to predict over the past year so you don't want to be aggressive in calling a pick up. But if we look back a year from now and growth outperforms and we see something like 3% to 5% volume growth in your business, what do you think are the most likely commodity groups that drive that upside?

**<A - Keith Edward Creel>:** I would say the upside if that were to happen would probably have to come from somewhere like crude. I just don't see any other location. And I don't necessarily think that the spreads are going to support that. So, you've captured the essence of the way we feel about this.

I mean we're assuming pretty substantial growth on the bulks. We're assuming growth on merchandise, we're assuming growth in a lot of areas. That crude piece is just a big headwind that we have to work up against.

So if that turned around for us, is there some upside? Sure, there is. But unless it does and frac sand does to a higher degree than it has, I think we're taking the prudent approach, a conservative approach and the responsible approach with our guidance.

**<A - Nadeem Velani>:** And Justin, I would just add, if some of the impacts of the new administration were to play itself out in the latter half of 2017 and provide a boost to overall infrastructure spending, et cetera, I would expect that that could be potential upside areas and in line with the merchandise side of the house, plastics and so forth.

**<Q - Justin Long>:** Okay. That's helpful. And maybe as a follow up to that, as we hopefully transition out of this freight recession that we've been in in 2017, maybe I'll ask a bigger picture question on the longer term volume growth outlook. If you look out over the next several years, how do you think CP's volumes will perform relative to the U.S. rails? I know there's a lot of moving pieces but big picture, do you feel the volume opportunity is worse, better, about the same, how would you answer that?

**<A - Keith Edward Creel>:** I would say my view would be it depends on what bulks do and what crude might do. I mean I would naturally think if the domestic spends and a significant amount of manufacturing comes to the States that they might outpace Canadian GDP but that's just my gut feel. I don't know, Nadeem, if you've got a...

**<A - Nadeem Velani>:** Yeah, there's a lot of variables. I mean the U.S. dollar is very strong and that's going to be impactful to the U.S. rails, I think. Canadian dollar, the weakness, I don't think we've seen some of the benefits of trade as a result of a weaker Canadian dollar. It does take time for that to be – to add to the amount of output on the Canadian side. I mean we've gone through a pretty meaningful dip in Canada in terms of what took place from an energy point of view and the impact that had on us in Alberta and so forth. So, there's a lot of moving parts. With does met coal do on for the U.S. rails as well. So I think that's difficult to speak on a relative basis. I think we feel confident that, for our story, that we can grow faster than the economy and that we can grow faster than – gain back share from trucks and so forth, and that's kind of where our focus.

**<Q - Justin Long>:** Okay. Great. I know it's a tough question but appreciate that color.

**<A - Keith Edward Creel>:** Okay. Thanks, Justin.

**Operator -** Your next question comes from Bascome Majors from Susquehanna. Please go ahead.

**<Q - Bascome Majors>:** Yeah. Thanks for taking my questions. Keith, the plan has really been in place for some time, as you said earlier. I mean, you're still – mostly the deck is set for management as you kind of commented earlier but Hunter's presence clearly cast a long shadow. I'm curious if there is an opportunity here with him being gone six months earlier for you to pull forward anything or any initiatives or something else that we could see happen a little earlier than expected?

**<A - Keith Edward Creel>:** Well, Hunter's never, never stood in my way. So his shadow, he's always supported me and he's trusted me for a long time and I've done this transition with him once before in my career. So I guess, the short answer would be no, or I'd be doing it. We're going to do the right things. He's taught us well. We know the fundamentals. We clearly understand how we work and why, and how we sustain our success and you can expect more of the same.

My style is a bit different than Hunter's, obviously. Maybe my shadow's not as great as his, but certainly if he's done his job and he has done it well, I've learned a lot from that gentleman over the years and we know how to railroad this company and we're going to make money for our shareholders.

**<Q - Bascome Majors>:** Thank you. Appreciate that.

**<A - Keith Edward Creel>:** Thank you.

**Operator -** Your next question comes from Konark Gupta from Macquarie. Please go ahead.

**<Q - Konark Gupta>:** Good. Thanks and congratulations, Keith.

**<A - Keith Edward Creel>:** Thank you.

**<Q - Konark Gupta>:** Just a question on mix first. So did you include mix when you said pricing would be 2% to 3% roughly in 2017?

**<A - Keith Edward Creel>:** No, no.

**<Q - Konark Gupta>:** Okay.

**<A - Keith Edward Creel>:** That's just 3% price, yeah.

**<Q - Konark Gupta>:** So the core pricing, okay. And what do you think about mix in 2017? Because the volumes are coming back in most of the segments. So should we expect the mix to sort of improve some?

**<A - Keith Edward Creel>:** Slightly down.

**<Q - Konark Gupta>:** Okay.

**<A - Nadeem Velani>**: Yeah, there would be a bit of – depending on the quarter. Q1 is such a dramatic decline in crude in Q1 with the comps. But – so that might be a little different, a little more impactful, but beyond that we should net out, like Keith said...

**<A - Keith Edward Creel>:** And you think about the things that we move a lot of. When we move a lot of it, the cost per goes down a little bit, like coal and like potash. So on a cents per RTM basis, the more of that we move, the more adverse impact it has on mix on price.

**<A - Maeghan Albiston>:** And they also have a lower average cents per RTM versus the rest of the book, which we've seen play over the last two quarters as well.

**<Q - Konark Gupta>:** Right. So when you said positive volume growth like slight positive, did you allude to RTMs or were you alluding to car loads?

**<A - Keith Edward Creel>:** Yeah. No, we're talking RTMs. RTMs, RTMs, RTMs.

**<Q - Konark Gupta>:** Perfect. Okay, thank you. And then just a quick follow up on – I think you have previously mentioned about repatriating about CAD 200 million to CAD 300 million business from trucks, mostly. Where do you stand on that? And like do you anticipate some of that materializing in 2017?

**<A - Keith Edward Creel>:** Yeah, well, it's actually CAD 200 million to CAD 300 million repatriating from the strength of our networks – some from trucks, some from rail share. I'd say we're probably a third into that, if you look at it. And there are some gains that we're looking at in 2017. We've assumed certainly, we just signed a contract with one particular customer on the strength of our franchise and our service. We're shifting about 10% business to our rail that wasn't there before. So, on a CAD 111 million contract, 10%, you do the math, that's CAD 10 million or CAD 11 million. So again, it singles and doubles and triples, it's not any big CAD 450 million or CAD 200 million accounts. But again, what we bring to the table, we put it straight to the bottom line. It's pretty compelling value proposition.

**<A - Nadeem Velani>:** Sometimes, you've got to recall that when you have these big lumpy contracts, they don't come on at the same level of contribution. So, for us, our focus is of gaining those CAD 5 million, CAD 10 million here and there, comes out at a much better margin to the net bottom line.

**<Q - Konark Gupta>:** Okay. Thanks for the color. Appreciate it.

**<A - Keith Edward Creel>:** Thank you.

**Operator -** Your next question comes from David Tyerman from Cormark Securities. Please go ahead.

**<Q - David Tyerman>:** Yes. Hello. My first question's just on the OR and the productivity. I just want to actually clarify. So, on the productivity guidance that you gave, 100 to 200 basis points, does that include or not include the impact of the net of the pension and the change in land sales?

**<A - Nadeem Velani>:** That does not include that.

**<Q - David Tyerman>:** Okay. So, it's going to be more than that in theory and then you should be able to get from pricing, too, since your core price is larger than inflation. Is that the way to think of it?

**<A - Nadeem Velani>:** Yes.

**<Q - David Tyerman>:** Okay. Just wondering if your head count isn't actually changing this year, where are we likely to see the bigger buckets of those kind of improvements on the core side?

**<A - Keith Edward Creel>:** It's across the board, on the operating improvement side. It's absorbing the additional RTMs we're talking about without increasing head count. We're running longer trains with having fewer train starts. It's just the way we run our business. It's taking switches out of the track. It's upgrading our locomotive fleet so that they run better, they break down less. It's going into like on operating maintenance, when I'm talking about taking out switches, I'm not cutting my operating maintenance, I'm talking out the work places that I have to do work so I cut my operating expense.

So, it's in issues like that across the entire board that this operating team, every year, we challenge them and push them, we haven't converted this thing over night. There's a top 10 and we fixed those 10 and there's 10 more to go after so it's something that we focus on. We challenge expense. We're always looking for better ways to improve this railway, be it process, be it culture, be it safety, be it waste elimination, and that's sort of how you continue the story. It worked in the past and it's working now and there's still many more chapters left to come.

**<Q - David Tyerman>:** Okay, fair enough. That makes sense. And then just on your domestic intermodal, your RTMs were actually down and your revenues were actually down in 2016 but it sounds like it's a fairly big focus area. Just wondering what the difference between the actual and...?

**<A - Keith Edward Creel>:** So, the revenues were down overall but the RTMs up second half and again, the focus is wholesale. We put a product in marketplace that had about 8% growth, I guess, effectively between Toronto and Montreal, and Chicago across the border domestic which is what outpaced the industry. So, again, it's just a further evolution of us growing our book of business on the domestic side. We've got the shortest routes between Toronto and Calgary, the major markets. We're developing the market across the border, working in partnership with the trucking companies as partners as opposed to competitors and we're winning market share so, it's working well for us.

**<Q - David Tyerman>:** Okay. So, it's really a second half and moving into this year kind of comment?

**<A - Keith Edward Creel>:** Yeah. It's a much better demand situation in 2017. You had a lot of additional capacity out in the marketplace in 2016 that was a headwind for us.

**<A - Nadeem Velani>**: And then, David, I would just point out, in terms of the OR, keep in mind that as fuel prices go up and you add back revenues that are effectively 100% OR, that has a negative impact on just the math of that. So, keep that in mind as well.

**<Q - David Tyerman>:** All right. Okay. Helpful. Thank you.

**Operator** There are no further questions at this – there are no further questions at this time. I will now turn the call over to Keith Creel.

## Keith Creel

*President & Chief Operating Officer, Canadian Pacific*

Okay. Well, thank you very much for your time this afternoon, for the meaningful questions. We look forward to a very positive first quarter. Our first quarter together as a senior team and we look forward to sharing those results soon.

Have a safe day.

**Operator**

This concludes today's conference call. You may now disconnect.