NEWS

www.cpr.ca (TSX:CP) (NYSE:CP)

Transcript

Barclays Industrial Select Conference

February 21, 2018

Miami, Florida

CP Participants:

Keith Creel - President & CEO, Canadian Pacific

Other Participants:

Brandon Oglenski – Analyst, Barclays

QUESTION AND ANSWER

Brandon Oglenski – Barclays

All right. Running a couple of minutes behind here, but I appreciate you guys. So next up at Barclays is Canadian Pacific. Keith Creel is the CEO and President of the company. I think, Keith, you've been there since 2013 and was previously Chief Operating Officer of their primary competitor, Canadian National, and your railroad career goes all the way back to 1990s, right, with Burlington Northern?

Keith Creel – Canadian Pacific

That's correct.

Brandon Oglenski

So we're very happy to have CP presenting here today. And just for some of you in the room that might not be that familiar CP, they are the second-largest railroad in Canada with a significant operation here in the U.S. And just for some context around their mix of business, about 34%, 35% exposed to ag markets, including a pretty sizable potash business. About 30% merchandise and industrial traffic, which includes some energy. Intermodal and consumer close to 21%, coal 10%, but mostly metallurgical coal and autos at 5%.

And I just want to comment as a rail analyst because we haven't had much of a public venue recently, but unfortunately, Keith worked with Mr. Hunter Harrison for a number of years in his career, and obviously, as an analyst, we really appreciate covering Hunter over the years. So just tragedy with his passing last year, but figured we'll give him a little bit of a tribute.

So, Keith, thank you again for coming down. Can we queue up question number one? Do you currently own CP? Overweight, equal weight, underweight on ownership? …Sizable owners in the room. Can we queue up question number two? What is your general bias towards CP right now? Positive, negative, or neutral? …Favorable response here. And then question number three, in your opinion, through cycle EPS growth for CP will be above peers, in line, or below peers? While we get that response, Keith, I think I just want to open it up, I mean...

<A - Keith Creel>: Can I answer that one?

<Q - Brandon Oglenski>: Of course you can.

<A - Keith Creel>: There's only one box I'd check

<Q - Brandon Oglenski>: We can get you a voting button, too.

<A - Keith Creel>: Yeah. We're going to have to win some people over here. We've got majority, but there's an opportunity there.

<Q - Brandon Oglenski>: So you've been CEO now for about a year after Hunter left to go to CFX. Can you just tell us what changes have you made now that you're in charge?

<A - Keith Creel>: Well, a lot of the same. Hunter and I worked together two decades. The operating model is the same. It's never going to change. If we're going to make money in this business, it's not catchwords; it's an operating philosophy, precision schedule railroading. So you continue to do that. That's the foundation. If you're going to keep the engine running and running healthy so that you're not going to disappoint your investors or your customers, you got to protect that. So we've protected that.

With that being said, the reason Hunter came to CP, the reason I came to CP with Hunter was to actually create that value proposition. This company was broke. Very strong franchise, great people, great strength in the key markets that it served, but

it just was not being run in a way that the customers could depend upon it or the shareholders could depend upon it. So, we worked together, spent five years fixing the engine. The engine is running extremely well. We've created capacity. We've got a great footprint.

Now my mandate as the CEO is to take that and convert it into future earnings growth that we can sustain, which is exactly what we've done. So I started initially as soon as I took over. I had a lot of time to think about this so I hit the ground running. Obviously, as Hunter transitioned. It was my stage. He taught me well. I know how to make money in this business. I know how to run the railway. We focused and built up our team on the marketing side to create the same disciplines we created on the operating side.

John Brooks, who's been a very effective Chief Marketing Officer. He came from CP. I had the chance to work with him for two years. He's the President and COO. I head the marketing department, I believe, the entire time I was there. So I knew his talent set. I knew he knows the way we run the business. There was a level of trust and focus. He's taken his expertise. He's gone to the marketplace and brought people to our company that have helped us raise our game on the marketing side and on the sales side.

Coby Bullard, who's just joined us back in February. He has past railroad experience. He started his career with the Burlington Northern. He left and went into the intermodal business. So sort of stayed close and connected to the rail business. So to bring him on was phenomenal. Jonathan Wahba joined us. Jonathan used to work with us at CN years ago. Jonathan too went out on his own, very progressive talented individual that's running for Automotive and our Intermodal franchise. He has been partnered with and strategic and part of the team creating this value proposition, converting this great service that we've created and this capacity that we have.

And as we go forward and we grow forward, we look at capacity as a commodity. Number one, you got to have great service. You got convert at the marketplace and when you bring customers on to your franchise, not only do you have to satisfy your existing customers. If you're going to grow, it's not growth for growth sake. You've got to be able to provide service to the new customer, do what you say you're going to do while you protect your existing customer. And if you lose sight of that, you can create a whole lot of ill will with your customers and they have long memories because they depend on you, the partners. And you can destroy a whole lot of values. So that's something as we grow forward as an operating individual, as operating CEO running an operating company, we're not going to lose sight of that.

<Q - Brandon Oglenski>: I appreciate that feedback. I guess we'll be critical for a second. A lot of investors can say, well, the precision scheduled railroad model drives a lot of cost efficiencies, but it doesn't necessarily lead to growth and CP didn't have a lot of expansion in the last few years partially because of the economy and the energy complex in Alberta. But how do you take that criticism, say, actually, the precision railroad mode can actually drive a lot of expansion in the future?

<A - Keith Creel>: I'd say it's a lack of understanding. I don't take it as critical. It's a very disciplined approach to running the business. To me it's like trying to think of an analogy. If I'm going to have a race car, I'm not going to go out win races with a Volkswagen engine. So if I'm getting on the track, I've got to have a reliable car that's got to have a good engine, and I got to be able to compete. So that's sort of table stakes. Once you do that, when you go to the marketplace and you have customers, the customers have a choice. There's two very capable railroads in Canada. They are two railroads capable to compete or partner with West of the Mississippi. There are two East of the Mississippi.

You've got to create value for the customer, and the value comes in reliability. It's not just the cost. The cost is important. Obviously you've got to be competitive, but it's a supply chain. We're handling their product to create what they used to sell to their customer. And if I jeopardize that and I compromise that, they can't win in the marketplace, I don't win in the marketplace.

So, we fixed that. Now, that we've done that, we've got an ability to go into a marketplace where we're experiencing growth. There are opportunities. There's demand out there. Yes, we're a potash railroad. Yes, we're a grain railroad. Those things are always going to be true. Yes, Teck is a valued customer, does that not mean that I still partnered with and helped them win in the marketplace, which we've done through the downtimes. And as we go forward and try to diversify our franchise, we've backed away from business.

We backed away from business we were not making money on. We backed away from business we couldn't compete at an 80% operating ratio. I can compete today 20 points lower. I can compete head to head with my competitor, and now it's my franchise versus theirs and what best value proposition do I give to the customer.

So part of what we've done now as we grow forward, we've got an ability, where some others might not have, to provide reliable capacity. We've spent this past year creating this opportunity with a very unique inflection point. We've got international contracts. We walked away, since I've joined CP, probably the last five years to get this thing right.
We walked away from order magnitude $400 million worth of business. We're now repatriating the business, but we're being very strategic in the partnerships we create.

So as we go forward, we've probably talked about this, we've been very humble about this but we've partnered with the new line that's coming into effect April 1, ONE which is a consortium, a combination of NYK, MOL and K Line. Today – or yesterday, end of December, K Line was our customer essentially and our competitor dealt with MOL and NYK. April 1st, ONE is the combined railway, all that business – and to keep it simple, it was 50-50-50 from a dollar standpoint. So CAD 50 million of one opportunity business, CAD 50 million in the second and CAD 50 million in the third. We had a third of that. So we had one of the 50s.

As we go forward, we're going to have the lion's share of that business and we're going to be their strategic partner calling on the port of Vancouver, taking their product to marketplace as they grow their business. So to me, that's a very compelling proof point. You can grow, but again it's not growth for growth sake, it's got to be accretive, it's got to be good for the customer, it's got to be good for the railroad, it's a long-term game. It's not a sprint, it's a marathon. And if you do that time and time again, you're going to be rewarded with the business, controlled, sustainable, profitable growth is the way we're going to run this company and we're going to outpace and drive earnings. We're going to outpace the industry, we're going to outpace the normal economy as we repatriate business. So we're in a very good position… extremely good position right now.

<Q - Brandon Oglenski>: I can't help to bring it up because we just had CN on the stage and they had phenomenal growth last year, plus 10% in RTMs, but they're highlighting that we have capacity constraints now. So they're putting more capital into the business, arguing that's going to be a short-term process. We'll be back up and growing. Do you think this is an environment where both the Canadian railroads can see growth or is this going to evolve into just matching on price?

<A - Keith Creel>: And I'm going to say right now, this rail is not going to match on price. We're not going to commoditize ourselves. I think that especially in Canada, I've got a very unique knowledge base on both railways. They're both two great franchises. We both uniquely serve certain markets and I think balance is healthy.

We're growing as well. We grew last year 5%. So far, quarter-to-date now, I've got 7% and there is a lot of demand out there that I'm not turning away, but at the same time, we're going to make smart strategic decisions. I'm not going to tell my shareholders, I'm not going to tell my existing customers, you know what? I'm going to make you happy for a quarter that I'm going to grow 10% or 15% but I'm not going to bring to the bottom line and for that extra 5% or 6%, 100% of the customers I have today are going to get deteriorated service. I don't think that's a long term – in the long term best interest of CP or our customers. That's the game plan that we're going to follow with this railway.

I'm not going to be concerned about Canadian National. It's a great franchise, great folks over there. I worked with them a long time. I'm just saying at CP, we're not going to lose sight of what got us here, and that's the key to success in this industry, controlled, profitable, sustainable growth. You can't be everything to everybody because you can promise in the moon and if you don't deliver, you compromise their business. You compromise your partnerships. Long term, that's not in the best interest of anyone.

<Q - Brandon Oglenski>: And on this ONE agreement with the ONE line, is that a multiyear contract, or should we be thinking about this as...

<A - Keith Creel>: Yeah. No, it's a multiyear contract. It's not long but I'll say long term. To me long term is anything more than three years. It's the term – the term of the deal is just under three years.

<Q - Brandon Oglenski>: Okay. And I assume that this is now meeting the price threshold, the return threshold that you guys

are looking for.

<A - Keith Creel>: It's good for ONE. It's good for their customers. It's good for our customers, absolutely. And it's won on the base of service, the service offering, the strength of this network.

<Q - Brandon Oglenski>: Well, I think a really interesting aspect of CP's story as well is the expansion in Vancouver at the port. Can you talk to us a little bit more specifically about what's going on with the terminal infrastructure there, how you guys could really benefit from that?

<A - Keith Creel>: You're talking about expansion at the Deltaport?

<Q - Brandon Oglenski>: Right.

<A - Keith Creel>: Yes. So GCT, which is a very strategic value partner of ours, they've spent quite a bit of money to increase their capacity, I don't know, 40%, 50%. They spent the money last year. Were there some growing pains that we have to work with them? Yes. But they're well positioned for the future growth, which serves us well with our partnerships and our customers.

And that's exactly – to me, that's a partnership. You've got the steamship line calling on GCT who runs the port, who runs the facility. Our own – CP's own docked wells in Vancouver are records – they're under three days. So that's compelling. Well, they're a key piece of that. They're the ones – they're the connecting link from the ship to the train.

So they've created the capacity. We're strategically aligned. They do well. We do well. And our partners, their partners, their customers, their steamship lines when they partner with them, they can rely upon GCT taking their capacity to put that steamship box off the ship to the ground to the railcar, and get it to the marketplace in less than three days. That's what service will do and that's where the value is in the marketplace. That's where the reliability comes from for the customer. So, there are strategic pieces in doing that.

<Q - Brandon Oglenski>: And you know, you explained a lot about inland ports and where can we get this destination wise. Can you talk about some of the partnerships you guys have inland and how you're offering more from Vancouver?

<A - Keith Creel>: Yeah. I can – I could talk about any of the terminals. That's something I didn't hear coming to this railway. This railway had an intermodal franchise where the physical footprint at each of the locations, I don't care if it's Vancouver, if it's in Calgary, if it's in Chicago, if it's in St. Paul, Vaughan, our flagship terminal in Toronto, there's additional room for expansion with the existing footprints. So the land is there. It's a matter of adding the track. It's a matter of adding the pads to offload. So we have room to grow.

And again, those are those are significant capital discussions and decisions. But that's exactly what we're doing. Like in Vancouver, we're open – we have opened literally in a matter of months last year our transload facility which is located in our yard to provide compelling economics for the steamship lines to add really where we think this is going to. You come off the ocean. You take the 20-foot or the 40-foot international container. We're going to rail it from Deltaport or we're going to rail it from Centerm or Vanterm straight to that facility. It's going to be transloaded into a 53-foot domestic box which would be going back East empty anyway, and it's going to go East and penetrate the country.

So you're taking trucks off the road, you're creating capacity inside the port, you're creating economics both ways for the steamship line, as well as the railway, as well as the customer. It's a very compelling mousetrap that CP is unique to our network because we have the footprint to be able to do it in a place where land is a commodity. There's not additional land in Vancouver to build these facilities on. We have the footprint to be able to do it, you just to have the right business sense. We've done the same thing – some of the things to make it easier for our customers to grow with us. Down at Portal where we go into the U.S. We had an issue where with customs when you go into the U.S., they do random inspections.

So you might have a five pack and you've got one container that has to be inspected and you hold all the customers hostage. We were having to set the whole car out. So much like our competitor, it had a little bit to do with that facility when I worked for that railway. We invested the money this past year to do the same thing at CP.

So we can specifically pick off that one individual container, not affect the balance of the business. And from an operational standpoint, where this is located and it's 30 below zero, the last thing you want to be doing is break in a train line on a 10,000-foot train and pumping air for two hours trying to get the train to move again. So there are synergies on the revenue side. There are synergies on the cost side. There are synergies on the productivity side.

So again, there's a multitude of those opportunities. This is a story. Again, it's a destination. As we go through this thing, we're in a different place than our competitor might be. We've got capacity convert. We've got many more chapters of the story to write. But just tapping from the value proposition standpoint, be in a very compelling place right now at this railway.

<Q - Brandon Oglenski >: So looking out longer term, do you think this is a sustainable growth story that can outperform the industry? Is that a fair...

<A - Keith Creel >: When I say long term, I look at 24 to 36 months, there's no doubt in my mind. The opportunities we have in front of us, if we do our jobs and do them correctly and we do this thing strategically, our customers are going to win, our shareholders are going to win, and the economy is going to win. It's a very good place to be in right now.

<Q - Brandon Oglenski >: But I do want to ask a near-term question. If there's any investor questions here, please raise your hand with this here mic. In the near term, it does look like you guys actually have favorable volume. And I know there's a lot of operational challenges with the cold weather, which happens every year. But the economy does feel pretty strong. Is that a fair characterization?

<A - Keith Creel>: I'm going to make you an operating guy because I have to remind my team that this does happen every year. Let me talk about the short term. A lot of demand out there. We've got 7% RTM growth year-over-year. And again, whether it's frac sand, whether it's crude oil, whether it's intermodal, whether it's chemicals, we've got to protect our service. We're in a winter unlike last year. Last year, actually, Mother Nature was pretty nice to us.

This year, we've had – I can give you all the data – we've had more snowfall in the first 10 days of January than we had the entire month last year. So, record snowfalls in B.C., record snowfalls in Alberta. So, revenue is up, and business is up, but costs are up a little bit, too. If not for that, could revenue be up a little bit more and the OR benefit a little bit more? Yes. But we've got some headwinds.

But again, this is a four-quarter game, so there's nothing that causes me to lose sleep. We're fluid. We don't have trains parked. Our team is engaged. Do we run the same way we do? Non-winter, no. We're in winter. We're running it. But the underlying demand is encouraging. And as we get out of winter and we transition to the other three quarters of the year, you'll see us regain normal momentum. You'll see normal train speeds. You'll see us executing, you'll see costs come down, and you'll see us bring on revenue in a controlled approach. I'm not just going to dump a bunch of revenue on this railway and not be able to handle it.

So we're doing things. I think about this crude opportunity. We got burned at this company. Hunter and I were just coming in; that was probably at that time, if I go back and look at it, as we were pushing business away to try to right-size the railroad, that was the one growth area that we had. None of us knew the $100 an oil barrel was all going to go away overnight. You got to be very careful on the capital decisions you make.

So the discussions we have today, we're looking at short term, we're looking at long term. We're looking at making strategic decisions with partners that have a book of business in crude as well as other needs. The other 12 months of the year, next year, the following year, when this opportunity and the pipeline finally gets built, this crude is going to shift back to the pipeline. I don't want to be holding a bunch of assets – be it rail, sidings, locomotives – that I can't use.

So we're making business decisions that are smart. We're controlling the growth that's coming on to us. We're prioritizing those partners that want to truly partner with us. We've got deals being literally inked now with one particular partner, a major player that has an MVC in it. It covers our cost of capital for the money we're going to spend on our locomotives to make sure that we have reliable locomotives to handle their business. It covers our costs short term. And eventually when this business goes away, there's going to be other lines of revenue that they need our services for that we'll enjoy through partnership. So those are the kind of decisions, the kind of thought process that we're going through as we try to control this demand and

make sure that we make the right decisions for this company not just short term, but most importantly long term.

<Q - Brandon Oglenski>: Well, I am an analyst, I'm going to ask you about your guidance as well because I think you guided to low-double-digit EPS growth. But you do have some tailwinds this year. I think by our math, interest costs are going to come down. This is going to add a little bit to EPS, pension is a tailwind by a few points. And you also said on your fourth quarter call, we want to see core margin expansion of 100 to 200 basis points this year.

<A - Keith Creel>: Yeah.

<Q - Brandon Oglenski>: That would give me to an EPS number a little bit higher than low double digits. So, what are we not contemplating in that equation?

<A - Keith Creel>: Well, I don't have a crystal ball. I can't argue the numbers. Could you say there's some conservatism? Yes. I think it's realism. It's being responsible. I think about the things I can't control. I had no idea in December what the snowfall was going to be in January. When you have a lot of snowfalls and operating guy, you know what I think about next? I think about spring/fall. I think about how fast that snow melts and if Mother Nature makes it melt too fast and you've got too much water flow the same place where you had snow now becomes mud, and you have mud slides and you have other challenges that I just can't predict.

The other thing to think about with our business, what's going to happen in South America, what's going to happen with the crop at the second half. We've been under a lot of pressure with our U.S. grain franchise because there's a whole another competitive alternative out there. I don't know what's going to happen in second half. I don't know what the U.S. grain or the Canadian grain harvest is going to be second half. I don't know what NAFTA is going to do second half.

I think that NAFTA, if you ask me the question is it going to get resolved and is it going to be in a good place for Canada and the U.S.? Absolutely. I think it will be because that's in our best interest collectively. But how that's going to play out? I mean, it's your guess as good as mine.

So those are the kind of things I'd put in the blender and I look at guidance and guidance to me should be what we have a reasonable belief that we'll be able to achieve. And I definitely believe we'll be able to achieve margin improvement. I definitely believe we'll be able to achieve double-digit earnings growth.

And if some things go away, could it be better? Sure. And we'll have more color to that, I think, as we get to the spring. So as we go into our Investor Day in June, you can expect that I'm going to have a little bit more finite view what I think could happen. And I would suggest it's going to be on the positive side, certainly not on the negative side.

<Q - Brandon Oglenski>: Well, can we queue up question number four for the audience? In your opinion what should CP do with excess cash, first; two, our M&A; share repurchases, number three; four, dividends; five, debt pay down; and six, internal investment?

Keith, we haven't talked about M&A in the industry maybe a year. But I think when you first came on CP call you said inevitably we're going to see M&A in this industry. Is that a view you hold true today?

<A - Keith Creel>: I think the thesis does not change. As long as the economy depends upon railways, you're not going to be able to build railways. You've got to create capacity. The only way you create capacity is, in simple terms, you've got to eliminate complexity, which means you eliminate hand-offs, which means consolidation occurs. You've got to run bigger longer networks with fewer handlings. Some people get that. It's ultimately where you have to get to.

Think about population growth in the US. Imagine the U.S. without interstates, if you just had normal highway systems. When you're trying to justify and pay for them, I don't know, 50 years ago, they'd been around all my life, but they were being built when I was a young child. You think about how does it make sense. Well, eventually it's inevitable. If you're going to handle growth, you've got to create the capacity.

And again I haven't met anybody in a long time, and I've dealt with a couple of times, they want railroads building new rails

right through their backyards. They'll stand there and they want the products that rail moves but they don't want the headaches or the concerns. They don't want to change. So to me inevitably consolidation must occur to create the capacity to continue to drive the North American economy. I just don't know – I don't think it's now. I don't think it's imminent. I've got a lot of opportunities. Our team does, focused on CP for our customers and for shareholders, but eventually I think within my career whether it's 5 years or 10 years, I think it's the next step. It inevitably has to happen. You can't deny it.

<Q - Brandon Oglenski>: We tend to agree, actually. Question number five, please? In your opinion on what multiple 2018 earnings should CP trade? And while we pool the room on this, I want to ask here in CapEx, kind of along those lines with the cash question. Is this the market where you should actually be increasing CapEx or is there enough capacity on the CP network?

<A - Keith Creel>: I think it depends on the opportunity and that's, we've got some unique opportunities. If it were a capacity-only story and we didn't have these opportunities, I'd say I'd keep it status quo. But if you look at our spend in 2018, in 2019, we've got a demographic with our hopper fleet where we've got a big piece of our business that's moving grain. We've got a very, I've inherited a very aged, seasoned - and I'm being a nice - unreliable, high cost, low capacity, worst in industry hopper car fleet. That's a compelling opportunity for us.

So as Bill C-49 gets debated, if it comes through the way we feel like it's going to come through, the way the government has indicated that it will for the bifurcated cost index which allows us to get the benefit for our shareholders for the investment. We've got money set aside, that's involved in ramping up that CapEx to buy 5,000 state-of-the-art, modern, optimal, they're shorter cars, they weigh less. They haul more grain. You could apply those cars to my existing network. There is revenue synergies, there's operating synergies, there's growth synergies, there's capacity synergies. To me, that's compelling value creation long term.

So, for us, it depends on where you're at. It depends on what the opportunity is. I'm not just going to throw money at the railroad. I'm not going to start eating depreciation expense if I can't return and drive earnings growth. I'm just not going to do that. But right now, again, if you understand the chapter of this railway, we've been presented a challenge. But for me, it's a unique opportunity to continue to drive that productivity story, to continue to drive part of your revenue, to continue to drive, most importantly, earnings for our shareholders on a go-forward basis. And that's going to take two to three years to be able to spend that money, to ramp up and be able to do that.

But it's – and then once you go back, you've got – I get to 2020. I don't have a crystal ball, but if things stay the same beyond that opportunity, you'll see our capital spend come back down, because of that number, we spend CAD 800 million to CAD 900 million as just table stakes. It's keeping the railroads safe, replacing ballast, replacing tires, replacing rail. But it's an incremental opportunity that we'll take it on a year-by-year basis. It's all driven by the return demand, right?

<Q - Brandon Oglenski>: And then I think we're almost out of time, but if we could queue up question number six, what do you see as the most significant investment issue for CP? Core growth, margin performance, capital deployment, or execution of strategy? Keith, as we sum this up, I guess this is a pretty transformative year for you. You have a lot of capacity, a lot of growth runway. The economy is behaving well. I appreciate you coming down here to Miami.

<A - Keith Creel>: Absolutely my pleasure, and I'll tell you, it's an honor. This railway, we worked extremely hard the last five years to get to this place. 2017 was a phenomenal year. There's nothing in my mind that it says 2018 doesn't give us the economy and the opportunity to exceed we did in 2018 – or 2017 during 2018, for sure.

So it's a good place to be. It's a fun place to work. It's not easy stuff. It's hard. We worked our tails off for our customers and for our shareholders. But I believe firmly – maybe I'm a bit biased because I put them together – we've got because I put them together, we've got the best team in the business with the best opportunity in the industry.

Brandon Oglenski
All right. Appreciate it. Thanks, everyone.

Keith Creel
Thank you.