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Transcript

Bank of America Merrill Lynch Transportation Conference
May 17, 2016

Participants

Keith Creel, President & COO Canadian Pacific
Ken Hoexter, Bank of America Merrill Lynch

Ken Hoexter
Bank of America Merrill Lynch

We're going to jump back. I apologize for running Keith one minute off here. But next up, we have Keith Creel, Canadian Pacific President and COO. Welcome him back for the conference many times – many time participant, but just passed the three-year anniversary at CP, focusing on ops, marketing and sales.

Prior to CP, for those that don't know, he was EVP and COO at CN, serving as EVP of Ops. Before that, SVP for the Eastern Region, Western Region, and Prairie Division. Began his career all the way back at Burlington Northern back in 1992. Happy to have Keith with us.

Let me just – we're going to – Keith is open to kind of doing just a Q&A throughout, so really helpful. So I'm just going to throw it open to you to kind of jump in with how's the railroad running and kind of throw your thoughts on with volumes being down as large as they are, although better than your Canadian peer on a carload basis, maybe closer on an RTM basis, but how well are things progressing?

Keith Creel
President & COO, Canadian Pacific

Well, let's say – Ken, everyone, thank you. Always an honor to come back and speak at your conferences.

I think, overall, the company is running extremely well. My expectations when I came to CP three-plus years ago, I really didn't know the opportunity that was here. I didn't understand how much the network had not been properly invested in, how sub-optimized it was ran. I competed against this company for 17 years and I heard about all the challenges. I didn't know about the opportunities, which I've learned since I've came here.

I think that the willingness to changing this company has far exceeded my expectations. I think we get a lot of proud railroaders that are becoming railroaders every day. So if you take that culture change, which we still have so much more left to do, you're not going to convert all the employees overnight.

But we've built our bench. Our bench continues to get stronger, our operating capacity. More people that think and look at opportunities and develop opportunities the same way Hunter and I have for our careers were multiplying everyday, which is allowing us in this down market to take this operating model and drive operating synergies that are outpacing the industry. That's certainly part of the success.

But with that said, again this company is four years into this. We're not anywhere near down from physical plant standpoint. We see opportunities all the time and we go out on a property, culture-wise. We've had a lot of success with all the unions but one, our Running Trades employee, which is the largest union we've had two strikes with, but we're trying to change that. I think we're making better progress developing around the ground the employees' better relationships.

Hunter and I just last week, we spent eight hours with the General Chairman, the leaders of the TCRC, trying to figure out a way through all this change, which has been dramatic, how do we move forward and be more progressive. So from a leadership standpoint on the TCRC side, I think they see the power of working closer together, just like we do. We've been at odds for a long time. So down the line, I think that bodes well into our ability to continue the success.

From a demand standpoint, we've obviously got some headwinds. Bulk, especially as of late, bulk has been a big drag on us in RTM basis. Quarter to-date, we're down about 11%; to year to-date, 7%. We're a little bit less than what our guidance says. But, again, our guidance is based on picking up some in the second half, which I think is still going to happen.

So, I'm optimistic on Canadian grain movements in the second half. I think our service offering, both from where we're located with our customers, but as well as the Dedicated Train Program that we have put in place is going to bode well for us, moving grain second half.

I think you'll see year-over-year increase in Canadian grain moved. U.S. grain has been pent up. They're starting to see the market dynamics change there, and the commodity prices are going up.

The competitive option in Brazil, the threat there is coming down. The crops are going to be coming in. They're going to have to move grain in the U.S., and we're starting to see some shipments start to move. So has the tailwind hit us yet? No, but we're starting to see signs of it which is encouraging.

The crude piece, that's the challenge as of late. The fires that are going on, very topical right now. I know a lot of investors have asked us what do you know. It's too soon to know. We're working with those producers, and obviously, our second half guidance assumes an uptick in some of that production that was coming online that was being driven to rail by takeaway pipe capacity.

So, we still got to figure out how that all shakes out. I saw this morning in the paper, I think the fires are now turned and heading toward the refineries. Now, if that happens, that's obviously something we've got to keep a close eye on because that could affect

volumes, more so than what we're experiencing today.

But outside of that, if you take crude out, if you take the headwinds with grain, overall, what we expected to happen in the economy is happening in the economy. So we do think there's some optimism. We do think things have bottomed out. There's more positives than negatives. We just got some significant headwinds still to deal with.

Ken Hoexter

Bank of America Merrill Lynch

So let's take – knock a big one out of the way upfront and obviously, you worked hard to acquire Norfolk Southern, even CSX along the way. When we step back and think about this, what does this mean for CP investment? Does this kind of alter your big picture growth capability? Was that a statement that we need something else to continue to grow, or there's just too much opportunity? Or now that you're kind of back home and looking at the network, what does that do for the internal?

Keith Creel

President & COO, Canadian Pacific

Yeah. I would say when we did our Multi-Year Plan a couple of years ago, obviously some of the macro-economic things have changed, that was based on crude being at a level that it's obviously not at. That was based on intermodal growth and that was based on CP, with its existing book of business, taking the service offering and growing our merchandise book because we'd earn the opportunity in new freight that we haven't been a reliable transportation provider for from our existing customers and some of our competitors' customers. So the M&A thing we then asked was all about value creation and it was about timing.

Now that that's over, we just effectively reverted back to optimizing our business. The growth story, the organic growth opportunities, converting the service to revenue, taking our level playing field now. Before when our costs are 2,000 basis points higher than our competitor, there's certain business we can't compete for. We can't make a buck at it.

Now that we've got an on par cost basis as our competitor, if you got a compelling service offering and I can move assets faster because my franchise is shorter in certain routes, I should own that business, which is exactly what we're getting after.

So we've realigned the marketing team. We've got our leadership team stabilized now. The last change we made about a month ago, you saw that we took the three operating regions, consolidated into two and sort of created an EVP Operations as part of the process.

Now, the guy in the West has bigger responsibility. The guy in the East has bigger responsibility. I've got Robert Johnson, who I've worked with – literally, a lot of people don't know this. My first railroading job that began in 1992, he was my yardmaster. So our operating history goes long and deep.

He's been with our team for a little three-and-a-half years. He was the first guy I brought here when I came to strengthen our bench, and we've just gotten better at railroading day-in and day-out. So, with our transition, Hunter's going to retire next year in June. We're prepared now.

If Hunter were to leave tomorrow, certainly I don't want him to, but he hasn't done his job if he hasn't taught me how to railroad well enough to make sure that we don't lose an inch, and I've been through this transition before. When he left CN, I was the COO – I became the COO and I ran the railroad day-in and day-out and things didn't get worse. I would argue and I used to brag to him maybe it got a little bit better.

So I think this company is well-positioned and I think M&A or not, we're going to do well, we're going to continue to grow earnings and we're going to be the, to me, the most accretive, the highest percentage on a percentage basis earnings story in the industry for a long time to come.

Ken Hoexter

Bank of America Merrill Lynch

Okay. And maybe we're already seeing a little bit of this in carloads, right, if I look at your – and I know you like to talk RTMs a little bit more, or might be a little bit closer, but carloads are down overall quarter-to-date 7% versus your peer in Canada down 14%. Can we look at that as share gains already on the improving service? If I point out one specific one, intermodal's down 3%, CN is down 7% quarter-to-date. Can we see that already taking place or is it...?

Keith Creel
President & COO, Canadian Pacific

Yeah. I would think – well, it's two things. Some of it's market shift, obviously. Again, if I'm not doing my job, we're not going to grow carload growth from service, but we're doing that.

We've taken – on the domestic intermodal side, historically CP did not have a valid competitive cross-border domestic offering. So Montreal-Toronto track to Chicago, our competitors sort of own that lane. We've created a marketing team now that's synergized around that, selling our service offering and our service value to our customers.

So we're seeing some growth there. Now, that's not all coming from my competitor; that's truck stuff, that's truck competitors. So we're taking a share off the truck.

On the domestic side, similar to the story we've had in the past, our franchise in the key domestic lanes versus truck is extremely compelling from a value standpoint as long as we're reliable. So, we've won customers in the past and continue to win some customers that in the past pay for the premium to be on the road to get that reliability and some market share gains as well from our competitor again because I've got a faster transit time. I've got a shorter route.

If I'm doing my job, I should be able to convert that in the marketplace. Likewise, in certain lanes, their franchise has a competitive advantage from a transit time over ours. And in those markets and in those lanes, I think they should be winning the business. So I do think you're seeing the service offering that we've given put in the marketplace, starting to grow the top line, and that's driving demand a little better performance in a down market.

Ken Hoexter
Bank of America Merrill Lynch

Let's switch over to bulk a little bit. You talked before about kind of bulk being fairly ugly, is there – maybe talk a little bit about the difference between the Canadian market on the wheat side, U.S. market. It seems like we've got storage that's high, but yet keeps creeping up even with a newer, larger crop coming. It seems like the U.S. shippers are still hesitant to move that freight with stocks well above historical averages, but maybe contrast the Canadian grain market with the U.S. side.

Keith Creel
President & COO, Canadian Pacific

Yeah. The Canadian grain market, we don't have the strong carryover that we've enjoyed the last two years. So we had a record crop, we had a horrific winter, the normal Canadian carryover is around 7 million metric tons. That jumped up to 15 million tons. So last year, we benefited from sort of that tail.

This year, we don't have it. So we're starting to get to more normal levels where the shipments go down in the May to June, July timeframe, then you'll see them ramp back up with a new crop year.

Now, I think we're still doing okay in that marketplace because of our Dedicated Train Program. We implemented a dedicated guaranteed capacity to our Canadian shippers, to the big shipping companies. A certain percentage of our fleet we dedicated to this so they know the assets they're going to have.

They commit to them; we commit the sets to them. If they don't move grain in those cars, they got to pay for those. So there's a what's in it for them, what's in it for us scenario that's going on that's driving some market share gains now that's helping a little bit to offset some of the weakness that's out there.

The other thing I think, and just call this luck, some of our elevators are better positioned towards some of the grains left to move. Now, as the new crop comes in, again I think with our Dedicated Train Program, our shippers enjoy the reliability, the consistency. It's been very well received. I think you're going to continue momentum, I think, on the Canadian side. With a normal crop, we're going to finish up versus last year with a better-than-normal crop. There's upside.

On the U.S. side, you're right. I'm sitting here, shaking my head saying the site's going to run in eventually. And what's going to happen is you've got all this pent-up demand. The farmers who built more storage space from the worse of 2014, so they've learned that game, they want to hit the sweet spot and get the best price they can.

But the problem is, as soon as it runs in, they all are going to move at the same time and they're going to be calling Mr. Elliott's office. They're going to be complaining because we don't have enough cars and locomotive to move it all, but I can tell you this. There's been a lot of infrastructure built since then on the other roads. There's been service improvements. Our velocity has increased. Capacity has

been invested in our Dedicated Train Program.

We're going to do a much better job in moving it. But still my – and maybe they call this a public service announcement, they need to understand and manage their expectations because you can't move two years of crop in one year, it's just not possible.

So again, though, we're starting to see some signs that's starting to move and year-over-year, we've got an increase in our U.S. grain product, which is encouraging. It's just not at the level that needs to be, I think, yet and where I think it's actually going to be second half.

Ken Hoexter
Bank of America Merrill Lynch

Okay. Do they need the dollar deteriorated a little bit more to get that moving or can that still be more just the drastic moves?

Keith Creel
President & COO, Canadian Pacific

Yeah. I'm sure if it deteriorated, it would help and send a little bit more movements, but I think just the pure realities of the marketplace given that the crop comes in and they've built more storage, but they don't have enough for two years' worth of crop...

Ken Hoexter
Bank of America Merrill Lynch

Yeah.

Keith Creel
President & COO, Canadian Pacific

...it's going to push some product for us.

Ken Hoexter
Bank of America Merrill Lynch

Okay. Jump over to coal, it's small, but still 12% of your carloads – virtually, mostly Teck on the met coal export side. Does that continue to deteriorate given what's going on with the globe pricing and [indiscernible] (13:37)?

Keith Creel
President & COO, Canadian Pacific

No. Actually, from a Teck standpoint, if you look at our carloads, that's where it gets a little bit confusing. From the carload standpoint year-over-year, we're down, but it's not Teck; it's more of the U.S. franchise.

So I think our U.S. number year-over-year, Nadeem, I think was around 70%. Yes, 60%. It's compelling, but we had a phenomenal year the year before because we rebased some business, we shifted lanes, we picked up additional carloads, there is a replenishment of stock because of what had happened in 2014 and it's less than 1% of our revenue.

Ken Hoexter
Bank of America Merrill Lynch

Okay

Keith Creel
President & COO, Canadian Pacific

So, I would discount that. If you look at just Teck, Teck is down a little bit. But given their guidance, the price has bottomed out. They fared well, I think, better than some of their competitors in the world marketplaces, so they picked up some share. And what they're telling us based on what we've got in our guidance, there's some upside in it second half. So I think you're going to see a marginal tick-up versus what we're expecting on the Teck coal side.

Ken Hoexter
Bank of America Merrill Lynch

Yeah. I'm going to step back to your operations at your favorite area, because I remember last time you were here, we did the same discussion. You talked about the whiteboard sessions you had just held. And I don't know if you remember a story you told that you were telling us about how you had jumped in the car on the track with Hunter and literally had just gotten out of the yard and found a bunch of steel sitting on the side.

And you asked the head of the yard how long that's been there, where it's going and he said, well, I don't know, I just got appointed to this role, and he couldn't remember. So, you sent him back and he said it's been here as long as I can remember. So now, as we're – I think that might have been two years ago.

Keith Creel
President & COO, Canadian Pacific

Yeah.

Ken Hoexter
Bank of America Merrill Lynch

Now that you've kind of take a step, you opened up by saying, hey, there's still more room to go. Presumably, it's not sitting there on the side of the road anymore. Do you still run through these kind of sessions and look at how you can still restructure this work? You said the culture is still changing, how much more room do you think you can take?

Keith Creel
President & COO, Canadian Pacific

Let me answer the last question first. To me, that's a process that never changes because you've got to continually adjust your assets to the business demand. So as of late, two weeks ago, three weeks ago, in response to volumes being not at the level we thought they were going to be, it sets us time to get the whiteboards back out. Just look at all the yards, look at our operations, how many cars are being pulled out of each customer based on what we assume, how many assignments do we have dedicated to it and we cut 28 jobs across the system. That's pretty compelling number in cost savings. But those things happen all the time. You do it with the ebbs and the flows of the business.

As far as converting this physical plant, similar to that whiteboard session, we looked at how many switches out there. How much track, how much capacity do we have out there that's dormant that we don't use, that we don't need? So we're trying to create a railroad that runs efficiently with long sidings to run long trains, which means fewer train starts, which means create more capacity, which is what the model is based on. So we're on that story of converting the railroad. We're not done with that yet.

But at the same time since we've got a demand or a reduction in business, I said, listen, let's look at all the main line switches which are derailment waiting to happen. It's also a maintenance expense. It takes a whole lot more manpower to maintain a switch than it does a straight piece of rail.

Let's look in the yards, let's look at backtracks, let's look at tracks that are rusted that we don't need, and we came out to what we're taking out this year. We've get over 300 main line switches that are coming out that we're going to get done through 2016 and into 2017. We've got almost 90 miles of rail that's coming out. We've got over 300 yard track switches that are coming out. And what that will do for us once we take them out, it reduces expense which reduces head count based on the same level of business, which improves safety and which reduces our go-forward capital costs not only from a replacement or replenishment standpoint, but also as we get back

into growth.

We had a big plan to spend $900 million in growth capacity that was tied to crude and a lot of them on the North Line. Well, now, when that business does come back and eventually it will, it's going to come to fruition. The cost of the capital is not going to cost the same because I'm not going out buying these switches. I've already guided inventory of existing stuff that I've already paid for that I'm going to be able to put in the physical plant and I don't need the same capital spend.

And then the other thing, we shut five hump yards down. When you shut a hump yard down, the hump yard lead can take a productive flat switch lead configuration that's totally different. We still not have gone into those facilities and said, okay, let's spend the money to create a productive switching lead. So let's reconfigure the hump leads and let's create a high throughput, low-cost, reliable switching lead.

So once we do that, down the line when we get to that point in the story to be able to do it, then all those facilities of our switch cars today, I'm not going to need as many switch engines. I'm not going to need as many people. I'm going to be – our cost of new business is going to be lower. So those are still just a few of the many chapters that we haven't even got to this in the story yet.

Ken Hoexter
Bank of America Merrill Lynch

And is that a capital investment you have to make to be able to reconfigure that yard typically?

Keith Creel
President & COO, Canadian Pacific

Oh, yeah, typically.

Ken Hoexter
Bank of America Merrill Lynch

Okay.

Keith Creel
President & COO, Canadian Pacific

Yeah. But again, it's going to be lower cost because we're cascading used material and the return is compelling. The other piece we're still working on, we started last year. I was amazed when I came here that we didn't use remote-control locomotives. So all of our switch crews were engineer, conductor, brakeman in all of our terminals. So the cost of three people versus my competitor that use remote-control locomotives, which requires two, is significantly different.

Last year, we converted about 50 jobs across the network from a head count standpoint. Even if we didn't get more productive, it meant we needed about 100 less engineers. We're in phase two of doing it this year, so there's still more yards to convert.

There's a collect agreement provision called Material Change, which you have to go through for the terminals to be able to make these kinds of changes. We're negotiating all that now so there's a certain number of terminals still left to do in the network that might emulate what we've already done in that regard. And not only do you get headcount reductions, you get lower cost of doing business. You can get more productive because I've always felt if I'm on the ground and I've got two people on the ground operating switches and controlling the locomotive, it's a safer work environment, number one, than relaying to someone that might be a hundred cars away.

I'm in the move in the moment doing it, but you can also get more productive with it because you're not going to have all the delay time that you have relaying information to somebody else to come ahead five cars, do this, do that. I mean, there's just so much complexity and waste of time every time you do standoffs. When you go to a remote-control operation, you eliminate all that. So you get a productivity improvement and you get a safety improvement.

Ken Hoexter
Bank of America Merrill Lynch

It's amazing year-after-after to hear your excitement about how much more room there is to continue to find to cut costs. And going back to the M&A for a quick second, you've kind of opened up the possibility of open access and if things were approved under certain kind of circumstances, right, if your service was not foreign to customer mandate, did that open a can of worms in terms of ongoing reviews at the STB? Do you think in terms of, hey, wait, you've already offered it, then it must be okay, now we're going to mandate it? Do you think that kind of opened up that?

Keith Creel
President & COO, Canadian Pacific

Well, we haven't – bottleneck pricing and keeping a customer capture has never been something we've been too exposed to at least with our existing footprint because in Canada, we pretty much have it already.

So we know we've operated in that environment for a long time. Now, has it opened a can of worms for our U.S. partners? I'd say ask the STB. I'm not certain. I know that the shippers have called for changes for a long time. I know that eventually, if you don't give shippers a good service and you just raise rates, you're begging for the regulators to come in and make your decisions for you and I don't think that's healthy for the industry.

I don't think it's necessary. But, again, I think what we suggested in the event of a consolidation or M&A, it's fair game. And I think if you're not afraid to compete, it's not going to hurt the business. It's going to help the business.

Ken Hoexter
Bank of America Merrill Lynch

So, operationally, what's different or where do you think you are in terms of if you want to call it innings or what have you, where you are now at CP versus where you were when you left CN?

Keith Creel
President & COO, Canadian Pacific

Well, CN, obviously, we started that transformation in 1998. I left in 2013 so 15 year, 16 years of doing it versus we've been doing it for four years. So, just sheer math, Rome wasn't built in a day.

When I can go out and still just see things fall into my lap, like the switch issue, the opportunity, I mean you don't know what you don't know. So, the more you spend time on the property, the more you see these opportunities. The more we educate our operating officers to act and think like we act.

I think we're in the early innings. That's still 34th inning versus CN is – they're sort of much more mature. They've got the physical plant done. As long as they maintain the culture, you should see slippage, but to have the same kind of monumental gains that we've enjoyed, it's tough. It's more steady state 3%, 4%, 5% improvements every year just becoming better railroaders than it is quantum leads like we've made.

And sort of the same goes for us to suggest that over the next three years, I'm going to be able to improve locomotive productivity 40% or train speed 40%. You get to a point where you're limited about the assets and it does take investment. And to make those kind of quantum advances, I would have to have a quantum change in my collective agreements to pay for them.

But again, for us to deal with headwinds and to control our margins and bottom line, there's still a lot of stuff out in the ground left to convert. There's still a lot of synergies. There's still a lot of culture to change.

Ken Hoexter
Bank of America Merrill Lynch

A big part of the discussion it seemed like through M&A was always about Chicago and making Chicago more efficient. You kind of love the EJ&E for a while there now when you think about what's going on with Belt and IHB and what other access you have to deal with Chicago. Where is that sense? It's obviously a lot easier now than it was a couple of years ago when everything was backed up into Chicago, but how are things flowing now?

Keith Creel
President & COO, Canadian Pacific

Things are flowing well in Chicago now, but some of it had been because there've been operational improvements. Some of it had been because there's been investment in capacity. Some of it's because the railroaders I think, the railroads do business better together if we start to get into challenges.

I think we all understand that Chicago is a challenge for our industry. We took a big black eye in 2014. So there's more we can do working together, that I see a willingness to do from an operating perspective, but it doesn't change the underlying problem. Chicago is not fixed.

Business is down dramatically. Once business comes back and normalizes, there's just not enough capacity to handle all the volume that goes through that city, especially its freight grows. If I believe all the specialists and the experts that say in 10 years, traffic is going to double in Chicago, then there's a train wreck waiting to happen. And it's going to be in my lifetime, it's going to be within the time that I feel that I'll be end of the road industry and as much as I'm going to work with my colleagues, there's not a simple fix.

Consolidation to me, maybe it's going to be at a time where we're witnessing pain, which we were trying to avoid that. Maybe that's inevitably what it takes, but I think eventually it's going to have to happen.

Ken Hoexter
Bank of America Merrill Lynch

Yeah. Let's talk about it on the cost side for a minute here, employees ended at about just over 12,000. Is that a good run rate? You're trending down about 13% year-over-year. Is that as lean as you can get in this environment or given where volumes have come down, you still say, hey, we've got more to go?

Keith Creel
President & COO, Canadian Pacific

Yeah. Well, based on what we assumed with our guidance, we saw an opportunity to go year-over-year about 1,300 heads out. As we get more productive and sometimes when you're challenged, you become more effective at what you're doing, which is what we're doing. I think there is additional opportunity. Is it 100, 200? I'm not certain, but I still think there's more opportunity as far as becoming better railroaders and becoming more efficient.

Ken Hoexter
Bank of America Merrill Lynch

You target an OR below 59% for this year, if I recall. Given what's going on with volumes, is that still an achievable target? I guess somewhere we're maybe taken a little back. It includes some asset sales. Is that regulated that you had to put them in there or is that just historical? Why it was that not kind of normalized out in terms of...

Keith Creel
President & COO, Canadian Pacific

Yeah. Well, from an asset standpoint with our last quarter's results, it was actually probably compared to what we had the previous year. So to me, those are sort of a wash.

From an operating margin standpoint, I still see a path to sub 59%, not backing away from that. Now, if there's something catastrophic that happens with these all shipments that I'm not aware of at this point, then we can reassess that and look at it. We'll keep a conscious eye. But at this point, I see no reason to change it. I still see a path to it.

Revenues not performing as well as I thought it would, to a point. But at the same time, our operating synergies are exceeding what I thought it would, so they're sort of offsetting each other. So unless again there's a huge downturn, still to be determined on the crude side, I still see us getting there.

Ken Hoexter

Bank of America Merrill Lynch

Okay. And just to revisit that for a second on the crude side, you said the fires did impact the volumes, or only if they approach the refinery. Well, obviously impacted because the workers had to be...

Keith Creel

President & COO, Canadian Pacific

Yeah, short-term this month. They've impacted the volumes. I'm not going to suggest they haven't, because that's… What was driving shipments on rail in crude was not the arbs – it wasn't the money that they made – it was takeaway capacity. So the pipelines were essentially full.

So, if the pipelines are full, the oil's got to go somewhere. If you look the second half of the year, they got additional production that's coming on line. Pipelines are full. Oil has to go somewhere. Rail shipments increase. So that's the thesis.

Short term right now, when you take a million barrels out of the pipeline, there's capacity. So the lower that does move, the economics are better. Because of the price of the oil, it's going to move in the pipe. So that's what's going on short-term.

Long-term, if this sustains itself because just say hypothetically, some of these facilities get affected by the fire that's now moving north, then obviously there's going to be more room in the pipe. And unless the price of oil goes up and the arbs drive the business to the rail, then you're going to have a headwind.

So, just right now, we got to wait and see what happens. I think over the next month, we'll get a better view. Obviously, let them control the fires. Let them get that put behind. I think the capacity is still going to come on. I don't think that's threatened, and we'll see how this thing shakes out, but at this point, it's just too soon to call.

Ken Hoexter

Bank of America Merrill Lynch

When you think about your returns on invested capital, I mean given where your margins are, is there a point where you get to a certain level of margin where returns makes it harder to get whether up in Canada or at the STB pricing above inflation? Or I'm backing into the question of are you concerned that ability to price above inflation gets taken away by regulators at some point or is that something that as long as you're spending the capital investing, that you should be able to continue to improve those returns?

Keith Creel

President & COO, Canadian Pacific

I think in Canada, it's always a threat and I think Canadian roads versus U.S. roads have taken a much more conservative approach to price because there's a mechanism in Canada called FOA that's pretty immediate and pretty risky. You're going to this baseball arbitration. It's my best case versus theirs.

So, if anything, I think that mechanism, we've all learned to be responsible. So, if I'm going to take a lot of price more than that, then there's got to be the economics behind it. It's because my investment is more. It's because I can justify, because if I go in front of that arbitrator and they're arguing – I'm saying I want a 4% rate increase and they're saying they want a 4% rate decrease, there's a lot on the table. So I think it's always going to be that sort of keeps everybody in balance in Canada.

On the U.S. side, I think if the railroads continue to improve service, which they've done as of late, I think the business comes back if they do that and they're giving a fair transportation value for the price take they're taking. I think they're going to be okay. But if there's

an environment where it's terrible service and higher rate increases, then you're going to beg the regulator to get involved. We're just not going to be part of that.

Ken Hoexter
Bank of America Merrill Lynch

Okay. Thinking about your CapEx, you have $1.1 billion, down from $1.5 billion, is that – are you comfortable with that? Can you push that down further? Anything else you can pull out of that growth CapEx?

Keith Creel
President & COO, Canadian Pacific

No, I think that's a – we were able to do that because, number one, we're further ahead than we thought we would be. We've got train speed up, we've sort of exceeded our Multi-Year Plan goals, velocity is up, dwell in yards are down, and when you do all those things, assets turn faster. When assets turn faster, I don't need as many locomotives, I don't need as many cars, and I don't as many people. So that's allowed us to take our capital spend down.

And the things I've talked about like the switches we found, all that stuff, that's going to allow us to sort of keep it down even as we grow with the business in the future. So we've got a lot of existing capacity that we've created and the future capacity that we'll need when business comes back, it's going to be at a lower cost and I don't see any change for the next two to three years in that $1.1 billion number locomotives.

We've got 200 more than I had last year. I've got 665 locomotives in storage, that's a lot of capital waiting to be deployed. So, again, this operating model is creating opportunities for us that gives me good confidence that that's the number.

Ken Hoexter
Bank of America Merrill Lynch

Okay. Let me go short term on you, when you think EPS, you target double-digit EPS growth for 2016, are we looking at given the volumes I guess similar to first quarter, given where volumes are that we still expect EPS to be negative in the second quarter? I know you don't want to really want to go short term... but just given the switching volumes here?

Keith Creel
President & COO, Canadian Pacific

Yeah. So, second quarter is going to be the trial for us. It's going to be challenging. But we still feel good line of sight to double-digit. Obviously, the wild card is what I said about these fires that if that changes and we get a different view, then I've got a fiduciary responsibility. I'm going to tell you, but at this point, sort of the positives – the goods are outweighing the bads and we're doing better operationally. We see some upside on the grain side. We see upside on potash. We see a little upside on coal. So, some of those big needles that are against us now turning to tailwinds the second half. We still see a line of sight to getting to double-digit growth.

Ken Hoexter
Bank of America Merrill Lynch

Wonderful. With that, I'll open it up to questions, if there are any.

<pause> If not, I'll wrap up with one more...

Keith Creel
President & COO, Canadian Pacific

Okay.

Ken Hoexter
Bank of America Merrill Lynch

...which is your asset sales. Remember when Hunter kind of started up kind of set a target of asset sales, where do think you are in terms of progression on that?

Keith Creel
President & COO, Canadian Pacific

Well, a lot of that has to do to get that big number, redeveloping/repurposing land. So we've got a partnership with DREAM, we're in the process of doing that. I don't think you see those numbers start hitting us for another, I don't know, maybe it's 24 months. Pretty much what I see, is what we've done in the last couple of years – probably, I'd be assuming about $75 million a year in asset sales.

{And then, any big uptick, if I get some of the big conversions, it's going to be later I would say 2018, 2019. It's not a 2016 or 2017 story.

Ken Hoexter
Bank of America Merrill Lynch

Wonderful. Appreciate the time today.

Keith Creel
President & COO, Canadian Pacific

Thank you, Ken.

Ken Hoexter
Bank of America Merrill Lynch

All right.
