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Transcript

RBC Capital Markets Canadian Transportation Conference

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Participants

Keith Creel, President & COO Canadian Pacific

Walter Spracklin, RBC Capital Markets

Walter Spracklin

Okay. Thank you, everyone. If we could have everyone join? Take your seats. We're in the final session of the day. Last but certainly not the least here, very pleased to have CP present with us and having Keith Creel as representing CP.

Keith is obviously President and Chief Operating Officer at CP. He's been with the organization just since, I guess, February 2013. He was made President and COO. One of the most, and I can say, successful rail operators in the industry without question. He has helped CP generate and achieve an impressive operating ratio with significant efficiency gains over his brief tenure there, and we look forward to continue to see how his role evolves at CP over the coming years.

Part of this conference has been really focused on transformation, Keith, and we heard Air Canada at the beginning and a lot of the transformation they're going through. The trucks have gone through transformation, Westjet has gone through transformation. You were part of CN's transformation at that time and now CP going obviously through a significant transformation as well.

Can you talk to us about – it's easy to say that a company can transform and really turn things around. Can you start out just by telling us what happened with regards to your experience at CP, obviously, going from one of the industry laggards to one of the industry leaders now from an organizational standpoint?

Keith Creel

Okay. Well, I can go back to 2013, when I joined the CP team. You only know what you know from experience a lot. So I learned how to railroad when I was at CP in my previous life and I stepped into this position assuming it be a similar battle. A lot of culture change, a lot of resistance, old age industry doesn't change very easily. You got people that have 30 years, 40 years experience. And sometimes, experience is your greatest resister to change, because they want to do it the way they've always done it, and what's comfortable.

But what I probably underestimated to a large degree is the willingness to change at this company. And if you understand the two very proud Canadian companies, two large railroads, both have very strong franchises, CP for a long time is the industry leader. And then, CN went through the transformational change that CN went through and they became the industry leader, not just in Canada, but in North America. Created tremendous amount of value, a very formidable competitor, but it was through a whole lot of pain and suffering, multiple strikes that I was participated in.

So I sort of thought the same, I came here and I inherited a culture that number one, contrary to what I was told, in certain markets and certain line segments, this franchise has strengths. And when I say strengths, we've got the shortest route to the markets. And for so long, I read all about the mountains and the grade and, what I call as an operating guy, the excuses as why we can't succeed instead of looking at the opportunities to succeed.

So the resistance to change, it was not as great. These employees that, in large part, probably 95% – there's not a lot of new people, there are some new people in strategic locations, obviously. But the ones that couldn't do it then are the ones that are doing it today, because they want to be part of something successful. And with the right leadership, they've been empowered and they've created a vision and then accountability in an operating model that gives them a chance to succeed.

It's now an operating-centric company, not a marketing company. Now, obviously, we've got to market the product that we create, but if you don't run it from an operating-centric position, you'll never create a product that provides the service that the marketing team can convert in the marketplace. So that's exactly what we changed in the pace of change exceeding my expectations. And that's the reason we've been able to accomplish so much in the big scheme of things relative to the past experience versus what that experience was.

Walter Spracklin

So now you talked about marketing and there's obviously things in your control and things outside of your control and let's start with the ones that are not in your control and that is the kind of demand environment out there; it's been lackluster to say the least. It's probably – not by any surprise in the sense that you've guided us toward that challenge, but the severity, I think, has caught some of us by surprise certainly. Can you give us an update? Let's start with an overall environment, kind of a demand environment, but getting specific into, let's start separating before we go into the sub-segments, just consumer, merchandise intermodal versus bulk and are we seeing a little bit of a reversion now where bulk might start to pick up in the back half?

Keith Creel

Yeah. I would say, number one, we anticipated, specific to this quarter, it was going to be our most challenging quarter. Number one, the economy was contracting, and number, two last year this quarter was pretty strong. So we benefited the first quarter from a very, what I'd say, a mild winter, a non-Canadian-type winter. So I was loving like every day not having to face some of the things I faced in the past. But into the second quarter what we anticipated would be stronger grain shipments. What we anticipated would be or could not have anticipated what happened in Fort McMurray with the impact of the crude fire.

Some of those things were surprises, which further dragged down what we thought were going to be a challenging quarter. But from a signs of hope, as we move forward, I think, you're seeing a dynamic unfolding now, the Canadian grain is encouraging. We assumed in our model, in our back half, if we're going to see growth, we assumed a normal crop. I think we're seeing as of late with the moisture content, not 60 million to 65 million metric tons, but more 65 million to 70 million metric tons. Well, if that happens and, I think, it will, then, obviously, we're going to benefit from that.

Walter Spracklin

With the revenue cap being actually higher as well...

Keith Creel

Revenue cap, 4.8%. That's a big swing. I think last year, it was like a 5.6% reduction haircut. Now, we get a 4.8% raise in rate. So that's going to help us on the price side. That's going to help us on the result side. So there's more volume there. There's more upside than we had anticipated.

The dynamics are changing on the U.S. Grain side. CP has a very strong grain franchise in the Northwestern part of the States. And where we're located, where elevators are located, again, the yields are increasing and the products are going to increase. They're estimating about 9% more product to move versus last year.

Now, if you take that dynamic with more product to move, you've got the U.S. dollars that's moderating. You've got commodity prices that are increasing, because the competition in Brazil is not the same that it was. So in a world market, we're well-positioned to benefit from that and you've got a pent-up demand because it was all suppressed last year.

So you've got a lot more than ever that's sitting in bins, waiting to move. You've got a strong crop that's coming in, we're starting to see that product move. So, again, there's some upside as that headwind becomes a tailwind for us in the second half on U.S. Grain.

Coal is another area. We had some concern in the first part of the year, last part of last year. Teck, obviously, a very large customer of ours. We've worked very hard to be efficient for Teck to help them compete in the marketplace. I think for the most part, that's bottomed out. I think they picked up some share. So, I think, we'll see – we'll meet or exceed. There's some upside as far as the coal given the projections that Teck's given us for the coal that will move this year.

Potash is an area that – Canpotex, we all understand the dynamic every year. It's sort of the market set by the negotiations with Asia and then, India follows. Well, Asia is holding out and Canpotex is holding out. Nobody has blinked. Canpotex, at least from what we're being told is – my most recent information, they're not changing their guidance. They think they'll get this resolved. I think India will follow fast back. We're going to get into the second half last year where it actually contracted the volumes – or the comps are going to get lighter. So, again, we think the back half represents some upside on the commodity standpoint.

Now, U.S. coal, we had a phenomenal last year sort of recovering from a deplenish stock supply, we repriced some contracts. We shipped the coal from St. Paul, Minnesota over one particular carrier that originated it to a longer haul over a different part now that we benefited from. So those things don't recreate themselves. But, again, our U.S. coal is 1% of our revenue franchise. So it's nothing to get too excited about if I shifted intermodal.

Walter Spracklin

Just to understand a bit, but I mean, you guys didn't reduce your guidance with the first quarter despite the...

Keith Creel

No.

Walter Spracklin

... the first quarter trend. And listening to you at the various conferences, I get the sense that that's the difference, right? I mean, bulk commodities which, what, 55% of your business is really tied to is showing – in grain, I think about 33% of revenue, if that's showing the life that you're kind of indicating, that would explain your relative optimism.

Keith Creel

Yeah. So the optimism is tied to U.S. grain, Canadian grain, a little bit of coal, not a lot. I'm not going to tie my, or couple my train to it. And then, potash moving, which hasn't moved. And then, there's also some additional upside. We're seeing more sand moving with the price of oil going up. It's not moving – the arbitrage is as far as the spreads, we're not moving trains of crude to any large degree, but we're moving more sand trains, which is good for us as well because then it contracted dramatically first half versus last year and versus last year overall. So that's some additional upside.

And then even more forest products. So the housing starts in the U.S., although that's not a huge piece of our revenue, that's additional incremental business that we had not assumed. It's giving us a bit of a tailwind on the second half.

Walter Spracklin

Now, with the second quarter doing what it did, the wildfires and the significant drop in crude by rail obviously, with your relative optimism coming out of first quarter and maintaining guidance, your continued positive outlook for the back half were positive, but, I think, it's relative, I guess, optimism with regards to Bulk. Where do the two things square up in terms of your guidance? Was second quarter so severe that despite your optimism on back half, they got pretty bad compared to what you're looking for? Or was it not severe enough to really offset some of the further lift you might be seeing now in the back half?

Keith Creel

I think it's a story of both. So if you take a pragmatic view, and we only what we know, we're give-up artists. We work hard. We could have easily, I would suggest, sort of read the tea leaves and said we're not going to be able to do what we thought we'd do, but we've surpassed our expectations in the margin side. So our operating costs have came down in excess of what we assumed they would be. We're getting better running the railroad. We're getting faster. We're putting more assets up, more locomotives up. So the expense control has exceeded expectations.

The optimism in the second half even in the face of some of this headwind that we didn't anticipate, because this quarter has obviously been weaker than what we expected on the top line. I think we're down right now from an RTM basis about 12%. I would have guessed 8% or 7% would have been the number before. So, yes, there are some headwinds. It's not a layup, but again, I think there's enough second half optimism coupled with the expense control that we created that it's only paid part of the dividend now. You're going to really see the benefit expense control on the second half.

That's going to mix the bottom line control with a little bit of top line optimism and we think reality that's coming to fruition now that gets us back to our guidance. So that's exactly why we haven't backed away from it.

Walter Spracklin

So I interrupted you on your merchandising intermodal outlook.

Keith Creel

Yeah. The intermodal side, again, a tale of two stories. Our franchise is very well-positioned from a service standpoint, strength, shortest routes, Toronto to Calgary, Calgary to Vancouver. Obviously, we've got a very formidable competitor both in truck and with our rail competitor. But as the fuel price starts to go up, which it is, you're going to see some of that very cheap, inexpensive capacity start to come out of the marketplace.

And then, we're doing things CP has never done in the past. We've always, I guess, fundamentally and strategically, philosophically, in the domestic side, a lot of our business came from concentrated. So big box stores, certain anchor customers. That was probably two-thirds of the business. We've taken an approach that said, listen, we've got a great product, we're going to put in the marketplace. I'm going to do contracts, but I'm not doing long-term contracts, especially, not now, because I don't want to get locked into a down-cycle. I want to make sure that I get a return for this product that I'm putting out in the marketplace, and we're diversifying the book of business.

So it's not just the big box retailer we're attracting. We're trying to create tranches of business. So I've got the big box retailer. I've also got a wholesale market that I haven't effectively marketed before. That's a certain – going to be a certain percentage of the business. And the other piece that we haven't marketed is cross-domestic business. So essentially, stuff coming from Montréal, Toronto to the U.S. so that cross-border domestic-type business we're marketing very aggressively now. We've got a very good service we established with the partnerships, sort of similar to what our competitors are doing but we are doing with the Hub Group. So using their marketing team, coupled with our marketing team, coupled with our service to take trucks off the road.

So it's more share that's on the road now that we're targeting, that we're starting to convert to the rail. And we've seen some pretty substantial growth in that lane.

Walter Spracklin

And domestic intermodal has been a challenged area from a pricing standpoint. Are you seeing any signs that that is improving or your trucks still with a lower fuel pricing environment creating a little bit of problems from that...

Keith Creel

I think it's bottomed out. I really do. Again, I'm starting to see customer behavior where they're getting aggressive, wanting to lock up business, which tells me that they see the fundamentals changing as well. So, right now, short term, no, but I think it sets us up well.

We've actually got growth this past month. I think we're going to finish the year with a little bit of growth year-over-year and domestic intermodal, which I think is a powerful story, it attests to the marketing effort, it attests to the service in our lanes that we're strong in. And I think it sets us up well for growth in 2017. So I think this tailwind, things are changing. It's evolving and what becomes a headwind or has been a headwind becomes a tailwind next year.

Walter Spracklin

Moving to pricing, just in general terms now, the rails have always said kind of 3% to 4% or price above inflation and so on. And we've seen that kind of come down a little bit now, and we're hearing more about 2.5% to 3.5% as a range. Is that a structural phenomenon? Is that a – you're just getting harder to push through – push your price in this environment or is it because inflation is coming down? Why are we seeing kind of the slowdown in pricing and should we be worried?

Keith Creel

Yeah, I think it's a reflection of the additional capacity that's out there. Obviously, crude's under pressure. So if you're going to move crude, you're not going to move at the same margins, at the same price when the demand was there. So that's some of it. But, again, if you go back to my point about short term, number one, we're not going to do a bad business deal. It's got to be earn its cost to capital. And I'm not locking myself in long term. So that has created some of the pressure and then the other has been domestic intermodal.

Domestic intermodal, obviously, with a truck, there's a lot of capacity out there that wasn't in the past and especially our franchise,

from a volume number of unit standpoint, we had a pretty good business between Montréal and Toronto on the expressway. That train typically was full five days out of seven days. Now, it might be full three days to four days out of seven days. So there is capacity there that is going to the truck, because of the margins. But as that fuel goes up and that capacity gets consumed, you'll see some of that come back.

Now the benefit, it's a low-margin business. Now, we make money on it, but we don't make a lot of money on it. So our domestic franchise, long story short is very well-positioned. I think it's done extremely well to this downturn and we're positioned for a pretty strong, profitable growth as we go forward.

Walter Spracklin

Hunter talked a lot about incremental pricing, about filling that last part of the train. And as you mentioned, the trains aren't as full right now. Have you used incremental pricing so far? Is it something that really works best during a more robust volume environment? How has that been playing out?

Keith Creel

I think it works in both. And we have, to a point, but it hasn't moved the needle. I mean, you could only stimulate demand so much. If there's not demand out there, which is a lot of what we've been going through in some of these markets; it's not going to do a lot for you.

But in certain lanes, even when business comes back, I'm never going to have a network that is ideal, where I get 150-car train sets out there running. There's going to be certain lanes that there might be 120, 130. Now, the incremental cost of that additional car is fuel. It's cheap and it's business that's on truck today that would be on rail if I get the price right, and as long as I don't lock myself in long term, and that's the key to this.

The way we manage it, number one, you can't cannibalize your existing business; and number two, this is a month to three-month type commitments. And if you want to get a regular seat on that train and be a protected customer, so to speak, day in and day out, you got to get on the other train and you're going to pay the normal rate. You're not going to get this discounted rate for that incremental business.

So it allows us to sort of play the market and play the lane. And if it makes sense, in down markets it works, we'll do it if it makes sense in up markets, strategically, we'll do it. Surgically, we'll do it. We won't do it all over the entire network.

Walter Spracklin

So are you alluding to a reduction in the length of term of your contracts now as you go more spot basis and… [indiscernible] (17:46).

Keith Creel

Yeah. You're seeing a shift with us – and listen, I've learned to never say never, but a five-year deal I'm not enamored with. A 10-year deal, it would be an extreme exception. A two-year deal probably in this market is the longest I want to go. And we've done some one-year deal things – this team in the past, if you would have told them, no, I'm not doing a five-year deal, it's got to be a one-year deal, they'd want me to get drug-tested.

Now, they understand the benefit of it. Because again, I can make an argument with the customer, I don't – this could be bad for you. It could be bad for me. You want to have optionality. I want to earn your business every day if I give you service, and there's a compelling value, give it to me for a year, you'll give it to me another year after I do it well for a year. And if I'm not, then you can take the business away from us.

Walter Spracklin

Your confidence in your service, you can go… [indiscernible] (18:30).

Keith Creel

Absolutely. And that's something this company just never had before. They never had service to be able to go in with confidence and have those kinds of discussions.

Walter Spracklin

Let's go to margins now, and I get the question every day almost, how low can margins go or how low can the operating ratio go in terms of the forward outlook and whether it's a limitation because of capacity, whether it's a limitation because of the regulator? How would you answer that question about the potential for your operating ratio?

Keith Creel

Well, I think the most important thing to focus on and Hunter taught me this a long time ago, I'm not going to get married to the operating ratio. The measure of success is not the operating ratio. The measure of success is how much I can create and how much value and how much earnings I can spin off from the company. So if I could have C$12 billion company at a 60% operating ratio, that's better than C$5 billion at a 50%. And especially in Canada, if I transition to the – talk about the regulator, I think if you get to a point where you're making too much money and I'm going in and I'm asking for 2% to 3% price and my margins are 50%, I'm going to begging for regulation. Canada has a very robust mechanism called FOA that some of our U.S. counterparts don't have to deal with which, I think, in fairness to the customer and in fairness to the railroads, has enabled that 3% to 4% story. And I think, it's good for them and I think it's good for us.

It's a healthy environment. We've all adapted to it. We all see the benefit in it. And I think it's allowed us to protect consistent, reliable, healthy environment. And you don't see us tied up with FOAs. You don't see all that detention.

And I don't apologize. I mean, think about railroad, we're probably 90% of our work force unions. And I value our union employees. I've got to give them a fair wage. I've got to cover cost of living. And if I've got to do that, I don't have a problem going and telling a customer, listen, the guy and the girl that provides your service that allows you to make money in your business, I'm paying them 2% to 3% more. You can't expect that you're not going to pay me 2% to 3% more. And most reasonable logical people, especially, if you have service to show them that there's value in, it works.

Walter Spracklin

Yes. Railroad is always seen as an order business around forever. But, I think, technology is alive and well in that sector. And I know when I asked you about on-the-horizon technologies which, I think, was five years or six years ago, you talked to me about distributed power and how that was going to really change the train lengths and margin improvement on railroads. Is there anything that's coming down the pipe from your perspective that can really dramatically or even incrementally improve margin that we haven't adopted yet as an industry?

Keith Creel

As far as improving margin-specific, I have nothing that I'm aware of. As far as making a quantum change and our ability to protect a safe operation, our ability to control service, provide consistent service to improve some margin, control cost because we limit accidents, there's technology out there now that I'm a strong, staunch advocate for and that's cameras on locomotives.

To me to be able to take a camera that records the interior work office of a locomotive to make sure that what's going on inside that locomotive is safe and productive is in the best interest of our company, it's in the best interest of our customers, the product we carry, the Canadian communities we operate in and through and the Canadian economy.

Now I'm dealing with some resistance. I'm speaking about this frequently every time I get a chance. I've talked to Minister Garneau about it. I've talked to the TSB about it. I've talked to The Safety Board about it, and I'll continue to do it. Obviously, the laws have to be changed. There's certain laws, which were enacted in 1989 in Canada, the TSB, the Rail Safety Accident Act, which prohibits the use of cameras except for a post-accident investigation by the TSB. And I've taken a position, I'm not going to spend millions of

dollars of my shareholders' money to equip – put cameras on locomotives that'll only explain why somebody died.

I want to put them on proactively. Now, again, I believe 99 out of 100 employees are good, honest, hardworking employees, they comply with the rules. They come to work, wanting to operate safely, and they do their jobs properly. So all we're going to do with these cameras is commend them for doing that, but it only takes one to create something catastrophic that has an adverse impact on this industry.

Walter Spracklin

Let's talk about safety a little bit and how you saw CP coming in in terms of how it's been doing and particularly on crude by rail, obviously, we had Lac Megantic a long time ago, but we're still dealing with some of the accidents here very recently. How would you view the railroad's ability to provide a safe service, particularly on crude and how might that involve in the future?

Keith Creel

I think that – let's talk about specific to CP first. So when I came to see CP, CP had been, from a train accident standpoint, it led the industry and the train accident ratio seven years. We've continued that for the past three years, then, we've progressively gotten stronger. And part of that has been through technology investment, through process and through culture change.

So we got employees today, they can – rules compliance is greater than it's ever been. There's always room for improvement. It's a journey. It's not a destination, because as you bring new employees in, you got to train them right and create the right culture, so they can follow the rules and choose the right way and not the easy way in most cases.

The technology side, we've invested internally at CP with ultrasonic rail testing equipment. So, historically, the railroads, they have some internal capacity, but most of it is contracted out to certain service providers. So you can limit how much rail you can inspect based on how much money you pay that contractor or if you in-source it and you buy the equipment yourself, and I can turn those assets as much as I want to and staff up, staff up, staff down based on work blocks, based on business, based on where I want to put this equipment, I've got a lot more flexibility.

So we've taken capital investment, invested millions to equip our railroad, and we focused it on specifically crude routes. Given our – number one, we got a common carrier obligation to haul it. We don't have a choice. But if I'm going to haul it, I'm going to do it as safe as possible. And knock on wood, anything could happen any day. I'm going to suggest we'll never have an accident. But this railroad has done extremely well, deploying that technology to find accidents before they find the trains.

We found broken rails. We found things through inspections, stuff like inspecting ahead of the trains. On dark territory, we literally require track inspectors to go ahead of the train movement and sometimes behind the train movement, depending on the weather, to try to find these suspect areas that may end up finding a derailment before we find it.

So things like that have helped us. I get concerned, though, Walter, in the industry we see like last week, UP had a very unfortunate derailment down in Oregon. And you see all the opposition come out, you see all these folks saying, you know what, don't haul bomb trains, don't haul crude trains. But, wait a second, I pay the same person that's buying the gasoline that the refineries are using that crude to create to suggest that we want the conveniences of this product, we want a cheap gas, we want to be energy-dependent and dependent in North America, but yet, we don't want to haul crude is a little bit, to me, biased and uneducated. And it's Pollyanna to me, you can't do it.

So we got an obligation to run it safely. We work hard. Every derailment to me is unacceptable. But at the end of the day to say, because we have one derailment, to me, that's akin to saying you know what, if a tire blows out in your car, never drive your car again, and you can walk to work the rest of your life. Or if unfortunately, a plane comes down somewhere in the world and people die, it's absolute tragedy. We should learn from it, but to suggest that we never fly planes again, it's just not a realistic expectation.

And this is a very similar not-in-my-backyard kind of mentality where, I think, because of these very topical front and center microscopes on those accidents that occur, again, I want to prevent them. And I think most are preventable and we're working hard to do that. But, occasionally, less than 1% of the time or a small – 0.1% of the time, something like this occurs to suggest that 99.9% of the time, the national economy and citizens don't enjoy the benefits of moving this product, I think, is not the right answer.

Walter Spracklin

Okay. I'm through the income statement part of my questions. Is there any questions for Keith from the floor before I move on? You've answered them all. Oh, TJ, yeah?

[Question Inaudible] (27:27-27:41)

Walter Spracklin

So just to repeat the question, the not-in-my-backyard trend, is it getting worse and is it affecting your ability to go 24/7?

Keith Creel

Yeah. It's certainly a risk. It has not impeded our ability to go 24/7. It's certainly requiring that we have a lot more external advocacy. We spend a lot more time with municipalities, explaining to them how we run our business, the efforts that we take to make sure we protect safe operations. So I think rail shipping in the past, a lot of it has happened sort of in our backyards and we didn't pay a lot of attention to it, so it's broad-focused, and it's broad – I call it a microscope.

And that's not all bad, because there's been some positive changes came as a result of this. The tank car standard is one. For a long time, I've been an advocate of more staunch and more rigid tank cars, but the issue is – and a lot of people don't recognize this – we don't own the tank cars. And we can, as an industry, compel the tank car owners to change the standard. We've been challenged in courtroom for requiring and compelling safety changes that some of those court cases we're still battling as an industry.

So a lot of this has brought about positive change. I think it's obvious that we educate more. We certainly understand what our moral obligation and our legal obligation is and our fiduciary obligation. So we're compelled and focused around that as an industry. I would suggest overall more so than ever before. But in spite of that, eventually, something is going to happen. It's in our best interest it never does, but I can't predict and tell you perfection, because it isn't going to exist.

But the alternatives, I mean, think about some of the products we haul. Is the better alternative like the chlorine that goes in the water we drink, do you want it on the highways? Do you want it in a tank truck that's going through the middle of neighborhoods and cities all over the place in instead of having 10 tank cars of chlorine, there's 30 trucks out in the road. I mean, it's just a story that a lot of people don't understand. Some of it, you don't have a choice. It's a very safe means of handling this product. Occasionally, things happen. It should be very occasional. It should be an exception, but it is the safest product and the safest way to move this product. I mean, if we're going to keep drinking water, we're going to keep buying gas, keep driving cars, this stuff has got to move somehow, someway.

It's just my objective and my vision and my commitment to my company and to this industry to do it as safely as possible. And if that means not being the popular guy because the unions don't like my position on cameras then I get thick skin. I'm going to do what's right. Period. I'm not going to do what's convenient. So you'll continue to see CP take those kind of positions. We came on tank cars early. I'm going to come out on cameras. And then, to your point if there's something else monumental, our quantum changed that this industry can adapt that's going to improve safety, to me, a safer railroad is good business. We're going to do that.

[Question Inaudible] (30:37-30:42)

Keith Creel

I think that's the challenge. If it makes sense, then somebody's going to pay for it, and then, the other thing is wherever you move it to, they don't want you in the backyard, either. I mean I lived this in my previous life in Chicago. Hunter moves me to Chicago, I have no idea that we're going to do the EJ&E deal and I moved to Barrington. Well, guess who the – I had signs in my own yard. My kids coming home, dad, why does everybody hate CN? Just don't tell them I work there. I don't want the kid giving you a black eye at school.

But at the end of the day, nobody wants you in the backyard. Everybody has this lack of understanding about how safe railways are and every derailment we have in the industry can compound that problem. So again, that's why we work so furiously to prevent them. It's sort of – it's part of the business. I mean, if I had a choice, I wouldn't haul any of that nasty stuff. I don't – I legally have to. So without being compelled, I'm going to move it to safe as I possibly can. And overall, we do a pretty darn good job and we're moving it safely.

Audience Question

Can you talk about the – we heard earlier today that Vancouver terminal is getting [inaudible] (31:45) more complex there. How do you see it? [inaudible] (31:50).

Walter Spracklin

So at a previous session we had mentioned that shifting in jurisdiction led to some disruption in the Vancouver area for truck drivers. And the question back then was whether rail can take an opportunity to gain some share goods truck out of Vancouver as a result.

Keith Creel

You know what, to me, if there's shift going to rail versus truck because of disruption, the trucking community, they're not the first market folks. They're eventually going to adjust that. So I don't think it would be long-term share. And I don't know all the intricacies of what's created this.

I know from a rail perspective in Vancouver, capacity is constrained. I know that Deltaport, they're challenged. They're going through expansion now. They're trying to improve their productivity. I know that eventually Prince Rupert is going to come online with the expansion that seems investing in.

But I think overall, there's enough demand out there that there's a spot for both those capacity improvements. And the more we improve capacity, the lower the steam ship lines costs are going to be, the better the margins are going to be for the people that actually operate those terminals and the better our service and our cost is going to be for the railroads that serve it. And I think there is always going to be a place for truck. There's enough congestion in Vancouver that we all could improve our supply chains and all benefit from it and the Canadian shippers benefit from it.

Walter Spracklin

A couple of questions left for me. Just on the dividend, obviously, you did a – let me ask on capital, because that leads into the dividend. Your capital expenditure program, rails are often criticized or observe that it's very capital-intensive business. You brought your capital expenditure down quite significantly around 28% this year. What is your view on your CapEx program and the intensity of that CapEx over the next, say, longer-term three years, four years, five years.

Keith Creel

Okay. I think what you see today, I know what you see today unless we have some rapid volume growth that exceeds my expectations. We've got a lot of excess capacity now with the way we're running the railroad. The money that we have invested over the last four years, we ramped the capacity up dramatically. It's a contrary to all this urban legends that we come in and slash and burn and cut cost. We actually spent C$4 billion more than our predecessors did in the same comparable timeframe.

And we've done it in rail, we've done it in ballast, we've done it in ties. We've done it in taking physical plan and taking redundant assets out and optimizing and instead of having 10 sidings, I've got five sidings at a longer length. So I'm creating additional inventories that I can cascade down the line to minimize and offset my future capital cost.

So we played the catch-up game. The railroad is safe to operate on. As I've said, we continue to get better every day. Our numbers prove it. Work in progress, but I don't need the same level of spin. So we're protecting the basic capital to keep it safe. The rails, the ties, the ballast. That's about C$750 million to C$800 million of the C$1.1 billion we spent and the balance is as we need

reinvestment inventory, replace computers. There're some strategic what I call productivity capital. If I can go on to a particular terminal and spend a lot of money and save a job at a pace forth, then I'm doing it.

And there are some regulatory and then there are some PTC. Now PTC will fade away in 2018. We're spending about C$40 million to C$45 million a year. So I've got more room for contraction if I need to. But, as it is today, I've got enough capacity to carry me through 2017/2018. I've got 662 locomotives stored. I've got railcars stored. I mean, I've got a lot in this fiscal plan.

So you can assume the same – we're going to take cash flow that we create. I think this year we're about C$1.1 billion. We're giving it back through share buyback. We increased our dividend modestly, not trying to get along with the industry, because we still think there's a lot of opportunity for value creation where we are in our sort of the chapter of our book of evolution. So you won't see us get to that heavy dividend that some of our peers might do. But again, going forward, first call capital is going to be spent internally to grow the top line or to create something that's very accretive from a synergy saving and their operating side. If there's some niche M&A stuff, we're going to keep our powder dry so we can do that.

Other than that, we're going to return it through a similar share buyback that we realized in the past. And if right now, I think, 5% to 6% is where we're at, and if the stock continues to be weak, and we have a good second half, what I'd go back to board and make a recommendation, we do differently. We probably would if it's a bargain. But otherwise, we're going to maintain the status quo, protect our 2.5 terms on our leverage, which is what we've told the investment agencies we're going to do and sort of steady state for the next several years.

Walter Spracklin

And as a last question, I guess, on M&A you mentioned really is it niche opportunities that you're going to be looking at now or what's your view on future opportunities for CP in terms of that?

Keith Creel

Yeah. As far as anything huge that moves the needle, obviously, we've sort of been there and done that, and the environment and the appetite is not now for that. I think eventually it will happen. In the meantime, there's some short lines this company has over the years sort of rationalized off. I'm looking at those, as we speak. Some are long term, some are short term, if they make sense. We'll try to bring them back into the family but, again, it's niche. It's not going to move the needle. It's got to be accretive. There's one area that we haven't really invested in and I don't see us ramping up huge investment but modest investment is more like a CP global, so we can work with the third-party providers. It could be accretive to the intermodal package that were out in the marketplace trying to sell transload facilities. We've built the facility in Bensenville last year. We've spent about C$7 million. It's not a huge investment, but it's bringing product to the railroad. We're getting carload in and intermodal out. So all that is sort of the beginning stages for this railroad. So that's something over the next three years to four years we will be playing out.

Walter Spracklin

Perfect. Well, with that, Keith, thank you very much for your time.

Keith Creel

Thank you, Walter.

Walter Spracklin

Appreciate it. Thank you

Keith Creel

Thank you.