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Transcript

Wolfe Research Global Transportation & Industrials Conference

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Participants

E. Hunter Harrison, CEO Canadian Pacific

Scott Group, Wolfe Research

Scott H. Group

So, this is the final panel of the two day conference. I'm not sure I've seen the room this full at 4:00 P.M. on the second day of our conference yet and I know it has nothing to do with me and a lot to do with the guy to my left. So, I'm really happy to have Hunter back at the conference and Hunter is going to make a couple of opening comments, and then we'll jump right into questions.

E. Hunter Harrison

Well, thanks for the invite. It's nice to be here. I think one of my comments would be that some of you aren't very good listeners. But maybe those of you that aren't good listeners will clear some of those issues up during this session. I would make a couple of comments, Scott, that are probably – I would imagine, I didn't get to hear the other presentations or – that are probably very similar.

Clearly, 2016 has turned out to be quite a challenge for us, particularly as we look at second quarter and softness of some of the volumes.

Having said that, I would say that there's some good news on the horizon. If I had made these comments two or three months ago, they'd of been a little less bullish, I think.

We've heard some good news out of Canadian grain with the recent changes in the pricing regulations in Canada, which will mean, I think, about $6 million, $7 million for us. Nadeem can keep my math straight. Which is good, positive for us. I think that some of the information and some of the outlook in the way of bulk is pretty good given that there's some good news certainly relative to what it was coming out of Canpotex potash. So I think a lot of those things are very positive.

I'm proud to report that we, and not only us, and I don't want to be selfish about this, but have not been directly affected by the fires, and there's good news coming out there that people are being allowed to go back in – and it was a horrific situation – and so that is a little more positive than it could have been in the reports earlier.

And then I think that we've always said, and we're sticking with it – that the back half of the year, we look to be a little better than the first, particularly the second quarter. So having said all of that, I think we're still – and I know a lot of people have interest in this – but given some of those positives, depending on some of the dynamics of things like FX, mark-to-market compensation where we have to mark-to-market. Some of those things that is just hard to put your finger on what's going to happen there. But given that we see some positives there, I think that I'm still hopeful – and realistically, I think, hopeful – to give you some kind of sense that we can stay with our guidance for next year or for this year. Yeah, I know some of you don't agree with that and I respect your opinions. And we'll see who is right and wrong unless somebody changes their numbers.

Scott Group

So, you're saying Hunter that, yeah, we had a very tough kind of second quarter or tough second quarter ahead of us, but you still feel comfortable at this point given what you know about currency and fuel and things like that, you still feel comfortable saying we can hopefully do double-digit earnings growth?

E. Hunter Harrison

Yeah. Maybe the word is not comfortable. I think it's realistic that we could certainly make those numbers. Now, is it going to be easy? Is it going to be comfortable? Probably not. But I think it's something that's certainly doable for those reasons that I mentioned. And I didn't go through all of them, but there's some others that we could talk to you offline about that – or any of you. So overall, I feel pretty good there.

Scott Group

Okay. I've got tons of questions and not so much time. So I don't want to spend – we're not going to go through a kind of commodity segment by commodity segment. I don't think that's kind of what we need to do right now. But the one question I've been trying to ask every rail is the one area that I think has been most surprising from a volume standpoint is the weakness in intermodal volumes. Do you have a view on or an explanation for why intermodal is so weak? And then we'll move on to some questions beyond that.

E. Hunter Harrison

Well, I think...

Scott Group

Is it just as simple as the economy and...

E. Hunter Harrison

Yeah, it is.

Scott Group

Yes.

E. Hunter Harrison

I mean, I think we always see this in times of real softness in the market. One of the first things you see is softness in domestic intermodal. So I think that's not something that we didn't expect and it's not something that we – as long as the trend with the economic conditions continue, that there'll continue to be some pressures there. Once again, on the domestic side. Now, international is a whole other can of worms – and it's just a different animal right now.

Scott Group

Okay. Let's talk about pricing a little bit. So, CN on last quarter's call made reference to the competitive environment in Canada. It feels like it's – or the environment in Canada feels like it's getting a little bit more competitive. What's your perspective on what's going on from a pricing competitive standpoint in Canada? Do you agree that you guys are competing a little bit more, and is that starting to impact the pricing that we should expect from you guys?

E. Hunter Harrison

Well, I think competition in pricing is good. And I think – I didn't know there wasn't a time where we weren't competing very vigorously for the business. I hope that doesn't infer some behavior that's not expected. I think that my former employee you make a reference to, they're a worthy competitor. They do a damn good job, and we're trying to do the same, and I think that's all healthy for the market.

Now, people can say, well, look, that's – competition is bad and that leads to depressed price and so forth. I don't really buy into that. I just think that there's more to it than that. There's more upside than downside. And I think you have to think about carefully – as I'm going to say this carefully – reactions of regulators relative to those comments.

We have kind of a saying back home that if you abuse authority, you lose it, and I certainly don't want to be strutting around here with a baton talking about pricing – pricing is getting competitive, like it hadn't been before, and that's not good. That's a double-edged sword.

Scott Group

Sure, maybe asking a little bit differently, I think a lot of us have grown kind of very comfortable with this idea that the rails can maintain, call it, 3%-plus kind of pricing is – has anything changed in your mind and your ability to get that? And maybe just add one thing to this a few years ago, you had talked about this idea that, hey, we had for years prior to you getting there not really earned any pricing and once our service gets good enough, we're going to earn even better pricing than the market is getting. Is that still an opportunity? So maybe one is the risk that we – I guess, part A, is the risk that we could fall below 3% and is there still this catch-up opportunity from a pricing on the upside for CP?

E. Hunter Harrison

Well, I think there's – you always have been taking into account what the competition is going to do, and I don't really know what they're going to do. And to some degree, you're going to be reacting to their reactions. I still think that service has a great impact on the price you can extract. I still think there's opportunities there. Now the degree of the opportunities is debatable. I'm a person that believes in a pretty simple formula that the market gives you the price; you decide whether you want to play or not.

So, I think given those kinds of issues, I think rails and I think we – as long as we continue to raise the bar with the service offering– do what we say we're going to do, that we can expect to see price increase, and I think more importantly, price increased from, in my view, the main competition, which is not of the rails, but the highway. And to me, that's the big opportunity out there. I think that's, in my view – I hesitate to even mention this, but I've never let that stop me before – I think that people missed it about the consolidation piece because the big opportunity I thought with the consolidation piece was market share gains. And that was the real opportunity to say that the real competition is the highway, and we're going to be able to extract our share of the highway. And when I go, we go to a customer and say, "Hunter, I'd like to know what your service is from Winnipeg to Dallas." And I say, well, from Winnipeg to Vancouver is – "I don't want to go to Vancouver. I want to go to Dallas." Well, I don't go there. "Well, you can't help me." So what do I say to them? So we, together, don't have a service that we can offer to the shipping public out there that's competitive as long as we don't have connections and working together. And we've always, I think, have fought ourselves into losing business and to discounting price, and I think that's not the way to play the game.

Scott Group

Okay. I want to shift the focus a little bit to the operating ratio. So you guys did a 59% operating ratio in the first quarter. I think the guidance is, I think, sub-59% for the year. Kind of what goes through kind of how you think the rest of the year kind of plays out in terms of seasonality from first quarter to the rest of the year from an operating ratio perspective? And then long term, what you think kind of that new goal should be? Should it be a mid-50%s? Can it ever be low-50%s, or, A, realistically, does it have to go to low-60%s at some point once oil maybe goes up again?

E. Hunter Harrison

Well, I think we feel much more bullish on our operating ratios than I think we do, at this point, than we do revenue. I think that our performance in the past should be an indicator of what you can expect in the future. Now, there's a little different dynamics going on from time to time as to how we get there. But I think that it's – one of the exciting things here is this, when the economy returns, and it will, okay. I don't think anybody that argues it's not coming back; it's just a matter of not if, it's when, it comes back and you're out there with an operating ratio in the mid, low-60%s, that's a powerful place to be because you really have a great deal of leverage working for you. So...

Scott Group

And you said mid, low-60%. So, is your point that realistically that this is not a – if oil goes up at some point, when the economy comes back, that 50%s is not a sustainable number? Is that what you're trying to say?

E. Hunter Harrison

No, no, no.

Scott Group

No.

E. Hunter Harrison

The opposite, if I've misled you.

Scott Group

Okay.

E. Hunter Harrison

I think that clearly, we believe that the type numbers that we've achieved, the type of numbers that we've given guidance this year for on the OR are certainly achievable and sustainable. I see nothing stopping this. Now, once again, there are some things that is hard to call the shots on that I've related to earlier with stock-based compensation and market-to-market and foreign exchange and some pinching issues, some of those things that we just – I think it would be wrong in my part to try to predict that. But having said that, I think I'm very comfortable that going forward, the thing I'm most confident is we will see the OR continue to track, like it's tracked in the past, which is I think pretty positive.

Scott Group

Okay. Okay. As we think about buybacks each of the past two years, you guys have announced the buyback and then a pretty nice upsize kind of middle of the way through, kind of given the free cash flow you have, kind of your views on economy, the balance sheet, all that stuff, is that kind of what you think we should expect again at some point is an upsize or given other factors, is that less likely this year?

E. Hunter Harrison

No, if I had to characterize it, I would say it's probably more likely. I think we have to look – and look, the first call on the capital is the company, is what the company's needs are and what we need to reinvest in the company. And seeing that we don't have either needs or opportunities there for adequate returns, then we would turn to either buybacks – that you referred to – or some dividend. And I think you've seen us have a little bit of a shift recently and that we modestly, I would describe it, increased our dividend. And I say that because, I mean, look, this is a very dynamic board. It's an active board. And some of us see the world a little bit differently. And that was one on the page that we should have been a little more aggressive on the dividend side, understanding the tax advantages in U.S. and whichever tax band you're in and so forth. I still think you need to recognize – we need to recognize that a lot of our shareholders happen to reside in Canada and it's nice to have a friend where you operate.

So I think maybe we're getting to the right balance between buyback and – let me qualify that, given that the numbers are right. I mean, look, if the intrinsic value changed dramatically, all bets are off and we do something differently. But under a normal scenario that we're speaking of, I think that we would look at buybacks and a little more favorably than maybe we have in the past with dividends.

Scott Group

Okay. Just wanted to go back to margins just for one quick second. I don't want to get too near-term focused, but we typically see the operating ratio improve nicely from the first quarter to the second quarter, given maybe some of the real estate impact in the first quarter and then just the volumes in the second quarter, is that less – are we less likely to see margin improvement from 1Q to 2Q, or is there still enough cost momentum and seasonality that should kind of drive sequential margin improvement?

E. Hunter Harrison

Well, I think one of the things that we've seen and we're trying to achieve and our Chief of DREAM here, our sub who deals with the real estate is here with us today. But I think one thing we're trying to accomplish was take some of the volatility out and not be so quarterly driven and kind of have a relatively smooth flow. And so in trying to achieve that, I think we've accomplished the point that we do not see that volatility and we can see much more stability in the market there as far as what we do and what we experience in that regard.

Scott Group

Okay. Let's turn to M&A for a second.

E. Hunter Harrison

Do we have to?

Scott Group

Just – we'll do it quickly. I guess...

E. Hunter Harrison

I was just kidding.

Scott Group

Sure. But should we be operating under the assumption that M&A is just not happening anymore? And then, maybe just to add on to that, what have you learned from the process that the next time that you or maybe it's going to be Keith, what have you learned to maybe next time to get it done?

E. Hunter Harrison

Well, number one, this is Hunter Harrison thoughts. And these are big board decisions. I still think it's going to happen for the right reason, sometime. And I don't want to debate some of my friends about the whole issue, but I hear no one that comes up with answers. I don't think many of us disagree that we've got industry problems in Chicago. You can argue about how bad they are or how bad they could be.

So I think that's kind of a given, which is – and then if you look at that and say, well, how do you solve that, and if it's not going to be through some form of consolidation, I don't know how you do it. And I think experience in the past says you do it through consolidations. And all the people that we're griping about – and I chose that word gripe for a purpose, okay? We're doing that for a reason. They get their merger. They said it was a wonderful thing, but it's not good for us. I have trouble following that logic.

So I don't – I think I can safely say, it's not something that CP is focusing on today. I think we made – what we'd like to say was a

valiant effort, but we understand when the U.S. Army and the Justice Department lines up against this, it's pretty tough competition. And then when you go see Justice and Justice is arguing with the STB about who's got jurisdiction, it's a little frustrating. And I guess I would finally say that relative to what CP might do in the future, my thoughts are – is that I don't want to put words in his mouth, but we've discussed this, I think Keith is on a similar page, that this is something that is good for our shareholders. It's good for North America and it's the right thing to do, and how and when CP might pursue it in the future, it's just – it's not for me to say. It won't be my call.

Scott Group

So with that in mind, it's June of 2017, is that right?

E. Hunter Harrison

My birthday.

Scott Group

Exactly.

E. Hunter Harrison

Yeah.

Scott Group

And by the way, we obviously would love you to come May of 2017 at our 10th annual and give kind of a farewell address, but what would you like to accomplish over the next year and what are the key transitional things that you're doing with Keith and the team right now? And I guess – just because for the sake of time, and I've got one more topic I want to discuss, the short version of that, I guess.

E. Hunter Harrison

Well, look, I want to see, for a lot of reasons, Keith be successful, number one. I think once again, it's good for him. Obviously, it's good for the shareholders. Maybe I'll say this selfishly. I have an investment there. Keith and I have spent 20 years together. I've given in all I've got in the way of knowledge and experience and maybe a little expertise, and I'm hoping and I'm convinced that, that'll be helpful to him going forward and will become part of his legacy or CP's success going forward.

I can tell you this, I want the shareholders of this company to know that the last day I work here, I'm going to be working as hard as I was the first. This is not something I'm going to take a vacation the last six weeks. Keith and I are just as concerned and engaged about accomplishing the things that we want to accomplish for the shareholders for the right reasons now as we were six months, eight months ago.

So I want to see this company successful. I want to see the shareholders rewarded. I happen to be one that didn't think that shareholders get the recognition they deserve today. And I'd like to be, maybe if I'm right there, a little part of that change.

Scott Group

That all sounds good. So, the last question is, and I guess I'm asking this to someone who says that the – it's a lot more fun following the industry when you're a part of it. What does your – what do you think of your next life post-June of 2017? Do you think – is it at the board level? Or potentially, I mean, do you think you have it in you to do this kind of one more time at another rail? Would you have interest in something like that?

Because, I mean, I guess I'm coming from the standpoint of three months ago, you were ready to stay at rail do it for several more years. So, even if it's not M&A-driven, I mean do you think you've got the capacity, desire, or willingness to do this again?

E. Hunter Harrison

That's a 19-part question, Scott. I think we'll take it one step at a time here.

Scott Group

Perfect.

E. Hunter Harrison

Look, I'd go back to some degree to my answer to your previous question. I want to see this company, this organization successful and shareholders rewarded. Now, what I want to do and what I'm able to do are probably two different things. If somebody said I don't have it in me, they might have a fight on their hands, but at the same time, it's not something that I think fits right now in my life. So, and I say that because – and hopefully say this with the appropriate degree of modesty – we, the teams have been part of – have been pretty successful. So I'm not trying to create some legacy. I'm not trying to create some – my legacy is I did the last merger, whatever, and it's time for Keith to shine, okay? And I'm not sure you know...

Scott Group

So that's more maybe of the staying at the board question at CP. So that's maybe the first part of the 19-part question. And how about meaning – and sorry to interrupt, like just from the idea of would you do it, could you, would you do it at another rail? Do you have the desire to do that?

E. Hunter Harrison

No. Look, I'm hopefully, and I can tell you this, hopefully you can buy it. I'm very loyal individual to groups I'm associated with. This company has been very good to me. Hopefully, I've been good to them and given them what I've got. And the question on about staying on CP's board is kind of up in the air. And I'd say that I'm not sure that's my thing. I'm not sure I'm a board member kind of guy, good or bad. And I'm serious when I say that, and so I'm giving it some thought.

And I've always said, look, if I could go on a board and make a contribution, and that organization thinks I'm making a contribution and it's something that I can enjoy, I'd take it an advisement. And that's what I would do today, would take an advisement. I have a very expensive hobby in horses, so I don't need a place to spend my money. My daughter has got a place for that.

So, the question about the board, don't know. Besides the board with CP, I just – it's hard for me to visualize. It's just, I just don't think it's in the cards. I can't imagine how or why given what my circumstances are, which most of you either understand my circumstances, or once again, you're not very good listeners, and that's to be determined. Okay. So, that's the best I can do.

Scott Group

Okay. Well, unfortunately, I think we have to wrap there. Thank you so much, Hunter. Really appreciate it. And thanks everyone for your support and a great two days, and sometime in May of 2017, we'll be back for the 10th Annual.
Thanks, everyone.

E. Hunter Harrison

Thanks.