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Transcript

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Corporate Participants:

Keith Creel – President and Chief Executive Officer, Canadian Pacific

Chris De Bruyn – Director Investor Relations and Treasury

Other Participants:

Ravi Shanker – Analyst, Morgan Stanley

QUESTION AND ANSWER SECTION

Ravi Shanker

Analyst, Morgan Stanley

All right. So, next up, we have Canadian Pacific, and I'm very happy to welcome back CEO Keith Creel. Keith, thank you so much for being here.

Keith Creel

President & CEO, Canadian Pacific

Always my pleasure.

<Q – Ravi Shanker>: So far, we've had a couple of rails present, and I think they have kind of kicked off with a few opening remarks about how they see the state of the world. I don't know if you would like to have open that way as well?

<A – Keith Creel>: Yes. At CP, a bit countercyclical to the industry obviously. We realized growth in a world where we see contraction, not as robust as it was obviously and a bit below what our expectations were. Some of the reasons for that, that have developed that's unique again to us, that's new and unexpected, we've got a grain harvest. Obviously, we move a lot of grain, a lot of bulk products in Canada. That's delayed 20% to 30% in some areas just because of wet fields. So, it doesn't mean the grains are not going to move, and the encouraging part of that is actually the quality of the grain is high, the yields are high, everything that we've read from our customers, 70 million metric tons plus, last year was 70 million metric tons so the quantum with the carryover, we think, is actually an upside opportunity. It's more of a timing issue. But you do see some of that mute some of our growth in the third quarter. The other piece is potash. Obviously, Canpotex, we moved quite a bit of their tonnage for export. That's a cyclical negotiating process that occurs with China, so that's not new. What is new is obviously the political environment. So, at this point, those negotiations continue. That's muted some of the demand, some of what we moved in because the first half of the year counter-cyclical as well. We moved quite a bit of potash. So, more to come on that. That's a micro issue, not a macro issue. Short-term issue, long-term, the world consumption, the need for potash continues to grow, and Canada is a key supplier in that supply chain, and CP is a key enabler to move that potash. So those two issues, and then the last piece would be crude. We all know about the volatility that was interjected into the crude market, that collapsed the spreads when the Alberta government, the previous government, decided to become crude shippers. That unrolling of those contract commitments that were made to Canadian Pacific, as well as to Canadian National, we think is coming to fruition. I think last week the Alberta Energy Minister made some comments that their process to, in the market, shift that contractual commitment as well as that capacity to the oil companies is coming to closure, we think in October that may be resolved. Will it take some time for the spreads to adjust? It will. But I'll remind everyone in the room, I'll remind our investors, we didn't make our guidance based on runaway crude movements. We took a conservative approach in the beginning, so we still are moving more than we were last year, we'll still finish the year out. We set about a 30,000 run rate in the fourth quarter. I think we'll do 28-ish, 27-ish in the third quarter. But again, it's minimized the upside and it's muted some of the demand that we were seeing or some of the expectations we had in our guidance. So, if you look at overall, those needles that are moving, those levers that are moving offset by and muted by, again, exceptionally strong operating performance. Our operating metrics in July and August in this quarter followed a very successful second quarter when we hit peak levels of business and still at peak levels of train speed improvements and productivity improvements. We've replicated that July and August where we've hit new levels at or exceeded new operational levels when it comes to train lengths, train weights, train miles per day, car miles per day, locomotive productivity, fuel efficiency. So, all the natural outcomes of running a railway in a true PSR disciplined fashion continue to move the right way and they offset some of those headwinds. So, from an RTM standpoint, we're going to have positive RTM growth in this quarter. We're going to have positive RTM growth in the fourth quarter. We've said we're going to do mid single-digit RTM growth, that's going to be a challenge. I think it's more probable, for the year, low single-digit RTM growth, but absolutely RTM growth, which again in a space, in an industry where we're seeing contraction, is pretty exciting, exciting for us. And what's even more exciting is what 2020 looks like and what 2021 looks like because, again, our unique growth opportunities, what I call self-help, our market repatriation business and the new revenue streams that are coming under our railroad that are unique to CP.

<Q – Ravi Shanker>: Got it. Very helpful overview. Just to follow up. The first three issues you highlighted, all three of them seemed like timing issues with the weather, Canpotex and with crude. Can you just give us a sense of kind of what kind of timing they're looking at for those issues to be resolved like weather should be fairly short-term. Is that in a matter of weeks or...

<A – Keith Creel>: Yeah, I think grain movement is probably within the next two weeks. September is going to be muted. Depends on how fast it comes in. We literally just realized a week of dry weather. So, does this start to pick up the second half? I think it does. Is it at full level? In September, probably not. But October and November on, it's going to be strong. The potash is just a question mark. We've got to wait to see how that plays out.

<Q – Ravi Shanker>: And can you just help us understand some of the dynamics around that contract and kind of how that works? Because I don't know if many investors spend a lot time thinking about like potash volumes for CP and kind of what the implications are. So, can we just like – similar to when the crude by rail opportunity first came up in 2017, can we just size the bull-bear base case here?

<A – Keith Creel>: I would say, at a high level, 2018 we moved rough numbers 10 million metric tons of potash. This contract negotiation, the lion share of it is with China. Of that quantum, about 20% of what Canpotex exports is to China. So that's what's in play right now. For us, if I boil that down to the risk that I see that we're sort of baking into what I'm saying relative to our muted RTM growth is 300 million metric tons a month. So, that's it. I say 300 million – 300,000 metric tons a month. Yeah. So, that's it. And even with all that said, we're not backing away from our guidance when it comes to the earnings growth. We still see line of sight to double-digit EPS growth year-over-year, which again, from an investment standpoint, for our investors, for our shareholders is pretty compelling. It's unique to the industry and it's pretty exciting. We don't see anything that's going to change that.

<Q – Ravi Shanker>: Got it. You guys obviously have won a number of new contracts both in autos, Yang Ming, and a couple of others. Can you just talk about the timing of when those volumes come on kind of going into 2020?

<A – Keith Creel>: Yeah. So the new automotive business, we really haven't seen the full benefit of what we've won yet. The Ford business is new. The Ford business is going to Vancouver. We talked to the investment world. We made a decision last November. We've got some land in Vancouver, very strategically located. There's a big demand for a place to land automobiles. There's one facility called Annacis Island, which is essentially sold out. It's where import vehicles come and it's where also to feed the domestic market vehicles come to and get offloaded and put in trucks, and they go to dealership. So it's controlled by the SRY railroad. It's a short line served, it's expensive, and it's not very good service because they're oversubscribed. We built our terminal. We spent CAD $15 million for design, Ford is our anchor tenant. They've got about half the capacity, and we're marketing the balance of the capacity. So, some of the incremental volume growth, counter-cyclical, the reason we've grown in automotive has been as a result of that. But the true benefit is yet to come. So we're currently in negotiations with FCA. Their entire contract comes up – is up for bid. That business will not be realized until 2020 mid-year. I think it's July, if I remember correctly. So, once that comes to fruition, we're in a very competitive position. We've got capacity, we've got great service. I fully believe we're going to repatriate some of that business, because we're naturally best served to serve some of that business.

<Q – Ravi Shanker>: Sure.

<A – Keith Creel>: Will we get it all? No. I'm not competing for all of it. There's only a certain part of that business that I best serve that plays into our model, that fits our capacity, that fits our lanes, that allows us to give them a great service offering, and allows us to grow revenue. The other piece that we haven't benefited from yet, we've got some of it, but not all of it, is the Glovis contract. The Glovis contract, we won two years ago, I guess. Glovis has built their facilities. There's a facility built outside of Montréal at a place called Les Cèdres. That's literally on our land. It's sort of hook and haul for us, it's their capital. They manage inside the gate. We drop off the autos, we pull the autos, and it creates empty supply for the loads going back West. So, this whole layering on at the West Coast Terminal in Vancouver has even improved the synergies of that model because we have loads going both ways now. And we will when that business comes online. So, that again is unique to this railroad, and that's a 20 – that's a late 2020 story before you see the full benefit of that. So, all that automotive piece is really yet to be realized. We're just getting the fringe of it now, but the real material change will be in 2020.

<Q – Ravi Shanker>: Got it. What about Yang Ming kind of…

<A – Keith Creel>: Yang Ming comes on January the 1st.

<Q – Ravi Shanker>: The 1st.

<A – Keith Creel>: Yeah. You'll see it immediately. We're preparing for it now. We've – we're getting the systems in place. We're in lockstep with Yang Ming preparing for that transition. They're out meeting with their clients, with their customers. Now advising in January the 1st you'll see 100% of it on our railroad. And the benefit of that, what's exciting to me beyond the revenue is the service offering that we're going to give our customers. Part of that strategy, again, sell to the strength of our franchise. We're not going to be everything to everyone. We'll be a quality provider. Our commodity is our service, that's the value of it. So, if we look at, and I looked at this last year when we sold this, this is about a two-year process, but THE Alliance and the consolidation that occurred in the shipping industry landed on an alliance called THE Alliance which is Hapag-Lloyd, Ocean Network Express, and Yang Ming. So we won the Ocean Network Express contract last year. Hapag-Lloyd is our flagship international intermodal carrier. So, two of the three were on those ships, sharing the same ships, but they were getting a different service experience because when you call on a port and if each railroad doesn't have equipment there, literally what transpired is the ship would come in, offload the Hapag-Lloyd, the Ocean Network Express stuff, the Yang Ming stuff went back out to harbor in some instances.

<Q – Ravi Shanker>: Okay.

<A – Keith Creel>: So, if that happens, if it happens once, you've lost your operational synergies by sharing ships. So not only do you not have a great service experience inland, you've got a cost disadvantage which drove the consolidation in the first place. So that's part of the proposition, part of the value offer. We'll take out complexity, you've got all three enjoying the synergies which drove the consolidations and drive the margins for the shipping companies, which allowed them to compete for business, as well as the service experience. And then the last piece, GCT, which is the operator of the terminal. Their complexity is reduced, their velocities increased, their capacity goes up, and this is all in lockstep with the CAD $400 million investment they made to increase capacity. So, if I go back a year-and-a-half ago, we got as low as 20% of the business that was calling on GCT, as this shifts we're at 70% of the business.

<Q – Ravi Shanker>: Okay.

<A – Keith Creel>: So you've got a dock that's going to flip those containers. That on-dock dwell is going to be the best on the West Coast. Not the best in Canada, the best on the West Coast, with the shortest route to the Midwest, which gives the people that partner with CP a service experience to go out and charge a premium for to attract the customers that care about service, reliability, capacity and ratability.

<Q – Ravi Shanker>: Right. Speaking on the West Coast, you guys have done phenomenally well in Vancouver. Obviously CN has done pretty well with Prince Rupert. It clearly appears to be this share shift from U.S. ports to Canadian ports. Is there any way you guys can size this – size that shift at this point, kind of what innings are we and kind of further opportunity in that shift? And do you see potential for something similar happening on the East Coast?

<A – Keith Creel>: You know what? The major quantum share shift, I think, has already happened.

<Q – Ravi Shanker>: Okay.

<A – Keith Creel>: As long as we do our job, there's a natural competitive advantage in Canada because the cost of doing business is less.

<Q – Ravi Shanker>: And you're closer.

<A – Keith Creel>: Capacity to get to the Midwest is there. The terminal fees are less. You've got a hedge on currency that helps. So the Canadian ports are at a cost advantage as long as the service experience is the same. So we'll continue to grow, making quantum share shift changes. I don't think that happens unless there is a lot of unpredictability and unreliability that occurs on the West Coast because of labor issues or challenges or capacity constraints. I just don't see that happening. So I think it's good, it's continuing to be strong, but you won't have quantum shifts. And on the East Coast, I don't. – other than the Port of Montréal, I don't serve the East Coast. You'd have to ask my competitor. They've got a strategy whether it plays out or not, I guess they're best served to tell you that. I just think we're in a good place in Montréal with our franchise, with our service, and that's where we play in this. We'll continue to play here.

<Q – Ravi Shanker>: Got it.

<A – Keith Creel>: I can't tell you about Halifax.

<Q – Ravi Shanker>: Got it. These shifting gears on the cost side, look, clearly, you guys have been very focused on growth and that has played out over the last couple of years and will play out in the coming years. But I mean, there's clearly this difference in messaging between the Canadian rails who are talking about growth and the U.S. rails who are talking about costs, largely because you guys already have chopped a lot of the wood on the cost side and yet you guys are still among the leaders on OR in the space, right? So I think you guys have been very clear in kind of not focusing on OR for the sake of like just one number. But what is the cost and OR strategy going forward? Are you guys looking to be the best OR in the industry? How do you think of cost vis-à-vis the growth opportunity?

<A – Keith Creel>: The focus is earnings growth. That's the focus. But to be able to do that, you got to be able to control your cost. And if you run a true PSR railroad, it's an operating business. It's not a marketing business. So you got to have, – when I say low cost, profitable, sustainable growth, those aren't catch words. Those are recipes to success or recipes to failure.

<Q – Ravi Shanker>: Sure.

<A – Keith Creel>: So it's a natural outcome. If you have good service, you turn your assets. You're getting a rate of return. They value your service. It happens. Do I want to be best-in-class? I want to be best in anything we do, but am I seized with that? No. What I'm seized with is making sure that if the needle moves with my competitor, I'm not at a competitive disadvantage because that's where CP was for a long time. When you got a 20-point cost base differential, our competitor could win business and compete for business, and I couldn't even make a buck at it.

<Q – Ravi Shanker>: Yes.

<A – Keith Creel>: And this is a capital-intensive industry. So, as long as I'm not disadvantaged, then I'm going to use my leverage and my service and my low cost and reliable service to grow business. And if I've got to exchange a little bit of operating ratio to get top line growth that drives accretive earnings growth, that's what this railroad will do. But I'm not going to do it and expand short-term, chase business that makes me spend capital that gets captive that I can't sustain long-term, i.e., the crude story. We talked about that. I could be – this railroad could be king of crude if we wanted to be king of crude, but I would suggest to you if we do that as a shareholder, I'm making 40-year capital decisions that 4 years from now a lot of that market won't exist.

<Q – Ravi Shanker>: Absolutely.

<A – Keith Creel>: So I'm just not going to chase short-term earnings. I'm not going to do that. I'm going to be good stewards of capital. We're going to be disciplined. We're going to make sure our capacity is in lockstep with our growth, and we're going to sell to our capacity because our capacity determines our ability to provide that service. That's the recipe in this company. That's what a true PSR railroad will do. And we're all in different phases. This railroad is going to – we fixed the engine. It's running well. We know why it runs well. It's because we take this disciplined approach. It's woven in the DNA of the way we rail – run the railway, and then that creates the markets. We create the solutions with the capacity we have when we sell to that, and it's in lockstep, it's in partnership with the marketing department.

<Q – Ravi Shanker>: Right.

<A – Keith Creel>: If you ever lose sight of that and you start just selling business and making a bunch of promises that your operating team can't keep, it's going to destroy in a PSR world your fluidity, your asset turns which is what drives that low cost which is what produces that operating margin. You won't be able to do that. You're going to lose credibility with your customer, and eventually you lose credibility, you're going to lose business. It's a recipe that if you flip it the other way and you don't pay attention, it could be extremely damaging to a franchise.

<Q – Ravi Shanker>: Right. If I were to just ask that same question another way, I think a few years ago there was this huge focus on 55 OR and can you go to 50? Do you want to go to 50? Will you go to 50? Obviously with the reset in accounting rules and such, is 55 achievable? Do you want to achieve it? Would you rather stay in the high 50s and grow the top line? Kind of how are you guys thinking about OR?

<A – Keith Creel>: You know what? I see line of sight, there's always going to be, I believe, if we become better railroaders, we become more efficient, we become better leaders, we become more productive, which we have a history of doing and we'll continue to do that. That's the way we think. Doing more with less and sweating assets. We're not done. We don't – our people aren't the most efficient as they can be. They're the best-in-class, but we can always get better.

<Q – Ravi Shanker>: Sure.

<A – Keith Creel>: We can always use fewer locomotives. We can always be more reliable with our maintenance. So I think there's incremental margin improvement in the cards. I see this year we're going to drive margin improvement, I see 100 basis points. The line is clear, line of sight could be better, but I see 100 basis points. I look at the profile for next year and the opportunities that we have on revenue, I see another 100 points. Do I see a world where I'm going to go to 50 and be seized with that? I could cut my way to it? But if I do it, I'd do it at the expense of growth, and I don't think, long-term, that's the right answer. If you think about the accounting changes that have been made, a sub-60, high 50s OR now is a 55.

<Q – Ravi Shanker>: It is yeah.

<A – Keith Creel>: For our railroad that's 400 points – it's 400 points of headwind.

<Q – Ravi Shanker>: Yes.

<A – Keith Creel>: So we're there. Again, I just want to make sure we're not at a competitive disadvantage. I don't want to get in a place where, especially in Canada, you've got a very active regulatory environment. 60 days, you can have an FOA, its final offer arbitration. A customer could say, look at that railroad, they're making tons of money. We're bleeding money. They're trying to raise our rates to protect their money-making machine.

<Q – Ravi Shanker>: Right.

<A – Keith Creel>: ...that's the dialogue that happens. And if you're an arbitrator and you don't understand, that's pretty dangerous.

<Q – Ravi Shanker>: Sure.

<A – Keith Creel>: That's very risky business. You can lose big or win big, and we just choose to be conservative and choose to avoid those fights. I want to be fair to my customer. I'm going to give them reasonable rate increases. I'm going to give them great service. I'm not going to give them a case to go to the neutral or to the government and say we're being unfairly treated. So, I just don't think that's a safe place to be for this railroad.

<Q – Ravi Shanker>: Right. It's a great segue to my next question, which is the regulatory environment. We've seen the STB take some actions which I'd say, over the course of the last 12, 18 months, may be perceived as being more shipper friendly than they have been in the past. We obviously saw in Canada with Bill C-49 some of the grain issues in the last couple of years. Do you feel like that tide is shifting a little bit? And maybe the regulatory environment is something you guys need to keep a closer eye on?

<A – Keith Creel>: I do see it shifting some. I think the STB is becoming more nimble. I see signals that they're willing to be more shipper-friendly. That doesn't concern us because we're shipper-friendly. We want to treat our shippers fairly.

<Q – Ravi Shanker>: Sure.

<A – Keith Creel>: We're not a railroad that takes price up 7%, 8%. I'm not suggesting others do, but I'm suggesting we won't. Our history says we haven't, and our future says we will not. So, again, the regulatory agency is always going to be there. It's there to protect, to me, the strength and the importance of commerce that moves on rail. It's there to protect the shipper, but if we don't threaten the shipper and we're protecting them with the service and with the value that we give them, I'm not too concerned about regulatory action. As long as we do our jobs, we're not going to give them a case to come against us. And I think if you're railroad does that, STB can exist. They can be shipper-friendly. But if we have a good relationship with our shippers, we're not going to pick a fight with them.

<Q – Ravi Shanker>: Right. What is the normalized price level, do you think, going forward? As you said, there were very unique circumstances that drove high single-digit pricing in the last decade. You guys have been doing mid-ish in the last couple of years. What's the rate going forward?

<A – Keith Creel>: You know what? Canadian roads and CP, we're not unique. It's 2% to 4%. It depends on the economic cycle. When you've got a weak economic cycle, it's going to be closer to 2%; when it's strong and it has been, it's a 4%. We're still in the 3% to 4% range.

<Q – Ravi Shanker>: Yep.

<A – Keith Creel>: Maybe we're a little bit slighted more to 3% than 4%, because we were 4%-plus before...

<Q – Ravi Shanker>: Yes.

<A – Keith Creel>: ...but I still see 3% to 4% is the range.

<Q – Ravi Shanker>: Got it. How much of that is actually physically tied to inflation in your contracts versus just standalone price?

<A – Keith Creel>: Well, typically there are some contracts that are weighted to inflation. The bigger contracts, long-term contracts. And over the last two years, especially as we shifted into an environment where we had more strength, more pricing strength. Instead of taking more price, we tried to steer away from those indexes. So it's fixed rate.

<Q – Ravi Shanker>: Yes.

<A – Keith Creel>: It's – there's a minimum, there's a maximum, there's a floor that's not tied to an index. So we're trying to weight our contracts more like that. And then the other thing that we've done is we try to avoid long-term contracts, two-to three-year contracts.

<Q – Ravi Shanker>: Right.

<A – Keith Creel>: Even some cases, in a weak economic cycle, we'll do one-year contracts. So, again, we try not to get ourselves locked into a bad economic cycle, and we use the length of the contracts to be able to sort of leverage that and offset the risk that's associated with doing anything different.

<Q – Ravi Shanker>: Got it. I'll open up the audience, if anyone has any questions. I see one up here.

<Q – Undefined Participant>: Yeah. Can you just remind us what you're aiming for on employee head count for the full year? And then, with a weaker top line, if you could walk through some of the other cost levers that could drive that 100 basis points of margin improvement.

<A – Keith Creel>: Okay. As far as head count, we were saying mid single-digit RTM growth would equate to about 1% to 2% head count increase. Some of that, obviously, we had to hire ahead for that. So I'd still say that 1% to 2% head count increase is a good number to go for. That just means that we'll be a little long employees. You'll probably see us do some surgical layoffs, not any mass layoffs, to control guarantees in some of those locations where some of that business is soft. But that 1% or 2% is a good number, and it positions us well for growth next year. As far as the levers we pull, the operating focus is key; fuel efficiency, train starts, crew starts, train lengths and weights. The other piece that helps us with the weaker revenue environment, we talk about this, we don't talk about it a lot, but some of the contracts that we've signed in this volatile market which we had not had in the past that help us are take-or-pays. So there's liquidated damages that are tied to some of this business that is not moving, which will show up in other revenue. Again, that helps us drive some of that margin increase and gives us line of sight to our 100 basis points. So those are the levers. There's no one big single chunk, it's singles and doubles, and it's spread across our balance sheet. But as long as we run the railway in an efficient manner, the way we're doing, and when business goes down, we stay ahead of, not behind, which we started to do months ago, adjusting. And actually that's why our productivity numbers continue to improve, because we're taking assets out. And as long as we tweak that and we do it across the board and we stay on top of it. We don't get behind it. You'll still continue to see us protect our margins.

<Q – Ravi Shanker>: Can you remind us again how those take-or-pay contracts work? Do you get paid for the fixed cost study you incur and then you cut out the variable costs?

<A – Keith Creel>: They're all different.

<Q – Ravi Shanker>: Okay.

<A – Keith Creel>: Yeah, they're all different. Some pay us for the revenues, some pay us – there's a minimum. Obviously, I'd rather have the business, the lions share of them just to have a fixed rate that's in it. If they don't ship a certain number of cars as a per charge, at the end of the quarter they've got to make us whole for it. And essentially the way we did it was to cover the cost for capital...

<Q – Ravi Shanker>: Sure.

<A – Keith Creel>: ...for the locomotives that we had to bring on line to be able to handle the business.

<Q – Ravi Shanker>: Got it. Any more questions?

<Q – Undefined Participant>: And then on the potash side, can you just walk through you know they had a pretty steep first half ramp and then maybe some drop off or ongoing negotiations there, and how any China or tariff impact could focus that business.

<A – Keith Creel>: The first half, I mean, if I moved 10 million annually, we exceeded that pace the first half of the year because we're actually up. I don't know the exact number right now. There's 300,000 that's at risk, that's baked into what our expectations are. So, if that's soft the balance of the year, that's an opportunity when you come back into the first half. The first half, potash alone, the compare is going to be tough next year because we moved a lot. So, again, I don't think that's going to be a tailwind. That might be a slight headwind, but it's nothing I'm going to lose sleep over. But again at the macro level, Canada is uniquely positioned. We're world-class, low cost producer, reliable supplier of potash. The need is there. Population is growing. We'll get through this noise, so to speak, with this China negotiation. And CP is going to be in a good place and the potash producers in Canada are going to be in good place. Now, the dynamic that will help us next year though, that will mute a bit of the headwind as far as Canpotex. I'll remind you, we had a very wet potash season, got a lot of rain, the Mississippi River, astronomical flooding across. So it muted our volumes in spite of we moved more potash. It was driven by Canpotex. Next year, first half Canpotex strength may not be there, but we've got to return more normalized domestic shipping model of potash that will sort of offset that and mute it. So, again, that's sort of underlying why I'm not too concerned about it. And then the last piece of that something I didn't mention, part of what's helping us as well on the margin side and with our guidance, our tax rate is coming in a bit better than what we had anticipated. We guided to 25.5% to 26%. You'll see us come in this year more towards 25.5% as opposed to the 26%.

<Q – Ravi Shanker>: And that's like a normalized number.

<A – Keith Creel>: That's correct.

<Q – Ravi Shanker>: Got it. Got it. Keith just to round out, can I talk to you on CapEx?

<A – Keith Creel>: Sure.

<Q – Ravi Shanker>: What's the normalized CapEx level for North American Class I railroad at this point, do you think?

<A – Keith Creel>: For?

<Q – Ravi Shanker>: North American Class I railroad. So just, what's the normalized level?

<A – Keith Creel>: You know what? I don't get into percentages of revenue. I know that models work well that way, but I'm more of a fixed dollar guy.

<Q – Ravi Shanker>: Okay.

<A – Keith Creel>: It's – we're all at a different story. So if I think about PSR, PSR naturally allows a railroad when they implement it to take a capital holiday. So it's all different. I don't know enough about UP, know enough about NS and CSX to know how much surplus locomotives they've created and how many surplus cars and how many terminals they can isolate and eliminate. I can tell you, it allows you to take a capital holiday. But at CP specifically, we're at a sweet spot. So, once you do a PSR railroad, you got to keep it safe. You got to keep the ballast. You got to keep the ties. You got to keep the rail. At CP, what that means for us, it's about CAD $900 million. Add-on computers that we've got to keep working, add on buildings that we got to keep in good shape, those type facilities to keep the lights on. It's about CAD $1 billion spend at CP. Everything beyond that, it's all about productivity, capacity, and growing the top line. So, if I look at us, we're CAD $1.6 billion, that's inflated a bit because we're spending on locomotives and we're spending on a hopper fleet. That's a unique investment opportunity for our company. That's going to roll off at the end of 2021. So you're going to see a higher revenue top line as we grow and we lead the industry, we have the last two years, we will this year, we will the next two years. You're going to see higher top line growth and a convergence with that capital spend reducing with the hopper cars, they're going to pay out in 2021. So, 2022, normalized for us isn't CAD $1.6 billion, it's CAD $1.5 billion, it's a CAD $1.450 billion.

<Q – Ravi Shanker>: Okay.

<A – Keith Creel>: So the free cash flow conversion is going to get even more compelling for this railroad, more U.S.-like...

<Q – Ravi Shanker>: Right.

<A – Keith Creel>: ...as we get into 2021 and 2022, which from a value proposition is pretty compelling.

<Q – Ravi Shanker>: What about technology? I mean, do you feel like there's going to be this push to automation data analytics? Does that call for more capital to be spent?

<A – Keith Creel>: No, not at our railroad. Here's where I am with technology. I think we have to be aware of it. I've experienced it in a different – working at a different company where we've written off a lot of capital, technology capital, and not a whole lot of return. Not tens of millions, hundreds of millions. That's not going to be part of CP story. I call that the bleeding edge of technology. I'm not going to be bleeding edge in technology. We're going to be just beyond – behind leading edge. So...

<Q – Ravi Shanker>: Sure.

<A – Keith Creel>: ...we're going to stay aware. We're going to innovate. We've got some very, very talented engineers in our company that are looking at big data analytics, that are making investments surgically and strategically where we can drive safety improvements, where we can drive a lot of reliability improvements which ultimately go right to the bottom line in the way we run a railway. So we'll continue to invest in technology. As far as it moving the needle, I don't see it happening. And if I think about the needle movers down the line, eventually you might get to a world where you could run an autonomous train. Technology will allow you to do it, but will the regulations allow you? And will the reliability of the components that keep the train together allow you? Those have to be developed. In the meantime, what I see most – some say it's a challenge, I say it's an opportunity, if you look at our unique business mix, when it comes to domestic intermodal? Domestic intermodal in Canada is different than the U.S. because of length of haul, because the interstate systems. Much longer length the haul...

<Q – Ravi Shanker>: Yes.

<A – Keith Creel>: ...much less developed interstate systems.

<Q – Ravi Shanker>: The weather would be different.

<A – Keith Creel>: So – and the weather is the other variable. The highways literally get shut down in Canada when it's 40 below zero. You can't drive to the West Coast when they shut down the parks because you've got to drive right through the middle of them. The railroad’s still running, ok, so you've got a different dynamic. At CP specifically, we move a lot of domestic. We're – we have the best service, the best network, the best revenue stream for domestic intermodal in Canadian space. We also were a big payer of dray moves. So, when it gets to our terminals, it's got to get to the warehouse. So we're buying that on the open market. We don't take the risk of owning our own trucks. So, if autonomous comes, that's the first place it comes, it's going to lower the cost of the last mile, so to speak...

<Q – Ravi Shanker>: The dray, yeah.

<A – Keith Creel>: ... where we're paying a higher rate now, so we're going to benefit from that. So I see that as an opportunity. Now, is that a quantum opportunity? No. But it's all those singles that add up to winning this ball game and it's what allows us to keep our industry-leading – or at industry-leading operating margins as well as drive revenue growth.

<Q – Ravi Shanker>: Got it.

<Q – Ravi Shanker>: Keith, thank you so much for joining us.

<A – Keith Creel>: Thank you so much.

<Q – Ravi Shanker>: Thank you.