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Transcript

Morgan Stanley Laguna Industrials Conference

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Webcast

Corporate Participants:

John Brooks – Executive Vice-President and Chief Marketing Officer, Canadian Pacific

Maeghan Albiston – Assistant Vice-President Investor Relations and Pensions

Other Participants:

Ravi Shanker – Analyst, Morgan Stanley

QUESTION AND ANSWER SECTION

Ravi Shanker
Analyst, Morgan Stanley

Good morning, everyone. Welcome to the 8th Annual Laguna Conference obviously in the virtual world this time. But we promise it's going to be just as insightful as the real things just assume that there is crashing of waves outside your window. I'm Ravi Shanker of Morgan Stanley's freight transportation and airlines analyst. And we're very pleased to kick off the transportation track of this conference with our top rail pick, Canadian Pacific. And we're very pleased to be joined by John Brooks, EVP and CMO as well as Maeghan Albiston, AVP of IR & Pensions. Before I turn over to the management team, I need to read out that this webcast is for Morgan Stanley's clients and appropriate Morgan Stanley employees only. This webcast is not for members of the press. If you are a member of the press, please disconnect and reach out separately. For important disclosures, please see Morgan Stanley Research Disclosures website at www.morganstanley.com/researchdisclosures. If you have any questions, please reach out to your Morgan Stanley sales representative. Also to the members of the audience who are on the webcast, you can send your questions for the management team through the Q&A section of your webcast browser. And with that, John, Maeghan, do you want to kick off with any opening remarks?

John Brooks
EVP and CMO, Canadian Pacific

Yeah, absolutely. Thanks, Ravi. And like you much rather be in Laguna today, but hopefully next year. So let me start by first of all, I'd be remiss if I didn't acknowledging CP has the best railroaders in the industry, Ravi. And I'd tell you they've reconfirmed that to me every day, day in, day out the 12,000 strong family that we have at CP through this crisis has done just amazing things. Collectively the power of coming together and providing safe reliable service for our customers in North America has been paramount. I've never been prouder as a CP employee. Let me talk a little bit about volume starting off here. So Q3 is actually playing out a fair bit better than we expected. We spoke – we knew on our Q2 call and we spoke about it that we'd have some tough comps as we moved into Q3, we had a really bang-up volume year in 2019 and that's what we saw. July, albeit the tough comps, we exceeded our internal plans on volumes and we saw a pretty steady increase on our volumes as we moved through August.

Now, we knew that was going to set up though for what we expected to be a pretty strong or actually very strong September and that has started to play itself out for us. Midway through the month, I guess, today, our RTMs are up about 4.5% year-over-year, a trend – a certainly a nice trend to finally see in the positive and a trend I expect to continue to see as we move through the year. When I look at specifically, as an example, our seven-day average for RTMs, just comparing even like the second week of August versus now, I guess, the second week of September which was last week, RTMs in that instance were up about 9% and are building. So quite optimistic as we move and close out the quarter here in September and move into October. I will note unfortunately we did have a derailment yesterday outside of Vancouver in our directional running zone. So we'll have to keep an eye on that as we all know that that Vancouver territory is critically important and particularly this time of the year.

Few more comments. As I look across our book of business lots of optimism, not only optimism from what I see in terms of recovery but also maybe more importantly optimism driven by our own unique opportunities. It's the execution of the commercial strategies that we've been now talking about as we pivoted to growth a couple of years back and really those are the areas that as much of the recovery is nice to see, that's really driving our outperformance. We've led the industry in the last couple of years in growth. There's no doubt my expectation is we follow suit and do that in 2021 and right in the – or 2020 and right into 2021. Our bulk franchise is – Ravi, as you know is a unique strength to CP. It has a high level of resiliency in challenging marketing times. Bottom line is the world needs to eat. It needs nutrients to grow grains and food products and feed products and the CP franchise is best-in-class to deliver those. So, we're expecting a strong Canadian grain crop potentially record crop and we're positioned well. We've embarked upon a couple of years back our 8,500 foot grain model and it's really something that the industry across Canada and the US has embraced, but you take that model along with our investment in our covered hopper fleet of which I'll tell you we've got about 3,300 of our new covered hoppers in service as of today. And you know we expect to be up around 4,000 hoppers by the end of the year. But this is giving us a distinct advantage in the marketplace. You can see it, you can see it play out in the last crop year, we can see it already play out so far early in this new crop year. And the exciting piece of that is the industry is just really embraced our model, the terminals in Vancouver whether it would be G3, the terminals on the South Shore have built their facilities and expanded their facilities to accommodate CP's grain model, let alone all the elevator investment in the country with loop tracks, the new facilities and then the number of expanded facilities that, that we have underway. So I'm quite optimistic in Canadian grain and knock on wood but for the first time a long time I'm actually quite optimistic about the US grain front. Chinese demand is back. It's been a few years since some of the trade issues that, that took place, but our movements to the PNW for wheat, corn, soybeans, look to outperform.

And then overlay that looking to potash, I'll tell you so far in September our potash RTMs are up about 38%, Canpotex is sold out through December which gives us obviously significant confidence in that area for the balance of the year, but maybe more importantly, I think it's important to point out to the listeners that Canpotex has done a great job in diversifying their demand markets and particularly during some of their challenges in their Chinese negotiation. So India and Brazil become much bigger pieces of their book. In fact Brazil will surpass China in 2020 as Canpotex' number one end market. So, quite bullish on potash not only in 2020, but as we look to 2021.

On the automotive front it's been an area that we have outperformed our rail peers. We welcome Chrysler, FCA to our Vancouver and Calgary auto compounds in July and that Vancouver auto compound is just another example of CP using our land assets and capacity to create unique solutions that can't be replicated in the marketplace. In addition, we've been talking about this one for years. Glovis business has finally started up here in September with us, quite exciting the business levels appear to be much stronger than when we contracted with Glovis a few years back. So, September I think we sit here today I was looking at the numbers this morning, September automotive RTMs are up about 31% year-over-year on CP.

The last business area I'll touch on before we get into some questions, Ravi, is the intermodal front and I want to then speak specifically to the press release we put out this morning. On the Intermodal front despite I would say some early challenges around pandemic and in the crisis we're all facing we are running quite strong now. Our domestic container fleet in particular is essentially what I would consider sold out across our property. Volumes are strong. In-gates and all our terminals, our reefer fleet has

been sold out going on now our fourth straight month. We had a record by all accounts in domestic intermodal in August and I think September RTMs are up about 15% – 14%/15% as we're half way through the month now, so quite strong in domestic. And the international side, we've certainly seen volumes ramp up through Vancouver. Our partners are adding vessels to their current lineups. We had unique situation at the Port of Montreal with the strike. But to be honest, it gave us the great opportunity to begin to provide a proof point around our new port at Saint John. And so, we did five vessels through the Port of Saint John here over the last month or so. And again, I think it's just becoming a great proof point with our partners there in Saint John with DP World and then you couple that with our over 200-mile route advantage as you depart west out of Saint John into Montreal, Toronto and Chicago. It's a great growth opportunity as I look to the future for our CP franchise. Speaking specifically in the intermodal front, Ravi with our partner, DP World, I look for upwards of about 1.4 million TEUs of new capacity that's going to fit sort of right in the CP's wheelhouse coming on by 2023 when you think about the growth at Centerm on the South Shore coupled with the growth at the Port of Saint John. So quite optimistic on the intermodal front as I look forward.

So I do though want to now speak and just take a couple more minutes to talk about the press release this morning essentially announcing a new long-term partnership with Maersk. I think, it would be best if I took the listeners back to our 2018 Investor Day and basically our message that day if you recall you that we were going to deliver sustainable profitable growth at CP, but do it in a surgical disciplined selling way and that's what we've done. And that means picking partners that best can leverage the qualities we bring as a railroad. The qualities and advantages we have on our network. So around picking winners in the marketplace, those that we believe are going to be successful in the good times and the bad times. And maybe most importantly how we utilize our unique land capacity to create solutions, Ravi, in the marketplace, that again just can't be replicated. We think about our Vancouver auto compound, you think about our, the things we built on CP land for Glovis, for IPL, for Suncor, for our Transloads in Milton and our new Transload literally that's opening up, opened up yesterday in Montreal. All these things are proof points and sort of now a culmination of what we're going to be doing with Maersk in Vancouver. So this opportunity with them sort of checks all the strategic boxes in my mind. I couldn't be prouder of the team effort to land this opportunity. This partnership will truly be transformational, not only in terms of CP's network, Maersk's network, but also as you begin to think about the consumers across North America, across Canada, the – frankly the city of Vancouver and the port of Vancouver.

To give you a little more detail essentially CP in partnership with Maersk will be building a new transload and distribution facility using CP land at our Vancouver intermodal facility right at the terminal. So, this is going to not only create, best way to call it sort of long-term stickiness, relationships not only with Maersk, but the customers that collocate with CP at our terminal. The construction of the facility, Ravi, is underway. We expect to have it completed as we move into the second half of 2021. The facility is really going to be designed hand-in-hand with Maersk to really foster their global integrator strategy that they've talked about. Offering rail solutions for not only import, but exports and also domestic intermodal movement. It's quite exciting. It's going to be uniquely environmentally conscious project. It has the opportunity I think unlike other transloads and maybe some of the other inland ports in BC, this facility is really going to be I would call it purpose built to take trucks off the road. We can – I can see a solution where for ultimately tens of thousands of roundtrip truck movements come off the road in BC while eliminating obviously all the CO2 emissions that, that come with that. We're excited that we're doing our part in this environmental effort, but not only that but to reduce truck traffic and congestion save road infrastructure in and around. To give you a better sense, it's really going to provide shippers the opportunity to import traffic instead of having it trucked into the terminals or into a transload,

they're going to be rail shuttled into our facility. At the same time it's going to give the capability for exports whether it would be grain or plastic pallets or wood pulp or lumber and panel products to be railed into the transload facility, reloaded into containers and rail back down to the port to be loaded on vessels. It will also then allow obviously those domestic good, those retail products with our big box customers to be loaded directly in the 53 foot containers and shipped whether it would be across Canada or into the United States. So we're – this partnership is a game changer, we're super excited about it. I think, you can tell by my tone, it's just frankly another compelling chapter in the CP growth story. So I know that was all a mouthful Ravi, so maybe let me stop there and I'll be excited to talk more about it.

<Q – Ravi Shanker>: No, that was a super comprehensive update, John, thanks for that. I mean what pandemic, right, it sounds like you guys haven't missed a beat from where you left off, you left off a year ago before all this started off. Maybe if I can throw in a couple of follow ups to your opening comments, maybe starting with that where you ended on the intermodal side. Clearly a huge growth opportunity has been for yourself and your peers on the Canadian West Coast side. Is this just a pie that is growing significantly, is this share gain from truck, is this share again from the US ports? What is the primary driver of that growth? Do you feel like there's you have enough visibility into the volume growth over the next five years that you can add all these capacity and more and kind of is there any risk that there's too much capacity going without the demand?

<A – John Brooks>: Let me make a couple comments on it because I think it overlays not only it's good proof point and sound bite relative to what we've seen on the West Coast Ravi, but also I think what we're going to see and what we're developing in terms of a mousetrap on the East Coast at Port of Saint John. So I think particularly when you think about CP and our unique story, it's a little bit of all the elements you've talked about. I think we've definitely -well, we have- we've benefited from share rebalance as we've pivoted to growth as we've developed in our intermodal – international intermodal and domestic intermodal products have matured. Right. So there are some natural share rebalance that – that's taking place that we've benefited from.

But I really believe the West Coast and will continue to has really cemented itself in terms of a distinct advantage of the capabilities to draw traffic out of and away from California and the West Coast ports of the United States. And I think that you've seen obviously our competitor, at Prince Rupert, ourselves at Vancouver really capitalize on some of those distinct advantages. And, yeah, I do believe there is an opportunity for that momentum to sustain itself. Part of that proof point is, as I mentioned earlier, we got significant capital investment that went in at Deltaport with GCT, adding capacity to their terminal capabilities, you've got Centerm that over the next couple of years that you know will be adding upwards of 600,000 TEUs to 800,000 TEUs at that facility.

And then, as I shift to the East Coast I think the story is as or even more compelling as you begin to think about again specifically the opportunity for CP. Our acquisition of the CMQ and the direct route it has given us in partnership with the NBSR into the Port of Saint John. It's something that is going to be a – we haven't begun to feel the effects of that growth opportunity. And I look at it again in three buckets. I think, number one, and this is obvious, there hasn't been a competitive alternative in the Maritimes for 20-plus years, we believe on that fact alone and the enthusiasm we're receiving from the intermodal and steamship line industry that there is going to be a share opportunity for CP in that eastern marketplace. Number two, I think there is a – and maybe this one is, I'll call it, Ravi, maybe in the early innings as trade shifts continue to materialize that we understand what manufacturing around the world

looks like a little differently over the coming years whether it's less in China more in Southeast Asia more in India, more in South America. Maybe, near shoring and how that picks up, I think that is sort of the second bucket of opportunity for us at the Port of Saint John if I look at that opportunity. And then, maybe the third bucket and specifically to your point around our ability to shift share away from the US ports, I think similarly in Eastern Canada, there is a tremendous opportunity for us at the Port of Saint John to potentially shift share away from New York, New Jersey up to up to our terminal. So we're quite excited there, there's going to be significant work, turnkey type work with DP World to bring the Port of Saint John up to a world-class facility quickly here. So I think it's actually a fairly similar story on both coasts, Ravi.

<Q – Ravi Shanker>: Got it. That's really helpful. And sounds like the medium to long term story here is very firmly intact. Maybe kind of shifting tack a little bit and talking about the short term for a little bit. Clearly, you guys outperformed the industry in terms of volume growth in 1Q and 2Q. You lagged a little bit in 3Q, but you were very clear about that in terms of facing a tougher comp. Can you remind us what the puts and takes might be in 4Q in terms of the comp as well as of the end market that dynamics? Anything, particularly to keep in mind. I think obviously last year obviously crude by rail was in a very different place. And your competitor had a strike. So anything in particular we think of in terms of what to expect, RTM wise, or volume wise heading into 4Q?

<A – John Brooks>: Yeah. Maybe a couple comments on that front. So, again, I think September is playing out as we expected. We're quite bullish as we look over the final few weeks here. Also as we watch this derailment I mentioned play out. As I look in the October, I pretty much down the list outside of let's call it frac sand which continues to be challenged, certainly crude by rail continues to be a challenged, maybe a little bit of those refined products have been slower to recover. But really outside of those areas Ravi, I look for that momentum and the volume momentum to continue as we move into Q4. So I look for the potential for positive RTMs in October. Now, as you mentioned we had our competitor had their challenges and we closed out 2020. We also had some pretty significant crude by rail. I think our biggest single month as we closed out 2019. So those comps will be a little tougher as you close out the year, but I also as I mentioned we remain quite bullish on potash, this grain is going to be significant in Canada and in the US grain is an area that, that frankly wasn't there last year, but it's going to be this year. So you know all that into the blender. I think we're still very confident on our guidance and maybe some upside as we close out the year.

<Q – Ravi Shanker>: Understood. We have a few minutes left. I wanted to remind the audience to send us any questions via the webcast. I do have a few questions that come in. So may I can kick off with these couple of questions on RTMs. Does the 4.5% RTM growth comment applied to September only or Q3 to-date? And what have been the main areas of inflection from negative 12% in 2Q to the positive 4.5% in 3Q?

<A – John Brooks>: Yeah. So that's September month to-date just so we're clear. I think currently on the quarter, we're in that 8% to 9% down. So we've seen some of that bounce back as we've had this strong September. Certainly, we've seen an inflection in our grain business. The harvest is underway. As you recall last year, there was kind of wet conditions a little slower harvest ramp up. So we've seen some inflection there. Potash, we were really moving into the sort of heat of the Chinese negotiations. Volumes had dropped off. So as I mentioned I think our potash lines were up close 38%/39% month-to-date so far here in September.

But what may be as important for – as important for that question and whoever put that in as I look down our fertilizer business, our forest products business, our ECP business, our – what I call our general merchandise, our lumber and paper and in steel, automotive business, domestic intermodal all those areas are trending positive right now. So certainly I think our bulks are really moving the needle. But as I look down the list today, I've got quite a bit of green on my daily revenue report and that spreads across a lot of different commodity areas.

<Q – Ravi Shanker>: Got it. You said it earlier that you feel really good about your full year guidance and maybe even some room for upside. Obviously your messaging on the RTM side obviously appears pretty strong. If you were to continue that down the income statement to the OR, how do we think about 3Q or maybe even 4Q relative to the first half? Obviously this is by no means a normal macro environment yet. However you should be getting some pretty strong incremental margins that are kind of coming off the bottom here with these RTM numbers talking about. So are we thinking kind of normal seasonality, are we thinking kind of better than that on the incremental margin side given the coming off the bottom here?

<A – John Brooks>: Well, see a couple of things there, Ravi. First and foremost I would guide towards sort of normally the opportunity we see as we move on an OR perspective into the back half of the year. I can tell you as these volumes ramp up my team working with Mark Redd, the operating team, we're not bringing back resources on a, lack of a better way one-to-one sort of basis. We're capturing those cost opportunities that we've been able to recognize now certainly this is requiring ramp-up, is requiring more locomotives, we're ratably bringing back people as this volume ramps up but I think in terms of cost and margins Q3 and if this continues into Q4 I'm quite bullish in terms of margin accretion, operating ratio and particularly if we get a little bit a further boost in some of these RTMs as we close out the year.

<Q – Ravi Shanker>: Got it. And maybe if I can sneak one more in here...

<A – John Brooks>: Yeah.

<Q – Ravi Shanker>: ...just given your role as CMO, how would you characterize the pricing environment overall? I think, Canada has been much better than the US, but given some of these very volatile end markets here and kind of some of the shifts and mix as well as lumpiness and capacity visibility and your need to invest do you feel like there is upside on pricing relative to normal? Do you think the incremental capacity going in puts more pressure on pricing, kind of how do you characterize this environment?

<A – John Brooks>: To answer all that, yes, Ravi, I do. I'm quite pleased with how we've performed even through the low volume periods in terms of pricing it, I think, to your point it has held in there fairly well. I can tell you it is a key area of focus for the team here at CP because we do see upside. I think, to your point exactly as whether it be trucking capacity begins to fluctuate and change, rail capacity begins to build or tighten that opportunity presents itself. I remind you, my sales team here at CP, a fair bit of their compensation based on price and I can tell you just over the last few days it's been a big focus on what opportunities we believe, what markets, what lanes can we push in and try to capture again a fair price for the service and capacity we're providing.

So all of that to say and I know we're up against timing, I do see opportunity as we close out the year and hopefully in the 2021 on the price front.

<Q – Ravi Shanker>: Very good. John, Maeghan, thanks so much for joining us today for the update and we will speak soon.

<A – John Brooks>: Great. Thank you, Ravi. Take care.