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Transcript

Barclays Industrial Select Conference

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Webcast

Corporate Participants:

Keith Creel – President & Chief Executive Officer, Canadian Pacific

Other Participants:

Brandon Oglenski – Analyst Equity Research, Barclays

QUESTION AND ANSWER SECTION

Brandon Oglenski
Analyst, Barclays
Okay. Good afternoon, and welcome back to Barclays 38th Annual Industrial Select Conference. I'm Brandon Oglenski, Airline and Transport Analyst. And next up on the transport track we do have Canadian Pacific, the Canada's second largest railroad, but obviously not second in ambition I'd say. They generate about $7.7 billion in Canadian revenue last year with a near-leading 57.1% OR for the industry.

And joining us from the company today is CEO, Keith Creel. He's been with the company since we had a turnaround back in 2013 and was promoted to CEO in 2017. Before that, he was COO at Canadian National and started his career, I think, almost three decades ago at Burlington Northern. So I know we're going to have a great chat.

And just as a reminder, usually, when we're down in Miami, we have the audience response system. For ownership and sentiment on Canadian Pacific stock. If you are a shareholder, we'd love you to take the survey on this webcast, just click through the six questions. The feedback is always appreciated. And then last but not least, if you have questions, please hit the question link or e-mail me, we'll try to work them in here.

So Keith, I know you had a couple of things you wanted to mention before we go on in questions.

Keith Creel
President and CEO, Canadian Pacific
Brandon, thanks. Appreciate the introduction, and I always appreciate the opportunity to speak about our CP story. I also appreciate you reminding me that I'm not the youngest guy any more three decades in this business, time flies when you're having fun. So let me start by saying and expressing a huge gratitude of thanks to our employees. We talked about this a lot last year.

Our CP railroaders are 12,000 strong CP family created a very unique outcome in a very unique and challenging world, both locally and globally. And I tell you, their efforts and their sacrifices and their contributions make me every day proud to serve with them. And I'll tell you, especially, so I think about the past couple of weeks, and I'll speak to this in my comments, we're a Canadian railroad. It's an outdoor sport. We've been really reminded of that the past 12, 13 days specifically, and I count every day because, obviously, the weather has created some challenges for us.

But with that said, we're not going to focus on the challenges we try to turn challenges into opportunities because at the end of the day, it's what you do with those challenges, that determines how you succeed. And I've got extreme level of conviction and confidence in our ability to produce as we have in the past.

So with that said, let me say this. Today is a very special day. You may not be aware of this, Brandon. A lot of people likely are not, but today is our birthday. Canadian Pacific is 140 years old today. So I thank our predecessors our forefathers for having the vision to incorporate this company on February 16, 1881, to give us this opportunity. We've got a rich history that we take seriously. There's a lot of pride in this company. Pride in our past and also pride in our responsibility and what our shareholders and our customers expect us to produce as we go forward.

So with that said, let me say this, the first quarter, I'm extremely pleased with the way it's playing out. Our RTMs right now are up low single-digits in spite of the last 12 days of headwinds we've had with the weather. I can tell you that January was a very strong month. We carried momentum from the fourth quarter into 2021. We exceeded expectations, both on the cost side as well as the revenue side, which created a bit of a cushion for us, which we're absolutely calling on now, but at the same time, it sets us up well as we go into March.

So we've got from a compare standpoint, you probably saw some weakness in our numbers today with the RTMs that were reported. That's on a backdrop of this weather that I've spoken to as I look to next week and the following week. Two of our biggest weeks in the quarter, our two actual biggest weeks in the quarter from a compare standpoint.

But in spite of that, the weather has broke for us, we're on the tail end of our coldest days, we're getting back to an ability, at least on 90% of the network today, we can run big trains, which is the first day that we've been able to do that or I could say that in the past 12 days. And as I look forward over the next 48 to 72 hours, our entire network will be out of the deep freeze, we'll be able to get our rhythm back over the next week, and you'll start to see sequential RTM growth.

We sort of hit the low point, I think, this past week. And then once we get beyond those tough compares, if you look at March, the first two weeks, we had fair compares, not as strong as these next two that we're up against. Then we get into the last two weeks of March, if I look at last year, and that's when we start to see the pandemic start to affect us. And of course, it dropped off in April.

So we're set up well with the demand that we have. Overall demand across the entire book of business, I feel very good about our opportunity to overachieve in March. And I still feel very bullish about our year outlook. So with that said, let me stop with that, and I'll take anything else or any other issues or points that we may want to talk about in my questions. So over to you, Brandon.

<Q – Brandon Oglenski>: Keith, yes, thanks for that intro. And I guess, happy birthday to you and all the CPers out there. Not to focus on the near-term too much, but it sounds like whatever disruption you've got on the network because of weather it's nothing from a commercial standpoint, I mean as you just reiterated, your full-year outlook still remains intact. That's correct, right?

<A – Keith Creel>: Yes, absolutely, Brandon. And let me elaborate a bit. We've got a very strong list of initiatives that are, again, unique beyond what the economy has given us that are coming to fruition for us in '21 that gives us our bullishness in our guidance and our expectations for the year from a demand standpoint, and nothing's changed.

The CMQ, the Saint John, terminal expansion, capacity increase. We've got Hapag-Lloyd that we talked about last year. That vision is coming to reality. Last week of February, we actually had the first ship that's going to land and we anticipate that with performance there and on a backdrop of a potential strike in Montreal that, that business is there to stay. So, the art of the possible instead of that coming to us the first week of March and staying for the balance of the year; we fully anticipate one potential reality is it comes in February, and we keep it. So we get essentially a month early. So that's playing out well for us.

Maersk, we're super excited about that as well. That's a transformational contract that we signed last year for a bunch of different reasons that we've talked about in the past. That's ramping up. We're -- full

integration the beginning of March for that business. We've got a full year of automotive growth with Glovis and FCA, which are both contracts that we didn't realize full year, last year that we signed that we'll get to enjoy this year. Continued strength in grain as we build out this 8,500-foot redefining what good grain movement looks like in Canada.

This model, specific to that, we finished 2020 with about 30% of our elevators that can launch an 8,500-foot train. We've got 15 more facilities that will either be new builds or expansions of existing facilities. They are going to get us to about a 45%, 46% of our origin network that can launch those trains. You couple that with our increasing profile and demographic of these high-capacity cars that we're purchasing that's a needle mover for us. The DRU too, that's something in 2021, we've been talking about for a long time. That comes to fruition.

And I'll just remind our investors when that comes on this summer, boiler nameplate capacity is 100,000 barrels a day. That's essentially two trains a day. We've got one of those two trains committed. That's going to come online mid-summer that's accounted for within our guidance. But that second train, we think, by the end of this year, we'll be able to talk about successfully selling that capacity as well. So from an energy standpoint, ECP, as demand comes back, that's another bright area for us with refined fuels as demand normalizes with the macro economy, which we feel strong about in the second half. So really across the entire book Brandon, and I could speak to any business unit. There's underlying strengths that gives us our conviction and our bullishness on our outlook for this year.

<Q – Brandon Oglenski>: I definitely appreciate that and want to dig into each one of them, but maybe even higher level. I think at your Analyst Meeting a couple of years ago, and I'd love to come back to this, but the constructive tension, I think, is what you called it, within the business and your management team. This culture seems to really be delivering. Is that possibly your best asset? I don't mean this to be a softball question, but it does appear that you guys are performing a little bit better than your competition right now.

<A – Keith Creel>: Yes. I mean, culture, at the end of the day, this is a people business. It's people managing processes. And quite frankly, the culture we created in this company. I was blessed with a company of railroaders that had a whole lot of pride and wanted to do well, and we tapped into that. We tapped into that pride, we tapped into their ability and commitment to work and their talent and their skill set and what we've done, effectively turning the company around operationally, you took strategically that same discipline that culture of performance and accountability. That's a keyword. And applied that to our marketing team, and we've created a culture across the company, where simply said, we know as leaders, we have to produce results.

It's a culture of accountability. It's one that I'm not going to apologize for it. It's -- we're in a pursuit of excellence as cliché as that may sound, you have to keep recreating yourself continually. I say this, and I say this often internally, success breeds success but it also breeds high expectations. And when you have investors and customers that have expressed their trust in you, either voting and buying your shares or giving you their business, we've got to work hard to protect that and to honor that daily. And then when you do that, as we've seen in the marketplace, shareholders are going to reward that trust that you earn and that respect.

Just as well as our customers have as they allow us to partner closer with them, building out these unique, what we call self-help initiatives, customer-specific solutions that allow them to win in their markets. And when you do that, you can continue to create the kind of success that we've created.

But again, the culture is the bedrock and the foundation. There are no free rides. We all have to earn our seat at the table. But when you do that and you surround yourself with people and a team, that understand that value proposition and that are wired that way and that aspire to do something better than themselves collectively as a team. That's the secret sauce. It's hard to replicate. It's not easily replicated, but I can tell you, once you get it, once you create it and you continue to strive and sustain and protect that culture of accountability and performance and delivery, delivering our results. It is a difference-maker. And it is what I think is very unique about this company.

<Q – Brandon Oglenski>: Well, and I guess along those lines, John Brooks, your Chief Marketing Officer, I think he would say we work very close with network planning and operations to make sure that we're taking on the right capacity. Is that -- is this just a different way of running the business because you've been at a number of railroads through your career now?

<A – Keith Creel>: Well, I'll tell you -- I don't know if it's I can't speak to what the other railroads do, but I think it's very unique for what I've done in my career, and it was very intentional. I've experienced PSR that works well, and I've experienced PSR that doesn't work so well. And I realize at the end of the day, if you overcommit your capacity and overcommit the ability for your operating team to produce what you sell to the customer, it destroys value. It doesn't create value. So I knew when I took over this position. Took over this job for us to grow, it had to be profitable, sustainable controllable growth. It can't be growth for growth's sake. Because if you do that, you not only destroy your profitability you destroy your ability to deliver to your customers and then you destroy your credibility, which again, it's all woven together.

So at the end of the day, it's what's worked for us. It's what will continue to work for us, and it is part of our secret sauce. And John and Mike Foran, who leads that for us when it comes to rightsizing assets, to look at it a business opportunity that comes, how does it fit the market? How does it fit our network? What train capacity do we have? What crew starts will we need? The last thing we're going to do is overcommit and under-deliver. And I personally take, as an operating CEO, a hands-on approach in these models. When we talk about these big contracts that we go and sell when we talk about a Maersk, when we talk about these needle mover transformational opportunities, at the end of the day, rest assured, we all sit it at a table. We make sure that what we commit to, we can deliver -- we control the growth in that way.

And I think at the end of the day, our customers that we've partnered with, and we learned a long time ago in this journey, we can't be everything to everyone. But the ones that we commit to, we darn well better deliver. We take that seriously. We approach every business opportunity that way, and it's worked well for us. That allows us to drive growth that allows us to get closer to our customers, allows us to protect our margins and to protect the fluidity of our network.

And to me, putting all those together is what true PSR is all about. It's about creating a reliable service that's local cost that your customer values that allows them to win them in the marketplace. And if you overcommit and jeopardize your ability to do that, then you're jeopardizing your ability to succeed in my book. That's just the way it works in simplest terms.

<Q – Brandon Oglenski>: Well, appreciate that. And you laid out a number of initiatives this year. You called out CMQ, Saint John opportunities and some intermodal contracts as well that you've taken on as well as an automotive segment, grain, petroleum, are these all equally exciting to you? What is really driving these favorable expectations for the next year or even beyond?

<A – Keith Creel>: I mean, they're all, obviously, different quantums, but it's -- there's a couple of -- I wouldn't call them home runs, but I'd say they're infield homeruns. This Maersk deal, opportunity for us, it moves the needle in so many places. It's not just a material revenue play for us. It's a material value play and the fact that we're taking existing resources. We're not having to spend a tremendous amount of capital. The capital we're spending is to support the business concept overall in the facility that we're building in Vancouver and the transload facility.

You speak specifically to that transload facility, again, not only is it revenue opportunity, which, in fact, just this morning, I was talking to John Brooks, what we thought that represented the revenue opportunity that, that specific transload represented the demand for that is being received so well, but it's exceeding our expectations already, and we don't even have it open yet. So once that comes into play, and part of what's happening around us, we talk about ESG. You think about the ESG positive components of that unique solution, the trucks it takes off the roads in Vancouver. The carbon footprint, it reduces, the capacity it creates, the supply chain stickiness it creates all those metrics, and it checks all those boxes.

So that deal in and out of itself, especially with Maersk of all customers. And I'm not saying I love one more customer than the other. I'm just thinking about the potential here with the Maersk the scale that they have. They have similar ambitions. They care about ESG, they care about the environment in a huge way and their footprint is big. When they have the scale of the largest ocean carrier in the world to be able to partner with us in a strategic customer solution, I just think the opportunity there is exponential for this company, exponential for Maersk, for our customers, their customers and for the environment.

So that one to me is something we're especially proud of for all of those reasons. But I can go across the other opportunities, the transload opportunities outside of that. Given that we've opened three transloads. We haven't talked a lot about this, but just in the past 60 days, so last year, we built the transload facility in Montreal. We've got that above board. It's exceeding our revenue expectations with the potential to be 50% more than we thought it would be within the first year. That's something to get excited about.

We just literally opened up a transload, a lumber transload facility in Bensenville, which is in a very strategic location in Chicago, which is where a tremendous amount of the economic growth and the expansion in Chicago, the North part and going north into Wisconsin is occurring that puts us in a very strategic location to benefit from that. And the demand for that is -- I don't want to say it's overwhelming, but it's exceeding what our expectations, and we just literally started to land lumber in there last week. So that's super exciting for us.

We've opened a facility to transload liquids and to transload propanes in Saskatchewan as well. So across the board, all these initiatives are resonating well with our customers as demand comes back in the economy. They all serve a unique customer solution that's allowing them to grow, and we're going

to benefit from it. So literally, across the board, all of these we call them self-help initiatives that we've got. And we've got examples of one in every business unit, continues to give us enthusiasm and bodes well for our marketing strategy converting the capacity that we've created through implementing PSR, the reliability in our service, the low-cost margin position that we enjoy allows us to compete for business and earn cost of capital and make a great return for our shareholders.

So it's more of the same in 2021 and these unique initiatives that are beyond what the normal economy is going to give us, again, continues to bode strength for this franchise and feeds our bullishness for what the year looks like.

<Q – Brandon Oglenski>: I appreciate that. But I guess, on those lines, you guys have referenced better utilizing your terminal footprint. I think that was part of the Glovis auto deal that you have. Is there the risk that if we look out beyond 2021 or 2022, that those easy wins or the low-hanging fruit network that was underutilized before becomes that much more challenging to outgrow GDP? Or is this a multi-year opportunity?

<A – Keith Creel>: Yes. I think there are many -- there are still many plays in this playbook. We still have other landholdings that we haven't monetized yet. We have a pipeline of initiatives. We've got some ideas that I can't talk about publicly that gives me conviction that you can expect more of the same from CP as we go forward over the next two to three-year time frame.

<Q – Brandon Oglenski>: Pretty bullish Keith. On the grain side, it does look pretty robust right now, especially with U.S. Exports to China. And I know that Canadian crop's been pretty strong. Is that maybe running above trend right now? Or should we be thinking this can continue?

<A – Keith Creel>: Well, we feel good about our Canadian -- I'm sorry, our U.S. grain franchise for the first time in a long time. We went through some tough lean years. And of course, the battles that we had with China, or that the U.S. Government have had with China, which took away some demand, but that came back. We had strong double-digit growth last year. We're extending the same demand this year. We've also developed some new markets during those lean years, which are giving us some additional strengths.

We're starting to sign more trains into the second quarter of this year. We're going to be taking corn, taking feed lot up into Canada. To feed a market there, which has some pretty attractive returns on it. So a diversification of that book of business. So we have an underlying strength with U.S. Demand for the U.S. Product as well as an ability to ship into Canada that we essentially developed during the lean years. We get the two of those together. We'll have continued strength on the U.S. Grain front.

And on the Canadian side, as you continue to read every year, let's not say every year, every month, we're talking about new records in grain. We've got a great demand. We've got a great crop. We've got a great product. And as we continue to scale up our ability to move more grain in those 8,500-foot trains and become more efficient with that supply chain. We're moving a lot more grain. You can expect that that's going to continue, in line where the yields are continuing to improve. So as long as Mother Nature doesn't throw a drought our way. We have a normal grain harvest. You can expect to see continued momentum and strength in the Canadian grain front as well.

<Q – Brandon Oglenski>: Okay. Appreciate that. And just because we have limited time, I want to talk about petroleum as well with the DRU coming online, I guess, this spring or summer. And I think you

alluded to that your guidance included about one train a day worth of products, but you said it could potentially be up to two and does the pipeline cancellations that we've seen impact the discussions you're having with your customer base? And you've talked about this before, but how do you make it different than the peak that we saw back in 2014 as well?

<A – Keith Creel>: 2014 is a bad year to refer to. That's -- we still got some scars from that one. So I guess the thing that we learned from that, that we carry into today is we're going to take a very measured approach into what we commit to with our customers. We're not going to over-stress our network. The demand has simply said, the demand is increasing. The decisions that the Biden administration made relative to the pipeline is only strengthened the underlying thesis. Obviously, the pipeline will eventually be built, or pipeline capacity will be built, whether or not that one ever gets built, I'm not sure, but I'm certain it's not going to be anytime soon.

So with that said, as the spreads open up, as demand comes back the second half of the year, especially. You already see the price of crude going up. As pipeline capacity, doesn't match the demand that the increased consumption is going to drive, you're going to see spreads open up, which is going to bode well for underlying strength in crude. We still have taken -- last year, if I think about what we moved in '20, rough numbers, that was somewhere, I want to say, around 60,000 carloads. We're looking in our guidance at a 75-ish range, but the potential is north of 100.

So again, we're going to be very measured in that. We're going to make sure we have discipline in that. We're not going to overstress our network. We're going to commit to our customers and move what we can ratably move, but we do see that as a potential tailwind for us as we get into the second half of the year.

<Q – Brandon Oglenski>: Appreciate that. And I think your guidance this year is for at least 100 basis points of margin improvement or operating ratio improvement, including the lapping of the Detroit tunnel sale, which you had in the last quarter. Can you just talk to, I guess, the confidence around that outlook? Is it more cost driven? Is it price-driven or all of the above?

<A – Keith Creel>: You know what, it's just a natural outcome of running the business the right way. It's applying PSR, it's controlling your costs. It's obviously making sure that we're extracting the right value for the service that we're providing. So again, if you go back to that constructive tension, that's the key to it's pulling all those levers.

And when you do that, you don't oversubscribe your network, you don't destroy your ability to turn assets, which is exactly how we control cost and deliver superior service. You can't do one without the other. Then that's the natural outcome. And we see with the variables that we have, we have the confidence with the team that we have to continue to move the dial, so to speak, which gives us conviction to commit to at least 100 basis points of operating margin improvement in spite of some of the headwinds that we've experienced.

It's again, a natural outcome. I can speak to the productivity side. I can think about some of the things that allow us every year as we become better railroaders. We've talked about it, to a small degree in the past relative to these exemptions that we've earned from a safety standpoint with Transport Canada that we're applying to our potash fleet.

We don't have yet a full year of experience in that, but I tell you to be able to take 15, 16 trains, loads one way, which is essentially, if you think about it, both ways, you're talking about 32 moves a week through a terminal. That's a very busy terminal for us to take four or five hours of train delay, locomotive delay, people delay, the labor that you free up to shift them from being finders to fixers that improve your car reliability. It's just, at the end of the day, it's part of what we do. It's continuing to evolve and grow this culture, become better railroaders and get better at what we do.

Again, it's not quantum leaps because when you're at industry-leading levels, it's unrealistic to expect that. But rest assured, we expect constant improvement. We spend money strategically. We invest in capital, we invest in the physical plant, but we also strategically invest in capacity capital, and efficiency capital, and we demand a return for that internally within our own operating team.

So you should expect the needle to continue to move. When we have a high demand environment and an ability to take some reasonable price from our customers, we've got a fluid railroad running at a low-cost margin. It's a natural outcome. We're going to bring it to the bottom line.

<Q – Brandon Oglenski>: Yes. And I guess, my last two questions, we'll combine them here because we are running out of time. But Keith, I appreciate it. Is there a bottom on the operating ratio? Or should we think about it as a mix of both growth and the ability to take margin on the business? And I guess along those lines, you're spending about, I think, around $1.6 billion in CapEx this year. I think that includes some higher capacity grain cars, as you've talked about, the Canadian business. As we get beyond that grain investment, I think you've said CapEx could even come down, but still maintain that growth profile. I mean sounds like a pretty good equation to me. So is the operating ratio the right way to measure business now?

<A – Keith Creel>: Again, I don't want to sound like a broken record, but the operating ratio is a measure that I think people understand. It's an outcome. It's not something that we're enamored with, at end of the day, the only way that I really get truly concerned about where my operating ratio is, if it were to become a competitive disadvantage. So if the competition around me were to gain advantage, then I got to pay attention to that because it means I can go back, didn't seem so long ago, back six years ago, there was a 2,200 -- 2,000 basis points difference. It was huge.

The spread was so much that there was a business, my competitor could win and earn cost of capital on that I couldn't even breakeven on. That doesn't exist anymore. So now that we're on an even playing field, if not a bit ahead from a margin standpoint, we can compete for business that makes sense for our network. So again, I'm more concerned with earnings. That's what we're most concerned and that's what we're going to pride ourselves and give our shareholders a fair return.

That's just, again, the way we're going to run the business. The operating ratio naturally will be low when we do our job and do it well. And as we go forward, I don't see anything that keeps us from making that incremental gain day in and day out as we grow the top line with the capacity that we're creating and the service that we're providing our customers.

<Q – Brandon Oglenski>: And I guess we'll wrap it up with one more question. The CMQ was an interesting deal for you guys. I guess, outside of reinvestment in the network? Is it technology? Is it further M&A? What's your goalpost few years down the line here?

<A – Keith Creel>: Well, we'll continue to look to invest in the network to get to run what we have more efficiently to provide a better service, so we can grow. We see plenty of opportunity to do that. We're going to keep a strong balance sheet. You've mentioned capital a minute ago. What we're going to do this year, we pulled some capital forward last year because it's productive capital. It allowed us -- what we otherwise would have been trying to get in the ground for the lack of better term in an increased demand environment to do it last year.

So productivity, cost was less. We got more work done. We've cut capital this year, about $100 million as a result of that. So we went from a high watermark last year that mid 1.6 in number, we're going to about 1.55 this year. You can see us next year, we're going to take that down another probably $500 million. And as those hoppers roll off, that $1.5 billion is where we will stay.

And then we'll continue to make sure we've got a strong balance sheet and look for an opportunities that make sense like CMQ. I don't -- there's nothing imminent that I can share with you today. But I can tell you, we're going to keep a strong balance sheet, we're going to keep good powder, we've got the best team, I believe, in the business. We've got a proven model that works for customers that allows us to provide a great return for our shareholders and should something unique, become available in the future that makes good sense. We think we're going to be in a good position to be a part of that discussion.

<Q – Brandon Oglenski>: Keith, unfortunately, we're out of time. I could spend another 30 minutes with you, but I always appreciate the participation here.

<A – Keith Creel>: Always a pleasure, Brandon. Thank you for the opportunity. Stay safe and we look forward to seeing everyone in person again as soon as we can.

<Q – Brandon Oglenski>: Thank you.

<A – Keith Creel>: Thank you.