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Transcript

RBC Capital Markets 2021 Automotive, Industrials and Transportation Conference

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Webcast

Corporate Participants:
John Brooks – Executive Vice-President & Chief Marketing Officer, Canadian Pacific

Other Participants:
Bernie Allion – Analyst, RBC Capital Markets

QUESTION AND ANSWER SECTION

Bernie Allion

Analyst, RBC Capital Markets

My name is Bernie Allion, and I head equity sales in Canada at RBC, and I'll be hosting the session for Canadian Pacific Railway today. Typically, our rail analyst, Walter Spracklin, would be moderating this session. However, due to research restrictions, I'll be taking his place.

The format of this session will be Q&A, but due to these restrictions we will not be accepting any questions from the audience, unfortunately. I recognize this is a CP Rail session, but I'm required to state the following disclaimer. RBC Capital Markets is acting as financial advisor to Canadian National Railway in respect of a proposal to combine with Kansas City Southern, as announced in the press on April 20, 2021. In addition, RBC is committed to providing financing to Canadian National Railway should they enter into a definitive merger agreement with Kansas City Southern.

With the formalities out of the way, I would like to welcome John Brooks, Executive Vice President and Chief Marketing Officer at Canadian Pacific Railway. John has been in his current role since February 2019 and he has a long career in sales and marketing with senior responsibilities in all lines of business including coal, chemicals, merchandise products, grain and intermodal. John began his railroading career with Union Pacific, and later helped start I&M Rail Link, which was purchased by Dakota, Minnesota and Eastern Railroad in 2002. John was Vice President of Marketing at DM&E prior to it being acquired by CP in 2007. John is responsible for CP's business units, strengthening partnerships with existing customers, generating new opportunities for growth, enhancing the value of the company's service offerings, and developing strategies to optimize CP's book of business. With more than 24 years in the railroading business, John brings a breadth of experience to the CMO role that is pivotal to CP's continued and future success.

John, welcome and thanks for taking the time with us today. Maybe I'll start with some revenue and market-driven questions. So, on the topic of volume trends, there's been significant demand for transportation services over the past year due to the recovery from the pandemic. Can you give us a summary of where volume trends stand by segment, zeroing in on those that are doing particularly well and others that are underperforming?

John Brooks

Executive Vice-President and CMO, Canadian Pacific

Yeah. No. Absolutely, Bernie. And again thank you for having me. Thank you, Walter, also for having me, certainly under some unique circumstances here that we have at CP. Let me first, if I can, Bernie, start off by maybe thanking the 12,000 strong CP employees. Certainly, we have gone through collectively as a world a unique 2020, but the relentless drive of these folks to deliver on our success story is truly inspiring. Proud to be part of the – what we believe are undoubtedly the best railroaders in the industry.

I will certainly jump in to your question. If you don't mind, I am going to make just a couple of other general comments before I tackle that, and as you said I am going to focus the discussion today around the quarter and how the business trends are unfolding. And I'd certainly like to give a few updates on some key initiatives that we're certainly excited about at Canadian Pacific.

So, let me, to maybe your point, and I'll expand upon it as we get going here, how the quarter is shaping up. I can tell you I've been super pleased with how this transition from an all-time record March we had into April, and now where we sit in May. There has been no let down by the team. Demand has remained strong. Weather has been good. We've outperformed from a volume perspective, from an operating perspective, all signs are very positive. I could tell you that, quarter-to-date, our RTMs are up about 11%, right on plan where we expected them to be. As you know, we're facing the toughest comp industry as we basically have the last three years, and we significantly outperformed the industry during the pandemic.

As I look back, even compares to 2019, we continue to lead the industry in terms of volumes. So, I think that is principally on the back of not only our unique growth opportunities that we'll speak about, but also, frankly, our operating performance. We are delivering a high level of service to our customers, our trip plan, Bernie, on-time performance is well over 80%. Our train weights are sustaining record levels and is moving nearly record gross ton miles. So, I'm very pleased. Getting into the commodities and maybe more directed towards your question, we saw a record April again in our grain business. We continue to be very bullish on the product that we've introduced in the marketplace. We are getting a tremendous level of investment from our grain shippers on both sides of the border to reinvest in their business and drive longer, faster trains to market.

US grain franchise continues to hum well. Currently, I think, we're up north of 50% our US grain business. I'll tell you, we have seen and we're watching this very closely in the grain business. It has become pretty dry across the upper US and also the Canadian prairies. And this currently has the farmer holding back a little bit in terms of sales, but the outlook for rain makes grain, and the outlook looks pretty good here over the next couple weeks. So, we're – we continue to be very optimistic on the grain front.

If you look at our energy, chemicals and plastics business portfolio, excluding crude, we're up double-digits. I tell you, I think recovery in this space has been better than I expected, and it may be even sooner than I expected. That is despite Canada continuing to be in a pretty tight lockdown. So, there's a lot of optimism in that space. And even as I look at crude by rail, and I'll talk about our status of our DRU project. But I think we even see some opportunity in the back half of the year as we look at our traditional crude by rail business.

Some other notables. The automotive business, think we're up over 1000% this month and quarter-to-date of over 700%. And you know that those numbers are certainly impressive, but coming from a pretty low base. But I can tell you, unique to CP, we are benefiting from a number of contract wins in the automotive space. We have opened a number of new compounds across our network that is helping to drive that growth and create those unique partnerships with the auto industry. And of course, like everyone else, we're benefiting from some recovery in that space.

I tell you, all that being said, I am a little bit disappointed versus our plan in the auto space, but that is purely a function of the chip shortage and the impacts that have had on unloading over the last three to four weeks. The good news on that front though, Bernie, is we've certainly seen an uptick in terms of our automakers' abilities to load. This week will be stronger than last week, and I think, maybe knock on wood, but that we've turned the corner a little bit on this just chip situation. So, more to come on that.

And then on the intermodal space, as I look at both our domestic and international business units, they're performing quite well right now. Our domestic business is up over 20% year-to-date. Despite the lockdowns in Canada, consumer demand, manufacturing signals are all pointed the right direction on, frankly, both sides of the border. So, I remain optimistic on the intermodal front. And

we've seen a strong ramp-up of our new product into Atlantic Canada. And we've also seen a strong ramp-up with our new international contract with Maersk shipping lines. So, a lot of positive on that – those fronts.

Let me just – I'll pause for a second because I do want to talk briefly about two additional initiatives, and then let you kind of get back in any follow-up questions. But I think it's important to also note that a big part of our growth story, as you look into the remainder of 2021 and into 2022, is our acquisition of the CMQ. And certainly albeit a different order of magnitude compared to our combination with KCS, I think is just truly representative of the power of the CP model in terms of growth opportunities that we've been able to develop with that property. In just a short amount of time, next week we're officially welcoming Hapag-Lloyd into the Port of Saint John. Their Liverpool vessel will make its first regular port of call on May 27 into Saint John. This is, I can tell you, a significant milestone for Canadian Pacific, for NBSR, for DP World, frankly, for New Brunswick in all trade across Canada. So, we are quite pleased about that.

And then the second point I'll make and then I'll turn it back over to you is, and I mentioned it is part of the crude discussion or crude comments, is our diluent recovery unit is going to come on line at Hardisty in July. And it's a project that we've been talking about for quite some time now. We're quite excited about it. It is going to provide a long-term stable base book of business for our crude franchise, and we're particularly excited about it being a non-hazardous commodity and certainly improving the safety of crude by rail for years to come.

So, a lot said there. I certainly can dive into the volume pieces through further questions or that, but with that I'll stop and turn it back over to you, Bernie. Thanks, John. Yeah, so clearly very strong demand, and we're seeing that, I guess, across all modes of transportation including trucking. I guess, just curious, how has that tighter capacity in all these modes impacted pricing? And do you see meaningfully higher same-store pricing in 2021 versus 2020?

<Q – Bernie Allion>: Thanks, John. Yeah, so clearly very strong demand, and we're seeing that, I guess, across all modes of transportation including trucking. I guess, just curious, how has that tighter capacity in all these modes impacted pricing? And do you see meaningfully higher same-store pricing in 2021 versus 2020?

<A – John Brooks>: All right. Without a doubt, Bernie, the demand environment and, frankly, then the corresponding pricing environment is quite strong. I was talking to a colleague earlier, and really we saw an inflection point, I would say, mid Q3 of last year. And in renewal pricing, really began to pop. We always talk about inflation plus, but I'm going to say it's inflation plus, plus, plus. And that momentum that we saw mid Q3 of last year has sustained itself into Q4, and then actually accelerated into Q1 and Q2 here. I think to your point, it's a culmination of a number of things. You got a continued tight container market. You got continued tight assets in terms of trucking trailers. You've got manpower shortages, and you couple that with again, I think, robust recovery and good demand across most sectors. Commodity price is high and all that is sort of the perfect recipe for upside in terms of pricing.

<Q – Bernie Allion>: Thanks, John. And maybe just to shift over to the topic of yields, despite the solid pricing, we've seen yields negatively impacted by mix. Can you comment on the trend that you're seeing in yield and do you see that reversing in 2021?

<A – John Brooks>: I do. I think the quick answer to that is I do think we've passed an inflection point on that and you're going to see yield improvement here despite a pretty strong FX headwind. You're going to see yield improvement in Q2. And on the mix front it's a little bit dynamic right now with some of the

maybe shift in volumes in the grain space and also the auto space maybe being a little lighter due to the chip situation than we anticipated. But I also expect mix to progressively improve as we move through the year. And you layer on that again the pricing piece and that only helps the cost.

<Q – Bernie Allion>: Okay. Well, maybe we'll shift over to the cost side given the strong demand can also be a challenge with respect to congestion. Maybe you can just talk about some of your pinch points that have emerged on the network and how you look to address them?

<A – John Brooks>: Sure. Again I think this is an area which we've proved over the last few years in particular that that were unique to the industry, certainly unique to our competitor. We really don't see the pinch points out there in terms of our network and capability to grow. And there's a lot of fundamentals as to why. I'll start maybe more on the physical but then also talk a little bit, Bernie, about just how we approach the market and how we grow that I think is unique and again a little different than our competitor. I think a capacity and in sort of three buckets, it's locomotives and people, the ability to have that over the road capacity to get from A to B, and then the critical important, you got to have the terminal capacity on each end to be able to grow. And as I look down those three buckets at Canadian Pacific they're all green and they're all pretty wide open. The key is how my team works with and collaborates with our asset team and operating team to understand how these volumes are going to move in and be introduced to our company and to our network.

But it's about picking the right customers and the customers that value the service in the lanes where you have that latent capacity because that's really what drives operating ratio and margin opportunity. So I feel good about those pieces. As we've long talked about at CP where you need. We've got very strong landholdings across our major terminals and in whether it be Vancouver, Edmonton, Calgary, but certainly the Toronto area, Montreal, Chicago those are areas where that we've not only taken those land assets to create unique customer solutions to win in the marketplace, we're also able to take those land assets and use it to create that surge capability or that opportunity for our inland terminals to be able to size up to handle the volume. You can create all the capacity you want over the road, but if you don't have the terminal capacity to ultimately handle the volume - that matters when you're talking about congestion.

I think point number two, as you think about CP and our ability to ramp up with recovery and greater demand, again we don't sell for sell sake. We don't grow for growth's sake. We are very calculated in terms of the business opportunities that that we bring on. And I can tell you there is a lot of constructive tension that goes into the discussions between myself, Keith, Mark Redd, Mike Foran, our operating team to make sure that the business pieces that we're bringing on this railroad: that we can execute to them, that we can provide a high level of service for our customers. And ultimately that comes back in the form of operating ratio and value to our shareholders.

<Q – Bernie Allion>: Thanks, John. And as volume growth continues to come on onto the network, do you need labor to bring on labor one-for-one or maybe you could just touch on staffing levels as you see them come through the course of this year with the strong demand?

<A – John Brooks>: Sure. Definitely not one-for-one. I think we've talked about in the past and our guidance in terms of volume in 2021 is high-single-digit volume growth. With that Bernie we would expect head count to be more low to maybe mid-single-digit head count growth. So certainly not one-to-one. And the critical piece there though is the timing in measured steps in which you bring those individuals on to be able to handle the business. And so it's not only about doing more with less but it's also about making sure that we're bringing on those individuals in the right locations at the right time so we can ultimately deliver for our customers.

<Q – Bernie Allion>: Thanks. And it appears the US carriers are now investigating the opportunity of going to a one-person cruise. What are your thoughts on that occurring over the next couple years and just your thoughts around driverless trains?

<A – John Brooks>: Well, look, I think it's probably longer than the next couple of years but it's certainly something that at Canadian Pacific we would be probably not on the very leading edge but certainly be part of that opportunity. The great news is we've been able to build very strong relationships with our unions. So if that opportunity presents itself, I can say with a high degree of confidence that we would involve a robust discussion with our labor to make sure it's done in the right way and then in the safest manner. Driverless trains, driverless trucks, I think I view all that is further upside in opportunity.

I think about driverless trucks and the potential for that to revolutionize our intermodal terminals and our last mile, first mile service of our containers, domestic intermodal boxes as a – as an opportunity for the future, I can tell you we're in deep partnerships with the likes of Bison and Consolidated Fast Freight and others in terms of a think-tank around what opportunities are out there to collaborate in this space to make sure that we're on the front edge as much as possible around those technologies to where they can not only benefit the trucking industry but also us being a big user of trucking business in our intermodal space, how we can capitalize on those efficiencies also.

<Q – Bernie Allion>: All right. Thanks, John. And maybe just some details around your CapEx plans over the next several years, maybe you can touch on a percentage of revenue any major initiatives that are included in your plan or anything that would be incremental?

<A – John Brooks>: Yeah. So, typically, Bernie, we do not look at our capital as a percentage of revenue, it's – I can tell you it's a robust battle internally every year for that return on capital and we're going to deploy those precious shareholder dollars. As I look at our capital plan for 2021, it's about CAD 1.55 billion. In 2020 we were aggressive on the capital front. We use the drop in volumes and track time available out there to deploy a little heavier capital in 2020 to get ahead of the recovery. We've also been very aggressive in our capital deployment on our CMQ acquisition to ensure that we get that service product in place through our standards and expectations for 2021.

So as I look at capital going forward, maybe a couple of big notables you have rolling off. We're pretty deep into our hopper car acquisition. I think we're at the latest number around 4,500 or so new high cap hopper cars that have been deployed. But that CapEx which is pretty significant is going to roll off over the next couple of years. We've also had a pretty aggressive locomotive remanufacturing program in place that won't end but certainly will likely be reduced or scaled back relative than it has been in prior years. So those are a couple of things that I see tailing off that present some further opportunities in terms of what that deployment looks like in the coming years.

<Q – Bernie Allion>: Okay. Thanks, John. And so we've covered quite a lot of ground. Any concluding remarks before we end the session.

<A – John Brooks>: Yeah. So I certainly appreciate the time to speak today about the business in general. I couldn't be more excited about the effort the CP team has put in in terms of executing our playbooks and our commercial strategies to grow and to continue to grow our company at a strong pace or frankly leading industry pace. I'm bullish about the remainder of 2021 and the outlook for 2022 we've got a number of exciting projects on the horizon and maybe I'll just make one concluding comment

about the KCS. I could tell you the CP team remains highly convicted that our merger proposal is the only Class 1 merger proposal that can get approved. And that is simply on the basis that ours is unique, it is end to end, it is pro competition, it is the two smallest Class 1 railroads, and we're really coming there to create parity in the rail industry. And that parity I think exactly what others and frankly our competition is shying away from. We're going to – this end-to-end combination will drive competition into the North American rail network like it hasn't seen before.

So with that, I'll end there, Bernie, and I appreciate the opportunity to speak today.

<Q – Bernie Allion>: Thanks, John. Yeah, we've approached the end of this session unfortunately. Really appreciate your time today, and thank you to everyone for dialing in.

<A – John Brooks>: Thank you.

<Q – Bernie Allion>: Thanks.