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Transcript

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Webcast

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

Other Participants:
Konark Gupta – Analyst, Scotiabank

QUESTION AND ANSWER SECTION

Konark Gupta
Analyst, Scotiabank
Okay. So, up next, we have CP Rail. And I'm very pleased to welcome John Brooks, EVP and Chief Marketing Officer at CP. And John, welcome and thanks for the time this morning.

John Brooks
Executive Vice-President and CMO, Canadian Pacific
Absolutely, Konark. Thanks. Thanks for having me.

<Q – Konark Gupta>: Thank you. So, John, why don't we kind of jump in with what's the latest with CP, what's happening right now in Q4, the current state of freight. Lots going on, obviously. Grain is a peak season here; retail, shipping and logistics issues, whatnot. And maybe any other updates from milestone perspective on KSU or KCS transaction.

So, why don't you get started on that, and then we can dig into some of the questions later on.

<A – John Brooks>: All right. Yeah. Let me let me jump right into here. So, first off, Konark, let me start by just saying I want to thank our 12,000-plus strong employees at CP. This is – as you and I were talking about a little bit ago, it's bit of a heck of the last two years. But their resilience, their drive to ultimately provide our customers and the industry world-class service has been inspiring. And I tell you, this volume environment and certainly all the uncertainty we've faced hasn't made it very easy on those employees. So, I want to thank them.

I also give a shout-out, we have our CP team out in British Columbia over the last couple of days. As you've probably seen on the news, there's been sort of torrential rains and now mudslides that have taken place out in that region. And it basically has our main line shut down. Well, frankly, just about all land access shutdown in that region. It's pretty significant event and we're still sort of uncovering what it all means, but certainly that's our busiest corridor out in that region. So, time will tell, but they're out there battling trying to get our main line back opened up.

Talk a little bit about, we're halfway through the quarter, and where we stand. As I look at volumes today, I'm pretty pleased with how October and the first part of November have played out. Obviously, we wish some of these challenging supply chain areas would smooth out, but I'm not sure that's going to be the case for a while now.

Our RTMs are slightly positive at this point through the quarter, and I truly believe that's a testament to our resiliency. As you know, we are facing a pretty significant headwind as it relates to Canadian grain and the Canadian grain crop being, I guess, now almost over 40% smaller year-over-year.

But I could tell you, we're doing everything we can to mitigate that. As I look across the business as a whole, really excluding grain, Konark, our RTMs are up 5% in the quarter. So, that tells me we're doing all the right things in our other business units despite some of the challenges that we're facing.

I look at our US grain space. There's an area where we're trying to make lemonade out of the lemons in Canada and the grain crop. And we're actually having quite a strong US grain shipment not only to the PNW, but we worked hard to create new markets for corn and soybeans and wheat up into Canada to sort of backfill some of their needs. And we've actually seen some US products now

beginning to export out of Vancouver, which is a great opportunity to give us more optionality for our grain shippers.

As you look across the other businesses, potash is performing well. We've gotten some of the challenges we've had. Mosaic's Colonsay mine is up and running, Konark. Canpotex is pretty focused and we're working hard with them to close out the year strong. If you look at our carload business, forest products, steel products, energy, chemicals, plastics, all those are performing well. And how we drive that volume is really through service. In that area, it's about optimizing asset turns for our customers and spinning their fleet to get that extra load or two. We've seen a little bit of surge in frac sand to our Bakken oil production region. And most recently here, our crude business has had a slight little uptick, too.

If you think about a couple of the other areas, few more comments. The auto area, obviously, well-publicized, the challenges there. We've lapped some of our contract wins with GLOVIS and FCA. And so, we're feeling a little more pressure on the year-over-year comps in that area because of the chip shortage. The good news is this: as I look at like our three- to four-week run rate, on our auto demand, we've seen a nice improvement week after week. Actually, coming into this week, Konark, we have sort of our biggest demand profile of the automotive sector that we've had for quite some time. So, I'm going to say I'm cautiously optimistic we're starting maybe to turn the corner a little bit there.

And then, finally, our intermodal business. Despite all the supply chain challenges, we performed quite well. I could tell you, October was an all-time world record for our domestic intermodal franchise. We've talked a lot about our transload in Vancouver that we built with Maersk. That facility is up and running, and it's quickly getting sold out. So, we're offering good solutions for our domestic and international customers on that front.

Let me just – one other thing, you mentioned KCS. So, maybe just a short little update on that. As you know, a couple of weeks ago, we filed our application to the STB. We are excited. We are energized. We have that in, we've got a lot of work going on with KCS team towards integration, planning, while we go through this next year or so with the STB on the regulatory process. I can tell you, my team, we are working close with customers. We're working close with port terminals and transload facilities to better understand their needs, Konark.

This is about sort of listening to the voice of the customer as we navigate through this regulatory process to learn. Frankly, from them, what they think of this powerful footprint of the combination of these two railroads can do into the future. So, we're excited. They're excited about this competition. And I think, ultimately, what we can do to better enable their supply chains.

<Q – Konark Gupta>: Perfect, that's a good overview, John. Thanks for that. So, maybe let's dig into some of these aspects. And then I think maybe before we do that, the one that we didn't touch upon initially was on pricing, I guess. From what we are seeing and what we are hearing, and you can maybe corroborate that, the supply demand is this kind of imbalance to the extent that demand still remains high or growing and supply is constrained, as you said.

Obviously, there's kind of light at the end of the tunnel on supply, but still tight right now. The whole industry is talking about significant growth in pricing at this point and shippers are ready to pay for that to get capacity. What are you seeing right now? Is what you are seeing – is it sustainable as well or is there further upside in the short-term?

<A – John Brooks>: Yeah. So, in – I've been sort of, I think, fairly transparent over this last year plus, we started to see the pricing turnaround take place actually in Q4 of 2019. And you're exactly right,

Konark, it has accelerated itself through the year. And at this point in 2021, you're right, it continues to be strong.

We're seeing renewal pricing definitely at the upper end of the scale, in many cases 5%-plus. But in actuality, in a lot of instances, that's sort of just keeping up with inflation. All you have to do is go to the grocery store or to the gas pump and you can see the prices that are being charged out there. And frankly, our philosophy and we try to hold true to this on the pricing front in good times and in bad times, Konark. And I tell it literally every day to my sales team, we price to the value of our service and our capacity, and that's how we approach this.

And if we do this right, it's kind of like Keith always talks about on the OR. The OR is an output of all the good things we do. Well, certainly, I think somewhat our pricing results fall in that same bucket. If we're selling our service, if we're working with our partners and our customers, and they value what we bring to the table and how we do it, pricing somewhat of an output. And that's been our approach. To answer your question relative to, I think, really inflation and where this goes, I'm not sure I totally know the answer to that, other than I think – and as I look into 2022 – this pricing momentum is going to continue forward.

And I don't know if it's going to hold up as robust as it is, I would say, right now. But certainly, I think we're in a prolonged pricing and inflation period, and that's how we're going to continue to approach the market. I don't see in the near term some of these congestion and supply chains issues working themself out quickly. I don't see some of the issues that are facing the trucking industry working themself out quickly. And I think at the end of the day, that constrains capacity, and then allows for this pricing environment to be where it is.

<Q – Konark Gupta>: Right. No, that makes sense, John. Thanks. Then before we get into some – I have some questions on KSU, obviously. But maybe perhaps touching on couple of hot topics right now.

Grain, you mentioned, obviously, Canada down about 40% this crop year. And you're clearly coming off of maybe the best ever crop in the 140 years last year through mid this year, right? Anything that you can do here that can change things. You mentioned about US grain flowing through Vancouver.

Obviously – any other kind of aspects? Obviously, you had this high efficiency grain system that you are building, but that creates a lot of capacity now, right, clearly, given the grain is down. So, like can we talk about grain a little bit? What are you seeing right now? Are there any improvements or are you seeing any other opportunities to backfill the grain capacity that's coming out?

<A – John Brooks>: Yeah. That's – yeah, Konark, it's going to be a challenging crop year, for sure. I would say, we're generally past the harvest peak. I would say that some of the volumes have tailed off a little quicker than we had anticipated. It's – commodity prices, well, pretty much across the board are high and that goes the same for Canadian grain values.

That's making it a little tougher on those grain companies to make the sales. I could tell you we – all the things that you commented on there, we're doing. We're working hard with the Canadian grain customer base to figure out how we can utilize all that capacity that they've built. And I can tell you in particular, as you look at the Southern Alberta region in that feed territory, we've got a number of 8,500-foot elevators that are fast loading facilities that don't have the outbound crop to ship.

And what actually we're doing is we're taking US corn and we had a pretty good corn crop in our territory. And we're shipping corn into that Southern Alberta region, and we're utilizing those big loop track 8,500-foot facilities and turning them into destinations instead of origins. And it's actually

been pretty highly efficient operation for us. We believe the opportunity is significant and will provide somewhat of – not 100% insulation, but certainly a little bit of offset as we move into 2022.

And part of the nice piece about it is when they do have ability to load grain outbound then, you kind of get a double haul, right? You're moving corn inbound that the train can get unloaded, and then reloaded it with wheat or canola to go to Vancouver or Thunder Bay or whatever market. So, there's a lot of levers the team's pulling. No doubt this is – the grain will be a headwind, but we're not going to make an excuse. We'll battle through it and find other opportunities out there.

<Q – Konark Gupta>: That makes sense. Makes sense. And so, we have a few questions coming in as well on the webcast here, so perhaps I can take one of that. So, you talked about Vancouver mainline being shut down recently because of the flooding. Which business lines are you thinking are most impacted by this? And then, we will probably see that show up in this week's report that comes out next week.

<A – John Brooks>: Yeah. So, certainly, that Western Corridor is our lifeblood of the railroad. So, we just about all commodities to some extent flow through that. Obviously, it's an important corridor for our grain business that we are hauling. I know the team was active this morning working with our customers to find alternative markets or directions to send the grain. Obviously, it's an important corridor for our potash business. The good news is we've worked hard with Canpotex to build up their export out of Portland, Oregon. So, we're working with them to shift some of that volume down into that corridor.

It's too early to tell what the ultimate impacts are. But I can tell you this, as this team has always done, is we will get that mainline open. It amazes me the ability of that engineering and operating team. They will get that mainline open as soon as we physically can. And I tell you, we'll be ready with our customers, we'll be ready as an operating team to get that freight back moving certainly as quickly as we can.

<Q – Konark Gupta>: That makes sense. And then maybe on potash, like, we are seeing, obviously, Canpotex talking about how they are going to sold out for many months out now. So, it seems like a lot of strength is coming in clearly.

And then, you also have maybe potentially opportunities like BHP coming in and we saw them signing a contract with Westshore, where you had the Teck contract due to some extent that you kind of lost to CN for the last mile. What can you tell us about BHP discussions? Like, what's going on here? Is there an opportunity for you to backfill that capacity you left open at Westshore? And how does it tie in with your discussions or negotiations with Canpotex?

<A – John Brooks>: Yeah. To be frank, I'm not sure there's a real direct link there, Konark. If you look at the global potash market and needs, I think just like Canpotex, we remain bullish on the growth profile for world exports for potash, and Canpotex is at the center of it. Obviously, we're – we are pretty knowledgeable about build-in to the potash mines. We built into the K+S facility a few years back. We operate 100% of their business, and I think has been a good experience for K+S.

I can tell you, we're working with BHP. We fully expect and believe that that potash facility is – will be a reality. They've already made, as you know, significant investments to this point. And it appears there is a strong commitment to move forward with that. Our team is working with them, frankly, like we would any customer on what that would look like and what that opportunity would be. I do believe that amongst some of the coal mine opportunities, growth in our grain, growth in our intermodal business, all present good backfill opportunities to you reference on some of that Teck business now being handed off to our competitor in Canada. So, I certainly believe it's a natural fit to

Westshore, that's a good move for us, and we'll work hard with BHP when the time is right to put that rail service in place for that.

<Q – Konark Gupta>: That's good color, John. Thanks. First, talking about some of the energy commodities here. Clearly, commodity prices are going up nicely. We saw a good rebound in frac sand lately. Crude by rail, you guys started out Drubit, I guess, right? And maybe that's going on well as well. But perhaps can we touch upon how's the Enbridge Line 3 that's going to start it up in October? Is that impacting or making any impact on your crude shipments?

<A – John Brooks>: Yeah. It's – we fully expect as that pipeline capacity continues to make itself available. That will provide a cheaper, lower cost egress alternative for the dilbit for the traditional crude by rail. You mentioned the DRU. We are excited about it. It is up. The facility is working well. It's running, we're hauling that business down to Kansas City and handing it off to the KCS to go down to Port Arthur.

We continue to have discussions with a number of customers about building out that second 50,000 barrels of opportunity on the DRU. I'm optimistic that just the fundamentals of what this provides the marketplace and how it does it in a safe manner that that opportunity will come to fruition. In the near term, we're not banking on crude, Konark. We've learned our lesson in the past in that market that it's pretty volatile.

As I said, right now, we've – the spreads have actually opened up a little bit. The producers in Canada are producing well and we've seen a little bit of a short-term opportunity in this space. But, again, nothing that I can tell you that we're fully banking on other than the DRU business and growing that as you look into 2022.

<Q – Konark Gupta>: Great. That's good color, John. Thanks. And then, perhaps KSU now. We saw you guys, as you said, filed the application two weeks ago. I am still trying to go through the 4,500-page application, so kudos to the team on building that up. Maybe if I can ask you first, the application reaffirms that CPKC will not reduce competition, but are there any gateways where KCS and its partner – or partners, they compete with the CP alliance today that could be an area of contention?

<A – John Brooks>: Konark, and I think the facts have been the facts since day one and have ultimately prevailed through this journey we went through with our acquisition of KCS. It is truly an end-to-end merger, and with the only connection point being there is in Kansas City.

We have had extensive dialogue with customers and short-line partners and other parties to this and there are no competitive overlap areas. So, look, we'll have ongoing dialogues with certainly the other rail carriers, the shipper associations in terms of some of their wish lists and items. At the end of the day, this is a pro-competitive opportunity and one that, unlike any other combination is out there, would not be available and would not be available in terms of creating new North/South competition that just can't be created without this combination.

<Q – Konark Gupta>: Right. No, truly, it looks like that's the case. And we have seen you guys talk about synergies in the last six months or so or some months, right, since the acquisition was announced. That has been revised up as well at one point.

The application kind of talks about the net benefit in revenue of about $716 million and something about $173 million cost efficiencies. Look, I often get asked by a lot of investors, what's really the realistic kind of synergy target or synergy expectation there? Maybe you really moved up a little bit here, but is there further upside? And if there's an upside, where do you kind of anticipate that's

going to come from? I mean, like is it one commodities, multiple commodities? And you never know, right, when you're going to join hands. It creates opportunities that you don't even anticipate in the first place. So, can you talk about synergies?

<A – John Brooks>: Konark, I'll start off by saying my conviction around the opportunity when we put these two railroads together has never been stronger. And I say that, not only from a perspective of it's my team that has done a lot of work to analyze and worked with others to put this together, but the real conviction comes from talking to the marketplace.

And as I said in my opening comments, the outreach that my team has undertaken with our customers, with port terminals, with transloaders, with short lines to understand what they believe the opportunities are to take sort of our analysis and put it to reality. That gives me the conviction that this opportunity is everything we've said it is and greater than that. There is upside. I would say the – if you think about the upside, it all relates to timing. I have no doubt. And to your comments, once you get in the body shop and under the hood of that car, you can really understand what's taken place.

It's going to be a little time before we have that opportunity. We get through the regulatory process. We get towards the end of next year. We're hopeful through this that everything we've said about this merger, the STB agrees with. And when we take control, I know the base synergies that are out there, whether it be the grain side of the business creating products in the intermodal side of the business, expanding our carload franchise, there's an area, Konark, where we've been pretty heavy bulk at CP in the past, but now this opens up a whole new world of that merchandise and carload business.

But not only sort of these base synergies, but once we really get in and can work with the KCS team and get a look under the hood, I think it's just a matter of time. It's going to take some time for contracts to roll over. It's going to take a little time in areas for products to be developed, but no different than what you saw us do in terms of our transformation of CP from Hunter to Keith, and Keith to the growth we've been on. I think you're going to see that journey replicate itself as you think about the KCS.

So, high conviction in all those areas. Some of them are going to be a little more low-hanging fruit. Others, again, are going to create a little – going to require some product development, but the opportunities are out there.

<Q – Konark Gupta>: Right. No, absolutely. We'll probably have to wait and see how it goes for sure. Pretty exciting. Now, the application kind of talks about, as you mentioned, North/South, so kind of removing 64,000 trucks and potentially gain about 80,000 carloads and 137,000 intermodal containers from competing railroads.

So, clearly, there's an opportunity to your point, like, that's clearly pro-competition, right, if you look from shipper's standpoint. But how do you think your competitors and customers are feeling about it in terms of you guys removing those many trucks and containers?

<A – John Brooks>: Let me kind of separate the two. We'll talk about the customers a little bit more here, but let me start on the competition. I think as you've seen in the filings, the competition is going to be vocal and they're going to be vocal for all the reasons, Konark, that you just described. We're going to come hard with a high level of competition. That's why this merger works. That's why this opportunity makes so much sense. And we would expect them to be vocal. They've had the lion's share of the opportunity in terms of being the only route in town in a lot of these lanes.

And I think, again, we've proven – look at some of the industry statistics, look at our customer satisfaction scores. We're going to bring a high level of service focus to that north-south corridor. And the ability to do that, to link new markets to capitalize on the USMCA, to link Mexico to Canada and the Chicago markets, I can understand why the competition is reacting like they are.

They're going to have to, by definition, compete because we're going to bring a high level of intensity, customer focus, and service to that corridor. Shifting to the customer side of that. Again, I think they're excited. They've had only so many options. I think about, Lázaro Cárdenas, the port out in Mexico that KCS has had a fair amount of success generating business into and out of. But if you think about the KCS network, they're really limited on where they could go in terms of market reach once you move out of Mexico into the US.

This now gives those steamship line and those importers and, frankly, exporters, a whole new market option with whole new market reach. And Konark, you think about the power of that, particularly with the supply chain constraints and disruption we're facing today to create that port diversification, to create new optionality for retailers or steamship lines. There's two million TEUs of capacity down at that terminal. It's far underutilized.

We believe we can create a product that ultimately that can get shippers into the Texas and Gulf market from there, a few hundred miles shorter and faster than California options. We believe we can get to Chicago in five, six days and create a whole new market option for those importers and exporters. It's allowing them to diversify from some of the challenges that we see taking place today at LA Long Beach.

<Q – Konark Gupta>: Yeah. That truly sounds like a compelling argument for customers and shippers there. So, I think with that, John, I think it's never enough to talk about, but we are at time. So really appreciate your time here again and all the best for the KSU merger.

<A – John Brooks>: All right. Well, appreciate it, Konark. Always a pleasure. Thank you.

<Q – Konark Gupta>: Okay. Thanks.