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Transcript

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Webcast

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

Other Participants:
Kevin Chiang – Analyst, CIBC

QUESTION AND ANSWER SECTION

Kevin Chiang
Analyst, CIBC
All right, we're going to kick off the afternoon session here. Hopefully everyone had a great lunch. Obviously a great speech and discussion with the admiral there. It's my great pleasure to introduce CP Rail this afternoon. With us from CP is John Brooks, EVP and CMO, as well as Maeghan Albiston, who I believe is somewhere in the crowd, VP of Capital Markets. So, John, thanks for joining us in Whistler this year. Great to see you in person.

John Brooks
Executive Vice-President and CMO, Canadian Pacific Railway
Absolutely, it's great to be here, Kevin. Thank you.

<Q – Kevin Chiang>: We'll make this a fireside chat. So, if anybody has any questions, please raise your hands. But I've got a number of questions here, so maybe I'll kick it off with maybe some update on how things ended 2022, specifically around the operations and weather. Very challenging December, it feels like, across North America. What did you see there?

<A – John Brooks>: Yes. Well let me, I guess start by saying, and it's a good way to start it, I'm going to thank the CP men, women, employees out there because we always say it's an outdoor sport, railroading. And certainly, the most of December proved that to be a reality. So, it was tough. I'll tell you this. So, I think the reality of it was, as you think about those volumes, Kevin, in most cases, that's not lost volume, that's kind of just pushed volume. So, we grinded. Actually, I saw some of the metrics those last couple of weeks of December. Some of the toughest productivity operating metrics that we've seen in ten years. The good news is, I think unlike maybe the past, the resiliency, the bounce back effect and how long that takes, I'm pleased to tell you that coming out of the new year into the first 18, 19 days of January, things have – the network has bounced back well.

I'd say we're operating probably as best as we've had for the last six to eight weeks. The volumes have picked right back up. So, I'm pleased with where we sit here, at least maybe a third into the quarter.

<Q – Kevin Chiang>: Okay. No, that's great. Obviously a lot of discussion of a potential recession here as we enter to 2023. Maybe what are you seeing across your portfolio? Where are you seeing signs of softness? Where are the areas of strength?

<A – John Brooks>: Yes, so, certainly all you got to do is turn on the TV and you get endless bombarded around that. But as we, you and I were talking before we started, honestly, freight volumes feel pretty good right now at CP. I'm not suggesting at all that we're immune to some of these issues that are going on.

And inventories have improved, I think across Canada and certainly our northern part of our network. But our 2023 story, and as you think about it, into 2024, I think is quite unique. We've got sort of three storylines at CP that I think are quite different, Kevin, than what maybe others in the industry or in the transports are going to face.

And I'll talk about those, so, number one, where 40% of our franchise is a bulk franchise. So, our grain, our potash, our coal, we've got big, high expectations for those three areas. You know, we had the drought last year in Canada, so we've got really favorable comps, as you think about it, through August of 2023.

We got the fifth largest crop. We've got 48 of our new high-capacity elevators in play across Canada. We've got, of course our new rail cars, grain rail cars. So, we're bullish on Canadian grain. The U.S. grain market seem to be pretty good, as I look into at least the first part of 2023. So, we check the box on grain, but honestly, our potash and our coal business have a lot of upsides.

Currently, we're forecasting, I'm going to say 10% growth in both our coal business and our potash business in 2023. So, those two areas combined with Canadian grain makes our bulk outlook pretty strong. I'd say the second leg of the stool is our self-help initiatives.

We've been the fastest growing railroad over a number of years now, and it's because we've created our own opportunities, picking our partners, using our land assets. So, you think about in 2023, we really ramped up our international intermodal business. We had a couple of nice contract wins. We've done a lot of great things at the Port of St. John.

So we're going to see some tailwind from those opportunities, despite maybe intermodal being one of those areas that has kind of softened a little bit. Our year over year compares are pretty favorable there because of our success in the marketplace. I'm also very excited about our auto part of our business. It was kind of a challenging year in 2022 in autos, but we announced a new contract with Ford.

It's starting up right now. I just saw some photographs of some new Ford products unloading up our new compound in Edmonton, Alberta. We've also opened a new compound in Bensenville in Chicago. So, there's kind of a long list of initiatives that we had some success in 2022 on that despite I think if things do soften somewhat in some of these other business units, as you move into 2023, they create some resiliency to battle against that.

So you got a strong bulk, you got some resiliency with some of these initiatives. Then maybe that third leg of the stool is maybe the most transformational and exciting piece of this new story. That's our merger with the KCS. So, very optimistic that we will be in control with STB approval in Q1, so I'm excited. You got the bulk, you got the initiatives, and then you've got everything we're going to layer on in terms of those revenue synergies and opportunities with KCS the back half of 2023.

<Q – Kevin Chiang>: As you can imagine, we have a lot of questions on the pending approval here, but maybe just to close the loop on some of those opportunities, you talked about the market share wins. You mentioned those on the Q3 call as well. A lot of in that merchandise and intermodal portfolio. If you kind of put it all together, is there a way to frame the size of the opportunities in terms of revenue or volume upward from these internal initiatives?

<A – John Brooks>: You know what, I've kind of pegged it. I think initially around $200 million. But honestly, with a few others we've added in there, it's pushing $300 million of opportunity. I guess Kevin, it's certainly – that's good and that's nice top line growth that we've added to that will, again make us resilient somewhat if we see softening in some of our other business units in 2023. But again, it's pieces of business that we – it wasn't a shotgun blast.

It was a very surgical approach in terms of we want to partner with this customer or this piece of business because we believe in the long term, not only from a CP perspective that this is a winner in the marketplace and it can be most accretive to our shareholders to bring this piece of business on. But we also did it with an eye to CPKC and picking those partners that we think ultimately then give us a stronger bond as we look to the future on what we can do with a combined network is a powerful thing.

<Q – Kevin Chiang>: For sure. Maybe just turning to the CPKC transaction then I'll turn it over to the audience for any questions. I think expectations are that you'll receive regulatory approval in the coming weeks. Maybe walk us through once that approval is achieved, what are the plans over the next like 30, 60, 90 days from the CP side, and maybe even the KCS side, to minimize the integration risk?

<A – John Brooks>: Yes. So, a couple of comments on that. So, we are awaiting the final EIS, which I believe the STB publicly said they expect to get February 3. So, with that, we would expect a decision and control again to happen here in Q1. I can tell you. And I am just reminding people, we've been at this for two years now.

This has been quite a journey. We are chomping at the bit to get control, certainly respecting all the STB regulations around that. But we feel quite prepared to not only come in and begin to operate and influence some of our mechanism, technique, approaches to the business.

I can tell you my commercial team, myself, were chomping at the bit to get after some of these customer opportunities. I personally have met with hundreds of the KCS and potential customers that we see for this network. I can tell you, it's less about the quantum of opportunity because I could tell you just about every one of them, the opportunity is bigger than what we initially expected, which is really good news.

It's more about, again sort of picking those right opportunities, what's going to be the right cadence to bring them onto our network and working with Mark Redd and Keith and the operating team on making sure that we bring it on, and we can be successful. We've got to create the right product, day one, to ultimately drive our success on what these business opportunities – when we bring on these business opportunities.

<Q – Kevin Chiang>: That makes sense. Maybe I'll open up to the floor for any questions. I'll keep on going then. You kind of teed me up for my follow up question here. So, you're out there with a stated synergy of a billion dollars U.S. in EBITDA over three years, but 82% of that is going to come from market opportunities.

The general view is that this is conservative. Maybe where are some of the opportunities that you see the upside? Are there specific commodities that you'd highlight? Then on the flip side, given the economy is slowing, are there certain synergies that you saw two years ago or a year ago that become a little bit more challenging in the current economic environment?

<A – John Brooks>: And I mean this with all the opportunities are a greater magnitude in all the areas. I wish I could tell you that was one or two. I think the U.S. shipper, and frankly, North American shipper the last few years, have dealt with a lot of issues, whether it be trucking issues, whether it be just simply supply chain, their current, maybe incumbent rail providers. I think the idea of a unique new entrant in the market in some of these corridors, in some respect, I think they're looking to diversify their book. Just – we want to try something different. This is what we've had forever. I think that's one thing.

I think the other thing is the quantum of truck conversion opportunity is far bigger than we initially thought. I think we pegged some pretty healthy targets out there in our STB submission around what that truck conversion could be. But those discussions, not only with customers that are using industrial development to create solutions in Mexico and looking for what new options to bring rail into the U.S. or Canada, but existing customers that are out there today that have never really had a product where they could open up that truck book and potentially look at converting it to intermodal.

And I think an interesting piece of that that is becoming a far bigger sales tool or maybe arrow in our quiver is the value that these shippers will get from a greenhouse gas emissions savings. I can tell you we just ran some test shipments in an interline basis with the KCS from Chicago to Laredo southbound. We did the shipment in just a little over 72 hours. That is on par with what a single driver truck can do in the marketplace.

Again, this is interline service. This isn't a direct route yet, so we're super pleased with the service performance. But we also worked with the shipper to calculate what we believe the greenhouse gas emissions savings would be for those specific movements. It was 72% versus their current mode of just trucking it down to that marketplace.

So look, I'm not suggesting that's the be all, end all decision maker, but if you can put consistent, reliable service in the marketplace, we can compete against trucks. We can provide, I think a better product than maybe the incumbents. We're going to be a very hungry sales team; I can promise you that. You get some ESG and environmental benefits to it. It's a compelling value proposition.

<Q – Kevin Chiang>: So you're not going to tell me how much more than a billion? I kid you.

<A – John Brooks>: I'm not. You know what, the answer to that is, you know what, it's a good question. The good news is that the quantum is significantly greater. It's really all about timing.

We get really caught up in what these first one year, two year, three years going to be. I have no doubt we're going to announce some really exciting partnerships and business propositions soon after – as soon as Maeghan lets me begin to announce them. But it's more about how this long term, I think this is a – CP is a great play for a long-term shareholder. It's the opportunity to keep doing this beyond year three and year four, and what that value creation can be, is compelling.

<Q – Kevin Chiang>: For sure. For sure. When I think back to the 2018 Investor Day back in Calgary, one of the key takeaways I had was the excess land that was in CP's portfolio that you would be able to leverage in order to win market share, to drive revenue growth.

We sit here today, and you talked about some of the self-help levers. It seems to have leveraged a lot of that real estate. Can you talk about the opportunities, when you think of those synergies with KCS, how land plays a role in some of the excess land that KCS may have in order to win in the marketplace?

<A – John Brooks>: Well Kevin, I tell you, we're not changing that playbook. It works. That will be a key part of if we – when we have another Investor Day I would expect that theme to be prevalent too, and I hope everybody catches on to that. I think we're in the mid innings on CP in terms of our development. We already brought up the Edmonton terminal and the Bensenville terminal that we just opened up for autos.

But the KCS, maybe even at a bigger quantum, has significant land assets that are not only contiguous, they've got about 4,000 acres contiguous to their property that present development opportunities. If you've been down to their terminal down in Dallas at the Wiley, it's kind of a field of dreams. The opportunity to pick the right partners and develop that land is going to be a powerful tool for us.

But you look at Steel Dynamics made an announcement yesterday around building a new facility down in San Luis Potosi down in Mexico. Again, that's an adjacent property to the KCS line that they're going to develop a steel facility down there. So, it's definitely going to be a big part of our playbook as you look to how will we build this KCS network out in the coming years.

<Q – Kevin Chiang>: When I think of the revenue opportunities, at least the stuff I've read, I think a lot of it originates in North America or in Canada and the U.S. There's obviously opportunities coming out of Mexico. Is there a way to frame what that could be? Especially in a world of if we're near shoring more stuff, and it seems like Mexico is well positioned to the extent that we're bringing manufacturing back to North America, how does the CPKC benefit from that? Or how is it positioned to take advantage of that?

<A – John Brooks>: The best in the industry. We will again create a three-country link between Mexico, the U.S., and Canada that just doesn't exist today and can't exist with any other route option. That's not to say we're not going to do a lot of business with the UP and BN and other roads in and out of Mexico, but there'll only be one CPKC that can create an ecosystem that can originate in Monterey, Mexico, and terminate in Montreal, Canada. I'll tell you this, as we dig deeper into what those opportunities look like, there's certainly a fair amount of that that's moving on rail options today.

But again, the bigger opportunity is to create these ecosystems that don't even exist today such as maybe temperature controlled and refrigerated or heated products that can move across borders from Canada all the way down to Mexico. Beef and proteins moving south, and fresh vegetables and that moving north. Or opportunities in the auto industry where, because of car supply and service, maybe current modes are truck in short seed of reach market versus the ability to put it on the rail directly, minimize the handling and get directly to market.

So there's a whole world of these opportunities. It's, again more about the cadence over the coming years on how we build out our network to then be able to provide that service and quality experience for those customers.

<Q – Kevin Chiang>: Okay. Maybe turning back to CP standalone, let's start with the pricing environment. Exceptionally strong in 2022. Pricing to reflect the inflationary environment. How should we think about renewals as we get into 2023 here?

<A – John Brooks>: Yes. I honestly believe the guidance I've provided sort of the last couple of quarters holds true. We've seen the pricing through Q4. It's going to continue to be strong, and it will be as you look to 2023. I've guided my team to a six percent plus type pricing environment. And honestly, that will sort of be dependent on what this inflationary environment continues to look like. There certainly could be upside to that.

Obviously with the wage inflation issues that the U.S. roads have been dealing with I think presents, and you're going to see that U.S. roads probably react in a manner to try to work against – to battle that inflation. You know, I think we're in a little better position in terms of wage inflation in Canada, but nonetheless, I expect pricing to remain fairly robust through 2023.

<Q – Kevin Chiang>: That's excellent. Any questions in the audience? Maybe turning to one of the self-help levers you mentioned, the growth out of Port St. John. When we look out into, let's say 2023 or beyond when I think back the last couple of years, it was a beneficiary of some of the congestion in the, in the west coast ports. I'd say maybe the east coast ports, Gulf coast ports in general were beneficiaries of some of that congestion. As that congestion has eased, what do you think it means for Port St. John in terms of the growth rate or the opportunity set?

<A – John Brooks>: Yes. So, Kevin, honestly, our acquisition of the CMQ and the development of that rail line into St. John has been nothing short of a home run. We're super pleased with the performance at DP World to service that port, the MBSR and the Irving Group there to help us provide service coming out of there.

We built that service and that proposition based on the fact that really Atlantic Canada had one option, and we felt with our shorter route miles from the coast to ultimately get to Montreal, Toronto and Chicago, we could just flat out put a better product in the marketplace. And that's what's happened. When you do that and sell it the right way, the business will come. And it came. So, not that we haven't had some growing pains at which the pace that growth came on, but I'm quite pleased with where we sit there today. It was about 150,000 TEU terminal, fairly small. I can tell you right now, DP World is installing two new cranes that will allow two vessels to berth at one time.

It will jump up the capabilities of the terminal up to about 300,000 TEU a year. Then they are in a second phase of a modernization project, and what you're going to see is ultimately that terminal go from 300,000 TEU to 800,000 TEU a year.

So we're super excited. We think there's still early innings or mid-innings on opportunities to continue to grow that East Coast port. And honestly, I don't believe it was a function of the U.S. West Coast. Or really the U.S. East Coast. Certainly, we've targeted some of those opportunities as a result of their struggles. But I think we've grown it on the heels, and we'll continue to grow it on the heels of creating a better market for the marketplace. If we can do that and we can provide consistent, reliable service and strong capacity, it will grow.

<Q – Kevin Chiang>: You talked a little bit about labor, obviously headline news in 2022. Just given maybe the more contentious negotiations between the 12 unions and the NCCC, which KCS is a part of. When the merger is approved, and KC and CP come together, just how does the labor environment change or how do these contracts come together under this merged entity?

<A – John Brooks>: Yes. Well maybe I'll first remind everyone that CP's U.S. franchise, we were not part of those negotiations. We have what we would consider a very innovative, progressive hourly agreement. Allows us to pay our employees more. It allows us to be more creative with how they work. We believe it provides a better work-life balance for those employees. I can tell you we are excited about the enthusiasm in working with the labor unions on the KCS.

I would say although we're in the very early innings of that, those discussions have been positive. I think we see opportunities that potentially, once we get control, once we help them understand how we think about labor, how we think about these types of issues, that perhaps we can work towards the solution to implement some of those rules down onto the KCS. Got a ways to go, but nonetheless, this is what we're going to push hard towards.

<Q – Kevin Chiang>: Okay. Then you talked about being prescriptive in terms of bringing the growth on, right? You don't want to overload the network. You want to make sure you're picking the right opportunities. You laid out some capex plans back when you originally announced the deal in terms of the investments you would need to make. Has that dramatically changed just given the inflationary environment or some of the opportunities that you see in front of you today?

<A – John Brooks>: You know, Kevin, it really hasn't. We've been pretty locked in to, and I think with a pretty good understanding of how we felt or what were some of the areas we wanted to create a product day one that would be successful in the marketplace. Then what we needed infrastructure wise to make that happen. I can tell you day one, we are going to introduce a north south intermodal product that we're going to be confident in, that it's going to replicate what we were able to do in Canada from Calgary to Toronto.

It's going to be truck competitive, so we've got a pretty good understanding of what we need to do capital wise. I think we said 350 or 375 million of growth capital that we're going to apply to this. You know what, how that layers in, it will probably move around a little bit.

But nonetheless, that's going to cover. That number hasn't gone up or really down. It stayed pretty static. It'll be more about as we sort of overlay the business that comes on, maybe we deploy a sighting a little later than we had planned, or maybe we advance a sighting or two earlier than we had previously planned.

<Q – Kevin Chiang>: Okay. We have under two minutes here. Maybe, as a CMO, it'd be interesting to hear how ESG has changed, how shippers bid on work or secret request for proposals, how it plays into the bidding process today versus maybe five years ago?

<A – John Brooks>: Yes. I'll tell you, the reality is, right or wrong, five years ago, it wasn't in the discussion at all. I'm not suggesting that shippers aren't consciously making a decision now based on greenhouse gas emissions and tier three emissions and that, but it is a major talking point. It is, as a CMO, it is something I'm doing to equip my team with as many facts and tools as they can get their hands on. So, when we do sit in front of that shipper, we can talk to them specifically about it because it does matter now.

Now, if you think about historically success railroads have had with truck to rail conversion, I think most would say it hasn't gone as fast as it should have. I think this is a new arrow in the quiver, whatever you want to say selling tool that the rails have never had today that now matters.

And I think shippers are saying, hey, if I can diversify my portfolio, consider putting more on intermodal and reduce my greenhouse gas emissions, that might be a pretty good deal. So, anyways, I think CPKC, that will be something that we're going to work hard to maybe bring to the forefront of how we sell that property.

<Q – Kevin Chiang>: Well, it's going to be an exciting year for CP in a couple of weeks. I think we're expecting a pretty positive announcement here. So, best of luck as you get through this. It sounds like exciting times.

<A – John Brooks>: All right. Thanks Kevin.

<Q – Kevin Chiang>: Thank you very much, John.