Transcript

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Webcast

Corporate Participants:
John Brooks – Executive Vice-President & Chief Marketing Officer, Canadian Pacific Kansas City
Mark Redd – Executive Vice-President & Chief Operating Officer, Canadian Pacific Kansas City

Other Participants:
Konark Gupta – Transportation and Aerospace Sector Analyst, Scotiabank

PRESENTATION

Konark Gupta
Transportation and Aerospace Analyst, Scotiabank

Hi, everyone. Good morning, and thanks for joining us on day one of our two-day conference. I'm Konark Gupta, Transportation and Aerospace Sector Analyst at Scotiabank.

As Jeff was saying, we have some of the most respected leaders in the transportation and industrial sector today so I'm really excited to start out this year's conference with CP Rail. I'm pleased to have EVP and CMO John Brooks, and EVP and COO Mark Redd. John and Mark, welcome and over to you for any opening remarks before we get into Q&A.

John Brooks
Executive Vice-President and CMO, Canadian Pacific Kansas City
All right. Maybe I'll kick things off. Appreciate, Konark, the warm welcoming. Glad to be here in Toronto this morning, representing all the employees of CPKC across our network spanning, certainly across Canada, down through the United States, and now into Mexico and all the way to Lazaro Cardenas.

To say it's been a exciting 2023 would be an understatement. Chris was saying we're almost to the day seven months into the integration of the KCS network. Certainly, it's not been without its challenges, but I sit here today telling you we are quite pleased with how the integration of these two companies has transpired.

As I look to the current, it's certainly been a challenging, I would say 2023 from a macro, certainly geopolitical, and then everything on top of it. I sit here quite pleased on our focus relative to where we sit. Certainly, relative to our industry peers, but also with the opportunity in front of this company for many, many years to come. I think we closed out October about flat-ish or slightly up on RTMs. That was sort of an inflection point.

As I sit here, month-to-date in November, our RTMs are just under 4% up. So, I'm pleased with the progression. We've seen nice sequential improvement, really starting a few months ago overall on our top line. That's not to say there's not a lot of heavy lifting to do yet, Konark, to finish things out, but I'll tell you we're focused on -- certainly Mark will talk to it, the service and cost control, the pricing environment, I continued to be pleased with the team's efforts in that area.

Of course what I think we do best is self-help. Creating markets and initiatives and supply chain solutions that was spoken to just a few minutes ago that are going to be unique and needed as you look to the future. So that's our focus. And maybe, as I said, I'm really pleased on how the operating environment and the service that we're offering to our customers has really improved over the last 30 to 60 days and maybe I'll turn it to Mark to make a couple of comments. Thanks.

Mark Redd
Executive Vice-President and COO, Canadian Pacific Kansas City

Yes, so thanks, John. Really, just pleased to be here representing our employees, our CPKC across three nations. First event for me, so appreciate the invite, Konark. The – for us, we've been focused on just the integration of the two companies. We want to make sure that we don't get, certainly, our service in front of John to make sure we get capital in place to take care of our trains, train movement across the network, make sure our yards operate efficiently.

From a business side, we've been focused on dwell, we've been focused on car miles per car day how we do that, just mainly through whiteboarding. We pulled out our old whiteboards from the past to make sure that we have our time studies in our yards focusing in that area. Again, we don't want to oversell. We want to make sure we put capital in place before we bring on marginal amount of business, but certainly working close with John, creating tension with each other to make sure we don't do that, but also just make sure we complement each other to execute what we do, do what we say and make sure we do what drives this organization.

QUESTION AND ANSWER SECTION

<Q – Konark Gupta>: All right. Yes, no, that's great. Thanks for that remark. So, maybe we can start off with a big-picture question from macro standpoint. Like 2023 had been sort of a volatile year for the industry, especially the summer. Things are getting better a little bit sequentially at least. Heading into 2024, if you can talk to us about what do you see in the economy. You have a big network now, Canada, U.S., Mexico. Any thoughts on how are you approaching the macroeconomic outlook for 2024?

<A – John Brooks>: Yes, sure. Well look. I'd love to say that relative to the interest rates, some of the macro pressures we're facing that we're going to flip the calendar and things are going to change. The reality is geopolitically, we've got quite a situation going on across the globe. The reality is we've got a couple very meaningful, political elections in 2024 that'll be somewhat, I'm sure, interesting TV.

That being said, look, I do believe we've seen an inflection point on our volumes. Now, is it a hockey stick? By no means. It's a slugfest out there, but it really boils down to leveraging our network to try to create these solutions ultimately, Konark, that maybe don't generate the hockey stick day one.

But as this then returns, then I guess it's anybody's guess. It's probably more second half of 2024 than it is first half of 2024. As this thing turns, we've got the solutions in place for our customers, then maybe you do see that hockey stick.

Maybe just a couple other comments specific to the lines of business, I'd think about it like this. Generally, our intermodal business is challenged. We've seen a little bit of an uptick. I see that run rate as you see it today particularly the international intermodal staying as-is for the foreseeable future.

Our bulk business, which was a long bellwether franchise for our CP network, continues to perform strong, I will tell you, albeit the broader drought situation in Canada has been a little more impactful than we had planned and anticipated. That's pressuring some of the near-term volumes and we'll see how next year plays out.

The good news is with the KCS network, our U.S. franchise is somewhat, not insulated us, but it's helped diversify that grain book, so we're in a little better position from that standpoint. The auto business, I expect to continue to run strong right into 2024, Konark.

And our general merchandise business has actually been pretty decent if you think about the energy, chemicals, plastics, steel-type business. A lot of good synergy opportunities that we've been able to uncover in that area that I think give us tailwinds as you think about 2024.

<Q – Konark Gupta>: Okay that's great. Mark, if you look at the operating environments in Canada and U.S., we've seen a lot of labor changes across the industry, a lot of disruption, some strikes here and there. How are the operating environments right now for you guys in Canada and the U.S. maybe?

<A – Mark Redd>: I would start with the U.S. I knew from day one when we took CPKC over, or Kansas City over, that we understood that I needed to get in front of the union leadership. We spent a lot of time prior to the takeover just due to the fact of having integrating contracts within Kansas City itself, the proper area.

We've spent some time with sleeves rolled up with the general chairman. We built that relationship. We continue that relationship. Within the first two weeks, I had all local chairman, general chairman in Kansas City, really just for -- just to shake hands, understand the business, understand who I am, understand my team and what we're all about.

Part of that, I think has really helped us just throughout the summer, throughout this fall so far, just to create that conversation of what we can do, how do we control cost, what we do when we control cost, and what that looks like. It's not a surprise when we come in and take out a few jobs here and there. It's all about that conversation, how do we get there, and why we do what we do.

Part of that is building upon hourly agreements. Hourly agreements is something unique to this company and maybe one other, but the fact is these hourly agreements take the handcuffs off of operating people where it can do with when you arrive in the yard's terminals or depart, you've got more flexibility within that schedule. That's one thing we've been able to do with Kansas City Southern in and around Kansas City itself, but we'll push that through the rest of the property. Throughout the, I would say six months to a year, we'll have that completed across the KCS.

Again I think it starts with that, just building that relationship with the unions. I think it starts with just doing what you say. If they have issues, you dive into issues immediately. If they have some discipline stuff going on, you dive into discipline and understand what happened, what do we do, and how do we create that environment where we can work together. I think you see it in Canada, you see it on the U.S. property for SOO Line, you see it with Kansas City Southern as well.

<Q – Konark Gupta>: I think just along those lines, you end up -- I think you are looking at the U.S.-Canada operations mostly, right, and John Orr is focusing on Mexico. Can you talk to us about how are you managing the entire network together and how are you splitting the responsibilities to focus on different aspects of the network?

<A – Mark Redd>: Yes, great question. Really, from Beaumont South, John is going to take the lead with running the operation. The reason for that is there's so much integration and so much customer build-outs and things in that area where John is going to be more experienced in that space. That's what we want him to do, is focus on that area. To where I've got some history with Kansan City Southern, Shreveport, a lot of different areas and we can bring that company together quicker, create synergies for ourselves quicker, efficiencies.

And just -- I'm going to be frank, we've been able to take out about 30% cost in Shreveport alone just based upon job alignments through whiteboarding and things like that where John is seeing just the complements on the Mexico side as well where he's created that environment with the unions and creating some space and agreements to build out flexibilities and release some handcuffs in a couple different areas to where we can spot trains on arrival and/or bring power to trains, and the last piece is really just longer trains.

<A – John Brooks>: Konark, I tell you, directly to the question of John and Mark and that, I'm on the phone with one of the two, or if not, both of them about every day talking about what's going on in the network, where we can improve, where we're getting customer feedback. Super pleased with the progress that John has made down in Mexico.

Our GTMs in a given day, we're setting records down there, all-time KCS records -- or KCSM records down on that property. The amount of opportunity and volume that is available down there with the consistency of an operation like that, just no different than what Mark and his team have done in Canada over the years. You just see the revenue and the opportunities generate themselves, so super pleased with that.

And Mark's being modest. We've had a really good run here most recently in terms of our on-time performance and dwell and car velocity, really across the whole network that you got enough other battles to fight relative to the -- all the things we face. To be able to lean on commercially a strong, stable service is kind of core to who we are at CPKC.

<Q – Konark Gupta>: We certainly did see that in your weekly network performance metrics. They are moving in the very, very right direction, so that's great. I think things are coming up, obviously. Talking about Mexico and KCS, any updates for the revenue and cost synergies, how much you have achieved so far or realized so far?

<A – John Brooks>: Specific to Mexico or broader?

<Q – Konark Gupta>: Across KCS, yes.

<A – John Brooks>: You know what? I think about it like this. I think it was Keith said, I don't know, it was about a month ago or maybe a little longer than that, that we saw a comfortable run rate in that $350 million, I think ballpark. I can tell you we're better than that. The number is north of that. I feel very comfortable with saying that.

Maybe more exciting, as you think about as we move into 2024, our unique story is, regardless of the macro, and don't get me wrong, the macro puts overall pressure on the big pie, but regardless of that, it doesn't change the fact that we have a unique network that spans three countries on a single line haul. And customers are attracted to that.

Regardless of what our competitors do, regardless of ultimately the macro, if you believe supply chains need resiliency that to some degree, nearshoring, or whatever term you want to put on it, is a ongoing momentum in North America, we're set up to provide that service. As much as I'm excited about the fast start out of the gate, I really get excited what the next two, four, eight years look like, Konark, as I think about the multi-year plan.

And as these facilities develop and some of the products that we're introducing, like our Reefer supply chain, or our automotive closed-loop system, or our Mexico Midwest Express train, they're just in their infancy right now and if they're generating low 100s today, that only gains momentum

as we move forward and more customers begin to test it. Certainly, the macro gives us a lift as we come out of this sort of environment we're in today.

<A – Mark Redd>: And I would just add on some of the synergies and efficiencies is, we have a little higher headcount but the question gets to be, okay what are you doing with the headcount? I mean I've got -- I mean this isn't a tomorrow story, this is many years in the future. So, if I think about efficiencies of guaranteed pay for people sitting at home not doing anything, I'm going to turn the tables and say okay well let's train them to be engineers, because I'm going to need engineers in the future and it takes me six to seven months to generate an engineer, so let's do it now.

Let's make the investment now to where John gets more and more business, synergy business, we can run a cross haul and create something special quickly, not just wait until we train engineers at that point instead of just sitting back and paying guaranteed.

The other piece was locomotives. We've talked about locomotives before and it's about controlling costs, okay? If I'm going to control costs because this is a growth story, it's about pulling locomotives, it's about pulling assets.

We've been able to pull about 6,000 cars that you see in the week-to-week numbers, but we've also still from Day One, I've talked about these locomotives, we still have pulled and maintained about 130 or so locomotives pulled out of the network and continue to do that. As we head into fall peak and we head into fourth quarter, we'll certainly have locomotives on hand to do what we need to do or tie them up, whichever.

<Q – Konark Gupta>: Okay that's great. You touched on -- John, you touched on competition a little bit. Obviously right out the gates, we saw some response, right, from EMP changes to Falcon. Quantum recently, J.B. Hunt announced some changes as well. No surprises, I'm sure, some interlines. How are your customers reacting to that competitive response and how are you blocking and tackling?

<A – John Brooks>: Yes. Well I guess let me first say they're all proving our thesis from day one. We told the STB, we told, well, a lot of you. We told our customers that we're going to be a disruptor. We're going to create more competition. The better products we put in place, our competition is going to have to react and I think that's exactly what we've seen.

Look, at the end of the day I'll put Mark up against any of them. It all boils down to how you operate and the capacity you have and that long-term discipline. I would tell you, we feel good how we've let that story play out across our legacy-CP and across Canada in the past and it’s the same playbook, Konark, as I look going forward. I think customers have reacted positively. They got more options in the marketplace to play us off against each other.

But if at the end of the day a single-line haul, one-stop-shop, fastest service in the industry matters, it easily wins. At the end of the day, I think regardless what product specific, you were talking about largely intermodal products, I feel really good about our chances to execute with our partners. And look, there's, I think, been a reason KCSM historically was maybe a little bit more of the dominant provider in Mexico because the routes are good, the capacity's strong, and the service product in the marketplace has traditionally outperformed, and we expect the same going forward.

<Q – Konark Gupta>: With respect to intermodal and these competitive products are mostly centered on that, obviously right? Can you talk to us about the truck-to-rail conversion opportunity in that U.S. Midwest to North-South corridor of market? What percentage are you trying to capture on that?

<A – John Brooks>: Well maybe that's the other side of the story you just asked about. The good news is we introduced these additional competitive products in the marketplace. I don't believe at all that it's a zero-sum game relative to it's just a share shift between competing competitors. Now, I'm not saying there won't be some of that going on, of course there will, but the truck market available to everybody out there is massive.

And I think we've long been criticized. Maybe the rails historically have just been too focused on stealing from each other versus really stealing from the true competitor and that's trucks. I think we identified, I spoke about it at Investor Day about 1.8 million annual truck addressable market as we just simply look at that central Mexico up into the Midwest area. All you got to do is take a field trip to Laredo and look at the congestion going across through the border there. There's a tremendous opportunity.

And again, not all that is just conducive to intermodal in our product, but when we're able to run 3.5, 3.9 days between Chicago and SLP, that is truck-like service and that will convert over-the-road. We've had some early success and if you believe, more and more companies are environmentally conscious around reducing their greenhouse gas emissions, and we can provide a product that can do that to the clip of 60%, 70% in that quarter, I think that all becomes meaningful.

There's a lot of muscle memory in a buyer picking up the phone and calling a truck to show up to go to Chicago but once you begin to chip away with that and they can experience the discipline and consistency of the product, they get the benefits of some of the greenhouse gas emission savings and we can do it at a competitive price, I think you see more and more of that conversion opportunity.

Frankly, Konark, that -- my thinking has traditionally been more in that north-south corridor. The volume of trucks and opportunity that are moving between the Southeast U.S. and that Mexico market too around that horn which we have note the best route again in the industry, that presents itself a whole other layer of truck conversion opportunity and we're super excited. We've got an existing partnership and great route with the NS.

We're developing a new route with the CSX that just opens up a whole other world of customers that maybe have never had. So, we're super excited to work with both those partners to attack, and I mean attack, that truck market in that lane.

<Q – Konark Gupta>: Okay. If we extend that Tex-Mex to the ports, Lazaro has seen some success, obviously initially. I think you recently talked about some new opportunities that come up there. What's happening in that market right now? Where do you see that going? Is there any traction you're seeing with a lot of shippers? Is that really an alternative to some of the ports on the West Coast?

<A – John Brooks>: Yes, macro-wise, developing international business at a time today couldn't be any harder. We've set ourselves up to develop Lazaro, arguably, in some of the challenging international import-export conditions we've faced in some time. That being said, I'll tell you the reception around a long-term alternative to LA Long Beach, to the challenges at Vancouver and Prince Rupert, to the challenges that shippers are facing through the Panama Canal, is getting traction. Is it as fast as I want? No. I think again part of that is driven around we just got such a soft import-export overall environment.

That being said, you look at volume through ports in North America, there's really one port that is up and they're up 26% import and export, and that's Lazaro. Our business in and out of there is actually

up 34%. So much of that business was being, in the past, trucked out of that port. We've actually grown our share out of that port in addition to the growth that it's seen.

We're pleased. I would say this one, we're early innings, but I'm very optimistic that we're going to see some significant calls in 2024 that will not only begin to further build that domestic Mexico demand, import and export, but also begin to build that demand in and out of the Texas market and up in the United States.

<Q – Konark Gupta>: Okay. I want to just shift the gears a little bit to Mark. On the operations side, the regulatory environment has been a little bit topical lately. So recently, STB came out with reciprocal switching rules, which is a reboot of 2016, I guess. Any thoughts there? What does it mean for you guys? We read some of the comments that you guys provided in response to that. I know it's still going to work its way through over the next several months. Any thoughts on how does it impact your operations in the U.S.?

<A – Mark Redd>: I'm sorry. We said inter-switching?

<Q – Konark Gupta>: Reciprocal switching.

<A – Mark Redd>: Okay. I missed that. I apologize. It's an environment we live in today. I mean in Canada, you have that environment. It's nothing new to us. So, we know how to navigate through that environment. Really, it's simple. Provide the service, Mark. That's what I've got to do as a team, is to make sure that we provide the service for John to where customers don't want to go to someone else.

Obviously, we work in that space with customers. We've done a lot of work with different entities in that space. But at the end of the day we've just got to provide service and you don't have an issue that way. Even with STB today you have ways that they can create some friction with railroads. But we haven't really dealt with that through the STB. If I have an issue or John has an issue, he comes to me, we work through it, we work through a service plan if it's a service plan environment, or if it's just an execution environment, I'll work with the execution side.

Again, it's something we live through today with Canada. We don't -- we'll just -- we'll take it in stride. We'll understand what the expectations are once they land. At the end of the day, we're experienced in that space.

<Q – Konark Gupta>: Okay. Then with respect to Mexico only, I would think -- is there any specific low-hanging fruits you would like to call out? Where you can exceed on the next couple of years or so to improve the operations, obviously its more for John Orr I guess. In terms of any sort of sharing best practices from Canada to U.S., any low-hanging fruits you can talk about?

<A – Mark Redd>: Yes, so two things really. I would just say, first thing is labor agreements, working through labor agreements, as I talked about earlier, how do we get toward a daily rate, much like what we do at hourly rate, it'd be a daily rate. How do we get bigger train sizes? Something we've worked on.

How can we spot customers without using a second job to spot customers? So it's just many nuances that we would do in that space. It's like just a couple of data points of how we collectively put something together to develop a better service plan. That's one thing I would say.

The other piece is, I would tell you, as you look at when you talk about Mexico, but I'm going to look at it as a network. And case being that grain trains will flow through Canada, they flow through U.S.,

they go through Mexico, wherever this operation was cycling. But one thing we've done is IFG, which is just south of Kansas City, it's our intermodal facility.

We have literally been able to take our grain trains through this yard that come out of Mexico. So, it's a Mexico compliment, but they come out of Mexico, go into Kansas City, and we re-wheel cars that may be bad order, or work on cars intrain, and never stop the train, never pull the crew off.

We actually pull in this facility, we do all of this mechanical-type work, and then we're still able to take it to the next destination for the final spot. Being if it's on the gateway towards St. Louis, being if it's on the Council Bluff area, we have that ability to do that. That's just part of some of the low-hanging fruit I would say as a team collectively as three railroads, you can have that kind of mind thought, think of that type of work. Where we've done this work at Thunder Bay where we've done this work at Calgary, and other locations, KCS has not done so much of that to where we can bring something to the table.

Vice versa for them. They have plenty of ideas that we've used as far as train handling and how we operate trains in Mexico through the mountains that we've been able to trade off and really just have a whiteboard session and understanding how we can do and how we can be better in that space, because we both have mountains.

<A – John Brooks>: Konark, I'd add just real quickly, we're just in the early innings of doing some very customer-focused deep dives with really focusing on the auto industry first in Mexico because that opportunity is staggering, but more about stop-watching, getting into their facility, figuring out what the infrastructure looks like.

Just like we did across Canada in the early days of that transformation, we're going to go customer by customer, industry by industry, the steel guys, the grain guys in Mexico, as you think through 2024 and 2025, really to hone and tighten down those efficiencies at every one of those industries. The ripple back that you get out of that in terms of not only volume, velocity, and cost savings, just builds upon itself, as you think about Mexico in the future.

<Q – Konark Gupta>: Great, I think that sets for a great future, I believe. So, thanks for the time, gents, and all the best for the next year.

<A – John Brooks>: All right. Thank you.

<A – Mark Redd>: Thank you.