Transcript

Q3 2023 Earnings Call

October 25, 2023

Canadian Pacific Kansas City Corporate Participants:

Keith Creel – President & Chief Executive Officer
Nadeem Velani – EVP & Chief Financial Officer
John Brooks – EVP & Chief Marketing Officer
Mark Redd – EVP & Chief Operating Officer
Chris de Bruyn – VP, Capital Markets

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon. My name is Travis, and I will be your conference operator today. At this time, I would like to welcome everyone to CPKC's Third Quarter 2023 conference call. The slides accompanying today's call are available at investor.cpkcr.com. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions)

I would now like to introduce Chris de Bruyn, Vice President Capital Markets, to begin the conference. Please go ahead, sir.

Chris de Bruyn

Thank you, Travis. Good afternoon, everyone and thank you for joining us today.

Before we begin, I want to remind you, this presentation contains forward-looking information. Actual results may differ materially. The risks, uncertainties and other factors that could influence actual results are described on Slide 2, in the press release and in the MD&A filed with Canadian and U.S. regulators.

This presentation also contains non-GAAP measures outlined on Slide 3. Please note, in addition to our regular quarterly financials, there's supplemental Q3 combined revenue and operating performance data available at investor.cpkcr.com, which some of today's discussion will focus on. With me here today is Keith Creel, President and Chief Executive Officer; Nadeem Velani, our Executive Vice President and Chief Financial Officer; John Brooks, our Executive Vice President and Chief Marketing Officer; and Mark Redd, our Executive Vice President and Chief Operating Officer.

The formal remarks will be followed by Q&A. In the interest of time, we'd appreciate if you limit your questions to one.

It is now my pleasure to introduce our President and CEO, Mr. Keith Creel.

Keith Creel

Alright, thanks, Chris. Let me start by thanking the CPKC family of 20,000 railroaders across our three great nations who've been hard at work providing service for our customers. The effort and the passion they've demonstrated each day as we integrate and execute is truly commendable. So, let's take a look at the results of the quarter.

The second quarter produced revenues to CAD3.3 billion on volumes that were down 3% versus last year, with an operating ratio of 61.7% and core EPS of CAD $0.92. So, no doubt a challenging quarter as we dealt with the softer demand environment and supply chain impacts from the strike at the Port of Vancouver, but we'll let John talk more about that in a few minutes.

As you've seen in the press release, given a more challenging environment, further stressed by the labor strike, we're adjusting our '23 guidance accordingly. Certainly not the outcome we had planned, but it's the prudent thing to do at this point. That said, it's not the challenges that define us, but rather how we respond to them. I'm very proud of how this team, our collective CPKC family's, responding to the challenges.

Let me say a few things about the Mexico Task Force. That's an excellent case in point to how we respond in the task force. You recall back in our second quarter call, we talked about an enhanced focus on operations in Mexico. Shortly after that, we deployed a task force to Mexico that was led by John Orr.

John, who many of you are familiar with, has a lot of experience in Mexico from his previous role as EVP Ops of KCS and KCSM, and I can tell you this effort was monumental. It brought together railroaders from every part of the organization. Nearly 100 employees across information services, network services, marketing, engineering, mechanical, and many others came together to support John and the task force objectives. And we're seeing the results from that effort. You can see noticeable progress across all the operating metrics, train speed improvements, terminal dwell reduction, car miles per car day improving, locomotive productivity improving, and ultimately the most important part, the service experience for the customer.

And this transformation is ongoing. And the investment in people, process, infrastructure, and technology in our Mexican operations, as well as our U.S. and Canadian operations, is a continual journey. On the safety front, we've continued to rise to the challenge from a safety perspective. Mark will speak to some of this in more detail in a moment, but I can tell on a combined basis, we've seen year-to-date improvement in FRA personal injuries of 12%, FRA train accident frequency of 37%, which is a tremendous result that I want to commend the entire team on as we continue to lead the industry in this space. Safety is a never-ending journey and it continues and will always be our number one priority.

Few comments on the integration. On the integration front, integrating these two companies obviously is a challenge in and of itself, particularly so in today's world with an industry with a history of merger-related service challenges. We certainly have not been perfect. There are opportunities to improve that, that we're mining every day 24/7, but the teams from the Legacy CP and Legacy KCS have embraced the challenge, they've united, working together to produce a unique outcome that will benefit our customers, our communities, and each other.

A couple of points on the MNBR, while we continue to make progress integrating these two railroads, we also continue to progress the MNBR transaction that we announced in June. Pleased to announce that we filed our application for the deal with the STB on October the 6th.

So, in closing, we're a little over six months into this combination, into our forever story. There's no doubt there's a few near-term challenges from a softer demand environment, regardless of the differentiated growth opportunities we've laid out and guided to remain unchanged. We're successfully integrating this network. We maintained our commitments to our customers, to the regulators, and we're seeing momentum in our operating performance.

So, with that said, I'm going to hand it over to Mark to speak to the operations before John brings some colors on the markets and Nadeem elaborates on the numbers.

Mark Redd

Thank you, Keith, and good afternoon. I'd like to start by thanking the CPKC operating professionals for their tireless work and dedication to safety and operational excellence. The first six months of the merger has been both exciting and challenging, but this team was up to the task and they're delivering on their mandate to integrate the CP and the KCS network seamlessly by maintaining safety as CP's top priority.

So, if we're looking at safety for the quarter, I'm pleased to report that we continue to build on industry-leading record. Our Q3 FRA reportable injuries improved by 35% to a 0.97. Our train accident is reported improving 9% to 1.3.

As I discussed on last quarter, stakeholder engagement is a core pillar of our safety performance. We regularly engage our employees, our union leadership, our regulators, to collaborate safety-best efforts, ensuring alignment.

Since day one, we have held two safety walkabouts where CPKC leadership and partners directly engage

with the field employees across the property. Our safety walkabouts are key to a strong, consistent safety culture.

Now turning to the operating performance, I'll speak on the metrics from a comparison to CPKC with a combined -- if the combination occurred in 2022. Locomotive productivity improved 4% versus Q3 last year. Average train speed and length declined 2% and 1%, respectively, and average train weight was down 2%.

As we focus and remain on our aligning operating practices across our network, we feel very good about the progress that we have made in the first six months. We're optimizing our train consists to improve locomotive productivity and fuel efficiency.

To that, our fuel efficiency improved sequentially Q2 to Q3 and I expect that to continue on the area for opportunity as we look forward. So, if we look at where we sit today, network-wide dwell has improved 13% since the beginning of the third quarter.

We have further to go, but the metrics across the board, locomotive productivity, Car Miles / Car Day, and dwell, are all moving in the right direction. We feel confident that these gains are sustainable. If we look at our capital projects for the year, construction of the second span of the Laredo bridge is 35% complete. We remain on target operationally, should be in by the end of 2024. If we look at our USD275 merger capital commitment we've made, we have put in service two of the five sidings. We look for the next three sidings to be within service within three months.

As we, in closing, when we look at the early stages of the journey as a combined company, I'm very confident in the actions and in taking the development of the network and alignment operations, this story will continue to have continuous improvement, and my team will be laser-focused on delivering strong results.

With that, I'll turn it over to John.

John Brooks

All right. Thank you, Mark, and good afternoon, everyone. So as Keith said, we're just over just over a half a year in as CPKC, and I want to say that I'm as excited as ever about the unique opportunities that this franchise has to offer our customers.

Well, it's certainly been a more challenging quarter than I expected,othing that we've seen diminishes any of the exciting growth opportunities that we've guided to over the long-term.

My team has been hard at work at creating new markets, capturing new business, and I'm extremely proud of what we've accomplished to date, despite this challenging economic backdrop. CPKC's unique footprint and our self-help initiatives are differentiators in this marketplace, and we are extremely well-positioned as the volume environment rebounds.

Now, as I look to the third quarter results, on a reported basis versus CP standalone in 2022, total revenues were up 44%, while volumes were up 31%. On a combined basis, total revenue was down 4%, while volumes declined 3% versus pro-forma CPKC a year ago. FX was a 3% tailwind, while fuel was a 6% headwind on the quarter. The pricing environment remained strong, with inflation-plus renewals across our book of business.

Now, taking a closer look at our third quarter revenue performance, I'll speak to the FX-adjusted results on a comparison versus CPKC had the combination occurred in 2022. Starting with bulk, grain revenues

were up 7% on 9% RTM growth. Canadian grain volumes were up 13% year-over-year, driven by the improved harvest, lapping the drought affected prior year.

U.S. grain volumes were up 6%, as this year's harvest has been solid in our service territory, and we are benefiting from our expanded destination market reach. We continue to see new and unique grain flows emerge on the CPKC system. Customers are taking advantage of the opportunity to connect grain origination and destination in ways never available to them in the past.

Now looking forward, projections for the current Canadian grain crop harvest has come down since our Q2 call. Our customers are now estimating the crop size to be in the 60 to 65 million metric ton range. Currently in Canada, we are seeing customer demand to start this crop year at levels below our resource planning, giving us available capacity to offset some of this headwind with shipments of U.S. grain.

As a reminder, the CPKC combination has further diversified our grain franchise, and the U.S. grain markets now make up more than half of our grain revenues.

On the potash front, revenues were down 22% on a 28% volume decline. Our potash volumes were impacted in the quarter by the strike at the Port of Vancouver and continued outage of Canpotex's Portland Terminal. To say this has been a challenging supply chain year for our export potash volumes with Canpotex is a true understatement.

Now looking ahead, although we do not expect the Portland Terminal to come back online before the end of the year, we do have a strong demand outlook for Q4 and we're working hard to maximize our volumes through all available terminals to build some momentum with Canpotex as we close out the year.

And to finish out on our bulk business, coal revenue was flat on 7% volume growth. With favorable compares on Q4 following last year's outage of Teck's Elkview mine and higher met coal prices as we sit here today, I see a strong, a very strong, growth in coal as we finish out the rest of this year.

Now moving on to merchandise, the Energy Chemicals Plastics portfolio saw a 3% decline in revenue on a 5% decline in volumes. Lower volumes were driven by a decrease in crude business as a result of a facility maintenance and less demand in LPG. However, this was partially offset by growth in our refined fuels, including new business with Shell that began in August and continues to ramp up, and plastics growth out of Canada into the U.S. and all the way down into Mexico.

Now, as we move into the fourth quarter, I expect positive RTM growth in Energy, Chemicals, Plastics, driven by continued strength in refined fuels as Shell continues to ramp up and we onboard new share wins.

Forest products revenues declined 6% on a 4% decline in volumes. While we are seeing the impact of a softer economy and slower housing markets, we are very encouraged about the quick development of long-haul forest product shipments from Canada down to our Southern markets. The combination of our seamless route to market and the development of our transload network will position us well to capture synergies in this market as it rebounds.

The Metals, Minerals, and Consumers products portfolio was up 2% on a 1% decline in volumes. Performance in this space was mixed as consumer products and frac sand were down, but metals continued to have a strong performance. We are particularly encouraged by continued growth from the Mexico steel space. Production is ramping up to support strong demand for the auto industry and for infrastructure construction projects, and CPKC's footprint in Mexico is uniquely positioned to service this growing market.

Automotive revenues continued to be strong, up 21% on 11% volume growth, a record quarter. Demand for finished vehicles remains strong as the auto industry continues to be challenged with high finished vehicle ground counts exceeding available supply chain capacity to move these vehicles to market. We are working with many of the OEMs to create unique solutions to improve rail efficiencies that will increase capacity and help clear this inventory.

I'll note that as of now, we do not expect the auto strike to materially impact our business, as we are focused on servicing the strong demand from our production facilities in Canada and in Mexico.

And finally, on the intermodal side, revenue was down 19% on a 10% volume decline. Domestic intermodal volumes continue to be pressured by soft market demand, higher inventories, and competitive over-the-road rates. However, we remain extremely encouraged by the uptake of our new 180/181 cross-border service. The opportunity in the cross-border intermodal space is significant. Our service is consistent and truck-like, and we are in the earliest stages of developing this premium rail market.

Moving over to the international intermodal area, volumes were challenged in the quarter by the Vancouver port strike and softer demand. Although we are excited as ever about this space, and we look to continue to expand our services out of the Port of St. John and to grow Lazaro Cardenas, we expect near-term headwinds as ocean carriers continue to blank sailings and right-size their capacity in reaction to this softer demand.

In closing, so certainly while we are not immune to the headwinds impacting the economy and certainly the entire rail and transportation sectors, we remain uniquely positioned to deliver long-term differentiated growth. This powerful combined franchise is creating new opportunities for our customers to grow, and our synergy gains and the opportunities ahead of us continue to exceed our expectations.

So, with that, I'll now pass it over to Nadeem.

Nadeem Velani

Thanks, John, and good afternoon. I would like to first thank the entire CPKC team for its hard work, focus, and resilience. This team of railroaders is making history, and I'm very pleased with their perseverance and dedication in the face of a more challenging operating and macro environment.

Looking at the quarter, CPKC's reported operating ratio was 64.9%, and the core adjusted combined operating ratio came in at 61.7%. Earnings per share was CAD0.84, and core adjusted combined earnings per share was CAD0.92. Results this quarter were impacted by the change in fuel price on both revenue and operating expenses. The impact of fuel price was a CAD95 million headwind to combined operating income. This includes a CAD72 million unfavorable lag effect on combined fuel revenue.

The CAD95 million impact to combined operating income translated to a 70-basis point and CAD0.08 headwind to core adjusted combined operating ratio and EPS, respectively. Based on where fuel prices sit today, we expect the fuel price headwind from Q3 to be a slight tailwind in Q4.

Now taking a closer look at our income statement, reported operating expense is provided on Slide 14 and combined operating expense on Slide 15. Similar to what we shared last quarter, our combined operating expense illustrates the estimated effects of the acquisition for the third quarter as if the acquisition closed on January 1, 2022. Reported comp and benefits expense was CAD598 million, down 4% on an FX-adjusted basis when compared to combined comp and benefits expense a year ago.

Driving the FX-adjusted decline was lower current service costs in the DB pension plan resulting from higher discount rates and lower stock-based compensation. That decline was partially offset by wage inflation.

Headcount was down slightly sequentially in Q3. We expect headcount to be down sequentially again in 4Q, which will continue to give us improved operating leverage as volumes accelerate into the end of the year. Fuel expense was down CAD86 million or 21% on an FX-adjusted basis when compared to combined fuel in Q3 2022. The decline was primarily driven by a CAD93 million or 16% decline in combined fuel price along with lower GTMs versus prior year.

As I mentioned a moment ago, that reduction in fuel expense due to price was more than offset by a CAD188 million headwind from a decline in combined fuel surcharge revenue. Combined materials expense was down 4% on an FX-adjusted basis. The decline was largely driven by reduced locomotive maintenance material spend.

Equipment rents were up CAD24 million on a combined basis or 34% on an FX-adjusted basis. Equipment rents increased due to higher car hire payments resulting from automotive volume growth, lower use of CPKC intermodal equipment by other roads, and increased use of pooled equipment.

Combined depreciation expense was up CAD32 million, or an FX-adjusted 6%, resulting from a higher asset base. Combined purchase services and other was CAD506 million, or roughly flat year-over-year on an FX-adjusted basis. A business interruption insurance recovery in the quarter related to 2021 flooding and wildfires in British Columbia offset increased casualty expense and cost inflation. Looking to 4Q, I still expect PS&O to come in around CAD530 million to close the year.

Moving below the line, other components of net periodic benefit recovery decreased CAD17 million, reflecting higher discount rates compared to 2022, and other expense was up CAD6 million in the third quarter on a reported basis.

Net interest expense was CAD207 million, or CAD202 million on an adjusted basis. The decline was driven by a reduced debt balance. On a combined basis, income tax expense was CAD258 million. We now expect the CPKC core adjusted combined effective tax rate to be approximately 25% for the year, a reduction of 50 basis points from the outlook provided in Q2.

Turning to Slide 17, we are generating strong cash flow with cash provided by operating activities of CAD1,027 million in Q3. Our first call on capital remains the business and growth. And in the quarter, we reinvested over CAD700 million in line with our expectation to invest approximately CAD2.7 billion in combined capital in 2023.

We generated CAD454 million in adjusted combined free cash flow on the quarter and just under CAD1.4 billion year-to-date. Our combined leverage is 3.6x on our path back to our target leverage of 2.5x.

In review of the quarter, despite challenges, John's teams continue to bring on synergies and our operations are gaining momentum, especially in Mexico. We remain well-positioned to deliver on our long-term guidance, and I am extremely confident in this team's ability to execute. I'm excited about what this franchise can deliver, and I look forward to sharing our success with you going forward.

With that, Keith, let me turn things over to you.

Keith Creel

Okay, thank you, gentlemen. Let's go and open it up to questions.

Question & Answer

<Operator >: Thank you. (Operator Instructions). As previously highlighted, please limit yourself to one question. Our first question comes from Chris Wetherbee, Citi.

<Q – Chris Wetherbee>: Hey, thanks. Good afternoon, guys. I guess you just mentioned that you've been able to capture some of the synergies from the deal, so maybe, if you could help us sort of understand what you think from a synergy perspective you'll be able to realize here in 2023, and then I guess what it'll take to maybe re-accelerate earnings growth back towards some of the longer-term targets that you have, is it simply just getting into a better macro environment, or are there some, incremental cost actions or others that you can take sort of early in 2024 to kind of re-accelerate the earnings growth profile?

<A – John Brooks>: Well, maybe I'll start, Chris, on the Synergy piece. This is John. So, as I said, I'm really pleased.

Despite the challenges we're facing, certainly in the macro and all the geopolitical things going on that we're all facing, the team has been laser-focused on the Synergies and certainly delivering on a lot of things we laid out at Investor Day.

I think, we said at Investor Day we saw an immediate run rate of USD240 million sort of annualized. I can tell you; I know we pushed that to USD350 million that we talked about at some conferences, and I'm comfortable in telling you that we're beyond that now. I'm not going to peg quite a number for you at this time, but I'm quite comfortable we're going to end up north of a number like that. So, I'm quite pleased and I'll tell you there's a number of contracts and opportunities that are ready to go, but we'll start up in 2024. That'll continue to add to that story.

<A – Keith Creel>: Chris, I'll just add a little color on the cost side. We're ahead of our target on the cost side as well. If we talk about accelerating, what I expect to see in 2024, as we de-bottlenecked and continue to improve upon even numbers that Mexico was experiencing back to November of last year, that momentum will continue. We've got the investments that we made this year in the physical infrastructure that's tied to the merger application. I think we've got five sidings that are few are online now, two more come on within about a month, and then we've got one more to close the year out. So, we'll get the benefit of that in '24.

So, what I expect is the railroad to continue to incrementally improve from a fluidity standpoint, a locomotive productivity standpoint, and ultimately you put those two together, you're going to turn your assets faster, we'll have better car productivity, car miles per car day, and you'll see operating expense tied to the synergies of putting these two networks accelerate a bit from the run rate that we've been at for the last six months.

And again, I'll finish where I started. We're exceeding our expectations. There's some puts and takes to that, but as far as where we thought we would be or where we should be, to realize the synergies we committed to on the cost side, we're in a good spot, getting better every day.

<A – Nadeem Velani>: And Chris, I'd just add, running a fluid network, which we're seeing clearly today is going to help us on us on the operating cost side, ex-synergies. We had talked about finishing the year with a lower labor headcount number, and that's certainly going to be the case. I think we'll have incrementally, sequentially, about a 1,000-person reduction in headcount, and that's just attributed to timing of some of the work projects and also just your normal seasonality.

So, you're going to see us see the benefits of operating leverage. We do expect to see growth in this quarter from a volume standpoint, so that operating leverage is going to naturally provide us the ability to take our costs down and improve our margins, and I fully expect, and I'm sure we're going to get this

question so might as well hit it now, I fully expect a sub-60 OR in this quarter.

<Q – Chris Wetherbee>: Okay. That's very helpful. Appreciate the time. Thank you.

<Operator >: Our next question comes from Scott Group, Wolfe Research.

<Q – Scott Group>: Hey, thanks. Afternoon. So, Nadeem, you got me on the OR question already, so I won't ask it again. How are you thinking about --

<A – Nadeem Velani>: Next question, Travis. Kidding. Go ahead, Scott. Sorry.

<Q – Scott Group>: How are you thinking about RTM growth in the quarter? And then, I know it's early, but when I think back to the Analyst Day, you talked about high single-digit revenue growth, mid-teens kind of earnings growth, do you have visibility to getting to those kinds of growth rates in '24? Is it just too early to tell at this point?

<A – Keith Creel>: Now, let me take the RTM piece. We're slightly positive now for the quarter, Scott. We continue to expect to ramp up in November, December, and I fully expect a quarter probably mid-single, 4% to 5% RTM growth versus last year.

<A – Nadeem Velani>: Yes, and, Scott, I mean, when we gave our guidance, I guess, three or four months ago now, we had talked about the five-year plan, nothing's changed on that front when you look at it from a long-term perspective. We didn't expect it to just be without some level of cycle during that time frame.

We're seeing that macro challenge now. I think we'll see a bit of a softer grain crop in Canada next year. We've diversified our franchise, as John pointed out. We're not as reliant on Canadian grain, but it's going to affect us probably Q2 of 2024.

That being said, I fully expect when we give guidance in January, consistent with what we described in June, that we're going to have double-digit EPS growth in our sights. We always said that over that four or five-year period of guidance that we're going to ramp up the synergies. In the outer years, you're going to be at stronger levels, not only because of the ramp-up in synergies, but also the benefit of some, the ability to buy back shares and lower the share count and what that provides from EPS accretion. So, from our perspective, as we stand here today, I certainly expect double-digit EPS growth.

<Q – Scott Group>: Thank you, guys.

<A – Nadeem Velani>: Thanks, Scott.

<Operator >: Our next question comes from Brandon Oglenski, Barclays.

<Q – Brandon Oglenski>: Hey, good evening, and thanks for taking the question. John, I think, on the last earnings call here, we were talking about incremental business wins that had you guys pretty relatively bullish on the volume outlook in your network for the fourth quarter.

Is that still coming through the way you thought back then? And can you talk to some of those specific opportunities that we should be looking for coming online in the near term?

<A – John Brooks>: Yes, Brandon. So, certainly we've seen, we talked about the win in the ECP area with Shell. We have definitely seen that volume ramp up and that frankly has caused the ECP area to inflect positive. I'll tell you that, that's an area where I continue to see ramp up. There's two or three recent

contract renewals in that area that I feel really good about the share growth that CPKC and the team has delivered in that area.

So, I think you'll continue to see upside in that space. I said we're just getting started on that 180 and 181 train pair north-south. There's a number of pieces of business that you should expect to see start up on that train pair, Chicago, Kansas City, down to and into Mexico and at Laredo.

We're projecting nearly I'm going to say 10% growth in our reefer business this year, in a year where much of intermodal is down that's been an area of growth, and it's going to be an area of growth you're going to see to continue to come on to that north-south train pair.

And then maybe last, I'll leave you with this. As you look across, all the North American ports, I'm quite pleased with where Lazaro Cardenas sits today. It's got, we're seeing import-export growth of about 26% at that terminal.

And if you think about LA-Long Beach, minus 20, Rupert minus 30, the East Coast ports, minus certainly double-digits, Lazaro is seeing growth. And I'm not suggesting, we've got a long way to go and a lot of work to do in a challenged international area, but we are making some headway or doing a lot of ease-of-business thing. We're working with Hapag. I don't know if you saw, but ZIM recently announced a new port of call into Lazaro that's going to start up November 9th for, not only domestic Mexico, but for also shipments into the U.S. So, that's another area that I just think you're going to see us continue to position ourself well. And when things rebound, we're going to be in a really good spot there.

<Q – Brandon Oglenski>: Thanks, John.

<A – John Brooks>: Yes.

<Operator >: Our next question comes from Fadi Chamoun, BMO.

<Q – Fadi Chamoun>: Thank you. Good evening. John, I'm not sure if you're willing to take a stab at, like, this USD350 million. What would that number, hope to look like kind of a year from now, given the pipeline of all these kinds of opportunities that you seem to have your eyes on?

And just to follow-up on some of the cost commentary Nadeem, you had a 10% decline in your ex-fuel costs, kind of Q4 -- Q3 versus Q2 on flat volume, which is impressive, obviously, but were there any unique items in there? Or you're calling headcounts going down again, going into Q4, is this a new level that we get to improve from, or are there some unique items maybe in the second quarter – I mean the third quarter that we should take into account?

<A – Nadeem Velani>: No, this is a new base, now we're going to expect some volume growth in Q4, so we're going to have some volume ramp up. We did have an insurance recovery in purchased services, now we also had higher casualties, so the net of two is a small benefit in purchased services and other, and that's why I mentioned that we'll ramp that up a little bit from CAD506 closer to CAD530, but certainly we expect labor costs to come down as the headcount comes down, and we don't backfill. Attrition does its job on that front. So.

<A – John Brooks>: And, Fadi, I'll just say that I continue to see us exceeding in our revenue synergy area, and I would say, you know what, in our Investor Day, we guided to, sort of what our multi-year plan expectations would be annually. We're right on pace for that, or even, again, some upside as I look to that.

<Q – Fadi Chamoun>: Great. Thanks.

<Operator >: Our next question comes from Steve Hansen, Raymond James.

<Q – Steve Hansen>: Yes, good afternoon, guys. Thanks for the time. John, question for you, perhaps. The disruptions and constraints facing potash have been significant thus far, as you've described. You've now got some constraints in the eastern direction with the seaway as well. I mean, do you want to maybe just give us a sense for how the potash volume outlook looks through the next quarter or two, as we sort of get through some of these constraints?

<A – John Brooks>: Yes, thanks, Steve. And also, Canpotex has a pretty good sales book on for Q4. It's just their ability to execute without the Portland terminal, which is a significant workhorse for them and a good route for us, it's been horribly challenging.

So, I'm optimistic that we're going to sequentially improve. The numbers were so low we better sequentially improve as we move through Q4 in potash. And we'll get that terminal back up at the end of the year. And as I said, I'm hoping we gain some momentum in November and December and really hit the ground running as you look to 2024. I know Canpotex has ambitious plans to sort of gain back the market share that they've lost over 2023 into 2024 as a result of a number of these challenging -- challenges they've faced.

<Q – Steve Hansen>: That's great, thank you for the time.

<Operator >: Our next question comes from Tom Wadewitz, UBS.

<Q – Tom Wadewitz>: Yes, good afternoon. So, I know you've had a couple of questions on '24. I want to kind of circle back to that a little bit. I think the broader theme for transports has been, somewhat weaker freight markets, lowering of expectations for 2024, just to reflect that kind of lower momentum.

I think, you have a lot of puts and takes, right? Like, clearly, the conversation on Potash, you would think that's easy comps in '24, but I know you got Canadian grain down a little bit. So, maybe just at a high level as you go into '24, do you view that as kind of a low base or easy comps so you can have, kind of stronger growth than normal? And that maybe gets you up towards where the street is with 20% earnings growth?

Or do you think that it's like, hey, well, let's be a little careful because there is enough weakness, it's kind of macro weakness in the markets that we ought to be, a little bit careful on expectations? Thank you.

<A – John Brooks >: Tom, I'll make a couple comments and then Nadeem, if you want to make a comment or two. But look, I got bit in 2023. I thought I was had easy comps for potash coming into 2023. And, well, frankly, the numbers were I saw 10% growth in potash and we're at a 10% decline in potash. Fool me once…

So, we're going to be a little more cautious on that front. Again, in that area, I expect to be set up well. You know what, we're going to move a lot of Canadian grain, U.S. grain over the next, couple quarters here, and we'll watch what materializes, Tom, as we move into Q2 and beyond with this crop that's certainly more challenged in the southern part of Canada.

And maybe my last comment is, overall, I feel hopefully good about the synergies and that ramp up as we look to next year. I do believe this pricing environment continues to be favorable as I look to next year. It's all about the macro in the base and how the intermodal business and some of these, very heavy consumer-driven areas rebound or not. And we're just going to be very prudent about how we look at those volumes into 2024.

<A – Nadeem Velani >: Yeah, and Tom, not to get into too much detail, I mean, it is still October here, about '24, but I think just fundamentally, you should think about it in the usual way of how we've been successful in the past, which is, some volume growth, pricing. We've been hurt by inflation. It's been a -- call it a significant impact, I think, in transportation in general in 2023. But I think the ability to price above inflation comes back in '24, which will be positive and accretive.

I think currency is going to be -- could be supportive as well. And so, you factor that in, and you can get to that kind of mid-to-high single digit revenue number. And then I think the more important thing is the operating leverage, as this network starts humming, as we start to continue to invest the capacity sidings that Keith mentioned and Mark mentioned, you get the benefits of running a better network as a whole. You get the benefits of some of the synergies, both on the top line and on the operating costs.

I think it formulates a pretty decent EPS growth number. So, I'm not backing off. We're not backing off what we think we can achieve. Sure, there's going to be some challenges on the macro side that we're fully aware of, and we'll get into that in January and have a better view of that. But as we stand here now, I don't think we're changing kind of the earnings model of how we've been successful in the past both at CP and at KCS.

<Q – Tom Wadewitz>: Okay, great. Thank you.

<Operator >: Our next question comes from Jon Chappell, Evercore ISI.

<Q – Jon Chappell>: Thank you. Good afternoon. John or Nadeem. About six months in where do you think you stand on the unique pricing true-up opportunities that you had across the entire portfolio? Is that something that's easier to do once you've integrated for a full-year, when you have more of a demand tailwind at your back? Or was that something where you can enact pretty quickly and we should start to see the benefit of that as soon as the fourth quarter?

<A – John Brooks>: Yes, I would say we, Jon, we've attacked that pretty aggressively. I feel good. In terms of where we are, we're still discovering things, and I don't know, maybe we're in the mid-innings of that story as a whole. I can tell you, I think you'll start to see some of those benefits become probably Q1 of next year, but we still have a number of areas of opportunity that we're going to work over the next, certainly this quarter and into Q1.

And I do believe that that's given us -- that does give us a little bit of tailwind as you think about some of our pricing and cents/RTM as you look to 2024.

<Q – Jon Chappell>: Yes, that makes sense. Thank you.

<Operator >: Our next question comes from Cherilyn Radbourne, TD Cowen.

<Q – Cherilyn Radbourne>: Thanks very much. Good afternoon. As everyone is aware, the industry is facing a softer freight demand environment. And so, I'd be curious whether there are any capital projects that you would contemplate accelerating to take advantage of lower network activity levels and better position the company for synergy capture once we get into an eventual recovery scenario?

<A – Keith Creel>: Cherilyn, I would say that from a sourcing standpoint, maybe materials, we'll look at that. But as far as actually executing capital projects uniquely in this industry. We've got a pretty full plate across our network in line with the commitments we made to the STB, the Laredo Bridge, the expansion in Bensenville, the sidings. So, for us to have too much of an aggressive appetite, I don't think would be the right thing to do because we certainly don't want to size up and start laying a bunch of people off. I

don't think that's a cycle we want to get into.

So, we'll be opportunistic on material purchase perhaps, on steel perhaps, maybe look at locomotives. We are looking at our locomotive fleet and developing an overall long-term strategy relative to our demands, our unique industry demands for the business growth, as well as some of our ESG objectives and commitments. So those two together may give us some chances but to leverage, but again, I think there'll be opportunistic and not anything large scale.

<A – Nadeem Velani>: Yeah, it's helping some of our, to your point that, the overall capital efficiency on what we can get done in terms of, the fundamentals of changing ties and putting ballast and getting access to the network. So that's where we're seeing the benefit overall, Cherilyn.

<Q – Cherilyn Radbourne>: Thank you for the time.

<A – Nadeem Velani>: Thanks.

<A – Keith Creel>: Thank you.

<Operator >: Our next question comes from Konark Gupta, Scotiabank Capital.

<Q – Konark Gupta>: Thanks for taking my question. Just on the Q4, John, I wanted to figure out mid-single-digit RTM growth. Currently, you are down about maybe flat to down in the first three weeks of October. Coal, potash are doing fine. They're easy comps, but I think intermodal and grain are still a bit soft here.

Do you expect some sort of rebound in grain and intermodal as you head into November/December? And any new contracts you can point to which might start later this month?

<A – John Brooks>: Yes. So, as I sit here today, actually, we're slightly positive from an RTM perspective, Konark, in October. I do expect acceleration as we move into November and December. I think the grain outlook, not only Canadian grain, but also our U.S. grain franchise looks positive.

As I said, frankly, the potash area couldn't have been more troubling, and I'm optimistic we're going to gain some rhythm to close out the year with potash. Again, we're just really ramping. Met coal prices are high. Teck has really strong demand.

We're lapping that outage, so we've got pretty strong growth in not only in our met coal, but some of our thermal coal in the U.S. And I do believe, as I said, you'll continue to see us add strategically volume to our 180/181. We'll continue to ramp up some more ECP synergy wins and share wins that all help sort of carry the day to get us to that low mid-single-digits for our fourth quarter.

<A – Keith Creel >: I'd say the last bit of color I would add to that is don't underestimate the power of revenue and RTM generation with the pent-up demand that we have in Mexico that's obviously been subdued because of the lack of capacity and the operational challenges as we continue to free that railroad up.

In fact, I think right now we're at an all-time high GTM, RTM level in the Mexico franchise with no shortage of demand. So, the automotive market, the metals market, those are two key economic drivers and demand drivers that the more capacity we free up, the more that we get to move.

<Q – Konark Gupta>: I appreciate that color, guys. Thanks.

<Operator >: Our next question comes from Walter Spracklin, RBC.

<Q – Walter Spracklin>: Thanks very much, Operator. Good afternoon, everyone. I wanted to actually come back to John on the West Coast port volumes and the strike that you had alluded to there.

And it's, the July, the strike occurred in July, and you cleared out your backlog pretty quickly, but the volume declines have continued quite substantially here into August and now September. I'm just wondering if you're concerned at all that, given some of this is discretionary into Vancouver, and certainly we saw the decline, even though it doesn't affect you up in Prince Rupert, very strongly, this discretionary aspect of these volumes going into Chicago, have they found another route?

Are you concerned that that's going to be a while to come back? Do you have any view on how long it comes back? And is Mexico enough of an offset? I know, when you look at those port volumes, they're off the charts for Mexico, which is great, into September, and is that enough to offset if there is some more, let's call it structural impact from this strike that happens in Vancouver? Can you entirely offset that by Mexico, or is it just not big enough to offset that kind of decline if it were to continue?

<A – John Brooks >: Yes. So, maybe to answer that question first, Walter, I think that's a fair call out. No. I mean, we expect growth at Lazaro, and I said, I'm excited about the future of what we can do at that port, but it's going to take some time to ramp that up.

So that is not a one-for-one by any means. I do believe structurally there's been somewhat of a change on the West Coast ports. By far, and you just look at our train lanes and our and where our volume -- import volume is going. It's all domestic Canada. And we've got very little volume going into the U.S.

I think it'll be a function of two things. One is how quickly this market actually does rebound. I just had my team visiting all the steamship carriers over in Asia and also in Europe. And they didn't paint a very bright picture. Certainly, it's going to be through 2024 as we see that ramp up. And then, we'll have to watch. Certainly, there's a reason why Vancouver and Prince Rupert and that had success.

We had port fluidity. We have some economic advantages. As things tighten back up and as the volume improves in LA-Long Beach, that is really what will be the tell on if you see that freight moves back up there, but in the meantime, I can tell you we're focused on the business that we're handling within domestic Canada and we are laser focused on how we grow this and leverage that port with a ton of capacity down at Lazaro, and again, it won't be a one-for-one offset, but I'm confident we will grow domestically into Mexico and also into that Texas market.

<A – Keith Creel >: I think a very encouraging comment about the Port of Lazaro. We just had a trade mission, actually the governor of Michoacán came up and met with John and myself and the team two weeks ago in Kansas City, so that's a… that's a local government the state governor that is motivated for economic growth. He understands the potential that Lazaro has, and I can tell you this historically KCS had challenges I think structurally perhaps, they didn't go didn't go deep into the U.S. and have an opportunity to provide competitive interline rates to a West Coast alternative.

That's not the case now, we do. And I think the other challenge was the reliability of the gateway. There was a lot of issues with teacher strikes, with blockades. I can tell you that governor was proud to tell us the day he met with us two weeks ago, that was day 702. He is committed to keeping that track open. He is committed to growth over that port. And not just that port, there are many other products. Once you create the ecosystem in the transportation, the reliable trains back and forth to take products that are grown in that state, that are consumed in the Midwest, and consumed in parts of Canada, that this new reefer ecosystem we're creating can benefit from and serve.

So, more to come on that. Again, does it ever replace all of it? No, but it's certainly a unique growth opportunity for us coming from Mexico, both on a domestic move, as well as leveraging the international opportunity.

<Q – Walter Spracklin>: Appreciate that color, Keith, and John. Thank you.

<Operator >: Our next question comes from Ken Hoexter, Bank of America.

<Q – Ken Hoexter>: Hey, great. Good afternoon, Keith and team. So, I think, Nadeem, just a quick numbers question and a long-term question. Just the CAD51 million, is there a reason why you didn't take that out of them? I mean, you took a million dollars here and there and CAD22 million numbers. Just want to understand why that was left in, if it was a historical thing?

And then, long-term, it's kind of a tale of two cities here on the, I guess, prepared remarks, it was a bit more sanguine about the economy, and it was maybe even more negative than what we heard from your Canadian peer or the Eastern Rail that we just heard from. But now you're talking about kind of mid-single digits, and it seems like a much more upbeat, I don't know, Q&A. It's just a very different position. I just want to understand the message that you're trying to send here in terms of the outlook because Nadeem, talking about Sub-60 or into the upper 50s on the OR, just maybe delve into the thoughts there?

<A – Nadeem Velani>: Yes. I mean we answer them like we see them Ken, you've known us for a long time and that's the visibility we have on near-term and what we expect for 2024 so that's our honest and transparent answers of what we think we can deliver and what we hold each other accountable for.

So, I'll leave it at that. I mean, I don't. There is pause for concern with the macro environment. We're not of the view that it's a robust economy by any stretch. But we think that what we can control, we're focused on controlling and will deliver. And the visibility that we have on the top-line as John mentioned in the near-term over the RTM of call it 3% to 5% I think is genuine.

Why we didn't strip out the insurance, we had I think, CAD40 million increasing in casualty made up of a bunch of one-time items through the year. CAD20 million jury settlements and such, same reason I guess we didn't strip out when we had about CAD150 million impact from the flooding and cost associated in 2021. So, we're just being consistent with how we approach that would be how we thought about that insurance recovery.

<Q – Ken Hoexter>: Great. And if I could just squeeze in a follow-up. I get you were just talking about Mexico you sent a team of 50 or 200 down there. I guess Keith, is there any update on that have you changed any operations around?

<A – Keith Creel>: Yes. Yes of course we have. We've tweaked and adjusted. But yes, we initially started, Ken, with 50, 52 officers that were down there around the clock. It was a group of every discipline within the company, from engineering, to operating, to IT, to customer service, to kind of de-scramble the egg, for the lack of a better term.

We were locked up. We were congested. So, we de-bottlenecked. We've now shifted from a response phase to an enhance and build phase. We made structural changes from a leadership standpoint. John Orr, who led the team, is now focused day-to-day.

He's responsible for all the Mexican operations, and actually up to Beaumont, which is the crew change point where the Tex-Mex, they take the train south through Houston. That's a natural break. And then, of course, Mark has everything north of there.

So structurally, we've got a very focused team. He's continuing to develop talent. We've got the place running smoothly again. We're making progress with labor, which is very encouraging. It's not the kind of progress that creates monumental quantum change like we've experienced on other parts of our network and our history, but I'll tell you this, to make the change that we're talking about relative to what's been changed in the past is a testament to the understanding and commitment of the union leadership.

I met personally with the President of the union and explained our journey, explained our opportunity and how we could uniquely partner with our employees, his members, and I can tell you he and our members are excited and energized by it.

So, there's structural change, there's progress that's ongoing, and what I would say is expect it to continue.

<Q – Ken Hoexter>: Thanks for the time. I appreciate it.

<Operator >: Our next question comes from Brian Ossenbeck, J.P. Morgan.

<Q – Brian Ossenbeck>: Hey, good afternoon. Thanks for taking the question. So, I just wanted to ask maybe, John, about the closed-loop automotive potential. It looks like you've been making some significant progress more recently. I don't think we heard an update on it this call, but just if you can go back to that. Are you close to ordering the cars? What's been the, to get the guaranteed car supply, what's been the uptake and the interest level from some of the OEMs? Obviously, some noise with the UAW right now, but is that something we could see perhaps coming forward in 2024? Thank you.

<A – John Brooks>: Yes, Brian, it's been strong. Maybe as far as an update, we've got construction underway in the Dallas market for our auto compound there. We expect to see that up and active and frankly sold out by mid-next year.

So, quite excited about that. I said the closed-loop, we've got currently receiving new bi-levels right now. I think, we'll receive upwards of 1,200 or so over the coming months to really be targeted at that closed-loop model. So, we've got some good early wins there, and I expect you to see that being fully deployed as we move into the start of 2024.

<Q – Brian Ossenbeck>: Okay. Thanks, John.

<Operator >: Our next question comes from Ben Nolan, Stifel.

<Q – Benjamin Nolan>: Yes, thanks. I appreciate you guys fitting me in. John, I remember, as it relates to potash, I remember a couple years ago, or last year maybe, you mentioned that there might be some opportunities to move potash to the Gulf Coast. Just given everything that's gone on in Portland, is that something that's materializing, or is there an opportunity maybe to do that?

<A – John Brooks>: Yes. Ben, I think right now, given everything that's gone on, there's a little bit of pause in terms of that. I don't think anything's changed in terms of what we believe the opportunity to create sort of what I would consider a true third outlet for export potash out of Canada, whether it's K+S, Canpotex, Future BHP, I think we continue to see that as a long-term opportunity.

In terms of timing on that, it's probably pushed out a little bit further than when we were thinking about it about a year ago when I spoke about it.

<Q – Benjamin Nolan>: Alright. I appreciate it. Thanks.

<A – John Brooks>: Thanks, Ben.

<Operator >: Our next question comes from Justin Long, Stephens.

<Q – Justin Long>: Thanks. I was wondering if you could provide an update around your expectations for the level of inflation that you're seeing in the business this year, and how that compares to your early expectation for inflation as we move into 2024? And when you think about that kind of price versus cost gap, how you see that trending in the quarters ahead?

<A – Nadeem Velani>: Sure, I'll take that, Justin. So, we've seen all-in inflation closer to that 7% level. And as you know, I mean, it's been pretty, pretty apparent, a lot of that has been on the labor side. So, the biggest cost buckets, we have seen also, up north, the impact of some of the work-rest rule changes that have also impacted comp and benefits.

So overall, inflation has been a challenge. It's been a headwind, much higher than we anticipated at the beginning of the year. It's partly the reason I think that margins have been where they are. I would say that, we expect in '24, that to moderate, I think as some of the rate hikes and some of the action by the Fed and Bank of Canada kind of moderate. I think we should start seeing that settle. I think we should start seeing even some of the recent inflation numbers have moderated. So, I think we'll be closer to call it a 4% level rather than that 7% level.

And I think that's what gives me confidence in our ability to price above inflation. We're still getting strong pricing. John and his team have done an excellent job. It's just -- it's been a high bar this year in particular, just because of the call it one-time nature of some of the labor increases.

<Q – Justin Long>: Got it. Thank you.

<Operator >: Our next question comes from Benoit Poirier, Desjardins Capital Markets.

<Q – Benoit Poirier>: Yes. Thank you very much. Good afternoon, gentlemen. Keith, you provide great color about the opportunities and John about the obviously Mexico but you're also create the rationale around Vancouver what's happening, could you maybe provide more color about the eastern part of your network, if we look at the port of Montreal there's an upcoming labor agreement with the dock workers.

So, I'm just wondering if you're having any discussion with shippers about some potential cargo diversion and whether the port of Saint John could get some volume uptick and with respect to Contrecoeur expansion, we've seen some announcement lately, I know it's a very long-term opportunity which is having some challenges, but how do you see the potential opportunities for CPKC longer term? Thank you.

<A – John Brooks>: Hi, Benoit, I would say, yes. Again, I had the team just recently overseas meeting with all the various ocean lines and certainly Montreal and the, I don't know, it seems like annual struggles there with labor certainly is a big topic. Unlike years past we really didn't have an option but now we've got a ready-made option with a lot of capacity and new equipment and an eager partner in DP World to get after it.

So, I do believe those back stops in terms of, if freight does need to move out of Port of Montreal, St. John presents us now a great opportunity that to move that freight. In terms of Contrecoeur, as of right now it's not a facility or port that we will be looking to serve, now who knows, those discussions maneuvering of access to that port is ongoing but our frankly our efforts are focused on continuing to service the Port of Montreal and grow St. John as fast as we can grow it.

<Q – Benoit Poirier>: Thank you very much gentlemen.

<A – John Brooks>: Thanks, Benoit.

<Operator >: Our final question comes from David Vernon, Bernstein.

<Q – David Vernon>: Hey good afternoon guys and thanks for hosting the call. I wanted to dig in a little bit to the headcount commentary. It, sequentially it looked like we had headcount growth and Nadeem, I think you mentioned we're going to be coming down in headcount. Can you help us understand kind of what we should be expecting in sort of Q4 for cost per employee and where the heads are shifting and what's driving sort of the shift? Is this in the transportation function? Is this overhead functions? Is this just moving jobs up and down the bigger network here? I'm just trying to get a sense for what's happening with the choppiness in the headcount? Thanks.

<A – Nadeem Velani>: Fair question. So, we had anticipated this for some time. I'd I kind of pointed to Q4 as an opportunity to see that inflection. We've been ahead of the curve in terms of hiring and training, just given the challenges I think the economy has seen in terms of getting qualified employees and servicing customer. That doesn't change, but, as you see attrition work through our industry and work through our system, and as volumes don't materialize the same way that you can expect, grain, for example, we know that it's going to be less robust next year than this year.

You can make a call in terms of what you do from hiring and training. And so, there's some seasonality as well, as I mentioned earlier, in terms of headcount. And then when you think about the opportunity as far as synergies, we were going to have some natural opportunities as far as headcount on the synergy side. And then, as you get operating leverage, as you turn to being able to run longer trains, more density and so forth, you need less employees per GTM and for the volumes you're moving. It's a combination of all those factors that's going to drive a bit of a reduction in headcount sequentially.

And as far as comp per employee, somewhat dependent on stock-based comp. That's been a bit of a tailwind near-term. Who knows where that's going to end at the end of the year, but kind of mid-single digits is probably a fair estimate as we stand here today.

<Q – David Vernon>: Alright. Thanks very much for the added color, guys.

<A – Nadeem Velani>: Thanks, David.

<Operator >: We have reached our allotted time for Q&A. Yes, sir. I'd like to turn the call back over to you.

<A – Keith Creel>: Okay. Thank you, operator. Well, listen, thanks for everyone taking their time to spend with us this afternoon. I can say in closing that we're six months into our forever story, and I'm extremely proud of the progress that we're making, both integrating and executing.

We're realists. We're not immune to the macro challenges that we're all facing with this economy, but I can tell you we're focused on controlling what we can control, and that's to operate safely always, efficiently, and continue to sell to what is a very unique three-nation network that we've created that's allowing us to grow in a unique way at a micro level, be it share-shift, be it customer solutions with new markets, be it take trucks off the road in spite of the macro environment, and when the macro comes back and turns favorable, now it gets exciting.

So, we look forward to sharing our fourth quarter results next time we talk in January.
Thank you.

<Operator >: This concludes today's conference call. You may now disconnect.