Transcript

Barclays 41st Annual Industrial Select Conference

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Webcast

Corporate Participants:
Keith Creel – President & Chief Executive Officer, Canadian Pacific Kansas City
Mark Redd – Executive Vice-President & Chief Operating Officer, Canadian Pacific Kansas City

Other Participants:
Brandon Oglenski – Analyst, Barclays

PRESENTATION

Brandon Oglenski
Analyst, Barclays

Good morning, everyone. Welcome to our third or fourth session here at Barclays 41st Annual Industrials Select Conference.

I'm Brandon Oglenski, Airline and Transport Analyst. And thank you, everyone, for being here. Up next, I'm very excited to host Canadian Pacific Kansas City. And with us from the company, Keith Creel, CEO, and Mark Redd, EVP, Chief Operating Officer. I know we're going to have a great chat here, but just like every presentation, if we could do the audience response, question number one here.

Keith, we're going to find out how many people own your stock. In the back there, can we queue up question one? Thank you. Do you currently own the stock? Yes, overweight, market weight, underweight or no.

Keith Creel
President and CEO, CPKC

I'm way overweight.

Brandon Oglenski
Analyst, Barclays

Long CP. All right, there's owners here, Keith. Question number two, please. What's your general bias towards Canadian Pacific Kansas City right now? Positive, negative, or neutral?

All right, and then question number three. In your opinion, through-cycle EPS growth for Canadian Pacific Kansas City will be above peers, in-line with peers or below peers? Thank you all for participating.

QUESTION AND ANSWER SECTION.

<Q – Brandon Oglenski>: All right, Keith and Mark, thank you guys for being here. We've just gone through -- rails are always an exciting sector and these past few weeks aren't letting us down. But from your perspective, we closed on Kansas City, drove the final spike in April of last year. What's been the outcome in the past 9 to 10 months with the merged networks?

<A – Keith Creel>: Well, I'll tell you, number one, thanks for having us here again, and I'm honored to have Mark, the guy that makes my life a lot easier every day running our operation. He's one of the best operating chiefs, if not the best, in the industry. I'm blessed with two very strong operating minds and very committed. So thank you for being with me, Mark.

Let me say this. And I say this all the time, and I kind of have to pinch myself. We have created something extremely special. We're 10 months into a forever story, not a multi-year plan story, a forever story, building out a network that, number one, is unparalleled and that is on the path of becoming the most relevant North America.

Not only because we connect and we're the only railway that ever will single-line serve Canada, US, and Mexico, but because of what's happened even before our transaction and since the pursuit of our transaction with the near-shoring and ally-shoring, the growth that this has unlocked by allowing the single-line network to become the backbone and the infrastructure that allows manufacturing to come to Canada, that allows product to be produced in Mexico, to come to the US, vice versa. To create an ecosystem to serve kind of the spine of industrial growth at a time where we're going through a revolution, that's truly unique. So our team overall, a lot of work, a lot of complexity.

If you think about this, putting two large companies together takes a lot. And history says railroads haven't done too well with it. A lot of investing of time, energy, money, effort to make sure that history shows we got it right.

So we take a very methodical approach. The team has worked countless hours, and while we've worked countless hours to integrate, we've also had to make sure that we've kept the railroad running right for our customers so that the STB, who quite frankly, took a lot of risk in approving our transaction from a political standpoint, we've got to do well on both parts and Mark and team, and John and team in Mexico have done a phenomenal job of doing that.

We've got a stable railroad. The marketing team has gone to work creating, converting the synergy pipeline, creating solutions for customers that, quite frankly, without this extended network had never been possible. And that's rail-to-rail conversions. That's truck-to-rail conversions. That's ag. product that we're moving in a more efficient way. That's international intermodal optionality with the ports that we connect. That's domestic opportunity, making that border more seamless. So all those things have been occurring for us.

We kind of progressed through the year, got to the fourth quarter, and you started to see the potential. In spite of the macro, in spite of before at legacy-CP, grain is king. We were a grain railroad. We're experiencing a drought. We still closed last year as the only railroad with positive growth. You get into this year, that momentum that was created, we had 3.5% growth year-over-year in the fourth quarter.

That momentum pulling into the first quarter, same opportunity, still a macro challenge. But in spite of that, and in spite of the weather, I think with the weather that we had in January, we finished the month 7%, on an RTM basis, down.

We've now today, not quite at the end of February, we're just a little over 2% down. And we get in the next month with this increased demand, with these synergies coming online that we've converted last year, we'll get to a place when the quarter with a strong operating performance, controlling costs, turning assets from a top line standpoint we'll be, from an RTM standpoint, either flat to be a little bit positive, which sets up extremely well to meet or exceed our expectations for the year from a guidance standpoint.

So overall, this railroad is becoming more and more relevant every day, partnering with our customers and creating these new supply chain solutions that have never been needed more in this industry's history.

<Q – Brandon Oglenski>: Keith, maybe that's a great segue for Mark. Given your past history with the network, I think under Kansas City Southern, I covered it a long time, always operating challenges south of the border, never quite coming to plan. At least that was my perception for quite a period of time. What have you guys done differently now with operations in Mexico?

<A – Mark Redd>: Well, I would say as we, as we learn the railroad as CP, certainly John has done a lot of work, John Orr has done a lot of work at the south of the border with some of the unions, some of the, the way they do business. But it came apparent during the summer as we focused on the US operation, strengthen up the KCS product, Mexico we need to get boots on the ground in Mexico.

We put the task force in place. John led it. It was really about just, not major changes, but understanding who does what, roles and responsibilities, how you execute in the yards, how you teach people to execute at a greater level like CP would do in the terminals. Boots on the ballast. We've talked about the auto industry. We've talked about a couple of the major key customers that we had in Mexico, but it was boots on the ballast, understanding how they did business.

Are they working seven days a week? How do we cut minutes out of the day? How do we elongate the time that we have to switch the box car, make the cycle, make the turns? How do we get different type of equipment out of the system so we can get inventory down? Obviously, dwell goes down, obviously the velocity increases as a result. So it's just really just basic blocking and tackling is what we did.

We still have people that go in and out today just to understand business flows, understand products of customers, and how we can mutually make each other better.

<Q – Brandon Oglenski>: Well, and I agree, Keith, because the history of network combinations historically across transport networks has been pretty shaky at best, but it seems like you guys have done this pretty seamlessly.

Mark, was there a lot of additional resiliency costs that you guys can work through productivity, looking forward?

<A – Mark Redd>: Moving forward, yes. You hear me talk about these train master stories I have today as I talk about just switching a box car, just getting a locomotive off a service track.

And if I look at it just from an engineering standpoint, we talked about it on the first quarter call -- or the fourth quarter call that we talked about how we can do more in house for engineering. We can pull tens of millions of dollars out just by the way we look at rail, the way we in-source our ties at our tie plant that KCS owns, how we have wheel shops in Winnipeg and we can create synergies with each other because we're working together.

Certainly different things like that. Engine overhauls that we can expand at Shreveport. Shreveport has a huge facility, and they can do more work in that facility. We can upgrade to a third shift, which we have done, and we can create engine overhauls. We can do that type stuff ourselves where we don't have to contract it. Number one, our employee gets a better job. Number two, the employee base is stagnant -- I wouldn't say stagnant, but more 365, every day. They can do the work three shifts a day, and that's what we want. If we can in-house work, we will.

<Q – Brandon Oglenski>: Well, and Keith, maybe if we can come back to the annual guide, because I think low single-digit outlook for volumes, is that correct? Or revenue.

<A – Keith Creel>: Yeah, that's correct. Volumes.

<Q – Brandon Oglenski>: Right. I got a little bit of feedback from investors. Is that a good outlook for CP? And I think maybe looking back on the call, your outlook is still that you want to outperform industry volume outcomes. Is that correct?

<A – Keith Creel>: Yeah, that's correct. Kind of getting to the nuts and bolts of our guidance, though, as far as growth expectations. That low single-digit is driven by synergies. That's the difference. That's the uniqueness of this franchise. Because like all of the railroads, we're in a very challenging macro environment. And if you look at our railroad specifically, grain is an excellent example. That's a 1% to 2% headwind of total volume for the railroad that we're having to overcome.

So based on what we see, a flattish type macro-level, base business that we've always had being flat. In spite of those headwinds, 2% to 3% of RTM growth is driven by synergies, and that gives us positive RTM growth. Now, the second half, our expectations are based on our normal grain harvest. So as long as we have a normal grain harvest, expect us to do that. If it's better, it's a tailwind.

The other thing that's occurring that we see strength in, that is offsetting some of the weakness on the domestic side is international intermodal. Last year, if I go back to the fall, the steamship lines had just taken one of their ships out of the series that we're calling on Vancouver, the PN3, very large ship from the Alliance, 13,000 TEU ships.

So they make these adjustments every six months, and based on what they saw, and of course, they had no idea about the Red Sea. They had no idea about all these geopolitical events that would occur. They saw less demand. So we modeled that. What we're seeing now is double digit. I mean, Vancouver's busy, extremely busy.

Some of that is Red Sea. I think this is going to accelerate in anticipation for a potential strike on the East Coast. We forget that strike or the potential strike we had on the West Coast shifted a lot of businesses as a response to protect your supply chains through the canal to the East Coast.

That traffic now because of the same thing on the east, is going to shift back to the west. You get the Red Sea, you get the streams they consolidated to play on Vancouver more so than alternative ports in Canada because there's more of a consumption market. So again, if that continues, and right now, at least for the short term, we see that demand sustaining itself. Then again, a good macro, get a little tailwind and we have an opportunity to do some unique things.

<Q – Brandon Oglenski>: And I guess, thinking beyond ‘24, how does the team deliver on longer term targets, Keith?

<A – Keith Creel>: Yeah, that's the beauty of this thing is it all plays out. So again, I'll go back to our plan. Asset turns, network capacity, fluidity; it's all part of a true PSR model. You can't do one without the other. So you can't oversubscribe and bring synergies on two paths without the infrastructure.

So Mark and the team got six sidings done last year out of our plan we submitted to the STB of a total of 30 we're doing, and this is essentially from across Wisconsin, we call it River Junction on the legacy-CP down to the Laredo border. We're going to get about another seven or eight this year. As you layer this business on, assets start turning faster. 180/181 service gets better, automotive equipment turns faster, grain moves quicker. You start to layer that on top of these solutions, the synergies, and you start to see growth.

Now, this year, what I call kind of a rail-to-rail conversion, the value proposition, we won some significant win on ECP. That contract was ordered in September. We don't have a full year of it.

Obviously, it's still ramping up. So ECP, you're going to see big growth this year. The automotive piece, we set a record last year. We combined networks. We'll do the same thing again this year.

And then as you get into next year, there's one of those big three OEMs where there's additional opportunity that becomes available to compete for with this single-line service network and our closed-loop concept that we're selling to the marketplace on the automotive side, another tranche of business. And then you get into ’26, again, I'm sticking to automotive. There's another very large contract that comes into play. And again, we won't go after all the business. We're playing to the strengths of the network.

But that single-line served ecosystem, this closed-loop project we created with the automotive industry has gotten legs, and it's gaining a lot of traction. And the way I kind of look at it, it gives you reliability, gets your product to the marketplace, builds those dealerships up, and there's a demand for those cars and the OEM that does it, they have the vehicles there reliably, they win market share. The OEM that doesn't, they're at a disadvantage.

So again, when one does it and it makes sense, oftentimes the other is going to be interested as well. And that's the demand we have. The compound that we talked about at Investor Day, we needed a bookend or a destination terminal in the Dallas market. That compound comes online at the end of the second quarter. We literally have it sold out already.

Do we expand it? Do we do something different? We'll see. We'll wait and see. But again, that becomes part of the sale, part of the value proposition to continue larger than normal industry growth when it comes to taking this network and creating and optimizing this product that we're selling to our customers.

<Q – Brandon Oglenski>: Well, it sounds like you're being quite thoughtful with capital. Mark, isn't there expansion to Laredo Bridge coming online later this year? What type of capacity is that going to open up for you as well?

<A – Mark Redd>: So a couple of things. We touched on just the siding capacity downfield from the Laredo Bridge itself, open up different locations where we can run trains, but also just manage the siding itself. Who meets trains, what trains take on the mainline, all of that increases capacity. So when you get to the bridge, end of this year, we'll have the second bridge open. And what that will allow for us is today we have a four-hour window where we swap trains back and forth.

We can get away from a four-hour window and run on demand. The work that John Orr and KCS and Pat has done in the past with how you cross that bridge has been phenomenal. The security work that they've done between those two yards, 18, 20 miles, it has set us apart, away from the other competitors where we don't have the line blockage, we don't have tracks taken out of service because of security risk. But layer on top of that the foresight that Pat saw to build that bridge, we just did a double capacity across that bridge easily for us.

<Q – Brandon Oglenski>: And if there's any questions in the audience here, just raise your hand. David?

<Q – Unidentified Participant>: You could have maybe some uneven grain volume coming in the second quarter. I think moisture impacted you guys significantly. What are the challenges in operating to try to deal with abnormal grain volumes and then a ramp up into the back half of the year?

<A – Mark Redd>: What I would say to that is there's balance between some of the potash or some of the balance that we've talked about with international. It's understanding where the business flow may be and increase that business flow. Grain may be down a bit. It's all going to depend on when the farmer wants to sell that grain as well, and what route that farmer takes.

We'll be certainly focused on what lane. If I need to tie up locomotives, if I need to do what I need to do operationally to pull costs out of there, that's what we'll do to make sure we balance the revenue and the cycle of the expense, and that's what we would end up doing.

<Q – Brandon Oglenski>: Keith, can I ask you about culture? Because I think that's been a differentiator at CP over the years. What's your priorities now with the combined business from a management perspective and a frontline employee perspective?

<A – Keith Creel>: Culture was literally the foundation of everything we do. You can't execute your operating model if you don't have the right culture. And our culture is defined as a constant pursuit of safety and operational excellence. And if you do that and you have a discipline to do that, you run a plan, you have a disciplined plan, you measure everything, and you hold people accountable, then you can create a culture of execution. That said, coming into this merger, we've created, I call it constructive tension. I call it accountability.

Back in 2014, when we came to CP, there was a lack of common vision and a common culture. You had a culture in Montreal, you had a culture in Toronto. You had a culture in Calgary. The Westerner saw differently than the Winnipeggers. And I kind of learned that in my previous life living in all those locations. And the key to culture is making it consistent, create a vision that people understand what you expect them to do when you're not there. It's that simple.

But when we approach this, we spent a lot of time ready to deploy the leadership training. We call it Consequence Leadership, is what it's called. I don't apologize for the name, because the consequence can be a good thing or it can be a remedial and constructive thing. So we took our training, we trained over, since 2014, thousands of officers in the CP network.

Mark and the team trained. We have a training team, and as soon as we took control, we started having workshops. And the way we do it, the way we did at CP, the way we're doing at CPKC is we prioritize the operating first, because that's 85% of what we do. We're an operating company, so we get our operating officers training. It's typically a two-day training we go through. We participate. It's leader-led, senior officers. I speak to the groups myself. It's my mandate. It's not optional. This is the way we're going to run the railway. It creates a common language, a common culture, common vision.

We integrated, started on the KCS, the Legacy-KCS network in 2024. We're now expanding that into the Mexican network. So the vision will be in a very short period of time, you've got common vision, common language, common direction. It's a culture of accountability with a team that, they understand, and this is the piece where those values come in, when you can tap in emotionally to somebody's pride, and I believe as a leader, you leave it better. I believe as a leader that human beings are made and wired by God. If you serve something bigger than yourself, that's more important than money. It just truly is. We want to know that we add value as a human. We've created a network. Tap into pride.

And that's the one thing people ask me. What surprised you about this? Well, maybe the politics are a little bit different in Mexico, arguably, but the pride that's in that country and the people that work there, their work ethic and the pride they have to work for the railroad. And now you think about the backdrop of both Legacy-KCS, Legacy-KCM and CP. Both railroads, the two smallest, for decades.

We've been pushed around, kicked around. There's a mentality that until we kind of restore ourselves, especially at CP, I took great pride in kind of running CP in the ground when I worked at the other company.

They didn't have the same product, they didn't have the same pride. But when I came there, that was a different way to do this. And we can win in the marketplace. You start to create that success, people taste that, they experience that. It's not just about making money, it's about changing people's lives.

And that might sound high level, but that's what it is. You've got an opportunity to work for a railroad with a network to build to, you never had in your life. You don't have to apologize anymore. You don't have to worry about UP penalizing you if you don't participate the way they want you to participate. We have our own network now. We can partner with UP, we can compete against UP, we can partner with NS, we can compete against NS, we can partner with CSX.

I mean, it's such a unique ecosystem we've created. And to be part of that, especially back to Mexico, that is a growth engine, and it's going to continue to drive growth. It's a gem. You got to go through the politics, you got to do the hard work. But the opportunity for growth there is unlike anything in North America. Most people knowing they're part of that, from being the little railroad to being the only railroad that connects all three nations, and we're creating value for all stakeholders, that's a powerful, powerful human motivator. It's hard to replicate. So that's all about culture. That is the foundation of everything we do. That's what you lay with (inaudible).

<A – Mark Redd>: Brandon. If I could, I would add just another point to that, because you give me the greatest compliment in the back of the room when you said, hey, I still have your coin that you gave me, Mark. And it's about Home Safe. And it's that connection you have with individuals, connection with peers that you have at ballast level. When you see something, you say something, you stop someone before they get hurt.

We are the best railroad at safety, we, by far. We have led that for 17-plus years now. But when you said that to me, I smile internally because I think about, that's the message we're sending to our employees. Our employees know that in spades, they understand what Home Safe means. And that's why we have that interconnection with our employees, the union, the collaboration we've had from Day One with CPKC, with the KCS union leadership and KCS at the moment.

<Q – Brandon Oglenski>: And these are the things that, intangibles you can't put in the spreadsheet as analysts, but definitely drive outcomes for organizations. I think probably reflected in your valuation relative to others, too. Can you talk maybe more specifically, though, about some of your labor agreements? I think we have negotiations going on in Canada, correct?

<A – Keith Creel>: Yeah, we've got, I guess, tale of two stories I can tell you. In Mexico, I'm extremely pleased that we just recently renegotiated our contract and it included what some might deem as small work-rule concessions and changes. They're monumental because history says there's never been none. Annually, you renegotiate annually, you're just replicating with wage increase, with cost increase, with no productivity offset.

You're kind of memorializing the future forever. That's been the Mexican model. With this network and with this vision, we created a relationship with the Mexican labor leader and his team that we're building trust. And in exchange for that trust, in exchange for a better opportunity to better themselves financially, we've got some work-rule flexibility we never had. Now, how do I quantify that? You'll see it in asset turns. You'll see it locomotive productivity. You'll see it on the cost synergy

side, which also replicates to the service side. So that's a great story for us. Beginning of many, many chapters, I think, of progress.

Now in Canada, it's kind of more of the same. We're facing a negotiation. The thing that's unique, the contract itself with the conductors and engineers. For us, it's 3,000 of our employees, hardworking men and women who move those trains day in and day out, which I have a ton of respect for. But unfortunately, leadership and vision is a challenge, and change is a challenge with their union officers.

History has shown the last nine -- nine of the last ten negotiations have not been successful negotiation. It's been through back to work legislation, it's been through a strike, it's been through an arbitrator. And it looks like we're kind of on the same path in all honesty. The thing that's unique though, is that, first time in my career, I don't know, it's been decades, I don't know in history, that show has been the same in Canada at all. Both railroads are facing the same challenge.

And on our side, not only are the running trades employees in conciliation now, which we triggered last week, also the dispatchers, which are represented by the TCRC. We tried to negotiate an agreement with the TCRC dispatchers last year. We have a phenomenal relationship with them, but their internal politics said, no, we're going to wait. We're going to do it together.

So they have both railroads aligned, which creates some risk, obviously, but it also is a huge challenge for the country and for the country's leadership. Are you going to shut the entire nation down? Are you going to shut every port down? Will they do it? Is that a potential outcome? Sure it is. But how long can they do it?

But the alternative is people say, well, why don't you acquiesce? Well, the reality is, at least for us, I can't speak for CN, the demands they've asked for exceeds $700 million of demand. If I were to say yes to that, it's not just cost implications that could take me out of market and not allow me to compete, which ultimately would cost them to lose jobs, not gain jobs. It's also the complexity. You add more and more layers to work agreements that prevent you from running trains and running a scheduled railroad, and it bubbles over into what we've committed to our customers, which also could lead to either you don't realize the growth or you lose market share.

So either of those outcomes is not a positive outcome. So it's kind of a choice of unless through this process, and I hope they do, become realistic and understand that we'll do a fair deal, but we're not going to be held for ransom. It just says you're better off -- it's the lesser of the two evils.

You take short term pain now, or if you acquiesce, it's baked into the base forever. And we're not going to acquiesce. It's not in the best interest of the employees. It's not in the best interest of the country. The other unions that are impacted that are coming up to negotiate, or our shareholders. So we'll see how it works out the way they should expect it to play out.

The way the laws work in Canada, the right to strike or the right to lock out are protected. Self-help is protected. So if you get to an impasse, which we've negotiated for five months, and the straw that broke the camel's back, in all honesty, was last Friday. We gave them two alternatives, a traditional contract renewal with their wage increase, market wage increase, and then a more progressive agreement, which we're giving scheduled time off, a significant pay increase and in exchange (inaudible). They told us they'd give us a response by Friday. Well, at Friday, the response was, we'll tell you next month.

And if you think about what's playing out later this year with two of the unions, there's already enough risk. I said, no, we can't do that. So you have to serve (inaudible) an impasse. It starts around

a six-day clock. The government appoints a facilitator, mediator within 10 days, and then you go through negotiations. And in the end, if you don't come to an agreement, this is going to take us probably to the second week of May. You've got 72-hour notice. Either serve them to lock them out or they serve us to strike.

So again, I'm optimistic, but I'm a realist. We're going to come in good faith and continue to negotiate. And I hope with the help of the mediator we can get there. History says I might be more optimistic than realistic. I hope I'm wrong and I hope we get to a good outcome. But in the end, if we don't, we'll recover.

If both railroads are on strike, the business is going to be there to move. The customer is going to need us to move it. Once we come back online, whether it's a week or 10 days or two weeks, we'll bounce back. We'll bounce back.

<Q – Brandon Oglenski>: I appreciate that update. We're almost out of time. If we could just queue up question number 4 for the audience. Keith, this has been a great chat. By the way, in your opinion, what should CP rail do with excess cash: bolt on M&A, larger M&A, share repurchase, dividends, debt paydown?

Last one? We'll just go immediately to question five: your opinion, at what multiple 2024 earnings should CPKC trade? And then very quickly, question number six: in your opinion, share price headwinds for CPKC, core growth, margin, capital deployment, or execution? Keith, Mark, while we get these results, I really appreciate you guys coming down. I hope you have a few interesting weeks ahead of you here, Keith, but definitely looking forward to the long-term potential of this network.

<A – Keith Creel>: Thank you for the opportunity and I thank our investors for their trust. And those of you who are considering us, we've got a unique story in this industry. If you care about this industry and understand the way we do business and how and what we're building, it's special.

<Q – Brandon Oglenski>: Thank you both.

<A – Mark Redd>: Thank you, Brandon.