Transcript

2024 Bank of America Transportation, Airlines, and Industrials Conference

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Webcast

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

Other Participants:
Ken Hoexter – Managing Director, Bank of America

PRESENTATION

Ken Hoexter
Managing Director, Bank of America

Again, for those just coming into the room, welcome to day two of our 31st Annual BofA's Transportation, Airline and Industrials Conference.

I'm Ken Hoexter, for those of you new into the room, I'm BofA's Airfreight and Surface Transportation and Marine Shipping analyst.

Next up, we've got Canadian Pacific Kansas City Chief Marketing Officer, John Brooks. Busy times at CP as we move past the -- one year past the merger.

John has been Chief Marketing Officer for 7 years now. We welcome him to his first time presenting at our conference. However, this is CP's 17th time in the past 23 years participating that we've hosted the event. So I truly appreciate your time, your commitment to the conference. Also from the company in the audience, we've got Ashley Thorne from Investor Relations. And with that, John, let me turn it over to you.

I guess, maybe your thoughts on the state of the market and really what are the three key takeaways we should leave with today?

John Brooks
Executive Vice-President and CMO, Canadian Pacific Kansas City

Yes. All right. Well, thanks, Ken. I appreciate it. Honored to be here. Certainly honored to represent our 20,000 railroaders across three countries now, Mexico, the U.S. and Canada. And as you mentioned, Ken, we're a year into this -- actually a year and about a month exactly, into this as Keith would say, forever journey. And I'll tell you, we're just scratching the surface.

We feel really good about where we sit in this integration. 2023 was a busy year for us, focused on culture and safety and getting the operations right. And honestly, I think we came out of that in really good shape operationally, as we closed out 2023.

I can tell you, I also had the marketing and sales team running pretty hard. So, we were pleased how we finished '23 on that front. And I'll tell you, 2024 is off to a good start for us right now. We had a little of -- railroading being the outdoor sport it is, we had a little bit of hiccups here and there in Q1 on that front. But nonetheless, ended Q1 positive on an RTM basis.

And Q2, has started off really strong. I think our RTMs are up this morning, Ken, about 7%. And really, it's a pretty even mix across our commodities.

On the market as a whole, I would say this, and I would also say this in the context of why I think our investment in CPKC and our thesis around our network and our franchise is completely

different than anything in the rail sector or transportation sector. The combined franchise, having Mexico, the U.S. and Canada, and being able to do that and move goods on a single-line haul, secure borders, efficient movement, strong operations is -- can't be replicated. And it's something that's going to give North America, I think advantage for years and years, and years to come.

As you think about growth, we don't need the macro. And I think that's quite unique relative to this industry and maybe historically in the rail industry. I can tell you, I get less and less bullish around what the second half of '24 is going to look like on the macro. I don't think we're going to get much -- at least we're not counting on much of a tailwind at all there. But I don't think it changes the fact at all that we are going to grow this franchise, and we're going to do it on the heels of our self-help initiatives and in the synergies that the connectivity of this network brings. And nobody else can do that.

So you take that. As you know, Ken, we've been very disciplined pricers also. We -- I continue to see us perform very strong. But when you combine our synergies and our pricing, I think it sets us up for a really good 2024, and we're well on our way.

QUESTION AND ANSWER SECTION

<Q – Ken Hoexter>: That's great. Although, maybe not on the macro. That's not -- so it's not. Go ahead.

<A – John Brooks>: You know it's a tough thing to figure it. Look, at the end of the day, we've got, what, still two elections looming. We got all sorts of geopolitical things that are still out there. And obviously, interest rates are yet to sort of really come down. I think inflation has improved a little bit here. But we'll see. Again, I don't think we need it to deliver what we said we were going to deliver. It's the power of the franchise that ultimately is going to do it.

You asked about three takeaways for this group. And if I had to think about it, I'd say, one, simply, again, the -- it's a unique investment because it doesn't need the macro. Number two, we are a proven operator, we've been -- Mark Redd and his operating team, and Keith's leadership, we've had the best operating model in the industry for a long time and that momentum is only going to continue as we get deeper into integration with the KCS. So you can count on a strong operating product. You combine those two things and you should feel real good about not only a near-term investment thesis, but this is really a long-term story.

A lot of these products we're creating that just can't be replicated are going to take time and investment and momentum to get up and running, I think about like our reefer product. We've invested in 1,000 reefer containers. We've inked a long-term partnership with Americold to build new cold storage facilities across our network. And it's a $100 million-plus type opportunity for our franchise. And I think we've maybe moved a handful of that. So it's really the long-term story of opportunities like that and Mexico that excite us.

<Q – Ken Hoexter>: Wonderful. Thanks for adding that back on. Let's knock some things out of the way. We had the impending May 22nd date for the CTRC -- CRTC strike potential deadline. I guess, yesterday, the Minister, or day before the Minister came out and said we're going to look at some propane issues that could -- we're going to have submissions by the day before now, so the 21st.

What do you think that does for -- how are the negotiations -- whatever you can update us on how negotiations are going? What does that do for the strike deadline potential? What are your thoughts on the process?

<A – John Brooks>: So, Ken, it's kind of -- it's an ongoing saga to be honest with you. And the unfortunate thing is this probably throws just more uncertainty, flames that fire with not only our employees across Canada, but all of our customers. So it's a little frustrating on that front.

Ultimately, the CIRB has said they want to consider the health and safety of Canadians and what that -- how that could be impacted. If CPKC and potentially our competitor in Canada are on strike. And as we look at it and specifically to your point, they pointed at propane, but I don't know how you can point to one good over another commodity. The grain guys, the fertilizer guys, the health/medicine shipments and containers. And so that's going to be a challenge for them.

I think at the end of the day, it puts this whole timing of May 22nd on pause. They did put out a procedural time line around to your point, submissions on the 21st. And then I think the ability to rebut or provide additional 10 days later by the 31st.

So I think the best of our knowledge, it's right now business as usual. We'll see how this plays out. We're going to urge them to be expeditious because ultimately, we want to get on with this one way or the other.

And Ken, look, all that doesn't mean we aren't continuing to be at the table to bargain if the TCRC wants a bargain.

<Q – Ken Hoexter>: Yes. Let's just talk about that in general. Obviously, there's no specifics because you haven't resolved the negotiations yet. How does the switch conceptually from hourly- to mileage-based change the cost structure, it may not be your expertise. But any general thoughts on how we should think about this, the change of that?

<A – John Brooks>: Well, you know what, I'm going to turn it to how I think about it specifically when I sell this franchise to a customer. At the end of the day, being able to create quality of life and flexibility for our employees -- is what we believe the hourly agreement or it does provide. And we've had success certainly in the U.S. in implementing that program, ultimately allows us to then run our yards, run our trains, maybe in a little different manner than if, in fact, an employee was refined to a specific territory or job.

And -- but how that translates and when I'm sitting in front of a customer is ultimately the ability to not only stick to or commit to a level of service with that customer because we know we're going to have an employee available to switch a facility or to work a yard job. Maybe a little differently than we have dependent in the current scenario in Canada.

So it's really about that balance of how do we give an improved quality of life to the employee but also then do it in a way that can be a catalyst in terms of service to our customer. I don't know if we'll get there in Canada in this round, Ken, we can hope and we have that offer on the table. And we also have a very -- what I would consider a traditional approach on the table, too. So we'll see how that plays out.

<Q – Ken Hoexter>: So we're halfway through the quarter. You mentioned RTM's up 7%. We were at 6%, so a little bit ahead. Carloads, I know you don't pay attention too much to carloads, seem to be down a little bit, 0.5% versus our up a little bit target. Is there a shift in mix or anything that you're seeing at this point in the quarter?

<A – John Brooks>: You know what? I was saying to Ashley, Ken, that really in Q1, our mix was quite a dynamic. I think it was about a 4% or so headwind if you think about cents per RTM. So it's pretty significant. And there's, I think, a little bit of a perfect storm. I expect that to moderate as we move through the year.

There's a fair amount of -- when you think about the carload number. We have a lot of carloads that were, I'm going to say, trapped, in Mexico historically with the KCS standalone, with two or three domestic intermodal shippers that no longer are moving their freight on CPKC in Mexico. And that's sort of – that was a lot of units that have come out of our plan, but again, it's -- the beauty of it is it's part of the reason our domestic intermodal length of haul is up 20-plus percent right now. We've traded and we're reusing that capacity with shippers and customers that are really leveraging the total length of haul of our network.

And really, we've seen that across all the lines of business, just to sort of varying degrees. But also, we actually had a pretty strong grain, and grain continues to be a little better than we had expected. Long length of haul, lower cents per RTM creates a little bit of a mix headwind. And then we had already talked about the U.S. coal with that being down, that kind of creates some dynamics in that area also.

<Q – Ken Hoexter>: So I'm going to back step for one second. I think Nadeem had even said just going back to the strike or the double-digit earnings growth outlook, I think he had said that you can still hit double-digit EPS growth with a short strike. Did I catch that right?

<A – John Brooks>: You did. Yes. No, again, we feel good what's in front of us that we can control. Now look, if this thing goes on for weeks and weeks. Now historically, Ken, it hasn't. We don't expect it to, particularly if both railways are out and there's some disruption to passenger rail in that. We don't expect it.

And if you look at what's ahead of us and we get -- the rains continue in Southern Canada to help that grain crop out, we look for a really strong second half of the year.

<Q – Ken Hoexter>: I'm going to stick on another Nadeem type of question, but the last 5-year average was a 410 basis point improvement in operating ratio from first quarter to second quarter. Noted some costs can continue. So we target a level a little bit below that. Can you outpace that? Or do you see some of these costs being sticky at this point?

<A – John Brooks>: You know what, there's a lot of -- pretty intense level of focus on it right now, Ken. I think sequentially, you're exactly right. You're going to see improvement, I fully expect year-over-year improvement too. I'm probably not going to – Ashley would be mad at me if I gave you guidance on the quarter, but I think we feel pretty good on how April came in. And kind of strike aside, or if we have a work stoppage aside, I think the way you're thinking about Q2 feels right to me.

<Q – Ken Hoexter>: Okay. Last June, you set long-term targets for double digit, about 15% EPS CAGR between '24 and '28 led by, as you've run over kind of high single-digit revenue gains and what $300 million USD, $320 million USD in cost synergies. But you talked about $350 million USD of cost synergies this year. Maybe you want to just run through how you're progressing towards that goal? How are you on the synergy side?

<A – John Brooks>: You said cost and really that's revenue if you think about that. I feel great about it. Again, we have been laser-focused even leading up to April 14th of last year, hit the ground running in 2023. We've been very open around our run-rate on revenue synergies, closing 2023 in excess of $350 million USD annually. And our full expectation to double that in 2024. I would tell you, through April, we're ahead of pace. And I see a strong pipeline that exists out there to get us certainly to that number or even some upside to that number.

So from a revenue synergy standpoint, I would say you think about that chart we laid out at Investor Day with the synergies being two, three points, the price piece. As you think about, right now, current time, I'd say we're ahead on both of those bars. And then the third bar was the macro. Obviously, that one is lagging and going to be a challenge. But look, if we get any sort of tailwind in that last bar, I think look out. What is already a strong investment thesis and growth story without the macro, just gets another little tailwind to it.

<Q – Ken Hoexter>: Just on that macro side, are we seeing something on the consumer taking a little bit softer move recently?

<A – John Brooks>: You know, I'm watching like our -- right now, our forest products line of business closely. That's an area where I think this time last year, we moved zero cars of lumber from Canada to the Texas market. Now our team has done a tremendous job leveraging this franchise. We're on a pace of 50 to 60 cars a month now we're hitting into that market.

But as I look at it as a whole, I've seen our forest products, our paper segment, our cardboard, now sort of some of the building materials, definitely soften. And I just think it's -- as interest rates continue to be high and consumers maybe in terms of goods, sit on the sidelines a little bit. I think there's reason to continue to pause getting really excited that the macro is going to do anything.

<Q – Ken Hoexter>: So I'm going to go to your area of sweet spot here, but you mentioned $5 billion USD in addressable revenue opportunities from nearshoring to industrial development, truck share gain, self-help opportunities, and even some Class 1 rail diversion. Maybe -- do you want to walk through some of those or each of the categories and kind of how you think you're progressing?

<A – John Brooks>: Sure. You might have to prompt me through them a little bit. But maybe I'll start with kind of the industrial development and kind of ties into Mexico a little bit. I'd say, first of all, the pipeline as a whole, it continues to exceed our expectation. Honestly, Ken, there's no shortage of opportunity. It's really about pace of conversion, picking the right partners, making sure we're working closely with Mark Redd and Mike Foran and the operating team that we can do what we said we're going to do and deliver to the customer needs.

So it's kind of more about pacing, it is, than really having to go out and find the opportunities. As you think about Mexico, it's exceeding our expectations. Just think about the last couple of weeks, Volvo, Yokohama, Home Depot, the announcements relative to -- I don't know if it's totally nearshoring, but certainly, foreign investment dollars coming into Mexico, sort of driving that opportunity, continues to be quite strong.

I just sent my Mexico sales team -- maybe a little bit of a tangent here, I'm sorry -- but I sent my Mexico sales team out on sort of a cold calling blitz, the last -- kind of old school -- last couple of weeks. I think they met with 510 new potential customers.

And really the takeaway, as I read through in Salesforce sort of all the opportunities that generated out of there, it's truck conversion. The truck market, and I think that was sort of one of the areas that the conversion opportunity relative to trucks is really strong.

And as you think about the second half of this year with our announcement around the network extension with CSX over the Meridian Speedway to reach their markets, there is just a huge truck market between Mexico and the Southeast U.S. that's going to fit right in the wheelhouse. Not only with CSX, but also NS into that corridor.

<Q – Ken Hoexter>: All right. Jumping to kind of some back to margin maybe discussion. Nadeem noted maybe 60%, 70% incremental margins, which could lead to almost a 50% OR at the end of the 5-year plan. Does that sound right?

<A – John Brooks>: Ken, don't trap me into that. I think the margin that is consistent with what we've said from Day 1 relative to the growth of CPKC. I think from the moment we announced the potential transaction, we felt good about that. And I think that is what we're seeing today as we bring on this traffic. The long-term OR story, I'd maybe just lean back on the history of what we've done at CP and now you take the power and be able to leverage the total power of this franchise. We're going to keep that thing moving in the right direction, but in a very disciplined way relative to bringing on the top line revenue to. I'm not going to mention the 50%, but we feel pretty good about it.

<Q – Ken Hoexter>: All right. Let's go near term then for this year, you're targeting double-digit EPS growth, just about $2.75 billion in CapEx, low single-digit volume growth or RTMs. We're at about 3.5% in our view. But – anything give you concern as we're here almost midyear?

<A – John Brooks>: No. Actually, not at all. We feel quite comfortable with it. Mark and team are really hitting their strides operationally. The network is performing good there. I can tell you, customer satisfaction is building and I think that's just a function of us catching our stride in some of these areas as you think about this combination. The synergies will deliver exactly how we described, and that's going to be the recipe.

And honestly, Ken, I'm not dangling this carrot out there. But if we see any sort of life at the back half of the year, I truly believe that it's not necessary to get to where we said, but it's upside to what the story could be in '24.

<Q – Ken Hoexter>: Yes. No, it definitely still seems to be something that is a consistent overhang. Let's go to your – some of your specialties here and talk some of the commodities. Grain carloads are actually trending up – I'm going to go carloads, sorry -- versus our prior down target because we were all fearing the comp over a weaker grain crop.

RTMs are now up 12% quarter-to-date. So a couple hundred basis points better than we thought. It seems like the long feared weak grain crop isn't as bad as feared? Or is it that the farmers are moving more or they had delay from last year? What's going -- because those are big numbers.

<A – John Brooks>: Yes. I think a few things in those numbers. I think the headwinds relative to Canadian grain are still real. I think we're down double digits year-to-date. Now Q2 has been a little better. April was pretty decent. And I think that is -- it's ahead of our plan, but below year-over-year, year-to-date.

But I think it's a function of we didn't see a lot of the grain move in peak like we normally would. So the farmers were sitting on a little more, we saw some of that move in April. But really, our U.S. grain franchise has been quite strong, Ken. We had a really good corn crop across the Dakotas and Minnesota. We've seen a lot of that move out into the PNW. And actually, we've seen a fair amount of new growth with our grain franchise in our northern territory starting to reach down into the KCS territory and ultimately down into Mexico.

So I think our U.S. grain franchise outperformed and our Canadian franchise maybe performed better than we anticipated. And we'll see how that plays out here.

<Q – Ken Hoexter>: This is great. This is the whole part of the story of we're not just Canada anymore. You get a whole bunch of extended lanes and longer lines.

<A – John Brooks>: It is. It's right in the wheelhouse.

<Q – Ken Hoexter>: It's great. Intermodal, down two cars but 7% jump in RTMs. Maybe talk a bit about the mix of international versus domestic. Where are you winning on cross-border, right? I mean that was a big discussion. Are you moving not only past the border, but now through KC through to Chicago?

<A – John Brooks>: Yes. So maybe starting on domestic intermodal. I think we've seen a little bit of an inflection recently, particularly in Canada, maybe as shippers are pulling ahead, fearing a work stoppage, but certainly a stable domestic Canada product.

Our North-South product, we've seen great growth. I think sequentially, the last two months are up 10% each month -- month-over-month, up close to 60% on the run-rate versus closing out 2023. So we -- we've seen despite shedding some of that lower-margin, short-haul business in Mexico, we've seen good growth on our long-haul business in domestic. And that's only going to continue.

Think about the international space, I'd say we definitely saw a Q1 surge greater than we anticipated. I think, frankly, greater than the ocean carriers anticipated. I think you saw some shifting back into Vancouver. I think you saw the impacts of Red Sea, Panama Canal, maybe in the East Coast, labor strike, kind of maybe a little bit of a perfect storm.

On our network, we've worked through that volume in Vancouver and actually sit in a pretty good position today. And honestly, have shifted a lot of our focus into continuing to grow and talk to the steamship lines around Lazaro. And that is now a backstop or another alternative for their supply chains relative to L.A.-Long Beach or some of the other ports.

We're making steady progress on that front. We've got three steamship lines today that are pretty active in importing goods through Lazaro and shipping them across border into the U.S. And I fully expect, again, that's an area that you think about synergies where we really haven't even, Ken, crossed the -- scratched the surface. That's going to be, I think, a big 2025 story for us. So overall, I feel good about where we sit intermodally.

<Q – Ken Hoexter>: Wonderful. I'm going to throw, one, maybe smaller, category out, but potash is up 29%, 18% RTMs. Those are big numbers. Is that new plants? Is that anticipation of new crop? What's driving that?

<A – John Brooks>: You know what, if I bring you back to last year, we had a significant -- Canpotex, our largest exporter, they had a significant outage. Their Portland terminal had an infrastructure failure. So really, that volume was off the table last year. So really, you're seeing this surge as a function of that being back up online. Plus they're shipping strong. They -- Canpotex is forecasting, I think, record volume in 2024, and we're going to be the beneficiary of that.

<Q – Ken Hoexter>: Let's talk about revenue per RTM, which was flattish in the first quarter. Maybe talk about -- you even threw out maybe a little bit of the mix impacts, pure pricing, thoughts on what's going on underlying it? And how impacted is it by the historically weak truck pricing we're seeing?

<A – John Brooks>: Yes. Again, pricing was quite strong. I'd maybe put it like this. I've said mix, probably about a 4% headwind, fuel about a 3% headwind, and that pretty much wiped out pricing. So that brought you to your flattish.

So -- you know what, I think the good news is I fully expect that it's not going to totally go away, but it's going to moderate as we move through the year.

<Q – Ken Hoexter>: So let's talk about service and metrics, right? In terms of -- how do you look at the metrics, right? Or maybe talk about what Mark looks at in terms of kind of daily things. And then -- I'll start there, and I'll jump in with some finer questions.

<A – John Brooks>: Yes. You know what? So I'll tell you, Mark looks at a lot of metrics every day. But I'll tell you what, I zero in on a couple of things. If I see our -- really three things right now. Our car miles per car day, our trip plan and compliance to trip plan, and our volume moved in and out of Mexico are really kind of three key metrics that I key in on.

I'll tell you this. In those three areas, we're operating day-to-day, but 75% plus trip plan depending on the area. I feel good about that. That's been a steady improvement in an area of focus for Mark and team. We're seeing essentially close to record or really good car miles per car day across the network.

And Ken, we've been moving literally all-time record GTMs in and out of Mexico since we've taken control. And look, I'll give a lot of credit to the task force we put in place last year. John Orr did a heck of a job leading that. We've got a really good team and foundation down there in Mexico. And again, it's going to be a big part of our growth story going forward. And I'm really excited about the way we're moving that -- moving those goods.

<Q – Ken Hoexter>: So after KC, it seems the future of rail mergers is at least for the next maybe decade, it's -- you're doing some tuck-ins, right? We've seen the Meridian -- what is it, the Meridian & Bigbee railroad acquisition. So you've continued to make tuck-ins. You've shifted. It seems like with working a little bit more with CSX in terms of that Meridian partnership. What is the future of the -- as a marketing guy, the future of the alliances with the other Class 1s in terms of showing how the growth can work? I mean, you're obviously continuing to work on it on your own in getting Mexico all the way up as far north as you can. But now you're obviously more focused with these alliances in terms of improving the performance. How does that look to you?

<A – John Brooks>: Yes. I see a lot of opportunity, Ken, frankly, to work with both of the Eastern carriers. That Mexico to Northeast U.S. and Southeast U.S. is a really strong marketplace that is dominated by trucks and frankly, maybe even been dominated by our competitors into some of those lanes. So we see a lot of upside.

I wouldn't maybe characterize it as a movement or favoritism towards CSX. Certainly, this new route in my mind, unlocks their customers in their markets, whereas in the past, KCS was fairly just linked to the NS marketing customers. So it really just broadens the scope of opportunity for us.

And with the development of our new auto compound in Dallas, I think it just gives that east-west route opportunity, whether it be NS or CSX, a lot of upside that really was never built into our model. And I think that's a key part of this story.

These relationships with the Eastern carriers are really what I would consider upside -- long-term upside to sort of the model.

And the other thing I'll point out, it doesn't necessarily -- just if you think about it, that Meridian Speedway isn't the only area. I'm really excited about a product we've been working on some time with NS to run up through Kansas City up into the Ohio Valley. If you look at a route map, it's the best route out there to be able to link what I would consider premium goods in and out of Mexico up into that Ohio Valley area.

And certainly, now with John at NS, I think there's a natural understanding of how deep the product needs to go, how good the product needs to be. And again, I just think it's -- much like the CSX option into the Southeast, provides a whole another market outlet for our customers.

<Q – Ken Hoexter>: I think there's a little confusion in the market with what went on with John in terms of the Meridian Speedway discussions. Is there -- was there something else that you can talk to that was gained in terms of what NS gave up on the Meridian Speedway access?

<A – John Brooks>: Ken, I think it was kind of a lot done about not much of a story there. Again, it simply opened up NS -- or CSX customers into the Dallas market. And so that really isn't going to take away, in my mind, anything from the NS. That is a truck dominated -- if you know that Atlanta-Dallas Lane, if you drive it, it's truck dominated. There's an opportunity for both carriers and CPKC to take trucks off the road and create some nice revenue opportunities for both of us.

<Q – Ken Hoexter>: So if I were to try and sum up here, and you've given us a lot of information, but, you know, CP has got the unique investment. You don't need the macro to make some of those targets. Still looking for, confidently for the double-digit targets. Proven team, strong operating products, so operations still running well in your mind, and you've given us some other stats that we -- that you look at that highlight what you're focused on.

Near term, long term, this is – for, what is Keith's word, forever, forever step here in the merger. And RTMs, quarter-to-date, we're looking at up, up what 6%, 7% right -- up 7%. So off to a good start, that helps you get to your target and let's just hope the macro, kind of even without the macro, you achieve your targets, but macro can be upside if we get some of that. Anything else you'd throw in?

<A – John Brooks>: Honestly, Ken, you nailed it. That was perfect. I appreciate the opportunity.

<Q – Ken Hoexter>: Awesome. Thank you, John. Appreciate it.

<A – John Brooks>: Thank you.