Transcript

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Other Participants:
Konark Gupta – Analyst, Scotiabank

PRESENTATION

Konark Gupta
Analyst, Scotiabank

Okay welcome guys. Thanks for coming in. Pretty exciting times, and I know you were just here when we were chatting with CN. Tracy clearly talking about some of the issues and some of the opportunities for the space in 2025. So maybe John, I don't know if you want to make any opening remarks or you want to jump into Q&A, so, yes.

John Brooks
EVP and CMO, Canadian Pacific Kansas City

Sure. Well thank you. Certainly appreciate the opportunity, Konark. Good to see you. I'm here today with Ian Gray. So, pleasure having Ian here with us today.

Generally speaking, I'm super proud of the efforts of the CPKC family to get to where we are. I think as you heard from Tracy, it's been a pretty wild year, really across the industry, and certainly in Canada, and we're still facing challenges as we sit here today relative to the labor disruptions that we've had most recently in Montreal and out in Vancouver. But all that being said, we've stuck by our guidance from day one and feel in really good position to be able to close that out over the next 45 days or so of the year. As a whole, volume trends, Konark, remain pretty positive. Our bulk business has been strong. We're seeing some signs of good activity in our intermodal business. Certainly we're going to have a lot of pent-up demand in Vancouver as this strike in Montreal, as this strike comes to a close. Our automotive business continues to be a shining star for our company. So I think we're set up well to close strong and then really set us up for 2025.

Maybe, Ian, you want to?

Ian Gray
SVP Accounting, Planning and Procurement, Canadian Pacific Kansas City

Sure, no, thanks, John. Good morning, everyone, and thank you for the invitation. It's great to be here.

John's talked a lot about some of the opportunities we have in front of us, and as a finance organization, we're well-placed to support him in those efforts. Keith talks about constructive tension. He talks about not letting our appetite for growth outpace our ability to deliver it. So we've been very proactive in a lot of the investments we've done to support the capacity, so things like the Dallas auto compound, Bensenville, and a lot of the north-south infrastructure we've put in place in line with our STB commitment.

So as John starts to deliver some of that growth, we have the capacity to be able to support it

from a network standpoint but also from equipment. So auto racks was very key as we continue to grow our auto business. The refrigerated units is a very unique opportunity that's going to start to play out in 2025, and we're very proud that we've been able to do all of that while at the same time paying off debt. We're very close to approaching our leverage target, and in 2025 we'll really start to evaluate what we're going to do from a shareholder returns perspective. So with that, I'll pass it back for Q&A.

QUESTION AND ANSWER SECTION

<Q – Konark Gupta>: Yes, no, thanks for those intro remarks, and we have a lot to unpack here. CP is a big pack. So let's dive in.

First of all, I think John, you mentioned, obviously you're expecting a good finish to the year. Obviously we can see in your volume numbers clearly. I think you're probably one of the few railroads or freight carriers, at least, who has seen a pretty decent volume environment despite all that we have seen.

What really has driven that strength? I know KCS has been part of the equation, and there's some synergies and all that, but it also feels to me like, and correct me if I'm wrong, there's been some self-help CP-specific initiatives as well that might have helped.

<A – John Brooks>: Yes, no, certainly. Well look, let me start by saying it's all driven by the power of the franchise. There's a lot to unpack because it's a big network to unpack it with. We've been really candid since 2017, as I think back, Konark. Number one, our job and mission, self-help growth initiatives, period.

How do we create an environment where this franchise can grow despite what's going to unfold in the macro? And, frankly, I think that's what differentiates us. Now you just layer on this extended network, three countries, the connectivity that it brings, and it's a differentiator.

I guess when I look over this past year, I think you're right. I think of the Port of St. John as an example. We are humming out there. There's a lot of eastern Canada freight that we're now seeing discharged that, again I think is completely separate from the synergy bucket, but certainly giving us maybe a unique tailwind that some of our competitors maybe don't have.

I also think we've had a ton of success in our energy, chemicals, plastic space. I was looking today. I think volumes are up and revenues are up close to double digits for the year in that space. And certainly a large part of that is the connectivity of the network, and I'd say we're in the early innings of how we're seeing those flows change. But a lot of that is a lot of the hard work that we've gone into developing distribution franchises, not only in Vancouver but also in the Toronto market here for fuels coming out of Alberta.

But then the other piece is, I think the synergy piece. I've long thought that if our self-help initiatives could generate a couple of points or so of growth, that would be success. I see this now being three to four points of growth just simply by how we put together the power of the franchise. The automotive area is a great example.

I was looking today. Our average length of haul in the automotive business is up 20%, and that's really just now utilizing the strength of that business, 17 to 19 facilities down in Mexico, production plants, that we're able to unlock, provide service, provide certainty of car supply, and drive a length

of haul, whether it be up into the upper Midwest, up into Canada. The beauty of that is in the past, KCS did a lot of that work and had a lot of that responsibility for that first mile service, but a lot of that traffic was then handed off.

But now the power of this franchise is to create that length of haul and ultimately that high incremental return that we get in terms of margins for lengthening that out. So I think you've just seen a lot of those very idiosyncratic type opportunities develop as we've moved through the year, and, again sets us up well for 2025.

<Q – Konark Gupta>: Okay. So you -- maybe talk to us about the KCS synergies, right, both from revenue and Ian, from the cost side as well, if you can. So I think coming into the year, obviously there was an expectation of a certain amount of synergies that you were expecting for '24. You ramped up that, expecting to exit the year at a double clip to the beginning of the year.

What's causing that? What's driving that? Is it more like conversations with the customers are getting to a point where they think okay so now they see value in the network, or it's more like you probably undermined some of the opportunities and now they're coming in much stronger than expected? Or, I don't think macro is much more bullish than you thought before.

<A – John Brooks>: Yes, no, it's definitely not. And, again I would say as I think about it, I'm definitely not counting on it as I look forward. It would be a nice tailwind if things produce. I'll let Ian speak to the cost side, but just a couple of comments on the revenue side.

I think beginning of the year we were very candid that we saw a path to about a USD $700 million plus type run rate. In 2024, I can tell you I feel really good that we're embarking upon an USD $800 million type run rate to close out the year. So you're right, there has been, I think more momentum, more upside in that space. And, Konark, it's a combination of a lot of things.

It's, one, us getting familiar with the new franchise. It's the operating team getting their legs under them and creating that service product to sell to. It's contracts that have been in place that are just starting to roll over to allow us to have that different discussion with the customer and find those opportunities to create savings for them. Then it's blood, sweat, and tears.

It's going out and doing what I think we do really good as a commercial team at CPKC. It's selling. It's helping customers understand what the Laredo second bridge is going to do to our capacity, how we can create a different, seamless product, how we sell our new connection to the CSX into the southeast. It's all those pieces. I just think this is an evolution of it coming together, and you're going to continue to see that over the coming years.

<A – Ian Gray>: Well thanks, John. Then from an expense standpoint, this merger was done from a growth perspective. But when you pair up two railroads like us and run it as PSR is intended, a lot of synergies come out, not just from the expense side but also on capital.

So as Mark and team redesign trains, they improve their cycle times, their locomotive utilization, that decreases our need to buy locomotives as well as cars. We get it on the expense side through improved metrics, but also on the capital by not needing to have as much equipment.

On the procurement, there's still lots of self-help that we can do. We're a bigger company now, so it's just that negotiating power that we have with vendors. Then insourcing. The key thing that we did at CP Legacy was insource where it made sense. So it's not huge, big, sexy things. It's crew management or crew accommodation. We do that on our own now, but it's millions of dollars that really starts to pile up.

And another thing that we're really proud of the last couple quarters is we've internally developed a fuel center of excellence. (Technical Difficulty). So it's leveraging a lot of technology, a lot of discipline on the fuel side. So using Fuel Trip Optimizer, throttle limitation, locomotive isolation to really start to improve our fuel metrics. That's led to $20 million of savings over the last two months.

And 2025 is going to be a big, important year for us from a systems standpoint. As we finish the work that needs to be done on the IT, back office, support functions, that will be completed towards the middle of the year. Then after that, we can start to rationalize through attrition some of the head count that we have in the support functions. So that will be another leg of a tailwind for the expense synergies.

<Q – Konark Gupta>: Okay. That's a great update. John, as you build out the network, right, as you fill in the capacity and expand the North America/USMCA network that you have, which is pretty unique to you guys. The USMCA is reopening in '26. Obviously Trump just came into the office. There's Trump 2.0 concerns, or I don't know, at least monitoring out there.

Are you losing sleep at all on what could come out of this 2.0? People obviously talk about the risks to Mexico, et cetera. You guys are obviously a little bit more indexed to Mexico than some of your competitors. So how do you think about all the potentials out there?

<A – John Brooks>: Well maybe I'm always losing sleep, but I don't know about on that one. I mean I think if you look back, Konark, historically, 2016, certainly the headline of some of the issues that came out at that time certainly created some volatility, no doubt about it. But at the end of the day USMCA was created. I think it was a tailwind, and it flourished, and it was very positive for the KCS.

I think we view it as no different today. There's certainly going to be some headline volatility, I would guess, over the coming months. But at the end of the day I think North American free trade, what's good for the three countries is good for collectively North America, and we've got a North American franchise that touches it all. We're going to be intimately involved, whether it be with President Sheinbaum or the Trump administration and here in Canada, on what shaping that, how that looks, and what we can do to do our part in it.

I think some of the country-of-origin rules that were part of USMCA honestly created opportunities for KCS. You know what, if there is tariffs in specific areas, I don't know, I think our initial view is some of those areas where they might be targeted might be pretty minimal impact to any trade that we currently do. At the end of the day, I think there's a reason that Mexico became the U.S.'s largest trade partner over the last four or five years. It makes a lot of sense. It helps supply chain certainty.

And I would say there's good momentum we feel, I think within Mexico and desire in terms of cross-border movements to move more and more away from fully dependency on truck to supply those goods to more on rail. And as I said, we've got our second bridge coming on here at the end of the year that effectively will double our capability to move rail freight in and out of Mexico through Laredo.

<Q – Konark Gupta>: Okay. Staying with Mexico for a bit here. Sheinbaum's administration just obviously also took the office recently. I think there's been some news coming out of that with respect to reforms and other things they want to do. What have you seen changing in Mexico since the administration changed there? It's still the same, I guess like it's part of the AMLO franchise.

But what evolution have you seen so far? Are customers a little bit concerned that things can go south because of passenger rail or something else? Any risks or concerns out there among your customer base?

<A – John Brooks>: Yes. I don't know if I would classify it risk or concerns. I would say certainly maybe a number of boardrooms were on pause a little bit, just watching to see what that election would do, watching to see what the U.S. election would do. But I can't tell you. And I was down in Mexico not that long ago, the amount of development that is not moving rail that already exists there today is staggering.

All we had to do was really harness that opportunity and convert it to rail. And frankly, if there was no more new development, there's plenty down there existing today that is convertible, that makes sense to move on rail.

But I'd say overall, the dialogue with the new president, and that has been positive. I think she's been very transparent around her intentions on the passenger freight issue, and that being its own separate line that will be funded by the state of Mexico.

So we've been pleased with that ongoing dialogue. I think she's also been generally very supportive about the notion of, to solve congestion and to continue to grow Mexico, more and more use of freight railroads to help solve that problem and take trucks off the road is an opportunity for them. So I'd say generally, we're pleased with the dialogue so far. I know Keith will be, hopefully we're trying to set up some meetings with the President shortly. We'll just keep that dialogue open.

<Q – Konark Gupta>: Okay. What does it mean for your team, Ian, then, like in terms of capacity or planning or cost or CapEx with respect to passenger rail? Does it come on to CP in terms of funding some of that or subsidizing some of that development that Mexico is looking for? Or if they put some trains, passenger trains on freight tracks, which are concession, does it increase the cost or it reduces the operational efficiency?

<A – Ian Gray>: Well we're pleased we're starting to get a lot more clarity on what the approach for passenger rail is going to be. So with this administration, John mentioned, they're very pragmatic on their approach to rail. They understand the importance of freight for that country to excel economically, as well as move trucks off the road onto our freight network to help with congestion.

There have been lots of meetings and discussions as it relates to passenger rail. But our concession doesn't obligate us to run a passenger rail system. What is being proposed is a parallel track next to our right-of-way so that passenger rail can go and remain fluid and not impact our freight franchise. So as we look forward to Mexico, John talked about it. He's bullish on Mexico. We continue to invest in the franchise.

So in 2024, we spent $75 million on sidings and yard configuration to help with fluidity. So that lowers our cost base, allows us to deliver more freight, and have really good incremental margins as some of that traffic starts to come on to our network. But as it relates to the passenger rail, we're aligned with the Mexican government. We understand the need to do it. But us, as a CPKC freight railroad, won't be impacted with passenger rails on our network.

<Q – Konark Gupta>: Okay. That's good news, I guess. One topic, John, I think it's -- I feel like an excitement whenever I talk to you about that. It's Lazaro. I think it's just like going gangbusters if I can say that, recently in terms of volumes and traffic. How do you see the opportunity base there? Are customers or shippers starting to see the value in Lazaro as an alternative to some of these U.S. ports or, I don't know, even Canadian ports?

<A – John Brooks>: Yes. You know what? It's been quite a journey, not only educating ourself around the opportunity and the infrastructure down there, but also educating the customers and the beneficial cargo owners on what that opportunity could look like.

As we sit here today, fundamentally, I think about it like this. You've got a lot of capacity down at Lazaro. You've got two very motivated operators that I think generally have underperformed in Hutchinson and APM terminals down there. Both are committed to capacity expansions at that terminal.

Intra-Mexico demand and growth is extremely strong. To be able to then take that product, overlay, I think, a good rail network and operating plan that we can put in place, and then drive that freight up into the U.S. particularly, Konark, into that, let's call it Gulf, Texas-type region, I think that's the sweet spot for that opportunity, is a big part of our growth profile for 2025 and beyond.

And I think about it in the context as not a replacement for, like, a Vancouver or L.A. Long Beach. It's never going to be that. But if there's ever a time North America, given all the labor disruptions and issues we've had, port diversification and more optionality in general is a good thing for supply chains. I believe, really, that's the bill that Lazaro can fill. And, honestly, we'll capture our piece of that. We'll provide good rail service. We'll continue to build confidence with our shippers in that gateway. I think you'll see steady growth coming in out of Lazaro.

<Q – Konark Gupta>: Okay. The MMX, right, I mean it had a lot of success initially, right? Then you also got now the CSX/MNBR deal, right, around Alabama. How do the MMX and the CSX deal fit in the portfolio? And, what do they do to the franchise? Are they helping you connect to these ports between, I don't know, Vancouver, St. John, Lazaro? Or are they just doing the trucks, over-the-road thing?

<A – John Brooks>: Yes, so I think truly an underdeveloped market by the KCS is that movement between Texas, Mexico, and the southeast U.S. And, again the amount of truck traffic, this isn't all about rail-to-rail conversion or share shift. This is all about converting from truck to rail. And certainly, KCS had a long history with the NS in exclusively moving traffic between those corridors with NS. Really this is an opportunity to unlock, I think a whole new customer base.

It's complementary to the current NS route. It's not a shift from one to the other. Because, frankly, I take a customer like a Schneider National. They are more aligned typically with the CSX in the east. So with all the business development we've been able to create with them north-south, for them specifically, this opens up a whole new lane opportunity for them in and out of Mexico, in and out of Texas, into that southeast U.S. that really they've not been able to aggressively market.

So I'm super excited about what we can do from an intermodal premium aspect. But also I think it opens up with our new Wylie Automotive Compound that we opened up this last July. It opens up a whole new automotive flow that I think can be very complementary to our network.

<Q – Konark Gupta>: Okay. Well it sounds like automotive will be a pretty solid franchise going forward with that.

<A – John Brooks>: I believe it will.

<Q – Konark Gupta>: Yes. So talk to us about the auto closed loop service that you launched recently. I think the Dallas was the latest addition to the team. What opportunities do you see there? Are you seeing customers coming to you, getting attracted to that service? And is it differentiated than what's out there?

<A – John Brooks>: I'll let Ian maybe talk about a little bit of the capital investments we've made in equipment in the compound. But I would tell you this. The automotive piece of this story was something that we felt was going to be a longer journey to get to.

I think what we've been able to do quickly is develop a product that these OEMs have looked at and said, look, if I can better guarantee my car supply at my production facility, which is something they've struggled with for a long time, if I can control it from end to end, from originating in Mexico to unloading in Toronto, and then take that unloaded car and put it back in my production facility in Ontario and load it down to Dallas, and I can create this closed loop and watch my vehicles move, is attractive. And honestly, the more we've talked to two or three of them, built some momentum, proved it out in the marketplace, then you get the me too's.

And how do we participate in this, and how do we capture some of those natural closed loop synergies that we've been able to create? And honestly, that's what we've seen develop. So we're going to turn in a really strong automotive year. Again I think our length of haul is up close to 20% in automotive year to date. I think irregardless of what you see for finished vehicle sales for 2025, which actually may be a little bit better than some of the recent data I've been seeing, I think our franchise, regardless, though, is set up well to continue to build on that.

<A – Ian Gray>: Yes, just to add. I think autos is a really good example of synergies arriving earlier than what we had originally anticipated. So it's just that flexible, disciplined approach we have to capital. So as we develop and leverage our land footprint in Dallas and in Bensenville and other areas, that John and team are able to offer that differentiated model to justify the capital expenditures, to put those things into place.

And with that higher returns, we can play around with the portfolio of capital to make sure that we then have the capacity and the footprint in order for John and team to deliver on that capacity so that we're not overselling the network and causing issues elsewhere. So autos is a really exciting example, I think on the power of the merger, the flexible approach that we're taking, and the high return capital projects and great margins that we're able to get from that line of business.

<A – John Brooks>: I think we've brought on over 2,000 auto racks in 2024 to, again just create that certainty of supply with the OEMs that we can control. But it's become as I think Ian alluded to, a very investable line of business for us.

<Q – Konark Gupta>: Okay. That's exciting, I guess. Then maybe for you, Ian, in terms of capital projects, and I think some of the technology side, I think you guys have been ramping up hydrogen locomotives, initiatives like that. Where are we on that? Are we getting real traction? Does it seem like a credible technology to you, or it's just one of the options that you're exploring?

<A – Ian Gray>: Yes. I think we're very much invested in hydrogen as a potential option for what we're trying to do. We are very much focused on fuel efficiency. I mentioned that earlier. We have that Fuel Center of Excellence. We are leveraging technologies. We are looking at renewable diesel and biodiesel and the blending to help on the emission standards.

But as we look what's the next 10 or 20 years down the line, hydrogen makes sense for us, just given the range that we have, the success that we've had on some over-the-road business that we've pulled with it, as well as the yard. Just having that tender car and the ability to fuel where, from a battery standpoint, the infrastructure needed for electrification and or charging batteries is just a little bit more daunting. We've had good success with CSX and the joint venture that we have there.

So they are able to take on some of the hydrogen locomotives. They're able to test it, and that's what really we want to do. We want to run it through the cold winters in Canada. We want to run it over CSX's network. We want to understand and really stress test that technology, and it's been very positive. So it's something that -- it's cutting edge. It's taking time, but with all signs pointed, being a very optimistic outlook for what that technology can deliver.

<Q – Konark Gupta>: Okay that's great. Then last few seconds here, John, any closing remarks, any specific milestones we should be looking for in 2025 for you guys, from growth standpoint or synergy standpoint?

<A – John Brooks>: Yes. Well again appreciate the opportunity to speak today on behalf of the CPKC family. We're excited about 2025. Look, we're in the early innings of this transformation of these two companies and leveraging this network. I'm super pleased, I think as a company where we sit today so far in this journey. We're going to finish the year strong. We're going to meet our guidance.

And as I look to 2025, I think between the synergy growth that's opportunity, the unique initiatives on each individual network property, the growth within Mexico, Konark, that we spoke to, all those things can provide a strong catalyst. You know what? We don't need to count on the macro. We don't need to – sure would be nice to see some of those fundamentals and swing our way a little bit, but if they don't I still think we're set up to provide a good strong growth in 2025.

<Q – Konark Gupta>: Okay. On that note, gentlemen. thanks for this insightful discussion, and all the best for 2025.

<A – Ian Gray>: Thank you.

<A – John Brooks>: Great. Thank you.