Transcript

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Webcast

Corporate Participants:
Nadeem Velani – Executive Vice-President & Chief Financial Officer, Canadian Pacific Kansas City
Ian Gray – Senior Vice-President, Accounting, Planning & Procurement, Canadian Pacific Kansas City

Other Participants:
Steve Hansen – Analyst, Raymond James

PRESENTATION

Steve Hansen
Analyst, Raymond James

I'm very pleased to have Canadian Pacific with us here today, Nadeem Velani, CFO; Ian Gray, Senior VP of Accounting and Purchasing.

I think the goal here today really, is just to get right into some of the topics at bay. There's a lot going on in this space. It's been topical for most of the year. We got news probably today or tomorrow again on tariffs. So I'm going to get right into the Q&A and talk about a few of the relevant things that are topical and then probably more focused on the items that are within their control.

So just at the outset, we've obviously got some decisions coming here quickly around tariffs. What are you seeing from a behavioral standpoint, if anything, for your customers thus far? And how are you planning for the inevitability of some sort of announcements that are coming?

Nadeem Velani
EVP and CFO, Canadian Pacific Kansas City

Yes, thanks for having us, Steve, and yes, it's interesting. All the uncertainty, I'd say that just the stop and start has created some inefficiency, if you will. We saw a lot of pretty significant demand through January. Volumes were up double digits, and we had a great start to the year. February certainly brought some challenging weather conditions, but the demand has not strayed at all.

As far as customer behavior, we saw some push to get in ahead of potential tariffs and that uncertainty. But the underlying strength is pretty significant. We'll see what happens tomorrow. It's still a lot to be -- a lot is still indetermined. But customers are changing some of their behaviors as far as certainly on the auto side, maybe parking vehicles, as far as not looking to ship at certain times or shipping as much as they can very quickly and try to get ahead of the tariff.

So obviously, uncertainty is never a good thing in our industry or for our customer. Hopefully, we can get things resolved in a positive manner, hopefully sooner than later, so we can get back to trade that supports all three nations and supports the economy and the macro environment.

QUESTION AND ANSWER SECTION

<Q – Steve Hansen>: Thank you, I'll agree with that.

On the auto front, again, moving to things that are more within your control and some of the self-help things, you've had back-to-back record years in auto, the Dallas compound is live, and you've talked about it being almost sold out. What are the prospects for additional negotiations and

expansion on that front? Should we expect additional investment in '25 around that broader system?

<A – Nadeem Velani>: Yes, a big part of the combination, combining CPKC and getting deep into the U.S. and utilizing the extent of our network across three nations was auto compounds. And so early on, our sales and marketing team, our operating team worked closely with our customers to look at the map and say, what are their needs? How do we resolve some of their concerns?

If you go back a few years ago, a lot of the OEMs were having challenges with car supply, having challenges getting their product to dealerships, getting to the lots. And effectively, we looked at a unique solution with dedicated equipment for some of our customers. GM was one of the first on board.

And then we built an auto compound in the Dallas area to support them. It was opened up last June. It was pretty much sold out before we even got it open. And it's been a great outcome for both customers and for us. And we're utilizing our closed loop solution, which is a win-win as far as asset utilization, turning the assets, being able to get the rail cars unloaded, getting access to the originations across the network for our customers. And so that's been a, it's almost been too good. It's sold out, but good problems to have.

So we've looked at opportunities for expansion and maybe Ian can talk a bit about that.

<A – Ian Gray>: Certainly, so Dallas was a good example of synergies that perhaps came on a little bit quicker than what we initially anticipated. But one thing at CP we really pride ourselves on is a very disciplined, diligent approach to capital, that we're not overselling the network, so that we're not hindering the service commitments that we've made to customers.

So as it starts to ebb and flow, we really need to be flexible. But that discipline and flexibility can coexist at CP with our constructive tension. So the sales and marketing team really understands that they need clear line of sight into the autos that are coming on, and we're starting to get that. So as we look into '25 and '26, there's definitely potential to expand our footprint, be it at Dallas or Bensenville, or even from the auto rack side.

<Q – Steve Hansen>: And is it possible to reframe, looking back at the Investor Day target for '23, and USD $250 million had sort of been one of the targets for auto. I mean, is it possible to understand where we are today? Would you even recalibrate what the opportunity is now, given your success?

<A – Nadeem Velani>: Yes, so we ended the year just above USD $800 million of revenue synergies. January we had incrementally -- additional synergies on top of that 2024 exit. I think this year we're going to add at least USD $300 million of additional synergies. Some of it's going to come from autos. Some of it's going to come from additional investments in the network.

We have Americold, we've talked about them on the intermodal side. The bulk side continues to ramp up. So that initial view of synergies of the top line that we had of about a USD $1 billion will exit this year ahead of -- probably be at about USD $1.1 billion.

At our Investor Day, we talked about the potential of the size of the pie expanding. And if we think about the initial synergy view of a three-year plan, it's probably extended. And it's one of those things that there's no start or end date on synergies as we learn more about the franchise, as we work closer with our customers. And if we get a bit of support from the macro side, certainly USD

$1.5 billion of revenue synergies is something that I fully feel we can achieve in that 2028 timeframe.

<Q – Steve Hansen>: No specific target on auto though?

<A – Nadeem Velani>: I think on auto, the USD $250 million that we're at today, I think we can expand that, I'd say at least another USD $100 million. It gets to a point though, when you look at it and you say what's synergies versus what's base growth and so at some point that that line starts tripping over each other. So I do feel confident about our ability to grow autos.

We have the new MNBR acquisition working closely with CSX that gives us access to a lot of new plants in the southeast of the U.S. and utilizing our network and some of our compounds across our network. So Ian mentioned Bensenville in Chicago, that's going to be a huge opportunity for us as well.

So I feel good about autos. I do think another USD $100 million in synergies over top of the USD $250 million is something that we have a good line of sight for the next three years.

<Q – Steve Hansen>: Good. And you mentioned Americold, so I just want to dig into that one a little bit more. So you've got a site under construction today, sort of the flagship one in KC. You since announced a new facility, one for Saint John and two for Mexico, I believe. And how should we think about that broader opportunity today relative to the way that was maybe originally framed?

<A – Nadeem Velani>: Yes, so Americold, we talked about I guess in 2023 during our Investor Day. They are a -- if you look at our network and if you look at Mexico, which is a huge supplier of produce into the central U.S. and conversely when you think about the central U.S. and some of our network, a lot of the proteins going south into the Mexico consumption market, it's a natural fit for balanced traffic going north and south.

We work closely with Americold, which is a huge player in that market. We quickly came to an agreement. They are building as we speak, a facility co-located on our property in Kansas City at our intermodal facility there. And so we're building an integrated supply chain to support refrigerated products, and it's something that we'll probably have open this summer.

They've announced a similar kind of opportunity in Saint John in eastern Canada that can be an import-export facility. And if you look at how we can move that traffic, we've invested in 1,000 reefers that will help support the equipment side.

And then we've come to an agreement as well. We're going to house, actually, Mexico Customs at our intermodal facility, so that product can be pre-cleared before it can get to the Laredo border.

So when we talk about integrated supply chain, we think about it across the board. And we've got history. In Canada, we're the largest mover of refrigerated products for Loblaws, which is one of the biggest retailers north of the U.S. border, so excited about that opportunity.

I know, Ian, you want to add a little bit more to it.

<A – Ian Gray>: Sure. So part of the opportunity there is much like how we approached autos. So one thing from the synergy standpoint and the targets we gave at Investor Day, we talked about that USD $5 billion pipeline. A lot of the opportunities are ebbing and flowing. So we, again, just need to be really diligent and really thoughtful on how we approach the capital.

So as Nadeem mentioned, we bought 1,000 reefers in anticipation of this traffic coming on. We have the capital to help from a co-location standpoint at the IFG terminal in Kansas. So return on invested

capital is integral in how we look at things. We take the responsibility of being good stewards over capital really importantly. But we also know we need to spend for growth. So the autos we talked about this morning is very important, as well as this Americold opportunity.

<A – Nadeem Velani>: And so we have two facilities potentially that we're looking at with them, as well, in Mexico. So we're finalizing that with them. So they're going to be a huge kind of anchor tenant, utilizing our land, utilizing our combined knowledge on the intermodal supply chain and the food supply chain, so very excited about that.

<Q – Steve Hansen>: That's great. And if we just shift to intermodal for a minute, I think you've talked about this, the Gemini Alliance coming on the network here, really just through February. How's that gone? I guess is the first step.

And then part two is just, you know, how do you see that ramping through '25 and into '26? Are there any specific milestones, whether it's infrastructure or anything else coming on that would help that growth?

<A – Nadeem Velani>: Yes. So Gemini, it's an alliance between Maersk and Hapag-Lloyd. Hapag-Lloyd is one of our largest customers, one of our closest customers. What they are doing as far as combining in that alliance is going to support what we do in terms of how we look at our complete supply chain. So they utilize, obviously Vancouver, your backyard Steve, is a key port for them. We have -- it's a key port for -- key gate for us as far as our international and mobile product.

We've had strong success with Hapag growing the Port Saint John on the east coast of Canada. That port is expanding to 800,000 TEUs. So the Gemini Alliance, part of their rationale is bigger ships, utilizing kind of key suppliers and key ports that they can turn their assets much faster and so it fits very well with ours.

And you factor in our network now with Lazaro, Maersk has a strong presence as well. So as we combined and became CPKC and the additional dots on the map across the network, the additional ports, it fits perfectly with someone like the Gemini Alliance. So they are going to be a key partner.

You haven't seen the numbers yet in the metrics. It's just starting to ramp up. You'll start seeing that in Q2. We think we're going to grow market share with this alliance, and we're going to have a better service product.

So again, it's going to be a win-win in terms of that mindset of working with our customers, of turning their assets, helping their cost structure, and having a better, more reliable service for our customers, and in this environment, that's key. So that alliance is going to start seeing market share wins and market share growth in Q2 of this year.

We saw some volumes impacted negatively in 2024, and that was by design. So as Ian said, you don't want to oversell the network. So we picked our strategic partner, which is the Gemini alliance, and we de-marketed some traffic in 2024 that consumed some of the capacity that we'll be selling towards the Gemini Alliance. So you're going to see some additional growth, and then the comps are going to be much easier versus 2024.

<Q – Steve Hansen>: There was a lot of disruptions, like your comps pretty tuned. Just shifting to the bulk of things, people focus on a lot of the merchandise traffic, but I don't want to ignore the bulk side. You had good harvest on both sides of the border. We're seeing that reflected in some of the traffic today. But you've also introduced some new services around grain in particular, like in our south. Do you want to maybe speak to how that's gone and what the opportunity is going forward?

<A – Nadeem Velani>: Yes, so grain is one of our largest commodities that we move. We had to overcome a challenging crop in the 2023-2024 timeframe. The new crop that started in August of 2024 is a very strong one. I think 71 million metric tons, which is kind of a five-year average, maybe a little bit higher.

And so we've seen, again, strength in our Canadian grain business. We've seen, obviously easy comps, but that growth is pretty significant. You factor in on the regulated portion of that, we had the Canadian government come out with the rates increase, which allowed us to take a 6.49% rate increase on top of that.

The U.S. is strong as well, so we've got strong volumes on the U.S. part of our franchise. And then you factor in the combined network and the opportunities that we looked at as far as grain synergies and the ability to look at our mix of business differently. I think last year we moved about 130 trains from Canada south of Kansas City.

And so we increased our length of haul by about 6%. So kind of underlying in that number, you know, a carload isn't a carload isn't a carload. You can get additional volume, length of haul, you can get additional profitability and support our synergy story as well, so an opportunity as far as grain, and then on the U.S. side as well. So excited about what that's going to do for us in 2025.

<Q – Steve Hansen>: Great. And it looks like acreage is going to be up this year pretty substantially, particularly in the U.S.

So on the potash front, it's been a bit of a choppy market internationally, but Canpotex is now reporting record or sold out, sorry, for Q4 and into Q1. What are you thinking about the Potash move for the balance of the year? And is it too early to start thinking about Jansen late next year?

<A – Nadeem Velani>: Yes, Potash has also been a very strong story. We had, you know Canpotex and there was a challenge as far as Portland the previous year. That's been fixed. The outlook and the market is exceptionally strong. We had a record year in 2024, and we're certainly very optimistic about 2025.

So the demand is pretty significant. February, there were some challenges as far as the supply chain in terms of the weather. As a Canadian, Steve, you know that. But it was -- certainly demand is very strong for this month. We're going to finish the quarter out very strong. And I think the outlook for the year is, again, on the Potash side, going to be an opportunity for us to support our mid-single-digit volume target for this year for the entire business. So bulk is a strong focus area for us.

<Q – Steve Hansen>: Too early for Jansen? I know it's still waiting –

<A – Nadeem Velani>: You know what, we're not as optimistic on Jansen as far as I think our competitor has an inside track on that one. So, you know, we're a strong mover of Potash and Mosaic is a strong customer of ours, and Canpotex as well. We'll see what happens with BHP and Jansen, but we're not overly optimistic, I'd say.

<Q – Steve Hansen>: And if I do -- I don't want to dwell on coal too much, but just I think you described a lot of challenges through ’24, strikes, wildfires, multiple different events. Coal was also impacted by that, along with some additional production problems there. I mean, if I just sort of wrap bulk into a broader question, I mean you talk about your guidance for the year. I mean, are you assuming some sort of base level growth in your guidance with the bulks, just in the context of, you know, the economy is going to do what it's going to do, but bulks seem a little bit more secure?

<A – Nadeem Velani>: Yes, I think you look at 2024, bulk was challenged across the Canadian network with port strikes, with our labor disruption that we had in August, and some infrastructure challenges that our customers had. Coal is, on the metallurgical side, but Teck, formerly known as Teck, now is Elk Valley Resources.

They have a strong outlook. I think they are doing -- the new owners are coming in with operational efficiencies and opportunities out of the same mines to be able to produce more. So I think they're not only just easy compares from the operational challenges of '24, but I think longer term I think there's going to be some underlying growth in metallurgical coal on our franchise. So yes, we're excited about what that can bring and that's rateable good traffic.

That also supports one of our initiatives as far as our hydrogen locomotive that we're utilizing and working closely with them. So I think bottom line, bulk is going to be a driver across the board on our franchise.

<Q – Steve Hansen>: That's great. And just as you – you know, maybe a question for you Ian, we've talked a lot about revenue synergies for the last number of years, I mean, what about the cost side or the CapEx side? Are there efficiencies drawn from the combined network on the cost front? I mean, how do you think about that opportunity?

<A – Ian Gray>: Sure, so the merger was done from a growth standpoint, from a revenue standpoint. I think it still makes a lot of sense, we're seeing a lot of opportunities there. But underappreciated, even two years in, is the amount of expense synergies that we can continue to capture.

So we look at it in effectively three buckets, the first one being operations. So as Mark and team get more familiar with the network, more familiar with the customers and that natural operating leverage that we experience, improve train design and improve locomotive utilization, which means you need less locomotives, less capital, you can turn your assets faster, so less rolling stock and you can keep your crew costs in check.

The other one is the procurement side. So just as a bigger entity, we have that much more buying power. We can consolidate contracts. We get more interest on our RFPs, but one thing that I'm most excited about is just our ability to insource. So previously as two smaller rails, insourcing didn't make a lot of sense in certain areas, but we are able to do that more effectively now. So as an example last year we did crew accommodations. So instead of paying a provider per hotel charge, we can do that internally. We have higher standards, we're available 24/7 so we actually get better value, better service.

And then on the capital side, Kansas City had a tie plant. So we've invested money into that. We spend a large amount on replacement CapEx. So it'll produce 400,000 ties. We save $20 a tie. That's $8 million per year pretty quick. So really excited about that opportunity in 2025. So finalizing our system integration and that'll just be the natural headwind -- or sorry natural tailwind post mid-year when that wraps up from a IT standpoint. You have one process, one system, and you can get additional efficiencies there.

So even two years into the process opportunities are still presenting themselves. So we feel really good at that USD $300 million target in 2026 and probably could best that.

<Q – Steve Hansen>: That's great. And in just sticking to maybe the disruption theme a little bit, labor has been a bit of a problem underlying a lot of the challenges we saw last year. Just not internally, but some external partners, and so how do you feel about the outlook for '25 and

beyond. You've signed a number of deals recently. Just give us an overview of how we think about that risk profile.

<A – Nadeem Velani>: Yes, so I think certainly coming out of COVID we saw labor challenges across the (technical difficulty) and in Canada and we've had our fair share of those on the teamsters side, the arbitrator was assigned and we're optimistic by mid-Q2 that we'll have a deal in place on that front. But we've got, short term, we've got labor certainty until that decision made, and when that decision occurs, I expect it to be a good length of time. Hopefully four years would be a good outcome as far as providing us labor certainty on that front.

We signed deals most recently with our mechanical engineering employees, and so that's put us in a position as far as on the Canadian labor side being in a strong position to be able to have labor certainty. So I'm optimistic over the next three, four years, we're not going to have the same challenges that we've had the last few years.

We're going to have potentially -- we're going to have a new Prime Minister, we're going to have a potentially changing government, which I think may be positive as well as far as broader labor issues and labor uncertainty we've had as far as our supply chain with some of the ports the last few years as you know, Steve.

So I feel good about that not being as big a challenge, because it has impacted Canada's reputation as a reliable trade partner and a reliable supply chain partner across the board, so we'd like to get that resolved and move forward in a positive manner.

<Q – Steve Hansen>: And I think the Canadian election, depending on the outcome, it's probably an underappreciated catalyst for a lot of people focused on U.S. elections only and the impact that Canada's coming and if we can take the lead blanket off Western Canada that might be good. There might even be a prospect of building some things again. We'll see.

Just wanted to shift to the balance sheet and the buyback. We got good news just recently. I think it came arguably a little bit sooner than maybe some were expecting, that buyback from a Canadian standpoint and an allocation of capital standpoint going forward.

<A – Nadeem Velani>: Yes, so we're obviously optimistic for this year. We did what we said we were going to do as far as paying back our debt post the announced transaction. So we paid back (technical difficulty) debt in the last two years here, two and a half years. So we're -- our balance sheet is in a much better spot as far as our leverage target and obviously our optimism around our near-term outlook and into 2028. We felt it was the right time to announce our buyback. So we announced a 4% buyback last week.

And our targeted leverage, we did get Moody's at our targeted level of Baa1. And so now we're going to start buying back shares and manage our balance sheet to a leverage target of 2.75x debt to EBITDA going forward. As far as how we look at the cadence, you know we're, as Ian mentioned, our discipline on capital, we're at that 2.8-2.9 -- $2.8 billion, $2.9 billion of capital this year, with currency as it stands today, probably closer to $2.9 billion. But the amount of free cash we generate is pretty significant.

And you look at the opportunities we have in the next several years, it's going to be a meaningful part of the story. And so we're in a position now to return cash to shareholders. We haven't done anything with our dividend in the last four years. So you can expect a movement there to balance our shareholder returns with the buyback and dividend. And you can expect a cadence of that 3% to 4% type of buyback annually as part of the shareholder return scenarios going forward. So investing

strong in capital, record amounts of capital, but in a disciplined manner, and then returning cash to shareholders.

<Q – Steve Hansen>: And just on the CapEx front, in terms of now that we're a couple years into the plan. Is there anything that's coming up in terms of additional things you need to buy or facilitate, like any growth CapEx, again, facilitate all this growth that we're seeing for the self-help level?

<A – Ian Gray>: Yes, I think that's a great question. We invested a lot for capacity, both on the Kansas City and the legacy CP side in advance of the acquisition. We're continuing to improve north-south capacity from a sidings perspective. But kind of the exciting thing in 2025 is we're starting to purchase some Tier IV locomotives.

So I talked about the asset efficiency is a really important component of our capital planning, but eventually you're as efficient as you theoretically can get with your locomotives. So to take on additional growth, you do need that additional power. Again, we get improved reliability with new locomotives, obviously improved fuel efficiency, improved OpEx. So that's a new capital program.

And then a lot of the integration capital will naturally start to shift off. So we talked about the system integration. That'll wrap up mid-year. So that'll free up capital again to deploy towards the more growth area. But as Nadeem mentioned, that $2.8 billion, $2.9 billion, we feel comfortable for that from a multi-year standpoint, kind of in line with what we talked about from an Investor Day previously.

<Q – Steve Hansen>: And just out of curiosity, is more capital, we talked about congestion a while back now in Mexico, but it feels like that discussion has largely gone away. Is there -- if the capital projects have been effective down there, taking care of that issue largely?

<A – Ian Gray>: Yes, I think for the most part, like Keith describes, Mexico was operating very differently than the U.S. and Canada, and kind of lacked those sidings. So we spent $75 million of capital and continue to spend capital in 2025. And that's just a few sidings properly placed here and there can really free up fluidity and capacity. So we'll continue to see benefits from that, but long-term investment in Mexico will continue. It's a strong growth engine of ours. So we'll continue to deploy capital there.

<Q – Steve Hansen>: Okay, we're running out of time and I'm respectful of everyone. Thanks for the time, gentlemen. Thank you for being here.

<A – Nadeem Velani>: Thank you.