Transcript

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Webcast

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PRESENTATION

Walter Spracklin
Director of Canadian Research, Co-Head Global Industrials Research, RBC Capital Markets

Okay, so just as a -- first of all, Nadeem Velani, CFO of CPKC, I don't think needs much of an introduction. Thanks for joining us here today, Nadeem.

So, the macro environment, like I mentioned, is -- certainly a lot of uncertainty out there. So, can you give us a bit of a lay of the land on what you're seeing in terms of volumes and your interaction with your customers?

Nadeem Velani
EVP and CFO, Canadian Pacific Kansas City

Great. Well, thanks for having me, Walter. It's great to be back in Toronto. And, yes, certainly interesting times. It's been two years now since we've been CPKC. And really proud of what the team's been able to generate. So, we're the only single-line serving railroad of -- across North America from Mexico, the U.S., into Canada. And so, really proud of how we've been able to take our regional view, if you'll indulge me as well of being a Canadian railroad, and really expand into North America.

And so, what we've been seeing, certainly very uncertain environments, a lot of headline noise impacting trade and tariffs to an extent, tariff-driven trade uncertainty. But we've seen strength in a lot of our key markets. So, if you look at what we were able to deliver in 2024, double-digit EPS growth. We led the industry in RTM and volume growth. And that momentum's really carried into 2025.

So, Q1, we had mid-single-digit volume growth. We had a very strong quarter, mid-teens EPS growth. And near term, we've seen that actually accelerate. So, April has been a -- was a very strong month for us. May, we've seen volumes continue to accelerate. And so, while there's a lot of headline noise and macro uncertainty to an extent, the CPKC model has really resonated with our customers.

So, we're seeing the base growth continue to perform well. And then when we look at our own self-help initiatives and the synergies from -- that we had highlighted as CPKC really gain traction, allow us to overcome some of the weakness. So, looking at our key markets, bulk has been double-digit growth in Canadian grain. Coal, Canadian coal with Elk Valley Resources has been double-digit strength. Even potash has shown -- been resilient. So, our overall bulk franchise has continued to perform well.

And while there's been some tariff impact in steel and aluminum, it's been a small portion of our business. And the merchandise side has been resilient. Our auto segment, while there was some pause in production for a short time, we've seen it really accelerate. And it's part of the reason

why I'm very optimistic at a near term as to what we can deliver and as far as our mid-single digit volume growth for the year.

QUESTION AND ANSWER SECTION

<Q – Walter Spracklin>: Could you talk a bit -- so when you first acquired KCS, you had a target out there in terms of revenue synergies and cost synergies as well. As you mentioned, now two years into the combination, what surprised you? Perhaps, frame the revenue synergy opportunity that you're looking at, how that may have evolved in the context of the US $5 billion total opportunity? And what surprised you, both positive and negative, in terms of your revenue capture on that synergy?

<A – Nadeem Velani>: Yes. So, when you go in a deal like this, you take two franchises, there's only so much you know. And then obviously, we're in a very volatile environment as far as trade and a lot of our key end markets. So, when we combined the two franchises and had a chance to really peek under the cover and look at the opportunity, I'd say that we're much more optimistic around the auto segments, what we could do as far as delivering for the auto supply chain.

CP, legacy CP, we were restricted with some of our reach and we had a strong origination here in Southern Ontario that could get to some of the auto manufacturers. But we didn't have -- have obviously the connection in Mexico and into the U.S. as we do now. And so, I'd say on a positive side, the auto franchise has been a significant enabler of synergy growth.

We had thought that about US $1 billion of revenue synergies was achievable, and about -- call it US $200 million of expense synergies. I think our revenue synergies are going to surpass that. We had framed it over a three-year period. I think we exited Q1 with a run rate closer to US $800 million, US $900 million of revenue synergies already, less than two years into the combination. So, I'd say that the overall size of the prize is going to be larger. And I think in some key end markets like autos, I'd say intermodal is going to be stronger.

And then I'd say that from -- where maybe we were a bit more optimistic was on the crude franchise. So, we had looked at opportunities to export crude out of Port Arthur and DRU product out of Edmonton to export, and potentially potash out of Port Arthur. Let's say that we haven't seen that market materialize in the near term. It's not that it's just going to go away. We'll keep pushing it, and it could be an opportunity in future years, but that's where -- maybe being a bit more negative. But overall, much more positive as of the size of the pie.

<Q – Walter Spracklin>: So, when we look at auto, I know auto was -- you gained some great traction in auto. We were in Wylie to look at your facility there a year ago. And it -- from what I heard from Jonathan Wahba at the time, you were exceeding already by the end of this -- the last year, your targets for around US $200 million. So, that's great. You're seeing high-teen on the back of high-teen, low-20 last year. So, it's great on auto that that's coming in.

But intermodal is where I'd like to focus in on a little bit here now. That's a big part of your synergy target. And when we were at your -- when we hosted the Vancouver port tour just a month or two ago, I kept hearing a lot about what Gemini was doing for you. So, Gemini is the alliance between Hapag-Lloyd and Maersk. I know Hapag-Lloyd has been a great customer of yours for so long, dating back to CP Ships, but Maersk was a new customer for you.

Can you talk a bit about -- and we put out a report on this yesterday, so I'd love to hear your thoughts on how Hapag-Lloyd is facilitating your potential penetration into Maersk and what it means as Gemini and the opportunity set there, both in Vancouver and in Mexico.

<A – Nadeem Velani>: Yes, so that alliance, I thought your report captured it extremely well. So, the alliance with Maersk and Hapag-Lloyd, Hapag-Lloyd is one of our largest customers. They've been a very, as you mentioned, a very strong customer of ours ever since CP Ships became part of their franchise. And the alliance, we continue to grow with Hapag-Lloyd, big part of our acquisition of the MMA was in -- was utilizing the Port of St. John as a key outlet. And it's -- they've been extremely successful in leveraging that port. And they've -- they being Hapag-Lloyd has -- that service has really resonated for them.

So, importing into the East Coast serving markets of Montreal and into the U.S. And so, continued growth with them in Vancouver. I think the bottom line is we've provided them exceptional service. It's allowed them to really improve their supply chain and capture business for their customers throughout COVID. And that growth is -- has led to an opportunity with Maersk. So, as they combined and had an alliance with Maersk, which was not a customer for CP of any sort of magnitude, now they're -- that alliance is, bottom line, it's going to be a pretty significant market share gain for CPKC as that alliance starts really ramping up.

And you're seeing it in the numbers today. I think our -- quarter to date, our international volumes are up more than 20%. You would never know that with the headline of all the tariff risk and all the -- what we're seeing on a headline point of view. But we're seeing it in our numbers. We're seeing it in our volumes. And that's just starting to ramp up. So, St. John, Vancouver imports into the – into Canada and to the U.S. That's going to see growth for us.

We're continuing to see growth in Lazaro to our earlier conversation about the synergies. Maersk has a big asset in and around the Port of Lazaro. And that's been an underutilized asset for some time that we've been really driving towards growing that port as well. And so, we're excited about what that opportunity entails.

<Q – Walter Spracklin>: So, the international intermodal component, about US $200 million, you feel good that you're – if maybe, perhaps you're there already, or you feel good about achieving those targets for sure.

<A – Nadeem Velani>: No, I think there's absolutely upside on the international side and intermodal as a whole.

<Q – Walter Spracklin>: Let's push to domestic. Obviously, trucking has been difficult. Pricing there, challenging. Talk a bit about how that part of your synergy, I think that one's also US $200 million forecast. How is that one coming along? And if it's coming a little slower, what's the opportunity going forward to get that?

<A – Nadeem Velani>: Yes, I think the trucking market, I mean, we've been in the middle of this freight recession for two-plus years, and you're seeing it through the trucking capacity has been much greater capacity than the market requires. And you've seen it on the pricing side. We were not immune to that. We've seen some of our domestic intermodal volumes in 2024 and 2023 not be as strong. And that's turned here in 2025.

So, part of it is our Canadian retailers that we're partners with have been -- we've been able to grow with them. And a big part of it as well is to your point about the synergies. So, we built this product, service, the 180/181 train, the MMX, that can go single-line service from San Luis Potosi in Mexico to

Chicago. It's single-driver competitive. And it takes time to build that up, especially in a loose trucking market. But we've seen that service and that capacity uptake increase. I think it's up 40% year over year. It's up 10% sequentially. We recently –

<Q – Walter Spracklin>: It's got to be pretty full. Getting –

<A – Nadeem Velani>: It's getting -- it's not quite full, but it's starting to really ramp up and just taken on some new business with auto parts that's going to be putting containers and put on that service from the Midwest into Mexico. So, we're starting to see that really ramp up. And that's why we have seen it in our numbers in our domestic intermodal. What was a negative, call it in that '23, '24 time period, has really turned positive, and we're starting to see domestic volumes up double digits to start the year. We're pretty bullish on our domestic intermodal.

<Q – Walter Spracklin>: That's all pretty impressive, right? You're seeing domestic up double digit during what's still being described as a freight recession. You've got international intermodal coming on. Bulk's doing amazing, right? Bulk's doing great. Every time we see good numbers out of you, I get the question: is this pull forward, right? Is this pull-forward numbers that are coming in ahead of a potential cliff that's coming up, perhaps in May and June?

We've seen the numbers coming out of LA-Long Beach saying that yes, there's going to be a big decline in -- or a big increase in blank sailings and so on. Are you seeing any of that? Are you seeing any pull forward? Are you seeing any evidence that this is behavioral and not demand-driven in terms of –

<A – Nadeem Velani>: No, not at all. So, in fact, when you look at our international volumes, I had a report this morning or last night from our team overseas and they're quite bullish near-term in terms of what's transpired over the weekend and what was reported as far as some of the negotiation between China and the U.S. And I think the fear was there was going to be some blank sailings or air pockets of volume. We're not seeing any of that on our franchise whatsoever.

And you can -- again, you see it in the numbers. Our visibility into the next six weeks is extremely strong. And in fact, the reports that we're getting is that we're going to start seeing it continue to ramp up as peak season is not too far away. Christmas shelves need to get filled. And so, I think from an international volume point of view, we're going to continue to see things ramp up. We're not going to see the blank sailings. We're going to see the benefits of the market share wins I just mentioned, as far as the Gemini alliance. So, I'm pretty bullish on international intermodal.

<Q – Walter Spracklin>: I've got -- that's pretty much all my volume-related questions. I'll go into pricing and expense. But any questions from the floor, perhaps from a volume perspective that Nadeem hasn't covered off? Okay, let's move down the income -- well, stick in revenue here and talk a bit about pricing. I mean, pricing can obviously vary by sector. Trucking has a weight on -- a bit of a drag on pricing, but overall, inflation is -- exists, and your ability to pass it on also exists.

Can you talk a little bit about any pushback you might have gotten in pricing? Have you been able to achieve the pricing gains? And is there any nice up -- still pricing to renegotiate -- or negotiate that can lead to continued upside in your pricing?

<A – Nadeem Velani>: Yes, so number one, the pricing, you got to have the service. And our service has been exceptionally strong. If you look at our key metrics, they've never been as good as we're seeing it today. I think the value of the CPKC single-line service is really resonating with customers, not only with synergies of new customers and new business, but also existing customers that are

seeing that ability for us to turn those assets and not have to interchange traffic to other rail partners. You're getting a more reliable and faster supply chain for customers.

So, with that, we're seeing the ability to see win-win opportunities with customers that are seeing the benefits of this. And when they own the rail cars, you look at, for example, our -- some of our petroleum chemical customers. In many cases, it's their rail cars. So, when you're turning those assets much faster, they're getting value in that. They're getting -- either they can reduce some of their inventory carrying costs, or even the rail car capital requirements are lessened. And so, there's a benefit to them and you can sell that service to the customer and get not only market share gains, but pricing benefits.

We also saw the benefit or the opportunity just to go back to one of your earlier questions, is where's upside? I'd say, as far as when we looked at the CPKC combination and synergies, pricing is certainly an upside area. When we opened the book and looked at opportunities and what was being charged by legacy KCS, they were charging what was appropriate for the network that they had. Now, you see this expanded network and the ability to have a better service, better product in the marketplace. That creates pricing opportunities and pricing synergies.

We saw the fact that our inflation had gone up rather significantly over the course of '22, '23. We saw the labor side really accelerate in terms of inflation. That has now moderated. That's now stabilized. But a lot of the book hadn't turned over yet in terms of being able to price for the new reality of the new cost structure of some of these higher inflation areas. And so, we've been able to continue to increase pricing and see value from that piece. But the spread between price versus our own cost structure is starting to increase. So, we'll start seeing the benefit of that in our operating ratio.

When we look at pricing today, we're in that 4%-4.5% type of range. Still closer to 4.5%, but inflation has moderated significantly. And so, that spread is an opportunity for us. But again, you have to have the service, and you have to have the value for your customers, which we're seeing.

<Q – Walter Spracklin>: Let's move now to capacity. And obviously, you're seeing -- you talked a bit about how bullish you are about some of the growth you're seeing onto the network. Oftentimes, you don't notice capacity constraints until you get that volume and you see where the pinch points are. What -- how do you feel about your capacity to bring on new business? Are there any pinch points along any parts of your network that you think need some investing in? And just your overall view on your capacity would be helpful.

<A – Nadeem Velani>: Yes, so a couple things. First of all, when we entered our Day One of our CPKC transaction, we wanted to make sure we serviced the heck out of the business and make sure that we weren't short on capacity. It was a tough time to get people, to get -- takes a while to hire and train conductors and engineers. And so, I'd say that we were long on the people side, partly by design.

And partly, we were in this freight recession that was unexpected. So, I think we had overestimated the opportunity as far as the volume side. So, we had more people than required. And we also had more people by design, given the spotlight we would have and given the fact that you didn't want to enter a Day One in the first Class 1 consolidation in 20 years, and not have the people.

So we're growing into that, the people resource. We have hourly agreements on much of our U.S. portion of our network that gives us flexibility as far as being able to be more productive with our train and engine workforce in the U.S., and that gives us the ability to flex up and down. There's an

opportunity to continue to build upon that hourly agreement in the U.S. that we're working on today.

So, from a people point of view, I don't see any challenge from a capacity point of view. We've been aggressive acquiring railcars to support some of our synergy growth and volume growth as well. We took on 1,000 reefers that will support our intermodal synergies. Recently, we've -- we're about to take on additional locomotives, 100 new locomotives. The first ones CP has bought -- or CPKC now -- in over 12 years. So, I think we've -- we look very -- from a resourcing point of view, I think our network is set up extremely well to take on this volume, and that's going to bring up -- come on at low incremental cost.

And finally, I'd say that from an infrastructure point of view, part of our commitment for the transaction was to invest into the infrastructure. And KCS was early days of PSR, didn't have the benefits of the long sidings and the ability to run longer trains and a more dense network. And so, we've been investing in -- on our, mainly on the U.S. side of the network as far as infrastructure and capacity, as well as our Mexico franchise in order to really see the benefits of PSR and the ability to ultimately benefit the customer from the single-line service and running longer trains and more dense traffic. And so, we'll start -- we're good on capacity.

<Q – Walter Spracklin>: So, with – now dovetailing that into capital, I know you talked a lot a bit -- a lot about growth over a multi-year time frame, you kept that CapEx band steady. Are you comfortable that you can maintain CapEx within that band? And then if we could talk a little bit about what you do with the excess cash, in terms of you started up your repurchase program recently.

<A – Nadeem Velani>: Yes. So, bottom line is, yes, we're comfortable in that $2.8 billion-$2.9 billion CapEx range. It's one area that we've seen that weaker Canadian dollar impact us to an extent. A lot of our capital is in U.S. dollar currency. So, we see a benefit on our operating income, but it does hurt us on the capital side. So, that's why it's been inflated closer to $2.9 billion for this year, as opposed to our long-term guidance in that $2.6 billion to $2.8 billion.

Apart from that, though, we're -- I don't see any reason why that wouldn't be within that range. There's always tariff noise, and that could have an impact and retaliatory tariffs on the Canadian side. But we're working through that process to ensure that we're not impacted from a CapEx point of view.

<Q – Walter Spracklin>: And the share purchases, I think -- I detect a little bit more of a strategic aspect to your share repurchase plan, that you're going to have this base. But I think the rating agencies have given you a little bit of flex in terms of being more tactical with your share purchase. Did I -- am I reading that right?

<A – Nadeem Velani>: Yes. So, one of our commitments, we want to make sure that we followed through on our ability to get our leverage back to the 2.5 point -- 2.5x debt-to-EBITDA that we had -- that we were at when we entered our transaction. We spend a lot of time with our rating agencies. We want to make sure that we're not doing something that is putting our balance sheet at risk.

I think when you look at where we were as CP versus where we are now at CPKC, we've grown in scale significantly. We shown our -- we showed our resilience through COVID. Our ability to get through that time period and still see volume growth and show that our balance sheet can still withstand a shock like COVID was. And we continue to delever. We didn't do anything from a capital return point of view for five years post the announcement of the deal and brought our leverage down closer to that 2.5x level.

Now, the feedback from the rating agencies was also we -- they would support a higher leverage target, given where we stood within the industry and given some of our peers. And so, we raised our leverage target closer to 2.75x. And that is impacted by the Canadian dollar, obviously.

So, our balance sheet, a lot of our debt is U.S. dollar-denominated. And when that Canadian dollar weakened significantly, we were still closer to that 2.9x leverage. But given our confidence in the business, given our confidence in the ability to execute, our visibility into our volume outlook, we were very confident in order to pull forward our share buyback.

So, we announced it maybe a month early, six weeks earlier, in March, and took advantage of the pullback in our valuation and pullback in the markets. And yes, so we're going to be a bit strategic and be aggressive on the buyback. We've bought back -- we announced a 4% program. We've probably bought back a quarter of that to date at prices which we think are very much undervalued relative to our intrinsic value.

So, when you see these pullbacks, I think there's an obligation to be a bit more tactical and being able to not just have an ongoing buyback but also be strategic where there's pullbacks. And I think our shareholders will be rewarded long term. And I think the feedback has been very positive.

<Q – Walter Spracklin>: A few minutes left here. I'm going to move into expenses and OR, but any questions from the floor for Nadeem? All right. Okay, so let's move into the OR discussion. And obviously, February was a tough month. We had some real cold weather. My hockey rink has never been better this year, so it was great for that, but bad for railroading. You had to tighten in your train lengths. That leads to inefficiency that affect your results in Q1.

You signaled that in Q2, that was going to improve. We're looking at the metrics that come out from the AAR. It certainly seems like it has been. Can you give us an update as to how the fluidity and how the network is running?

<A – Nadeem Velani>: Yes. So, bottom line, Q1, we reported a 62.5% OR, which is a 150 basis point improvement year over year. We're pleased with the results. I think Q4, we were closer sub 58% to end 2024. To my point about -- we've seen volumes continue to accelerate, April was a very strong month. We feel really good about our volume near-term in May as well. And I think to my earlier comments about our visibility into not having any cliff coming and double-digit volume outlook on grain, strong grain pricing. And bottom line is our operations are running extremely well. And that leads to operating efficiencies.

I think we're continuing to see sequential improvement in the OR from Q1. I mentioned I think we could do 200 and 250 basis point type of improvement Q1 into Q2. I'm certainly not backing off of that, given the fact that volumes have been a bit better than expected both in April and May. And I think for the year, a sub-60% operating ratio for full year 2025 is certainly within the cards and within our outlook. So, I feel good about how we're running, our ability to run efficiently.

We have very easy comps in the back half of the year. We had labor disruptions. We had port disruptions. We had a significant derailment in Q3 of -- that had expense costs -- significant expense costs associated with it. So, I feel really good. As we stand here today, we had lowered our guidance in Q1 modestly, and that was really driven around the fact that the Canadian dollar had appreciated rather rapidly. That has now turned a little bit more favorable, given the stability in the markets and the stability in the U.S. dollar. So, that's probably upside given where we were a month ago.

I think the tariff news is upside. I think the headline risk of a recession has probably lessened as we sit here today than where we were a few weeks back. So, do I think that we're going to hit the high

end of our guidance for the year? Absolutely. Is there upside beyond that? Potentially. So, I feel really good about where we stand here, almost five months into the year.

<Q – Walter Spracklin>: That perhaps is my last question then in -- and I picked up on it in all your answers here is better than expected. Blank sailings that aren't going to come in. Are you hearing a change in your customers that perhaps were going to tighten back, pull back a little bit, are now giving you indication that this is not going to happen?

And you already answered the question, but what is that in terms of the new guidance range that you provided? It sounds like there is upside to that. But is it happening that fast where a customer will come in two weeks ago and say, look, we're going to start slowing down a bit, and then the news comes out and a tweet come -- happens and we're back on again. Is it that dynamic?

<A – Nadeem Velani>: It -- to an extent in some markets, absolutely. Bulk is pretty solid. It's been that if we're going to grow it, we're going to move it. And the grain market is very strong. I'd say that in some areas, like international and in autos, there's a bit more of that dynamic. And like I mentioned on the international side, things are extremely strong. We're starting to see -- we're going to start seeing that ramp up for peak season.

And on the autos side, I think our order book for current week and the last few weeks has been exceptionally strong. And so, I think the worst is behind us in that segment. So, yes, that's a big reason for my optimism now that's continued to improve over the last month.

<Q – Walter Spracklin>: That's fantastic. Well, we're out of time. Well, thank you very much, Nadeem, for your time, as always. Thank you.