Transcript

Barclays 43rd Annual Industrial Select Conference

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Webcast

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Chris De Bruyn – Vice President Capital Markets

Other Participants:
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QUESTION AND ANSWER SECTION

<Brandon Oglenski>: All right. Good morning, everyone. Welcome to Day three of Barclays 43rd Annual Industrial Select Conference. I'm Brandon Oglenski, Airline and Transport analyst. And very excited to be kicking off day three here with Canadian Pacific Kansas City, and joining us from the company, Keith Creel, President and Chief Executive Officer; and Chris De Bruyn, Investor Relations and Treasury. So very excited to have him here.

I think we're going to have a lively conversation. But I'm sure you guys have been through the fireside. Now if you can pick up a little keypad there, we'll go through an audience question number one.

Do you currently own CPKC? Yes, overweight; two, market weight; three, underweight; and four, no. Go and vote really quick. Appreciate everyone participating. We do publish these after the conference.

(Voting)

Okay. Question number two, please. What is your general bias towards CP right now? Positive, negative or neutral. And then question number three, please. In your opinion, through-cycle EPS growth for CPKC will be above peers, in line with peers or below peers? Thank you, go ahead and vote.

(Voting)

Well gentlemen, thank you for coming here to Miami. Really appreciate you being here. I think a lot of folks in this room and at this conference have been talking about railroads and specifically M&A. And Keith, I mean I want to ask a lot of questions about your business too, but obviously that's a topic that I think has been close to every rail CEO here. We just had Jim Vena on stage yesterday. Obviously they have the view that this is going to be pro-competitive. But I think CPKC's had a slightly different view on the proposed UP-Norfolk merger.

<A – Keith Creel>: Well I would say that would be correct. I've been very transparent about our feelings relative to, I guess, two aspects. One, CPKC's view; and then two is someone that's been in this industry now for 3.5 decades and have lived and experienced consolidation of this industry, the last round back in the '90s and early part of the first 10 years of my career, I've got some pretty strong views about the risk that those consolidations entail and what they represent.

So from a CPKC standpoint, that's the first place to start. And for my responsibility, most support it. The threat of consolidation or the reality of the UPNS combination, I guess, better said, is not that concerning to me, in and of itself. Given that we're North-South network, there's very little of our business, it would be directly exposed to the competitive dynamic that they would represent going East and West, in fact, less than 1% of our revenue. And I think if you look at their own submissions, it's about 30,000 carloads.

It's about $100 million. So yes, $100 million is $100 million. But that said, if the deal were to get approved, I'm confident based on my knowledge of the regulations, the law as well as the competitive dynamics and the regulators themselves having the experience that we obtained in achieving our consolidation three years ago, that the deal to get -- if it gets approved again, it's going to be with significant concessions that would allow us opportunities in markets to participate today in bringing customer solutions that at the end of the day, would drive upside opportunity for us.

So I think that's the first place to start. So it's not a threat of competition. The issue of concern to me, most importantly, for the industry is unnecessary consolidation. And again, the risk both in operational integration, day-to-day operation of something that big, literally a Goliath in the industry relative to the operational concerns as well as the market power and the concentration it creates.

And then layer on top of that, especially, and this is not a secret, if you've been in this industry, if you think about any one railroad that's never been bashful or hesitated to use their power, their size, their scale to try to impose their will on customers on other railroads. It's Union Pacific historically, and Union Pacific was the product of significant consolidation. They came as they are today back in the '90s, a very painful process through the two meltdowns that they created and their integration itself.

But since then, there are numerous cases and instances of other railroads, customers, use of embargoes or abusive embargoes, there's a litany of issues of concern. So again, it's not competition that concerns me.

It's anticompetitive behavior that concerns me. And quite frankly, I may be one of the only people sticking our voice out or extending ourselves and speaking so strongly about it, but rest assured, there's no shortage of customers and/or other railroads or other constituents that had to deal with that size and scale and that behavior that don't share the same concerns.

And this process, as it unfolds, once they resubmit their application and concerned parties filed their notice of intent to participate, so they have a voice on file and in the regulatory review process will unfold over the next, what, I guess, it's going to be April 30 is what they've said. So once that application is accepted, there's about a 30-day period by the statutes.

I believe this next application obviously should be and would be accepted by the STB. And from that point forward, there's an additional two weeks. So that window up until, I guess, it would be the middle of May is a critical window for those that may be concerned about this application and their ambitions to file their notice of attempts so they can participate and voice those concerns.

<Q - Brandon Oglenski>: Well it sounds like maybe you said you're not concerned necessarily from a competitive standpoint. But you still have the view that this doesn't necessarily enhance competition in the industry. Is that right?

<A – Keith Creel>: Yes. That's at least what they proposed at this point. The reality of the new rules which have never been tested. They were written in 2001 and prospective matters, they were written full stop to pause and stop mergers. The industry has gone through decades of

consolidation. There was an over abundance of capacity. The previous rules to 2001, in fact, encouraged consolidation.

But at that point, the regulator, the STB, Linda Morgan specifically was the Chair, said enough is enough. The BN Canadian National initial application to merge is what triggered that. And the rules were rewritten to effectively raise the bar to essentially say, you've got to serve the public interest, part of sublet public interest is you've got to satisfy that you've enhanced competition relative to the shippers and the shippers with a primary concern to make sure that the goods outweigh the bads of the consolidation.

So that's the formula. That's the math. And that's the reason, in many ways, we've said all along that their application was incomplete because it didn't address all of the market analysis, obviously which is what the STB called out. And in fact, their definition of enhanced competition which is being defined by their gateway pricing mechanism they put in place which has an expiry date, by the way, to me, falls grossly inadequate.

It's way short of what the law requires. It's way short of what the STB is going to require. So no, I do not think as it's presented now that it remotely addresses the definition of enhancing competition.

<Q - Brandon Oglenski>: Okay. I guess along these lines, what would you guys be looking for specifically in form of concessions?

<A – Keith Creel>: The concessions we'd look at, and we've developed a pretty fulsome list, essentially boils down to opportunities and access for our customers and for our shippers to get into markets that perhaps we don't get into today.

So if you look at any locations where we overlap, you can look in Chicago, you can look in St. Louis, you can look in Kansas City, you can look at that in Baton Rouge locations where UPNS, CPKC exists today. When you combine the two regardless of UP's position, the 4 to 3s, the 3 to 2s, not just the 2 to 1s, all to me are part of defining are you satisfying enhancing competition or are you reducing competition? So anywhere that logic would apply, you can expect us to be looking at potential concession requests with our submission that we give the STB.

<Q - Brandon Oglenski>: Okay. I guess specific to your business, and not to pivot. But I guess you guys are benefiting from the consolidation you drove with Kansas City in 2023. Can you talk to markets that are still benefiting from those synergies of that network combination this year?

<A – Keith Creel>: Yes. So let me -- that's a good point because some -- obviously there's some people in this room that aren't aware of our story. Let me back up just for a minute. So our combination, we were the first merger that's existed or created in the industry three years ago, April the 14th will be our three-year anniversary. It's two companies, both that they date back to the 1880s, two historic railroads, but the two smallest railroads of all the Class 1s, that came together.

It was truly an end-to-end, hand-in-glove, Kansas City, was the southern tip of our network and Kansas City was the northern tip of the KCS network. So we uniquely and only connect all three nations through this infrastructure that we combined in our transaction back in 2023. That said, by definition, zero, not one customer lost options. We were additive to interline options for the lanes

that we operate in. So it's not an issue of meeting the old standard or the new standard by either definition, although we went under the old rules, we absolutely enhance competition.

We created, for instance, an additional single-line move from Chicago to the border of Texas. And in fact, because of our continuity into Mexico on our network, we have a single line move that's created a tremendous benefit for customers that's directly truck competitive that runs out of Chicago every day that goes deep into Mexico, it goes to Monterrey and it goes south near Mexico City.

You're talking about truck-like reliability. You're talking about truck competitive service and the border becomes seamless. So in that case, and that's part of what we've grown with over the last several years, that is a perfect example of enhancing competition. That's a perfect example of building and optimizing a single-line network that allows customers to benefit from truck-like reliable service.

It does take trucks off the road. It has taken trucks off the road. It's a win-win. That said, the scale that we've created, again, we enhanced, we added, we didn't eliminate anything. And then the scale we created from a market power standpoint, it's still the two smallest coming together to become the smallest. We don't have market concentration power where customers feel that we're going to use our size and scale to impose our will impose our rates or impose our service on them. They have a choice.

<Q - Brandon Oglenski>: I guess, again, specific to that, Keith, where you guys actually guided probably to the best outlook this year within North American railroads. I think double-digit EPS growth rate, low double digit. And within that, I think mid-single-digit RTM growth, but it looks like the first quarter might be off to a slightly more difficult spot. Is that right?

<A – Keith Creel>: Well I think it's all relative again. We said what we would expect to happen, if we go back to last year, remember last year, we had kind of a pull forward of freight in the industry given the looming threat of the April 2nd tariff liberation day effectively. So from a compare standpoint, we're up against some pretty tough compares. However that said, we go into January of this year, carrying tremendous operating momentum.

We closed out December with great momentum and cost control. And while we had a bit of, let's say, a bit of a headwind in January, we expected flattish RTMs. We were down slightly. But now if you get into February, the grain harvest which this year is a record grain harvest, 85 million metric tons, it's 23% more than last year. We've got a tremendous amount of demand for our grain and the grain is flowing and moving.

So this year, month-to-date or this month-to-date, we're up 11% this morning. For the quarter, now we're plus 2.3%. So again, we're in line with exactly what we thought. In fact, we're gaining momentum relative to the demand that's out there. And it's driven by grain, it's driven by continued demand and growth in our 180/181 product, that's the train I talked about a moment ago that run Chicago to Mexico on a daily basis. And then, of course, the reverse route going North.

It's driven by international growth. Our alignment last year with Gemini which is the strategic combination of Maersk and Hapag-Lloyd which are our two flagship carriers. That continues to

grow for us. This year, we've got St. John with an expanded capacity. They'll be discharging more there as well that's continuing to grow. And then Americold which is a company that was also enabled by our transaction. It's one of the United States' leading cold storage facilities.

They built a facility inside our terminal in Kansas City. That was a multiyear process, US$137 million capital commitment on their part. It opened in August and has started to ramp up. We're running about 200 loads a week now, proteins going south to Mexico, refrigerated goods coming back north, and that's going to continue to ramp up through this year.

So if you start to look at these levers that were all merger-enabled. They're all synergies that we've committed to and we're converting. I think we exited last year at US$1.2 billion of new revenue synergies that the merger has enabled. We're going to add another US$200 million this year.

So if you put all that together with strong cost control, that's what gives us strong conviction in line of sight to again hit a double-digit earnings CAGR, operating margin improvement again this year based on mid-single-digit RTM growth for the year. And given that and despite of the challenge in January in winter, the railroads never ran better, cost controls continue to gain momentum and demand is ramping up. And that's all in the backdrop of still flattish macro.

Now there's green shoots. We see the same things when others are seeing relative to truck capacity tightening up. We haven't seen the economy turn yet, but we think it's on the verge. And once it does, if you layer on regular GDP growth, then that's going to get us back to the CAGR we talked about at our Investor Day which is not mid-single digit RTM growth, it will enable high single-digit RTM growth.

<Q - Brandon Oglenski>: And by the way, if there's audience questions, just raise your hand, we'll get you a mic. Keith, can you talk about the tariff environment though, especially between Canada, U.S. and Mexico. And I believe we're going to be -- or we are renegotiating USMCA this year, correct?

<A – Keith Creel>: Yes. Well listen, we knew last year, given historically what happened with USMCA. We knew that President Trump, who was the signatory and the originator in support of the agreement that's being renewed this year in his last administration, we knew there'd be some choppy waters.

I did not think that the tariffs would have the impact that they had or be so profound as they have been, not just in the United States and with Canada and Mexico, but worldwide. I don't think anyone would have assumed that. That said, President Trump wants to rebalance trade, and that's what we're seeing the curve. We saw an impact last year, the changes that were made on our steel franchise, aluminum franchise, automotive franchise all in, it was about a $200 million haircut for us.

That said, we believe kind of what it is, is likely a worst outcome. And from this point to these negotiations, we firmly believe that once this thing settles down, some of the investments, some of the decisions that were kind of put on pause, waiting on this uncertainty to clear up. We'll re-engage later this year. We're hopeful that this gets renewed, renegotiated through the next several months.

It's supposed to be renegotiated by the end of this year. And again, that's going to free up capital. That's going to free up decision makers to continue to invest in these three countries. And given that we uniquely connect all three, even if it rebalances, we believe we're in a prime position to benefit from increased trade, especially between Mexico and the United States.

And in fact, if you think about this, probably a lot of people don't realize, the reality is when it comes to our network, there's about 18% of our revenue that's represented between trade between the United States and Mexico on CPKC, 2.5x more goes south than comes north. So 15% of the 18% literally is traffic that we're originating in the United States that's going to Mexico.

It's an export move, it's not an import move. So I believe, as we go forward, the labor force in Mexico is plentiful, proximity to the marketplace. It's diversified risk from overseas suppliers. There's a strong partnership between those two nations, United States and Mexico and as well as Canada in the United States. So we will get back to a place where you're going to see trade grow between the three nations once the uncertainty gets resolved relative to the tariffs that President Trump had put into place.

<Q - Brandon Oglenski>: But to be clear, even in places like automotive, you're seeing incremental growth of customers. Is that right?

<A – Keith Creel>: Yes. The uniqueness to our network in spite of the tariff challenges, we've created something that's kind of a niche. And this is something that goes back to 25 years ago, experience that I had in this industry. The way the automotive market has always worked, kind of the Mississippi River is the dividing line for the lack of a better term. The eastern carriers would originate finished vehicles at the automotive manufacturing locations which primarily were heavily concentrated in the Michigan area as well as in Ontario.

And then we ship west, you go to Chicago was the typical gateway and you give it to the UP or give it to the BNSF. But if you're the originating carrier, you were only as good as their ability to turn the empty back to you once they offloaded it.

So it created a disconnect in the supply chain that has forever been very, I guess, noisy for the OEMs. Quite frankly, we originated quite a bit of traffic. That's when I worked for another railroad in Michigan, and I got kind of tired of being yelled at by General Motors were not having any car supply. So when we put this network together, thinking about those complexities.

We have an ability now with the strongest automotive origin network in North America, facilities that originate manufactured vehicles in Canada, facilities, 16 locations we serve in Mexico, those are the bookends. So the concept is if you keep the car fleet on your railroad, you don't interchange.

It's called a virtual loop with those cars, those auto racks. You load it in Ontario or you load it in Michigan you ship it to a dealership in our instance, say, in Dallas, Texas or at a Wale terminal, you offloaded make it empty, you reposition it to Mexico. You load it back up with vehicles, you ship it back to Dallas, you offload it, you send it back to Ontario, you send it to Minneapolis. So again, these cars just cycle like a supply chain, a constant belt, a constant loop.

And when you do that, you solve tremendous supply chain challenges for the OEMs and the

exchange is, the rates are higher. You guarantee car supply which has never been done in this industry. So we have guaranteed commitments, take-or-pays with our OEMs that we have this model established with. We charge a higher rate, but they get a better quality of service.

And in the end, because you've eliminated this inconsistency, their supply chain, their assembly lines continue to move, you take noise and you take cost and you create liability for the OEM and they're willing to pay for that.

So that's been something that's allowed us the last three years. converting modal share even in a shrinking automotive market because of the uniqueness of the product to bring value to the OEMs and they reward us with additional market share in business. And it's extended length of haul. We eliminate empty miles, it's efficient for us, it's efficient for them.

<Q - Brandon Oglenski>: Maybe it's a good time to queue up question number four for the audience. If you guys don't mind grabbing the key pads. In the back, please question four. Yes. In your opinion, what should CPKC do with excess cash, bolt-on M&A, larger M&A, share repurchases, dividends, debt pay down or internal investment? Okay.

And then question number five, please. In your opinion, what multiple of 2026 earnings CPKC trade. We can vote now please. Multiples have come higher over the years. We use the same range for a decade.

And then last question, please. What do you see as the most significant share price headwind for CPKC - core growth, margin performance, capital deployment or execution and strategy?

Chris, maybe while we wait for this. Can you talk to the capital budget this year and what the priorities are, especially across the network as well?

<A – Chris De Bruyn>: Yes, for sure. Thanks, Brandon. So when we put the two companies together in 2023, we laid out, capital guidance of $2.6 billion to $2.8 billion. A lot of that capital initially was focused on building capacity into the network. So key investments such as twinning of Laredo bridge, merger sidings, adding CTC across the network.

So a lot of that core infrastructure and capacity has been put into place. Our capital priorities have shifted a little bit now. We're spending more on locomotives. We brought 100 new Tier Four locomotives onto the network last year. We've announced that we're bringing on 100 more Tier Four locomotives this year. And you've also seen us take our capital down.

So our capital year-on-year is going down to $2.6 billion to $2.7 billion, that's a 15% decline. So we're going to be producing a lot more free cash flow. And you saw us in January announce a 5% share buyback program. So that capital allocation policy is certainly aligning with the numbers we saw in this.

<Q - Brandon Oglenski>: David, did you have a question?

<Q - Unknown>: Can you talk about how Laredo expansion has compared to what you expected? And then any second order effects on operations, how that's created commercial opportunities?

<A – Keith Creel>: What was the first question, sorry?

<Q - Unknown>: How the Laredo expansion has compared to your expectations?

<A – Keith Creel>: So at the end of the day, that bridge, we've got -- if you look at our network, Laredo is the single largest, busiest transit location, commerce location when it comes from movement into and out of Mexico and the United States. We control the route. There was a single bridge that we share with the Union Pacific. Union Pacific actually comes together at our railroad literally at the bridge and a lot of people probably don't realize this south on that route in New Mexico we're Union Pacific's agent.

They pay to use our railroad. That said, that bridge in the past has been a bit of a choke point. So when you look at a PSR railroad, you identified locations that create congestion or capacity constraints. And as the throat of an hour glass goes, that was one location. So back actually when President Trump was the President -- his last administration, Pat Ottensmeyer and team worked closely with the Canadian government and with the administration to get a permit to get authority to build a second bridge.

So we started on that bridge when the company combined and completed it last year. We now have dual bridges going across the river that allow us unfettered access in and out of ability to pass trains. So it's effectively doubled the capacity which we don't need completely today, but for the next 100 years, we're set up in a very good position from a capacity standpoint.

And the other key aspect, if you get into some of the challenges with the bridges and the passes into and out of Mexico from an immigration standpoint. Just last year, maybe it was the year before kind of all the years run together now. The Eagle Pass alternative which is the other border point that UP and BNSF use today currently was shut down a couple of times by the U.S. government because of issues and concerns about security and illegal immigrants coming across the border. That's not an issue at Laredo.

We have an exhaustive security system, where we've integrated deep into Mexico. We are known for the most secure passage way into and out of Mexico when it comes to damage, when it comes to theft, those type of things, they happen occasionally in our railroad, but it's more an exception, not a rule.

So that's another value add for our customers when they ship across that Laredo Gateway. It's not only the fluidity, but it's also equally as important, the security of their shipments. What was the second question?

<Q - Unknown>: Have (inaudible) created additional commercial opportunity –

<A – Keith Creel>: Yes. Actually, that security piece, you'd be surprised, is critically important to customers. Just last week, we -- because of our reliability that we've created through this gateway, we won a big contract with a manufacturing company, a well-known name here in the United States, a product that's produced in Mexico that shipped to the Midwest for distribution, that has been running pure truck. Well we went to them two years ago, sold a concept to them that, listen, we've got a truck-like reliable service.

We can give you a hybrid model of not just truck but also boxcar, because some of the shipments, they're going to big box retailers here in the United States, they need it on the shelves. People want these products immediately, washers and dryers, when it's broke, you want one now you don't want when two weeks from now. So they had to keep stock in the Lowe's of the world and the Home Depots of the world that's readily available to be purchased.

But there's also backup stock. So if you combine the two, we've allowed them to make a modal shift and save money from trucking by putting it into rail, both boxcar and as well as our intermodal product.

But one of the key aspects, it's their reputational reliability and their contracts of delivering those truck shipments which are now on rail to the Lowe's of the world, to the Home Depots, they take significant fines and reputational damage from a reliability standpoint if the shipments don't get there, and they have been dealing with.

And I don't think this is a secret some of the cartel challenges and issues of product being commandeered on the highways of Mexico which our solution eliminates. So again, there are customers that are starting to see and experience the value of that security aspect. It's not just something we talk about, it's something that's material to their bottom line.

<Q - Brandon Oglenski>: Keith, we only have about a minute left and so much more to talk about. But I guess maybe not a topic that's been pretty relevant here, inflation. And I think inflation has been running higher for most railroads including CP. But you're guiding to margin expansion this year. Just how are you managing through higher cost inflation, but also driving better outcomes on the bottom line?

<A – Keith Creel>: Well the reality is that PSR operating model, we're a railroad that's never apologized for it. It's part of the way you run a business. It's all about managing processes, optimizing processes, controlling costs, eliminating waste. So the exercise of doing that, you create efficiencies and doing more with less - labor, productivity across the board that allows you to offset the headwinds that you have with inflation.

The other key issue that we benefited from is in Canada, we have not experienced the same wage inflation that the U.S. roads experienced. In fact, we just through an arbitration award, renewed our contract last year which is for the next four years. We've had one year, so we've got three years left on it, and that was a 3% wage increase which is dramatically different than what the U.S. roads experienced in the United States.

So again, when you combine the cost control, you combine some of the things that we've done relative to labor as well as through the consolidation in our purchase services, our ability to scale and size that we've obtained to work with our suppliers to get better rates for and to drive cost savings to the bottom line to offset some of those efficiencies and some of those issues with inflation have allowed us to continue to improve our margins and offset what the market would give us otherwise.

<Q - Brandon Oglenski>: All right. Well Keith, Chris, thank you very much for attending. Appreciate it.

<A – Keith Creel>: Thank you.