Transcript

Q4 2019 Earnings Call

January 29, 2020

Corporate Participants:

Keith Creel – President & Chief Executive Officer
John Brooks – EVP & Chief Marketing Officer
Nadeem Velani – EVP & Chief Financial Officer
Maeghan Albiston – AVP, Investor Relations

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, thank you for standing by and welcome to Canadian Pacific's fourth quarter 2019 conference call. The slides accompanying today's call are available at www.cpr.ca. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

I would now like to introduce Maeghan Albiston, AVP Investor Relations and Pensions to begin the conference.

Maeghan Albiston

Thanks, Jack. Good morning, everyone, and thanks for joining us today. Before we begin, I want to remind you that this presentation contains forward-looking information and actual results may differ materially. The risks and uncertainties and other factors that could influence our actual results are described on slide 2 in our press release and in the MD&A filed with Canadian and US regulators. Our presentation also contains non-GAAP measures, which are outlined on slide 3. With me here today is Keith Creel, our President and Chief Executive Officer; Nadeem Velani, EVP and Chief Financial Officer; as well as John Brooks, EVP and Chief Marketing Officer. Our formal remarks will be followed by Q&A and in the interest of time, we'd ask if you could limit your questions to two. Now, my pleasure to introduce our CEO, Keith Creel.

Keith Creel

Thank you, Maeghan and good morning. Thank you for joining us this morning to review our fourth-quarter results as well as our view on what we see as another strong value-creating year ahead for our shareholders, our customers, and our CP family. I can tell you, as a leader, it's my honor to represent the results we're going to cover on behalf of our CP team which I'm extremely proud of. For the quarter, the team delivered fourth quarter revenues of CAD $2.1 billion, operating ratio of 57% and adjusted EPS growth of 5% for the year. I'm extremely proud to report financial records across the board for revenues, up 7% and all-time high of CAD $7.8 billion, combined with an all-time record operating ratio of 59.9%, producing operating income growth 10% to CAD $3.1 billion and adjusted EPS of CAD $16.44, another double digit year increase of 13%.

These strong results were driven by an industry-leading operating team. As I advised on our last call, Mark Redd, who we promoted to his new role as EVP of Operations, started in September of last year in his first full quarter in this role. The results serve, I believe, as a true testament to what a true leader does. Leaders do not sustain performance, they improve them. Mark and the talented group of men and women he leads daily set a number of operating metrics through the quarter. Terminal dwell down 9%, car miles per car day, CP record up 11%. Locomotive productivity up 5% and trip plan compliance as well an impressive 90% for the quarter. All, again, a testament to the power of executing with our proven operating model. So, a special thank you to all those dedicated railroaders, the men and the women that serve CP across all of our departments, with a special unique thank you and words of recognition of the men and women that work in our Winnipeg terminal. Their contributions to our success, which is obviously covered in these results, earned the distinction of Terminal of the Year in 2019, which I look forward to honoring at our upcoming CEO awards in a few weeks. Speaking of safety, which is foundational to all we do at CP, I'm also proud to report a strong performance in the quarter, with train accidents down 31%, personal injuries down 10%. Safety, being paramount to our success at CP, precision railroading isn't about cutting to the bone or sacrificing safety to achieve results. It's absolutely about earning financial returns that enable reinvesting into the network to ensure a safe physical plant that when combined with

the culture of accountability, care and concern for each other, it allows us all to go home safe every day, which is our fundamental objective. That said, I also want to recognize a few pockets of safety excellence among many at CP. In Thunder Bay, Ontario, where our running trades employees have worked in excess of 1,150 days injury free, as well as our locomotive shops in Vancouver and Winnipeg, for both have worked in excess of 900 days injury free. So, thank you for setting an example of excellence for all of us to follow.

I'm also happy to highlight a number of positive announcements this past quarter that will be benefiting this franchise and our shareholders, customers, and fellow colleagues for years to come, namely, in the CMQ acquisition. In November, we announced the acquisition of the Central Maine and Québec Railroad. This acquisition enables CP to extend its reach to St. John on the East Coast, New Brunswick and increase our presence in the eastern US with access to a port in Searsport, Maine. We closed the transaction successfully at the end of December. I was excited about the strategic value of the network addition which enabled when we purchased it, but after spending time on railroad the last few weeks, I feel even more compelled and convicted about the addition to our CP family franchise and the value it represents. The value proposition is simply compelling. Operationally, we'll work hard at bringing our expertise, our safety record, and our disciplined culture to the railroad as quickly as we possibly can. Commercially, the customers are extremely excited to have service alternatives which they simply have not been afforded in over two decades. We'll be able to offer the shortest routes from the Maritimes to Montréal, Toronto, Chicago, and Western Canada that will be truck-like reliable, and truck-like competitive. On a service standpoint, it obviously, much more compelling than a cost standpoint. We're going to stick to our expertise making a rail acquisition where our team has proven that we know how to create service solutions that enable compelling value for our customers, for our shareholders, both at the same time.

And then on to what truly gets me most excited about the topic of crude oil is our DRU announcement. As John's going to speak shortly, in December, Gibson and US Development, great business partners to CP, announced they'll be constructing and operating a diluent recovery unit near our rail served terminal in Hardisty, Alberta. This is a game changer for crude and what is a unique and innovative development that will enable our franchise to enjoy sustainable crude-by-rail revenues that are safer and more efficient to move for the long term, which is unique to CP's franchise in Canada. And finally, on guidance as I stated in our press release, we're targeting mid-single digit RTM growth, continued opportunity to improve margins and high single to low double-digit earnings growth. I can tell you, I've never been more convicted or confident in this team's ability to deliver on our long-term potential in our journey to produce continued sustainable profitable growth. 2019 marked the second consecutive year we've led the industry in volume growth and as we enter into 2020, I certainly expect to continue that trend as we deliver another record-setting year. So with that, I'm going to hand it over to John to bring some color on the markets before Nadeem closes as he elaborates on the numbers and we open up the discussion for questions.

John Brooks

All right. Thank you, Keith, and good morning, everyone. So, total revenues were up 3% this quarter to a record CAD $2.1 billion. RTMs were down 3%. FX was flat while fuel was a 1% headwind, and pricing landed in our targeted range while mix was slightly positive. The quarter was not without its challenges, as you saw. But you also saw the resiliency of the CP family that Keith just spoke about. We steadily gained momentum across the quarter and across our book of business. We are carrying that momentum into January and into 2020. On the year, total revenues were up 7% and on an FX adjusted basis to a record CAD $7.8 billion.

So, we'll take a look now at the fourth-quarter revenue performance on the next slide and I'll speak to the results on a currency-adjusted basis. So, grain volumes were flat on the quarter, but revenues were up 4%. Despite a challenging Canadian grain harvest, we delivered our single largest quarter in the company's history, with 7.9 million metric tons delivered to the market. This historic quarter capped off 2019 as the largest Canadian grain and grain product tonnage shipped in any single year of our history. This achievement is a true testament to the

dedication of our employees, our investment in the grain industry, and collaboration with our customers in driving the most efficient operating model. As I look ahead, with the delayed harvest and more recently, the extreme wet weather in Vancouver, I expect Canadian grain shipment demand to remain strong through the first half of 2020. In the US side, volumes were up 3%, largely as a result of increased soybeans shipment to PNW as positive US-China trade settlement talks have helped rally spot grain movements in this export lane. Now, moving onto coal, revenues were down 10% where volumes were down 8%. Canadian coal volumes were down as a result of maintenance at the mines and, again, the weather challenges I spoke about in Vancouver. Further, low natural gas prices resulted in US coal volumes being down 17%. All in all, I expect coal volumes to be slightly down in 2020. On the potash, front volumes were down 29% and accounted for nearly all of our total RTM decline, and revenues decreased 26%. Continued delay with international contract negotiations weighed on export volumes in the quarter; however, as expected, we did see volumes begin to pick up the back half of the quarter, as India and other smaller export contracts were resolved. Based on our latest information, we are optimistic that the Canpotex contract with China will be resolved toward the end of Q1. Overall, our belief is the macro demand outlook for potash remains solid for 2020 and volume growth, both Canpotex and K+S, will be weighted to the back half of the year. The energy, chemicals and plastics portfolio saw revenue growth of 33%.

Q4 was the third consecutive quarter with record revenues in our biofuels portfolio, as our ethanol plants continue to be well positioned to compete in both the domestic and export markets. This was also our largest crude-by-rail quarter in the company's history with over 36,000 carloads. We're expecting a similar run rate as we look out to Q1 and beyond. I'm also extremely excited, as Keith mentioned, about the announcement to construct the diluent recovery unit near Hardisty. This innovative development creates a sustainable and safer crude-by-rail shipping model to the US Gulf. When operational in 2021, the DRU process will remove the diluent prior to loading the railcar at Hardisty, allowing for approximately 30% more crude to be loaded in each tank car, making crude-by-rail cost competitive with pipe. Further, by removing the diluent, it returns the crude to a more concentrated state and is no longer classified as hazardous commodity. The capacity for this facility equates to two trains per day and, as Keith said, creates a long-term revenue stream for crude-by-rail. Moving on to forest products, revenues were up 3%, while in MMC revenues declined 14%, largely driven by lower steel prices and continued declines in our frac sand shipments to the Permian basin. Automotive revenues were up 12%, an outstanding outcome, given the pressures on this sector. Our surgical approach to this market has driven growth through partnering with the right automakers and developing unique market solutions that cannot easily be replicated. In 2020, we will enjoy a full year of our Vancouver auto compound, we'll welcome GLOVIS to our franchise, and we will continue to look for those opportunities to open new auto compounds that will further enhance our value proposition in this sector. I continue to see a path in 2020 to grow auto revenues at a significant pace.

Finally, on the intermodal side, quarterly volumes were up 4% and on a full-year basis, I'm extremely pleased with the strong growth we had in intermodal with volumes up 5%. On the domestic intermodal front, we had a record quarter and our third consecutive record year. I fully expect continued growth in 2020 as we leverage our demand management tools, our premium service in the market, and continue to deliver over-the-road conversion. On the international side, we extended HMM to a long-term contract, and January 1st, we welcomed Yang Ming aboard. We will continue to leverage this business and the capacity brought on at Deltaport to grow with our customers through the Port of Vancouver.

So, let me just close by saying over the last couple of years and even back to our Investor Day, I've talked about this team executing our strategic playbooks. And what you're seeing is exactly that playing out in the marketplace. We are doing what we said we were going to do. We are leveraging our distinct advantages to grow revenues at a sustainable, profitable manner. And these are creating unique growth stories for CP and I'm extremely proud of the results this team is delivering. So, look, as I look ahead, there remains a very strong pipeline of opportunities to

bring incremental volumes to this railroad at a price that reflects our service. And this includes some very positive initial discussions, as Keith spoke about, for opportunities utilizing the CMQ network. I'm excited about the opportunities in front of us for 2020 and beyond. So, with that, I'll pass it to Nadeem.

Nadeem Velani

Thanks, John, and good morning. Before I start my prepared remarks about the quarter and the year, I just wanted to take a moment and congratulate Maeghan Albiston, who was recently named as the Best Investor Relations Professional in all of Canada in the industrial sector by Institutional Investor magazine's inaugural Canadian survey. So, congratulations, Maeghan, a very well-deserved honor.

I'm extremely proud of the results the team is delivering today. Through the back half of the year, this team has continued to demonstrate an ability to adapt to a dynamic volume environment and exhibit the power of a true PSR railroad. We adjusted and rationalized resources effectively and are well positioned with the momentum we've built through the fourth quarter and early into 2020. Overall, the operating ratio increased 50 basis points to 57%, driven by stock-based comp headwind of CAD $30 million as well as lapping a land sale from 2018.

Taking a closer look at a few key items on the expense side, comp and benefits was up 5% or CAD $18 million versus last year. The primary driver of the increase was the higher stock-based comp I mentioned earlier, primarily as a result of the increase in the share price. This was partially offset by decreased volumes and increased operating efficiencies. Fuel expense decreased CAD $20 million or 8%, primarily as a result of lower fuel prices, lower volumes, and a record fourth quarter fuel efficiency of 0.952 gallons per 1,000 GTMs. Depreciation expense was CAD $178 million, a decrease of 1% as a result of asset retirements. Purchased services was CAD $294 million, an increase of CAD $44 million or 18%. The main driver of the increase was lapping 2018 land sales of approximately CAD $35 million.

Moving below the line, other components of net periodic benefit recovery were negatively impacted CAD $10 million or 10%, primarily due to a lower discount rate applied to year-end workers' compensation valuations. Interest expense decreased CAD $2 million as a result of lower effective interest rate resulting from our 2018 and 2019 debt refinancing's. Income tax expense increased CAD $38 million or 20%, primarily as a result of a provision of an uncertain tax item of a prior period. This is being backed out of adjusted earnings. Rounding out the income statement, adjusted diluted EPS grew 5% in the quarter.

Turning to full-year results on the next slide, the fourth quarter performance caps another record year for CP. For the year, revenues grew 5% and operating income grew 9%. Full-year operating ratio was 59.9%, a 140 basis point improvement year-over-year as we continue to demonstrate our ability to improve margins in spite of a softer volume environment overall. Adjusted income grew 10% and the continued disciplined approach to our share repurchase program helped us achieve adjusted diluted EPS growth of 13%, as Keith mentioned, our third consecutive year of double-digit EPS growth. Turning to our 2020 guidance in the release this morning, we highlighted mid-single digit volume growth, CapEx of CAD $1.6 billion, and high-single digit to low-double digit EPS growth. A few specifics to call out. We will be facing a pension headwind, both above and below the line, of CAD $30 million and CAD $40 million, respectively, largely as a result of lower discount rates at the end of the year and a reduction in our expected return on assets for our pension plan. Depreciation is expected to increase to approximately CAD $190 million a quarter as a result of a larger asset base. Last year in Q1, we incurred what's typically our full year of casualty expense, which is part of the purchased services and other line.

Moving on to free cash, 2019 cash from ops increased by 10% to a record of nearly CAD $3 billion and free cash increased by 5% to CAD $1.4 billion. Shareholders continue to be rewarded. We took a brief pause following the completion of our NCIB in October. In December, we announced a new 3.5% share buyback program to repurchase up to 4.8 million shares over the next 12 months. In 2019, we returned over CAD $1.5 billion to shareholders through share buybacks and dividends. Our balance sheet remains strong with leverage of 2.4 times adjusted net

debt-to-EBITDA. CapEx came in around the guided CAD $1.6 billion. Our disciplined approach to capital investment and the strong returns we are generating are evidenced by an adjusted ROIC of 16.9%, compares to 10% back in 2012, that's clearly demonstrating a prudent investment in the business. As we go forward, we expect to remain at that CAD $1.6 billion for the next two years in terms of capital investment. And that's also inclusive of the capital we expect to be invested back into the CMQ to bring that asset up to CP standards. That acquisition is one that we are increasingly excited about as we invest back into our core competency of railroads. As we continue to grow earnings and remain disciplined on capital, you can expect to see CP's free cash conversion improve both in 2020 and beyond. Overall, 2019 was not without its challenges, but in spite of that, it marked the third consecutive year of double- digit earnings growth and the third consecutive year of delivering on or exceeding our earnings guidance. This is a company built on a culture of accountability and delivering on what we say we'll do. We are going to continue to be an industry leader in 2020. With that, I'll turn the call back over to Keith to wrap things up.

Keith Creel

Okay, thanks, John, thanks, Nadeem, for the color. But before I open it up to questions, I, too, want to echo your comments and congratulate Maeghan for such an honored achievement as well as congratulate you, Nadeem, for being recognized as the best CFO in Canada. And finally, congratulate our 13,000 strong CP family for being recognized as the best overall company in 2019 in the industrial space in Canada. Votes of confidence by investors like this are deeply valued and we don't take them for granted. They're received with a high degree of responsibility to honor the trust that you place in us, and we do that by producing future performance that meets or exceeds your expectations. So, thank you for that trust. And with that said, we'll move to the questions.

Question & Answer

Operator

Certainly. [Operator Instructions] Seldon Clarke with Deutsche Bank, your line is open.

<Q – Seldon Clarke>: Hey, guys. Thanks for the question. I know this is still somewhat of a developing situation, but as it relates to phase one of the US-China trade deal and China's agreement to start purchasing more goods from the US, do you think this could present a risk to any of the exports that CP handles if China does indeed start relying on the US for more like ag products or met coal, things like that?

<A – John Brooks>: Seldon, actually no. I think, frankly, we've started to see a little bit of upside as some of the more sort of positive outcomes of this trade deal emerge. The Canadian ports continue to be cost competitive relative to the US side, so we've seen a nice surge of volumes sort of offsetting some of the trade disruption, volumes from Vancouver into the US. And then, frankly, if we can start to see some of these ag products begin to move, I see upside potentially in our US grain franchise as we move towards the end of the year.

<A – Keith Creel>: We actually take a view that this is a net positive for all West Coast ports, be they Canadian or US, which again, this franchise uniquely will benefit from.

<Q – Seldon Clarke>: Okay. That's helpful. And then kind of a longer term and just higher level question, but if you look at the revenue per RTM of CP versus your Canadian counterpart, the discount that CP is earning is wider than it's ever been, or it was in 2019 and kind of has been steadily increasing for the last several years. And obviously, you're both impacted by things like fuel and currency, but can you just maybe talk about what you think is driving this divergence and whether this presents any opportunity for you guys to make up some ground as it relates to pricing?

<A – Nadeem Velani>: I think it's a reflection of length of haul and mix of business. So, as we've grown our potash business, as we've grown crude recently, so forth, that does have an impact on overall cents per RTM and impacts the overall company reported cents per RTM. So, I think that's the major item.

<Q – Seldon Clarke>: Okay. So, we shouldn't be reading too much into it as there's some ground we made up on the pricing side?

<A – Keith Creel>: No.

<A – Nadeem Velani>: No. And I think not that the OR is a reflection of everything, but I think there's a – we're getting close to a 10-point gap between ORs in the company this quarter. So, I don't think pricing is really a reflection of anything. I think it's just solid execution.

<A – Keith Creel>: Yeah, I think the most important number to pay attention to is double-digit earnings.

<Q – Seldon Clarke>: Yeah, absolutely. All right. Thanks for the question, guys. Appreciate it.

<Operator>: Walter Spracklin with RBC Capital Markets. Your line is open.

<Q – Walter Spracklin>: Yeah. Thanks very much. So, there were some news, obviously, on the Teck side about having gained some share on the Kamloops either up to Ridley or over to Neptune. Can you quantify the impact that you expect on that? I know it's only one third of the haul for a portion of the business, but curious your quantification of the impact on that?

<A – Keith Creel>: Walter, I'd say the worst case scenario and this is assuming a worst case scenario assuming that we don't sell any of that precious capacity that goes west to Kamloops into Vancouver and assuming we don't improve profitability on the existing book of business that remains with us, both of which are not realistic expectations, is a 1% headwind. I'm not concerned. Obviously, we value our relationship with Teck and we value their business. That said, I'm convicted and convinced with my 28 years of railroading experience and quite a bit of that being in Canada running both railroads, that Teck will value our service in a way they never have given their overall experience. To me as a PSR railroad, I'm not one that sells complexity. I'm not one that creates velocity and faster asset turns by introducing it. The game is to eliminate and to minimize complexity, to turn those assets faster. So, right now, what we're seized with is making sure that we clearly work closely with Teck as well as Canadian National to ensure that interchange location, which today's state will not handle any marked movement or increase in volume, is able to handle it efficiently, so it doesn't have an adverse impact not only on Teck's business but the balance of our book of business. So, that's what we're seized with. At the end of the day, we're going to do our dead level best to make sure Teck succeeds given what we could control to move as much coal as they can. We'll make a fair buck at doing it and enable Teck to continue to succeed in the marketplace. That's what we're seized with. Not seized or concerned with the 1% headwind on the revenue.

<Q – Walter Spracklin>: Okay. That makes sense. Appreciate that color, Keith. Moving over to Nadeem, question here on operating leverage and volume cadence. So, as your mid-single digit volume plays itself out, can you give a sense of whether this is something you're building into the back end or is this something that we can see sooner rather than later? And as that volume comes on, you've always typically indicated a 100 basis point roughly OR improvement with 500 basis points of volume. Does that hold here in this scenario as well as your efficiencies pile on each other? It certainly gets a little harder to achieve, but just wondering if that still holds for this year. Thank you.

<A – Nadeem Velani>: All right. Thanks for the softball there, Walter. So, if you recall last year, Q1 was a very difficult and challenging quarter in terms of how the impact of that tragic derailment had on our network and the impact that that had of a very challenging winter throughout February time period. So, we have very easy comps in Q1. I expect a very, very strong Q1 report, both from a revenue point of view, volume point of view, and an

expense point of view. So, I think we're going to have a very strong start to the year. We were impacted in the spring last year with network outages from flooding in the Midwest and so forth. So, very achievable kind of first half volume trends. We expect to see continued year-over-year improvements in volumes. Where it gets a bit more challenging is in the second half, just in terms of where we used to have line of sight to volumes. Recall some of the positives that we do have is in the Canadian grain space. So August, September, we had a very late start to the grain crop. So, you should see some benefits there. And potash as well, we had the impacts of a sudden 30%, 40% kind of drop in potash volumes. So, that should be a very favorable environment as well to report RTMs. So, overall, I think we have good line of sight to a very strong year. We've guided to that mid-single digit RTM growth. And I don't think it's necessarily just front-end loaded by any stretch. I think it's going to be consistently strong. In terms of our operating – our incremental margins and so forth in our operating leverage, we're going to do what we always do, which is take the volumes and bring it to the bottom line. And so, I would expect continued operating ratio improvements and nothing less than that from our team.

<Q – Walter Spracklin>: Okay. Appreciate the time.

<A – Nadeem Velani>: Okay. Thanks, Walter.

<Operator>: Brandon Oglenski with Barclays. Your line is open.

<Q – Brandon Oglenski>: Hey, good morning, everyone, and thanks for taking my questions. Nadeem, I guess, following on that answer there, you did speak to a couple of cost headwinds I think in 2020. And more specifically – if you could just re- highlight those for us? And more specifically on purchased services, because that did come in maybe a little bit higher than what we were thinking.

<A – Nadeem Velani>: Yeah. Pension was probably the item that we know is a headwind and both above the line in terms of our compensation benefits and then below the line given discount rates and also, as we've – being a bit more conservative in terms of our expected return on assets of the pension plan. The other item would be depreciation. So, we've had kind of record CapEx spending in the last year. And so, as we had that higher asset base, we'll see depreciation trend up a little higher. And then the other item that we faced is stock-based comp. That's been a, I think, a well-received headwind by investors, but it's something that we expect to face again this year. We don't have any sort of accruals from a bonus point of view that we're going to face any sort of headwinds there. We've been consistently performing and consistently paying the management team for the efforts, so nothing on that front. And what was the back half of your question, Brandon, again?

<Q – Brandon Oglenski>: It was just about the right level of purchased services.

<A – Nadeem Velani>: Yes. I think overall, we're not expecting much in the sense of land sales. Maybe we could see CAD $10 million to CAD $20 million. That would create a bit of noise between quarter-to-quarter, but nothing that we'd call out in terms of volatility quarter-to-quarter on purchased services.

<Q – Brandon Oglenski>: Okay. I didn't mean to de-minimize the outlook which is pretty strong. And I guess, Keith or Nadeem is, I asked this question to your competitor the other day, but there's clearly a trend at some US railroads I think CapEx can be at 15% of revenue. But there's also a clear track record of not a lot of growth below the border either. I mean, can you guys talk to that divergence? Because obviously, yourself and your competitor included have gotten better growth, but obviously higher CapEx too. Is that the right equation?

<A – Keith Creel>: I would say it's just understanding the two stories. Obviously, every railroad is at a different place in their implementation and progress with the operating model precision scheduled railroading. We enjoyed a capital holiday given the excess of surplus assets that are a natural outcome of implementing PSR where PSR didn't exist. If I look at our spend now, we were still enjoying some of those tailwinds in locomotives but we're also investing for growth. So, again, our absolute numbers where we're at is where we expect to stay. We're going to

continue to invest in our hopper cars; we're about halfway through it by the end of this year. We're at, rough number, 2,200 cars. We'll be around 3,000, 3,200 end of 2020 with a view to finish that program end of 2022. And once we get there, you'll see free cash flow improve in a material way and you'll see our total dollars come down. And, again, if you get into percentages, obviously, that's going to improve as well. But we do both. We should have a lower call on capital; call on cash when we run an effective and efficient railroad. But at the same time, we're making money so we can invest money to grow and protect our physical plant and that's the formula.

<A – Nadeem Velani>: Yeah. Our scorecards our return on invested capital, which is getting closer to 17%. So, that's always a good kind of basis to see how we're operating in terms of our capital deployment.

<Q – Brandon Oglenski>: All right. Appreciate the constructive tension there.

<A – Nadeem Velani>: Thanks, Brandon.

<Operator>: Fadi Chamoun with BMO Capital Markets. Your line is open.

<Q – Fadi Chamoun>: Good morning. You mentioned the CMQ a few times on the call. I just wanted to see if you can offer up a little bit more kind of details about the opportunity you see there than on the intermodal side and also, the timing of that opportunity that you see as well as this kind of 2020, 2021 or beyond that timeframe.

<A – Keith Creel>: Well, number one, the art of the possible, Fadi, in all fairness, we're still developing. I can tell you, I see opportunity in intermodal growth, be it domestic, be it international. I see an opportunity in automotive growth, be it domestic inbound product, be it off the water inbound product. I see opportunities in fuels. I see opportunities in lumber. Just across the board, you think about an environment, and that's yes, the paper industry has walked through some very challenging years; yes, there's been a reduction in available shipments in eastern Canada, but at the same time, the strategic value of that port in St. John has not been unlocked. We've got a railroad now that is very efficient, it's very safe, and a St. John to Montréal option is the shortest distance. And if you run your best day the shortest distance versus a truck running its best day, or your competitor running its best day at a longer distance, I'd say that's a compelling opportunity to open up value for our customers as well as, obviously, our shareholders and our franchise. So, as far as timing, our quantum, our magnitude, we're going to be working hard at that in 2020. The most important thing we're working on, though, Fadi, is investing in the physical plant to get it up to a CP standard, which we owe that to ourselves and we owe that to the communities that we now operate in and through. So, we'll do that in 2020. We'll finish the year with a stronger physical plant, with a more efficient – we've already worked with the leaders at CMQ that are under trust until the STB gives us approval – we hope gives us approval and anticipate approval in May of this year to implement a more CP-like operating plan. We've taken time out of the schedules with the existing physical plant. It's not that we're running trains faster, per se, it's in totality the transit time has reduced because we're handling the trains differently and the schedules differently and philosophically it's differently. So, more to come. I think 2021, you'll start to see the needle move in 2021 and 2022 for certain. Those are two key years for us. The timing couldn't have been better as we prepare for those business opportunities and I look forward to celebrating some of those successes and sharing more color on them as we go forward through 2020 and into 2021.

<Q – Fadi Chamoun>: Okay. That's helpful, Keith, thank you. Is the upgrade of the physical footprint, the need to CapEx required are included in your guidance, I would assume, right?

<A – Keith Creel>: Yeah, it's absolutely baked into it. We've got a big chunk of it, we're focusing on ties and rails and ballast in 2020. We'll do the same thing in 2021. And we'll come out with a Class 3 track that allows us to convert that short distance in a very safe and reliable fashion by the end of 2021 for certain.

<Q – Fadi Chamoun>: And a quick question to Nadeem on the labor cost line. So, I'm understanding that we should assume some inflation, obviously, the pension expense increase above the line. How about head count? Like,

you've got a big swing going on in 2019. You went up and then you went down and you ended the year where you started pretty much. So, how should we think about 2020 with volume up mid-single digit?

<A – Keith Creel>: The formula for us is we always want to do more with less. That's what – as we become better railroaders and we invest in our physical plant, and that's what we should be able to do and we owe that to our shareholders. So, actually, in 2019, we finished down about 1% on flat RTMs, or actually, just positive RTMs. We're super proud of that just positive, because we're the only railroad in the industry to be able to do it in a very challenging macro environment. And I know what great efforts it took from our sales team and our operating team to produce that. So, that's where the pride comes from. But with that said, if we look at 2020, on a mid-single digit RTM guidance, you can assume a low-single digit head count increase.

<Q – Fadi Chamoun>: Awesome. Thank you.

<A – Keith Creel>: Thank you, Fadi.

<Operator>: Chris Wetherbee with Citi. Your line is open**.**

<Q – Chris Wetherbee>: Yeah, hey, thanks. Good morning, guys. I wanted to touch on crude by rail. So, I think you mentioned 36,000 carloads in 4Q. Wanted to get a sense of what you think the capacity could be in maybe 2020 on a quarterly basis, assuming there is some potential demand growth there. And then maybe as a second part to that question, how do we think about sort of the DRU opportunity and sort of what that means in terms of what you might need to do to add capacity or how we might think about it relative to the 36,000 carloads you moved in this last quarter? Just trying to put some numbers and some structure around the crude by rail opportunity in 2020 and then 2021.

<A – Keith Creel>: Chris, I'll speak to the capacity piece and I'll let John provide the color on the run rates and what the potential upside might be. Capacity, it's a simple answer, it's zero. We have the people, we have the assets. This growth, we've prepared for it. We prepared for it in 2019 and 2020. We worked in lockstep with our partners in this business and the demand has been delayed. So, it's there. We continue to rifle shot invest in it and there will be no surge or peak in capacity needed to be able to handle and enjoy the current run rates that we're at with some potential upside.

<A – John Brooks>: Yeah, I mean, it kind of, Chris, sits in a timeframe where you could be able to see some of the pipe capacity come available. So, it might actually act as an insulator. Not quite a one-for-one replacement, but as Keith said, from a capacity standpoint, there shouldn't be any issues there. In terms of the run rate, I'm kind of looking at Q1 to land probably in a similar space as we saw Q4. I do think sort of market pending, and as we know, the crude by rail market can be pretty volatile. But if things hold in the spread range that we see today, I could see some acceleration as the government contract fully gets converted. You could see a little bit upside Q3 – Q2, Q3 and probably that sort of run rate continuing as we look to close out fourth quarter and the year.

<Q – Chris Wetherbee>: Okay. Okay. That's very helpful. I appreciate the color.

<A – John Brooks>: Yeah.

<Q – Chris Wetherbee>: And then maybe bigger picture question just around pricing and there's been some higher profile competition amongst the players in Canada, but it seems that pricing has remained a reasonable focus for both players. Just want to get a sense of kind of how you think about the pricing dynamic in 2020. Should there be meaningful variation from what we've seen over the course of the last 12 months?

<A – John Brooks>: Yeah, I don't think so. I am extremely pleased with my team's results on pricing for the value of our service through 2019. Just as a reminder, my teams, a big part of their compensation is built around our pricing

efforts. And I think we're prudent and we'll compete because we have the low cost structure head-to-head where we need to compete. We're also, not going to go down to the level and grow for growth's sake as we've spoke about. So, I expect that similar level of discipline as we move into 2020 and we'll be driving inflation plus, for sure, Chris.

<A – Nadeem Velani>: Chris, I would just add that in this environment where both railroads can see growth opportunities, both in the short, medium, and long term, I think that's very healthy for rational pricing.

<Q – Chris Wetherbee>: Got it. Thank you very much.

<A – Nadeem Velani>: Thanks, Chris.

<Operator>: Scott Group with Wolfe Research. Your line is open.

<Q – Scott Group>: Hey, thanks. Good morning, guys.

<A – Nadeem Velani>: Good morning, Scott.

<Q – Scott Group>: So, Nadeem, I had a couple of questions for you, first just to help with the models. Is CMQ going to be in the weekly volume reports? And if not, maybe just how much revenue a quarter we should be assuming. And then first quarter's just got so much noise, can you just help us sort of think about RTM and OR for first quarter as you guys see it?

<A – Nadeem Velani>: Sure. So, yes, the carloads are in the numbers. Reminder that the Canadian component of the CMQ we've acquired, but the US assets are being held in trust until we get STB approval. So, the accounting of that will be an equity pick up for that until we actually get approval. We're hopeful by the middle part of this year. So, there's a bit of noise in terms of where we see things the first half of the year. And then we'll fully get the benefits of the full entity going forward past mid-year. And at that point, then, you'll see kind of the full revenue picture. So, it's not meaningful in terms of the current incorporation of the revenues. So, we're talking $40 million US kind of in total. So, we're getting a portion of that as we speak, if that makes sense. And as far as Q1, last year we had about a CAD $70 million impact in Q1 year-over-year increase in casualty. Or sorry, the Q1 number was CAD $70 million of casualty. Typically, that would be closer to CAD $20 million a quarter. So, there's a pretty big year-over-year improvement that we expect for running the railroad as the way we should. So, that's certainly going to be beneficial to Q1 operating ratio. I think we had the worst operating ratio in the industry last year, kind of mid-60s level. You should see something closer to a 60% level, is probably a fair assumption. So, it should be a pretty meaningful improvement year-over-year. We're always cautious when we give our guidance a little bit at the beginning of the year, given we're a Northern railroad and given there's uncertainty around winter weather. We had an extremely cold environment a week ago. Very challenging on the network. But our best operating team in the industry which happened to be CP employees got through it extremely well. We entered that situation in a very good state overall in terms of the network, in terms of the terminals and we came out of it very well. So, it's not something that we can't overcome. It's not going to be impactful. You'll see the volumes recover very nicely through this week and through the February timeframe. So expect to have a very, very strong Q1 report, Scott.

<Q – Scott Group>: Did I just hear that? You said around 60% for the first quarter?

<A – Nadeem Velani>: Yeah.

<Q – Scott Group>: Okay. Great. And then can I just ask one more? Keith, you talked earlier about the DRU as being unique to your franchise. Can you just expand on that?

<A – Keith Creel>: At this point, the DRU that's been announced to be built in Hardisty, a single line solely served

by CP. So, there is a potential down the line to build one in Edmonton. Some of the players have talked about doing that. It may or may not happen, I'm not sure. That's their decision to make. But should it occur in Edmonton, we'll benefit from that as well because we also serve that facility. So, Hardisty at this point is the only one that is not a maybe. They're moving forward. It's well underway. We expect it to be operational in 2021 and we will uniquely serve it.

<Q – Scott Group>: Thanks for the time, guys.

<A – Nadeem Velani>: Thanks, Scott.

<Operator>: Konark Gupta with Scotiabank, your line is open.

<Q – Konark Gupta>: Thanks, and congrats Nadeem and Maeghan for your achievements. So, just wanted to begin with a question on your guidance for EPS. So Keith, if I can ask you, what is causing you to be conservative in the sense that you are guiding high single-digit EPS growth at the low end? I mean, like, obviously, you have talked about low double digit before but there seems to be a little bit of caution here because of maybe some uncertainties you are looking at. Can you share with us what is that that's causing you?

<A – Keith Creel>: To some, it's conservative. To me, it's prudent. This team takes great pride in being a team that we guide to what we believe is achievable and exceedable. And in this case, that's exactly what this guidance is. I have full conviction and line of sight, giving things I can't predict and things that I got a pretty good feel for that this team can certainly achieve that guidance. And I'd be disappointed to sit here a year from now and not be in a position to congratulate our team for exceeding that guidance. So with that said, I think prudent is the right approach. We've worked hard to earn that reputation to meet or exceed and we don't take it lightly and we expect to continue to do that. But rest assured, if there's an opportunity to exceed and achieve in any of our endeavors day to day, the end result is going to be earnings growth. We're going to do that with this team. It's a culture of performance. It's culture that pursues excellence. We're blessed to work with the best team of railroaders with a strong franchise with its own unique set of, in many cases, counterintuitive to the industry, growth opportunities that embolden our guidance and our conviction about being able to meet, and, again, I think a key word is exceed.

<A – Nadeem Velani>: Yeah, in 2017 we raised – in 2018 we raised. In 2019, we're the only one to meet. So our track record, I think, speaks for itself.

<Q – Konark Gupta>: Okay. No. Thanks for that. And then, on the market share opportunity. So, we obviously heard about a few opportunities at your last Investor Day and clearly there's been some contract announcements over the last couple of years toward that. If you can remind us, are there any more opportunities from those kind of intermodal and automotive opportunities you laid out before? Is there anything else that you are kind of looking at over the next 12 to 18 months? Or is there any new opportunity base that has opened up? You mentioned about CMQ, I know, but is there anything else within the existing CP franchise that you think is up for grabs? Thank you.

<A – Keith Creel>: Absolutely, yes. And I'll let John speak to some of those exciting things that we talked about and some things we haven't been able to speak to yet, but we soon hope to be able to provide color on.

<A – John Brooks>: Yeah. So, I'd look at our domestic intermodal franchise in particular. So, just recently in the fourth quarter, we signed long-term agreements with Bison and Consolidated Fastfrate, two leaders in the trucking industry, two leaders in the wholesale industry and we're creating solutions with them without needing to purchase them. We're providing solutions in the marketplace that will drive new first mile, last mile innovation that the industry hasn't seen. On top of that, there is an intense focus with my team to drive over-the-road conversion. We think 2020 and into 2021 present a whole new opportunity in over-the-road conversion. With again, these two partners and others to bring that business to our railroad. So, look, you combine that with

onboarding Yang Ming, future growth at the Port of Vancouver, all the good things we're doing on the auto side, energy, chemical and plastic side of our business in terms of our refined fuels growth into the eastern markets. Our refined fuels growth into Vancouver for export. And you begin to layer on the diversity that the CMQ brings, not only from a commodity and product and customer perspective, but one thing that Keith didn't mention about the CMQ that I'm super excited about is all the new gateway access to the short line partners that we've never reached before as part of the CMQ and to the eastern carriers creating new routes and new markets. The level of interest from that part of the northeast US and eastern Canada has, frankly, been overwhelming in the last 60 days. And I can tell you my team and our leadership has been out on that property and talking to these folks. We'll see if it's 2020 story, but it sure makes us excited about what 2021 could look like.

<Q – Konark Gupta>: Okay. Thank you

<A – Keith Creel>: Thank you.

<Operator>: Tom Wadewitz with UBS. Your line is open.

<Q – Tom Wadewitz>: Yeah, good morning. Let's see…

<A – Keith Creel>: Hi, Tom.

<Q – Tom Wadewitz>:...I guess a fine point maybe for, John, on the energy, chemicals, and plastics line had very strong revenue per car. I assume that's due to the strength in crude, but I think you were, like, CAD $4,860 per car. Is that something we ought to model going forward that that continues? Or how do we think about RPU on that line in 2020?

<A – John Brooks>: Yeah, so, certainly, we had a pretty good tailwind as it relates to price in general. We saw some nice increases there. We did benefit, Tom, on the mix front also in that space and then last, you're right, a lot of it was driven by the crude. I think you continue to see some of that into Q1 and then it sort of begins to moderate.

<Q – Tom Wadewitz>: So, okay. It stays at that level but the year-over-year moderates, is that what you're saying?

<A – John Brooks>: You could even see some acceleration as we move through Q1 and then it begins to moderate Q2 and beyond.

<Q – Tom Wadewitz>: Okay. Great. Wanted – I don't know if I can – just a, I guess, a quick one as well on the network. You've got mid-single digits RTM, very good growth outlook for this year. Your commentary is positive about the opportunity to keep growing. How do we think about the kind of network where, if you have stretches of single line or sightings spaced out or whatever, where eventually you get into some potential line constraints, is that something to consider or kind of bottlenecks in the network? Or are you pretty good in terms of line capacity on a multi-year basis?

<A – Keith Creel>: Yeah, from a capacity standpoint, Tom, there is no lines or constraint on the horizon at all. Nothing that's material, nothing that's concerning, nothing that we couldn't address as far as increasing capacity and lockstep with growth. As always, I remain – keep my eye on Chicago. Chicago can always bubble up given the right conditions, albeit Chicago has never been in a better condition given the benefits of PSR that the other railroads are implementing as well as some of the infrastructure investments. So, I don't let my sense get to a false sense of security in that space, I pay attention to it. But at this point, not concerned – overly concerned. The other place I pay attention to is Vancouver. Obviously, that port is critical to the commerce in Canada. It's critical to our railway as well as our competitors' railway. So, as much as we compete hard, working in partnership to make sure we protect the capacity to the benefit of everyone is something that I pay attention to. And that's why I'm so seized with focus on Kamloops. I want to support Teck as much as I can for them to realize business success

because I know with their success comes CP's success. And if that formula can do that, I'm all for it. I've just got to make sure that that formula doesn't destroy value or capacity on my network, especially given so close to being in the corridor of Vancouver, which we all depend upon, both as railroads as well as commerce in the country. So, long answer to your question. Line capacity is not an issue that we can't manage and that we don't manage day in and day out. You can take a look at our business, we've ran at our highest levels, we've never ran better, faster, more fluid. That's a testament to that process and you can expect that to continue.

<A – Nadeem Velani>: Yeah, and reminder Tom, when we had our Analyst Day in 2018, we guided to mid-single digit RTM growth, double-digit EPS growth. And if anything, 2019 RTM growth was lower than expected. So, we have our capital plan that was to support that multi-year plan as it was lockstep into that mid-single digit RTM growth. So if anything, there's probably more capacity available than we expected back then.

<Q – Tom Wadewitz>: Okay. Great. Thank you. Appreciate it.

<A – Keith Creel>: Thank you, Tom.

<A – Nadeem Velani>: Thank you, Tom.

<Operator>: Ravi Shanker with Morgan Stanley, your line is open.

<Q – Swayer Rice>: Hi. Good morning. This is Sawyer Rice, on for Ravi. Maybe just a couple cleanup ones from me, I guess. Just following on some of the CBR questions we've had. Can you update us on your current timing expectations around the government contract in Alberta at this point?

<A – John Brooks>: Yeah. So, I'd say generally we are, in terms of our agreement with the highly-likely party that it will be assigned to is completed. That party is working with their suppliers, their destination markets they'll sell into. I would expect we may see some ramp-up of that associated volume as we move into February here. So fairly tight.

<Q – Swayer Rice>: Got it. Understood. And then maybe just taking a step back. Could you refresh us on how you're thinking about capital allocation priorities here? Good to see the CMQ announcement back in November, maybe just how you think about the M&A balance between short line and potentially other transportation modalities versus investing in the rail?

<A – Nadeem Velani>: Yeah. So, we have a line of sight to invest our CapEx of CAD $1.6 billion over the next several years. Combination of investing in hopper cars as a major project, fundamentally investing back into the basic infrastructure of about CAD$ 800 million to CAD $1 billion a year. And then we have some locomotive modernization to add some additional modal power, if you will. Apart from that, we will look at adding to the network where there's opportunities. We're more focused on rail than other types of supply chain opportunities. So, it's just there's not a lot available out there, so. The CMQ came at the right time at the right price and that was maybe a unique opportunity. Beyond that, we'll look at continuing to increase our dividend. We have guided to get that to the 25%, 30% payout ratio over time and then we'll look at returning cash through buybacks, which we've consistently done in that 3% to 4% kind of level. We announced a new buyback program in December of 3.5%, and so, that will be the other opportunity for capital allocation.

<Q – Swayer Rice>: Got it. Appreciate the time.

<A – Nadeem Velani>: Okay. Thank you.

<Operator>: Brian Ossenbeck with JPMorgan, your line is open.

<Q – Brian Ossenbeck>: Hey, good morning. Thanks for taking the question. Maybe one more on capacity, but from a labor perspective. Clearly, there's a lot of head count reductions elsewhere in the industry, but you're looking to grow and expand head count there. But it wasn't too long ago where there was more widespread shortage and obviously the labor market's not any looser, I don't think. So, can you just talk about how you perceive the tightness in the labor market and if there's anything you're doing sort of proactively to get ahead of what might be some challenges in some of those specific areas you look to grow?

<A – Keith Creel>: At CP – let me start with right now we still have surplus labor. We've got employees that we've invested in and trained in that unfortunately our business doesn't – the business demand at this point doesn't warrant the need that are in furlough status. So, we have that to call upon as we bring on additional incremental RTM growth. But with that said, even in a tight labor market, it's about value proposition. I mean you've got a company that – we pay you well, we strive to treat our employees well, there's a tremendous amount of pride in working for this company and the success that we've created and we continue to succeed. And success breeds success. We've not had any meaningful challenges attracting and hiring and training employees. And, in fact, our retention rates, if you look at the last two years, I'm especially proud of, have improved dramatically, double-digit improvements to add industrial if not railway best. So, employees are coming, they're enjoying their jobs, they're being paid well, they're contributing to and enjoying the success we're creating. So, at this point, we have not and I do not foresee any additional problems to be able to hire and train in lockstep with our growth.

<Q – Brian Ossenbeck>: All right. Thanks for all the details there, Keith. One for John. If you can just talk about the capacity that might be unlocked when the Teck transition happens next year. Is it too early to start to have those conversations with potential customers? And what do you think that might do to the overall mix that was previously going over that segment as you start to transition to something that's a little more diversified? Thank you.

<A – John Brooks>: Yeah. I don't know if there's a big mix change. Obviously, there's an ongoing opportunity to grow our grain business. We've moved five or six trains into the new G3 terminal here recently as they prepare and commission their silos to open up. We've opened here in 2019 six new 8,500-foot elevators that will primarily service that Vancouver market. There's additional coal opportunities that we're working that we expect to come on right around the right timing of this transition. So, it's definitely not too early. We're having those discussions with customers today, but I think it's pretty diverse in terms of the opportunities.

<Q – Brian Ossenbeck>: All right. Thanks, John.

<Operator>: Benoit Poirier with Desjardins Capital Management, your line is open.

<Q – Benoit Poirier>: Yes. So, congratulations for the good results. Could you come back a little bit on the potential opportunities to replace the Teck business from Kamloops to Vancouver? And eventually how the – the potential to come back with EPS accretion to offset the 1% dilution that could be again another scenario right now?

<A – Keith Creel>: Okay. Let me, if I could, Benoit, let me say this. To put it in its simplest terms, the loss of the Teck business, in and of itself, stand alone, worst case scenario is, as I've said, about a 1% earnings headwind, but it's margin accretive. Our operating ratio improves as a result of that. Now that said, the opportunity, and John can provide a bit more color, but be it grain, be it everything that we move in that corridor, the capacity that's going be unlocked and available to convert with improved service and faster asset times, I see incremental growth across the book of business. Beyond that incremental growth, this discussion, which is advancing rapidly with this alternative met coal producer in Riversdale, is real. It's substantive. It's taking positive steps. And to John's point, I fully believe and expect that it can be online shortly after this coal transitions through the switch at Kamloops over to the Canadian National. So, again, it's an opportunity that we fully intend to be accretive and do. And to realize leading up to and certainly after and through that transition. John, I don't know if you want to add anything I missed but...

<A – John Brooks>: No. Again, Benoit, I think it really is across a large piece of the book of business. Our ECP team continues to add on to our energy train. We're only going to see, I think, the refined fuels export market grow through Vancouver. And we've got the best mouse trap in the industry to service that. So, it's capacity like that. It's the coal. It's future growth in the intermodal sector. And, again, don't underestimate the power of the operating model related to our 8,500-foot grain model and what that's going to do into Vancouver.

<Q – Benoit Poirier>: Okay. That's really good color. And with respect to crude-by-rail, John, as the – you will move toward DRU and neat bitumen, how the exposure to neat bitumen will be down the road and what about the pricing given it's nonhazardous? Is there a big discrepancy versus typical crude-by-rail or it's about the same we should forecast going forward?

<A – John Brooks>: Yeah. I don't know if I can give you a number, Benoit, relative to how we've priced sort of standard crude reserve price. I can tell you this, it's a safer commodity. So, we have looked at it differently in terms of how we get it to market and the partner, ConocoPhillips, that we're working with to market the product. I don't know. That's...

<A – Keith Creel>: I think an important piece that we can't lose sight of is the length of haul is going to improve. We're going to be interchanging a large percentage of the crude that we move over Kansas City as opposed to shorter gateways given the 10-year deal with – partnership with KCS and ConocoPhillips. Whereas today's model, much of that business that it's replacing is interchanged over a gateway that's much closer to the origin than Kansas City is.

<A – John Brooks>: Yeah. That is a fair point. It will depend on, sort of, how that mix rolls in and out of our business at that time.

<Q – Benoit Poirier>: Okay. That's great color. Thank you very much for the time.

<Operator>: Justin Long with Stephens. Your line is open.

<Q – Justin Long>: Thanks, and good morning. I wanted to ask about the trend in comp and benefits per employee and kind of what you're expecting on that front this year relative to labor inflation. And then Keith, you made the comment earlier on head count that with mid-single digit RTM growth this year, we should see a low single digit increase in head count. Is that a good way to think about the framework longer term as well?

<A – Keith Creel>: Yes, in general. It's all mix dependent. If we were to drive all of our growth through 8,500-foot grain trains or 152-car set coal trains or 172-car potash trains, there are limitations, obviously. We can't incrementally make monumental train length changes in those consists. But in general, across the board, that's a good rule of thumb. It proved to be true last year. It will prove to be true with our mix this year. And I can tell you when it comes to our cost per employee on an RTM basis, we have negotiated and ratified some pretty progressive agreements. I talked to them, I guess, last year. Probably don't talk a lot about it. But effectively, we tied our success and our growth to our employees. So, we start with the base and many of our contracts on the collective agreement side are union contracts that have a base of 2% and incremental can grow up to 3% wage appreciation if the growth is there. As it was, given flat RTM growth in 2019, then obviously we're going to realize the lower side of that model as opposed to the higher side of that model. Now I'm not saying that proudly, I'd love to be able to give our employees the higher side of that model. And we've set it up so that we can do that because they are key contributors to our ability to be able to grow with the service they provide. So, I don't expect a headwind in that space in 2020 given the RTM and it's all tied to the RTMs. That's why we always speak RTMs at CP. We get paid by the RTM, not the carload. It's by the RTM. So again, hopefully that helps give some color to your question.

<A – Nadeem Velani>: And the only other – we talked about CAD $30 million headwind in pension under comp

and benefits that you should add to your model. And that's equal each quarter, so you can add an extra CAD $7.5 million to each quarter's comp and benefits. And then, whatever you think the stock-based comp will be in terms of our performance. That's always the variable. It was a big headwind in 2019 and we fully expect it to be a big headwind in 2020.

<Q – Justin Long>: Thanks. That's helpful. And maybe one other bigger picture question around the OR. Obviously, a lot has, kind of, changed in the last year with how the economy has progressed, the freight market progressed. You mentioned some of the contract announcements, and we've seen the headlines on that. When you put it all together, how are you thinking about the right framework for OR improvement going forward? Is it still something around that 100 basis points of annual improvement? If we're growing RTMs mid-single-digits or is there an updated way to be thinking about that?

<A – Nadeem Velani>: Yeah, Justin, I mean, good question. We don't necessarily look at the OR for the sake of OR. It's a product of doing everything else well and it's a bit of a scorecard. So John and his team, they have been very successful in leading the industry in growth, continue to do that, that's going to be sustainable, profitable growth. It's not going to be growth for growth's sake and pricing to the service and the value we give our shippers, that's going to be beneficial to the OR. The operating team executing safely and executing in a controlled fashion in terms of – from a cost control point of view. The operating leverage, we should get, some of the investments that we're making in terms of assets and infrastructure and terminals that will allow productivity improvements to be achieved. All of that goes into the blender. And you should naturally see a benefit to the OR. We put up some very strong numbers in the back half of 2019. And there's no reason outside of stock-based comp, which I mentioned again is we expect to be a headwind. Outside of that, we should see continued improvement in the OR. And I'm bullish on what we can achieve relative to the industry.

<Q – Justin Long>: Okay. I'll leave it at that. Thanks for the time.

<A – Nadeem Velani>: Thanks, Justin.

<Operator>: David Vernon with Bernstein. Your line is open.

<Q – David Vernon>: Hey, good morning. Thanks for the time. So, Keith, I wanted to ask a little bit about the decision to extend the network a little bit with short line purchase. Obviously, it's a little bit of a switch from prior rationalization to short line. Is this a shift in sort of philosophy in terms of looking for ways to further enhance the value of the network? Or was this just like a onetime opportunity that seemed like a good fit in the network?

<A – Keith Creel>: We've always embraced the philosophy that we're continually looking for value-accretive opportunities to grow our network and this certainly was a compelling one. I look at this railroad, some people know this, some people don't. This is a railroad that our predecessor sold 25 years ago. For the reasons that only they can explain or properly give justice to, they made a decision to exit the market. The world's changed in 25 years. The railroad's changed. It's evolved. We've got a very, very compelling, competitive service offering that we're able to produce that when you lay that over that geographic footprint, it represents strength and opportunities for long-term sustainable, profitable growth. We're going to help those customers win in the marketplace. It just makes too much sense. It fits right in, folds right in to the strategy that we've executed across this railway the last three years when we shifted from our mandate to fix the strength and the stability and the long-term sustainability of the company to one of growth using the value and the capacity that we created by implementing precision scheduled railroading. So we'll continue to look for these. I would suggest, I don't see any that are as compelling that have made themselves available. But we've got dry powder, we've got the balance sheet to act and we certainly have the expertise within this company to convert it. So we'll continue to look. Again, nothing I see in the immediate future, but our eyes are wide open.

<Q – David Vernon>: And maybe just as you think about integrating it into the business, will there be some time for it to, kind of, get up to the return level you'd expect? I'd imagine there might be some CapEx you need to put in. The labor may be coming over at a little bit of a higher rate, if you're going to be bringing those employees into the existing contracts. How should we think about the return profile on that extension of the network? Should it be a little bit more back-end loaded or will it start from day one?

<A – Nadeem Velani>: Yeah, I mean, you'll see some small accretion, kind of, day one. But it's nothing that's going to move the needle in any way. So, some of the growth opportunities we talked about to your point in terms of getting the network back up to the levels of capital condition that we expect. It will take some time. So, it will be more back-end loaded. It is a strategic opportunity that we're not going to rush. We're going to do it right.

<Q – David Vernon>: All right. Thanks, guys.

<A – Nadeem Velani>: Thanks, David.

<A – Keith Creel>: Thank you.

<Operator>: Ken Hoexter with Bank of America, your line is open.

<Q – Ken Hoexter>: Hey, great. Good afternoon. Maeghan and Nadeem, congrats on the awards. And Keith, I appreciate the comments to Konark earlier about your conservatism in your outlook. But just really quickly, I just want to follow up on that. Would you be more surprised on the volume side, meaning you're more concerned about the revenue outlook, or is this more cost returning that Nadeem talked about? Just because you've been so adamant about kind of double-digit growth in 2019, 2020 and 2021. So just a little bit of conservatism. I'm wondering, what – where you're leaning the revenues or cost side?

<A – Keith Creel>: You know what, from a prudent view, Ken, if I knew what winter was going to do in this first quarter, and I knew that all of this uncertainty in this trade space was going to be resolved, and I knew that the ground moisture was going to be favorable, and we don't have the same wet weather we had when we harvested our crops last year, you could convict me for conservatism. I just don't know that yet. I see an opportunity to firmly achieve the guidance that we've issued, which we pride ourselves in that and we owe that to you and our other partners in this business. But likely, again, I'll be surprised if we don't exceed. Given some good fortune, given the hard work and the potential this team represents and these opportunities, I see opportunity to meet and exceed on the cost side as well as to meet and exceed on the revenue side. All of which leads to meeting and exceeding on the earnings. That's truly what the bottom line is.

<Q – Ken Hoexter>: Truly fair. I just wanted to see if you were throwing it in on one bucket versus another in terms of why you were adding that little bit more conservatism. That's helpful. And then I guess, lastly for me, your peer talks a lot about this potential growth of Halifax opening up the eastern. When you talk about CMQ and the port Maine or St. John, is that what you're looking at or is that kind of a minor portion of what you can do in Montréal or elsewhere? Just want to kind of gauge when you talk about this future, is that, kind of, you're opening up the east for additional capacity?

<A – Keith Creel>: I see it as competitive option, a direct competitive option for the existing business that currently calls on or is served in the Maritimes, to Halifax obviously. But I see it as opening the door and being competitive to trucks and creating new solutions that don't call on the Maritimes now from an inbound standpoint. And to John's point, we can't really provide the color yet because the devil's in the detail and we're going to do this right. But we're having some very encouraging discussions with customers about existing moves as well as new moves to the rail industry in providing solutions that, frankly, even though the geographic advantage was there, the service proposition wasn't there, given that you go from some of these lanes would have been a three railroad move to a two and in some cases, one. And we believe, in partnership with the short line that does the final mile into St.

John, what will feel like and look like and the experience will be like a single-line serve railroad from East Coast to West Coast in Canada and certainly compelling into with speed into the Midwestern markets. I mean, you think about St. John to Montréal in a day, that's pretty darn compelling, especially when it's reliable. That's truck-like reliability with a railroad that not says it, but does it. And from a service standpoint, if that speed matters, that's compelling. You think about St. John to Chicago in three days, consistently, reliably. These are products that haven't been put in the marketplace that have still got to be tested by the customers. And once they do and they see the value of it, those that sign up early are going to realize the value early. And those that are a little bit late to the party to compete, I just truly believe it's too compelling for them to ignore.

<Q – Ken Hoexter>: Truly appreciate the time. And, Nadeem, looking forward to that 60% in the first quarter, that's great stuff. Appreciate the time, guys. Thanks.

<A – Keith Creel>: Thank you.

<A – Nadeem Velani>: Thanks, Ken.

<Operator>: Allison Landry with Credit Suisse, your line is open.

<Q – Allison Landry>: Thanks for sneaking me in and I'll just ask one, but just following up on the discussion with the CMQ in Eastern Canada. Is there anything that's specific that may relate specifically to the Brookfield transaction of Genesee & Wyoming? Is there anything in that portfolio that you think may be an opportunity to further extend conductivity to either eastern Canada or the northeast US? And then just any comments on your willingness to take up leverage for M&A?

<A – Keith Creel>: Allison, the question there specific to the Genesee & Wyoming transaction, I would say maybe. I'd say it just depends. Obviously, there's a piece of that network, again, that's sort of is reflective of the CMQ story. Railroad that we used to own that went to Quebec City, that just depends. It may or may not come into play, but it could represent compelling value. Just depends on the willingness to sell it and what the numbers are and if we can make it work. So, with that said, that's an opportunity. And the other way, I look at this and think about this, I think about, in simple terms, how important and critical Vancouver is to our network and how it – it's the bookend or the starting point or the ending point of the strength of our franchise with the shortest routes to the key markets in Canada, the major metropolis centers in Canada as well as to the Midwest of America. If I go to the east and I look at St. John, to me the art of the possible there is St. John could be the Vancouver. It could be the Vancouver in the east that can get you to those same key routes in the Midwest. So, a franchise that has a Vancouver in the west and its sister, brother in the east, I think that's pretty compelling and again, it's the art of the possible. But what's impossible is if you don't have that network, you can't create that vision. And we think we can do that.

<Q – Allison Landry>: Okay. Great. Thank you, guys.

<A – Nadeem Velani>: Thanks Allison.

<Operator>: This ends the time allotted for our Q&A session. I would now like to turn the call back over to Mr. Creel for final remarks.

<A – Keith Creel>: Okay. Well, thank you again for your time and for your vote of confidence. As I've said, we don't take it lightly at this company. We're going to work hard to meet or exceed your expectations and to reward you for the trust you put in us, as we reward our customers with our service so they can win in their end markets and our employees that make this all possible, for their sacrifices and their contributions. We look forward to meeting again and discussing again what we anticipate to be strong results for the first quarter of 2020. Have a safe and productive day.

<Operator>: This concludes today's conference call. We thank you for attending Canadian Pacific's fourth quarter 2019 conference call. You may now disconnect.