Transcript

Q1 2020 Earnings Call

April 21, 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

Good afternoon. My name is Christine, and I will be your conference operator today. At this time, I would like to welcome everyone to the Canadian Pacific first quarter 2020 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

Thank you, Christine. Good afternoon, everyone, and thanks for joining us today. Our sincere apologies for the delayed release and start to our earnings call. We ran into a few technical difficulties, but those are now behind us. So we appreciate your patience and understanding. Before we begin, I want to remind you that this presentation contains forward-looking information and that actual results may differ materially. The risks, uncertainties and other factors that could influence actual results are described on slide 2 in the press release and in the MD&A that's filed with Canadian and US regulators. This presentation also contains non-GAAP measures, which are outlined on slide 3. With me here today is Keith Creel, our President and CEO; Nadeem Velani, CFO; and John Brooks, our Chief Marketing Officer. The formal remarks today will be followed by Q&A. In the interest of time, and so that we can get to as many analysts as possible, we'd appreciate if you could limit your question to one.

It's now my pleasure to introduce Mr. Keith Creel.

Keith Creel

All right. Thanks, Maeghan. And let me start by thanking all that have joined us today during what are certainly unprecedented times. In fact, better said, I would say they are extraordinary times, which happen will continue to require extraordinary efforts and sacrifices to endure this battle that we're all facing. With that said, before we review our results, I want to say thank you. Thank you to our 13,000 strong CP family that's not only enabled these results, but who are sacrificing day in and day out ensuring the essential services that we provide continue for something bigger than any one of us, and that's for the health and the well-being of society. A picture is worth a thousand words, which is exactly why we shared the picture that's in our deck today. It was taken trackside in Ontario last week erected by someone in that community to thank the true heroes at CP that are risking their lives day in and day out to serve. I also want to thank and recognize the first responders, healthcare professionals and all other frontline providers for their ongoing dedication and sacrifices during this COVID-19 crisis. I can tell you as a leader and as human being, I'm extremely proud of our CP family, of professional railroaders for the body of critical work that they're doing right now for the Canadians and Americans alike to protect our lives and our livelihoods. Now shifting my comments to our results which speak for themselves, I'm going to be short of my comments. I'm going to spend more time speaking to them to highlight what this PSR model is truly capable of. In a quarter where the other railroads experienced negative volumes, CP grew RTMs by 9%. For the first time in CP's history we produced a sub-60% OR in the first quarter, enabling us to grow earnings by 58%. Rest assured, the same operating model that produced these results is just as resilient heading into the challenging times that we're facing. It's a model and a team that's proven its ability to adapt our resources and our costs in a rapidly changing volume environment. In respect to our updated guidance, recognizing there will be volume headwinds ahead, we're now expecting RTMs to be down mid-single digits for the year. That said, given the buffer that we built through the first quarter, we felt comfortable guiding to flat earnings. Not only can we weather the storm I'm convicted, based on the strength of this team and the power of this operating model, we will come out on the

other side as stronger and more resilient company. We're entering these turbulent times with a strong balance sheet and ample liquidity. The management team is battle tested. We're ready to weather the storm. We're not panicked. We're not distracted. We're prepared, we're engaged and we're agile. There's certainly no playbook for times like this, but as a leader I know, this is where our culture and a discipline set strong companies and teams apart from the rest. We certainly recognize there are going to be challenging times ahead. That said, I've never been more confident in our company's and our team's ability to succeed in spite of this environment we're all facing. To me, it's a unique opportunity where the uniqueness and the potential of our team and the uniqueness of our story at CP will shine the brightest for our investors, our customers and our employees. So to wrap my comments up, I'll leave you with this. At CP, we continue to invest in our network. We're going to continue to invest in our people, and we continue to look for ways to support and grow closer to our customers. That's what strong companies do and what strong leaderships do. We turn our challenges into opportunities. We'll grow stronger. We'll create our own unique success at CP. With that said, I'm going to turn it over to Nadeem and John to cover the balance of our numbers as well as our customer opportunities.

John Brooks

All right. Thank you, Keith, and good afternoon, everyone. So total revenues were up 16% this quarter to a Q1 record of CAD $2 billion. RTMs, as Keith said, were up 9%. FX was up 1%, while fuel was flat. Pricing remains stable, landing in our targeted range while mix was positive as we moved lower volumes of coal and potash. Obviously, as Keith said, a lot has changed in a short amount of time. Rest assured, my team is continuing to work closely with the operating team and our customers to ensure we stay aligned during these challenging times. I will now briefly highlight our first quarter performance and provide some color on our outlook for our major lines of business. I'll speak to the results on a currency-adjusted basis. Starting with grain, grain volumes were up 8% on the quarter with revenues up 10%. I want to start by congratulating the CP team and our grain customers for delivering an all-time Q1 tonnage record for Canadian grain and grain products at approximately 6.4 million metric tons. Our 8,500-foot grain train operating model is enabling new capacity on existing train starts. And our covered hopper fleet investment is giving customers the ability to load more grain per car. In fact, our high capacity cars alone enabled the movement of an additional 100,000 metric tons a grain in Q1. CP and our grain partners are delivering greater productivity, reliability and sustainability into the grain supply chain. As I look ahead, grain will remain a bright spot. Our Canadian grain market share is approaching 54%. And with strong demand at both Vancouver and Thunder Bay, I expect ongoing momentum. On the potash front, volumes were down 10%, and revenues decreased 2%. For export potash, we delivered a strong Q1 for our partners despite market challenges. And tonnage projections remain solid as I look ahead to Q2 and for full year 2020. On the domestic side, with consecutive poor application seasons, due to flooding and cold wet weather, we see upside in the North American markets, as the industry looks to replenish nutrients during the spring application season. So bottom line, I remain optimistic about the demand outlook for both domestic and export potash. In fertilizers and sulphur, revenues and volumes were up 21%. Similar to our domestic potash story, we are seeing strong demand for nitrogen and phosphates from our retail and wholesale outlets across our fertilizer distribution network. So overall, with our bulk sector making up over 40% of our book, I expect our grain, coal and fertilizer to provide a level of resiliency looking forward. The energy, chemicals and plastics portfolio saw revenue growth of 55%, while volumes grew 39%, with growth across many of our commodities in this area and record crude by rail volumes. Now, looking forward, we see demand pressures across all these commodities and markets. Crude volumes are rapidly slowing, given the steep decline in demand resulting from COVID-19 and the impact of oversupply from the Saudi Arabia-Russia production dispute. As we've seen in the recent days with all the volatility, we are expecting low demand environment in North America and globally until recovery starts to ramp back up. As a reminder, we have structured our contracts to provide protection in times like these. All of our crude contracts are multi-year and have minimum volume commitments and liquidated damages associated with them, to help offset some of these declines. Moving on to forest products, we were up 8%, while in MMC, volumes improved 13%. The growth in these lines of business were largely driven by strong pulp demand, steel and frac sand shipments to the Bakken.

Looking forward, although segments such as pulp will continue to be strong, we are seeing softening across many of the industrial sectors. Additionally, frac sand volumes have declined and are expected to remain challenged due to the pressures on the energy markets that I've already spoken to. In automotive, revenues were up 13% while volumes are down 3%, an outstanding outcome given the pressures on this sector. The near-term outlook for automotive business remains uncertain given the temporary plant closures. However, we are staying close to our automakers as they assess possible start-up timing. When things do start to ramp back up there are some positives to look forward to in this sector. Recently, we have entered into a new five-year contract with Fiat Chrysler as they will join Ford starting in July as a long-term partner at our Vancouver auto compound. Additionally, this agreement with FCA will expand our partnership where CP is earning new lanes into Calgary, Chicago and Minneapolis. So despite the challenges across the auto industry, the start-up of Chrysler and Glovis later this year, we expect this new business to help offset industry declines as we continue to leverage our network developments and our strong service model. Finally, on the intermodal side, quarterly volumes were up 10% as a result of another record quarter in domestic and double-digit growth in international. On the domestic intermodal front, CP is a key partner in the supply chain for essential goods for North America. And we are working closely with customers such as Loblaw, Canadian Tire, Nestlé and others to fill the critical needs of consumers. In international, we have successfully on-boarded Yang Ming in Q1, and we closed the quarter with a record March for revenue. So while we are seeing blank sailings and variability in volumes, and expect this to continue as we move through Q2, so far our partners have been less impacted than others in this space. So let me close by saying, as the environment has rapidly changed, we have been closely aligned with our ops and finance teams to ensure that our resources adapt quickly and in lockstep. We have an excellent team of sales professionals that are proven, that are working closely with our customers to understand their current needs, changes in demand, and maybe most importantly, how we can help customers be successful when we move into recovery. So although we are all navigating through uncertainty, I'm confident that this team's proven record and our surgical growth strategy will continue to position us to lead as we emerge from these unprecedented times. So with that, I'll pass it over to Nadeem.

Nadeem Velani

Thanks, John, and good afternoon. I'm extremely proud of the record results the team is delivering today. We carried the momentum from 2019 into the first quarter of 2020. And I know I surprised some of you with the 60% OR comment I made in January, but our team made up of the best railroaders in the industry went out and managed to exceed my high expectations. Overall, the operating ratio decreased 1,010 basis points to 59.2%. This is a new CP record and the first time we have gone sub-60% in the first quarter, simply outstanding performance by the women and men of CP. Some of the more notable items on the expense side, comp and benefits expense was down 2% or CAD $9 million versus last year. The primary driver of the decrease was lower stock-based compensation of CAD $30 million, primarily as a result of the decrease in the share price. This was partially offset by an increased incentive compensation accruals versus Q1 2019. Fuel expense increased CAD $1 million as a result of higher volumes, partially offset by 4% price decrease and record Q1 fuel efficiency. Depreciation expense was CAD $192 million, an increase of 19% as a result of an adjustment in 2019 and a higher asset base. Purchased services was CAD $312 million, a decrease of CAD $47 million or 13%. The main driver of the decrease was lapping an abnormally high Q1 2019 casualty expense. Moving below the line, other components of net periodic benefit recovery were negatively impacted CAD $12 million or 12%, primarily due to a lower discount rate. Interest expense was flat as a result of the lower effective interest rate, offset by higher commercial paper outstanding in Q1 2020. Income tax expense increased CAD $46 million or 33%, primarily as a result of higher taxable income. Rounding out the income statement, adjusted diluted EPS grew 58% in the quarter. The same discipline and constructive tension that enabled these results will enable us to adapt in the weeks and months ahead. As Keith noted, as powerful as the PSR model is in good times, performs even better in the challenging times. In fact, in spite of record GTMs and RTMs in Q1, we are parking locomotives and have been adapting resources real time. I've often noted how collaborative our finance, asset management, marketing and operation teams are when they look at demand and capacity. Our team's ability to align our resources is the best in the industry, and are very proactive

that becomes particularly evident in times like these. We turn to the next slide on free cash. Cash from operations increased 18% on the quarter. Free cash is down quarter-over-quarter as a result of increased capital expenditures in the first quarter. We're going to continue to reinvest in the network and remain committed to our CapEx guidance of CAD $1.6 billion. We plan to proactively take advantage of additional track time to do necessary maintenance to be in a position to capitalize when demand normalizes. Times like these can provide opportunity to stretch capital dollars further in terms of attractive material costs and production allotments. We have a pipeline of high-return projects, including the covered hopper investment, and we are absorbing the headwinds from higher FX in our capital envelope. We will continue to evaluate economic conditions, but our disciplined approach and commitment to investing in the business is evident in our adjusted ROIC of 17.4%, an industry best. Turning to the next slide and a comment on the environment we find ourselves in today. The COVID-19 situation continues to evolve. However, I am confident that we are very well positioned to navigate this uncertain time. From a financial standpoint, we are in a strong liquidity position. We had two highly successful debt issuances in Q1 with record low coupon rates that enabled us to pay down the majority of our short-term debt. We don't have any debt maturing until Q2 of 2021. As of yesterday, our USD $1.3 billion revolving line of credit is fully undrawn. Additionally, the facility can be expanded by an additional USD $1 billion should we need to do so. As previously mentioned, the balance sheet remained strong with leverage within our guided range of 2 to 2.5 times adjusted net debt to adjusted EBITDA. On the shareholder return front, we have been prudent in the near term to protect the strength of our balance sheet. In March, we temporarily paused our share buyback program, which is about 40% complete. We wanted to get greater clarity on the economic impact of COVID-19 and how that would impact our customers and volumes. We also delayed our dividend increase for the same reasons. So although in the short term, we are sitting on about CAD $400 million in cash, once we have comfort around the economy restarting in North America, we plan to revisit both the buyback program and the dividend. We just believe this is the right thing to do given these unprecedented times, and our shareholders have been fully supportive of this conservative approach. We are in an enviable position to weather these uncertain times, and we'll continue to proactively manage our liquidity. We are taking proactive action to control costs in a way that protects us when the volumes return. With that, I'll turn it back over to Keith to wrap things up.

Keith Creel

All right. Thanks, Nadeem and John, for that color. And I think we'll save the balance of our time for the questions. So let's open it up now for Q&A.

Question & Answer

Operator

Thank you. [Operator Instructions] Your first question comes from the line of Chris Wetherbee from Citi. Your line is open.

<Q – Chris Wetherbee>: Great. Thanks. Good afternoon, guys. I wanted to just maybe ask about the guidance, and I appreciate you giving us a stab at guidance given the uncertainty that's out there. As I look at the RTM guidance versus the EPS guidance, looks like you're maybe thinking about kind of low double-digit declines or around 10% declines in RTMs for the rest of the year. And then the EPS guidance for the rest of the year would suggest something down, maybe a little bit more than that. So can you just sort of walk us through some of the puts and takes and the things you're doing with the network to try to offset some of the potential negative operating leverage? Obviously, you guys did a great job in the first quarter. I kind of want to understand some of those puts and takes of what may drive earnings down more than RTMs if that's ultimately what happens here for the next three quarters.

<A – Keith Creel>: So Chris, let me provide a couple of high-level comments, and I'll let Nadeem add any color that I might not cover. So I think it's important for everyone to understand, and I think the numbers speak for themselves. At CP, this is a unique story in this industry. It has been the last two years. It continues to be. So at a micro level, we've got some uniqueness. We've got a unique business mix. 40% of our business base or our revenue is obviously bulk driven, and these are areas that even in spite of these challenging times, they are underlying strengths and we're capitalizing. We're executing in those marketplaces. So our guidance is influenced by that, and at the same time it's influenced and tempered by the same things that you're seeing, I'm seeing, we're all hearing. So it's phased in demand that's coming back mid-May. It's certainly going to be down in the second quarter in a major way. It's going to start to ramp up. It's going to be a bit stronger in the third quarter. It's going to be stronger in the fourth quarter. And I'd suggest it's probably first quarter of 2021 before it normalizes. But again, what you see external overall for the industry, CP has got a unique space in that because of our business mix, because of the team, because of our ability to adjust and control costs. We're eight years into PSR. This isn't something we just started. So we've been adjusting, controlling and tempering our cost in lockstep with our demand. It's in our DNA. It's part of how we do what we do. So again, we're going to continue to do and play to our strengths in this franchise, and we're going to play to the strengths in our business mix. And we're going to adjust our asset base and our cost to match and lockstep the demand that we see to protect our margins and to protect our earnings as best as we can through this storm, and at the same time position ourselves to exit strongly. We're doing unique things not only controlling costs but with our employee base as well. And I've talked about this in the past. Listen, at the end of the day, this is a people business. And we're all having to sacrifice, we all have anxieties, we all don't know about the unknown. But one thing I do know and I believe firmly, this economy is going to come back. The strength is there, this business mix the strength is there. And when it comes back, we need our people, their minds and their hearts and their commitment. So we're doing things above and beyond for our employees, to make sure that when we come back and when the business bounces back that they're there, they're available and they're ready to return to work, giving them and sending them and paying them in ways that contractually we don't have to, but it's the right thing to do, number one. And number two, it's going to cement and let them know how much they mean to us and how much they mean to our business so that we can appropriately respond when the business bounce back. So I know that's a long answer to your question, but I think to understand the problem and the context is important. Nadeem, let me turn it over to you if you want to fill in any of the colors relative to specific numbers or anything I missed.

<A – Nadeem Velani>: Yeah. Chris, I'd just say, in Q2, likely you'll see more pronounced, kind of, negative operating leverage versus Q3 and Q4, which we'll be better positioned. And that's just given the rapid decline in volumes that John mentioned. So I think we'll see as the economy restarts, whether that's later in May or June or beyond that, we'll be in a better position. But certainly, when you have a significant drop, just in Q2, no matter how proactive we've been, you're going to have certain kind of fixed costs like depreciation year-over-year that are going to be headwinds and so forth. But for the most part, the expectation for the year still assumes that we're going to be able to improve our operating ratio, which I think is a testament to how we can protect earnings even with negative volumes.

<Q – Chris Wetherbee>: Got it. That's very helpful. Thanks for the time. I appreciate it.

<A – Nadeem Velani>: Thanks, Chris.

<A – Keith Creel>: Thanks, Chris.

<Operator>: Your next question comes from the line of Allison Landry from Credit Suisse. Your line is open. Please go ahead.

<Q – Allison Landry>: Thanks. Good afternoon. So I just want to ask about the capital allocation. I know you reiterated the CAD $1.6 billion of CapEx this year, but how much room, if any, do you have to scale back if the environment necessitates? And then if you needed to preserve cash, would you prioritize delaying some of the

spending or just cut the dividend?

<A – Keith Creel>: Allison, I'll let Nadeem fill in the numbers. But I can tell you, from our approach, we're protecting this capital because this is a long-term game. This is a marathon, it's not a sprint. This business is going to come back. The money that we're spending surgically and strategically so that we can accommodate growth and protect our margins and protect our fluidity and protect sort of the magic that's in our operating model. Asset turns matter, safety matters, velocity matters, all those things. So when this business comes back, given that we're investing in hoppers that make us more efficient, more reliable, it plays to our margins, it plays to our capacity, given that we're investing strategically in our track, in the spaces that we need infrastructure to make sure that we can protect our fluidity as business comes back and, in fact, improve, not slip back. I'm not one that says we need to cut our capital. I think about this from an opportunity standpoint. We have the ability. We have the need. We have the business case to invest in the business. We have an ability now with demand down and with business down to actually do more with less to take that capital spend and putting in more ties, more rails, more ballast, more surfacing, more grinding, all those things at the end of the day when the business comes back, when you need the capacity the most, not only is what we had there, it's increased. So to me, the last thing to do right now, unless financially we need to, to protect the strength of the company, which uniquely we don't, I'm not going to cut back but our capital expenses. That said, we do have an envelope of, if necessary, we can. But we're not anywhere close to getting to that point. So Nadeem, I don't know if you want to add to that. But that philosophically and fundamentally, I'm convicted, that's where we stand in this company.

<A – Nadeem Velani>: Yeah. And I would just add that between John and his team on the sales and marketing side, leading the industry in growth for the last several years, having a short kind of construction season that we have up north, you have less of a window to do some of the work. And so you're not as productive as you'd like to be. So on the one hand, we don't like seeing negative volumes, but it does create for us an opportunity to be a lot more productive and efficient, as Keith highlighted. And so it's an opportunity for us. And certainly, we look at this as being able to pull forward even some work from 2021, if we can be more productive and do it more efficiently and cost effective, then we're going to do that. From a financial position, yeah, I mean we still see free cash flow in excess of CAD $1 billion. We still plan on completing our share buyback. We still plan on revisiting the dividend and increasing that. We've talked about a payout ratio closer to 25%, 30% range. So I don't think any of that is at risk, given the financial strength that I mentioned in terms of our balance sheet, the fact that we have CAD $400 million of cash at hand. We're just being prudent in how we return cash to shareholders in the near term. Now, I will also say we've done effectively 40% of the program that we announced December 20th. So we're ahead of pace on the buyback. It's not like we're slowing it down materially in any way.

<Q – Allison Landry>: Okay. That was really helpful guys. Thank you so much.

<A – Nadeem Velani>: Thanks, Allison.

<Operator>: Your next question comes from the line of Walter Spracklin from RBC Capital Markets. Please go ahead.

<Q – Walter Spracklin>: Hi. Good afternoon, everyone. I just wanted to focus on your mid-single digit decline volume guidance, wondering if you could decompose that a little bit. John, you certainly indicated and suggested that bulk is doing well and is likely going to continue to do well. So perhaps just to put it simply, are you expecting bulk in the balance of this year to see year-over-year growth in that segment?

<A – John Brooks>: Yeah. I think there is the opportunity out there, Walter, in the bulk space. Given the way this Canadian grain crop has set up itself, I think our expectation sees that potential through Q2, and all expectations are certainly another strong crop coming out of Canada towards the back half of the year. So I think that presents an opportunity. Potash is, has been an interesting one. Canpotex on the export side has done a really good job of, to some extent, deleveraging China as part of their book. Now, it's not perfect, and it's not certainly complete. But we think given soft compares that we had the back half of last year on the potash front and what our expectations

are with them for potential movements that presents itself an opportunity there. And beyond potash, as I said, the other fertilizers, North America, in particular, has been quite depressed in terms of returning those nutrients to the soil. And I think our team is pretty excited about what we're seeing on that front. Teck, we'll see. I think in some of the coal, there's probably a likelihood we see a little decline year-over-year in that space. But I can tell you right now, as it stands, there's been some challenges through Q1. We got some make-up to do I think in that space as we look forward. So I'm not counting that one out either, Walter.

<Q – Walter Spracklin>: Okay. That's my one. Thanks very much

<A – Keith Creel>: Thanks, Walter.

<Operator>: Your next question comes from the line of Steve Hansen from Raymond James. Please go ahead.

<Q – Steve Hansen>: Yeah. Hey, guys. Thanks for the time. I'm just curious about your new five-year contract with FCA. It sounds like a solid win the way you described it. I'm just wondering perhaps if you could give us some sort of sense of magnitude, first part. And second part, just curious if this is really – it sounds like this is a broader extension of the land strategy that you laid out a couple of years back now, I believe, late 2018 at the Investor Day. I'm just trying to understand what inning we're in in that broader strategy as it relates to new contract wins and opportunities you see as you roll this out. Thanks.

<A – John Brooks>: I think you nailed it, Steve. It absolutely is part of the broader strategy. I think, we were pretty clear from day one. We were confident that Vancouver auto compound was going to be a home run in terms of bringing customers to Canadian Pacific. It just makes too much sense in that marketplace. And certainly, we've got it full Ford and FCA are going to be long-term partners at that terminal. That contract, I think we could expect CAD $40 million to CAD $50 million. But you add Glovis onto that, and that almost doubles that type of number. So there's a pretty significant chunk of business that's layered into our franchise in the auto sector as we move into the second half of the year that we're awfully excited about. My other comment is around the network development. We've been pretty clear that it is what makes Canadian Pacific's growth strategy unique in the industry. If you go across our network, the ability to take the land holdings we have and convert those with our partners into these types of opportunities is unmatched. And so you saw it in Vancouver. We've got some exciting things in the auto space under development in the Chicago land, but it's not just the auto sector. It's what we've been able to do in our transload space. Those volumes for Q1 and for our transload business enabled revenue, we're up 30%. We set an all-time record for our transload business. We're just scratching the surface there. We've got the new facility that's going to be opening up in Montréal here in the coming months, and we think there's an opportunity to put that dot on the map and replicate it at a few places across our network. Again, utilizing existing land, existing terminals that have become redundant. And frankly, a lot of them have sat vacant for years. And it's the strength of the marketing team, understanding what those opportunities look like and combining it with the strengths of our service model, Steve, that has created what I consider just, again, unmatchable growth opportunities for this property.

<Q – Steve Hansen>: Very helpful. Thanks.

<A – Keith Creel>: Let me, if I could, Steve, I'll add a bit of color to that. Steve, let me add a little color to that. So everything that John said, you take that and you add on the CMQ property, it just enhances it. Now, we've got reach to the East Coast that we didn't have before. That transaction, for us, strategically made tons of sense to give us East Coast access. And now as we approach the STB approval, we anticipate an approval, we should hear something May the 4th. We take control of that railroad completely June the 4th. Now, we've got a route from tidewater on the East Coast into Montréal, Toronto, the Midwest into feeding those facilities where we have capacity that's 200 miles shorter than our competition. That's better than truck. Its truck-like competitive and truck-like reliable. You add that on top, and it's a powerful, powerful, unique differentiator that allows us to grow. That's a USD $40 million revenue railroad that we're taking over that has the potential, and we see line of sight within 24 to 36 months of taking USD $40 million of revenue and making that USD $100 million plus with CP-like

margins. That's a needle mover.

<Q – Steve Hansen>: Very helpful. Thanks guys.

<Operator>: Your next question comes from the line of Brandon Oglenski from Barclays. Please go ahead.

<Q – Brandon Oglenski>: Hey, thanks. Good afternoon everyone. I appreciate the question here. John, so can you talk to us a little bit about what has changed, though, on the negative side in the forecast? I mean, you did mention the auto compound. I mean, autos are in a pretty difficult position right now. And I think energy, when we think about crude and frac sand makes up a pretty big share of your book of business. So what's the outlook for maybe some of these more challenged segments through 2020?

<A – John Brooks>: Yeah, Brandon. Certainly, like, we're not insulated in some of those industrial and energy markets for sure. As you stated, we set a record for crude by rail volumes in Q1, over 36,000 carloads. But frankly, and this is built into our guidance, it's not, inconceivable given the volatility we're seeing, that can move to zero. You couple that with, I think, some of the downstream pressures related to the fuel markets, the diluents, the distillates, the LPG, and obviously, we're not seeing equal type of crude by rail pressures on those markets, but certainly, down double-digits for sure. The frac sand business, we've done a good job of diversifying our book, as we've talked about in the past, away from the Texas markets into the Bakken. We've seen certainly, again, a nice quarter in those movements. But those pressures that are on the energy markets are certainly putting a lot of pressure on those volumes also. The industrial sector is just like you're seeing the scrap and the steel products, certainly non-essential, domestic intermodal products. We're seeing the blank sailings as others are in the international space. And as I said, that's going to continue. Now, I think our international carriers that we partnered with are least so far to date are outperforming maybe some of their competitors in the marketplace. So that's given us a little bit of a tailwind. Let me just close on one more comment around this. I've talked a lot about over the past couple of years, the power of picking your partners in this business and the surgical approach on how we want to grow. And the right partners in the up markets certainly provide a lot of tailwind and look good. But equally or maybe more important is picking the right partners in the down markets. Our partners are resilient. The customers in the auto space are the vehicles that consumers want to buy. In the food space, it's the grocery stores that consumers want to go to. So look, there's no doubt, you can read the news, the biofuels and the ethanols and all these products, there's going to be a ton of pressure on them over the coming months. But I do take a fair amount of solace in the fact that I think we have the right partners. They're going to outperform in the down, and then when this thing comes back, we're going to go right back to the top of the heap with those partners.

<Q – Brandon Oglenski>: Appreciate the thorough response. Thank you.

<A – John Brooks>: Yeah.

<Operator>: Your next question comes from the line of Fadi Chamoun from BMO Capital Markets. Please go ahead.

<Q – Fadi Chamoun>: Yes. Hi, thank you for taking my question. So John, if you can dig into little bit more into crude by rail, what was the volume in the first quarter, what are you expecting for the rest of the year? And can you also give us some indication on the penalties and kind of the minimum volume? Does this roll into 2021 as well? And if not, how should we think about kind of 2021 from a kind of liquidity damages or volume commitments that you have in that business? Thank you.

<A – John Brooks>: Yeah. So Fadi, we're over 36,000 loads of crude by rail in Q1. And just being really honest with you, it's hard to tell what that goes to. As I think I said, it's not inconceivable as we see. We're seeing it ramp down through Q2 here. I think we probably could end the year in the, if things don't improve, I don't know, 40,000 to 50,000 carloads total. And we did 36,000 in Q1 to give you that order of magnitude. I think what you've seen in Q4, you've seen in Q1 in terms of other revenues, I think that's a pretty good guide for you as you look forward to the balance of this year, what to expect in terms of liquidated damages. As you look into 2021, I'd have to look, Fadi,

exactly around. But I'm pretty sure and confident in saying that most of those crude by rail contracts extend all into 2021. So you'd expect similar types of performance clauses as we move out of 2020.

<Q – Fadi Chamoun>: Great. Thank you.

<Operator>: Your next question comes from the line of Tom Wadewitz from UBS. Please go ahead.

<Q – Tom Wadewitz>: Hi, yeah. Good afternoon. I guess, it's kind of sticking with the same topic, John. You know we can, the crude by rail volumes you've been explicit with the comments on that, and it's pretty helpful. How do you think about how broad the exposure is to kind of, I don't know, if you want to say Calgary-Edmonton economy in Western Canada sensitivity to energy because the direct is fairly straightforward, but I guess it's a little trickier to say, well how much of your book is kind of subject to the pressure in the energy markets, is it 20%, or how do you think about that kind of broader question on just negative impacts from, really, the low oil prices that could last a little while?

<A – John Brooks>: So I mean, let's look at it. Let's maybe back into it. 40%-plus of our book is bulk, so non-energy. And I've talked about that actually I feel quite good about it. You've got 20% to 30% as you look at our automotive and intermodal business. And again, we're going to go through the ride like everybody else in that space. When it bounces back, I have no doubt we continue along the path of the success we've had in domestic intermodal and in the international space and growing that business, and the growth we've talked about in the automotive space. Our crude by rail book is, and Maeghan can fact check me on this, but 6% roughly. So look that will be impacted, no doubt. Our ECP business, above and beyond that, I do think there is a pressured-tail on all those types of refined products that we're going to continue to experience. I don't know, does that make take the 6% in crude and another 6% maybe 8% in that space is probably a rough order of magnitude. But look, those demands for those products link pretty closely to consumer recovery. And yes, I guess, right now, it's anybody's guess as you think about diesel and jet fuel and when people are going to start flying again. The good news is, I think we've positioned our franchise in that space to be a successful winner, as we talk about export diesels with Suncor in those terminals we've built, the IPL plastics facility, which is moving forward. So you know what, we're going to take that energy hit in the near term. But I think in those types of products related to that space, I think we'd expect to bounce back pretty quickly along with the recovery in those areas. Hope that's helpful.

<A – Nadeem Velani>: And Tom, I would just say, it's less relevant to say Alberta consumers, very much tied to feedstock in North American economy and US and broader Canadian demand as opposed to localized to Alberta, Calgary or Edmonton.

<Q – Tom Wadewitz>: Okay. So it sounds like we ought to think about it more as kind of the economy comes back and the products come back and just kind of think about crude by rail a bit separately.

<A – Nadeem Velani>: Yes.

<A – John Brooks>: Tom, I think that's the right way to look at it, yes.

<Q – Tom Wadewitz>: Right. Okay. Thank you. I appreciate it.

<A – John Brooks>: Yeah.

<Operator>: Your next question comes from the line of Konark Gupta from Scotiabank. Please go ahead.

<Q – Konark Gupta>: Thanks and good afternoon. I just have one question on – as you said, Keith, you anticipate the conditions to start returning to normal from early 2020. So just trying to understand what actions have you taken so far to protect margins in the current downturn? And then how do you plan for market recovery, considering some parts of the economy could gradually reopen in the next few months? Thank you.

<A – Keith Creel>: Okay. Listen, as far as adjusting and taking actions, it's something we do on a daily and on a weekly basis, again adjusting our assets to demand, be it people, be it locomotives, be it equipment. The first

quarter strength is what it is. But if I look at April month-to-date numbers, I'll just give you a couple of proof points here. If the business is down and we measure business in terms of RTMs, revenue ton miles and GTMs, and generally, they're pretty similarly aligned. Now, if I look at April month-to-date numbers, RTMs are down, rough number, 10%, which again, compared to maybe the industry is unique in and of itself, but our crew costs are down in similar numbers. If I look at year-to-date, overall, you see that our RTMs and our volumes are up. They're positive. Our crew cost per GTMs down more than double-digits. Train starts down more than double-digits. I'm looking at month-to-date, our train starts are down 15%. Our yard crew starts are down almost 18%. Our train speed is up 6.5%. So if you put all those numbers in the mix and you start to use the measures that we use day in and day out, to lead us to the right actions to take to make sure we adjust our resources, that's how you protect the margins. There's no secret recipe. It's staying on top of your business, keeping your finger on the pulse of the operation day in and day out, using the measures that we live and die by to lead us to the right actions, that's in the DNA of this company. And that's how we'll continue to protect our margins, be it today, be it next month, be it later. I can't control ultimately what the macroeconomy does. We're uniquely benefited by micro business mix that's unique to this industry, and we're uniquely beneficial by an operating model and a team that knows how to use it to respond to what the economy gives us. And that's what allows us to protect our margins, and that's what allows us to protect our unique earnings in this troubled time that we're facing today, and allows us to position ourselves to bounce out of it in a very responsive and impressive and rewarding way for our shareholders.

<Operator>: Your next question comes from the line of Scott Group from Wolfe Research. Please go ahead.

<Q – Scott Group>: Hey, thanks. Afternoon guys. So you typically give us some thoughts on how to think about current quarter RTMs and margins. Maybe it's tougher right now. But if you have any thoughts on how to think about second quarter, that'd be great. And then just separately, the commentary on pricing stable in the first quarter, do you think that that can continue in a softer volume environment? Thank you.

<A – Nadeem Velani>: So Scott, yeah, we're not going to go to Q2 guidance on this one. I gave you Q1. I'm not going to get cocky here. It is unprecedented times, and I would just say that we're going to – I expect us to fully lead the industry and operating ratio for the year. And I did point to for the year that we'll be sub-60%. Beyond that, tough to say. We see the weekly RTMs. We've been leading the industry, and I think we've separated ourselves yet again from both the Canadian railroads and the US roads in terms of where we are relative to year-over-year volumes. And I expect that to continue as well. So I'll give you relative numbers.

<Q – Scott Group>: That's fine. And any thoughts on the pricing environment?

<A – John Brooks>: You know what, I'm not going to give any numbers, but my expectation is, as we've stated, is inflation plus. And the team is set up to continue to sort of drive in that approach. There's no doubt as some capacity certainly loosens across the industry and maybe truckers are less apt to go cross-border, and maybe that puts a little pressure in domestic Canada space, that there's pressures there, but it doesn't change our approach and stay inflation plus.

<Q – Scott Group>: Okay. Thank you, guys.

<A – Maeghan Albiston>: Thanks.

<A – Nadeem Velani>: Thanks Scott.

<Operator>: Thanks. Your next question comes from the line of Seldon Clarke from Deutsche Bank. Please go ahead.

<Q – Seldon Clarke>: Hey, guys. Thanks for the question. Just following up on the last question. If I could just ask it a different way. You guided to mid-single digit RTM declines for the year, but how should we think about the general cadence of the declines? And maybe what sort of extends to – what sort of decline are you considering in your downside scenario or side of worst quarter scenario in that mid-single digit decline for the year?

<A – Nadeem Velani>: Yeah. I think we spoke to that a little bit earlier that we'll see much steeper declines in Q2. And if you listen to what some of the government responses have been North America of slowly starting to ramp up the economy and, call it, mid-May type of timeframe and beyond, you should expect Q2 to be the bottom from a volume decline point of view and then gradually improve starting in Q3 to Q4 timeframe. And all of that, I will say, assumes you don't get secondary waves and impacts from COVID-19 that can have a false start to the economy and then take a step back. So that would be a whole other scenario that we're not currently building into our guidance. But what we know today, based on kind of our current macroeconomic view, based on some of the guidance that we're seeing given by government entities around how to phase in and restart the economy, Q2 will certainly be the worst of the volume environment.

<Q – Seldon Clarke>: Ok, I appreciate the time. Thanks guys.

<A – Nadeem Velani>: Ok. You're welcome.

<Operator>: Your next question comes from the line of Brian Ossenbeck from JPMorgan. Please go ahead.

<Q – Brian Ossenbeck>: Hi, thanks for taking the question. Nadeem, can you give some color on – what you're expecting a cost inflation. You gave some commentary on D&A earlier and how that's going up. Crew starts, train starts, obviously, more operational driven volume variable. But what do you see on the inflation side? Are there opportunities to actually get cost down a little bit like you're doing with the CapEx program, and doing a little bit more while the block hours are more available? Any context on that would be helpful. Thank you.

<A – Nadeem Velani>: Yes. I mean, obviously, fuel and energy has its own story. Outside of that, I mean, you'll see some opportunities from the steel price, overall cost of steel as that declines. One thing we do battle on the expense side is also currency. So a lot of our US dollar-denominated expenses, we'll see a bit of an increase given the depreciation of the Canadian dollar. But I mean, overall, I think if inflation has been in that 2%, 2.1%, you're probably looking closer to 1.5% types of levels. We put in some labor agreements several years back that had some level of tie-in to our RTM growth. So we'll see that not necessarily pay out an increase in 2020 based on the guidance we've given you. We're hopeful and we want to pay out those increases that usually means that RTMs are growing well. So those are the kind of key areas I'd point to. Are there opportunities from a procurement point of view? Absolutely. But right now, it's really around – the focus is around consolidating train starts, increasing your train weights, increasing your train length and improve the density of what's moving, and really focused on the health and safety of our employees.

<Q – Brian Ossenbeck>: Okay. Thanks for the context. I appreciate it.

<A – Nadeem Velani>: Thanks, Brian.

<Operator>: Your next question comes from the line of Ken Hoexter from Bank of America. Please go ahead.

<Q – Ken Hoexter>: Hey, good afternoon. Great job on the first quarter. Keith, maybe you could talk a little bit about your thoughts on furloughing employees. Given your expectation of a rapid bounce back in your talk on resource allocation before, is that something you try to stay away from and feel the pain in the second quarter, but then be prepared for when that faster ramp-up comes in the back half if the economy comes back as strong as you anticipate?

<A – Keith Creel>: Ken, let me say this, number one, we don't take those decisions lightly, again to my point, its a business. But it's not anything we can afford to stay away from. I believe in transparency. I believe in communicating and letting our employees understand what we're facing. So we've been very transparent from the beginning. We understand and we recognize we're in a storm. We've always made adjustments here. So it's not new news. Our employees certainly understand and respect that. And as long as we communicate the greater need to do that, at the end of the day that's the best we can do, and that's exactly what we're doing. Now, what we're doing unique to our adjustments. I look at our numbers now, order of magnitude as of next week with the

reductions or the adjustments we're making now as we tweak down, running trades wise, we're down around 800 employees. That's a big number, and that's a big impact. But at the same time, we've got 12,200 other employees that we owe an appropriate response to, to make sure we protect the health of the company. And those 800, I want them back as quickly as we can. So what we've done proactively, again, to ensure that they understand how much they mean to us, we're doing things on our own progressively to give them benefits, to make sure that we ensure they continue to get their insurance, to make sure that they have benefits above and beyond what unemployment insurance gives them. And in response, our employees have given us a commitment to come back sooner than they would have otherwise. Typically, in these agreements, especially with the running trades employees, the standard is normally 15-day callback times. We stepped forward and extended ourselves, for our employees and our employees, in turn, working with our union leaders, they've committed to us that they're going to come back in many cases in 72 hours or less so that we can bounce back. So again, it's a give and take situation. It's not a situation or a decision that we take lightly, but we feel compelled and obligated to make sure we continue to adjust in lockstep with our demand. That's what we have done. That's what we'll continue to do. So these changes or these tweaks are not shocking. It's something that's expected. And in fact, as tough as it is, I think it's respected by our overall employment base.

<Q – Ken Hoexter>: So Keith, just so I understand, when they go on furlough and you call them back, there's no delay of any licensing or anything else that has to be done. They can come right back in and step right back in as engineers and conductors. You don't lose any timeframe in reinvestment, right?

<A – Keith Creel>: That's correct. 72 hours, we should have them back on the property ready to pull freight for our customers.

<Q – Ken Hoexter>: All right. Great. Thanks for the time.

<Operator>: Your next question comes from the line of Jordan Alliger from Goldman Sachs. Please go ahead.

<Q – Jordan Alliger>: Yeah, hi. Question for you, can you talk – I know there's a lot of puts and takes to the volumes, but can you talk a little bit about mix effects as you sort of take it all into consideration? Obviously, yields or revenue per ton mile were up 6% or 7% in the first quarter. How do you think about that with the various volumes that you're looking at for the balance of the year? Thank you.

<A – John Brooks>: Well, I think you see maybe similarly what we faced in Q1, depending on potash, coal, and crude volumes. All those are long haul. You probably see slightly positive mix as you move into Q2 and Q3. Again, we'll continue to see positive other revenues along the sort of the similar run rate that we saw in Q4, in Q1. But I'd say slightly positive.

<Q – Jordan Alliger>: Thank you.

<A – John Brooks>: Yeah.

<Operator>: Your next question comes from the line of Jon Chappell from Evercore ISI. Please go ahead.

<Q – Jon Chappell>: Thank you. Good afternoon. John, you mentioned partnering with the right customers. And as you're bringing on and on-boarding these new customers, both in the early part of this year and the back half of this year, has there been a shift to the way that they've talked about the equipment necessary to meet their commitments? And any other commentary from your customers on whether there's kind of we'll-wait-and-see mode until there's a little bit more transparency on the economy, or any signs of optimism maybe going into the end of the second quarter?

<A – John Brooks>: Yeah. So look, as you can imagine, those customer discussions over the past six, eight weeks have been pretty dynamic. And really, honestly, our focus on the front end of this has been around rightsizing our assets, working closely with Nadeem's team and the operating team and those customers to try to get that as right as possible. Certainly, I think those customers in the energy space that maybe control their assets are thinking

about that differently and trying to understand what their future demands are. But there's no magic Rubik's cube in terms of figuring this out. This is I think, as Keith said, it's dynamic, it's day-to-day. It's critical that we're communicating and staying in lockstep. I think the positive is, again, we believe with the right partners and the right level of relationships and transparency that you create, it's a give and take and trying to create that perfect model so we can run their business in the downtime, and then be prepared to add the resources back as needed as the volumes continue to ramp up.

<Q – Jon Chappell>: Thank you.

<Operator>: Your next question comes from the line of David Vernon from Bernstein. Please go ahead.

<Q – David Vernon>: Hi. Thanks for the time. So John, just to kind of take a look a little bit more at a couple of the commodities. You mentioned the bulk was going to be pretty resilient. I'm just wondering, if you could talk a little bit about the export coal outlook, what you're maybe hearing from Teck, and whether you see any sort of policy changes on the Canadian Government side to maybe help the Canadian economy recover quicker, whether it's obviously down the road interest rate cuts, but even maybe looking at pricing approach to the regulated products like grain, whether you think that the economic situation is severe enough to consider, to I think that there's some outside risk that you maybe haven't seen before coming down the road?

<A – John Brooks>: Yes. So on Teck, I'll just – I think we're modeling in the 23 million metric ton range for 2020 right now. Teck has not provided any formal guidance. That's our number. It's slightly down. As I said earlier, we saw some challenges with the supply chain in Q1. And actually, we think there's some opportunity to sort of build up and do some recovery as we move into Q2 and forward. You know what, it's hard to speculate in terms of stimulus. I think, obviously, in the US there's been a lot done. I think anything that can be done in Canada, the Canadian Government, and I'm not going to speculate, but could only help. I think the number one thing my team and we can do right now, David, is to work with these customers to understand what we can do to get them positioned right for recovery. And that means aggressively working with them to understand what they're moving on truck. That means, working with them to understand if there's opportunities that we can leverage our advantaged franchise to help them ramp back up quicker. I can tell you, I've got my team laser-focused on that type of discussion, and it's a shift. As this thing was emerging, it was understanding, frankly, how we right-size our assets with them, and now it's a shift to what we can do in the marketplace so as this does recover that we're positioned to lead the way with them in their recovery.

<Q – David Vernon>: All right. Thank you.

<Operator>: Your last question comes from the line of Bascome Majors from Susquehanna. Please go ahead. Bascome Majors, your line is open. Please go ahead.

<Q – Bascome Majors>: Yes, thanks for taking my question. Nadeem, can you comment and see if you guys have heard any requests from customers on relaxing payment terms? And maybe just, generally, how you're assessing credit risk, both within and beyond the energy markets where customers may have been disproportionately impacted by what's happened to date? Thanks.

<A – Nadeem Velani>: Sure. So yes, I mean, we have had some requests, which is you would expect in this kind of environment. I think our team that manages our credit terms and so forth with our customer service facility in Winnipeg does an excellent job of onboarding customers the right way so setting the right payment terms that's associated with their risk. Now, as things evolve, we do monitor payments on an ongoing basis and to make sure we're not taking on undue risk. So I'm comfortable, we're comfortable at this point in terms of where we are, how we're managing through that, how we're keeping an eye and communicating with customers. I don't see material risk whatsoever. There are, there could be opportunities even to help customers that are in need. I think that to one of previous questions, I think that David Vernon had is just around what's the government doing. The government is doing some things to support customers and their credit, which I think directly does support us as

well and help that relationship with our customers. So I think it's something that we're managing and we're watching closely.

<Q – Bascome Majors>: Thank you.

<A – Nadeem Velani>: Thanks, Bascome.

<Operator>: We are out of time, and I will turn the call back over to Mr. Keith Creel.

Keith Creel

Okay. Well, let me finish with where I started, thanking for taking the time to spend with us today during these unprecedented times. Let me say this. At CP, we're realist, we understand we're in for a bumpy ride, we're in the storm. We're not denying that. But at the same time, we think it's our responsibility to provide the most transparency and the best insight that we can. We've got a unique business mix. We've got unique opportunities, not only with the mix, but with our self-help initiatives that we've been working on for many years leading into this that didn't just start today, benefited by a very unique first quarter result in this industry, all fueling our unique guidance. We want to thank our investors for the confidence and the trust they put in us through this storm before and after, and we certainly intend to reward you for that confidence. We look forward to sharing our results after the next quarter. I want to wish everyone the best. Stay healthy, and we'll talk soon. Thank you.

<Operator>: This concludes today's conference call. You may now disconnect.