Transcript

Q3 2021 Earnings Call

October 20, 2021

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 & Pensions

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Sylvie, and I will be your conference operator today. At this time, I would like to welcome everyone to Canadian Pacific's Third Quarter 2021 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]

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

Maeghan Albiston

Thank you, Sylvie. 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 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 filed with Canadian and US regulators. This presentation also contains non-GAAP measures, which are outlined on slide 3.

Today, we're joined by Keith Creel, our President and Chief Executive Officer; Nadeem Velani, EVP and Chief Financial Officer; and John Brooks, EVP and Chief Marketing Officer. The formal remarks today will be followed by Q&A. And in the interest of time, we would appreciate if you could limit your questions to one.

It's now my pleasure to introduce our President and CEO, Mr. Keith Creel.

Keith Creel

All right. Thank you, Maeghan, and welcome back. So let me start by thanking the 12,000 strong CP family that obviously continue to drive the results that we're presenting today. As we're all aware, the industry has experienced some pretty unique volume challenges in the quarter, and as you've seen in our press release, we've updated our volume guidance to reflect those challenges. But in spite of that, we've reaffirmed our guidance for double-digit EPS growth in 2021. The team remains focused on the elements we can control, delivering excellent service to our customers and managing our resources in lockstep with our business, which obviously creates a compelling value for our shareholders.

The results themselves, it's the collective efforts, third quarter revenues more than CAD 1.9 billion, an increase of 4% year-over-year, and operating ratio of 59.4%, driving earnings growth of 7%. Continued improvement in train weights and lengths as we continue to become more productive at Canadian Pacific, all-time records and fuel efficiency in the quarter. Happy to say that we've improved our fuel efficiency by more than 20% just over the last decade, which makes CP's ESG value proposition even more compelling for our customers, and the time has never been more important to the customers or to the environment. So that's something we're certainly excited about.

John's going to speak to it, another record quarter in domestic intermodal, building on four consecutive record years. We certainly had a tremendous amount of success converting share from truck. We're looking to replicate that same success on a much larger scale, obviously, with our combination with the KCS. We've got capacity in our terminals, capacity in our network. We provide a truck-like reliable service, especially in today's market. That's extremely compelling and value creating, both for our customers as well as for our shareholders. And we're extremely excited what the future holds for Canadian Pacific, in particular, in combination with the KCS from an operational standpoint, a financial

standpoint and an environmental standpoint.

So with that said, let me say a couple of things about the KCS. Obviously, it's been a journey, an epic journey. It's been a great battle, I think, one for the ages, but one we were extremely proud to participate in and extremely pleased with the outcome. So speaking to the path forward, as we're all aware, September 30, the STB reaffirmed our trust approval, which certainly we were pleased by that decision. We plan on filing a merger application with the STB before the end of this month. We continue to expect to close the transaction actually in the fourth quarter. That's still a very real potential outcome. We're making some progress with COFECE which is encouraging, so assuming that continues to proceed well as it is now.

We've got our comments back from the SEC on our F-4. We intend to have our shareholder meeting December 8. We expect to have solid support from our shareholder base in support of this historic combination. With those things said, we do see a path to get closed in the fourth quarter. And in the worst case, perhaps that rolls over to the first quarter, but again, we're focused on the fourth. From there, the STB will begin the review process of the merger, which we expect to take 10 to 12 months. Obviously, we make commitments as part of the application that we'll honor, but the fact that the combination are extremely unique.

I know some have spoken to concessions, and I'll say this now and I'm happy to take it in questions, significant concessions are required to offset losses of competition. Issues of network overlap, issues of predatory pricing or poor service, which this combination uniquely does not represent any of those concerns. We've got zero overlap, zero shippers losing option. We're going to create new competition, new service options for our shippers, which are all very positive, compelling facts that supports this combination.

The combination is going to unlock capacity and create the first US-Mexico Canadian railroad at a time it's never been needed more. So there's certainly challenges ahead as we look forward to our base business. We've got a smaller Canadian grain crop. We've got some supply chain issues, challenges that the balance of the industry are also experiencing, but the macro environment is extremely strong. The opportunity set for CP-KC is growing, which continues to drive and increase our excitement about what lays ahead for our combined entity, for our employees, for our customers and for our shareholders.

So with that said, I'm going to turn it over to John to bring a bit of color on the markets. Nadeem will elaborate a bit on the numbers, and then we'll step into some questions.

John Brooks

All right. Thank you, Keith, and good morning, everyone. So as Keith said, the quarter certainly wasn't without its challenges. I would maybe characterize it as just flat out frustrating in a few areas. But as Keith said, we remain focused on controlling what we can control. I believe many of these supply chain issues that certainly we faced, and frankly, the industry faced are temporary in nature. Our pipeline of initiatives that I look at remains as strong as it's ever been, and frankly overall demand fundamentals, as I go down through the commodities, and many of our markets still remain favorable. Now, looking specifically at Q3, revenues were up 4% in the quarter, RTMs were down 4%. Fuel and FX combined to be a 2% tailwind. Price and mix combined to be positive 6%. We'll talk about the pricing environment some this morning, but it continues to be strong.

Now, taking a closer look at our third quarter revenue performance, I'll speak to these results on a currency adjusted basis. Grain volumes were down 27% in the quarter, while revenues were down 21%. The challenges in the Canadian grain crop have been well documented with the crop size expected to be around 50 million metric tons or about 40% lower than last year's record crop. On the US side, the crop is definitely looking less challenged. Although the harvest definitely is smaller, we expect high demand and we're seeing high demand given the Canadian grain shortfall and a fairly robust soybean and corn export markets.

Despite the challenging Canadian grain crop, I'm excited, we continue to build out our franchise with our customers, expanding to our 8,500-foot high efficiency product. We have six elevator upgrades complete in Q3 alone, and many more to come in Q4 and into 2022.

On the potash front, volumes were down 22% in the quarter. The decrease in volume was a reflection of ongoing port maintenance and upgrades at the Neptune and Portland terminals. We saw supply chain disruptions due to the wildfires and also with the early closure of Mosaic's Colonsay mine. Despite that we see demand fundamentals for potash continuing to be strong. We see upside as we move into Q4 and into 2022 and beyond. And further, we are excited about the prospects of renewing our Canpotex partnership for the years ahead. I can tell you, we expect to announce the extension of a long-term contract with Canpotex in the very near future. And to close on the bulk business, coal revenues were up 22%, while volumes were down 2% as the supply chain rebounded well in August and September following the fires.

Moving on to the merchandise side of the business, the energy, chemicals, plastics portfolio saw revenues increase 27% to a record Q3. Excluding crude, ECP volumes were up 10% as we continue to see recovery and strength and growth in our refined products and plastics. DRUbit started shipping in Q3 and ramped up quickly to more than 15 trains per month. We are excited about the stable long-term viability of this business and the pipeline competitive nature of this new product. Forest products volumes were down 3% and revenues were up 10%. We saw volumes decline sequentially as lumber prices fell off the record levels in Q2. In MMC, revenues were up 35% and volumes increased 30%, largely driven by a recovery in the demand for steel and frac sand. Steel capacity utilization and prices continue to drive growth in our steel and metals franchise.

Automotive revenues were down 8%, while volumes were up 3% on the quarter. We lapped our Glovis contract in September and like all the other roads continue to see the impacts from ongoing chip shortage. Q4 will be choppy on the automotive front as we see this chip shortage continuing, and frankly it's volatile from week-toweek. Looking into 2022, though, dealer inventories remain low, demand continues to be strong and we see good opportunity for the automotive business to bounce back in 2022.

Finally, on the intermodal side of the business, quarterly volumes were up 4%, where revenue was up 16%, another Q3 record. We have now had four consecutive record quarters in domestic intermodal. With our reliable service product and capacity for growth, we continue to perform well in this space, anchored by our strong retail franchise.

The two things in particular that really excite me on the domestic intermodal front; on September 1st, we opened our Pacific Transload Express, our new Vancouver Transload facility in partnership with Maersk. Direct port to rail transload facility is one of a kind in Vancouver and will take approximately 100,000 truck moves per year off Vancouver roads. The customer support to this facility has been extremely strong, and I can tell you, we're already talking about expansion. Secondly, I'm excited about the sequential growth we've seen in our domestic intermodal with our new Atlantic-Canada service. We have driven a 39% increase in volume through Saint John domestic intermodal versus Q2 2021.

On the international front, we performed extremely well in the quarter as we onboarded COSCO, OOCL and the Maersk volumes continued to grow. We continue to see strong demand and we are working closely with our customers to manage the ongoing supply chain congestion. We expect challenges in the international intermodal space to persist into 2022.

So let me close by saying, while we continue to battle some of these temporary supply chain issues and challenges, and certainly we monitor and work closely around the Canadian grain crop, the CP team is focused on the things we control and making our own luck in this marketplace. We remain committed to delivering quality service for our customers, while at the same time improving our overall customer experience. As I look further out, the network combination between CP and KCS will create a new set of service and route options for customers, while enhancing competition across North America. The positive feedback from customers, transloaders, short line partners on bringing these two networks together has been overwhelming, and the list of opportunities continue to grow.

With that, I'll pass it over to Nadeem.

Nadeem Velani

Great. Thanks John and good morning. I am proud of the results this team produced on the quarter, especially given some of the challenges John mentioned. We faced some transitory headwinds on certain business segments, and while some of those will persist in the near-term, we will manage them in the same way you've come to expect from this team. On the quarter, adjusted operating ratio was 59.4%, which is a 120-basis point increase from Q3 2020. Softer volume environment and higher fuel prices put pressure on the operating ratio, partially offset by the strong pricing environment John spoke to.

Looking at the results, you'll note that we adjusted a total of $98 million in costs related to the KCS transaction, $15 million from purchased services and other and $83 million below the line and other expense. This is largely pertaining to some pre-issuance interest rate hedges. I'll speak to the adjusted results on a currency adjusted basis this morning.

Taking a closer look at a few items on the expense side, comp and benefits expense was up 2% or $6 million versus last year. The primary driver of the increase was additional training and head count along with higher accruals on long-term incentives. Fuel expense increased $65 million or 49%, primarily as a result of higher fuel prices, partially offset by a 2% improvement in fuel efficiency.

Equipment rent was down $6 million or 16% as a result of lower price paid for pooled equipment despite higher IMS volumes. Depreciation expense was $203 million, an increase of 6% as a result of a higher asset base. Purchased services was $288 million, adjusted for acquisition costs, an increase of $19 million or 7%. The main driver of the increase was increased casualty costs in the quarter and incremental spend from the British Columbia wildfires.

Moving below the line. As expected, other components of net periodic benefit recovery was up $9 million, reflecting lower discount rates. Income tax expense decreased $20 million or 11%, primarily as a result of tax recoveries related to the Kansas City transaction and a lower effective tax rate. Rounding out the income statement, adjusted diluted EPS grew 7% to $0.88 in the quarter.

Moving on to the free cash flow to wrap things up, we generated strong cash from operations in the quarter with an 11% increase. Year-to-date, we have over $1.2 billion in free cash generated. We continue to invest in the railroad and are on track to meet our $1.55 billion guided CapEx spend for the year. We remain disciplined stewards of capital with our industry-leading adjusted ROIC of 15.9%.

Our balance sheet and liquidity remain very well positioned with leverage of 2.4 times adjusted net debt to adjusted EBITDA, well within our targeted range. Our share buyback program remains paused, while leverage will increase with the pending KCS transaction, we remain committed to our BBB+ credit rating and will reduce leverage back to our targeted range over approximately 24 months. So while Q3 had some challenges, the network is running well, and we remain on track to deliver on our guidance of double-digit EPS growth. We have a strong team in place and a transformational opportunity in front of us.

So with that, I'll turn things back over to Keith.

Keith Creel

Thanks, Nadeem, and John. I guess just to summarize, overall, certainly not a shortage of challenges, but no excuses. This team is controlling what we can control. We can't make it rain, but we certainly can stay in game shape, provide best-in-class service, control our cost, allow those customers where demand is there to actually grow in the marketplace and realize a better outcome and prepare for this transformational transaction. It's going to unlock untold compelling long-term value for our customers, for our employees and for our shareholders.

With that said, let's open it up to questions.

Question & Answer

Operator

Thank you. [Operator Instructions] And your first question will be from Tom Wadewitz at UBS. Please go ahead.

<Q – Thomas Wadewitz>: Yeah. Good morning. Keith, I wanted to ask you, you made some comments on the deal and on the timeframe. I wonder, how are things going with the discussions with shippers and other railroads? Has that been something you've spent some time on or does that come later? And would you say that, is there anything of interest in those discussions in terms of going well or resistance both from the conversations with other railroads and with shippers?

<A – Keith Creel>: Great question, Tom. I can tell you this, obviously, we're not a team that waits for things to come to us. We go to the issues, and we've approached that. We've worked very progressively so far with shipping organizations. Obviously, we had an opportunity to have some discussions initially that we've rekindled since we've become reengaged with KCS and they're progressing well. Obviously, they have concerns. But given our facts, are completely unlike anything they've experienced in the past and our track record to actually integrate and run the railway well, bear well for us, we're going to address, we're going to be reasonable. We're having reasonable discussions, and I expect those to come to a good place.

Same thing with our partners in the rail industry. Obviously, we haven't spoken in depth with all railways, but we have started some very indepth discussions with a couple of very larger railways that the combined entity would have quite a touch point with when it comes to interchanging and being a part of their moves. And again, those are very progressive, encouraging discussions. And I think as long as we continue, and we will, to take a reasonable approach, and that's met with reasonable expectations from customers and reasonable expectations from other railways and our supply chain partners.

We'll get to get outcomes because, again, these facts are so compelling that it's unlike anything they've experienced in the past where those same concerns just simply do not exist. The facts matter. We're going to speak to the facts. We'll stay humble, we'll stay reasonable. And again, we'll get to a good place and we're going to create something that's going to be great for this industry, great for the customers, great for competition. And in the end, the US rail industry overall will benefit from this, not be threatened by this.

<Q – Thomas Wadewitz>: Okay. Great. Thank you.

<A – Keith Creel>: Thanks, Tom.

<Operator >: Your next question will be from Walter Spracklin at RBC Capital. Please go ahead.

<Q – Walter Spracklin>: So I know looking at the volume changes you've had some pretty significant moves on in particular Canadian grain. Canadian grain being roughly 15%, 16% of your revenue and down 25% this year. Looking out to next year and some of the share gain opportunities that you've had, and I guess this is a question for John, do you think that those have been enough success on share gain, economy reopening and so forth, to offset the decline in grain such that you can achieve volume growth for next year? Do you think that's in the realm of possibility there, John?

<A – Keith Creel>: Yes. Let me – I'll take the high level, and I'll let John get into the color. Absolutely, Walter, we definitely see a path to positive RTM growth, we see a path to margin improvement. So in spite of those headwinds, and when you think about that, you quantify the quantum challenge that grain represents in this book of business, to overcome that and still produce positive volume growth, positive RTM growth and margin improvement, that tells you the compelling value of the work that John and his team have actually been able to convert in the marketplace with our service and our capacity. So I'll let John provide a bit of color to those strengths that, quite frankly, are being muted by this challenging grain

story, that once that dissipates and transitions out, it's extremely, extremely exciting.

<A – John Brooks>: Yeah. Walter, so as Keith said, we do see a path in 2022 to positive volumes despite the grain headwinds. And you know what, we're still sort of educating ourselves on what this all means. As much as we're frustrated, we've had a good ride in Canadian grain over the years, and it's going to open up new markets and new opportunities for our US grain franchise. And frankly, that may provide more of an offset to some of the challenges in Canada that then we fully realize at this point. Beyond that, there's been a lot of good work, not only in terms of market share gains, but just creating solutions for our customers, adding new customers that I do think will provide us that tailwind. We've got inter pipeline starting up next year.

We've got this COSCO, OOCL business that, frankly, is about 20%, I think, stronger volume than we anticipated, that we'll get a full year on.This Maersk transload, as I said, we're already trying to figure out how we can squeeze more out of that facility, and there could be an expansion in the future. There's a significant opportunity in the crush, Canadian grain crush business as more and more of those oils want to move into the renewable fuels, the Saint John CMQ opportunity, we've already doubled that franchise business from when we acquired the CMQ. And there's still a fair amount of meat on that bone. So DRU is ramping up. So I can go down the list. Despite the challenges and the Canadian grain headwinds, just about all the other commodity areas, I see a fair amount of upside and opportunity.

<Q – Walter Spracklin>: Sounds great. Exciting opportunities, looking forward for the updates. Thanks everyone.

<A – Keith Creel>: Thank you, Walter.

<Operator >: Thank you. Next question will be from Fadi Chamoun at BMO. Please go ahead. Fadi, please unmute your line.

<Q – Fadi Chamoun>: Yes. Good morning. Apologies, I was muted. So I wanted to ask on the pricing side. So can you help us understand a little bit the pure price momentum that you've experienced maybe in the last couple of quarters and the opportunity to touch the business maybe in 2022 from a pricing perspective?

<A – John Brooks>: Fadi, really, the team – I guess, number one, pricing is always an initiative at CP. Our team is disciplined. We sell to the value of our service, and that's how we price. We've long talked about the pricing environment in good times being that 4% plus, and in maybe more challenging times slightly inflation plus on the lower end. We are seeing pricing has accelerated through the year. We've got about 25% of our book roughly renewing here in Q4. And again, I expect to be on the upper end of that range. As I look to 2022, I don't know about you, but I don't see a lot changing at least right now in terms of the truck markets, in terms of capacity and sort of, I think, ongoing discipline growing with the other rail carriers in terms of how they're valuing their service. So I'm looking to 2022 to shape up maybe very similar to what we've seen in 2021. Hello.

<Operator >: Thank you. Fadi, did that answer your question?

<Q – Fadi Chamoun>: Yes. Thank you.

<Operator >: Thank you. Next question is from Chris Wetherbee at Citi. Please go ahead.

<Q – Chris Wetherbee>: Hey, thanks. Good morning, guys. I was wondering, Keith, if you could talk a little bit about some of the stuff that we're seeing out of KSU in the last quarter or so, particularly as

it pertains to some of the Mexican business that they're running. They had a teachers strike, which I think has been sort of on and off for the last year or so and maybe some slowdown in the refined products which might be related to some regulation dynamics going on there. Maybe not necessarily so deep into the specifics, but sort of bigger picture, how do you still sort of view the opportunity for the combined company in Mexico? Can you maybe sort of put some thoughts around what you see now relative to what you thought during the whole diligence process leading up to the initial bid? Has anything changed? Is it still as good an opportunity in your mind?

<A – Keith Creel>: Yeah. Chris, we can't deny there's some noise or transitory challenges they're dealing with to your point on the refined fuels, which we see is working itself out. The issue with the teachers strike, obviously, there's some politics there that we can't control. Ultimately, that port that's there at Lazaro, once they get that resolved, and I believe they will, that is a very compelling opportunity with reliable service to displace cargo that has challenges getting into the interiors of the US coming on a US West Coast port. So certainly, maybe not now, but that's a future opportunity for us that we certainly intend to convert.

But in the meantime, all the other positives and the discussions we're having, Chris, and if you think about and we've said this, but I mean, it's undeniable. If it made sense six months ago with all the pain and suffering, that offshoring has caused North American customers, it's even more compelling today. So the discussions that we're having, I'll tell you, I had one last week in Toronto with a major Canadian retailer, the art of the possible to be able to take more control of their supply chains, to be able to source and not be exposed to some of these things we can't control that are happening in on the West Coast, and there's so many different issues and moving parts in that, to be able to stabilize your supply chain near shore or near source, the components that allow you to compete in business and succeed in business. It's an undeniable compelling discussion.

So those issues that they're dealing with, the KCS, they've done a phenomenal job and continue to do so navigating those challenges. It's noise in the opportunity chain, but it's not noise that concerns me at all, and it's certainly muted by the other opportunities that continue to develop themselves and present themselves. So we're just as bullish, if not more than we were when we stepped into this, and we're going to take those lemons that the world and the life and the markets give us and make lemonade with it.

<Q – Chris Wetherbee>: Got it. That's helpful color. Thank you.

<A – Keith Creel>: Thank you, Chris.

<Operator >: Your next question will be from David Vernon at Bernstein. Please go ahead.

<Q – David Vernon>: Hey, good morning guys. Thanks for taking the time. Nadeem, I wanted to ask you about the sort of transition here from an accounting standpoint. What should we be thinking about in terms of the percentage of KCS net income to be sort of rolling up into the other line, while it's held in trust? And then, as you think about sort of doing the merger accounting, have you started to put any thought into sort of asset write-ups or marking up the value of the asset in a way similar to what Berkshire had done when they bought Burlington?

<A – Nadeem Velani>: Yeah. So I'll take your second question first. So we're working through the PPA process, and a lot of work being done internally right now. So that's ongoing. Certainly, given the value that we paid for it, there'll be lots of work as to what that asset write-up will be, and you'll see that through our depreciation, and we will update that in Q1, in January. As far as the percentage of

net income, while in trust, we'll have to get back to you exactly what that looks like. I don't have that necessarily in front of me. So again, when we consolidate them, there will be an equity pickup below the line for initially. And then a year from now, they'll be fully consolidated once we get full approval. So that's how the accounting will work. But as far as what that equity pickup will look like, I don't have that for you right now David.

<Q – David Vernon>: Okay. Thank you.

<A – Nadeem Velani>: Thanks, David.

<Operator >: Your next question will be from Ken Hoexter at Bank of America. Please go ahead.

<Q – Ken Hoexter >: Good morning. And congrats on going through the process. Nadeem, maybe some thoughts on your margin outlook. You were very early to say confidence in sub-60 through the year, and achieve that given what John was just talking about in terms of pure pricing. Maybe your initial thoughts on where you head into 2022, excluding KSU, just kind of looking at your thoughts on the network. Thanks guys.

<A – Nadeem Velani>: Sure. So we're still confident we're going to have margin improvement this year. So I think it gives you a good sense of what's left in Q4. And keep in mind, of course, that we're – all the rails were all facing the impact of higher fuel prices. So certainly it's not as big a margin improvement as we had anticipated at the beginning of the year, given some of the noise around fuel surcharge. But I think it's pretty strong performance to still get margin improvement. As far as 2022, as John mentioned, Keith mentioned, we see the path towards positive RTMs. And assuming 2022 looks similar to this year in terms of the macro, so fuel and FX, et cetera, I think we still have good line of sight for increased improvement in the operating ratio. So margin improvement in 2022 is our view at this point, and we feel very confident we'll be able to achieve that.

<Q – Ken Hoexter >: Any scale or target levels on that? Is it another 100 basis points, just given the pricing, is there a natural flowthrough or...?

<A – Nadeem Velani>: You'll have to wait three months for that answer there, Ken.

<Q – Ken Hoexter >: Thanks Nadeem.

<Operator >: Your next question will be from Brandon Oglenski at Barclays. Please go ahead.

<Q – Brandon Oglenski>: Hey, good morning everyone, and thanks for taking my question. John, we've heard and seen so much about congestion on US West Coast ports, especially. Can you talk about how maybe you guys are approaching the situation differently and how the situation is in Vancouver?

<A – John Brooks>:

Yes. So Brandon, maybe a couple of thoughts on that is, and I'm just kind of going back to Keith's lemons to lemonade. A year ago we were a one port railroad, essentially Vancouver. We've added with through the CMQ, East Coast, Atlantic Coast access, with the acquisition, we add the Gulf in the US and then two ports on each coast of Mexico. And I think given what we are seeing diversity and having that port diversity will matter. And I can tell you, those discussions with our customers are robust on that front. They like the ability now that Canadian Pacific will have well today, but also in the future to diversify their books.

I can tell you – and I was talking to my international team this morning early, we've got three extra loaders coming in on Q4. So that's the team working with our shippers to find ways to get them to move out of the

congestion in the LA Long Beach area, and utilize the capacity we have at Canadian ports. I can tell you, we've got two or three opportunities with smaller chartered vessels which we would look to also bring into either East or West Coast ports, to try to not only alleviate the congestion but drive some revenue in that capacity we have in those areas. I think the bottom line is, it's going to be hard, at least it's hard to quickly decouple for these steamship lines, what they're facing. But we're optimistic that this will drive longer-term change. And with the ability of our new network to touch all these ports, we think presents a tremendous opportunity for the future.

<Q – Brandon Oglenski>: Thanks, John

<A – John Brooks>: Yeah.

<Q – Maeghan Albiston>: Sylvie do you want to progress to the next question?

<A – Keith Creel>: Yes, please.

<Operator >: Please go ahead, Justin. You're next.

<Q – Justin Long>: Thanks, and good morning. Have you done more diligence on the synergy opportunity for KCS? I was curious, if you have any updated thoughts on the cadence of those synergies over the three-year period. And as we think about preparing for integration and those synergies, are there any incremental operating costs that we should be mindful of as we think about next year, and how incremental margin should flow?

<A – John Brooks>: Well, I'll touch to the revenue synergy piece. As Keith said... Okay, Justin. Sorry about that. So look, we've done a lot of work and we're actively meeting with customers and quantifying the timing of these opportunities as we speak. I can tell you we've got the team, CP team coming together next week to go through exactly what you just described. The good news is, I'd say a lot of the initial revenue synergies, I think, are becoming more front-end loaded. There's a lot of opportunity there. As we work with customers to try to line up their timing for these opportunities, at the end of the day it will probably spread pretty equally through the three years, as you think about that top line $1 billion in revenue. And then, we'll obviously work with Nadeem and the operating team to make sure that we have the capital and the products in place to be able to hit those synergies running.

<A – Keith Creel>: Yeah. I'll provide a little color on the cost side and on the capital side. I've been very involved in this and I'll continue to be. I can tell you now that KCS, the team, John Orr and his operating team, they're doing a better job every day of running the railway as they get further into their integration of a true PSR railway. So we would expect that their cost will continue to improve, their service will continue to improve, which increases capacity at the same time, and in lockstep, Mark and our team, we're working closely to make sure that joint agency as well as in our network that from a partner standpoint, from an interline standpoint, any work that we can do to help them become more fluid and vice versa we're going to take advantage of that. And obviously, through our planning for our operating plan, which is part of the merger application, we've uncovered several opportunities to be able to do that.

So we'll do that now. We've already started to implement some of those things, and it serves us, it puts us in a good place. So as we integrate the two companies, once we get STB approval, the capital spending, obviously, we've got a plan over a three-year period that will be in lockstep with the business. It's very prescriptive, it's planned for, there's nothing that's surprising in it at all. But what it will allow in a very short period is a CP-like in a CPKC pro forma environment, operating experience with similar margins, similar train lengths, once we get into that three-year period, a lot of capacity to grow with our customers in a very reliable, compelling value proposition. So we're excited about it. We're not resting on our laurels. We're actively engaged in that process, and we'll continue to be as we go through the STB review process, and then pro forma as we execute and convert and exceed those synergies.

<Operator >: Next question comes from Konark Gupta at Scotiabank. Please go ahead.

<Q – Konark Gupta>: Thank you, operator. Good morning, everyone. So John, just wanted to kind of dig into your comment. You had about, how you are kind of using supply chain congestion at, let's say, Vancouver and how the Saint John and CMQ, they have increased the business. Can you speak to – are you seeing any discussions or having any discussions or seeing any interest from shippers or steamship lines an incremental sort of west to east or west to south shift in shipping lanes due to supply chain constraints perhaps or maybe other opportunities?

<A – John Brooks>: Yeah, Konark, we are. I think initially, many of the steamship lines were apprehensive to make – or attempt to make massive changes in terms of their flows, hoping that this would be fairly short-term in nature, now that this has continued on, and I think most expect will lead into 2022. I would say those discussions are accelerating. As I've said, we've worked with the steamship lines to maybe reconfigure some of these boats in terms of how they load, or to in some cases where typically a vessel would come into Vancouver and then drop down to SeattleTacoma and then maybe head back overseas, look what are the opportunities to maybe eliminate that SeattleTacoma stop, because it might take 20 to 30 days out of the cycle of that vessel and make a quicker turn. So we're looking at all those options. And as I said, we're starting to see some, I would say, better momentum in terms of those opportunities. We're going to see some of that in Q4, and I think that accelerates as you move into 2022 as these issues persist.

<Q – Konark Gupta>: Thank you.

<Operator >: Your next question will be from Jason Seidl at Cowen. Please go ahead. Jason, please unmute your line.

<Q – Jason Seidl>: Sorry about that guys. I wanted to talk a little bit about your domestic intermodal and the long-term opportunities of keeping some of this freight that you've taken off the highway because clearly, right now, we're probably in one of the most congested truck markets that I've ever seen. What percentage of this business that you've taken, let's say, over the last year, year-and-a-half, do you think you're going to be able to keep on the railroad?

<A – John Brooks>: Jason, here's the interesting thing about the domestic intermodal front. I think we believe that the opportunity to convert this traffic maybe not that is directly running on truck, but actually growing the rail wallet share with our base retail customers has existed. We've got the shortest routes, we've got the best service. We control the capacity in our terminals that allows for quick turn of trucks. And I can tell you, since we've implemented our demand management program that we spoke extensively about back at our Investor Day, it's allowed our customers to really help manage their supply chains, and frankly, get the opportunity to potentially pay a cheaper rate or a premium rate depending on how they want to flow their traffic into their distribution centers. And that's allowed us to really smooth out our train lengths, but I think it's also created a product that makes this business we've converted sticky long term.

<Q – Jason Seidl>: So you think it's more of a supply chain shift from your customers.

<A – John Brooks>: Yeah. And again, as much as there is a nice pop we've seen relative to maybe some incremental loads given this environment, this isn't an overnight thing. This has been building the last two, three years. And I think we're experiencing and enjoying sort of the fruits of our labor. And again, I do believe it stays sticky to CP, and we continue to enjoy that freight.

<A – Keith Creel>: Jason, I'll add a little bit of color to that, just some recent discussions I've had with some of our key retailers, especially in the Canadian space. They've enjoyed because of our service, it's part of their formula, it's a partnership, and that's the way we've approached this. And you can say the words, help your customer grow so you can grow with them. But when you're a key enabler in their meaningful growth, and they're taking market share from their competitors, and you become part of that recipe that gets baked in. So as long as you provide that reliable service, that value proposition, customers don't shy away from paying a fair rate increase. They don't treat you like a commodity, they treat you like a partner because, again, you're part of that formula.

And especially, and this is unique to our network in Canada, given the long lengths of haul, given the way the distribution centers are set up, and all these key metropolises, these key urban centers, we have land capacities that we've used as part of that formula as well as terminal capacity, and you match that up with our superior service running reliably from node to node, from town to town, from distribution to distribution center, again you become baked in and part of the integral recipe for their success. So that's the magic to this thing. So again, it's not transitory, it's fundamental, it's foundational, it's the way we have built the book of business, and it's the way we'll continue to grow the book of business.

<Q – Jason Seidl>: Now, that's great color, and I appreciate the time as always gentlemen.

<A – Keith Creel>: Thank you.

<Operator >: Your next question comes from Scott Group at Wolfe Research. Please go ahead, Scott.

<Q – Scott Group>: Hey, thanks. Good morning. So Keith, maybe any conversations you've had with the STB regarding the expedited timeline for the merger? And then, can you just remind us, while you own KCS in trust, what are the kinds of things you're allowed to do with either customers or operations or interchanges just so you can sort of hit the ground running post-merger?

<A – Keith Creel>: Yeah. So let me start with the second question first. What you can do when you're in trust is run the companies independently. So KCS has to run KCS, CP will run CP, like we could before the combination or the marriage, we can discuss interline opportunities, and we'll continue to do that. We have done that. Obviously, if you're one of those customers that participate in an interline move and you're looking to diversify your book of business, you're looking ahead, you're looking at, do I want a seat at the table, you can have those kind of discussions as far as planning. But as far as exercising control, you can't. As far as doing anything unnatural, you can't, and we will not.

The last thing we're going to do is put ourselves in a position where we're going to violate and/or draw the ire or irritate the STB. The STB is the regulator, they're going to regulate. And we're not going to put ourselves in a position to give them any reason or justification to take exception to what we're doing. So we're being very cognizant of that.

On to the point about discussions with the STB on timing, we've not had any updates. We filed within our application. We filed what we would like, what we've request as far as the timeline, they have not commented yet. It could be, and we expect that once we file that merger application at the end of this month, perhaps we'll get comments back on the timing at that point. But at this point, today, we have asked, but they have not replied, and we expect to hear something hopefully soon after we file that merger application.

<Q – Scott Group>: Okay. Just so I understand, so if a customer is not using interline service today, they can start using – it still obviously has to be interline, but they can start using interline service next year.

<A – Keith Creel>: Absolutely. There's nothing that stops the customer from giving us more business. It's just we can't act as if we're one company, obviously. KCS has to negotiate their piece of the business as they see best fit for their railway and CP will do the same thing.

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

<A – Keith Creel>: Thank you, Scott.

<Operator >: Your next question is from Brian Ossenbeck at JPMorgan. Please go ahead, Brian.

<Q – Brian Ossenbeck>: Hey, good morning. Thanks for taking the question. John, I want to come back to you on the coal market, maybe some of the things that could offset the Canadian grain for next year. So this has been really strong for coal despite some of the supply chain challenges and the market share

shift. So maybe you can talk about what's driving that. And just given where prices are and expected to be here for the foreseeable future, do you think you're going to see some mines come back to life? Is there volume upside as you look into the fourth quarter into 2022, and again, to possibly offset some of those Canadian grain challenges going back to that list you were running down earlier? Thank you.

<A – John Brooks>: Yeah. So beyond Teck, which as I said, rebounded quickly coming out of the fires, they're going to turn in a pretty strong growth year-over-year, I think over 26 million metric tons. As you described, the met pricing environment continues to be strong. And I think Teck has – and as we work closely with them on plans for 2022, we expect a fair amount of growth opportunity right there. We initially had modeled more of the business running to Neptune. We see opportunity with Westshore to play a role in this as you look at 2022. In addition to that, we've seen a good bump in our US coal volumes. Now, whether or not that's sustainable, we'll see. We don't have any imminent mines that are opening up, maybe dissimilar to our competitor, I know they talked about that as an opportunity to offset next year. I see more as it being in this organic growth with Teck and the US side.

We have worked on a number of other facilities that could be the Riversdale mine and a few others that could be longer-term opportunities. Those discussions are ongoing, and we'll have to see how those play out. The biggest thing that gives me comfort as I look at 2022, again, is all the self-help things that we've described as really presenting that opportunity to offset. Frankly, just to give you an example, as I look at Q3, if you just sort of normalize grain and potash, our RTMs were up over 7%. And that's a lot of those other business units where we've created these opportunities with our customers. And again, as I work with my team, that is our focus running into 2022. How do we take all these other opportunities that are in the pipeline, get them delivered and get them ramped up as fast as possible to offset that grain headwind.

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

<A – John Brooks>: Right.

<Operator >: Your next question will be from Steve Hansen at Raymond James. Please go ahead.

<Q – Steve Hansen>: Yeah. Good morning guys. Thanks for the time. John, I'm just going to dovetail on your last comment there on the potash front. We're currently pushing decade ahead pricing here. I think we've got a seven handle now in the Western Hemisphere, even 800 in Brazil, yet to be your prepared remarks, there's been a number of issues both on the production front and on the terminal side that have held back volumes this year. So can you just perhaps give us a little bit of color on how you see the potash environment shaking up next year for you guys, and whether any of those impediments that have been holding us back will allow volumes to flow more aggressively?

<A – John Brooks>: Yeah. I think, Steve, that this is a good news story. I was actually meeting with the Canpotex team here just in the last few days, and talking about their projections. And I'm not going to speak for them, but they have a pretty strong growth trajectory. Part of the challenges we saw were, frankly, their upgrades at Portland. We see as a diversification play to Neptune, now the ability to essentially land three trains into Portland is going to make a big difference for Canpotex. So whether it's Canpotex and their growth expectations, I think world fundamentals around grain and feed and fuel and the need for those nutrients all remain very positive. K+S, I can tell you similarly has strong growth projections, not only in terms of their ability to up their export capabilities, but also their domestic opportunities. So I do see potash, Steve, as a good growth story for us in 2022 and also into 2023 and beyond.

<Q – Steve Hansen>: I appreciate the color. Thanks.

<A – John Brooks>: Thank you.

<Operator >: Your next question comes from Benoit Poirier at Desjardins Capital Markets. Please go ahead.

<Q – Benoit Poirier>: Yes. Good morning everyone. Could you talk about the opportunities to either

leverage or accelerate the excess land deployment in light of the overall supply chain issues?

<A – John Brooks>: Our land opportunities, Benoit?

<Q – Benoit Poirier>: Yes, exactly the excess acres you have across your network, whether there is an opportunity to accelerate this to leverage this deployment in light of the overall supply chain issues we see these days.

<A – John Brooks>: No, I think there definitely is. I think Keith spoke to it earlier. As we look at the development of a new international product that includes in the future with the KCS, the Gulf and two ports in Mexico, as we see the introduction of a domestic product that runs north-south through the US, as we see the new found sort of opportunity to extend haul with the automakers, I think all of those bode well in terms of our land capacity, not only to create solutions, new automotive compounds, but also it gives us the landing spot. And that's something that I think is different than a lot of the other carriers in the industry. We not only have the over-the-road capacity to attack this volume, but we have the landing spot at our inland terminals due to this land capacity to improve our footprint. So Benoit, I think it's a differentiator as you think about our story the last few years and our story looking forward.

<A – Keith Creel>: I think the other very – Benoit, the other very exciting point that can't be lost, with the credibility we've created with our ability to actually execute this land strategy, matching it up to create additional value combination and capacity for our customers, the success we've had, scale that up when you go to the KCS when we combine these two railroads, they have very strategic land assets as well that are contiguous to their property and don't expect that we're not thinking and planning to take what we've done at CP at a much larger scale as part of that combined supply chain integration success store that's going to be created with CPKC.

<Q – Benoit Poirier>: That's great color. Thanks for the time.

<A – Keith Creel>: Thank you, Benoit.

<Operator>: Thank you. We're now out of time. I will turn the call back over to Mr. Keith Creel. Please go ahead, sir.

<A – Keith Creel>: All right. Well, thank you again for your time this morning. I can tell you this team, we remain focused. We're going to get through this fourth quarter. We'll close the year strong. We're going to have margin improvement. We're going to have some RTM growth, and we're going to set ourselves up well for 2022 to replicate the same. And at the same time, prepared to hit the ground running as we integrate these two railroads with a successful review with the STB, when we come out as a pro forma company. This team remains humble, hungry, disciplined and driven, focused on creating compelling long-term value in a way that was never possible without what this combination allow us for these two companies, as we go forward into the future, in a unique way, unique to this industry, that uniquely supports North American commerce and the US rail network and competition.

So with that said, we look forward to speaking to everyone in future events and reporting our results next quarter. Take care.

<Operator:> Thank you, sir. Ladies and gentlemen, this concludes today's conference. You may now disconnect your lines.