Transcript

Q3 2022 Earnings Call

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Canadian Pacific Corporate Participants:

Keith Creel – President & Chief Executive Officer
John Brooks – EVP & Chief Marketing Officer
Maeghan Albiston – VP Capital Markets
Chris de Bruyn – Managing Director, Investor Relations & Treasury

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon. My name is Gretchen, and I will be your conference operator today. At this time, I would like to welcome everyone to Canadian Pacific's Third Quarter 2022 Conference Call. The slides accompanying today's call are available at investor.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 like to now introduce, Chris De Bruyn, Managing Director, Investor Relations and Treasury, to begin the conference.

Chris de Bruyn

Thank you, Gretchen. Good afternoon, everyone, and thank you for joining us today. Before we begin, I want to remind you that this presentation contains forward-looking information. 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 outlined on slide 3.

With me here today is Keith Creel, our President and Chief Executive Officer; John Brooks, our Executive Vice President and Chief Marketing Officer; and Maeghan Albiston, our Vice-President Capital Markets, who is standing in for Nadeem. The formal remarks will be followed by Q&A. In the interest of time, we would appreciate if you could limit your questions to one.

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

Keith Creel

Thanks, Chris. Listen, before I get into the results, as Chris mentioned, and I'm sure you'll notice, Nadeem is not with us here today, but he sends best from Boston, where he's attending a program at Harvard, which obviously is a part of our commitment at CP to invest in our most precious assets, which are our people. And I'll tell you, I've always felt that the measure of the impact of a leader is felt best when he's not around or she's not around for a prescribed period of time, I'm sure that he's proud to see the great job that Maeghan, Ian, and Chris are doing in his absence. It certainly reflects well for him.

Some might suggest how in the world could Nadeem be at Harvard in these times that we're facing. I would suggest there's never been a better time in this lull before what we hope is an expected ramp-up as we get into what we expect to be and hope to be a favorable ruling from the STB. He'll be back, finish the course, I think, end of this month. After that though, don't tell him, he may not know this yet, but he's going to be out on trains in the coldest of winters learning a bit more about the operation. I know that he's going to step into that and be a better railroader as a result of that. So, we'll get him back in the saddle I would suggest end of January just in time for funner times ahead.

Now to our results, I want to start with a special thank you to Mark Redd, the operating team and our 13,000 railroaders that continue to evolve our safety culture, allowing more folks every day to go home safe. Their efforts in the quarter produced a remarkable 76% reduction in our train accident ratio to an all-time record low of a 0.37 FSU, and equally impressive performance on the personal injury side with a reduction of 12% year-over-year to a 0.86 personal injury ratio.

On the financial side, second quarter revenues of $2.3 billion and OR, operating ratio of 58.7% and core EPS of $1.01. Speaking to the metrics, on the operating side, with 6.2% of RTM growth, the network remained fluid, no degradation to train speed, weights increased, which spells productivity; lengths increased, respectively, 3% and 4%. Crew starts in spite of 6.2% additional business, a modest 1.5% increase, and even re-crews improved as well year-over-year. So the railway is running well. It's running safe, and that's the key to our success is you run a truly successful precision scheduled operating model.

On the resourcing side, we said all along, this is going to be a tale of two halves. We've ramped up our hiring to make sure that we're resourced properly for this great grain harvest that we're about to be taking to tidewater. We're certainly -- you'll see it in the numbers in the third quarter, the largest demand, though, obviously coming into the fourth quarter. We've hired about 1,500 conductors year-to-date, all in about 2,000 craft employees. We're investing in our physical plant. We're accelerating some capital into this year, again, to make sure our physical plant is ready for future opportunities in 2023. So, suffice it to say, overall, we're in excellent shape from a resource standpoint. The network is ready and willing and able to handle this very encouraging grain crop as well as the strong demand in potash in intermodal that John and his team are winning and bringing to the operating team to convert day in and day out.

Now let's say a couple of words on the CPKC transaction. Obviously, it's been pretty exciting last couple of weeks. Last month I'm extremely pleased that I had the opportunity to personally sit in through the public hearings in Washington, D.C. John and I were there. Obviously, Pat as well as John Orr and our regulatory team, James Clements. It was a pleasure to be able to lay out in detail our facts and our very compelling truth-based case on this very transformational merger that we're pursuing. Some have suggested in some of the readings and maybe some of the talks that I've had, that the hearings stretch out certainly longer than they expected. And I'll tell you, I've said this to the STB and I'll say this publicly now, I applaud the seriousness and the thoroughness in which the STB handled these hearings. I know for certain they take their jobs seriously. They want to make sure that the facts are heard and make sure they get this right. And I can tell you that was a fair process that allowed all parties a fair chance to share their facts, to share their perceptions of what they believe to be true as well as anything they had to say positive or against the transaction. And I'll tell you, having listened to all the testimony, I'm never more convinced about the benefits this merger will create for all stakeholders, for the public interest, for our employees, for our economies of these free nations, for our customers, for the environment. Check all the boxes, perfect is a high stand, but I tell you, this is an ideal merger and a very uniquely, unlike any in the rail industry's history, in the past or in the future. So in terms of next steps, as we all know, we filed our final brief, all parties did this past Friday. We continue to anticipate a decision sometime in the first quarter of 2023.

So, with that said, let me turn it over to John. I'll let him provide a bit of color on the business and then Maeghan to cover the numbers, and then we'll transition to taking your questions.

John Brooks

All right. Thank you, Keith, and good afternoon, everyone. So let me start by saying I'd say overall the quarter played out much like we expected. Looking at the results, as Keith mentioned, revenues were up 19% on the quarter, volumes were up 6%, and FX and fuel provided us about a 13% tailwind. The pricing environment, as we'll talk about, I'm sure more, continues to be very strong. Contract renewals for us in Q3 trended towards the high-single digits. I'll take a look at the second quarter results now, and I'll speak through the results on a currency-adjusted basis.

So, let's start with grain. Grain volumes were down 2% on the quarter, where revenues were up about 9%. We saw this year's grain harvest really start to begin the last couple of weeks of the quarter, and volumes have quickly now ramped up as we move into Q4.

The most recent expectations for the Canadian grain crop size is around 75 million metric tons. This would make it a top five all-time crop and about 7% better than the five-year average. This comes at a great time, certainly following a lot of investment into the supply chain but not only Canadian Pacific, but many of our grain partners. This will be the first year we have a critical mass of our new high-capacity grain cars. As you recall back in 2018, we announced a multiyear plan to purchase 5,900 new high-capacity grain cars, and we're going to receive the last little bunch of those later this year. So if you look at that investment, we are seeing on average about a 5% lift in our loaded tons per car. And by the end of this year, I can tell you we'll have over 50% of our origin elevators capable to load 8,500 feet. As grain typically makes up about 20% of our book of business, as I look ahead, we are well-positioned for strong performance across our grain network on both sides of the border.

On the potash front, we had a record third quarter with volumes of 31% while revenues were up 48%. Although the record pace has slowed some as we moved into Q4, the long-term outlook for potash remains extremely strong, and we continue to work closely with our partners to drive more resiliency and efficiency into the supply chain.

And to close out the bulk business, coal revenues were down 2%, while volumes were down 11%. An outage at Teck's Elkview mine in September has impacted our volumes on the quarter and is expected to remain a slight headwind as we move into November.

On the merchandise front, the energy, chemicals and plastics portfolio saw revenues decrease 10% while volumes were down 1%. The decline in ECP was driven by less conventional crude by rail, partially being offset by increased volumes of our DRU crude. I'm extremely pleased with how this non-hazardous pipeline competitive product is performing. This unique product now accounts for nearly two-thirds of our crude by rail business, providing stability in this historically volatile business segment. The third quarter also saw IPL begin to ship from their newly built Heartland Petrochemical facility that is single served by Canadian Pacific. Our partnership with IPL expands CP's plastic service to both export and domestic markets, and this volume growth will be a tailwind for us as you look to Q4 and into 2023.

In the forest products line of business, volumes were up 5% while revenues were up 18%. Increased velocity across our lumber network, as well as higher volumes of newsprint and pulp enabled by our CMQ acquisition in close partnership with the Irving companies drove record Q3 volumes.

In MMC, revenues were up 22% and volumes increased 8%, setting an all-time quarterly volume record. Pricing and demand for frac sand remains robust as we continue to see strong drilling activity resulting from higher WTI prices.

In automotive, revenues were up 31% while volumes were up 4% on the quarter. We continue to see pent-up demand in this space and ongoing inventory replenishment. Although the OEMs are making progress on this backlog, vehicles built shy holding at CP origins remains well over 7,000 VINs. I'm excited to announce today that CP and Ford Motor Company have again partnered on a long-term contract to expand our relationship and the development of new supply chain solutions. Similar to our strategic development of CP land to create the Vancouver auto compound back in 2019, CP is excited to welcome Ford into our new Chicago auto compound located in Bensenville. Additionally, I'm also pleased to announce we are reopening our Edmonton auto compound to provide more service options to Ford as our anchor tenant for shipments of trucks and SUVs into this Northern Alberta market. Both of these facilities will be opened January 1 and will provide new capacity for over 200,000 VINs in this marketplace.

Finally, on the intermodal side, quarterly volumes were up 18% while revenue was up 44%, both all-time records. International volumes were up more than 30% in the quarter as our strong service, capacity, and

CMQ acquisition continued to drive growth. Domestic intermodal continued to be strong as we saw good growth with our anchor customers and continued strong renewal pricing. With our market share wins and expansions underway at the Port of Saint John, I expect our intermodal franchise to have a strong finish to the year.

So let me close these remarks by saying as I look towards the remainder of 2022, with the new business we have brought on over the course of the year, of course, with the strong Canadian grain cost, we are on pace to deliver double-digit RTM growth the back half and volume growth for the year. As I look further ahead into 2023, while we are all still watching the broader macro environment, my team is staying close to the customers and our operating team and we'll navigate any changes appropriately. We remain laser-focused on executing our playbook and making our own luck through delivering our unique self-help initiatives. As you think about it, with our strong bulk franchise, a pipeline of new growth opportunities, and CPKC only gaining momentum, we believe we have a truly unique position as you look to 2023.

So, with that, I'll pass it over to Maeghan for her remarks.

Maeghan Albiston

Thanks, John, and good afternoon. I'm pleased to be standing in for Nadeem today and to speak to the results that the CP team has produced this quarter. Looking at the quarter, the adjusted operating ratio came in at 58.7%, a point better sequentially and 70 basis points better year-over-year. Taking a closer look at the expense side, I'll speak to the variances on an FX- adjusted basis. Comp and benefits was up 2% or CAD 8 million versus last year. The primary drivers of the increase were higher volumes and training costs as well as general wage inflation. I would note, on a sequential basis, stock-based compensation was a CAD 19 million headwind. You'll also note, average head count was up quarter-over-quarter by an additional 4% as we continue to resource up for the fourth quarter. Fuel expense increased CAD 153 million or 75%, primarily as a result of higher fuel prices, which were up 60% versus last year. Materials expense was up 29% or CAD 15 million due to higher non-locomotive fuel costs as well as higher locomotive and track maintenance-related expenses. Depreciation expense was CAD 213 million, an increase of CAD 8 million, as a result of a higher asset base. And purchased services and other was CAD 294 million, after adjusting for acquisition costs, an increase of CAD 2 million.

Moving below the line, equity pickup from KCS was CAD 221 million on a GAAP basis or CAD 275 million after adjusting for KCS' acquisition-related costs and the impact of purchase accounting. Other components of net periodic benefit recovery increased CAD 7 million, reflecting a higher discount rate compared to 2021. Net interest expense was up CAD 62 million versus last year as a result of higher debt to fund the KCS acquisition in Q4 of 2021. Income tax expense increased CAD 27 million or 16%. Excluding KCS-related items and a one-time deferred tax recovery, the effective tax rate was 24.25% on the quarter. Rounding out our income statement, core adjusted EPS was CAD 1.01, up 15% in the quarter. Core adjusted net income was up 60%, partially offset by a higher share count year-over-year.

On the free cash side, you'll see we received a $200 million dividend from KCS in the third quarter. To date, CP has received a total of $465 million USD in dividend payments from KCS. Both CP and KCS continue to reinvest in their respective businesses. As we prepare for the growth, we expect to be able to deliver upon a favorable ruling from the STB. Beyond what is needed by the business, we're using our free cash to pay down debt. Year-to-date, we repaid nearly CAD 1.2 billion in debt and have several maturities coming due in early 2023. With 100% of our term debt at a fixed rate and with no near-term financing requirements, we're on a strong path to return to our target leverage of 2.5 times net debt to EBITDA.

With that, I'll turn things back over to Keith to wrap things up.

Keith Creel

Thanks, John and Maeghan. Surmise it all to say, the bottom line, CP is in an excellent position to execute a very strong fourth quarter and carry ourselves into 2023 with tremendous momentum into an opportunity-rich environment that represents, I think, an industry unique, strong value creation story in 2023 and beyond.

So with that, operator, let's stop our comments and open up for Q&A.

Question & Answer

<Operator >: Thank you. [Operator Instructions] The first question comes from Chris Wetherbee, Citi. Please go ahead.

<A – Keith Creel>: Hey, Chris.

<Q – Chris Wetherbee>: Thanks, good afternoon guys. Maybe if I could start a little shorter term and think about the cadence for the back part of the year so in particular the fourth quarter, I guess the RTM acceleration is happening to get RTMs in the second half, how should we think about the operating ratio improvement? You've made some improvement from 2Q to 3Q, should we expect a significant amount more improvement as we get into the fourth quarter, just want to get a sense of how we should think about the cost scaling as RTMs ramp up?

<A – Maeghan Albiston>: Yeah, Chris, fair question. I'd say that we're certainly on track in terms of our OR progression. We talked last quarter about being in – I think it was a high mid-50s from an OR perspective, and we remain convicted in that view. So, you will see further sequential improvement on the operating front as we get into the fourth quarter and continue to see volumes ramp and that operating leverage flow through.

<A – Keith Kreel>: Yeah. You should see an exit rate in the mid-50s, Chris.

<Q – Chris Wetherbee>: Okay, okay. That's helpful. Thank you.

<Operator >: And our next question comes from Fadi Chamoun from BMO Capital Markets.

<Q – Fadi Chamoun>: Okay. Thanks. Good afternoon. I'm curious if you can kind of dig maybe a little deeper into some of the comments you provided about 2023. I guess you have a lot of strategic business wins and CP-specific opportunities, I guess, and a big grain crop. But what does 2023 look like to you based on what we know right now? I know the economy is a little bit all over the place, but can you grow volume? Can you kind of give us framework how we should think about 2023 for you from a volume perspective given all these kind of help – yeah.

<A – Keith Creel>: Let me take a first run at that and I'll ask John to provide a little color, and unfortunately I'm not in a position to give guidance but I can say this – We're set up well for the first half, obviously, from a compare standpoint, grain versus last year, potash strong versus last year, Port of Saint John coming on for the first half, we didn't have that – IPLs online now so the first half I think we're in a really good position. And then you get into second half, some of that carries into the second half obviously, but then you start layering on these new market wins. You start laying on these self-help initiatives. You start laying on with a favorable STB decision some pretty exciting synergy storylines and fact points that obviously we're not in a position to discuss yet, but rest assured, it's going to be exciting. Bottom line, I'll say, all things being equal you should certainly expect volume growth in 2023 at a pretty

exciting level.

<A – John Brooks>: I will echo that. That's the last part I was going to add, Fadi. We fully expect the volume growth. Obviously, we're watching the macro environment closely, but I'd say so far, we've been able to buck a number of those trends. And others speaking about declines in international and refined products, we've seen some acceleration in some of those areas. And not that over time, the macro won't impact some of that. But again, some of these initiatives that we've been talking about for quite some time continues to sort of propel our volumes as we move into 2023. And just building a little bit on CPKC and again, assuming we get the favorable response from the STB, I've talked a lot about just how that propels not only opportunities for the new railroad, but how it even makes some of those conversations and opportunities different with our existing franchise. And part of that, just look at the announcement of these two new auto compounds. We've talked about Bensenville for a while. Edmonton's going to play an important part in our future also. And so that in itself in 2023 is a pretty big opportunity for this company.

<A – Keith Creel>: Yeah. I think – let me add a bit more color, Fadi, just to put things in context. You're thinking about a world where a lot of shippers, not all, but I'd suggest most have experienced supply chain constraints. Obviously, there's been a unique demand environment that perhaps doesn't sustain itself. But I'll tell you, there's lessons learned in every crisis that you go through and having new alternatives, new choices, not putting all your eggs in one basket, diversifying, these supply chains that we're going to be creating with the power of this combination, if it's approved by the STB. When I say transformational, they're unique end-to-end single line opportunities that simply don't just allow us to be competitive.

I would suggest that supply chains need the resiliency, never more so than before and that this solution, this combination creates a whole lot of solutions to a lot of the shippers' problems in our nation that they've experienced. And we're excited to get into the solution-providing business. That's exactly what we're focused on and that's exactly what we're going to do with this larger scale network pending the STB's approval, to serve the public interest.

<Q – Fadi Chamoun>: Great, just one follow up on this, on the automotive opportunity you talked about with Chicago and Edmonton – this is a new Ford business coming on CP starting January, did I get that right?

<A – Keith Creel>: Yeah, that's correct. It's new organic growth.

<Q – Fadi Chamoun>: Okay, thank you.

<A – Keith Creel, Maeghan Albiston>: Thank you, Fadi.

<Operator >: Our next question comes from John Chappell from Evercore ISI

<Q – Johnathan Chappell>: Thank you. Maeghan, I don't know if you're best to answer this. When we look at the KCS contribution in the third quarter, it's effectively flat from the second quarter despite the fact that their volumes, carloads were really strong. I've seen your appendix here that their OR actually deteriorated. Is there any information you can give us as what was happening there – was that a cost issue, was that a pricing issue mix, any info as to why they had some OR deterioration while you and of course the CP network did so well in the third quarter.

<A – Maeghan Albiston>: Yeah. So I'll let Ashley and Mike speak to KCS' results. Having looked at the numbers like you have, the one thing that I would highlight is that they did have a CAD 9 million prior period adjustment related to the labor agreements embedded in those numbers. And certainly I know that from an operating standpoint they weren't immune to some challenges in the quarter. I'll leave it there and would certainly encourage you to reach out to the KCS team if you want to dig into it in a little bit more

detail.

<Q – Johnathan Chappell>: Okay. Just really quickly, do you know if there is any of these prior period all these rails – all the rails prior period stuff that we've been stripping out kind of apples to apples? I can follow-up with Ashley, but if you happen to have the number on any prior period accruals that we can strip out right now, that would be helpful.

<A – Maeghan Albiston>: Yeah. So, they had 9 million in the numbers this quarter and I believe going into 2023 they are expecting an increment 6 million dollars going forward into 2023.

<Operator >: And our next question comes from Walter Spracklin from RBC Capital Markets.

<Q – Walter Spracklin>: Yeah. Thanks very much, operator, and good afternoon everyone. I wanted to zero in, John, on intermodal. And I know you've got a number of new lanes that you've been developing and just love to hear an update on your Saint John route on your – on the Lázaro Cárdenas route that you were testing out there. And wondering if the Mississippi, and I know there's been some media reports about low water levels, if that sustains as a long-term trend with KC now as part of your network subject to the ruling. Would that be another area of upside for you on that north/south route?

<A – John Brooks>: Yeah Walter I'll start with the water levels first. I think near term this is going to provide itself to be a rail opportunity. Now it's a little early for CPKC to enjoy in some of that, but I think some of those north/south routes will see the natural gravitation of those grains that would truck to the river, find rail heads and want to rail down to the Gulf for export. So I do see this as a potential rail tailwind.

As we look to the future, CPKC, I certainly think there's an opportunity for us to play in that space. I think there's a origin elevator development piece of that component that will compete in that sort of territory that would be impacted in the future. And then as we gain access into that Gulf market in Texas and also down into Mexico, I believe it's right in the wheelhouse of the new organization. Back to your prior question, we've had a ton of success. I couldn't be prouder of our intermodal team this year. The asset team that works with our intermodal group, the terminal operators, our operations group and Mark's team and the marketing and sales team, I can tell you, that supply chain is still not real clean across the US and Canada, but we've navigated it, I would say, as good or better than anyone in the industry.

There's still challenges out there. We got a lot of tonnage in Saint John. We've had a lot of success. We're putting a lot of good pressure on that port, and that fluidity and opportunity is only going to continue to grow for us. We've got the best route from the Atlantic Tidewater not only into Canada, but also down into Chicago and beyond into the future, down to Kansas City. I'm super excited about that.

You raised Lázaro and I can tell you, my enthusiasm around that opportunity is only building. I actually believe we've got some more test and trial containers on the water right now that we're working on an interline basis with the KCS team as sort of this ongoing proof of concept. And I think the feedback relative to the optionality it creates for shippers, not as a replacement for certainly LA Long Beach or some of those other gateways, but to diversify the portfolio is going to be a tremendous opportunity for CPKC.

<Operator >: And our next question comes from Tom Wadewitz from UBS

<Q – Tom Wadewitz>: Yeah. Good afternoon. John, I wanted to ask you about the pricing. I think you said that you had like high single-digit renewals in the quarter. I believe that was the comment and I don't know if I recall you having a comment about renewals quite that high before. So I'm wondering, should we be anticipating even stronger pricing the next couple quarters relative to the kind of maybe 5%, 6% that I

normally think of as being favorable. And I guess just related, it feels like there is just a more favorable pricing dynamic in general in the rails – maybe Canadian rails, if you think that's true is there some persistence to that, that could last more than a couple quarters. Thank you.

<A – John Brooks>: I do, Tom. I'm actually quite bullish on the pricing front. You can ask my commercial team as we're working on our plans for next year and their targets. I do think fundamentals have shifted a little bit on that front in terms of just how all carriers are thinking about the value of their capacity and their service. I'd tell you, I think we have remained consistent in this space and the narrative has been, as always, we are in good times and bad times going to price to the value of the service Mark and his team provides. And I believe capacity is more valuable than it maybe ever has been in the past. So, I do believe there's – even in a maybe tighter demand environment as you look forward potentially and if there is some recessionary pressures, I think that discipline sticks. You know what? I think I said to somebody in my 28 years of railroading this last quarter, the renewal pace, you're right, is about as strong as I've seen. And I think that opportunity, we'll see how it plays out into Q4, but I think my expectations kind of fall right in line with what you saw in Q3.

<Operator >: Our next question comes from Justin Long from Stephens.

<Q – Justin Long>: Thanks. And I guess to start with a follow-up on that last question, John, when you look at the gap between pricing and inflation, how has that gap changed? Because it sounds like pricing is very strong, but obviously, inflation is moving higher. So, just curious if that gap is changing at all. And then I think you had previously talked about adjusted EPS growth in 2022. Is that still something you expect?

<A – Maeghan Albiston>: I'll maybe start off with that first question. We're certainly on pace to see adjusted EPS growth for the year.

<A – John Brooks>: And on the pricing thing, you're right. That inflation plus renewal spread always kind of moves around a little bit. I would say you're right. Well, I don't know how you – what you measure inflation exactly as and all the various components of it. But I'd say we have definitely hit the mark here most recently. And as I said, in Tom's question, I think it's the same in Q4 to have that definitely be inflation plus. And then again, we'll see how the pressures – how they change as you think about 2023.

But irregardless, again, I'm going to fall back on the value of our capacity, I think, has never been as important in this sort of environment that we live in today. And a big part of that is making sure when we do work with our customers and whether it's bringing on new ones or working on the renewals, that we're being certainly fair on what that value is and ultimately what that pricing looks like. And I just don't see that changing as you look into 2023.

<Operator >: Our next question comes from Ken Hoexter from Bank of America.

<Q – Ken Hoexter>: Great. Thanks. Good afternoon, Keith, John, and Maeghan. Just before I begin my question, Maeghan, just to clarify what you just answered, that was off a 3.76% normalized last year and 2.63% reported normalized so far this year, right? So you're talking at least CAD 1.13 for the fourth quarter? Just to clarify that.

<A – Maeghan Albiston>: That's correct.

<Q – Ken Hoexter>: Okay. Perfect. So Keith, lot to unpack in front of you. Once you turn into 2023 and post-approval, maybe you could talk a little bit about how the process unfolds. Is this a year of resetting train schedules and things get messy upfront? And so first quarter or second quarter can get a little messy. Are there services you're able to launch right away? Maybe understand the flow of what we

should expect as synergies as to what you've talked about already in terms of, now they are only a few months away.

<A – Keith Creel>: Yeah. It's certainly not a case where we're planning for any messiness, Ken. As you can imagine, we're pretty adept at planning. We're taking some exhaustive steps with an integration management office that we've created and a lot of pre-planning. We've got about 165 processes of change that we've got mapped out across each discipline of the business. We've got disciplined leaders that are full-time assets. If you look at it all together, either full-time or part-time in part, there's over 1,000 people that are involved in the planning process for this integration. So the operating plan itself, we've got everything mapped out from leadership change, what's going to happen the first 30 days, 60 days, 90 days. The operating plan changes on the operating side. We've got that laid out so we're going to pull everybody together. We're going to get aligned quickly.

And I can tell you, this is a beautiful part about this transaction that I think is very unique. Number one, it's not a horizontal merger. It's not a horizontal integration. So the horrors that some have suggested in the past, failed executions or painful executions, simply it's just not that complex. You don't have lines that are redundant. You don't have a bunch of rerouting of traffic. You don't have tremendous amount of stresses coming on to the network all at one time, this business that we're talking about. And I've said this. It's in our application, and it's part of the way you run a PSR railroad. You don't get ahead of yourself with business and oversubscribe your capacity. I've taken inspection trips just last week. I took a look at all the infrastructure that's going in from up at the La Crosse river junction down into Kansas City. A couple months ago, I took a trip over to KCS from Kansas City Laredo. So I've laid my eyes on each one of these sightings, these locations, the work that's being conducted now. And I'll tell you, the choreography will be strong. We've got an operating plan that will allow us to layer this business on, and we're not going to disappoint our customers. That's the worst thing in the world that we could do is overcommit and underdeliver.

We're going to have to motivate our customers. They've got choices. We're not eliminating one choice. They get to maintain all the choices they enjoy today but they get to get inspired and motivated about the new option we're going to give them. And for them to get motivated, inspired, it's got to be good. So rest assured, we're going to do that. We're going to be resourced up right with people, resourced right with assets, be it rolling stock, be it locomotives, and the physical infrastructure to get out here and get this done. And I'll tell you, I'll be boots on the ground. I'll be in Kansas City. I'm in Kansas City today. I came down to visit our terminal. We had our board meetings. So rest assured, there are plans being laid. It's not going to be perfect. We're not perfect human beings. The operating world is not perfect, but we certainly are doing all of our homework upfront and plan to exceed expectations. And you'll start to see synergies both on revenue as well as on the cost side as we grow this railroad going forward. You'll start to see them second quarter, they'll start to ramp up third, fourth, and that momentum will continue in 2024.

<Operator >: Our next question comes from Scott Group from Wolfe Research.

<Q – Scott Group>: Hey. Thanks. Afternoon. Keith, just wondering, coming out of the hearings, anything surprising or anything that you think that we need to be thinking about from a concession standpoint? And then just as we think about 2023, obviously it sounds good volume, price, synergies. Any initial directional kind of thoughts on how we should think about operating ratio next year?

<A – Keith Creel>: Sequential improvement, I can't give you guidance Scott but certainly when we layer this volume, first half just CP standalone is pretty compelling opportunity with that density that we'll have next year that we didn't have last year. And we start to combine these networks and take out train handlings, car handlings, car hire savings, locomotive savings. It leads to a natural outcome of margin improvement next year sequentially, and I think moving to a place that's going to be very exciting to allow us to continue to create cash and invest in the network and reward our shareholders. And that's what it's

all about, I think, at the end of the day.

As far as the hearing, Scott, my only surprise is where there are some very creative minds and creative lawyers that some of it was so overreaching and unreasonable, some of it, I found it to be a bit shocking. But the thing that that to me was encouraging is most of that shock was -- it was completely unsubstantiated by FAC. And I think this is an STB board of board members that take their jobs seriously. I don't think that attempts to pull the wool over their ice will be taken lightly. I think they do their homework. And I think they want history to show they got this right. It's the first major transaction in two decades. I would suggest arguably it might be the last one. Scott, in all honesty, I think it could be the one that solidifies, the industry increased the most impactful and meaningful rail network in this nation for our future's growth. So again, everybody made their best case. I think our facts are better. I think our facts lead us to an undeniable case that says this is in the public interest. And ultimately, I believe, based on fact and based on the belief that this STB body takes their job seriously and makes decisions not on rhetoric but on fact-based after doing their homework, I think our facts are in a great place, and we look forward to getting to work, again, pending their -- they're aligning with what my view of the facts are. But to me, the truth is the truth, I've said that from the very beginning, and I think that's what's going to carry the day in this merger application.

<Operator >: Our next question comes from Steve Hansen from Raymond James.

<Q – Steve Hansen>: Yeah. Thanks, guys. Appreciate it. Just a quick question on the staffing levels, if I may. Keith, I think you referenced the big uptick in conductors and trade employees in anticipation of this back half traffic surge here. Just curious if you're sort of at a standstill now or where you need to be or should we continue to expect roll higher?

<A – Keith Creel>: We ramped up in the third quarter. The train ahead you'll see it slow down in the fourth quarter and we'll finish full year just about flat – maybe about 1% - a little less than 1%, is where you should model to.

<Q – Steve Hansen>: Okay. Perfect. That's great. And just a follow-up, if I may, is just on the corridor capacity issues in your prior commentary. Just curious about the Western Corridor in particular, given the surge in bulks we've been seeing. How do you feel about the corridor capacity, whether it's infrastructure or rolling stock related?

<A – Keith Creel>: In all honesty I feel good and let me tell you why I feel better than I have in a long time. I never was able to get this done when I was the head operating guy, Mark has, and the engineering team they have just done a phenomenal job. You imagine that is the most dense part of our network, we're facing a bumper crop. We've got a lot of expectations, we're going to meet expectations so the last thing we need are extended work blocks and what I call capacity draining capital work going on. So typically you strive to get it all done so that you can get out of the way for this big surge of demand.

I just never really got it done the way Mark has and his team. They've got all the major capital work buttoned up, they finished in September. We start to see it in the momentum. The record numbers of grain cars they've gone a couple of weeks where they've hit all-time highs. I think you had 6,900.

Two weeks of 6,900 going to the West Coast for exports. So I think at the end of the day, when it's all said and done, we never have been in better shape. Steve, now listen, I don't want to get arrogant here at all. Mother Nature can humble us tomorrow. That's a tough railroad to operate in, but I'm very, very pleased and happy to say that Mark and the team have done all they can do to control what they can control, short of that and set us up for great success. So we're in a good place.

<Operator >: Our next question comes from Jason Seidl from Cowen and company.

<Q – Jason Seidl>: Thank you, operator. Afternoon, everybody. Keith, can you give us maybe an update on any puts or takes for some of the revenue synergies that you guys have previously talked about with the KCS transaction? Just like to see how you're feeling based on what you said before and what we're seeing now in the marketplace?

<A – Keith Creel>: I'll let John provide the color about the puts. I don't know too many takes.

<A – John Brooks>: It's definitely been more puts. As I mentioned Lázaro earlier in the call that continues to be a bright spot and a huge opportunity and I've had a team over in Asia here the last week or so and the feedback that we're receiving from a lot of the steam ship lines and frankly, even more so the beneficial cargo owners around having that supply chain optionality to the current options today continues to be a powerful opportunity. I spent the better part of today, working with Keith and my intermodal team and Mark on our north-south strategy and what that domestic train looks like and what the key opportunities are on that, and I continue to be very bullish on that front.

I think somebody raised the water issues earlier, but the bulk franchise in the grain opportunities into Mexico, we've talked a lot about that, but ultimately, also into that Gulf Region in Texas and competing into some of those feeder markets continues to be a bright spot. You've got this renewable diesel phenomenon that is rolling across bringing crush plants to light across our territory and certainly the Canadian franchise that presents itself as the unique opportunity for CPKC.

So again, I would tell you – I even foreshadow a little bit this whole – the auto compound in Bensenville and Edmonton. There's a reason we're opening those now. Assuming we get the STB approval, those are going to be important cogs in those negotiations with the automakers and the parts opportunities too. So there's no slowing down. I can just tell you, we remain super optimistic that we're going to get this over the finish line. And then as Keith said, we'll begin to ramp up and you'll see us capitalize on this stuff.

<Operator >: Our next question comes from Konark Gupta with Scotia Capital.

<Q – Konark Gupta>: Thanks and good afternoon, everyone. So, John, I just wanted to ask you on the intermodal contracts you have won so far this year. How are they performing versus your expectations in light of the recent macro uncertainties we have seen. And if somebody can speak on behalf of KCS perhaps, there's a recent sort of USMCA energy dispute going on with Mexico, and there are talks about tariffs on Mexican cross-border traffic. How does that play into your sort of synergy books for the next couple of years?

<A – John Brooks>: On the intermodal front, how the values are trending I would say specific to the Port of Saint John, they have exceeded our expectations. We have a lot of freight out there to haul and obviously we're working very closely with the MBSR, the short line railroad out there, the Port of Saint John, DP world, the operator. Those expectations on those volumes have again exceeded our expectations and no real slowdown. We also brought CMA onto our franchise this year. I would say the majority of that has come through the Port of Vancouver and those volumes have lived up to everything that they've said. I think if the question is really around are we seeing any sort of macro slowing in that volume, I would say maybe a little lane segmented. We might be a little left to the US but certainly, I would say our Canadian franchise has held in there very strong. And I see nothing that would impact how you should view finishing out the year, and then we will look to next year on that front.

<A – Maeghan Albiston>: On the USMCA? Yeah. Just on that topic, Konark, we have a general belief that free trade benefits the North American economy and this movement of goods across the border is beneficial for all parties. So CP and CPKC by extension would be uniquely positioned to benefit from

USMCA and free trade, so STB-willing, we look forward to providing great service for all three nations.

<A – John Brooks>: And its not like we have got this massive bucket of synergies tied to that, we have known through our due diligence and being into this for well over a year now, in this effort, that there is some volatility in that space. So, certainly if things work out, great, and we see some resolution in that space. We're just going to benefit -- I would consider that all incremental on top opportunity if you think about synergies.

<Operator >: Our next question comes from Ari Rosa from Credit Suisse.

<Q – Ari Rosa>: Hey. Good afternoon and congrats on the strong momentum here. So I wanted to ask a question about the CPKCS transaction. And just thinking about the extent to which it has the potential to maybe alter the competitive dynamics between the rails. We've seen some of the rails kind of raise some complaints certainly at the STB about the transaction and potentially take some kind of retaliatory actions in response. Just wanted to hear your thoughts on the extent to which you see yourself as kind of competing with them versus maybe taking some volume away from trucks, and if that's really where the true opportunity comes from? Thanks.

<A – John Brooks>: I'll maybe start. I'd say this, there's certainly a part of the revenue opportunity for CPKC that is flat head-to-head against the competitors that are in in those lanes. And what I've heard from the customers is they want another option that maybe service in some of these lanes hasn't been up to expectations. They're looking to just like you would and your money, they want to diversify their books and there's going to be, I think, a natural opportunity for some, call it, share shift in some areas. But the flip side is I think the bigger opportunity is some of these products that don't exist today, maybe some new creations and initiatives of new lanes that -- to service markets that don't exist today.

And then you said it yourself that the truck piece of this business is actually, I think, bigger than we even know. I can tell you the discussions around the value of trucks off the road in the Scope 3 emissions, greenhouse gas reductions that we can bring to the table by providing truck-like service north-south through that corridor, I think it's compelling to shippers.

So, you know what, the competitive response is what it is. It's going to be out there. The other rails are going to do what they need to do on that front. But we're going to compete hard just like we have in the past, and we're going to find the areas where we can drive success with our customers.

<Operator >: And our next question comes from Brian Ossenbeck with JP Morgan.

<Q– Brian Ossenbeck>: Hi. Thanks. Good afternoon. So a quick follow-up for John. First, one of the puts I didn't hear about was potential second bridge in Laredo. I think those of us have been watching that waiting that for a long time, and it seems like it's actually moving forward a bit faster than at least we initially had anticipated. So curious to hear your thoughts on that.

And then a broader one for Keith. Quicky hear your thoughts on the CPKC deal standing on its own merits but as you mentioned there's a lot of other interested and potentially affected parties, do you think there is going to be any settlements or agreements that you reach with any of them. Other freight rails, shipper groups, passenger rails, before it goes in front of the STB or do you think that the board is able to handle all that and you would rather the merits speak on their own without doing any additional deals before then?

<A – Keith Creel>: Yes, let me start with the latter. Listen, I've always believed that you can do a better deal yourself and expect the government to do a deal for you. We've been reasonable from the very beginning. We said we're open to reasonable settlements. A lot of the arguments that we heard,

unfortunately, don't represent reasonable. So if those positions remain the same, then I would suggest there's not an opportunity for us to reach a reasonable settlement. But I'm hopeful and optimistic that some of the parties, after they've weighed all the facts and perhaps better understand the assurances we provided, the positions that we take and our commitment to keep gateways open. Our service assurances, we're going to be good partners. Listen, we're not doing this to go to war with every railroad. We're doing this to create value for all stakeholders. We're doing this to benefit our employees, our shareholders, the environment, the North American rail network.

And we're going to -- after the dust settles, we still have to be great partners. We'll be competitors and partners at the same time with some of these railroads. So all that being said, reasonableness matters. We're going to stay reasonable. And if we can come to an agreement, then I'm optimistic -- we might it's to be determined. But at the end of the day, if we don't, it's because we've exhausted all reasonableness and we have nothing -- no choice but to allow the STB to rule because we won't -- what we will not do is allow unrealistic expectations impede our ability to deliver the public interest benefits that we've committed we're in business to deliver. That's part of our thesis. Those are the facts, and we're going to protect that.

The other point you made about the bridge, super excited, you're exactly right. Pat and the team have done a phenomenal job. They're actually having a ground-breaking ceremony, I believe, on Monday, down at Laredo. The time to get the bridge built, as Pat shared with me, is going to be about a 15- to 18-month process. So again, when it comes to, strength in the North American network, resiliency, capacity, all those things that allow commerce to flow freely over that border between Mexico and the US in to or from Canada. We're going to a better place. So I'm super excited about that enhancement to the physical plan at the border.

<Operator >: Our next question comes from Bascome Majors with Susquehanna.

<Q – Bascome Majors>: Keith or Maeghan, the complexities, both practically and from a legal standpoint of the KCS transaction have kept you from guiding and updating the Street in the way that you normally would this year. As we get into next year, is there an opportunity to give a more traditional CP annual guide in January or is that -- and maybe some form of a investor day after the transaction closes more likely as far as the updates that you can give and expect to.

<A – Keith Creel>: We will get as traditional as the facts allow us to. Obviously, there might still be some uncertainties, but certainly more clarity than we were able to provide today and I'll go ahead and let you know as far as Investor Day we're certainly planning on -- we haven't landed on the exact date, but we're targeting likely the first part of June.

<Operator >: And we have reached our allotted time for question-and-answer. I would now like to turn the call back over to Mr. Keith Creel.

<A – Keith Creel>: Okay. Well, thank you for your time this afternoon. I know you sense our enthusiasm and our optimism. And I tell you, I've done a bit of reflecting. It's hard to believe, I used to be the young guy in the room. I'm not anymore. I'm about to close out my 30th year in this industry. I've had a lot of good years and been blessed to work with a lot of people and to collectively create a lot of success in the industry, but I'll tell you, I've never faced a team more ready or talented and equipped in a combined CPKC. I’m talking about the team at CP, I’m talking about the folks at KCS -- to put these two teams together to create a CPKC family equipped with an opportunity rich environment that is unlike any I’ve ever experienced in my history and certainly I believe unlike any that exist in the industry. Extremely exciting times for value creation for all stakeholders. There is something in it for all of us, our nation included, and we’re ready to get to work. Everybody stay safe, we look forward to sharing our results after this quarter soon. Take care.