Transcript

Q4 2022 Earnings Call

January 31, 2023

Canadian Pacific Corporate Participants:

Keith Creel – President & Chief Executive Officer
Nadeem Velani – EVP & Chief Financial Officer
John Brooks – EVP & Chief Marketing Officer
Maeghan Albiston – VP Capital Markets

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 Fourth 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 now like to introduce Maeghan Albiston, Vice President of Capital Markets to begin the conference.

Maeghan Albiston

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 and 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 U.S. regulators. This presentation also contains non-GAAP measures, which are outlined on slide 3.

With me here today is Keith Creel, President and CEO; John Brooks, Chief Marketing Officer; and we're welcoming back Nadeem Velani, our Chief Financial Officer and CP's newest conductor. The formal remarks 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, President and CEO, Mr. Keith Creel.

Keith Creel

Well, thanks, Maeghan. Let me start by thanking our 12,000 strong CP family, for their efforts have allowed us to produce these results in the fourth quarter and certainly over the course of 2022, and I can tell you what I'm most proud of, which is I know it's only enabled by their individual and collective efforts is the safety performance that the team produced in 2022, producing our lowest ever FRA accident frequency ratio in the company's history and our 17th consecutive year of being best-in-class, best-in-industry as it's related to reportable train derailments in the industry, something to be extremely proud of.

And then to Maeghan's point, we're – our bench is only getting better. I'm tickled to death as we've got our CFO, Mr. Nadeem Velani, who adds another acronym to his title, Chief Financial Conductor Officer, CFC, CFO, whatever you want to call it. He's had a very rich experience. He is – obviously his business acumen from his time in Harvard has increased, but most importantly, his railroad acumen and ability to apply his business talents has increased with the railroad knowledge as he has obtained in the last 5 years – 5 years, it seems like probably 5 years and is 25 below. The last 5 months specifically out on the railroad boots on the ground in the ballast, spending time not only getting conductor qualified, but also riding trains, time in the mechanical department, time with the track department, time in the locomotive department, all the functions that truly make this company run day in and day out, by the great professional railroaders we have, the men and women that make CP what it is. So, with that said, again, welcome back Nadeem, glad to get you back in the seat. And I also want to commend Chris and Maeghan and Ian for the great work they did when you were gone, in your absence. They certainly made you proud.

Now moving on to the results. In the fourth quarter, we produced revenues of CAD $2.5 billion and operating ratio of 59.1%, and core EPS of $1.14. For the year, the total revenues were up 10%. We delivered an operating ratio of 61.4%, core EPS of CAD $3.77, which was flat versus last year. But we knew from the beginning 2022 would be a year of two halves, and particularly, we had high expectations for the fourth quarter, which we were ready and resourced to meet. Unfortunately, there were some factors that impeded our fourth quarter to some degree. But with that said, I'm very pleased with how we began the year. Strong revenue and operating performance in January, which is going to carry great momentum into the first quarter of this year and as we play out in 2023.

We're in a great place from a network and resource perspective in spite of a historically tight labor market in '22. It was a record year of hiring at CP, we added more than 1,600 conductors over the course of last year, and we made some significant progress with our labor agreements with the recent tentative collective agreements, both with Unifor, as well as the BLET, both of those agreements are out for ratification. Specific to the BLET and this has to do with the consolidated territories, which are obviously contingent upon the STB approving our merger application. This agreement with the BLET, which are the locomotive engineers and the earlier agreement that we signed with SMART, the conductors for the KCS in Kansas and Missouri, they're both progressively hourly agreements, which will improve our operational flexibility as well as the predictability in our employees' quality of life.

Again, it's an agreement that gives us flexibility, in turn, enables our employees to realize higher pay, scheduled jobs and a better quality of life compared to a traditional labor agreement is in U.S. rail space. Parts of these agreements that of course remain subject to the STB's approval of the merger, but we certainly see additional opportunities down the road pending and assuming, depending upon an approval to create a framework for the benefit of all employees in a combined CPKC network and also, obviously, the reliability benefits in service that this agreement will prove for a combined CPKC.

And I'll say a couple of words about the transaction. On the CPKC front, both of our teams at both CP and KCS are hard at work preparing to seamlessly integrate these two iconic companies. I can tell you there's been a ton of tremendous work that's been accomplished by teams at both railways to ensure the smooth transition.

I'm extremely pleased last week also to note the release of the final environmental impact statement. Certainly, that's no small feat and huge quantum of work by the STB to get that done in the meticulous thoughtful way that they handled not only just the environmental impact statement, but in handling this entire file. So, I commend the team for the work they did throughout the process, as I've said, the STB has been very thorough. They've been meticulous and we continue to eagerly anticipate their decision on our merger applications, which we expect this quarter.

On the environmental front, couple of words. CP continues also to make strong progress in this space, specifically on sustainability. I'm pleased to see that the company's efforts continue to be recognized – for the first time in our history, CP was named to the Dow Jones Sustainability World Index, which is a tremendous achievement for the entire CP family that we can be proud of. We were also named to the Dow Jones Sustainability North American Index for the third consecutive year and finally named to the CDP A list, which is an absolute reflection of our commitment to comprehensive climate disclosure at Canadian Pacific.

We continued to demonstrate our leadership and commitment to a more sustainable future, also through our hydrogen locomotive project, which is unique in the industry. In late October that project hit a significant milestone when the locomotive performed its second mainline test and first revenue move and are seeing the experience with the second hydrogen locomotive, which is the GP38, a 4-axle DC locomotive over the next month, which will be making its debut so to speak, as we get it out rolling and

operating so we can work the bugs out of it.

So let me close by saying ‘23, we're poised and ready to roll. It's going to be a very special year for two historic companies. We can't wait to get to work combining these two great companies and creating value for our customers, our employees in the North American economy. We're focused on executing the plan and I'm very pleased with the start that we've had to this year to what I expect will be a historic year. So with that said, I'm going to hand it over to John to bring some color on the markets and then Nadeem will wrap up elaborating on the numbers, and then we'll open it up to Q&A.

John Brooks

All right. Thank you, Keith, and good afternoon everyone. So as Keith mentioned, the fourth quarter wasn't without its challenges as certainly customer supply chains and the winter weather we faced impacted our volumes. We ultimately fell a little short of our RTM growth we expected to deliver for the year. However, I'm pleased, as Keith said, to the start to 2023 and believe we are uniquely set up for the year.

I'll take a look at our fourth quarter results now. Total revenues were up 21% on the quarter, volumes were up 8% on the quarter, while FX and fuel combined to be a 15% tailwind. The pricing environment continues to be strong. Now taking a closer look at the fourth quarter and the 2022 revenue performance, I'll speak to the results on a currency-adjusted basis. Grain volumes were up 27% on the quarter, while revenues were up 42%. Working in concert with our grain supply chain partners, CP set new all-time monthly tonnage record for shipping grain and grain products in October, and we delivered our second largest quarter ever for grain volumes.

Our newest 8,500-foot high-efficient elevator, a Richardson greenfield facility in Saskatchewan, started receiving grain in December. And in 2023, we expect to be over 50 origin elevators that will be 8,500 foot capable, enabling us to continue to move record amount of grain more efficiently. On the U.S. front, we saw strong demand in Q4 for both our export and domestic markets. I fully expect our grain franchise to continue to be an area of strength as we move through 2023.

On the potash front, volumes were down 2% on the quarter, but we ended up 9% on the year. While we saw volumes for export potash impacted by weather challenges, the long-term outlook for potash remains strong and unchanged. I expect to see similar growth in 2023 as we saw last year in potash. And to close out the bulk business, coal volumes were down 25% on the quarter and declined 18% on the year. An outage at Teck's Elkview mine in September impacted volumes through much of the fourth quarter and lasted longer than we anticipated. We lost over 100 trains in the fourth quarter due to these challenges. Looking ahead in coal, given the disruptions we faced in 2022 combined with a solid macro demand environment, we have a good setup from the compare standpoint as we move into 2023. So when I look at our bulk franchise, which makes up 40% of our book, it is extremely well-positioned in 2023, whether it's through strong demand fundamentals, favorable compares or both, we have a setup to deliver double-digit growth in this less macro sensitive portion of our book of business.

Moving on to merchandise. The energy, chemicals and plastics portfolio saw volumes grow 4%. We saw increased volumes in our DRU-bit during the quarter as well as plastics from our new IPL petrochemical facility, single-served by CP in the Alberta Heartland. Despite macro uncertainty, I expect ECP volumes to remain resilient as we start off 2023. Forest products were down 4%, while revenues were up 17%. Despite the Q4 decline in volume, this caps a record year for CP and forest products. While housing starts are expected to decline in 2023, CP's demand is softer compared to our record 2022. Our lumber, panel and pulp volumes have stabilized, and we are working with our customers to maximize new market opportunities.

Automotive revenues were up 27%, while volumes were up 11% on the quarter. On our Q3 call, I talked about over 7,000 vehicles sitting at CP origins waiting for final components. I'm pleased to see that we are seeing definite improvement in parts supply and more vehicles are moving towards shippable status. We have also begun moving the new Ford business that started up January 1st and I'm pleased with the startup of our new auto compounds at both Edmonton and Bensenville. Looking ahead, demand for finished vehicles remains fairly strong, and we are working with our customers to replenish inventories at dealerships across their network. Those fundamentals, combined with the new business we brought on, has positioned our auto business well for 2023.

Now finally, on the intermodal side of the business, quarterly volumes were up 17% while revenues were up 29%. Despite demand coming off record levels that we've seen in the past few years, our unique market wins have differentiated us in International Intermodal with volumes up more than 40% on the quarter. With favorable compares with the first half of 2023 driven by new business that started out the back half of 2022 and the continued port expansion at the Port of Saint John, we are well-positioned to continue to outpace the industry in this space. Port of Saint John continues to see tremendous growth, eclipsing 150,000 TEUs in 2022, more than a 70% increase year-over-year. Our partners at DP World are in the midst of deploying super new Post-Panamax cranes and this coupled with the new berth and track at the port, will result in a doubling of the capacity by April 1st. The Port of Saint John remains on plan to grow its total capacity to 800,000 TEUs in 2024.

On the domestic side, although demand with our core retail customers have come down from their recent highs, our temperature-controlled products continue to be strong. CP is a leader in the temp controlled space across Canada and we look forward to paving the way into new markets across North America with CPKC, should the STB approve our merger.

We are continuously working hard with a variety of customers on test moves on an interline basis, which are going very well. We recently completed a southbound test shipment from the U.S. Midwest market to Laredo, carrying temp controlled products in about three days, which is competitive with a single-driver truck. Further, we've also been testing the northbound lane focused on those service sensitive products to markets across the upper Midwest, the U.S. and into Canada. These markets are 100% served by trucks today and present a tremendous conversion opportunity for the combined CPKC to provide truck competitive single-line service, pending the STB approval of our merger.

So let me close by saying, as I look out at 2023, with the broader macro environment certainly remaining uncertain, CP's strong bulk franchise, our self-help business wins and anticipated opportunities as part of CPKC, have us in an advantageous position. My team is focused on staying close to our customers and selling the value of our service. So with that, I'll finish up and pass it over to Nadeem.

Nadeem Velani

Thanks John, and good afternoon. Great to be back and speaking to the results the CP team produced this quarter. Some of you are aware I've been out of the office in the field in the last five months, it's been a very energizing time on the railroad. And I'm thrilled to see the passion and pride from our people firsthand. I had a chance to spend a few months in our world-class training center, getting conductor qualified along with a strong pipeline of new railroaders that will enable us to deliver on our growth agenda, safely and efficiently.

Let me take a moment just to thank four specific trainers that helped me; Jeff McLean, Nate Blunt, Mark Mariam and Joe Wansaku, who shared their collective 140 years of rail experience with me, and I'm very grateful. I too also want to thank Maeghan Albiston and Ian Gray for their supports in backfilling for me and doing a wonderful job. So thank you to the two of you.

Now looking at the quarter, the adjusted operating ratio came in at 59.1%. Taking a closer look at a few items on the expense side, I'll speak to the variances on FX-adjusted basis as usual. Comp and benefits expense was up CAD $1 million versus last year. Increased volume and wage inflation were largely offset by lower accruals for incentive and share-based compensation. Fuel expense increased CAD $153 million, or 62%, primarily as a result of higher fuel prices, which were up 43% on the quarter versus last year, and roughly flat sequentially. Materials expense was up 33%, or CAD $17 million, as a result of cost inflation largely in non-locomotive fuel. Equipment rents were up 43%, or CAD $13 million, as a result of higher car – higher payments resulting from stronger volumes in intermodal and automotive.

Depreciation expense was CAD $219 million, an increase of CAD $9 million as a result of a higher asset base. Purchased services came in at CAD $310 million, an increase of CAD $54 million, or 21% when adjusted for acquisition costs. The main driver of the increase was higher pickup and delivery costs and other third-party services.

Moving below the line. The equity pickup from KCS in the fourth quarter was CAD $287 million, when adjusted for KCS' acquisition-related costs, purchase accounting, and a gain KCS had from an interest rate hedge unwind. Other components of net periodic benefit recovery increased CAD $6 million, reflecting higher discount rates compared to 2021. Net interest expense was up CAD $32 million versus last year as a result of a higher debt balance related to the KCS acquisition in Q4 2021. Income tax expense decreased CAD $49 million. Excluding KCS related items and the reversal of a previous provision for an uncertain tax item, the effective tax rate was approximately 17.5% on the quarter. Looking ahead, I expect the CP standalone tax rate in 2023 to be approximately 24%.

Rounding up the income statement, core adjusted EPS was CAD $1.14 in the quarter. On the year, core EPS was CAD $3.77, flat versus 2021. We continue to generate strong cash flow with cash provided by operating activities of CAD $4.1 billion in 2022. We continue to reinvest in the railroad and finished the year with a capital spend of just under CAD $1.6 billion. I anticipate a similar level of investment for CP standalone in 2023.

In the fourth quarter, we received dividends from KCS totaling $415 million U.S., which were utilized to pay down short-term debt. Over the course of 2022, we received a total of USD $880 million, or approximately CAD $1.2 billion in dividends from cash flow in excess of the capital KCS has invested in their railroad. Inclusive of the dividends, we generated CAD $2.7 billion in free cash flow. Over the course of 2022, we repaid more than CAD $1.6 billion in debt. Pro forma leverage ended the year at 3.8 times, and we remain committed to returning to our target leverage.

Looking at the year ahead, despite uncertainties with the macro environment, inflation, and interest rates, I couldn't be more excited. We have a transformational merger with Kansas City Southern and a strong pipeline of opportunities for the team to deliver. With that, let me turn it back to you Keith to wrap things up.

Keith Creel

Okay. Thank you for your comments and the color, both John and Nadeem. So operator, let me open up the line for questions.

Question & Answer

<Operator >: Thank you. [Operator Instructions] Your first question comes from Jon Chappell from Evercore ISI.

<Q – Jon Chappell>: Thank you. Good afternoon. John, I know that you guys clearly didn't put out any guidance targets for all the obvious reasons. But when you hear you walk through all the different segments, bulk being 40%, double-digit volume growth, tailwinds on auto, et cetera, et cetera, when you look to 2023 on a CP standalone basis, understanding the macro headwinds, does it seem to you that you can have volume growth that's not just at or better than GDP but substantially better, almost like a multiple of that, just given all your idiosyncratic tailwinds that you have on your own network?

<A – John Brooks>: Well, Jon, look, I definitely see a path to growth. You know what, we're unique in that 40% of our book is our bulk franchise, and I'm leaning heavy on that. As you said, certainly the macro environment is uncertain and we're not going to get too far over our skis in trying to predict what that's going to look like. But the Canadian grain franchise is set up well. Canpotex gets through their contract negotiations with China and India, we believe there's a path to a double-digit growth opportunity there. And as I said, Teck had a tough year between the weather and some of the mine challenges they had. There is, I think a significant upside and a good market demand environment in the metallurgical coal area. So, if you sort of build that out, Jon, and you can make your own predictions on sort of where those more industrial and consumer market go, it definitely leads to a path to some growth.

<Q – Jon Chappell>: Understood. Thank you, John.

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

<Q – Tom Wadewitz>: Thanks. Good afternoon. Wanted to see – I think you've given us quite a bit of color over time about the opportunities for growth when you get the approval with KCS. Is anything changing or is there anything that's kind of new in developing as we wait for that STB decision? Or is it pretty stable and it's kind of the same pipeline, same opportunities that you've been talking about?

<A – Keith Creel>: Look, Tom, I'll just say this in short. Number one, I can't get ahead of the STB. The STB is the authority here and ultimately we need their stamp of approval. Now, I do think that our facts are very strong and it's very compelling value creation for all stakeholders and enables growth at all the things that we as said, all along remain to be true, but ultimately, they have to decide and when they do. Nothing has at all muted our optimism for the opportunities and all the discussions we've had contingent upon that approval. We have an opportunity rich list that we're going to be able to execute that we're looking forward to get to work on.

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

<Operator >: Your next question comes from Chris Wetherbee from Citigroup.

<Q – Chris Wetherbee>: Hey. Thanks. Good afternoon, guys. I think as we're looking out into 2023 and thinking about sort of the combined, combination of this business, I guess, maybe curious of your thoughts on the ability to improve the OR from what was obviously a bit of a transition year or a tale of two halves as you mentioned Keith, in 2022. So I don't know, Nadeem, if you'll be willing to sort of think about on a CP specific basis above the line, your thoughts around either EBIT growth or OR improvement from where we finished 2022?

<A – Keith Creel>: Let me size it up like this, Chris. Let me start by saying, the 61.4% is not a CP standard. So – for that is an absolute fact and a belief. We look forward - there's a lot of moving parts. Obviously, we don't know what the economy is going to do, but we do know our story is unique and we know we're going to control what we can control. And I do see a path to OR improvement. So let me leave it at that.

<Q – Chris Wetherbee>: Okay. Thanks.

<Operator >: Your next question comes from Walter Spracklin, RBC Capital Markets.

<Q – Walter Spracklin>: Yes. Thanks very much. Good afternoon, everyone. And Nadeem, great to have you back. My question, I guess is on Saint John and you mentioned going to 150 this year, obviously up from a less than 90 run rate. And now you're pretty much running at a 300-run rate, so probably double that again in '23. You're pointing to 824. Just curious, when you get to that level, how long do you think it'll be that you could fill that 800 capacity in '24? And is LA Long Beach in the shorter queues in the less congestion over the West Coast, does that hurt your ability to get up to 800,000 on a quick basis in '24 or beyond?

<A – John Brooks>: Well, Walter, you know what, I don't think so. And the thesis all along, if we think back to when we bought the CMQ. Number one, it was – there was only one competitor in that marketplace. We identified a route that with our investment, with our partnership with the Irving and the NBSR, we're able to create a service package that ultimately long-term we believe is what is the enabler of the growth. We can get to Toronto, Montreal, Chicago, on a 200 plus mile faster route, that's not undeniable. And I think that's given us opportunities to talk to the steamship lines maybe a little differently than we have in the past.

And I think the other point, as I think about your timeline in '24, '25 and beyond, is a CP network that reaches coast-to-coast across Canada, and with the STB hopefully approving our transaction, being able to link in the Gulf and also potentially Lazaro down in Mexico, gives us a really nice menu to be able to work with our customers on. And as part of that, I see that enabling customers to not only look at the West Coast, but grow that East Coast port of call with us, but then also potentially further diversify themselves by potentially going down and utilizing the ton of capacity that we're going to have available coming in through Mexico.

<Q – Walter Spracklin>: That's a great story. Appreciate the time.

<A – John Brooks>: Thank you.

<A – Keith Creel>: Thank you, Walter.

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

<Q – Ken Hoexter>: Hey, great. Nadeem, welcome back and good luck on the rest of this process as you go through here. It's an exciting time to follow it. Can you talk about the test runs? I think you talked some of the lanes you're testing with KCS on a commercial basis. Is there anything you can kind of talk about in the interim, you mentioned moving the lane was a 100% served by trucks. Maybe can you quantify that specific opportunity or the potential there?

<A – John Brooks>: Well, Ken, I'll say this at this point, as I said, these are interline test moves that we've put together to, I guess, somewhat replicate or begin to sort of proof-of-concept with these customers. As I said, they're moving 100% truck today. So, part of the sale is helping the customer understand what that process and what that opportunity could look like.

Obviously in the future, if we're blessed with single-line service between Toronto and Chicago and Laredo, and ultimately down into Mexico, we wanted to begin to prove that we can compete head-to-head with trucks and ultimately, provide that reliability that those customers are going to require. I can tell you the second part of the story that's kind of neat around some of these opportunities is, in these couple of examples I spoke to, we've done some work with the customers to identify the greenhouse gas emissions savings at about a 60% to 75% clip versus their current mode on those specific moves. And it's really

become a unique and exciting sales tool that may be far more than ever in the past some of these customers have stood up to say that – beyond the price and the savings and the reliability and the service, this is an important story for our company. So, hope that helps, Ken.

<Q – Ken Hoexter>: Yes, John. It's something I guess we'll hear about more in the future. Thanks a lot for the time.

<A – John Brooks>: For sure.

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

<Q – Scott Group>: Hey, guys. So I understand 61's sort of not the CP standard. So do you think maybe, is this a year where we can get back to that 57, 58 OR we had in '21? And then just in terms of like the consolidated results and I know we can't give specific guidance yet but last year you gave us directional commentary low-single-digit kind of earnings growth. Anything you could say, you know double-digit earnings, the street's got high-teens earnings growth, any sort of directional color you can share? Thank you.

<A – Nadeem Velani>: Thanks Scott, appreciate the question. I'd just say, if we wanted to give guidance we would have given it. It's difficult in this environment. So we're awaiting a decision from the STB. So out of respect for that I think we should hold off on guidance for a consolidated entity.

And in terms of the OR, I think Keith said it perfectly. I mean, 61.4% is not something that we write home about. There's opportunities as John highlighted, this year, in terms of – on the volume side but there's also uncertainty on the macro front. So, we think, and we expect to see improvements. But to give you a quantum, I don't think it's appropriate right now, Scott. We'll update you as the year unfolds. And as we progress on our potential transaction and you can expect an Investor Day from us later this year, and I think that will be time – plenty of time to give you a more formal kind of guidance when the time is appropriate.

<Q – Scott Group>: All good. Totally fair. Thank you, guys.

<A – Nadeem Velani>: Thank you, Scott. All right.

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

<Q – Jason Seidl>: Well, Nadeem, welcome back. I wanted to touch on pricing a bit. I think you guys noted that it continued to be strong. I was wondering, if you could sort of compare it to where we were at in 3Q and then does it need to actually get better from here given cost pressures?

<A – John Brooks>: Jason, I would say, we sustained and maybe even improved a little as we move through Q4. I'd go as far as saying that high-single-digit type pricing on renewals, certainly inflation plus. And just looking out so far Q1, Q2 expectations in 2023, I'd say it pretty well lines up in that similar space. So, I remain optimistic on our pricing. And as we've always done in the past, certainly, we're very conscious of this inflationary environment. But a big part of our philosophy is pricing to the value of our service and capacity and whatever the inflation environment is going to be, you can assure that we'll continue to – the sales team will continue to price that way in the marketplace.

<Q – Jason Seidl>: Appreciate the color, understood, and look forward to the next big announcement.

<A – Keith Creel>: As do we. Thanks, Jason.

<Operator >: Our next question comes from Brandon Oglenski from Barclays.

<Q – Brandon Oglenski>: Okay. You talked about new progressive hourly agreements with the SMART in the BLET unions, how important is that towards working - towards a quick integration? And what advantages do these hourly contracts have versus maybe some of your competitors?

<A – Keith Creel>: Well, it's critically important. It's a success enabler. I can tell you that and I don't know if we have a lot, enough time to go through this on this call. But think of one collective agreement, think of a conductor, think of an engineer, think of no complexities from yard rules and road rules where we have two classes of employees. So you have one class of conductors and engineers, they make more money, they have scheduled time off. And as a result of that, we have more predictability. And when you offer a better quality of life, especially in today's world, you pay more money and you let people know when they have to come to work, in the rail industry, that's a very unique and compelling value proposition.

So, to be able to expand that, we've benefited from that on the single DM&E properties at CP. We've had a unique outcome even through last year and the year before. So that's been part of our recipe for success and to be able to leverage that and give something to our employees they'll be proud of, their families will be proud of. And I think it's part of the recipe not only to succeed in realizing our revenue synergies and the growth that we've committed to, as well as operational synergies but most importantly, I think it's necessary in today's world to be the employer of choice. Employees in the rail industry have to work their tails off. It's not an easy job. They have a choice of where to work. All the railroads are hiring. CPKC, pending of course the STB's approval of our transaction, I believe has the potential again for the employee to create a unique experience in this industry. And that's what I'm most excited about.

<Q – Brandon Oglenski>: Thanks Keith.

<Operator >: Our next question comes from Konark Gupta from Scotiabank.

<Q – Konark Gupta>: Thanks operator. Good evening, everyone. Welcome back, Nadeem. So, I wanted to ask on the one of the comments you made on the largest hiring and CapEx programs you undertook in preparation of the opportunities ahead. How much hiring and CapEx are you expecting to unleash once the transaction is fully approved?

<A – Nadeem Velani>: Well, from – I'll tell you from a CP standalone, our CapEx is CAD 1.6 billion. So let me comment on Kansas City Southern's CapEx. But they've had a number of initiatives, call it, whether it's from a bridge point of view or from other land acquisition and so forth, they're hitting record CapEx levels as well.

From a hiring point of view, we hired starting in the spring of 2022. We've had a strong pipeline in anticipation of the grain crop coming back. So, we saw our employee counts, I think get up to almost 13,000 people at the end of the year. And so, we hired I think close 2,500 new people were hired and trained. So that was certainly a significant expense in 2022 and it will be a significant expense this year as we prepare for growth. So those RTMs that we expect to come along – the GTMs, assuming a positive response from the STB, the synergies that one day we'll realize, will take some people. So we're hiring a few thousand at a time and we're spending CapEx at record levels on our property and KCS on their properties. So just a bit of color. Hopefully that helps, Konark.

<Q – Konark Gupta>: No, no, that helps. Appreciate it. Thank you, Nadeem.

<A – Nadeem Velani>: Thanks.

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

<Q – Steve Hansen>: Yes. Good afternoon. I appreciate the time. So noted that KCS has faced some of its own OR headwinds in the past couple of quarters here, even stiffer than the CP quarter. Just to the degree that you can comment at this juncture, just curious how addressable you think those headwinds are and how quickly they can be reined in upon a successful STB decision?

<A – Keith Creel>: Yes. It's hard to hard to put a number on that, Steve. The things I think about, obviously I can't stick my hands into their business. John and Pat and the team are very competent and capable and talented railroaders and they're managing those situations, now, pending STB approval – and we have an ability to get our hands into it. Then obviously, when you put the combined network together as we come together as a team, you create fluidity, you take out handling, you do a lot of those things that whatever challenges they're dealing with, is going to get better from a fluidity and operational standpoint.

And the other thing is as we win this business that we're talking about and we create these new markets, you take out some of the complexity of cars being handled back and forth with a single line move versus an interchange move. That's true for CP-KCS, that's true for an interline move perhaps that might be going UP, BN, CN, all of the above – single-line that's part of the value of this for the customer. It's part of the efficiency, as far as the asset turn, you control the move cradle-to-grave. You charge a fair price for it, you create capacity and as a result, you have a more efficient railway which produces a lower operating ratio. It's just the way you'd effectively run the business. So, I can't put a number on it. I can tell you that you should expect improvement naturally because of all those reasons and I can tell this is going to be a team committed to driving that improvement.

<Q – Steve Hansen>: Appreciate the color.

<A – Keith Creel>: Thanks, Steve.

<Operator >: Our next call comes from Brian Ossenbeck from JP Morgan.

<Q – Brian Ossenbeck>: You know there is a change in the paid sick time in Canada starting the end of last year. It was called a CAD300 million headwind at your peer. I just wanted to see how you're thinking about that at your own network here in the next year. And then maybe for John, if you can comment on just the price mix and I guess, other was a 200-basis point headwind this quarter. Putting it together, it looks like you might be facing similar trends in the first half of next year just based on the comps and the wins that are coming on the network. But I wanted to see if you could give us some high-level color in terms of how to think about mix and how that impacts you next year. Thank you.

<A – Keith Creel>: I'll say a few short words about these new regulations and the paid sick days. I'm not thinking in tens of millions of dollars, I'm not thinking in hundreds, I'm thinking about the practical application of this. Number one, those sick days have to be earned through '22 or '23. So really they don't come into play until '24 full-year effect. Number two, our manpower models, and I don't care if it's the mechanical group, the running trades group, locomotive group, the maintenance group, we model because employees obviously get sick, sick days, it's already on our manpower models.

So to suggest it's going to go from 0 to whatever, to 10, a multiple of 10, would be to me irresponsible on my part. Our employees, if I look at running trades, for instance, we've got average sick days in a year's – I think the rough number's 4 or 5. So that's already kind of baked into the manpower model. Now, if I've got to pay them for those 4 or 5 days, there's some impact. But at the end of the day, it's not going to be material. I don't know exactly what it will be, but we won't have full effect in '23. I know that for a fact and when we do, I don't think it's going to be material.

<A – John Brooks>: And Brian, you know what, you're right. I kind of see similar trends evolving as we move into the first half of 2023. Typically, our bulk franchise just by nature a little lower on average cents per RTM basis relative to the rest of our book. That'll kind of maintain or keep some of the pressures relative to the mix that's as you described.

<Q – Brian Ossenbeck>: Okay. Thank you for your time.

<Operator >: And our next call comes from Ari Rosa from Credit Suisse.

<Q – Ari Rosa>: Great. Good afternoon. So thanks for taking the question. I just wanted to see if Nadeem or Keith maybe could talk about the expectations for the progression of the debt pay down, kind of how are you seeing that play out over the course of 2023 and maybe into 2024? And what kind of impact might that have on your interest expense? Thanks.

<A – Nadeem Velani>: So yes, we're generating a significant amount of free cash, as well dividend payments from Kansas City Southern. So we're kind of on pace to continue to delever, get back to our 2.5x target leverage. So we've gone from kind of little bit above for 4x, 4.1x, 4.2x, down to 3.7x, 3.8x levels as we speak, and we expect that to get in the high-2s, by the end of the year. And so over the course of 2024, we should be back in target leverage, keep it at that level. And as far as interest payment, I just follow that – follow-up with Maeghan and Chris post call. I'm back in the office three days so far, so you caught me on that one – so better to connect with them on the interest cost.

<Q – Ari Rosa>: Got it. Fair enough. Thanks for the time.

<A – Nadeem Velani>: Thanks Ari.

<Operator >: And our next question comes from Amit Mehrotra from Deutsche Bank.

<Q – Amit Mehrotra>: Thanks, operator. Hi, everyone. I joined the call a little bit later. So apologies if these questions have been asked. But one, Nadeem, I was wondering if you could talk about non-fuel costs. Obviously, there's inflation, I assume you have some visibility if you could help us kind of think about (inaudible) OpEx this year? Another I guess a follow-up separately, with Kansas City OR, there used to be a time where they provided U.S. OR and Mexico OR and I assume that based on where they are today, may be safe to assume that they're kind of in the 70s now in terms of the U.S. business. I don't know you want to comment or talk about that, but just trying to understand (inaudible) gap in terms of where they are in the U.S. business and where CP is?

<A – Nadeem Velani>: Sure. Yes. Thanks for those questions. You cut out a little bit, so forgive me, if I didn't get – I don't get the full question and respond to you correctly. But I think you mentioned about inflation ex-fuel. We were running close to high 6%, almost 7% in Q4. So significant inflation that we haven't seen in some time or certainly haven't seen in my career.

The good news is, John has been – as he updated on the call, we've pricing above inflation and we fully expect that in this uncertain macro-environment. We'll see what happens with inflation. Certainly, we've seen it kind of slowdown in some areas, some of the latest economic indicators have seen, hopefully peak inflation and we'll see that come down through 2023. But irrespective – we're protected from an operating income point of view. In terms of OR, KCS versus KCSM, yes, not appropriate for me to comment and I couldn't even tell you the answer if I wanted to, so – if I knew it. So more to come on that and not something that I'm going to answer on this call.

<Q – Amit Mehrotra>: Yeah. I thought I'd try anyways. Thank you very much. Appreciate it.

<A – Nadeem Velani>: That's a heck of a try, Amit. Thank you.

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

<Q – Justin Long>: Thanks and good afternoon. I guess to follow-up on some of the questions about pricing, can you talk about what percentage of your business is getting repriced this year? And as you've started to pursue some of the new business opportunities as a result of the KCS merger, are you seeing any of the other rails respond to that with more competitive pricing? And if not, how are you thinking about that risk as you integrate the deal?

<A – John Brooks>: So Justin, we should see roughly 40% of our book roll over in 2023. And that's I would characterize that as pretty typical for us. A competitive response – I fully expect that they're going to do what they need to do in areas where we're going to go head-to-head, again, assuming the STB approves our transaction. That being said, I'll also say this. A lot of the examples I've provided today and I've spoken to in the past, are really non-rail moves today. It's about focusing on these opportunities that I think uniquely can be solved by CPKC and are really competing against truck. And as I think about, even traffic that we're looking at, potentially out of Mexico up into markets that – that's moving short sea or other alternatives that aren't head-to-head versus rails. So look, we'll - we're going to compete where we compete. And I fully expect the U.S. rail competitors to do what they need to do on that front and we'll do the same. And again, we'll try to focus on those growth opportunities that are more, may be non-competitive with those and moving via truck or other modes.

<Q – Justin Long>: Understood. Thanks.

<Operator >: We have reached our allotted time for Q&A. I would now like to turn the call back over to Mr. Keith Creel.

<A – Keith Creel>: Okay. Thank you, operator, and thank you for joining us again this afternoon. As you can sense, these are unique opportunities. It's a unique time in this company's history. Obviously, contingent upon the STB approving our merger application, we are poised and ready for a historic year for a combined entity, CPKC. Historic for our customers, for our employees, for the communities we serve, for the North American economy, in a very unique way.

So that said, we look forward to waiting on that decision and pending that decision is positive, as we hope that it will be and we believe the facts support, we will be scheduling and let you know a date to protect in the future sometime in June, late June, we'll be in a position to be able to come together and share all these facts and answer a whole lot more questions and provide some color as to what the true opportunity lays ahead of us for 2023 and beyond.

So thank you for that. Stay safe, and we look forward to talking again on our next call.

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