Transcript

Q2 2023 Earnings Call

July 27, 2023

Canadian Pacific Kansas City Corporate Participants:

Keith Creel – President & Chief Executive Officer
Nadeem Velani – EVP & Chief Financial Officer
John Brooks – EVP & Chief Marketing Officer
Mark Redd – EVP & Chief Operating Officer
Chris de Bruyn – AVP, Investor Relations & Treasurer

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon. My name is Leo, and I will be your conference operator today. At this time, I would like to welcome everyone to CPKC's Second Quarter 2023 conference call. The slides accompanying today's call are available at investor.cpkcr.com. 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 Chris de Bruyn, Assistant Vice-President, Investor Relations and Treasurer to begin the conference.

Chris de Bruyn

Thank you, Leo. Good afternoon, everyone and thank you for joining us today. Before we begin, I want to remind you, 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 U.S. regulators.

This presentation also contains non-GAAP measures outlined on Slide 3. Please note in addition to our regular quarterly financials, there's supplemental Q2 combined revenue and operating performance data available at investor.cpkcr.com, which some of today's discussion will focus on. With me here today is Keith Creel, our President and Chief Executive Officer; Nadeem Velani, our Executive Vice President and Chief Financial Officer; John Brooks, our Executive Vice President and Chief Marketing Officer; and Mark Redd, our Executive Vice President and Chief Operating Officer.

Opening remarks will be followed by Q&A. In the interest of time, we'd appreciate if you limit your questions to one. It is now my pleasure to introduce our President and CEO, Mr. Keith Creel.

Keith Creel

Hey, thanks Chris and good afternoon. Let me start by thanking our CPKC family of railroaders across all of North America who have been hard working bringing these two companies together, serving our customers, while serving each other, as you can imagine the quantum of work has been monumental, the effort against that quantum has been inspiring.

So let's take a look at the results in the quarter. In the second quarter, we produced revenues of CAD3.2 billion and operating ratio of 64.6% and core EPS of $0.83. We saw volumes down 5% on the quarter headcount up 6% versus last year, so no doubt a challenging quarter, as we dealt with a softer demand environment, but John is going to speak more about that in a few moments.

Despite the challenges in the quarter, as we stated in our press release, we continue to expect to deliver on the guidance that we laid out at our Investor Day. Let me spend a few moments talking about some of the early wins. So looking where we stand today, we're just over a 105 days old forever into this combination, but I am extremely proud of the work this team has done to get us to this point and what we've accomplished so far. First and foremost, a seamless transition operationally and combining the two networks, which is no small feat. I think in historical terms, it's refreshing to see the results versus most merger histories. Understandably, based on those histories, there's been no shortage of skeptics that pointed to an industry with a history of merger-related services challenges, as I said we would, we've taken a realistic and measured prudent approach, a more humble approach to bring these two networks together and it's pay dividends.As we bring the networks together, we will continue to identify areas of opportunity to make the service better and to improve operationally. In the second quarter, we're proud to

announce several key customer wins, Schneider, Knight-Swift, Americold. These are deals that as we said before, in some instances for 18 to 24 months in the making. They utilize the advantages of this unique network, including our land holdings, as well as the only single line service spanning U,S,, Canada, and Mexico. And again on March 11th, we launched our flagship 180/181 Mexico Midwest Express Service, which again is the only single line fastest transit time consistently across our three nations, or I guess from Chicago into SLP. We've executed well beyond our advertised transit times of less than 100 hours each way.

We've also not been resting on our laurels from a strategic point of view, we continue to expand the service offering and our reach within the hour transaction that we announced connected CSX in Alabama and creating a new gateway between Mexico and Texas and the Southeast United States. And on the sustainability front again, we announced a very strategic partnership with CSX to expand on our hydrogen locomotive program.

And finally, we also announced part of our extended partnership with Tech and the contract that we just renewed plans to utilize the hydrogen locomotive in our Western corridor. So listen, a lot of tremendous work leading to this combination. I applaud the great railroaders that has made this possible prior to and since day one to come out of this result and listen, this is not to say that everything has been perfect, certainly been challenges this softer macro environment, the strike at the port. That said, on the strike, I'm encouraged that the Longshoremen are back to work. We've got a contract that's out for ratification, we should get a result from that if not today, tomorrow and I'm anticipating the best outcome for everyone involved with the ratification of that agreement.

By heading into the combination of these companies, the last thing also that we were going to allow is to be short on resources. We certainly can't grow without the resources in place to accommodate. You'll see that reflected in our cost this quarter, but at the end of the day, that is the absolute right thing to do. This is a long game. It's not about the first quarter of a combined company. It's about ensuring that we're prepared to grow with the growth that we see coming and position this company for long-term success.

So in closing, we're in the early stages of this combination, despite some short-term headwinds and unique growth outlook that we laid out last month is unchanged. CPKC is poised to be the most relevant rail network in North America. We're uniting a continent. We are enabling commerce amongst the United States and Mexico and Canada.

With that said, I'm going to turn it over to Mr. Mark Redd to speak to the operations before John brings some color to the markets and Nadeem elaborate some of the numbers.

Mark Redd

All right. Thank you, Keith and good afternoon. I'd like to start by thanking the CPKC operating professionals who continue to work tirelessly to deliver best in class performance, who are delivering on our service commitments to our customers. As John will discuss the long-term opportunities in the pipeline, my team has been working closely with the marketing and asset management teams to evaluate and onboard new business that fits within our network.

Turning to our safety performance in the quarter, I'm pleased to report that during the first quarter as a combined company CPKC, we continue to build upon its industry leading lowest train accident frequency, which declined at 48% to 0.79 comparable to Q2 at a 1.51. From a personal injury perspective, our Q2 FRE reportable personal injury rate increased to 25% to 1.25, it's just a continuing reminder that safety is an ongoing journey, we still have a lot of work to do in that space.

Safety and leadership development is critical to CPKC success. We will continue to be – it will continue to

be a key area of focus. In the first 90 days, we have rolled out our homes safe program across entire CP, CPKC US property, and we are now in the process of introducing it at Mexico.

Home Safe is an initiative designed to build on the safety culture by tapping into the human side of safety, but also promoting both safety engagement and feedback. We launched Home Safe back in 2016 back on CP property to help drive record improvements in the reduction of personal injuries across our system. This program along with our safety walk abouts where we directly engage with our employees across the property is essential to building strong consistent safety culture across the entire network. Safety has been and remain our top priority.

I'm also pleased with the nearly 100 KCSR our operating leaders, who have already gone through our two-day leadership program. We fully expect to have U.S.-based leaders through this program by year end. Turning to the metrics, I'll speak to our metrics on a comparison versus CPKC we had if we combined during the 2020 and 2022-year. Average train speeds 1% versus last year. Average train weight is down 2%. Our average train length is flat versus last year, our productivity for locomotives improved 4% versus the Q2 2022.

Bringing two companies together and the size of CP and KC is no feat. We have spent a lot of time planning, preparing in advance and I'm pleased to say that our network is running smoothly. So as part of that, as Keith spoke to, heading into the merger we ensured we are prepared for a resource perspective of hiring and training. This puts us in a strong position to generate operating leverage as the volume environment improves. We also continue to identify and implement opportunities to improve operating practices. We talked about Investor Day. I spoke about 130 locomotives that we reduced from the network, 1,000 cars that were reduced from the network by aligning operating models and improving efficiencies.

These efforts will continue to happen. We'll stay focused on the recovery of the strike at the Port of Vancouver, which will take some time to achieve and in closing, I'm confident the changes we have made in the first three months are continuing to make will generate benefits in the back half of the year. With that, I'll turn it over to John.

John Brooks

All right. Thank you, Mark and good afternoon, everyone. So as Keith said, we're just over 100 days in as CPKC and I tell you, I'm extremely proud of the work my team has done to begin to capture and deliver the growth that this new franchise will undoubtedly unlock. And while we are certainly not immune to the broader economic headwinds and supply chain challenges, our unique business and self-help initiatives continue to serve us well compared to the industry and put us in a strong position until volume environment recovers.

Now looking at our second quarter results, on a reported basis versus CP standalone in 2022, total revenues were up 44% on the quarter, while volumes are up 24%. On a combined basis, CPKC saw total revenue grow 2%, while volumes declined 5% versus pro forma CPKC a year ago. FX was a 4% tailwind in fuel was a 3% headwind on the quarter. The pricing environment continues to be in line with expectations with inflation plus renewals across our book of business.

Now, we'll take a closer look at our second quarter revenue performance. I'll speak to the FX adjusted results on a comparison versus CPKC as the combination occurred in 2022. Grain volumes were down 5% on the quarter, where revenues were down 2%. Canadian grain volumes were strong on a year-over-year basis, driven by an improved harvest for the 2022 to 2023 crop year; however, that volume was offset by -- softer demand for U.S. grain driven by the challenging year-over-year comps we faced by moving a lot of corn out of the U.S. into Western Canada due to the drought. As we move into this year's

harvest, I expect our grain franchise to return to growth.

On the potash front, volumes and revenue were down 18% on the quarter. The decline in volumes in the quarter were driven by a major mechanical failure at Canpotex's Portland Bulk terminal that happened in April. We are not planning for the Portland terminal to come back online before the end of the year.In the meantime, we're working hard with Canpotex to divert volumes to Neptune, Thunder Bay and a variety of other terminals across North America. Looking ahead, despite the Portland outage and of course the most recent impact of the strike in Vancouver, I'm excited as ever about the long-term opportunity for export potash, as Canpotex has effectively and continues to expand their market share across the globe.

And to close out our bulk business, coal volumes were up 1% on the quarter while revenues were down 3%. With favorable compares in the back half of the year, following last year's outage of Teck's Elkview mine, I expect to see strong growth in coal in the back half of 2023.

Now moving on to merchandise, the Energy Chemicals Plastics portfolio saw an 8% decline in revenue and volume. We saw our crude and plastics business is impacted by core spreads in the market and maintenance outages respectively, while also our LPG were lower to a warm spring across our network.

On the contrary, refined fuels have remained steady across our entire network driven by business growth, leveraging our broader network service offering and we are pleased to announce today a new material expansion of our deep partnership with Shell through the execution of a new multi-year contract that will unlock significant volume growth of new share across all lanes of the CPKC network.

Looking ahead, as Shell ramps up in August, we expect to see upside in ECP, as they begin to move through the back half of the year. Forest products revenues declined 4% on a 5% decline in volumes. Although we are seeing the impacts of the softer economy on residential construction and related building products, we are very encouraged about the development of long-haul lumber shipments from Canada down on to the legacy KCS markets.

This is a prime example of where our new network is connecting markets and creating opportunities that didn't previously exist for our customers. The metals minerals and consumer products portfolio grew 7% and a 5% increase in volumes. The growth in this area was driven by higher volumes of frac sand and steel, which drove a record quarter for this area. We are particularly encouraged by growth in Mexico, as we recently added new steel products units train from Lazaro Cardenas into the interior of Mexico. We are also working closely with both Ternium and FDI on their new industrial development opportunities that will further accelerate growth in this business over the coming months.

Automotive revenues were up 24%, while volumes were up 11%, again an all-time record for this area. Demand for finished vehicles remains strong, as the industry continued to play catch-up on North American inventory shortages that will result of part shortages and of course supply chain challenges. CPKC is working with our key automotive partners to develop unique transportation solutions that leverages unmatched benefits of this expanded franchise and also our development of new auto compounds.

On the intermodal side, quarterly revenue was down 10% on a 4% volume decline. Domestic intermodal is challenged by soft market demand, high inventories across North America and certainly a more competitive over the road rates. However, we are extremely encouraged by their early success, as Keith spoke to of our new 180/181 cross border train. We have seen a steady increase in volumes, as our partners begin to take advantage of our fast truck-like service on this unique north-south service offering.

International intermodal helped insulate our intermodal business with a record Q2 volumes. Our self-help wins with CMA and continued growth at the Port of St. John helped to offset softer macro demand in the

international space. And finally, we are very pleased as Mark and Keith spoke to see the strike at the Port of Vancouver finally get resolved. We are working closely with operations and our customers to rebalance the network and move the backlog of traffic that could not move during this outage.

At this point, we are estimating the strike had a negative impact of about CAD80 million in revenue, much of which we will work hard to claw back over the remainder of Q3 and into Q4.

So let me close by saying, we are just over 100 days into this journey of CPKC. I can tell you my team is out on the street. We're excited, we're energized, we're incentivized to get out and capture this unmatched growth opportunity. As we laid out a few weeks ago at Investor Day, we have a very strong pipeline of opportunity in front of us and we are laser-focused on locking in the right business for this network and delivering on our commitments to all stakeholders.

So with that, I'll pass it now over to Nadeem.

Nadeem Velani

Great. Thanks, John, and good afternoon. I also would like to thank the entire CPKC team for their work and dedication to bringing these two companies together. Although it was a challenging quarter financially, I'm very proud of the progress that we've made and extremely excited about the path ahead for the combined CPKC family.

Looking at the quarter, CPKC's reported operating ratio was 70.3% and the core adjusted combined operating ratio came in at 64.6%. Earnings per share was $1.42 and core adjusted combined earnings per share was $0.83. Taking a closer look at a few items on the expense side, I'll speak both to the reported operating expense on Slide 14 and the combined operating expense on Slide 15.

Our combined operating expense illustrates the estimated effects of the acquisition for the second quarter, as if the acquisition closed on January 1, 2022.

Reported comp and benefits expense was CAD659 million or CAD690 million on a combined basis, up 26% on an FX adjusted basis. This quarter's comp and benefits expense exclude acquisition-related costs of CAD63 million, which have been excluded on a core adjusted basis. The year-over-year results on an adjusted and combined basis include increased share based and incentive compensation, driven primarily by higher stock price. Wage inflation and higher T&E headcount also drove the year-over-year increase. As I mentioned at Investor Day, we have resourced appropriately for expected volume growth starting in the back half of 2023, given some of the shorter-term volume headwinds we are carrying surplus headcount and incurring additional expense in the quarter.

However, as the growth comes on in the second half and into 2024, we will be prepared to handle strong incremental margins. Comp and benefit increases were partially offset by lower current service costs in the DB pension plan, resulting from higher discount rates.

On the fuel side, fuel expense on a reported basis increased CAD27 million year-over-year and the transaction occurred in 2022 fuel expense would have declined CAD144 million on an FX adjusted basis. The decline was driven by lower fuel prices on the quarter, as well as lower year-over-year volume on a combined basis.

Materials expense was up CAD35 million versus Q2 2022 CP results. On a combined basis, materials expense increased CAD13 million on an FX adjusted basis driven mostly by increased safety and maintenance activities across the network.

Equipment rents were up CAD51 million versus Q2 2022 CP results or CAD22 million on an FX adjusted

basis, as the business has been combined in 2022. Equipment rents increased due to increased use of pooled equipment lease, inefficiencies driven by supply chain challenges along with lower locomotive receipts.

Depreciation expense was up CAD199 million on a reported basis or up in FX Adjusted CAD21 million, as the business is being combined in 2022 resulting from a higher asset base.

Purchased services and other was CAD586 million on a reported basis, combined PS&O came in at CAD615 million, up 23% on an FX adjusted basis.

The quarter's purchased services expense includes acquisition-related costs totaling CAD53 million, the year-over-year increase was driven primarily by increased casualty expense of CAD45 million, which accounted for more than half of the variance excluding FX. Assuming a more normalized quarter from a casualty perspective and excluding acquisition related costs, I expect PS&O to land in the CAD530 million level per quarter in the back half of the year.

Moving below the line, the equity pickup from KCS for the first 13 days of the second quarter was CAD26 million. Other components of net periodic benefit recovery decreased CAD18 million, reflecting higher discount rates compared to 2022 and other expense increased CAD14 million. Net interest expense was CAD204 million, you will note also CAD7.2 billion loss on remeasurement of KCS resulting from the transition from equity accounting to consolidation upon control this quarter.

The loss relates to tax attributes of the equity investments, which are realized separately as a CAD7.8 billion deferred tax recovery. These two items net together for a favorable impact to reported earnings of CAD657 million. Reported income tax recovery CAD7.7 billion, which includes the outside basis tax recovery that I mentioned a moment ago, continue to expect the CPKC core adjusted effective tax rate to be approximately 25.5% for the rest of 2023.

Rounding out the income statement, our core adjusted combined EPS was $0.83.

We continue to generate strong cash flow with cash provided by operating activities of CAD892 million in Q2. Our first call on capital remains the business, and in the quarter, we reinvested just over CAD600 million.

We continue to expect to invest approximately CAD2.7 billion of capital in 2023. We generated CAD431 million and adjusted combined free cash flow on the quarter. In the quarter, we repaid CAD439 million US in term debt and our adjusted combined leverage is down to 3.6 times on our path back to our target leverage of 2.5 times adjusted combined net debt to Adjusted combined EBITDA.

Following the close of the transaction, we increased our credit facility for CAD1.3 billion to CAD2.2 billion while also increasing our commercial paper program to CAD1.5 billion.

So as I sit here today, we are in a strong position from a resource perspective and have pre-spent and invested to some degree, when it comes to hiring and training. John continues to bring on synergies and as the changes marking the operating team are making take hold, I think we're set up well for the back half of the year to deliver on our guidance and carry us into 2024. While we had some ground to make up from a prolonged strike at the Port of Vancouver, the future is certainly bright and I look forward to sharing our success with you going forward.

With that Keith, I'll turn it back over to you.

Keith Creel

Thanks, John, Mark, and Nadeem. We will spend the rest of time taking questions. Operator, if you could open up the line.

Question & Answer

<Operator >: Thank you. (Operator Instructions) Your first question comes from Ken Hoexter of Bank of America.

<Q – Ken Hoexter>: Great. Good afternoon and thanks for taking the question. Maybe Nadeem, you ran through a lot of numbers there and obviously a lot on the combined accounting here, maybe just talk about the cost side. Right. It looks like costs got maybe a little bloated here and I want to understand you kind of give the purchased services and kind of run rate there maybe just your thoughts on how we should think about that in the back half in terms of what costs are coming out, especially as you look at things like casualty expense you noted was a little elevated, are there things going on in the blended network now you look and you can see ways to continue to take expenses out and what we can see near term in that blended. Thanks.

<A – Nadeem Velani>: Sure. Thanks, Ken. So casualty, we faced a couple of one-time items I would characterize tune of about CAD45 million, one was a litigation settlement and one was a very expensive derailment that's added to it, so part of the reason why I say more normalized number of CAD530 million is these aren't things that are going to occur on a quarter-over-quarter basis, so we feel very confident that purchased services and other will come down to our normalized CAD530 million. Certainly, we're in the early stages of cost takeout from a synergy point of view. We're in this for the long game, so as you mentioned, we've hired -- we certainly the macro environment, the volume backdrop wasn't as strong as we expected and kind of hit us by surprise. That being said, we weren't going to take a short-term view and take head count down just to kind of mitigate it knowing what we have in the back half of the year certainly on the bulk side and some of the market share gains that John mentioned. And then as we enter 2024, what we have in front of us and the natural macro recovery as we expect. So we see a strong path volume recovery in the back half in Q4, to high-single digits. So we're long people right now, short-term, but it's the right choice to maintain that level of people. It takes a long time to hire and train to also attract and retain employees.

So it's elevated our costs. There's no doubt that with the volumes that we had, labor being up 5% that delta is at its peak, it will normalize as we get through the back half of the year, I expect labor to almost be flat to slightly down year-over-year and volumes to inflect positive high single digits, so you'll see a much better expense and productivity performance in the back half of the year.

<A – Keith Creel>: Yeah. If I could add a little bit of color to that, Ken, you use the word bloated. I wouldn't say bloated, I'd say that we had the one timers, as Nadeem spoke to, but above that carrying the head count that was an intentional decision, it's a timing issue, obviously we didn't know this softness would have been here, perhaps we would have hired a little bit later and trained a little bit later, but nevertheless, we have very unique growth opportunities that are counter to the macro environment that give us great confidence, that it doesn't make a lot of sense to lay a lot of employees out the risk losing them and not having them, 4 weeks from now, 5 weeks now when you've got potash moving very strong demand. You've got the harvest that's came in and we've got some these self-help initiatives that we've got -- that we talked about coming online. I don't – John hasn't got into a lot of detail, but there's some pretty exciting business share-shift wins that we're going to get start benefiting from in August that's going to help cover some of those additional costs that we carried. The other point I would say on the operational front, Mark and team, we said this from the beginning, we're going to make sure we get the U.S. network and the Canadian network stabilized. We've done that. Now we're turning our attention to Mexico, if you look at Mexico, the numbers you see the same numbers I see. There is -- there's a lot of

opportunity for improvements in Mexico and the way we serve our customer, the way we control our costs, the way we manage the business, so in preparation for that effectively -- actually next week, we've got John Orr and a team of about 50-55 officers, that are going to go to two locations in Mexico and plant and sales there from a holistic business approach standpoint from the commercial side, from the customer transactional side, the operational side. So we're going to spend a lot of time with our brothers and sisters and family members in Mexico. Getting that operation to a point that at the end I fully intend and expect to see our velocity improve, our train speed improve, some of those costs that are tied to excessive car dwell and or not getting it to where it needs to be, is going to be able to complement the productivity we're already starting to see in the locomotive side that Mark and the team are producing.

So more to come on that, but certainly again, bloated is not the right. I would say word, I would say intentional, and expect more improvement over this next quarter, as we start to realize the benefit of those initiatives.

<Operator >: Your next question comes from Tom Wadewitz of UBS.

<Q – Tom Wadewitz>: Yeah. Thanks, good afternoon. If for maybe John, I could ask you a question just in terms of kind of demand framework. We're generally hearing from I think transports and other the railroads about caution on market conditions. Maybe Intermodal improvement being pushed into next year, maybe forest products, some areas of weakness and chemicals. How do we kind of think about the, I guess, impact of that underlying weakness or your optimism on that relative to some of the things you're talking about that obviously are maybe idiosyncratic good news or maybe on the bulk side, so just kind of trying to figure out how to think about the combination of those two and volume look like 3Q and beyond that?

<A – John Brooks>: Yeah. Thanks, Tom. So yeah. There's no doubt. I think we're in the same boat, as what you've heard from the other rails in terms of the intermodal business. I'll tell you we saw sort of our valley or trough point the last half of April beginning of May. But on a week-over-week basis, we've started to actually see a little bit of improvement, frankly, if you look at legacy CP, legacy KCS, the combined companies over these last 8 to 10 weeks, again not a very hockey stick looking improvement, but at least the numbers that are starting to improve a little bit, I do believe a certain amount of that is self-help, Tom, I've got the team I'll tell you right now, we are on a three-week blitz over 3,000 cold calls. We got boots on the ground. We're blitzing all our major territories. We're not sitting idle. I do see the intermodal challenges persisting, but we're going to make self-help, we've got the fastest intermodal service in our North-South superhighway. We're going to continue to put more footage on that train. Mark has been given me a hard time that the trains are too small and in the mandate is the team to go out there and add business to that.

I see upside opportunity Tom, as you think about the automotive business, there's a lot of vehicles that remain on the ground down in Mexico and we are working closely with those OEMs to create new solutions that I think initially we felt were long-term plays. But I think there's some opportunities there given the situation, where we're going to see some benefit in the near term with some of those opportunities.

Our frac sand business continues to be strong, our steel business as I spoke to is quite strong in and out of Mexico and we're no dissimilar -- we're not dissimilar to the other rails, as you think about the forest products in the lumber business, it's hard for me to see a major rebound in that space in the near term, but I can tell you we're doing a lot on the self-help initiatives front in that space to prepare, so we're out working with these customers to create these long haul cycles with our center beams opening up new markets. We're deep into kind of, in my mind, creating a whole new mousetrap in the Texas and Dallas market around transloading again stuff that probably you won't see a lot of needle-moving in that space in the near term given the headwinds, but as housing construction area of bounces back, it's an area we're

going to be ready I think we're set up for success when that comes back.

And finally, maybe the other thing I'll point to is we went out and we bought 1,000 reefers, not that long ago, we announced the Americold development and I can tell you that progress in terms of getting a spade in the ground and getting that building built in Kansas City is well underway.

But that's not the start of that journey. That journey has started now and we're already starting to see a building of our reefer product on that 180/181 train pair and again beyond just the dry opportunity as we look to the coming months. I think you're going to see -- we're going to see a nice buildup of that opportunity of reefers down to Laredo and ultimately down into Mexico to service that market. So again, that's I think an opportunity if you think about this unique franchise that we're the only one doing it out there in the marketplace and if the Intermodal domestic market remained soft, there is another area where I think we can, we can potentially outpace it to some degree as we build this reefer product.

Lot there, but I hope that helped.

<Operator >: Your next question comes from Walter Spracklin of RBC Capital Markets. Your line is open.

<Q – Walter Spracklin >: Yeah. Thanks very much, operator. Good afternoon, everyone. So I wanted to focus in on bulk. John, you highlighted a few things that have happened in your key franchises within bulk that have created a lot of volatility here in particular the outage at Teck's mine and the other jet Canpotex's terminal. We've also seen a pretty significant crop this year that now the conditions look a little less favorable for next year.

So I'm trying to put it all together here to see what, what the layout for next year looks like. Given some of those significant outages. Is it possible that we see kind of high single digit, low double-digit increases in your coal and potash business just based on simply lapping those outages and on the flip side did you see the crop that's developing from where we are now, is this a risk of kind of high single-digit downside risk on the crop side, as we go in 2024? Big items here in your bulk franchise lots going on, just wanted to make sure we're modeling that correctly.

<A – John Brooks>: Yeah. Walter, it has been noisy and six months ago, if you would have said all that would transpire in our bulk franchise, I wouldn't have believed you at all. It's been frustrating, but nonetheless look as I said, I remain very bullish on the outlook for potash, we've actually got a very big plan for Q4. We've worked our tails off to diversify some of the ports, we're crossing our fingers that maybe Portland can get opened a little early and I think our belief and frankly Canpotex's belief around their position and our CPKC as being their number one transportation provider looks strong for 2024.

So I would expect I think double digit, if you looked at 2024 given what we've seen is definitely a reasonable expectation if you think about potash. On the coal side, we're going to see strong compares to close out the year. That Elkview mine issue that took place Q4 right at the end of Q3, Q4 last year will give us really good comps. And if you look to 2024, I don't know if you see as big as a jump as it relates in that space, but you know what we're optimistic that Teck's outlook or at least our discussions with Teck, so far looking at next year look to be positive in terms of growth, probably not as extensive as the described relative to potash.

And on the grain front, now look if this crop comes in closer to 65 million metric tons, what I -- let me think is kind of the middle point of what our customers are saying, you got to remember, we've got a much bigger carry-in this year, call it maybe post the 10 million metric tons. So I really don't see any impact as you think about the gut slot in Q4 and in that time period. We are going to run hard, we are going to run hard right probably into the spring and then we'll see. And if not, we'll see because I don't think there'll be grain out there, you have to move, but as we saw this year, this sort of the weather issues and the

dryness that did persist certainly put the farmer on the sideline certainly more than we expected to happen.

I am pleased with our year-over-year comparison, if you look at Canadian grain in Q2. But I actually I'll tell you, I thought it would be much bigger. And certainly, I think the Canadian farmer and the U.S. farmer to some extent got spooked and sat on the sidelines a little longer to see what will transpire in that space. So look, we're a grain-hauling railroad and now with the combination of the KCS network to create more markets as those develop, I certainly expect 2024 to continue to be a growth area for us in grain.

And then, maybe I'll just throw one more comment out there because you got me going on grain Walter. If we see some dryness in some crop further deterioration in our Southern territory, Southern Alberta Southwest Saskatchewan, it actually begins to present that opportunity for that corn haul into that area to feed those cattle markets and I can tell you just over the last three weeks, we've seen a pretty significant uptake on those markets connecting and some train volume beginning to build for that market. Again that's an area that we didn't have in the calculus a few weeks ago, but certainly could provide a little further upside to the U.S. part of our franchise, if that further develops. Thanks, Walter

<A – Mark Redd>: And John, if I could add just one key point is, from the operational side, it's allowed us to open up the engineering work windows a bit more west of Calgary. So when we do get into Q3 and Q4, we won't have maintenance gangs in the way so we can cycle this grain fold certainly potash to the West Coast.

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

<Q – Chris Wetherbee>: Hey. Thanks. Good afternoon. I was wondering if maybe we could kind of run through some of the assumptions around the mid-single-digit EPS growth for the year, particularly in the back half, and maybe get a sense of the the pace of RTM recovery in the back half and then maybe some thoughts around the operating ratio even possible.

<A – John Brooks>: When you think about the -- Chris the RTM piece, as we sit here today end of July, we remain slightly positive on a full year RTM basis. We got ourselves dug into a quite a hole here in July with the strike, but I think you're going to see and my expectation is, we're going to claw our way back as we move through the quarter and certainly, I expect improvement versus where we sit today and then there is upside as you think about Q4, so I think ultimately we see volume growth.

<A – Nadeem Velani >: And Chris, just in terms of -- When we think about sequential OR and earnings, given we see a stronger Q4, as we get some of the share wins and the synergies start getting up to their full run rate the first year the synergies, Q4 would see a much larger performance than Q3 for example, but sequentially, certainly we see an improvement in the OR sequentially from Q2, I think, Q4 is going to be the breakout quarter and I think it set us up well for 2024, but we have confidence in that mid-single digit EPS guide that was – we wouldn't have kept it there and reiterated it. I think we just have some catch up to do from the strike, but the volume is there from our bulk franchise and from the synergy perspective.

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

<Q – Brandon Oglenski>: Hey, good afternoon and thanks for taking my question. Nadeem, I guess maybe following up with that and maybe John can chime in too on like self-help contracts that you guys are talking about, but does that set you up for potentially a stronger 2024, just given some of the headwinds that you've had early in 2023, when look at that '24 to '28 outlook.

<A – Nadeem Velani>: Yes. Absolutely, I mean I think some of what John has described today and I

know he couldn't get into much detail from a confidentiality perspective and from a customer perspective, but we've had some wins since Investor Day that we -- that we weren't factoring in to be quite frank, so I feel very good about 2024. I feel very good about Q4 to be actually – to be honest. And like I said we're long people, we're kind of a peak on from a, if you think about the volume versus workforce. We have a peak of the delta in a non-productive way. That will start to even itself out in Q3 and into Q4 and it sets us up well to the operating leverage we talked about both into the back half of this year, but 2024 looks very strong.

And so if we see that path to recovery, this investment in hiring and training, I think it's going to pay dividends as well as the work we're doing on a capital front on the network as well as the work we're doing on the capital front on acquiring railcars and then we'll start seeing some benefits of the synergies on the expense side from that operating leverage and the work that's taking place to improve operations for yourself on the network. So I'm pretty excited, although we've seen obviously a very tough reporting quarter for us in all the rails. I think we have a pretty optimistic view on this year and into 2024.

<A – John Brooks>: Brandon, I might just add that, I mean you're right this macro environment and some of these broader challenges have been very frustrating, but the fact that we're planting the seeds right now, I think you're right when you say you begin to see some of the benefit of some of these projects. I just think about our efforts right now to get BCOs all set up for Lazaro Cardenas as you look to 2024. I think about our announcement on the auto compound down in Dallas that'll be up second quarter ish in 2024. If you think about the Toronto fuels terminal in Milton and Agincourt that Coby spoke to at Investor Day, that will all come up in 2024. The Dallas transload that support the lumber, that market down there are coming up in2024. All those things I think support what Nadeem spoke to and if we get a little bit of tailwind on the macro background, then I think again, we're off to the races.

<A – Keith Creel>: I can't help, but add a little bit more color to that, so as an operating CEO, I've been dreaming about it and having visions of the closed loop automotive network since my days of servicing automotive manufacturing facilities back in the late 90's. Going through the pain and suffering of not having enough empty car supply to keep your production lines going and being the guyor the gal that got yelled at because of that when you control the destination, leave scars that you don't ever forget and it created opportunities, so we set from the very beginning the vision, one of the visions of this network is extended reach networks when you connect the book-ends, the manufacturing in Mexico, manufacturing in Ontario and automotive compounds in between and create this closed loop network, it's powerful.

I can tell you that we've made some significant progress there to the point that we're close to ordering cars to serve this closed loop network and those that we partner with in this space that have taken the step of faith with us are going to have their own guaranteed car supply by turning those assets. And it's going to allow them to get more vehicles from their manufacturing facilities to the dealerships. They need to sell them and create our own empty car supply to feed the opposite end of the loop.

So that's not a dream anymore, that's coming to fruition, that's going to be showcasing itself in a very powerful way in 2024 and that is ahead of my expectations, So we're super, super excited about that development.

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

<Q – Scott Group>: Hey, thanks. Afternoon. So just a couple of things. The high-single digit growth in Q4, maybe just some color on which overall segments you think will do best and then Nadeem just wanted to clarify, are you saying that labor costs come down sequentially from here, or actually come

down year-over-year that be a pretty big sequential drop. And then, all the other rails have talked about big fuel headwinds in the back half of the year, are you any different or should we assume same kind of headwinds there. Thank you.

<A – John Brooks >: Scott. So as Keith spoke to, I think our auto sector, the frac sand sector, steel sector will see I fully, I'm going to push Mark and his team to see that materialize in our grain business. Our coal, we've got easy compares there and strong demand, so I see a lot of upside in coal. We had a decent Potash Q4 last year. If we hit the expectations of our partners, you'll see good growth in potash. So I call out those areas and then the Shell contract win is significant and that's going to start up in August for us and I think that'll only help not only insulate potentially show some good growth in our ECP business also.

<A – Nadeem Velani >: Scott, just on headcount, should be flat sequentially in terms of our workforce and so forth and we'll see what stock-based comp does in terms of what the stock price does, that's been a headwind for us. So my point is the productivity volumes will increase, headcount will stay relatively flat. So, and then year-over-year and in Q4, we see benefit on headcount year-over-year. So that will be meaningful efficiency for us. On the fuel side, I wouldn't say we're seeing a meaningful headwind on that front for us.

<Operator >: Your next question comes from Fadi Chamoun of BMO Capital Markets.

<Q – Fadi Chamoun>: Yes. Good afternoon and thanks for taking the question. Just one quick clarification first. So Nadeem, guidance is basically $3.95. You've earned a $1.73 year to date. So we're talking about a 28% sequential improvement in the second half versus the first half. I just want to make sure we're on the same page on that. But my question is maybe Mark or Keith, the speed is 18 miles per hour now CP did '22, '23 consistently in the past the same thing if we look at locomotive productivity in train lengths and all these metrics.

What does this record look like three, four years down the road? Is this a step-up that we're going to see consistently and what's going to drive it the revenue mix, as you take on that business that you highlighted in June or is it investments in the infrastructure that you need to do, look, I'm just trying to understand kind of what does this network look like once you are done doing some of these key kind of program that you highlighted in June.

<A – Keith Creel>: Certainly, for all the synergy volume that we're talking about bringing home, Fadi, we're going to need those investments. The way I kind of look at it right now, the CP standard is something that we're working to that's what this merger is all about. So as we integrate the operations, what we've seen, which we expected is on the former KCS network, train speed has improved, fluidity is improved. We put this operating plan in place and it's working.

On the Mexican network, at this point, that's what's diluting the overall improvement opportunity and that's exactly why Phase 2, we're focused on Mexico. So will we get to 23, I haven't done the math yet, and will it improven a material way? You should expect so and you'll see from that driving of our synergies. You'll see car hire savings because we're going to need fewer cars to do the same amount of business. Those assets are going to turn, you're going to see revenue improvements. There's not enough car supply to feed all the demand we have for automotive, as we speed the network up in Mexico. We're going to create our own car supply, we're going to get more loads. It's going to drive more revenues. So you get it on both sides on the bottom line and on the topline and you'll start to see some material impact to our results. But again, is it going to be 23, it's not going to be 15, maybe it's not 23, but it's certainly going to be somewhere between 17 and 18. I'll do the math later, I haven't at this point. I just know I have a very firm expectation that it will improve in a material way.

<A – Nadeem Velani >: And Fadi, yes, we're guiding to $3.95 core adjusted combined diluted EPS.

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

<Q – Konark Gupta>: Thanks operator, good afternoon. Just wanted to ask you, John, any color on the Shell contract contribution annualized and wondering if it is a result of merger synergies and as well as do you expect any more conversion of opportunity pipeline heading into '24. Thanks.

<A – John Brooks>: All right. Thanks for the question. I know it's probably coming from somebody and no I can't provide any further details. I will say this. Shell is a great partner of ours and they have been a number of years and one of those customers that identified that early on that this combination was going to be meaningful to them and it's just again the culmination of a lot of work between our teams to create the right package and an opportunity, and you're exactly right, leveraging the entire CPKC network.

So again, you'll see the results come through our ECP areas, we began to ramp that that business up once we get into August here.

<Operator >: Your next question comes from Brian Ossenbeck of JP Morgan.

<Q – Brian Ossenbeck>: Hey, thanks for taking the question. Just wanted to ask a couple of clarifications. Nadeem, can you just walk through what the FX exposure looks like right now. I see there is a line item on I think Slide 15 in terms of the book, so you can just maybe talk about hedging or how we should be thinking about modeling that. And then just on the Mexico, if you can elaborate -- you can in terms of what's actually the challenges there. How long you think it'll take and generally, what you're trying to work through to get that network a little bit more fluid.

<A – Nadeem Velani>: Hey, Brian. I'm just going to have Ashley and Chris follow up with you on the FX piece that's just pretty late in the call here, so they will give you the details and I think we have some posted as well on the website, but I'll pass it to--

<A – Keith Creel >: Brian, I think the main focus on Mexico was getting our inventory reduced, so that we can get the terminals more fluid. We're also taking a concerted focus on renewing our existing contracts. At this moment, until we can see benefits in the operation overall, there is no sense to distract ourselves trying to create any kind of potential conflict, integrating a more modernized agreement. That's not to say that we're not still interested and it's not very compelling. That's going to be a more Phase 2 as opposed to a Phase 1. Our employees need to want our deal, it's much better for the employees. They'll make a lot more money, they have a better quality of life but right now, the first order business, making sure that we optimize our network and fluidity with the existing contract we have, which received and focused on and then step 2 will be to discuss modernization when the time is correct.

<Operator >: And your next question comes from Jon Chappell of Evercore ISI. Your line is open.

<Q – Jon Chappell>: Thank you. Good afternoon. Just talking about the yield side a little bit, Nadeem, you already pointed out that you're not going to have the same fuel surcharge headwinds that most of the others will. You're re-pricing the portfolio both the core business and then the combined business. Is there a lot of kind of step-up opportunity in the second half of the year from a yield perspective to kind of help you get to that guide to the back half.

<A – John Brooks >: I think Jon certainly, the discipline that you've seen from I guess legacy CP and how we approach contracts in our pricing, the step function is how we sort of overlay that disciplined approach to the KCS network and some of those contracts. Is that quantum leaps? No, but I think that's a lot of singles and doubles. We're still seeing renewals I would say low high single-digit type range, which I'm quite positive about. I don't foresee that changing, as we move through the remainder of the year.

And there are some legacy contracts and opportunities out there that we're working with a variety of customers on around repricing for the value of our capacity and service and some of those could create a larger step function in some areas. But I don't -- I'm not going to call that a major driver in terms of, as you think about Q4, and actually that probably creates a bigger benefit for us as you look into the 2024 renewals.

<Operator >: Your next question comes from Benoit Poirier of Desjardins Capital Markets.

<Q – Benoit Poirier>: Yes. Good afternoon, everyone. Looking at intermodal, obviously, it's an important part of your growth story going forward. Was wondering if the current softening environment brings more fortunate fees and an increased number of discussions with customers and what would be your average length of all on the intermodal side for the combined entity. Would be curious to know whether the lower fuel expense and lower spot rates bring more competition from the truck right now. Thanks.

<A – John Brooks >: Yeah, Benoit, maybe a couple comments on that. I do believe, and I've said this before, these type of depressed markets typically the transportation buyer becomes more aggressive in terms of looking for options to lower their prices. That is a buying opportunity for my marketing and sales people. As I've said also, we're not sitting by and waiting for the phone to ring. We're out pounding the pavement looking to fill that train up there. We need to continue to add train length to that 180/181 pair and frankly, get the business going back on our legacy franchises across Canada.

Train length. I think about -- if you think about our legacy network in the 1400 to 1700-mile sort of wheelhouse between Toronto and in Calgary. I look at that very similar as you think about specifically Chicago, down to Laredo and down to the San Luis Potosi area or Monterey area, it's a very similar length. And I do believe historically, we're more insulated across Canada and I think so in this corridor to some extent against that shorter haul movement that might be more conducive to flip quickly back to truck. So I think that makes us a little more sticky and again, our focus on today is adding density of that corridor.

<A – Keith Creel>: Okay. With that said, it's been a long call. We can get to everyone. I apologize for that, but I would encourage if you can have any further points to address, touch base with IR they'll make themselves available for any follow-up. We look forward to sharing our third quarter results. In the meantime, we're going to continue to focus on integrating well, growing uniquely as we build out this network, very methodically and obviously step-function improvement when it comes to operational performance most specifically in Mexico.

With that said, have a safe day and we appreciate your time this afternoon and we'll talk soon.

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