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Transcript

Q2 2017 Earnings Call

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Corporate Participants:

Keith Creel, President & CEO Canadian Pacific

John Brooks, CMO Canadian Pacific

Nadeem Velani, CFO Canadian Pacific

Maeghan Albiston, AVP Investor Relations Canadian Pacific

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon. My name is Mike, and I will be your conference operator today. At this time, I would like to welcome everyone to Canadian Pacific Second Quarter 2017 Conference Call. The slides accompanying today's call are available at www.cpr.ca. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there'll be a question-and-answer session.
[Operator Instructions]

I would now like to introduce Maeghan Albiston, AVP, Investor Relations, to begin the conference.

Maeghan Albiston

AVP Investor Relations, Canadian Pacific

Thank you, Mike. 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, our President and Chief Executive Officer; John Brooks, our Chief Marketing Officer; and Nadeem Velani, our Chief Financial Officer.

The formal remarks today will be followed by Q&A. And in the interest of time, we'd ask that you limit your questions to two.

It is now my sincere pleasure to introduce Mr. Keith Creel.

Keith Creel

President & CEO, Canadian Pacific

Thanks, Maeghan. Welcome everyone this afternoon and obviously-- needless to say we're pretty proud of these results that we've just shared with the markets, with our shareholders. Extremely proud of what this team of 12,000 strong railroaders were able to produce for our shareholders, as well as our customers.

We took on increased volumes in the quarter, year-over-year, about 12% RTM growth in a very disciplined and cost effective manner. This is exactly precision railroading model at work -- growing the top-line by 13% at a lower incremental cost. And the results speak for themselves. If you look at these numbers that we shared, and we're happy to get in a little deeper into later in our Q&A, record operating ratio of 58.7% for this company, which represents about a 330-basis-point improvement over last year, in spite of about 2 points of headwinds, which we can delve into later, operating income of \$679 million, that's a 23% increase; adjusted EPS 35% up versus last year at \$2.77, all second quarter financial records for this company.

So, this precision railroading model is the gift that keeps on giving. It allows us to continue to grow at low incremental cost. On the operating perspective, Robert and his team, I'm equally as proud of him, Tony, Mark and our talented team of operators across this railway. Team effort. Terminal dwell, car miles per day, all all-time records, partially as a result of us starting to leverage and benefit from the trip plan improvement -- the system we put in last year -- as we start to railroad tight with that. Train weights were a second quarter record, a reflection of productivity improvements and the capital investments we've made along our network over the last several years. And even train speed, it was down about 3% year-over-year, but this is a strong outcome, given that a lot of the traffic volume that we experienced was bulk traffic, 12%, which obviously is not moving at the highest rate of speed versus some of the other traffic that we enjoy.

Let me speak a little bit about trip plans. June, an exceptional month, record trip plan performance. We averaged over 90% for the second month in a row, resulting in about just under 90% for the quarter. This is a testament to deliver both productivity and service at the same time for our customers. It's a measure of doing what we say we'll do, when we talk to our customers as far as moving their

freight from point A to point B.

The next phase: we're not done yet with trip plan implementation. We're working on a container level, which we'll be launching in the next two weeks for our Intermodal customers. This is going to enable us to further improve our service offering in the intermodal space, better track inventory at the ports and in our terminals and also sets the platform for the reservation systems, as we look to optimize and control cost inside our intermodal terminals as we go on through 2017.

Winning in the markets -- we said we were going to do it. This is proof that we're starting to do that. As you're going to hear from John shortly, we enjoyed and earned very strong volume growth during the quarter. We handled record grain into Vancouver, record grain into Thunder Bay, export coal into Vancouver and potash into Portland, and on top of that, we moved record frac sand volumes and welcomed new business onto our network -- which John will get into as well.

We're working with our customers to leverage our network strengths, powerful proof points here, strengths to the benefit of our business. We've got recent wins we'll talk about. Be happy to take questions on the new chemical business that we're going to enjoy into 2017 and 2018.

We're adding more dots on the map -- that seems to be the catchphrase lately -- extending our reach and allowing our customers access into new markets through new transloads, which we'll elaborate on, interline agreements, and service options. And I can tell you we're back in Detroit. Detroit's open for business again. Seven days a week service, best-in class service for our customers to give that as an option for their destination traffic.

So, with that said, I'm going to turn it over to John to add some color to the markets and the initiatives. And we'll let Nadeem talk more about the numbers, and then we'll wrap up with Q&A.

John Brooks

CMO, Canadian Pacific

All right. Thank you, Keith, and good afternoon, everyone. As already noted, total revenues were up, \$1.6 billion, 13% this quarter, a strong result that frankly surpassed mine, and I think the team's, expectation. RTMs were up 12% year-over-year. Foreign exchange and fuel surcharge both added about a 2% benefit each. Fuel surcharge revenues totaled \$59 million. That compared to about \$24 million last year. We continue to achieve inflation plus pricing in the 2.5% range. This was partially offset by negative mix as a result of our strong bulk shipments and weaker volumes in automotive.

I won't walk through all the commodities this afternoon, but I will highlight a few notables. Much of the strength this quarter came from our bulk franchises, as Keith spoke about. You recall last quarter, I said this to you that we expected significant strengthening in trends in grain, coal and potash -- and this delivered. As we said, it was a record quarter in all of those aspects. Coal and potash were both up well into the double-digits. We experienced all-time record for our export coal shipments. We had a record quarter for potash exports through our Portland terminal.

Strong export volumes will continue into Q3 and Q4, and we'll expect to see our first shipment out of our new K+S mine next month. Production levels will support about 500,000 tons of production to be shipped in the second half of the year. This will continue to ramp up as we get into 2018. CP continues to strengthen its dominant position in our potash market.

Our grain franchise performed exceptionally well -- RTM's up 21% this quarter. As expected, with the opening of Thunder Bay, our velocity really picked up. In fact, this quarter, we saw our Thunder Bay volumes increase by nearly 60%, resulting in our largest market share position at this port in the last five years. Likewise, Q2 volumes into Vancouver were, again, another record. Again, both a testament to our customers and our partnerships, and our operations excellence.

Looking ahead into the new crop year, we are seeing record demand for our Dedicated Train Program, despite some of the uncertainty that's growing in the marketplace related to dry conditions across Canada and the U.S. And let me note one other thing. Moving grain just isn't about building elevators on your network. At CP, moving grain is embedded in our DNA and it has been for 130-years-plus. Today, we're working with our customers on product innovation and industry-leading developments that will change the operating model for efficiency into the future. With over 40 network development projects in the works, including greenfields, route enhancements, terminal expansions, we're focused on shifting the model in grain from the standard 112 cars to a new model, where a

8,500-foot power-on train drives a new standard.

On the Intermodal side, another tremendous story in both Domestic and our International side. Domestic Intermodal was up 10% on a revenue basis, outpacing the economy and the reflection of our strong strategies in retail, wholesale and our cross-border. Cross-border volumes on key trains were up nearly 40% year-over-year. On the International side, we continue to leverage our strong partnerships, network strength and improved service off the West Coast to grow with our existing customers and I'm proud to say during this quarter, we fully offset the impacts of the contract that was let go last year.

Now, let me touch on three initiatives in Q2. First, we just opened the first of a series of CP transloads in Vancouver. This facility is co-located between our carload and Intermodal terminals, allowing us to utilize rail movements between terminals and ports. This will offer our customers a lower cost and a strategic advantage. The team recognized this opportunity and moved quickly. We went from conception to completion and moving traffic in less than 90 days.

Also, we successfully started a live lift operation in Portal, North Dakota border crossing. This service allows us to lift single containers off trains for inspection by customs as opposed to having the entire cars set out. This operation makes it easier and faster for our customers to do business in cross-border lanes, particularly where we already have the fastest service in the industry between Vancouver, the Twin Cities, Chicago and Chicago Beyond.

Further to support our growing Intermodal business, we are replacing and expanding our genset fleet in order to grow our position in the temperature-controlled market and we will have the most technologically-advanced equipment available for the marketplace.

And last, success breeds success. Momentum is gaining across all of our carload units. Recent wins are stacking up in our Chemical business. We are focused on executing the strategies in our transload areas to better support our merchandise franchise and we are retooling our competitive offerings for our automotive customers.

I am pleased with these initiatives. I'm pleased with the sense of urgency to convert opportunities and drive results. So again, it's been a great quarter, but the focus and determination is growing. There's still a lot of work to be done and we are laser-focused in building momentum.

With that, over to Nadeem.

Nadeem Velani

CFO, Canadian Pacific

Thanks, John, and good afternoon. With results like these, it's a pleasure to walk you through the highlights.

As Keith mentioned, the team delivered an outstanding performance this quarter. We set new Q2 records in operating income, operating ratio and adjusted diluted earnings per share. As already mentioned, revenues were 13% higher, driven by 12% RTM growth.

Disciplined cost control, combined with strong operating leverage, drove a 330 basis point reduction in the operating ratio. This top-line growth and margin improvement generated a 23% increase in operating income and a 35% increase in adjusted diluted earnings per share. For the quarter, the incremental margins were 75%. So this is certainly a case where we understand it's not the growth for growth's sake, but the importance of bringing it to the bottom line is not lost on this management team.

Let's take a closer look at a few items on the expense side. I'll be speaking to the results on an exchange-adjusted basis, which is shown on the far right column in the slide. Overall, operating expenses were up 5% on an exchange-adjusted basis. Comp and benefits expense was down 4% or \$12 million versus last year, largely as a result of higher pension income and operating efficiencies. This was partially offset by higher volumes and \$15 million of higher stock-based compensation. Our workforce is now approximately 12,200, up 2% compared to last year, despite a 12% RTM increase. Materials expense increased 23%, driven by higher locomotive and railcar maintenance. We expect materials to remain in the \$45 million to \$50 million range for the rest of 2017.

Purchased services increased by \$31 million or 13%. You'll recall last year, we recognized a \$17 million gain on sale of surplus freight cars, which accounts for the majority of the year-over-year increase. The remaining increases were mostly due to higher intermodal trucking and terminal handling costs, some higher property taxes and higher dismantling costs related to track programs. Casualty

costs were higher due to a few notable derailments this quarter. There were no material land sales this quarter, but we still expect about \$50 million of land sales for 2017. Note that purchased services has been running in the high \$270 million range, excluding land sales and expected to stay at this level through the balance of the year.

This quarter really does demonstrate the power of our operating model. Yes, there was pension benefit working in our favor, but we also overcame a 3 point headwind from stock-based comp, fuel prices and a \$70 million gain on equipment sales last year. When you put it all together, it's a pretty impressive result and a solid feat.

Taking a look at the next slide, free cash. We generated \$361 million of free cash year-to-date, which is more than twice as much as last year. Cash from operations is \$192 million higher due to a combination of higher pre-tax earnings and favorable impact from non-cash working capital balances. We've invested nearly \$600 million in capital projects year-to-date, roughly in line with last year. Proceeds from the sale of our properties is lower this year, mainly due to sale of Arbutus Corridor in 2016.

We remain committed in taking a balanced, thoughtful and opportunistic approach to capital allocation. We announced a new share buyback program this quarter for the repurchase of 4.4 million shares or approximately 3% of our float and we have been opportunistic repurchasing nearly 700,000 shares to date as part of this program. As we've seen on multiple contract to industry lows, we're not going to be shy to take advantage of the weakness in the market.

We also announced a 12.5% increase to our quarterly dividend. Our debt-to-EBITDA has improved to 2.7 times and we're on track to naturally de-lever to our long-term target of 2 times to 2.5 times. The rating agencies are also supportive. Moody's upgraded our outlook recently. Future debt issuances will only be required to refinance existing debt. As a result, we decided to unwind a portion of an interest rate hedge that we entered into a number of years ago.

This resulted in a \$13 million charge this quarter. The remaining portion of the hedge was rolled forward to align with debt maturities in 2018. It's worth noting that the stronger Canadian dollar helps our leverage metrics, as 80% of our debt was in U.S. dollars. Roughly every \$0.05 strengthening of the Canadian dollar improves our leverage by 0.05 turns.

The FX sensitivity on Q2 earnings worked out to about \$0.04 of EPS for every penny change in the FX rate. We expect FX sensitivity to be closer to \$0.05 of EPS going forward as volumes grow and the mix of business changes. We've attached some sensitivities in the appendix of today's presentation.

In summary, we are extremely proud of the record results that we produced this quarter in the first half of the year. As we look to the second half, we still remain cautiously optimistic on the volume outlook, but we remain very confident in our ability to deliver results for our customers and shareholders.

And with that, Keith, I'll hand it back over to you to wrap up the formal comments of the call.

Keith Creel

President & CEO, Canadian Pacific

Okay. Thanks, Nadeem, thanks, John, for the color. As you said, Nadeem, tremendous effort, tremendous result. This team is going to continue to work tirelessly as we go forward for the balance of second half of 2017.

And I can tell you we started out strong and I can anticipate likely the first question. So let me go ahead and address this. You're probably thinking why are we not updating our full year guidance, given such a strong quarter. I'm just going to be upfront, we're confident in our guidance and the team's ability to execute, but there is also some elements that we've got to realize are outside of our control at this point -- be it currency, which is changing on a daily basis, whether it's the size of the upcoming grain crop, there is some uncertainty there, and even the timing of land sales.

So I think overall, it's prudent to wait until there is more clarity on some of these key items before we revisit our outlook which we'll likely do, I would think, at the end of the third quarter. So with that, I'll open the line up for Q&A.

QUESTION & ANSWER

Operator: Your first question comes from Fadi Chamoun, BMO Capital Markets. Please go ahead.

<Q – Fadi Chamoun – BMO Capital Markets>: Thank you. Good afternoon, and congratulations on a strong quarter.

<A – Keith Creel>: Thank you, Fadi.

<Q – Fadi Chamoun – BMO Capital Markets>: So, I know you mentioned the guidance and some of the things you're seeing in terms of making you cautious. But ultimately, given the first half results, you only need 5% basically EPS growth in the back half of the year to get you to your guidance. My specific question is on grain. How tough can this be basically in the back half of the year? It looks like the wheat market in the U.S. could be difficult. I wonder if you can give us a little bit more detailed feedback from your end, what do you see happening in that market?

<A – Keith Creel>: Sure. We'll be happy to, and we can sense John's passion about grain, so I'm going to let him answer this one, Fadi.

<A – John Brooks>: Fadi, I think there is some concern we have certainly in the Western third of our U.S. franchise. I think maybe it's going to end up impacting some of the other carriers a little more than us, but certainly we're going to feel the effects of it in North Dakota. And I think there is, on top of that, a fair amount of uncertainty starting to build in Southern Alberta and Southern Saskatchewan. And I think it's going to be somewhat hit and miss across that territory. I think the upside is there is a quite a bit of a weak carry in Canada and we're going to likely see some maybe higher proteins coming in, in Canada, and that may present actually a market opportunity for us to push more wheat into the U.S. from our Canadian franchise. So I think it's a little early to tell. Certainly we could use some rain in some key areas in the next two weeks, but we'll see how this plays out.

<Q – Fadi Chamoun – BMO Capital Markets (Canada)>: Okay, thanks. My second question is about the head count. I mean, it was up – if I look at it sequentially 4.5% and carloads were up 6% sequentially quarter-over-quarter, so basically Q2 over Q1. How should we think about this head count going into the second half of the year, assuming typically you would – obviously volume are less stable versus what we saw in Q2?

<A – Keith Creel>: I think to really understand that, Fadi, you got to think about where we increased our business, it's hard to make a unit train bigger, so if you're adding a unit train business, that's going to take additional head count. But the numbers I look at, we were up about 2% as of now on our head count year-over-year, and to get to 12% RPM growth, I think that's a pretty good ratio. I don't know if that answers your question, but I don't expect much of that to change. We're going to continue to obviously improve productivity. And if something happens on the grain side, then obviously you could expect to see head count down, cost would be down. We're going to adjust for the market, which is what we're doing now even in July. We started a little bit soft versus where I thought we'd be. We've got employees that are furloughed. We've got cars that are down, we've got locomotives that are down. So rest assured, we're going to be taking the appropriate steps and pulling the right levers, rightsizing our assets against the business that's out there to control the bottom line.

<Q – Fadi Chamoun – BMO Capital Markets>: Okay. So some of these opportunities or investments you're making to increase the dots on the map, like do these require sort of upfront investments in head count or otherwise for you to get to where you want to go on this front?

<A – Keith Creel>: Yes. The investment in the Vancouver facility was minimal. Portage, we had that in our capital plan in Portal as far as improving the service over the interchange location going into the States. We've had that plan for a while. Extending the reach going into Detroit is down to capital outlay. We've got a terminal that's already there, we have just scaled back service over the last several years because it wasn't very quality service. We've now created an ability working with our rail partners to be able to drive service through the CP into that terminal again, which makes sense for our customers and makes sense for our cost. The only capital outlay I really see that we talked about would be the genset investment as we go forward into next year.

So we're going to invest appropriately to grow with this company. We have to invest to grow. We think the best call for cash, if we have a good return, is going to be internal, and that's exactly the strategy we're going to deploy. But we're not going to overspend or extend ourselves too soon and we'll show strong fiscal discipline as we do these investments.

<A – Nadeem Velani>: Fadi; I'll just add, recall after we invested in TransCare in the Southern Ontario region as part of our foray into transloads, and this is just some of the ongoing investments are what John and Keith referred to are just leveraging that investment and taking on additional facilities, taking on additional business and growth. And so, it's very minimal head count, we never look at it from a head count point of view, but we look at it from a return point of view in a way to support our growth agenda going forward.

<A – Keith Creel>: Yes and a little more color on Vancouver even, Fadi, as an example. The facility we just opened up is something we've owned, it's been an asset that we've had that was leased out, I guess in years past to another customer that's not there anymore. So, we took a look at it, we said wait a second, this is in our footprint, it's right in our backyard, it's literally next door to our Intermodal terminal, which is next door to a rail terminal, which is next to a highway. So it's a very compelling low cost value-add for our customers that we – in the past for whatever reason, having converted it, we get the opportunity of doing that's going to be something that's great for our customers, great for us at the same time and lower incremental cost to open it up.

<Q – Fadi Chamoun – BMO Capital Markets>: Great. Thank you guys.

<A – Keith Creel>: Thank you, Fadi.

Operator: Your next question comes from Chris Wetherbee, Citigroup. Please go ahead.

<Q – Chris Wetherbee – Citigroup>: Hey. Great. Thanks. Good afternoon, guys.

<A – Nadeem Velani>: Good afternoon, Chris.

<Q – Chris Wetherbee – Citigroup>: Yes. Wanted to just kind of pick up on some of the volume outlook if you guys think about the second half, you've given us some details on some of the line item specifics. But when you think about RTM growth and sort of the pace relative to the comps that you face in the back half, I mean, can you just give us some – maybe some parameters around that within the context of your guidance? How we should be thinking about RTM growth in the second half of the year?

<A – Keith Creel>: I'll let John add a little color, Chris, but I would say it's going to be positive, except for I don't know what's going to happen with the grain, assuming the bottom doesn't fall out there, which I'm [ph] praying to rain (24:44) myself, so it doesn't, I would say it's going to be positive, but I'll let John add a little more color.

<A – John Brooks>: Yes. No. I would just say the trends we've seen certainly in the bulk franchise, the grain, the coal, the potash, I'll throw frac sand into there, all continue to – I think the trends look fairly strong in the back half of the year. I think the crude continued to sort of be a little bit of a question mark, but we've seen a little bit of an increased activity on that front too. So as Keith said, I think we started off, we're positive so far here in July and we'll see that continue into Q3, Q4.

<Q – Chris Wetherbee – Citigroup>: Okay. Okay. That's helpful. And then within that outlook, when you think about competitive opportunities, is there anything on the horizon we should be focused on in terms of sort of contracts of size that you guys are thinking about and potentially can see coming back to the CP network, or is it more just sort of blocking and tackling look at each one of this individual markets and kind of maybe chipping away?

<A – John Brooks>: Well, there's certainly a lot of blocking and tackling that's being done on this front, but I think everyone knows. There's notable contracts out there in the Intermodal space, the automotive space and so far. And as I said, we're doing a lot of things to take our product, look at it differently, make the right investment, add the dots on the map. And when those contracts come available, we're going to be aggressive and go after them. But as Keith has said, we're not going to take on business for business's sake, it's got to be sustainable, profitable and then we'll go hard on the contract that we want to win with the partners that want to be partners with CP.

<A – Keith Creel>: Yes, Chris, if it's good for them and good for us, we're going to be there, we've got a great franchise, we've got a great footprint. The lanes that we operate in, we do well in. We can do well for our customers, we've got reliability, we've got respect now. We have conversations we could not have in the past. So we're going to be a competitive option for certain for our customers to help them win in the marketplace.

<Q – Chris Wetherbee – Citigroup>: Okay, it is helpful. I appreciate the time. Thank you.

<A – Keith Creel>: Thank you, Chris.

Operator: Your next question comes from Walter Spracklin, RBC Capital Markets. Please go ahead.

<Q – Walter Spracklin – RBC>: Thanks so much. Good afternoon, everyone.

<A – Keith Creel>: Hey Walter.

<Q – Walter Spracklin – RBC>: I think you wanted to focus on crude, I know you mentioned, it was John or Keith that is starting to come back and certainly there is a lot of projects online right now and I'm referring to the Canadian oil sands that pipe capacity just doesn't seem to be there. And so, one, I'd like to know if you could give us a little bit more color on what early signs you have been seeing and really what share of – if we were to take a broad look at the amount of capacity coming online, if it doesn't find a home, how much of that could you get? What would you say is your – from this point forward, your incremental market share opportunity into the Canadian oil sands for every barrel of oil that comes out?

<A – Keith Creel>: So I'm going to caution you, John, with your comments. You get burned, you learn. This is an area that we've been burned from in the past. And I don't mean to be crass about it, Walter, it's just hard -- until you see the whites of their eyes -- given our past experience.

I just don't want to couple this railroad to crude growth. We want to move it if it's there and we can make a buck and help our customers. And I do think you're seeing the dynamic right -- pipeline takeaway capacity is going to become an issue. But what I see, I see it more toward the end of the year and into 2018. And then what I also see is, from a future standpoint, how long does it last? I just don't know. With that said, John, feel free to...

<A – John Brooks>: Yes. No, the only thing I'd add Walter is, I'll give you this color. Certainly the activity level, in conversation with our customers, with our marketing and sales team has really amped up over the last 30 days. So, where there's smoke, there's fire. As Keith said, we've been burned in the past. So, I would say we're taking a pretty strategic approach with these customers. We want to make sure that they're going to do business and they're going to commit some business to us. We've got the resources and the capacity to handle it. From a market share perspective, I think it's hard to tell.

<A – Keith Creel>: I think the other thing to keep in mind, Walter, is we got a very unique facility in Hardisty, Saskatchewan. So when the crude moves out of the pipe to the railcar, we're in a very unique position to be able to benefit from that.

<Q – Walter Spracklin – RBC>: Okay. And Keith, you talked about a number of interesting innovative new initiatives here. You talked about reengaging the customer and I don't know if this is the best question for you or for John, but what is your sense, and I know you pointed to a few contract wins and you mentioned it in your prepared remarks. Can you talk about what areas that was in, where are you catching the customers' attention and what's your area of most opportunity if we are to see share shift, where will we likely see that and what product segment?

<A – Keith Creel>: Sure. Go ahead, John.

<A – John Brooks>: You know what, I think Walter, we continued to do a heck of a job of rebalancing some share and some opportunity in the intermodal front, as I mentioned. In particular, we've seen big gains in our cross-border business on the backs of what I consider to be some of the best service in those cross-border lanes. So I think that area if it continues to present the opportunities.

<Q – Walter Spracklin – RBC>: Sure, John. Was that Domestic Intermodal or International Intermodal you're referring to?

<A – John Brooks>: Domestic primarily, yes.

<Q – Walter Spracklin – RBC>: Okay. Okay.

<A – John Brooks>: And then, we're picking away, and as Keith mentioned, we've had some wins in the energy, chemical, plastic space. So, these are large strategic customers that the team has rolled up their sleeves. We've extensively worked on the value of our service compared to the competitive alternatives that we've targeted some lanes and we've been able to take some business back on those – in that area also.

<A – Keith Creel>: Yes. And Walter, that's – it's just more of the playbook. We help them save money. We help them own fewer assets. We help them leverage the strength of our franchise, the shorter routes where it makes sense, and that's what brings value to the bottom line. So we're partnering and it works. It's working for us. It's worked with Imperial, it's worked with Shell. You'll cross the board where our franchise serves them well. We've got a reliable product, we've got a very well run railway. We can convert that to marketplace and that's what value and service is.

<Q – Walter Spracklin – RBC>: That makes sense. Okay. Thanks very much for your time.

<A – Keith Creel>: Thank you, Walter.

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

<Q – Scott Group – Wolfe Research LLC>: Hey, thanks. Afternoon, guys.

<A – John Brooks>: Hey, Scott.

<A – Keith Creel>: Hi, there.

<Q – Scott Group – Wolfe Research LLC>: So, I'm struggling a little bit with the excitement you guys have for second quarter and you talk about momentum building and then kind of the commentary around the second half, when you talk about RTM is positive, it sounds like you're thinking low-single-digits relative to plus 12% in the second quarter. So, I guess I want to understand, is this just comps getting a lot tougher? Is something actually getting worse? Or is it just like extreme kind of conservatism here?

<A – Keith Creel>: Well, if you look back at 2016, Scott, second quarter was our absolute weakest quarter in the last seven or eight, I guess, if I think about it. That was sort of the trough when things started to turn around a little bit. The compare, to your point, year-over-year was weak. Certainly, we did well in the marketplace, but it was the weakest compare. As we go forward, the compares do get a little bit tougher, but at the same time, we've got some things that we lap and we lost last year.

And the other things we said, we just don't know what's going to happen yet with grain, we don't know what's going to happen necessarily with crude. We don't know the exchange rate -- we're trying to digest, if that does or doesn't affect our customers. So there is some conservatism in our outlook. We just need to make sure that we get this... I'd rather be right than wrong, I'd rather be prudent, I'd rather be a little bit more conservative than I have to be aggressive, in all honesty.

<Q – Scott Group – Wolfe Research LLC>: Okay. And then just on the grain point that you brought up a bunch, is the kind of the drought issues enough to offset last year's issues of the delay in the shipping of the harvest?

<A – John Brooks>: I do think the maturity of the crop, if you looked year-over-year, is a further advance. So, there may be some opportunity in terms of when these guys get in the field to push that certainly earlier in the new crop year, definitely.

<Q – Scott Group – Wolfe Research LLC>: Okay. And then just last question, I think last quarter, you guys had talked about 150 basis points of margin improvements for the full year. Is that still how you're thinking about the year or just currency changed that or anything like that?

<A – Nadeem Velani>: That's fair, Scott. I think just – I would just caution on the fuel surcharge and how that impacts the overall margins and currency to a much lesser extent. But apart from that, no, from a pure cost point of view, the railroad and the management team couldn't be more focused on making sure that all this growth and all the good things that Keith and John had talked about in terms of our approach with customers and adding the dots, it's going to for certain come at a very low incremental cost. I mean, if you look at our incremental margins and so forth as a proof point, but I would – I'm comfortable with that 150 basis points.

<Q – Scott Group – Wolfe Research LLC>: Okay. And then just – but you mentioned fuel like – if I'm thinking about this relative to last quarter, I'm guessing fuel is a help on margin relative to last quarter?

<A – Nadeem Velani>: It hurt less, yes.

<Q – Scott Group – Wolfe Research LLC>: Okay. All right. Thank you guys.

<A – Keith Creel>: Thank you, Scott.

<A – Nadeem Velani>: Thanks.

Operator: Your next question comes from Ken Hoexter with Merrill Lynch. Please go ahead.

<Q – Ken Hoexter – BofA Merrill Lynch>: Great. Good afternoon. Hey, Keith or Nadeem, in terms of – you’ve talked a lot about precision railroading, Keith, in your opening comments and still a lot of things to improve. Maybe you can talk a little bit about that, down at a 58% OR, do you still see more room to go? You’re still doing kind of things that Hunter used to do like the whiteboard sessions? Do you see room for improvement in productivity or is this the point you’re rounding out and you want to start looking at that top-line growth?

<A – Keith Creel>: Ken, I’m doing both, and you can’t take your eye off both. I mean, I’ve been doing this for 25 years and it’s worked the last 20 extremely well. Worked in my previous life, it’s working here. So you never stop trying to improve. There are always, what I call, noise in the system. Sometimes it requires investment, sometimes it’s all about policy. We think about this physical plan, I’m looking at it now for next year, part of our capital outlay. I’m looking at the terminals, what do we spend in the terminals, how can I be more efficient in the terminals, how can I help and give the tools to the operating guys to be able to get cars through the terminals and out of the terminals faster? We haven’t invested a lot of money there yet. So there is still a laundry list of opportunity from productivity and investments, productivity opportunities we haven’t converted, which is going to help control the bottom line. Sort of like it recreates itself every year. There is always going to be a top 10 list.

<Q – Ken Hoexter – BofA Merrill Lynch>: Okay. And then you talked a little bit about the outlook and some of the commodities that are slowing. Can you talk a little bit maybe more about Intermodal, where we’re seeing it down already quarter-to-date? You talked about what your thoughts are on grain, but it seems like a bunch of the commodities are starting off a little bit softer. Is there something endemic in this quarter in terms of the comps or – and maybe intermodal more specifically?

<A – Keith Creel>: I’ll let John provide color, but what I see, Ken is, we’ve got a couple of customers that are a little bit soft the first two weeks. We see the ships coming. There’s more ships out in the water on the way to Vancouver now and I think that laps itself, takes care of itself and the strength of the domestic product we have, we’ll finish the quarter ahead in the intermodal total.

<A – John Brooks>: Yeah, yeah. No, I would agree, Ken. Certainly, I think some of the West Coast supply chain struggles we’ve seen in the first couple weeks didn’t help because that slowed some of our cycles in that area. And then as the team, as Keith said, as the team looks at sort of what’s out on the water right now, on the international space, it looks like the volumes are bouncing back pretty good.

<Q – Ken Hoexter – BofA Merrill Lynch>: Okay. Because I mean, you’re close to almost down double, double-digit so far, right? Is that – am I correct? Or is there a contract loss in there? Or is that just, as you’re mentioning, just business starting the quarter slower?

<A – John Brooks>: Yes, there’s no contract loss there.

<Q – Ken Hoexter – BofA Merrill Lynch>: Okay, all right. Appreciate the thoughts. Thanks guys.

<A – Keith Creel>: Thanks Ken.

Operator: Your next question comes from Steve Hansen, Raymond James. Please go ahead.

<Q – Steve Hansen – Raymond James Ltd.>: Yes. Hey, guys. Just want to tap into John’s passion a little further here and his comments on grain. Was just hoping you could add maybe perhaps a little bit more color about your market position in grain relative to your competitor because there has been some commentary lately about market share take or gains. And just maybe more specifically, how you view your – few of the future share of the grain handles going forward?

<A – John Brooks>: Yes, as we’ve said last quarter, I fully expected Thunder Bay to give us a significant lift and it did exactly what we said. So I expect the end of this crop year to be somewhat traditional on how the market share plays out. As I look down the road, we are actively working with our customers to sort of change this model that I talked about and it is as much about developing and building out the network. So certainly we’re building greenfields, we’re expanding terminals and we’ll have access to all terminals in the West Coast. But it’s looking at additional routes to capitalize on the specific markets, how can we drive more into the milling markets, how can we leverage our U.S. franchise. I’m very bullish on the future of CP grain and I would add when you overlay that with a sort of new

best-in-class operating model, in which we're increasing train lengths, adding power on and improving that discipline to the export markets, I think it's going to be a powerful thing.

<Q – Steve Hansen – Raymond James Ltd.>: That's very helpful. And just maybe if I could is, could you provide an update on where you stand on the labor front? If I recall correctly, one of your key competitors ironed out a key settlement a few months back. I'm just wondering where you stand at this point.

<A – Keith Creel>: Sure. Couple things, I guess, TCRC Maintenance of Way Employees, which is about 2,000 of our employees, is about the same as the running trades in Canada; that's out for ratification now. It's a very progressive, I think a very good agreement that we came to terms with that's out – we'll probably find out on Friday, and what we're hearing, what we're seeing, we think that's going to be favorable news. The next step is the TCRC running-trades employees. And as I said, when I took this job over, we've not had the best relationship in all fairness.

A lot of significant change over the last couple of years, we had a strike in 2015, a strike in 2012. So we spent some time with the President. We spent some time with the Vice President. We spent a lot of time with the General Chairman, the leaders of the TCRC running trades, as well as my operating officers. To the point that I spent two days specifically last month in Ottawa with our general managers and with those same leaders on the TCRC side. And the relationship's improving. We're talking about some progressive things for our employees -- scheduling, which gives something to the employee, quality of life. It also gives something for our customers -- in predictability. We're talking about some schedules in the yards for our employees as well. So there are a lot of, what I would call, very beneficial benefits for our employees as well as our customers that we want to try to pilot with the TCRC.

So in order to do that, what I've done is extended an offer to extend the current agreement for 12 months to give us time to rebuild some trust between the parties, to give us time to get these pilots out into workplace, to make sure that they prove out and they do what we think they're going to do to improve service with the customer and to improve quality of life for the employee.

I'm hopeful, I'm cautious, so I'm optimistic that we'll get a favorable response, but we're going to sit down at least over the next two weeks to talk about that in more detail. So more to follow on that after we give the process a chance to follow itself.

<Q – Steve Hansen – Raymond James Ltd.>: Very helpful. Thanks guys. That's it from me.

<A – Keith Creel> Thank you, Steve.

Operator: Your next question comes from Ravi Shanker, Morgan Stanley. Please go ahead.

<Q – Ravi Shanker – Morgan Stanley & Co. LLC>: Thanks. Good afternoon, everyone. So, Keith, if I can just follow up on the earlier crude by rail comments. Given, I think as Walter said, what we're hearing from the oil sands and from the pipeline guys, what do you need to see from them to be convinced that the stuff is real? And kind of, are you prepped for this on a – from a capacity, volume and pricing side for later this year and next year if it does come?

<A – Keith Creel>: Let me say this, from an asset and a resource standpoint, that's not an issue for us at all. So if the business is there, we're going to be there for the customer to move the business. And we want to do that. But at the same time, as we go forward -- commitments, they help a lot, they help from a planning process. We have to -- if business grows exponentially down the line, you got to hire people, you got to have locomotives to move the crude tank cars in the first place. So before I'm going to invest our shareholders' money into those kind of decisions, the commitments have to be a part of it. But again, short-term, what we're seeing, as we get into the fourth quarter of this year, we get into next year, we've got locomotives, we've got people, I don't want our customers to be concerned, we'll be there for them. But long-term, before we asset up, we're going to have the commitments to be able to do that.

<Q – Ravi Shanker – Morgan Stanley & Co. LLC>: Got it. And not to kind of give away your strategy here, but knowing what do you guys feel about crude, are you going to be focusing on volume or price when we kind of get to that point?

<A – Keith Creel>: Volume or price, I'm not sure I understand your question.

<Q – Ravi Shanker – Morgan Stanley & Co. LLC>: Meaning, if there is certain quantity of oil that you have to move, will you be looking to maximize your price even if you kind of give up share and volumes to do that or happy to move as many barrels as it takes?

<A – John Brooks>: Yeah, I would say this: it will be all about sort of building a whole profitable, sustainable commitment. So we'll

look at each of those opportunities individually. Certainly, as maybe the volume grows on our railroad and we begin to earn some pricing power in that front, we're going to leverage it where we can, definitely.

<A – Keith Creel>: I think something to keep in mind too is the strength of this franchise. You got to have the end market, you got to have the connection with where the crude's coming from. So if the crude's coming out of Hardisty and it needs to go to Western U.S., if it needs to go to Texas, if it needs to go to Oklahoma, there's only really one railway that makes sense to get you there. So it all depends on where the destination is.

<Q – Ravi Shanker – Morgan Stanley & Co. LLC>: Got it. Understood. And just finally on pricing. I think you mentioned 2.5% for the quarter, I think that's a little bit of a sequential decline. Can you just talk about kind of what the factors were there and kind of what's the near-term trajectory for pricing?

<A – John Brooks>: As I think between Q1, Q2 hopefully, we've sort of hit the bottom on that front, but time will tell. I was hoping there would be a nice price story to tell as we sort of approach the back half of the year into Q4. My gut feel now is it's kind of turning more into a 2018 story than a 2017 story. I think in some of the chemical, the merchandise space, maybe we've gotten a little bit better of a story, but there's other commodities out there certainly that remain highly competitive, highly competitive against our competition and trucks.

<Q – Ravi Shanker – Morgan Stanley & Co. LLC>: But you're still confident of getting pricing over inflation?

<A – John Brooks> We will continue at that pace.

<Q – Ravi Shanker – Morgan Stanley & Co. LLC>: Okay. Thank you very much.

<A – Keith Creel>: Thank you.

Operator: Your next question comes from Thomas Wadewitz, UBS. Please go ahead.

<Q – Tom Wadewitz – UBS Securities LLC>: Good afternoon. And congratulations on the good results as well.

<A – Keith Creel>: Thanks, Tom.

<Q – Tom Wadewitz – UBS Securities LLC>: Yeah, wanted to get your thoughts on train length and whether there are particular opportunities that, I mean, I think it was roughly a year ago, you sort of talked about the train length opportunity in Canadian grain. Are there other segments of the business, where you say there's – even if it's unit train business where there would be an operating leverage opportunity on train length? And then also, I think you were asked a little bit about productivity earlier, but if you could maybe offer us thoughts on what the biggest productivity drivers are as well?

<A – Keith Creel>: Tom, when I think about train length opportunities, obviously, our manifest trains are not as large as we can make them. When I think about unit trains, we've got opportunity which we're executing on now, with the 8,500 feet and 134 cars. And the math to that is all about the locomotive. Maximum locomotive horsepower against the tonnage that effectively we're picking up 17, 18, 19 cars a train versus what we were running without adding an additional locomotive. I don't want to add another locomotive and not be able to get the additional tonnage to heat up the horsepower. So I'm not going to eat that operating expense.

We're still running 130-car potash trains down to Portland. We've got a multiyear planning process, investment process, both with us and our partners in UP to try to improve that. So that's an opportunity that's on the horizon for us, if we can get a spot there to land them properly, working with Canpotex. That's something we're looking at.

And then ethanol trains. We're running quite a bit of ethanol on our network coming out of the U.S. properties. Those trains give us an opportunity. They're 80 now. If we get them up to 100-plus, that's another opportunity for us on the train length side on this network. So, several of those are out there in the coming years. We'll be working with our customers to try to convert them from a productivity standpoint.

If I look at other opportunities of productivity, we haven't talked about it yet. If we get what we think we're going to get and the law comes out with the MRE with this [bifurcated] index, we're looking at potentially investing in our hopper fleet. In our hopper fleet, Tom, if you look at the age of it, if you look at the capacity of it, we've got a lot of 263 cars, not 286 cars. We've got an opportunity to

improve the quality of the fleet, to improve productivity and to give our customer frankly an easier car to do business with. So, there's a lot of those opportunities still left in this railway we have not converted. That will make us easier to do business with, and at the same time, make us more productive.

<Q – Tom Wadewitz – UBS Securities LLC>: Going back to the manifest train length, can you give me a sense of what the average – I'm sure it varies a lot across the network, but maybe the average manifest train length and what that could get to?

<A – Keith Creel>: We're probably around 7,000 feet now.

<Q – Tom Wadewitz – UBS Securities LLC>: Okay.

<A – Keith Creel>: I could see it getting to 8,000 feet, 8,500 feet with the tonnage and the locomotives. So, there is a pretty big opportunity there, Tom.

<Q – Tom Wadewitz – UBS Securities LLC>: Okay. So, I guess if we continue to see volume growth, volume growth is probably the key driver for margin expansion, if we look at the next couple of quarters. Is that fair?

<A – Nadeem Velani>: Yeah. No, that's fair. I think that – Tom, it's Nadeem. I think that certainly the operating leverage does provide, when you get to this point where you're in the mid to high-50s, operating leverage just provide a good platform for continued margin improvement.

<Q – Tom Wadewitz – UBS Securities LLC>: Right. Okay, great. Well, thank you for the time.

<A – Keith Creel>: Thanks, Tom.

Operator: Your next question comes from Turan Quettawala, Scotiabank. Please go ahead.

<Q – Turan Quettawala – Scotia Capital, Inc.>: Yes. Good afternoon. Thank you for taking my question and a good quarter, guys. I guess my first question, I was wondering if you could give any numbers with regard to the share that you've gained here. Is it possible to give us some kind of a volume – maybe a revenue number or something attached to that maybe on an annualized basis that we can think about?

<A – Keith Creel>: No, let me say this. We said this time and time and time again, there is enough space in this country and business opportunities for both of these railways to do well. If you look at the RTM growth, that's public information for both railways, it's double-digit. That's pretty powerful.

CN can do well. CP is going to do well. Our customers in Canada are doing well. So, it's about taking the service that you have and where it makes sense for our customers – I've said this before. If I can help them lower their operating – their total transportation spend, I can help them win in their marketplace, I'm going to grow my business, and that's what the recipe is.

So, those that are on us – and a lot of these customers are dual-served. Trucks off the highway, that's an opportunity for us as well, which John and the team are converting. But it's not necessarily going against – or going for each other's market share. It's what naturally should be served well by your railroad, and if you do that well, you're going to earn the opportunity to move them.

<A – John Brooks>: And I'd add to that and say, if you think about – and I mentioned our success in some of the cross-border business, that's largely not a share story. That is rolling up our sleeves with a number of our, I would say, sort of incumbent large customers that move a lot of product in those lanes, and it's conversion. It's conversion of their trucks. It's building their business, so they're growing and outpacing sort of others in the industry. And that's – we're putting them on our railroad in those lanes.

<Q – Turan Quettawala – Scotia Capital, Inc.>: Okay, fair enough. Thank you. I guess the next one, I was just wondering, obviously, your competitor talked a bit about technology there at their last investor event. Just wondering, a lot of the stuff that they were talking about, I'm pretty sure, it's sort of off-the-shelf products there. So, I was hoping you can give us some color as to where you are on this piece and if we should expect you to invest more on that front as well?

<A – Keith Creel>: You know what, Turan, if I'm going to invest in technology, you got to be able to convert it. This railway is not in a mode at this point that I'm looking at investing significantly in technology other than internal and the systems that we're using. We've

got some – our locomotives – again, at a different starting place, our locomotives are all AC locomotives. They're all equipped with DP technology. We've equipped the locomotives from a reliability standpoint, so that we get predictive information before they fail. So, we're doing some of those small things. But again, it's got to pay for itself and there's got to be a productivity gain for us to be investing in it at this point.

<A – John Brooks>: And I think the other thing I'd add on that is, with the implementation of trip plan and using that technology within Canadian Pacific and leveraging how we sell to our customers, it is in fact sort of an information leapfrog that we've taken into the business. And ultimately, how we then take that product and our trip plan and make it transparent to our customers is a way that we're going to continue to use that to try to grow.

<Q – Turan Quettawala – Scotia Capital, Inc. >: Okay, great. Thank you very much for your help.

<A – Nadeem Velani>: Thanks, Turan.

Operator: Your next question comes from Brandon Oglenski, Barclays. Please go ahead.

<Q – Brandon Oglenski – Barclays Capital, Inc. >: Hey. Good afternoon, guys, and thanks for getting me in here. And I apologize, because I'm going to keep asking the question around market share, because we all did just get indoctrinated at CN, a month ago, about how great they are. But maybe you guys could talk about what your plan more specifically at Vancouver is, some of the natural network efficiencies that you have maybe versus your competitor. And Keith, you guys have been talking about a growth outlook now for a number of years. I know we hit the industrial recession, so that definitely put it on pause. But isn't there just this natural growth threshold that the network can achieve that's not necessarily contingent on what CN is doing?

<A – Keith Creel>: The answer is yes, Brandon, and I'll let John provide a little color. But I'm going to caution him, and we're probably going to answer the same way. We have a very compelling service offering in this railway. So, again, it's about serving the market to be served and doing it well. I think about what I see over the next couple of years as opportunity, I think that in 2018 – John made a comment to this – we don't have a lot of our book that's out there that comes open for competition next year. So, we've got an opportunity to, again, convert this service offering to win with our customers.

We've got a chance to grow with our existing customers. We talk about the contract that we've lapped in business, this Yang Ming loss that we had last year. I appreciated Yang Ming's business, but I couldn't afford to move it at the price they were going to pay us this year, so we had to make a business decision. But at the same time, we've growing with our existing shipping lines. The challenge was then, okay, we had to make this decision, we got to go back and replace this revenue. Let's go out and find some low cost, sustainable, profitable revenue to replace it with. And that's exactly what John and the team has done.

<A – John Brooks>: I would add, as you think about Vancouver and their product offering out there, so transloading is not new to the industry. All rail carriers have been doing it for years. But frankly, at CP, it's about pulling it all together into a very defined strategy, and it all starts in Vancouver and then we'll roll this out in a series of major metropolitan cities that we serve across our network to expand our footprint. And with that, we're going to add customers, we're going to deepen partnerships.

As I think about Vancouver, it's as much as creating a better mousetrap, but it's a way to be able to capture the exports, so we can create an export market for our potential new customers that would be bringing imports into Vancouver. And then, I'd add this, and this goes exactly to what Keith was talking about in terms of the strength of our network. We've got a great opportunity to continue to work with our customers to drive more product in through Vancouver, because we can reach the Twin Cities, Chicago and Chicago Beyond markets faster than any other competitive alternative, and that's powerful. And frankly, it's now about getting that in front of our customers to convert that. And that's what the team is focused on.

<Q – Brandon Oglenski – Barclays Capital, Inc. >: I appreciate it, guys. I'll leave it at that.

<A – Keith Creel>: Thank you, Brandon.

<A – Nadeem Velani>: Thank you, Brandon.

Operator: Your next question comes from Allison Landry, Credit Suisse. Please go ahead.

<Q – Allison Landry – Credit Suisse>: Hi. Thanks for getting my question in. As we're thinking within the context of talking about volume growth and the operating leverage that comes with it as being a driver of margin improvement going forward, along with the different comments that you've made throughout the call about areas where you may invest, do you see a point where you'd need to take CapEx up meaningfully from 2017, and I guess in other words, does the growth become incrementally more expensive?

<A – Nadeem Velani>: Allison, I wouldn't say that the growth is more expensive. I would say that we have a number of, I'd say, unique opportunities ahead of us for CP to reinvest in the business and generate very strong returns. I would say that you might see us likely reinvest more internally to drive those returns that are going to support both the growth and productivity that we talked about.

So, we talked about potentially on the hopper cars, potentially reinvesting back into network infrastructure that's going to help offer a better service offering and network speed and turn assets and all that good stuff behind precision railroading. So, that's something that we're looking at very closely as we speak, kind of are future three to four years and how we can capitalize on these opportunities to drive our returns on our investments to the mid-teens and beyond. And so, yes, that might be something that's in our future.

<Q – Allison Landry – Credit Suisse>: Okay. Thanks, Nadeem. And I just had a quick clarification question. Keith, when we were talking about Intermodal, did you mean carloads are expected to be up or RTMs for Intermodal or both, I guess?

<A – Keith Creel>: Well, we look at everything from an RTM basis essentially...

<Q – Allison Landry – Credit Suisse>: Okay.

<A – Keith Creel>: Since we get paid that way. So, RTM specifically, Allison.

<Q – Allison Landry – Credit Suisse>: Okay, great. Thank you.

Operator: Your next question comes from David Vernon, Bernstein. Please go ahead.

<Q – David Vernon – Sanford C. Bernstein & Co. LLC>: Good afternoon and thanks for taking the question. Keith, the last time we spoke, we talked a little bit about the commercial turnaround that was underway. And I was wondering if you could kind of give us an update on where the company is in terms of retooling the sales and marketing effort and if there is anything – any further color you can give us around sort of commercial wins outside of cyclical growth in grain that gives you confidence that that turnaround is taking root?

<A – Keith Creel>: Well, the team – we've got the team in place. We've got John leading it. We added Jonathan Wahba. We've got Tommy Browning. We might make some additional enhancements to the team later this year if we get the right candidate, obviously, to help us be a little bit more focused in the marketplace that John's – John's got the proxy to be able to do that, if he finds the right person and we need him, he's going to bring him on. So, I feel really good about the team.

Some of the wins in the marketplace, John spoke to a little bit. You look at the business that we just won from Shell. Shell is on the strength of our network. It fits our franchise. Where it fits our franchise, it works well. We can turn their assets, we can help them save money, we can make money at the same time. They're a very valued partner and they're giving us an opportunity to earn their business. And that's why we're excited about it. That's another proof point this year, that's just a recent win that we've enjoyed. I don't know if John can add anything.

<A – John Brooks>: Just on the culture front, six months into this as leading this team, I'm extremely pleased. We had a fair amount of maybe turnover in the last year or so in our marketing and sales team. But frankly, that was driven largely around building accountability and changing the culture and really developing sort of a sales team that was prepared to be out pounding the pavement, doing what we need to do with our customers to convert the service. So, I feel good from that perspective.

<A – Keith Creel>: My vision – we got A-players in the operating side. My expectation for John is we're going to have A-players in the marketing side too. We're going to have the most talented railroaders, be they marketing, be they operating. It's a recipe for success.

<A – Nadeem Velani>: [And just because we don't] put the customer logos on a PowerPoint slide, it doesn't mean we're not winning market share.

<Q – David Vernon – Sanford C. Bernstein & Co. LLC>: Yeah. I guess as you think about the team where you wanted to be versus kind of where you were six months ago and where you are today, I'm just trying to get a sense for how much more runway for

improvement there is from a top-down perspective? Obviously, leading a culture change and that type of stuff, it does take time to get the people in the right place, to get the tools built. I'm just wondering how far away from optimal sales and marketing execution performance do you think you are. I know it's a hard question to answer, but any sort of color or commentary you can give us as far as kind of how much more room there is to go to get that team up and running would be great.

<A – John Brooks>: Look, I don't know if you ever get to – well, you don't get ever to 100%. But if – maybe I'd peg it at the 80% range. And so, we've got a little bit of work to do. And as Keith said, if I find the right person and we can add to the team and it's accretive and helps deliver results, we'll do that. If not, we'll continue to build on the strengths we have.

<Q – David Vernon – Sanford C. Bernstein & Co. LLC>: All right. Appreciate the color. Thanks, guys.

<A – John Brooks>: Yup.

<A – Nadeem Velani>: Thanks, Dave.

Operator: Your next question comes from Benoit Poirier, Desjardins. Please go ahead.

<A – Keith Creel>: Hey, Benoit.

<Q – Benoit Poirier – Desjardins Securities, Inc.>: Hey. Good morning and good afternoon, guys. Question for Nadeem. When we look at your debt situation, it's improved quarter-over-quarter, and obviously the strength of the Canadian dollar will also improve your debt metrics. So, I'm just wondering, where would you expect your debt-to-EBITDA to end toward the end of the year, is it still 2.5x and will it give you an opportunity to be a little bit more aggressive on the share buyback?

<A – Nadeem Velani>: So, say, if – Benoit, if currency stays kind of at current levels, Canadian dollars around \$1.26, as we speak, we could be probably close to the 2.5x, 2.55x, so right at our target level. It could be at the upper end of our range.

In terms of the buyback, I spoke to a little bit about the fact that we have a huge amount of internal opportunities. I would probably expect us to invest more internally than looking at upping the buyback. But again, we've been pretty vocal, it depends on the value and the stock price and so forth, and we're going to be opportunistic to take advantage of the pullback we've seen and the lower multiples. And so, we are very return-focused – as a whole. So, that's how we look at our capital allocation. We're approaching this in a very balanced perspective going forward.

<Q – Benoit Poirier – Desjardins Securities, Inc.>: Okay. And I'm just wondering, if the changes in the regulation among the CTA give you some incentives to invest a little bit more in the business, the CTA put out a new document, so wondering if it gives you some opportunity.

<A – Keith Creel>: Are you talking specifically to the MRE, Benoit?

<Q – Benoit Poirier – Desjardins Securities, Inc.>: I think so, Keith.

<A – Keith Creel>: I don't know that -- the thing that gives me hope is, if the law comes out from C-49, the Transportation Modernization Act, if we have a separate index, and CP can invest, and CP gets a benefit for our shareholders and for our customers, that I'm much more likely to recommend my board that we invest, than if not. I mean, that's the best way to say it. So, if it's there and once – whether the law gets out, you read it, if it's a lot of what we think it's going to say, then I think it's a fair expectation to see us move.

<Q – Benoit Poirier – Desjardins Securities, Inc.>: Okay. And last one, very quickly. Any implication from the wildfires so far in terms of logistics and the overall network?

<A – Keith Creel>: Yeah, I'd say, not necessarily for revenues, it's not material. The thing we're really seized and concerned with are employees that might be affected. We've spent a lot of time and energy shipping products into that area to help the folks, we donated through the Red Cross, we're matching employee donations to help the folks that are going through hardships in those areas. But as far as the business itself, no material impact. It's just the people concern that we're focused on.

<Q – Benoit Poirier – Desjardins Securities, Inc.>: Okay. Thanks again for the time.

<A – Nadeem Velani>: Thanks, Benoit.

Operator: Your next question comes from Brian Ossenbeck of JPMorgan. Please go ahead.

<Q – Brian Ossenbeck – JPMorgan Securities LLC>: Hey, guys, and thanks for taking my question. Appreciate it. So, I was looking at the breakdown of freight revenue per RTM ex-FX and fuel, you mentioned a little bit of comment, I hope you can expand on it. The pricing mix being negative 3% seemed a little bit of a large number if it was just attributable to auto, and if you're getting pricing at 2.5%. So, John, maybe you could help pull apart that a little bit more and give us a bit more detail as to what was driving the mixed headwind and how that might look in the second half of the year?

<A – John Brooks>: Yeah. So, I think, we – the second half of the year that continues, that gap closes. We definitely -- our autos was a -- that volumes that were down with high [cents per] RTM business that did have a pretty significant impact. You couple that with such a strong bulk performance in Q2, which is typically a lower [cents per] RTM. We moved a lot of potash over to down to Portland, again, very lower [cents per] RTM movement. And, I think, you have the sort of perfect storm between the two that created that impact. And, again, I think, that gap closes as we move forward.

<Q – Brian Ossenbeck – JPMorgan Securities LLC>: Okay. And just on the auto, you mentioned retooling the effort, I was hoping you could elaborate on that a little bit as well.

<A – John Brooks>: Yeah. So, it's not dissimilar to some of our efforts that we've described in the international space. We had to sort of pull that back, pull that product apart a little bit, and then figure out; number one, what customers really fit our network, what do they need from us, what do they want from us, how our lanes can be leveraged to better reach the markets we want to go to, how we look better at equipment supply to make sure we're ending up with equipment sort of in the regions of production. And then, also, we're looking at a number of areas on the information system side that I think will create a better product in terms of easing doing business with our auto customers, and then, the sooner we can roll that out as a total package, little bit of a combination of all those pieces, before we know we have a new auto product and we're pretty confident in going out and selling that in the marketplace.

<Q – Brian Ossenbeck – JPMorgan Securities LLC>: Okay. And just one quick clean-up for Nadeem. You mentioned the pension impact in the quarter. I was wondering, if you can give us an update on what that would be for the full-year, and if there's -- and if it is enough to call out, there's any way to think about how that might progress into 2018, and if not, what the moving pieces we should be cognizant of where? Thanks.

<A – Nadeem Velani>: Sure. So, the pension is about a \$23 million benefit each quarter and you can lock that down, so there's not going to be any variability to that. Going into 2018, we don't know until January 1, to be quite frank, so it's very much dependent on our return on assets, of course. Obviously interest rates have been rising and yields have been increasing even very dramatically, even recently. That's supportive to our pension income. About a 10 basis point change is about a \$12 million benefit to pension income. But, again, that number can change pretty dramatically between now and January 1. So, it's difficult to predict. I would assume, from where we are today, assume kind of a flattish year-over-year pension income is probably the best guidance that I can give you at this stage.

<Q – Brian Ossenbeck – JPMorgan Securities LLC>: Okay. Thanks. I'm sorry, can you repeat the sensitivity? It's a little hard to hear -- for every 10 basis point?

<A – Nadeem Velani>: For every 10 basis point, it's about \$12 million benefit to pension income, as interest rate increases by 10 basis points.

<Q – Brian Ossenbeck – JPMorgan Securities LLC>: Okay. All right. Thanks for your time.

<A – Nadeem Velani>: Thank you.

Operator: Your next question comes from Konark Gupta, Macquarie Capital Markets. Please go ahead.

<Q – Konark Gupta – Macquarie Capital Markets>: Thanks and good afternoon. Just wanted to ask a couple of questions. First on cost, wanted to dig into operating ratio as we look into second half, my math suggests that you were expecting a pretty significant overall improvement in second half based on what we have seen in first half. So, one, does that sound reasonable? And two, can you help us breakout the key elements, such as cost-out and operating leverage, which would be driving such kind of improvement? And I'm

looking outside of pension tailwinds basically. So, what are the key drivers there, and trying to understand why slower volume growth would not impact OR improvement in the second half?

<A – Nadeem Velani>: That's a lot of questions for the last one of the day, I would say. You didn't give us the lay-up for the end, and I'm sure some of our participants probably had some coffee, tea by now. I would say that, the assumption that, that we're going to have year-over-year improvement in the operating ratio is absolutely a valid assumption based on our guidance and the commentary we've given. We do expect the OR to improve annually, and given where we are so far, in the first six months, you can expect a continued improvement year-over-year -- 250 basis points is not a unrealistic number in the back half.

I would say that if you want to get into some of the details, certainly operating leverage and the power of volume growth, you've seen that this quarter, the ability to -- if you factor out some of the headwinds that we had, we probably improved the operating ratio by about 500 basis points this quarter on the back of 12% RTM growth, and certainly having operating leverage is a huge driver, given where we are in the mid- to high-50s operating ratio level.

It's difficult to say what the stock is going to do, from a stock-based comp and what kind of headwind that could or could not create going forward. Some of the productivity improvements that Keith talked about, some of the investments, allowing us to run longer train length and the ability to take on the incremental volumes at a lower incremental cost is really the biggest driver, I would say, not adding additional head count, taken on the additional volumes by running longer, not adding additional assets to the mix. Apart from that, I'll leave it with Maeghan and the Investor Relations teams to follow-up if there's some more pure modeling you want to go through.

<Q – Konark Gupta – Macquarie Capital Markets>: Okay. That's helpful. And just on the grain actually, what kind of outlook for Canada and the U.S. are you assuming in your full-year guidance for the next harvest in the context of maybe five-year averages or absolute numbers if you have? And then, what do you make out of the NAFTA objectives that were issued yesterday by the U.S., particularly around agriculture?

<A – Keith Creel>: Right. On the -- from the five-year average, that's the number you should use, that's what we are assuming. So, dramatically up or down, then obviously, you'll know where that takes you to, so that's in the model for the second half.

And as far as NAFTA, listen, here's what I'm at, I think President Trump is the negotiator. I know who he is. I think, he is trying to create leverage obviously. I think, at the end of the day, he's going to do what's right for this country and for -- when I say country, North America, for U.S., for Canada, and we're a very critical trading partners to the U.S., and at the end of the day, I think, we're going to be fine.

<Q – Konark Gupta – Macquarie Capital Markets>: Okay. Thanks for the clarity. Thank you.

<A – Keith Creel>: Thank you.

<A – Nadeem Velani>: Thanks.

Operator: Our last question at this time comes from Justin Long, Stephens. Please go ahead.

<Q – Justin Long – Stephens, Inc.>: Thanks. Good afternoon, and appreciate you squeezing me in. Wanted to ask first about the new chemicals business you mentioned. Is there any additional color you can provide on the contribution from that new contract and some clarity on when it starts to ramp?

<A – Keith Creel>: The business comes soon, and the only color I give you is yellow and it's a great company. So, I don't know, John, if you want to add anything else to that?

<A – John Brooks>: No. I really don't want to add anything to that. You know what, it's in key lanes, it's a partner that we certainly are going to grow with, or deepen this partnership with, and as Keith said, it will be starting up pretty soon here.

<A – Nadeem Velani>: I would just add, Justin, that, when we look at taking on additional business, we take it on, we look at it from, collectively, that it's truly incremental and accretive to the bottom-line. We look at this as a, making sure that's supporting the returns that we expect and, again, it supports the sustainable profitable model that we were raised by.

<Q – Justin Long – Stephens, Inc.>: Okay. Got it. And then, maybe just another quick one, Keith, to follow-up on the comment you

made about potentially replacing the hopper fleet. Could you put some more context around that comment in terms of the cars that you would potentially look to replace?

<A – Keith Creel>: It would be the old 263s, the old government hoppers that are deployed in our fleet now. We've got about, rough numbers, that are coming to end of their useful life, around 6,000 cars that we're looking at. And, obviously, we wouldn't replace 6,000 -- we would not need to, because we're going to get more uptake with the 286 car versus the 263. But order of magnitude, that's what we're focused on.

<Q – Justin Long – Stephens, Inc.>: Okay, great. That's helpful. Appreciate the time.

<A – Keith Creel>: Okay. Thank you.

<A – Nadeem Velani>: Thank you, Justin.

Keith Creel

President & CEO, Canadian Pacific

Now, with that said, I don't want to get into too much caller fatigue here. I think it's an outstanding quarter, outstanding effort, outstanding result for our customers, for our shareholders, for our employees-- which are the three constituents we're focused on. This company is moving forward, we're moving well. We're excited about the 150th anniversary of Canada, this year we're celebrating, we're kicking off the CP 150 next week in Vancouver with 13 stops across the country, landing in Ottawa in late August to celebrate the CP Ladies Canadian Open in our nation's capital.

With that said, I'll wrap it up and I look forward to sharing our results again at the end of the third quarter. Thank you.