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Transcript

Q1 2018 Earnings Call

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Corporate Participants:

Keith Creel, President & CEO Canadian Pacific
Nadeem Velani, EVP & CFO Canadian Pacific
John Brooks, SVP & CMO Canadian Pacific
Maeghan Albiston, AVP Investor Relations Canadian Pacific

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon. My name is Julianne, and I will be your conference operator today. At this time, I would like to welcome everyone to the Canadian Pacific's First Quarter 2018 Conference Call. The slides accompanying today's call are available at www.cpr.ca. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer situation. [Operator Instructions]

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

Maeghan Albiston

AVP Investor Relations

Thank you. 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; Nadeem Velani, Executive Vice President and Chief Financial Officer; and John Brooks, Senior Vice President and Chief Marketing Officer. The formal remarks today will be followed by Q&A. In the interest of time, we would appreciate if you could limit your questions to two.

It's now my pleasure to introduce Mr. Keith Creel.

Keith Creel

President & CEO

Thanks, Maeghan. Welcome to the call this afternoon. Certainly, the results we've just issued represent a very challenging quarter on the operating side with extreme cold temperatures and record snowfall in our operation, which obviously created some challenges, which were compounded by additional supply chain constraints and an increase in unexpected overall demand in certain territories on the network. That said, regardless, I'm very proud of the commitment shown by the men and women at CP who worked tirelessly through the quarter to enable us to move 6% more volume than last year, which drove a 4% increase in revenues and 8% earnings growth in the quarter.

Operationally, in spite of the weather challenges, our operational efficiencies continue, and we were able to deliver improvements in both train weights and train lengths as well as a 3% improvement in fuel efficiency. I'm encouraged by momentum the team's built up through March and early April. The network continues to grow stronger and more fluid every day. And as John will detail shortly, our demand environment remains very robust, that several of our lines of business are moving at or near record volumes and we continue to welcome new customers like ONE to our network just this month.

And in response, as we planned, we're adding resources. We're in the process of hiring and training more than 700 new employees and reintegrating 100 locomotives into service to handle this increased demand. While the volume outlook is strong, I'd be remiss not to stress that we will continue to take a disciplined approach to the marketplace to ensure we protect the reliability and the fluidity of our network for our existing customers. We're not going to change growth for growth's sake, as I said before. Rather, we're looking at growing in a sustainable and profitable way over the next several years.

So, before turning over to John, I think it's only appropriate I take a little bit more short-term focus, near term focus, and provide comment on the current plat of uncertainty we have in the marketplace relative to the labor front. As is publicly been announced, we've been communicating with our customers and all key stakeholders, we're faced with potential work stoppage effective 2359 Friday night to 0001 Saturday morning with the TCRC running trades employees as well as the IBEW, who are the employees and family members that maintain our signal system on the railway.

We remain committed to negotiating a fair and balanced deal. I'm staying in very close contact with negotiations. I've got a very deep knowledge of the issues that are at hand and we're focused to negotiating a fair deal, but fair is a key word. It's got to be balanced, one that protects CP's long-term interest. Long-term is a key word as well. We cannot make, and will not make, a bad short-term deal that jeopardizes our ability to protect the long-term interest and strength of this company that benefit our customers, our employees, and the Canadian economy.

So, with that said, I'll hand it over to John to bring some color on the markets and after that, we'll let Nadeem elaborate on the numbers.

John Brooks

SVP & Chief Marketing Officer

All right. Thank you, Keith, and good afternoon, everyone. Total revenues were up 4% this quarter, as Keith mentioned, $1.7 billion. RTMs were up 6% year-over-year. Foreign exchange was a 2% headwind, offset by a 2% benefit on our fuel surcharge. As expected, positive pricing was offset by negative mix as a result of very strong potash shipments, crude volumes, combined with weaker automotive and other commodity mix shifts. Overall contract renewals for the quarter continue to move in the right direction, landing around 3%. And although it's early into Q2, we've seen some further upside so far in April.

Taking a closer look at the first quarter revenue performance on the next slide, I'll speak to results on a currency-adjusted basis. The bulk commodities were mixed this quarter. On the grain side, Canadian grain volumes were down 4% versus record levels last year, and as Keith mentioned, tough operating conditions in January and February. Despite these challenges, though, crop year-to-date, CP has moved 2% more grain in the 2016-2017 crop year and we expect strong, steady demand as we move into Q2. U.S. grain volumes were a different story and they were down substantially at 19% as pressures continue to mount against our exports, given their strong global supply.

Coal revenues grew by 3%. And finally, potash revenues were up 18%, driven by strong export and domestic demand. CP delivered record levels of exports in Q1 through a combination of solid Canpotex volumes in Vancouver and Portland and a continued ramp-up of K+S. On the domestic side, we are working closely with Mosaic as we move into what is expected to be a condensed spring season. Overall, we expect potash to remain strong through the remainder of the year. On the merchandise and energy portfolio, this continued to perform exceptionally well, growing 11%.

Our refined product, LPG, chemicals, and plastics, all contributed to growth, as did frac sand and crude. Frac sand volumes continued to run at a rate of about 20,000 carloads per quarter. And in March, we signed a new agreement with Smart Sand, who recently acquired the rights for the Van Hook crude terminal in North Dakota. Smart Sand will invest in the terminal to enable unit train frac sand unloading. In addition to $20 million in incremental revenues, this will provide a single line-haul service from Wisconsin to the Bakken, as longer train lengths generating better margins. Additionally, the team seeks further upside with our sand franchise, by expanding CP's destination reach not only into the Bakken but also into the Marcellus and Alberta drilling regions.

And with spreads widening significantly, of course, demand for crude by rail continues to be strong. Crude volumes came in at approximately 17,000 carloads during the quarter, with strong demand across many of CP's commodities.

We remain very committed to growing responsibly with our crude-by-rail shippers to make sure that we can provide reliable service to all of our shippers and commodities. I can tell you we remain in active discussions with a variety of crude-by-rail shippers and we continue to take a very disciplined approach on any new agreements.

And finally, the intermodal portfolio, which continues to gain momentum with 14% higher revenue this quarter. We saw another outstanding quarter in domestic intermodal, with revenues up 15%. We hit record levels with strengths in our wholesale, our food product, the use of our new temperature-controlled equipment, and of course, on our flagship service from Toronto into Western Canada. On the international side, revenues were also up double-digits. And with the recent addition, as Keith mentioned, the Ocean Network Express contract, we expect double-digit growth trend to continue throughout the year.

So, as Keith mentioned, overall, the demand environment is very healthy. I'm pleased, as I stated, through 2017 and so far, what we're seeing in 2018 on the pricing environment. But I can tell you, Q1 wasn't without its challenges, but I'm certainly encouraged by the momentum we picked up in March and now into April. As Keith mentioned, RTMs in March were at their highest level since 2015, and I can tell you the sales and marketing team is executing with precision on our strategic growth initiatives.

Before I wrap up, I also want to note and make reference to a new member to the sales and marketing team. Joan Hardy has joined CP as our Vice President in charge of our grain and fertilizer portfolio. Joan brings a unique background to this position, will be a great asset for CP, 20 years of railroad experience and then, the last decade as a fertilizer and grain shipper at Richardson International. So, I want to welcome Joan and I look forward to introducing her, Jonathan, and Coby at our upcoming Investor Day.

And with that, I'll pass it to Nadeem.

Nadeem Velani

EVP & Chief Financial Officer

Thanks, John. It's a tough act to follow. Good afternoon, everyone. Before we review the results, just a reminder that we're now reporting under the new accounting standards for pensions. Last year's first quarter adjusted operating ratio was originally reported at 61.3%. Restated for the new pension accounting standard, the 2017 OR is 430 basis points higher at 65.6%. Also, a reminder, this accounting change does not impact net income.

As Keith and John noted, this quarter we faced substantial challenges from extreme temperatures and record snowfall. The additional costs and impact on efficiency resulted in a 1-point increase in the operating ratio. It also impacted our capacity, which likely shifted some revenues from Q1 into Q2. Rising fuel prices increased the OR by 1 point, but did not materially affect income.

Finally, we faced OR headwinds from FX, higher pension costs, higher depreciation, and some increased training costs. These headwinds aside, we continue to drive productivity improvements and grow volumes at strong incremental margins. As a result of these factors, the operating ratio increased by 190 basis points to 67.5%.

A few specifics on expenses this quarter. Comp and benefits expense was up 27% or $79 million versus last year. The primary driver of the increase is last year's management transition recovery of $51 million. Excluding this, comp and benefits increased 8%, or $28 million. The remaining increase was mainly driven by labor inflation, higher volumes, winter costs, as I mentioned earlier, and pension current service costs. These increases were partially offset by productivity improvements from increased train length.

Fuel expense was up 31%, primarily as a result of higher fuel prices and increased volumes. It was partially offset by fuel efficiency of 3%, as Keith mentioned, which was driven by improved train utilization from higher volumes. Materials expenses is $55 million, an increase of $7 million, or 15%, driven by higher wheel expenses and non-locomotive fuel costs. Purchase services was $275 million, up slightly from last year. Higher snow removal costs and higher intermodal pickup and delivery costs were mostly offset by reduced locomotive repairs. There were no material land sales this quarter.

And just an update on that, we did guide to $50 million of land sales, which includes one large sale, in particular. We have now reached an agreement on that sale, which is currently before the STB for approval. We currently expect the sale to close in the second half of the year. Excluding FX, operating income improved by 1%. Adjusted net income improved 6%, and adjusted EPS grew 8%.

Taking a look at the free cash flow on the next slide. We continue to generate strong free cash flow. Cash from ops increased by 26% and free cash flow nearly doubled, driven by higher adjusted income. We remain committed to being responsible stewards of capital and continue to bolster our balance sheet. As a reminder, we have approximately $575 million of high coupon debt maturing this quarter, which we expect to refinance at lower rates. We plan to refinance $500 million, which will generate interest expense savings of more than $20 million Canadian annually. While we plan to retire a small amount of debt, we continue to de-lever primarily through earnings growth. We expect to reach our targeted range of 2x to 2.5x net debt to adjusted EBITDA by year end, probably sooner.

To date, we've completed 85% of our current share repurchase program, buying back shares at an average cost of $213 per share. We plan to complete the program in the next two weeks. As I mentioned on our last earnings call, you should expect us to make decisions on future share re-purchases in Q4. This allows us to align free cash generation with our shareholder cash returns.

As you've heard today, we are extremely encouraged by the demand environment and the momentum we've built through March and April. And although this labor impact may be a near-term headwind, we are extremely excited with the opportunities we see in the back half of 2018 and beyond. There is no question our plan's working.

And with that, I'll hand it back over to Keith to wrap up.

Keith Creel

President & CEO

Hey, thank you for comments, John and Nadeem. I'll only say this and save more time for Q&A. Certainly in a quarter where we faced record demand, we've worked hard to put ourselves in the position to be a reliable service provider, both for our customers and to provide low cost, high-volume service to the marketplace, which I think bodes well for us in the quarter. As we go forward, these results are going to demonstrate to you and certainly to our team, in spite of record demand, we're going to maintain our precision scheduled railroad focus, which is fueled by controlled sustainable growth as we grow through 2018.

So, with that said, we'll open up the line for questions.

QUESTION & ANSWER

Operator: Thank you. [Operator Instructions] Your first question comes from Chris Wetherbee from Citigroup. Your line is open.

<Q – Chris Wetherbee – Citigroup>: Okay. Great. Thanks. Good afternoon, guys. I wanted to touch probably on the guidance first and just sort of understand a little bit of the cadence that you move forward. Can you help us a little bit with the walk of OR if you put the pension aside? I think you talked about the potential for maybe a couple of hundred basis points of improvement. Can you give us a sense maybe how we get there after a more challenging first quarter and that ramp as we go through the rest of the year? That'd be helpful.

<A – Keith Creel – Canadian Pacific>: Well, control expenses and additional revenue is obviously market strength are the ways to get there. When I said 100 basis points to 200 basis points, I qualify that. Said there's a lot of uncertainty given what Nadeem shared with you. Certainly, did not expect the headwind that we had in the first quarter with the weather. But in spite of that we still see an opportunity, line of sight, to improved operating ratio performance on a year-over-year basis. So still a lot of work left to be accomplished, but with our focus on our disciplined operating approach with the business opportunities that we have out there, when we lay that over our network, as long as we execute and do our jobs, outside of some full on strike that I can't predict, and I certainly hope we avoid, I certainly still see a line of sight to improved operating ratio performance year-over-year.

<A – Nadeem Velani – Canadian Pacific>: Yeah, Chris, I would just add that the OR, although 190 basis points worse year-over-year, to Keith's point and my earlier point about winter, fuel costs as well, and currency, we don't see those as being a significant headwind certainly going forward. So you should expect us to continue what you're used to with us improving our OR year-over-year. And so, I wouldn't be concerned about that.

<Q – Chris Wetherbee – Citigroup>: Okay. That's really helpful. And then can you talk a little bit about sort of the revenue growth side. It would seem based on some of the wins that you guys have talked about whether they be on the intermodal side – I think there's some sand opportunities and probably will be incremental crude opportunities as you move through the rest of the year. How does that sort of play out particularly in the context of how good March was relative to the first couple of months of the year? Maybe can you help us contextualize, is there potential upside from a revenue perspective and sort of when some of this business might come onto the network?

<A – Keith Creel – Canadian Pacific>: Yeah, I'll let John provide a little color, but I'll give you a high-level, Chris. We're planning this additional business. We got to make sure we've got resources up against it. So, we're in the process now of overhauling locomotives. We're bringing those locomotives online. That 100 that I mentioned is through stepped level. It's certainly not all at one time. So, when those locomotives come online, you'll see that our head count up a little bit. So, anticipation for growth, we're obviously – we've got some employees that are moving the business today, and we've got some employee we're training to move the business that will come to us late third quarter, early fourth quarter. That's when I would see the peak.

Other than that, I'll let John provide any color he might want to add.

<A – John Brooks – Canadian Pacific>: Yeah, no, I would agree with those comments. Maybe additionally, certainly, the demand environment as I look down just about all the commodities, again, maybe with the exception of the U.S. grain and frankly there might be some upside there later in the year too, I think there is opportunity. But as Keith said and as my team is diligently doing, we are connected at the hip with the planning team and the operating team and how we want to bring this growth on. So, it's been very diligent. I think the opportunities are out there. It's now around how this team picks and chooses the right ones and executes in the marketplace and then brings that on. And I do believe that begins to continue gathering some steam as we get into the third and fourth quarter here.

<A – Keith Creel – Canadian Pacific>: Yeah, I would only add to emphasize there's no shortage of demand. We've just got to make sure that we take a disciplined approach. The last thing we need to do that's going to serve conserve our long-term interest is to over-commit to a customer or a series of customers, jeopardize existing partnerships and/or creating ill will or bad experience that would prevent us from going in the future. So, we're going to be very disciplined as we approach this. Is there upside? Yes. But we're going to make sure before we pursue any upside that obviously we're in a position to protect existing business as well as protect that upside, and do it in a manner that drives confidence and reliability and loyalty to our service offering.

<Q – Chris Wetherbee – Citigroup>: Great. Thanks for the time. I appreciate it.

<A – Keith Creel – Canadian Pacific>: Thank you, Chris.

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

<Q – Walter Spracklin – RBC Capital Markets>: Thanks very much. Good afternoon, everyone. I want to touch a little bit more on the energy side. Could you give us update in terms of what you're running at in carloads kind of on a run rate basis in Q1? And some indication as well as how that compares to this type of business that you were running in 2014, which had a little bit more of the Bakkan in there. So, could you touch on a little bit of length of haul, the pricing structure that you kind of look at when you look at this type of crude business? And your prospect I guess for any new more substantial recurring longer-term contracts with any of the producers would be helpful.

<A – John Brooks – Canadian Pacific>: So, I guess in terms of the run rate, we saw about 17,000 carloads in the crude space this quarter. And actually, that was pretty similar to what we saw in the fourth quarter. For the near term, I expect that to be pretty consistent. But that being said, certainly, we are in discussions with, I would say, initially, a variety of our existing customers and terminals. And to Keith's point, looking towards that opportunity later in the year. So, could that grow this run rate, grow by, I don't know let's say, 15 to 30 trains a month as we move towards the back half of the year? Yeah, it certainly could. But as we've been diligent in saying, those fields aren't done. And those fields got to be supportive of the resources, the equipment, the people, the locomotives to bring that on. Now, I can tell you the positive piece is the shippers we're working with and the opportunities out there, they're definitely active in discussions. So, I do think there's a realistic opportunity that we get some of those done.

<Q – Walter Spracklin – RBC Capital Markets>: That's fantastic. And John on the issue of pricing, I think you mentioned 3%. I mean that's a good steady pricing. And the interesting part is that you're bringing on higher volume with higher pricing. And can you talk a bit about the moving parts of pricing. What's helping? What's hindering? Touching particularly on intermodal and if you're seeing some truck capacity, if that's helping your repricing. And then with some of the contract wins that you've been getting, as a result of disruption elsewhere in the networks, is that allowing you to bring that volume on with a higher price as well?

<A – John Brooks – Canadian Pacific>: Yeah. So, you're right. There is quite a few moving parts in the price piece here this quarter. And frankly, driven – potash has been so strong certainly the year-over-year change in crude has been pretty robust. We didn't see a very strong January/February in the automotive sector, which also hurt our mix. And you pile in actually pretty sluggish wheat volumes and some other commodity areas and it really created a pretty significant drag on the mix front.

Now, that being said, I am very encouraged around where I'm seeing pricing going. And I can tell you, I just did a snapshot of April so far on our renewals and it's about 3.8% on the renewals here over the last few weeks. But, again, there's a whole lot of quarter yet to play out and certainly moving in the right direction. I would also say, generally, as we look at all new business opportunities, we're definitely – that capacity that we have is precious. So, where we can take an opportunity to move that initial bar, that base rate up where it makes sense, the market's supportive, as the team is being pushed pretty intensely to do that.

<A – Keith Creel – Canadian Pacific>: Yeah, I would add that, Walter, in this high demand environment that we're facing, the value of reliable service is meaningful. And the wellness of the customers to commit to fair price increases that represent the value of that service to lock in that reliable service is certainly there, which is encouraging.

<Q – Walter Spracklin – RBC Capital Markets>: Makes a lot of sense. Okay. Thank you very much.

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

<Q – Tom Wadewitz – UBS Securities LLC>: Yeah. Good afternoon. I wanted to ask you a little bit, I guess, about the – more on the capacity and kind of how you think about the constraint. So, what would be the kind of risk because you have volume come on and maybe how much volume growth you can handle, given what you have in the pipeline for crudes and locomotives and whatever kind of line constraints you might have? So, how do we think about maybe the risks and also how much volume growth you could handle if you look maybe to the third quarter?

<A – Keith Creel – Canadian Pacific>: From a demand standpoint and a capacity standpoint, Tom, I guess I'd put it this way. Fiscal plans not an issue at all. We've got room to grow, terminals to grow into, yards that are fluid. Our challenge that we're being very careful to manage and lockstep with the demand we're bringing on, it's making sure we hire the right number of people, these employees, training the employee is expensive. We pay our employees extremely well. We want to make sure that they're productive, both for their sake and for our sake.

The next step is locomotives. Obviously, we have quite a few locomotives that are in storage for us to bring locomotives forward that we had planned for outyears to handle growth, given this unexpected increased demand. We're making capital decisions to do that. So, again, we're being very diligent with our capital. We're making sure that the economics of our deals justifies pulling that capital forward. But with that said, there is a limitation in the industry overall for additional locomotive capacity. So, there aren't any locomotives sitting around, that's horsepower locomotives that are reliable that we can go lease, there aren't any that we can buy. If you want to get them produced and manufactured, the lead times, we're looking into next year. So that is the constraining factor. It's more external than internal. So, internal, we constrain ourselves, but we are facing external limited capacity abilities with the locomotive producers in the marketplace itself, given the overall demand in the industry. So, that would be the most prevailing constraint with the locomotive capacity, bringing it on and making sure it's in lock step with business, Tom.

<Q – Tom Wadewitz – UBS Securities LLC>: Okay, great. And then, the second topic, you talked a bit early on in the call about the kind of the labor negotiation right now. I guess, my experience or my recollection is that you can't have strikes in Canada and they tend not to last a long time, so they tend to be more kind of noise than something beyond that, I guess if you look at it from an investor perspective. I'm sure it's more disruptive from a shipper and a company perspective. But are there any reasons why we would think that this would be different than maybe the historical experience? And I think of maybe if there's a strike, it's a week long and then, someone kind of steps in. Just wonder if you could frame a bit how we might think about the process and the risks around a potential work stoppage? Thank you.

<A – Keith Creel – Canadian Pacific>: Okay. Well, from a financial standpoint, taking a long-term view, I would agree with you. It is financial noise. Certainly, there's a cost tied to it. We'll work through these issues whether it's short-term, it doesn't happen, it lasts a week, it lasts two weeks, if it does happen, or longer. That's all just guesswork on our part. I stay focused on the long-term impact to the company, which guides us to making the right decision, even if it's not the easy decision, it's the tough decision. I'm very concerned about if we have a work stoppage, the impact to our customers, the impact to the Canadian economy, and that impact would be felt. I don't care if it's a one-day strike, a 10-day strike, or a 20-day strike, those are serious impacts to those stakeholders.

But as far as the process, what's uncertain, we have a new government, obviously. I've been in very close contact with the government. I spoke to the Minister of Labor this morning. I've spoken to the Minister of Transportation. They both have expressed their commitment to the collective bargaining process. They've expressed their desire and commitment to the Canadian economy and they're encouraging the parties to reach settlement. They're optimistic that we can. I'm remaining open minded and optimistic as well, but I also have to be a realist and we have to plan with our customers to make sure they have contingency plans. I hope that we do not have to execute ours or theirs, but certainly we're taking steps as if we will. Should this happen Friday night, Saturday morning, as far as the term, I really don't know what to say except that I'm hopeful that long-term interest of all parties and all stakeholders will bring the parties to a reasonable outcome. But again, CP cannot be put in a position where we're held hostage and we can't make a position that's going to destroy our long-term ability to be on solid financial footing, to be able to run this company, to be able to reinvest in this company, to invest for growth for our customers, to invest for growth for our shareholders, and to provide reliable transportation service to the Canadian economy. If it means that we have to experience short-term pain to avoid that long-term damage, then that's my fiduciary responsibility to all stakeholders and we're going to uphold that.

<Q – Tom Wadewitz – UBS Securities LLC>: Okay, great. Thank you for the time and insight.

Operator: Your next question comes from Fadi Chamoun from BMO Capital Markets. Your line is open.

<Q – Fadi Chamoun – BMO Capital Markets>: Thank you. Good evening. Is there an opportunity, John, to pivot capacity towards maybe higher yielding traffic in this kind of strong demand environment? Or you have, I don't know, contractual political obligations that kind of prevent you from doing that?

<A – John Brooks – Canadian Pacific>: No. I think – look, we're – part of the whole strategy that we're developing here and have emphasized within our marketing team is almost exactly that. Right?

So, you can't pick and choose and certainly we want to be diligent with the opportunities, whether it's potash or crude, or it's intermodal, whatever it is. But part of this growth strategy is picking the ones and the commodities and the movements and the trains that are going to yield the highest margins to us. And as we – look, we're just in sort of the infancy stage of really capitalizing and delivering on a number of these strategies. But I think that will begin to continue to prove itself out. But that doesn't mean, for maybe that lower RTM commodity, that it can't be operated or be brought on or we wouldn't want to bring it on because we run a highly efficient model in a lot of those areas, whether it be potash or crude or whatever it might be.

<A – Keith Creel – Canadian Pacific>: I think a good example – case in point of making a decision to exit a market particularly so that we could redeploy assets where their – their return is greater and more need for the company and our existing customers is our Expressway product that we de-marketed from there between Montreal and Toronto. Obviously, the 401s there, there's an opportunity where traffic that otherwise would not be on the railway, it's sort of surge traffic, it's not on the highway – to go back to the highway. It was not earning its cost to capital, it was not a moneymaker for CP, did not make a whole lot of sense to be running a terminal for practice when we have compelling demands for those resource elsewhere. So, we made the decision, as sensitive as we had to be with our customers, the right business decision to redeploy those assets.

<Q – Fadi Chamoun – BMO Capital Markets>: Okay. You've mentioned 3.8% kind of being able to see on renewal kind of in this market recently. How should I think about how much of the book of business you're able to touch this year and kind of leverage this demand environment with?

<A – John Brooks – Canadian Pacific>: I think we're looking at the latest number for renewals this year in the 30% to 40% of the book, 40% might be a little high, Fadi, but – and with the majority of that yet to come as we move into – through Q2 and into Q3 and Q4.

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

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

<Q – Steve Hansen – Raymond James Ltd.>: Yeah, good afternoon, guys. Just a quick one, a little bit focused on the short term. You described the recovery that you're seeing thus far in April as being quite good. But is that a broad-based statement that applies to the entire network? Could you perhaps just give us a bit better detail on where the recovery is – where the recovery might not be as fluid thus far and whether the competitor in the space is hindering any of your recovery, thus far, as well?

<A – Keith Creel – Canadian Pacific>: Yeah, the recovery overall good for the network. We moved to record amounts across the entire network in March. We called back grain, we called back some potash. We got our yards cleaned up, we got our dwell cars turning, assets turning, ran into a little bit of a speed bump though, last week, Steve. We had quite a significant snowfall in the corridor going down to St. Paul, Minneapolis. I think we had almost – probably 12 inches, 13 inches of snow this weekend that we had to spend a little money that slowed things down a little bit. But that was a little bit of a bump. We'll regain our momentum, obviously. We're having to do some things now to prepare for what might be an eventual strike, which may slow us down a bit. But if we do again, as soon as we get through that issue, we'll regain the same momentum and pace we had and be able to move record amounts of GTMs.

<Q – Steve Hansen – Raymond James Ltd.>: That's very helpful. And just one last one if I may on the energy complex, which is topical. Are you guys able to quantify the size of the opportunity that we're looking at over the next year or so? As you look out, you've had discussions with a number of customers thus far. Maybe the focus specifically on the ones that might be willing to contract longer term, is it a double from here, is it less than that or is it more than that? Just some rough context for the size of the opportunity would be helpful.

<A – John Brooks – Canadian Pacific>: I think the opportunity out there is probably double. But again, opportunity and actually delivering to the agreements that we need to make the investment and ensure that it's long-term are two different things.

<A – Keith Creel – Canadian Pacific>: Yeah, so I would suggest, we'll have much more clarity and color we can provide at our Investor Day on that because there's a lot of hard work in final I think avenues in our negotiating processes with these potential customers to expand that revenue on the right terms that we need to work to conclusion. We can't compromise our principles. We won't compromise our principles. Again, these are all tied to long-term capital decisions that we take very seriously. So, with that said we'll be more than happy to provide more color on that when we meet and when we see the investor community in early June.

<Q – Steve Hansen – Raymond James Ltd.>: That's helpful. Thanks.

Operator: Your next question comes from Ken Hoexter from Bank of America-Merrill Lynch. Please go ahead.

<Q – Ken Hoexter – Bank of America Merrill Lynch>: Great. Good afternoon, Keith and team. The head count on the employee side has been up the last two quarters. Can you talk about the balance between the weather impacts versus precision railroad? Have you passed the peak of cuts from the precision railroading and does this now become the trend with volumes? And then, in that vein, one of the western carriers noted trouble hiring some staff and the need for signing bonuses. Are you seeing any trouble hiring in this type of economy?

<A – Keith Creel – Canadian Pacific>: Yeah, number on, precision railroading focus obviously is, it's our underlying founding principle. It's what we make every decision over. The big cuts and the big quantum productivity gains are over. We're in a growth mode now as we've talked about in the past. But it's controlled sustainable growth. So, the upside, the additional hiring we did in the fourth quarter was anticipation given the lead time it takes to qualify these employees. You're talking a four to six-month window to get them selected, hired, and trained, so that they can actually start producing a revenue service. We've anticipated some of this growth and obviously the second half of what we're doing now is what's going to fuel the second half growth. So, I wouldn't be misled by those numbers at all. I think we'll end the year up, over probably 3%, 4% at max and we're going to be producing better than that in revenue growth. So, don't ever think that we're not going to continue to strive to do more with less and drive additional efficiencies.

<Q – Ken Hoexter – Bank of America Merrill Lynch>: Great. I appreciate that insight. Follow-up would be on your STB letter. You noticed a bunch of the auto issues, the trouble with getting some of the empty traffic from the western carriers due to some operational and crew issues. Can you talk about have you seen improvement in performance especially in your ability to get or grow that business and your relations with the other rails?

<A – Keith Creel – Canadian Pacific>: Yeah, from an operational perspective, I think I have seen improvements or I have seen material improvements from all the rails as far as the flow and the transfer and interchange of cars. And the revenue opportunity, I'll let John comment to that.

<A – John Brooks – Canadian Pacific>: Yeah, I'd say definitely. So, our April revenue numbers on our automotive sector have actually been fairly strong here for a few weeks. And not dissimilar to our international business unit, the automotive business unit that the team is stepping back and really putting together the strategy on what we need to do to transform our product in that space, whether it be compounds and lanes scenarios and customers we want to focus on. And, yeah, I think we see certainly towards late this year and into next year, some new opportunities in that space.

<A – Keith Creel – Canadian Pacific>: That's definitely an area that we're focused on for controlled sustainable growth where we see much more upside than downside.

<Q – Ken Hoexter – Bank of America Merrill Lynch>: Great. Keith, John, appreciate the time and insight.

Operator: Your next question comes from Scott Group from Wolfe Research. Your line is open.

<Q – Scott Group – Wolfe Research>: Hey, thanks. Afternoon, guys. So, John, it sounds like some of the mix headwind in first quarter may be some of it was temporary? As you think about the rest of the year, as pricing's accelerating and maybe some of the mix headwinds go away, do you see an opportunity for that price mix number to turn positive or should we still think about that being a net sort of negative going forward and maybe any view on how that price mix impacts operating ratio?

<A – John Brooks – Canadian Pacific>: I think it certainly becomes less of a headwind as we move certainly into Q2. Again, as I look at initial first few weeks here of April, it actually looks a little better right now. And I think we've seen some improvement in some of the lower RTM business units along with price. They're starting to lift that up. I fully expect into Q3, Q4 ongoing price momentum to help offset that. Now, that being said, we also have a lot of growth opportunity in some of those lower RTM. If we see growth improved by rail, additional certainly strong Potash, we'll keep a close eye on it. But certainly, price is going to help offset.

<Q – Scott Group – Wolfe Research>: Okay. That's helpful. And then so one more on crude, so maybe some perspective then on why we haven't signed some of these contracts yet. And I know the spreads got super wide and then they've started to come in a little bit. Where do we want the spreads to be? And has this recent compression, is that having any impact on pricing discussions at all? And maybe can you just talk about like duration of contracts you're talking about, meaning one or two or three or four years. Just any sort of color you can give us there would be great.

<A – John Brooks – Canadian Pacific>: In terms of the spreads, I think you're seeing sort of a dynamic of the number of issues within the producer industry that is impacting that. In terms of that affecting our pricing decisions or the rates, I haven't seen any impact on that. Right now, typically the terms we're discussing with the shippers are three years. And I would say we're close in agreements, but we'll work through that the next few weeks and we'll see how those ultimately materialize.

<Q – Scott Group – Wolfe Research>: That's fair. And in your view, where do the spreads need to be? At what level or about where do you think they need to be.

<A – John Brooks – Canadian Pacific>: Sort of I'd say where we're at right now seems about right. I think the last I saw we're at $17/$18 and that -- north of that is where I expect it to be. Does it sustain itself down to $13/$12? We'll see, but at least the producers and folks we're talking to, the terminals, really believe that the levels that we're at right now and above are likely where they're going to be.

<Q – Scott Group – Wolfe Research>: Okay. Very helpful. Thank you, guys.

<Q – Scott Group – Wolfe Research>: Yeah.

Operator: Your next question comes from Matt Russell from Goldman Sachs. Your line is open.

<Q – Matt Russell – Goldman Sachs>: Yeah. Thanks for taking my question. Just wanted to go back to the point on repricing and that 30% to 40% of the book that you're renewing this year. When you say the majority of that is still to be done, is it fair to assume you've done a quarter and you still basically have 75% to reprice. Can you frame that majority a little bit for us?

<A – John Brooks – Canadian Pacific>: Yeah. So – no. The bulk of the renewals typically take place the second half of the year. So, you probably – we've got a disproportionate amount of those renewals that'll take place then. If you look at it, that's excluding grain, that's excluding all of our tariff pricing and specifically our contracts. And as I think about the contracts that are out there, it's probably that 30% number that yet needs to be renewed, and again it's the second half of the year. And so that wouldn't include Canpotex, that wouldn't include Teck, that certainly wouldn't include some of our bigger shippers and contracts.

<A – Keith Creel – Canadian Pacific>: And anything lock-step and long-term deals, that's not inclusive. So, you've got be careful with your modeling to exclude those big chunks.

<Q – Matt Russell – Goldman Sachs>: Sure. Sure. Okay. Thank you. And then just one more on crude. Of the 17,000 crude carloads that you're carrying today, what percentage of those volumes are tied to any type of long-term contract over a year or more? Is it entirely on spot or is there a percentage of that, that's already on long-term contracts?

<A – John Brooks – Canadian Pacific>: A small very – I'd say a very small part of that is on annual and the rest of those are on a couple year, two-year max, three-year contracts.

<Q – Matt Russell – Goldman Sachs>: Thank you.

Operator: Your next question comes from Turan Quettawala. Your line is open.

<Q – Turan Quettawala – Scotiabank>: Yes. Good afternoon. Thank you for taking my question. I guess, so first one for John. I was wondering if you could talk a little bit about how you expect RTMs to trend here in Q2. You have a fairly difficult lap, I guess, from last year, but presumably grain's going to be fairly strong here as we get better weather. So just some color there would be helpful. Thank you.

<A – John Brooks – Canadian Pacific>: I would expect mid-single digits. I think we're – I saw there we're sitting right in that area right now.

<Q – Turan Quettawala – Scotiabank>: Okay, that's helpful. Thank you. So, I guess it should be fairly even here through the course of the year, John?

<A – John Brooks – Canadian Pacific>: You know what? That's what we're guiding to. And you know what? We're hopeful if there's upside towards the back half of the year and the resources are there to handle it, we're going to take on business opportunities that make sense for us.

<Q – Turan Quettawala – Scotiabank>: Thank you. And I guess if I could just ask a quick clarification from Nadeem. Just wondering, I think you mentioned fuel and FX, Nadeem, there for – as a negative impact to operating ratio in Q1. I know it's sort of a little bit more semantics than anything else, but just wanted to try to see how much the fundamental change was in OR. Would you be able to give a number there in terms of what the impact was from those two items in Q1?

<A – Nadeem Velani – Canadian Pacific>: Yeah. FX was about 50 basis points and fuel was about 80 basis points.

<Q – Turan Quettawala – Scotiabank>: Thank you very much. And I think you said fuel wasn't going to be an impact going forward. Is that...

<A – Nadeem Velani – Canadian Pacific>: No, it will still be an impact. I would say not – I mean, depends predicting fuel, but as we see it right now, kind of spot rate, it shouldn't be as big a drag.

<Q – Turan Quettawala – Scotiabank>: Okay. Thank you. That's helpful.

Operator: Your next question comes from Brian Ossenbeck from JPMorgan. Your line is open.

<Q – Brian Ossenbeck – JPMorgan>: Hey. Thanks for taking my questions. So, the first one is just on the mix. I mean, we're seeing record percentage of private cars versus your own cars online on the network, going back to 2014 peak. I'm assuming that's moving more volume in private equipment like sand, but does that come with – maybe you can confirm that? And then also, does that come with any sort of operational difficulty, even if it is a small bit on the margin? If it's not your equipment, perhaps you don't have the same ability to do backhauls to reposition or things like that. So, what's driving that factor? And then, how does that affect operations, if at all?

<A – John Brooks – Canadian Pacific>: Well, I think, certainly, we're seeing more private cars, if you look like at growth in crude, growth in our frac sand, growth in our potash markets, all those typically move in private cars. But, frankly, that's big, long trains, generally pretty efficient, high-margin opportunities for us. So, from an operation perspective, yes, in terms of maybe backhauls and utilizing that equipment differently, there may not be as many opportunities, but in terms of the direct operation of the unit trains with those cars, I'd say, there's really no impact.

<Q – Brian Ossenbeck – JPMorgan>: Okay. Thank you. And then the other one is just on – just the political environment. There was a grain hearing about a month ago and both Canadian rails. So I just wanted to see if there was any follow through from that. And then, can you just give us latest update on Bill C-49? Thank you.

<A – John Brooks – Canadian Pacific>: Well, I'll say on the grain front, no. Obviously, we're working directly with our shippers where their priorities are. So, we've had a good grain season year-to-date. Obviously, as Keith had mentioned, January and February ran into some tougher operating conditions, but now with Thunder Bay opened and a lot of the shippers sold out well into Q2 into Vancouver, we look for big numbers on our Canadian grain side.

C-49, you know what, I'm not sure our position really changes on that. We're anxiously waiting for the government to finalize and sign that bill. And as soon as they do, that allows us to take some action on our grain car fleet.

<Q – Brian Ossenbeck – JPMorgan>: Any specifics there on timing or just you'll know when they announce it?

<A – Keith Creel – Canadian Pacific>: Yeah, I think that's more guesswork. We would have hoped it would have been by now, but certainly there's some compelling benefits for the supply chain for our grain shippers and for the reliability of the product getting to the marketplace. The sooner we can get those cars built on the right terms where we can support the investment, the better off that entire supply chain will be. But with that said, the politics, the amendments that have been made, that's a better question answered by Ottawa. But certainly, we're doing all we can to educate not only the shippers but the government as to the capacity that's slipping away the longer that decision and the longer that legislation is taking to come out. But to John's point, when it does, assuming that it's on the terms we think it will be, then we have money set aside to invest in a fleet that's going to be a renewed fleet that will be much more productive, much more reliable and increase the capacity for Canadian Pacific to deliver reliable grain supply chain to the ports for export.

<Q – Brian Ossenbeck – JPMorgan>: Okay. Thanks for the time. I appreciate it.

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

<Q – Ravi Shanker – Morgan Stanley>: Thanks, operator. One quick question, crude by rail again. The Trans Mountain pipeline delay and potential cancellation, does that have any impact on the way you think about this opportunity potentially making more attractive for you?

<A – John Brooks – Canadian Pacific>: No. It really doesn't. I mean, again, individually, we're working with the crude shippers that are interested in working with us. And it really has had no impact.

<A – Keith Creel – Canadian Pacific>: We're not a railroad that has a view that the top lines will not come to fruition. They will. It's not a matter of if. It's really just the when piece that we don't know. And I do think long-term, there'll be some level of business left in niche markets so to speak from a diversification standpoint and from a quality and optionality standpoint where the oil companies will partner with the railway. But we're under no false impression that the railways ultimately are going to replace the pipelines that will be built.

<A – Nadeem Velani – Canadian Pacific>: Great, and you could argue there's more upside for us from an economy point of view, from the confidence of investors in Canada point of view for some of these pipelines to be built, we're better off as a railroad. We're better off as a company than they are.

<Q – Ravi Shanker – Morgan Stanley>: Got it. And, also, not to steal your thunder here, but can you just help set the table for us in terms of what we can expect from you at your upcoming investor event? Are we kind of looking at long-term targets? What CP looks like in five years, or is it more of kind of just laying out the blocking and tackling in the near-term?

<A – Keith Creel – Canadian Pacific>: Well, near term to us, anything that we can have a bit of reliability is going to be a three-year view. We'd be guessing at five, so you can expect to come and get some color on our best estimates. What we're being led to as indicators indicate to us for the next three years. And I can tell you what you should expect, it's encouraging.

<A – Nadeem Velani – Canadian Pacific>: I think it'll be a good opportunity to meet with a new team that many of you haven't had a chance to kind of interact with. And just to see how the interaction I think is a key component of Investor Day, aligning our long-term targets with our plan. I think you'll see continued focus on precision railroading. A heck of a lot less focus on crude. Although you guys keep trying to pull us back into that, but so I think you'll see – I think it'll be a good couple of days.

<Q – Ravi Shanker – Morgan Stanley>: We are pretty old school in the way we think. So hopefully – just sell us the future there as well. Thanks very much, guys.

<A – Nadeem Velani – Canadian Pacific>: Thanks, Ravi.

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

<Q – Benoit Poirier – Desjardins Securities>: Yeah, good afternoon, gentlemen. My first question is on the CapEx. You maintained the guidance for the year and obviously the top end of the range will depend on the government decision. But given that you're bringing one of your new locomotives, that business fundamental remains strong, how should we be thinking about CapEx 2018 and even going beyond 2018? And potentially also the impact on the OR that comes from training more employees?

<A – Keith Creel – Canadian Pacific>: As far as the capital itself, I mean, you hit the high points, Benoit, there's some uncertainty and some risk and the money we set aside relative to the hopper investment. Which tells us that in spite of some of the additional CapEx that we're bringing forward, the locomotives, those are natural hedging against each other. So, we don't plan to do anything, expanding our capital envelope.

<A – Nadeem Velani – Canadian Pacific>: Yeah, I mean I think as Keith said, the upper end is probably closer to where we'll be, or we hope to be if we get the green light in terms of the capital decision on the hopper cars, where we can make that investment. Somewhat tied to how currency goes too. I mean, a lot of capital is U.S. dollar based. And we'll see what occurs with the Canadian dollar in terms of volatility. That's going to drive some of it. But we're – to John's point about some of these contracts that have long-term commitments, whether they come to fruition some of that will require potentially some capital investment. So, there are a lot of moving parts where we see things today is still within that range, but maybe some of the mix has changed of how you allocate the capital.

<Q – Benoit Poirier – Desjardins Securities>: Okay, okay. That's pretty good. And my second question is on the crude by rail. I'm just wondering if you were to sign a significant deal today, when could you start moving the crude? And do you have already some locomotives that are committed to the crude by rail?

<A – John Brooks – Canadian Pacific>: So again, we'll ramp this up responsibly based on what the resources are available to us. I would expect us to sort of take place the second half of the year where you see those volumes increase if in fact we make these agreements work.

<Q – Benoit Poirier – Desjardins Securities, Inc.>: Okay.

<A – Nadeem Velani – Canadian Pacific>: There are a lot of resources allocated to our current shippers. We're not going to reallocate existing resources to new business. We've got to protect the service, that we're mindful of and we need to be able to service the customers that are on our business today and will be there 10 years from now, so that's an important factor.

<Q – Benoit Poirier – Desjardins Securities, Inc.>: Okay. And maybe just – do you have the ability of partners to – given you don't go direct to the Gulf Coast?

<A – Maeghan Albiston – Canadian Pacific>: Sorry, Benoit, you broke up there. Could you repeat that question?

<Q – Benoit Poirier – Desjardins Securities, Inc.>: Oh, yeah, sure. Given you don't go direct to the Gulf Coast, I was wondering about the ability and the willingness from your partners to handle crude by rail.

<A – John Brooks – Canadian Pacific>: Yeah. So, we're working with all our potential U.S. carriers on those opportunities. And there's willingness with all of them.

<Q – Benoit Poirier – Desjardins Securities, Inc.>: Okay. Thank you very much for the time.

Operator: Your next question comes from the line of Seldon Clarke with Deutsche Bank. Your line is open.

<Q – Seldon Clarke – Deutsche Bank Securities, Inc.>: Hey, guys, thanks for the question. Can you just talk about the coal business for a minute? Is there an opportunity to see some profit improvements as some of your major coal contracts expire? Any thoughts there would be helpful in terms of outlook for pricing of the coal franchise.

<A – John Brooks – Canadian Pacific>: We really don't have any pending near term renewals on those agreements. So, a lot of the work continues to be around operating efficiency and capturing those opportunities as they become available.

<Q – Seldon Clarke – Deutsche Bank Securities, Inc.>: Okay. Just follow-up to that, if you can just help me understand how the cost profile of your coal business has kind of trended over the last couple of years, that would also be helpful.

<A – John Brooks – Canadian Pacific>: I'm not sure I can speak to the exact cost profile of our coal network. But other than that, what I would say is in the case of some of our thermal coal and those opportunities where we can work with our connecting partners, we're looking to increase train lengths and doing the things we need to do to make those more efficiency – more efficient.

<Q – Seldon Clarke – Deutsche Bank Securities, Inc.>: All right. That's helpful. I understand. And then just quickly on head count. Was there anything temporary like maybe some delayed retirements or temporary hires that came on in March that might roll off into – as we go into 2Q? Or is this kind of like the good base to think about sequential head count growth as we move throughout the year?

<A – Keith Creel – Canadian Pacific>: Well, there's some – a lot of moving parts and that – part of that head count you would have saw in March on the engineering side as we ramp up our capital work with shift to capital work. But I – there was nothing – no anomalies, I guess. I think from a modeling standpoint, I would plan end of the year head count, year-over-year 3% to 4% range, which is going to demonstrate efficiencies in absorbing some of our growth through efficiencies. So, that's probably a good place to be.

<Q – Seldon Clarke – Deutsche Bank Securities, Inc.>: For the full-year 2018?

<A – Keith Creel – Canadian Pacific>: That's correct, yes.

<Q – Seldon Clarke – Deutsche Bank Securities, Inc.>: Okay. All right. Thanks a lot. I appreciate the questions.

Operator: Your next question comes from Justin Long with Stephens. Your line is open.

<Q – Justin Long – Stephens, Inc.>: Thanks for taking the questions and good afternoon. So, the broader commentary on the 2018 outlook didn't change. But from a high level, do you feel better or worse about the EPS growth opportunity than you did a few months ago? And maybe as you answer that question, it would be helpful to understand some of the up or down arrows relative to what you were thinking back in January.

<A – Nadeem Velani – Canadian Pacific>: I'd say we feel better. I would say that certainly the demand environment, as we mentioned, is certainly much stronger. So, despite a difficult weather environment, that's more than offset by stronger economic outlook and stronger kind of commodity by commodity, not just demand, quite frankly, it's just the way the team is operating and the way the team is bringing on business. The pricing environment is a lot stronger and more robust; our stock-based comp headwinds lower than I thought it would be as we continue to be undervalued. I mean, I could go on and on, Justin.

<Q – Justin Long – Stephens, Inc.>: Okay. That's very helpful. And second question, I was wondering if you could provide an update on the K+S business and how much of an incremental volume or revenue uplift you're expecting from that customer in 2018?

<A – John Brooks – Canadian Pacific>: Well, I'd say for the full year, we've modeled 1.3 million metric tons. The volumes have steadily increased week to week, month by month. We started off running 135 car trains, I think we're moving to a 155 right now with the ultimate objective to get to 177, I believe, by this summer. So, the business is coming on sort of as we expected now and full-year outlook remains at that sort of 1.3 number.

<Q – Justin Long – Stephens, Inc.>: Okay. Great. I appreciate the time.

<A – John Brooks – Canadian Pacific>: Thank you.

Operator: There are no further questions at this time. I will now turn the call back over to the presenters.

Keith Creel

President & CEO

Okay. Well, we'll wrap it up. I think as evidenced in the numbers and this Q&A has demonstrated there's a tremendous amount of confidence in the demand that's in the marketplace. At the same time, we're matching that with discipline to make sure we maintain our precision set to grow our model which is fueled by profitable sustainable growth. We've got some choppiness behind us, we've got a little bit of choppiness in front of us with the uncertainty around the labor front. But, again, we'll remain optimistic, we'll remain disciplined with the view and a true belief that we'll land in a good place. Be it that we've got to go through short term pain or not, from a long-term view we'll go through these choppy waters. We'll have a solid second quarter, I think a very encouraging third quarter and fourth quarter.

We look forward to seeing our investors, our analysts, and our partners in business in Calgary in June and showcasing the strength and the opportunity that we see, which is very encouraging from a shareholder point of view, from a business point of view, from a long-term economic health and sustainability view for CP in June of 2018. So, safe travels to those of you that are coming. We look forward to welcoming you to our corporate campus headquarters in Calgary. We will see you soon.

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