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Transcript

Scotiabank Transportation & Industrials Conference

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Corporate Participants:

John Brooks – Senior Vice President & Chief Marketing Officer, Canadian Pacific
Maeghan Albiston – Assistant Vice President Investor Relations, Canadian Pacific
Chris De Bruyn – Director Investor Relations, Canadian Pacific

Other Participants:
Turan Quettawala – Director, Scotiabank Capital Inc.

QUESTION AND ANSWER SECTION

Turan Quettawala

Director, Scotiabank Capital Inc.

Our next speaker is John Brooks. John was appointed SVP and CMO at Canadian Pacific in February of 2017. John started his railroading career with Union Pacific and has held senior responsibilities in all segments including Coal, Intermodal, Chemicals, Merchandise, and Grain over the last 20 years. John, it's a pleasure to have you here again.

John Brooks

SVP & CMO, Canadian Pacific

Thank you. Okay. Good to see you.

<Q - Turan Quettawala>: Okay. I guess maybe I'll just start off here with regard to overall growth and volume in the business. I know overall, it seems that the economy is still holding up pretty well here. So, there's no major issue there. But just in terms of how is RTM growth going here, it's, I guess, in line with sort of what you guided to, I guess, in the quarter. But just - and what prospects do you see for 2019?

<A - John Brooks>: Yeah. So, as I looked this morning, our RTM growth trend is 7-8% quarter-to-date. And honestly, I see opportunity for acceleration as we get into the back half of the quarter. So, if Mother Nature helps us out a little bit, who knows? There might be some upside on that.

As I looked to 2019, there is - it feels like a lot of noise out there relative to the economy and trade speculation and et cetera. But as I looked down on our commodity base, generally things look pretty strong. I think we remain pretty bullish around what 2019 could be.

<Q - Turan Quettawala>: Okay. So, I guess, can you talk a little bit about maybe which parts of the business you think are well-poised to grow here next year?

<A - John Brooks>: Yeah. So, as I think about our grain business, there's going to be a fairly sizable carry-in that came in Canada along with a decent-sized crop, so I think that grain tail extends well into Q2 in Canadian grain. Certainly, the U.S. side is a tale of two stories maybe. The impact of the tariffs and particularly on soybeans in the U.S. has impacted our business there. But that's a big crop out there. So, a lot of those bushels, whether it be soybeans, corn, have gone into the bin, so it's going to move at some point. So, honestly U.S. grain, you maybe get a little turnaround or a break in some of these trade discussions could become an opportunity in 2019.

I expect potash to remain very strong in the 2019. Our coal business particularly with Teck appears to be very strong for 2019. As I look at our intermodal business, we've had a lot of success in domestic intermodal. I see nothing changing not only from a volume perspective but also from a pricing environment expected in domestic intermodal. So, generally speaking just about all commodities are some positive signs.

<Q - Turan Quettawala>: Well, you didn't mention crude. And so, that was a really good story because I'm sure crude is going to go above average still here, so maybe talk just a little bit about that and where you're seeing it right now? I know it's not a big focus and I understand that but just overall. Obviously there is a tailwind here on the crude side.

<A - John Brooks>: Yeah. And let me just say this, it's not a big focus. It's a big focus in that we want to do it right...

<Q - Turan Quettawala>: Yes.

<A - John Brooks>: and we want to be disciplined how we take that business on. You know what? Certainly crude-by-rail is going to be a bright spot in 2019. I am pleased with the work we did through 2018 to partner with the right customers in that space to build contracts that have - you know what? We did a very poor job the first crude cycle on those contracts. This time around, we've done a darn good job. So, we've got the right partners, the right contracts with the right term to them. The

pricing is strong in these contracts. The escalators are strong on these contracts. And the more capacity we commit, there's a bilateral commitment by the contract holders to use that capacity. So, I think we're set up honestly great in the 2019 and crude-by-rail. And once we get by, I would say the heart of the grain harvest and we get through winter weather and into Q2, I think it presents the opportunity to see more crude-by-rail.

<Q - Turan Quettawala>: Okay. Perfect. Is there a car issue at all that you think will be a concern?

<A - John Brooks>: Honestly, if you look at the volume we're moving today relative to the capacity we've sold, it's not in alignment, and part of that is because the lead time that we've seen to ramp up to bring sets on to handle that crude-by-rail. Now, look, it is ramping up. We're active with those shippers and in bringing those additional sets on. But I do think it is something that not only the industry, but also at CP we're constantly monitoring.

<Q - Turan Quettawala>: Okay. Perfect. I guess maybe moving on to talk a little bit more about Intermodal I know that's a big - obviously a big focus as well as we get into the growth for next year and beyond here as you really use and leverage that business and use the precision scheduled railroading model here. I know an international contract is helping you right now. I guess there's probably more coming up for renewal next year. Can you talk a little bit about, to whatever extent you can, timing of those contracts next year for renewals?

<A - John Brooks>: Yeah, so very similar to what we talked about at our Investor Day, there's a lot of opportunity in that space that's going to come available over the next 12 to 18 months. But let me be very clear, we don't need all of it. We don't want all of it. It would be irresponsible to go after all of it. Our philosophy is a very disciplined sales approach whether it'd be intermodal, automotive, certainly - really all the spaces. So, we're going to figure out which of these partners fit our network well, certainly utilize Vancouver well, hit the right lanes can be very accretive to our bottom line, and those are the opportunities that we'll go for. It may be one, it may be two, we'll see how it shakes out, but it's really a 2019 and into 2020 story.

<Q - Turan Quettawala>: Okay. Okay. That's good to know. And then I guess, just a little bit about CN kind of bit of an interesting move they bought TransX, I guess a couple of weeks ago here. Just wondering what's your thinking on that kind of potential investment? Would you make a similar move? And I guess would your view change on that if you were living in a world where maybe automated trucking was a reality?

<A - John Brooks>: Yeah. So, not dissimilar to CN where we're always looking at whether it be direct rail, linking type partners or whether it be within the supply chain opportunities to diversify our business and maybe bring that link tighter together. You know what, if we view the trucking industry and we've got quite a bit of experience, our Intermodal leader came from the trucking industry, we don't find it highly accretive to our bottom line at this point. Their business model is - and an opportunity is theirs, but for us it's probably not the right fit at this time.

We've had a ton of success in our domestic intermodal space and growing by double digits really the last three years. And as I look at it in terms of the opportunities in the marketplace today, to continue to do that, a pricing environment in domestic intermodal that with continued I think tightness around drivers, driver logs coming into play in Canada, I think there's a robust pricing environment also in domestic intermodal. So, I think we would continue to march down a path to grow that way in that space versus sort of integrating a trucking company.

<Q - Turan Quettawala>: Okay. And then I guess if there were automated trucks out there, does that mean anything or...

<A - John Brooks>: I'm not sure it really does. If it does, it's quite a ways down the road. And again, our approach relative to that is autonomous. It's probably less likely to immediately impact the long haul. And look, that is what we are good at. We are good at that 2,000-mile haul across the country. And frankly, it may provide an opportunity for us with our great partners in the last mile to lower our costs of that last-mile delivery.

<Q - Turan Quettawala>: Okay. Okay. And then I guess maybe one more last question on Intermodal. Obviously, it's big growth focus for you and you all are - I think at the Investor Day, you highlighted a lot of capacity that you have at Intermodal business. Just wondering as a business line though, do you think it needs more CapEx dollars much as maybe some of the other areas such as coal, et cetera? So, maybe you can throw some light there just because you've got to grow terminal's, you've got to grow yards, and so forth.

<A - John Brooks>: Yeah. So, I think what a lot of folks don't realize is the blood, sweat, and tears that went into implementing precision scheduled railroading at CP created a lot of capacity. We laughed, but we say it's the gift that keeps on giving, and it really does. It's freed up a lot of latent capacity in our terminals and frankly, over the road, to give us that opportunity to grow today. Now, you overlay that then with the capacity of our footprint which again it's unparalleled in the industry. If you go from Vancouver to Edmonton to Calgary to Montreal and Toronto, our footprint to grow those terminals at a fairly low capital cost is impressive. So, that's sort of the next generation of capacity that's available to us. That's completely unique to CP.

The other point though and I don't want to miss this one is our work in what we call our demand management space is critical to generating that next level of capacity. We've talked about where people want peak days of the week capacity on our trains, so typically you'd see the spikes in train length and then it would dip down coming into the weekend days. And we've worked really hard at CP to smooth that out, to give our customers a tighter menu on when they want their deliveries at destination. And what it's done, it's created our bellwether train is running consistently at about 10,000 foot a day. But the beauty of that is it gives us about a thousand or two feet of additional capacity to sell to. So, we're in a good space in the Intermodal area.

<Q - Turan Quettawala>: Okay. Okay. Maybe spend a few minutes talking a bit about grain here. With the changes in C49, obviously you're investing more in the grain business. There's a lot of new terminal capacity coming up in Vancouver over the next few years. So, just talk a little bit about where you think CP's grain share could go in the next maybe three to five years.

<A - John Brooks>: Well, look, there's - grain has been king at CP for over 130 years, right? It's - we're good at hauling it. And the exciting thing that I think most people don't realize is the next step function of capacity we're creating at CP is a game changer for the industry. When you take a look at the investment we're making in our cars that are larger and shorter. And then you begin to marry that with the efforts we're undertaking with the grain companies to expand their facilities in the country, it ultimately allows us to run a train that's 134 cars and is creating about 40% more capacity than an average grain train today.

Think about the power of that not only from taking costs out, less train starts, less locomotives required, less capacity consumed in our western corridor. But the flipside of that is if you continue to run the same train, so think about the power of market share that we should be able to attract to our railroad with that operating model.
I honestly believe our 8,500 foot model can be a game changer, and it's going to implement over the next, well now to the next 5 years, - this will phase in over that time period.

<Q - Turan Quettawala>: Okay. Okay. And, do you think like over the next three to five years, like is grain volume up like 20% to 25%, or even...

<A - John Brooks>: Well, I...

<Q - Turan Quettawala>: Just because of all the terminal capacity that's coming on, right, on - in Vancouver.

<A - John Brooks>: Well, here is the thing. It was only 10 years ago that the average crop size in Western Canada was 50 to 60 million metric tons. Now, the average crop size 70 million metric tons. And if you talk to the industry between precision farming, crop switches and yield per acre increases, it's not inconceivable that 90 million metric ton crop could be the reality 10 years from now. That's a lot of incremental grain that's got to be exported and that's right in our wheelhouse.

<Q - Turan Quettawala>: Okay. Perfect. Anything from the audience?

<Q - Unidentified Participant>: Yeah. The industry had some weather-related issues of cold weather in the past. How do you guys looking to address that looking forward?

<A - John Brooks>: Yeah. So look, as we know, railroading is an outdoor sport, right? So, it - we are dependent on making sure that not only we've planned and are ready for that the best we can, but also we're at the mercy of Mother Nature a little bit too. So, it's about - largely about resourcing. So do you have, number one, the capacity of the physical plant, but then you do - you have the locomotives and the people as we head into the winter to be able to operate the trains efficiently. I think as we sit here today, we're in a good position but it's also about the effort of our sales team as we work with our customers to protect the supply chain. I look at it like our potash business. We set records in Q3, but we went off to a little bit slower start in

Q4. A lot of that is supply chain related around some of the winter weather we had early in Canada. But as we work our way through that, as we work with the customers for, as an example, more power-on or power-ready trains where we keep air on trains at a customer site, we keep locomotives either attached to the trains or close by the trains ready to pull those trains, it's all those little things that ultimately add up to give us more reliability as you come into the winter months. The bottom line, though, is we can manage snow. You get that prolonged cold weather below minus 20 degrees, and then that certainly slows everything down.

<Q - Turan Quettawala>: There's a question. Just wait for a mic, please.

<Q - Unidentified Participant>: Thanks. I just wanted to ask you what was that bellwether train, John that you talked about? You said the bellwether train was moving. Was that intermodal only? Is it unit train, or was it mixed? And following that, what percentage of your intermodal business goes and manifests or mixed service versus dedicated unit train?

<A - John Brooks>: So, Tony, I was speaking about our 101 100 Series intermodal train. So, that's our flagship domestic intermodal train, Calgary to Toronto. It is flagship from a perspective of the shortest route miles, quickest turn. It's got truck-like service, and it's really what we've anchored our whole intermodal growth around that train start.

Your second question was around mix of... 100% of our intermodal is set up on specific intermodal trains. So, we are - I can't think of any, Tony, now we're doing some as an example our new service into the Ohio Valley which we link with a short line. I think they're run in that in conjunction with a manifest that intermodal. But just all of our other intermodal is hub-to-hub intermodal trains.

<Q - Turan Quettawala>: At the Investor Day, you talked a little bit about connecting better with short lines and using that as a way to grow your revenue and your business. Just wondering, is there a possibility at some point maybe to actually go there, as we go there and maybe buy some of these short lines and add them to the network? Or do you think just sort of relationships is good enough?

<A - John Brooks>: You know what? I can tell you, we are aggressively always looking at those opportunities. If it can be a natural fit back into our network. The reality is a lot of these properties have pretty low operating ratios. They can be nonunionized, and they feed our network well. Frankly, our focus on the short line side of business is really about reconnecting our relationships. I think for a lot of natural reasons in terms of being internally focused during our turnaround, we lost sight of our short-line partners to some degree. And our efforts here have been to sort of regenerate that because that piece of business - and look, I come from that background that piece of business - and, look, I come from that background, so I know it well.

Its singles and doubles, but there's a lot of singles and doubles out there to be hit with those folks, and honestly they become an extension of your network. So, I would like to grow with these short lines more as connecting partners than I would through acquisition, but certainly we consider that. We recently hosted a short line conference and had a pretty good group in, I think a real fruitful discussion not only helping them understand our philosophical approach to running the business and how we want to grow at CP, but also then linking in the opportunities that they can bring to the table in conjunction with us to grow their business. We walked away with CAD $30 million to CAD $50 million of revenue opportunities, new additional revenue opportunities that CP, that we're actively working with that group. We don't do that, that opportunity probably goes truck. It goes to our competition. And I'm not saying we're going to win all that. But there's a nice chunk of that probably makes a lot of sense to move on Canadian Pacific.

<Q - Turan Quettawala>: Got it. Okay. I don't know if you can really - how much you're going to answer this, but I'll ask it anyway. In terms of Teck, they're obviously seriously looking into expanding Neptune. From CP's perspective, do you think from an operational standpoint, I guess to certain extent, are there any differences in the supply chain in servicing Neptune versus Westshore?

<A - John Brooks>: You know what, I think Teck's desire to expand Vancouver, period, is a good thing. Whether it's Westshore or Deltaport or Neptune, I'd say, generally, we're indifferent, to, and it's probably good business. It's good business for Teck, and that it gives them a higher degree of diversification in terms of outlets. But frankly, it's not bad business for us either. It's - it gives us a diversified route and train pair that if one terminal becomes congested or supply chain comes backed up, if you have that alternative outlet, it's a good thing for CP too.

I think the other important part is we've worked hard with Teck to create a world-class supply chain. They have been successful in the marketplace, in the world marketplace in selling their coal, and I like to take some pride that we believe as a good partner, that we've helped in that. And our focus, whether it'd be at either of the terminals in Vancouver is to continue to work with them to improve the supply chain.

<Q - Turan Quettawala>: Perfect. Let me talk - I'll ask you to talk a little bit about technology. You've been, certainly, you showcased quite a few things at the Investor Day in terms of what you're doing on the technology side. Do you think this is going to be a real material driver in terms of your revenue line? I know there's a cost angle to it for sure. But just from the revenue line, I think there is a material angle there, as you work through some of these technology investments over the next few years?

<A - John Brooks>: Well, look, I do. And I think in some cases, it's not as simple in that space to say, hey, we're going after this contract and it equates to X, Y or Z. But ultimately, the more we can do through technology to enhance our customer experience, to bring innovation that makes customers sticky to CP, I think ultimately, it has an outcome that's positive from a revenue perspective. So whether that's directly related to movement transparency and communication with our customers, look, RBC recently have put out their report on some of the customer feedback they received, and if I read it, I read that communication is one of the biggest pieces that shippers are desiring. So the more we can do from a technology standpoint and we've got a lot under way with our customer advisory council at CP to build that transparency and improve that communication, ultimately brings I think opportunity to the bottom line.

<Q - Turan Quettawala>: Got it. Okay. And then just talking about e-commerce, obviously there's a massive growth area here as well. And it is changing the way in which people are purchasing goods and certainly a lot of people are focusing on the last mile. But how does the railroad fit in there? Like, obviously, not the last mile but how does the railroad fit in their overall longer term?

<A - John Brooks>: Yeah. So I guess, first of all, CP is - we are strong in the courier business, so with Purolator, UPS. So as that small package, that, I don't know, call it, Amazon affect grows throughout Canada, we're hauling a lot of that today. And we've seen good growth with our shippers in that space. As I think about our role in it, though, certainly the last mile is important. But if we're not getting the goods on time, that 2,000 miles leading up to that last mile, what good is it?

So as you think about precision scheduled railroading, if you think about our demand management, if you think about the transcon service that I spoke about that's truck-like, our focus will continue to be with our shippers to dial in that service and reliability and frankly speed as much as we can to make sure that we match up well with that last mile. So, look, whether it's brick and mortar, which we've done well with the retail industry in Canada, or if it's e-tail, I think we've had a lot of success, and we play a strong role in that also.

<Q - Turan Quettawala>: Okay. We've talked about probably a lot of the - most of the businesses here in terms of your revenue line. Can you talk a little bit about which ones do you think you're most bullish about for 2019 and just maybe one that you think could be a little bit on the weaker side next year?

<A - John Brooks>: Sure. Maybe the weaker side first. A couple of areas that we're watching closely. U.S. grain, I spoke about it a little bit earlier. Certainly with U.S. trade issues with China, our soybean business, some of our PNW export business is a question mark right now. I've been in the sales and marketing side of this and close in the grain area for 25 years, and frankly I don't know if I've seen as much uncertainty right now in that space as I see today. The flip side of that, as I mentioned earlier, though, is there's a lot of grain out there, and it's going to have to move. It's going to have to go to market eventually. So, we're just going to have to watch how that plays out into 2019.

The frac sand area is an interesting area. Certainly, we are going to continue to see a deceleration into the Permian. We're seeing it now, and I expect it to continue somewhat into 2019. The good thing is we've done a lot to diversify our destination market at CP. We've built three terminals in the Bakken. We're going to be more in the Marcellus, more into the Alberta region to sort of backfill that. I don't know if we'll backfill that one to one on what's not moving in the Permian. But I can tell you the margins and the cycle time benefits that we get on some of these other lanes from an OI, operating income perspective, I feel good about frac sand. I think we'll be more on par with what we're doing this year even though the volume will be less than 2019. On the positive side, the merchandise in carload business in merchandise and also energy chemical plastics, I think, present a huge opportunity for CP. Working with the short lines that I've talked about, we've had a lot of good things still on

the horizon in the transload space that again only makes customers particularly in merchandise more sticky to CP, brings more opportunities to us. So, I'm bullish about that space. Certainly, we've had a nice run in the intermodal area, but I don't see anything in the way of stopping that. I think we continue to post pretty strong numbers in domestic intermodal, and I think as maybe some of these contracts come available in international intermodal, we get a tailwind there also.

<Q - Turan Quettawala>: Great. Okay. I guess maybe one last one on - there's a lot of change obviously in the U.S. with regard to some of the railroads trying to get into PSR and so on and so forth. You obviously interchanged with most of them. Just can you talk a little bit about has there been any issues from that standpoint as they go through their transition from a service perspective?

<A - John Brooks>: Yeah. So no. I would say generally there hasn't been any issues. Implementing PSR is as much as a service change and full philosophical approach to providing service. But PSR is a culture change right? And so, it'll be interesting to see certainly how some of these other roads are successful in really implementing that deep-rooted culture that I think is required to be successful. All that being said, as you mentioned, we connect with these folks. So, whether it'd be the NS or UP, I hope they're wildly successful because ultimately I think you get two like-mind operating philosophies, and it only ultimately improves service levels. We do we do a lot of business with the UP, whether it be with potash or grain to the PNW. The power of a more like-minded operating model related to precision scheduled railroading, I think would be a powerful thing for our customers in terms of service.

<Q - Turan Quettawala>: Okay. Perfect. John, thank you very much.

<A - John Brooks>: All right. Thank you.