The Owl Fund
William C. Dunkelberg Student Managed Fund

Initiating Coverage Report | 29 September 2023

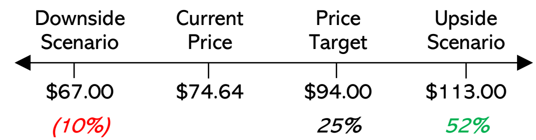
Canadian Pacific Kansas City Ltd.

A Freight Time to Invest in CP

- Due to a slowdown in rail volumes and increased costs from carrying a surplus of employees, investors are mispricing the value proposition of CP's new network and improved operational efficiency. As a result, the Fund has been presented with the opportunity to enter CP, a name that stands to drastically outperform rail peers moving forward.
- With the merger of CP and KSU, the Company now possesses the first-and-only rail network connecting all North American nations. Regardless of the strength in CP's end-markets, the Company is poised to see volume growth due to the attractive opportunities that its network provides. Projects like the MMX are particularly attractive to certain end-markets, allowing CP to capture market share.
- CP, the Company that pioneered precision railroading, looks to once again leverage this scheduling to deliver margins above the Company's previous record setting numbers. Now with a single-line network spanning North America, CP has the opportunity to offer complete accountability to customers. As a result, volumes will grow, allowing CP's industry-leading incremental margins to shine through. Additionally, revenues from the lower margin, primarily interchange, KSU will be significantly more valuable to the combined enterprise.
- Despite CP's previous successes with M&A and building coast-to-coast networks, the Street doesn't believe CP will meet its volume guidance and integration costs will exceed expectations. As a result, CP trades at a ~18.0% discount to its 1-year median EV/EBITDA of 19.0x, and a ~3.0% discount to its 1-year median P/E of 23.2x, thus providing the Fund with an opportunity to enter a best-in-class name at an attractive valuation. Through our DCF and multiples analyses, our team sees CP shares reaching $94, representing a ~25.0% return.

COMPANY OVERVIEW

Canadian Pacific Kansas City Ltd. (CP) is a Class I railroad company. After completing its merger with Kansas City Southern (KSU) in Apr'23, CP now operates a ~20.0k mile transnational rail network, spanning across both coasts of Canada, the U.S. Midwest, and several points in Mexico. CP's rail network is the first-and-only to connect all three North American nations. CP diversifies its revenue through eight business segments: Intermodal (25.4% of 2Q'23 revenue), Grain (20.1%), Energy, Chemicals & Plastics (15.8%), Potash, Fertilizers & Sulfur (11.1%), Metals, Minerals, and Consumer Products (10.0%), Coal (7.0%), Automotive (6.5%), and Forest Products (4.1%). The Company is expected to release its 3Q'23 earnings on Oct 25th.



Symbol	NYSE: CP
52-Week Range	$65.16 – 85.40
YTD Performance	(0.3%)
Market Cap (M)	$69,525
Net Debt (M)	$14,370
Dividend Yield	0.8%
NTM EV/EBITDA	15.6x
NTM P/E	22.5x
ROE	11.2%
ROA	5.7%
ROIC	7.6%

FY (Jan)	2022A	2023E	2024E
EPS (Adj.)			
Q1	0.50	0.63	0.78
YoY Change		*26.0%*	*23.8%*
Q2	0.64	1.06	0.80
YoY Change		*65.6%*	*(24.5%)*
Q3	0.73	0.71	0.88
YoY Change		*(2.7%)*	*23.9%*
Q4	1.00	0.86	0.98
YoY Change		*(14.0%)*	*13.9%*
Year	2.87	3.26	3.44

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Source: Bloomberg, FactSet, CapitalIQ. The William C. Dunkelberg Owl Fund does and seeks to do business with companies covered in its research reports. Thus, investors should be aware that the Fund may have a conflict of interest that could affect the objectivity of this report. All prices are current as of the end of previous trading session from date on which report was issued.

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INVESTMENT SUMMARY

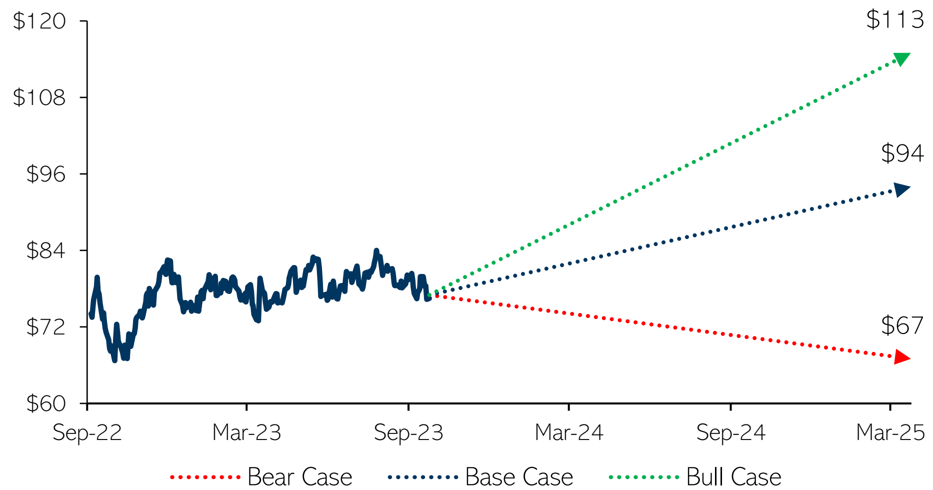
Headquarters
Calgary, Canada

Chief Executive Officer
Keith Creel

Number of Employees
20,624 (as of 2Q'23)

GICS Classification
Industrials

GICS Sub-Industry
Transportation



PRICE TARGET SCENARIOS

Bull Case Price Target: $113.00

12-18 Month Target Return: *+52%*

Revenue grows at a 17.0% CAGR from FY'22 to FY'27 as the value proposition of CP's new rail network connecting all North American nations shifts demand from competitors to CP. Segments, such as Automotive and Intermodal, grow at a ~19.3% and ~21.7% CAGR, respectively, as CP's new network is most appealing to these end-markets. As a result of this volume outperformance, the Company's strength in incremental margins become apparent. CP's operating margins exceed their previous fiscal year record of 42.9%, reaching 49.0% by FY'27. Part of this margin improvement also stems from CP being able to offset its higher-than-currently needed workforce with a surplus of volume. Capex comes in slightly above the Street as CP builds out unique service offerings for end-markets. Debt repayment is above Street estimates as CP utilizes its robust FCF generation for the Company's deleveraging efforts.

Base Case Price Target: $94.00

12-18 Month Target Return: *+25%*

Revenue grows at a 11.5% CAGR through FY'27 as CP captures additional volumes from end-markets most attracted by CP's new rail network. Representing this, Automotive and Intermodal revenues grow at a 12.9% and 15.2% CAGR, respectively. Operating margins improve to 46.0% by FY'25, however, expansion slows after FY'25. The Company's workforce issues subside as CP is able to offset higher expenses and lower utilization with growing volumes. Capex comes in-line with the Street at ~$2.5 bn in FY'25 as CP looks to build out infrastructure on the Mississippi. Debt repayment comes in-line with the Street as CP meets its leverage target of 2.5x before FY'25.

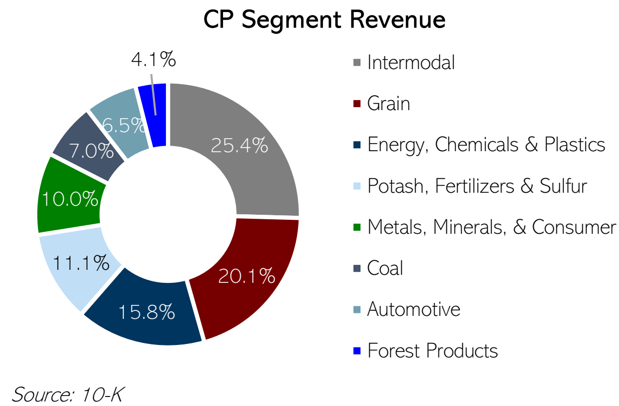
Bear Case Price Target: $67.00

12-18 Month Target Return: *(10%)*

Revenue grows at an 5.2% CAGR from FY'22 to FY'27, underperforming expectations attributed to lagging demand from key end-markets. Namely, Automotive, Intermodal, and Energy, Chemicals & Plastics, grow at a 7.4%, 9.2%, and 4.7% CAGR through FY'27, respectively. As a result of lagging demand, margins struggle to improve. CP reports a 40.0% operating margin in FY'27, in-line with the Company's pre-merger margins. CP is forced to cut employees because of lagging volume, causing Compensation & Benefits expense to decline by 19.0% in FY'25. Again, capex falls relatively in-line with expectations from the Street, reporting ~$2.2 bn in FY'25. Debt repayment falls below the Street's expectations as CP looks to meet its leverage target but struggles to generate capital.

BUSINESS OVERVIEW

Intermodal



Source: 10-K

Cross-border intermodal is the transportation of freight between the U.S., Canada, and Mexico. Cross-border intermodal freight is typically manufactured consumer products. Domestic intermodal is the transportation of freight intra-country. Domestic intermodal freight usually includes goods for the consumer, wholesale, retail, food, and commodities industries. International intermodal is the transportation of freight between North American, European, and Asian end-markets. Goods originating in Asia make up ~86.3% of international intermodal revenue. A majority of CP's containerized traffic for global imports moves through the Port of Vancouver due to its exposure to the Pacific Rim.

Energy, Chemicals & Plastics

This segment moves energy products, such as liquefied petroleum gas (LPG), fuel, oil, asphalt, and gasoline. Most of the Company's Western Canadian energy traffic originates in Saskatchewan and the Alberta Industrial Heartland, Canada's largest hydrocarbon processing region. CP's biofuels traffic mainly originates from facilities in the U.S. Midwest, and is shipped to destinations in the U.S. Northeast, the U.S. Gulf Coast, and Alberta. The Company moves crude from production facilities throughout Alberta to refining markets primarily in the U.S. Gulf Coast region. Most of CP's crude is now being transported as DRUbit, a sustainable heavy crude oil that is specifically designed for rail transportation. The Company's chemical traffic includes products, such as ethylene glycol, caustic soda, sulfuric acid, and methanol, which originate in Western Canada and the U.S. Gulf Coast. CP also transports plastics, including polyethylene and polypropylene, which are used to make products like shopping bags, clear food wrap, and detergent bottles. Half of CP's plastic traffic originates in Central and Northern Alberta and is transported to the U.S.

- In its 2Q'23 earnings call, management noted that the Company signed a multi-year contract with Shell PLC (SHEL), potentially bolstering volumes in this segment. The Company has not released any additional information on the details of the contract, nor have sell-side analysts provided any quantification on the matter. However, management seemed optimistic in regard to refined energy product transportation demand.

Grain

CP's rail network is positioned in the heart of grain-producing regions, including the U.S. and Canadian Prairies. These regions are comprised of the Saskatchewan, Manitoba, & Alberta provinces, and the states of Kansas, Oklahoma, Nebraska, and North & South Dakota. The Company transports grains through Canada and the U.S., using an 8.5k-foot train comprised of high-capacity hopper cars. CP moves both whole grains, such as corn, wheat, canola & soybeans, and processed products like feed, flour meals, oils & malts. In partnership with other railways, the Company moves grain to export terminals in the Pacific Northwest (PNW) and the Gulf of Mexico.

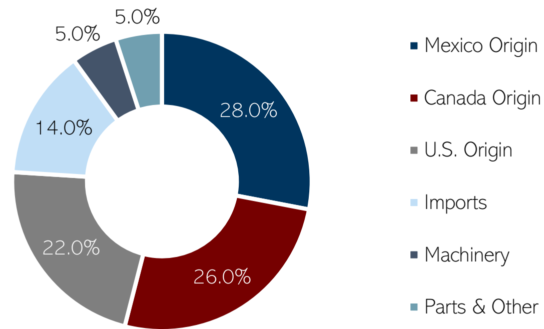
Metals, Minerals & Consumer Products

Metals, Minerals & Consumer Products freight revenues are generated from transporting aggregates, including frac sand, steel, food & consumer products, non-ferrous metals, cement, limestone, and gypsum. Most of its frac sand, a material used to fracture rocks in fracking, originates at mines located along CP's rail network in Wisconsin and is often transported to the Bakken and Marcellus shale formations and Permian shale basin. Cement is shipped directly from production facilities in Alberta, the U.S. Midwest, Ontario, and Quebec, to energy and construction project sites in Western Canada and the Pacific Northwest. CP transports steel from mills in the U.S. Midwest, the Canadian Prairies, and Ontario to a variety of industrial users. Metals like aluminum and steel are transported from mines to smelters & refineries, and then finished products are delivered to automotive and consumer product manufacturers.

Automotive

CP's automotive portfolio consists of four finished vehicle traffic components: (1) Canadian-produced vehicles that ship to the U.S. after being manufactured at Ontario-based facilities. (2) Vehicles from foreign countries that move through the Port of Vancouver to Canadian markets. (3) U.S.-produced vehicles that are shipped domestically and cross-border to Canadian markets in Ontario, Alberta, and Manitoba. (4) Mexican-produced vehicles that ship to Canada and the U.S. In addition to finished vehicles, CP transports used vehicles, machinery, and automotive parts.

CP Automotive Breakdown



Source: 10-K

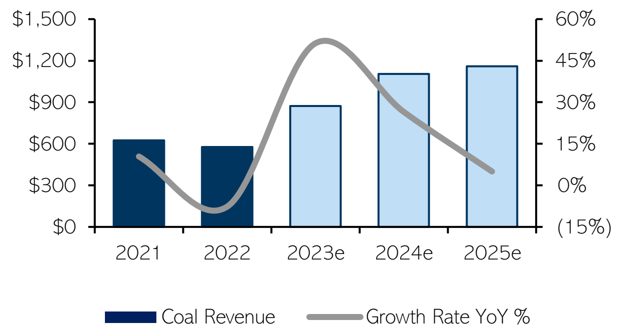
Potash, Fertilizers & Sulfur

Potash is a material made from potassium carbonate & potassium salt and is used to support plant growth, crop yield, and disease resistance. CP's potash traffic moves from Saskatchewan to offshore markets through the Ports of Vancouver, Portland, Prince Rupert and Thunderbay. CP's fertilizer traffic includes dry fertilizers like phosphate, urea, nitrate, and ammonium sulphate, and wet fertilizers, such as anhydrous ammonia. Sulfur is extensively used in the production of phosphate-based fertilizers, hence the two often being transported together.

Coal

CP transports metallurgical coal to steelmaking end-markets, which is then used in the steel production process. Most of CP's coal traffic originates from one customer: Teck Resources Limited (TECK), a Canadian-based exploration, mining, and processing company. CP moves coal from TECK's mines in Southeastern British Columbia to port terminals for export to foreign markets. TECK is currently divesting its coal business and plans to increase production at its Elkview plant, which will bolster CP's volumes in this segment.

Coal Revenue



Source: 10-K

Forest Products

Forest Products includes the transport of pulp, paper, and panel products from key-producing areas in British Columbia, Ontario, Alberta, the U.S. Northeast & Southeast and New Brunswick. The end-use of these commodities mainly includes cardboard packaging, LCD screens, air filters, among others. These products are transported to destinations throughout North America, including the U.S. Northeast & Southeast, and exported to foreign markets through the Port of Vancouver. Lumber is also a largely transported commodity in this segment. CP is investing in a $275.0 mn terminal logistics park in Dallas with a lumber transload to capture Texas demand for Canadian lumber.

Mexican Midwest Express

Currently, highway congestion problems at the Laredo gateway, the busiest U.S.-Mexico freight border, have plagued cross-border intermodal transportation. The gateway is open for merely 16 hours a day and trucks are required to change drivers. In May'23, CP announced the addition of the Mexican Midwest Express (MMX), North America's first single-line rail service connecting the U.S. Midwest to Mexico, a market that is exclusively served by trucks. Moreover, it's the first railway to offer refrigerated shipping. Running through Laredo, the line operates 1.0k, 53-foot containers. The MMX's temperature-controlled service will move fresh and frozen produce, baked goods, and other food & consumer products to Mexican end-markets. Additionally, the MMX is a direct application for grain transportation as its temperature-controlled containers can maintain certain humidity levels, ensuring quality.

INDUSTRY OVERVIEW

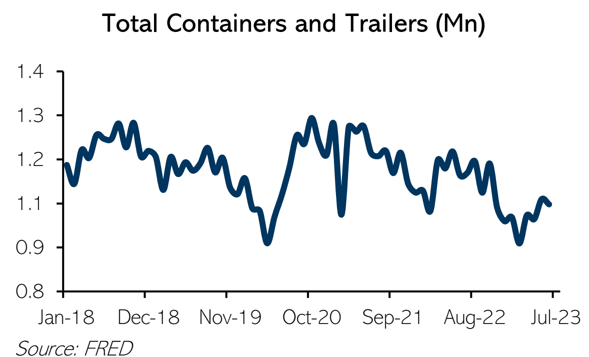
The North American rail industry has incredibly high barriers to entry and is comprised of a few, well-established players like CSX Corporation (CSX), Union Pacific (UNP), Canadian National (CNI), Canadian Pacific Kansas City (CP), Burlington Northern Santa Fe (BNSF), and Norfolk Southern (NSC). They operate as oligopolies, regulated by the Surface Transportation Board (STB), and have fairly straightforward business models. Railroad companies charge customers for carrying cargo over their network of rails and use of rail cars. Within the rail industry, railroads are defined as either Class I, Class II, or Class III which are thresholds set by annual revenue.

Since Aug'22, depleting water levels of the Mississippi River, caused by the Jackson Water Crisis, have resulted in a dramatic shift away from domestic barge transportation and towards ground transportation methods. In Aug'23, 61.0% of the Midwest was classified as "abnormally dry" with no recovery in sight, according to Accuweather. The AFBF reports that barge operating capacity is 15.0% below normal levels, and in some locations, freight rates have risen ~20.0% week over week. In addition, nearshoring, the process of moving supply chains back to a company's home country, continues to be major trend. As companies look to minimize geopolitical risk and cut costs by investing in domestic manufacturing operations, railways are posied to benefit due to increased freight volumes.

According to the Association of American Railroads (AAR), rail traffic in North America has increased by 4.1% in 1H'23, which is significant growth considering how mature and slow-moving the rail industry is.

Intermodal: Where Paths Meet

Intermodal is the transport of retail goods in overseas and domestic containers that can easily be transported between train, truck, and ship with no additional reloading or unloading. Intermodal transportation takes on three main forms: Rail-to-Truck, Rail-to-Ship, and Ship-to-Truck. The intermodal Rail-to-Truck process is simple. First, a truck brings an empty container to a shipper, the container is then loaded with cargo and taken to a railyard. Next, the container is moved onto a train and taken to its destination region. Finally, the container is put on a truck, delivered to the recipient, and the cargo is unloaded. The other two methods, Rail-to-Ship and Rail-to-Truck involve a similar process.



Source: FRED

Demand for intermodal freight has grown significantly. The intermodal market is expected to grow at an ~8.3% CAGR from CY'23 to CY'28 due to rising fuel prices. WTI Crude prices are up ~19.5% YTD, hovering around $90.0/bbl. Road transportation has become more expensive resulting in greater utilization of trains in the freight transportation process. But why do companies prefer trains over trucks in the face of rising oil prices? It's because on average, **railroads are three to four times more fuel efficient than trucks on a ton-mile basis.** Freight trains can carry one ton of freight nearly 500.0 miles while only burning through 1.0 gallon of diesel fuel. One freight train can also haul 200 railcars or more, each with 100.0 tons of freight. For reference, it would take ~800 trucks to move the same amount of cargo. The slow demise of Mississippi water levels, coupled with the cost advantages of railways, provide a favorable outlook for the intermodal transportation industry.

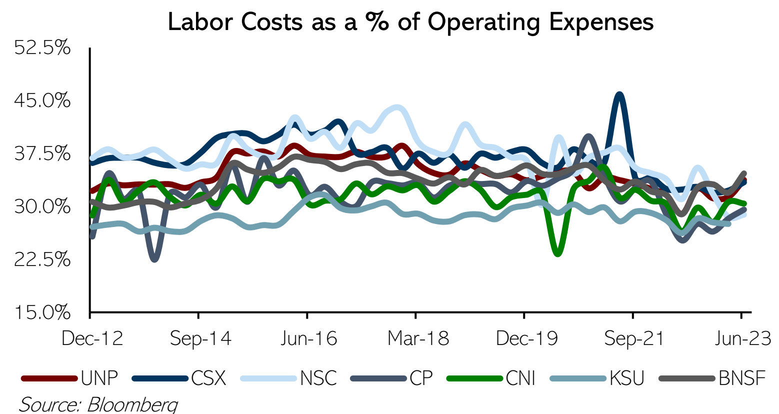
Charging Forward

Automotive: According to the AAR, freight rail moves 75.0% of new vehicles and light trucks purchased in the U.S. each year. Railroads serve most of North America's 70+ automobile manufacturing plants, carrying 1.8 mn carloads of vehicles and parts. As such, railroad utilization is propelled by growth in automotive manufacturing. Automotive manufacturing is recovering from trough levels as consumers put vehicle-related purchases on the backburner post-pandemic. Volumes are strong as they are up 8.2% YoY. The North American automotive manufacturing market is expected to grow at a ~5.3% CAGR from CY'23 to CY'28, with Mexico becoming a robust region. According to the International Trade Administration, 90.0% of the vehicles produced in Mexico are exported, with ~76.0% destined for the U.S. Furthermore, the UAW labor dispute has not had a material impact on the Railroad industry yet.

Energy: Energy is one of the largest end-markets for railways as they dominate the transport of liquefied petroleum gas (LPG), fuel, oil, asphalt, crude, and gasoline. Railroads account for ~60.0 - 70.0% of ethanol transportation. In addition, the AAR reports that railroads moved 3.3 mn and 3.4 mn carloads of coal in CY'21 and CY'22, respectively. Despite the uptick in CY'22, coal transportation demand has fallen 50.0% over the past decade due to the increasing popularity of natural gas and renewables like solar. Additionally, railway energy demand is susceptible to legislation. For instance, during Trump's administration in CY'20, railroads were given provisions to transport LNG. However, in Sep'23, the Department of Transportation's Pipeline and Hazardous Materials Safety Administration (PHMSA) formally suspended the authorization of LNG transportation by the use of rail because of environmental issues.

Grain: The AAR reports that ~40.0% of grain exports are moved by rail, meaning that railroad utilization is also driven by a prolific grain harvest. Canada's grain harvest, the world's largest, struggled significantly last spring. Wheat growing areas in Canada experienced their driest conditions in two decades, with Alberta being hit the hardest. However, the Spring drought represented trough levels with an imminent recovery. **Statistics Canada forecasts the CY'23-24 total Canadian crop size to be ~95.7 mn metric tons (MMT) and Western Canadian grain production to be 73.0 MMT, compared to ~67.1 MMT in CY'21-22.**

Locomotive Labor



Source: Bloomberg

Following the COVID-19 pandemic, all major North American railroads adopted Precision Scheduled Railroading, a strategy intended to increase efficiency through staff cuts, streamlining schedules, and prioritizing on-time performance. But in actuality, it was unsuccessful as a reduced headcount dampened network capacity in the face of growing freight volumes. Staffing shortages also induced more responsibility on each individual rail worker which led to worse working conditions. In CY'22, major North American railroads underwent a rampant hiring spree under pressure by the STB as it looked to restore staffing levels and mitigate the issue across the industry.

However, rail workers are still unhappy as wages remain low and hours high. A wildfire of unionization has spread throughout the Transportation industry. Recent events, such as the UPS & Teamsters dispute, have set a precedent for union success, compelling rail workers to follow suit and continue advocating on the picket lines. Strikes have hurt bottom-lines significantly. For instance, the five-week strike at the Port of Vanouver, which is used by CNI, CP, and BNSF, resulted in a daily $370.0 mn in economic losses. What's more, the Canadian Chamber of Commerce estimated that Canada lost $5.5 bn during the strike as $800.0 mn in goods move through the port every day. Aside from operational disruptions, railroad margins are already pressured because of elevated head counts.

(Near)shoring Up Savings

Geopolitical tensions, the replacement of NAFTA with the USMCA, and an influx of fiscal stimulus (CHIPS and Science Act, IRA & IIJA) have set the stage for a return to industrial production growth. **The U.S is experiencing a factory building boom, with construction spending for manufacturing facilities up ~76.3% YoY**. In addition, Mexico is becoming a hotspot for companies to near-shore their supply chains from Asia. North American companies are turning to Mexico as it offers geographical advantages, a large, low-cost labor force, and free-trade agreements with the U.S. and Europe. Mexican manufacturing exports to the U.S. are expected to grow from $455.0 bn to ~$609.0 bn by CY'25, exhibiting a 6.0% CAGR. **In addition, Uber Freight estimates that since CY'22, 453 companies have begun the process of relocating supply chains to Mexico**, and further investment is coming from companies that already have a presence in the country. For example, Mattel, BMW, Tesla, Constellation Brands, among countless other companies, have invested in Mexican-based production facilities. This also showcases how railroads can benefit from shifting automotive and consumer trends, including electric vehicle production.

CATALYSTS & DRIVERS

Although peers like UNP and BNSF operate over ~30.0k miles of rail infrastructure, CP has a huge competitive advantage: it's the first-and-only railroad company to connect all North American nations. Why does this matter? Access. The expanded network has direct access to key end markets, unlocking significantly greater opportunities for scalable revenue growth. CP's unique network will also allow for outperformance relative to its peers as it provides a more attractive rail offering to its customers through enhanced efficiency and expanded geographical reach.

Full Steam Ahead!

Automotive: Separately, Canadian Pacific and Kansas City Southern served auto assembly plants in Ontario and Mexico, however the two companies struggled with short hauls from the plants to interchanges with other railroads. These interchanges slowed rail service significantly. **Now with a seamless network, CP can link assembly plants in southern Ontario and Mexico with consumers in Texas and the upper U.S. Midwest without using an interchange.** In 2Q'23, Automotive revenues were up 24.0% YoY and volumes were up 11.0% YoY, representing an all-time high in the region. Demand for finished vehicles remains strong as the industry continues to catch up on North American inventory shortages from supply chain issues. The efficiency and geographic reach enabled by the merger will allow CP to fulfill shipment orders and capture growing automotive production demand. As such, we forecast Automotive revenue of $~1.9 bn by FY'27 in our base case, growing at a ~12.9% CAGR.

Bulk Commodities: Despite grain volumes struggling this year due to severe droughts, CP's expanded network allows for greater geographical reach which will drive demand and offset these headwinds. CP plans to supply the capacity required to move 685.0k metric tons of grain each week when the Port of Thunder Bay is open (August to Mid-December & April to July). During the winter months, CP plans to shift operations to the Port of Prince Rupert, allowing for year-round transport. This has proved successful as CP received 5.1k grain orders in the first week of Sep'23 and 5.7k orders the following week, and expects to move 33.0 MMT of Canadian grain by FY'24.

Steamin' Past the Competition

Although all railroads will reap some sort of benefit from industry volume recovery, our team believes that CP will significantly outgrow peers and that investors aren't pricing in the true potential for outperformance. Management's synergy expectations from the merger are modest considering its supplementary competitive advantages in Intermodal. Namely, the launch of the Mexican Midwest Express (MMX) and its recent contracts with Knight-Swift Transportation (KNX) Schneider National (SNDR), and Shell PLC (SHEL).

MMX: The MMX provides CP with a prime opportunity for truck conversion. CP plans to construct a $100.0 mn International Railway Bridge that's open for 24 hours and is exclusively operational for the MMX line. **CP expects these initiatives to result in 1.8 mn truckload to rail conversions by CY'28, representing a total value of $1.4 bn.** The fuel economy of railways, grain volume recovery, and highway congestion issues are all direct paths that point customers towards the MMX, benefiting CP's Intermodal business. As a result, we forecast an Intermodal revenue of $4.1 bn in FY'24, a 48.7% increase from our FY'23 projections and an ~83.0% increase from FY'22.

KNX & SNDR: In Apr'23, CP announced a new multi-year agreement with KNX and SNDR to move truckload intermodal transportation operations to CP's MMX line. KNX and SNDR are the largest full-load trucking companies in North America. **The three companies have agreed to convert 64.0k trucks to rail each year**. KNX's and SNDR's established customer bases in Mexico, coupled with CP's vast network of rail lines, terminals, and cross-border efficiency, sets the stage for a robust future of truck-to-rail conversions.

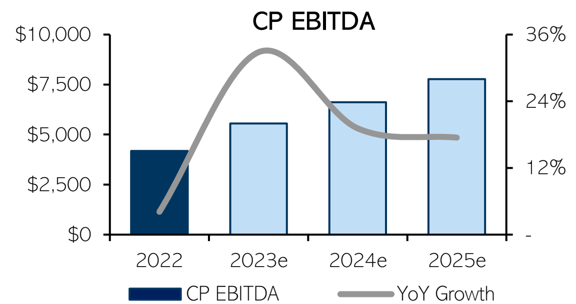
Shell: Although there's limited information on the contract, we believe that it's a testament CP's allure. Rail customers ultimately have the goal of transporting their goods from Point A to Point B as efficiently as possible. SHEL, a behemoth in O&G, was swift to sign with CP following the completion of the KSU merger. As such, we hold similar optimism in CP's ability to attract large clients and drive volumes; we forecast ECP revenue of $3.3 bn in FY'23.

In essence, CP's expanded network allows for greater demand as automotive and grain volumes begin to recover. The MMX and new partnerships create strong competitive advantages, driving outperformance.

Nothing Can Stop CP's Momentum

After reporting weak margins in FY'21 and FY'22, operational efficiency has once again become the main objective of CP's management. The Company was a pioneer in precision railroading, allowing CP to move from an industry laggard to leader in margins. Since then, nearly every Class I railroad has adopted this strategy, but has failed to implement it effectively, at least in comparison to CP. Once again, CP's management will rely on precision scheduling to drive margin growth, however, this time the Company has an extremely unique advantage in doing so.

Precision scheduled railroading isn't fully achievable without a single-line network. Historically, to complete these deliveries it would require an immense amount of operational and administrative coordination between companies. A small delay from one company threw off deliveries for others as these trains were precisely timed for optimal rail utilization. A lack of accountability from a number of rails led to bottlenecks, ultimately causing delays and higher costs. However, as CP now touts a single-line network connecting all North American nations, the Company that pioneered precision scheduled railroading finally has the opportunity to offer customers complete accountability.



Source: Model

Some may argue this is already accounted for in CP's expected $1.0 bn in annual synergies. However, our team would argue that this figure doesn't even begin to reflect CP's opportunity for the following reasons. Within railroads, it has been extremely difficult to complete acquisitions thanks to a historical precedent of anticompetitive lawsuits. As a result, CP is more inclined to be conservative with its synergy estimates. Representing this, when CP acquired Central Maine & Quebec Railway, the Company created a single-line network spanning the coasts of Canada. As a result of this acquisition and CP's ability to efficiently precision schedule, **the Company outperformed its initial synergy guidance by over 250.0%** according to Spree Capital**.** Now, with a network spanning North America, our team is extremely optimistic on synergies exceeding expectations.

More Than Just Incrementally Better

Kansas City Southern, before being acquired, was primarily an interchange carrier, transferring over 80.0% of volume to another company to complete deliveries. As such, margins lagged behind peers that provided a more valuable service to clients. On the other hand, CP's precision scheduled railroading has allowed the Company to achieve industry-leading operating ratios. In particular, CP has been an industry record-setter with incremental margins, which represent the profit margin for each additional dollar of revenue earned by the Company.

A rail's efficiency is tracked using dwell time, the average time a car resides within a terminal, and rail speed, how quickly on average a company's trains move. KSU, being an interchange carrier, lagged in both categories, meanwhile, CP outperformed in both. For comparison, CP, KSU, and CSX in FY'22 reported a dwell time of 8.0, 23.6, and 11.3 hours, respectively, and average train speed of 21.1, 13.4, and 16.1 MPH, respectively. Moving forward, our team shares a similar optimism to the Street in regard to these figures for CP. With a single-line network, dwell time is going to decrease drastically, likely outperforming FY'22 results before FY'25. CP's network is particularly attractive for long-distance transportation, which will boost train speeds. With competitors previously struggling to maintain a similar efficiency as CP, they stand no chance against CP with the Company's new network.

With CP's recent margin struggles due to its labor force, Bloomberg expects that just by combining the networks **CP's margins will improve by low double-digit percentages.** However, the real opportunity lies within CP's incremental margins. Considering CP has historically reported an **astounding ~75.0% incremental margin**, each additional dollar of revenue from the low-margin KSU is significantly more valuable to the combined enterprise. Additionally, the considerable volume growth from the value proposition of CP's new network will further CP's margin expansion past its industry records that no one previously believed were possible. As a result, in our base case we forecast revenue of $21.9 bn and operating margins of 46.0% in FY'27, and in our bull case we forecast revenue of $27.8 bn and operating margins of 49.0%, highlighting how impactful CP's volume growth will be on margins.

UNDERVALUATION & THESIS

A Trip Down Memory Train

2Q'23 was a rough start for the newly merged rail. Adj. EPS came in at $0.61, down ~13.0% YoY and below consensus of $0.69. Revenue fell in-line with consensus at $3.3 bn, however CP's operating ratio came in well above expectations at 64.6% v. 61.6%. Higher-than-anticipated integration costs were the main driver behind the miss, which is concerning considering management's strong track record. The merger between CP and KSU is one of the largest in rail history, making it difficult to seamlessly integrate the two networks. With CP's 2Q'23 miss, many on the Street speculate that there will be more unanticipated costs, potentially preventing CP from meeting its goal of $1.0 bn in annual synergies by CY'25. Sure, this is a valid concern. However, investors are failing to fully realize that CP's growth opportunity remains fully in-tact, which is significantly more important than its cost-control. Despite peers cutting estimates, management reiterated its guidance of double-digit EPS growth through CY'28.

On Track for Improvements

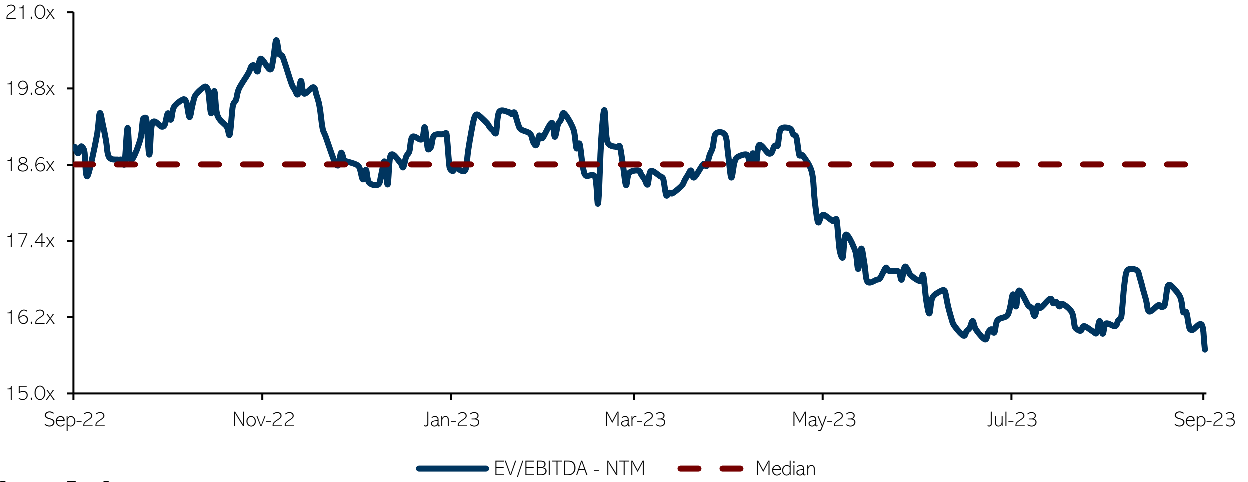
A myriad of challenges with CP's workforce have emerged, pressuring margins and forcing the Company to eat higher costs. It starts in CY'21, following the announcement of the CP and KSU merger, CP began aggressively hiring to capture the additional demand driven by the value proposition of the Company's new rail network. In doing so, CP grew total employees at a ~7.7% CAGR and also took on ~10.0k employees from KSU, raising total headcount by ~75.2% from CY'21 – 2Q'23. However, a slower-than-expected economic recovery and lagging demand from a number of end markets have caused rail volumes to remain relatively flat YoY. Competitors are operating as usual, meanwhile CP is carrying a larger-than currently needed workforce, negatively impacting the Company's bottom line. Highlighting this inefficiency in CP's workforce, gross-ton-miles (GTM) per employee has fallen at a ~7.5% CAGR since CY'21. This puts CP in a tough position as it need these employees to fulfill its long-term growth initiatives, however as rail volumes remain muted, CP is forced to deal with lower utilization rates.

Bloomberg believes that rising interest rates, high inventories, China's slow reopening, and a looming recession could limit rail volume growth until 2H'24. Declining demand for Forest Products and Coal moving into CY'24 will also challenge volumes. Additionally, the Street believes that end-markets like Automotive face difficult YoY comparisons as they have been a source of strength for rails over the past year. Economic data is still generally bearish which doesn't provide a favorable outlook for rail volumes. With this bearish outlook, the Street believes CP's labor situation will only become more challenging to manage. However, the reality is, CP's growth story is idiosyncratic and regardless of the strength in its end-markets, the Company will grow volumes purely because of the value proposition of its rail network. This network demand will more than offset potential lagging demand from end-markets, ultimately allowing CP to maintain a more optimized workforce and expand its margins as a result.

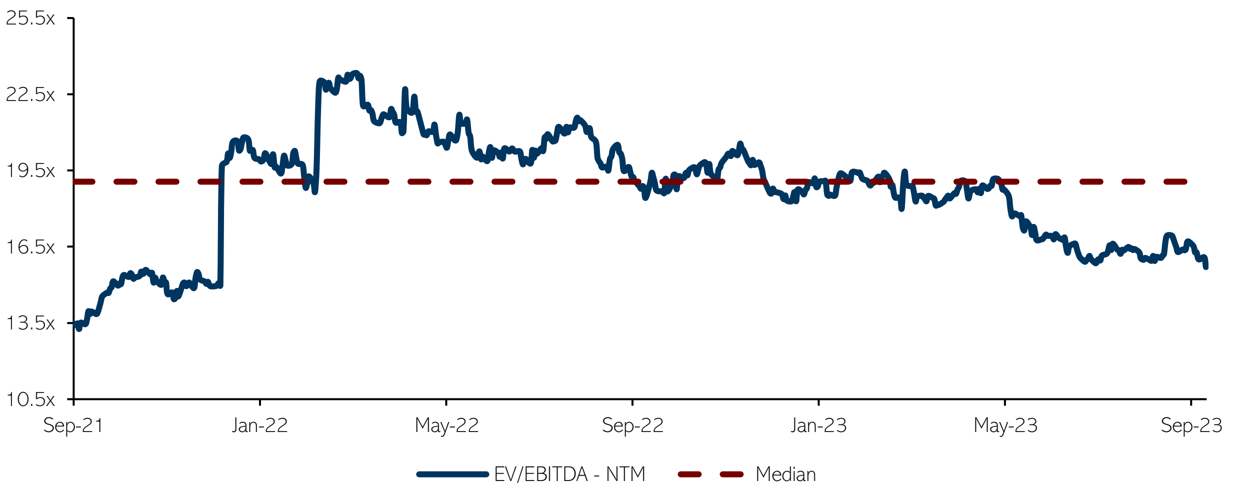
Take the Train Back to Work.

Continuing with labor issues, on July 1st, about 7.5k dock workers went on strike from port facilities located in the Pacific region of Canada, namely in Vancouver and Prince Rupert. For CP, these ports are responsible for originating the majority of the Company's international intermodal travel. Given the essential location of these ports, it is estimated that these strikes interrupted ~$370.0 mn of economic activity per day. After a little over a month of negotiating, a deal was finally reached on August 4th. The aftermath, an estimated ~$10.7 bn in economic losses, significant shipping backlogs, logistical nightmares, and a slow recovery to normal operations. To this day, the Potash market remains in disarray. Canpotex, a company responsible for one third of global Potash production capacity, has reported it is withdrawing all offers for new sales for the foreseeable future due to the strike. As a result, in 3Q'23 our team forecasts Potash revenue falling ~15.3% YoY despite the CP and KSU revenue synergies.

According to Deutsche, CP's revenue-ton-miles (RTM) was down ~16.0%, and intermodal volume fell ~34.0% during these strikes. In addition, Canadian rail traffic has continued to lag behind US rail volume, a trend that started as a result of these strikes. RBC reports that based on the way Canadian rail volumes are trending, CP would miss volume guidance by ~6.0% in 3Q'23. Within the railroad industry, the tensions had the largest impact on CP as ~20.0% of the Company's post-merger carloads originate in the Pacific region of Canada.



Source: FactSet



Source: FactSet

Source: FactSet

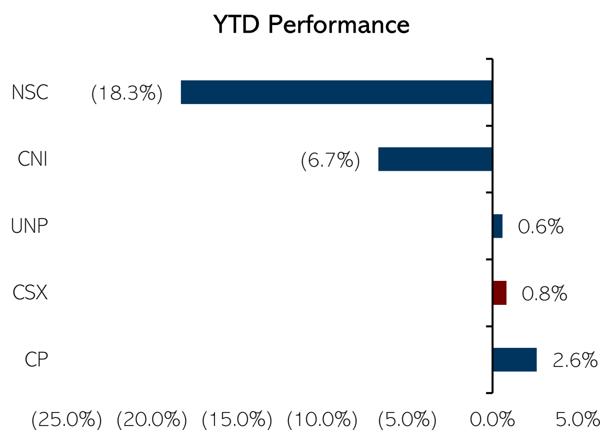
PEER GROUP ANALYSIS

Canadian National Railway Company (CNI): CNI is a Class I railroad with a ~19.5k mile rail network that serves Canada, and the U.S. Midwest & Southeast. The Company offers rail services to the automotive, coal, forestry, chemicals, and consumer staples industries. CNI diversifies its revenue across the following business segments: Intermodal (28.8% of FY'22 revenue), Petroleum & Chemicals (19.2%), Grain & Fertilizers (16.6%) and Other (35.4%). The Company is expected to report its 3Q'23 earnings on Oct 24th.

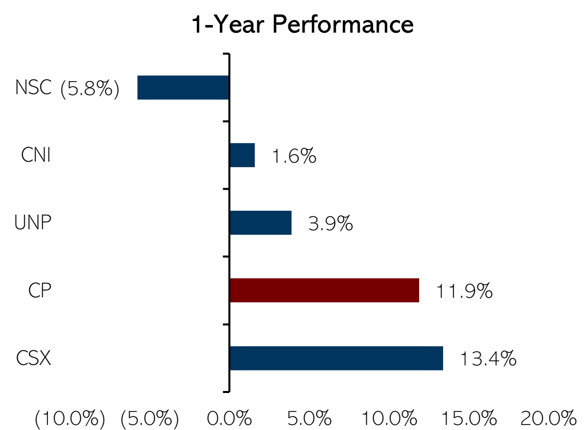
Union Pacific Corporation (UNP): UNP is a Class I railroad company that serves Canada, and the U.S. Southeast & Southwest. The Company has been a long-standing player in the rail space since 1969, operating ~56.4k freight cars and 7.3k locomotives on a 32.5k mile rail network. The Company mainly transports agricultural products, automotive, chemicals, coal, and industrial products. UNP diversifies its revenue across the following business segments: Industrial (33.7% of FY'22 revenue), Bulk (29.2%), Premium (29.1%), and Other (8.0%). The Company reports its 3Q'23 earnings on Oct 26th.

CSX Corporation (CSX): CSX operates a rail system of ~20.0k miles along the East Coast of the U.S., from the U.S.-Canada border down to South Florida. The Company primarily transports freight to the industrial, construction, agricultural, and consumer end-markets. CSX's broad portfolio of transported products includes coal and new energy products, such as biodiesel & ethanol, automobiles, military equipment, and chemicals. CSX diversifies its revenue across the following business segments: Merchandise (55.5% of FY'22 revenue), Intermodal (15.5%), Coal (16.0%), Trucking (7.0%), and Other (6.0%). The Company is expected to report its 3Q'23 earnings on Oct 18th.

Norfolk Southern Corporation (NSC): NSC is a provider of rail transportation services. The Company's ~34.6k mile rail network serves primarily the U.S. East Coast and Midwest. NSC transports raw materials, intermediate products, and finished goods. NSC is a major transporter of industrial products, such as agriculture, forest, consumer products, chemicals, metals, and construction materials. The Company diversifies its revenue across three business segments: Merchandise (57.5% of FY'22 revenue), Intermodal (28.9%), and Coal (13.6%). The Company reports its 3Q'23 earnings on Oct 25th.



Source: Bloomberg



Source: Bloomberg

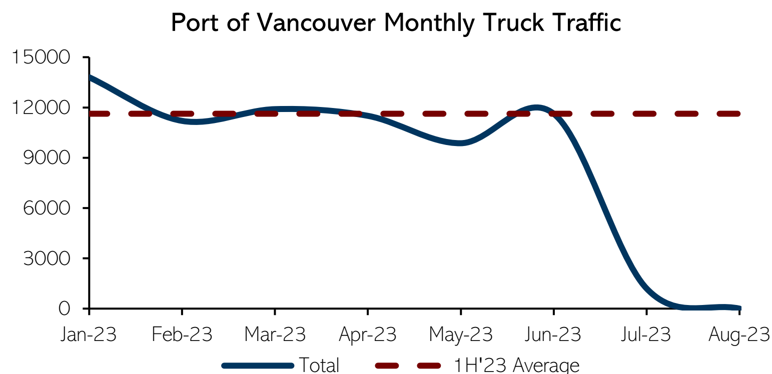
Primary Peer Group

Company	Ticker	Market Cap	Enterprise Value	Sales LTM	Sales 2023E	EPS LTM	EPS 2023E	EBITDA Margin LTM	EBITDA Margin 2022E	Profit Margin LTM	Profit Margin 2023E	Enterprise Value / EBITDA LTM	Enterprise Value / EBITDA 2023E	Enterprise Value / Sales LTM	Enterprise Value / Sales 2023E	Price / Earnings LTM	Price / Earnings 2023E
Canadian Pacific Kansas City Limited	CP	$96,054	$120,042	27.3%	53.2%	58.8%	2.8%	52.0%	48.5%	42.0%	27.0%	18.9x	18.3x	11.8x	8.9x	22.4x	26.3x
Union Pacific Corporation	UNP	127,523	161,558	5.7%	(3.1)%	2.1%	(7.0)%	47.4%	48.3%	27.2%	26.3%	13.3x	13.9x	6.5x	6.7x	19.1x	20.1x
Canadian National Railway Company	CNI	97,073	113,882	13.2%	(1.8)%	7.1%	(1.0)%	56.8%	50.9%	30.2%	29.0%	11.2x	13.3x	6.5x	6.8x	19.0x	19.9x
CSX Corporation	CSX	62,597	80,079	7.8%	(1.6)%	10.6%	(3.8)%	50.1%	49.8%	27.4%	25.9%	10.5x	11.0x	5.3x	5.5x	15.7x	16.6x
Norfolk Southern Corporation	NSC	45,971	61,078	6.9%	(4.6)%	(11.1)%	(11.4)%	46.6%	45.2%	20.2%	23.0%	9.7x	11.1x	4.8x	5.0x	18.1x	16.4x
High		$127,523	$161,558	27.3%	53.2%	58.8%	2.8%	56.8%	50.9%	42.0%	29.0%	18.9x	18.3x	11.8x	8.9x	22.4x	26.3x
Mean		85,843	107,328	12.2%	8.4%	13.5%	(4.1)%	50.6%	48.6%	29.4%	26.2%	12.7x	13.5x	7.0x	6.6x	18.9x	19.9x
Median		96,054	113,882	7.8%	(1.8)%	7.1%	(3.8)%	50.1%	48.5%	27.4%	26.3%	11.2x	13.3x	6.5x	6.7x	19.0x	19.9x
Low		45,971	61,078	5.7%	(4.6)%	(11.1)%	(11.4)%	46.6%	45.2%	20.2%	23.0%	9.7x	11.0x	4.8x	5.0x	15.7x	16.4x

Company	Ticker	General Statistics: Tax Rate	General Statistics: Beta	General Statistics: Dividend Yield	Returns Analysis: ROIC	Returns Analysis: ROE	Returns Analysis: ROA	2022A Leverage Analysis: Total Debt / Cap	2022A Leverage Analysis: Total Debt / EBITDA	2022A Leverage Analysis: Total Debt / Equity	2022A Coverage Analysis: EBITDA / Int. Exp.	2022A Coverage Analysis: (EBITDA - Capex)/Int.	2022A Coverage Analysis: EBIT / Int. Exp.	Liquidity Profile: Quick Ratio	Liquidity Profile: Current Ratio	Credit Profile: S&P	Credit Profile: Outlook
Canadian Pacific Kansas City Limited	CP	15.2%	0.83	0.7%	5.6%	11.2%	3.6%	0.3x	4.2x	0.5x	7.3x	4.9x	5.8x	0.46	0.59	BBB+	Stable
Union Pacific Corporation	UNP	22.9%	1.12	2.5%	15.4%	52.0%	9.0%	0.7x	2.8x	2.9x	9.8x	6.9x	7.7x	0.53	0.72	A-	Stable
Canadian National Railway Company	CNI	24.3%	0.69	2.1%	16.5%	25.0%	10.1%	0.4x	1.6x	0.7x	18.0x	13.0x	14.4x	0.45	0.84	A-	Stable
CSX Corporation	CSX	23.1%	1.22	1.4%	15.4%	32.4%	9.1%	0.6x	2.5x	1.5x	10.1x	7.2x	7.9x	1.38	1.56	BBB+	Stable
Norfolk Southern Corporation	NSC	20.8%	1.29	2.7%	13.3%	19.9%	7.4%	0.6x	2.5x	1.3x	9.4x	6.6x	7.1x	0.61	0.76	BBB+	Stable
High		24.3%	1.29	2.7%	16.5%	52.0%	10.1%	0.7x	4.2x	2.9x	18.0x	13.0x	14.4x	1.38	1.56		
Mean		21.2%	1.03	1.9%	13.2%	28.1%	7.9%	0.5x	2.7x	1.4x	10.9x	7.7x	8.6x	0.68	0.89		
Median		22.9%	1.12	2.1%	15.4%	25.0%	9.0%	0.6x	2.5x	1.3x	9.8x	6.9x	7.7x	0.53	0.76		
Low		15.2%	0.69	0.7%	5.6%	11.2%	3.6%	0.3x	1.6x	0.5x	7.3x	4.9x	5.8x	0.45	0.59		

RISKS TO INVESTMENT THESIS

Unionization



Source: Canadian Chamber of Commerce

Class I railways, including CP, are parties in collective bargaining agreements with various labor unions. The majority of CP's employees belong to labor unions and are subject to these agreements. Workers' demands for higher wages and improved hours have been pressuring corporate bottom-lines. In Dec'22, a collective bargaining contract, representing 12 rail unions and over 115.0k employees was ratified. According to Bloomberg, the contract called for a 14.1% raise effective immediately, a 4.0% hike in Jul'23, and 4.5% boost in CY'24. In addition to eating profits, labor strikes result in lost revenue by halting or disrupting normal operations. CP, in particular, was significantly affected by the five-week strike at the Port of Vancouver, a major hub that enables the Company's international intermodal business. It is estimated that the strike cost CP $80.0 mn in lost revenue. As labor strikes become more prevalent in the transportation industry, they pose a significant risk to CP's upside as an investment.

- *Mitigant:* The Company is directly addressing this issue by ramping up activity through the Port of St. John in eastern Canada once demand recovers, offsetting losses from the Port of Vancouver. Although this seems like a short-term solution, the Company intends to grow business in alternative areas to bolster its ability to withstand weakness at a singular port, should labor strikes continue to arise. CP plans to leverage its expanded access in Mexico to capitalize on a potential rebound in automotive and bulk commodity demand in CY'24. The Company is making strong efforts to sign customers in the region and essentially set the groundwork for a long cycle business that will diversify its revenue streams, reducing its dependency on a singular port.

In our bear case, we modeled Compensation and Benefits as a % of revenue remaining well above historical levels because of potential labor disputes, lowering utilization and raising employee wages.

Integration Risks

With any M&A transaction, integration risks are inevitable. However, as the Canadian Pacific and Kansas City Southern merger was the largest deal in North American rail history, these risks cannot be overlooked. Following the deal's approval by the Surface Transportation Board (STB) in Mar'23, management noted that the full integration of the two companies is expected to take place over the next three years. With this horizon, there's significant potential for integration challenges, threatening the accretive nature of the merger. In addition, if management's synergy expectations are not achieved, investors may lose confidence in the name.

- *Mitigant:* Aside from CP historically having a strong track record for successfully executing M&A, for example the acquisition of Central Maine & Quebec Railway, management is employing strategies to ensure a seamless integration. At the Morgan Stanley Laguna Conference on Sep 13th, management explained how they split up the executive team's area of focus. Chief Operating Officer, Mark Redd is exclusively working on integrating operations in Canada and the U.S., while Chief Transformation Officer, John Orr, is responsible for Mexican operations. Thus far, the Company is on track to hit its cost synergies, and has seen ~$240.0 mn of revenue synergies, exceeding its expectations. At the conference, management also noted that the merger is accretive so far and there have been no issues or setbacks with the integration process.

In our bear case, we modeled operating margins remaining below historical averages through FY'26 as CP struggles to integrate KSU. Following this, margins still remain slightly below historical averages.

VALUATION ANALYSIS

DCF Assumptions

In our FY'23 base case, we assume revenue will continue to grow ~12.0% QoQ for the rest of the year. CP will continue to see revenues grow as more customers opt for the inter-continental single-line network. The largest growth for CP occurs in Intermodal as KSU, a former interchange rail, further integrates with CP and favorable tailwinds play out. Grain also sees large growth as Canada's grain harvest is strong, the number of crops grown has increased, and face weak YoY comparison. From this volume growth, Compensation & Benefits as a % of revenue decreases in tandem to the Company's growth. In our base case, this figure decreases from 20.0% in 3Q'23, to 17.5% in FY'24. As a result, in our base case, operating margins increase from 39.0% in 3Q'23 to 46.0% in FY'24.

As a result, we estimate that CP nearly meets its annual EBITDA synergy guide of $1.0 bn in FY'23, two years before the Company's initial forecast of FY'25. The Company also achieves 15.0%+ EPS growth through FY'28.

Discounted Cash Flow	2020	2021	2022	1Q23	2Q23	3Q23e	4Q23e	2023e	2024e	2025e	2026e	2027e
Revenue	$5,717.3	$5,928.6	$6,535.9	$1,680.3	$2,353.6	$2,620.1	$2,948.0	$9,602.1	$13,040.1	$14,053.5	$15,055.5	$16,206.1
EBITDA	3,032.9	2,978.8	3,101.1	781.6	1,003.3	1,286.3	1,472.9	4,544.1	6,801.0	7,883.0	8,357.4	8,905.0
EBIT	2,455.2	2,377.4	2,468.6	614.7	700.0	1,021.9	1,208.7	3,545.3	5,744.0	6,464.6	6,925.5	7,454.8
Income Tax Benefit (Expense)	(562.1)	(569.5)	(465.7)	(120.9)	5,689.1	(202.6)	(244.9)	5,120.7	(1,190.1)	(1,367.0)	(1,479.4)	(1,607.1)
NOPAT (EBIAT)	$1,893.1	$1,807.9	$2,002.9	$493.9	$6,389.1	$819.3	$963.8	$8,666.0	$4,553.9	$5,097.6	$5,446.2	$5,847.7
% YoY Growth		*(4.5%)*	*10.8%*					*332.7%*	*(47.5%)*	*11.9%*	*6.8%*	*7.4%*
Depreciation & Amortization				166.8	304.0	264.5	264.3	999.6	1,057.1	1,418.4	1,431.9	1,450.1
Stock-Based Compensation				7.4	6.7	7.4	8.4	29.9	37.0	39.8	42.7	46.0
Capital Expenditures				(300.3)	(471.6)	(445.4)	(471.7)	(1,689.0)	(1,888.3)	(1,897.2)	(2,032.5)	(2,187.8)
Goodwill Impairment				-	(5,320.5)	-	-	(5,320.5)	-	-	-	-
(Increase)/Decrease in Working Capital				(100.1)	92.7	250.8	67.9	311.3	104.2	0.9	51.0	58.6
(Increase)/Decrease in LT Items				-	-	-	-	-	-	-	-	-
Unlevered Free Cash Flow				$267.7	$1,000.3	$896.6	$832.6	$2,999.6	$3,863.4	$4,659.6	$4,939.3	$5,214.6
% YoY Growth									*28.8%*	*20.6%*	*6.0%*	*5.6%*
Discountable Unlevered Free Cash Flow				$0.0	$0.0	$896.6	$832.6	$1,729.1	$3,863.4	$4,659.6	$4,939.3	$5,214.6
Full-Year Discount								*0.26*	*1.26*	*2.26*	*3.26*	*4.26*
Mid-Year Discount								*0.13*	*0.76*	*1.76*	*2.76*	*3.76*
Discount Factor								*0.99*	*0.95*	*0.88*	*0.82*	*0.77*
Present Value of Future Free Cash Flow								$1,713.3	$3,663.2	$4,120.7	$4,074.0	$4,011.6
% Growth									*113.8%*	*12.5%*	*(1.1%)*	*(1.5%)*

Perpetuity Growth (PGR) Method	
Terminal Year FCF:	$5,215
PGR:	2.25%
Terminal Value:	107,353
PV of Terminal Value:	82,586
PV of Stage 1 Cash Flows:	17,583
Implied Enterprise Value:	$100,169
(+) Cash & Equivalents:	241
(-) Preferred Stock:	0
(-) Total Debt:	(17,250)
(-) Pension Obligations:	0
(-) Non-Controlling Interests:	(686)
(-) Capital Leases:	0
Implied Equity Value:	$82,474
Diluted Shares O/S:	933.8
Implied Share Price:	$88.32
% Return:	*19.5%*

EV/EBITDA	
Current Multiple	12.5x
Historical Average	18.8x
Premium/(Discount)	*(33.7%)*
Premium Applied to Historical	*(5.0%)*
Implied Multiple	17.9x
NTM EBITDA	$5,984
Implied Enterprise Value	$107,050
(+) Cash & Equivalents	241
(-) Preferred Stock	0
(-) Total Debt	(17,250)
(-) Pension Obligations	0
(-) Non-Controlling Interests	(686)
(-) Capital Leases	0
Implied Market Cap	$89,355
Shares Outstanding	933.80
Implied Price Target	$96
% Return	*28.5%*

Price/Earnings	
Current Multiple	27.1x
Historical Average	25.4x
Premium/(Discount)	*6.9%*
Premium Applied to Historical	*(5.0%)*
Implied Multiple	24.1x
NTM EPS	$4.04
Implied Price Target	$97
% Return	*30.8%*

Implied Share Price

		Perpetuity Growth Rate				
		1.8%	2.0%	2.3%	2.5%	2.8%
WACC	6.2%	$83.68	$87.92	$92.59	$97.75	$103.50
	6.7%	$82.03	$86.20	$90.78	$95.86	$101.50
	7.2%	$80.32	$84.40	$88.90	$93.88	$99.42
	7.7%	$78.84	$82.86	$87.28	$92.18	$97.64
	8.2%	$77.29	$81.24	$85.59	$90.41	$95.76

		NTM EV/EBITDA				
		15.9x	16.9x	17.9x	18.9x	19.9x
EBITDA	$4,787	$62.51	$67.64	$72.76	$77.89	$83.02
	$5,386	$72.69	$78.46	$84.23	$89.99	$95.76
	$5,984	$82.87	$89.28	$95.69	$102.10	$108.51
	$6,583	$93.06	$100.10	$107.15	$114.20	$121.25
	$7,181	$103.24	$110.93	$118.62	$126.31	$134.00

		NTM P/E				
		22.1x	23.1x	24.1x	25.1x	26.1x
EPS	$3.24	$71.46	$74.70	$77.93	$81.17	$84.40
	$3.64	$80.39	$84.03	$87.67	$91.31	$94.95
	$4.04	$89.33	$93.37	$97.41	$101.46	$105.50
	$4.45	$98.26	$102.71	$107.16	$111.60	$116.05
	$4.85	$107.19	$112.04	$116.90	$121.75	$126.60

Implied % Return

		Perpetuity Growth Rate				
		1.8%	2.0%	2.3%	2.5%	2.8%
WACC	6.2%	12.3%	18.0%	24.3%	31.2%	38.9%
	6.7%	10.1%	15.7%	21.9%	28.7%	36.3%
	7.2%	7.8%	13.3%	19.3%	26.0%	33.5%
	7.7%	5.8%	11.2%	17.2%	23.8%	31.1%
	8.2%	3.8%	9.1%	14.9%	21.4%	28.6%

		NTM EV/EBITDA				
		15.9x	16.9x	17.9x	18.9x	19.9x
EBITDA	$4,787	(16.1%)	(9.2%)	(2.3%)	4.6%	11.4%
	$5,386	(2.4%)	5.3%	13.1%	20.8%	28.6%
	$5,984	11.3%	19.9%	28.5%	37.1%	45.7%
	$6,583	24.9%	34.4%	43.8%	53.3%	62.8%
	$7,181	38.6%	48.9%	59.2%	69.6%	79.9%

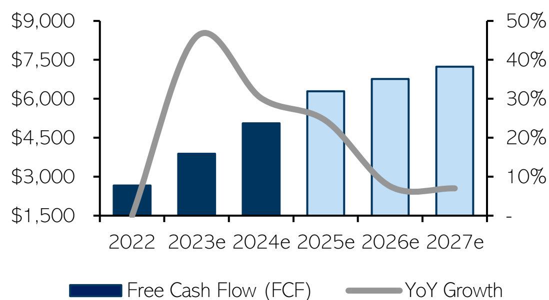
		NTM P/E				
		22.1x	23.1x	24.1x	25.1x	26.1x
EPS	$3.24	(4.1%)	0.3%	4.6%	9.0%	13.3%
	$3.64	7.9%	12.8%	17.7%	22.6%	27.5%
	$4.04	19.9%	25.3%	30.8%	36.2%	41.6%
	$4.45	31.9%	37.9%	43.9%	49.8%	55.8%
	$4.85	43.9%	50.4%	56.9%	63.4%	70.0%

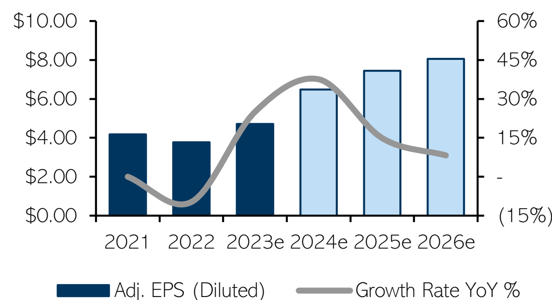
Returns Profile

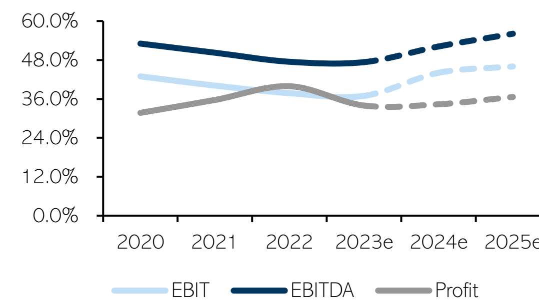
	Methodology	Implied PT	Implied Return
	DCF		
25.0%	*Perpetual Growth Rate*	*$89*	*19.5%*
	Historical Multiples		
25.0%	*NTM P/E*	*$97*	*30.8%*
50.0%	*NTM EV/EBITDA*	*$96*	*28.5%*
	Blended Average	*$84*	*13.3%*
	Weighted Average	*$94*	*26.8%*

FINANCIAL ANALYSIS

Summary	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Total Company Revenue	$7,710.0	$7,995.0	$8,814.0	$12,948.9	$17,585.2	$18,951.8	$20,303.1	$21,854.8
% Growth QoQ		*0.0%*	*0.0%*	*46.9%*	*35.8%*	*7.8%*	*7.1%*	*7.6%*
Grain	$1,829.0	$1,684.0	$1,776.0	$2,397.5	$3,237.5	$3,431.8	$3,603.3	$3,783.5
% Growth QoQ		*0.0%*	*0.0%*	*35.0%*	*35.0%*	*6.0%*	*5.0%*	*5.0%*
% of Total Revenue	*23.7%*	*21.1%*	*20.1%*	*18.5%*	*18.4%*	*18.1%*	*17.7%*	*17.3%*
Coal	$566.0	$625.0	$577.0	$872.9	$1,104.4	$1,159.6	$1,194.4	$1,230.3
% Growth		*10.4%*	*(7.7%)*	*51.3%*	*26.5%*	*5.0%*	*3.0%*	*3.0%*
% of Total Revenue	*7.3%*	*7.8%*	*6.5%*	*6.7%*	*6.3%*	*6.1%*	*5.9%*	*5.6%*
Potash	$493.0	$463.0	$581.0	$584.7	$701.7	$750.8	$788.3	$827.7
% Growth		*0.0%*	*0.0%*	*0.6%*	*20.0%*	*7.0%*	*5.0%*	*5.0%*
% of Total Revenue	*6.4%*	*5.8%*	*6.6%*	*4.5%*	*4.0%*	*4.0%*	*3.9%*	*3.8%*
Fertlizers and Sulphur	$290.0	$305.0	$332.0	$382.1	$447.6	$483.4	$512.4	$543.2
% Growth		*0.0%*	*0.0%*	*15.1%*	*17.1%*	*8.0%*	*6.0%*	*6.0%*
% of Total Revenue	*3.8%*	*3.8%*	*3.8%*	*3.0%*	*2.5%*	*2.6%*	*2.5%*	*2.5%*
Forest Products	$328.0	$348.0	$403.0	$690.6	$879.9	$950.3	$1,007.4	$1,067.8
% Growth		*0.0%*	*0.0%*	*71.4%*	*27.4%*	*8.0%*	*6.0%*	*6.0%*
% of Total Revenue	*4.3%*	*4.4%*	*4.6%*	*5.3%*	*5.0%*	*5.0%*	*5.0%*	*4.9%*
Energy, Chemicals, and Plastics	$1,519.0	$1,563.0	$1,394.0	$2,362.7	$3,301.6	$3,664.8	$4,031.2	$4,434.4
% Growth		*0.0%*	*0.0%*	*69.5%*	*39.7%*	*11.0%*	*10.0%*	*10.0%*
% of Total Revenue	*19.7%*	*19.5%*	*15.8%*	*18.2%*	*18.8%*	*19.3%*	*19.9%*	*20.3%*
Metals, Minerals, and Consumer Products	$629.0	$728.0	$884.0	$1,629.3	$2,027.3	$2,159.1	$2,245.4	$2,357.7
% Growth		*0.0%*	*0.0%*	*84.3%*	*24.4%*	*6.5%*	*4.0%*	*5.0%*
% of Total Revenue	*8.2%*	*9.1%*	*10.0%*	*12.6%*	*11.5%*	*11.4%*	*11.1%*	*10.8%*
Automotive	$324.0	$376.0	$438.0	$978.2	$1,420.2	$1,548.0	$1,702.8	$1,890.2
% Growth		*0.0%*	*0.0%*	*123.3%*	*45.2%*	*9.0%*	*10.0%*	*11.0%*
% of Total Revenue	*4.2%*	*4.7%*	*5.0%*	*7.6%*	*8.1%*	*8.2%*	*8.4%*	*8.6%*
Intermodal	$1,563.0	$1,724.0	$2,242.0	$2,759.5	$4,102.7	$4,430.9	$4,829.7	$5,312.7
% Growth		*0.0%*	*0.0%*	*23.1%*	*48.7%*	*8.0%*	*9.0%*	*10.0%*
% of Total Revenue	*20.3%*	*21.6%*	*25.4%*	*21.3%*	*23.3%*	*23.4%*	*23.8%*	*24.3%*







APPENDIX

Exhibit I: Sell Side Discussion Summary

Analyst: Ariel Rosa | Credit Suisse

Credit Suisse' Investment Thoughts: Ari's team recently dropped coverage of CP, however he did offer the opportunity for our team to give him our investment thesis and receive some thoughts. To start, Ari noted its important to first determine what our team was most bullish on: pricing or volumes. Obviously our team is bullish on volumes, but he made our team reconsider the impacts of pricing. Ari discussed how truck capacity is tightening and in turn improving pricing power for railways. He then confirmed our initial thoughts, that by purchasing CP, our team is bullish on the North American Manufacturing renaissance and nearshoring. We then began to discuss the Company's valuation. CP currently is the most expensive rail. However, Ari argued if you use numbers for perhaps FY'25, many on the Street would argue CP is currently the cheapest. Finally, we discussed CP's opportunity with incremental margins and wanted to garner Ari's thoughts. To start, he noted that railroads have a high percentage of fixed costs because of things like a rail network and traincars representing a significant portion of the cost structure. That being said, an additional dollar of revenue does not necessarily constitute an additional portion of expenses. Ari noted CP has been a leader in incremental margins, largely attributed to its precision scheduling.

Industry Knowledge: Our team wanted to ask Ari some questions that were hard to understand from an outsiders perspective on the industry. We first asked why a company would choose to ship using intermodal with a railway in opposition to just utilizing a truck. Ari noted the significant pricing differencee between the two. For trips under 500.0 miles, the cost difference between the two isn't significant. However, for trips over 500.0 miles, railways are significantly more cost effective. We also wanted to clarify why some on the Street prefer a P/E valuation over an EV/EBITDA valuation. Ari noted that rails incurr a significant portion of depreciation, and felt it was unfair to value the Company using EV/EBITDA considering it removes this depreciation expense.

Analyst: James McGarragle | RBC | $124.00 PT | Outperform

RBC's Investment Thesis: RBC has been bullish on the name since the initial announcement of the CP and KSU merger. Since then, CP's valuation has increased pretty signficantly in comparision to peers, so although James remains bullish on revenue growing and margins expanding, his team remains cautious because CP is going to have to drive growth well above peers. Then longer-term, after the intial synergies from the acquisition, the Company will have to sustain its elevated growth above peers to warrant this higher multiple. That being said, James' team believes that the Company's opportunity is exceptional, both on a relative and absolute, near-term and long-term basis.

Forecasting Volume Growth: James starts most rail models with revenues growing at 2.0%, in-line with GDP. He then looks at management's forecasts, and uses his assumptions to back into numbers. For instance, if management forecasts grain revenues to grow at 8.0% but James is more bullish on grain, he'll forecast 10.0% growth. However, James doesn't try to pinpoint growth in each quarter. Commodities fluctuate in nature, which impacts the demand for rail transportation. Some will try to forecast revenue growing QoQ and falling the next, but James thinks its best to take a more holistic approach. He'll only do so when he has extremley strong conviction about an end-market.

Short-Term v. Long-Term: CP isn't a Company that you should buy because you are bullish on a certain quarter like a number of hedge funds have done. The Company's appreciation is going to be driven by it's longer-term, more holistic company growth. Near-term labor issues are going to increase expenses, but what investors really should be concerned about are figures like volume growth that are representative of the Company's future success.

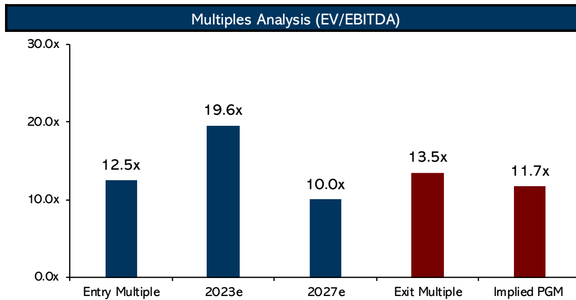
Exhibit II: Model Output

Canadian Pacific Kansas City Ltd. (CP) Valuation Overview

$ in Millions Except Per Share Data

Price Target Scenario:	Base Case
Current Share Price:	$74.64
Valuation Date:	9/29/2023

Multiples Analysis (EV/EBITDA)



Return Summary	
Exit Multiple Method	
Implied Enterprise Value:	$147,834
Implied Equity Value:	123,972
Implied Share Price:	$98
% Return:	31.9%
Perpetuity Growth Method	
Implied Enterprise Value:	$131,477
Implied Equity Value:	107,615
Implied Share Price:	$85
% Return:	14.5%

	Annuals							CAGR	CAGR
Consolidated Financials	2021	2022	2023e	2024e	2025e	2026e	2027e	Historical	Projected
Revenue	$7,995	$8,814	$12,949	$17,585	$18,952	$20,303	$21,855	*6.9%*	*19.9%*
YoY % Growth	*3.7%*	*10.2%*	*46.9%*	*35.8%*	*7.8%*	*7.1%*	*7.6%*		
Gross Profit	$7,995	$8,814	$12,818	$17,250	$19,102	$20,346	$21,778	*6.9%*	*19.8%*
% Margin	*100.0%*	*100.0%*	*99.0%*	*98.1%*	*100.8%*	*100.2%*	*99.6%*		
YoY % Growth	*3.7%*	*10.2%*	*45.4%*	*34.6%*	*10.7%*	*6.5%*	*7.0%*		
EBITDA	$4,017	$4,182	$6,128	$9,172	$10,631	$11,270	$12,009	*0.3%*	*24.7%*
Margin	*50.2%*	*47.4%*	*47.3%*	*52.2%*	*56.1%*	*55.5%*	*54.9%*		
YoY % Growth	*(3.2%)*	*3.8%*	*43.6%*	*62.0%*	*12.5%*	*7.1%*	*7.6%*		
Net Income (Loss)	$2,852	$3,517	$4,395	$6,037	$6,935	$7,505	$8,153	*20.0%*	*18.3%*
Margin	*35.7%*	*39.9%*	*33.9%*	*34.3%*	*36.6%*	*37.0%*	*37.3%*		
YoY % Growth	*16.7%*	*23.3%*	*25.0%*	*37.4%*	*14.9%*	*8.2%*	*8.6%*		
Adj. EPS (Diluted)	$4.18	$3.77	$4.71	$6.48	$7.45	$8.06	$8.75	*(54.2%)*	*18.3%*
YoY % Growth	*(76.8%)*	*(9.7%)*	*25.0%*	*37.6%*	*14.9%*	*8.2%*	*8.6%*		
Free Cash Flow	$2,252	$2,661	$3,885	$5,057	$6,291	$6,764	$7,237	*48.6%*	*16.8%*
YoY % Growth	*86.9%*	*18.2%*	*46.0%*	*30.2%*	*24.4%*	*7.5%*	*7.0%*		

	Annuals							Average	Average
Capitalization and Key Ratios	2021	2022	2023e	2024e	2025e	2026e	2027e	Historical	Projected
Leverage									
Total Debt / EBITDA	5.0x	4.7x	3.6x	2.0x	1.6x	1.3x	1.1x	*4.0x*	*1.9x*
Total Debt / Equity	0.6x	0.5x	0.5x	0.4x	0.3x	0.2x	0.2x	*0.8x*	*0.3x*
Total Debt / Total Assets	0.3x	0.3x	0.3x	0.2x	0.2x	0.2x	0.1x	*0.3x*	*0.2x*
Liquidity									
Current Ratio	0.8x	1.1x	1.3x	1.3x	2.6x	3.8x	5.0x	*0.9x*	*2.8x*
Quick Ratio	0.6x	0.9x	1.2x	1.1x	2.4x	3.7x	4.8x	*0.7x*	*2.6x*
Cash Ratio	0.1x	0.3x	0.5x	0.5x	1.8x	3.0x	4.2x	*0.1x*	*2.0x*
Profitability									
Return on Assets (ROA)	4.2%	4.8%	5.5%	7.4%	8.0%	8.2%	8.3%	*6.4%*	*7.5%*
Return on Equity (ROE)	8.4%	9.0%	10.2%	12.5%	12.7%	12.3%	11.9%	*17.0%*	*11.9%*
Return on Inv. Capital (ROIC)	5.3%	6.0%	6.7%	9.1%	9.8%	9.9%	9.9%	*8.5%*	*9.1%*
Coverage									
Interest Expense	$440	$652	$755	$719	$602	$550	$498	*$517*	*$625*
Capital Expenditures	1,532	1,557	2,278	2,546	2,558	2,741	2,950	*1,713*	*2,615*
EBIT / Interest	7.3x	5.1x	6.3x	10.8x	14.5x	17.0x	20.2x	*6.5x*	*13.7x*
EBITDA / Interest	9.1x	6.4x	8.1x	12.8x	17.6x	20.5x	24.1x	*8.2x*	*16.6x*
(EBITDA - CapEx) / Interest	5.6x	4.0x	5.1x	9.2x	13.4x	15.5x	18.2x	*4.7x*	*12.3x*
Efficiency									
Asset Turnover	0.1x	0.1x	0.2x	0.2x	0.2x	0.2x	0.2x	*0.2x*	*0.2x*
Days Sales Outstanding	37.5	38.0	37.5	37.1	38.0	38.0	38.0	*38.3*	*37.7*
Days Inventory Outstanding	0.0	0.0	0.0	0.0	0.0	0.0	0.0	*0.0*	*0.0*
Days Payables Outstanding	0.0	0.0	0.0	0.0	0.0	0.0	0.0	*0.0*	*0.0*
Cash Conversion Cycle	37.5	38.0	37.5	37.1	38.0	38.0	38.0	*38.3*	*37.7*

Exhibit III: CPKC Network Map

EDMONTON
CALGARY
VANCOUVER
HUNTINGDON
KINGSGATE
COUTTS
REGINA
PORTAL
NOYES
WINNIPEG
THUNDER BAY
DULUTH
MINNEAPOLIS / ST. PAUL
MILWAUKEE
DETROIT
TORONTO
BUFFALO
QUÉBEC CITY
MONTRÉAL
JACKMAN
SAINT JOHN
SEARSPORT
ROUSES POINT
ALBANY
NEW YORK (THE BRONX, FRESH POND)
DAVENPORT
CHICAGO
KANSAS CITY
ST. LOUIS
SHREVEPORT
MERIDIAN
DALLAS
BATON ROUGE
BEAUMONT
MOBILE
GULFPORT
NEW ORLEANS
HOUSTON
PORT ARTHUR
LAREDO
CORPUS CHRISTI
MONTERREY
BROWNSVILLE
ALTAMIRA
TAMPICO
SAN LUIS POTOSÍ
QUERÉTARO
VERACRUZ
MEXICO CITY
LÁZARO CÁRDENAS

CP
CP HAULAGE/TRACKAGE RIGHTS
KCS
KCS HAULAGE/TRACKAGE RIGHTS/LEASED
PORT
BORDER CROSSING

Source: Trains.com

TFA STATEMENT

Established in honor of Professor William C. Dunkelberg, former Dean of the Fox School of Business, for his tireless dedication to educating students in "real-world" principles of economics and business, the William C. Dunkelberg (WCD) Owl Fund will ensure that future generations of students have exposure to a challenging, practical learning experience. Managed by Fox School of Business graduate and undergraduate students with oversight from its Board of Directors, the WCD Owl Fund's goals are threefold:

- **Provide students with hands-on investment management experience**
- **Enable students to work in a team-based setting in consultation with investment professionals.**
- **Connect student participants with nationally recognized money managers and financial institutions**

Earnings from the fund will be reinvested net of fund expenses, which are primarily trading and auditing costs and partial scholarships for student participants.

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