

Canadian Pacific Kansas City Ltd

Synergies ahead of tgts; aims for DD growth (not quite mid-teens); PO \$87

Reiterate Rating: BUY | PO: 87.00 USD | Price: 79.40 USD

Sets double digit '24 EPS tgt; ahead on rev/cost synergies

Canadian Pacific Kansas City (CPKC) posted adj 4Q23 EPS of C\$1.18, up 3% year-year, above our C\$1.11/Street C\$1.12 targets. Less than one-year its merger with Kansas City Southern, CEO Keith Creel noted revenue synergy targets are trending ahead of schedule, as it exited 4Q23 with north of C\$350 million in annualized revenue synergies (vs its target for \$300 mil/yr). CFO Nadeem Velani targets 2024 double-digit core adj EPS growth from its 2023 base of C\$3.84 (we were C\$4.35, or +13%, now C\$4.30 or +12%), and operating margin improvement from 62% (we were 58.5%, now 59.6%). Mr. Velani noted the targets assume low-single digit revenue ton mile growth (RTMS; we were +2.4%, now +2.3%), as revenue opportunities from its expanded offering and improved service offset a weaker Canadian grain crop, as well as 1Q impacts from challenging winter weather in January. Mr. Velani targets flattish headcount growth in 2024 as momentum in network fluidity accelerates, and it grows into its expanded pre-hire base at lower incremental cost. CPKC posted accelerated year-year improvements in train miles (+9%), terminal dwell (-11%, better), train speeds (+6%) and locomotive productivity in 4Q23, highlighting discipline in aligning operations. Cost inflation outpaced pricing in 2023, a headwind it aims to overcome in 2024 as it reprices legacy Kansas City Southern and pre-inflation ramp contracts.

Solid core beat; Adj EPS gets \$0.04/sh help from tax

Revenues were C\$3.78 billion, up +4% year-year, C\$138 million above our forecast. Adj Operating income was C\$1.56 million, up +10% year-year, C\$51 million above our forecast (C\$0.04/sh above), for an adj operating ratio of 58.7%, a 220 bps improvement year-year, 20 bps worse than our forecast. CPKC effective tax rate was 22.2%, below our 25% forecast, adding \$0.04/sh benefit to adj EPS.

PO to \$87

We reiterate our Buy rating and increase our PO to US\$87 (from US\$84), on 27.0x our 2024e EPS (from 26x). Our target multiple is above its 13x-19x range as its post-merger synergies aid its earnings growth. We are positive on CPKC's ability to gain share given its leading service product and offerings. We lower 2024 EPS 1%, to C\$4.30 from C\$4.35, but hold our 2025 at C\$5.15, given 1Q24 weather costs.

Estimates (Dec) (C\$)	2022A	2023A	2024E	2025E	2026E
EPS	3.77	3.84	4.30	5.15	6.05
GAAP EPS	4.45	4.16	4.30	5.15	6.05
EPS Change (YoY)	0.3%	1.9%	12.0%	19.8%	17.5%
DPS	0.76	0.76	0.76	0.76	0.76
Valuation (Dec)					
P/E	28.5x	27.3x	24.8x	20.7x	17.6x
GAAP P/E	24.2x	25.2x	24.8x	20.7x	17.6x
Dividend Yield	0.7%	0.7%	0.7%	0.7%	0.7%
EV / EBITDA*	19.1x	18.1x	16.5x	14.6x	13.0x
Free Cash Flow Yield*	3.2%	1.7%	3.0%	3.8%	4.7%

* For full definitions of *IQmethod*SM measures, see page 8.

30 January 2024

Equity

Key Changes

(C\$)	Previous	Current
Price Obj.	US\$84.00	US\$87.00
2024E Rev (m)	14,488.3	14,574.4
2025E Rev (m)	15,723.5	15,895.9
2026E Rev (m)	NA	17,262.8
2024E EPS	4.35	4.30
2026E EPS	NA	6.05

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Stock Data

Price	79.40 USD
Price Objective	87.00 USD
Date Established	30-Jan-2024
Investment Opinion	B-1-7
52-Week Range	68.92 USD - 85.40 USD
Mrkt Val (mn) / Shares Out (mn)	74,144 USD / 933.8
Free Float	100.0%
Average Daily Value (mn)	189.99 USD
BofA Ticker / Exchange	CP / NYS
Bloomberg / Reuters	CP US / CP.N
ROE (2024E)	9.3%
Net Dbt to Eqty (Dec-2023A)	51.9%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

DD: Double- digit

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Timestamp: 30 January 2024 10:21PM EST

iQprofileSM Canadian Pacific Kansas City Ltd

iQmethodSM – Bus Performance*

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	5.6%	5.4%	5.6%	6.4%	7.2%
Return on Equity	9.7%	8.8%	9.3%	10.6%	11.5%
Operating Margin	39.1%	38.8%	41.3%	43.9%	46.4%
Free Cash Flow	3,094	1,669	2,999	3,822	4,689

iQmethodSM – Quality of Earnings*

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.3x	1.2x	1.4x	1.4x	1.3x
Asset Replacement Ratio	1.1x	1.7x	1.8x	1.8x	1.7x
Tax Rate	23.0%	24.2%	25.4%	24.7%	24.7%
Net Debt-to-Equity Ratio	49.4%	51.9%	44.1%	37.3%	30.8%
Interest Cover	6.0x	6.5x	7.6x	9.0x	10.8x

Income Statement Data (Dec)

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	12,945	13,609	14,262	15,571	16,925
% Change	13.0%	5.1%	4.8%	9.2%	8.7%
Gross Profit	6,422	6,747	7,401	8,385	9,445
% Change	-18.8%	5.1%	9.7%	13.3%	12.6%
EBITDA	6,422	6,747	7,401	8,385	9,445
% Change	52.9%	5.1%	9.7%	13.3%	12.6%
Net Interest & Other Income	(486)	(557)	(509)	(471)	(447)
Net Income (Adjusted)	3,521	3,582	4,018	4,789	5,569
% Change	37.3%	1.7%	12.2%	19.2%	16.3%

Free Cash Flow Data (Dec)

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	3,521	3,582	4,018	4,789	5,569
Depreciation & Amortization	1,362	1,466	1,508	1,550	1,598
Change in Working Capital	(92)	(308)	127	115	129
Deferred Taxation Charge	136	(710)	137	157	183
Other Adjustments, Net	(276)	107	(40)	(40)	(40)
Capital Expenditure	(1,557)	(2,468)	(2,750)	(2,750)	(2,750)
Free Cash Flow	3,094	1,669	2,999	3,822	4,689
% Change	43.5%	-46.1%	79.7%	27.4%	22.7%
Share / Issue Repurchase	32	69	0	0	0
Cost of Dividends Paid	(707)	(707)	(710)	(707)	(699)
Change in Debt	(1,622)	(1,300)	(1,975)	(1,900)	(1,900)

Balance Sheet Data (Dec)

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	451	464	1,043	1,258	1,347
Trade Receivables	1,016	1,887	2,017	2,134	2,259
Other Current Assets	422	651	445	445	445
Property, Plant & Equipment	67,476	51,744	52,986	54,186	55,338
Other Non-Current Assets	4,130	25,156	25,556	25,956	26,356
Total Assets	73,495	79,902	82,046	83,979	85,745
Short-Term Debt	1,510	3,143	3,143	3,143	3,143
Other Current Liabilities	1,703	2,567	2,824	3,056	3,310
Long-Term Debt	18,141	19,351	17,376	15,476	13,576
Other Non-Current Liabilities	13,255	12,430	14,584	15,702	15,845
Total Liabilities	34,609	37,491	37,927	37,377	35,874
Total Equity	38,886	42,411	44,119	46,602	49,872
Total Equity & Liabilities	73,495	79,902	82,046	83,979	85,745

* For full definitions of iQmethodSM measures, see page 8.

Company Sector

Rail Transport/Railroads

Company Description

Canadian Pacific Kansas City Railway (CPKC, ticker CP) provides rail and intermodal freight transport services throughout North America. CP's 13,800-mile rail network and KCS' 7,000 route mile network serves the principal centers of Canada, from Montreal to Vancouver, and the US Northeast and Midwest regions. CP feeds into America's heartland from the East and West coasts. KCS' network extends from the Midwest and southeast portions of the US south to Mexico. KCS and CP connect in Kansas City.

Investment Rationale

CPKC is beginning the integration of Canadian Pacific with Kansas City Southern (it targets \$1 billion in synergies in the first 3 years). It remains focused on improving operations as well as top line growth. It bought back 25% of its shares between 2014 and mid-2018, and should return to buybacks after deleveraging post acquisition. We look for the stock to trade above its 10-year 13-19x historical trading range, reflecting potential synergy gains.

Stock Data

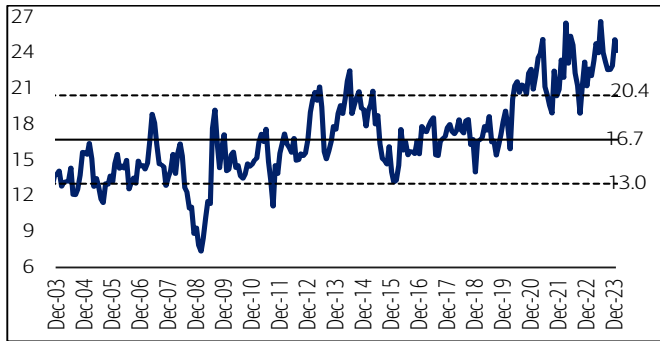
Average Daily Volume 2,351,154

Quarterly Earnings Estimates

	2023	2024
Q1	0.90A	0.93E
Q2	0.83A	1.01E
Q3	0.92A	1.06E
Q4	1.18A	1.31E

Exhibit 1: CPKC Forward P/E

Shares are trading at 24x 2024e EPS, above its 13x-20x range.



Source: BofA Global Research estimates and Bloomberg.

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Targets double digit EPS growth in 2024

CPKC targets double digit adjusted core EPS growth in 2024 (we were +13, now +12%) driven by low-single digit revenue-ton-mile (RTM) growth (we were +2.4%, now +2.3%), pricing above inflation, and flat headcount (we were/are +2%). Its EPS growth target is slightly below its June Investor Day view of doubling earnings from 2024-2028, which implies mid-teens EPS CAGR. CEO Keith Creel noted its 2024 target is based on conservative assumptions with factors such as a normalized grain crop, soft domestic intermodal, and impacts from 1Q24 weather, could potentially provide upside to CPKC's targets if conditions improve. CPKC targets 2024 CapEx of C\$2.75 billion (we were C\$2.65 billion) and expects to lower its leverage ratio to 2.5x (from 3.4x in 4Q23). Its 2024 EPS target does not include share repurchases (we target a restart in early 2025).

Volume and yields accelerating, aided by synergy gains

Carloads were up 1.8% year-year, above our +0.2% target, as all carload categories (outside of Autos) were above our targets. CMO John Brooks highlighted business wins as a key driver to 2024 growth given its strong pipeline of new project wins in Energy, Chemicals & Plastics (ECP), as well as closed loop network opportunities with Forest Product shippers. Domestic Intermodal demand remains challenged due to soft retail demand and excess truck capacity, yet its single-line cross-border MX180/181 service continues to drive truck conversion. Average Revenue/Carload was up 1.9% year-year, above our -0.3% target as increased length of haul (RTMs +4% vs carloads +2%), strong pricing gains offset lower fuel surcharges. CPKC sees further pricing opportunity in 2024 as it aims to align the rest of its portfolio of freight to rail inflation.

Service levels and efficiency continue to improve

Service metrics accelerated across all categories in 4Q23. Train speed increased 6% year-year to 18.6 miles/hour and average terminal dwell improved 11% year-year to 9.3 hours. COO Mark Redd highlighted the usage of shorter trains to improve network speed which aided fluidity. Locomotive productivity improved 13% year-year to 164 gross ton-miles/operating horsepower as increased velocity led to higher asset turns. CPKC aims to further drive efficiency in its network as it aims to grow RTMs at low-single digits yet hold employee count flat in 2024.

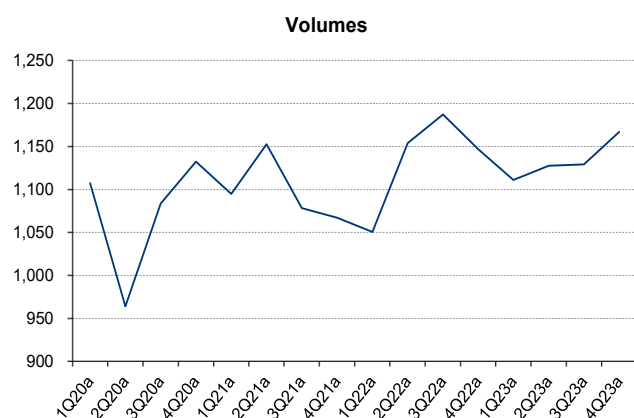
Synergy gains tracking ahead of schedule

CPKC appears to be making solid progress on stated revenue and cost synergy targets as it integrates Kansas City Southern. CFO Nadeem Velani noted CPKC exited 4Q23 with north of \$350 million in annualized revenue synergies, tracking above its immediate run rate target of \$240 million. Mr. Velani sees 2024 opportunities from single-line service offerings and over-the-road conversion. The company previously targeted \$1 billion in annualized EBITDA synergies within three years of deal completion, with \$820 million from growth and market opportunities and \$180 million from cost and efficiency

improvements. Mr. Velani noted the company is ahead of schedule on operating/cost synergy targets and expects further ramp in 2024.

Exhibit 2: CPKC Carloads

Carloads were up 1.8% year-year, above our +0.2% target.

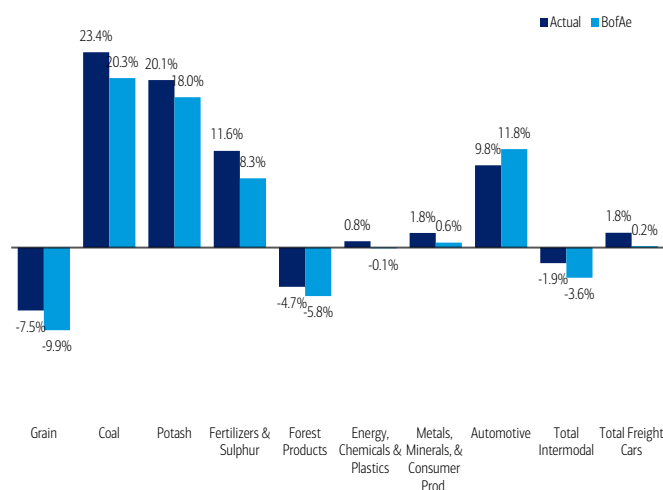


Source: BofA Global Research estimates and company reports.

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Exhibit 4: CPKC 4Q23 Carload Growth Actuals vs Estimates

Carloads were up 1.8% year-year, above our +0.2% target.

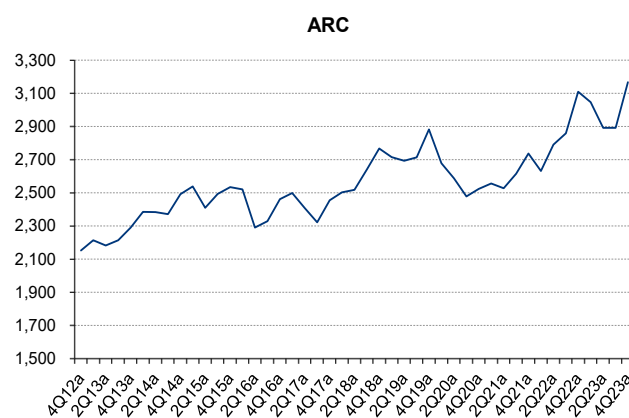


Source: BofA Global Research estimates and company reports.

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Exhibit 3: CPKC Average Revenue/Carload

Average revenue per car was up 1.9% year-year, above our -0.3% target.

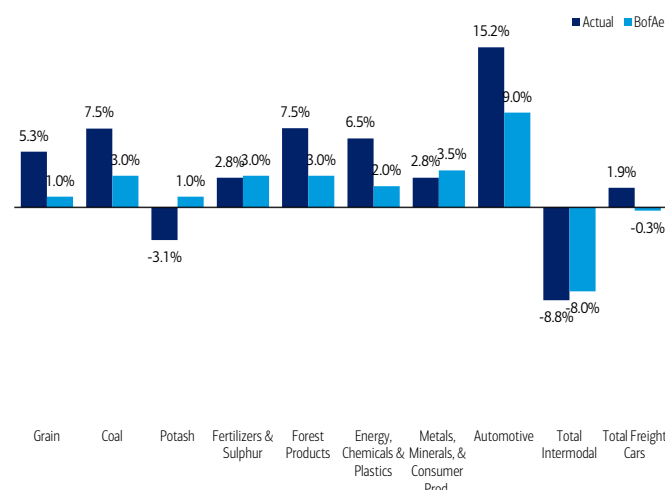


Source: BofA Global Research estimates and company reports.

BofA GLOBAL RESEARCH

Exhibit 5: CPKC 4Q23 Revenue/Carload Growth Actuals vs Estimates

Average revenue per car was up 1.9% year-year, above our -0.3% target.

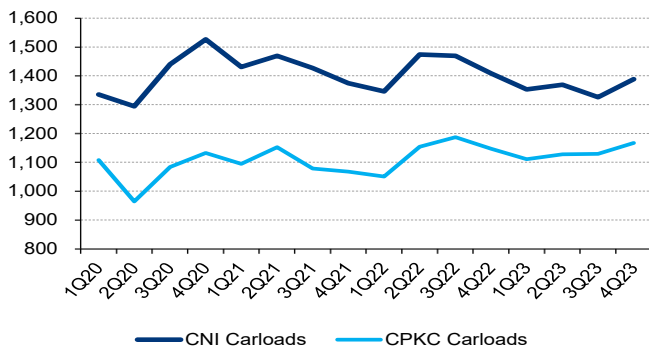


Source: BofA Global Research estimates and company reports.

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Exhibit 6: CPKC vs CNI Carloads

CPKC's 1.2 million carloads compares to CNI's 1.4 million in 4Q23.

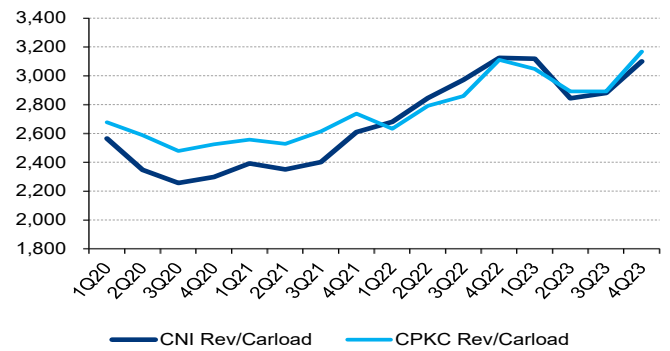


Source: BofA Global Research estimates and company reports.

BofA GLOBAL RESEARCH

Exhibit 7: CPKC vs CNI Revenue/Carload

CPKC's revenue/carload of C\$3,168, above CNI's C\$3,100 in 4Q23.

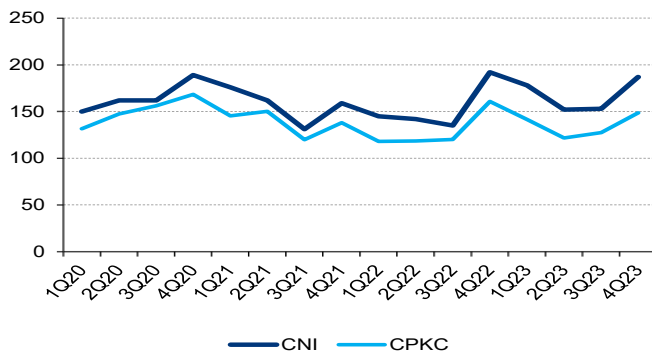


Source: BofA Global Research estimates and company reports.

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Exhibit 8: CPKC vs CNI Grain Carloads

CPKC's 149k Grain carloads compares to CNI's 187k in 4Q23.

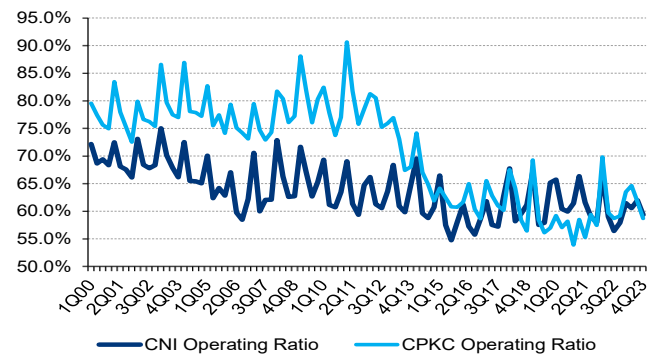


Source: BofA Global Research estimates and company reports.

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Exhibit 9: CPKC vs CNI Operating Ratio

CPKC's 58.7% adj Operating Ratio compares to CNI's 59.3% in 4Q23.

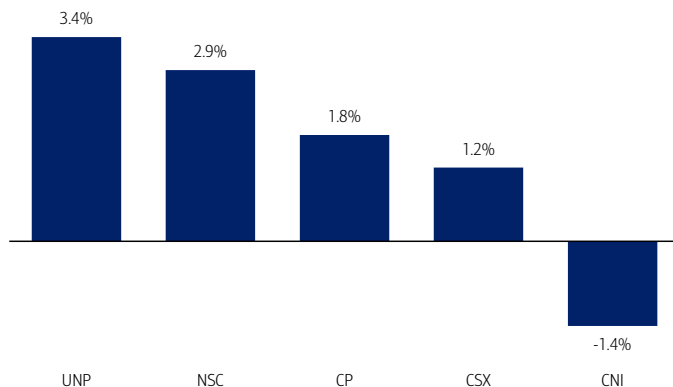


Source: BofA Global Research estimates and company reports.

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Exhibit 10: Class I Rails 4Q23 Carload Growth

CPKC outperformed CSX, CNI yet trailed NSC and UNP.

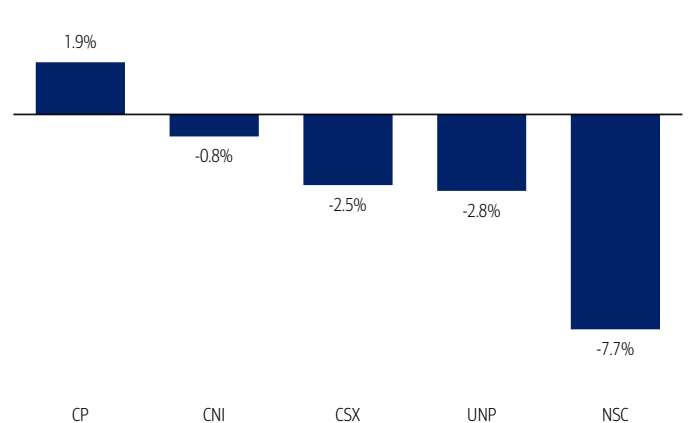


Source: BofA Global Research estimates and company reports.

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Exhibit 11: Class I Rails 4Q23 Average Revenue/Carload Growth

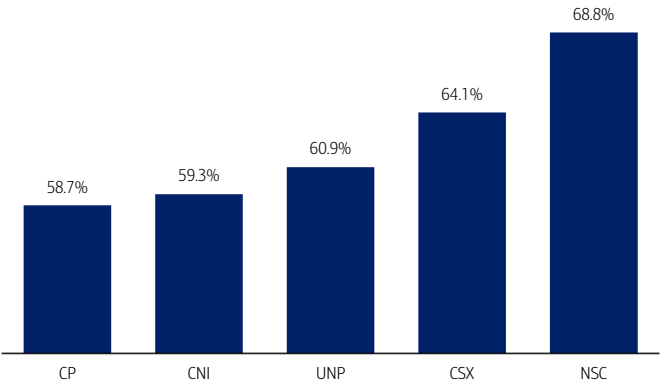
CPKC was the only Class I rail to increase carload yields in 4Q23.



Source: BofA Global Research estimates and company reports.

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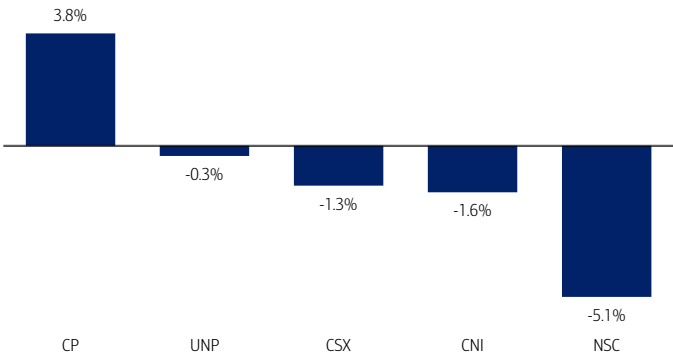
Exhibit 12: Class I Rails 4Q23 Operating Ratio
CPKC Operating Ratio was 58.7% in 4Q23, 20 bps worse than our target.



Source: BofA Global Research estimates and company reports.

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Exhibit 13: Class I Rails 4Q23 Revenue Growth
CPKC increased revenues 3.8% year-year, \$138 million above our target.



Source: BofA Global Research estimates and company reports.

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Price objective basis & risk

Canadian Pacific Kansas City Ltd (CP)

Our US\$87 objective is based on a 27x target multiple on our US\$ 2024 EPS estimate (which includes synergies from its KCS acquisition), above its 13x-20x historical band. Our '24 estimate remains somewhat depressed, as it works to rebound with initial synergies post KCS acquisition, as well as benefit from a rebounding economy. Our target PE is above the rail average, reflecting the strength of CP's management and its network, as well as potential upside from its KCS acquisition.

CP consistently demonstrates its ability to manage costs in a rapidly declining & rising volume environment, highlighting its operating model and one of the best management teams in the industry, led by CEO Keith Creel. We see upside to estimates from synergies with its KCS acquisition.

Risks to our PO are slower-than-expected economic growth, higher-than-expected pension expense/cash contribution requirements, high fuel costs (CP's exposure to crack spreads), potential disruptions from a highly unionized (79%) labor force, volume or pricing softness, regulatory changes (such as retroactive grain rate changes), change in the Canadian dollar beyond targets, external factors (such as weather) impacting operations, as well as Mexico concession network ownership/renewal risk. Disruptive rail re-regulation that limits the company's ability to earn proper returns on its investments, and inability to fully merge with KCS.

Analyst Certification

I, Ken Hoexter, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Transportation Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Canadian Pacific Kansas City Ltd	CP	CP US	Ken Hoexter
	CSX Corporation	CSX	CSX US	Ken Hoexter
	FedEx Corp.	FDX	FDX US	Ken Hoexter
	J.B. Hunt Transport Services	JBHT	JBHT US	Ken Hoexter
	Kirby Corp	KEX	KEX US	Ken Hoexter
	Knight-Swift Transportation Holdings Inc	KNX	KNX US	Ken Hoexter
	Norfolk Southern	NSC	NSC US	Ken Hoexter
	Old Dominion Freight Line	ODFL	ODFL US	Ken Hoexter
	RXO, Inc.	RXO	RXO US	Ken Hoexter
	Saia Inc.	SAIA	SAIA US	Ken Hoexter
	Teekay Tankers Limited	TNK	TNK US	Ken Hoexter
	Union Pacific	UNP	UNP US	Ken Hoexter
	Wabtec Corp.	WAB	WAB US	Ken Hoexter
	XPO, Inc.	XPO	XPO US	Ken Hoexter
NEUTRAL				
	Canadian National	CNI	CNI US	Ken Hoexter
	Schneider National	SNDR	SNDR US	Ken Hoexter
	Scorpio Tankers Inc.	STNG	STNG US	Ken Hoexter
	TFI International	TFII	TFII US	Ken Hoexter
	TFI International	YTFII	TFII CN	Ken Hoexter
	UPS	UPS	UPS US	Ken Hoexter
UNDERPERFORM				
	ArcBest Corporation	ARCB	ARCB US	Ken Hoexter
	C.H. Robinson	CHRW	CHRW US	Ken Hoexter
	The Greenbrier Companies	GBX	GBX US	Ken Hoexter



US - Transportation Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Werner Enterprises	WERN	WERN US	Ken Hoexter
	World Kinect	WKC	WKC US	Ken Hoexter

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

EV / EBITDA

Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

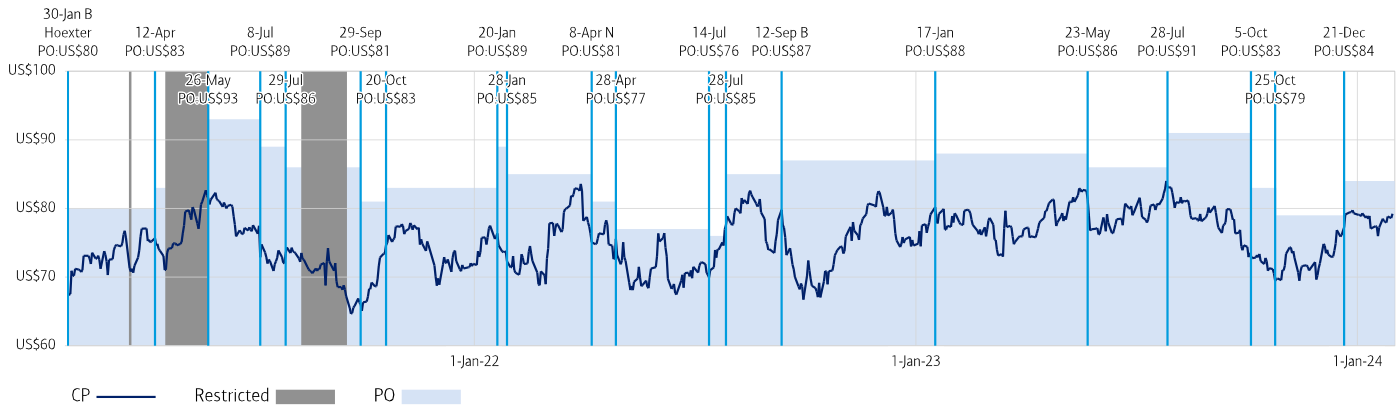
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Disclosures

Important Disclosures

Canadian Pacific (CP) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Transport/Infrastructure Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	67	50.38%	Buy	44	65.67%
Hold	31	23.31%	Hold	13	41.94%
Sell	35	26.32%	Sell	17	48.57%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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