THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

NSC - Q4 2013 Norfolk Southern Corp Earnings Conference Call

EVENT DATE/TIME: JANUARY 22, 2014 / 1:45PM GMT

OVERVIEW:

NSC reported 2013 revenues of $11.2b and net income of $1.91b. 4Q13 revenues were $2.9b and net income was $513m or $1.64 per diluted share.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Michael Hostutler *Norfolk Southern Corp - Director, IR*

Wick Moorman *Norfolk Southern Corp - Chairman & CEO*

Don Seale *Norfolk Southern Corp - Chief Marketing Officer*

Mark Manion *Norfolk Southern Corp - COO*

Marta Stewart *Norfolk Southern Corp - CFO*

CONFERENCE CALL PARTICIPANTS

William Greene *Morgan Stanley - Analyst*

Allison Landry *Credit Suisse - Analyst*

Chris Wetherbee *Citigroup - Analyst*

Justin Yagerman *Deutsche Bank - Analyst*

Tom Wadewitz *JPMorgan Chase & Co. - Analyst*

Anthony Gallo *Wells Fargo Securities, LLC - Analyst*

Walter Spracklin *RBC Capital Markets - Analyst*

Jason Seidl *Cowen Securities LLC - Analyst*

Justin Long *Stephens Inc. - Analyst*

Thomas Kim *Goldman Sachs - Analyst*

John Larkin *Stifel Nicolaus - Analyst*

Ben Hartford *Robert W. Baird and Company, Inc. - Analyst*

Scott Group *Wolfe Research - Analyst*

Jeff Kauffman *Buckingham Research Group - Analyst*

Ken Hoexter *BofA Merrill Lynch - Analyst*

Keith Schoonmaker *Morningstar - Analyst*

David Vernon *Alliance Bernstein - Analyst*

Brandon Oglenski *Barclays Capital - Analyst*

PRESENTATION

Operator

Greetings. Welcome to the Norfolk Southern Corporation fourth quarter 2013 earnings call.

(Operator Instructions)

As a reminder, this conference is being recorded. I would now like to turn the conference over to your host Mr. Michael Hostutler, Director of Investor Relations for Norfolk Southern. Thank you. You may now begin.

Michael Hostutler - *Norfolk Southern Corp - Director, IR*

Thank you and good morning. Before we begin today's call, I would like to mention a few items. First, the slides of the presenters are available on our website in the Investors section. Additionally, transcripts and MP3 downloads of today's call will be posted on our website for your convenience.

Please be advised that any forward-looking statements made during the course of the call represent our best, good faith judgment as to what may occur in the future. Statements that are forward looking can be identified by the use of words such as believe, expect, anticipate, and project. Our actual results may differ materially from those projected, and will be subject to a number of risks and uncertainties, some of which may be outside of our control. Please refer to our annual and quarterly reports filed with the SEC for discussions of those risks and uncertainties we view as most important.

Additionally, keep in mind that all references to reported results, excluding certain adjustments, that is non-GAAP, numbers have been reconciled on our website in the Investor section. Now, it is my pleasure to introduce Norfolk Southern Chairman and CEO, Wick Moorman.

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

Thank you, Michael, and good morning, everyone. It is my pleasure to welcome you to our fourth quarter 2013 earnings conference call. With me today are several members of our senior team, including our President, Jim Squires; our Chief Marketing Officer, Don Seale; our Chief Operating Officer, Mark Manion; and Marta Stewart, our Chief Financial Officer.

I am pleased to announce the Norfolk Southern had an excellent fourth quarter. We achieved fourth quarter record highs in revenues, income from operations, net income, and earnings per share. As you know, these fourth quarter results capped an outstanding 2013 performance, and led to record results for the full year, including all-time highs for revenues, operating ratio, income from operations, and earnings per share.

Looking at our topline, revenues for the fourth quarter were $2.9 billion, an increase of $197 million, or 7%. Overall volumes rose 4%, as the decline in Coal volumes was more than offset by growth in Merchandise and Intermodal traffic. For the full year, revenues were $11.2 billion, a 2% increase over 2012, despite a 12% decline in Coal revenue. As usual, Don will provide you with all of the revenue details in a few minutes.

The combination of volume increases coupled with our continued focus on expense control resulted in net income for the quarter of $513 million, up 24% year-over-year, and diluted earnings per share of $1.64 up 26%. For the full year, net income and earnings per share increased 9% and 12%, respectively. Marta will provide you with all of the financial details.

The Railroad ran extremely well in the fourth quarter. This was a continuation of the superior service levels we maintained for all of 2013, with sustained high metrics in network velocity and terminal dwell throughout the year. These metrics in turn were important drivers in our ability to maintain a high average composite service index. As we have said many times before, an efficiently run network helps in our efforts to keep expenses under control. Mark will give you all the fourth quarter operating results.

In 2014, we will continue our focus on improving customer service and running our network efficiently. Part of that plan is strong capital investment, and Marta will provide you some details of our planned $2.2 billion capital program. At this point, I'll turn the program over to Don and the rest of the team, and I'll return with some closing remarks before we take questions. Don?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Thank you, Wick, and good morning. Revenue during the fourth quarter was $2.9 billion, up $197 million or 7% versus 2012. We set new quarterly records in Intermodal of $618 million, up 6% and Merchandise with $1.6 billion, up 12%. These favorable results were partially offset by a 2% decline in Coal revenue, due to lower volumes of Utility and domestic metallurgical coal.

With respect to the components of revenue growth, higher volumes across the business accounted for increased revenue of $105 million, favorable price and mix accounted for $41 million of the overall gain, while higher fuel surcharge revenue accounted for $51 million year-over-year. Total volume for the quarter increased by nearly 70,000 units or 4%, with revenue per unit of $1,547, up $49 or 3%.

Turning to revenue per unit on the next slide, Coal RPU in the quarter was up 7%, driven primarily by favorable Coal export Coal mix and a $15 million volume shortfall settlement with one of our Utility customers. Merchandise RPU was up 4%, and Intermodal RPU was down 1% as compared to last year. Total revenue per unit was up 3%, based on improved pricing, increased fuel surcharge revenue, and a favorable mix and contract settlement that I just mentioned in our Utility coal market.

Turning to the next slide in volume, with respect to volume as shown on slide 4, total shipments for the quarter were up 4% with robust growth in Intermodal and Merchandise, offsetting an 8% decline in Coal volume. Strong volume growth within Merchandise during the quarter was driven by gains in all five commodity groups.

Drilling down into our major markets, starting with Coal, revenue for the quarter was $641 million, down $16 million or 2% for the quarter. Weaker demand across nearly all markets resulted in an overall volume decline of 8%. Utility Coal, which was the largest driver of the decline, was down nearly 20,000 carloads or 9%. Volumes in the North were up an estimated 1% versus last year, while Southern Utility volumes were down 18%. That was driven by continuing competition from natural gas and excess stock piles at Southern Utilities.

Export shipments were down 8%, largely due to declines in Steam Coal at the Port of Baltimore, partially offset by higher fourth quarter volumes at Lambert's Point in Norfolk, which increased by 13%. In the domestic Metallurgical Coal segment, volume was down 14% for the quarter as a result of reduced demand from our steel customers, but on a positive note, Industrial Coal increased 11%, due to business gains.

Turning to our Intermodal business, revenue in the quarter reached in an all-time high of $618 million, up $34 million or 6% over fourth quarter 2012, driven by 6% higher volumes. Revenue per unit declined by 1% due to positive pricing being offset by decreases in the fuel surcharge. Volume gains in Intermodal came from both our domestic and international markets.

Domestic volume was up 7% due to continued highway conversions, while organic growth across our international accounts boosted international volume by 6%. Much of this growth moved in our expanded and enhanced Intermodal corridors, running an efficient double-stacked train service. Our highest performing sector in the fourth quarter was our Merchandise group, which set a new revenue record of $1.6 billion, up $179 million or 12% over last year, driven by an 8% increase in volume, combined with the 4% higher revenue per unit.

Metals and Construction, our largest market segment, experienced a 1% increase in volume, due primarily to increased shipments of iron and steel and higher shipments of frac sand and miscellaneous construction materials. These gains were somewhat tempered by lower aggregates volumes.

Moving to the Agriculture market, which was up 6% in volume, increased corn and soybean volume offset declines in our feed markets. Corn shipments were up 23%, driven by increases in short-haul movements to Midwestern processors and longer haul volume to ethanol producers. A favorable export market also drove increased shipments of soybeans over Gulf and Atlantic ports.

Our Chemicals volume was up 22% for the quarter, continuing to benefit from strong growth in crude oil. Increased shipments of natural gas liquids, industrial intermediates, and plastics also boosted growth in this group. Turning to Automotive, volume was up 10%, more than double the projected North American vehicle production increase for the quarter, as a result of new business and increased production at plants we serve. Finally, Paper volumes were up 2% with a 16% increase in lumber, and a 13% increase in pulp volumes offset by declines in waste and scrap materials.

Now, concluding with our outlook for 2014. We see growth opportunities ahead in our Intermodal and Merchandise markets while the Coal market continues to present challenges and headwinds. While demand for electricity was up 2% in the fourth quarter, 2014 demand is still expected to be sluggish, particularly in the South. In the export market, we continue to expect a challenging environment with strong competition in the Atlantic Metallurgical Coal market, and soft demand and oversupply of Thermal Coal.

On the upside, our outlook for Intermodal remains bright as we continue to add attractive freight to our new corridors and terminals. The South Carolina inland port opened in the fourth quarter, and our new Charlotte terminal officially opened December 9. Highway conversions and growth with our international shipping partners represent ongoing opportunities, and we will remain strongly focused on delivering superior Intermodal service and efficiencies across our double-stacked network.

In our Merchandise markets, we anticipate continued strength in crude by rail, as well as shale related liquid petroleum gases. Frac sand shipments into the shale production region should continue to grow as hydraulic fracturing technology evolves and requires higher volumes of sand.

Within our metals markets, US steel production is projected to expand by 5% during 2014, due to increased steel usage in the auto sector and the recovering construction market. Automotive production will continue to see solid growth as North American light vehicle production is projected to increase 3% in 2014. We expect growth opportunities ahead in both Agriculture and Forest Products, as the larger crop and housing recovery spur increased shipping activity throughout the year.

In summary, our market based diversity, high-quality service, and ongoing network investments continue to support steady growth, despite headwinds in the Coal market. With respect to the overall value of our service product, we'll continue to employ market-based pricing that equals or exceeds rail inflation to support ongoing investment, both in our infrastructure and service delivery capabilities. We'll also continue to focus on developing new markets and providing the safest and most cost-efficient service possible to all of our customers. Thank you for your attention, and I'll turn it over to Mark.

Mark Manion - *Norfolk Southern Corp - COO*

Thank you, Don. Starting with safety performance, our personal injury performance for the fourth quarter stands at 1.28 and for the full year, 1.15. 2013 marked an important shift in our approach to safety improvement at Norfolk Southern.

Our operations managers and workforce have all attended behavior-based leadership training, and we've implemented a new approach in behavior-based safety. We like the fact that we're seeing a more engaged workforce, and while we haven't reduced the number of overall injuries, we've seen an 11% drop in serious injuries.

Looking at our train accidents, we've seen a slight uptick in incidents to 2.4 per 1 million train miles. These have been related primarily to switching and storm related occurrences earlier in the year. Crossing accidents for 2013 is down slightly from the prior year, at 3.5 per 1 million train miles.

Moving on to service performance, our composite service metric reflects a consistently high performance through the year. For 2013, the service composite was a best ever 83.3%. In the fourth quarter, our service composite was 82.4% and reflects typical season patterns with operations around the Thanksgiving and Christmas holidays, as well as strong Intermodal and unit train volumes. We continue to see very solid performance in fluid operations through the period.

Turning to the next slide, continued high service performance is also reflected in train speed, a primary component of network velocity. Train speed over the last couple of years has remained consistently at historically high levels. In the fourth quarter, train speed averaged 23.8 miles an hour and for the full year, 23.9 miles an hour.

Moving on to terminal dwell, the second major component of network velocity, here again we've sustain very high levels of performance over the last couple of years. Terminal dwell in 2013 averaged 21.6 hours. The fourth quarter was 21.9 hours, reflecting the normal seasonal variation due to curtailment of operations around the Christmas holiday period.

In the fourth quarter, we saw efficiency gains in many of the same areas where we saw improvement throughout the year. With volume increases, we were still able to reduce crew starts by 1% in the fourth quarter and 3% for the full year. In the fourth quarter, Merchandise shipments increased 8%, while crew starts increased only 2%. In Intermodal, shipments increased 7%, while crew starts increased only 1%. In Coal, both shipments and crew starts declined 8%.

T&E overtime hours increased only 1% against a volume increase of 4% in the fourth quarter. For the full-year, with a volume increase of 3%, we were able to reduce overtime hours by 10%. We continue to reduce re-crews by 5% in the fourth quarter versus the same time period last year, and we saw a reduction of 9% for the full-year. Taking advantage of existing train capacity for new volume growth, carloads per locomotive improved 4% of the fourth quarter, consistent with patterns we've seen most of the year.

Fuel efficiency in the fourth quarter was negatively impacted by a colder December, but the general trend has been improving as reflected in the 1% improvement for the full year. That's a trend we expect to continue going forward. With strong network performance, combined with a number of ongoing productivity initiatives, we fully expect to see in excess of $100 million in productivity and leverage gains in 2014. Thank you, and now, Marta, I'll turn it over to you.

Marta Stewart - *Norfolk Southern Corp - CFO*

Thank you, Mark. I will now review our fourth-quarter financial results, which as Wick mentioned, rounds out a year of record performance. I'll close with an overview of the full-year financials and discuss our capital spending plan for 2014.

Slide 2 summarizes our quarterly operating results. Don review the 7% revenue increase in detail, and recall that it was largely driven by a 4% improvement in volume. On the 4% unit growth, expenses rose only $30 million, or 2%. That leverage translated into record fourth-quarter income from operations of $881 million, up 23%.

The resulting 69.4 operating ratio improved 400 basis points. The next slide shows the major components of the $30 million net increase in expenses. Compensation and benefits drove most of the increase, and fuel costs were also higher. However, lower expenses for purchased services partly offset the increases.

Now, let's take a closer look at each of these categories. Compensation costs rose by $35 million or 5%. The first couple of items continue the trend seen in prior three quarters of the year. Higher pay rates increased expenses by $14 million, while reduced employee activity levels lowered cost by $10 million. Much of this is directly related to the crew start to volume relationship that Mark discussed with you.

The third item, higher incentive compensation, reflects a $22 million increase in bonus accruals, driven by the strong fourth quarter results. For 2014, we expect the wage rates and labor hour trends to continue. Additionally, we expect lower accruals for pension and post-retirement medical liability. This is largely due to a combination of strong equity returns, which increased plan assets, and a higher discount rate, which reduced the plan liability. This will result in approximately $25 million of lower quarterly accruals and 2014 versus 2013.

Moving on to fuel expense, it rose by a net of $8 million or 2%. As Mark mentioned, the increase in consumption exceeded our traffic volume increase and was largely due to the colder weather. Offsetting the unfavorable consumption was a lower price.

The average price paid per gallon was $3.02 this fourth quarter, versus $3.24 in the fourth quarter of 2012. Depreciation expense was flat for the quarter, as lower equipment rates resulted from a depreciation study completed in 2013, offset the effects of a higher capital base. Going forward, we expect depreciation in 2014 to return to a more normalized increase of about $10 million a quarter.

Slide 7 addresses the $12 million or 3% decline in purchased services and rent. Most of the reduction was due to last year's $15 million charge for an accident that occurred on Conrail in November of 2012. The remaining variances in this category were small, with increases of volume related cost, but decreases in roadway repair cost and legal and consulting fees.

The materials and other categories shown on the next slide was basically flat. Higher mechanical materials expenses and smaller miscellaneous expenses were more than offset by $22 million of favorable development in the accruals of prior year injury claims. As you know, we have experienced a net favorable development in recent quarters in our actuarially determined casualty claims expenses. While we may see additional favorable development in the coming quarters, we do not expect it to the extent seen in the past several quarters. As a result, total expenses for casualties and other claims in 2014 will likely be closer to the levels we saw in 2012.

Turning to our nonoperating items, increased returns from corporate and life insurance were largely offset by reduced Coal royalties, a result of lower Coal production. Interest expense on debt was up $8 million, due to increased borrowing.

Next, income taxes totaled $270 million, and the effective tax rate was 34.5%, compared to 33.5% in 2012. 2012 included a $6 million benefit related to the completion of an IRS examination. Additionally, both periods benefited from state tax adjustments that we do not expect to recur. Therefore, looking forward, the effective rate in 2014 will likely be close to the combined federal and state statutory rate of about 37.5%.

Wrapping up our quarterly overview, net income and EPS comparisons are displayed on slide 11. Both measures set fourth quarter records. Net income was $513 million, an increase of $100 million or 24%. Diluted earnings per share were $1.64, up $0.34 per share or 26%.

Focusing next on the full-year results, revenues were up 2%, while operating expenses rose only 1%. This resulted in income from railway operations of $3.3 billion, a 4% increase which generated a 70 basis point improvement in the operating ratio, to an all-time annual record of 71.

Net income for the year shown on slide 13 was $1.91 billion. Excluding the large land sale in the first quarter, net income would have been up about $1.85 billion, up 6%, and earnings per share would have been $5.85, an increase of 9%.

As shown on the next slide, cash from operations covered capital spending and produced $1.1 billion in free cash flow. We distributed $637 million in dividends and applied $627 million towards the repurchase of 8.3 million shares. Cash and short-term investments totaled $1.6 billion at year-end. We have concluded a record year with a strong balance sheet and full confidence in our outlook, which is a great segue into our 2014 capital spending highlight. Here, we show historical and budgeted capital expenditures. The 2014 total of $2.2 billion is a 12% increase over 2013, and about even with 2012 and 2011.

As reflected on the following slide, and similar to previous years, the majority of our capital expenditures, roughly two-thirds, will be invested in replacement and core projects. This includes improving the condition of the right-of-way, rebuilding locomotives, and replacing freight cars and other equipment. A quarter of the budget reflected here in green supports traffic growth or productivity projects, including additional locomotives as well as yard and siding expansions. The remaining 10% of the budget will be spent on positive train control. A more detailed listing of the category is shown on slide 17.

Our capital plan was constructed to maintain safety and quality of the network, to improve service and operational efficiencies, and to support business growth. Thank you, and I'll now turn the program back to Wick.

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

Thanks, Marta. As you've heard, Norfolk Southern punctuated 2013 with an excellent fourth quarter, with strong volume and revenue increases, even in the face of continuing declines in our Coal franchise.

The real story of 2013 was the ability of our team to run the Railroad at a sustained high velocity, providing superior service for our customers, and at the same time, delivering continued operating efficiencies. While the extreme weather conditions we've seen in January have slowed the entire North American rail network, we are confident in our ability to drive further productivity and service improvements in the months ahead.

Looking ahead, it certainly seems like the economy may be improving at a somewhat faster pace than we saw in 2013. As Don told you, the outlook for most of our business segments is good, but Coal still remains the wild card. Regardless of the near-term forecast for any of the markets we serve, we do remain very confident that the strength of our franchise and our long-term strategy of providing excellent service at rates that enable us to reinvest in the business, and provide excellent returns for our shareholders. Marta described one part of that strategy in terms of our 2014 capital budget, where we're investing to grow the business as well as maintain all of our assets in top class condition.

Another part of that strategy was illustrated yesterday with the announcement that we're raising our dividend by $0.02 per share, a strong indication of the confidence that we and our Board have in our ability to execute our plans for growth. That confidence springs from our belief in the strength of the Norfolk Southern team, who are the best in the business. We believe that our fourth-quarter and full-year 2013 results are just one more indication of why they're the best. Thanks. We'll open it up now for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

William Greene, Morgan Stanley.

William Greene - *Morgan Stanley - Analyst*

Don, can I ask you to offer a little bit more clarity on your comments, as you look forward? Because we had good fourth-quarter trends. We've had some weather here starting out in the first quarter. When we look at the January trends, do you feel like the underlying improvements are consistent with the kind of strength we saw in the fourth quarter? I'm just curious how to think about some of these calendar effects in weather, and what the underlying outlook really is.

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Good morning, Bill. The first two weeks of January had been weaker because of the weather. We've seen about a 22% jump in our volumes in the next week after those first two weeks, the third week. We think volumes are going to be fine. We will make up most of the business or all of the business that was deferred because of the first two weeks of bad weather. I feel pretty good about the ongoing volumes in the merchandise and intermodal business. As I indicated, I'm not so robust or optimistic with respect to coal.

William Greene - *Morgan Stanley - Analyst*

Okay. On that point, as we start to renegotiate utility contracts, the rail industry generally has been very disciplined on price there. Do we feel like these next round of negotiations, given where natural prices are, given the concerns longer-term on regulation and whatnot, did the utilities have a lot more leverage here such that we need to be thinking about there may have to be some give backs, if you will, so to speak on price, i.e., not as much upside left there?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Bill, the market continues to evolve. Certainly, gas is competing with coal more effectively. We'll take that into account as we address our contract renegotiations. We have only about 16% of our utility book this year under renegotiation to complete by the end of the year. We're engaged with those discussions now. As we always do, we take into account current market factors and market conditions as we reprice.

William Greene - *Morgan Stanley - Analyst*

Okay. Thank you so much for the time.

Operator

Allison Landry, Credit Suisse.

Allison Landry - *Credit Suisse - Analyst*

Actually, I wanted to ask a question about crude by rail, and the concerns surrounding the composition of Bakken crude and its low flashpoint characteristics. Given Norfolk is a connecting carrier, what is really in your control, in terms of taking some extra safety precautions, in order to avoid an accident? Are you in active discussions or working with the originating carriers to implement any additional procedures?

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

Allison, the entire industry quite clearly is focused on this. We're in very active discussions across the North American railroad industry as to how best to manage this growing business. We're also very clearly in discussions with the producers and with the regulators. There are really three, I think, central issues that we're talking about. The first is, of course, the safety of rail operations. The railroads have a great safety story. Our numbers have consistently gotten better over the past 20 years now. There's always more we can do, and we're looking at different operating practices, possibly doing some things on speed and routing. We'll continue to work hard on making it a safer operation, not only for Norfolk Southern, but for all of the carriers.

The second thing that I think there's a lot of discussion about is what you mentioned. That is, what exactly are the characteristics of the crude that's coming out of the Bakken. It's certainly more volatile than we originally thought, that any of us originally thought. I know that the regulators are very concerned with that and taking a hard look at it. Then, the third issue is the tank car issue, and what is the appropriate safety standard for the tank cars that will be transporting not only the crude oil, but ethanol and other substances.

In addition, there's a new standard the industry voluntarily adopted in 2011. The cars that have been built since that time are to this newer safer standard, but there's clearly going to be an evolution there in terms of what's the ultimate tank car design for these kinds of materials. There is a lot of work underway on the part of not only the rails, but the car owners, our customers, and the leasing companies, as well, to come up with that new standard, and to understand exactly what we'll do with the cars that are out there now.

Allison Landry - *Credit Suisse - Analyst*

Okay. That's a very comprehensive answer. Thanks. Just as my follow-up question, how much latent volume upside do you believe that Norfolk has related to the housing recovery, and some expected improvement in the non-resi construction market?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

The housing market is a bright spot for 2014. We expect starts to be up in the range of 23%, 24%. There's a strong multiplier effect to that market as it expands. Obviously, I mentioned our lumber traffic was up 16% in the fourth quarter. But we also see plastics, polyvinyl chloride on the chemical side, PVC pipe going into housing, roofing granules for roofing. There's a range of commodities that we transport that are favorably impacted by that increase in housing starts.

Allison Landry - *Credit Suisse - Analyst*

Okay. Any volume magnitude that you could place on that?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

We'll have to wait to see how it shakes out, but I feel good about the prospects.

Allison Landry - *Credit Suisse - Analyst*

Great. Thank you very much.

Operator

Chris Wetherbee, Citigroup.

Chris Wetherbee - *Citigroup - Analyst*

Maybe just a question on the coal side, if I could. Your Eastern competitor mentioned roughly a 20% decline in their outlook for export coal. Obviously, they're a little bit more heavier in the thermal market. I wanted to get a rough sense of how you think, Don, about the outlook for 2014, specifically on the export side of coal.

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Good morning. We completed the year right at 29 million tons of export coal, of which 80% was metallurgical and 20%, roughly, was thermal coal. We all watched the API 2 index with respect to export thermal coal. We know it's not strong. We know US producers face cost reduction, cost of production challenges participating in that lower-priced market. Also, we're seeing some challenges with respect to the met coal exports from US as well because of the low settled price that US producers are facing. We don't expect our export market to be as strong in 2014 is it was in 2013.

Chris Wetherbee - *Citigroup - Analyst*

Okay. In order of magnitude, I guess it's a little bit more weighted to the thermal side, so that would make sense. My follow-up question would just be on understanding the dynamic within coal yield, specifically. Obviously, if you add back the liquidated damages benefit that you got in the quarter, it seems like yields were roughly flat from the third quarter to the fourth quarter. Is that the right way to think about it? It doesn't sound like you have a lot of exposure on the utility side in 2014. I guess exports are going to be what they are. I'm just curious on how we should be thinking about that.

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

In the quarter itself, the $15 million liquidated damage accrual, if we deducted that instead of a 7% increase in revenue per unit, we would've had a 4% increase in revenue per unit. That was driven off favorable export, longer haul export volumes to the Port of Norfolk that I mentioned.

Chris Wetherbee - *Citigroup - Analyst*

Okay. Going forward, I guess we'll have to see how the mix persists. But I guess the way utility contracts are working, there's nothing that should change materially on that as list as we roll into 2014 at least.

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

That's true.

Chris Wetherbee - *Citigroup - Analyst*

Thanks very much for the time. I appreciate it.

Operator

Justin Yagerman, Deutsche Bank.

Justin Yagerman - *Deutsche Bank - Analyst*

A question for Wick. At the end of the prepared remarks, you talked about the economy gaining steam. I wanted to potentially get a little bit more color from you on what that was predicated on. Obviously, we've seen strong numbers from the ISM. Housing starts are supposed to be up this year. I think we all know that just because the economic data looks good doesn't necessarily mean it will be good. I'm curious if you're getting this from customer conversations, that you're expecting CapEx across the board to be up, or if this is more based on just the same dashboard stuff that we're all looking at? Any color would be really helpful.

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

I think it's a couple of things, Justin. One is, we all do look at the same dashboards and there, we certainly see, Don mentioned all of these things some continued strength in autos. I think the steel manufacturers feel a little bit better about next year. Certainly, housing is going to get better. The pace is still to be determined, so all of those factors weigh into it.

I think the other thing that just makes us feel a little bit better about the direction the economy is, as we look at our second half volumes, and really to some extent, our fourth-quarter volumes as compared to the first half of 2013, I would tell you, in the first half of 2013, we were less sure about the economy. As the year went on, we felt better about a lot of our business segments. We don't see anything on the horizon right now, particularly because it does seem to be, knock on wood, a little quieter in Washington that might provide a serious drag for that.

Justin Yagerman - *Deutsche Bank - Analyst*

That's fair. One question, just as a follow-up. On the intermodal markets, you really haven't talked about that much. RPU was actually down year-over-year for you guys. It looks like your competitor is starting to see a little bit of resurgence in their domestic business, with on highway conversions being better. I'm curious how you guys think about Eastern intermodal market share, and how you'd rate the fourth quarter performance from your standpoint? When you think about the competitive dynamic in 2014, do think it's getting tougher? Or, are you guys still confident with all the investments you've made, that you'll still have the premier domestic network?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

It's the latter. We remain confident with the investments, the network that we have developed, the new terminals, the services and products that we've launched. Also, the capability of providing a high-quality product, service product, that's truly competitive with the highway. Our growth is going to come from the highway. It's coming from the highway. That will continue.

With respect to the revenue per unit, as I mentioned in the quarter, the fuel surcharge actually was the largest driver of the 1% decline. Revenue was up 6%. We still believe that the trucking industry will face some capacity constraints in the face of hours of service regulations, as well as, as the economy ramps up in demand increases, that capacity won't be as available as it is today. The outlook for intermodal, in our view, in terms of coordinated conversion from the highway into a highly efficient network that we've invested in remains very bright.

Justin Yagerman - *Deutsche Bank - Analyst*

Obviously, I don't want you to speak to them, do you think that their surge in traffic was probably more driven by more loads getting converted to the rail? Or did you guys feel like you had any high-profile losses on the margin in the quarter from a customer standpoint?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

In every quarter, you have to look at the comps from the previous year and the Sandy effect. It all impacted volumes and increases throughout the Eastern network in the fourth quarter.

Justin Yagerman - *Deutsche Bank - Analyst*

Fair enough. Thanks for the time, guys. I appreciate it.

Operator

Tom Wadewitz, JPMorgan.

Tom Wadewitz - *JPMorgan Chase & Co. - Analyst*

Congratulations on the strong results. I wanted to follow-up, briefly, on the part of Justin's last question. Your Crescent Corridor, maybe if you could just tell me how much Crescent Corridor volumes grew in the fourth quarter? In terms of the pace that we had seen the last couple of quarters, it maybe hadn't been quite a strong contributor to overall intermodal volume growth as we had anticipated given the capacity investment. Is that something when you look to 2014 that you would say Crescent Corridor is going to be a bigger driver of your overall intermodal volume growth?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Tom, this is Don. With respect to your first part of your question, in the quarter, Crescent was up 6%, for the year it was up 8%. Heartland was up 9% in the fourth quarter. For the year, it was up 16%. You can see that gives you a flavor of the percentage increases. As we pointed out, as we've invested in high-efficiency service, competitive with the highway, we're being very focused with respect to the business we're bringing on in these corridors, to ensure that this business pays for itself, and generates the type of return that we're seeking with the investments that we've made. We're not looking to load up the network in one to two or three quarters. What we are looking for is good, high-quality freight that we will continue to handle over time. Does that make sense?

Tom Wadewitz - *JPMorgan Chase & Co. - Analyst*

Yes. Sure. That's great. That's very helpful. My follow-up would also probably be for you, Don. Your yield performance, the revenue per car, can often be affected by mix. I think of the 2013 yields, there was probably some mix effect, in coal on short-haul growth and things like that, and maybe some other mix effects, and also in exports. How would you want us to think about the mix effect and also the impact from export coal pricing, as we forecast yields in 2014?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Tom, as I pointed out earlier, we expect lower export volumes in 2014 with respect to overall export. We think the thermal component will be weaker. We also think the met coal component will be weaker as well. The market, hopefully, is at a bottom with respect to world prices, in that $135 to $140 range, actually a little lower than that right now. The API 2 is $85 or less. It's bouncing around $85 a ton. With those dynamics, we are where we are on pricing, I will tell you that. We're not planning to make any adjustment this quarter in export pricing, but with respect to overall demand, we see a softer outlook there.

Hopefully, with the weather that we're seeing, stockpiles in the South on our utility network will normalize. We think that's underway, not there yet, but it's underway. That is longer haul, higher RPU traffic. If we get some replenishment of stockpiles in the South, that would be a favorable mix impact, as export is softer.

Tom Wadewitz - *JPMorgan Chase & Co. - Analyst*

Okay. Export impact on yield would be negative. Maybe on utility, it's positive. Overall mix effect, do want to comment on that?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

The overall mix effect, we think in merchandise, will continue to be comparable to what we're seeing right now, no significant changes. We will continue to see our non-coal energy component of our business increase, and that includes everything from crude oil to natural gas liquids to ethanol to frac sand, things that we're putting into that bucket, which I will tell you, Tom, in the fourth quarter and for the year, is close to 10% of our merchandise business, our volume now.

Tom Wadewitz - *JPMorgan Chase & Co. - Analyst*

Great. Thank you for the time. I appreciate it.

Operator

Anthony Gallo, Wells Fargo.

Anthony Gallo - *Wells Fargo Securities, LLC - Analyst*

Congratulations. I wanted to go back to crude by rail. Maybe if you could speak to what you see as your capacity to expand that? Could you double the business, for example, based on current resources? Then, I have a follow-up question on your potential regional railroad partners with crude by rail.

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

In terms of capacity, the vast majority of this crude moves across our Northern region, which is, for the most part, double or triple track. It's a very high-capacity railroad, so we certainly have the infrastructure to expand. We can accommodate it with the crew base that we have, so we have a lot of room to grow.

The ultimate limitation on crude by rail in the East really is just purely the number of refineries. There are, as you know, a number of refineries from Delaware up the coast all the way to Nova Scotia, I guess. A lot of them are already taking crude by rail. There are others that are preparing to, in terms of infrastructure, but that's the limitation. That will be the cap on the total crude by rail that moves across Norfolk Southern, or for that matter, moves across the Eastern part of the US.

Anthony Gallo - *Wells Fargo Securities, LLC - Analyst*

Certainly. As a follow-up, do you do any business with regional railroads? I'm thinking about it in the context of some of these regulatory changes that may ultimately change the liability aspect of that, and to the extent some of these smaller regional railroads might not be able to handle it because of that. Is there any interaction with regional railroads where we should worry about their liability risk, if the regulatory environment does change?

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

You're talking about interaction in terms of the crude business?

Anthony Gallo - *Wells Fargo Securities, LLC - Analyst*

Exactly.

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

The answer is not really. The crude by rail that we handle, as far as I am aware, and I'm looking at Mark, we don't hand it off to anyone. It moves Norfolk Southern direct, or moves into the shared assets area.

Tom Wadewitz - *JPMorgan Chase & Co. - Analyst*

Thank you.

Operator

Walter Spracklin, RBC.

Walter Spracklin - *RBC Capital Markets - Analyst*

Just a quick question, just a follow-up on intermodal. It looks like you pointed toward an improving economy. You pointed toward the trucking capacity constraints. All that is suggestive that things, the environment, should get better in 2014, particularly from a competitive environment with truck. Am I right in assuming that you haven't seen that yet? The impact of that tighter capacity on truck and that better economy of playing itself out in contract repricing that you're doing on intermodal today?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Spot pricing, yes, on our contract pricing that tends to run year-to-year, no. We are in that period in the first 90 days of this year. We will see some of that playing out in our current negotiations. As you know on spot, we see that fairly immediately. But with a lot of our intermodal business being under commitments for at least one year, this is an active time for repricing of that intermodal business in the first quarter.

Walter Spracklin - *RBC Capital Markets - Analyst*

But it's safe to say the spot trend is a good leading indicator to how your contracts are going to develop?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Certainly, the spot trend is positive. I cannot tell you that it's going to translate into contracts because we're facing motor carrier competition. Before we convert it, they attempt to hold onto it.

Walter Spracklin - *RBC Capital Markets - Analyst*

Thanks. Okay. Second question. I don't know if it's for Mark or Marta. Mark, the employee count, I'm looking back to my notes. What you were indicating toward the end of the year when we spoke at third quarter, it looks like it came in a little bit better than what you had indicated. As we go into 2014, how do you see the seasonality and accounting for all the seasonality, how do you see the employee count evolving as we go through 2014?

Mark Manion - *Norfolk Southern Corp - COO*

Well, we have had a pretty good reduction during 2013, and as we go forward, I think we'll stay relatively flat. We've got a couple areas where we will, just because of the various efficiencies and productivity initiatives that are going on, we'll continue to see some reduction. Of course, particularly with respect to our T&E forces, all that is very dependent on what the volumes are, so relatively flat.

Walter Spracklin - *RBC Capital Markets - Analyst*

On wage inflation slide, Marta, you had indicated we should still see the same level of trends although perhaps not as much on the incentive compensation. In other words, are we looking at just base wage inflation now as we project into 2014? Or are there other factors we should consider?

Marta Stewart - *Norfolk Southern Corp - CFO*

Yes, the wage inflation should be about the same. There will be a union wage increase in the middle of the year, as there was this year. The portion I spoke to what was a reduction in pension and post-retirement medical costs. We think those will be down as a result of our plans being in a better funded position this year.

Walter Spracklin - *RBC Capital Markets - Analyst*

Okay. But offsetting some of the stock based compensation lift that we might not see the same kind of growth next year?

Marta Stewart - *Norfolk Southern Corp - CFO*

We really think the incentive compensation in the quarter was heavy, but year-over-year, annualized should be about the same.

Walter Spracklin - *RBC Capital Markets - Analyst*

Okay. That's all my questions. Thanks very much.

Operator

Jason Seidl, Cowen and Company.

Jason Seidl - *Cowen Securities LLC - Analyst*

I want to go back to your commentary on your crew starts. It looks like they were down 1%, I think you said in 4Q, but 3% for the year. Should we expect that 1% level to continue? Or is that going to be challenging as we see volumes grow?

Mark Manion - *Norfolk Southern Corp - COO*

We certainly have got more of a challenge, just because we've got a real winter this year. That will have an effect in the short-term. Beyond that, I don't know that we'll see some of the steep rate of reduction that we saw in 2013. But again, with some of the various improvements we've got going on into 2014, I think we'll still continue to see a positive trend.

Jason Seidl - *Cowen Securities LLC - Analyst*

Okay. Following up on some of the intermodal questions, you mentioned that you're seeing, Don said, improvement on the spot. I don't think I caught it. Can you remind us what percent you guys have that's more spot or transactional in nature, and how quickly do you think you could react to a tightening truckload market to bring your existing spot rates up?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Most of our business is committed, I would say. The spot is in the range of 15% of the book.

Jason Seidl - *Cowen Securities LLC - Analyst*

Okay. And you can change that spot pretty quickly?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Not really. That percentage continues in a fairly stable way. It's not changeable, because we have commitments.

Jason Seidl - *Cowen Securities LLC - Analyst*

What I'm saying, the spot price that you have is very fluid in terms of the current marketplace?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

That's correct.

Jason Seidl - *Cowen Securities LLC - Analyst*

Perfect. Thank you so much for the time, gentlemen.

Operator

Justin Long, Stephens.

Justin Long - *Stephens Inc. - Analyst*

Mark, first question is for you. I was wondering if you could provide an update on where things stand on the implementation of both LEADER and movement planner. Also, as you think about your $100 million plus productivity target for 2014, how much of that amount is coming from those two items?

Mark Manion - *Norfolk Southern Corp - COO*

Well, as far as both LEADER and movement planner, movement planner is get scheduled to be completed by the end of 2014. We'll see a pretty rapid rollout of essentially the last half of our system this year. That will be very good. LEADER, we will get most of the system, the core part of the system, covered with LEADER in 2014. Then, once we get it covered, we will continue to see, and it's going to take us well beyond 2014, benefits from leader as we get better and better at turning on the benefits from that technology.

As far as the amount of benefit we're getting out of that, we've got so many things at play. I would really be taking a wild guess at that, which I would rather not do, but substantial benefits from both of those.

Justin Long - *Stephens Inc. - Analyst*

Okay. That's fair. As a follow-up, I was just wondering, if you strip out the lower level of rail inflation that it sounds like we're seeing, have you seen any changes in the overall core pricing environment in the past three to six months? Could you just talk about your expectations for pricing headed into 2014?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

This is Don. No changes in the pricing environment. I will say that if the economy continues to gain traction, we believe that that environment will become more favorable. Obviously, we'll participate in the market and price to the market, as we always do.

Justin Long - *Stephens Inc. - Analyst*

Great. That is good to hear. I appreciate the time this morning.

Operator

Thomas Kim, Goldman Sachs.

Thomas Kim - *Goldman Sachs - Analyst*

This question is for Marta. Your cash balance has been steadily increasing. Obviously, you announced an increased dividend yesterday, but it would certainly seem you have the potential to do a lot more on the capital front. I would just appreciate your thoughts about how you're think about free cash flow allocation during the year. Thanks.

Marta Stewart - *Norfolk Southern Corp - CFO*

We really haven't changed our overall approach to free cash flow allocation. We reinvest in the business, and we talked about our capital program. After that, we return to shareholders in the form of dividends and share repurchases. Really part of the reason for our increase in cash balances at the end of the year is we did an opportunistic debt issuance in November. We wanted to go ahead and take advantage of the low rate. So, that's partly why you see it a little bit higher than we've run in the past.

Thomas Kim - *Goldman Sachs - Analyst*

That's fair, but the net debt level is actually still decreasing. Another way for me to inquire is do have a minimum cash level that you would like to maintain, or a minimum debt ratio that you're targeting?

Marta Stewart - *Norfolk Southern Corp - CFO*

Yes. We target to stay within our credit ratings band, and that's one of the reasons why we went ahead and issued the debt. We just try to modulate and make sure we've got plenty cash to invest in the business and still stay within there. You're right that net, if you take our debt minus our cash right now, we're running a little bit lower. It's not intentional deleveraging. It's just the up-shoot of the fact that we have very strong free cash flow during the year.

Thomas Kim - *Goldman Sachs - Analyst*

Okay. Thanks. Don, could I ask you about the comment on new business gains within the industrial side for your coal business?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Could you repeat the question? It didn't quite catch it.

Thomas Kim - *Goldman Sachs - Analyst*

Sorry. Let me ask more clearly. Earlier, you'd mentioned that you had won some new business within the coal segment, and it related to industrial. I was wondering if you could just elaborate on that? Was it share shift? Or was there something else going on, new development, new plant, or whatnot?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

No, this is coal increases with some of our industrial accounts, like the paper industry, like the cement industry, where they are using more coal, and coal is more competitive now with natural gas. Also, they're seeing increased production and usage of coal.

Thomas Kim - *Goldman Sachs - Analyst*

They're not new customers coming on. It's just organic growth with existing customers?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Organic growth that we've been able to displace gas with in some cases.

Thomas Kim - *Goldman Sachs - Analyst*

Okay. Thank you.

Operator

John Larkin, Stifel.

John Larkin - *Stifel Nicolaus - Analyst*

First question was to ask Don, perhaps, to dig a little deeper into the Southeastern utility coal situation. First of all, do you have any timetable as to when those stock piles might be normalized? Is that a 2014 event? Or do you see that happening more in the 2015 or beyond time period? Once they are normalized, will the replenishment come from Central App mines, or more likely from the Illinois Basin mines? If from the Illinois Basin mines, what type of a favorable mix impact would that have on RPU?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Your the first part of your question, with respect to Southern utility stockpiles, our best estimate is that that normalization of stockpiles will take most of the first half into the third quarter depending upon, obviously, continued weather patterns that we're getting, which are favorable. The second thing, with respect to the basins, that's a good question. We see more coal flowing to the South from Illinois Basin sourcing, and some Northern App sourcing flowing to the South as well. Central App will continue to be pressured in our view with respect to sourcing into the South, just from a cost of production perspective and being competitive.

Now, I will say that with gas still being in the range of $4 to $4.50 right now, even though we're having a real winter, as Mark pointed out, gas continues to be competitive in the Southern utilities, and in the North as well. Our volume's down 18% in the fourth quarter, tells you that gas is still very, very much a factor in the Southern network.

John Larkin - *Stifel Nicolaus - Analyst*

With a shift from Central App more toward Illinois Basin or Northern App, presumably, when things do ramp up to replenish those, those ultimately reduce stockpiles, that should have a positive impact on your yield in the coal business?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

John, that's correct. It will be longer haul, most likely higher revenue per unit coal flowing from those new origination points. It all depends on how much coal they actually take from those new sources.

John Larkin - *Stifel Nicolaus - Analyst*

Thank you. As a follow-on, normally on these calls we don't talk about what's happening down at the STB, except with respect to the reciprocal switching proposal, but there are a couple of rate cases there that currently involve Norfolk Southern. One is the DuPont case, and there's a smaller one, the Sunbelt case. How long do think it'll be before those cases are resolved? How do you characterize the risk associated with those cases?

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

This is Wick. We don't normally comment a lot on anything that's up at the STB. We clearly feel that we have a strong position for the rates that we charge. I think the time table is such that those cases both should be resolved in 2014. We'll just see how that comes out.

John Larkin - *Stifel Nicolaus - Analyst*

Okay. Thank you very much.

Operator

Ben Hartford, Robert W. Baird.

Ben Hartford - *Robert W. Baird and Company, Inc. - Analyst*

A quick question on the EMP fleet, I was wondering if you could give us a size of the fleet in 2013? And provide any context to what the expansion plans would be for 2014, specifically the number of container net adds in 2014? Thanks.

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

The approximate size of the fleet, we are around 29,000 containers in the combined fleet. We expect that to expand by about 2,500 boxes.

Ben Hartford - *Robert W. Baird and Company, Inc. - Analyst*

Great. Thank you.

Operator

Scott Group, Wolfe Research.

Scott Group - *Wolfe Research - Analyst*

First one for Don, just on coal. The rise in gas prices we've seen and obviously the cold start to weather, do you think that's having more of an impact on Northern or Southern utilities, as we think about mix there going forward?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Certainly, the temperatures in the North have been pretty intense, but they have in the South as well. They are, as we speak, this morning. I would have to say that the stock pile impact in the North is greater at this point than the South. If we continue to see this weather pattern for the balance of the winter, and have a favorable shoulder period through April on into May, I would say that the South will have their turn in it as well.

Scott Group - *Wolfe Research - Analyst*

Right. But it sounds like we should think about Northern coal, coal going to Northern utilities better, at least for now, at least the next couple of quarters, than going to the South?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

That's a correct statement. The Northern utilities that we serve, the stockpiles are at normal. They are normalized now. They're facing this increased generation demand, so they will have to replenish fuel supplies. In the South, we still have the excess stockpile overhang. Even with some increased demand, the overall fuel supply inventory is better.

Scott Group - *Wolfe Research - Analyst*

Okay. That's helpful. One for either Mark or Marta. The PTC budget for 2014 is pretty similar with 2013. Once we get through 2014, how much is left? Are you on track to have your stuff finished by 2015?

Mark Manion - *Norfolk Southern Corp - COO*

We're going to have, as far as the hardware that's installed, we're going to have everything pretty well in place by 2018, and then we'll have continuing training efforts and those type things that I expect will take us out to 2020. Then, it's fair to say for everybody, it remains to be seen what the reliability of these really complex systems are, going out beyond 2020.

Scott Group - *Wolfe Research - Analyst*

You are expecting the mandate to get pushed out by three years?

Mark Manion - *Norfolk Southern Corp - COO*

Well, it's hard to know just what's going to happen in Washington. But I can tell you that from the standpoint of what is possible, we're not going to be ready in 2015. I think that's pretty clear to everybody.

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

The laws of physics prevail in things like this. Even the FRA has acknowledged that there's going to have to be a several year extension.

Scott Group - *Wolfe Research - Analyst*

You think that's still likely to get a full three years even given some of the safety issues we've seen over the summer and winter?

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

Well, it is, as I said, there is just the simple fact that we, not only we, the North American rail industry is not going to complete this project by the end of 2015, and it will take several years after that to conclude it. There are still substantial parts of this technology that are not tested. We will have a lot of issues to deal with, even after we get the software completed, which it's not, and the hardware all installed, which obviously it's not.

We are dealing with, as you know, with an issue within the government, where we can't get the FCC to give us permission to put the antennas up that we require. There are tens of thousands of those. It's just a situation where the facts are the facts, and it's going to take some substantial amount of time beyond 2015 to get the system up, more importantly, as Mark said, to get it working at a level of reliability where the industry can continue to function.

Scott Group - *Wolfe Research - Analyst*

Makes sense. Thanks, guys.

Operator

Jeff Kauffman, Buckingham Research.

Jeff Kauffman - *Buckingham Research Group - Analyst*

Congratulations, as John said, thank you for taking my question. A quick question for Marta, and then a follow-up on coal. Marta, is free cash flow probably going to be about neutral this year versus next year, when I take into account any earnings gains, higher depreciation, and lower pension offset by the higher CapEx? Or is there something on the non-cash side I should be thinking of?

Marta Stewart - *Norfolk Southern Corp - CFO*

We never know about some of the non-operating items, but with regard to free cash flow, I think the most significant difference is the one we described today. We think we're going to have about $200 million higher of CapEx. Other than that, it's normal operations.

Jeff Kauffman - *Buckingham Research Group - Analyst*

Right. But your earnings should grow. Your depreciation, which is non-cash expense is higher, and your pension should be lower, or the contribution is not going to track with the lower expenses.

Marta Stewart - *Norfolk Southern Corp - CFO*

We don't have any, and we haven't had in the last, required contributions. The pension is a non-cash item, also.

Jeff Kauffman - *Buckingham Research Group - Analyst*

Very good.

Marta Stewart - *Norfolk Southern Corp - CFO*

That doesn't flow through.

Jeff Kauffman - *Buckingham Research Group - Analyst*

Quick question, follow-up on the call, given where the heating degree days are in your North and Midwest regions, I understand your trepidation on the export side. I am a little surprised you're not a little more optimistic on domestic coal. I know we focused a lot on the Southern region where the utilities are still an issue, and there's more gas competition, but could you talk a little bit more about your expectations for domestic thermal volumes next year versus, maybe, pricing or customer discussions? It would seem to me, given what I'm seeing, that the domestic coal story would be a little bit better than you seem to applying.

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

It's a good question. Let me put a little bit more color around thermal coal. If you look sequentially, in our tonnage, from the third quarter to the fourth quarter, we're down about 2 million tons in utility coal. Year-over-year, for the entire year, our utility business was off almost 5 million tons, a little more than 4 million tons. We're at 97 million tons of utility coal. We do not see a dynamic out far enough in 2014 to indicate that that will stabilize, or that it's going to be equal to that 97 million tons at this point.

Even with the weather we're having right now, we only see this as a snapshot in the first three weeks of the year. There are a lot of question marks, obviously, about what we will see for the balance of the year. The dynamics, the competitive dynamics, between coal and natural gas are such that we're not comfortable providing any outlook that says that utility book at 97 million tons will stay at 97 million tons. We just don't think it will.

Jeff Kauffman - *Buckingham Research Group - Analyst*

You're not saying, necessarily, less bad, you're just saying not necessarily better? Is that a fair way to read it?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Yes. I don't see the degradation that we've seen getting worse. I'm only saying that we think the market itself will not support growth.

Jeff Kauffman - *Buckingham Research Group - Analyst*

Okay. Very good. Congratulations again and thank you.

Operator

Ken Hoexter, Merrill Lynch.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Marta, congrats on the new role. Mark, just a question on the plan that you talked about. You talked about rolling out the last few quarters, is this a renewed attack on safety and service that you're addressing with new programs?

Just as an aside, you saw dwell climb a touch, but crew starts and re-crew and cars per unit all improving. Is that a mix issue in terms of seeing the dwell decline a bit?

Mark Manion - *Norfolk Southern Corp - COO*

It's Mark Manion. Good morning. As far as our safety process goes, we are about really about three years into this, two in a big way where we've had the workforce engaged. Like I said, we've had a lot of work that went on in 2013, just as far as education and the process, both on the management side and our 24,000 workforce population.

The core of it is all about engagement of our people, our people understanding how important they are to the business, creating an environment where they want to come forward with their ideas, participate in problem-solving, improving the business, finding ways to be safer. It is definitely geared toward our safety process, but it really touches on all aspects of the business. We're in the beginning throes of this.

This will be ongoing forever. We hope to see a lot of good things, not only from a safety standpoint, but for the business in general, as our people get more and more engaged.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Any thoughts on the dwell time? Is that a mix related trend?

Mark Manion - *Norfolk Southern Corp - COO*

As far as terminal dwell, we saw good improvement during 2013 and we have got a pretty large project relative to improvement in our terminals. So far, we've only been through a pretty small number of those terminals with this project. Of course, we're starting with our biggest terminals. We've been through maybe 20% of our terminals so far. As we continue to see overall improvement in efficiencies in the terminals, we think that it will have an effect on lowering the dwell time.

Again, this is hooked up with our behavioral leadership project and engagement of people. It all works together. So, we think we'll see improvement in that area. It's hard to know how much through, Ken.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Thanks. Don, for a follow-up on the ag business, just given the bumper crop, do you look for volumes to accelerate into 2014? Or are inventory levels being replenished, and this is a good run rate for the fourth quarter?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

In the ag market, there are puts and takes in it. The was a strong crop, obviously, of corn and soybeans. That's the good news. The not-so-good news, it was a strong crop in close proximity to the Southeastern feed mills. A lot of that corn and soybean product will be trucked to those local mills, displacing longer haul corn and soybeans that would have moved from the Midwest, had the Southeastern crop not been as strong.

We'll have to work through that supply, and we will as the year progresses. Then, we will see Midwestern grain start moving at a higher volume. You put it all together, it should be a much better market than it was last year, but it won't be as robust as one would think, just based on the overall production numbers.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Great insight. I appreciate it. Thanks, guys.

Operator

Keith Schoonmaker, Morningstar.

Keith Schoonmaker - *Morningstar - Analyst*

Marta, concerning use of cash, I see you budgeted about 10% of total 2014 investment for PTC, and about the same for facilities and terminals. I won't ask what part of PTC investment you're most excited about, but could you highlight a couple of the major facilities investments you think will bear the most fruit?

Marta Stewart - *Norfolk Southern Corp - CFO*

Well, and Mark can maybe talk about this a little more than me. We're having major expansion underway at our Bellevue yard, which is really going to help with the flow of operations in the Northeast. That's one of the portions of that that I'm most excited about. Mark?

Mark Manion - *Norfolk Southern Corp - COO*

That's absolutely right. We're going to pretty much conclude that project by the end of this year. Ever since we were fortunate enough to get the Conrail portion of our network integrated with the rest of the old Norfolk Southern, that is just an area where our business wants to go. It wants to go into that upper Ohio area, so this will allow for a lot of efficiencies, just being able to handle that business in that area in a more productive way.

Keith Schoonmaker - *Morningstar - Analyst*

Second question. Noticed that your quarterly 10% growth in auto related volume was substantially better than market growth. In fact, it's about double light vehicle production growth. Could you add some details to the sources of that growth?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Number one, we had production at the plants that we serve growing ahead of the market. Obviously, Ford Motor Company would be one of those customers. Toyota is another one of those customers, Honda being another one of those customers, et cetera. That's number one. Number two, we've had some market share gains as well, as we compete with haul away in terms of over-the-road movement of vehicles in that network as well.

Keith Schoonmaker - *Morningstar - Analyst*

Thank you.

Operator

David Vernon, Alliance Bernstein.

David Vernon - *Alliance Bernstein - Analyst*

Don, the 97 million tons of utility coal that you guys had done for 2013, what percentage of that would be utility North versus South?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

It's a fairly balanced portfolio with about half of the business in the North on a tonnage basis and about half in the South. Although, I will tell you that our percentage declines in the South are eroding that balance to where the North now is a little bit heavier than the South. I can't give you the actual percentages off the top of my head, but traditionally, it has been about an equal portfolio. But, with Northern utility, for example, being flat essentially for the fourth quarter and the year, and the South being down in the fourth quarter as much as 18%, that balance is changing.

David Vernon - *Alliance Bernstein - Analyst*

All right. The mix is now more heavily Northern then, right?

Don Seale - *Norfolk Southern Corp - Chief Marketing Officer*

Slightly.

David Vernon - *Alliance Bernstein - Analyst*

Okay. Marta, perhaps, could you help us out with some guidance for what should be a good effective tax rate for 2014, and also a cash tax rate for 2014?

Marta Stewart - *Norfolk Southern Corp - CFO*

Yes. We think we'll have about 37.5% effective tax rate for 2014. On cash taxes, we don't have bonus depreciation coming up. So, we think the cash taxes will be higher in 2014.

David Vernon - *Alliance Bernstein - Analyst*

Any dollar value or percentage number higher that you could help us out with?

Marta Stewart - *Norfolk Southern Corp - CFO*

About $200 million.

David Vernon - *Alliance Bernstein - Analyst*

Great. Thank you very much.

Operator

Brandon Oglenski, Barclays.

Brandon Oglenski - *Barclays Capital - Analyst*

I'm going to ask one. It's probably for Wick or Marta. You had two quarters now of pretty solid year-on-year operating ratio improvement. When you talk about $100 million of productivity gains targeted this year plus, Marta, I think if I heard you're right, you said $25 million less pension expense per quarter. That's another $100 million of pension reduction. Is the OR improvement sustainable in 2014? What are some of the offsets that investors should be thinking about?

Marta Stewart - *Norfolk Southern Corp - CFO*

I'll let Wick handle the general question, but I did want to point out we do have the $25 million reduction, and that's pension and post-retirement together. Then we have $10 million of depreciation per quarter that we think is going to be higher. I did want to mention that.

I also mentioned on the casualties and other expenses, that we think run rate year-over-year, those will be higher, about $10 million a quarter. The three of those that I mentioned somewhat wash. I'll let Wick handle the overall question about our OR.

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

Well, clearly, as we've always been, we're focused on trying to take the OR down further. We're optimistic that with a better business climate in 2014, even with what we do expect, as Don said, to be some continued pressure on our coal volumes even over 2013, that we'll be able to produce better business results. We're very happy with the productivity improvements that Mark and his team have outlined.

Our goal every year is to drive the operating ratio down further. That's certainly our goal for 2014. We'll just have to see where we end up. We think that there are a lot of positives looking at the year that we'll be able to take advantage of.

Brandon Oglenski - *Barclays Capital - Analyst*

Those positives are more robust in 2014 than we've seen in the last couple of years, when you've had effectively flat OR outcomes, right?

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

Well, I certainly would point first at the fact that we do believe, as does everyone else, that economic growth in this country is picking up. We're starting to see housing rebound as we've talked about, which is a critical part of GDP. Norfolk Southern, a lot of our business is driven directly by the US economy. As the US economy improves, our results should improve with it.

Brandon Oglenski - *Barclays Capital - Analyst*

Thank you.

Operator

Mr. Moorman, there are no further questions at this time. Would like to make any closing remarks?

Wick Moorman - *Norfolk Southern Corp - Chairman & CEO*

Well, let me just say thanks to everyone on the call for your patience. Thanks for all of the questions. We look forward to talking to you next quarter.

Operator

This concludes today's teleconference. You may disconnect your lines at this time, and we thank you for your participation.
