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EDITED TRANSCRIPT

NSC - Q4 2014 Norfolk Southern Corp Earnings Conference Call

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OVERVIEW:

NSC reported 4Q14 revenues of $2.9b, net income of $511m and EPS of $1.64.

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PRESENTATION

Operator

Greetings. Welcome to the Norfolk Southern Corporation fourth-quarter 2014 earnings call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Katie Cook, Director of Investor Relations. Thank you, Ms. Cook. You may begin.

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Katie Cook - *Norfolk Southern Corporation - Director, IR*

Thank you, Rob, and good morning. Before we begin today's call, I would like to mention a few items.

First, slides of the presenters are available on our website at NorfolkSouthern.com in the Investors section. Additionally, transcripts and downloads of today's call will be posted on our website.

Please be advised that during this call we may make certain forward-looking statements. These forward-looking statements are subject to a number of risks and uncertainties and our actual results may differ materially from those projected. Please refer to our annual and quarterly reports filed with the SEC for a full discussion 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 Investors section. Now it is my pleasure to introduce Norfolk Southern Chairman and CEO Wick Moorman.

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

Thank you, Katie, and good morning, everyone. It is my pleasure to welcome you to our fourth-quarter 2014 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; our Chief Financial Officer, Marta Stewart.

As all of you know by now, after 39 years of exemplary service, Don has decided to retire effective March 1. Therefore, this will be his last earnings call. And I know all of you join me in wishing him a long and happy retirement.

Turning now to our financial results, I am pleased to report that Norfolk Southern achieved another solid quarter, which completed an outstanding 2014 financial performance with record annual results across the board including all-time highs for revenues, income from operations, operating ratio, net income, and earnings per share.

Looking at our top line, revenues for the fourth quarter were $2.9 billion, flat compared to our record 2013 fourth-quarter revenue, despite a 15% decrease in coal revenue and lower fuel surcharge revenue. Overall volumes increased 4% as growth in intermodal and merchandise more than offset a 6% decline in coal volumes. For the full year, revenues were $11.6 billion, up 3%, notwithstanding a 6% decline in coal revenue.

Don will provide you with all of the revenue details in a few minutes.

Our fourth-quarter operating expenses were down 1%, resulting in a fourth-quarter record $891 million of income from railway operations and a 69.0% operating ratio, which is a 40 basis point improvement compared to 2013. This enabled us to end the full year with an operating ratio of 69.2%, the Company's first ever sub-70% operating ratio and a 180 basis point improvement over 2013.

As all of you know, we were able to achieve these results in the face of service challenges and the fourth quarter was no exception. However, as you also know, we have worked diligently to improve our velocity and operating metrics, and we saw definite improvement after the Thanksgiving holidays. Mark will go over our service metrics and provide you with the latest update on our initiatives for improvement.

Fourth-quarter net income of $511 million and earnings per share of $1.64 were comparable to 2013's record results. For the full year, record level net income and earnings per share increased 8% and 9%, respectively, excluding the large land sale that benefited 2013. Marta will cover this as well as the rest of the financials with you in more detail.

We are excited about delivering another year of record results and even more excited that our service product has turned the corner after a few difficult months. We remain optimistic about our prospects going forward, and on that note I will turn the program over to Don, Mark, and Marta. I will then return with some closing comments and we will take your questions. Don?

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Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Thank you, Wick, and good morning, everyone. Our fourth-quarter revenue was $2.9 billion, as Wick indicated, roughly even with a very strong fourth quarter of 2013, with gains in merchandise and intermodal offset by a decline in coal. Merchandise revenue increased $56 million, or 3%, while intermodal revenue increased $31 million, or 5%, compared to last year. Coal revenue declined $98 million, or 15%, with weaker shipments in utility and export markets.

Volume increases in intermodal and merchandise generated $103 million of positive revenue variance in the fourth quarter. Despite volume increases, fuel surcharge revenues declined $45 million compared to 2013 as a result of a 13% decline in West Texas intermediate oil prices compared to 2013. Additionally, revenues were impacted by the negative mix effects associated with higher intermodal volumes and lower coal volumes. The combined impacts of reduced fuel surcharge revenue and negative mix resulted in an overall ARPU decline of 4%.

Total volume for the quarter was up 4%, or roughly 66,000 units, due to a 6% gain in intermodal shipments and a 5% gain in merchandise shipments, which offset a 6% decline in coal. Our merchandise business benefited from very strong chemicals and metals and construction volumes, which were offset by declines in agriculture and paper and forest products.

Fourth-quarter intermodal volumes were up over 57,000 units, or 6%, compared to fourth quarter 2013 with particular strength in international volumes. And our coal volumes declined by 6% due to weak shipments in both export and utility markets.

Now breaking out the market segments on the next slide starting with coal, as shown on slide 4, coal revenue was down $98 million, or 15%, compared to fourth quarter last year with volume down 6%. Coal ARPU declined 10% in the quarter as a result of reduced fuel surcharge revenue as well as the negative mix impact of reduced export volume.

Overall utility coal volume declined by 6% in the quarter, driven by lower coal burn and lower natural gas prices.

Shipments to northern utilities were down 9%, due primarily to a previously announced market share loss, a negative comparison which we cleared on January 1 of this year. Finally, utility coal volumes were suppressed by weakened service levels, which we estimate to be about 1 million tons in the quarter. We expect to make up most of those deferred tons not handled in the fourth quarter.

The export coal market continues to be impacted by strong global competition and a weak demand environment. Weak market fundamentals and the falling Australian dollar drove a 25% decline in export shipments for the quarter. Volumes within our domestic metallurgical markets were up 13% with customer-specific gains in coke shipments driving growth.

Intermodal revenue in the fourth quarter increased by $31 million, or 5%, to $649 million due to 6% volume growth. Revenue per unit was down 1% for the quarter as positive pricing activity was offset by lower fuel surcharge revenues and the negative mix impact of higher volumes of lower ARPU international freight.

Domestic intermodal volumes were up 4% for the quarter with gains due to highway conversions and growth with key accounts. Growth in this segment was slowed in the quarter as a result of poor network velocity.

On the international side, strong growth of 10% was driven by new contract business, the introduction of new service lanes, and West Coast labor disruption. The five carload business groups, shown on the next slide, within our merchandise market had mixed results in the fourth quarter, with strong gains in metals and construction and chemicals offset by weaker volumes of agriculture, paper, and forest product commodities.

Total merchandise revenue of $1.7 billion was up 3%, or $56 million, versus 2013 with ARPU down $31, or 1%, for the quarter as a result of lower fuel surcharge revenues. Metals and construction volumes were up 12% for the quarter, with increased volumes of slabs, coil steel, frac sand, and aggregates. Chemicals volumes were up 14% for the quarter, driven by continued gains of crude by rail and natural gas liquid shipments.

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Following a strong quarter, our automotive volumes were flat in the fourth quarter compared to 2013. These volumes were impacted by both plant downtime and model changeovers at key Norfolk Southern plants.

Volumes within our agricultural markets were negatively impacted by network velocity as soybean shipments declined versus last year due to longer cycle times, which limited railcar availability. This decline was partially offset by increased corn volumes to ethanol producers and feed markets in the Southeast.

Finally, paper and forest products declined 2% in the quarter, with increased volumes of lumber and wood products offset by declining shipments of graphic paper and municipal solid waste.

Now before I conclude with our outlook, I will make a couple of comments about our fuel surcharge programs. The WTI oil curve shown here in this graph on the slide will negatively impact our surcharge programs at current projected oil prices. Over 85% of our revenue base is covered by negotiated fuel surcharges that totaled $1.3 billion in 2014. These surcharges were almost evenly split between WTI and on-highway diesel-based programs.

More than two-thirds of the WTI-based surcharge revenue programs contained trigger prices above the current WTI price per barrel. At these expected prices, these contracts will yield zero fuel surcharges in 2015. The remaining WTI-based contracts, as well as the on-highway diesel-based contracts, are expected to generate fuel surcharge revenue, but at a substantially lower rate than in 2014.

Now concluding with our outlook, we anticipate continued opportunities for volume and revenue growth across most of our business units in 2015 despite headwinds with fuel surcharge revenue. The exception again will be the coal markets, both domestically and in the export sector.

We expect utility coal volumes will be impacted by lower natural gas prices. Within the export sector, global oversupply, low commodity pricing, and a weaker Australian dollar will leave US producers at a disadvantage in the world marketplace.

Turning to intermodal, highway conversions will continue to generate growth with key domestic customers across our strategic intermodal corridors. And on the international side, we expect additional volumes due to new customers and service offerings.

Our outlook for our merchandise book of business continues to be positive. We project continued growth in crude oil shipments to East Coast refiners, but possibly at a lower rate of growth in view of current WTI and Brent spreads. And we expect continued gains in natural gas liquids and drilling materials, such as frac sand and pipe, due to strong activity within the Marcellus and Utica shale regions.

We anticipate higher steel volumes to support the commercial construction and automotive sectors and increased road construction activity will boost volumes of aggregates and asphalts, while growth in housing starts will generate higher volumes of lumber and construction materials. Automotive volumes are expected to increase with vehicle production at several key NS-served plants, well above the industry average increase of 1% in production for 2015.

And within agriculture we expect increased soybean volumes and higher ethanol and feed shipments ahead. So in total we expect broad-based growth in 2015, but the headwinds will be coal and top-line revenue associated with the fuel surcharge forward curve.

In summary, moving forward in 2015 as we manage the components of the top line, we remain committed to making the necessary improvements to provide the level of service our customers expect with growth across our intermodal and merchandise business segments. We will also continue to employ market-based pricing, which, due to tight transportation capacity across all modes, will trend higher in 2015.

Thanks for your attention and Mark will now go over our operations report.

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Mark Manion - *Norfolk Southern Corporation - EVP & COO*

Thank you, Don. It's good to see the continued traffic growth in the fourth quarter. While network velocity for the full fourth quarter declined, our velocity and overall operation improved in December.

Remember that last quarter I said customers should start to notice improvements in service and service consistency during the fourth quarter, and that has indeed been the case as December numbers showed a decided uptick in our performance levels. As we continue to apply resources where needed and focus on improving the operation, we expect that improvement to continue.

Turning to slide 2, our 2014 reportable injury ratio is 1.20 for 200,000 employee hours worked. That is a slight uptick from 2013, which was driven by a difficult first quarter in 2014.

The primary objective of our safety process is for all employees to get home safely to their families after each workday. We are working hard in 2015 to build on the benefits of behavior-based safety and working collaboratively with our employees to prevent injuries.

We are very pleased to report that there were no employee work fatalities in 2014. That is an important safety accomplishment, but it goes without saying that we are continuing to work to significantly reduce all injuries. Train accidents for 2014 were up slightly from 2013 at 2.4 per 1 million train miles, but the NS accident ratio remains better than the industry average.

Grade crossing accidents have increased to 3.9 per 1 million train miles for 2014 compared to 3.6 for 2013. As you can see, they have improved in the fourth quarter. NS remains at an active leadership role with the national Operation Lifesaver driver and trespasser safety education program as well as company campaigns.

I am also pleased to let you know that we recently accepted -- were accepted as a member to the Campbell Institute, the research arm for the National Safety Council. Membership is reserved for companies that demonstrate world-class environmental and safety leadership. Achieving membership reflects our continued commitment to environmental health and safety leadership and improvement.

Moving to slide 3, our composite service metric dropped to 62.8 in the fourth quarter, but you can see there was some nice recovery in December. As I said last quarter, positioning T&E forces was our immediate focus and I outlined several steps we've taken to bring T&E forces in line with current and expected volume.

I also outlined several infrastructure projects across the Chicago/New Jersey corridor that were nearing completion. In addition, I detailed the timeline for the acquisition of additional locomotives in the fourth quarter.

The first of the larger conductor trainee classes completed training and were placed in qualified status beginning in November. In November and December we qualified and placed into service 397 new conductors. The Englewood flyover at Chicago was completed in October, separating NS and Metra operations for improved fluidity.

In November we completed the expansion of our classification yard at Bellevue, adding capacity and additional flexibility to operations across the northern region. Also in December, we put six new staging tracks for unit trains at our Conway terminal near Pittsburgh.

In regard to locomotives, we took delivery of the 50 new EMD locomotives in December and 34 of the 100 SD90MACs that were purchased. With these efforts, service began to improve in December and will further improve into 2015 as we bring on additional T&E forces to meet growing demand.

Additionally, by the end of the first quarter, weather permitting, we will complete projects such as a new connection track at our 51st Street yard at Chicago and a new connection linking our terminal at Elkhart, Indiana, to our line going south through Marion, Indiana. This will enable more fluid operations around one of our largest terminals and the growing volume quarter between Chicago and Atlanta.

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On slide 4, train speed data reflects the same trends of improving performance and network fluidity toward the end of the quarter. For the full fourth quarter, train speed averaged 19.7 miles per hour with an increase in December.

On the next slide, terminal dwell averaged 29.7 hours for the full quarter. We did see improvement in December even though average dwell is somewhat skewed due to the Christmas holiday shutdown. In the post-holiday period we have seen average terminal dwell continue to fall and expect that trend to continue as train operations become more consistent across the network.

A summary of key operating metrics shown on slide 6. With a volume increase of 4% in the fourth quarter, our crew starts remain flat, the same pattern we've seen for the full year. The availability of crews created more opportunities to combine and annul trains.

The impact of crew shortages and a slower velocity, particularly during the first two months of the quarter, resulted in increased overtime in the fourth quarter. But as I noted earlier, we are adding nearly 400 new conductors in November and December and will be increasing the number of qualified crews over the next few months. Additionally, as our train speed continues to improve as we saw in December, we will see a decline in overtime.

Carloads per locomotive also declined, due largely to an increase in light locomotive moves as we directed more power to our terminals across the northern region and increased the number of premium intermodal trains to protect service levels over the seasonal peak going into Christmas and the holidays. For the full year, carloads per locomotive was flat. In the fourth quarter, gross ton miles per gallon continued to show the improving trend we've seen through the year, down 3% over the same period last year.

Improvements toward the end of the fourth quarter reflect our efforts of the last several months to increase crews, increase locomotives, and implement infrastructure improvements. As you can see, these additional resources are coming on board and will continue through the first half of the year. Our customers have seen improvement in service, which will continue as operating performance improves.

Thank you and now, Marta, I will turn it over to you.

Marta Stewart - *Norfolk Southern Corporation - EVP & CFO*

Thank you, Mark, and good morning, everyone. I will now discuss our fourth-quarter financial results, which concludes another year of record performance. I will finish with an overview of the full-year financials and speak to our capital spending plan for 2015.

Slide 2 summarizes our quarterly operating results. Railway revenues, as Don discussed, were about even for the quarter while railway expenses decreased by $21 million, or 1%. This resulted in record fourth-quarter income from railway operations of $891 million, up 1%. The operating ratio improved 40 basis points to 69.0%.

The next slide shows the major components of the $21 million net decrease in expenses. Lower fuel costs, as well as lower compensation and benefits, were somewhat offset by increases in purchased services and rents, materials and other, and depreciation. Now let's take a closer look at each of these expense categories.

As shown on slide 4, fuel expense decreased by $56 million, or 14%. For the quarter, our average price per gallon was $2.52, a 17% decline.

On the consumption side, gallons used rose just 3% on the 4% growth in fourth-quarter volume. As Don just showed you, the WTI forward curve is projecting further declines and we are currently paying about $1.70 a gallon. If this continues, we will see meaningful savings in the coming year as we use about 125 million gallons of diesel fuel each quarter.

Turning next to compensation and benefits, these costs declined by a net of $47 million, or 6%. Continued favorability and post-retirement medical and pension accruals, coupled with slightly lower health and welfare costs, resulted in a $47 million reduction in expense. Additionally, incentive compensation showed a relative decline of $32 million, largely due to the higher accrual level in the fourth quarter of 2013.

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Partly offsetting these declines were increased pay rates of $15 million, higher overtime of $11 million, and $5 million related to the temporary transfer program Mark discussed with you on last quarter's call and which was in place to increase crew availability primarily in the northern region. For 2015, we will have a higher quarterly increase related to pay rates because our labor agreements call for a wage rate increase effective January 1 instead of July 1, as we have in the previous five years. Therefore, while each quarter of 2014 reflected about $15 million for this item, or a total of $60 million, for 2015 it will total approximately $85 million and will be weighted about two-thirds first half of the year.

Slide 6 depicts purchased services and rent, which were up $46 million, or 11%, largely due to higher volume-related activities, particularly in the areas of intermodal operations, equipment rents, and joint facilities. The slower network velocity Mark described also contributed to the increase.

The materials and other category rose by $29 million, or 15%. About $16 million of this was due to higher casualties and other claims as the prior year, the fourth quarter of 2013, have a large favorable personal injury adjustment. In addition, $6 million of the increase is related to higher material usage. And, lastly, $2 million was due to higher T&E travel and temporary housing costs associated with the transfer program.

Turning to slide 8, depreciation expense rose by $7 million, or 3%, which is consistent with the trend in the third quarter and is reflective of our larger capital base. That brings us to our income tax accruals and effective rate, which are shown on slide 9.

Total taxes were $279 million for an effective rate of 35.3% compared to 34.5% last year. The effective rate was somewhat lower than previous quarters of 2014, primarily due to $9 million related to tax credits in the extenders legislation which passed in December. Since the legislation was only for 2014, those credits will not benefit our 2015 tax accruals and, therefore, the effective rate in 2015 is likely to be closer to the combined federal and state statutory rate of 37.5%.

Wrapping up our quarterly overview, net income and EPS comparisons are displayed on slide 10. Net income was $511 million, a decrease of $2 million. Diluted earnings per share were $1.64, even with the prior year and matching our all-time fourth-quarter record.

Focusing next on the full-year operating results; revenues were up 3% while expenses only rose by 1%. This resulted in record operating results up 10% and an all-time best operating ratio of the 69.2%. As you might expect, the record operating results also provided for record bottom-line results, as shown on the next slide.

Net income for the year, depicted on the left side, was $2 billion. Excluding the large land sale that benefited 2013, net income increased 8%, which translated into a 9% increase in earnings per share to $6.39.

Moving on to cash flows, our cash from operations covered capital spending and produced $734 million in free cash flow. While the year-end tax legislation I just mentioned also extended bonus depreciation for 2014, it did so after we had made our fourth-quarter estimated tax payment. Therefore, the cash flow benefit of 2014 bonus depreciation, which amounted to approximately $250 million, will not be reflected until 2015 when we can reduce our April estimated tax payments.

Turning to shareholder returns, we distributed $687 million in dividends, reflective of the two dividend increases made in 2014. As Wick mentioned, our Board has approved another $0.02 per share dividend increase effective with our first-quarter 2015 dividend payment. In addition to the dividend, we also repurchased $318 million of stock.

In 2015 we anticipate a higher level of share repurchases more in line with our average of the past five years. Our operating expectations will be supported by a robust capital program in 2015. Slide 14 shows four years of historical capital spending as well as the projection for 2015. The $2.4 billion budget is 13% higher than 2014.

Slide 15 splits our planned capital spending between core, growth, and PTC. Similar to prior year's, core spending comprises about two-thirds of the total and reinvests in our track, our freight cars, and our locomotives. Growth and productivity-related capital make up about a quarter of the budget as we invest for additional volume, add locomotives, and increase track capacity.

Slide 16 provides you the detailed amounts by type of expenditure. Most are generally in line with recent years proportional spending.

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In addition to the $2.4 billion capital budget, the acquisition of the DNA South assets from Canadian Pacific of approximately $215 million will also be reflected in property additions on our cash flow statement in the quarter in which that transaction closes. We believe this capital program positions us well to efficiently grow in 2015.

And with that, I thank you for your attention and I will turn the program back to Wick.

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

Thanks, Marta. Well, as you have heard, we had a good fourth quarter which capped off a very good year in spite of some of our, and the industry's, operating challenges. The good news for all of us is from that standpoint is that we and the other carriers seem to have turned the corner from a network velocity standpoint. And while we obviously still have a few months of winter to go, we at Norfolk Southern are confident that our metrics will continue to recover and reach their 2012-2013 levels by the second half of 2015.

From a business standpoint, our outlook is positive but there are clearly some question marks out there. As you have heard from Don, coal remains something of a wild card for us with continued weakness in the international markets and natural gas currently in the $3 range.

It is also unclear how the effects of lower oil prices will play out. Obviously the reductions in lower -- will result in lower fuel expenses for us and should provide an additional boost to segments of the economy that can generate more traffic for NS. However, our revenues from fuel surcharges will also be considerably lower and it may well result in slower growth in the energy-related segments of our traffic base, including frac sand and crude oil.

Quite frankly, neither we nor anyone else we know of understand exactly how this will all play out, but we are obviously watching it closely and are ready to respond to whatever happens to the best of our ability. At the end of day our strategy remains the same, do our very best to operate an efficient, high-velocity railroad, which enables us to offer the best possible customer service and retain and grow business at rates that provide a superior return for our owners.

That's easy to say, but as 2014 proved, not always easy to do. But Norfolk Southern has the best team in the business and I am very confident in our ability to reach that level again quickly and stay there.

Thanks and I will turn it back to the operator for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Bill Greene, Morgan Stanley.

Bill Greene - *Morgan Stanley - Analyst*

Thanks, good morning. Wick and Mark, I wanted to ask you about costs because in the past we have seen Norfolk tend to want to keep some of the resources in place a bit longer to maintain the service when volumes start to grow.

Obviously we have been in a period of strong volumes and the service hasn't quite been there, so if volumes this year turn out to be less than expected, much of the cost structure is kind of fixed? How much could you go back and touch, or are we kind of in a world where, no, given the service challenges, we're going to hold this regardless of what volume does?

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Mark Manion - *Norfolk Southern Corporation - EVP & COO*

Bill, one thing we can react to pretty quickly is we can dial back on our crews. As far as locomotives, we've kind of got what we've got, but I think it was very beneficial that we got these 100 SD90MACs, so that was not as expensive a play as far as the locomotives go.

And then as far as costs go, so much of this has to do with what's baked into our operation from a productivity standpoint and these big projects we have had that you are familiar with over the last particularly two or three years, where our leader continues to rollout, movement planner continues to rollout. We will complete our last division in February.

All the benefits we're getting from our productivity projects in our terminals with engaged, similar type projects with insight in our locomotive shops, all those things continue to actually lower our cost structure. So we will keep a really close eye on it and we think we can dial things back if things are not as robust going forward.

Bill Greene - *Morgan Stanley - Analyst*

Okay. Don, or even Wick if you have a view on this, too, obviously the fuel surcharges have been a focus. Given the way you've constructed yours and a number of contracts being WTI-based, is there an opportunity here or even a desire to shift that more toward the on-highway diesel to better match revenue and costs so that we don't have mismatches of this magnitude?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Good morning, Bill. As you mentioned in your question, most of these fuel surcharge components are embedded in contracts so it would take us some time to convert over time. We continue to look at the various formulas that we apply in the marketplace.

We have done that over time. We will continue to do that, but there are no plans in the immediate sense to convert from WTI to on-highway diesel. We continue to look at it and, as contracts expire, we will continue to look at that and assess it.

Bill Greene - *Morgan Stanley - Analyst*

Okay, fair enough. Thank you for the time.

Operator

Allison Landry, Credit Suisse.

Allison Landry - *Credit Suisse - Analyst*

Good morning, thanks for taking my question. I just wanted to ask a question about the decline in coal yields and if you could maybe give us a breakdown of how much was mix versus lower fuel surcharges versus price. And if that included any rate cuts on the export side.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Good morning, Allison. This is Don. I can assure you there has been no price adjustment on the export; the mix and the fuel are the two highlights of the decline. Let me address mix.

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As I pointed out in my comments, export shipments were down 25% in the quarter. Those are our longest-haul, highest ARPU ship coal shipments, but we also had negative mix within export as our Lamberts Point pier, which is the longest of the long-haul, was down about 32% in volume while our shorter-haul export traffic at the port of Baltimore was up 5%. So we had negative mix within the export segment.

And then within utility we had some partial offset. Our northern utility tonnage was off a little bit more than our south. We were down 9% in the north and 1% in the south, and then fuel was the remaining component of the offset.

Allison Landry - *Credit Suisse - Analyst*

Okay. That's very helpful, thanks. And I just wanted to ask -- you did mention expectations for solid growth as it relates to NGLs and frac sand in the Marcellus and Utica.

Are you -- I guess are you getting a little bit more cautious just given where nat gas prices are and the rig counts that are falling? I know that right now it seems like the Marcellus and Utica are more insulated than some of the oil plays, but how are you thinking about that for 2015?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Allison, that's a good question and gas continues to be disconnected from oil in terms of the marketplace. Low gas prices, as we pointed out, puts pressure on our utility coal market, but we expect the Marcellus/Utica region for frac sand, pipe inputs, as well as natural gas liquid outputs, to continue to be rather strong this year.

The outlook on oil is a little more problematic as the spreads have collapsed and in January we've seen Brent actually for a day or two move below the WTI levels. So as long as we see oil in that below $50 range and spreads that are very close or nonexistent, crude by rail from the West will be more problematic than it was 60 days or 90 days ago.

Allison Landry - *Credit Suisse - Analyst*

Okay, great. Thank you for the time.

Operator

Tom Wadewitz, UBS.

Tom Wadewitz - *UBS - Analyst*

Good morning. Don, I just wanted to say it's been a pleasure working with you over the years and wish you the best in retirement.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Thank you, Tom.

Tom Wadewitz - *UBS - Analyst*

Let's see, on the surcharge topic, is there a framework you can give us to think about this? Because I think the sense is that you are probably a bit over covered, maybe partly due to WTI, maybe due to just the way some of the contracts work, and there is somewhat of an operating income headwind as well as lower revenue.

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Is there any way you can frame that? Should we look back maybe to 2009 and use that framework for maybe the change in revenue versus change in expense? How would you want us to think about how large that headwind is from the operating income headwind from lower surcharge in 2015?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Tom, looking at 2015 specifically, as I mentioned, our fuel surcharge revenue generated in 2014 was $1.3 billion. If you look at the formulas we have, about half are WTI-based and about half are on-highway diesel. And about two-thirds, as I mentioned, of the WTI-based are out of the money right now with oil below $50.

The other third will continue to generate fuel surcharge revenue this year, as will the on-highway diesel fuel surcharge revenues. So if you put all that together, I would tell you that we expect fuel surcharge revenue slightly below 50% of what we collected last year.

Tom Wadewitz - *UBS - Analyst*

Okay, that's helpful. How do you think about the -- second question, how do you think about the utility coal sensitivity to gas price? I'm wondering what percent of your coal consumption would be in the PJM region or I don't know if you would call that Mid-Atlantic. But what percent of your coal consumption is there and how much risk do you think there might be at current gas prices of switching really taking coal tons away from you?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Let me frame your question, Tom, which should be helpful to you and others on the call. Our utility coal business was down about 3.5 million tons for the entire year for 2014 and that was after a market share shift in the North that we talked about, which is about 5.5 million tons of loss for 2014. So we actually had on the margin a small improvement in overall utility tonnage, but I will tell you natural gas prices that are now $2.85 per million BTU, in that range puts a lot of stress on our coal utility plants in the North in close proximity to the Marcellus and Utica gas production fields, where gas is trading well below the $2.85.

In the Southeast, the southern portion of our utility fleet, we also see fairly significant pressures on our utility coal burn as a result of gas being that low. So the North is more pressured with respect to proximity and lower spot gas prices, but the South has competitive pressure as well when gas is below $3.

Tom Wadewitz - *UBS - Analyst*

Can you give a rough sense of the mix between what's North and what's South?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

In the year, we were slightly over 50% in the North on tonnage. Like 52%/48%.

Tom Wadewitz - *UBS - Analyst*

Okay, great. Thanks very much. Thanks for the time.

Operator

John Barnes, RBC.

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John Barnes - *RBC Capital Markets - Analyst*

Good morning, thanks for taking my call. In looking at your CapEx outlook for 2015, you highlight the rebuild program and the used locomotive program.

Just curious, with EMD out of the market, how long are those programs, the rebuild and the used program, a sufficient Band-Aid to cover your locomotive needs? Especially if you get any material volume growth again this year, I know coal is weak, but in the other commodities, how long can that serve as a Band-Aid until EMD is back in the market?

Mark Manion - *Norfolk Southern Corporation - EVP & COO*

This is Mark. I don't think about it as a Band-Aid, and keeping in mind that at this point we are figuring on a steady state of at least 50 locomotives a year and after a couple of years we will even increase beyond that. So that is very helpful to us.

Then we just got 50 new locomotives in the last year and, like I said, the 100 SD90MACs coming up, that's going to cover us very nicely for 2015. And then we've got space reserved for purchases in the two years beyond that, so we are in good shape for locomotives.

John Barnes - *RBC Capital Markets - Analyst*

All right, very good. Then turning on the pricing side for intermodal, truckload rates should move higher. Even though they are experiencing a decline in fuel surcharge, there's some talk about capturing some of that in core rates.

Do you think the outlook for intermodal pricing is similar, that you ought to be able to replace some of the lost fuel surcharge with an increase in base rates? And is this a year where maybe there is the potential to close the gap between truckload and intermodal pricing?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

This is Don. The first part of your question, absolutely. We see an opportunity based on tight transportation capacity in the truckload market and across other modes of transportation that sets up a good, solid opportunity for improved pricing across our intermodal book.

You will see the results of that in our ARPU as we go through the year, but that will be offset somewhat by lower fuel surcharges. We may not be able to capture all of the delta in the base rate, but we will make more substantial headway this year in improving base rates in intermodal.

John Barnes - *RBC Capital Markets - Analyst*

Okay, all right. Thanks for your time, guys. Appreciate it.

Operator

Chris Wetherbee, Citigroup.

Chris Wetherbee - *Citigroup - Analyst*

Thanks, good morning. Mark, just wanted to touch back onto the service side. Just kind of get a rough sense of maybe what cost was allocated maybe to service issues in the fourth quarter, if you could highlight that.

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Then, as we think about 2015, assuming nothing major from a weather event and obviously there might be some issues in the East Coast in the next couple of days, but as you think about the outlook for 2015, how should that recovery progress as you get these crews back online? When do you think you have service back towards levels that we saw maybe a year or two ago?

Mark Manion - *Norfolk Southern Corporation - EVP & COO*

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Chris, let me take that question and then I'm going to turn it over to Marta to put some more numbers on that. But as we go forward, the way I am thinking about it is we have managed to hang on to the recovery that we started with back at the end of the fourth quarter. That's been good. Hopefully we can continue to do that, so the way second quarter shapes up will depend on how the rest of the winter goes.

But I am thinking of the second quarter in terms of improvement over where we are right now. And very much as we go into the second half I am thinking of us being back to our old selves in terms of higher velocity, which is certainly going to help cost fallout. So as I think about 2015, I think we will not see extraordinary costs just due to the fact that we are ramping up.

Marta, can you put some numbers on that?

Marta Stewart - *Norfolk Southern Corporation - EVP & CFO*

Yes, I can. In the fourth quarter, Chris, there was a number of pieces I mentioned. If you put them all together, the service cost comes to about $35 million. I mentioned the $11 million in overtime, the $5 million of temporary transfers that we had that was in comp and benefits, and then in materials I mentioned $6 million of increased materials usage.

And the final piece is in purchased services and rents. That was up due to volume, but there was a service component to it of about $12 million. The last piece I mentioned was in the other category, the travel for the temporary transfers. So if you put all that together it's about $35 million of additional costs in the fourth quarter.

Chris Wetherbee - *Citigroup - Analyst*

Okay, that's great. That's really helpful. Then just circling back to the fuel surcharge component, I guess I am just trying to understand sort of maybe why there isn't more of a push to move towards the diesel-based or on-highway diesel-based fuel surcharge programs. It would seem like that would be maybe a better match to the input cost.

I guess I'm just kind of curious why that wouldn't be something that you would be thinking about doing over the course of the next couple of years as these contracts come up for renewal.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

First and foremost, as I mentioned earlier, it's the fact that we have to cycle through contracts to be able to make those changes. We are -- we will continue to assess whether or not we want to make those changes when we negotiate with our customers, but first and foremost it's a timing issue.

Chris Wetherbee - *Citigroup - Analyst*

Okay, but it is something that you would consider I guess going down the road here?

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Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Well, the fact that we are at 50% of our surcharges are on-highway diesel shows you that -- demonstrates that we have been moving in that direction.

Chris Wetherbee - *Citigroup - Analyst*

Okay, that makes a lot of sense. Thanks very much and, Don, congrats on the retirement.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Thank you.

Operator

Thomas Kim, Goldman Sachs.

Thomas Kim - *Goldman Sachs - Analyst*

Good morning. Thanks for your time. I just wanted to ask on the export side for coal, I presume the $3 million in coal royalties is primarily related to that. And I guess should -- and please correct me if I'm wrong there.

And I'm wondering is that rate in the fourth quarter something that we should be sort of looking forward to as sort of the run rate for 2015, bearing in mind that it does seem like the run rate in the fourth quarter was slower than what we have seen in the first nine months of 2014. Thanks.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Good morning. Of course the export coal does not have a royalty revenue associated with it. This would be Pocahontas Land, which is our energy subsidiary in West Virginia that has coal leases to coal operators. And that would continue to -- that is recurring income based on coal production and coal volumes.

Thomas Kim - *Goldman Sachs - Analyst*

Great, thanks for the clarification there. Then just with regard to your overall export volumes in coal, the fourth quarter did show some further deterioration in the absolute tonnage. If we were to annualize that for 2015, we would be looking at sort of a similar decline for the year, call it about 18% or so.

Do you think that is a fair assumption or could you give us some color as to what sort of export toll -- export coal tonnage we should be anticipating for the year?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Let me frame your question just looking back. We saw our export volume in 2014 fall from 28 million to 23 million tons. In that marketplace in 2014, we saw the thermal market to northern Europe decline from the mid-$70s all the way down to under $60 now on the API2, $60 a ton. That is well below the cost of production for most or all of Central App producers, so our producers that have historically moved thermal coal to northern Europe are out of the money with respect to production cost.

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And also on met coal we saw continued softness in the world settlement price, below $120 per ton, and we saw Australia continuing to increase production as well as watching their currency weaken against the dollar, which gives them a further cost advantage. So 2015 is shaping up to be a very challenging year for export coal. I won't go out on a limb and tell you how much we actually expect, but we don't expect it to be strong.

Thomas Kim - *Goldman Sachs - Analyst*

I appreciate that. Thanks very much for your time.

Operator

Brandon Oglenski, Barclays.

Brandon Oglenski - *Barclays Capital - Analyst*

Good morning, everyone. Wick, it seems like we come back to this question quite a bit, but for investors this is all a relative game, right? So I think when we were at your analyst meeting last year you talked about how Norfolk has targets to really improve profitability right along with the rest of the industry, but obviously you guys don't provide any specific forward guidance.

But today it seems like the call has been focused on a lot of negatives here. You still have lingering service challenges this year. You have higher capital spending, increased coal headwinds. You have the whole issue with the surcharge mismatch right now.

So what is the risk here that 2015 really shows a slowing in the margin improvement? Is this an event here where we see very robust volume demand across the industry, and yet, because of the specific issues at Norfolk, we can't get a lot of earnings expansion or keep up on a relative basis? Or am I thinking about this too negatively?

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

Well, I think that you are a little negative on that, Brandon. I think that if you kind of look at the positives, the first is we are clearly in an economy that continues to expand. And the negatives that can go along with the decrease in crude oil prices and fuel surcharge decreases are countered by the fact that I think we are going to see strong economic growth. And that is going to drive some segments of our business that are very profitable for us and where we can continue to make volume and margin headway.

The second thing I think that is important is that we and a lot of the rest of the industry in 2014 really did labor under operating challenges. We feel, as Mark has told you, a lot better about where we are operationally. We have more to do, more resources that are coming on, but resources that aren't going to add a lot to our overall cost structure.

And as you look back at 2014 and you look at not only the expenses that we incurred but, quite frankly, there are some places where we could have handled more volume had the network operated at a higher velocity. I think we have a lot of positives in that regard as well.

Mark mentioned that we are optimistic that we are going to be back, certainly by the second half in terms of the operation of the railroad and we're going to improve throughout the first half. So I think there are a lot of positives that we are looking at in 2015. Clearly there are headwinds and we want to be up front about those headwinds, but as I said at the beginning, I am optimistic that we are going to have a good year in 2015.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Brandon, this is Don. I would just add to that, too, that if you look at the latest quarter, it is instructional with respect to the pending improvement in our network performance. If you break down our fourth quarter -- we don't normally do this by month but I will do this here.

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If you look at our volume increases in October, we increased volume by 2% year-over-year, albeit against a strong comp from last year. November, at the bottom of our overall service performance metrics, our volume was flat and then in December, coming off the network reset after the Thanksgiving holiday and with the improved operation after that reset through December, our volumes were up 9%. Our December was much stronger with respect to volume and revenue than the prior two months.

The only reason I'm going through that data is just to point you toward the strength in our network with respect to overall demand for merchandise in intermodal and coal that was deferred we generate better cycle times and improve velocity in this network, which we saw in December.

Brandon Oglenski - *Barclays Capital - Analyst*

I don't want to put words in your all's mouth here, but does it sound like that the positives offset the headwinds that we are focused on this morning on the [channel]?

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

Brandon, I would certainly say on balance that we think so. We certainly hope so.

2015 has got a long way to go and we are not sure what is going to happen in a lot of sectors, but right now, as I said, we remain optimistic. We do have some headwinds but we have got a lot of positives in front of us as well.

Brandon Oglenski - *Barclays Capital - Analyst*

All right, just one more. Don, by the way, congrats on retirement here. I'm sure you'll be happy not to take any more coal questions going forward.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Oh, I will miss those more than I can say.

Brandon Oglenski - *Barclays Capital - Analyst*

If I can just get one last one in then, we've talked a lot about it here, but what is the actual outlook for utility and export coal in 2015? Should we be expecting --? I think in the past you are talking about a 1% to 2% decline from MATS, but has that outlook deteriorated just with where natural gas prices are in the discussion we have already had?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Brandon, the outlook on utility coal with respect to MATS is the same as what we talked about last fall at our investor day conference. Nothing has changed there.

Natural gas prices have trended lower. The forward curve is lower. That will put, as we have already said, additional pressure on our utility coal burn at our utilities. The question mark is whether or not gas will stay low all year and we just have to wait and see that.

With respect to export, the metrics for export thermal as well as metallurgical coal are not good. We will have to see if those change, but we don't see any drivers in the world market that would change that at this point.

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Brandon Oglenski - *Barclays Capital - Analyst*

Appreciate it, thanks.

Operator

Bascome Majors, Susquehanna.

Bascome Majors - *Susquehanne Financial Group - Analyst*

Yes, thanks for the time. Don, since you like coal questions so much, I've got another one for you here.

At a really high level -- I know we've talked about it lot, but there's a lot of concern out there from investors that 2015 in coal could be a repeat of 2012. And that's understandable given the weather, natural gas prices, and the export headwinds that you've talked about at length already today.

But the supply side today is also a little bit different there. Can you talk a little bit --? Do you think you and your coal customers are better equipped today versus coal headwinds than 2012? And maybe why or why not?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

I think we're better equipped with respect to handling the demand and also the cyclical nature of demand in 2015. Should we see the rest of the winter extremely cold -- we are having a storm in the Northeast as we speak that is bringing something called winter weather, cold and snow, to that area and that will increase electricity demand.

Demand in electricity in our service territory for all of 2014 fell by 1%, even with the polar vortex in the first quarter. So we don't know how cold the rest of the winter is going to be or how hot the summer is going to be, and I will tell you those two unknowns are a big component of what utility will actually do for 2015.

We are -- I think we are better positioned to handle spikes in demand than we were last year. Our crew base is stronger. Our locomotive fleet is stronger. Our network is more resilient. So I am optimistic that if we see opportunities ahead that are driven by those short-term spikes or changes, we will be able to take advantage of it.

Bascome Majors - *Susquehanne Financial Group - Analyst*

And can you give us the latest sense of stockpiles from your customers in each region? What are you hearing today?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

We were down about 18% going into the fourth quarter. The fourth quarter, including December, was relatively mild and even with some of the deferred tons that we didn't deliver, our stockpiles now are close to normal in the North and close to normal in the South.

Bascome Majors - *Susquehanne Financial Group - Analyst*

All right, thanks for the time this morning.

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Operator

Justin Long, Stephens.

Justin Long - *Stephens Inc. - Analyst*

Thanks and good morning. You gave some helpful color on fuel surcharge and the potential revenue headwind this year, but just to be clear on the potential earnings impact, if WTI and fuel prices continue to trend in line I guess with the forward curve, what is the operating income headwind you expect in 2015, all else being equal?

Marta Stewart - *Norfolk Southern Corporation - EVP & CFO*

I think, as Don said, and the amount that he said where it could be half of what it was last year is based on the prices that we are seeing now, the current prices. So if you take that same viewpoint of current prices in our fuel expense, you can see the gallons that we burn on average per quarter. And to get a point estimate you would take the current price, and as I said we are paying $1.70 a gallon, so I think you could model it out.

If it changes, I think we would like to give it in those kinds of pieces because Don has given you what would happen if prices stay where they are now and I have given you what the pieces would be if prices stay now. So that way if the amounts -- if either of those change, you can forecast the two pieces separately.

Justin Long - *Stephens Inc. - Analyst*

Okay, fair enough. Second question on service. As we think about the potential for a gradual service recovery that could occur over the course of the year, is there any way to frame up how significant a one mile per hour improvement in velocity on the network could be for the business, whether it's the additional capacity it creates for volumes, the cost savings, or some other way to think about the financial impact?

Mark Manion - *Norfolk Southern Corporation - EVP & COO*

This is Mark. One thing that comes into play is that it affects our locomotive fleet. Our analysis on that reveals that for every mile an hour you get about a 70 locomotive, 75 locomotive benefit from that.

And then, from the standpoint of just pure improvement that we get from velocity, of course some of our costs drop off. We see the number of re-crews go down, so we don't have that expense. We see reduction in our overtime. And beyond that it just frees up the network to where we just run so much more fluidly and that's just got various benefit to it.

So barring an unusual winter, I would think we could get an additional mile per hour. We're bumping around 21 miles an hour right now, and I am hopeful that we could get another mile per hour out of that in the second quarter. And then, like I said, return to more historical good times in the second half.

Justin Long - *Stephens Inc. - Analyst*

Okay, great. That's helpful detail. I appreciate the time today.

Operator

Matt Troy, Nomura.

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Matt Troy - *Nomura - Analyst*

Great, thank you. Just a question on service. You covered it, I think, from the cost side, but if we wanted to be a little bit more conservative in our outlook, maybe in light of the current storm heading into the Northeast, could you just talk about what areas of the network are a little bit more sensitive or where you might be a little bit more focused and vulnerable through the balance of winter?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Our line between Chicago and New Jersey, of course is our heaviest mainline, and we can have over 100 trains a day running over portions of that area. And so, particularly in the face of storms, that is where we can see challenges. That's where we definitely saw challenges in the third quarter, particularly in that Chicago to Cleveland area.

So in light of that, what we have actually done is we have shifted some of our volume on to other lanes and we are helping ourselves in that regard. And so, even in spite of the fact that additional resources applied to that area, the fact that we have unloaded a little bit of that tonnage we think will be helpful as well. You put all that together and we are optimistic going forward.

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

Let me add to that, though, from a macro standpoint, clearly the area that -- it's not just Norfolk Southern that we are almost vulnerable to is disruption in Chicago. We interchange so much traffic there, as do all of the carriers, that prolonged bad weather in that part of the railroad, as Mark says, is problematic.

We have done a lot to try to mitigate the potential downsides of that. The other carriers have as well, but that is the place where the industry is still clearly most vulnerable. As I say, not from a single bad storm.

We've seen some bad weather already in the first couple of weeks of the year up in that part of the world, and it didn't help, but hasn't had a whole lot of lingering bad effect. But if we saw something like we saw last year in terms of just an ongoing series of storms, that is when I think we would all really have to scramble.

Matt Troy - *Nomura - Analyst*

Understood, and will keep an eye on that. I guess my second question would be for Don. And, Don, again, congratulations. Echoing the earlier comments.

Just one last one on coal. I'd like to take the question from a different way. If I look at an export market that was 23 million tons and is a run rate that's maybe it's 20% off that based on more recent volumes, I guess if you look at all the pricing metrics and the competitive factors, why did any of that coal need to move? How much of it is under contract?

But if I just look at the outline, why should we think of any of it needing to move at such structurally depressed prices where US coal is not relevant in global markets?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Part of that is that we do have some contracted coal and our suppliers have that contracted coal. The other is that our suppliers are running mines with an intent to keep those mines in production, to bridge to a point in the marketplace which now looks like it could be 2016 at the earliest before that market starts to turn and pricing starts to move up in the world markets. So part of it is suppliers with contracts.

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The other part, a larger part, are suppliers that are staying in those markets to have a place at the table and to keep their employees at work and keep production going until they can get better prices.

Matt Troy - *Nomura - Analyst*

I guess I was just trying to ask a long way of how much do you have under contract and visibility in 2015 on a percentage base? Is that something you could dimensionalize?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Our metallurgical coal in the fourth quarter -- and I will give you this as an example -- with 80% of our export we only had 20% of our volume that was thermal. And the contracts that we have are in the thermal side and not a significant portion of the thermal.

Matt Troy - *Nomura - Analyst*

Okay. Don, thanks and congratulations again.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Thank you, sir.

Operator

Scott Group, Wolfe Research.

Scott Group - *Wolfe Research - Analyst*

Thanks. Morning, guys. I will try and ask two quick ones. Don, when you add up all the moving parts -- the fuel, the volume growth, pricing getting better -- do you think you will see revenue growth this year?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

We do. That's the short answer.

Scott Group - *Wolfe Research - Analyst*

Okay. Is there a longer answer or --?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

No, no, I think your question is a good one. We expect revenue growth in 2015. We expect, as we indicated in the remarks, our merchandise business continues to be strong and I would just remind everybody how strong that merchandise segment was in the fourth quarter of 2013. I would look at the comps and look at the growth on top of those strong comps in the fourth quarter.

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So we expect that to continue. It may be mitigated somewhat with energy-related commodities that are a little bit weaker, but we have fundamentally strong merchandise franchise. And then I look at this maybe a little biased, but we have the best intermodal network in the East. We have invested in that intermodal network and the time for growth is now and the time for margin expansion is now.

Scott Group - *Wolfe Research - Analyst*

It sounds like between volume and then maybe price offsetting mix is enough to get you to positive revenue?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

We are confident that that will be the case.

Scott Group - *Wolfe Research - Analyst*

Okay, great. Then just one for Marta. I know you talked about ramping up the buyback this year back to historical levels.

Can you give us a little color on what you mean by that? We've got a couple years of $2 billion of buyback, some years $1.3 billion, 2013 with $600 million, so what kind of range were you thinking with that comment?

Marta Stewart - *Norfolk Southern Corporation - EVP & CFO*

Right. If you look over last five years, the average -- you're right it has gone a bit up and down, but over the last five years it averages a little over $1 billion.

Scott Group - *Wolfe Research - Analyst*

Okay, great. Thank you.

Operator

John Larkin, Stifel.

John Larkin - *Stifel Nicolaus - Analyst*

Good morning, everybody, and thanks for taking my question. Maybe this is for Wick.

Given that Don has been such a consummate professional for so many years, could you maybe share with us the thought process of replacing him? I assume the replacement will come from an internal person, but perhaps you could illuminate us a little bit in that area.

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

Well, I think all I can really say is that we are obviously looking our hand over and we are talking with our Board, which ultimately makes or helps us make decisions like this. We look forward to coming up with a replacement candidate in the fairly near future.

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I will say that, in some ways, Don is irreplaceable, particularly his patience in answering questions about coal. But, no, we are on track to name a new Chief Marketing Officer in the fairly near future.

John Larkin - *Stifel Nicolaus - Analyst*

Thanks for that. Then maybe just a question on the capital program that Marta reviewed earlier. I was a little surprised to see a large freight car program of -- I think it's 404 million. Usually over the years I think the freight car percentage of the total has been a little lower than that.

Can you give us some color on where that money is going to be spent, given that so many of the cars that are employed in the new energy business are typically leased cars or shipper-owned cars?

Marta Stewart - *Norfolk Southern Corporation - EVP & CFO*

John, you're absolutely right that that is a little bit of a higher percentage than we have had in the recent years. One of the reasons why is exactly what John just talked about; is expected growth in our intermodal market. So we've got some containers and chassis that we will be purchasing.

In addition, he talked about the automotive sector and how strong we think that's going to be for us, so we've got bi-levels and tri-levels in there and we've also got coil cars. So it is to replace -- those are the growth that I mentioned and it's also to replace other units that are either coming due for their normal capital replacement or that we are going to capital instead of leasing. So we've got growth and replacement in there.

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

I think that -- to add a little bit to what Marta said, which is exactly right, when we look at our freight car fleet -- and we have some components of it in addition to our coal hopper fleet that are aging -- and we look at our business prospects, we really fundamentally believe that when we see the need for car types where we know we are going to be in that business for a long time. It's good business for us and business that doesn't fluctuate wildly over a cycle.

It makes more economic sense for us, if we have capability to do so, to buy rather than lease. We are constantly doing those types of economic analyses. And in these cases we feel that it is better business and offers ultimately a higher return for us to buy the cars rather than leasing, as we might have in the past. But that is not, we feel, the best thing.

John Larkin - *Stifel Nicolaus - Analyst*

Thanks for the color.

Operator

Jason Seidl, Cowen and Company.

Jason Seidl - *Cowen Securities - Analyst*

Thank you. I guess I will first start off by saying, Don, you will definitely be missed and best of luck in retirement.

I guess I will switch it up a little bit since it's late in the call. You guys mentioned that there was some shutdowns and some retoolings in some of your auto plants and that you are expecting a pretty strong 2015. Based on the fact that some of the shutdowns and retooling were in the fourth quarter, should we expect some of the strength to be front-end-loaded in the year?

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Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Jason, this is Don. We will see ramp up volumes of the F-150 for Ford, for example, out of Kansas City. That was one of the plants.

The new Transit at Kansas City, which is a van, also ramping up. And then, of course, General Motors at Wentzville, Missouri, also ramping up. So we will see some front-end loaded growth and growth throughout the year though from those plants that I'm mentioning.

Jason Seidl - *Cowen Securities - Analyst*

Okay. And I will switch my second question here to intermodal. Obviously this issue that has been going on with the West Coast ports pretty much since July, is there any way to quantify a benefit that Norfolk might've seen from that, if any?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

It's not very easy to quantify the exact benefit. We have seen more all-water service coming to the East Coast ports, but, frankly, we had seen that pattern develop over the last five, six years.

So our East Coast ports are busy. They probably are on the margin busier than they would have been had the ILWU negotiations not impacted West Coast port operations. But what we are seeing in our international growth more fundamentally than that is new accounts and new services, one of which I will mention is the South Carolina inland port at Greer, South Carolina. That is ramped up and continues to grow.

And our heartland corridor and terminal projects associated with the other corridors have helped us continue to grow our business with new accounts in the international space.

Jason Seidl - *Cowen Securities - Analyst*

Don, do you think, given all the issues the West Coast port has had now and then even a couple years back and the projections for ramping up a lot of East Coast ports to handle larger ships, do you think some of these wins can be sticky for the East Coast?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

I think the larger ships that are continuing to come online that are coming to the East Coast ports already through the Suez Canal, that is something that is notable and certainly sticky. That will continue. The Panama Canal has been delayed, as we know, into 2016.

But the Suez Canal, as we have said all along, because of the shifting nature of international freight origins in Asia from China back toward Vietnam and Malaysia etc., we are already seeing those large ships come to the East Coast ports. And we expect that to continue.

Jason Seidl - *Cowen Securities - Analyst*

Thank you so much, Don. Gentlemen, thank you for your time as always.

Operator

Jeff Kauffman, Buckingham Research.

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Jeff Kauffman - *Buckingham Research Group - Analyst*

Thank you very much. Thank you for taking my question. Congratulations, Don, and best of luck.

Let me also ask you a question on your way out. If you had to guess how much business the railroad did not do because of service congestion, service issues -- and I'm thinking more specifically intermodal, but I will leave it open -- how much business do you think the Company could do next year if service levels normalize and you get some of that business back?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

We certainly will do more business because our fleets, our equipment fleets have better capacity when we turn them at a faster pace. Certainly we believe we could have handled more volume in 2014, and the numbers that I walk through earlier in the call just in the fourth quarter demonstrates that with 9% growth in December alone in terms of overall volume versus pretty much flat volume growth in October/November.

So we will see more business because demand is strong and we expect that demand to continue to be strong. Wick mentioned the consumer market benefiting from lower gasoline prices. We think that will certainly have an impact on overall demand in intermodal.

And also the strong dollar, while it is a headwind for exports, it will definitely be a tailwind for imports. Again, our international business will benefit from that and turning the equipment faster gives us more capacity, generates better customer satisfaction, and also supports our pricing negotiations.

Jeff Kauffman - *Buckingham Research Group - Analyst*

Should I think of the D&H acquisition as more of a revenue opportunity or an optimization opportunity?

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

I think you would think of it as both. We have been a substantial user of the D&H for some time now as one of our major routes to access New England, along with the Pan Am Southern. We do believe that we will be able to some extent to streamline and improve our operations as a result of this. But we also have done a careful analysis of the market and do see increased revenue opportunities, so we think that from both standpoints it's a good deal for us.

Jeff Kauffman - *Buckingham Research Group - Analyst*

Okay, and last follow-up with Marta. Marta along the lines of the question I asked Don, you outlined about $35 million of congestion-related costs that you believe occurred in the fourth quarter. As the service levels do normalize and the miles per hour go up and some of the older locomotives can be put down, overtime is not being paid, what do you think congestion costs you all-in in 2014?

Marta Stewart - *Norfolk Southern Corporation - EVP & CFO*

Well, that's a good question. In 2014 -- and we talked about some of the pieces on each of the calls -- in the first quarter we had a weather-related impact that we talked about, first quarter 2014, that was $45 million. And then in the second and third quarter we talked about service impacts that were about $25 million a quarter and then this one, as I said, is about $35 million.

So we had weather first and then we had some degree of service-related -- most of it is related to velocity, as you would expect -- additional costs. So going into 2015, as Mark said, we are hopeful that we are going to gradually improve through the first two quarters, so we will still see some of that, some of those costs in the first couple of quarters we think. And we will also have, as he mentioned, the fact that we have additional employees that we got in the fourth quarter, those will carry forward and we are continuing to add employees in 2015.

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So you are going to see the costs that are related to service I would say front-end loaded in 2015 and then gradually the overtime, the extra materials, the extra purchased services due to velocity work themselves off in the latter half of the year.

Jeff Kauffman - *Buckingham Research Group - Analyst*

Okay, thank you. Don, best of luck and congratulations.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Thank you very much.

Operator

David Vernon, Bernstein Investment Research.

David Vernon - *Sanford C. Bernstein & Company - Analyst*

Great, thanks for taking the question. Maybe Don or Mark, a question for you on capacity within the intermodal network.

Are you guys sort of thinking about --? Could you talk a little bit about how you guys are thinking about the growth opportunity on the domestic highway conversion and whether you will be adding any new train starts or new services within the intermodal network this year and what kind of room you have to actually take new volume growth?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

This is Don. In terms of our network capacity for domestic intermodal and also international, we have invested in the terminals and the corridors to the extent that we have capacity in the network to grow in a significant way. Certainly the train service plan is set for 2015. And if we see that demand changing or enhancing or growing beyond that, we may look at new trains, but at this point we don't see a need for significant new train service in the network.

We will continue with our densification program and stacking programs to generate more boxes per train to the point that they reach a length of train that we decide to add a section to it. But all of that said, we have capacity in the network without adding anything right now.

David Vernon - *Sanford C. Bernstein & Company - Analyst*

Great. Then maybe just as a quick follow-up, Marta, a question for you on some of the non-operating stuff. We had about $150 million, $0.30 tailwind from the pension and post-retirement stuff this year. Is there anything else like that that we should be aware of from a modeling perspective for 2015? Is there any sort of large one-time non-operating items that you should be putting into our estimates?

Marta Stewart - *Norfolk Southern Corporation - EVP & CFO*

In that area pension and post-retirement, you're right; we had that big decline 2014 over 2013. But the accruals for pension and post-retirement, which are in compensation and benefits, those are expected to be flat in 2015 versus 2014.

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David Vernon - *Sanford C. Bernstein & Company - Analyst*

And there's no other non-operating stuff that we should be -- that we should have on our radar?

Marta Stewart - *Norfolk Southern Corporation - EVP & CFO*

No. As you know, our non-operating items include the coal royalties that Don mentioned earlier and also include real estate sales. If you look historically, those are lumpy but right now we don't have anything that we are anticipating that is going to make that significantly different from 2014.

David Vernon - *Sanford C. Bernstein & Company - Analyst*

All right, thanks very much for your time. Thanks.

Operator

Ken Hoexter, Bank of America.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Great. Don, let me throw in some thanks for your thoughts over the year and good luck in retirement. If I can just follow-up maybe on the fuel surcharge programs, I just want to understand, maybe clarify some comments earlier to build. At the start of the call you mentioned no plans to convert from WTI to on-highway, and then to Chris later on you noted it is a timing issue and you will consider it.

Can you just state -- why wouldn't you clearly state that every contract going forward at least would be discussed or converted from WTI to on-highway diesel in the contract?

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

Ken, we plan to make the best business decision with those negotiations for each contract, so we wouldn't want to say one way or the other. But we are certainly open to it and it will be part of our negotiations and we will make the best business decision for us going forward.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Okay. And then on the CapEx, a question for Mark. Just with service rebounding, as you accelerate CapEx 15% could that impact your service improvements at all? Does it accelerate it? Does it slow it down in instances where you need to make capacity investments?

And then thoughts on the D&H. Does that fit in there at all as well in terms of accelerating any of the service rebounds?

Mark Manion - *Norfolk Southern Corporation - EVP & COO*

In terms of -- I presume you're talking about infrastructure improvement, is that right?

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Yes.

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Mark Manion - *Norfolk Southern Corporation - EVP & COO*

And I've talked about that on these calls before how very beneficial that is. We have been spending for going back probably 10 years, more than 10 years now. It's that approximately $50 million a year.

And, like I said, in a very surgical way where we've got the tools these days to look out to see where the capacity needs are. We've got a bundle of infrastructure improvement projects that are teed up right now. They are always rolling out of the pipeline and they continue to be very beneficial to the overall operation, so that is part of what will get us improved velocity as we go forward this year and after that.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

So as the investments come on you don't see it impacting your slow, steady improvement comment earlier?

Mark Manion - *Norfolk Southern Corporation - EVP & COO*

I do see it positively impacting us. For example, the Bellevue project is well outside of what I was talking about with the surgical projects that I referred to. But Bellevue for example, as beneficial as that was, and when we turned that on in the second half we saw big improvements to that, but the reality is we have only implemented half of the operating changes related to Bellevue.

So more to come.

And, in fact, we will implement the rest of that around the end of this first quarter. So improvements from that, improvements from a variety of other projects that -- not necessarily real big, but the key cumulative effect is very positive.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Appreciate the insight. I could just wrap up, my favorite Don statement years ago was we were in a hot hotel room conference room at the end and he said, just helping coal out, leave your air conditioning on when you leave the hotel rooms to help burn more coal. So, Don, appreciate the thoughts over the years.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Ken, it works good with heat as well. Leave your windows open. Thanks, Ken.

Operator

Don Broughton, Avondale.

Don Broughton - *Avondale Partners - Analyst*

Most of my questions have been answered. I had one little housekeeping thing. Marta, you said that because of the timing of the renewal of bonus depreciation you were going to recognize a catch-up in Q1 for 2014. In order to properly model, what is the nominal amount of that catch-up?

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Marta Stewart - *Norfolk Southern Corporation - EVP & CFO*

And that is a cash one. I don't know if I was completely clear on that. That is a cash effect so we already recorded the deferred tax proportion related to that in the fourth quarter, but we made our estimated [surplus] paying your taxes ahead of time. So cash effect.

Don Broughton - *Avondale Partners - Analyst*

Perfect, that's perfect sense. Thank you.

Operator

Cherilyn Radbourne, TD Securities.

Cherilyn Radbourne - *TD Securities - Analyst*

Thanks very much and good morning. I wonder if you could, as your peers have done, give us a sense of your total exposure to crude by rail, frac sand, and pipe, either as a percentage of total revenue or a percentage of total volume.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Yes, good morning, this is Don. Our crude oil based on the actual loads handled in 2014 was a little less than 1.5% of our volume for the year. If we factor in the natural gas liquids and Marcellus, Utica inputs and outputs, including natural gas liquids, and put it with crude, it is a total of 3%.

Cherilyn Radbourne - *TD Securities - Analyst*

Okay, that's very helpful. Then just in terms of network performance; clearly that was a challenge all year, but particularly in November and December it looked like those were very challenging months, then followed by some good improvement in December. Can you just talk a little bit about what made October and November so challenging and then the reset that you did post-Thanksgiving?

Mark Manion - *Norfolk Southern Corporation - EVP & COO*

Sure, I'd be glad to. As we got into the third quarter, that was the point of the year in 2014 where we had the lowest crew base, keeping in mind that as we finished the tough first quarter of 2014 and velocity was not good due to all those weather challenges, we did get a surge in volume. And the surge in volume was -- it was in some specific areas, mostly in our northern region.

And as we got those volumes and were pretty well keeping up with them through the summer, but as we got deeper into the third quarter those volumes were still up there and that is when we hit the trough as far as the lowest point of our crew base. You may recall that we had a temporary transfer program where we sent about 120 conductors up into that northern region. It was extremely helpful, but again, we had to paddle hard in order to keep up with it, so that's why we were up against some pretty difficult situations and got into some congestion in that October/November range.

But then, as we have been saying, the resources, particularly the crews, those people that we hired right after the end of the bad winter, they became -- they started becoming available in bigger numbers in November and that is when we saw our improvement.

And Don referred to the reset. It's nothing magical, but simply put, with the advantage of those resources, the additional conductors in November with the advantage of some additional locomotive power we had we took advantage of lower volumes that come on each year that we experience

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each year around the Thanksgiving holiday. Customers aren't loading as much freight, so we took advantage of those lower volumes and those increased resources to what we call reset the network.

And at a point in time at all of our terminals, we come out of the gate with an on-time railroad and we were able to sustain that, so it has been very helpful.

Cherilyn Radbourne - *TD Securities - Analyst*

That's perfect. That's all from me, thank you.

Operator

Cleo Zagrean, Macquarie.

Cleo Zagrean - *Macquarie Capital Securities - Analyst*

Good morning and thank you. With regards to pricing, ex-fuel, could you please comment on the outlook for core trends for coal and the rest of the business excluding coal, and how you expect mix to impact the operating ratio in 2015 versus 2014? Thank you.

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

This is Don. Good morning. I will address the first part of the question first.

With respect to the pricing outlook, we expect it to be stronger based on transportation demand capacity issues in the marketplace. Truckload capacity is constrained as well as other modes, as we indicated earlier, so we expect the pricing outcome to be stronger in 2015 than we have seen in the past couple of years for sure.

Can't get into the actual components of it, but we do not expect to see price increases in export coal. We will maintain our current pricing. As we have indicated in past quarters, we don't believe that we can move that market now with changes in our price so, therefore, we will maintain our quarterly pricing we have in place.

With respect to our utility coal contracts, we have escalators that are in those contracts that will escalate. I will tell you that the all-inclusive less fuel index this year is projected to be up around 2% and then up 3% in 2016, which is a better outcome than we saw in 2014.

Cleo Zagrean - *Macquarie Capital Securities - Analyst*

Would you say that transportation at the margin may help the competitiveness equation for domestic coal and there may be some thinking or trade-off that you would consider there to help volumes?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

I think if we see the economy continue to expand, which we believe it will with low energy prices, higher consumption based on savings to the consumer from those energy prices, that we will see increased activity in the economy both on the industrial sector, the manufacturing sector, as well as the consumer economy. So that should lead to improving electricity consumption and production and that certainly -- those two things certainly would help the utility franchise through the year.

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Cleo Zagrean - *Macquarie Capital Securities - Analyst*

Thank you. And then the mix impact on operating income?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Well, the mix impact, we will see more intermodal versus coal shipments. Our intermodal is growing the fastest of our entire network. Our merchandise is second and then coal, of course, has been contracting up to this point.

All of that business is positive with respect to operating margin and operating income. I will tell you that intermodal puts a little bit more pressure on the operating ratio than, say, coal growth or strong merchandise growth.

Cleo Zagrean - *Macquarie Capital Securities - Analyst*

Thank you very much, and my follow-up relates to the operating ratio outlook. Can you help us understand your expectations for improvement this year for the main drivers, maybe price volume and productivity, and with any detail you'd like to offer about operational initiatives that you are looking forward to this year, Bellevue and any others that you would like us to be aware of? Thank you.

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

Well, I will take a stab at that. We clearly have a goal every year to continue to lower our operating ratio. We were successful at that, as you know, for 2014 and I guess that all I can say about various initiatives is that the operating ratio is -- has a numerator and a denominator and we have a lot of initiatives underway in both.

We think that improving velocity will have very positive impacts on our cost structure. And as you heard Don say, we think this is a good pricing environment and we think that the general strength of the economy gives us very good prospects for growth in a lot of the key elements of our business. So using both of those elements, it's our goal and intention to continue to lower the operating ratio in 2015 and in the future as well.

Cleo Zagrean - *Macquarie Capital Securities - Analyst*

Thank you very much.

Operator

Rob Salmon, Deutsche Bank.

Rob Salmon - *Deutsche Bank - Analyst*

Thanks, Don. As you had answered one of Scott's questions earlier about kind of the intermodal side of the business, you had highlighted the fact that the time for intermodal margin expansion is now. And clearly there is a train length extension component of that, but if I switch over to the pricing side, could you give us a sense of how much of your domestic intermodal business is up for repricing in 2015 and whether that is a front-end loaded or a back-half loaded thing?

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Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

Good morning. This is Don. I will tell you that on our domestic intermodal book about 60% of the business is being repriced in 2015. The largest tranche of that will be effective February 15. We have previously -- that is a contract and I won't get into the increased level.

I have previously indicated what our plans were for our public prices for EMP boxes, our domestic boxes, and that is running in the range of 5%.

Rob Salmon - *Deutsche Bank - Analyst*

Thanks, Don. Then just a quick follow-up with regard to the cycle turns in intermodal. Can you give us a sense of how much the box turns have declined in 2014, whether you can speak to kind of where they are on the E&P or on the triple crown on a per month basis, or just overall percentage changes and how we should be thinking about that improving as velocity comes back?

Don Seale - *Norfolk Southern Corporation - EVP & Chief Marketing Officer*

I don't have the percentage that I can give you offhand, but I will tell you that our -- as our train speeds declined in 2014 our cycle times declined with that. We were running somewhere in the range of 27 to 28 miles per hour in our intermodal network only; not our total network, but our intermodal network. And that declined in the range of 22 to 23 miles per hour, beginning to come back up.

So you can take that delta and certainly get to your answer with respect to cycle times.

Rob Salmon - *Deutsche Bank - Analyst*

Perfect. Thanks so much for the time and, Don, best of luck in retirement.

Operator

Thank you. There are no additional questions at this time. I would like to turn the floor back to management for closing comments.

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

Thanks very much for your patience. Thanks for all your questions. Again, all of our thanks to Don for his great service to our company and we look forward to speaking with you all again at the end of the first quarter. Thank you.

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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