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EDITED TRANSCRIPT

NSC - Q4 2011 NORFOLK SOUTHERN CORP EARNINGS CONFERENCE CALL

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OVERVIEW:

NSC reported full-year 2011 revenues of $11.2b, net income of $1.9b and diluted EPS of $5.45. 4Q11 revenues were $2.8b, net income was $480m, and diluted EPS was $1.42.

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PRESENTATION

Operator

Greetings and welcome to the Norfolk Southern Corporation fourth-quarter 2011 earnings conference call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. (Operator Instructions) As a reminder this conference is being recorded. It is now my pleasure to introduce Mr. Michael Hostutler, Norfolk Southern Director of Investor Relations. Thank you, Mr. Hostutler, you may begin.

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

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

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

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

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

Thank you, Michael, and good afternoon, everyone. It is my pleasure to welcome you to our fourth-quarter 2011 earnings conference call. With me today are several members of our senior team, including Don Seale, our Chief Marketing Officer; Mark Manion, our Chief Operating Officer; Jim Squires, our CFO; and Deb Butler, our Chief Information Officer.

As we typically do in January, Deb will be presenting our 2012 capital budget, and in order to allow enough time for that presentation, I will include a brief operations update in my remarks on Mark's behalf. Mark will be available to answer any questions later. I am very pleased to announce another record-breaking quarter for Norfolk Southern. We achieved fourth-quarter highs in revenues, net income, and earnings per share. As you know, these fourth-quarter results capped an already outstanding 2011 performance and lead to across-the-board record results for the full year, which include all-time highs for revenues, income from operations, net income, and earnings per share.

Looking at our top-line, revenues for the fourth quarter increased 17%. Volumes rose 6% lead by double-digit growth in Intermodal, Automotive, and Metals and Construction. Revenue per unit rose 11% lead by our Coal franchise. For the full year, revenues reached $11.2 billion, 17% more than 2010 on 5% higher volume. Don will provide you with all of the revenue details in a couple of minutes. Net income for the quarter of $480 million was up 19% and diluted earnings per share rose 30% to $1.42. For the full year, net income and earnings per share rose 28% and 36% respectively, and Jim will provide you with all of the financial details.

These record results resulted in strong operating cash flow, which, for the first time in Norfolk Southern's history, exceeded $3 billion. In recognition of this performance as well as their confidence in Norfolk Southern's strategic direction, our Board this morning increased the quarterly dividend by $0.04 or 9% and this return to shareholders followed the $2.6 billion in share repurchases and dividends paid out during 2011. These outstanding results were driven by a solid operating performance which improved as the quarter progressed. While handling an additional 6% in volumes, we improved terminal dwell and maintained our average network velocity. Moreover, the increased volumes were handled with only a 5% rise in crew starts. Our operating performance improvement is continuing into the first quarter and we're seeing significant improvements year-over-year in network velocity and terminal dwell. The fourth quarter also saw improvements in our fuel efficiency driven by milder weather conditions and the turnback of less fuel efficient leased locomotives.

I would be remiss if I also didn't say something about our safety performance for the year. We finished 2011 with a projected safety ratio of 0.73, which is an absolutely remarkable number and a full 18% below our previous best. We have a great team at Norfolk Southern and they're doing a terrific job on safety and service. In 2012, we'll continue to focus on improving service delivery and operating efficiency while positioning our franchise for continued volume growth. Part of that plan is continued strong capital investment and Deb will give you some details of our planned $2.4 billion capital program for this year. I'll have more to say about our 2012 outlook in a few minutes, but now I'll turn the program over to Don.

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

Thank you, Wick, and good afternoon, everyone. For today's call, I'll recap our fourth-quarter and year-end performance, including the key drivers of our results and then I'll conclude with our outlook going forward. The environment during the fourth quarter was marked by overall economic improvement and tightening truck capacity. These factors, combined with our ongoing business development activity, produced the strongest fourth-quarter revenue on record. In total, revenue for the quarter reached $2.8 billion, up $405 million or 17% over fourth quarter 2010. Yield improvement across-the-board up 11% and volumes grew by 6% lead by gains of 21% in Automotive, 12% in Metals and Construction, 11% in Intermodal and 3% up in Coal. Of the $405 million in revenue growth during the quarter, approximately two-thirds came as a result of higher revenue per unit, including pricing gains and fuel surcharge revenue. Higher volume accounted for the remainder of the revenue increase.

Slide 3 summarizes our full-year performance which was our best revenue year ever at $11.2 billion, up $1.66 billion or 17% versus last year. Coal, Intermodal, Agriculture and Chemicals posted revenue records for the full year. Higher revenue per unit contributed $1.16 billion or 70% of the revenue gain, while volume growth of 5% accounted for the remaining $493 million. With respect to yield, as shown on the next slide, revenue per unit reached a record $1,548 for the quarter and $1,570 for the year with increases of 11% and 12% respectively. We posted across-the-board gains for both the quarter and the year as a result of market-based pricing and increased fuel surcharge revenue. We remain committed to market-based pricing that equals or exceeds rail inflation and we will maintain this focus going forward. The demand for rail transportation remains high and truck and barge capacity remain tight, both of which point to a favorable pricing environment for 2012.

As I mentioned previously, volume for the quarter was up 6%. Turning our discussion to the full year as shown on slide 5, volume was up a solid 5% over 2010, a 15% improvement in domestic Intermodal coupled with a 5% gain in International volumes lead to a 10% year-over-year growth within Intermodal. In our Coal market, significant gains and export volume up 24% versus 2010 and a 1% increase in Utility volume, despite mild weather and low gas prices, helped drive our coal volumes up 4% for the full year. In our Merchandise sector, volume was relatively flat for the year, solid increases in Automotive and Metals and Construction traffic offset declines in Chemicals, Agriculture and Paper. As I've mentioned in previous calls, negative comps from 2010 within the Chemical and Agriculture groups contributed significantly to the declines in both businesses.

Now turning to our major business sectors in the fourth quarter, starting with Coal. Revenue of $850 million was up $165 million or 24% due to a 21% improvement in revenue per unit and a 3% gain in volume. As depicted on the next slide, the overall 3% volume increase in Coal came from a 27% increase in export. Fourth-quarter volume at Lamberts Point was up over 37% and volume through Baltimore was up 6%, driven by increased global demand for steel production, which was up 3% during the first two months of the fourth quarter. These gains more than offset lower Utility volume, which was down 3% versus fourth-quarter 2010, but up 1% sequentially over the third quarter of 2011. Reduced demand for electricity due to mild weather as well as competition from gas impacted Coal burn across our network. We also saw improvement in the quarter within our domestic metallurgical coal network which was up 8% in response to greater coking demand associated with domestic steel production.

And on a more recent note, as shown on slide 8, we completed our largest single-coal loading ever at Pier 6 two weeks ago. The M/V Cape Dover shown here on the left was loaded with nearly 160,000 tons of metallurgical coal destined for China. The coal which arrived in over 1,500 railcars to our terminal was loaded on the Cape Dover in less than 48 hours. This event truly highlights the service and capacity that have become the hallmark of Lamberts Point.

Now let's turn to our Intermodal network. Revenue in the Intermodal network in the quarter reached $554 million up $83 million or 18% over fourth quarter 2010, driven by 11% higher volume and a 6% increase in revenue per unit. Slide 10 shows that the volume gains in Intermodal came mainly from our domestic market, up 15% or 54,000 loads for the quarter due primarily to highway conversion. Our International segment also posted a gain for the quarter, up 9% due to improved retail demand. In the fourth quarter we completed clearance work between Cincinnati and Columbus, Ohio, which was the last remaining link in our Intermodal network to realizing a fully double stacked capable network. And four of five terminals are scheduled for completion this year, ranging from Memphis and Birmingham in the South to Green Castle, Pennsylvania and Mechanicville, New York in the Northeast. In fact I'll point out that we ran our first Intermodal train through the new Mechanicville terminal just last week, as we began to ramp up operations there.

Now turning to our Merchandise markets. Revenue for the quarter of $1.4 billion was up $157 million or 13% due primarily to an 11% gain in revenue per unit. Volume of 566,000 units was up 1%. As you know, our Merchandise network includes a large base of manufacturing companies and we

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see positive signs in this sector. The ISM manufacturing index had a six-month high in December of 53.9%, marking the 29th consecutive month of expansion, and we're seeing improved demand for manufactured products, both domestically and for export.

As we drill down on the next slide into the five groups that comprise Merchandise, you will note strong quarterly volume gains in Metals and Construction and Automotive, at 12% and 21% respectively. Miscellaneous construction materials, which includes frac sand, was the primary driver in the Metals and Construction volume growth, which was up 24% for the quarter due to increasing demand for products related to natural gas drilling. New business opportunities within this market have been leading the way for growth throughout the year and we expect that to continue.

Steel and Automotive manufacturing both saw increased activity levels for the quarter, which was favorable for our Metals and Automotive businesses. Steel volume for the quarter was up 13% as we saw domestic raw steel production grow about 12% during the quarter. And North American vehicle production for the quarter was up nearly 400,000 units or 13%. Three of our Merchandise sectors experienced volume declines for the quarter. Agriculture was down 7% due to the negative comp within fertilizer and lower corn shipments to short-haul midwest destinations, while chemicals volume was down 10% due primarily to the comp effect resulting from the completion of the Tennessee Valley Authority Fly Ash project we handled in 2010. We cleared this negative comp on December 1, 2011.

Now, before concluding with our business outlook, I want to highlight our Industrial development results in 2011 which certainly reflect the resurgence of US manufacturing that I mentioned a moment ago. 2011 was a record year as we brought on new and expanded projects worth $335 million in revenue, and more than 152,000 new car loads of business for our system. As you may have seen in our announcement this month, NS facilitated $9.5 billion of investment by our customers in 2011. These new plants and expansions are expected to create 6,800 jobs across our service region, and nearly half of the revenue secured in 2011 through our Industrial development activity included foreign direct investment in such projects as Steel and Automobile manufacturing. The Energy sector was also a major contributor to these results accounting for 27 locations and expansions across 15 states. The gains included new Coal business as well as projects related to Marcellus Shale gas exploration, which we see as an area for continued growth. Obviously, these new projects will support further growth in 2012, but more importantly, growth for years to come.

Now, concluding with our outlook. We see a variety of new business opportunities ahead in a gradually recovering economy. For our Coal business, port capacity improvements, new metallurgical coal production coming online and new steam Coal business support opportunities for growth in the export market. With respect to our Utility network, we see new opportunities for Illinois Basin coal, which will partially mitigate the effects of a mild winter and competition from natural gas.

On the Intermodal front we anticipate continued opportunities for highway conversions as tightening truck capacity and favorable international trade patterns continue. And finally with Merchandise, Merchandise volumes are expected to improve in the crude oil and waste product sectors, along with continued growth in ethanol at new and existing terminals. Also, increased demand for materials associated with natural gas drilling, along with higher projections for North American vehicle production, bode well for both our Steel and Automotive businesses.

In summary, we expect our volumes ahead to continue to exceed both low-tech industrial production, as well as GDP, and market based pricing above the rate of rail inflation will remain a cornerstone of our plan going forward. Thank you for your time this afternoon and we'll now turn it over to Jim for our financial report. Jim?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Thank you, Don. I'll now review our fourth-quarter financial results which round out a year of record performance. I'll close with an overview of our financial highlights for the year.

Let's start with our fourth-quarter operating results. As Don described, railway operating revenues were a fourth-quarter record of $2.8 billion, up $405 million or 17% compared to 2010. Fuel revenues increased $100 million and this quarters lag effect was $46 million unfavorable. The following slide displays our total operating expenses which increased by $247 million or 14% for the quarter. Income generated from railway operations was $800 million, up 25% reflecting a sizeable increase in revenues. The resulting operating ratio was 71.4%, a 2% improvement compared to 73.2% in the fourth quarter 2010. Both measures reflect fourth quarter post Conrail results, exceeded only by fourth quarter 2008. Removing the $46

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million unfavorable fuel revenue lag, our operating ratio would have been 70.2%. This translates to a 3% improvement compared to 2010 of 72.3% operating ratio adjusted for a $29 million unfavorable fuel lag.

Turning to our expenses. The next slide shows the major components of the $247 million increase, fuel and compensation and benefits expenses accounted for over two-thirds of the variance. As displayed on the following slide, nearly all of the $95 million increase in fuel expense was due to higher prices. Our average diesel fuel price per gallon was $3.11, a 27% increase compared with the fourth quarter of 2010. Consumption increased 4% relative to a 6% increase in gross ton miles, a reflection of milder 2011 weather and returning many older leased locomotives.

Next, compensation and benefits increased by $75 million or 11%. Looking at the major components of this increase on the following slide, first higher incentive compensation reflects our strong year-over-year results of $37 million. Second, higher health and welfare benefits added $13 million, a little over half of which related to increased premiums. Third, activity levels due to increased volumes added $9 million, primarily for train and engine employees. Fourth, wage rates drove expenses up $5 million.

Pension expenses and payroll taxes increased $5 million and $4 million, respectively. Materials and other expenses presented next increased $35 million or 19%, reflecting higher volume related equipment maintenance activities, reliability initiatives for our locomotive fleet, and increased environmental remediation expense. Purchased services and rents increased $28 million or 7%, primarily reflecting volume related operating activities.

Turning to our non-operating items, increases in corporate owned life insurance and coal royalties were partly offset by the absence of favorable interest on uncertain tax positions that benefited 2010. As illustrated in this comparison, income before income taxes increased $161 million or 29%, due to higher operating income. Income taxes totaled $243 million and the effective tax rate was 33.6%. The lower than expected effective tax rate reflects $11 million in deferred tax benefits resulting from state tax law changes. Income taxes in the fourth quarter of 2010 were $160 million with an effective rate of 28.5% and were favorably impacted by a change in estimate for deferred taxes that resulted in a non-recurring reduction of $34 million.

Net income and EPS comparisons are displayed on the following slide. Both measures set fourth-quarter records. Net income was $480 million, an increase of $78 million or 19% compared to 2010. Diluted earnings per share were $1.42 exceeding fourth-quarter 2010 results by $0.33 per share or 30%.

Turning our focus to the full year. Record revenues of $11.2 billion, up 17% versus 2010, contributed to record income from railway operations of $3.2 billion, up 20% compared to $2.7 billion in 2010. These results generated a 70 basis point improvement in our operating ratio, which was 71.2% for the year, a close second to our 71.1% post Conrail records set in 2008. Net income for the year reached $1.9 billion compared to $1.5 billion in 2010 and diluted earnings per share increased from $4 to $5.45 per share. These results reflect a 28% increase in net income and a 36% increase in diluted earnings per share. Both measures set new records.

As shown on slide 16, strong 2011 net income drove a 19% increase in cash from operations, which covered most of the increase in our capital spending and produced $1.1 billion in free cash flow. In addition to increased capital spending, the lower 2011 free cash flow reflects accelerated accounts payable activity in late December, planned as part of our January 1 ERP implementation. This temporary decline in our year-end cash balance has since rebuilt to normal levels. From free cash flow, we distributed over $0.5 billion in dividends.

The remainder, combined with net proceeds from borrowings and cash on hand, supported over $2 billion of share repurchases. As we move forward, we expect continued capacity to generate free cash flow coupled with reliable access to debt markets that will position us to support future capital deployment initiatives, as evidenced by our Board's action earlier today, increasing our quarterly dividend by $0.04 to $0.47 a share. Debt repayments in 2012 are relatively low at about $150 million and dividends, as always, will remain a core means for distribution. Next, Deb Butler will share our 2012 capital investment plans. Thank you for your attention.

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Deb Butler - *Norfolk Southern Corp - EVP, Planning and CIO*

Thank you, Jim. As Wick noted we planned another strong capital investment program in 2012. Slide 2 depicts our 2012 capital program compared with prior year's programs. At $2.4 billion, our 2012 plan is budgeted to be 12% higher than 2011 capital expenditures and reflects our continuing confidence in and commitment to the growth and productivity of our franchise. As in prior years, the majority of our capital spending is targeted towards strengthening the franchise.

Replacement and core spending represent about $1.6 billion or 67% of our total capital budget. If we include in the core spending category $247 million budgeted for the continued implementation of Positive Train Control, the total is in line with our historical average of about 75% core and 25% growth spending. The growth portion of the budget shown here in green and totaling $545 million, is for track and terminal expansions and for projects to improve asset utilization, workforce productivity, and fuel efficiency.

As always, the largest percentage of our spending is targeted at keeping our right-of-way and the condition needed to move our customers' business safely and efficiently. Roadway spending in 2012 is budgeted to be $840 million or 35% of the total budget. Our roadway budget funds the replacement of rail, ties, and ballasts, as well as the improvement or replacement of bridges and culverts. Investments in infrastructure are budgeted to be $134 million or 6% of capital expenditures. Our infrastructure investments are specifically designed to relieve congested lines and improve capacity and velocity on line of road. New projects for 2012 will focus on the Birmingham/Atlanta corridor and our North South line between Chattanooga and Cincinnati. As in prior years, we'll also continue to invest in public/private partnerships such as those associated with Crescent Corridor and create.

On slide 8, investments in facilities and terminals throughout our network will total $322 million or 13% of our planned 2012 capital expenditures. About half of the spending in this category is associated with investments in Intermodal facilities, including continued work at three Crescent Corridor terminals in Tennessee, Alabama, and Pennsylvania, each of which also has a public funding component. The photo on the slide is an arial view of the massive Intermodal terminal project at Rossville, Tennessee, near Memphis. The remaining funding in the facilities and terminals category will be used to support new business opportunities, as well as to continue a multi-year initiative to expand and update our locomotive servicing facility. And speaking of Locomotives, spending in this category will total $242 million in 2012 or 10% of the total budget. Locomotive spending planned for 2012 includes the purchase of 35 new units, as well as continued investments in alternative power programs. Also included in this category is funding to rebuild and upgrade existing locomotives and for the installation of emissions kits to meet government requirements.

Freight car spending in 2012 will total $346 million or 14% of the total 2012 capital budget. We're continuing a multi-year investment in new coal cars as our existing fleet ages out, and in addition, we're ramping up the coal car rebody program in 2012. Freight car funding will also be used to purchase equipment to support our Intermodal, Automotive, Metals, and Scrubber Stone businesses. Not including Positive Train Control, investments in system technology will total $92 million or 4% of total investments in 2012. We've broken out spending on Positive Train Control into a separate technology category totaling $247 million or 10% of total spending in 2012. This compares with a budget of $146 million in 2011 and is in line with our plans to ramp up spending as the 2015 deadline approaches.

Our investments in technology were highlighted at last year's investors day and include a comprehensive suite of projects that enhance safety, improve operational efficiency and equipment utilization, and provide our workforce the tools to better plan and manage our network and processes. Included in this spending are projects such as LEADER, an energy management system that improves fuel efficiency, and UTCS movement planner, a system designed to optimize train dispatching and increase network velocity. And as noted, we are facing a significant increase in spending in 2012 to comply with the federally mandated Positive Train Control project. Funding will be used to upgrade communications and signals, to purchase and install onboard network devises on locomotives and to continue the complex process of integrating PTC with our other operating systems. Even with recent changes in the regulations, we still anticipate the total spending on PTC will exceed $1 billion.

I'll close with another shot of Crescent Corridor construction at Riverton Junction. As our capital spending plan for 2012 clearly demonstrates, we remain committed to investing in the safety, growth, and productivity of our franchise. And now I'll turn the program back over to Wick.

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Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

Thanks, Deb. Well as you've heard, our fourth quarter capped an outstanding year for Norfolk Southern and a year in which our results were matched by the returns to our shareholders. Looking forward, we share in what seems to be the consensus view that the economy will continue to grow, albeit at a fairly slow pace, assuming that the global economic climate remains reasonably stable. We remain optimistic, as you've heard, that Norfolk Southern can continue to grow overall volumes at a pace faster than the economy as we have done for the past couple of years.

As Don mentioned, the fact that many people in our service area have enjoyed an unusual amount of short sleeve weather so far this winter, coupled with low natural gas prices, may pressure our first-quarter Utility coal volumes to some extent, but we remain confident in the longer-term strength of our Coal franchise. 2012 will also see us continue to focus on our service product and the efficiency of our operations. In addition to the strengthening of our operations, 2012 will also, as you've heard, include the completion of several new major Intermodal terminals, which will result in additional capacity and service improvements.

As I've said many times before, increasing asset velocity on our property improves both our customer service and our operating cost structure, and we have a number of initiatives and investments under way that are focused on velocity. As I said earlier, we're off to a good start so far this year and looking to build on that momentum. I'm confident that we can and that the end result will be continued high-quality, high-value service for our customers and superior returns for our shareholders.

Thanks and we'll now open the mic up for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Jason Seidl, Dahlman Rose.

Jason Seidl - *Dahlman Rose & Co. - Analyst*

First, I'm going to concentrate on Coal. You sound fairly optimistic on the export market, if we just put utilities aside for the moment. Can you give us some more color, what gives you the optimism on met exports and also thermal exports for you guys?

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

Jason, good afternoon. With respect to the metallurgical coal which is the predominant share of our business as you know going to Europe, Asia, and South America, we're fortunate that we have a lot of very high-quality, low-vol metallurgical coal that's in great demand around the world and we're confident that that demand will continue. We're supplementing that metallurgical flow, I will tell you that we have executed a couple of deals for steam coal and we see an increased opportunity ahead for higher steam coal exports, and so you put those two together and we still feel optimistic about the export market.

Jason Seidl - *Dahlman Rose & Co. - Analyst*

Okay, fantastic. My follow-up question is going to be on the Intermodal side. You guys have been creating a network where you should be able to increase your productivity, yet in the same sense you also lost a contract beginning this year so you're going to lap that. Can you talk to us about what's left in the network in terms of how much excess capacity your Intermodal network is currently running at?

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Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

Well, we have capacity. It's to some extent lane specific but we still have a fair amount of capacity on a lot of our train starts. There are terminals where we're very very busy right now and part of our terminal expansion strategy is to give us additional growth headroom in those locations, Pennsylvania being an example. Mark, anything else you'd like to add?

Mark Manion - *Norfolk Southern Corp - EVP, COO*

The only other thing I'd add to that is our average train length for Intermodal is still under 6,000 feet and then of course that's an average, we've got some trains that are smaller than that and a lot of trains that are larger than that but suffice to say for the most part our Intermodal trains can operate at 8,000 feet, sometimes more than that so a lot of room to grow there.

Jason Seidl - *Dahlman Rose & Co. - Analyst*

Okay, gentlemen, I appreciate the color as always.

Operator

Justin Yagerman, Deutsche Bank.

Justin Yagerman - *Deutsche Bank - Analyst*

I guess the first question is on Coal mix on the Utility side. It looks like RPU was down sequentially. I'm assuming that's with the preponderance of northern Utility contracts that you guys could have a little bit of unfavorable mix hitting you. Maybe if you could just talk a little bit about how we should expect that to look as we head into 2012 and then obviously, there are a bit of secular headwinds facing that sector. What do you guys think volumes will look like on the Utility side if we could see things positive or flat to kind of a best case scenario in 2012? Thanks.

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

Well, Justin, as I mentioned our Utility volume for the full year 2011 was up 1% and it was also up 1% sequentially from the third quarter to the fourth quarter, so those were pretty good numbers in the current environment with historically low natural gas prices and a very mild winter, but in terms of the mix effect, we're constantly seeing some changes in the flow of our coal going to northern utilities versus southern utilities. I will tell you that our southern utilities now are generally on target with respect to stockpiles. While we have a couple of northern plants that are still below target that are taking coal but they're catching up on.

Justin Yagerman - *Deutsche Bank - Analyst*

Okay, that's helpful and then wanted to follow-up on a comment that I think is a big accomplishment that you guys talked about quickly in the prepared remarks which is the 100% double stackability in your Intermodal network. How does that change the way you go to market now, if it does at all and does it open up new capabilities in terms of getting into shippers that haven't been willing to look at you guys? How does that change the way you think about your Intermodal network and does it affect the domestic growth rate that we should be expecting at all?

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

Well certainly, we've had the plans to clear the entire network, the last link was Cincinnati to Columbus. We completed that in the fourth quarter in early December and just to put a little more color to that, that saves almost two days between the Florida/Virginia, half the roads and Detroit, for example, so it shortens the route, it makes it more efficient and we have been getting the word out to our domestic and international customers

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about that improvement for quite some time, so it does not change our posture on our plans to go to market but it certainly offers another arrow in the quiver for quality efficient service over our Intermodal network.

Justin Yagerman - *Deutsche Bank - Analyst*

Congratulations on that.

Operator

Ken Hoexter, Banc of America.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Can we just talk on the -- you talked on the export Coal side, maybe on the Utility domestic side. You were down just a touch, a couple percentage points, your peer in the region was down double-digits, why do we see such a difference and then maybe within that same conversation you can talk about your expectations for CSAPR and MACT rules coming in, what your expectations are for continued reduction on the Utility Coal side?

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

Well, our outlook for Utility as Wick mentioned, we're optimistic about our Utility network. Certainly we have cross winds and some headwinds with the environmental issues. The weather is probably the biggest concern we have right now and then of course natural gas at $2.50 per million BTU is another concern. We don't think that gas will stay at that level over the long run. We think Coal generation will be fine, with respect to Boiler MACT, as well as CSAPR, as you know both of those EPA proposals are being delayed due to court challenge and I will tell you that with respect to CSAPR and the older smaller coal fired plants in our universe, we don't expect a significant impact anyway with CSAPR. A 50-year old plant that is a 300-megawatt plant, a reinvestment is not going to take place there to install scrubbers and we expect those plants to fade away anyway.

So in a sense of looking ahead, we still feel good about the Utility network. I can only comment about our network. I can't really comment about the others but we've got slightly over 100 Utility plants in our Utility fleet. I will tell you that 70% of those already have scrubbers and that number is going up. Our largest single plant that we serve will have scrubbers installed by the end of 2013 and we will see that plant at that point start to take Illinois Basin coal and Powder River Basin coal for blending at that plant. It's a full PRB coal take at that plant today. So a lot of moving parts but we have a good network and we see opportunities ahead.

Ken Hoexter - *BofA Merrill Lynch - Analyst*

Sounds great, Don. If I could get a follow-up on a different commodity on Ag. Obviously we had the weather impact last year with the floods and inability to get fertilizer down. When do you start to see that anniversaried and maybe easier comps from a new planting season?

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

We will clear a comp in our fertilizer sector March 1, in our Ag business as we cleared a negative comp for TVA December 1, in our Chemical business, and I think you're making a very good point in your question. We are expecting to see fertilizer usage increase in the 2012 crop-year to enhance yield, so we see further opportunities in terms of phosphate fertilizers as well as potash and also, we had some very unusual weather patterns this past year with the corn crop. We saw regions get rain in Illinois that had good yield and then we saw other regions in Illinois, Ohio, and Indiana that didn't get rain and the yields were not quite so good. So that impacted our overall business but when we look at our Ag business in terms of the ethanol business as well as the poultry and animal feed mill plants, and the cycling trains that we have in place, we think 2012 is going to be a good year for Ag.

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Ken Hoexter - *BofA Merrill Lynch - Analyst*

Wonderful. Thanks for the time, Don, appreciate it.

Operator

Bill Greene, Morgan Stanley.

Bill Greene - *Morgan Stanley - Analyst*

Don, in your experience in the past when you look at kind of the volatility that we see in the export Coal markets or even over time maybe some volatility in the domestic markets, do you think pricing changes can stimulate coal demand in any way or is it just there's bigger forces beyond what rails can do on price?

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

Bill, my view is that obviously we're part of the supply chain but there are much larger factors that determine world markets for coal usage and coal demand. We constantly monitor that and right now, we see ongoing opportunity in the export market for growth. I will tell you that we will have some additional metallurgical coal coming online in 2012, expansions in Southwest Virginia as well as West Virginia, and as I mentioned these are high-quality met coals that can compete anywhere in the world and they will continue to be in demand. So I think obviously, we are attuned to the fact that we're part of an overall supply chain and we're always going to be sensitive to that, but we're not the driving factor in worldwide demand with coal.

Bill Greene - *Morgan Stanley - Analyst*

And how do we reconcile these comments that are pretty bullish in export coal with what seem to be production cuts from a number of coal companies out there? Is it just because of these unique attributes of the coal? Is that really possible?

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

Well, Bill, I think it could come down to cost of production and unique attributes of the coal being mined at those given locations, you've probably seen that one of our major suppliers in their capital budget that they have announced, they are actually expanding their capability of producing high-quality low-vol metallurgical coal in Southwest Virginia, so while you have some folks pulling back, you have others that are planning to move ahead and it all depends on cost of production and the quality of the coal.

Bill Greene - *Morgan Stanley - Analyst*

And if the volatility exists, is there a way that you can reduce resources in coal or is it such a high, if you will, fixed cost sort of unit trend business that you do get detrimental margins or you don't get them because of the way the cost structure works. How does that work? Thanks for the time.

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

Well, Bill, certainly we can manage crew starts and the number of crews but I will tell you, we don't expect a cutback in our coal.

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Bill Greene - *Morgan Stanley - Analyst*

All right, thank you very much.

Operator

Walter Spracklin, RBC Capital Markets.

Walter Spracklin - *RBC Capital Markets - Analyst*

Actually, first question for Deb here. When I look at the CapEx plan that you have and I sort of cross it with what you and your peers I guess have told us about a general sort of run rate of 16% to 18% call it revenue. I nevertheless note that all of the rail seemed to be bumping up above their 20% of revenue and just curious, is that purely a PTC phenomenon and will we start to see that 2.4 sort of come off even as your revenue grows or is this something that continues to trend higher given the PT spend that goes up to call it 2015, 2016?

Deb Butler - *Norfolk Southern Corp - EVP, Planning and CIO*

I think a large part of it is clearly PTC spend. That's why we break it out when we talk about our capital spending. Beyond that though and you'll recall that we have spoken for a number of years about the need to replace our coal car fleet and we talked about it again for 2012 spending. That's another big driver that you probably didn't see quite as much of in previous years, you're going to see it, and for the next couple of years as well and so we are replacing our coal car fleet. And as we did last year to the extent that we identify opportunities to replace leased equipment and replace equipment with equipment that we can purchase, that's also again nothing specific planned but that's something that we will look at as the opportunities present themselves, so PTC is by far the biggest driver but for us the freight car replacement is also another big driver.

Walter Spracklin - *RBC Capital Markets - Analyst*

Okay. So it sounds like it's long enough tail here that we should continue to model in this kind of magnitude of CapEx for the next few years?

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

I think that's fair. One other component that has been out there and will continue to do as you know, we discussed we're making some major facility investments right now.

Walter Spracklin - *RBC Capital Markets - Analyst*

Sure.

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

So we have some long-tail things but they will eventually end.

Walter Spracklin - *RBC Capital Markets - Analyst*

Okay. Second question here, Don. You gave us a pretty good outlook, I guess can you talk to us about sort of the areas where you're a little concerned where we might see some weakness and what areas do you really get excited about and sort of stand among the top of your business segments in terms of growth?

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

Well, not surprisingly the recovery in housing and the implications for the larger economy that that would have, that continues to be a concern. We've seen recently some, at least some indications of hope and optimism that housing is getting a little better. We're seeing our business start to pick up in lumber for example, but that area, paper, forest products continues to be one that is not robust for us. On the very plus side, as I mentioned the crude oil coming from Bakken as well as the tar sands crude oil opportunity, in addition to all of the materials that we're transporting into the Marcellus Shale region to support the activity there, that business has ramped up significantly.

I will tell you that it was north of 40,000 car loads for 2011 and our plans call for a significant increase over and above that for 2012, so that area is very positive and encouraging. And of course the Automotive market, I have to say, has made a remarkable recovery with respect to sales and production to support sales and I'm sure you've seen the recent reports that the age of the US fleet of automobiles on the highway is now approaching 11 years, 10.8 years. I was in Detroit a couple weeks ago and the sense of optimism was very high with respect to continued Auto sales growth and production, so that's another sector which feeds Steel and domestic coke and Coal demand which is -- they're all encouraging.

Walter Spracklin - *RBC Capital Markets - Analyst*

Okay, and just a housekeeping if I might for you, Jim. The low tax rate I think you mentioned was $11 million in deferred tax benefit, was the main driver, and I put in $11 million. I'm still getting a fairly low tax rate that brings it up to a 35% but still trending below what you typically get.

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Right. Fair enough. We did have other benefits in income taxes in the quarter but not benefits that we view as unusual or non-recurring and so match the $11 million up against $34 million of favorability and income taxes and a 28.5% effective rate in the fourth quarter and last year for example, so the $11 million we did flag as something unusual due to state law changes as we mentioned.

Walter Spracklin - *RBC Capital Markets - Analyst*

Okay, thanks very much.

Operator

Peter Nesvold, Jefferies & Company.

Peter Nesvold - *Jefferies & Company - Analyst*

Did I miss it or did you say what core pricing was for the quarter?

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

You didn't miss it. We don't reveal that. We talk about revenue per unit.

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Peter Nesvold - *Jefferies & Company - Analyst*

Got you, okay. Comp and benefit as a percent of revenue looked like it improved about 130 basis points year-over-year in the quarter and that was actually the narrowest improvement that we've seen since third quarter 2010 and I'm just curious, are there staffing actions that are being taken there, is there something that might explain the tightening there of the margin improvement year-over-year? Thanks.

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Well, you did see the hiring rate taper off some in the fourth quarter relative to volumes and I think that provided some benefit in comp and benefits relative to overall results, but nothing beyond that we can really point to. The incentive comp was a significant component of the increase and then on down the line from there, all familiar components of increases from quarters past.

Peter Nesvold - *Jefferies & Company - Analyst*

Got you, okay, thank you.

Operator

Matt Troy, Susquehanna Financial.

Matt Troy - *Susquehanna Capital - Analyst*

I know that the Coal year on the export side rolls every spring but was just wondering as we all grasp or trying to grasp what the export Coal outlook will look like, what is the process in terms of negotiations? When do they begin? When do you get a sense of a minimum committed tonnage, if you could just help us provide the window on the front and back end of that late spring date when the contracts get rolled out, that would be helpful.

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

Matt, between now and April 1 will be the period where most of the detailed negotiation and discussion takes place, obviously we've been having discussions leading up to this time but that will intensify between now and April 1 and we'll have most of that done by April 1.

Matt Troy - *Susquehanna Capital - Analyst*

Pricing included in those discussions?

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

Correct.

Matt Troy - *Susquehanna Capital - Analyst*

The second question just more on the domestic side, the 15% growth in containers is industry leading. I'm wondering if you could point to and I'm afraid the answer is going to be a lot of little things but are there one or two things that are driving your domestic share performance in Intermodal? It is so far ahead of what we're seeing elsewhere competitively in the region but just across the industry, is it one or two other projects in the last couple quarters? If you can just help maybe separate into buckets what's driving that higher, thank you.

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

Matt, as you'll recall in the third quarter and I did not show the stats for the fourth quarter, we are showing double-digit increases in our corridors, as we work on speed enhancements, as we rollout features of those corridors, Crescent Corridor, the Heartland Corridor, the Pan Am Southern, the Heartland Corridor so that's certainly helping us in that regard. And I will also say that we've got some very strong partners in the domestic Intermodal market that are working closely with us to convert highway freight in the East which has been untapped in the past, so it's a target-rich environment, East of the Mississippi in terms of truck flows. It's a combination of network and partners working with us to market that.

Matt Troy - *Susquehanna Capital - Analyst*

Okay, proof of concept, thank you.

Operator

Tom Wadewitz, JPfMorgan.

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

Wanted to ask on the Intermodal side you mentioned I think four new terminals coming online in 2012. Can you give us a sense of what that increase in terminal capacity is perhaps in terms of lifts relative to the total Intermodal network?

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

Tom, in terms of the increased lift capacity in Memphis, Birmingham, Greencastle, and Mechanicville, right at 0.5 million lifts so an incremental capacity.

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

So what is that relative to the prior Intermodal terminal network capacity?

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

In terms of a percentage improvement or increase?

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

Yes, if you just have total lifts of the network prior to that, capacity or percent increase.

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

It's in the range of 15% to 18%.

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

Okay. And how long, I'm sure you've got Mike McClellan out there working hard to market this and drive volume growth and so forth and I'm confident he will have success over time but how long does it take your partners to ramp that up as some of these would probably be new markets that they could access. Is that something that you can pretty quickly see volumes come into those new terminals or is it something where you kind of have a fairly gradual ramp up period in terms of actually getting traction where the new capacity is in the new markets?

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

Tom, to answer that question I'm going to use a horse analogy. They're chomping at the bit. They're ready to go when we are, and seriously, the capacity at some of these terminals we've grown so quickly that our partners and ourselves, we know where the next tranche of growth is and it will be turned on fairly quickly once we open the new terminals.

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

Okay, yes, if I can have one additional one on the Coal. I know you've talked a lot about Coal but given we haven't seen apparent switching or impact from low natural gas on your Utility coal business in 2011, do you think maybe some of that happened a couple years ago? I guess there was a step down in your Utility volumes probably two or three years ago, so is it partly that your older capacity that would have been affected by low natural gas already was affected a couple years ago? Or it still seems perplexing why you aren't seeing an impact from that whereas CSX is seeing a pretty big impact.

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

Tom, I will tell you that we did see an impact from low natural gas prices in our network in 2011 and we think that most of that impact has been realized at this point in terms of the plants that can actually burn gas and compete with coal but we did see an impact in 2011.

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

Okay. Great, well thank you for the time.

Operator

Chris Wetherbee, Citigroup.

Chris Wetherbee - *Citigroup - Analyst*

Maybe sticking on Coal just revisiting the discussion on Coal yields, I'm just trying to get a sense of the volatility in the average revenue per car, relative to the northern versus southern utilities, was there any other moving parts in there, is there anything that we can tease out from the export perspective? Was price volatile at all in the quarter and how should we think about that as we roll forward into the April 1 renewals just given the outlook that you guys have for export Coal?

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

No volatility in the export coal price but you'll notice in the charts that I've provided that our domestic metallurgical coal market was up 8% in the quarter and sequentially from the third quarter to the fourth quarter we were flat on domestic metallurgical coal from the third quarter. It's profitable business but it's shorter haul business for us with lower revenue per unit, so as domestic metallurgical coal goes higher as domestic Steel production goes higher, we will have some impact on RPU, but don't read anything into that other than mix.

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Chris Wetherbee - *Citigroup - Analyst*

Okay. So nothing from a profitability perspective, only simply from a mix perspective?

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

Correct.

Chris Wetherbee - *Citigroup - Analyst*

And then if I could just switch gears with the follow-up over to the headcount side for 2012. Jim, maybe if you could give us a sense of what your thoughts are as far as growth in the forest as we look at 2012 and then maybe what the cost inflation aspect might look like.

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Sure. Well, I'll take a shot at it and then I'll let Mark or Wick chime in as well, but I think we are at a point where we think we've leveled off in terms of T&E hiring and we're at or close to where we want to be in terms of our T&E workforce. We do expect however to see increased hiring in engineering and mechanical ranks in 2012 and there, we are in a sense paralleling what we have done with our T&E workforce in 2011 and the latter part of 2010 where we took it up an expectation of reaching a level that we think is sustainable and we're going to repeat something like that pattern in 2012 for our mechanical and engineering workforces.

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

Yes. That's our plan right now. We tied some of that to even further service improvement initiatives. We'll clearly watch the headcount carefully. Another thing that we'll be doing is making sure that we are hiring ahead of attrition. We have some demographics in the workforce. Those two workforces in particular that we need to manage through, so you look at all of that. We would expect some additional headcount growth as Jim said on the operating craft side, T&E looks pretty good. Right now we think we're well positioned for volume growth this year and for -- actually for a ways beyond this year in T&E and then everything else should be about what it is today.

Chris Wetherbee - *Citigroup - Analyst*

Okay, and the cost inflation kind of exclusive of any stock based compensation?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

In the health and welfare costs arena, we are expecting a significant increase again for the full year and now the premium is sort of up in the air but we'll have an activity base component increase in health and welfare costs of probably around $30 million or so for the full year. Pay rates are going to add, that's the agreement component by the way. Pay rates are going to add something on the order of $50 million or so to comp and benefits expense for the full year. Now, pension cost increases and other post employment benefit cost increases are going to be much more modest we think this year than they have been in the last few years.

Chris Wetherbee - *Citigroup - Analyst*

Okay, that's great color. I appreciate the time guys, thank you.

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Operator

Gary Chase, Barclays Capital.

Gary Chase - *Barclays Capital - Analyst*

Good afternoon, guys. Wondered if I could just ask Don a couple of quick ones here. First on the Utility mix, on the northern Utilities versus the southern Utilities, it sounded like the way you were describing things you hadn't really seen a material change yet. I'm wondering if you think we should expect or could see during the course of 2012 a more substantial mix shift that would sort of alter these revenue dynamics and maybe revert back to where we were say in 2010 before you had that big change in the first quarter of last year.

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

Gary, I would say that it's all dependent upon the weather. What really happens with the rest of the winter, the shoulder months and then of course the cooling degree days that we have throughout the summer, and we just don't know how that's going to work out. As I mentioned earlier, we have reached close to target for most of our Utilities in the south and most in the north with the exception of two locations.

Gary Chase - *Barclays Capital - Analyst*

Do you have a sense of why this just seems to have been more volatile in the last let's say 12 to 18 months than at least I remember?

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

Gary, volatility in what sense?

Gary Chase - *Barclays Capital - Analyst*

It feels like the mix is shifting to a greater extent than at least I recall. Maybe that's not accurate.

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

Well, we have a large Utility network that's 70% of our Coal business and then we have a large domestic metallurgical coal franchise that goes to domestic coking and that's directly related to Steel manufacturing. And of course we've seen economic dislocations over the last two to three years that's impacted Steel production, Automotive manufacturing, et cetera. So I don't think there's any fundamental shifts in the network itself. It's just the market dynamics have created different supply chain requirements at different times.

Gary Chase - *Barclays Capital - Analyst*

It sounds like we should expect that to continue given the backdrop outlook most people have, right?

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

Well, certainly we think the economy in North America, in the US is recovering slowly. We're seeing very encouraging signs across the board even with housing as I mentioned earlier, some glimpse of improvement there, and everything considered we think the economy looks better for 2012.

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Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

But I think one answer to your question is yes there's going to always be some volatility and unfortunately, it's not volatility that we can predict the timing of or the magnitude of, it's just part of our service franchise and so we'll see these swings from time to time. We're confident over the long term in the strength of the entire franchise.

Gary Chase - *Barclays Capital - Analyst*

Okay, thanks, guys.

Operator

Scott Group, Wolfe Trahan.

Scott Group - *Wolfe Trahan & Co. - Analyst*

So obviously been a bunch of questions on Coal and they've kind of been separate on export and Utility. When you add it all together and you take export, the domestic Utility and the domestic met, it sounds like the expectation is for positive volumes in 2012 and assuming I'm reading that correctly. When you add all of the moving parts how do you think about the overall mix impact within Coal for 2012?

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

Well, again, we can't predict the weather, so on Utility we can't really give you any additional insight on that. The export market looks good based on world demand for high-quality coal and as I mentioned we're adding some steam coal to our mix for 2012 that will help with that overall volume number and then Steel production in the US looks better. It's tracking improved Automobile production, so we think that that will be better. So all three of those areas and I'll also mention that in terms of the new Coal production that is ramping up in 2012 across our network in total, that could amount to as much as 6 million tons of additional production that's coming online. We don't know if all of that will come online or not but it has the potential for that.

Scott Group - *Wolfe Trahan & Co. - Analyst*

And is the new Illinois Basin coal, is that longer-haul than the traditional app coal?

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

When we take Illinois Basin coal to the southeast for Utility, it is a longer haul than Central App.

Scott Group - *Wolfe Trahan & Co. - Analyst*

Okay, great. And then just lastly, just higher level question for you, Don or for Wick. It feels like entering 2011, there is an opportunity to price the overall business a bit more aggressively to catch up with the market, and wondering where you think you stand today relative to the market. Is there another year or so if you want to call it catch up where you can price aggressively or do you you're now more in line with the market and overall pricing increases maybe moderate a bit?

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

Well, we price to the market and the truckload market based on some of the forecasts for 2012 projects that that industry will be running at 98% of capacity. If that projection is true and we think it is, we have every reason to believe that pricing as a result of the marketplace with truck will be robust continuing to be a good opportunity for us. Barge capacity is also very tight and we think that between those two modes if both are tight, transportation demand is such that the capability of pricing above the rate of our rail inflation will be there.

Scott Group - *Wolfe Trahan & Co. - Analyst*

Okay, thanks for the time guys, appreciate it.

Operator

Chris Ceraso, Credit Suisse.

Chris Ceraso - *Credit Suisse - Analyst*

A couple of items, it seems like the change in your operating ratio from Q3 to Q4, it increased a little bit more than it typically does and I know that there's a lot of noise in any given year but do you recognize that things were a little bit weaker than typical? Was it the incentive comp that you mentioned, was it a change in mix, was there some slowdown in your pricing growth, anything that we should note?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

I think Chris the headwind in the operating ratio to the extend that there was one in the fourth quarter was really more fuel driven, we mentioned the negative fuel surcharge lag effect and that held back operating ratio improvement to a meaningful degree. But you look at incremental margin in the quarter on a reported basis 39% versus third quarter's 44%, again thinking about the negative lag effect in the fourth quarter and a positive lag effect in the third quarter pretty comparable really.

Chris Ceraso - *Credit Suisse - Analyst*

Is that something that should get back towards 50% as we go forward?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Well, it will be affected to some degree by the trend in fuel, and WTI has moved up so we've got a higher basis at least thus far into the first quarter, that will be a factor, and we'll just have to see as far as other elements of the results are concerned.

Chris Ceraso - *Credit Suisse - Analyst*

Okay. And then just a quick one. You mentioned an increase in export thermal coal. What's the profit profile of that compared to export met?

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

We really, as you know we just don't get into the profitability of any particular component of our traffic.

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Chris Ceraso - *Credit Suisse - Analyst*

Was it longer-haul, shorter-haul?

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

It would be comparable in terms of length of haul.

Chris Ceraso - *Credit Suisse - Analyst*

Okay, thank you.

Operator

Keith Schoonmaker, Morningstar.

Keith Schoonmaker - *Morningstar - Analyst*

I think these are questions for Deb. At this point there's it looks like about $240 million or so of PTC spend. I'm just wondering what is that purchasing at this point?

Deb Butler - *Norfolk Southern Corp - EVP, Planning and CIO*

It's actually purchasing a lot of communications and signals work that we're getting out on the right-of-way and installing some of the equipment that we need. We're also purchasing and installing equipment for our locomotives and we are working not only internally and with vendors but with the rest of the rail industry on a very very complex technological project and that is to ensure the interoperability and to ensure that we have the technology and the communications in place to make PTC work. That is a time consuming and expensive proposition. So really it's line of road, it's systems, and it's locomotives for this year.

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

Let me add one of the host of disturbing things about this whole initiative is that because we have the 2015 mandate and it's an absolutely enormous project and just in terms of infrastructure we have to buildout we have started to buildout PTC infrastructure today that we won't turn on for several years but we have no alternative.

Keith Schoonmaker - *Morningstar - Analyst*

I see, and secondly, I guess can you speak to the deployments and maybe performance year-to-date compared to your expectations of the throttle position selection guidance software that you've shown us in the past.

Mark Manion - *Norfolk Southern Corp - EVP, COO*

LEADER has been rolled out most heavily during 2011 on our northern region between Chicago and New York/New Jersey and we've got an increasing number of our operations, we have implemented most heavily on the Intermodal side but now we've also gotten into Merchandise trains in that sector as well as beginning to run unit trains, loaded and empty. And we'll continue rolling out in that area and then about midway this year we'll also start rolling that technology out toward Atlanta through our Crescent Corridor. So we're looking forward to that.

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Keith Schoonmaker - *Morningstar - Analyst*

And has the performance met your expectations?

Mark Manion - *Norfolk Southern Corp - EVP, COO*

It really has and one of the things we've been concentrating on is getting our Locomotive engineers comfortable with the technology and as we go forward we are seeing better and better utilization of that LEADER equipment.

Keith Schoonmaker - *Morningstar - Analyst*

Thanks.

Operator

John Larkin, Stifel Nicolaus.

John Larkin - *Stifel Nicolaus - Analyst*

Had a question on the labor situation. Its been kind of a complex negotiation I guess with 13 total units, is that right? And I understand at least 10 of them have ratified the new contracts and a couple of others are putting their contracts out to vote but the Brotherhood of Maintenance of Way Workers is still in negotiation. Is there any reason to believe that that negotiation won't be wrapped up here before the end of the so-called cooling off period?

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

Well, we have, first, your numbers are correct in terms of numbers of organizations ratification. Each property has separate negotiations going on with BMWE on issues that are specific to those properties but wrapped around the BMWE's wish to have additional compensation in the form of travel expenses. I know that the negotiations are under way on every property there, they are certainly under way on ours. As to the likelihood that all of the carriers will reach agreements with BMWE prior to February 8, I really don't know that that can happen, if it doesn't then we'll clearly be back in a position of having to decide what further action is and probably even talking with congress about what might be done to avoid a work stoppage.

John Larkin - *Stifel Nicolaus - Analyst*

Okay, that's very helpful, thank you. And then your Board approved another increase in the dividend which is very nice, 9% I think you said, looks to me like your yield is somewhere around 2.5% at the current level of the stock price which leads the rail industry. Is it your strategy to continue to more or less be the dividend yield leader in the rail industry? Does that give you an advantage in some way in the capital markets, what's the general thinking there?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

John, we really don't think about the objective in terms of the yield. It's more a target payout ratio of about one-third. That's really been our guiding light as far as dividend policy is concerned.

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John Larkin - *Stifel Nicolaus - Analyst*

Okay. Thanks very much.

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Yield will be what it will be.

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

Yes.

Operator

Anthony Gallo, Wells Fargo.

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

A question for Jim and a clarification for Jim as well. Question, materials expense if I look at it on a gross ton mile basis it's continued to move higher over the last couple years particularly in 2011, could you speak to that, please? Am I looking at it correctly?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Yes, just addressing the materials and other expense increase as a category in the fourth quarter as I mentioned, that increase was $35 million or 19%. The increase did reflect a higher equipment maintenance activities and that was really one of the main drivers of the increase and we have been working hard to get our equipment fleet up to a point that we think will sustain higher volumes going forward and better service going forward.

So that's been an emphasis this year and that will be -- we'll be continuing with that next year and we're still coming up off of a base that was pretty low in 2009 when we reduced expenses significantly, so through the course of 2010 and 2011 we were ramping up materials and related spending at a faster than activity based rate. We had some other things going on in materials and other expenses in the quarter. Environmental remediation costs were five unfavorable in the comparison and a lot of little things going on there as well that made up the remainder of the 19% increase.

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

I'm sorry, is that some of the neat stuff you showed us at Altoona, and if so does that mean that there's less spend elsewhere down the road?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Certainly, I think some of that material spending will be productivity generating down the road for sure so we are investing with some of that and some of it is catch up off the 2009 low base as I mentioned.

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

Okay. And then if I can, clarification on the Chris Wetherbee question about wage and benefit inflation. I think the two numbers combined you gave was about $80 million, throw some additional on top of that. Is it right to think that wage and benefit growth year-over-year will be less than $100 million?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

I mentioned that the health and welfare cost number I cited was the activity component only and does not include a premium increase which we do believe we will sustain but at this point we're not quite sure what it's going to be.

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

Okay, fair enough, thank you.

Operator

Jeff Kauffman, Sterne, Agee.

Jeff Kauffman - *Sterne, Agee & Leach, Inc. - Analyst*

Jim, just quickly, you guys bought back a lot of stock this year. Good purchase prices but debt is up. You've got increased spend on CapEx, you've got increased spend on the dividend. When I think about share repurchase plans going forward, is there a certain level of debt whether you think about it in terms of debt to EBITDA or however you think about it that you just really don't want to go beyond right now even if the share price were opportunistically attractive?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Sure, sure. And it's true that debt is up but our debt to total capitalization ratio has been very stable and similarly, other credit metrics which actually improved some in 2011 notwithstanding a pretty high volume and shareholder distributions, and our strategy with respect to buybacks going forward will be similar to what we've done in past years and that is to dedicate incremental free cash flow, excess cash on hand, and incremental borrowing capacity within our target credit profile. So we will borrow to fund distributions as well as other uses of cash if appropriate, but keeping in mind our target credit metrics which are similar to what we have today in summary of a strong BAA1 BBB plus credit profile.

Jeff Kauffman - *Sterne, Agee & Leach, Inc. - Analyst*

Okay, congratulations, terrific quarter, thanks guys.

Operator

David Vernon, AllianceBernstein.

David Vernon - *AllianceBernstein - Analyst*

If I could refocus the conversation a little bit on CapEx, I think you said we were going to be expecting sort of bumping around that 20% of revenue number for the next couple of years; is that correct?

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Deb Butler - *Norfolk Southern Corp - EVP, Planning and CIO*

Well, we didn't specify a percent of revenue. It's just that the question was -- had to do with the continued spending on PTC and some other things that had driven it up in the last couple years and we do expect to continue to spend on freight cars on facilities on PTC, but we aren't predicting or calibrating those expenses against a percentage of revenue at this point.

David Vernon - *AllianceBernstein - Analyst*

Well, do you think the number will be coming down materially any time in the next couple of years?

Deb Butler - *Norfolk Southern Corp - EVP, Planning and CIO*

No.

David Vernon - *AllianceBernstein - Analyst*

Is there some amount of I guess I don't know clarity or expectations you can set around what type of margin gains we could get off of that higher-level CapEx?

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

Well, as Deb outlined, we don't expect any margin enhancement on PTC. We are really in the process of replacing our coal car fleet. Now, we will see productivity improvements as a result because the new cars are higher capacity than our existing fleet so you'll see some productivity enhancement there as we continue to invest in new Intermodal terminals as Don has outlined. That creates more market opportunity for us which we're comfortable we'll realize and then as we make other investments in things like technology and infrastructure we would expect to see that lead to increased network velocity and service improvements.

David Vernon - *AllianceBernstein - Analyst*

To the extent that there's some expectations around what that margin gain could be, like if I step back and look at the numbers over the last five years or so, CapEx is up about 85%, volumes off by 10%, and the margins have gained by about 170 BPS. So to the extent that the CapEx number keeps going up a lot every year, would you see some point where you'll see an inflection in the margin improvement relative to the capital spend or--?

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

I don't think we've analyzed it in quite that way. We do expect to drive additional efficiencies and some margin improvement but as to quantifying it I don't think we can do that.

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

David, we wouldn't be investing the money if we didn't think we could generate higher profits and better margin from it. PTC is a bit of an exception to that statement but otherwise the capital spending is going toward projects which we think will generate higher profits and better margins.

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David Vernon - *AllianceBernstein - Analyst*

Okay.

Operator

Neal Deaton, BB&T Capital Markets.

Neal Deaton - *BB&T Capital Markets - Analyst*

Just really quick going back to the health and welfare inflation figures, Jim. I know you mentioned a $30 million figure and then a $50 million figure, that's where Jeff was getting the $80 million earlier but I wanted to see would you mind just clarifying again if you would what those two components were?

Jim Squires - *Norfolk Southern Corp - EVP, CFO*

Sure. The $30 million I mentioned is the activity component or the employment, additional employment component of the health and welfare benefit costs increase we're expecting and that's for agreement workforce which is the preponderance of our additional workforce that we're expecting in 2012. And then there's another component of that which is the premium that we pay and that's somewhat uncertain right now. The second figure I mentioned was pay rates, a total of $50 million approximately year-over-year increase, the majority of which would be for agreement pursuant to the collective bargaining agreements we've negotiated.

Neal Deaton - *BB&T Capital Markets - Analyst*

Okay, that's perfect. Thanks so much.

Operator

Thank you. We have no further questions in queue at this time. I'd like to turn the floor back over to management for any closing remarks.

Wick Moorman - *Norfolk Southern Corp - Chairman, President and CEO*

Well, thanks for your patience, everyone, and we look forward to speaking with you all at our call next quarter. Thanks very much.

Operator

Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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