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NSC - Q4 2009 Norfolk Southern Corp Earnings Conference Call

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PRESENTATION



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Operator

Greetings, ladies and gentlemen, and welcome to the Norfolk Southern Corporation fourth quarter earnings conference call. At this time, all participants are in listen-only mode. A brief question-and-answer session will follow the formal presentation. (Operator Instructions). It is now my pleasure to introduce Leanne Marilley, Norfolk Southern's Director of Investor Relations. Thank you Ms. Marilley, you may now begin.

Leanne Marilley - Norfolk Southern Corp - Director of IR

Thank you, Scott, and good afternoon.

Before we begin today's call, I would like to mention a few items. First, we remind our listeners and Internet participants that the slides of the presenters are available for your convenience on our website at nscorp.com in the Investor section. Additionally, MP3 downloads of today's call will be available on our website for your convenience. As usual, transcripts of the call also will be posted on our website. At the end of the prepared portion of today's call, we will conduct a question-and-answer session. At that time if you choose to ask a question, the operator will instruct you how to do so from your telephone keypad.

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

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

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

Thank you, Leanne, and good afternoon.

It is my pleasure also to welcome you to our fourth quarter 2009 earnings conference call. Our goal this afternoon is to provide you with a comprehensive overview of our strategic, operational, and financial initiatives going forward. To help do that, I'm joined today by several members of our senior management team, including Deb Butler, our Executive Vice President of Planning; Mark Manion, Chief Operating Officer; Don Seale, our Chief Marketing Officer; and Jim Squires, our Chief Financial Officer, all of whom you will hear from today.

Our fourth quarter results demonstrate a continuation of the momentum we have generated since the second quarter of 2009. The results reflect a high level of performance throughout Norfolk Southern, and showcase the strength and flexibility of our franchise, our industry leading safety and service performance, and continuing strong cost discipline. Income from railway operations was \$549 million, down 32% year-over-year, driven by a 16% decline in revenues and an 8% reduction in expenses. Net income of \$307 million and earnings per share of \$0.82 were also down 32% compared with our record breaking results for the comparable period last year.

While the recession exerted pressure on volumes and revenues, we gained momentum in the fourth quarter, with the volume decline limited to single digits for the first time this year, at 9%. On a sequential basis, volumes improved 3% from the third quarter to the fourth quarter, and as Don will address in more detail in a moment, we saw a 52-week high in several commodities late in the quarter. Operationally, we continue to improve productivity. Against the 9% year-over-year volume decline, crude



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starts were down 10% and fuel consumption improved 9%. Mark will review with you additional operating efficiencies, which we expect to generate even more traction going forward.

As I mentioned, fourth quarter railway operating expenses were down 8%, with each expense category showing improvement, with the exception of depreciation and compensation and benefits. For the full year all expense categories, except depreciation, declined. Throughout the year in the face of unprecedented volume declines, our people were able to reduce our cost structure. Consistent with our balanced and deliberate approach, we made these reductions in such a fashion that many of the benefits should remain when more normalized volumes return. I am especially proud that these adjustments were accomplished while maintaining industry-leading service and safety.

Given the backdrop of continuing modest economic recovery, all of this sets the stage for an improved 2010. We remain confident in the fundamentals of our business, and continue to make strategic investments in our Company. In fact, as will you hear more about from Deb, we plan to invest \$1.4 billion in capital improvements during 2010 to maintain the safety and quality of our franchise, to further improve operating efficiency and service, and to support future business growth.

I will now turn the program over to Don, and will you also hear from Mark, Jim, and Deb. I will close with some comments about the legislative arena, and then we'll take your questions. Don?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Thank you, Wick, and good afternoon, everyone.

In my comments today I will recap our fourth quarter and year-end 2009 revenues, volume and yield, along with the key drivers of these results. I will then conclude my remarks with our outlook ahead.

Starting with fourth quarter revenue, sequential improvement in quarterly volume combined with continued pricing gains produced our highest revenue quarter of the year, at \$2.1 billion. Compared to fourth quarter of last year, revenue was down 16% or \$396 million. In the face of ongoing economic challenges, volume in the quarter was down 9% versus last year, representing \$229 million of the overall revenue decline. Another large driver of the decline was fuel-related revenue, which was down \$245 million, as the effective price of WTI oil declined by \$27 a barrel in the fourth quarter versus last year. In addition, we saw a \$15 million negative lag effect in our fuel surcharge program during the quarter versus a \$130 million positive lag effect last year. But as seen throughout the year we continued to generate improved pricing, which along with a favorable traffic mix contributed a positive effect offset of \$78 million in the quarter.

Turning to slide three, revenue for the year of \$8 billion was down \$2.7 billion versus 2008. The primary drivers of the decline were volume, which was down 19%, or a little over \$2 billion, and fuel related revenue, down \$1.3 billion for the year. Pricing and mix effect added \$581 million to total revenue for the year, as we continued to match price with our high-quality service delivery in the transportation marketplace.

Turning to yield on slide four, revenue per unit for the quarter was \$1,343, falling \$107 or 7% below fourth quarter 2008, which was our third-highest RPU quarter ever. For the year, RPU of \$1,338 fell \$113 or 8%. Reduced fuel-related revenue was the driver for both the quarter and full year decline, impacting RPU by \$156 and \$210 respectively. Our commitment to service delivery and value resulted in an average pricing gain of 4% for the quarter and 6% for the year. We achieved these results despite excess trucking capacity, which lowered truck rates an estimated 10%. Also we saw 17% decline in the [Rkf] rate escalator during the quarter, which primarily impacted certain coal contracts. Moderation in pricing for the quarter was due to three primary factors -- the timing of contract renewals and our book of business, which had the largest impact; some one-time coal contract adjustments in the quarter; and increased competition in the marketplace that I just mentioned. We expect the contract timing effect we saw in the fourth quarter to normalize in the first quarter of this year.



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Now turning to slide five, total shipments of \$1.57 billion fell 9% below fourth quarter 2008. This decline was slightly offset as three of our business groups produced year-over-year increases for the quarter. Agricultural gains were primarily driven by improvements in three markets. Export soybean volumes were up for the quarter, following a poor South American harvest. Ethanol volume was up 22%, as new terminals were added to the network. And fertilizer volumes grew as the result of improved demand in the phosphates market. Chemicals volume increased in our four major chemical markets, supplemented by strong project growth. Automotive volume increased, with improving auto sales and easier comps to for the fourth quarter of last year. During the quarter, North American light vehicle production was up 1%, led by Ford's 28% production increase and Toyota's 42% increase over the same period last year. Finally, our domestic intermodal business, which was flat for the year, was up 5% in the fourth quarter, primarily from highway conversions. We continue to be encouraged by the significant opportunity that this huge market represents.

Turning to slide six, I will conclude my quarterly volume discussion with coal. Although our total coal volume declined by 19% in the quarter, export met coal shipments shown here increased by 31% over the fourth quarter of 2008. This represented the highest volume of any quarter in ten years, led by shipments through Lambert's Point in Norfolk. Increased demand in China, longer vessel queues in Australia, and a shortage of coal in Russia created opportunities for US coal producers to export coal, both into Europe and South America. We expect this opportunity to continue through 2010.

As shown on slide seven, domestic utility coal is more uncertain, as lower electricity demand, based on the economy, competition from natural gas, and above normal stockpiles continue to impact demand at this time. But our expectation is that this market will start to improve by midyear and ramp back up in the second half of 2010.

With respect to year-end volume totals, as shown on slide eight, it was one year ago that our volumes started to fall off, as fourth quarter 2008 shipments fell 9% below strong third quarter results. This negative trend continued in the first quarter of 2009, and after reaching the bottom in the second quarter, our three major business sectors saw sequential improvement in quarterly volumes for the remainder of the year. Our second half volume increased 8% over the first six months, and we ended 2009 with our highest volume quarter of the year as automotive, agriculture and intermodal produced 52-week high car loadings during this period. For the year, total volume of 5.96 billion units fell nearly 1.4 billion or 19% below 2008, as a result of continued softness in consumer demand, along with a weak but improving manufacturing environment.

Now let's turn to slide nine and our outlook. We expect to maintain the volume momentum from the fourth quarter as we head through the new year. Growth will come from a slowly improving economy, and specific projects that we've been able to identify and implement. In that regard, our January merchandise and intermodal loadings are expected to be up 5%, with several markets such as chemicals approaching 52-week high loadings. Economic growth in our core chemical markets, and strong project growth, will add volumes throughout the year.

In agriculture, we expect continued growth due to a surge in the export soybean market through April. Fertilizer volumes should continue to recover as phosphate fertilizer production ramps back up, and 12 new ethanol terminals and three new ethanol plants will help drive further expansion in this market. As I've just mentioned, we remain optimistic about the prospects for our export met coal business. And finally, domestic intermodal's positive momentum following a 5% gain in the fourth quarter is expected to build into 2010. Highway conversions continue to escalate, and a great example of this is the month of December, in which our domestic business surged by 13% over last year.

As shown on slide ten, we're somewhat cautious about the next group of markets, but still expect some opportunity to maintain or modestly grow volumes in each segment. With respect to metals, global steel demand is projected to increase, resulting in a 17% gain in steel production, which we anticipate will lead to improvement in steel opportunities. New business recently secured will also play a role in this growth. With respect to utility coal, as I've just mentioned, we expect some recovery in this market in the second half of the year, when we anticipate that stockpiles should return to more normalized levels. We're also somewhat optimistic that our paper business will improve during the year, and it's already off to a good start, reaching a 52-week high in loadings in mid-June. Paper and forest products volume should see the positive effect of the rebound from historical lows in the housing market, and the resulting growth in lumber shipments. And new project growth should enhance paper



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volume for the year. And finally, we now see a modest increase in the auto market, as sales and production are expected to increase by 17% and 28%, respectively, for the year. While we will have the volume impact of about 33,000 less loads this year as a result of not handling as many shipments in and out of the Ford Mixing Center, as a result of the Ford Mixing Center redesign, we will volumes flat or slightly above last year, and revenues substantially above 2009.

Turning to the next slide, slide 11, we have only one market that we expect to continue to be down this year, and that's international intermodal. This is a market driven by the consumer and global trade patterns. Our volume in this sector was down 30% for all of 2009, and down by 22% in the fourth quarter. In our view, it will take most of 2010 for this market to show any appreciable recovery.

Now, in closing, we're encouraged by our results for the fourth quarter and the second half of the year, and looking at January volumes, we remain optimistic that we will see gradual but visible economic recovery in most of our core markets. This gradual recovery in demand will be supplemented by new projects that we implemented throughout 2009, and in many cases are now generating new volumes of business. In terms of service delivery, our network remains strong, and we're ready to handle new business in all of our markets. And we remain committed to providing the best customer service in the industry. From this strong service platform, our pricing strategy remains very consistent. We now have approximately 70% of our 2010 book repriced; the results of these repricing efforts meet our clear objectives of maintaining pricing above the rate of rail inflation to support both continued investment in service and efficiency.

Thank you for your attention, and I will now turn the program over to Mark for the operations report. Mark?

Mark Manion - Norfolk Southern Corp - EVP of Operations, COO

Okay, thank you, Don, and good afternoon, everyone.

Let's start with safety. Preliminary numbers show Norfolk Southern with an injury ratio of 1.08 for 2009. We continue to place a priority on the fundamentals, including rule compliance and employee engagement in the safety process.

Turning to operating performance, as we've gone through the year, we have right-sized our operating plan to match our volume. The green line indicates train starts, and as Don mentioned car loads declined through first half of the year. Train starts were 10% lower in the fourth quarter when compared to the same period last year, and 14% lower for the year. While train starts are one of the big levers we can pull in managing costs, we don't do it in a vacuum. We monitor and manage other service and cost drivers, such as car days, car handling, and car miles. As we adjusted our operating plan, first around decreasing volumes, then increasing volumes, we also monitored car days, shown in blue; car handling, next line shown in brown; and car miles, shown in gray. As we sized our operating plan, we were careful not to disrupt customer service or network velocity. You can see these key indicators were not adversely affected by the volume changes and, in fact, improved in some areas.

Turning to the next page, you see that while cars in storage peaked during late Spring, they declined and leveled off at the end of the year at around 20,000 cars. On the next slide, you see the same holds true for locomotives, ending the year around 200 locomotives in storage. On slide six, you can see with fewer train starts, locomotive fuel consumption was down 9% year-over-year.

Moving to the next slide you see train and engine employees finished the year down 12% from fourth quarter last year. Since the low point in the second quarter, total train and engine employees have increased 2%. Over the same period crew starts have increased 4% and car load volume increased 11%. Under our composite service measure, while we improved year-over-year 2.4%, the last half of the year was a challenge, and we did not have year-over-year improvement in the fourth quarter. We attribute this to the rate of operating plan changes and also to some disruption in our southeast service area. However, volumes have stabilized and so has the operating plan. Particularly since the holidays, we've seen a strong recovery in train and connection performance, and fully expect this improving trend to continue.



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On the last page, this summary scorecard highlights some of our achievements in the face of a struggling economy and continuing weak car load volume. While car loads were down 9% below the same period in the prior year, through ongoing efforts to adjust our operating plan, crew starts were reduced 10%. Across all departments, employment was reduced 9%. We also continued efficiency gains with improvement in key measures, including gross ton miles per employee per gallon and per train hour. Car hire days per car load remain flat, indicating that network velocity remains stable, even with significant adjustments to the operating plan.

I will now turn the program over to Jim Squires.

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

Thank you, Mark.

I will now review our financial results for the fourth quarter and bottom line results for the full year, and I will close with some observations about the year ahead. Let's start with our operating results. As Don described, railway operating revenues for the quarter were \$2.1 billion, down \$396 million or 16% compared to the fourth quarter last year, which was bolstered by a substantial fuel surcharge lag benefit of \$130 million.

Slide three shows our operating expenses, which decreased by \$132 million or 8% for the quarter. Income from railway operations was \$549 million, down 32%. The substantial decrease in revenues, driven by lower fuel surcharges and volumes, was partly offset by lower operating expenses. The resulting operating ratio was 73.9%, compared to our all-time record of 67.5% a year ago.

Turning to our expenses, slide four shows the major components of the \$132 million decrease. As you can see, cost control efforts contributed to significant savings in materials and other expenses, which were down 26%, fuel, which was down 18%, and purchased services and rents down 11%. Without the impact of higher stock-based compensation, compensation and benefits would also have been lower.

Now let's go through the details, focusing first on the materials and other expense category on slide five. Reductions in material spending contributed \$15 million. This was largely due to lower consumption of locomotive and freight car materials, due in part to stored locomotives and freight cars. Second, casualties and other claims benefited from favorable claims development and reduced personal injury accruals, which together totaled \$12 million. Third, other expenses reflected decreased bad debt, travel, taxes, and miscellaneous expenses.

On slide six, we see that fuel expense declined by \$48 million or 18%. As Mark noted earlier, fourth quarter locomotive fuel consumption was down 9%, which well exceeded the 6% decline in gross ton miles in the quarter. This accounted for the vast majority of our \$25 million consumption-related fuel savings.

As shown on slide eight, lower prices provided a \$23 million benefit. Our \$1.98 average price per gallon was 10% lower than the \$2.19 we paid in fourth quarter of 2008. Purchased services and rents decreased \$43 million or 11%. Slide ten gives some examples. Equipment rents declined \$9 million; transportation services and operations, which includes crew transportation and automotive costs, fell 8 million; mechanical expenses were down \$6 million, largely due to fewer freight car repairs, and intermodal expenses declined \$5 million. Other reductions of \$15 million reflect cost control efforts throughout the Company.

Next, on slide 11, compensation and benefits increased by \$4 million or 1%. Slide 12 shows the major components. First, stock-based compensation increased \$54 million. The large swing is due to two factors. First, our stock price declined significant in the fourth quarter of 2008, while it increased in the fourth quarter of 2009. And second, performance metrics deteriorated in the fourth quarter of 2008, while improving in the most recent quarter. Second, wage rates increased \$14 million, reflecting agreement pay increases in July 2009. Third, pension costs increased \$10 million, primarily due to last year end's reduced asset



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values. Fourth, volume related labor was down \$40 million, of which about \$19 million was T&E related. The remaining \$21 million was mostly reductions in engineering and mechanical activity levels. Fifth, incentive compensation was lower in 2009 as we lapped strong financial performance in 2008. And finally, payroll taxes and other compensation expenses decreased by \$10 million.

Now let's turn to non-operating items on slide 13. Interest on tax deficiencies was a favorable \$14 million, reflecting the IRS's completion of its review of our 2006 and 2007 returns, and the resolution of state tax issues. Corporate-owned life insurance benefited from higher returns, and interest expense was up \$7 million.

As illustrated on slide 14, income before income taxes decreased \$252 million or 35%, principally due to lower operating income. Income taxes were \$160 million, and the effective tax rate was 34.3%. Income taxes last year were \$267 million, with an effective rate of 37.1%. The decrease in the effective rate in 2009 was due primarily to the resolution of state tax issues and improved returns from corporate-owned life insurance.

Turning to slide 16, fourth quarter net income was \$307 million, a decrease of \$145 million or 32%. Diluted earnings per share were \$0.82, which was \$0.39 per share or 32% below last year. For the full year, as shown on slide 17, net income was \$1 billion compared to \$1.7 billion in 2008. Earnings per share declined from \$4.52 to \$2.76 per share.

Turning to slide 18, even with the decline in net income, cash from operations in 2009 was more than adequate to cover capital expenditures and dividends and, as in the past several years, yielded incremental free cash flow, which this year we used to boost liquidity.

Before I conclude, let me briefly cover a few factors we expect to pressure operating expenses in 2010, beyond the anticipated volumetric increases from higher car loadings. First, based on the forward curve for oil prices, we expect significantly higher fuel costs. Second, we expect additional annual compensation expense, including payroll taxes from higher union wage rates. Third, union health and welfare expenses will rise due to higher premiums. We estimate these higher pay rates and health and welfare premiums combined will increase quarterly compensation expense by \$37 million. We are also likely to experience higher expenses for incentive compensation, and casualties and other claims.

In summary, in 2010 we are projecting strong operating cash flow and financial performance driven by top-line growth, cost control, and productivity. Our balance sheet is in fine shape, having weathered the downturn admirably, and our access to credit markets is excellent. Debt payments in 2010 are just \$474 million, and based on the current schedule will decline from there over the next four years. Our pension plan should not require any funding in 2010.

As we generate free cash flow, we will continue to view dividends as priority mechanism for distributions, and will remain flexible with regard to share repurchases. And finally, as Deb Butler will cover next, we plan to maintain our commitment to capital investments, keeping our rail networks safe and efficient, and providing for future growth.

Thank you for your attention, and now we will turn the program over to Deb.

Deb Butler - *Norfolk Southern Corp - EVP of Planning, Chief Information Officer*

Thank you, Jim. Good afternoon.

The strategic drivers of Norfolk Southern's 2010 capital budget remain much the same as they were in 2009. Planned expenditures include investments to maintain the safety and quality of our existing franchise, to improve service quality and performance, and to support business growth. Investments to support our Track 2012 initiative are woven throughout the budget.



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As shown on slide three, total planned capital investment in 2010 is \$1.44 billion. This is roughly equal to our initial 2009 budget. However, will you recall that we reduced planned spending in 2009, primarily for locomotives, facilities, and infrastructure, as the magnitude of last year's economic contraction became clear. As a result our 2010 plan is 11% higher than actual 2009 spending. As in previous years, about 75% of our capital expenditures will be invested to ensure the continued safe and reliable operation of our railroad. This includes protecting the condition of our right of way, replacing equipment, and complying with safety and regulatory requirements. The remaining 25% of our 2010 budget supports the growth, efficiency and productivity of our franchise. Included in this category are projects to improve and expand track and terminal infrastructure, and to support the key drivers of our Track 2012 initiative -- service improvement, fuel efficiency, asset utilization and workforce productivity.

On the next two slides, I will provide more detail about each of the categories of capital expenditures highlighted on the slide. As shown on slide six, almost half of our budget is allocated to keeping our right of way in the condition needed to move our customers' business safely and reliably. Roadway spending in 2010 is budgeted to \$706 million or 49% of our total capital budget. Our roadway budget funds the replacement of rail, ties and ballasts, as well as the improvement or replacement of bridges and culverts. In 2010 we plan to replace 341 miles of rail, 2.6 million crossties, and 2.9 million tons of ballast. Investment in facilities and terminals throughout our network will total \$184 million or 13% of planned capital expenditures.

About half of the increased spending in this category is associated with investments in new terminals for the Crescent Corridor. Other facility investments to support our intermodal network include continued work on our new Charlotte terminal, as well as facility upgrades and expansion in the Chicago area. Non-commercial facility investments include new locomotive facilities in Atlanta, Georgia and Pittsburgh, Pennsylvania; the renovation of several buildings used by transportation and mechanical; and new or upgraded waste water treatment plants. As Don alluded to in his remarks, facilities for handling ethanol and other industrial products are among the investments we'll be making to support other marketing initiatives.

As shown on slide ten, investments in computers and technology are budgeted to be \$140 million or 10% of the capital budget. Norfolk Southern has made significant capital investments in technology in recent years, and that trend will continue in 2010. New or enhanced technology will be introduced throughout the year to improve safety, increase operational efficiency, improve fuel and equipment utilization, and to better plan and manage our network.

I will highlight a couple of the major projects. We're introducing SAP in our financial, human resources and material management systems. That effort will continue throughout the year, with implementation scheduled for the first half 2011. LEADER, a locomotive engineering coaching system, is one of our major Track 2012 projects that will be expanded significantly in 2010. The long awaited movement planner functionality embedded in our unified train control system will come on line this year as well. Finally, we will spend \$40 million on development of the federally mandated, but not funded, Positive Train Control project. We expect the total cost of PTC on Norfolk Southern to exceed \$700 million by the end of 2015.

Investments in infrastructure are budgeted to be \$110 million or 8% of capital expenditures. In addition to ongoing network improvement projects, investment in our previously-announced mid-America corridor initiative with Canadian National begins in 2010. You will recall that one of elements mid-America is an alternate route from Chicago to the southeast. We're also continuing to invest in public/private partnerships, such as the Heartland Corridor, which will be completed mid-year, and the Chicago CREATE project. The Crescent Corridor initiative is another prominent public/private partnership. And although there's some moderate infrastructure investment planned for 2010, the majority of the 2010 spending for intermodal terminals to support the corridor is included in the facilities and terminals category.

As shown on slide 14, equipment spending will total \$81 million or 5% of our expected capital expenditures this year. We do not plan to acquire new locomotives, at least of the traditional variety, in 2010. This is due partly to higher levels of acquisitions in previous years, and partly to asset utilization improvements, many of which are tied to Track 2012 initiatives. We will have, however, continue to make capital improvements to the fleet to maintain capacity and improve efficiency and reliability. Emission kits for both GE and EMD locomotives will be installed to meet Government requirements. And as we continue to explore alternative sources for locomotive power, we will expand our hybrid initiative to construct additional four-axle GenSet locomotives, and another six-axle battery locomotive. We will also take advantage of new technology to construct several locomotives with



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low-emission internal combustion engines. We do not plan to purchase freight cars in 2010, although the budget does include a small amount for freight car capital repairs.

Projects that fall outside of the categories I have previously described total \$221 million or 15% of our planned capital spending in 2010. These include core investments such as communications and signal projects, the replacement of vehicles and roadway machinery, and public improvements such as grade crossing separation.

To summarize, the \$1.44 billion planned for 2010 capital investment represents an increase of \$143 million or 11% compared with actual 2009 capital spending. Our 2010 capital budget is a reflection of, and consistent with, our continued confidence in our Company's long-term prospects for growth.

Thank you, and I will turn the program back over to Wick.

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

Thank you, Deb.

As you can see, we continue to make significant investments in our Company, based on our belief in our prospects for 2010 and beyond. While our traffic is still depressed on a historic level, we have seen positive momentum in terms of both volume growth and operating efficiencies; and as evidence, as you heard from Mark, when you compare to our low watermark of the second quarter, fourth quarter car loads are up 11%, while comparable T&E headcount is up only 2%, and crew starts are up just 4%. That's great operating leverage, and it's our plan and expectation that we will maintain this kind of leverage, provided that -- and it's always a big if -- we continue to see some reasonable level of economic growth this year.

The biggest black cloud on the horizon for Norfolk Southern and the industry is obviously the threat of unbalanced legislative action. You have already seen one example of this in Deb's discussion of our 2010 capital spending on PTC. While the \$40 million we're projecting for PTC CapEx this year did not force us to exclude any other critical items from our capital budget, it's just an installment towards what will be a total expenditure of well over \$700 million over the next five years. For that expenditure of over \$700 million, by the Government's own estimates, we will receive only \$1 in benefit for every \$22 spent. And that imbalance has risen as a result of FRAs proposed implementation rules, which would force us to extend the technology far beyond the legislative mandate.

The upshot of this ill-conceived, if well intentioned, unfunded mandate, and its associated rule making, is that we will be forced to forgo major capital expenditures for other critical areas of our property over that five-year period. And the result may well be less capacity than is required to handle traffic volumes, a diminished ability to provide good service, and even possibly a less safe working environment than we might have had otherwise.

Now, if PTC was the only thing to come out of Washington it would be bad enough, but as you all know, we are also facing the possibility of significant changes in the regulatory structure under which the rails operate. Without belaboring the issue, the bill which emerged from the Senate Commerce Committee at the end of last year was a disappointment to say the least, particularly given the dialogue that the industry had had with the Commerce Committee staff over the course of 2009. As you have already heard from some of my peers, it is not legislation that Norfolk Southern or the industry can support in its current form. We are certainly not giving up on the process, and we will continue to work with the Commerce Committee on changes which will be essential if we are not to oppose the bill.

We're also working with members of both Houses on both sides of the aisle to explain to them how the bill needs to be modified, to ensure that it provides for what I believe the vast majority of the Congress and the American public want -- a healthy, robust national rail system, which can continue to invest and continue to play a major role in addressing this country's growing



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infrastructure demand. At the end of the day, I believe that Congress will vote to encourage and expand our industry, rather than consign it to the conditions we experienced in the dark days before the Staggers Act of 1980.

In summation, I believe that our best days are before us. We have a great company and a great team, and it's our intention to take the positive momentum that we generated in the past two quarters and continue to move ahead, providing increasing value for our customers and our shareholders.

Thanks. We'll now take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, we will now be conducting a question-and-answer session. (Operator Instructions). Our first question is coming from the line of Mr. Jason Seidl with Dahlman Rose & Co. Your line is open. You may proceed with your question.

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

Thank you. Wick, team, Good afternoon. A couple quick questions. Don, just to make sure I understood you, you mentioned that there was a coal true-up for a contract, but that was last year's contract, that didn't happen in the fourth quarter, did it?

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

Jason, this is Don. We're referring to nonrecurring contracts' adjustments for some coal in the fourth quarter of 2009.

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

2009. Could you quantify that for us a little bit in terms of dollars?

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

It was approximately \$9 million.

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

\$9 million. Okay. Thank you very much. I guess I will just talk a little bit about leverage. With volumes up over the third quarter, and your productivity increasing nicely, and especially your met coal exports hitting a record number, I'm surprised to see the numbers weren't a little bit better than they were in the quarter. Was there anything else that you guys didn't touch on that might have been holding back margins on a sequential basis?

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

Well, I think Don hit all the highlights. The first, and I think foremost, is just kind of some of the timing of our contract renewals. As we have always said, they're not ratable on a quarterly basis. On top of that, we had the adjustments that Don mentioned,

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and it is -- as Don also mentioned, it's a more competitive marketplace out there, and we respond to that as well. But we were very comfortable with our fourth quarter pricing, and as Don said we continue to see positive pricing as 2010 progresses.

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

Okay. And, Wick, one more before I want to turn it over to somebody else, because I'm sure there's people on line here. A lot of the railroads, as you noted, spoke out against this bill on Capitol Hill here, and also laid out the case for Positive Train Control can probably adjusted a little bit. What else is there left that you guys can do in terms of lobbying? That's one. Two, do you think this is even a 2010 issue, given the current political environment? And three, if you are to forgo -- if you to have to forgo investments down the road before 2015, which one of your current projects will be the one that will be most impacted?

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

Well, let me answer them in reverse order. We have not reached any conclusions about what we will actually do or not do from 2011 onward in terms of CapEx. We'll make those decisions as we see how the year unfolds, and see what our other requirements are. In terms of 2010 being a year in which something might be addressed on this by the Congress, I don't know that 2010 is the year. As you point out, there are other issues in Washington these days, but I think it's important, and I think that all of the other CEOs in the industry think it's important, to start today to educate members of Congress as to what the implications of this legislation are. And we are out talking to folks, and quite frankly, I think there are substantial number of legislators who did not really understand what the impact of this might be on the industry, in terms of the dollars required, and they also did not understand the cost/benefit ratio that actually exists for the technology. So we're in an education mode right now, and we'll continue that, and then we'll see how it develops.

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

it seems like you're going to have some time to further educate some people on Capitol Hill.

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

Well, it's an ongoing process, Jason.

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

I appreciate the time as always.

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

Thank you.

Operator

Our next question is coming from the line of Mr. Tom Wadewitz with JPMorgan. Your line is open. You may proceed with your question.

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Thomas Wadewitz - JPMorgan Chase & Co. - Analyst

I wanted to ask you a little bit more on pricing. You talked about the base rate deceleration a bit. I think one of things Don mentioned was an increase in competition in the market. Are you referring, Don, to what's happening with respect to the more truck sensitive business and intermodal, or are you indicating the dynamic between you and CSX has changed somewhat, or what are your thoughts behind that comment?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Tom, as I mentioned, we've seen truck pricing move down in the depressed economic environment in which we're operating. Of course, pricing across transportation right now is more challenging than it was a year ago or the year before.

Thomas Wadewitz - JPMorgan Chase & Co. - Analyst

So is that more rail competition or more truck competition?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

It's all of the above.

Thomas Wadewitz - JPMorgan Chase & Co. - Analyst

All of the above, okay. And I think some of the items that you highlighted on the cost side, that Jim highlighted, would indicate that rail inflation would be perhaps a bit stronger in 2010 than what we might think as an ongoing number. So if rail inflation is 4% instead of maybe normally 2.5% or 3%, are you considering that when you say you will get pricing that's better than rail inflation in 2010?

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

Yes, we are, Tom. And your conclusion, I think, about our rail inflation for 2010, as Jim outlined, is a correct conclusion.

Thomas Wadewitz - JPMorgan Chase & Co. - Analyst

Right. Okay. One more, and I will pass it along. In terms of coal view, seems like there's a lot of uncertainty about how quickly coal will potentially improve, and I guess the more negative comment from your Eastern competitor and maybe a little more optimism in the West, but what is it that makes you think that -- what are your assumptions behind the view that you feel that coal might start to show some year-over-year growth in midyear?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Tom, two basic things. One, we're seeing incremental improvement in manufacturing and industrial demand. The second is that the weather pattern that we're seeing within our service territory is a weather pattern that's driving stockpiles downward. To put some color into that, the first two weeks of January we have input from some of our larger utilities directly that indicate that their stockpiles have declined by as much as 12% in those first two weeks. Also, generation peaks have been hit within the first two weeks of January, which generally in the Southeast, the Mid-Atlantic are hit during the summer, not during the winter.

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So these are very unusual peak generation periods, and looking at the data, we feel comfortable that with the continuation of an improvement in the economy, plus this type of weather pattern that we're seeing, we are seeing stockpiles mitigated to the extent that by the end of the first half of this year we should see utility coal start to move back up.

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

Tom, I will put a little bit of color on that. They're calling for the possibility of snow in Norfolk this weekend, and we will all enjoy it if it snows.

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

And a low of 14 degrees.

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

Interesting weather in Norfolk this year, indeed. Thank you for the time, I appreciate it. Very helpful.

Operator

Thank you. Our next question is coming from the line of Mr. Matt Troy with Citigroup. Your line is open. You may proceed with your question.

Matt Troy - *Citigroup - Analyst*

Thank you. Question for Don on the automotive front. Was wondering, Ford contract was up for renegotiation, which I believe closed in the fourth quarter, that was a deep legacy pricing opportunity. Was wondering if you could just frame directionally, did pricing come in in a range that you would have expected? Does that take effect in the first quarter, and is that your largest customer or one of your top three customers, I believe? Did you see any share gain on that contract in the latest renegotiations?

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

Matt, first, with respect to that legacy contract, it did expire at the end of 2009, and we do have new economics in place January 1st. We are pleased with the outcome of that renegotiation, and as I mentioned, we redesigned the use of the mixing centers in that legacy contract, and in 2010, the result of that redesign is we will be counting 33,000 less loads in and out of each mixing center, so we won't have the double count that we had in prior years. What we will see, though, is in our automotive total -- market in total, we expect that market to be flat to improving volume for the full year, and a substantial increase in revenue in 2010 over 2009.

Matt Troy - *Citigroup - Analyst*

On a near term basis, obviously the highly publicized problems with Toyota, you know, today talking the about halting production of eight of its ten top models. Have you been in dialogue with Toyota? How much of your book of business might be exposed to that? I know it's a near-term blip, but probably a sizable one for a week or so at least. Could you put some color around that?

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Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

We're pleased to say that Toyota is a major customer. We do see this as a short-term phenomenon. They're making the decision they feel they need to make. We don't feel that will have any material impact on us for the quarter or the year.

Matt Troy - Citigroup - Analyst

Thanks, Don. One follow-up for Wick, if I could. A lot of the questions recently I've been getting with the longer-term focus center around the opportunity for Eastern port share gains, specifically with the widening of the Panama Canal. Just wondering if you could put some thoughts around that, and maybe Don if you could weigh in. Specifically, are you looking at the potential for share gain into the East Coast ports as that canal gets widened in the next couple of years? Are customers actually talking about it, or is this more of an economic exercise, and what might be the opportunity there longer term?

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

Matt, I will let Don provide most of the color. I will tell you that we obviously are looking at that, as are a lot of people, and in fact, you hear some wildly divergent opinions about what it will ultimately mean for share. As we've talked before, we've clearly seen a substantial growth in East Coast business, and Don can give you some color on how our share of international intermodal business has shifted over the past five years. We think that the new canal offers some bright opportunities for some of the East Coast ports. We're certainly investing accordingly. The Heartland Corridor project is a big part of our plan for that, because we think Hampton Roads is a great port for a lot of that traffic. Don, why don't you add a little to that?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Matt, obviously we are positioning ourselves, as we've said in previous calls and communications, to participate in international growth over either coast. We want to be bi-coastal. But as the investments are made in infrastructure in the Panama Canal, and we have deep water draft ports on the East Coast, we're well positioned for continued growth through those East Coast ports; both at Savannah, Port of Hampton Roads, and on up the coast, the Port of New York as well. So we anticipate the opportunity for greater growth, but with that said, we have a firm eye on continued growth over at the West Coast ports as well.

Matt Troy - Citigroup - Analyst

I understand. Thank you for the color, guys.

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

Thank you, Matt.

Operator

Thank you. Our next question is coming from the line of Mr. Ken Hoexter with Banc of America Merrill Lynch. Your line is open. You may proceed.

Ken Hoexter - Banc of America/Meririll Lynch - Analyst

It seems like we're seeing some sequential increases in volumes, and I know you, Jim, touched on this before, but maybe a little bit more detail. It's just that we're not seeing the upside leverage on the fixed network that I thought we would see, and it

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seemed like everybody talked about how you wouldn't see expenses coming back on a one-for-one basis. So looking at that 640-basis point deterioration year-over-year in the operating ratio, what -- how do you guys look at the potential for improvement as these volumes come on? How much capacity is on the network now, as you see those volumes coming back on?

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

Thanks, Ken. This is Jim. Let me comment first on the year-over-year operating ratio decrement, and I think the perspective that we might want to include on that is to adjust both the revenue and the expense for the fuel price variance, and if we do that and work that through, the decrement -- the 640-basis point decrement year-over-year turns out to be something like about 70 basis points, and it had a significant effect on EPS as well. So on a year-over-year basis, certainly fuel was a significant part of the EPS decline and the operating ratio increase.

Going forward, we are confident that the sequential improvements in volume will be accompanied by productivity improvements and operating leverage. That's what we think we have seen in the last two quarters, and we'll continue to see as the volumes continue to pick up, we hope.

Ken Hoexter - *Banc of America/Merill Lynch - Analyst*

So when you talk about seeing it the last two quarters, I'm just looking at the operating ratio deteriorating sequentially from third to fourths quarter, what are you -- where are you seeing that, and to come back to that question, how much capacity do you think you still have in the network before you have to bring back some of those costs? I know you said the locomotive chart, you still have 300 sitting aside. How much, if you think about the cars and such, how much volume do you think you can handle before you start bringing back additional equipment?

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

In terms of the sequential operating ratio trend, Don went through a couple of nonrecurring factors in revenue in the fourth quarter of 2009 which I think held back some of the operating ratio momentum a little bit in the fourth quarter. In addition, we did see a bit of a sequential headwind in fuel expense in the fourth quarter. That was up as well. So I think between those two factors, it may have held back the OR improvement sequentially a little bit, but we think that we are going to start to see that margin improvement build momentum as the volumes pick up further.

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

We also saw, Jim, the big delta fourth quarter on stock-based comp, which actually drove benefits and -- compensation benefits over 4Q of '08. So I think, Ken, what I would go back to is what Mark talked about, and that is that if you just kind of look at the operating leverage in terms of how much more volume we're handling with only a slight increase in headcount in T&E, and some of that T&E headcount increase is actually driven by hours of service rather than volume increases -- Mark, anything else would you like to add?

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

Yes, Ken, just a word about those locomotives. We did bring some locomotives back in, and some of that was for the additional unit train business related to export grain and coal business, and we hope that's going to continue on. But we also had some congestion issues that we have totally worked through, and so we've really got a locomotive fleet out there that has -- that can handle more business than what we currently have, and so we're looking forward to taking on more business with the fleet that we've got out there rate new.



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Ken Hoexter - Banc of America/Merill Lynch - Analyst

Appreciate the time. Thank you.

Operator

Thank you. Our next question is coming from the line of Mr. Chris Ceraso with Credit Suisse. Your line is open. You may proceed.

Chris Ceraso - Credit Suisse - Analyst

Thanks, good afternoon. Not to harp on this, but revenues were up a little bit from Q3 to 4, operating profit was down. Maybe you could just quantify a couple of items. How much was incentive comp or overall comp up from Q3 to Q4? And maybe if could you quantify if there was somewhat of a fuel surcharge lag that hurt from you Q3 to Q4 also?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

Oh, Chris, it's Jim. As I mentioned a minute ago, I think probably the biggest factor here was the nonrecurring items that Don mentioned in the fourth quarter revenue. In terms of other sequential factors in the expenses, comp and benefits was up \$15 million sequentially. Of that variance, stock-based compensation was a factor; that was \$6 million of the unfavorable variance. And then I mentioned fuel a minute ago. Fuel went from \$192 to \$229, and that was a \$29 million unfavorable variance in fuel sequentially, and about 50/50 price and usage as well.

Chris Ceraso - Credit Suisse - Analyst

Okay. There's a mention in the deck about an increase in wage and benefits to 2010; either in dollar terms or percentage terms, what do you think that will be for the full year 2010 versus 2009, how much of an increase?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

In prepared remarks, I cited a \$37 million quarterly compensation expense increase in 2010, and that's for higher pay rates and health and welfare premiums combined.

Chris Ceraso - Credit Suisse - Analyst

Does that include any change in pension, or will there be any change in pension expense?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

That excludes any pension effect, and pension costs will be up somewhat as well for 2010. However, as I mentioned, we don't expect to make a cash contribution to our pension fund.

Chris Ceraso - Credit Suisse - Analyst

Okay. And then just the last one. You mentioned that you thought automotive volume would be flat year-over-year after accounting for the 30,000-odd change because of the way you're mixing the Ford business. What's the underlying assumption, either in terms of vehicle sales in the US or vehicle production in North America, that gets to you that flat number?

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Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Chris, this is Don. As I mentioned, we're expecting sales and production to rise in automotive from low levels in 2009, but based on that improvement in the overall sales and production forecast, and our position with respect to our accounts, that's where we're coming one either a flat or a modest growth in that volume for 2010.

Chris Ceraso - Credit Suisse - Analyst

Were there any plant closures, Don, that would cause to you not participate as much with the industry as it goes up?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Could you repeat the question, Chris? I didn't catch it.

Chris Ceraso - Credit Suisse - Analyst

Yes, sorry. Were there any plants that you serve that closed in 2009, such that when industry volume goes back up maybe you will miss out on some of that?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

There's a possibility of that. We don't have that built into our assumption for 2010.

Chris Ceraso - Credit Suisse - Analyst

Okay. Thanks a lot.

Operator

Thank you. Our next question comes from the line of Mr. Walter Spracklin with RBC Capital Markets. Your line is open. You may proceed.

Walter Spracklin - RBC Capital Markets - Analyst

Thanks very much. Good afternoon, everyone. Wanted to ask a question just to clarify the pricing, because obviously this has been one of focus, and I want to make sure you're being compared apples to apples. When you look at the 4% that you mention in the fourth quarter can you give us what -- that includes the [RCAF] adjusted for fuel. Can you give that number, excluding any fuel adjustment within the RCAF?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

That 4% excludes the RCAF impact.



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Walter Spracklin - RBC Capital Markets - Analyst

So that's comparable to the 7.1% that you did in the first quarter -- or in the third quarter?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

In the fourth quarter of 2008, quarter-over-quarter, we had a 7% price and a 2% positive RCAF.

Walter Spracklin - RBC Capital Markets - Analyst

Okay. Now, you mentioned three items that -- you said \$9 million for the coal contract, nonrecurring coal contract change, can you give us, either in percentage or in dollars, the other -- the quantification of the other two, most importantly the timing of the contract renewals, because I think you said that was the biggest factor in the quarter?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

The timing of contract renegotiation, I can't give you a percentage of that other than that we expect it to normalize in the first quarter of 2010 and going forward, so we don't expect that to continue. As Wick mentioned, we don't have a ratable number of contracts in each quarter that are renegotiated and repriced, so there's a little bit of a differential quarter to quarter as we go forward on that. The RCAF was about 1 percentage point, about 100 basis points, and also we had with a positive mix effect of about \$22 million.

Walter Spracklin - RBC Capital Markets - Analyst

Okay. Wick, you mentioned when you were talking about -- Surface Transportation Reauthorization Act, you mentioned that you're going to be explaining to Congress or the committee how it needs to be modified. Can you go into a little bit of detail what those items are that need to be modified in the Act as it's proposed right now?

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

Well, there are several items that he need to be modified. Clearly the items around access, but also a significant number of other items, and I'd rather just kind of make the global comment that the point that we're trying to make is that under the Staggers Act, the intention -- the clear intent of that legislation was to let the market prevail, but provide an outlet for shippers when there was some possibility of market failure, and only to those shippers which had particular lines of traffic where there might be such a market failure.

The bill, as it's currently written, in fact turns that on its head, and, in fact, lets rulings of the Surface Transportation Board prevail in lieu of the market, and we think that that is going to be highly detrimental to our industry over the short term and the long term, and that is the philosophy we're espousing, and we're trying to point out to the committee the places where modifications need to happen so that, in fact, is not what happens.

Walter Spracklin - RBC Capital Markets - Analyst

Last question here. Now back on the operating leverage story. I think a lot of expectations are built in for all these rails for an operating leverage into 2010. Jim, perhaps if you could just give us a few examples just to manage, in terms of that expectation that's being built in, what items are not likely to go the right way in terms of operating leverage, or are likely to go the opposite way, and I mean you touched on a few, casualty reserves, incentive-based compensation, depreciation will be in there as well.



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Can you highlight the main ones, so that we -- you know, we have built in that these are the items that aren't going to necessarily move in the right direction in 2010, and then we can look at the ones that will move in the right direction?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

Sure, well certainly the ones that you mentioned. In addition, fuel; fuel is likely to be a headwind as we lap lower fuel prices in 2009. So that plus the volume metric impact on fuel expense is likely to make fuel expense a significant headwind in terms of overall operating expenses. Then I mentioned the additional compensation expense associated with higher union wage rates, that plus higher union health and welfare benefit payments will be another headwind. Then casualty and other claims, although it is difficult for us even to quantify the amount of the casualty and other claims expected headwind in 2010 because, as you know, it is an actuarially calculated number, and -- but it's likely that the string of favorable reserve adjustments we've been having will eventually run out. It's just a question of when, and what the glide path might look like, but certainly we think we will see a bit of a headwind there.

I guess in terms of the potential for operating leverage, we are really focused on the productivity metrics that we went through, that Mark went through, monitoring very closely and emphasizing internally metrics like GTMs per employee per gallon per train hour, measurements of labor productivity, fuel productivity and asset productivity. Those will be key to generating positive operating leverage and earnings leverage in 2010. So we'll be monitoring those closely, and suggest that you do, too.

Walter Spracklin - RBC Capital Markets - Analyst

That's all my questions. Thanks very much for the color.

Operator

Thank you. Our next question is coming from the line of Mr. Edward Wolfe with Wolfe Research LLC. Your line is open. You may proceed.

Scott Group - Wolfe Research LLC - Analyst

Thanks. It's Scott Group in for Ed. Afternoon, guys.

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

Afternoon.

Scott Group - Wolfe Research LLC - Analyst

Just to follow up from Tom's question from earlier, is 4% kind of the number you guys are thinking the about in terms of inflation next year, or could it be a bit higher?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

Scott, it's Jim. I'll take the question. You know, as we've been through, we are going to have some expense headwinds in the year that will be above and beyond what we would normally consider to be inflation, whether rail inflation or general inflation. The key to the year, and to generating the earnings momentum that we think we are going to generate, will be to produce

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some level of pricing based on value for services above that amount, plus volume growth, plus productivity improvement. And if we can do all that, we certainly should see the operating leverage, the margin improvement and the earnings growth.

Scott Group - Wolfe Research LLC - Analyst

And in that scenario of rising costs but the pricing and volumes and productivity, what's your level of conviction in margins improving next year? I know Wick tends to have a cloudy crystal ball, but what are your thoughts on that?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

it's relatively high, and I hope that we've conveyed that our outlook is pretty upbeat for the year. Now much depends on the economy, and it's certainly true that there is lingering concern over the direction of the economy, but based on what we're seeing now in our car loads and our customers' behavior, we're feeling pretty confident about the year to come.

Scott Group - Wolfe Research LLC - Analyst

Great. On the pricing side, Don, your comment about contract renewals, the timing normalizing into first quarter, does that imply that pricing should be better than 4% in the first quarter?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

What we're seeing there is that the activity in repricing will return to a higher level than we saw in the fourth quarter in terms of the number of authorities and contracts and specific instruments that we're renegotiating. We averaged 6% for the year and the 4% for the fourth quarter, and I think we're comfortable with those two numbers.

Scott Group - Wolfe Research LLC - Analyst

With the contract renewals coming back, is there something new coming that's going to offset that and keep us at that 4% level?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

No, nothing that -- nothing on the horizon that would do that.

Scott Group - Wolfe Research LLC - Analyst

Great. And then last question, if I can, thanks for the time, Canadian National announced earlier this week that they were starting up share repurchases again, and announced a dividend increase. Jim, any thoughts on the billion of cash that you guys have, and timing for putting that to use?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

Well, our liquidity position is secure, and I think that's a good thing given, as I said, lingering concern about the direction of the economy. But our confidence is building, and as we become more certain that conditions are, in fact, are improving, it's probable that we will deploy some of the cash on hand for distributions. Debt repayment is certainly another possibility, as is additional capital investment as opportunities arise.

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Scott Group - Wolfe Research LLC - Analyst

Okay, thanks for the time, guys.

Operator

Thank you. Our next question comes from the line of Mr. Gary Chase with Barclays Capital. Your line is open. You may proceed with your question.

Gary Chase - Barclays Capital - Analyst

Good afternoon, everyone. Just a quick one for Jim, and then just a quick one for Don. You mentioned some of the headwinds in the comp and ben line for next year. You mentioned incentive comp, but didn't quantify it. Should we be thinking that's going to be a material -- in a material swing as you move from 2009 into 2010?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

Our expectation that incentive compensation will be a headwind rests on our expectation that we will see improvements in operating ratio, pretax net income and service, all of which drive incentive compensation. As I think we've said, we are expecting the year ahead to be better in all three areas, and that will drive incentive compensation. The better the improvement in pretax net income, operating ratio and service, the higher the incentive compensation and the bigger the headwind.

Gary Chase - Barclays Capital - Analyst

Could it conceivably compare to that \$37 million number you're using on the health and wage inflation, or is it going to be considerably smaller than that?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

No, certainly not. Certainly not comparable to that number. That was a quarterly number. I'd don't expect the incentive compensation, the headwind to be that large on a quarterly basis.

Gary Chase - Barclays Capital - Analyst

Then just for Don, a lot of the questions kind of suggested -- I guess what I'm wondering is, to what extent are pricing and inflation independent of one another? Is there a way to quantify what percentage of the book has some locked amount of escalation regardless of what inflation is, and how much of it is going to move at least to an extent as a function of what railroad inflation ends up actually being next year?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Gary, unfortunately I cannot give you a number that would help you with that question. I will reiterate, though, with having the high percentage of the 2010 book already repriced 70%, and we will have a relatively active first quarter in repricing which will move that number higher, we are comfortable that our price reflects that objective that I mentioned in my comments of having a price plus an additive above the rate of rail inflation.

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Gary Chase - Barclays Capital - Analyst

Okay, and then just curious if there was anything mix-related in the ag line that might have affected the pricing comps year-on-year in that specific segment?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

No, we did not have any negative mix effect in ag. We had a very active export program in the fourth quarter, very active ethanol shipments as we've had in previous quarters, and the normal domestic feed mill cycling trains that we have.

Gary Chase - Barclays Capital - Analyst

Okay, guys, appreciate it.

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Thanks.

Operator

Thank you. Our next question is coming from the line of Mr. Jeff Kauffman with Sterne Agee. Your line is open. You may proceed. Excuse me, Mr. Kauffman, your line is now open.

Sal Vitale - Sterne Agee & Leach - Analyst

Hello? Hi this is Sal Vitale for Jeff Kauffman. Just a few questions. First question, earlier you -- I think you mentioned that domestic intermodal volumes are up about 5% for the quarter. Can you give some color on what international volumes were for the quarter?

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

Yes, international volume, as I mentioned in my comments, were off 22% in the quarter.

Sal Vitale - Sterne Agee & Leach - Analyst

Down 22%. And was that more weighted towards any month? Was any month a more disproportionate contributor to that?

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

Not really, we basically saw the ongoing trend that our export component, that number was better, and the import component was not better.

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Sal Vitale - Sterne Agee & Leach - Analyst

Okay. And then just switching to the outlook for 2010, you provided guidance of higher volumes. What is your expectation of headcount? Do you expect to do that with a continued decline in headcount?

Mark Manion - Norfolk Southern Corp - EVP of Operations, COO

I would expect that we would see headcount right around -- if, in fact, volumes do increase, I think you might see a nominal increase in headcount, but would it only be nominal. If we continue to run more trains, at some point we're going to need a few more people and maybe a few more people to build and maintain our cars and locomotives, but we are not looking for a headcount increase that would be anything like proportional to the volume increase.

Sal Vitale - Sterne Agee & Leach - Analyst

Okay, so it sounds like you're pretty much -- on the headcount side, you're pretty much at capacity, whereas for -- on the equipment side for locomotives and car loads, you still have ample excess capacity. Is that correct?

Mark Manion - Norfolk Southern Corp - EVP of Operations, COO

I think -- let me say this. I think we still have capacity on the headcount side as well, but if you are asking about the entire year, as the year goes along, if we continue to see volume growth, at some point or another we might have to bring back a few more people.

Sal Vitale - Sterne Agee & Leach - Analyst

Okay. And then just looking at the outlook again, on the housing side I think there was -- one of the slides indicated a expectation of an improved housing market. Do you have -- what level of housing starts do you have regarding that expectation?

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

Moving from about 550,000 starts, which was a World War II low, in 2009, and moving back up to about 860,000 starts for 2010. But that's not the entire color on that. It's a combination of forest products, including paper, which we have gained some new business in projects, so in combination with the improvement in housing, a little bit of uptick in lumber, and a better portfolio of paper traffic in 2010 is the combination story.

Sal Vitale - Sterne Agee & Leach - Analyst

is okay. And then just one final question. One of the questions earlier, I forget who asked it, I think you mentioned more -- that you're seeing more rail competition and more truck competition. What particular segments, what commodities are you seeing more rail competition in, or is it across the board?

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

My general comment on competition was centered around capacity for transportation in today's market. Demand is down for transportation, and as long as we have additional capacity available in all modes, the competitive market is more challenging with that type of scenario than we would have if we had a full economic output taking place, with very little excess capacity in transportation.

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Sal Vitale - Sterne Agee & Leach - Analyst

Okay, thank you. Then just one final quick question for Jim. What is a good tax rate to use for 2010?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

In the high 30s, Sal, is kind of what we would be expecting.

Sal Vitale - Sterne Agee & Leach - Analyst

Okay, thank you for your time.

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

Thanks.

Operator

Thank you. Our next question is coming from the line of Mr. Randy Cousins with BMO Capital Markets. Your line is open. You may proceed.

Randy Cousins - BMO Capital Markets - Analyst

Afternoon.

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

Afternoon.

Randy Cousins - BMO Capital Markets - Analyst

For Don, just a couple. Your slide that you've got on export coal, my recollection is that there was some production or shipment problems at Lambert's Point. How much of that impacted Q4 volumes? Is there room to actually increase this number? Should we look at this 59.9 as sort of a sustainable number through 2010? How should we think about the export opportunity? And I wonder if you could give us some color as to sort of opportunities that are met versus thermal. Is this all metallurgical coal that you are moving?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Okay, first of all, in terms of the outlook, I would have to say, as you know, metallurgical coal is priced in the world market April to April, so we still to have to see those settlements take place, and those are beginning to take place as they normally do this time of year. So, you know, based on what we're hearing from receivers in Western Europe, some in China and some in India, we are comfortable that we will see an ongoing run rate of export coal that is higher than what we handled last year, certainly in the first half of last year.

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We did have a short disruption of dumping at Lambert's Point with a belt issue. We lost several days of dumping. I don't think that's going to be a material thing. We will -- we're recovering that in January, so that's not something that will be material going forward. But our outlook for export coal, and this is metallurgical coal, is good for 2010 and it's -- as I mentioned, it's largely driven off of a very extensive demand for coke and iron ore and coal in China, based on steel production there.

Randy Cousins - BMO Capital Markets - Analyst

Don, do you think could you actually replicate what you did 2000 in a terms of sort of export coal volumes?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Well, certainly after being up over 40% in 2008 in export volume, we exceeded that run rate in the fourth quarter of 2009. So if the coal is there available, and we feel it is, in terms of production, and we don't see any double dip or unanticipated decline in the economy, we remain optimistic along those lines.

Randy Cousins - BMO Capital Markets - Analyst

And what about pricing? There's a lot of debate about what the coal price is going to settle in for, for 2010. Can you give us any sense as to sort of whether higher met coal prices are going to have a positive impact on the rates that you get on your export business?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Well, of course, we look at transportation as transportation, and we don't price our service based on the cost of the product that we transport.

Randy Cousins - BMO Capital Markets - Analyst

Okay. That's it for me. Thank you.

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Thanks.

Operator

Thank you. Our next question is coming from the line of Ms. [Cheryl In Radbourne] with [Pusha] Capital. Your line is open. You may proceed.

Unidentified Participant - Analyst

Thanks very much, and good afternoon. I was going to ask similar questions about met coal, so maybe I'll just ask one with respect to utility coal. If you could just provide some commentary in terms of how a mix shift away from utility coal next year may influence your reported core pricing, and also your ability to achieve operating ratio improvements?

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

Well, first of all, the utility market through 2009 was a challenging market, and we had the perfect storm -- weather patterns that were not conducive to a lot of generation, industrial demand being down by about -- overall electrical demand being down about 4% nationwide, which is unheard of in any recession that we've seen, and then strong competition from natural gas. We've seen natural gas prices rise back up above \$5, in the \$5.80 range. We've seen weather, certainly a weather pattern currently, we don't know how long that's going to last, but certainly that current weather pattern is conducive to a much, much higher generation rate. And we're seeing is industrial demand pick up as well. So while we expect utility to be somewhat soft in the first half, we think that stockpiles by at least June or July will start to reach somewhat of a normalized level, and we'll see utility orders pick up, and utility volume pick up.

Just to add one more data point to that, Genscape tabulates information on stockpile and consumption of coal, and based on their study since December 1st of 2009 through the middle of January, there was 29 million more tons of coal burned than shipped, and that's the kind of reduction in coal stocks that will lead to opportunities in the utility market for growth later on in the year.

Unidentified Participant - - Analyst

Okay. So if it is a headwind, it's sort of a headwind in the first half of the year?

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

Yes.

Unidentified Participant - - Analyst

Okay, thank you. That's all my questions.

Operator

Thank you. Our next question is coming from the line of Mr. Bill Greene with Morgan Stanley. Your line is open. You may proceed.

Bill Greene - Morgan Stanley - Analyst

Good afternoon. Wick, I just had a question for you. Under the current regulations, if we think about revenue adequacy, you may not be revenue adequate for 2009, and so does that reset the clock, do you think, in terms of pricing regulation?

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

Well, I think your assumption about 2009 is probably correct. We don't know, is the best answer I can give you. We don't know if there is a clock, or if it gets set or reset. So I will just take a pass on that. I don't know that we have a good answer for you. But it certainly does look like we won't be revenue adequate by -- in 2009.

Bill Greene - Morgan Stanley - Analyst

Okay. Let me ask you, from the perspective of coal versus intermodal, intermodal is our growth area; coal seems to be at least in some way under bit of pressure longer term, especially if climate legislation is passed. So when I think about returns on capital,

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coal strikes me as being a better returning business than intermodal; how do we think about maintaining long-term margins and returns if that structural trend is in place?

Mark Manion - Norfolk Southern Corp - EVP of Operations, COO

Well, I guess I would say first first of all that we love all of our businesses, and we really don't try to differentiate between them in that way, but I will answer your question in this way. You're exactly right that coal is a car, very significant part of our business. And we, along with all of the other carriers, are watching what happens with climate legislation. We're trying to make our voices heard with a lot of other folks, in terms of the importance of coal and the need for rational thinking in terms of controlling carbon and using appropriate technology, so that we don't forgo the use of what really is our most abundant energy supply. So that's one side of the equation.

The other side of the equation, as you point out, is that intermodal is a growth business; and one of the strong reasons that it's a growth science that we, and I think the rest of the world, believe that sustained higher fuel prices are with us to stay. And as fuel prices increase, our ability to both capture traffic and retain -- and grow our business and grow our business at better margins because of our fuel efficiency, increases as well.

So we see a very bright future ahead in terms of being able to grow intermodal business with increasing prices and increasing margins, and it's good business today. As we grew a lot of business, intermodal business, over five or six years, the last five or six years, you in fact saw our operating ratio go down. So that's the best answer I can give you. Don?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Bill, the only thing I would add is also keep in mind, with respect to coal in 2009 versus 2008, that in 2008 we set an all-time record for coal tonnage at 194 million tons. And a lot of that record was laid in in the second half of 2008. We were up 5% in each quarter, 2008 versus 2007. So we had extremely strong comps for the entire year of 2009 versus the previous year, and in particular the final two quarters of the year. So while a lot of this was impacted by the economy and the other factors that I mentioned previously, I think that -- just keep in mind that our performance in coal in 2009 was against a record backdrop.

Bill Greene - Morgan Stanley - Analyst

Right. So the death of coal is premature.

Maybe I could just ask one last one just on domestic intermodal. You mentioned 13%, I think. That really just the J.B. Hunt contract, or did you win elsewhere, too? How much was non-J.B. Hunt in other words, I guess?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

That was for the month of December, and we don't think that was Holiday peak, because usually you see Holiday shipments move much earlier in the quarter than in December. Certainly some of that growth was J.B. Hunt, but we also saw growth with (inaudible) and our other intermodal providers.

Bill Greene - Morgan Stanley - Analyst

Thank you for the time.



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

Thanks, Bill.

Operator

Thank you. Ladies and gentlemen, our last question is coming from the line of Mr. Carter Leake with Davenport & Company. Your line is open. You may proceed with your question.

Carter Leake - Davenport & Company - Analyst

Good evening. Of the remaining 30% contracts that are yet to be repriced for 2010, can you provide any color as to which segment this repricing might apply?

Jim Squires - Norfolk Southern Corp - EVP of Finance, CFO

It's pretty much across the board, but with more concentration in coal and merchandise and less in intermodal.

Carter Leake - Davenport & Company - Analyst

Great, thanks. And then how about with completion of the Heartland Corridor project fast approaching, can you provide any color as to how this distance and volume improvement might impact any of your traditional operating efficiency metrics?

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

We have managed throughout the course of the project to maintain a highly efficient route through there. In fact, I will tell you that we did a lot of service planning to avoid disruptions. That has gone remarkably well, and we have not had to do some of the things that we thought we might have to do in terms of re-routing trains. So we don't look for it to have a significant impact in that regard.

Where we do look for a significant impact is in the reroute of the current double stack traffic that's flowing between Hampton Roads and Rickenbacker and Columbus and on beyond. Clearly the magnitude of those savings depends to some extent upon the traffic levels, and as you heard Don say, our international traffic is depressed right now, and we don't really look for a very rapid recovery. But we will see immediate ongoing savings once that last clearance restriction is limited, and as the traffic through Hampton Roads grows, driven in part by the improved service we'll offer, we'll see both volume and revenue growth, and operating efficiencies.

Carter Leake - Davenport & Company - Analyst

Great. And just one more. Are there any fuel efficiency initiatives that we should consider in our fuel burn assumptions for 2010 and 2011?

Don Seale - Norfolk Southern Corp - EVP, Chief Marketing Officer

Well, as far as giving you any actual statistics, I don't know that I can really pin that down. But I can say this. We're making good headway with several of our technologies, one of which is our LEADER technology, we're rolling that out more rapidly in 2010 and, in fact, we operated our first train yesterday, starting in Chicago, moving eastward over our northern region, and we'll have

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that technology applied to 500 locomotives throughout this year, and we'll be operating between Chicago and New Jersey on a regular basis.

In addition to that, our UTCS rollout, particularly with the additional technology that Movement Planner gives us is going to help improve fuel efficiency, and we've got plans to get UTCS rolled out over eight divisions by the end of this year, Movement Planner over five divisions. And when you start adding these technologies up, I'm sure it will have an impact, but I really can't give you a statistic that would help you.

Carter Leake - *Davenport & Company - Analyst*

Okay, great, thanks for your color.

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

You're welcome.

Operator

Thank you. Ladies and gentlemen, this does conclude our question-and-answer session. I would like to turn the floor back to management for any closing comments.

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

Thanks, everyone, for listening. We look forward to talking to you next quarter.

Operator

Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you, very much, for your participation, and have a wonderful afternoon.

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