

FINAL TRANSCRIPT

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NSC - Q3 2009 Norfolk Southern Corp Earnings Conference Call

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CORPORATE PARTICIPANTS

Leann Marilley

Norfolk Southern Corporation - Director of IR

Wick Moorman

Norfolk Southern Corporation - Chairman, President, CEO

Don Seale

Norfolk Southern Corporation - CMO

Mark Manion

Norfolk Southern Corporation - COO

Jim Squires

Norfolk Southern Corporation - CFO

CONFERENCE CALL PARTICIPANTS

Jason Seidl

Dahlman Rose - Analyst

Matt Troy

Citigroup - Analyst

Tom Wadewitz

JPMorgan - Analyst

Bill Greene

Morgan Stanley - Analyst

Edward Wolfe

Wolfe Research - Analyst

Chris Ceraso

Credit Suisse - Analyst

Jon Langenfeld

Robert W Baird - Analyst

Gary Chase

Barclays Capital - Analyst

Walter Spracklin

RBC Capital Markets - Analyst

Ken Hoexter

Banc of America Merrill Lynch - Analyst

Randy Cousins

BMO Capital Markets - Analyst

Justin Yagerman

Deutsche Bank - Analyst

Unidentified Participant

- Analyst

Donald Broughton

Avondale Partners - Analyst

PRESENTATION



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Operator

Greetings and welcome to the Norfolk Southern Corporation third quarter earnings conference call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal present. (Operator Instructions) As a reminder, this conference is being recorded. It is now my pleasure to introduce Leann Marilley, Norfolk Southern Director of Investor Relations.

Leann Marilley - Norfolk Southern Corporation - Director of IR

Thank you. 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 www.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 and will be available upon request from our corporate communications department. At the end of the prepared portion of today's call we'll conduct a question-and-answer session. At that time if you choose to ask a question, an operator will instruct you how to do so from your telephone key pad.

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 use of the words believe, expect anticipate and project. Our actual results may differ materially from those project 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 reported filed with the SEC for discussing those risks and uncertainties we view as most important. Additionally keep in mind that all references to reported results, excluding certain adjustments, such as non-GAAP numbers have been reconciled on our website at NScorp.com in the investor section. It is now my pleasure to introduce Norfolk Southern Chairman, President and CEO, Wick Moorman.

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

Good afternoon. It is my pleasure to welcome you to the third quarter 2009 earnings conference call. I'm joined today by several members of our senior management team, including Don Seale, our Chief Marketing Officer, Mark Manion, our Chief Operating Officer and Jim Squires, our Chief Financial Officer, all of whom you'll hear from today. We're pleased with our third quarter results which continue to demonstrate the strength of our franchise, our solid operating performance, and aggressive cost control. While third quarter results were clearly impacted by the recession, with a 20% reduction in volume, we did reduce operating expenses by 25%. The result was third quarter railway operating profit of \$562 million, which was 37% below last year. Earnings per share were down 41% year-over-year and our third quarter operating ratio was 72.8%, an increase of 3.7 percentage points over the comparable period last year, but an improvement of 7.5 percentage points and 2 percentage points respectively from the first and second quarters of this year. While revenues and volumes remained under pressure, we continued to take a balanced approach to exercising cost discipline and improving network efficiency while meeting our customer service requirements.

Importantly, even as we realize significant efficiencies in the quarter, all of the measures within our service composite performance index planned adherence, trained performance, and connection performance either improved or were stable year-over-year. We posted a 7% year-over-year improvement in system average train speed in the quarter. This improvement was chiefed by careful planning and execution that resulted not only in the overall average speed improvement but also continued improvements in fuel consumption which declined by more than both crew starts and gross ton miles. While the overall economic outlook remains clear, we are encouraged on a sequential basis. As you may remember from our last call, we indicated that the erosion of traffic volumes was beginning to moderate and our third quarter traffic volumes continue to suggest stabilization. Volumes improved 8% sequentially from the second quarter to the third quarter. And while the outlook and shape of the economic recovery remains uncertain, we are increasingly confident we have seen the bottom.

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As the economy does revive, we remain focused on ensuring that the efficiencies we have achieved will remain in place as we emerge from this recession and we'll continue to leverage and enhance the strength of our network. I'm now going to turn the program over to Don who will provide full details about our revenues, followed by an operations overview from Mark and then a discussion of our financial results by Jim. I'll then wrap up with some closing comments before we take your questions. Dom.

Don Seale - Norfolk Southern Corporation - CMO

Thank you, Wick. And good afternoon, everyone. As seen in the last few quarters, we continue to be impacted by economic weakness, lead by the automotive, housing and retail sectors. But signs suggest that the bottom was likely reached during the second quarter and our third quarter performance, which improved sequentially which Wick mentioned, is reflective of modest improvements we're now beginning to see in the economy.

As shown on slide 2, third quarter revenue totaled \$2.1 billion down \$831 million or 29% in view of the extremely tough comparisons to all-time high revenue of \$2.9 billion one year ago. Over two-thirds of the quarterly decline was driven by a 20% reduction in volume representing \$570 million. The next largest driver was fuel related revenue which declined \$436 million in the quarter, precipitated by the 50% fall in WTI oil prices. Within that total we experienced a \$10 million negative fuel surcharge lag affect during the quarter, compared to a \$55 million positive lag affect one year ago. To illustrate the impact of the volatility in oil prices, without the affect of the fuel related revenue, total revenue would have declined by 17%, or \$395 million versus the 29% decline reported for the quarter. This non-GAAP reconciliation is posted on our website for your review. And we also saw a \$22 million unfavorable impact in the quarter from coal related adjustments in the third quarter of last year. On the plus side, continued improvements in pricing and a favorable traffic mix partially offset volume and fuel revenue declines and provided a positive offset of \$197 million.

Turning to yield on slide 3, revenue per unit was \$1,355, falling \$172 or 11% below record third quarter 2008 revenue per unit. All business segments posted year-over-year declines primarily driven by lower fuel revenues. Pricing improvement continued during the quarter with an average pricing gain of 6.2%. As you know, our strong service product is a major driver in improving yield in the marketplace. In this regard, we recently completed the tabulation of our 2009 customer survey which showed a 6% improvement in our customers overall satisfaction with transit time performance and a 10% improvement in service consistency. Service consistency is the number one priority for most of our customers and the magnitude of improvement here is significant for future price support.

As shown on slide 4, during the quarter we continued to experience economic related declines in volume, across our book of business. Total volume was 1.5 million units down 373,000 loads or 20% below third quarter 2008. It's also worth noting that we experienced some very tough comparisons to third quarter of last year which produced agriculture's highest volume ever, the second highest coal carloadings and highest coal tonnage ever along with strong metals and domestic intermodal volumes. Despite these very strong comps, we saw improvement in the majority of our business geared volumes through each month in the quarter. In this regard as shown on slide 5 which compares third quarter's performance to this year's second quarter, volume was up 110,000 loads or 8%, driven by gains in all groups led by export coal, steel, chemicals and automotive. Finally revenue improved about \$206 million or 11% and revenue per unit grew by \$40 or 3%. We're cautiously optimistic that this sequential quarterly progress is a tangible sign of the start of economic recovery.

Turning to slide 6, as we move through the final quarter of the year and beyond, continued economic uncertainty highlights the advantages of our balanced portfolio of business as shown here, we expect growth in agricultural shipments led by higher volumes in soybeans, corn and fertilizer. The US 2009 soybean and corn crops could be the best on record following a poor South American crop. An ethanol volume will control as 13 new ethanol terminals will open in the next 12 months over our network. Chemicals year-over-year comparisons are expected to improve driven by project growth such as the newly contracted unit train fly ash business moving from Tennessee to Alabama for disposal. During the third quarter we handled 68 unit trains and expect to handle over 300 unit train loads in total under this contract over the next 15 months. Basic chemicals volumes are also improving sequentially.



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Export met coal volumes through the fourth quarter in 2010 should be substantially better than 2009 as shipments to western Europe and Asia expand in a recovering global steel market. Australian coal production challenges and port congestion will continue to play a role here as well. While export coal volume declined 24% in the third quarter, turning to slide 7, for reflecting the 34% decline in European union steel production, we're seeing very positive signs in this market. As depicted here, third quarter volume was twice that of the second quarter. And September volume was only down 28,000 tons, or 1% compared to last year's strong performance in September. During the month of September, we also handled our first direct cargoes to China and more are expected as the Chinese stimulus program drives demand for higher steel production.

Now turning to slide 8 and turning to markets that are showing some signs of recovery, but may remain flat year-over-year, we're seeing some signs of improvement and increasing demand in the domestic steel markets which will drive in proof volumes of domestic met coal and steel products ahead. During the quarter 7 additional NS served blast particles resumed production. We also expect domestic intermodal to continue to be flat to positive for the fourth quarter. But to resume growth in 2010 as highway conversions continue and economic activity improves. International volumes, however, will continue to be down until consumer demand picks up. But we remain unwavering in our commitment to expand our intermodal network for future growth. During the third quarter new terminals were formally announced at Memphis and Greencastle, Pennsylvania, which is south of Harrisburg and we're on target for a mid 2010 completion of the Heartland Corridor. Last of all utility coal volumes will continue to be impacted by current high stockpiles, lower generation rates at utilities and competition with natural gas. As always, utility volume will be dependent upon this winter's weather conditions which will to a large degree determine stockpile levels going into the second quarter of next year.

In closing, despite the continuing strong economic headwinds and very tough comps from 2008, we had a solid third quarter with notable sequential improvement from the previous two quarters. Going forward, we anticipate on going improvement in sequential volume and revenue as economic and project-related activity picks up steam and our customers across all business segments continue to recognize our strong focus on service-related investment and service execution as noted in significant improvements in customer satisfaction with our transit times and shipment consistency performance. Obviously this strong service performance represents higher value in the marketplace which in turn supports continued pricing and profitability enhancement, both of which are required to make the necessary investments in technology and infrastructure ahead. This, in a nut shell, is our on going value proposition for customers and shareholders alike. Thank you and I'll now turn the presentation over to Mark for our operations report.

Mark Manion - Norfolk Southern Corporation - COO

Thank you, Don. As Don noted, while business volumes continue at recessionary levels, we have seen a steady uptick from the low point in May. We continue to closely monitor changes in volumes to ensure that the operation is right-sized to meet changes in demand and to meet that demand as efficiently as possible. We continue to take a balanced approach to assure continued improvements in the safety of our operations and consistency of our service while we adjust to changes in business volume.

Let's start with a review of our safety performance, turning to slide 2, based on preliminary estimates, Norfolk Southern continues to lead the industry in safety of operations. As always, we continue to pursue initiatives to drive further improvement. Our estimated injury ratio for 9 months of 2009 is 1.15. Because they're paid on an activity basis, road and yard crew starts are one good measure of the results of our efforts to keep the network operation in line with our service and operating efficiency goals. On slide 3, the total increase in road and yard crew starts increased only 4% from second quarter to third quarter against a sequential volume increase of 8% as mentioned earlier. And yard assignments remained flat. Turning to slide 4 and comparing road and yard crew starts with the prior year, we continue to show reductions. Road crew starts were reduced 16% year-over-year, and yard assignment starts were 19% below the same period last year.

Similarly, on slide 5, you can see a very slight increase in the number of T&E employees in active service from the second quarter. This again reflects a change in volume, but also reflects the impact of the regulatory changes in hours of service requirements for T&E employees which went into affect during the third quarter. But the number of T&E employees remains 14% below prior



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year reflecting the reduced need for T&E employees in our current operation. The T&E employees are of course only part of the total employment picture and on slide 6 you will note we continue to hold the line. We further reduced total railroad employees in the third quarter with employment levels 9% below the same period last year.

Turning to slide 7 and looking at service delivery, we continue to closely monitor service delivery as we adjust the network to meet the challenges of the current business environment. A key measurement of overall service delivery is our composite service measure. Composite service performance combines the key service drivers of train performance, connection performance and planned adherence. In the third quarter we were again challenged to balance service with cost savings and increasing volumes. Train and connection performance declined slightly from the period last year. New hours of service rules for T&E employees as well as flooding in the southeast had some impact on performance. But these issues are now behind us. The combined service components, as you can see, essentially net out the same performance at the same period in the prior year.

And as you will see on the next slide, our car days per carload measure which has a direct translation into cost savings, continues to show a network operating at levels comparable to or better than last year. Car hire days per carload shown on slide 8 is another measure of network philosophy. I mentioned earlier that this measurement has a direct translation into cost savings because it looks at the direct impact of velocity on car hire costs. Car hire days paid per carload improved slightly in the third quarter down 1.5% from the same period last year. This improvement confirms that our focused approach to balancing costs and service has kept network velocity at steady or improving levels. This is critical in keeping car hire payments and other velocity-related costs in line with changes in volume.

Slide 9 illustrates the significant portion of our fleet that remains in storage due to continued weak volume levels. However, we have reduced the number of cars stored significantly from the peak of over 35,000 cars in July, to over 22,000 cars at the end of September. This represents about an 11% increase in the number of Norfolk Southern cars in active service since the first week in July. The reduction in stored cars primarily reflects increased demand for Norfolk Southern cars primarily in coal, ash, steel and automotive equipment. We have also reduced the number of locomotives stored from a high of 700 at the end of May, to about 380 at the end of September as shown on slide 10. We've pulled these locomotives out of storage to meet increases in demand since volumes bottomed out in May. Including continuing increases in coal trains, some of the reductions also represent retirement of our older fleet. The net increases in our available locomotive fleet at the end of September was about 7.5% higher than at the lowest point in the first week of June.

On slide 11, you see the impact of a reduced operating plan from prior year levels reflected in the locomotive fuel consumption, a 19% reduction. Sequentially, fuel consumption increased 5% from the second quarter against an 8% increase in volume. The reduction versus the same period in 2008 reflects our conservation efforts in the areas of train pacing, idling reduction efforts and ensuring that locomotive consist is correctly sized for the terrain.

Our focus remains unchanged and we'll continue to build on our strengths. Safety, commitment to service and operating efficiency. Of primary importance, we want every employee to end their work assignment in the same condition they started it. In this tricky economic period, we continue to monitor changing volume and traffic patterns. We are making ongoing adjustments to the operating plan in response to those changes. At the same time, we keep a close watch on service and network velocity, to assure that we meet customer expectations and make the most efficient use of our asset base. I thank you, and now I'd like to turn it over to Jim.

Jim Squires - Norfolk Southern Corporation - CFO

Thank you, Mark. I'll now provide a review of our overall financial results for the third quarter. Let's start with our operating results. As Don described, railway operating revenues for the quarter were \$2.1 billion, down \$831 million or 29% compared to last year. Slide 3 displays our corresponding operating expenses which decreased by \$499 million or 25% for the quarter. Income from railway operations was \$562 million, down 37%. The substantial decrease in revenues primarily driven by decreased volumes in fuel surcharges was partly offset by significantly lower operating expenses, the result of operating ratio was 72.8%.



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Turning to our expenses, slide 4 presents the major components driving the \$499 million decrease. Similar to last quarter, all of our expense categories are down with the exception of depreciation. Before proceeding further let me note in passing that we are currently engaged in a depreciation rate study for our equipment assets which we anticipate will conclude in early 2010. We intend to begin a depreciation rate study on our roadway assets next year that will conclude in 2011. Now turning back to our other expense categories, consistent with the first half of the year, the biggest driver of our overall operating expense decline was sharply lower fuel costs which decreased by \$282 million or 59%. As Mark noted earlier, third quarter locomotive fuel consumption is down 19%, which reflects sufficiency gains relative to 17% declines in both gross ton miles and crew starts. These operating efficiency improvements coupled with lower volumes, accounted for the vast majority of our \$92 million consumption related decrease in fuel expense this quarter.

As reflected on slide 6, lower prices provided a \$190 million benefit. This graph shows our average price per gallon of locomotive fuel for each of the last 7 quarters. The \$1.85 average price in the third quarter of 2009 was a 48% decline compared with the \$3.59 price per gallon in the third quarter of 2008. Delving deeper into the price analysis, slide 8 shows the components of diesel fuel price comprised of crude oil in green and other costs in gold. Other costs include crack spread, transportation and in 2008 an availability premium. As you may recall, these other costs were considerably higher last year driven in part by supply constraints experienced in the Gulf Coast region due to hurricane activity.

The next largest expense decline was compensation in benefits which decreased by \$110 million or 16%. Slide 10 presents the major components driving this change. First volume related labor was reduced by \$64 million in the quarter and I'll review this item in more detail momentarily. Second incentive and stock-based compensation fell \$33 million due to largely to less favorable performance in 2009 relative to 2008. Third, \$28 million relates to the absence of lump sum payments provided in last year's labor contract with our locomotive engineers. Fourth, payroll taxes decreased reflecting lower compensation levels. Somewhat offsetting these reductions were higher wage rates, up by \$14 million reflective of the agreement pay increases that went into affect in July of 2009. The pension costs increased by \$11 million primarily due to reduced asset values. And also medical costs for active and retired employees was up \$6 million.

Now turning to slide 11, as I mentioned, volume related labor savings were \$64 million for the quarter. Taking a closer look at T&E labor, road train and yard crew assignments were down 17% in third quarter. This reduction was the primary driver of a \$33 million decrease in T&E volume related compensation expenses in the quarter and remaining \$31 million of volume related payroll savings primarily reflects reduction in engineer and mechanical requirements also related to lower activity levels. Purchase services and rents decreased \$67 million or 16% which correlates with decreased volumes. Consistent with the second quarter, we have been successful in reducing expenses while maintaining solid network performance. Slide 13 provides some specific examples. Transportation services and operations fell \$22 million, which includes automotive related costs and lower crew transportation expenses. Intermodal expenses declined \$17 million and equipment rents decreased \$12 million. In addition engineering services were down \$9 million primarily due to reduced roadway repairs and mechanical expenses were down \$5 million, largely due to fewer freight car repairs.

Materials and other expenses decreased \$49 million or 25%. Slide 15 provides additional details to define this decrease. First reductions in material usage contributed \$24 million as we have aligned locomotive, freight car and engineering material use to conform with lower traffic volumes. This is largely related to historic locomotives and freight cars that Mark highlighted for you early. Second, casualties and other claims benefited from lower loss in damage claims. Finally other expenses reflect decreased travel and miscellaneous expenses.

Now let's turn to our nonoperating items on slide 16. Interest on tax deficiencies reflects less favorable experience compared to last year related to the IRS review of prior year's tax returns. Gains on property sales were up \$7 million from last year and corporate own life insurance benefited from higher returns. The remaining variance reflects a variety of smaller items, including lower interest income in coal royalties.

As illustrated on slide 17, income before income taxes decreased \$341 million or 41% principally due to lower operating income. Income taxes for the third quarter were \$178 million for an effective tax rate of 37% which compares with \$302 million or an



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affective rate of 36.7% last year. Slide 19 depicts our bottom line results, third quarter net income was \$303 million, a decrease of \$217 million or 42%. Diluted earnings per share were \$0.81 which was \$0.56 per share or 41% below last year. Thank you for your attention and now I will turn the program back over to Wick.

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

Thank you, Jim. Well as you've heard, by continuing to maintain a high level of service to our customers while remaining focused on aggressive cost control we were able to post very solid third quarter results while continuing to invest in the programs which are critical for our future success. I've said before that I believe our Company will emerge even stronger and more efficient when the economy recovers and we saw some indicators of our increasing operating leverage in the third quarter. For example, as you've already heard our third quarter volumes were up 8% sequentially while road train crew starts were up on 4% and yard crew starts were flat. Similarly, our T&E headcount increased by about 1% quarter-over-quarter, and I'll remind you again that T&E pay is activity based and we continue to reduce total headcount. We were also able to continue our tight control on overtime which remains at levels down 40% plus year-over-year. And finally on the asset side, as you heard from Mark, even with our conscious decision to rotate locomotives in and out of storage on a regular basis to ensure they're on going good condition, total locomotives available for service increased only 7.5% from May, our high water mark for stored power to September, while traffic volume increased over 10%.

As you've heard me say before, I firmly believe that rail, the safe, efficient and environmentally friendly way to ship freight, is a critical part of the solution to our nation's transportation crisis. As such, we're managing Norfolk Southern for the long-term. We continue to focus on service improvement through increased network efficiency in new product offerings. We continue to control costs and we continue to enhance the value of our franchise by making the investments necessary to position us for the future of transportation.

Looking ahead, as I stated earlier, it does seem like we've at least seen a bottom in our traffic levels. And while my crystal ball has it's usual amount of sediment swirling around inside, we're hopeful that an economic recovery may have commenced, although it's shape and duration are uncertain. Regardless of the form of the recovery, we're strategically positioning Norfolk Southern to fully capitalize on all of the opportunities that it will present. And I'm confident that in doing so, we'll continue to deliver superior results for our customers and our shareholders. Thank you and I'll now turn the program over to the operator who will instruct our telephone participants how to ask a question.

QUESTIONS AND ANSWERS

Operator

Thank you. We'll now conduct a question-and-answer session. (Operator Instructions) One moment please while we poll for questions. Our first question is from Jason Seidl from Dahlman Rose. Please go ahead.

Jason Seidl - Dahlman Rose - Analyst

Good evening, everybody. A couple of quick questions. A lot has been made of pricing or lack of clarity from some of the other conference calls that we had and you post very strong 6.2%. Can you talk about pricing into 2010 in terms of how much you have locked up and sort of what you expect, even if it's a ballpark number.

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

Take it, Don.

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Don Seale - Norfolk Southern Corporation - CMO

Good afternoon, Jason.

Jason Seidl - Dahlman Rose - Analyst

Hi, Don.

Don Seale - Norfolk Southern Corporation - CMO

We have approximately 60% of our 2010 book priced, as you'll recall, I indicated that we had 40% repriced in the second quarter call. That's now up to approaching 60% and the pricing levels reflect satisfactory levels of price that certainly will exceed what we think the rate of rail inflation will be for next year, plus an additive above that.

Jason Seidl - Dahlman Rose - Analyst

And an additive above it. That's good for a ballpark. I guess, Don, the next question, you guys started having some export coal shipped to China. Could you talk about the levels of that and is this going to be something that's going to be more consistent or spotty, depending on what Australia is doing?

Don Seale - Norfolk Southern Corporation - CMO

Jason, I mentioned in the third quarter our export volume was off 24%, our tons were off 23% for the third quarter. But we saw very rapid improvement month to month in the third quarter as orders picked up to western Europe and also to Asia, including direct shipments to China for the first time for us. As I mentioned, within September itself, we were within 1% of a very strong September last year. So as the quarter ramped up month to month, we saw it almost get back to even at the end of September. We are expecting continuation of that demand in the export market at least through the current coal year which, as you know, runs through about April 1st of 2010.

Jason Seidl - Dahlman Rose - Analyst

Okay. That's great. I'll let somebody have at it and get to the back of the queue. Thanks, guys for the time, as always.

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

Thank you, Jason.

Operator

The next question is from Matt Troy with Citigroup. Please go ahead.

Matt Troy - Citigroup - Analyst

Thanks. I was wondering if you could provide some detail. There seems to be a consensus [bare view] as it relates to Norfolk Southern that you guys will have a -- what's called a more difficult fuel surcharge recovery headwind in the fourth quarter. I think if you look at the numbers, there is support for that view. I was just wondering if you could maybe put some numbers



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around what the headwind may be. Some of the other railroads have been kind enough to do that. I'm just trying to get a sense of what the headwind will be assuming current spot prices hold.

Don Seale - Norfolk Southern Corporation - CMO

This is Don Seale. As I mentioned, the third quarter was \$55 million in terms of a negative fuel lag. The fourth quarter looks like it will be around \$130 million.

Matt Troy - Citigroup - Analyst

Right. Right. So there is nothing new or changed with that outlook?

Jim Squires - Norfolk Southern Corporation - CFO

Matt, let me comment on your question as well. This is Jim. With the decline in fuel surcharge revenue likely to be greater than the decline in fuel expense in the fourth quarter, we will face a margin headwind in the fourth quarter as we did in the third quarter and the second quarter as well.

Matt Troy - Citigroup - Analyst

Right.

Jim Squires - Norfolk Southern Corporation - CFO

And it's likely that that margin headwind will be somewhat greater in the fourth quarter than it was in the third quarter.

Matt Troy - Citigroup - Analyst

And the second question as it relates to that issue, some of the pushback we get also from the same crowd is that, late last year Norfolk Southern had changed some of its pricing strategy to incorporate a higher WTI spot assumption in its core rate increases, that was somewhat optically challenged back when WTI was at 20 or 30 but now we're back up at 70 or 80 is looks much more palatable. Can you talk about what percentage of your book of business was actually rolled forward based on a core rate increase based on that higher spot price and is there any reason to believe you are seeing any incremental pushback from those customers or is this people making noise about nothing?

Jim Squires - Norfolk Southern Corporation - CFO

No, we view fuel, and we've indicated this in the past, as a component of our price and we're looking at pricing into the marketplace to be competitive and reflecting the value of the service product that we're offering. So we do not feel that we have any unusual noise associated with that in the marketplace.

Matt Troy - Citigroup - Analyst

Can you directionally bogey how much of the book of business was remarked to the higher WTI spot assumption so we can quantify.

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Jim Squires - Norfolk Southern Corporation - CFO

No.

Matt Troy - Citigroup - Analyst

Last question I had, Don, when we were there in the summary you talked about cash for clunkers having a positive impact. I know Ford is in negotiations now, but are you seeing any follow-through? What is your assumption in terms of either SAR rates or what are you hearing from your auto customers about demand past this kind of a femoral bump from cash for clunkers? We have been using comps but are people looking for growth next year sequentially from what we say in 3Q? Thanks.

Don Seale - Norfolk Southern Corporation - CMO

We saw a good draw down of inventories from cash for clunkers with 700,000 vehicles sold and we saw our automotive volumes improve with that. Unfortunately in September we saw auto sales go back down by about 38%. So we're not seeing any ongoing strength in auto sales. I will tell you this, that auto production is projected to come in about 8.6 million this year. They're going to -- the projection next year is about 10.8. And global insight tells us that the replacement run rate in this country is 12 million. If that is correct, and production next year is 10.8, that means that we're continuing to see pent-up demand develop as the fleet drops out faster than it's being replaced. So at some point, we're going to see an inflection in the auto market, we just don't know when.

Matt Troy - Citigroup - Analyst

Got it. Thanks for the time. Good quarter, guys.

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

Thank you.

Operator

The next question is from Tom Wadewitz with JPMorgan. Please go ahead.

Tom Wadewitz - JPMorgan - Analyst

Yes, good afternoon.

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

Good afternoon, Tom.

Tom Wadewitz - JPMorgan - Analyst

I wanted to see if you could give a sense on coal. It sounds like your pretty optimistic on the export coal outlook. Do you think that -- I guess you're looking at a run rate that approaches the strong run rate of 2008 and the sense that that maybe continues beyond expiration of the current coal year. And then on the utility side, do you think there is risk given high stockpiles that you



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get past some contract minimums into 2010 or the contract minimums maybe are lower and you could actually see a further stepdown in utility coal volumes in 2010.

Don Seale - Norfolk Southern Corporation - CMO

Tom, this is Don again. With respect to the export, as I mentioned earlier, we do expect export demand to be stronger at least through April 1st, through the current coal year. In terms of European and Asian demand. So we feel pretty good about the export going forward. With respect to the utility market, as you know, the stockpiles are very high. Electric -- electrical demand is down about 6.5% in our service territory and we project or estimate the overhang in utility stockpiles for the plants we serve to be about 8 million tons, out of the total universe. That is a high stockpile. But if we get, as I mentioned in the prepared remarks, winter weather that brings natural gas prices up, and inventories down, and we get greater demand for electricity because of the weather, we could see that coal stockpile beginning to diminish and we certainly would see good coal availability, we think, in the spring in the shoulder months should that take place. So a lot of moving parts on the utility market, unless we get a cold winter that helps drive natural gas prices up, higher electrical generation up, and which will take stockpiles of coal down. If we see all of that, we see some opportunity for improvement. Not further declines in utility.

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

Tom, the good news is that in addition to global insight, we subscribe to a number of weather almanacs and the majority of them seem to be predicting a cold weather -- a cold winter. And if they're right, as Don said, this is the situation that can change very quickly.

Tom Wadewitz - JPMorgan - Analyst

Okay. So it sounds like you're best sense of it, it's hard to have visibility into 2010, but your best sense of it is probably the coal volumes are at least flat next year, maybe could even be up a little bit?

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

If we knew the future, we'd tell you, but --

Tom Wadewitz - JPMorgan - Analyst

Okay. That's -- that's fair enough. One other question for you. You've done really well on the cost side and I guess in looking at like the locomotive chart, you've clearly brought some locomotives back into service and the volumes have picked up sequentially, but on the headcount basis if we look at your headcount versus May, and we don't have a precise May number or versus second quarter or third quarter, it does look like your headcount is down a little bit. So is there a point whereas the volumes come back that headcount number needs to come back quite a bit, or is the way you're running, you can handle significantly more volume, run more locomotives and not see headcount increase sequentially? How do we think about that?

Mark Manion - Norfolk Southern Corporation - COO

Let me answer that, Mark Manion. The headcount we have right now is really capable of handling more volume than we're currently operating in. And that largely is because we will be able to fill out trains that are currently out there. We brought back -- we brought back several hundred people and we've increased -- we've increased the size of our operating plan accordingly. So we're really pretty well positioned to be able to fill out those train operations we currently have and unless volumes got significantly higher than they currently are, we probably have got the work force we're going to keep for right now.



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

There are a couple of moving parts in this. One, as Mark is saying, is the operating plan. And as we said earlier, road train starts were only up 4% on an 8% increase in volume. Yard crew starts were flat. If you look at average T&E, it was up slightly, I believe along the lines of 1%. We have called more people back than that. But the other thing we always have going on is just pure attrition. And so our furlough numbers are going to decline even at -- even as we keep headcount flat. But I'll reiterate what Mark said. I think as we see more volume growth, you're not going to see necessarily a proportionate number of increase in employees. We think we still have a lot of operating leverage in the system and as we said all along, and Mark and his team have done a great job of it, we figured out some smarter ways to handle some of this business.

Tom Wadewitz - JPMorgan - Analyst

The third quarter number, that 27,500 is pretty representative for, plus or minus for maybe the next few quarters on headcount?

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

I think there are a couple of moving parts in there. I think fairly representative is okay. I think if anything, it might continue to move down a little bit.

Tom Wadewitz - JPMorgan - Analyst

Okay. Great. Thank you for the time.

Operator

The next question is from Bill Greene with Morgan Stanley. Please go ahead with your question.

Bill Greene - Morgan Stanley - Analyst

Hi there. Good afternoon. I want to just do a quick follow up on some comments that Don made about pricing for next year reflecting a rate above rail inflation. What is the rail inflation rate that you'll use, because it's negative now I believe if we do the all-in. So how should we think about the right long-term number should be?

Don Seale - Norfolk Southern Corporation - CMO

Bill, this is Don. We're thinking a positive number and we are thinking a positive number of 3% with an additive above that.

Bill Greene - Morgan Stanley - Analyst

Okay. That's helpful. And then the second question that I have is the comments that you're making as it relates to pulling locomotives out of service or the sequential volume change, all reflect some confidence about the future at least on the sequentially basis which seems at least a little bit more optimistic than some of the comments we heard last week, so I'm wondering if there is something specific to Norfolk Southern that is causing you to be a bit more bullish or is it just as you're looking at the numbers mathematically where we are and the run rates that you're seeing that give you the confidence that in fact you should see some growth from here?

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

Well I think, and I'll ask Don to comment as well, it's in general driven by what we've seen in the third quarter, what we hear from our customers, what we see in the queue in terms of project growth. And that gives us some confidence that we're going to see volumes that look like they did in the third quarter and in fact we may see some continued sequential improvement. Don, is that --

Don Seale - Norfolk Southern Corporation - CMO

I think that's a good summary.

Bill Greene - Morgan Stanley - Analyst

So the fact that you pulled some of these locomotives out of service, does that suggest that you have less capacity in your network or have a lot of the declines in the locomotives that were stored or was that really just retirements?

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

There was -- it was a combination of three things. One was retirements. The second is, as I mentioned, was when we reached the high water mark for stored locomotives, we made a decision that keeping these very valuable assets stored and not moving for long periods of time wasn't necessarily a good idea in terms of their mechanical condition. It's not always good to leave mechanical equipment stored for long periods of time, so we consciously decided to start rotating stored power out on a regular basis. That in and of itself decreased the number of locomotives stored at any given time. And then the third was we brought some locomotives back into service as volumes increased. I think the important number is the one that Mark mentioned, which is what we really look at and that's locomotives available for service, which was up 7.5% over the low point.

Bill Greene - Morgan Stanley - Analyst

All right. Thank you for the time.

Operator

The next question is from Edward Wolfe with Wolfe Research. Please ask your question.

Edward Wolfe - Wolfe Research - Analyst

Thanks. Good afternoon, everybody. Don, can you talk a little bit about pricing renewals, about what is in the recent contracts. You back out 6.3% of pricing in the number currently, but I'm guessing you're not looking at 3% inflation plus 3 in pricing next year. What are you seeing in the most recent contracts and what are your expectations as those come up for pricing renewals?

Don Seale - Norfolk Southern Corporation - CMO

Ed, we're continuing to look at the marketplace. And obviously there is excess capacity in trucking out there that is impacting intermodal in particular. But as we continue to reprice for next year, I'll just repeat that we are getting the prices that we're satisfied with with respect to having covering that rate of inflation plus an additive above that and I will add that it's -- it's in line with what we've been reporting.

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Edward Wolfe - *Wolfe Research - Analyst*

Other than intermodal, that you just obviously referred to, are there other areas that are weaker than the norm or stronger than the norm?

Don Seale - *Norfolk Southern Corporation - CMO*

The market obviously, the supply chain today, has changed a lot since last year with demand being off substantially and supply of transportation being in excess, so I will tell you, Ed, that price negotiations is more difficult and challenging in today's environment than it was this time last year. But as we've indicated, our service product continues to improve. Frankly I'm very pleased to see our customers tell us that our consistency was up 10%. That is significant. And that means that we're more affective with respect to competing with truck and the other rail competitors and that translates to value in the marketplace and our prices will reflect that.

Edward Wolfe - *Wolfe Research - Analyst*

And you can talk a little specifically about coal. In your slide coal yields are down 16%. What is going on in terms of price and mix with coal?

Don Seale - *Norfolk Southern Corporation - CMO*

I mentioned the R-cap on the first slide which was a negative \$26 million, most of that resides in certain coal contracts. That impacted coal RPU, Ed, by a total of \$73. And \$17 across the entire book of business. So that \$26 million is what is really relating to coal itself in terms of RPU. Also I mentioned the export was off 23% on times, 24% on volume in the third quarter and that's higher RPU as well. So the two are the moving parts with respect to coal.

Edward Wolfe - *Wolfe Research - Analyst*

Okay. And on slide 8, Don, of your presentation, you mentioned your expectation is for international domestic demand to be on the weak side, but domestic intermodal more flattish. Can you talk about your different expectations going forward for those demands.

Don Seale - *Norfolk Southern Corporation - CMO*

Yes. Our international intermodal traffic in the third quarter, our volume was down 32%. And until we see consumption and the consumer become more active in today's economy, we do not expect that traffic to improve materially ahead. With respect to the domestic market, Ed, we were off 6% in the third quarter in terms of volume. But I would quickly point out that that was against a comp from third quarter of '08 where we were up 18%.

Edward Wolfe - *Wolfe Research - Analyst*

Okay. And last question. You mentioned that utility stockpiles were 8 million above norm for your customers, what's that on a base of?



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Don Seale - Norfolk Southern Corporation - CMO

That's across the 100 utility plants that we serve.

Edward Wolfe - Wolfe Research - Analyst

But it's 8 million on a base of how many millions of tons?

Don Seale - Norfolk Southern Corporation - CMO

We're looking at about 130 million-ton utility market.

Edward Wolfe - Wolfe Research - Analyst

Thank you so much for all of the time. I appreciate it.

Operator

The next question is from Chris Ceraso at Credit Suisse Group. Please go ahead.

Chris Ceraso - Credit Suisse - Analyst

Thanks, good afternoon.

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

Good afternoon, Chris.

Chris Ceraso - Credit Suisse - Analyst

Just a clarification on pricing at 6.2%. Does that include or exclude a fuel adjustment on R-cap. I think last quarter you had given us a number including and excluding.

Don Seale - Norfolk Southern Corporation - CMO

That includes the R-cap impact of negative \$26 million and if you back that out, it adds 9/10 of a percent, which would make the 6.2 now to 7.1.

Chris Ceraso - Credit Suisse - Analyst

Okay. Good. A lot of what you talked about today speaks to the leverage in the business where volumes are going up but people and equipment are going up less and if you look at the numbers it was about a 45% contribution on incremental revenues as you walk from Q2 to Q3 if my math is right. Is that the kind of contribution that we can expect as volumes and revenues go up going forward or did that help in Q3 beat a seasonal or any kind of one-time cost items that help you.



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

There weren't any one-time items in particular. I don't think that we've done quite the same computation that you have. But I would tell you that we would expect, if we see -- continue to see sequential improvement in volumes, that we'll continue to see very good operating leverage.

Chris Ceraso - Credit Suisse - Analyst

Okay. And then just a last one. You noted that automotive is in your down category, but you're talking about a 20% to 30% increase in output in 2010 versus 2009. Is there something that's making you more cautious than that vis-a-vis specific plants or products that you serve?

Don Seale - Norfolk Southern Corporation - CMO

In terms of the increased production for next year, we are cautiously optimistic that that will translate into increased sales, not go into inventory. We would rather see the consumer get a little more active and unemployment drop a little bit in that regard. So while we're not showing it declining, we're not -- we're not overly eager to characterize it as arising market next year either.

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

That's been born of somewhat lengthy experience, Don.

Don Seale - Norfolk Southern Corporation - CMO

Yes. Correct.

Chris Ceraso - Credit Suisse - Analyst

So you're moving the cars from the factory to the dealer, right, not from the dealer to the customer. So if they're building it, whether it's going into inventory or being sold through, you're going to feel it, right?

Don Seale - Norfolk Southern Corporation - CMO

Well unless it goes to a storage area close to the production facility, which this year a lot of that has taken place before it's released to go to the dealer.

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

But the -- the answer really is if volume -- if production increases year-over-year, we certainly should see that reflected in our business.

Chris Ceraso - Credit Suisse - Analyst

Okay. That's helpful. Thanks, guys.

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Operator

Next question is from Jon Langenfeld with Robert W Baird. Go ahead with your question.

Jon Langenfeld - *Robert W Baird - Analyst*

Good afternoon. Can you talk a little bit about your fuel usage. One of the lines you report is the revenue ton miles per gallon and I note that's been relatively flat year-over-year and probably for a couple of years now and I think a lot of your competitors or other rails have seen significant gains on that line. How should we expect that to trend and any idea on why there is such a difference there between you and your peers?

Don Seale - *Norfolk Southern Corporation - CMO*

Well, I guess the metric that we're focused on is the decline in locomotive fuel consumption relative to efficiency gains as measured in terms of gross ton miles and crew starts and the numbers there are 19% decline in locomotive fuel consumption year-over-year versus 17% declines in TTMs and crew starts. So we do see some consumption with efficiency improvements in those numbers and we saw some in second quarter as well. So we do feel as if there is -- we hope, a sustainable fuel consumption opportunity going forward as well.

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

And we're very focused on a lot of technology improvements that will drive reduced fuel consumption. One of the things we discussed at length at our investors day is we're rolling out the leader technology across our northern region which is our heaviest gross ton mile region. That should be fully operational hopefully by the end of the first quarter of next year. That we hope will drive sequential fuel efficiency advantages. And we remain very, very focused on driving that fuel efficiency forward.

Jon Langenfeld - *Robert W Baird - Analyst*

And is there any reason why -- so once we get that implemented, any reason why we would not see that then on the revenue ton mile per gallon of fuel consumed?

Don Seale - *Norfolk Southern Corporation - CMO*

Well we think we'll see continuing incremental improvements in fuel consumption driven by this technology and other initiatives we have underway. I'm not sure there will be quantum leaps in fuel efficiency or consumption improvements but certainly incrementally we think along the lines of what we've seen this year.

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

The other little variable in here to take into account is mixed changes which affect revenue ton miles versus gross ton miles. We generate a lot more growth ton -- revenue ton miles with coal than we do for example with intermodal. So there may be changes reflected in that. We think the two things that we're watching, which are train starts and gross ton miles are the best indicators of the work being performed and therefore the best metrics to judge our fuel consumption against.

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Jon Langenfeld - Robert W Baird - Analyst

Very good. And then the other question was switching gears to the Heartland Corridor which we know is coming up here. Can you just talk through conceptually, we've had some value being generated as you've been implementing the changes along that line, but obviously the big benefit comes when it's all in process. So can you talk about that process of rolling that out and how long until you really can see the benefits of having the full through line complete.

Don Seale - Norfolk Southern Corporation - CMO

Well, actually, let me just amend one thing that you said which is that we will not see any benefits from the project until the project is completed because we cannot start double stacking trains across that Corridor until every clearance has been enhanced.

Jon Langenfeld - Robert W Baird - Analyst

Okay. Okay.

Don Seale - Norfolk Southern Corporation - CMO

We are on schedule to get that finished in the first half of 2010. Once it's completed, we'll immediately change our operating plan to reflect that and start moving a lot more intermodal traffic up from the port of Hampton roads to Columbus and the midwest as well as some traffic coming back the other way. The benefits -- primary benefits initially are operational. They're clearly going to be impacted right now by the downturn in international traffic coming through Norfolk. But we should start to recognize benefits as soon as the last tunnel is cleared and we turn the trains on that way.

Jon Langenfeld - Robert W Baird - Analyst

And that will be both an efficiency benefit but also the ability to grab share of the traffic that is coming out of that port, I would assume?

Don Seale - Norfolk Southern Corporation - CMO

Well if you look at the port today, of course the volumes are depressed. We do think that it gives us a marketing advantage to the steam ship carriers that come through this port. It will take some -- some little bit of time probably to recognize more of that advantage. But an important part of the consider -- of the project and really the primary justification for the project was the operating savings.

Jon Langenfeld - Robert W Baird - Analyst

Got it. Okay. Thanks for the color.

Operator

The next question is from Gary Chase with Barclays Capital. Please go ahead with your question.

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Gary Chase - Barclays Capital - Analyst

Thanks, everyone. Good afternoon. Wanted to see, Don, if I could get you to just clarify some of the comments you made on the export coal side. I think you said you expect the strength to continue through April. Should we be thinking of that as Q3 levels or September levels because you've obviously seen quite a big pick-up as we move through the third quarter.

Don Seale - Norfolk Southern Corporation - CMO

Gary, we expect to see a more robust demand for export through the current export coal year which will run through April 1st, 2010. I'm reluctant to try to put it into terms of the run rate versus '08. September obviously was very close to '08. Within 28,000 tons. October, I will tell you, is running a little ahead of 2008. But beyond that, I hesitate to say any more about that other than we expect it to be better than it was in the first half through April 1st of next year.

Gary Chase - Barclays Capital - Analyst

Okay. And that's obviously something that would have helped coal yields in the quarter, which we thought looked good. Were there any repricings in there that would have given that line a boost as well?

Don Seale - Norfolk Southern Corporation - CMO

No, no significant coal repricings in the quarter.

Gary Chase - Barclays Capital - Analyst

Okay. And then if I could, just one for Mark. If I look at slide 7 of your presentation, and look at what you're showing in terms of composite service performance, no doubt the cost performance in the quarter relative to volume was good, but you do show at least in the third quarter not the same kind of improvement year-on-year in at least that metric. I know Don referenced several times service consistency being strong and I think the number was up 10. So was just wondering if you could shed a little bit of light on what's in there and maybe how we should think about that looking forward in an environment where volumes are potentially going to improve yet further.

Mark Manion - Norfolk Southern Corporation - COO

Yes, we didn't see quite the same rate of improvement in the third quarter that we had in the first half. And there is -- there would be several things involved in that. Keeping in mind that we had a -- we had a more difficult time down in the southeast with some weather-related issues and that probably -- that played a role in there. We had two of our primary routes out of Atlanta that were actually shut off for a period of 48 hours and then some recovery time after that. So that takes a toll. But that together with some of the adjustments we made to the hours of service changes that took place in the middle of the summer, those things are behind us and we've moved beyond that. So we're looking forward to good performance as we go on into the balance of the year.

Gary Chase - Barclays Capital - Analyst

Is consistency, is the concept Don is describing, is that what it takes to keep the cost low? Is it the predictability and the dependability?



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Mark Manion - Norfolk Southern Corporation - COO

It sure is. When we started back in 2001, with our thoroughbred operating plan, we -- keeping in mind that having not gone down that road before -- we were first concerned that there would be a high cost associated with that. We figured it would be good from a customer service standpoint, but the pleasant surprise was that it not only bodes well for customer service, but it really helps from a cost standpoint to operate scheduled railroad and operate with consistency and follow our operating plan. So our employees are well familiar with that and they're positioned to continue to follow that operating plan and follow consistent service.

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

And one of the groups that we have also found that really buy into this concept and the -- providing this regularity of service and high performance level on our train operation are our employees. It makes their lives more predictable and allows them to schedule and they're fully on board.

Gary Chase - Barclays Capital - Analyst

Okay, guys. Thank you very much.

Operator

The next question is from Walter Spracklin with RBC Capital Markets. Please proceed with your question.

Walter Spracklin - RBC Capital Markets - Analyst

Good afternoon. Just a quick question on balance sheet, Jim. You have a billion dollars of cash there now and haven't seen an increase in a dividend in the last few quarters. I'm just wondering are you considering you want to keep some cash in the till here. A billion dollars is a lot of money and what your terms are in a potential buyback and dividend increases going forward?

Jim Squires - Norfolk Southern Corporation - CFO

Well, as you said, we showed \$999 million at the end of the quarter and that is more cash than we need in the long run I think at any given time. But for now, and for the foreseeable future, I think we will be maintaining higher than normal cash balances. It doesn't feel like us, like it's yet time to reduce that cash balance significantly. So that's -- that's where we stand with respect to the cash balance. You'll probably continue to see it at rather high levels for some time to come.

Walter Spracklin - RBC Capital Markets - Analyst

So if we do see an improvement, what is your comfort level of cash buffer on your balance sheet that would you like to see?

Jim Squires - Norfolk Southern Corporation - CFO

Well, it depends on the outlook and current conditions and other factors as well. But I think certainly somewhat below what we're carrying today. But as I said, for now, that continues to feel like the right -- about the right level of cash on hand.



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Walter Spracklin - RBC Capital Markets - Analyst

Okay. And just my other question here is on your depreciation rate study you mentioned in the past we've seen those studies lead to a step up in depreciation. Now there's some reasons that could point to that not being the case here in particular given the slowdown in Capex spent. What -- was this something that is regular or did something prompt this and just gut feel, is this something that will drive your depreciation rate higher or lower?

Jim Squires - Norfolk Southern Corporation - CFO

It is a regularly scheduled and conducted depreciation rate study and I do not want to predict what the study will conclude, but I will say that with lower business levels, assets are likely to have a longer useful life.

Walter Spracklin - RBC Capital Markets - Analyst

Okay. Thanks very much, guys.

Operator

The next question is from Ken Hoexter with Banc of America Merrill Lynch

Ken Hoexter - Banc of America Merrill Lynch - Analyst

Good afternoon. Wick, can you talk about on the regulatory front where you stand with Senator Rockefeller's committee. Have you seen -- what level of draft have you seen, where are discussions and what your thoughts are on expectations for timing?

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

Well, I can probably give you the same answer you've gotten from some other folks as well. The operative word that we hear in terms of seeing a draft is soon. And that seems to have a fairly fluid definition. I don't think we really know when we'll see another draft. It could be very quickly or it could be still some good long time out.

I think the very positive thing that is coming out of this, though, is that we have as an industry had a very good dialogue with the Commerce Committee staff and therefore Senator Rockefeller in terms of the issues that are important to our industry, why the economics and regulatory structure of our industry today makes sense and how important it is that we be able to continue to earn an adequate return and invest the significant amounts of capital that we need to invest. I think that as we've had that discussion, it's been a learning experience for some folks who now I think have a much clearer picture of why we say what we say and how important it is to maintain a healthy railroad industry. So I have no idea right now when we'll get another draft or what the draft will look at, but I think that dialogue has been a very, very positive thing. And hopefully that will be reflected in whatever emerges from the Commerce Committee.

Ken Hoexter - Banc of America Merrill Lynch - Analyst

Has the dialogue picked up lately? Have they gotten more detail on open access or can you address any of those issues?

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

I really cannot. But other than to say I think that its just been a fairly continuous dialogue for some time now.

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Ken Hoexter - Banc of America Merrill Lynch - Analyst

Nothing that picked up recently that leads you to believe that something is more imminent than not.

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

I don't believe so.

Ken Hoexter - Banc of America Merrill Lynch - Analyst

I want to hit one quick one on the price that everybody's been hammering on, with what we heard from some carriers a couple days ago, why is there such a disconnect in the market with the east versus west, do you think right here? Are you starting to see some rail to rail competition pick up out west? Is it more the exposure intermodal. I'm wondering from your point of view why you see such a dichotomy of 2% to 3% ever pricing versus 6% on the east coast?

Don Seale - Norfolk Southern Corporation - CMO

Yes, we can only comment on our book of business and our position in our market. I can't comment on what others are doing.

Jim Squires - Norfolk Southern Corporation - CFO

It's Jim. Just to add to that, a little bit, I think one thing that investors should keep in mind is that these core price increases are not apples-to-apples comparisons in all cases. The carriers, as you know, use different methods to calculating core prices. Some use sales, some use RTMs and some use units and so I think its important to introduce that caveat in making comparisons.

Ken Hoexter - Banc of America Merrill Lynch - Analyst

Can you, Don, can you comment at all on JB Hunt on domestic intermodal if you're switching -- or thoughts on switching from contract business to more variable rates within the marketplace, what your thoughts are on that?

Don Seale - Norfolk Southern Corporation - CMO

Well, Ken, as I mentioned, our domestic intermodal business was off 6% in the quarter against a real strong comp from last year of about 18%. And that double digit increase continued into the fourth quarter. So we remain very optimistic about the business model for modal conversion in our service territory we continue to make good progress on our activity with the Crescent Corridor as I mentioned with a couple of new ramps announced in the quarter and I cannot comment on specific negotiations with any of our customers, but I will say just to conclude we remain committed to that market and we think it's going to be a good growth market for us ahead.

Ken Hoexter - Banc of America Merrill Lynch - Analyst

Great. Good job on the cost cutting during the quarter.

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

Thank you, Ken.

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Operator

The next question is from Randy Cousins with BMO Capital Markets. Please go ahead with your question.

Randy Cousins - *BMO Capital Markets - Analyst*

Good afternoon. Jim, for you, just with reference to the sequential change in compensation from Q2 to Q3, I notice that the headcount was down in Q2 to Q3 but the total compensation was up Q2 to Q3. Can you give us some sense as to what exactly went on quarter to quarter as distinctive from year-over-year.

Jim Squires - *Norfolk Southern Corporation - CFO*

A large component of that would have been the volumetric affect on activity and associated labor expense and I think that would have been the driver, as well as an inflationary component in labor wage rates as a result of the 4.5% increase for most crafts in July. That would have been a factor as well.

Randy Cousins - *BMO Capital Markets - Analyst*

Okay. One thing you've been talking about is the ability to leverage your fixed asset base and without having to add a whole lot of head count. This team seems to be in contrast. I wonder if you could explain this to me more or is this a case of reloading the system and in Q3 as a function of the volume and in preparation, can you give me additional -- is there any addition color you can give me?

Jim Squires - *Norfolk Southern Corporation - CFO*

Well I'll say this, I think that the issue to focus on on a sequential basis in the fourth quarter is a comparison, so it's not so much as a sequential perspective as the comparison coming up here in the fourth quarter. As you'll recall, in the fourth quarter of last year, we had a substantial decline in our stock price which drove down compensation and benefits expense in the fourth quarter of last year versus the third quarter and now we're lapping that. So you will see -- you will see some change there.

Randy Cousins - *BMO Capital Markets - Analyst*

Okay. For Mark, could you -- train speed, you're train speed has kind of peaked out in April, May, June, they've come down more recently. How important is train speed? Should we worry about train speed? Is higher train speed a good thing? How do you think about train speed for Norfolk Southern?

Mark Manion - *Norfolk Southern Corporation - COO*

Well improved velocity is certainly a good thing. And as commented on earlier by Wick, we had improved velocity so that's good. And like I said earlier, we may have taken a little bit of a hit on speed due to our unusual weather situation in the southeast. But aside from that, what we concentrate on is balancing our -- balancing our service with our costs. And so to the extent that we can continue to operate the plan, and I will say that there has been -- it's been challenging throughout the year to adjust the plan as much as we have, as the volumes have decreased, that plan was sized significantly. And it's something that is done with a lot of science and a lot of care. So as we've adjusted the plan downward, we just -- we watch the cost closely and we maintain the service and we'll keep the velocity up but at the same time we want to -- we want to operate as consistently as possible. That's our focus.



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Randy Cousins - BMO Capital Markets - Analyst

Okay. And Wick, last question. There is all different kinds of debates about the type of recovery we're going to have, certainly capital markets seem to think the end of the world is about to come once more. In terms of your planning, how are you guys thing about 2010 and if we have a stallout in this recovery can you still take costs out of the system or do we need volume recovery to get leverage?

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

Well volume recovery clearly gives us leverage. In terms of cost reduction, I think we've done a really good job of that in particular by sizing the plan and cutting all unnecessary costs. That's what we'll continue to do. Part of the -- part of this business for Norfolk Southern and for all of the carriers is that we're a network business, we have some considerable component of fixed or very long-term variable costs. They're harder to address, although we're addressing them as well. In terms of how we're thinking about next year, we're looking like everyone at all of the econo-metric data we can and listening to the pundits and trying not to get too confused and making our plans accordingly.

Randy Cousins - BMO Capital Markets - Analyst

Okay. Thank you.

Operator

The next question is from Justin Yagerman from Deutsche Bank. Please go ahead with your question.

Justin Yagerman - Deutsche Bank - Analyst

Hey, guys, appreciate you taking the questions. Looking at domestic intermodal and following up on Ken's question there. Outside of the difficult comp on a year-over-year basis, is there anything else going on in that business? Are you seeing with your negotiations with Hunt and diversion away to your other east coast competitor and would you expect that if you do actually win the partnership with them, or agree on a partnership with them, I should say, that that outlook on domestic intermodal could change from a net neutral to a more positive one?

Don Seale - Norfolk Southern Corporation - CMO

Well as I indicated earlier, we have a positive outlook on domestic intermodal. We see growth ahead. And an 18% comp from the third quarter of last year, an 11% increase in the fourth quarter of last year, those are strong comps. Where we're seeing the most headwind in that market right now is a lot of excess capacity in trucking and also less freight moving. Because of the economy.

Justin Yagerman - Deutsche Bank - Analyst

Okay. Are you seeing some of that come back sequentially as truckload pricing sounds like it's at least stabilizing or firming up on the margin?

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Don Seale - Norfolk Southern Corporation - CMO

We are seeing some truckload pricing firming up on transcontinental on a sequential basis which is encouraging. We're seeing a little more transloading activity on the west coast from international boxes to 53-foot boxes coming east. But I will tell you that overall we're still seeing a trucking market where there is too much capacity and looking ahead, we do not expect that to continue over time, even if the market doesn't recover as quickly because a lot of those assets are positioned where they're not being replaced. And the financial institutions that hold the financial instruments on that equipment, they're reluctant to repossess it, but if the end of the life of the asset is going to drop out.

Justin Yagerman - Deutsche Bank - Analyst

That's a fair point. A bunch of questions earlier on the export coal outlook that you gave runs contrary to what we've been hearing on coal in general. So it's pretty interesting. When I think about the coal pickup you've been seeing there, how much of that would you attribute to weak dollar and I guess when you think about the run rate and the outlook that you gave it's pretty long looking out to April. What gives you that length of visibility in this type of a market? Is it that there are specific infrastructure programs that are -- that are requiring minimums in terms of coal exports that you have visibility to, or is it that you just have a general sense that these projects are going to continue?

Don Seale - Norfolk Southern Corporation - CMO

The biggest driver in the export metallurgical coal market is that one the US, in particular Virginia, West Virginia, have some of the world's highest quality, low vol metallurgical coal for steel making. That's one data point. The second data point is that the Chinese stimulus program is probably the most effective economic stimulus program that we've seen in terms of the results it's driving. The Chinese steel industry this year is projected to produce over 400 million tons of steel to feed infrastructure projects driven by their stimulus plan. To contrast that to US steel production, we're expected to produce about 73 million tons.

Justin Yagerman - Deutsche Bank - Analyst

But prices in China are being slashed and inventories are high there. So some expectations are calling for their there to be a slowdown in terms of their demand. Is that something you guys aren't afraid of when you think about the exports you're seeing from a demand stand point?

Don Seale - Norfolk Southern Corporation - CMO

Well since the Chinese cargos are a very small percentage of our total export, what is happening here is China and the demand that it has for coal, for steel-making, is taking a lot of the Australian coal, the Australians in turn are having very difficult times keeping up with that demand. The ship queue at ports over there are as high as 60 vessels queued up, waiting to load. That's freeing up capacity for us into western Europe, which is where we will see the majority of our stronger position.

Justin Yagerman - Deutsche Bank - Analyst

That actually -- the length of hauls there make some sense. I guess one last question, I would be curious to get any commentary around boxcar business in Q3 and how that felt and generally what trends have looked like so far into October?

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

Our predominant commodities moving in boxcars like paper, pulp, still continues to be very weak. Forest products related to housing continues to be weak but we are seeing increased demand in food products and some of the other consumer staples that we're moving in boxcars.

Justin Yagerman - Deutsche Bank - Analyst

What about things like white goods and the rest?

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

Still very soft.

Justin Yagerman - Deutsche Bank - Analyst

Okay. And then lastly, can you talk a bit about Capex this year and what your thoughts are next year and maybe a lit bit about PTC and how that enters into those plans?

Jim Squires - Norfolk Southern Corporation - CFO

Very quickly, our Capex this year, Jim, will be something around \$1.4 billion or slightly under that. We have not completed our capital planning for next year. Although I would tell you, I don't expect a radical change in other direction right now. PTC depends on how the legislation goes and depends on where some of the technology goes, but our estimate right now is somewhere between maybe \$700 million and a billion.

Justin Yagerman - Deutsche Bank - Analyst

Over what period of time?

Jim Squires - Norfolk Southern Corporation - CFO

Well, the law right now requires that it all be implemented by 2015.

Justin Yagerman - Deutsche Bank - Analyst

By 2015. Thanks a lot for your time, gentlemen.

Operator

The next question is from Jeff Kauffman with Sterne Agee. Please go ahead.

Unidentified Participant - Analyst

Hi, this is Sal Vitally for Jeff Kauffman. I had a follow-up question on the discussion earlier about pricing, and there was -- someone said earlier that on the domestic intermodal side, that's being probably disproportionately impacted on the pricing side. And



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I'm just trying to get a sense for looking at the overall book of business, intermodal is about close to 20% of third quarter revenue. You have coal about 28%, so together they comprise close to half of revenue. So are we seeing more of the pricing strength and some of the other segments like some of the other economically sensitive segments like say chemicals, automotive, metals and construction? Is that the right way of looking at it or is there something else going on there?

Don Seale - Norfolk Southern Corporation - CMO

We look at -- when we report price, we're really talking about price across the book of business. And I can tell you on the intermodal book in the third quarter we had a modest positive on price, not a negative. So we're seeing a positive price effect across all of the book of business, not just coal, chemicals, et cetera.

Unidentified Participant - Analyst

Okay. But I was just trying to get a little sense for whether there were any particular segments, any particular commodities that had maybe something towards the upper single-digits in terms of pricing? Or maybe that's a little bit more color than what you want to give.

Don Seale - Norfolk Southern Corporation - CMO

That's going more granular that we would like to go.

Unidentified Participant - Analyst

Okay. And then just one other question on the export coal business. I'm just trying to get a sense for -- given what the percentage of your overall coal revenue, that it comprises, can you give us a sense for the differential in the revenue per car export coal versus thermal coal?

Don Seale - Norfolk Southern Corporation - CMO

Well, the revenue per car with respect to export, it's generally shorter haul than our utility coal. So it -- it will have a lower RPU in some cases based on length of haul from south West Virginia to the port.

Unidentified Participant - Analyst

Okay. Okay. And then just one final question. There was a comment made earlier about overtime pay, how it was down about 40% year-over-year. I'm just trying to get a sense for when we start to see the freight upturn, just trying to get a sense for how important that will be to an increase in labor cost. So in terms of dollars, can you tell us what that -- the decline in overtime pay was year-over-year?

Don Seale - Norfolk Southern Corporation - CMO

We do not break that out.

Unidentified Participant - Analyst

Just in terms of ballpark, how significant it is?



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Don Seale - Norfolk Southern Corporation - CMO

It's a reasonably significant number. We do not break it out.

Unidentified Participant - - Analyst

Okay.

Jim Squires - Norfolk Southern Corporation - CFO

I will say this, though, we have really cut back on overtime this year. That's been one of our key initiatives on the T&E and non T&E labor side in terms of the activity and I think our plan going forward will be to keep overtime in check as much as possible.

Unidentified Participant - - Analyst

Okay. So just to follow up on that, and I'm talking in hypotheticals here, but say you get a 10% increase in carload levels from current levels, what could that -- are we to understand that we should not see too significant an increase in overtime pay based on that scenario?

Don Seale - Norfolk Southern Corporation - CMO

That would be our expectation. Now let me also say that fourth quarter is always a little more interesting for us in terms of overtime because we never know what challenges the weather might be.

Unidentified Participant - - Analyst

Sure. Weather is always the wild card. Okay. Well thank you for your time.

Don Seale - Norfolk Southern Corporation - CMO

Certainly.

Operator

The next question is from Donald Broughton with Avondale Partners. Please go ahead with your questions.

Donald Broughton - Avondale Partners - Analyst

Thanks. All of my questions have been answered. Thank you very much.

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

Thanks, Don.

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Operator

There are no further questions in queue. Would you like to turn the call back to management for closing remarks.

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

Thanks very much everyone for your patience and we look forward to talking to you next quarter.

Operator

This concludes the teleconference. You may disconnect your lines. Thank you for your participation.

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