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NSC - Q1 2017 Norfolk Southern Corp Earnings Call

EVENT DATE/TIME: APRIL 26, 2017 / 12:45PM GMT

OVERVIEW:

Co. reported 1Q17 revenues of $2.6b, income from operations of $773m and EPS of $1.48.

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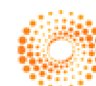

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PRESENTATION

Operator

Greetings, and welcome to Norfolk Southern First Quarter 2017 Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I'd now like to turn the conference over to Katie Cook, Director of Investor Relations. Please go ahead, Ms. Cook.

Katie Cook

Thank you, Robin. Good morning. Before we begin today's call, I would like to mention a few items. The slides of the presenters are available on our website at norfolksouthern.com in the Investors section along with our non-GAAP reconciliation. Additionally, transcripts and downloads of today's call will be posted on our website.

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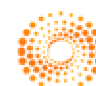

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During this call, we may make certain forward-looking statements which are subject to a number of risks and uncertainties and may differ materially from our actual results. Please refer to our annual and quarterly reports filed with the SEC for a full discussion of those risks and uncertainties we view as most important.

Now it is my pleasure to introduce Norfolk Southern's Chairman, President and CEO, Jim Squires.

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Good morning, everyone, and welcome to Norfolk Southern's First Quarter 2017 Earnings Call. With me are Alan Shaw, Chief Marketing Officer; Mike Wheeler, Chief Operating Officer; and Marta Stewart, Chief Financial Officer.

We are pleased to report another strong quarter of financial and operational results. Our first quarter record results reflect the successful execution of our strategy to drive both service and operational performance in a growth environment. As shown on Slide 4, we achieved a record first quarter operating ratio of 70% despite rising fuel prices as well as record income from operations of $773 million, up 7% compared to the prior-year period. Earnings per share increased 15% to a record $1.48. Capitalizing on our 2016 success, we have stayed focused on our core mission of safety, service, productivity and growth, the cornerstones of our strategic plan.

We have demonstrated our ability to adapt to a changing world. Last year, we excelled in a challenging economic environment, improved our service and significantly reduced costs. This year, we're off to a strong start. We are building on the momentum we've created and continue to focus on strengthening our company, positioning NS for growth and maintaining a disciplined cost structure.

As evidenced by our recent results, Norfolk Southern is relentlessly focused on improving productivity and prudently investing to drive efficiency and growth. Slide 5 highlights some of the components of our continued operational success. Our measure of network performance, the composite service metric, has remained steady even as units increased. We are driving continued improvements in customer service and efficiency through the solid execution of our operating plan. To ensure we are providing a service product that is tuned to our customers' needs and that drives return on assets, we have implemented strong analytical tools and multi-department insights. For example, our new crude planning model has enhanced our ability to manage employee resources effectively with demand, which supports our high service quality while also keeping costs in check.

We are confident that service will increasingly be an important differentiator for our company. Improved resource utilization also remains a core focus, and Mike will detail our initiatives and progress in all the major areas including employee, locomotive and fuel efficiencies later on in this call. We expect our initiatives to generate at least $100 million of productivity savings this year building on the $250 million of productivity savings achieved last year. We continue to make strong progress on our productivity initiatives and remain on track to achieve our objective of $650 million in annual savings by 2020. We have a balanced strategy that leverages strong long-term partnerships with customers and dynamic internal processes that support effective asset management. Our planning and operating technology informed by collaboration with our customers is strengthening our position in the supply chain. For example, we are working together with our customers to further align our internal metrics with those that are most important to their unique operations. Additionally, through this holistic focus on the entire supply chain, we are proactively aligning resources with demand.

We have initiatives for additional improvements ongoing as we develop new technology to optimize the distribution of empty equipment and that improves load scheduling, visibility and flexibility. As reflected on the lower right of Slide 5, the efficiencies we've already achieved have enabled us to effectively contain employee resources while delivering growth.

We are confident that our strategic plan is sustainable and provides a strong foundation to attain growth at low incremental costs, and that's a powerful formula for enhanced shareholder value. In 2016, we returned $1.5 billion to our shareholders through dividends and share repurchases, and we're on track for similar amounts in 2017. I'll now turn the program over to Alan Shaw, Chief Marketing Officer.

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Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Thank you, Jim, and good morning, everyone. Thank you for joining us today. Norfolk Southern delivered first quarter revenue of $2.6 billion, a strong 6% year-over-year increase, which was driven by volume growth of 5% and a revenue per unit improvement of 1%. We attained volume and revenue gains in all 3 of our major market groups with a particularly robust performance in coal, intermodal and steel, versus the first quarter of 2016. Additionally, fuel surcharge revenues increased due to higher on-highway diesel prices. We maintain our focus on pricing. Revenue per unit excluding fuel was flat as pricing gains were offset by negative mix associated with increased intermodal volume and short-haul utility coal. On Slide 8, merchandise revenue was up 2% for the quarter with a 1% increase in volume and overall revenue per unit growth of 2%.

(technical difficulty)

Volume gains were primarily driven by metals and construction strength due to improved steel production and increased construction and drilling activity. Although, the market declined slightly in the first quarter due to reduced energy shipments, truck competition and in automotive, decreased U.S. light vehicle production.

Merchandise revenue per unit increased 1% excluding fuel surcharge as positive pricing gains were partially offset by negative mix related to increased aggregate and soybean volume. Turning to our intermodal market on Slide 9, revenue of $571 million represents a 9% increase over first quarter 2016, with a 4% gain in volume and a 5% improvement in RPU. Our improved service product helped drive a 5% volume increase within our domestic intermodal franchise despite weakness across the trucking industry. Continued strength in East Coast ports activity supported international volume, which was up 3%. Excluding fuel, our intermodal revenue per unit improvement of 1% was driven by current pricing initiatives within the context of a soft trucking environment.

Moving to Slide 10, coal revenue increased 20% to $420 million in the first quarter driven by significant volume increases in the export and utility markets as well as pricing gains. Utility coal volume of 17.6 million tons in the first quarter benefited from our previously announced market share gain and higher natural gas prices, which offset the impact of mild winter weather. In our export market, we handled 6.3 million tons in the quarter through Lamberts Point in Baltimore, due to improved demand and pricing for U.S. export coal. More than doubling its shipments, Baltimore is primarily lower RPU thermal coal and represents 38% of our total export volume, while Lamberts Point grew over 50% and is predominantly metallurgical coal.

As we look ahead to Slide 11, our focus is on continuing to execute our strategic vision for growth. We are forecasting generally improved economic conditions particularly, related to manufacturing and consumer spending, which we expect will positively impact our volume. Merchandise volume is expected to be relatively flat in 2017. Crude oil, which represented over 50,000 units last year, is predicted to decline close to 30% in 2017, as shipments are diverted to the Dakota access pipeline. The largest year-over-year decrease is projected in the second quarter. Additionally, our projected 3.5% decline in 2017 U.S. vehicle production will negatively impact our automotive volume. However, metals and construction grain and plastics are expected to be up year-over-year. Within intermodal, our strong service product has and will continue to enable success in converting service-sensitive volume from the Highway.

Looking ahead, we expect positive macroeconomic trends to drive organic growth. Expected increases in transportation demand and gradually tightening truck capacity in the latter part of the year will provide potential volume growth through the remaining quarters this year. We expect year-over-year growth within our coal markets with export gains driven by the continued tightening of international supply

(technical difficulty)

most recently affected by Cyclone Debbie in Australia. Seaborne prices fell from the highs in late 2016 and earlier this year, the after effects of the cyclone recently increased prices again. This should be a short-term benefit to U.S. coals in the global market. Due to this volatility, we expect to exceed our guidance in the second quarter and return to 3.5 million to 4.5 million ton rate in the third and fourth quarters. We expect utility coal volume to grow this year, remain confident in our quarterly guidance range of 17 million to 19 million tons. It is important to note we are in shorter months when the utilities typically rebuild their inventories from winter, although this winter was relatively mild, particularly in the South and as a result, stockpiles remain elevated.

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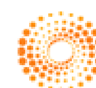

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Consistent with our strategic plan, we are securing high-quality revenue growth that complements our existing network. We have developed a service product conducive to attracting new revenue and launch new customer focused initiatives designed to improve our customer experience and make it easier to do business with Norfolk Southern. At the same time, we have a keen understanding of the capacity of our existing network and we'll work to balance growth in targeted areas with the needs of our customers. While leveraging the value of our service product, we will continue our initiatives to attain pricing in excess of rail inflation. As we have previously stated, we take a long-term view of our markets in pricing to yield sustainable shareholder value. We will continue to work with our customers to understand their expectations and remain an integral part of their supply chain. I will now turn it over to Mike, who will discuss our operational performance.

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Thank you, Alan, and good morning. In the first quarter, we successfully executed on our strategic plan to provide a high-level service product and to pursue productivity initiatives while handling more volume. Starting with safety on Slide 13, we are pleased to see a 13% improvement in our reportable injury ratio as well as a 26% improvement in our serious injury ratio. These reductions demonstrate our continued dedication to maintain safe working environment for our employees throughout operations and the communities we operate in. Working safely and efficiently is a key component of our efforts to drive sustainable value creation.

Turning to Slide 14. We continue to drive improvements in network performance and operate at high-service levels. Our service composite remains strong with dwell improving 4% and train speed decreasing 4%.

Moving to some of our productivity initiatives starting on Slide 15. 2016 was a record year for train length and we are on track to set a new record for the full year. This is one of the factors that has allowed us to handle increased volume without a commensurate increase in resources. Importantly, we are ensuring we keep our yards fluid and we are providing a good service product to our customers. As Jim mentioned, we achieved these results by optimizing our operating plan and aggressively accelerating use of distributed power, which utilizes locomotives on the head and rear of longer trains to allow for better training handling.

As shown on Slide 16, train length, along with the continued rationalization of our yard and local fleets, has resulted in significant improvements in our locomotive productivity. We removed 150 locomotives from service in 2016 and we removed another 50 so far this year with an additional 100 to be removed in the second quarter. We did this by again, reviewing our local and yard service and by combining deliveries so that fewer locomotives are required without affecting customer service. In total, we will have removed 300 locomotives from service since the beginning of last year. Consequently, we are on pace to set a new record this year for our locomotive productivity. Not only do these improvements drive lower maintenance costs, they also enhance our fuel efficiency and help protect our business against adverse fluctuations in fuel pricing.

Taking a closer look at our fuel efficiency on Slide 17, we achieved a 6% improvement in the first quarter versus the same period last year, and as you recall, 2016 was a record year for this measure. We accomplished this by improving train lengths, locomotive rationalizations and our energy management initiatives. Together, these initiatives continue to drive improvement in fuel efficiency.

Lastly, on Slide 18, we improved our employee productivity in the first quarter. We are continually rightsizing our workforce by working closely with our marketing team to project where we see growth and where we see reductions in our volumes.

Our strategy at implementing higher emplores, at our core locations, particularly in some, which have proven difficult to hire in the past, is a part of our process to maintain high customer service levels. Remaining properly staffed also aids our asset utilization through improved velocity. Our ability to achieve these improvements is driven by optimizing our operating plan and our increases in train length. In addition, we are realizing improvements from our strategy of terminal rationalizations, which we continued to review as markets shift. We expect our full year T&E headcount to be up slightly to handle expected increased volumes.

In closing, we are executing on our flexible and balanced strategic plan driving long-term growth through excellent customer service coupled with aggressive productivity initiatives. I will now turn it over to Marta, to discuss our financial results and achievements.

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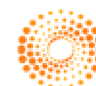

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Marta R. Stewart - *Norfolk Southern Corporation - CFO and EVP of Finance*

Thank you, Mike, and good morning, everyone. Our first quarter operating results are summarized on Slide 20. As Jim mentioned, both income from operations and the railway operating ratios set first quarter records. We expect to see year-over-year improvement in our operating ratio in each of the remaining quarters of this year as compared to 2016.

Before we take a look at the expenses in detail, let's examine the effects of changing fuel prices on both our revenues and our expenses. As highlighted at the top of Slide 21, the net impact from fuel on our operating ratio in the first quarter was 170 basis points. The table on the slide shows the year-over-year change by quarter for both fuel surcharge revenue and fuel expense. Throughout 2016, we have largely offsetting decline. In the first quarter of this year, while fuel surcharge revenue was higher compared to the prior year, the increase was not enough to offset the increase in diesel fuel expense, thereby negatively impacting operating income by $33 million. The graph below the table illustrates that this was largely due to the divergence, you can see reflected, in the first quarter 2016. Since the difference in prices narrowed thereafter, we do not expect a significant net effect on operating income in the remaining quarters of this year.

Turning now to the component changes in operating expenses on Slide 22. In total, expenses rose by $105 million with the majority of that increase relating to fuel as all other categories increased by less than inflation plus volume. Let's take a closer look at the component.

Fuel expense as shown on Slide 23, rose by $64 million and the higher fuel price accounted for all of the increase. As Mike described, we have markedly better fuel efficiency with a 1% decline in consumption despite the 5% increase in traffic.

Slide 24 highlights the major drivers of variance in compensation and benefits, which rose by $20 million or 3% year-over-year. Increases associated with wage inflation and higher health and welfare rates added $31 million to expenses and we expect these increases to continue at a similar run rate for the remainder of the year. Partially offsetting these inflationary items were reduced employee levels, which resulted in $12 million of lower expense. Headcount was about 600 employees lower than the first quarter of 2016. Going forward, we expect total employment levels to remain steady depending, of course, on volume.

Slide 25 shows the $16 million or 8% increase in the materials and other category. Claims costs were higher due to a case-specific accrual for a third party claim which totaled $9 million. Additionally, locomotive and engineering materials were up $7 million.

Turning to purchase services and rents on Slide 26. This category was down $2 million or 1% year-over-year. Equipment rents decreased by $6 million due to the lower automotive traffic Alan mentioned, as well as better system fluidity. Costs associated with increased intermodal traffic accounted for an $8 million increase in purchase services during the quarter.

Moving on to income taxes on Slide 27. The effective rate for the quarter was 33.9% versus 35.5% in the first quarter of 2016. The rate this year was lower, largely due to the impact of tax benefits associated with stock-based compensation.

Slide 28 shows our bottom line first quarter results. Net income was $433 million, up 12% compared with 2016, and diluted earnings per share was $1.48, a first quarter record. This performance demonstrates the effectiveness of our strategy, which continues to drive record results. I'll now turn the call back to Jim for closing remarks.

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Thank you, Marta. Now, before I move to closing comments and we open the line for Q&A, I do want to acknowledge a press release we issued this morning in conjunction with our earnings press release. This morning, we announced that Marta Stewart, our Chief Financial Officer, will be retiring effective August 1. Marta will be with us through the second quarter and will be back in late July 2 to present our second quarter earnings but I cannot let the moment pass without acknowledging her decision to retire and thanking her for her many contributions to Norfolk Southern, over the years.

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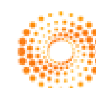

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We continue to execute our strategic plan and remain well on our way to reaching our goal of achieving $650 million in productivity savings and an operating ratio below 65% by 2020, all while maintaining our superior service product. Our plan is dynamic and flexible. And as we identify additional opportunities whether to improve productivity or drive growth, we will aggressively pursue them.

Our strategy has proven successful and we have a strong, engaged team to continue the momentum. And with that, we'll now open the line for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today comes from the line of Allison Landry with Crédit Suisse.

Allison M. Landry - *Crédit Suisse AG, Research Division - Director*

So, I guess, I'll take the obvious one here, since I have the first question but you put up solid operating results if you adjust out some of the onetime-ish items from the prior years as well as the current quarter. But if we think about the numbers that CSX, put up last week and an indication that the 2018 OR could be in the low 60s, does this up the ante for your long-term targets? And is there anything that you've observed in terms of the operational changes that CSX, so far including yard rationalization, et cetera, that you think you could adopt for your own network to bring out additional costs? I guess, long story short, does better competition breed better competition?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Good morning, Allison, and thank you, for your question. We are watching closely what's happening in the industry with our peer and we are doing many of the same things albeit at a somewhat measured pace and we will continue to do so. But we will focus on our strategy, which revolves around safety, service, productivity and growth. Safety, because it's absolutely the most important thing we do. We never take a day off when it comes to safety. Service, because we're a service company. Service excellence defined by our customers because we serve them not vice versa. Productivity because we have a very large asset base and it's our responsibility to manage it every day. Cost consciousness is in our bones. And lastly, growth, our customers want to go grow and we want to go with them, provided we can do so profitably.

Allison M. Landry - *Crédit Suisse AG, Research Division - Director*

Okay, great. And just as a follow-up, speaking about growing with your customers profitably, do you expect to take any share gains from CSX, to the extent that there's any network disruptions? And if so, what commodities do you think you would like to see the most benefit and there is any way to size the potential of that?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

We're always looking for good revenue growth opportunities. We have the capacity and we have the willingness to take on additional volumes and growth, provided we continue to maintain excellent service levels and the growth we take on, are close to the bottom line.

Operator

Our next question comes from the line of Chris Wetherbee with Citigroup.

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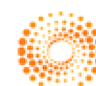

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Christian F. Wetherbee - *Citigroup Inc, Research Division - VP*

I wanted to pick up a little bit on that last sort of comment just thinking a bit about relative operating ratios between geographic competitors, we focus a lot on the OR. But I want to get a sense for a management's perspective, do you think that you're either at a -- do you think that different ORs put you at material disadvantages in terms of servicing the customer and market share opportunities. Just want to get a rough sense of maybe, sort of management thinking about where you might stack relative to other peers from a margin standpoint if it's that important for the customer service side?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

I guess, what I would emphasize, Chris, is that ours is a balanced strategy. We are working to grow the bottom line through top line growth and through better operating margin, and we get there through excellent service to our customers, that helps us grow the revenue, it'll also helps us to operate efficiently as well, as we've shown in the past. So it's really all about balance. It's a combination of top line growth, margin improvement driven by productivity and incremental margin. And all while keeping our eye on the service wall and making sure that what we do is sustainable for the long-term as well.

Christian F. Wetherbee - *Citigroup Inc, Research Division - VP*

Okay, that's helpful. And then just a follow-up, just thinking about the volume opportunity in 2017, so your comps get decently easier in the second quarter relative to the first quarter when you think about sort of the business opportunities ahead of you both from a competitive standpoint but also from an organic standpoint, how should we be thinking about sort of volume trends as we go forward through the rest of the year?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Well, I'll say this and then I'll turn it over to Alan, for a little bit of color. Certainly, in the second quarter to date, the volume in comparison to last year is looking very favorable. And volume conditions feel pretty stable right now. We're looking for a good year in terms of growth. Alan?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Yes, Chris, as you noted, we do have relatively easy comps in the second quarter. We also had that in the first quarter, and we delivered 5% growth. It starts to get a little bit more difficult in the third and fourth quarters, although that's the time period in which most analysts expect that trucking competition is going to tighten and so we're going to continue to leverage our very good customer focus, service product and try to take trucks off the highway. We did that in the fourth quarter of last year. We did that in the first quarter of this year in pretty loose truck environment. We feel good about where we are with growth. We've given you some guidance on what we see in our call and our merchandise markets and in our intermodal markets.

Operator

Our next question comes from the line of Ravi Shanker with Morgan Stanley.

Ravi Shanker - *Morgan Stanley, Research Division - Executive Director*

Jim, Marta, wondering if you can comment on pricing trends in the first quarter and how that compared year-on-year and quarter-on-quarter in terms of whether it accelerated or decelerated? And are you confident you can get pricing over inflation in 2017?

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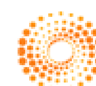

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James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Alan, why don't you take that one?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Yes, we saw consistent pricing in first quarter with last year and we're continuing to differentiate ourselves based on our service and ability to innovate as supply chains evolve. We're confident in our ability to continue to drive high-quality revenue that complements our network at low incremental costs, which will ultimately and continue to drive shareholder value.

Ravi Shanker - *Morgan Stanley, Research Division - Executive Director*

Can I just follow-up on that? When you say consistent pricing, did you mean the same rate of price increases you were getting last year as we we're getting this year? And can you comment on the sequential trends as well, please?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Sequentially, yes, it's pretty much the same as where we were last year, year-over-year and sequentially. We continue to see pressure in the trucking environment and we are getting some very significant competitive rate increases at our export coal franchise as truck markets tighten and economic conditions continue to improve, we fully expect additional opportunities for price later this year and into 2018.

Operator

Our next question comes from the line of Amit Mehrotra with Deutsche Bank.

Amit Singh Mehrotra - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

I just wanted to follow up on the margin trajectory versus the FX, the first question. Jim, I wanted to just get your thoughts on, is there any structural reasons why Norfolk Southern returns should be much different than CSX over time. I'm not asking you to comment on what CSX is doing, obviously, but the company, as you said, previously, I mean it's not really operating in a vacuum, you're very well aware, what your competitors are doing. So if you can just help us understand why there could be or would be any structural reasons, the returns in your business would be different than CSX as volumes do come back?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Thanks for the question. So let me put it this way, we have outlined a plan to deliver consistent reliable sustainable improvements in operating margin and bottom line growth, and that's what we're going to do. It's a combination of factors as we've been saying. It's a balanced plan, it relies on both growth and productivity. And that will deliver the goods for shareholders, we are quite confident.

Amit Singh Mehrotra - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

Okay. I thought I'd try to ask that question but I appreciate the answer. Let me ask you 1, specific one, with respect to the numbers. You talked originally about growing revenues at lower incremental costs and that's kind of obvious, right, in the capital-intensive business. And it seems like if you adjust the net fuel expense, it looks like incremental margins did come in just above 50% in the quarter, and it seems like it would actually have been quite a bit more than that, if the materials and claim expense were not as high as they were in the quarter. So just in that context related to your comment about year-on-year margin expansion in the remaining quarters, is kind of 50% to 60% normalized the right bogie in terms of

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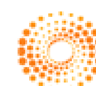

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incremental margins to drive that margin expansion? Or are there any specific items in the cost structure that may make that number -- that incremental margin number higher or lower as we look at 2Q, 3Q and 4Q?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

We talked in the past about the composition of volume growth and its effect on incrementals so that certainly a factor to keep an eye on but you're absolutely right. Volume growth through a relatively fixed cost base is the key to high incremental margin and corresponding earnings growth and that's really what we're focused on here. We're focused on disciplined cost structure that keeps costs in check while volumes are growing, as they are, in this environment. And with that, let me turn it over to Marta, to talk about the incremental margin in the quarter excluding some of the items that you mentioned.

Marta R. Stewart - *Norfolk Southern Corporation - CFO and EVP of Finance*

Yes, well, you're absolutely right that the fuel had a dampening effect in the first quarter. We don't think that's going to continue as I described in the second, at least not to that extent, in the second, third and fourth quarters. So our incremental margins excluding the fuel effect was closer to about 67% in the first quarter. In my remarks, I mentioned that we expect to have continued improvement in the OR. So year-over-year, in the second, third and fourth quarters, we expect to improve the operating ratio. As you know, since we embarked on this strategic plan for the past 5 quarters, we have shown year-over-year operating ratio improvement and we continue to expect that. So based on that, you should expect that we'll have similar incremental margins going forward.

Operator

Our next question comes from the line of Kenneth Hoexter with Bank of America.

Kenneth Scott Hoexter - *BofA Merrill Lynch, Research Division - MD and Co-Head of the Industrials*

Marta, good luck in the next phase of your career as you move forward. But, Jim, you suggested doing things at a measured pace. I just want to understand that comment a little bit. What does the board suggest that management start looking at? There was a recent 8-K, I think, talking about pay levels can accelerate significantly, if you accelerate the plan. Can you talk about what was behind that? Is that maybe, the board suggesting a faster pace or a larger scale in terms of your operating plan?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Sure, sure. So when I say measured, I want to be clear. What I'm talking about is the pace of change and improvement that is sustainable for the long run. We are trying to produce sustainable financial improvements for the long run. With that said, we are looking at everything out there to drive acceleration of our financial results and we won't stop with the plan that we have outlined. It's a flexible plan and when we see opportunities to improve upon it, we will jump on them. As you mentioned, Ken, the board did put in place an accelerated turnaround incentive and that's there to incentivize management to find those opportunities to drive improvement and acceleration. It's meant to be a stretch plan and that's what it's for, but we're going to work as hard as we can to achieve it.

Kenneth Scott Hoexter - *BofA Merrill Lynch, Research Division - MD and Co-Head of the Industrials*

Great. And then a follow-up, Mike, you noted the composite service at 79%, I just want to maybe dig into that a little bit. Is that a great -- I just want to understand, are you giving yourself a C rating on the service? Is that an on-time performance? It just doesn't sound that efficient if something is operating at 79% of capability. Is that -- maybe you can talk a little bit about the input and outputs there?

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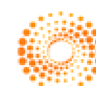

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Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Sure, and the composite service is made up of several components. It's made up of train performance. It's made up of connections and it's made up of planned adherence. So it takes into account all of those in different measures to make sure that we are taking care of the customers' needs and I would just relate that to the fact that our network velocity is still at all-time high records. So we feel very comfortable with that. It's providing a good service product and our customers like what we're providing.

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Ken, this is Alan. Network performance is one way to look at it. Jim's been very clear that we're driving customer specific service metrics that are unique to the markets that we serve in, in many case is unique to the demands of individual customers as their transportation needs evolve. This allows us to improve the value that we provide to our customers. It provides for more rich conversation with our customers as we're renegotiating contracts and looking for additional business, about the benefits of the Norfolk Southern product and they can be commented to defined as for individual customers or broadly, by markets. And if you look at, say, intermodal, it could be availability of a box on a chassis at a terminal and within the merchandise network, it could be consistency of delivery to a customer location to the original ETA. Those are all important things to the customer. And I can tell you, categorically, that for each of those individual customer metrics, we are in much better shape than we were last year and have improved year-over-year. And that's what we're doing as we are collaborating with our customers to find out what they want in becoming a much more integral part of their supply chain.

Operator

Our next question is from the line of Bascome Majors with Susquehanna.

Bascome Majors - *Susquehanna Financial Group, LLLP, Research Division - Research Analyst*

So, Jim, what are you and the rest of the board's priorities, both for experience and skill set as you search for Norfolk's next CFO? And can you just give us a little signal of where you're head is, the odds of an external versus an internal hire at this point from where you sit?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Well, granted we have big shoes to fill here, that's for sure, with Marta's departure. But look, we're looking for someone who is going to focus single-mindedly on shareholder value. That's the type of person we want in the CFO seat and throughout the C suite. Our focus is driving share holder value through successful execution of our strategic plan, that's the #1 criteria for the next CFO.

Bascome Majors - *Susquehanna Financial Group, LLLP, Research Division - Research Analyst*

And the internal versus external, is there any color you can give us on how you guys are thinking about that?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Yes, we have some excellent internal candidates and we're going to look at external candidates as well and we'll see what falls out of that.

Operator

Our next question comes from the line of Walter Spracklin with RBC.

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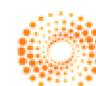

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Walter Noel Spracklin - *RBC Capital Markets, LLC, Research Division - Analyst*

So I guess, my question is on the efficiency trends that you did reaffirm here both for the full year and longer term but I don't think I heard an update as to what the run rate is for the first quarter and whether there has been any change to the cadence of that, particularly on the employee's side. I think I heard that you're guiding for up slightly now from flat and still at 5% inflation, all-in inflation. Is that correct?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

So we don't guide on quarterly productivity, let me just say that, at the outset. We did see some improvements in the first quarter. Marta, let me turn it over to you, to address the employment question, specifically.

Marta R. Stewart - *Norfolk Southern Corporation - CFO and EVP of Finance*

Okay. So on the employment question, and I'm glad you asked that because we have a couple of pieces there. So as Mike described, we do expect with the volume increase that Alan talked about, we do expect that they will need to add some train and engine employees. Those employees that directly face the customer, directly affect our service. However, overall, for our total employment, we expect to keep that about even for the remainder of the year sequentially, with the first quarter. As you noted, that is a reduction from last year. So previously, we had guided to stay even with last year's average, which was about 27,900. We now think that our employment level would be about 400 less, 27,500 for the full year. And so we plan to use attrition across the other areas. So in other words, the customer-facing folks, the train and engine folks, will go up, all of the other areas we will handle attrition to offset that.

Walter Noel Spracklin - *RBC Capital Markets, LLC, Research Division - Analyst*

Great. Okay, and then my follow-up is on tax, you were about 300 basis points below. I think the 37% you've been guiding to, Marta, before? Can you reconfirm, is it 37% we should be using? And what -- I think you mentioned it was on stock-based comp. Can you quantify that? Was that the full 300 basis points relative to what you've been guiding us for the 37% on a run-rate basis?

Marta R. Stewart - *Norfolk Southern Corporation - CFO and EVP of Finance*

Yes, just about it. It was substantially all of the difference and so the normalized rate, if you will, that you're correct we've guided to was 37%. In the first quarter, PSUs and RSUs were issued because they're earned out in the first quarter. In addition, as the stock hit all-time highs in the first quarter, options were exercised. So going forward, depending on what happens with option exercise in the remainder of the year, we may see the normalized 37% a little bit lower. However, probably won't be as much as the first quarter 3% because we don't have the PSU, RSU earnout, other than in the first quarter of the year. Does that make sense?

Walter Noel Spracklin - *RBC Capital Markets, LLC, Research Division - Analyst*

Yes.

Operator

Our next question will be coming from the line of Thomas Wadewitz with UBS.

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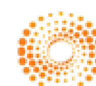

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Thomas Richard Wadewitz - *UBS Investment Bank, Research Division - MD and Senior Analyst*

Yes. I wanted to ask a bit on the operating side and you gave us some very useful metrics to look at for productivity, locomotive productivity, train length. What do you think the opportunity is as you look at the next several quarters and even into next year? Are there -- you talked about using distributed power, you talked about significant locomotive productivity gains and train length expansion. Does that opportunity continue as that kind of linger the next couple of quarters? Or have you realized a lot that you need to pause? Just wondering if you could offer some more on product productivity and a couple of metrics.

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Yes, we're not pausing it all on any of those. We talked about 50 locomotives already out this year and another 100, we're going to have out here in the next month or so. That will help. And then going forward, we continue to look at what opportunities there are further in reducing locomotives from the fleet, still keeping our service product where it needs to be. We're continuing to work on rationalizing our freight car fleet as well, taking freight cars out of the fleet but still providing good customer service particularly by going to a more homogenous fleet and flexible fleet. So those are big initiatives. We continue to aggressively implement distributed power, still lot of opportunities there. Fuel efficiency, a lot of initiatives still going on there. So I don't think that we're pausing it all. In fact, I think we continue to ramp up aggressively all these things. We just have a lot of productivity initiatives in the harper of that we're working on.

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Yes, Mike, you talked about our equipment strategy. And I think it's notable that our efforts to go to a more homogenized fleet don't just benefit operations. It also improves our ability to compete with truck and provide a better service product to our customers. It's more flexible by definition. It lowers investment risk. It lowers operating cost, and it improves our ability to provide a serviceable piece of equipment to our customer in good working order on time. So there's great collaboration between marketing and operations on a lot of these initiatives to make sure that we're taking a sustainable approach and a balanced approach to take costs out while improving our service -- individual service to our customers.

Thomas Richard Wadewitz - *UBS Investment Bank, Research Division - MD and Senior Analyst*

Can you -- that's helpful, I appreciate that. Can you give -- are there any numbers you can say, well, like distributed power, we've got X percent of trains on distributed power and we think we can get to Y. Can you give any kind of framework for that and not second quarter but just the next couple of years what you could get to or even on kind of maybe locomotives or cars, that you might be able to put in storage, things like that?

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

No, not really. All I can say is, it's always going to be more, we're going to have more distributed power. We've got a plan to have more cars out of the network like Alan talked about but still providing the good service. So all these things that we've got in place are going to be more and better but we don't have a quantity to put out there right now. But you will continue to see improvement.

Operator

Our next question comes from the line of Scott Group with Wolfe Research.

Scott H. Group - *Wolfe Research, LLC - MD and Senior Transportation Analyst*

Marta, I wanted to ask a different one on the operating ratio. So if I look historically, first quarter and then the full year, the full year is typically, on a 300 or 400 basis points better than the first quarter, so kind of implying a 66% or 67% operating ratio for the year. Is there anything wrong with that math? Or anything you want us to think about good or bad relative to kind of what we've seen historically from the model? And then just

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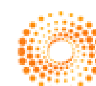

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maybe along those lines, can you just remind us how much more headcount you have to go relative to the initial plan as part of the $650 million of productivity?

Marta R. Stewart - *Norfolk Southern Corporation - CFO and EVP of Finance*

Okay. Well, as I mentioned in my remarks, we expect the OR in the second, third and fourth quarters of this year to the lower than the OR of last year, and I think we'll leave it at that in terms of detail. As you know, all of those quarters last year were well below 70%. So we continue to expect improvement in the operating ratio. Now with regard to the employee headcount levels, we are currently down 2600 approximately employees in total from the end of 2015 or the average for 2015. And so the going forward, the savings will be in maintaining that lower level of headcount as well as the other things within compensation that are not headcount-related. The overtime, which Mike and his folks are really working on, keeping the overtime down in all of our categories, the extra boards, the recrews. And so it's a combination to get to our total goal of about $400 million over the 5-year reduction in compensation and benefits with the headcount and a managing the average cost per employee number as well.

Scott H. Group - *Wolfe Research, LLC - MD and Senior Transportation Analyst*

And just to follow-up, do you think is there -- if volumes continue to improve and you need to add more T&E, is there enough of the non-T&E to potentially remove to keep headcount flat next year as well and flat in a growing volume environment?

Marta R. Stewart - *Norfolk Southern Corporation - CFO and EVP of Finance*

That is our goal. What we are look -- well, that's our plan for this year as Mike and I both described was T&E is going up, the others are going down slightly in order to stay level with the first quarter. Going into 2017 -- I mean 2018, to get out to the next year, we will always attempt to try to keep the appropriate resources to have the right about as a good customer service and then take it in elsewhere in the company, if we can. But that will depend on the level of growth of volume that we have in 2018, if we're able to offset it completely.

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Yes, and we're really not growing the overall T&E count. We're hiring to handle attrition and volume growth, right? So it's not a long-term growth of our T&E population.

Marta R. Stewart - *Norfolk Southern Corporation - CFO and EVP of Finance*

You mean in 2018?

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Correct.

Operator

Our next question comes from the line of Brian Ossenbeck with JPMorgan.

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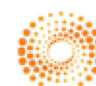

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Brian Patrick Ossenbeck - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

So, Alan, just had a follow-up on kind of the realized rates, ex. fuel and especially on coal. Revenue per unit there ex. fuel was down 1% exposures as you highlight that rate mix. Other were basically, down 2%. You mentioned the short-haul utility coal but just want to circle back to the export coal market pricing that we've all seen get pretty strong here recently. And also, the volume as you mentioned were actually up quite a bit, in Lamberts Point, I think, it was over 50%. So just wondering if you can help us figure out if that's going to come through on a lag or it's really a big mix headwind from the shorter haul utility coal that's keeping some of those numbers down?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Brian, I'm glad you brought that up. It's -- it is an issue with the mix headwind as you referenced. However, we did a very competitive rate increases, a very significant rate increases at Lamberts Point. Although, you should note that Lamberts Point is still only 14% of our overall coal volume. So it's a relatively minor component because we have a pretty diverse coal franchise. So while Lamberts Point grew over 50%, Baltimore, which is more of a thermal market and has a lower RPU, grew over 100% and so you can see some mix issues within that -- within export. And then we were supported by a market share gain in the North and the very mild weather in the South, limited our growth in Utility South. So last year, we had talked at this time, Brian, our Utility South volume was about 54%, 55% of our utility volume. That's flipped a little bit. And now Utility North is more than 50% of our utility volume. That also has a -- since they have a lower length of halls than Utility South and so that creates some pressure on our RPU. But I'll note, we are really focused on adding high-quality revenue that fits our network, complements our product and drives long-term shareholder value. And that's in our first quarter results reflect a successful execution of that strategy.

Brian Patrick Ossenbeck - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Okay. I appreciate the detail on that. And just as a follow-up, as we've seen the export met coal price continued to move up in volumes, some increase strong there as well. Would you expect the mixed headwinds to be at least a little bit better, maybe not as bad as we have not seen the same strength on the thermal export market?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Yes. You noted that with Cyclone Debbie, that prices have gone up that's a near-term phenomenon and we're already starting to see a correction there, although that will benefit clearly, our second quarter export volumes. And so in my remarks, I guided to the fact that we would probably exceed our previous guidance of 3.5 million to 4.5 million tons in the second quarter and then third and fourth quarters we'd be back within that range. There's a lot of volatility as you could expect within our coal network. Not only because of seaborne prices but also because utility coal is now load follower and stockpiles, while slightly down from last year, are still elevated. And so we're going to be watching the same things that you watch. We're going to be watching natural gas prices, weather or electricity demand, coking coal prices and API too.

Operator

Our next question coming from the line of Justin Long with Stephens.

Justin Trennon Long - *Stephens Inc., Research Division - Research Analyst*

So maybe to follow-up first, on some of that coal commentary. When you combine all of the puts and takes that you just walked through, do you think consolidated coal RPU can move higher sequentially over the remainder of the year?

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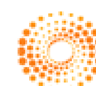

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Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

It's going to be highly dependent upon market conditions and those 4, 5 factors that I just referenced, Justin. We're getting price. We are particularly, getting price and the export met market, the sustainability of that is going to be dependent upon some of the factors, such as coking coal price.

Justin Trennon Long - *Stephens Inc., Research Division - Research Analyst*

Okay, and then maybe shifting gears to intermodal. Your 2 major IMC partners have both indicated the intermodal pricing environment has been highly competitive at the start of the year, and I was curious if your approach to that market has changed at all? And would you be willing to provide any additional rate relief to your intermodal partners this year? Or are those rate increases at this point unlikely to change?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Justin, we take a long-term sustainable view of our pricing equity, the value of our service product, the markets and the customers we serve, which ultimately is going to promote share holder value in near term and long term. We are fully confident that trucking capacity is going to tighten in the second half of this year, which will lift truck prices may be late this year and early next year. We're taking a long-term approach to this. We grew our volume in fourth quarter of last year in a difficult truck environment. We grew our volume in the first quarter of this year in a difficult truck environment as we leveraged the value of our service product.

Operator

Our next question is coming from the line of Brandon Oglenski with Barclays.

Eric Thomas Morgan - *Barclays PLC, Research Division - Research Analyst*

This is Eric Morgan on for Brandon. I just wanted to follow-up on some of your more structural costs. It sounds like you're making progress with terminal rationalizations. But, Mike, I think you mentioned you are actively reviewing some of those initiatives as markets shift. I guess, can you elaborate on some of the things you're looking at there and if that's where some of the opportunity is for acceleration in the plan.

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

I'll let Mike address the specifics of your question, but I want to emphasize just how focused we are on structural costs without doubt, that is a central to successful execution of our long-range plan so whether it's fixed assets in the network or it's mobile assets like locomotives, we are very focused on improving productivity in those areas. Mike?

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Yes, so there's couple of pieces to it. Obviously, we want to make our operating plan as optimized as we get. We spent every day doing that working through the plan. The other piece is the terminals. Where can you take cost out of the terminals, whether it's idling the terminal and taking it out of your network, we look at that all the time. There are things we are working on or just taking costs out by having less resources at those terminals, whether they go from 3 shift to 2, we're finding ways to do more in those terminals with less resources. So it's a combination of optimizing the operating plan to reduce costs, finding ways to take out costs in the terminals, whether it's taking them out of the network or just driving costs out of those terminals. And we're working on all 3 of those and you'll see all of those incrementally improved.

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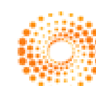

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Eric Thomas Morgan - *Barclays PLC, Research Division - Research Analyst*

All right. I appreciate that. And maybe just a quick follow-up on yard productivity. Can you just update us on the number of hump yards you're operating and maybe your views on converting the flat switching now that might impact both the cost structure and the ability to service the customer?

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Yes, so we have 10 hump yards. And as we've noted on here, we've idled 3 of those over the last couple of years the last being last year in Knoxville, Tennessee. So we continue to look at it. But those yards, they're part of our network. They're part of processing the volume of cars through the railroad and they're part of what we have to make sure we provide a good service product. So we're balancing making sure we've got a good service product but finding ways to take cost out and it wouldn't take terminals out and still provide a good service product and the velocity being there, we're going to do that.

Operator

Our next question comes from the line of Jason Seidl with Cowen & Company.

Matthew Youssef Elkott - *Cowen and Company, LLC, Research Division - VP*

This is actually Matt Elkott, for Jason. Staying on this topic here, I was wondering if you guys can talk a little bit about the potential track reduction opportunities?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Mike?

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Yes, we don't see large pieces of the network coming out. As Alan has noted before, we've got a network reach that's very good for our customers and that's an asset and competitive advantage. But we do look at ways to take cost off the lines and still provide the service product that we need. So if it's a lower density branch line, we're able to continue to reduce the speed, continue to take costs out but still safely service the customer commitments that we have on there. So we don't see large pieces of the network necessarily coming out from a line's standpoint but the cost will come out as we continue to find ways to service that, those pieces of railroad at a lower cost and we are doing it. A lot of initiatives we have in place to do that. So you won't see big chunks of the railroad coming out but you'll see cost come out.

Matthew Youssef Elkott - *Cowen and Company, LLC, Research Division - VP*

Got it. That's very helpful. And just one quick follow-up on the locomotive front, I know you guys have plans to take out or to remove from some service some additional locomotives. What does volume have to do from your current internal expectations for the year, whether accelerate or decelerate for you to reconsider the number of locomotives that you're taking out?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Yes, so what we've already committed to, the 50 that we've done and the 100 that we're going to take out is really not volume independent at all. Going forward, as volume comes back -- comes to the railroad, we've got the ability to add that volume to our trains without having to add

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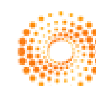

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commensurate locomotives. So we don't see having to add a bunch of locomotives to the fleet going forward to handle volume with all the initiatives we have going on.

Operator

Our next question is from the line of David Vernon with Bernstein.

David Scott Vernon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Alan, I wanted to see if you could comment a little bit about what you think the Norfolk strategy will be if the truck market does start to tighten. It seems historically, you guys have been more pushing volume into a less mature at a mobile network and keeping rates low in order to do that. Do you think that if the truck market tightens you'll be able to push both the price and volume levers? Or do you think it'll still be more of a volume story?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Dave, we're achieving price. We have achieved price and we're going to continue to do it. For us truck is pricing opportunity, convergence from truck create an opportunity not just in the intermodal but in our merchandise network. And we -- Mike and I talked about collaborating with customers on an equipment strategy that allows us to convert truck to rail and in the merchandise networks. So we're going to continue to push on price. We've achieved price and volume in very difficult truck environment last year and in the first quarter of this year. It's potentially, starting to tighten a little bit and we -- the analysts believe that it's going to tighten a lot more as the year progresses. So that's our focus, is taking a long-term view of our pricing and the value of our service.

David Scott Vernon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

How do I square that with the 1% gain in the intermodal RPU ex. fuel?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

We had some shifts within our intermodal network but we achieved our price. And clearly, truck is limiting the upside to our price. We've talked about that in the past too. We are confident in our ability as we move forward and our results reflect it.

Operator

Our next question is coming from the line of Jeffrey Kauffman with Aegis Capital.

Jeffrey Asher Kauffman - *Aegis Capital Corporation, Research Division - Analyst*

A lot of my questions have been asked at this point so let me turn to a longer term one, in terms of your capital plan. We've had a lot of rationalization. You've talked about putting more locomotives and cars in the storage. Yet the free cash flow is growing. What are your thoughts in terms of capital reinvestment in the business? And kind of where are the more attractive opportunities near term for capital dollars in the same may drive productivity here or may enhance operations?

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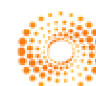

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James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

So we've outlined in conjunction with our long-range plan our intent with respect to capital allocation. First call on capital is always reinvestment in the business. We see great investment opportunities there, and we intend to continue to maintain our franchise through judicious capital investment and we'll fund growth opportunities as well, as appropriate. With the excess capital, with free cash flow, we'll buyback shares and we will pay a dividend, as we have always done. So that at a high level, that's our capital allocation strategy. Marta, you want to fill in some of the blanks in terms of what we've outlined for 2017?

Marta R. Stewart - *Norfolk Southern Corporation - CFO and EVP of Finance*

So with regard to the capital budget for this year, we have planned on $1.9 billion. You are correct to note that going forward, we think that's going to go down because that includes $240 million for PTC. As we complete that, we are looking to holding capital spending, still provide for growth capital. We analyze our growth capitals very strenuously. Mike and his folks too, one big component of that, as you noted too, is locomotives. We have a robust locomotive rebuild program that we started working on several years ago, have really accelerated last year and this year, and we expect that to continue into the future. We have a good base of fleet of locomotives that we can upgrade that well and that's going to be a key component in the future in being able to control our total capital spend.

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Upgrading the locomotives at a lower capital costs, it's a win-win.

Operator

Our next question is from the line of Benjamin Hartford with Robert W. Baird.

Zachary Nathan Rosenberg - *Robert W. Baird & Co. Incorporated, Research Division - Associate*

It's actually Zack Rosenberg on for Ben here. I want to shift the questions here a little bit. Saw that there was a comment from President Trump out expecting a tariff on softwood, lumber going into the U.S. from Canada. Just wondering specifically, if that has any impact to your business and network? But more broadly, just if you have any kind of updated thoughts on the potential impact to the business just from increasingly projection of this policy and any updates and thoughts around regulation?

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

I'll take the question about regulation generally. We are certainly in favor of a wider touch with respect to regulation in some parts of our business, and in fact, across the board. Any time we see an opportunity to achieve further productivity and in otherwise advance our financial objectives, we're going to be in support of it. And that certainly includes lightening the regulatory burden. Alan, why don't you comment specifically on the announcement recently?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

Yes, Zack, as we look at it, that may result in additional volume coming from the Pacific Northwest into our markets or it may result in additional volume that originates on our network. So all in all, we don't think it's going to have a material impact on our volumes.

Operator

Our next question is from the line of Cherilyn Radbourne with TD Securities.

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Cherilyn Radbourne - *TD Securities Equity Research - Analyst*

Just wanted to ask one because the call is running long. And that was with respect to your plan to move to a more homogenous equipment fleet, which has obvious benefits. Can you just comment on how quickly that happens through natural attrition of the fleet, if you will? And whether at some point you would consider stepping up your CapEx to accelerate that process?

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

Yes, this is Mike. No, we don't expect to accelerate our CapEx at all for that. And we've got a couple of thousand that are going to come out of the fleet this year because we are more homogenous going to a car that can be used in many different areas and it's already progressing. It's been part of what we've been doing for the last several years. We've taken several thousand, almost 17,000 cars out of our fleet over the last several years and we're continuing that but still being able to have a car when the customer needs it. Alan, anything you want to add to that?

Alan H. Shaw - *Norfolk Southern Corporation - CMO and EVP*

It's a process as cars fall out, we can scrap them. It's a homogenous fleet and it has quicker cycle times. You have to buy, purchase less cars, invest in less equipment to replace that carrying capacity and get more flexible.

Marta R. Stewart - *Norfolk Southern Corporation - CFO and EVP of Finance*

Cherilyn, the expectation of this gradual conversion to a more homogenous fleet is anticipated in our sites of capital plan, already.

Cherilyn Radbourne - *TD Securities Equity Research - Analyst*

Okay. Can you just elaborate on how many car types you would have today and where that might go directionally?

Michael Joseph Wheeler - *Norfolk Southern Corporation - COO and EVP*

We've got a lot of car types out there but we are -- probably, 50 different our types out there. We're trying to take probably, 10% of that out this year and probably took 10 of them out last year. So we've gone down from 60 types of cars to 50 with being in the 40s this year.

Operator

At this time, there are no additional questions. I would like to turn the floor back over to Mr. Squires, for closing comments.

James A. Squires - *Norfolk Southern Corporation - Chairman, CEO and President*

Well, thank you very much, everyone, for your time, attention and questions this morning. We will talk to you next quarter.

Operator

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

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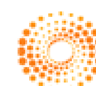

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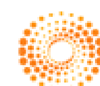

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