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Norfolk Southern Corp. (NSC)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Norfolk Southern Corporation first quarter 2022 earnings call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder this conference is being recorded.

It is now my pleasure to introduce Meghan Achimasi, Senior Director of Investor Relations. Thank you. You may begin.

Meghan Achimasi

Senior Director-Investor Relations, Norfolk Southern Corp.

Thank you, and good morning, everyone. Please note that during today's call we will make certain forward-looking statements which are subject to risks and uncertainties and may differ materially from 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.

Our presentation slides are available at nscorp.com in the Investors section along with a reconciliation of non-GAAP measures used today to the comparable GAAP measures. A full transcript and download will be posted after the call.

It is now my pleasure to introduce Norfolk Southern's President, Alan Shaw.

Alan H. Shaw

President, Norfolk Southern Corp.

Good morning, everyone, and welcome to Norfolk Southern's first quarter 2022 earnings call. I am joined today by Cindy Sanborn, Chief Operating Officer; Ed Elkins, Chief Marketing Officer; and Mark George, Chief Financial Officer.

I would like to start by recognizing the contributions of Norfolk Southern's employees who have worked safely and tirelessly to serve our customers in a challenging supply chain environment. I sincerely appreciate the commitment of our employees to Norfolk Southern and our customers.

Norfolk Southern delivered solid financial performance in the first quarter with record first quarter revenue, earnings per share and net income, while our operating and marketing teams worked around the clock with our customers to address current network challenges and a dynamic supply chain.

We know we need to improve service and are committed to increasing network fluidity and restoring service to levels our customers deserve. Cindy will share updates on our accelerated hiring and progress of our new operating plan, TOP|SPG. Viewing the results for the quarter, you'll note that revenue increased 10% as a 16% increase in revenue per unit more than offset a 5% volume decline.

Expenses grew over $200 million or 13% year-over-year, due primarily to a sharp increase in fuel price. Higher fuel costs, along with slower network velocity and reduced volume contributed to an increase in our operating ratio, which was up 130 basis points versus last year's first quarter record. We remain confident in our ability to improve service while simultaneously delivering productivity and growth. Our outlook is bright.

I'll now turn the discussion to Cindy for an update on operations. Cindy?

Cynthia M. Sanborn

Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.

Thanks, Alan, and good morning, everyone. I'm going to talk to you all today about the outlook for our operations. During the past quarter, resource levels have challenged the fluidity of our operation, yet we have continued our momentum on increasing train size. We are in the very early days of seeing the fruits of our hiring initiatives and are working every avenue to improve service levels as quickly as possible. I'll provide an update on our Thoroughbred Operating Plan initiative as well as what we're doing with technology to make the railroad safer and more productive.

First, turning to slide 6 as a recap of our operational activity metrics in the quarter, GTMs were down slightly, outperforming the unit volume decline as mix shifted modestly towards our heavier merchandise and coal segments. Our crew starts were down 5% in the quarter, which is a good news, bad news story. Resource levels prohibited us from operating some starts that we would have preferred to operate, and our recovery mechanism was challenged as a result.

However, on the positive side of the ledger, we continue to drive very beneficial road train consolidations across our segments, most pronounced in our bulk franchise as we move similar coal tonnage with 6% fewer train starts and saw train weight up across the board for intermodal, merchandise and bulk. In an effort to improve resiliency, we kept a portion of the surge locomotive fleet active, yet we still achieved another quarter of fuel efficiency improvement.

Turning to network performance on slide 7, train speed and terminal dwell closely resembled the levels they were at in the fourth quarter. Qualified T&E levels continued to decline throughout the quarter, culminating in what we expect to be the trough in March.

As we start to see relief in certain areas, we are prioritizing crew starts that can have the most impact on customer service levels, and we are redeploying our go teams when possible. I want to reiterate that improving service levels is our top priority. And turning to slide 8, I will provide more detail on where we are with our hiring efforts.

As we progress through 2021, we quickly identified the need to increase hiring within our transportation workforce. We were met with a very challenging labor market that made our ramp-up time longer than expected but we responded with a robust plan to streamline our pre-employment process, deploy a variety of financial incentives and mobilize additional onboarding resources. These efforts have paid off in a big way in 2022, and we now have over 800 conductor trainees on the property.

As a result, we now expect our qualified T&E head count to begin growing sequentially throughout the remainder of the year. We are laser focused on utilizing these additional employees to improve service levels and provide a solid platform from which to launch TOP|SPG, which I will discuss on slide 9.

As we did last quarter, I want to reiterate the approach of focusing on service, productivity and growth as equal pillars in our latest evolution of the TOP plan, which we envision launching in late second quarter.

Let's talk about service quality and resiliency first. Several key elements of PSR are having a simple and executable operation as well as having a balance. You heard NS talk about some of these PSR fundamentals when TOP21 was rolled out, and we now need to revisit a few of them with a renewed focus while ensuring they are embedded in all of our segments, including intermodal.

One of the greatest strengths of our network is the quality and positioning of our intermodal franchise. And as we've performed the zero-based review of how we link together our major markets, we've found opportunities to simplify how we connect those terminals while providing more capacity than what we have today. This will include ensuring we have assets flowing across our network in a balanced fashion so that less intervention is required for resources to be in the right place at the right time.

Let me be clear; TOP|SPG is another lever we're pulling to improve our service and represents an evolution of our current operating plan. This pathway towards enhanced service will allow us to better plan for and execute longer trains. Additionally, going back to the idea of encompassing all business segments, while we've made great progress on enhancing bulk train sizes within coal, there is more runway ahead.

Other facets of the bulk network, such as grain, will see benefits as we develop the capability to run longer trains through those parts of the network such as the Midwest. This productivity dividend is very complementary to the service pillar as it will give us more flexibility to handle commodity volatility. These improvements in train productivity have obvious benefits of reducing labor intensity but will also propel further fuel efficiency improvements.

Finally, these efforts will ensure that we grow capacity within our terminals and along our main lines, including the initiatives I've discussed with you before, to bolster our infrastructure with targeted siding extensions that are actively coming online. We are going to provide the capacity our customers want to grow with us organically while still creating the flexibility to respond quickly and effectively to new opportunities.

Moving to our safety update on slide 10. We have seen improvement in both FRA train accidents per ton miles moved as well as the FRA injury index year-over-year. However, we will not be satisfied as long as there is a single injury or accident, which is why we continue our efforts to get better in this area every day.

First, on the engagement front, in 2021 we conducted our first annual safety survey, which was across the entire workforce. This has provided us with insight on what and where we need to focus our engagement efforts. We've expanded our field training program to leverage outlets such as online training, classroom training and our signature safety train events so that we empower our workforce to actively engage in our goal of continuous improvement when it comes to safety.

Lastly, we're making great progress building momentum with technology investments that are focused on safe and efficient operations, and I'll give a great example on slide 11 with an update where we are with one of our key technology pillars: automation. More specifically, we are using machine vision technology to detect component failures before they occur.

We're in the process of deploying fully automated inspection corridors, which will cover more than 90% of the cars moving across our network using a variety of systems to detect signs and symptoms of pending failures before they occur. Equally as important as deploying the hardware is developing the next-generation AI algorithms that detect these failures with edge computing and procedures for intervening quickly. This is where we've made really exciting progress and we are already actively preventing incidents. We are finding that the technology is enabling us to achieve better outcomes than the human eyes alone can achieve.

One reason for this is the power of seeing how these components are behaving on a train in motion versus while stationary during a manual inspection. We're generating high success rates with very few false positives and detecting components that need to be replaced, but had no outward indication to the human eye. The close and effective working relationship between our data scientists and field team is creating a feedback loop that is accelerating our progress. This is one of the most revolutionary technologies we are working on, and I'm extremely excited for what we are achieving with our relentless pursuit of safety first and productivity.

I will now turn the call over to Ed.

Claude E. Elkins

Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

Thank you, Cindy, and good morning, everyone. If you would, let's turn to slide 13. Our results for the first quarter [ph] flagged (00:11:03) challenges that we experienced on the volume side with supply chain constraints and network fluidity. These were offset by record success in revenue per unit.

Overall, our volume decreased 5% year-over-year in the first quarter, driven by declines in our intermodal, automotive and steel franchises. But despite these volume declines, total revenue improved 10% year-over-year to $2.9 billion due to higher revenue from fuel surcharges and strong price gains.

Within merchandise, volume declines were led by automotive and steel for chip supply and equipment cycle time challenges significantly inhibited our ability to drive growth. Partially offsetting these decreases were gains in agri fuels, feed and aggregates due to increased gasoline consumption, higher demand for agriculture products, and rising levels of construction spending. Higher fuel revenue and price improvement more than offset the headwinds from volume and mix to generate 4% revenue growth year-over-year, along with record level revenue per unit.

Revenue per unit less fuel was also a record for the quarter. Total intermodal shipments declined 6% in the first quarter, driven almost entirely by the international market where tight drayage capacity, high street dwell for chassis and warehouse throughput drove customers to seek alternatives to Inland Point Intermodal, or IPI.

Domestic shipments grew modestly year-over-year on sustained consumer demand that outpaced supply. However, as network velocity improves, and as TOP|SPG is implemented, we're confident that we will provide the capacity our customers need to grow. Higher revenue from fuel surcharges was the leading driver of intermodal revenue growth this quarter, followed by storage revenue, price improvement and positive mix, all leading to record quarterly revenue metrics for the franchise. Intermodal revenue per unit less fuel grew for the 21st consecutive quarter.

Now moving to coal. Total volume was down slightly year-over-year in the first quarter as gains in utility shipments were offset by declines in export coal. Utility growth was driven by higher levels of demand for electric power and the need to replenish depleted inventories. Our export franchise experienced a number of acute service disruptions that limited shipments for a period of time, resulting in a year-over-year decline. But despite these volume headwinds, coal revenue grew 25%, primarily due to price gains, underscoring the near-term market demand opportunities we effectively secured. Revenue per unit and revenue per unit less fuel reached record levels this quarter.

Now let's turn to slide 14 for our market outlook for the remainder of 2022. In general, we anticipate continued consumer-driven strength in demand and improvements in our service product. Both of these will enable us to deliver year-over-year volume and revenue growth in 2022. However, we are closely monitoring a base of uncertainty in the macro economy, including inflation at levels we haven't seen in over 40 years, rising interest rates and evolving post-pandemic labor market and ongoing global geopolitical conflict.

Merchandise volume growth will be led by agriculture, forest and consumer products where we're seeing elevated demand for products such as soybeans and corn as global food supply chains face ongoing uncertainty. The USDA recently increased their expectation for export soybeans from the US amid declining foreign availability and highlighted rising demand for corn, both of which create opportunities for rail transportation.

Also contributing to volume gains will be automotive, for US light vehicle production is expected to improve 19% year-over-year in the months of April through December on improving chip supply. Total construction spending in the US has been steadily increasing since mid-2020 and currently sits at the highest level on record, signalling opportunities for our construction related markets.

Within intermodal, our expectation is for a healthy and resilient consumer in 2022 based on a strong balance sheet, suggesting increased spending power from excess savings despite record high inflationary pressures.

Growth in the consumer-led economy will drive demand for our domestic intermodal service, which we expect will benefit from service improvements in the second half of the year and drive growth to offset the volume declines that we experienced at the start of the year. Sustained tightness in the truck market and rising diesel fuel prices are both contributing to an economic environment that encourages highway to rail conversion and provides a superior value proposition for our customers because of our fuel efficiency advantage, especially when compared to the highway.

For our international franchise, we're working diligently to create the capacity our channel partners need to take advantage of the opportunities on Norfolk Southern. Our efforts are expected to boost volume recovery and drive year-over-year growth in intermodal this year.

And lastly, turning to coal. Record high seaborne prices continue in an already strong market that is amplified by geopolitical tensions. This will provide opportunities in the near-term. Pricing is expected to remain a tailwind in the export markets. In utilities, strength continues with higher natural gas prices, though it will continue to be counteracted by higher coal prices. Inventories are still lower than target heading into the summer season. In our domestic met market, consumer demand remains high for domestic receivers. Coal supply availability and production remain tight in every market, which will be the determining factor and upside potential.

Overall, we're confident in the growth potential for Norfolk Southern for the remainder of the year. And we expect to deliver revenue and volume growth over last year. I would like to thank our customers for their partnership and reiterate that we remain intently focused on improving service and driving value for our customers and shareholders.

I will now turn it over to Mark for an update on our financial results. Thank you.

Mark R. George

Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.

Thank you, Ed. I'm on slide 16. We delivered double-digit revenue and EPS growth in the first quarter. Both were record levels for NS. Starting with revenues, the 10% growth was despite the 5% volume decline, thanks to the strong RPU growth that Ed just detailed. Operating expenses were up 13%, driven in large part by a sharp increase in fuel prices, but also higher costs related to our network challenges.

Despite revenue dollar growth exceeding OpEx dollar growth, we experienced a 130 basis point increase in our operating ratio. Recall that at the first quarter conferences, we previewed pressure on our OR, compared to our original expectation of flattish sequentially due to lighter volumes that we were experiencing to start the year and also the rapid rise in fuel expense.

The way it landed, fuel prices alone represented 100 basis points of OR headwind relative to our expectations as well as year-over-year. We also booked an accrual adjustment within claims expense that created another 40 basis points of headwind. The volume shortfall also adversely impacted OR, as we previewed, along with incremental service related costs. These were only partially offset by the strong RPU improvements. OR aside, the operating income and earnings per share were both Q1 records, growing 7% and 10% respectively.

Drilling into the breakdown of operating expenses in the quarter on slide 17, you'll see that 60% of the $206 million increase in the quarter was from higher fuel prices on a year-over-year basis. Purchased services was up $31 million or 10%, driven in large part from inflation and service related costs that more than offset benefits that would typically come from lower volumes.

Equipment rents increased $13 million or 17%, driven by slower network velocity and less equity earnings from TTX. The $20 million increase in materials and others is driven by a $13 million accrual adjustment in claims related to the 2017 through 2020 years based on an actuarial study. Comp and benefits were up 1%, with compensation inflation offsetting savings from lower employee levels in several categories. Qualified T&E employees were down, mostly offset by conductor trainees. The unwanted attrition of qualified T&E employees drove higher over time cost to move the freight.

Shifting to slide 18, and a discussion of the P&L below operating income, other income was a $5 million expense in the quarter, driven largely by losses on the company owned life insurance investments. Pre-tax income was up 5% while net income was up 4%. Our effective tax rate in the quarter was 23%, in line with the 23% to 24% range that we guide. EPS was up 10% on the 4% net income growth thanks to nearly 2.2 million shares we purchased in the quarter, removing nearly 1% of the outstanding shares.

Closing with cash flow and shareholder distributions on slide 19, free cash flow was $605 million, down 19% from last year due to property additions in Q1 this year that are $124 million higher. Recall Q1 2021 property additions were quite low to start the year due in part to weather.

Free cash flow conversion in the first quarter was a healthy 86%. Despite the lower free cash flow year-over-year, shareholder distributions were nearly 7% higher with a 19% higher dividend payment and modestly higher share repurchases.

We'll now turn back to Alan for a wrap-up.

Alan H. Shaw

President, Norfolk Southern Corp.

Thank you, Mark. Turning to slide 20 we show multiple approaches on how we're building upon our record of sustainability leadership. With the launch of our next generation carbon calculator in mid-March, we've made it easier for customers to do business with us, incorporating carbon into their freight decision framework with quantifiable benefits of utilizing the most efficient and least carbon intensive mode of ground transportation.

Also in March, we announced the continuation of our locomotive modernization program in partnership with Wabtec, which will improve our operational performance and reliability and help us achieve our science-based target emission reductions of 42% by 2034.

The pace of our sustainability initiatives has increased and is recognized in the industry as evidenced by several prestigious awards received in the quarter including named as Supplier Engagement Leader by Carbon Disclosure Project for 2021; recognized with the 2022 Green Bond of the Year award from Environmental Finance; and earning the Responsible Care Energy Efficiency Award for Locomotive Fuel Efficiency from the American Chemistry Council.

We are incredibly proud of our progress in this area and we will continue to build upon our sustainability initiatives, which are good for business and the right thing to do for all of our stakeholders.

Let me close by confirming our commitment to deliver our targets this year. Our confidence at the stage is based on our assessment of economic indicators which, at this time, remain supportive of manufacturing and consumer activity, as well as our service recovery efforts associated with accelerated hiring and a successful implementation of TOP|SPG. These factors will support healthy volume growth in the back half of the year. In fact, potential upside exists to our revenue outlook if energy prices remain elevated throughout the year.

As you've heard from our entire team, we're disappointed with our current service levels. We're laser focused on restoring the quality of our product to a level that allows our customers to succeed and grow. We're confident that our decisive actions to restore service including hiring and the launch of TOP|SPG will create long-term, sustained value for our customers and shareholders, leveraging our unique franchise strengths.

Before we open the call to questions, I want to take the opportunity to thank our retiring CEO, Jim Squires, for his tremendous leadership to our company over the past 30 years. During Jim's tenure as CEO, NS improved our operating ratio by more than 1200 basis points, more than doubled our market cap, and returned over $17 billion to our shareholders. He led our company through the challenges of a freight recession and global pandemic. Jim launched an industry-leading digital transformation strategy, elevated sustainability through strategic business priority and personally championed diversity and inclusion. And Jim united our team in the new headquarters in Midtown Atlanta last year.

On behalf of all NS employees, retirees and stakeholders, thank you, Jim, and we wish you and your family all the best in your well-earned retirement.

We will now open the call to questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Chris Wetherbee with Citi. Please proceed with your question.

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.
Q

Hey, great. Thanks, and good morning everybody. Maybe just wanted to start on the outlook for the rest of the year, particularly on the operating ratio side. So I know fuel, I think, Mark, you said it was 100 basis points in the first quarter and presumably it could be elevated and could be a bit of a headwind to operating ratio in the subsequent few quarters. So wanted to get a sense of whether the 50 to 100 basis points of OR improvement is excluding fuel or inclusive of fuel. And if it is inclusive, kind of curious what sort of incremental productivity opportunities you see that will be able to sustain that 50 to 100 basis points.

Alan H. Shaw
President, Norfolk Southern Corp.
A

Hey, Chris, this is Alan. Thanks for the question. We've got multiple paths to achieve that OR target that we put out there. And certainly, improving service is first and foremost among those. It allows us to take on more volume, absorb costs. And as we bring more business onto the network, it comes with higher incremental margins. We did see some modest improvement in our network capacity in March. And as a result, we saw sequential volume improvements in March as well, which really helped out the trajectory of our OR within the quarter.

If you look at the markets in which we're serving, we've got a stronger coal outlook. Commodity pricing certainly helps, and we should see OR improvement sequentially throughout the year. And to be clear, we're talking about OR, including fuel. The headwind that we saw in the first quarter associated with sharply rising fuel prices is something that – the OR headwind, pardon me. It's something we don't anticipate as we move forward throughout the year.

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.
Q

Okay. Thank you very much.

Operator: Thank you. Our next question comes from the line of Brandon Oglenski with Barclays. Please proceed with your question.

Brandon R. Oglenski
Analyst, Barclays Capital, Inc.
Q

Hey good morning everyone, and thanks for taking my question. Alan, I guess, can you just talk more about TOP|SPG, or maybe this one's for Cindy, too. Is this the new operating plan? Or is that like the strategy guiding the new operating plan that you guys intend to launch later this quarter? And can you just give us some details on what's going to be implemented change-wise that can get you to better service outcomes? Thank you.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

Hi, Brandon, this is Cindy. I'll take the question. Thanks for the question. So think of TOP|SPG as a continuation of TOP21 with a pause for a pandemic in the middle. We worked on our manifest network in 2019 to very, very great results from a service perspective. So we're now moving from the manifest to looking at intermodal specifically.

The three main things that we're pulling from our analysis of where we are is, or where we want to be is balancing the network, executability of the plan and embedded in that is train size. And so those are the main initiatives around TOP21 generally and as it applies to intermodal specifically. We also have some secondary thoughts around what we expect the intermodal product to look like that include outlet frequency as well as blocking density.

So got a lot that we're working on looking at that product and basically taking a very unconstrained view and then building up into what we think that's going to look like. And as we noted, it would be – we'd probably implement that towards the second half of – back half of this quarter. And obviously with great communication with our employees as well as our customers, so we're largely in that phase of it.

And then as we continue from there, we're going to look at our bulk network. We've seen some great efficiencies in the numbers. And in my prepared remarks, I talk about bulk train size and efficiencies there. And we've seen that really in our Lambert's Point coal market coming out of West Virginia going down to the port with export coal. But we think there's opportunities both from a standpoint of doubling up trains other than those types of trains; could be trains coming over Chicago at interchange as well as our own grain trains.

And then secondly, behind that, on our local service for our bulk network, that's origin destination payer on NS, we think there's opportunity just to grow train size generally. We've seen some improvement with one of our metals customers in that regard, and we've got more work to do there. So I think what you'll see is as we implement it in the back half of the quarter, it will start with intermodal, and then we'll layer in and add into that over the course of the year, the bulk opportunities.

Brandon R. Oglenski
Analyst, Barclays Capital, Inc.

Q

Appreciate it. Thank you.

Operator: Thank you. Our next question comes from the line of Jon Chappell with Evercore ISI. Please proceed with your question.

Jonathan Chappell
Analyst, Evercore ISI

Q

Thank you. Good morning. Ed, when you break down the revenue variance of the different groups, for intermodal and coal especially, this rate mix and other component is pretty tremendous. Is there any way to kind of further parse out what is pure rate and potentially stickier going forward as we think about RPU as volumes start to inflect positively? And how much of it is maybe more temporary along the lines of storage, et cetera?

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

A

Sure. And thank you for the question. We have a strong environment out there for demand for our services, and that includes, of course, price associated with that. Price is a little bit north of a third in terms of the total composition. I will tell you that storage is another component there layered on top of that pure price number. And we expect, as service improves this year, and as supply chains improve throughout the year, we're going to see that storage number decline as the steamship lines in particular require less storage and are able to deliver more throughput capacity.

Jonathan Chappell
Analyst, Evercore ISI

Q

Okay. So just to be clear, that one-third of price, is that intermodal and coal? Or was that just intermodal and coal maybe is a bigger [indiscernible] (00:33:25)?

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

A

That's the whole shooting match. That's our portfolio.

Jonathan Chappell
Analyst, Evercore ISI

Q

Got it. All right. Thank you, Ed.

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

A

Yes sir.

Operator: Thank you. Our next question comes from the line of Scott Group with Wolfe Research. Please proceed with your question.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Hey, thanks. Good morning, and best of luck to you, Jim. Mark, I wanted to just ask the – any thoughts on the operating ratio for second quarter just to help give us some comfort on the bridge to the full-year guidance? And then Ed, just on the RPU less fuel for merchandise, it was only up 3%, which just feels a little light given the pricing environment and the inflationary environment. Does that get incrementally better from here, do you think?

Mark R. George
Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.

A

You want to start first?

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

A

Sure, I'll start first with the last question on price. I think everybody's familiar with the composition of our portfolio in general, which mean that every year, about half of our business comes up for pricing. We've still got probably a majority of that to go for the year on merchandise. And we are expecting to continue to deliver value in the form of yield based off the demand that we see out there, and as our ability to deliver capacity for that demand continues to improve this year.

We have a contract portfolio that's stacked with not only long-term contracts that you all are familiar with, but also short-term. We're testing the short-term right now. And we're delivering what I would call very encouraging results.

I would also say this: our customers are also delivering some encouraging results on their own that they're reporting to us in terms of their ability to attract new business and price.

Mark R. George
Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.

A

And Scott, with regard to the operating ratio, obviously, we've stuck to our guidance for the full year. And we're going to see progressive improvement sequentially as we go through the year with more of the improvement really in the back half as we enjoy the recovery in service, and in particular, in the fourth quarter. But I don't want to get any more granular with that given the dynamics in the marketplace.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Would you still expect it to be worse year-over-year in 2Q?

Mark R. George
Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.

A

Well, remember in 2Q, we had a fairly large property gain that really had a good lowering effect on our operating ratio. So all-in year-over-year, it'd be really hard to get close to that number, but it'll be certainly better than where we are right now. We saw within the first quarter, within the first quarter, the operating ratio, the rate of operating ratio improvement from January and February when volumes were very muted to what we saw in February – in the month of March was a pretty nice improvement. And I expect that in the second quarter with volumes at least holding at these levels and perhaps starting to ramp up a little bit, we'll see a nice jump. But Q2 is a very tough compare because of that land sale that we had called out.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Yeah. Okay. Thank you, guys.

Operator: Thank you. Our next question comes from the line of Jason Seidl with Cowen. Please proceed with your question.

Jason H. Seidl
Analyst, Cowen & Co. LLC

Q

Thank you, operator. You guys mentioned that there could be some upside to the numbers if fuel remains high. I'm assuming that could come in the form of intermodal and coal as well on the export or maybe even domestic side. Could you talk a little bit about how you're equipped to handle that business in terms of the fluidity of the network? And then are there any investments needed in the coal franchise which, as we all know, has not been getting ramped up over the last four, five years?

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

A

Yeah, sure. Let's talk about coal specifically. That's been a market that's been supported by price driven by capacity tightness. And with the current geopolitical disruptions that are out there, the market's got even hotter. And so we are very well equipped, I believe, with our franchise going to the Lambert's Point, to deliver value for our customers and for the marketplace on the export side. And that includes – we're ensuring that we have the fleet necessary to deliver that value. We know that there's some incremental capacity coming on later this year.

And so we are working right now to repair those portions of the fleet that need it so that we have a good order fleet of coal cars that can deliver value over at Lambert's Point, as well as to the rest of our customers that rely on that fleet.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

And as far as the network is concerned, you mentioned intermodal as well. I mean, obviously, the hiring that we're doing and you see the numbers and number of qualified employees starting to tick up. We expect that to continue through the quarter. I'm very, very optimistic about that. And I think that as that starts to be felt, I think, in addition, the intermodal TOP|SPG focus is also going to help us in the intermodal side. It really does do – it's completely streamlined between terminal operations, line road operations to drive some of the efficiencies that I described before. So I think that'll give us a great platform for being able to meet much more of the demand than we're meeting right now.

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.
A

And to reiterate, our customers wants to grow. And on the intermodal side, in particular, we're blessed with a great portfolio of customers who are investing for growth in 2022, and we're making sure that we're going to be able to deliver for them. With the way fuel prices are currently, we have a compelling product in the marketplace, which will only become more compelling as we're able to deliver more capacity.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

And I guess I would add one more on coal.

Jason H. Seidl
Analyst, Cowen & Co. LLC
Q

Well, we've been getting the same feedback from customers, so. Go ahead. I'm sorry, Cindy.

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.
A

Very good.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

Yeah, Jason, on coal, I should have also mentioned, we really have had a solid service product to the port throughout the year. And part of what you've heard me talk about, and I referenced it in my prepared remarks around train size has been the demand that we've seen, being able to double those trains up and operate the tons with less labor intensity has been consistent throughout the year, and we expect it to continue.

Jason H. Seidl
Analyst, Cowen & Co. LLC
Q

Great. Let me just send my best wishes to Jim before I sign off. Everyone, thanks for the time as always.

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.
A

Thank you.

Operator: Thank you. Our next question comes from the line of Brian Ossenbeck with JPMorgan. Please proceed with your question.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Q

Hey, good morning. Thanks for taking the question. So Cindy, sticking with you, obviously, the STB is having the hearing on urgent service issues. It seems like they want some improvement here in the next 30 to 60 days. So wanted to see if there's anything in particular that you had in the pipeline that could maybe accomplish that that you haven't really talked about yet here.

And then also, when you think about retention, obviously a lot of the service improvement intends – is contingent, rather, upon that inflection. But are you at all concerned about retention of the trainee size staying at the rate it is, retention of the more experienced people on the line of road? How are you feeling about that? What's your level of confidence? And in there too, are there any other actions you can take to increase that retention level? Thank you.

Alan H. Shaw
President, Norfolk Southern Corp.

A

Hi, good morning Brian. Thanks for the question. I'm going to start with that and then turn it over to Cindy. And just to be crystal clear, restoring service is the top priority of this entire leadership and every employee at Norfolk Southern. Personally, I've been out in the field and I've been in our dispatch center, and I really see the pride that our employees have in serving our customers and serving the US economy. I'm really encouraged by the employee engagement, and I'm frankly very encouraged about the steps that we're taking right now to restore our service product to where it needs to be.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.

A

And Brian, yes, I saw you yesterday at the STB hearings. The focus of the committee around – the board around trying to restore service as quickly as possible, we are lockstep in line with that mindset. And other – I think we have brought to bear everything we can to do just that. I can't think of anything that I heard yesterday that helps move it forward any faster.

So we're going to – as Alan has noted, we are laser focused on this. So I think a TOP|SPG will help us. I mean there's just a number of initiatives that we have already. And I think those are the ones that we're going to – we'll stick with, and I think they will bear fruit for us.

In terms of the retention of trainees, that is something that we look at and make our hiring decisions based on that. And they differ between some of the hiring groups that we have. We have put in signing bonuses at various levels based on attracting trainees and clearly outline what the job is to trainees and work very hard to make sure that we do keep the ones that we get in.

That said, one of the things that we also do once they are on and training is provide the work life in terms of being on call and working different shifts and working weekends in the training program to make sure they really do understand what it is we're expecting as a railroad employee. And to some extent, that may accelerate attrition, but that attrition comes early rather than later because it would ultimately come. So we feel like that's the best way to make sure that we manage the promoted trainee very effectively or the promoted conductor very effectively by trying to manage it on the front end. But we do see high attrition in the training ranks, but we plan for that.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC
Q

Okay. So just to summarize, it does feel like what you're communicating is you are at an inflection point in terms of getting the T&E, the right number of people in the right place.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

Well, you're seeing it on the slide that we showed with qualified T&E. It's starting to tick up. And looking at our hiring locations and the number of trainees that we have in place, or in flight right now, we feel really good about being – seeing good – as we exited – started the second quarter and ending the second quarter, we will see improvement across that timeline and acceleration from that. So I'm really enthusiastic about where we stand.

Alan H. Shaw
President, Norfolk Southern Corp.
A

And you couple that with the implementation of TOP|SPG late this quarter and a number of other specific tactical initiatives that Cindy has every day to improve the quality of our service and our labor utilization we've got a good runway ahead of us.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC
Q

Okay. Thank you for the time. Appreciate it.

Alan H. Shaw
President, Norfolk Southern Corp.
A

Thanks Brian.

Operator: Thank you. Our next question comes from the line of Jordan Alliger with Goldman Sachs. Please proceed with your question.

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC
Q

Yeah, hi. Just to follow up on TOP|SPG, I'm wondering, I know the deployment is forthcoming. How long would you see – how long do you think it would take to actually fully deploy and start to see the benefits? Is this something that you start to see the impact relatively quickly?

And then just as a follow-up, I'm assuming, I can't remember completely, that intermodal planning was part of the original PSR efforts three or so years ago. So is this just a function of three years in, hey, these are adjustments we need to make because something's not working completely right? Thank you.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

Yeah, Jordan. I would say that it's really just, as I described, kind of unconstrained approach. I mean, things have changed over time, post-pandemic included. And the original TOP21 was – the plan was to continue on with intermodal. And there's certain trains that could actually carry both. And that does exist today, and we probably have an opportunity or two to have it in the new version here.

But this is – it's really about, again, taking an unconstrained approach and figuring out how to balance our network, make sure we have a good executable plan and improve train size. So those are the main tenets of what the output should be.

Now in terms of benefits, I mean, intermodal's about 20% of our crew starts. So we will see it affecting that part of our business, and we'll implement schedule changes and those types of things as we roll it out fairly quickly. So I feel like that one will see some benefits as we get into the third quarter.

But then we'll move on to the bulk side. So I think it will be – TOP|SPG generally will be something that allow – it will be something that will take longer than just the intermodal portion. It will continue on through the year and beyond in some cases where we have bulk opportunities in places where there's some physical infrastructure constraints.

Alan H. Shaw
President, Norfolk Southern Corp.
A

Cindy, I think we think of it as a process of continual improvement.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

Yeah, absolutely.

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC
Q

Thank you.

Operator: Thank you. Our next question comes from the line of Ken Hoexter with Bank of America. Please proceed with your question.

Ken Hoexter
Analyst, BofA Securities, Inc.
Q

Hey, good morning. And Jim, again, best of luck and Alan and Cindy, I know everybody's been harping on this, but maybe if I can maybe come at it a different way. On PSR, it was all about resilience and something goes wrong, it kind of fixed itself. We're now in the second phase of it with TOP|SPG. So maybe you could just dumb it down for me. Is it just employees that you need that – as the STB said you kind of overdid it, and now you've got to get them to get the service back? Is it that the plan wasn't the right fully-built plan and now you kind of need to fix it? Cindy, you talked about kind of keeping a surge locomotive fleet. So what is it that needs to get the fluidity up?

And then kind of on the tail end of that, you've talked a lot about intermodal and the shift of freight east, yet international volume's down 20%. I guess, is that part of this equation of not enough employees? Is the congestion still on the network? Maybe walk through what has to happen to clean that up as well. Thanks a lot.

Alan H. Shaw
President, Norfolk Southern Corp.

A

Thanks, Ken. With respect to how we're approaching this thing, I mean, to be clear, our first priority is restoring our service. And our entire organization laser focused on delivering that objective. Once we've gotten that near-term goal, we are going to perform a retrospective analysis on how we got into this position. And we're going to understand what signals we missed, how we can improve the process and what mitigants we can put in place going forward.

For us, we firmly believe that right now it's a combination of our employee level and our service plan, which is why we very quickly implemented, decisively, initiatives to increase our hiring and to redesign our operating plan. That redesign of the operating plan is going to improve our balance, it's going to improve the simplicity of our product, and it's going to improve the executability of our product, which is going to help the service product in all three of our franchises.

Ed, do you want to talk about specifically about international intermodal?

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

A

Sure, absolutely. And thanks for the question. In terms of the intercontinental supply chain, which delivers products to the US consumer primarily from Asia, but from other places as well, there's been tremendous volatility as everybody on this call already knows. Not only are supply chains stressed in the US, and that includes really all the components of that supply chain, which are the ports, warehouses, railroads, truckers, retailers and other outlet venues. But it also includes the lines themselves on the water and at the ports of origin. So there's been a lot of volatility there.

We have seen steamship lines make decisions that really allow themselves to have more flexibility. And part of that is because of the congestion, which we've experienced, which the supply chains experience. But we're seeing some very encouraging signs in terms of where that goes going forward. We believe that intermodal still offers substantial value, not only for the steamship lines, but for their customers, especially in a high fuel environment or high fuel price environment. We think there's a compelling story there that we can deliver value for over the long-term.

And as we see those supply chains start to loosen up this year as the lockdowns in Asia continue to ease, we hope, we're going to see, we believe, customers look to IPI again for a way to add value on the inland supply chains. But there's a few forward-looking indicators or leading indicators that we want to look at, that's warehouse availability, drayage capacity. It's a dynamic situation.

Ken Hoexter
Analyst, BofA Securities, Inc.

Q

Wonderful. Alan, I appreciate the time. Thanks guys.

Alan H. Shaw
President, Norfolk Southern Corp.

A

Thank you, Ken.

Operator: Thank you. Our next question comes from the line of Ravi Shanker with Morgan Stanley. Please proceed with your question.

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Morning everyone. Jim, best of luck from us as well. I had a couple of questions on train length. Just to kind of understand that a little bit better, is increasing train length at a time when, obviously, network fluidity is not great and service is challenging, does that help or hurt at the current moment? Obviously, I get the long-term benefits of increasing train length. But at this time, just wanted to check if it helps or hurts.

And as a follow-up to that, I know the STB is very focused on service levels as a whole, but there's also been some scrutiny on train length specifically, especially at a congressional level and some recent shippers as well. So I'm just wondering if there's a natural limit to that or if there's diminishing returns over time. Thanks.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.

A

Yeah, Ravi, thanks. I think train length really helps us right now. It improves, or lessens our labor intensity. Now there's a point to which if you're unable to meet trains at multiple locations on a particular district, it could work against you, to your point. But I think where we are finding opportunities to move more traffic with one crew, that is really to our advantage. So I don't see it working against us both near-term, nor do I see it working against us long-term.

We want to be able to match our train size to our locomotive pulling capability. And as we invest in locomotives, and you've heard me talk about that in our prepared remarks, with DC/AC conversions, it's very helpful to us to improve train length.

From the standpoint of what the STB might do, I don't know. I know that it is a topic that even FRA brings up from time to time. But I truly believe that the technology that's brought to us with distributed power capability makes it a very safe and effective operation. I don't see a reason that we should expect or want or think necessary any restrictions on train length as long as we're continuing to move fluidly and not getting longer than the district that we need to run on.

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC

Q

Very helpful. Thank you.

Operator: Thank you. Our next question comes from the line of Amit Mehrotra with Deutsche Bank. Please proceed with your question.

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks. Hi, everyone. Mark, you've been helpful in the past talking about the cadence of absolute costs. I mean, I think we're in a somewhat uncertain volume environment as we look out six, nine months. I think it would be helpful to get your perspective on what you have visibility on, which is the absolute cost structure. So can you talk about at $1.8 billion in the first quarter, where you expect the cost structure to – how you expect it to move over the next few quarters?

And then I just had one clarifying question. When you talked about the year-on-year change on the second quarter OR, I fully understand the land gain, bringing that down. But it was I think at 60.3% excluding that. Do you expect to be better than that or worse than that year-over-year? Or is sequentially the right way we should think about it for the second quarter?

Mark R. George
Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.
A

Thanks, Amit. Look, yeah, we ended this first quarter with absolute costs in that $1.830 billion range. And when I look out from here, there'll be a step-up, even excluding fuel, I think as volumes start to rise. We'll see probably a step-up in absolute costs for sure. But I would still think inclusive of fuel, we're going to stay under that $1.9 billion level throughout each of the quarters going forward.

Now with regard to the year-over-year change in OR in the second quarter, again, I don't really want to get into any more specifics than to say we have a good chance to be in that range, ex fuel. But I don't want to put more of a finer point on it than that. I'm sorry, not ex fuel; ex the land gain from Q2 of last year. I'm hopeful we can be in that range.

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.
Q

Okay.

Mark R. George
Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.
A

But there's too many variables. I don't really want to put a fine point on it.

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. I appreciate you talking about the cost structure. That's very helpful. Thank you very much.

Mark R. George
Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.
A

Thank you.

Operator: Thank you. Our next question comes from the line of Justin Long with Stephens Inc. Please proceed with your question.

Justin Long
Analyst, Stephens, Inc.
Q

Thanks and good morning. I know the 2022 guidance for high-single-digit revenue growth didn't change. But is it possible to share what you're assuming for full-year volume growth within that outlook? And looking at the second quarter specifically, do you think there's the opportunity for volumes to inflect positively year-over-year?

Alan H. Shaw
President, Norfolk Southern Corp.
A

Yeah. Thank you for the question. We believe that not only is the US economy poised to continue to deliver growth for transportation providers who can add value, but we think that the consumer demand is going to continue here, at least for the foreseeable future. And you layer in some high commodity prices and some geopolitical conflict, and we believe that the US is very well positioned, in the current environment, despite some of those headwinds we all know about in terms of rate increases and high fuel prices.

That being said, we know that as we improve our service, as we deliver more capacity, that our customers want to grow, they're poised to grow, and we're going to be able to deliver that growth. So yes, I would say we're sticking with our view that we're going to be able to deliver growth for the full year in terms of volume.

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.
A

Yeah. Second quarter, in particular, was not necessarily going to be as strong in the back half.

Alan H. Shaw
President, Norfolk Southern Corp.
A

No, but we're going to ramp up. Right.

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.
A

So we're going to ramp toward the back half as service improves.

Justin Long
Analyst, Stephens, Inc.
Q

Okay, got it. And maybe a quick follow-up on TOP|SPG. I was curious if you could share how much additional capacity you think that will create in the domestic intermodal network specifically. And if we get into an environment where domestic intermodal volumes are increasing double digits, I just want to get some color on your ability to handle that over the remainder of the year.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

Yeah, Justin, I'll mention the secondary, kind of the secondary order of business on TOP|SPG, particularly intermodal, is to look at outlet frequency as well as blocking density that will help us be able to be as efficient as possible in our terminals and obviously then operate trains that support that. So that is a big component of the plan and how we're thinking about it, because we want to make sure that we build it with a platform to grow.

Justin Long
Analyst, Stephens, Inc.
Q

Okay. I appreciate the time.

Operator: Thank you. Our next question comes from the line of Walter Spracklin with RBC Capital Markets. Please proceed with your question.

Walter Spracklin
Analyst, RBC Capital Markets
Q

Yeah, thanks very much. Good morning, everyone. I'd like to come back to the regulatory question and really some of the concerns that are raised generally about rail service. And we're hearing it now from a number of different sources, not just the STB, but from other organizations, Federal Maritime Commission, Secretary of

Transportation and so forth. And I know in Canada, the regulator did make efforts to regulate service, and it was complicated and it created a fairly high level of uncertainty as the regulator tried to step in and regulate on service. Do you see any concern that, and I know there was some calling for that, that the regulator here in the US would look to follow suit and what form might that take? And do you have any concern whether that will affect your ultimate profitability if the regulator starts to move in on regulating service levels?

Alan H. Shaw
President, Norfolk Southern Corp.
A

Yeah, Walter, part of that's a hypothetical, as to what form it could potentially take. I can tell you that we are completely aligned with our customers and our shareholders and our regulators on the intent and the focus on delivering value to our customers. And we have every economic incentive and are self-motivated to fix this problem. And as a result, we are staying actively engaged with the STB. You saw Ed and Cindy and Annie represent Norfolk Southern in the industry yesterday in that venue. And I think what you heard from them is that we are entirely focused on restoring our service levels. That's our commitment.

Walter Spracklin
Analyst, RBC Capital Markets
Q

Thanks very much for the answer. Thank you.

Operator: Thank you. Our next question comes from the line of Tom Wadewitz with UBS. Please proceed with your question.

Thomas Wadewitz
Analyst, UBS Securities LLC
Q

Yeah, good morning. Thanks for the chance to ask a question here. I guess, I mean, you've talked a lot about crew and SPG adding capacity or crew additions. Do you need to do one before you do the other? Or I guess, and how would you think, like, would you expect to see velocity improve before you make some of the schedule changes? I guess I'm just thinking about related to execution risk when you make the schedule changes or perhaps they're incremental in the way you roll them out, and there's not a whole lot of execution. But wanted to ask about those two initiatives and just kind of how you would link them together and how you need to do them.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

Yeah, Tom. Well, I would tell you, if I pivot back to TOP21 when we've come out of 2018 with a lot of real service challenges and implemented TOP21, really, really effectively, and it went extremely well. So we're kind of using that as an experience that we've had to implement changes in operating plans. But at the same time, we have not completely finished the plan yet, and we will engage our employees and obviously our customers to make sure that how we implement it is the most effective way that we can implement it. And it is meant to be positive towards our service product. And if we need to do it more in a more sequential manner before that to support that, that's how we'll do it.

Thomas Wadewitz
Analyst, UBS Securities LLC
Q

So do you think velocity needs to be 20 miles an hour before you implement something? Or would you say they're not necessarily connected in terms of how well you're running before you make the schedule changes?

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.
A

Yeah, I think that the result of the implementation should help to lift velocity. And I don't think there's a gate of how fast we should be operating before we start something. And these will obviously be very localized changes. So we'll give those line segments a real good look before we actually implement. But I don't think there's a gate at which we have to be at a certain speed or a certain [ph] dwell (01:02:58) in order to implement. But we'll be very thoughtful as we implement to make sure it's supportive of improvement in service and not creating problems associated with that.

Alan H. Shaw
President, Norfolk Southern Corp.
A

Hey Tom, there's a dual path here, right? At the same time we're implementing TOP|SPG, we're going to start getting healthier with our crew base. And I'm very confident in the ability of our team out in the field to execute this.

Mark R. George
Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.
A

I might just add, TOP21 that we did in 2019 was really, in hindsight, a revolutionary operating plan change that unlocked a tremendous amount of productivity that we harvested. I think TOP|SPG is more of an evolution from that now, where we're looking to get back into an operating plan that we can execute on a more reliable manner and also resource more reliably because that's where we're dealing with the challenges, is on the crew resource.

So what happened in the middle was the pandemic that really altered a lot of our traffic flows and our traffic mixes, our commodity mixes, I should say. And that's really what necessitates us to evolve the plan a little bit and try to get back into balance. So that's one way to think of TOP|SPG.

So now as we go and we release the new plan, which is being – we're going through iterations right now internally and then ultimately with our customers, hopefully, we'll end up with more crews on the ground and we'll be able to execute in a much more predictable fashion. So they're kind of happening simultaneously.

Thomas Wadewitz
Analyst, UBS Securities LLC
Q

And will you see the result more in 3Q or in 2Q on velocity, let's say?

Mark R. George
Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.
A

Yeah, I would imagine we'll start to see it more pronounced in 3Q. That's not to say that we're not looking for opportunities here in 2Q to inflect upward.

Thomas Wadewitz
Analyst, UBS Securities LLC
Q

Okay. Thanks for all the time.

Operator: Thank you. Our next question comes from the line of Cherilyn Radbourne with TD Securities. Please proceed with your question.

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

Thanks very much and good morning. I just had another one on TOP|SPG and the emphasis on train size to drive productivity. So Cindy, I wonder if you could give us some perspective on where train size sits today and what you think the upside is as you leverage distributed power and make siding extensions and how you'd rank the remaining opportunity for train size improvements in bulk, merchandise and intermodal? Thanks.

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.

A

Cherilyn, thanks for the question. I think that you've seen train size incrementally improve over many quarters. Some of that is bringing volume on to existing trains. And that's just absorbing volume coming to us. So as we came out of the pandemic and we had more volume coming to us, we just added to existing trains. And then there's a piece of it that's a little bit more structural. And that structural piece can be in the bulk network where we can double trains up or where we can actually increase train size by 20 cars, let's say, in our green network or so forth because that matches the pulling power of our locomotives.

So as you see mix changes happen within intermodal or bulk or manifest, that will impact what the high end of our opportunity set is. But what we're really doing is matching the train to the locomotive pulling power and capability. And we really don't think of it as this is the output we're trying to get to. We more think about it incrementally and structurally, how we can change it to improve it. But the distributed power is what's unlocking that opportunity. The technology associated with distributed power is what's unlocking that opportunity. And you're seeing us invest in our locomotives. The rebuilt locomotives all come equipped with distributed power. It's helping us continue to do that. The locomotive fleet over the years from 2016, we started this process of DC to AC conversions, has incrementally added to our ability to take on train size. So that's how we think about it.

Operator: Thank you. Our next question comes from the line of Ben Nolan with Stifel. Please proceed with your question.

Benjamin Joel Nolan
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah, hi. Actually, Cindy, I wanted to follow up on that a little bit. You talked about, I think specifically in the intermodal part of the business, that there was some positive mix in there in the first quarter. And I assume that, obviously, that's the effort going forward. But how do you balance out trying to just add volume on an absolute basis versus also trying to add the premium volume that generates better margins? It's got to be a little challenging to do both at the same time, right?

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.

A

Yeah. So we think about in terms of balance. We think about in terms of executability. And I talked a little bit about outlet frequency. In some cases, we're running certain, several trains between two different cities but they're going to two different ramps. So how do we think about taking those two trains and getting outlets for our customers more frequently to be able to get to the destination cities and not think so hard about specifically what ramp we're going to? So that's some of what is embedded in our thinking.

And then how can we simplify the building of the train with blocking density and being able to make blocks that are bigger? So there's a lot that goes into the inputs of how we balance train size and the internal components of how we operate the trains and the terminals between which we operate them.

Alan H. Shaw
President, Norfolk Southern Corp.

A

Cindy, I would add that as we strike balance, we strike simplicity and we add crews, our train performance is going to improve. Train speed's going to improve. The quality of our product is going to improve and that's going to add more business to existing trains. And so just from that standpoint, even without a design change, we're going to add train length and train weight.

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

A

That's exactly right. And I would say, just to add one other thing, the structure of our network is such that we are blessed with a lot of optionality here, both in terms of the cities that we serve, the major metropolitan areas, but also multiple robust facilities within those metro areas, which we're going to leverage to deliver a simplified yet effective train plan for our customers.

Benjamin Joel Nolan
Analyst, Stifel, Nicolaus & Co., Inc.

Q

All right. Appreciate it. Thanks.

Operator: Thank you. Our next question comes from the line of David Vernon with Bernstein. Please proceed with your question.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Q

Hey, good morning. I had a question for you on somewhat related to service issues, but if you think about the volume inflecting in the back half of the year, adding some congestion to the network, do you worry at all that that might delay the recovery at least in the metrics themselves? And do you have any timeframe for when we should be expecting service to kind of normalize or return to a better level? I know we're talking about inflection here in the second, third quarter, but when you think about getting fully restored, do you have a timeframe for what that might look like?

Cynthia M. Sanborn
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.

A

Yeah, so I think what we've talked about is we're really confident in the pace of improvement this quarter and into the future quarters. Very dynamic environment we're dealing with. So it's hard to say when we'll "be back." But it's a very positive trajectory that we expect.

And from a congestion standpoint, as we speed up, by definition, congestion will ease. So as we bring – it'll be much easier to bring on volume because we are less congested. So we really – the idea is to start with crew resources and plan changes, to a lesser extent, but still supportive to the idea of being able to operate the railroad in a much less congested manner than we see, which will be reflected in our train speed going out.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Thanks for that. And then just as a quick follow-up, terminal capacity, your third-party contractors that are running some of the intermodal terminals, I think we've certainly heard a lot about service issues there as well. As you think about the resourcing that you're doing, can you comment at all around the resourcing that's happening at some of the terminal operations and when some of those sort of in gate, out gate problems might also start to get better?

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

A

Sure, I'll comment on that. We've taken a very hard look at our effectiveness in terms of throughput efficiency and our ability to deliver capacity for the market through our terminals. And in many cases, there's a lot of inflation working its way through the entire US economy. That manifests itself, of course, at the terminal level as well.

But what we are focused on is ensuring, number one, that we have the capability at the terminal level to handle the volumes that TOP|SPG is going to deliver for us going forward. We are reconfiguring some of those contracts as we speak to both make sure that we have that capacity for the future as well as ensure that the type of operation that we have is the one that we need.

So we're working on that as we speak, and we're confident that as TOP|SPG rolls out here, we're going to see it manifest itself as additional capacity for our customers and improved executability for the service we deliver.

Alan H. Shaw
President, Norfolk Southern Corp.

A

And the physical capacity of our intermodal footprint has allowed us to handle much higher intermodal volumes just as recently as 2018.

Claude E. Elkins
Chief Marketing Officer & Executive Vice President, Norfolk Southern Corp.

A

Absolutely.

Alan H. Shaw
President, Norfolk Southern Corp.

A

So the physical capacity is there. We're working on our engagement with our lift contractors, with shared service metrics, and we're working on how we can improve our own performance with the trains. And I think that's a recipe for success for our customers.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Q

Thank you. That's helpful.

Operator: Thank you. Our next question comes from the line of Bascome Majors with Susquehanna. Please proceed with your question.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP

Q

Yeah. Apologies, was on mute there. So your largest domestic intermodal [indiscernible] (01:13:30) partner recently renewed its vows with their Western Rail partner, committed to a really big capital investment going to drive midterm growth and share gain from highway. Can you talk a little bit about what your appetite for that type of commitment and customer visibility it might provide is at Norfolk? And whether a firmed up or expanded channel partner deal would be more or less likely after you get through some of the operating plan changes that you're currently undergoing for intermodal? Thank you.

Alan H. Shaw
President, Norfolk Southern Corp.

A

Well, there's probably very little I can talk about on any of those things. But let me say this: we are blessed with a fantastic portfolio of customers. The customer you're talking about is a very valued partner of ours, including some others. And they are positioning themselves for growth. Our customers want to grow; they're poised to grow. They're investing for growth, and we are too. And so you put the combination of very powerful intermodal franchise. We would argue the best certainly in the eastern United States, put that together with a robust portfolio of partners who are delivering value for their customers in the marketplace, and I think it's already a great combination. Can only get stronger.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP

Q

Thank you.

Operator: Thank you. Ladies and gentlemen, that concludes our question-and-answer session. I'll turn the floor back to Mr. Shaw for any final comments.

Alan H. Shaw
President, Norfolk Southern Corp.

Thank you for your time and your questions, and I appreciate you joining our call this morning.

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