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Norfolk Southern Corp. (NSC)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Norfolk Southern Corporation Second Quarter 2021 Earnings Call. [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, Ms. Achimasi. You may now 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 our 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 Chairman, President and CEO, Jim Squires.

James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Good morning, everyone, and welcome to Norfolk Southern's Second Quarter 2021 Earnings Call. Joining me today are Cindy Sanborn, Chief Operating Officer; Alan Shaw, Chief Marketing Officer; and Mark George, Chief Financial Officer.

Building upon our momentum to start the year, our team delivered another record-setting quarter as dramatic improvement in both revenue and volume, up 34% and 25% respectively, outpaced an 11% growth in expense. And while the year-over-year improvement is aided by easier comps from last year's economic shutdown, our performance in the quarter also improved sequentially in a number of ways, as shown on slide 4. Our results include second quarter records for net income and earnings per share and all-time records for operating income and operating ratio, which was 58.3% this quarter.

We are excited to share more details about our results. But first, I want to take a moment to thank each and every one of our employees for helping us run a more efficient and safer railroad while serving our customers. And I'll now turn to Cindy to go through our operations. Cindy?

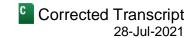
Cynthia M. Sanborn

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

Thanks, Jim, and good morning. We accomplished a lot this quarter, and I am most pleased with our PSR progress during the past several months. We continue to get more productive, face our challenges head on and seize the opportunities we are creating. In the second quarter, we saw the benefits of a structurally lower operating cost base, coupled with an operation that successfully absorbed increased volumes in the network.



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Turning to the operating metrics on slide 6; you can clearly see the operating leverage generated in the quarter, leverage that flowed directly to the bottom line. Our operating discipline enabled us to handle a 25% year-over-year volume increase with 8% fewer people in our workforce and a 1% decrease in active locomotives. This success shows our improvements in train size, reflecting our goal of absorbing more business into our existing operating network wherever possible and further driving productivity.

These gains were achieved in part by the increased deployment of distributed power and more blending of previously separate traffic types on the same train. We will continue to unlock train size increases through targeted siding extensions on key routes where train length is currently limited.

Terminal capacity enhancements, which we've achieved through more efficient operating practices, will also be a key factor in absorbing and processing growth on these larger trains. Increased train size promotes better fuel efficiency, and our progress this quarter reflects our commitment to closing the fuel efficiency gap with our peers. Our mechanical team, which manages the maintenance of our highly reliable locomotive fleet pulling these larger trains, has been crucial to many of these accomplishments, and I'll give you more detail on that a little later in my presentation.

On slide 7, you can see in the second quarter, we showed sequential improvement in terminal dwell and train velocity after we got through the severe winter weather in the first quarter. However, our progress was uneven and we lost ground in June, in part due to several discrete but geographically impactful operating disruptions. We aren't satisfied with our service levels and we are working extremely hard to seize the opportunity PSR presents to recover faster from disruptions.

As the graphs show, we resumed our improvement in July. We are committed to continuing to improve service levels and running a faster railroad, not just because a faster railroad is a lower-cost railroad but also because speed generates capacity for us to take on additional traffic within our existing train network.

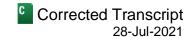
I'll move to slide 8. During the quarter, we strived to deliver a consistent service product, even with significant volume changes, by focusing on the consistency and productivity of our yard and local operations. We are teaching and equipping our field managers to better measure the work our yard and local crews do and answer some important questions.

Does the number of assignments working match the car volumes flowing through a terminal or territory? Are we getting full value out of each resource in yards? What's the right balance of overtime cost? Where are there further automation or process opportunities to help us reduce support costs, including clerical staff and mechanical presence? We are implementing technology to provide better and more timely data to answer these questions, which helps us reduce direct operating cost and improve service consistency.

In several locations, we've renewed our focus on more efficient remote control operations, which have been facilitated by the changing nature of the work over the last year. Local operations scheduled and properly sized to volumes enable us to be more predictable to our customers and move cars quickly. Having a higher balance of crews assigned to road train service while creating capacity within the terminal through process enhancements makes us nimble in responding to market changes and reducing our fixed costs.

Local service is at the core of our service product, and these changes are designed to improve that product. So far, we have reduced the cost per yard and local crew 7% versus last year and expect additional progress as the year continues. In a moment, Mark will discuss the benefits of reduced head count and employee activity levels in

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constraining overall compensation expense as we absorb volume. Our focus on yard and local productivity has played a pivotal role in driving those benefits.

We pursue targeted initiatives, such as these, with an eye towards the next generation of modern railroading, which we are bringing to life today. We continue to empower our workforce through the delivery of mobility solutions and have distributed 8, 000 smartphones to our T&E employees to facilitate improved reporting and to streamline the process of keeping trains moving.

In the third quarter, we will begin rolling out a next-generation local train reporting application to improve our visibility and customer service for the first and last mile. We are also in the final months of deployment of our current phase of the mobile track authority application that facilitates more efficient coordination between engineering and dispatching functions for right-of-way maintenance activities.

We are at a very exciting time for our company and industry, in which we have ample opportunities to drive customer and shareholder value through both operational improvements and technology, a powerful formula. Earlier, I mentioned the role the mechanical team has played in our PSR success, so I thought it would be useful to explain their crucial role on slide 9.

PSR railroads, Norfolk Southern included, end up needing fewer locomotives. What our mechanical department has done is to take that initial inning and use it strategically to cull the worst performing units and to make our locomotive fleet more homogeneous. Those changes unlock repair productivity.

Think about the benefits of repairing newer and fewer locomotives, which drove down the number of units out of service for repair. That started a virtuous cycle of improved reliability with 175% improvement in the days between unscheduled events to a shop versus pre-PSR levels. Meaning that when units do go into the shop, our craftsmen can spend more time on preventive maintenance instead of triaging issues. This cycle repeats itself and ultimately supports the efficient movement of trains and serving our customers.

Fewer, more reliable units also require fewer resources. So we need fewer servicing facilities and have fewer people maintaining locomotives.

This is just an example, a big example of Norfolk Southern's PSR transformation. These changes are purposefully aligned with our overall fleet strategy, including investments in our fewer but better units through our DC to AC conversion, energy management solutions and predictive analytic tools for maintenance planning and failure prevention. When taken as a whole, the benefits of this strategy flow through our materials, fuel and compensation expense lines, while ensuring we have a robust fleet capable of supporting profitable growth.

Now, I'll turn it over to Alan.

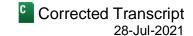
Alan H. Shaw

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

Thank you, Cindy, and good morning everyone. You can see on slide 11 that we are approaching pre-pandemic revenue levels. However, the composition of our business has changed dramatically due to the secular trends in the overall economy that were accelerated by the pandemic. Norfolk Southern is positioned at the forefront of these shifts due to the unique advantages of our powerful consumer oriented franchise, and the diverse industrial markets we serve.



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The progress we have delivered amid dynamic business conditions underscores the value we provide to the markets we serve. Norfolk Southern's network directly connects to the majority of consumption and manufacturing in the United States and is a vital resource for maintaining the flow of goods to support the economy. We are building on the inherent value of our network by working to provide our customers with the digital logistics solutions they need to compete and grow in an evolving market.

The sustainability advantages of the Norfolk Southern franchise deliver a competitive advantage, provide customers with solutions to their carbon offset goals and are an accelerant to growth. In the second quarter of 2021 we successfully capitalized on opportunities by leveraging productivity enhancements and collaborating with our customers. As a result, second quarter revenue in our non-energy markets exceeded pre-pandemic levels by 4%.

Growth this quarter was driven by consumer-facing and industrial segments, which helped to offset sustained headwinds in our energy markets. Revenue and our energy-related markets returned to just over two-thirds of pre-pandemic levels in the second quarter of 2021.

Our market position enabled a quick recovery in consumer and industrial markets, almost fully offsetting the 50% decline in our energy revenue. Despite the sharp decrease in this historically profitable segment, we reduced operating ratio, levering the strengths of our unique franchise to target segments of the \$800 billion truck and logistics markets, with a sharp focus on productivity.

Turning to slide 12, our quarterly volume and revenue improved significantly from pandemic lows in all three business units, reflecting our ability to capitalize and build on the momentum of improving economic conditions. Total revenue for the quarter was \$2.8 billion, up 34% year-over-year, on a 25% volume improvement. Rising fuel prices and price gains drove a 7% improvement in revenue per unit, led by our intermodal franchise, which delivered record-breaking revenue per unit and revenue per unit less fuel.

Sequentially, volume and revenue improved in all three business units over the first quarter, in line with the accelerating economic recovery. Beginning with our merchandise segment, both volume and revenue improved 29% versus the second quarter of 2020, driven primarily by recovery from COVID-19-related shutdowns in the prior period.

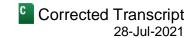
While automotive continued to face headwinds associated with the semiconductor chip shortage, shipments in the second quarter were up 122% year-over-year against easy comps associated with near complete shutdown of vehicle production in the second quarter of last year.

Our steel franchise also delivered strong growth this quarter, up 67% as record-level steel prices and elevated demand fueled production activity. Combined gains in automotive and steel volume represented roughly 63% of total merchandise growth for the quarter. Revenue per unit was flat while revenue per unit excluding fuel declined slightly, driven by mix headwinds in chemicals and automotive.

Turning to intermodal, our powerful franchise delivered record-breaking revenue, revenue per unit and revenue per unit less fuel for the quarter. The second quarter of 2021 marks the 18th consecutive quarter of year-over-year growth in revenue per unit excluding fuel for our intermodal franchise.

Strong consumer demand and tightness in the trucking sector drove growth for our domestic service product. Domestic shipments were up 17% year-over-year in the second quarter, and up 4% from the same period in

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2019. International shipments were also strong in the second quarter, improving 26% year-over-year on sustained high import demand, but were down 3% from the same period in 2019.

Revenue per unit gains were driven by increased accessorial revenue, higher fuel surcharge revenue, and price gains. Approximately 50% of the revenue per unit gain was driven by higher container storage time on terminal due to supply chain recovery challenges.

Lastly, our coal segment experienced some bright spots in the second quarter, due to higher demand levels driven by global economic recovery and weather events. Coal shipments improved 55% year-over-year, with strength in both the export and utility markets. Revenue per unit decreased slightly due primarily to negative mix experienced in our export markets where growth was driven by strength in the lower RPU export thermal market.

Moving to our outlook on slide 13. We expect the current economic momentum to continue through the end of the year and are raising our guidance for full year revenue growth to approximately 12% year-over-year. The overall economy continues to surprise to the upside with forecasts for 2021 GDP growth now at around 7% and approximately 5% for 2022.

Industrial production is forecasted to increase 6% in 2021 and north of 3% in 2022. Increased manufacturing, coupled with record low retail inventories, high savings rates and increased energy consumption all set the stage for continued growth in the second half of the year.

Merchandise growth will be led by strength in steel markets as low business inventory to sales ratios and sustained demand for durable goods drives manufacturing activity in the second half. We are well-positioned to capture opportunities associated with current strength in the steel markets as our network serves more integrated steel mills than any other railroad in North America.

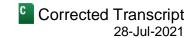
Merchandise energy markets will benefit from increased travel and commuting activities as businesses continue to reopen and virus restrictions are lifted. Pulp board and plastics volumes are also expected to increase as personal consumption drives demand for packaging. Merchandise gains will be partially offset by a year-over-year decline in automotive shipments in the third quarter due to planned production downtime associated with the semiconductor shortage.

Demand for international trade to support recovering global economies is expected to lead second half growth in our intermodal franchise. Domestic intermodal demand will continue to improve as well with consumer spending and e-commerce forecasts strengthening through the end of the year and ongoing capacity constraints in the trucking sector driving more opportunity for highway to rail conversions.

Our coal franchise will continue to capitalize on near-term opportunities to support global energy demand and steel production. Volume in the second half of 2021 is expected to improve year-over-year, driven by export markets benefiting from high seaborne coal prices, making US coals more competitive in the global market. Demand for domestic met to support growing steel production activity is also likely to produce year-over-year growth.

Gains in these markets will be partially offset by expected year-over-year declines in utility volume as this market deals with unit retirements, coal supply and planned maintenance outages. Volatility is an ever-present risk in the coal market. So we are closely monitoring geopolitical trade tensions and coal production, both of which have the potential to influence results.

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Overall, we expect economic conditions to be favorable for Norfolk Southern growth through the end of 2021. We are confident in our ability to leverage the strengths of our unique franchise and continue to drive revenue and margin growth.

I will now turn it over to Mark who will cover our financial results.

Mark R. George

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

Thanks, Alan. On slide 15, you see the reconciliation of our Q2 reported operating ratio and earnings per share versus 2020. The operating ratio of 58.3% represents a 1,240 basis point improvement. We had \$67 million of property gains in the quarter, of which there was one major transaction that closed at the end of the quarter and resulted in a \$55 million gain. We view this single transaction as incremental to our normal yearly operating property gain guidance of \$30 million to \$40 million, and it alone represents 200 basis points of the operating ratio improvement this quarter.

Earnings per share, at \$3.28, was \$1.75 higher than prior year. Aside from the \$0.17 goodness from the property gain, there was a state tax law change that resulted in a favorable adjustment to our deferred taxes of \$0.09.

Moving to slide 16. Alan walked you through the drivers of the 34% increase in revenue, including the 25% growth in volumes. At the same time, we contained growth in operating expenses to 11% as we harvested additional benefits from workforce and asset productivity. The volume growth, coupled with the productivity, drove strong incremental margins again this quarter, resulting in an operating ratio that was a record low 58.3%, improving 1,240 basis points year-over-year and 320 basis points sequentially, versus Q1, including the 200-basis-point tailwind from the major property gain.

Our operating income at \$1.167 billion in the quarter is another record, up \$557 million, or 91% year-over-year. And we generated free cash flow of \$1.47 billion through six months, also a record. And that represents an increase of \$447 million or 44% versus the same six months last year.

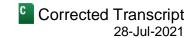
Moving now to a drilldown of operating expense performance on slide 17, you'll see that operating expenses increased \$157 million, or 11%, and fuel was the biggest driver of the increase with price driving expenses up \$83 million. Usage increased due to higher volumes, which was partially offset by another quarter of fuel efficiency gains, a 4% improvement in the quarter. The increase in purchase services and rents is driven by volumes, although we managed to keep the increase in these categories well below the volume growth rates.

Comp and ben is up 6% with savings from head count being down 8% year-over-year offsetting increases in pay rates and overtime. Higher incentive compensation in the quarter was \$39 million, reflecting the improved outlook for the year, and low accrual rates of last year. Despite the 25% growth in volume, materials were actually down year-over-year from lower spend associated with fewer but more productive locomotives, thanks to the rationalization of equipment last year and the initiatives that Cindy described earlier.

The big item in the Materials & Other column is the favorable compare on gains from property sales in Q2 and that was \$67 million in the guarter versus only \$2 million last year.

Turning slide 18, you'll see that other income net of \$35 million is \$14 million, or 29%, unfavorable year-over-year due primarily to lower net returns on our company-owned life insurance investments. Our effective tax rate in the quarter was only 21%, lower than we typically model. And that was primarily from the benefit associated with the state tax law change.

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Net income increased by 109% while earnings per share grew 114%, supported by the nearly 3.4 million shares we repurchased in the quarter.

Wrapping up now with our free cash flow on slide 19, and as I mentioned free cash flow was a record for the six months of 2021 at \$1.47 billion, buoyed by very strong operating cash generation, and relatively modest property additions of \$627 million thus far in the year. And that translates to a free cash flow conversion of 99% through six months although we still expect property additions to ramp up in the balance of the year and hit our \$1.6 billion guidance number.

Shareholder distributions through six months exceeds \$2 billion, an increase of \$870 million versus prior year, thanks to our recently increased dividend, and the meaningful increase in our share repurchase activity. And with that, I'll turn it back over to Jim.

James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Thank you, Mark. When we spoke last quarter, I took the opportunity to share our company's longstanding commitment to sustainability. Along those lines, I'm excited to report two brand new milestones in our journey. Earlier this quarter we became the first North American class I railroad to issue a green bond, launching \$500 million in green bonds to fund sustainable investments to reduce our carbon emissions and partner with customers to do the same.

As outlined in our green financing framework, potential projects range from improving locomotive fuel efficiency to fostering truck to rail conversions, powering company operations with clean energy to increasing the use of energy-efficient buildings and technology, and supporting the reforestation projects that restore natural landscapes and offset carbon emissions. In addition to our green bonds we achieved another significant milestone earlier this month with the approval of our science-based target, our commitment to reduce emissions intensity by 42% in the next 15 years.

These two steps are a critical part of our shared commitment to sustainability with our investors, customers, partners, and communities, underscoring our resolve to be an even bigger part of the solution.

Before we open the call to Q&A I'll take a moment to provide our updated outlook based on the current economic environment. As Alan mentioned, we are even more confident about growth for the balance of this year and we now expect revenue to be up approximately 12% year-over-year. Strength in our consumer-oriented and manufacturing markets will drive the majority of the growth and the near-term upside in coal markets will provide more of a lift this year than previously expected, though the market remains challenged in the long term.

We're also succeeding in driving productivity into our operations, and as a result we got on to our 60% run rate here in the second quarter. We expect to maintain this OR level for the balance of the year, which translates to at least 400 basis points of OR improvement for the full year versus our adjusted 2020 result. And we'll build upon this momentum for more improvements in 2022 and long-term sustained value for our shareholders and customers.

So with that, we'll open the call to your questions. Operator?

QUESTION AND ANSWER SECTION

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

Chris Wetherbee

Analyst, Citigroup Global Markets, Inc.

Yeah, hey, thanks and good morning. Maybe if you could just pick up where you left off, Jim, on the guidance, particularly for the operating ratio guidance, so obviously there have been some service dynamics that have deteriorated in the quarter, not just necessarily for Norfolk Southern, certainly, it's more of an industry comment. But I'm kind of curious how you think about resource management in the back half of the year so it sounds like CapEx is going to ramp back up to sort of get back on run rate for the full year target.

How do we think about head count, how do we think about some of the other resources that maybe you have some levers that you can pull? And kind of how quickly do you think service can kind of ramp up? So a few questions built in there but really kind of embedded in that OR guidance which is obviously better than what you gave us before, in the context of what we're seeing with service.

James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Okay, good morning, Chris, let me start and then I'll turn it over to Cindy to talk about some of the specific actions we're taking on the workforce front. We continue to see opportunities for workforce and other productivity in the second half of the year. Yes, we are facing some spot labor shortages, but they're just that. Systemically we think we'll manage and that we will continue to generate labor productivity in the second half, in fact. And that should translate into favorable results for expenses and for the bottom line as well.

We mentioned as part of the overall OR guidance the expectation for revenue, revised expectation for revenue. We took that up some too, so you put the two together and that gets you to the new guidance on the OR which is more than 400 basis points for the year.

Cindy, talk a little bit more about what we're doing on the resource side.

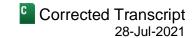
Cynthia M. Sanborn

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

Sure, Jim. Thanks, Chris. So, if you think about where we started the year, we had planned to hire – it wasn't going to be broad-based, we expected to gain productivity in our workforce throughout the year and largely it has played out that way. You might – my prepared remarks go into some more detail on that. I will say that from a standpoint of hiring, where we are hiring, there are a few higher group locations, the specific areas where the job market is extremely tight and so we are experiencing that in our ability to bring on new employees.

So – but it's fairly localized, it's not broad-based. So to mitigate that, we pull on some of our typical items to – that we – how we deploy people through what we call go teams, where we have employees that quickly can go into areas and support the existing crews that are there, temporary transfers, permanent transfers and even craft transfers from, let's say mechanical craft into transportation. And in terms of hiring some of the areas that we're

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working on there to be able to get people to come to us, we've increased our training wage, and we've also have some sign-on and retention bonuses for the new employees as they as they come on.

So we're working very diligently there. It is a headwind for us, we're watching it very, very closely. And you tied it to service and I will tell you that our service, as I think about that more broad-based and coming into the beginning of the year, we had fairly strong service measures, we went through a very challenging February and a very strong demand for volume in March on top of a really low demand for service because of the weather in February. And we started coming out of those challenges in late April and May and felt really good about where we are.

As we headed into June, we had -and I also described this a bit in my prepared remarks – sort of a series of events that, couple derailments, not big derailments, but just locations where they were challenging for us. And then, as we were recovering from that, we had some weather events that just elongated the recovery. So June was just a challenging month. As we came out of the July holiday, July 4 holiday, we have accelerated the gains from May and the run rates that we had from May and I feel better and good about where we are. We're not satisfied with where we are; we want to continue to improve service for our customers. But that's largely how I see the dynamic here between resources and service.

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

Jonathan Chappell

Analyst, Evercore ISI

Thank you. Good morning. Alan, everybody knows about the chip shortage and the impact it's having on the auto industry, but your comments about being down year-over-year in 3Q may be a bit surprising just given your network has been a little bit more immune, given the heavy SUV exposure there. Can you speak to your expectations beyond 3Q, especially as you get into that 12% increase in volumes for the full year for the total network? What are you expecting from auto, is there a massive snapback there where, the second half kind of looks the same, even though the third quarter maybe a little bit lighter, and how does that kind of portend into next year's view on the auto market.

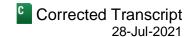
Alan H. Shaw

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

Yeah, Jon, the, the semiconductors are certainly the headline issue. What we're seeing right now is the impact of the Delta variant on producers who are in – our suppliers, I should say, in Southeast Asia. And so we've got a couple of plants that source parts from Southeast Asia and because of production issues over there, they've had to pull forward planned production downtime later this year. And so that has had an impact on our production and our volumes right now. Over time, we feel like we're going to get back to all the plants operating in August, but Jon, you know that – we've talked about that before and had to push it back, and then we're still anticipating by the fourth quarter, we're going to be in a position where we're at full production.

You're right, the plants that we serve and the products that we move are in high demand, so they will be the ones that get the first call on any available parts, whether it's semiconductors or anything else. Right now, finished vehicle inventories to normalized sales are in the teens. It's probably about a third or a fourth of where our customers want them. And so, we serve more US vehicle production than anybody else, and we serve an industry that's going to be very interested on inventory rebuild, both this year and as we move into next year. So we're pretty confident about the trajectory of our auto franchise once we kind of weather this initial bump.

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Jonathan Chappell

Analyst, Evercore ISI

Okay, so just to be clear that the 12% total volume growth, is that including a "made whole" on auto or that's in spite of auto maybe being weaker than you thought?

Alan H. Shaw

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

Yeah, I'm glad you brought that up. It is 12% revenue growth on upper-single-digit volume growth.

Jonathan Chappell

Analyst, Evercore ISI

Right, right, yeah. Okay, great. Thank you, Alan.

Operator: Our next question's from the line of Justin Long with Stephens. Please proceed with your question.

Justin Long

Analyst, Stephens, Inc.

Thanks and good morning. On the OR guidance, just wanted to clarify, are you including the \$55 million gain on sale in the expectation for 400 basis points to 440 basis points of year-over-year improvement and then maybe just thinking beyond even the second half of this year, would love to get your thoughts about incremental margins going forward as we look into 2022 and beyond and think about the opportunity beyond a 60% OR.

James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Mark, why don't you take that one?

Mark R. George

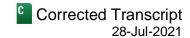
Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.

Sure. Look, Justin, the guidance does include – it's all in. So it does include this major property gain that we called out or highlighted for you. And look, I think incrementals, we had very, very strong incrementals here in the first half, and the guidance implies we're going to continue to have very strong incrementals in the back half, albeit less than the first half.

We do have some unique headwinds here in this second half. That would include things like fuel. Fuel is a headwind to us. A lot of the incremental revenue that we're adding here in our guidance change is coming from fuel. So it's fuel surcharge, which is mitigating incremental fuel expense. So there is really no incremental margin from that. So it tends to dilute what we have organically in the back half.

And then on top of that, we will have some diminishing accessorial charges, which hopefully help fuel some more volume that comes with it. And of course, we've got some IC headwind here in the back half as well. But that said, incrementals are good, and we continue to believe that going into 2022 we will continue to improve our OR on an incremental basis. And buoyed by some of the productivity initiatives and measures that we're constantly looking at and Cindy and her team are iterating on the T&E side as well as fuel efficiency, that should help, again, provide us consistent and continued improvement in our overall OR quest.

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Justin Long

Analyst, Stephens, Inc.

Okay. I appreciate the time.

Operator: Our next question is from the line of Thomas Wadewitz with UBS. Please proceed with your question.

Thomas Wadewitz

Analyst, UBS Securities LLC

Yeah. Good morning. Wanted to ask you a little bit about intermodal, I guess the first component just being, how do you think about the storage fees? I mean, I think you alluded to them being a pretty big factor in revenue per unit growth in intermodal. Do you think they continue at that level in the third quarter, second half? Is that a big falloff in that?

And I guess related to that, how do you think about the terminal operations? Are you constraining volume into Chicago? And kind of what's the chassis impact on your fluidity and how you think that may – how quickly that may change in terms of capacity constraints? Thank you.

James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Yeah, you're welcome, Tom. Our accessorial programs are designed to align the mutual goals of NS and our customers for a more efficient and reliable service product. And with the pressure on the drayage community and with the pressure on warehousing due to pandemic protocols and labor shortages, our customers in certain locations needed more space for storage.

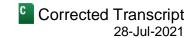
And so we responded to the market. We've added satellite lots in some areas. We've reconfigured our stack configuration at Landers, our heavily international facility in Chicago. And we've been able to accommodate a lot more international units dwelling on our terminals because that's what our customers need. Our accessorials, in this case, are in an activity-based service and price that we apply to the market.

We are absolutely focused on programs that encourage the fluidity of our operations. And really, our hope clearly is that the accessorials go away because that means that customers are pulling more quickly from our terminals. And as soon as customers pull boxes from our terminals, we can inbound more boxes into our terminals. It's not an issue of capacity, it's an issue of throughput. And we're working on some programs to encourage dual missions with the drayage community. So any time that they ingate a box, they're outgating a box as well.

You mentioned chassis, I'm glad you brought that up. As you know that about six weeks ago, we determined that over 5,100 of our chassis had a manufacturing defect. It was a supplier issue. And with our uncompromising commitment to safety, we didn't hesitate to pull those off the street.

Now that happened in a tough environment. We were already short of chassis because of elongated street dwell associated with the same warehouse and same drayage community pressures that I noted before. I'm very proud of the way that we have responded and, frankly, in collaboration with our customers as well, we stood up a number of different locations and an entire network of vendors to repair these chassis, the brand-new process. We've got 80 different locations, in which we are repairing chassis. Some of them are even off of our network, and we're working with foreign roads, our Western partners, on a number of gateway locations.

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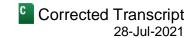


As a result, we've already repaired 40% of our chassis just in the first six weeks. Right now, we're on a run rate where we're repairing about 10% of those affected chassis. And we fully believe that by the end of August, we will have repaired about three-quarters of the affected chassis, which are effectively anything that's on our network. The rest have kind of migrated off network, and we're working with the foreign roads to get those back to us, so that we can repair them.

We haven't closed gates. I want to make it very clear. What we're doing in certain lanes where at the destination, we have a shortage of chassis because of this safety recall, we are metering or capping volume. And every day, this improves because every day we're repairing chassis, putting them back into the market and we are relaxing the metering program. You can see the impact on our volume sequentially as you move out of May into the first half of June and then where we are now. And that – as we continue to repair the chassis, you'll see volumes pick up.

Thomas Wadewitz	\cap	
Analyst, UBS Securities LLC	Q	
So I guess if – I mean, are you optimistic that improvement is quick? Or is that kind of slow? I think that's underlying what I was asking?	I think that's	
James A. Squires Chairman, President & Chief Executive Officer, Norfolk Southern Corp.	A	
Improvement in volumes?		
Thomas Wadewitz Analyst, UBS Securities LLC	Q	
Throughput. Yeah, you said throughput is the key.		
James A. Squires Chairman, President & Chief Executive Officer, Norfolk Southern Corp.	A	
Yeah.		
Thomas Wadewitz Analyst, UBS Securities LLC	Q	
Would you expect quick improvement in throughput? Or is that pretty gradual and throughout second half?	?	
James A. Squires Chairman, President & Chief Executive Officer, Norfolk Southern Corp.	A	
Well, it's going to improve as we get more chassis back into the market. As I told you, we're going to have three-quarters of these, all the ones that are on our network, repaired by the end of August. We're also state September, we're going to inject more [ph] assets (00:43:10) out of the lease market into our network as we are applying capacity to the growth opportunities that are out there for our customers.	arting in	
Thomas Wadewitz Analyst, UBS Securities LLC	Q	
Okay. That's helpful. Thank you.		

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

Scott H. Group

Analyst, Wolfe Research LLC

Hey, thanks. Morning guys. Mark, I wanted to ask you about some of the cost lines. We saw a step-up in purchase services and comp per employee in the second quarter. How should we think about that going forward from here? And then similarly, Alan, merchandise and coal RPU was – they were both down sequentially, any thoughts on how to think about that into the back half of the year? Thank you.

Mark R. George

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

Hey, Scott, let me – first, I'll tackle comp and ben per employee. It did step up a little bit here in the second quarter. Frankly, we ended up hitting our 60% OR a quarter or two earlier than we thought to get on that run rate, led us to increase our outlook for the year on operating ratio. And I think, as you know, our incentive plan is heavily oriented toward OR improvement. So that resulted in an increase to incentive comp accruals beyond what we had initially guided.

So you see about a 16% increase in the quarter year-over-year in comp and ben per employee. About half of that is from the incentive. The rest is really split between wage inflation, overtime, payroll taxes.

So now I think when you look at the balance of the year, just look at it on an absolute comp per employee basis, first half is roughly around \$33,000 between the first quarter and second quarter. And I think it's going to end up being pretty much in that territory in the back half as well, around \$33,000. So, pretty specific number there.

Purchase services, it did step up. I think we guided you that it would step up, that Q1 was more of an anomalous drop. There was some deferral of expenses. We were slow out of the gate on some spend. So I do think where we ended the second quarter was in line with what we expected.

I do expect a modest tick-up here in the balance of the year for Q3, Q4. We're containing it. It will be less than revenue growth, but probably a little bit of a modest tick-up in the back half as some of the engineering expenses step up here during the summer months and into the fall and also some of the IT spend will be coming through in the back half.

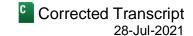
Alan H. Shaw

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

The question, Scott, was on RPU. We are exceeding our price plan that we had established at the end of the year. And we delivered 7% RPU growth for the quarter despite negative mix in each of our three business units. Within merchandise, rock salt was up about 40%. We're happy to handle the business, but that's generally lower-rated business. TIH, which is a very high-rated business, was down in the quarter year-over-year. And also within the auto industry, you know how disrupted individual plants have been because of these production issues or supplier issues, I should say.

And just as a result of plants that took some downtime, our auto length of haul was down significantly in the second quarter, which impacted overall RPU.

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And I'll pivot over to coal, you referenced that. That really is – continues to be a function of mix. And I guided to that, that that would be pressured going forward within our export thermal market. Volume was up 250% year-over-year. We've got a really good service product in that lane, and we're leveraging that to the benefit of our customers and to our shareholders.

At the same time, export thermal was up 250% which, as you know, was lower-rated, export met was up 20%. So we handled growth there. And in any given year, we'd be very happy with 20% growth, but that just creates severe negative mix, frankly, within export. Last year, three-quarters of our business was met. This year, it was 50-50. So there, you can see the impact on RPU.

Scott H. Group

Analyst, Wolfe Research LLC

Okay. Thank you, guys.

James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Thank you.

Operator: Our next question is coming from the line of Brandon Oglenski with Barclays. Please proceed with your questions.

Brandon R. Oglenski

Analyst, Barclays Capital, Inc.

Hey, good morning, everyone, and thanks for taking my question. Cindy, I guess I was – I wanted to talk about network velocity, because it does look like you're running pretty well below where you've gotten in 2019 and even early 2020, obviously with less volumes. But can you talk about your road service redesign and how that could be improving things, but is there a mix impacting that aggregated number as well?

Cynthia M. Sanborn

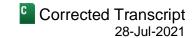
Executive Vice President & Chief Operating Officer, Norfolk Southern Corp.

Yeah, Brandon, so let me start kind of at a high level. I really see we've got some very strong building blocks in place. We've continued to bring on some talent with PSR experience. And Hunt Cary, who was running our operations efficiency team, has now added to his portfolio of responsibility to include our network operations center. So we have that going for us.

We have longer-term siding extensions that are going to allow us to continue to grow trains. We are still growing train length as you heard in my prepared remarks. But there's still some work to do from a consolidation perspective on our line of road. I do think that that should be a benefit to us because it unlocks capacity, the fewer trains that we have out there. And we're working every day to be better. So – and as I think about it in a more short-term view, we're working every day to be better.

Our recrews have come down substantially in July. And as I think about even from a capacity perspective, I'll give you this kind of data point. Last quarter, I talked about the fact that on our intermodal trains that about 10% were running above 10,000 feet. That's actually the same number this quarter, even with the train size increases that we've seen. So we're actually starting with the smaller stuff and being able to put that together. And then as we grow the sidings, we'll be able to even do more.

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And again, that just unlocks capacity on line of road. So I see a bright future here longer term. And then medium term, again, it's just basic blocking and tackling. And I think Hunt being in the NOC has brought some different thoughts into that work group and I think we're seeing those benefits already in July.

Brandon R. Oglenski

Analyst, Barclays Capital, Inc.

Thank you.

Operator: Our next question comes from the line of Bascome Majors with Susquehanna. Proceed with your questions.

Bascome Majors

Analyst, Susquehanna Financial Group LLLP

Yeah, good morning and thanks for taking my questions. I wanted to talk a little bit about intermodal pricing. I know much of that is on long-term contracts and there are some standard escalators in there. But can you talk a little bit – is there a lag benefit where you really do see a lot of what's happening in the truckload market and your pricing in 2022? Or will that be similar year-over-year? Just any thoughts on how you get paid for how the truckers are getting paid today would be helpful. Thank you.

Alan H. Shaw

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

Bascome, there is a lag in our long-term contracts on intermodal price. And so we would expect next year to see more improvement in year-over-year price than where we see this year on some of those deals. And I'll just reiterate, it's – we're not going to see a huge uptick like you see in the spot market.

We just are not structured to chase the spot market, either up or down. We take a much more measured approach with our customers. They're looking for rate surety as they go out into bid season. We want them to be successful. We're aligned with the best channel partners in the business.

They're focused on growth, and we're here to support that growth over time. That has generated rate increases in intermodal that exceed both the contract market and the spot market within truck. And as I talked about, we've got 18 straight quarters of year-over-year growth in RPU ex fuel and intermodal, both in up markets and down. So expect continued improvement as we move through next year, don't expect the kind of volatility that you're seeing in the spot market.

Bascome Majors

Analyst, Susquehanna Financial Group LLLP

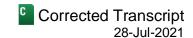
And I appreciate it. And I'm actually curious to your point about the long-term bias with these partnerships. Has this environment changed the conversation about how you want to convert traffic long term and work with your partners to do that? I'm just curious what might be different two to three years down the road compared to the last two to three.

Alan H. Shaw

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

There are a number of trends that were in place that we believe were accelerated by the pandemic. That includes more interest in rail, forward positioning of inventory, shifts from highway to rail. There's a number of reasons

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sustainability. Jim talked about that. That is definitely entering into the conversations with our customers. And in the intermodal space with our channel partners, that's helping them win business as well.

I look at our industrial development activities and compare it to just two or three years ago, and there is a lot more interest in economic development in rail-served sites. So yes, there is more and more activity, more and more discussion in both the merchandise and in the intermodal sphere for highway to rail conversions. And that's frankly the way that we've positioned our franchise. That's why we're so confident about the future.

Bascome Majors

Analyst, Susquehanna Financial Group LLLP

Thank you for that color.

Operator: The next question is coming from the line of Amit Mehrotra with Deutsche Bank. Please proceed with your questions.

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

Thanks, operator. Hi, everybody. Good morning. Alan, just following up on the chassis discussion, I understand, I guess, the cost to fix the problem is not very material, but I think it's 15% of the owned fleet for the company. So just for my own curiosity, is there any recourse or claim the customer has, if they're not able to move the boxes out of the terminals due to chassis availability? Or is this maybe an issue for – that impacts really your channel partners? If you can just give us some color on that?

And then just as a follow-up, Mark, you've been super helpful in the past on OpEx cadence. You're kind of highlighting some step-up in OpEx ex fuel, wondering if you could just help us put a finer point on that in the back half relative to the first half or the second quarter. Revenue looks like it's going to be maybe sequentially down a little bit in the back half or flattish at best. So, just wondering what the corresponding increase in OpEx ex fuel we should expect on the back of that. Thank you very much.

Alan H. Shaw

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

Amit, our primary focus is on safety and our primary focus is on injecting capacity to help our customers to grow. The downstream impact associated with this supplier issue is fluid, and it's – I'm not going to comment on that right now.

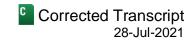
Mark R. George

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

Yeah. Amit, just the 12% revenue guidance kind of implies you're going to see flattish to maybe modestly down a little in the back half. And in terms of OpEx, I think fuel is one of the variables where that continues to creep up here in the back half.

And then, as I mentioned, I think the comp and ben for employees kind of just – that will stabilize and be at that \$33,000 per level. Other than that, we do see a little bit of a step-up, like I said to Scott, on purchased services, modest step-up there. I don't think we'll see continued diminishing materials spend. I think we're kind of hitting a bottom there. That will probably be more flattish.

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And rents, I think there will be some pressure. As volumes are coming back, there's a little bit of a lag usually with equipment rents. And I think especially if autos – when auto starts to come back, we'll see a little bit of pressure on rents from where we are right now.

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

Okay. That's helpful. And Alan, just maybe if I can approach – I respect you don't want to comment on it, but maybe I can approach the question in a different way. Do you think the impact of this chassis shortage is primarily a volume and service impact that rebounds when you finish – when the company finishes addressing these issues? Or is there some idiosyncratic cost issue as well that maybe is meeting some of the results that can unwind over the course of the next couple quarters?

Alan H. Shaw

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

Yeah, we've been — we stated that the revenue and the cost impact is not material for us to call out. We are intently focused on standing up a new program, preparing these chassis, serving our customers, injecting more assets into the network so that we can help them grow. And we got a great plan to do that. We've responded very quickly to this issue.

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

Okay. All right. Thank you very much. Appreciate it.

Operator: Thank you. [Operator Instructions] Your next question will be coming from the line of Jordan Alliger with Goldman Sachs. Please proceed with your question.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Yeah, hi. Just longer term, thinking about intermodal, can you maybe talk to or give an update on your thoughts about East Coast versus West Coast ports? And some of the issues around the West Coast maybe even stimulated further conversations, people making more of a shift, retailers, et cetera, to the East side. Thanks.

Alan H. Shaw

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

Yeah, Jordan, we saw or we've continued to see a kind of a measured shift in market share from West Coast to East Coast, and that's due to – over the last 10, 15 years, that's due to a number of issues, widening of the Suez Canal, labor strife on the West Coast in 2014, widening of the Panama Canal. Just basically the East Coast is where you're seeing a lot of growth in population and consumption.

We're very fortunate that our franchise serves a majority of the consumption and the manufacturing in the United States. And so yeah, we fully expect that our ports, which are very active in attracting new business, will continue to do so, and that's going to continue to be a strength for our unique intermodal franchise.

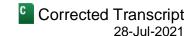
Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

All right. Thanks so much.



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Operator: The next question is from the line of Ken Hoexter with Bank of America. Please proceed with your question.

Ken Hoexter

Analyst, BofA Securities, Inc.

Hey, great. Good morning. Jim and Mark, maybe just a little clarification, a great outlook on the 400 basis points to 440 basis points of margin improvement. Can you clarify, did you say before, Jim, that you were going to stay at the 58% through the rest of the year? I thought you mentioned something about holding these levels.

And then just kind of wrapping up with what you've just talked about in the last couple of answers, you're kind of fighting the tide with higher fuel surcharge, which is 100% OR. You've got the bump now from the real estate gains, incentive comp challenges. So are you looking for a step-up in any of the segments in order to get further gains from – to these levels? Or I'm just trying to understand if we're looking for any additional gains or if there are real estate gains that are coming or any – or is it just the benefits may be from the higher revenues? Thank you.

James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Thanks, Ken. I'll take the first part of that. The guidance was that we would maintain the 60% run rate in the second half, which puts us for the full year where we had expected to be, but ahead of schedule, having gone to that mark in the second quarter. Mark?

Mark R. George

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

Yeah. So Ken, just putting a finer point on things, I mean, we don't expect gains like this to happen again in the back half. So it's really maintaining the levels ex gains is basically implicitly what we're trying to guide to here.

Ken Hoexter

Analyst, BofA Securities, Inc.

Wonderful. Thank you.

Mark R. George

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

Thank you.

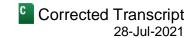
Operator: The next question comes from the line of Brian Ossenbeck with JPMorgan. Please proceed with your question.

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

Hey. Good morning. Thanks for taking my question. One for Cindy, can you just give us a little more context on the yard and local productivity? It seems like it's a recent effort for both service and on the cost side. How far along are you into this process?

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Is there any way you can kind of size that up for us? You mentioned you're getting some head count reduction benefits from that. But what else do you see potentially coming from this effort? And maybe you can help with how long – how far along you are with executing this initiative?

Cynthia M. Sanborn

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

Yeah. So thanks for the question. Yeah, so the team has done a really great job with our operations efficiency team out here, really fine-tuning our processes and operating practices, if you will, within our terminal footprint.

And so you've seen, again, broadly the transition from humping to flat switching, which has been – which has occurred in 2019 and into 2020. And now we're fine-tuning processes in other terminals as well as our big four humps that are left.

So it's essentially a very, very detailed process around matching big blocks of cars to outbound trains with the shortest amount of time between those big blocks being processed to departure. It's small things like that.

But then it's other things that we've been working on as well, that with the ability to generating the capacity that we have in our terminals, particularly, let's talk about Elkhart, we've actually been able to take in volume that traditionally we had bypassed intermediate switching carriers in Chicago for forwarding to Western destinations. We've been able to take those cars into our terminal and make direct connections to our Western carriers, our Western partners with traffic. So it's really twofold.

It is a matter of fine-tuning processes and generating more productivity, because we need less crews against the work in the terminal as well as freeing up capacity in the terminal to bring more work into our higher-powered humps that save us, in this case, intermediate switching charges with the Western folks.

So it's pretty broad-based as to what we're working on. And we will find opportunities as we look to reduce footprint at some of our smaller terminals. And also thinking about it, driving service reliability for our customers, because we're much more consistent as we work on this effort. So it's fairly broad-based.

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

All right. Thanks for that, Cindy, appreciate it.

Operator: 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

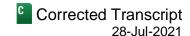
Thanks. I just wanted to follow up on the intermodal side in the near term. And some of your peers on conference calls this season have said that the current service issues makes it hard to drive incremental truck to rail conversion at this point, kind of do you see things the same way? And if you don't, do you see incremental share opportunities to take intermodal share from your rail peers? Thank you.

Alan H. Shaw

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

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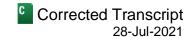
Ravi, as I talk to our intermodal channel partners, one of their primary concerns is overall capacity. They absolutely want to shift business from highway to rail. They are concerned about the overall throughput throughout the supply chain. And frankly, we're a big part of that, right? And I am confident that as our network fluidity improves, as we resolve these chassis issues, as the drayage community productivity improves, as warehousing productivity improves, then we're going to be able to grow more because there is a phenomenal opportunity out there. And our channel partners are starting to talk a lot more confidently about next year as well. So there is a lot of runway to the macro environment for us, and we're intent on addressing the issues that are within our control and working with our channel partners on things that we can do to help them grow.

Ravi Shanker Analyst, Morgan Stanley & Co. LLC	Q		
Okay. Thanks, a very quick follow-up. Did you quantify the accessorials in the quarter at all relative to a normarun rate and kind of how do we think about that going forward?			
Alan H. Shaw Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.	A		
Well, we said that is about half of the improvement in RPU within intermodal is a service that we provide, which is accrued under the accessorial program.	ssociated with the activity-based		
Mark R. George Executive Vice President-Finance & Chief Financial Officer, Norfolk Southern Corp.	A		
Incremental accessorials versus last year.			
Alan H. Shaw Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp. Yes.	A		
Ravi Shanker Analyst, Morgan Stanley & Co. LLC	Q		
Thank you.			
Operator : The next question is from the line of Fadi Chamoun with BMO Capita your question.	al Markets. Please proceed with		
Fadi Chamoun Analyst, BMO Capital Markets Corp. (Canada)	Q		
Good morning. Thank you. Maybe a question for Jim. I mean, if I look across the	e industry, there is at least two		

franchises in rail with strong indexation to intermodal. And these franchises have had a really tough time over the years to achieve and sustain below 60% operating ratio. And I think they attribute that to the intermodal business overall being a little bit more margin dilutive compared to others. So my question is, as you kind of now hit that 60% mark and you start to kind of look beyond that, what is unique about NSE's intermodal franchise that would allow it to achieve and sustain lower than 60% OR?

And secondly, has this pandemic kind of changed maybe the competitive positioning of intermodal versus the other modes and maybe helping make a better line of sight to under 60% OR on a sustained basis?

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James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Thank you, Fadi. Let me first start by saying that we're not done. We have more upside, more room to run when it comes to productivity and growth. So we hit the 60% run rate mark in the second quarter, we're proud of that. And we got there ahead of schedule. And that's due to the hard work of all of our employees. But we're not resting on our laurels. We'll continue to push.

Now, one of the clear growth engines for our company and for the industry generally is intermodal. And I will say this, the economics of the intermodal business are vastly improved from what they were, say, 10 years ago. There's been a lot of work done, hard work done inside our company and in partnership with our companies to really drive the value proposition in intermodal.

So there's lots of opportunity there for incremental margin and improvement in the operating ratio from growth in intermodal volumes going forward. And of course, the same goes for other parts of our business as well where the incrementals are also excellent. So I think we have a winning formula all-in-all. Growth opportunities certainly in intermodal and certain parts of merchandise as well, coupled with a continued focus on productivity throughout the company.

Fadi	Cha	m۸	un

Analyst, BMO Capital Markets Corp. (Canada)

Thank you.

Operator: 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

Yeah, thanks very much. Good morning, everyone. So, just keeping on the intermodal capacity question, looking back pre-pandemic, you guys were hitting about an 85,000 per month (sic) [week] (01:08:41) carload basis on intermodal and obviously dipping down during the pandemic. But coming right back up in the fourth quarter, again, hitting that 85,000 and then coming back down from that again.

So, my question here is, I understand the chassis issue and the efforts there. But given what appeared at least to be given those data, is there anything longer or more fundamental from a structural standpoint that you're looking at outside of chassis that will open up your intermodal capacity after this chassis issue is completed? What would be your growth potential in intermodal after that issue is resolved by your best estimate over the next year or two?

Alan H. Shaw

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

So Walter, you've got a chassis safety recall issue that I've highlighted. You also have the overall chassis, whether it's our chassis, our customers' chassis, the international gray pool chassis and box issue, that's associated with stress on the drayage community and warehousing.

When that gets resolved, when that starts to improve, and street times decrease by 20%, which is what they've been elevated by, then you're going to see more throughput through the entire intermodal supply chain ecosystem.

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With respect to our overall capacity, what we're doing about it as we improve our on-time performance and our train network, it allows our customers to schedule their appointments with more specificity, which will help them improve their overall equipment utilization. We're continuing to invest in our terminals, both physically and with technology to make our terminals more efficient, both for us and for our customers.

We're rolling out a terminal-based operating system for intermodal this year, which will help us improve. And we're working with our lift contractors on how we can help each other improve and make sure we're all looking at the same sorts of service metrics.

So, there's a number of ways in which we can all drive improvements and gains in the intermodal volumes. I'll tell you that based on our conversations with our customers, we're looking at multiples of GDP growth over the long-term, and that's effectively what we've been delivering over the last 10 or 15 years as well.

Cynthia M. Sanborn

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

And I also think steel wheel interchange...

Alan H. Shaw

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

Thank you, Cindy.

Cynthia M. Sanborn

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

...has been a benefit to us here as we work with our western partners to take pressure off the terminals in Chicago and having to drop boxes and dray them across town. So, that's another area that we'd love to see continue into growth, and it helps both parties to be more efficient.

Alan H. Shaw

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

So yes, so, Cindy is highlighting another area in which we're operating within the entire supply chain ecosystem in order to improve efficiency and fluidity.

Walter Spracklin

Analyst, RBC Capital Markets

So when this bottleneck of the chassis comes off, you see a clear path of getting – I think, I said monthly, I meant weekly volumes of north of 85,000 on the intermodal side And timeframe for the chassis issue overall, is that a 1Q – 2 quarters, 3 quarters?

Alan H. Shaw

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

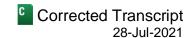
Walter, I think you're talking about the street dwell from the chassis. Is that right?

Walter Spracklin

Analyst, RBC Capital Markets

Yes, yes.

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Alan H. Shaw

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

I don't know. I don't know when that gets resolved. I mean that is a labor issue and that's a pandemic protocol issue.

Walter Spracklin

Analyst, RBC Capital Markets

Yeah, understood, yes. Okay, no, it's a tough one, I do understand. Thanks for the time. Appreciate it.

Operator: The next question comes from the line of Allison Landry with Credit Suisse. Please proceed with your question.

Allison M. Landry

Analyst, Credit Suisse Securities (USA) LLC

Thanks, good morning. Jim, I wanted to ask about the regulatory environment. Obviously, we had the executive order, the push for reciprocal switching, but also Chairman Oberman has recently expressed concerns about intermodal terminal congestion, demurrage as well as whether the rails have sufficient resources and labor in order to meet demand. So, could you comment on this and whether you're concerned about the risk that the broader regulatory backdrop becomes more onerous or challenging? And to the extent that you do have concerns, how might you plan to address these to the STB? Thank you.

James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Sure. Sure. Thank you, Allison. I'll get to your question about competition policy in our industry in just a minute. But I think it's worth pointing out to start with that our operations, our business model overlaps nicely with many of the administration's priorities, and we are very much in sync with what the administration is trying to achieve more broadly.

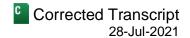
So for example, sustainability, as we've talked about for a long time, and we talked about today, we are the green form of ground transportation; pound per pound, mile per mile, we can handle freight more efficiently using less fuel and emitting less carbon than any other form of transportation. So, there's that. And we're building on it. I hope you noted the publication of our science-based – approved science-based target, the green bond that we issued and many other measures that will be detailed in our ESG report that should come out shortly.

Secondly, the administration and Congress are both very interested in infrastructure. Look no further than the rail industry for infrastructure that is in top shape. That's thanks to the private investment that's been made over many years in infrastructure. So we excel there and what we're doing is very much in line with what the administration and Congress want to achieve.

And third, the majority – the great majority of our jobs are good paying union jobs, to quote the President. So there, too, we are a heavily unionized industry. The jobs pay well. They're good jobs and we're hiring. So that too lines up nicely with the administration's priorities.

In terms of the STB, first, look, most of what we handle is truck competitive. And most of the freight that's on our railroad will move by truck if we move rates above the truck competitive level. For freight we handle that is less truck competitive, there exist many mechanisms before the STB to challenge the rates and to adjudicate their

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fairness. And the customers utilize those mechanisms all the time. So there is a way to challenge what we're doing before the STB, it works. The customers are familiar with it. The STB is familiar with it. It rests on a very sound policy framework. There's a lot of precedent. And so it's working. And we don't believe the STB will take measures to change all of that.

In the end, the STB has looked at reciprocal switching in the past and has concluded a number of times that it's not the right solution for the industry, would create severe operational disruption. And that's not good for customers. That's not good for the railroads. That's not good for passenger trains either.

So in the end, I think they'll – they may invite evidence on that once again, as they have several times in the past, but I think they'll conclude that that's not the right measure. The mechanisms that are already in place to determine whether rates are competitive are the best that we have. So thank you.

Cynthia M. Sanborn

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

Thank you.

Operator: And the final question for today is from the line of David Vernon with Bernstein. Please proceed with your question.

David Vernon

Analyst, Sanford C. Bernstein & Co. LLC

Hey, thanks for squeezing me in here. Alan, two quick ones for you. Can you comment on the trend in the intermodal RPU sort of ex fuel and the fee increase and what some of the drivers might have been there? And then the second question is really around sort of utility coal. You mentioned it's going to be down for the back half of the year. Are we kind of hitting a bottom as you think about it on a three-year view? Or do we see – as you think about the retirement pipeline that's ahead of you, is there still further kind of room for that to bleed out into 2022, 2023?

Alan H. Shaw

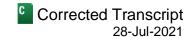
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.

So David, the trend on intermodal RPU ex fuels, as I noted, we've got, what, 4.5 years of quarterly growth year-over-year in that. So I expect that to continue. We – as I noted before, based on our contract structure, we're going to have a lot of support for pricing into a market next year, not only because the market is strong next year, but right now, intermodal rates lag truck pretty significantly. So there's a lot of headroom for us. And as our service product improves, there's going to be even more demand for what we're putting out there.

With respect to utility coal, we got some specific unit outages or retirements on our system that's going to impact year-over-year comps. We've got some planned maintenance. And then frankly, it's an issue of overall coal supply. Coal production in the United States this year is projected to be down 18% compared to just 2018.

There are some unsold tons out there from the producers, but we're not sure if those are going to go export or domestic with the export thermal market so hot with API too well above \$100, then there's a lot of pull for that product overseas. If that happens, we'll continue to handle it, and that was one of – certainly one of the drivers of our significant growth in our export franchise in the second quarter.

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David Vernon

Analyst, Sanford C. Bernstein & Co. LLC

All right. Thank you.

Operator: Thank you. This concludes our question-and-answer session, and I'll turn the call back over to Mr. Jim Squires for closing comments.

James A. Squires

Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

Thank you, everyone, for your questions today, and we look forward to talking to you again next quarter. Have a good day.

Operator: Ladies and gentlemen, thank you for your participation. This concludes today's teleconference. You may now disconnect your lines at this time, and have a wonderful day.

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