THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

NSC - Q3 2017 Norfolk Southern Corp Earnings Call

EVENT DATE/TIME: OCTOBER 25, 2017 / 12:45PM GMT

**OVERVIEW:**

Co. reported 3Q17 YoverY total revenue growth of 6%, net income of $506m, and diluted EPS of $1.75.





THOMSON REUTERS

## CORPORATE PARTICIPANTS

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

**Clay Moore** *Norfolk Southern Corporation - Director Investor Relations*

**Cynthia C. Earhart** *Norfolk Southern Corporation - CFO & Executive VP of Finance*

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

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

## CONFERENCE CALL PARTICIPANTS

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

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

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

**Benjamin John Hartford** *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

**Brandon Robert Oglenski** *Barclays PLC, Research Division - VP and Senior Equity Analyst*

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

**Cherilyn Radbourne** *TD Securities Equity Research - Analyst*

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

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

**Jason H. Seidl** *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

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

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

**Matthew Langley Troy** *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

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

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

**Suneel Manhas** *RBC Capital Markets, LLC, Research Division - Senior Associate*

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

**Tyler Brown** *Raymond James - Analyst*

## PRESENTATION

**Operator**

Greetings, and welcome to the Norfolk Southern Third Quarter 2017 Earnings Conference Call.

(Operator Instructions) As a reminder, this conference is being recorded.

I'd now like to turn the conference over to Clay Moore, Director of Investor Relations. Thank you, Mr. Moore, you may begin.

**Clay Moore** - *Norfolk Southern Corporation - Director Investor Relations*

Thank you, Rob, and good morning. Before we begin, please note that during today's call, we may 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 discussion of those risks and uncertainties we view as most important.

The slides of the presenters are available on our website at norfolksouthern.com in the Investors section along with our non-GAAP reconciliations. Additionally, a transcript and downloads will be posted after the call.

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

---

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

Good morning, everyone, and welcome to Norfolk Southern's Third Quarter 2017 Earnings Call.

Joining me today are Alan Shaw, Chief Marketing Officer; Mike Wheeler, Chief Operating Officer; and Cynthia Earhart, Chief Financial Officer. It is with great pleasure that I introduce Cindy to our quarterly calls. She brings a strong diverse background to this role. I look forward to her contributions as we continue to execute our strategy centered on the safety, service, stewardship and growth.

Highlighting our third quarter results on Slide 4. Net income was a $506 million, up 10% from prior year and earnings per share increased 13% to $1.75.

Our third quarter operating ratio decreased by 160 basis points to an all-time quarterly record of 65.9. Our third quarter results are an extension of the performance delivered throughout the year, resulting in a record 67.4 operating ratio and record earnings per share of $4.93 for the 9-month period.

These results demonstrate the successful execution of our proactive strategies and initiatives. Our continual focus on delivering results through cost saving efforts, efficiencies and asset utilization, have us on track to deliver productivity savings up over $100 million in 2017.

The unrelenting focus and resolve of our employees on delivering upon the goals we set out in our strategic plan is evident in our achievements to date. As shown on Slide 5, for 7 consecutive quarters, we have lowered the operating ratio on a year-over-year basis. We continue to make demonstrable progress towards achieving a sub-65 operating ratio. Our team remains committed to ongoing productivity initiatives and the pursuit of additional opportunities for improvement, and for these efforts, I am confident that we will reach that goal by 2020 or sooner.

We remain focused on both resource utilization and growth as we continue to successfully execute our multidimensional strategy. Our third quarter volumes increased by 4%, while average headcount was reduced by 4% versus last year's levels. We are resolute in our commitment to deliver a quality service product that our customers value and will provide opportunities for growth.

Now Alan will provide a marketing overview, Mike will detail our operational performance and Cindy will summarize our financial results. Then we'll take your questions.

With that, I'll now turn the program over to Alan.

---

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

Thank you, Jim, and good morning, everyone. Our third quarter 2017 revenue growth in all 3 business units reflects the strength and sustainability of our strategic plan. Total revenue for the quarter was up 6% versus 2016, driven by a combination of volume gains in intermodal, coal and steel and increased pricing.

Merchandise volume was down slightly in the third quarter as gains in steel, sand and fertilizers were more than offset by lower automotive shipments associated with U.S. vehicle production declines and reduced crude oil shipments. Overall, merchandise revenue was up 3% this quarter, as negotiated price increases outpaced volume losses.

Intermodal revenue increased $46 million or 8% versus the same period in 2016, resulting from highway conversions, organic growth with our existing customers and new service offerings. Intermodal achieved record volume for the second consecutive quarter, as total units once again topped the 1 million-unit mark.

Our intermodal growth in the third quarter is a result of our market approach, which aligns our service product with the needs of our customers, enhancing their ability to grow while positioning Norfolk Southern as an integral part of their supply chain. Coal posted year-over-year revenue and volume growth primarily due to increased export coal volume and pricing.

Coal RPU was up 1% due to the impact of pricing gains that were partially offset by a negative mix. Higher growth rates in lower rated export steam negatively impacted RPU despite improved pricing in our export markets.

Utility volume decreased as mild weather caused an approximate 15% year-over-year decline in overall coal burn at Eastern utilities.

Turning to Slide 8. We look ahead to the remainder of the year with confidence based on current economic trends. In merchandise, we expect low single-digit growth in the fourth quarter. Industrial production is likely to drive demand in steel while growth in construction will positively impact our aggregate volume.

Further, we expect increased drilling activity in the Marcellus/Utica region will continuing to drive growth in frac sand. These increases will be offset by declines in automotive and by lower crude oil, which is adversely impacted by pipeline activity.

Intermodal expectations remain strong as tight trucking capacities should be further impacted by the ELD implementation in December. We continue to enhance our service offerings, provide growth opportunities with our customers to further drive revenue, volume and shareholder value.

In coal, we expect fourth quarter utility volume to be in the range of a 15 million to 17 million tons, impacted by the mild summer weather. Export tonnage should continue to exceed last year's, with volume in the range of a 5 million to 6 million tons. We remained focused on pricing in all of our markets. Current indicators point to higher levels of demand and tighter truck capacity for the remainder of the year, continuing into 2018. Such an environment increases our value in the marketplace and we are confident that improvement will be reflected in our pricing.

Moving to Slide 9. Our market approach and current opportunities are consistent with our strategic plan, offering a balance of safety, service, productivity and growth to drive shareholder value. To execute this plan, we deliver a customer-centric service product that adapts to the needs of our customers while providing an environment in which it is easy to do business.

Our customer-centric service product first focuses on tailoring the right service to our customers. We collaborate with our customers to develop the best product that is beneficial to both our shareholders and customers. We pay close attention to customer feedback and continue to make adjustments to meet their needs, viewing our products through the lens of our customers.

Our goal is to enhance the competitiveness of our customers in an evolving marketplace, allowing them to quickly adapt and compete for growth, increasing revenue to Norfolk Southern, while strengthening our role in their supply chain.

Lastly, we a employ best-in-class industrial development team to help customers locate or expand on our lines, providing a future pipeline for growth. The continuity of our management team, operating philosophy and long-standing customer relationships, combined with improving the customer experience and product is the overarching theme of our growth initiatives. We're confident this approach differentiates our service product, allows us to compete with truck and will continue to provide the revenue and volume growth and shareholder value we delivered this quarter.

Thank you. And now I'll turn it over to Mike for an update on operations.

---

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

Thank you, Alan, and good morning. Our service levels are delivering growth consistent with our strategic plan. As shown on Slide 11, there were significant milestones achieved in the quarter as well as the first 3 quarters of the year. Our achievements in reducing train accidents combined with our improvements in train length, locomotive productivity and fuel efficiency, all helped to drive our record operating ratio.

Turning to the key drivers of our success on Slide 12. The safety of our employees in the communities we serve continues to be our top priority. Our reportable and serious injury ratios are stable and we are on pace to achieve our lowest train accident frequency on record.

For service, we achieved sequential improvement in our network performance metrics. Specifically, our service composite metric is back near 80%, which points to resiliency in our operation. This is particularly notable given volume was up sequentially while we also successfully controlled costs. Our current service levels are allowing us to not only take on short-term opportunities, but also positions us to have more impactful discussions with our customers concerning long-term opportunities.

Moving to some of our key productivity initiatives on Slide 13, we are driving improvement in all areas. Our continued rationalization of our yard and local fleets has resulted in significant improvements in our locomotive productivity. The third quarter was the highest quarter of locomotive productivity in our company's history and we are on pace to beat last year's record performance. Not only do these improvements result in lower maintenance costs, they also enhance our fuel efficiency, which improved 4% in the quarter and was an all-time quarterly record. As you may recall, 2016 was a record year for this measure and we are on track to set a new record this year.

These measures have been driven by optimizing our train plan and our improvements in train lengths, which is something we must balance with service. As you may recall, 2016 was a record year for this measure and we are on track to set a new record for the full year.

In closing, we are confident we will continue to provide a level of service to our customers that will grow our business, while at the same time driving sustainable productivity savings and superior returns for shareholders.

We are proud of our accomplishments and continue to identify opportunities to drive additional efficiencies for the benefit of NS shareholders.

I will now turn it over to Cindy, who will cover our financial achievements.

---

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Thank you, Mike. Good morning, everyone.

As Mike and Alan have discussed, we continue to execute on our long-term strategy, and the operating results for the third quarter show we are: One, reducing cost; two, driving productivity; and three, growing the company.

On Slide 15, you'll see we delivered a record quarterly operating ratio of 65.9%, a 160 basis point improvement over third quarter 2016.

We accomplished this by growing revenue 6% as Alan described, while holding expenses to a 3% increase, resulting in an 11% rise in income from railway operations.

Now turning to the component changes in operating expenses on Slide 16. In total, operating expenses were higher by $55 million or 3%, notwithstanding the 4% increase in volume. Improved productivity helped to offset higher inflation. The area of largest variance in the quarter, compensation and benefits, rose by $64 million or 9% year-over-year.

There are 2 primary reasons for the increase: First, improved operating results led to an increase in incentive compensation of $47 million over the third quarter 2016; and second, inflationary increases continue at a quarterly run rate of about a $30 million, which is higher than historical inflation.

As discussed in previous quarters, the increase is primarily due to the large increase in premiums on union medical plans. Partially offsetting these items, we reduced employee levels, which saved $26 million. Headcount was about 1,100 employees lower than the third quarter of 2016 and down over 300 sequentially.

Year-over-year, we are handling more shipments with fewer people. We expect to enter 2018 with an employment level flat to slightly higher than where we are now as we hire and train T&E employees ahead of the 2018 peak demand months in Summer and Fall.

Fuel expense rose $17 million, entirely attributable to higher prices, which added $20 million. The average price per gallon for locomotive fuel was $1.70 this year versus $1.51 in the third quarter of 2016.

Sustained improvement in fuel efficiency resulted in 2% fewer gallons consumed on 4% more volume. As Mike mentioned, we posted record fuel efficiency metrics and we expect our ongoing initiatives to further increase train lengths and reduce fuel consumption to support continued improvement.

Purchase services and rents decreased $9 million or 2% year-over-year. Equipment rents decreased by $6 million due to lower automotive traffic and improved equipment utilization. The materials and other category decreased $24 million or 13% year-over-year. Lower equipment and road way material usage drove over half of the decrease. As we've reduce the locomotive fleet and service, locomotive repair cost have decreased.

Third quarter 2017 also included $9 million more from gains in the sale of operating properties. Moving to Slide 17, which shows the full income statement. You can see the strong operating results fell to the bottom line, producing net income of $506 million, up 10% compared with 2016, and diluted earnings per share were $1.75, a 13% improvement.

Wrapping up our financial overview on Slide 18. We continue to return value to our shareholders through dividends and share repurchases. Free cash flow was $1.2 billion for the first 9 months and over $1.2 billion has been return to shareholders.

As we announced last month, the Board increased our share repurchases authority by 50 million shares and extended the program through 2022.

Our financial results for the quarter demonstrate our continued focus on cost-reduction, productivity and growth. Thanks for your attention, and I'll turn the call back to Jim for closing remarks.

---

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

Thank you, Cindy. As we head toward the end of 2017, we remained as committed and energized as we were at the onset of our plan to deliver sustainable changes that will improve bottom line results for shareholders.

Our plan is dynamic and flexible and provides an adaptive platform that will be the foundation of success for our employees, customers and shareholders. We have consistently delivered strong performance and we are confident in our ability to achieve further improvements and reach our objectives that will drive shareholder value.

With that, we'll now open the line for Q&A. Operator?

---

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question will be coming from the line of Allison Landry with Crédit Suisse.

---

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

I was wondering if you could speak to your view on the tightness in the truck market and how you think that could help results in 2018 from both a volume perspective and a price perspective. And then, sort of along the same lines, in terms of potential share gains from CSX. Could you elaborate or provide some color on what you think you received from them and how much you would expect to keep or give back?

---

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

Let's take the truck capacity question first. It certainly is an encouraging environment. We are seeing a truck capacity tight and getting tighter. Alan, why don't you provide some specifics?

---

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

Yes, Allison. As you know, we've clearly stated that our primary form of competition is truck. And within the East, we have a unique opportunity to divert shipments away from the highway to rail. Obviously, within intermodal container but also within a boxcar, within a gon and within a multilevel end.

As truck capacity tightens and that's the narrative that we hear from our customers on a daily basis, that has volume op implications for us and importantly, it has pricing implications. But certainly, I think we're seeing some of that the volume matriculate to us now and the pricing will continue into 2018 as our customers and we go through bid season. With respect to share gains, once again, our primary form of competition is truck. We are going to put out a very dependable service product and a very consistent approach. We feel like our customers value that approach. And so that has been reflective in our volumes and in our revenue.

---

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

Okay, great. And just as a follow-up as you think about just sort of the whole pricing umbrella. Are you seeing an underlying acceleration in your core pricing growth, whether I guess, compared to the second quarter?

---

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

As we're renegotiating contracts in the third quarter, we see more strength, particularly on the truck competitive business as you would expect.

---

**Operator**

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

---

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

I want to talk a little bit about sort of operating leverage as we think forward and sort of along the lines with the last question. You see it seems like there's an opportunity for both prices as well as volume as you move into next year as truck market is beginning to tighten up.

You put together good incremental margins in the third quarter. I just want to get a rough sense of maybe how you think about sort of that cadence as we go forward with the productivity initiatives you have and sort of the pricing if you put it altogether into some mosaic. How do you think about that over the next several quarters?

---

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

Good morning, Chris. Yes, we have seen a nice trend in operating leverage and incremental margin thus far this year. Looking out, the cadence will depend to some extent on the mix of volume growth we experience. Cindy, maybe you could address that a little bit further?

---

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Yes, sure. As Jim said, we've seen good incremental margins and I think we expect to see those going forward. You just -- remind you, I think we've talked about this before, is that we see this as sort of, a hierarchy in terms of incremental margins in our business. A highest, of course, is merchandise followed by coal and then intermodal. So it's really will be dependent upon where we see the incremental growth going forward.

---

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

Okay. But the setup that we have in terms of what's sort of working in sort of a tighter truck market, doesn't lead you one way or another when you think about that.

---

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

As Alan said, we do see the opportunity from a tightening truck market, not only in our Intermodal franchise but in general merchandise as well. And there we do have a significance incremental margin opportunity. In addition to the extent we're able to price into a tightening truck market, that too should support incremental margin going forward.

---

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

Okay, that's helpful. And there's a quick follow-up on headcount, I just wanted to make sure I was clear on sort of how you think about the progress in both fourth quarter and then maybe going forward. It sounds like there's some incremental heads may be coming to get advance of some peak business in 2018 but I just want to make sure I understood the cadence of that.

---

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

Cindy, why don't you take that one?

---

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Yes, Chris. So Chris, we -- certainly, we've seen good headcount reductions, our year-over-year headcount is down about 1,100. While I did mention in my prepared remarks that we expect headcount in the fourth quarter to be flat or slightly up, and that's really all dependent on our T&E hiring. We're hiring kind of ahead of our peak demand months in the summer and fall going in '18. So that's where you're seeing the increases.

---

**Operator**

Our next question comes from the line of Tom Wadewitz with UBS.

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

I wanted to ask you about pipeline on productivity and just how we might think of drivers of margin expansion if you look out into 2018? So I think, you had a number of structural cost-reduction that you put in place over the last few years and you're putting up nice incremental margin and further productivity gains. How do you think, Jim or Mike, about what's in the pipeline going into next year in terms of structural cost takeout or just what would support operating leverage in margin expansion next year?

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

Good morning, Tom. Productivity certainly has been a key driver of financial improvements this year and last and we expect that to continue. We've made a lot of progress in a couple of key areas already. We ticked off some of the records that we achieved in the third quarter as part of Mike's presentation. And yes, there are many additional productivity opportunities in the pipeline. Mike, why don't you comment on that?

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

Yes. Okay. So we just note that there is some things that are going to run through 2018 that we initiated this year, that reduction or the idling of one of our terminals earlier this year. The 150 locomotives we've taken out of service, that was the first half thing that will run through all of next year. And then, the division consolidation, we told you about before, actually goes into effect next week. So a lot of those things will run through full year next year.

But we continue to take a look at optimizing the train plan and as you saw that we had 4% more volume out there, but we reduced crew starts by 2%, so we handled 4% more volume with 2% less crews. So that's optimizing our train plan and train length. So we continue to take a look at how we can take cost out of the railroad. It may not necessarily be a big terminal or anything like that, but it's taking cost across the railroad out of the network but still making sure that we're able to provide the service that our customers are looking for. So there's a lot of initiatives going on, more to come. And we balance that with service but we're not letting up.

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

Okay, that's helpful. Maybe just a follow up on that. So if you look at 2018, what do you think would be the bigger driver of margin expansion? Would it be volume growth, the net supporting operating leverage, longer trains and so forth? Or do you think a bigger opportunity is from more of the kind of pure cost or productivity whether that's facility rationalization, changing the train plan, however you would frame it?

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

Tom, ours is a balanced plan, it's balanced, it's dynamic and it's flexible as well. And that's -- that's why we've been able to consistently deliver strong performance. So our expectation looking into 2018 and beyond is that we will continue to deliver bottom line improvements through a combination of growth and productivity.

**Operator**

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

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

Jim, we saw headlines couple of weeks ago about the various labor unions coming together to come up with an agreement with the Class 1 rails, which is pending ratification from the rank and file. I was wondering if you had any initial thoughts on how that agreement stack up versus your expectations.

---

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

We have reached a tentative agreement with a coalition of unions representing about 60% of our employees. It is out for ratification and we'll await the results of ratification before commenting further on the agreement.

---

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

Okay. And just as a follow-up. I'm sorry if I missed it. But did you quantify any impact from the hurricane in the third quarter? And also, given that you mentioned that your primary competition is truck. How much customer overlap do you really have with your Eastern partner in that if you have customers who are unhappy with their service, they could look to you as a long-term alternative?

---

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

We did not quantify any additional expenses as a result of the hurricanes in the third quarter. Alan, why don't you comment on the landscape, the competitive landscape?

---

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

Yes. Our primary form of competition is truck, Ravi, we do shares some customers with CSX. And as I suggested, we're offering a differentiated service product and a long-term approach of a balance between cost effectiveness and supporting our customer's growth. And so to extent the customers are looking for a dependable service provider, we're there.

Our primary focus is securing business from the Highway. And we see that spot rates are up 15% in trucking and dry van over the last couple of months and are up about 25% year-over-year, that's also buttressed us by an improving economy, in which consumer confidence and the PMI for new manufacturing are at effectively 13-year highs. So that's -- our focus is on competing with truck, that's been our thesis, that's the opportunity provided to us by operating in the East, and that's where we're going to see a lot of growth.

---

**Operator**

Our next question is from the line of Jason Seidl with Cowen.

---

**Jason H. Seidl** - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

I wanted to focus on freight that you might have won from your Eastern competitor due to their service issues in the quarter. It seems like whatever you did take on, didn't negatively disrupt your network and you kept your service levels high. Could you talk a little bit about the thought process of taking on that freight and how likely it is that you're going to retain it?

---

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

Sure. I would emphasize that our goal is to grow while pushing hard on productivity as well. So we believe we have an excellent service product in the marketplace that allows us to compete with truck and rail. Alan, talk a little bit about the specifics on in terms of market share -- rail market share in the quarter.

---

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

Yes. Jason, as we've talked before, there's a lot of collaboration within Norfolk Southern about volume opportunities. And our primary focus was on making sure that any volume we brought on was accretive to the bottom line and to our shareholders, and did not disrupt the responsibility that we have to our existing customer base to provide a consistent and predictable service product. And so that's how we went into this.

We could be judicious with the unit trains that we added and we look for opportunities to add trains into our scheduled merchandise network. And within intermodal, we also made sure that anything we brought on in the short-term did not necessarily reduce our ability to handle additional business at higher returns in the long-term.

---

**Jason H. Seidl** - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

Okay, that's some good color. And I guess, my next question is going to be on the incentive comp. Obviously, it was a little bit higher than I expected, and was issuing actually higher than you saw an increase last year in the third quarter. What should we look for incentive comp in 4Q?

---

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Jason, this is Cindy. Yes, you did notice we talked about in prepared remarks that incentive comp was up $47 million year-over-year. And maybe just a little bit of context. If you think back to 2015, we had a 0 bonus then going into 2016, we had a -- we did have a bonus, but a lower level of bonus. And then this year, really based on improving business results, you've seen the incentive comp go up. So when we think about fourth quarter expectation was, you would see a similar year-over-year increase in incentive comp in fourth quarter.

---

**Operator**

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

---

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

I wanted to ask if you could just offer some thoughts on growth. I guess, relative to the underlying market, there's obviously some idiosyncratic things happening, whether it's market share opportunities, truck loads capacity, tightening pricing. So against that backdrop, just wanted to try to get a sense of your thinking about your volume growth, revenue growth actually, potential relative to the actual underlying markets that you're serving?

---

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

Balance is really the key, we are aiming to grow but while achieving ever improving productivity as well. So Alan, why don't you talk a little bit about the major verticals and our growth expectations their as outlined in our current long-range plan?

---

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

Sure. Amit, we're pretty excited about the environment in which we're operating right now. We see truck capacity tightening significantly, buttressed by an improving economy, which should certainly assist our intermodal markets, it'll also assist many of our merchandise markets as we implement -- we continue to implement our plan of a strong service foundation, schedules that meet our customer's needs, an equipment strategy that supports growth, technology improvements that optimize the distribution of the equipment and make it easier to do business with us.

All of that is part of our strategic plan. It's all designed to compete with truck. And so those are positives for us. As I look into the fourth quarter, I'll draw your attention to export, we're still projecting 5 to 6 million tons of export coal. Recognize last year, the fourth quarter was our highest export coal quarter. I think through 3 quarters, we did about -- last year we did about 10 million tons of coal export and in the fourth quarter, we did 4.6 million. So the comps get a little bit more difficult. We also have a much milder summer in the East and the start to the fall has been mild. So I think, we're going to be somewhat limited in our utility volume in the fourth quarter.

---

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

Okay, that's helpful. And then just 1 follow up for me, if I could. And it's really a question about CapEx and cash deployment. The CapEx requirement of the business and really the industry, I guess, are kind of staying where they are today or if not going maybe a bit lower over the foreseeable future. Some companies, some of your peers in the U.S, at least, have committed to maybe more ambitious share repurchase activity.

Wonder if you can talk about that? You've chosen to pay down some debt. I just wanted to see if maybe we should expect a little bit more of a pivot on a cash deployment side towards more of what some of your peers were doing?

---

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

In terms of our capital allocation generally, our approach is very disciplined. We are putting the money back into the business that we need to, to reinvest in the business, to keep our service strong. In terms of shareholder distributions, we're targeting a 1/3 payout ratio with incremental free cash flow going toward share buybacks. Cindy, talk about the change that we made in the buyback program recently and our expectations for shareholder distributions for the whole year.

---

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Yes. So we did announced the Board approved up to $50 million more in share repurchases through 2022. In terms of the share repurchases, we also increased that. This year, we started out guiding at about $800 million repurchases and we're at $1 billion.

And so going forward, as Jim said, we have a very disciplined approach to cash deployment. We'll invest back in the business. Our plans are to distribute back to shareholders via dividends. And over the long-term, get to about a 33% dividend payout ratio and then to use remaining cash to have share repurchases. So that's our strategy going forward and I think that's been our approach all along.

---

**Operator**

Our next question comes from the line of Matt Troy with Wells Fargo.

---

**Matthew Langley Troy** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Just wanted to get a split -- you've talked about 4% volume growth in intermodal. I was wondering if you could provide some detail as to what the growth rates were in domestic versus international.

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

Yes, Matt, international was down slightly. Of course, we and the ports that we serve were impacted by the hurricanes. And so that was somewhat of a drag. And then, domestic was up about 7% or 7.5%.

**Matthew Langley Troy** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. And is it fair to think, given all the talk and anticipation about capacity issues in trucking, in a better pricing environment potentially merging next year. Is the biggest bite of the apple when we should think about the cadence of pricing improvement in intermodal? Is it still -- should we still be kind of bogeying the second quarter is where you really get that biggest bite or is it more spread out now?

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

Well, that is certainly when bid season typically occurs for our customers. We're -- we've already negotiated 85% of the revenue for this year. We've already negotiated about 54% of the revenue for next year. So it does, Matt, as you noted, it is tied to the bid season for our customers and it is also tied to the contract renewals that we have.

**Matthew Langley Troy** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. And my one quick follow-up would be, I know you don't guide to core pricing. But it sounds like it's going to be a better year next year. Can you just give us your expectations for rail inflation in 2018?

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

Right now all-inclusive less fuel is at 1.9% for next year.

**Operator**

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

**Brandon Robert Oglenski** - *Barclays PLC, Research Division - VP and Senior Equity Analyst*

Congrats to Jim and team. It's not lost on us that your OR is beating the competition here. But Jim, I want to ask on those lines, I mean we've seen a lot of volatility in your company's earnings from the past, especially with swings in export coal. Obviously that market can shut off and turn on very quickly. But it sounds like you're planning for a higher labor cost outlook, higher headcount next year, if I'm not mistaken by the comments you've made. So how could you mitigate the risk that maybe that market turns off quickly? What can be done on the cost structure that would keep the OR trajectory heading lower?

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

The plan is dynamic and flexible and that's really been the hallmark of our execution over the last couple of years. As you've seen business ebb and flow, we have been able to make adjustments and to react to changes in the marketplace. And that's what we'll continue to do. We will continue to drive hard on productivity and growth, wherever growth is available. If market conditions change, we will again adapt and be flexible.

**Brandon Robert Oglenski** - *Barclays PLC, Research Division - VP and Senior Equity Analyst*

I hate to nitpick on the call but Cindy, it looks like your other cost line came in about $40 million. And if I go back to last few quarters, you've been running, let's call it, somewhere between $75 million and $80 million. I know that you called out $9 million in land sale gains. But was there something else that favorably impacted the quarter? Or is that the new run rate that we should be looking at going forward?

---

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Brandon, as you said, I did call out $9 million increase year-over-year in the gain on sale of operating properties. And obviously, those things change from quarter-to-quarter. It's hard to predict when you're going to have gains. In terms of the large number of gains from year-over-year in the third quarter, I think we talked about third quarter of 2016, I think we've talked about around $28 million worth of large gains. In this quarter, in 2017, we had about $38 million worth of large gains. So that has some impact, that's probably the biggest thing. And again, it's hard to predict from quarter-to-quarter.

---

**Operator**

Our next question is from the line of Ken Hoexter from Merrill Lynch.

---

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

Jim, I guess, third quarter is typically your best operating ratio and looking at the cost strides you've made, do you need to overhaul ops like Hunter suggest to get down to the 60% range? Or can you keep doing the blocking and tackling as you've been doing to get to this point to get that progress? And maybe talk about the -- is that a realistic progress for your network to get to over a longer term. I know 65% is your near-term one. And then just your thoughts on the $100 million productivity, you mentioned, you beat the target. I guess, maybe your thoughts on the potential of scale as you move forward this year.

---

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

Sure, good morning, Ken. So let me begin by emphasizing that we've been making significant progress on our long-term objectives and achieving and exceeding our goals. So you saw in the third quarter, the seventh consecutive quarter of year-over-year operating ratio improvement, and that gives us confidence that we're going to be -- we'll continue to drive the operating ratio in the bottom line. And that we'll get to that sub-65 OR by 2020 or sooner. In terms of productivity, we've said, that we expect at least $100 million this year. Right now, we think that'll probably be closer to $150 million for the full year.

---

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

Great. And is there -- have you set a scale for next year yet or is that still just part of the 650 total?

---

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

Well, I can tell you this, we have the pedal to the metal, we are pushing as hard as we possibly can on all aspects of our strategic plan and we certainly expect to achieve significant, additional productivity savings next year and beyond.

---

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

And then just a quick one, I guess, Cindy, long-term debt went up. Rates are climbing but interest expense went down sequentially. Was there anything in that number that altered that interest expense savings?

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Ken, I would say that, that there was not really anything that would impact that. We did do a payoff of higher-rated debt in the quarter. So that did impact it.

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

But yet your long-term debt went up sequentially? I guess I could talk to you offline. It just seems like your long-term debt went up sequentially.

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

Well, you're seeing older debt at a higher rate roll off and be replaced by new debt at a lower coupon.

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Yes. As part of the exchange, Ken, we exchange about $550 million into $750 million worth of debt.

**Operator**

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

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

So I wanted to just kind of revisit the headcount and just more broadly the productivity discussions. So obviously, nice spread between volume growth and headcount this quarter, but we are seeing service issues when we just look at train speed lower year-over-year. Do you think -- are we kind of at the point where we can't cut headcount and can't cut locomotives anymore, and it's more just about leverage from volume or is that not the message?

And then, if we are sort of at that point, where we're seeing some service issues. Do you focus more on price than volume next year? I know you're going to say, you're going to focus on both, but you had to kind of prioritize price versus volume next year, how would you answer that?

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

Okay. Let's talk about service before and I'll comment generally. And then, Cindy can go back over our expectations for headcount this year and then Mike, maybe you can weigh in on kind of the resource balance. With respect to service generally, we are steadfast in our commitment to deliver quality service that our customers value, that's key to the value proposition. For the third quarter, as a whole, we saw network performance rebound back to first quarter levels, and roughly target composite service metric levels. And in that context, we were able to grow volume and the top line while providing a high-level service product to our customers. So that's the paradigm, that's what we'll be looking to do going forward.

Now Mike, why don't you start and talk a little bit about the resource balance, and then, Cindy will come back in and talk about where expect headcount to go.

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

Yes. So it's not like we don't have opportunities out there as we continue to look at the network and see what business grows on the network where we can optimize the cost. We still have resources available to us from the locomotives, we have about almost 400 units stored and available to help us handle growth, but it doesn't mean we're not looking at finding ways to reduce the cost structure of the railroad long-term.

A lot of initiatives going on. I already talked about the once we've done this year that are rolled through. We're not giving up on any of that. But I'll say that we also make sure that we've got to have a good service product. And Jim noted, it did improve sequentially over the quarter. And you know that some increases in -- as well in train speed.

I would just point out at that, at the end of the third quarter, as we had several hurricanes that hit our partners on the West and as well as 2 on the -- impacted us and we held some traffic in our terminals for that until our customers got back up to speed or our partners got back to up to speed, but really no damage to our railroad and we rebounded quickly. So that's kind of what you're seeing. So we feel comfortable about where we're going on further cost reductions. But still making sure that we're taking care of the service.

---

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

With regard to headcount specifically, Cindy did state that we expect headcount to be flat, up slightly at the end of this year versus today, but there's a specific reasons for that. So Cindy, go over the training cycle and the on-boarding process.

---

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Sure. As I said, the flat to slightly up was really completely dependent upon hiring ahead of what we see peak demand season for crews in the summer and the fall of 2018. As you know, the cycle to higher and train have those folks available, it takes several months to get that done. So that's really what's driving the headcount.

As I said before, 1,100 folks down quarter-over-quarter, that's really across the company in all areas. And productivity is extremely important to us, and we're going to be pushing on that, again in all areas. And we look very closely at T&E. And you'll note that, I think our volumes are up year-to-date about 5% and we've really held the T&E headcount pretty flat throughout the year. So it's something that we look very, very closely at.

---

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

And that bump ups is in the neighborhood of maybe 200 more employees for the next quarter or so until we get them ready to go out here. So it's slightly up and it's slightly up and it's by design.

---

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

So that's helpful. And I don't know, Alan, if you addressed kind of that price versus volume prioritization point. And then just to clarify on the headcount like, I think, early in the year, you said, "We may need to have some T&E but there's still non-T&E that we can reduce." Are we running out of that non-T&E to reduce?

---

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

Well, I'll take that one. Look, it focuses on all areas of headcount as Cindy said. We are looking at all aspects of employment and staffing and looking for reductions and have achieved reductions across the board. Now, with regard to your price versus volume question, it really isn't a question of price versus volume, it is both. And we're looking to achieve both volume growth and price increases, commensurate with the service product we have out in the marketplace.

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

Okay. And if I can just ask one more. Alan, so you talked about some of the weather issues in coal. Anyway to give a preliminary view on export and then domestic coal for next year. Meaning do you think the run rates that you talked about for fourth quarter are sustainable into '18 Or do we need to reset those lower for '18?

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

For export coal, what we're hearing, Scott, is that, that market has legs through -- potentially through the first half of next year. A lot of the run up in price has been event driven, which isn't necessarily good, but I think it also supports the theory that the market out there for export coal is fairly tight. Although, I can paint the other picture, as you're aware, API too is a backward dated right now so that suggests it's going down.

The best I can do, Scott, is kind of tell you what we're hearing, which I just did. And then, point you towards the economic metrics that we're looking at or indicators that we're looking at. With respect to utility coal, that's going to be highly dependent upon the weather. Natural gas prices are pretty similar to where they are, were at this time last year. Stockpiles are down slightly versus last year. I think there are down about, they're at like 79 days, there off about 22 days from the high, which is May of 2016. And really what happens in the first quarter and second quarter next year is going to be dependent upon weather patterns in the East in the winter. That make sense?

**Operator**

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

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

Alan, I think, you mentioned a little over half of your revenue for 2018 is negotiated at this point. Given that visibility, could you just talk high-level about how the price increases for that business compared to the last pricing up cycle that we saw? I'm just curious if you could provide some perspective on how the pricing environment next year could compare to the acceleration we saw in 2014 and '15?

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

Sure. So Justin the -- as I think, I noted the contracts that we renegotiated in the third quarter. Generally had a higher level of increase there and what we're able to secure in the second quarter. So that's a positive for us. I'll note that, one of the things that really supported year-over-year rate increases this year was in coal was the export market, and we certainly don't expect that level of run up next year. As trucking firms, we've got a lot of business that's transactional, and that is going to offer support for pricing.

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

Okay. But if you look at those noncoal businesses and where pricing is coming in for next year, I mean, is that roughly in line with what you saw when things picked up in 2014 and '15?

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

Yes. There was a lag there too because the uptick was relatively sharp, certainly a lot sharper than folks had anticipated generally in March of 2014. We might be a little bit ahead of it this year, in terms of the outlook because the commentary about the tightening truck market has been out there for a bit. Particularly associated around ELD. So we're certainly factoring that into our conversations with our customers and our bid approach. And frankly, our customers are having those same kind of conversations with their customers.

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

Okay. And maybe as a quick follow-up. On the last call, you talked about roughly 50% to 60% of your revenue that's typically renegotiated each year. When you look at what's left, or I guess, that other call it 50% or so are a little under 50% for next year. Is there any color you can provide on the commodity breakdown of this revenue that's still left for renewal? I'm just curious if it's more weighted towards the specific business or commodity group?

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

Well, we've move towards a shorter-term pricing and export, so that has to be renegotiated. But once again, that's a less than 3% of our overall volume. With intermodal, there are defined escalators, but there's also transactional business, and that has offered support for us. I know that even this quarter, we had RPU growth in all 7 of our major groups. Same thing we had in second quarter. Second quarter I would say, truck capacity was loose. Third quarter, truck capacity tightened and we were able to continue that march.

**Operator**

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

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

Alan, just wanted to see if you have bought through some of the contingencies that might need to be put in place if there was trade disruption with Mexico, given all the (inaudible) headlines of NAFTA? Just give us a sense of how much volume in revenues of Norfolk are really tied to cross-border trade?

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

Let me say that we are certainly full trade as a company as an industry. And in favor of our trade regimes that promote cross-border flows. Alan, comments specifically on scenarios for us.

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

Yes, Brian, it's a very small component of our revenue. We have every intention of growing that and we're working on opportunities to put together products that would improve that, but it's something that we're monitoring very closely, but there have been 4 negotiations so far and there are 3 more that are scheduled.

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

Right. And to clarify small meaning less than 5%? Is there a threshold you would consider putting that below?

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

Yes.

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

Okay. And then, one for Mike. You talked a lot about train lengths increase and then you have, obviously, a great run with that at this point. Are there -- you talk about balancing it with service? Is there any points in the East specifically, we have to worry about longer trains, you potentially blocking some grade crossings or interfering with some commuter traffic or other traffic patterns you might cost into congestions in local communities because we're starting to hear a little bit of concern from the regulators just in the East region in general on that aspect in particular?

---

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

Yes. So on the train length, we go to great effort to make sure the train lengths don't impact grade crossing. We try to keep our rail crossings clear and make a big effort on that. So frankly, it doesn't really that much of an issue for us that it can be making sure that start at single-track territories have enough capacity, but that is really a small area for us. So overall, train lengths continues to grow. And I'll just note this, so far into the fourth quarter it continues to look good. So we're very selective about what we do. We've got a lot of planning that goes into it. So to make sure that we don't create the problems that you're talking about because we're very mindful of those.

---

**Operator**

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

---

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

I wanted to follow-up on a couple of the earlier questions on what the tightening trucking market really means for Norfolk next year. And specifically, do your contractual obligations to your key domestic intermodal partners in the intermodal business there in the quote defined escalators that you mentioned in response to Justin's question, give you the flexibility to push harder on intermodal pricing next year?

---

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

Bascome, I think the key is the opportunity for both us and our channel partners in a tightening truck environment. We have strong relationships with channel partners throughout the intermodal business and we expect to grow along with them. So we see it as a win-win for NS and its channel partners.

---

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

Are you suggesting that it's really more about for you volume than pricing next year just given some of the constraints in your contracts? Or is that opportunity to dip more aggressively in both?

---

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

We see it as an opportunity to grow both volume and rate next year.

---

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

And I just want to clarify one other comment that you made. You're talking about adding employees to get ahead of kind of the peak T&E training period in the spring and summer. Are there any furloughed employees that could potentially be brought back at a lower cost and lead time compared to kind of the 6 to 9-month training of brand-new employees that you've talked about in the past when headcounts get a little tighter?

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

No, we pretty much got all the furloughs back just may be a handful less than double digit -- low double digit at best. So now we don't have that out there. But we stay in close coordination with marketing as to what they see. And you talked about the 6-to-9 month, we spent a lot of time reducing that time frame down also. So we do 2 things: one, we feel like we can bring them back and get them or bring them onboard and get them qualified quicker and we're pretty surgical about when we hire them so that they're available when we need them. So those are the 2 things that make us feel good about having the right T&E base ahead of when we need them.

**Operator**

Our next question is from the line of Walter Spracklin with RBC Capital Markets.

**Suneel Manhas** - *RBC Capital Markets, LLC, Research Division - Senior Associate*

This is Suneel Manhas for Walter Spracklan. I just wanted to circle back real quickly to CapEx. How should we be thinking of your CapEx here given the volume growth specifically? At what point could there be requirement for incremental CapEx to support the growth?

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

We're working on our capital plan for 2018 even as we speak. We'll have more say about that early next year. But I will say this, ours is a very disciplined approach to capital spending. We're looking to maximize returns on capital from our capital spending plan going forward. And that will include the usual categories of capital spending, both maintenance spending and growth spending.

**Suneel Manhas** - *RBC Capital Markets, LLC, Research Division - Senior Associate*

And just a quick follow-up. On the savings and the expectation initiatives you noted, are there certain regions of your network or lanes where you see the most opportunity?

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

I'm sorry, I didn't understand the first part of the question, could you repeat that?

**Suneel Manhas** - *RBC Capital Markets, LLC, Research Division - Senior Associate*

So on the productivity savings you're expecting for Q4. And you mentioned, expectations for further savings into 2018. Are there certain regions of your network or lanes where you see the most opportunity?

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

Productivity is really a network wide opportunity, so we see opportunities to drive productivity throughout our network.

**Operator**

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

**Cherilyn Radbourne** - *TD Securities Equity Research - Analyst*

I also wanted to dig in on the record train length a little bit. Can you talk about where you're making those gains? And what I'm driving out there is, I assumed that your coal network is close to optimal. So I'm curious if you're seeing improvements in merchandise or intermodal or both?

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

Yes. The answer is both. Intermodal has been the biggest driver but merchandise has well. And you're right, the coal unit trains have been optimized for a while. I will tell you on some of the other unit trains, stone and agriculture, we have increased those in coordination with our customers. So intermodal is the big driver, but merchandise is also growing as well.

**Cherilyn Radbourne** - *TD Securities Equity Research - Analyst*

And just by way of quick follow-up, you've been seeing some puts and takes in terms of the merchandise volumes. Is that creating any challenges in terms of making improvements in the merchandise network?

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

Well, Alan, why won't you go back over the merchandise growth trends in the quarter? Let's use that as the foundation for addressing questions about trends, sizes and operations in the merchandise network, generally.

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

Yes, Cherilyn. We started to see some fairly robust growth sequentially as we move through the third quarter effectively up until the hurricanes started to impact our customer base. And so we took a pause in September. Started to rebound in the fourth quarter. We're seeing strength in steel. We're seeing strength in frac sand. We see a little bit of crude oil. Although, that will be a year-over-year decline, but it's picking up sequentially. Automotive will post better comps in the fourth quarter year-over-year than it did in the third quarter as U.S. vehicle production declines are year-over-year less. And ag, has kind of got off to a slow start in the quarter due to the delayed harvests. Although, within the last 7 days, we started to see that volume tick up as well.

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

So much of the growth that Alan just went through in the merchandise arena has occurred within our scheduled train network. And that's one reason why you're seeing the incrementals you're seeing. We're also seeing some growth in unit trends as well.

**Operator**

Our next question comes from the line of Ben Hartford with Robert W. Baird.

**Benjamin John Hartford** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

My quick question for you on the topics to dwell and train velocity addressed earlier. Is it fair to assume that you're expecting improvements in both those measures in '18? Obviously, the hurricane disruptions aside, just as volume growth decelerates from peak 2Q levels, one. And then two, if so, what is your -- what is kind of a longer term target for both of those metrics? Can we view the 2012, 2013 levels of high watermarks? And do you have visibility to returning to or perhaps exceeding those in both dwell and velocity?

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

Yes. I think those are both numbers that we feel very comfortable about not only achieving, but also very comfortable about gave us a really good service product that allowed our customers to grow on our railroad. So yes, we do expect those 2 improve into 2018, absolutely.

**Operator**

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

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

Alan, I want to ask you a little bit about the pricing opportunity in intermodal. If you go back to the last of 10, 15 years, the intermodal RPU for Norfolk hasn't really budged that much despite 3% inflation in highway cost and a higher oil price and all that. It there something about the market dynamic or the density you are having in your network that's giving you a little better leverage to pricing intermodal over the next 5 to 10 years? I'm just wondering how those negotiations are going with shippers. And what's giving you a chance to maybe take a little bit more price up relative to trucks then you have in the past?

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

Well, David, what's occurred is that we're starting to see a much tighter truck environment. And we've got some market approach that our customers value. We've got a service product with schedules that the meets their needs. And so our conversations with them is, how do we grow together? And we firmly believe that negotiated rate increases reflect the value of your service product. And we're aligning with the price. We're not putting new dots on the map. We've got -- we got our capacity. We'll continue to invest in the big areas like Chicago and Atlanta. But our focus is on utilizing the existing capacity that we have to and lean an enterprise to drive shareholder return.

**Benjamin John Hartford** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Are you passing up a little bit more on the business that may be out there now relative to maybe your 5 to 10 years ago?

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

5 to 10 years ago, we implemented some corridor strategies, which has been very beneficial to us versus the Heartland quarter, we put in to handle business between the Ohio Valley and Chicago and Norfolk. And as volume moves to the East Coast ports, that's something that's going to support our growth. And we've got the capacity in place and now it's our opportunity to leverage it.

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

David, I want you to bear in mind as you look at the trend in our intermodal RPU over, say the 5 years is the effect of the Triple Crown downsizing. Our Triple Crown business had a significantly higher RPU than the average general intermodal RPU. When we -- for all intents and purposes shutdown that business, it did have a dampening effect on reported RPU, albeit it was best thing for the bottom line.

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

All right. I appreciate that color. And then, may be Cindy, just as a quick follow-up. Is there -- can you give us that range for what we should be expecting on property sales on kind of annual rolling basis here? And come up whether or how the property sales impacts on management incentives on EBIT and OR?

---

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

David, it's really hard to tell you how property sales are going to come in from quarter-to-quarter as I've said before. I mean they are obviously going to and operating sales will have an impact on our OR, which does impact our incentive plan. And I will tell you though that, when you look at our operating property sales in the third quarter, they were -- our improvement in OR year-over-year was not dependent upon those properties sales. And we expect fourth quarter that we'll also have year-over-year operating ratio improvements and they will not be dependent upon those sales.

---

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

Is Norfolk, may be using properties sales as a little bit more of a lever here for OR. Just given that the incentives in place and should it be expecting more relative to trend? Or is it just going to come up how it comes up?

---

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

Yes. I think that, obviously, we will always look at property that we have that's no longer is using the business and we will try to get rid of it. And as I've said, is very difficult to predict. Getting rid of that property is part of our strategy. But at the end of the day, it's really not going to be a big driver of our OR. The things that we've talk about, service, productivity and growth are going to be good things that drive our OR.

---

**Operator**

Our next question comes from the line of Tyler Brown with Raymond James.

---

**Tyler Brown** - *Raymond James - Analyst*

Alan, it seems like the prospects for domestic intermodal look really strong. I think, volumes are at record levels. But I was wondering if you could talk about IMC box availability. And second, do you and your pool partners have any plans to add to the EMP fleet to maybe support growth or do you feel like there's enough capacity there?

---

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

Tyler, capacity is tight with boxes, which is good for pricing opportunities particularly on the transactional level. As Jim noted, we're currently in the process of developing our capital plan for 2018.

---

**Tyler Brown** - *Raymond James - Analyst*

Okay. That's helpful. And then Jim, this is more of a strategic question. And I can't remember where I saw you speak. I think it was one of the rail shipper conferences. But I recall your presentation was really revolving around NS's strategy about revamping, how you face the customer. So I was just curious if you or Alan, could just talk about where you are in that program. May be what kind of initiatives, maybe technologies that we and customers would expect? And then, what do you hopefully -- hope to yield from these investments?

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

Well, I'll completely turn it over to Cindy, to go through some of the specific technology investments that we are making. But first, I do want to reiterate the importance to our strategy of customer engagement and customer interface. We are working hard to get closer and stay closer to our customers. And one of the main ways we're doing that is through investments we're making in technology.

**Cynthia C. Earhart** - *Norfolk Southern Corporation - CFO & Executive VP of Finance*

So let me just add a little bit of color to that. As a Jim said, we're investing quite a bit in the way we interact with customers and I would characterize that may be in 3 different areas. The first is, our -- or how we face the customer, we have a big project to upgrade our portal. And basically, change and not just the look and feel of it, but really everything behind it, the data, the data accuracy, the timeliness. We want to make it very easy for customers to be able to get the information that they need when they need it. We are secondly working on, what we call, customer relationship management, which is really technology within this company, so that no matter where you are in the company, marketing, accounting, transportation, customer service, we all have one view of the customer we all have the most relevant data and we can interact with the customer having that type of information and managing issue. And then, I think the third part is, we are looking very closely at the technology that we have implemented within our Customer Service Center and looking to upgrade that, so we can better serve our customers. So a lot of effort around that, multiyear project, but we think will be very beneficial for both us and our customers.

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

And Tyler, it's an ongoing process as Cindy said, we're implementing somethings now, something -- where investing have occurred in some areas and somethings will be rolling out next year. The foundation of it is a predictable service product. What differentiates us is our equipment strategy for growth from marginalizing the fleet that offers for better asset turns that offers better equipment reliability. The ability to provide equipment in safe working order to our customers on time, better transparency for our customers, it's a customer engagement, focused on proactive notification and a seamless interface with the customer. It's collaboration with our short line partners and economic development partners to extend our network reach, its innovative service products that utilize and generate a return on our existing assets. All those things are part of our strategy to differentiate ourselves and help us compete with truck.

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

And let me just close this subject by, by pointing out, that all of these different initiatives we've described are coming to fruition now and will continue to do so in the future. This is been a major emphasis and focus of our teams since I became CEO, and Alan, Mike, Cindy and I have all spent a lot of time with our customers gathering their input, their ideas for improvement and how we can refine and improve our service product and that's a -- that's where those ideas came from and that's why he we're driving so hard to implement them.

**Operator**

At this time, I will turn the floor back over to Mr. Jim Squires for closing comments.

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

Thank you. Thank you all for your questions. I'd also like to take this opportunity to thank all of our employees for their contributions to a record breaking quarter. Our balance and successful approach focused on increasing efficiency and delivering a strong customer service product gives us confidence in our ability to achieve our goals and deliver sustainable value. Thank you.

**Operator**

Thank you, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.