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NSC - Q4 2019 Norfolk Southern Corp Earnings Call

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OVERVIEW:

Co. reported 4Q19 EPS of $2.55. Expects 2020 revenues to be flat.

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PRESENTATION

Operator

Greetings, and welcome to the Norfolk Southern Corporation Fourth Quarter 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

At this time, it is my pleasure to introduce Pete Sharbel, Director of Investor Relations. Mr. Sharbel, you may now begin.

Peter Sharbel - *Norfolk Southern Corporation - Director of IR*

Thank you, Rob, and good morning, everyone. 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 full discussion of those risks and uncertainties we view as most important. Our presentation slides are available at norfolksouthern.com in the Investors Section along with our non-GAAP reconciliation. Additionally, a transcript and downloads 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 - *Norfolk Southern Corporation - Chairman, President & CEO*

Good morning, everyone, and welcome to Norfolk Southern's Fourth Quarter 2019 Earnings Call. Joining me today are Alan Shaw, Chief Marketing Officer; Mike Wheeler, Chief Operating Officer; and Mark George, Chief Financial Officer.

2019 was a remarkable year of transformation at Norfolk Southern. We launched our TOP21 operating plan to transform our railroad while fulfilling our commitment to dramatically improve our service product as we become more efficient. We've made tremendous strides on both of those fronts and delivered progress on our strategic plan. In the face of a challenging volume environment, we're pleased to share our results today that demonstrate this organization's strong momentum in streamlining our operations and making substantial progress toward our long-term commitments, thanks to the hard work and significant efforts by our workforce and leaders.

Slide 4 highlights those results. For the quarter, EPS was $2.55, and the operating ratio was 64.2%. For the full year, income from operations reached record levels at nearly $4 billion, resulting in a record operating ratio of 64.7%, a 70 basis point improvement over 2018. Earnings per share increased 8% to $10.25. We've now achieved record operating ratio results for 4 consecutive years. This year's improvement is particularly impressive against the backdrop of contracting volumes. These records demonstrate our commitment to continuous improvement. And underscore our steadfast dedication to creating shareholder value. Despite volumes deteriorating throughout the year, culminating in fourth quarter and full year volume declines of 9% and 5%, respectively, we remained focused on running our railroad as efficiently as possible and with a high level of customer service, achieving our locomotive and T&E workforce productivity goals despite having less freight to haul. These efforts contributed to the record full year results I mentioned a moment ago, and the core margin improvement accomplished during the fourth quarter, which Mark will discuss shortly, demonstrates the significant momentum we're carrying into 2020 and beyond.

As we enter 2020, we continue to build on the strategic plan initiatives we launched in 2019. While rolling out Phase 3 of our PSR-based operating plan, TOP21, which will drive additional productivity across our resource base, all while maintaining the high-quality service product established in 2019. The team will provide additional details regarding these initiatives as well as further details on our fourth quarter and full year results. Alan will cover trends in revenue. Mike will cover operational performance, and Mark will go over the financial results.

I'll now turn the call over to Alan.

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Thank you, Jim, and good morning, everyone. Macroeconomic headwinds challenged volume in 2019, particularly in the second half of the year. With these tough conditions, we continued our focus on margin improvement, supported by the value that our outstanding service product creates in the market.

On Slide 6, excess truck capacity, trade and economic uncertainty and manufacturing weakness negatively affected our markets, driving a 9% decline in volume. We partially mitigated the impact of declining volumes with stronger revenue per unit excluding fuel in all 3 of our business units, including quarterly records in our Merchandise and intermodal business groups. Norfolk Southern's revenue per unit has increased year-over-year for the last 12 quarters despite the market cycles over that period of time. The weak manufacturing environment and low commodity prices drove down Merchandise volumes in all groups, except chemicals, led by a 17% decline in steel. Import steel tariffs affected the traffic flows and lower steel prices reflected weak demand. Merchandise volume declines were partially offset by an increase in crude oil, which more than doubled its volume year-over-year.

Intermodal revenue declined 8% due to excess truck capacity in a weak freight environment. International comparisons were difficult as the inventory pull forward drove a spike in fourth quarter 2018 volume. Coal volume and revenue were down 21% year-over-year, with the largest volume decline in utility coal. Our Northern utility portfolio was impacted by low gas prices and combined cycle capacity. Export was influenced by falling seaborne met prices and Chinese tariffs, while export thermal prices remained at low levels, making it difficult for U.S. coals to compete globally.

Turning to Slide 7. In 2019, revenues decreased 1%, despite a 5% decline in total volume, evident from our margin improvement strategy, revenue declines were partially offset by a 3% increase in revenue per unit. Merchandise revenue reached a record $6.8 billion in 2019, while volume declined 3%. Volume headwinds occurred from weakness in the manufacturing economy, the lose truck market and declines in steel and natural gas liquids. We were favored by fuel price differentials that boosted crude oil demand to East Coast refineries, and we secured increased aggregate volume.

Intermodal revenue decreased 2% on a 4% volume decline as gains in international were offset by domestic declines. Lower spot truck prices and excess capacity in the trucking industry, reduced domestic intermodal demand in this weak-freight environment.

Turning to coal. Revenue declined 8%. Utility volume declines were predominantly in the north, where low natural gas prices suppressed coal burn, while southern utilities benefited from inventory build in the first half of the year. Depressed seaborne coking coal and thermal prices led to lower export volumes and prices that were further impacted by production issues. While uncertain economic conditions negatively impacted revenue and volume in 2019, we maintained our focus on improving our service and creating a product that will enable our customers and Norfolk Southern to grow when the freight environment improves. This approach supports our strategy of margin improvement, which is reflected in our increasing revenue per unit, providing opportunities for operating leverage when demand improves.

Moving to our outlook on Slide 8. We are closely monitoring developments in the macro economy and its impact on the industries and business segments in which we compete as well as our customers' expectations as we execute our strategy. GDP growth is expected to be in the 2% range in 2020 with the majority of that growth from personal consumption, creating opportunities in our consumer-driven intermodal and Merchandise markets. Continued weakness in manufacturing, low commodity prices will impact our coal franchise in other segments of our merchandise markets. Overall, we have not seen an inflection point in volume trends and a high degree of uncertainty exists. We see growth potential as we move into the second half of 2020 due to forecasted improvement in the trucking and industrial sectors and easier comparisons. U.S. light vehicle production is forecast to improve more than 5% in 2020. Improved price differentials are predicted to sustain fourth quarter 2019 crude volume levels through 2020. Overall, we expect total Merchandise revenue improvement enabled by our strategy with continued support from our consistent, reliable and quality service product.

The truck market remains lose with spot rates leveling off, yet our customers and data providers forecast some tightening later in the year. Based on this information and new business initiatives, our intermodal revenue and volume are expected to grow in 2020. In coal, additional gas and renewable generation capacity continues to erode coal share of electricity generation. Coking and seaborne thermal coal indices are substantially below prior levels, impacting both export volume and pricing.

In summary, as headwinds persist in the freight environment, we expect 2020 revenue to be flat with the first quarter similar to the fourth quarter of last year, and conditions improving as the year progresses. We remain focused on a disciplined pursuit of efficiency while recognizing the value our consistent, fast and reliable service product creates for our customers. In light of continued economic uncertainty and with our demonstrated willingness and ability to adjust to market conditions, this approach provides the platform from which we will further enhance value for both our customers and shareholders.

I will now turn it over to Mike for an update on operations.

Michael Joseph Wheeler - *Norfolk Southern Corporation - Executive VP & COO*

Thank you, Alan. Today, I will update you on the state of our operations. In the fourth quarter, we continued to deliver strong service for our customers and significant cost savings, which drove a record operating ratio for the year. This operational leverage is driven by our relentless execution of the core PSR principles and our TOP21 operating plan.

Moving to Slide 10. Our network is running fast and on time. Record train performance and record terminal dwell drove near record car level velocity and strong asset utilization for Norfolk Southern and our customers. These achievements support our strategy to meet our customers' expectations while eliminating costs and prudently managing our assets. Our momentum has continued into 2020 and will be a tailwind to our initiatives this year.

As seen on Slide 11, our operational performance is driving strong service levels as evidenced by our customer-facing metrics. Intermodal availability, which measures our customer commitment to grounding of the box, shipment consistency, which measures trip plan adherence for merchandise traffic and local operating plan adherence, which measures execution of the critical First Mile and Last Mile of service. All of these metrics were at or near record levels. We have been sharing our metrics with our customers for well over a decade, and we use them to have data-driven discussions to confirm the value of our service product. We remain committed to providing a high level of service for our customers while achieving our productivity goals.

Turning to our service and productivity metrics on Slide 12. These metrics align with our strategic plan as they measure key productivity and customer service levels. We have been aggressively reducing our resources to meet our productivity goals despite the drop in our GTMs. Starting with the service delivery index, which is the on-time delivery performance of our scheduled shipments indexed to 2018. This is a customer-facing metric that combines shipment consistency and intermodal availability, which were detailed on the previous slide. We exceeded our 2019 goal and actually achieved our 2021 goal 2 years earlier. We will maintain this high level of service by continuing to execute our TOP21 plan. We exceeded our 2019 T&E productivity goal despite a significant drop in GTMs. We are at our lowest T&E headcount on record while still providing exceptional service. We are realizing the benefit of our TOP21 plan, which has the added benefit of capacity in the train plan to allow for growth on the existing trains. While we missed our 2019 train weight goal for the full year, we actually met the goal in the second half of the year with the implementation of our TOP21 plan. We have, however, taken another look that our 2021 train weight goal in light of the continued change in the coal market. We believe the new goal of 6,700 tons, which is 5% higher than our baseline, reflects the improved productivity of our TOP21 operating plan, while taking into account the projected mix. We also met our goal for locomotive productivity for the year by aggressively rationalizing our locomotive fleet, which is 20% lower than 2018. As mentioned in our previous call, this has allowed us to significantly rationalize the resources associated with the maintenance of these locomotives, including a reduction of 600 positions last year and an additional 135 positions this year.

Regarding fuel, we will benefit from our lower locomotive fleet size, our aggressive implementation of energy management technology and our DC to AC conversions. And the cars online continues to be a positive story for Norfolk Southern. As we noted throughout the year, we exceeded our original 2021 goal, thanks to our fast and consistent service product. To that end, we have established a new goal of 129,000 cars going forward, which includes cars in storage that can be deployed as market conditions warrant.

In summary, we are confident we will meet our productivity goals for this year as we will now have the momentum of full year benefits of our previous rightsizing of our workforce and locomotive fleet. This will get us more than halfway to our 2021 productivity goals this year.

As you can see on Slide 13, we accelerated our progress in reducing crew starts during the fourth quarter. We continued to build on the success of TOP21 with phase 2 of the plan, which included an initial consolidation of some bulk movements into the manifest network and dividends from our yearlong Clean Sheeting program. This improved fluidity is allowing for the continued reduction in yard and local assignments. This quarterly year-over-year improvement accelerated in the fourth quarter, with the majority of these improvements being long-term structural gains. As previously mentioned on the other slide, we have capacity in the new plan to accept additional volumes without a commensurate rise in crew starts. We anticipate continued strong year-over-year comparisons as we begin to roll out phase 3 of TOP21, completing delivery of the promised 3 phases of the program in 1.5 years instead of the anticipated 3 years. Going forward our network planning and operations group will be evaluating the plan and the network for further optimizations.

In closing, this has been a critical year for Norfolk Southern. We started the year by detailing our implementation of the core PSR principles. We have successfully executed on these principles despite a challenging market. Our service is at record levels. We achieved a record operating ratio and our serious injury ratio was the lowest in the last 5 years. We are carrying this momentum into 2020.

I will now turn it over to Mark, who will cover the financials.

Mark George

Thank you, Mike, and good morning, everyone. Before we get into the detailed P&L, I want to point to a chart in the appendix that specifies for you some large and unusual items that impact the results and comparisons versus 2018. I'd like to talk to those impacts upfront on Slide 15 for the sake of clarity.

This chart illustrates the effect of those items on the OR and EPS for the quarter as well as for the year. The reported changes to OR and EPS are reflected on the bottom row, and we distill those drivers in the white rose above. The first item, as you may recall, relates to a property sale in the Atlanta area in the fourth quarter of 2018. That particular gain was $112 million and creates an OR headwind of 380 basis points in the fourth quarter of 2019 and 100 basis points for the full year, with a headwind to EPS of about $0.30.

Next was the $32 million receivable write-off arising from a legal dispute that we called out in the third quarter. This reduced the 2019 OR by 30 basis points and EPS by $0.09. The final headwind involves the nonoperating impairment that we booked in the second quarter related to the natural resource assets we have been actively marketing. In the fourth quarter, we took an additional $21 million impairment related to those same assets, and that had a $0.06 impact to EPS in the quarter. And when added to the 2 -- the second quarter impairment loss, the EPS impact for the full year was $0.14. You'll note we had a low effective tax rate in the quarter. This was driven by certain income tax credits authorized by Congress in December of 2019, which were retroactive to 2018. The impact to the fourth quarter EPS was $0.07, and for the full year, it was $0.04. Beyond these unusual items, the core improvement in the OR was 240 basis points for the quarter and 200 basis points for the full year, while core improvement to EPS was $0.28 for the quarter and $1.23 for the year.

Now moving to the fourth quarter, Slide 16. Revenue was down 7% in the quarter, driven by a 9% volume contraction, partially offset by RPU improvement. Operating expenses, as reported, were 5% lower, including 5 points of headwind from the absence of the prior year land sale.

Drilling into the expense categories on Slide 17. As Mike illustrated earlier, our TOP21 PSR-based operating plan has reduced the amount of resources we need to run the network, resulting in fewer trains and lower crew starts manifesting in substantial cost savings across multiple expense categories. Starting with compensation and benefits. We drove a $127 million reduction in expenses in the fourth quarter. That's a decline of 17% on a 16% reduction in employees. Our employment levels declined throughout the quarter, and this, along with lower overtime, health and welfare benefits as well as less recrews, saved us $86 million. This favorability was partially offset by $17 million of additional expense due to inflation in pay rates. In the quarter, incentive compensation expense was lower by $57 million, due largely to last year's higher payout that disproportionately impacted the fourth quarter of 2018. So we drove average headcount down by approximately 1,500 employees from last quarter and have reduced by 4,200 compared to the last year. Run rate benefits from this will continue into 2020 on top of additional efficiency actions.

Moving to fuel. Reduced consumption and lower prices drove a $52 million decline in fuel expense. We improved on our fuel efficiency as fuel consumption declined by 11% on the 9% decrease in volumes, despite adverse mix from weaker coal where our fuel efficiency is strongest. Here in 2020, fuel efficiency is getting intense attention through various initiatives, including continued locomotive upgrades and deeper energy management penetration as Mike mentioned. Moving over to purchase services, rents and materials. Our initiatives to improve asset utilization are also driving a reduction in expenses. The increased network velocity, improved fluidity, and fewer locomotives and freight cars on the network drove $15 million in savings associated with equipment rents and $12 million in savings of material cost. These expenses -- sorry, these savings were partially offset by increased detouring costs due to a bridge washout and derailment expenses that amounted to $13 million collectively. The fast response and strong execution by our operations team limited the financial impact of the derailment to only half of the $25 million we signaled at the last earnings call. So when looking at the big picture, the underlying change to our cost structure accelerated in the fourth quarter as we continue to drive resource reductions through the end of the year. The full year effect of those savings will be realized in 2020.

Moving to Slide 18. Let's take a look at our summarized fourth quarter financial results. Other income included $31 million of favorability from investment returns on our corporate-owned life insurance, where we had positive returns in Q4 2019 versus losses in Q4 of 2018. We also had $50 million of higher gains on the sale of nonoperating properties than prior year. These amounts were partially offset by the additional $21 million asset impairment loss that I mentioned earlier. The lower effective tax rate, 19.6%, was driven by both the retroactive tax credits as well as higher nontaxable returns on the corporate-owned life insurance. Income taxes will represent some headwind in 2020 as we expect the tax rate to be between 23% and 24%.

Shifting to the full year on Slide 19. We delivered impressive results for the year in the face of accelerating declines in revenue and the net headwind items we discussed on Slide 15. We reduced railway operating expenses by $192 million. We set company records for operating income and operating ratio. Our railway operating ratio improved 70 basis points over 2018. Net income improved by 2%, but diluted earnings per share grew 8% to $10.25 for the full year aided by a 5% reduction in our average share count. Achieving the cost reductions while pushing delivery performance for our customers to record levels, demonstrates our commitment to long-term value creation.

Recapping on Slide 20, our full year cash flows from operating activities was $3.9 billion, and free cash flow for the year was a record at nearly $1.9 billion. Dividends and share repurchases for the year totaled over $3 billion.

So to close, we clearly have created momentum on the cost side, despite the volume challenges and obstacles that were unforeseen at the beginning of the year. It's that momentum, plus new initiatives, which provides us with strong leverage going into 2020 to continue to drive profit growth and margin expansion.

Thank you, and I'll turn the call back over to Jim.

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

Thank you, Mark. As you've heard on the call today, the Norfolk Southern team made tremendous strides in executing the strategic plan we laid out a year ago. Amid a rapidly changing macroeconomic landscape, we pivoted our productivity initiatives and achieved a locomotive fleet reduction of 20% and a workforce reduction of 8% for the full year average, with those figures accelerating to 22% and 16%, respectively, in the fourth quarter. These resource adjustments significantly outpaced the volume declines, demonstrating strong cost momentum while maintaining exceptionally strong customer service levels.

Turning to Slide 22. I'll wrap up with our 2020 expectations. First and foremost, we will continue to execute our strategic plan with the top priority of running the most efficient railroad possible while being a best-in-class supply chain partner for our customers. As you heard, we are modeling net overall revenue to be flat for the year, with persistent headwinds in coal to be offset by improving comparisons in Merchandise and intermodal as the year progresses. Despite -- and within that environment, we have confidence that our productivity and efficiency formula will result in significant operating ratio improvement this year that will get us more than halfway to our committed 60% OR in 2021.

Lastly, as we continue to execute our highly effective locomotive fleet modernization program, we're targeting a capital expenditures program between 16% and 18% of revenues. We remain committed to returning capital to shareholders through a 1/3 dividend payout ratio, with remaining cash and borrowing capacity used for share repurchases. This disciplined capital allocation strategy represents our commitment to enhanced shareholder value through returning capital and ensuring Norfolk Southern is positioned for continued success.

Before we turn it over to questions, I want to thank each and every NS employee for their hard work and commitment to the strategic transformation of our railroad.

Thank you for your attention. We'll now open the line for Q&A. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from line of Bascome Majors with Susquehanna.

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

Mark, you've been in the CFO seat for about 3 months now and have had some time to get the lay of the land. Could you just take a step back and kind of give us versus your expectations coming in? Kind of what's as expected, maybe what has surprised you? And are there any changes that we should expect to see as investors with you leading the finance organization versus how assets handled things historically?

Mark George

Thanks for the question. Yes, coming in from the outside, a different industry, a culture that clearly is different than the one I've come from, I would say that I'm surprised that we see a great blend here of long-tenured industry experts, who are very passionate about not just the business, but the industry itself, and the infusion of new talent that come from different walks of life and different industry experiences and that they're actually being welcomed with their new ideas, including my own, frankly, coming from the outside. So that's been kind of a pleasant surprise, I would say. I was not expecting such a welcoming with regard to the new ideas and new concepts being brought in. I'm also kind of impressed by the speed and agility of an old company, so to speak, to react to a very rapidly changing economic environment. You see the charts that Mike showed on how quickly we've taken resources out to respond to volume declines. And then nimbleness, I would say, has surprised me. And coming in, another big observation is just how capital-intensive this business is compared to where I've come from.

We, obviously, spend a couple billion dollars a year in CapEx. We've got over $30 billion of fixed assets. And so it's certainly an area that I need to drill into a little bit more on understanding why we spend so much, certainly, half of that is related to maintaining this big infrastructure to serve your customers and to do it safely. But I do want to understand the rationale for the spends that we have. The justification financially for them and the prioritization process. So it's something that I expect to dig into a little bit. And maybe you've seen a little bit on this call, too. We just want to be transparent with the investment community about the path that we're on of which is to get to a 60% OR by 2021.

Operator

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

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

So Mark, I'm hoping you can help us with a little bit more clarity on some of the numbers here. So can you give us the -- what the real estate gains above the line were in the fourth quarter? And any expectations for this year in terms of what's assumed in the guidance? And then similarly, with incentive comp, I know it was down in '19 versus '18. Any way to think about is 2020 a year of the headwind tailwind or normal? Any help there.

Mark George

Sorry. The second question, Scott.

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

Was just on incentive comp, should we think about that as a headwind in '20? Or is it '20 versus '19, sort of just a normal year on incentive comp?

Mark George

No. We would hope that incentive comp is a headwind because we're hoping to have a better year in 2020 than we did, obviously, this year, where we fell a little bit short. So clearly, that will be a little bit of headwind for us. With regard to the real estate, excluding the big one that we carved out for you, gains in the year were a little bit higher than they were last year, less than $20 million. In the fourth quarter, roughly half of that benefit we saw in the fourth quarter of this year. So we had about $10 million of additional gains in '19 versus the fourth quarter of '18, excluding the big one that we carved out. And the guidance, Scott, on real estate. In any given year, we're expecting $40 million to $60 million of gains. It's going to be lumpy, be backloaded. It could happen middle of the year, with real estate, you never are quite sure when you can get things to close and get over the finish line. But we ended this year excluding -- sorry, we ended last year excluding the big gain in that range. And the same thing this year, we ended within that range.

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

Okay. That's helpful. And then -- so on the revenue guidance of flat, maybe if you have a thought on our volumes down and yields up. And then it does feel like you guys are losing some share on the volume side, but clearly doing well on the yield side. Are you okay with that, that yield up strategy and the trade-off of better yields, but weaker volumes than maybe your peer? Or do you feel like you've pushed it too far? Or just some thoughts how you're approaching the market?

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

Scott, it's Jim. Let me take the second part of that. The market share question, and then I'll turn it over to Alan to give you some more color on the components of our revenue guidance for this year. We are targeting the truck market. That's the market share opportunity. That's the big opportunity for us. And that is the linchpin of our growth strategy, is getting trucks off the road onto the railroad. So -- and there are opportunities there when it comes to our growth engine, intermodal. And there are also opportunities in the Merchandise round. So -- and we are also certainly committed to achieving value for the services we provide, which value is quite strong these days. We've got a great service product out in the marketplace. And we're very proud of that and think that we can create value for our customers through that service.

So Alan, a little bit more color on the 2020 revenue outlook?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Yes. Scott, coal is going to be a drag throughout the year. And it's going to be a drag both in volume and in price. We've got a great service product out there. And we're taking a long-term view of our markets. We take a long-term view of our approach with our customers as well and so we're very disciplined in securing the value and understanding the value that our service product creates for our customers. As Jim noted, our eyes are on that $800 billion truck market. And that's where the growth opportunities are. And that's where we're going to see improvement as the year progresses. It's -- it requires fierce competition and putting new products out there, new logistics services that our customers value. And we're doing it from a platform in which I'll remind you, we went out in front of our customers, and we told them what we were going to do with our operating changes with PSR. And then we did it. And there we've created a lot of credibility with our customers for our no surprises approach to our operating plant changes. We implemented it flawlessly. And what's unique about Norfolk Southern is that as we implemented PSR, our service got better. And so we're in a great position to grow as we move forward. And if you think about truck and the opportunities there, it aligns perfectly with the unique strengths of our franchise. We have a powerful intermodal franchise. And we have a very broad and diverse Merchandise franchise as well, and we're focused on opportunities to take business from truck and merchandise as well.

Operator

Next question comes from the line of Allison Poliniak with GR Energy Services.

Unidentified Analyst

It's Allison. Just a question, I just want to circle back to the cars online commentary. If I heard you correctly, I think you said that, that number included a level of storage so that there is some flex on flying or expected to up group. Can you just go through that again, sorry?

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

Yes. That's right, Allison. That's how we calculate that number. And we do it that way because we want to focus on the velocity of our entire car fleet, including those that are in storage. So that we're -- that's an asset that remains on the books, and we want to make sure that it, too, is being taken into account as we think about utilization of the freight car asset.

Michael Joseph Wheeler - *Norfolk Southern Corporation - Executive VP & COO*

Yes. This is Mike. Of that 129,000, we have 17,000 cars in storage that is available to us to flex up when the business arrives, and we're pretty excited about that.

Unidentified Analyst

Great. And then just, obviously, you're well into your strategic plan. Looking back over the past few months, what's been your greatest surprise in terms of your ability to perform in this environment?

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

I think Mark did a good job describing the progress that we have made, the core operating and core earnings improvement that we made in the fourth quarter. So the momentum stands out for all of us, I think, and that's not a surprise, and that we've been driving it. We've been focused on accelerating the improvements as we move throughout the year, and we did it in fourth quarter, and that will carry over into 2020 and beyond.

Operator

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

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

Jim, maybe just expanding on that target or -- of the 235 basis points year-over-year, or maybe for Mark. But does that include the headwind of the incentive comp for turning the $40 million to $60 million real estate gains? And then maybe just your thoughts on on what's going to happen with the employee base moving forward. Is this -- are you -- is this kind of the run rate level? Do you still see more productivity on the employee side?

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

Mark?

Mark George

Yes. Ken, look, I think in terms of headcount, we've taken a lot out this year. There's actually more to come. So not only will we enjoy the benefit of the full year effect of those employees that came out in the back half of this year, but there are more to come in the beginning part of this year. And then frankly, we just have to see how volume shakes out and determine how much further we can go and absorb the volume that we're assuming to get returned in the back half of the year.

Sorry, the first half of your question, Ken?

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

Was just to ensure that the 235 basis points improvement, which is great, but does it include the headwind of incentive comp...

Mark George

It does.

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

And the real estate gains that you mentioned. That's all baked in, right?

Mark George

It's all baked in, Ken. So the incentive comp returning to normal and the real estate gains being in that $40 million to $60 million in range. It's all part of the calculus.

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

It's a big number. And then I guess my follow up for Mike. Just note, it looked like you had no targeted improvement in the service delivery Index. Are you changing it to tighten your range? Or why would there not be given all the moves you're making in, I guess, a target for improvement there?

Michael Joseph Wheeler - *Norfolk Southern Corporation - Executive VP & COO*

So overall, we're pretty happy with our customer service levels, and our customers are as well. I will say we are targeting tightening some of our windows for delivery to customer and be better on the consistency part. So that's a part of it, but it doesn't roll up necessarily into changes at the macro level. But yes, we're pleased with our service but we're going to continue to dial it in, get better and better in the trucks.

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Ken, if I could add something, we collaborate with our customers on our service targets. And Mike noted that for years, we've been putting service targets out there with our -- for our customers and sharing with them our performance. In 2019, we upped the ante. We went out in front of our customers and said, here's what's going to change. With PSR implementation, and here's how your service is going to improve. And then we delivered it. And as you're going to see, our PSR implementation continues to evolve. We continue to make improvements and we're putting a product out there that helps us compete with truck. And as the truck market tightens as we move throughout the year, it's going to be a growth driver for us. We're very confident in the quality of the product that we're delivering, and we're pricing to that effect.

Operator

The next question is from the line of Tom Wadewitz with UBS.

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

Wanted to see if you could offer some thoughts on 2 of the segments where you have not seen improvement yet. So I'm thinking your purchased services, would you expense -- would you expect that line to improve in 2020 or 2021 as a result of phase 3 and TOP21 or the terminal improvement program, how do we think about that line? And also maybe a little more on fuel efficiency.

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

Mark?

Mark George

Yes. I'll take that, Tom. So look, purchased services. Clearly, there is intermodal terminal operating costs that are in there. I wouldn't call them strictly volume-variable. There is an element of fixed cost in there as well or committed cost in there. But bear in mind that in our purchase services category, we've also got other things that are not volume-variable. For example, a lot of the maintenance cost for the network that you don't capitalize flow through this line. So when you have repairs to rails and you have to maintain the trees and ensure that the lines are clear. A lot of the costs for maintenance of the infrastructure cannot be capitalized. It goes into this category. Building leases and rental costs are in there. And then the other piece that you have to bear in mind, Tom, is there's a fair amount of technology cost that flows through there, similar to what I described with maintenance.

There is a lot of the IT spend that can't be capitalized, runs through this line category. And frankly, it's a growing category. The good news, however, is a lot of those investments we're making in technology are delivering returns in (inaudible) in the P&L, as you saw through the call today. So we're investing in things like automation. It allows us to leave ourselves of some headcount-related to more transactional tasks. And we expect to continue to invest in this technology element as well. So that's, in large part, why purchased services is not moving as quick as we like. All of that said, I've got to dig in there a little bit, and we've talked about it quite a bit. We've got to look at this bucket for opportunities in 2020. It is an area where I think it's right for us to dig into a little bit more.

Your second question on fuel. We made progress in Q4 with some levels of efficiency, and we're really relying on a step-change improvement going into 2020 in fuel. The team has organized well. We continue the upgrades from DC to AC. That provides a lot of benefits to us in many ways, including fuel, but on top of that, we're having deeper energy management penetration. And so it's clearly an area in 2020 that we hope to see significant progress on.

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

Just -- if I can get a brief follow up. Jim, I think there is maybe a little increase in discussion in December on volume sensitivity of the $60 million OR target for 2021. Your guidance for 2020 seems to indicate there's not a lot of concern about volume. But how should we broadly think about the volume sensitivity of getting to $60 million? Do you need to improve volume growth in 2021? Or how do we broadly think about that?

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

Well, let me say first, this is a cost-structure, cost-reduction based plan, particularly in 2020, where we forecast flat revenue. So it's always all about achieving the efficiencies that we've tried to lay out for you that we have achieved already in 2019 and then rolling into this year and next. As far as 2021 is concerned, maybe get a little bit of a tailwind from some growth at that point. But we're not factoring in a lot. It's -- it remains fundamentally in an efficiency-oriented financial plan even as we move into 2021.

Operator

Our next question is from the line of Chris Wetherbee with Citi.

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

I wanted to dig in a little bit on the coal outlook, if we could, specifically maybe exports. Can we -- Alan, can you help us understand a little bit better, how we should be thinking about I think there's 2 impacts here, probably 1 on the volume side and then on the yield side. Maybe sequentially on the yield, should we see -- expect a step down in 1Q as some of these contracts get reset based on commodity prices? And then how should we think about the volume? Just trying to put some numbers around the coal headwinds we're looking at in 2020.

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

All right. Chris, let's refresh where we were as we move through 2019 and first quarter and second quarter 2019. Net coal prices were above $205 a metric ton. And then they started cascading down to around $160 in the third quarter and a closer to $140, $145 in the fourth. And so as we've talked about frequently, we saw sequential declines in both volume and in price in our met coal franchise, which is -- export franchise, which is about 2/3 of our export coal, which makes up about 25% of our overall coal volume. Right now where coal prices are now, it's in the low $150s. You're going to see a lot of pressure on price. And just recall, Chris that our RPU and export coal met was at its highest point in the first quarter of last year as prices were at the highest point. And so you -- comps. Comps are most difficult in the beginning of the year. There's not a lot of demand in Europe. And as a result, you're seeing coals sourced from other locations globally are being put out onto the water. And so there's increased competition for us there. Then of course, you know what's going on with thermal. That is going to have a market impact on export thermal volumes. So you're going to see volume pressure in both met and thermal exports, and you're going to see particular price pressure on net exports.

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

Okay. And the yield pressure is toughest in the first part of the year 2020?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Relative to last year, yes.

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

Got it. Okay. All right. No. That's helpful. And then, Jim, maybe a bigger picture question, coming back to the last 1 about OR in 2021 and some of your thoughts there. So some significant improvement this year and expectations for 2020. When we think about maybe some of those tailwinds that you could get from revenue growth, potentially returning in 2021. And given the progress you've made so far, how do you think about sort of the potential of the business? So I think a lot of us spend time focusing on your performance relative to peers. Is that the right way we should be thinking about it? So some of the numbers that we're seeing from some of the other rails out there. Are those the types of potential ORs we can expect from Norfolk over time? Just want to get a sense of how you're feeling about it kind of partway through this PSR initiative.

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

Should we see upside in the top line, we would expect much of it to flow through operating income and to the bottom line because there will be significant operating leverage in that growth. That's not our base case as we've been through, but the growth will return and resume at some point. We think we get a lot of operating leverage because we have restructured our costs and believe that we can handle volume growth with the resources on hand. Now there will be areas where we have to increase spending to handle the volume growth depending on how much it is. But by and large, we believe we can handle the volume when it returns with our existing resources.

Operator

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

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

I guess, Jim, maybe following off that line of questions. As we look at phase 3 of the TOP21 plan, is that going to drive pretty significant operational changes here, and that's why you guys have the confidence on the cost outlook and the OR improvement in 2020?

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

That will contribute to it and for all the reasons that the last major iteration of TOP21 drove efficiencies. So yes, that's a piece of this. In the next iteration of TOP21, we will continue to focus on train consolidations, on decreasing circuity on running longer, heavier trains to meet the goals that we put out there for those things. So it's really -- it's further to the types of goals that we were pursuing in the previous versions of the plan. I think at some point going forward, this becomes continuous improvement. And really, in a way, we're already there. We are looking every day, every week at shorter trains and working on a plan in consultation with our customers in the field to fold those trains into the network and achieve those efficiencies on an ongoing continual basis.

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

Okay. I appreciate that response. And not to get too specific on this call. But Mark, can you talk to the other expense line item? Because I think if we look at it, the last few quarters, it was running around a $60 million run rate. Is that the right level to think in 2020?

Mark George

Other expense?

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

Yes.

Mark George

Hang on. Yes. That's about the right level to be thinking about it, Brandon.

Operator

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

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

So maybe to start with the quarter, there were some onetime items that you've called out in the prepared remarks. So I was wondering if you could just help us understand if all of these items were baked into the guidance that you gave for 2019. I just wanted to get a better understanding of how things performed operationally in the fourth quarter versus what you expected?

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

Refer to Mark's opening slide for the components of the OR change and the EPS change, some of which were nonrecurring, others of which represent core earnings production during the quarter. Mark?

Mark George

Yes. So the -- when you go back to the appendix chart, basically, the property sale, we -- in 2018, we knew when we were building the 2020 -- sorry, the 2019 plan that we wouldn't be having a similar sale of that size. But the receivable write-off and the 2 asset impairments that we incurred in Q2 and Q4 were unforeseen. So those impacts are clearly not contemplated when the 2019 guidance was given.

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

And there were some other things that the taxes were lower.

Mark George

Yes.

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

And tax rate was lower in the fourth quarter. That was not how we projected when we gave the guidance on the quarter.

Mark George

So basically, think about it as those 3 roads, the receivable write-off asset impairment and the retroactive income tax credit were the surprises to us at the time of guidance a year ago.

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

Okay. Great. That's really helpful. And then secondly, I wanted to ask about Intermodal. Would love to get your thoughts on domestic intermodal growth this year? And what you're expecting? And then just from a margin perspective in Intermodal, as PSR gets fully implemented? And how do you expect incremental margins within Intermodal to stack up relative to the rest of the business? I know historically, you've talked about intermodal incrementals being lower than general merchandising coal. I'm just wondering if that rank order could change post PSR.

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

Alan?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Justin, we are expecting some growth in our intermodal franchise as the year progresses. As I noted, we're collaborating with our customers to look for logistics solutions that fit their needs. And we're really fortunate because we're aligned with the best channel partners in the business, and they're focused on growth. They understand our network. And so we're collaborating to see where we can compete with truck. We're encouraged to see an inflection in spot rates and truck. We haven't seen like a big uptick in it. So the first order -- or first derivative isn't all that great, but the second derivative is. I mean it's certainly stabilized and is improving, and that's going to provide some headroom for incremental volumes for intermodal as the year progresses. In addition to new service projects -- products that we're launching. And as we go through TOP21 V 3, we're going to look at consolidating some business. We're also going to look at reopening some lights and introducing new businesses for us.

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

And Justin, in terms of the incrementals within the intermodal sector. I would say this, for the last couple of years, the incrementals have actually been excellent during periods in which we were growing volume. The -- just looking back historically, one of the things that did hold intermodal incrementals back a little bit was fixed costs associated with the intermodal volume growth i.e. terminals and equipment costs. There -- as Mark went through, we're very focused on asset cost in this plan. And in the case of intermodal, making maximum use of the assets that we have, the terminals, the equipment that we have today. And keeping to a minimum, the growth CapEx that we're putting into that business. So lots of initiatives around terminal improvement processes and particularly in the environment we're in, keeping a lid on equipment costs.

Operator

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

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

So just going back to the materials and other line item, forgetting for now -- I just want to be clear, forgetting for now the fourth quarter 2018 impact. And just looking at your quarterly run rate through 2019, you were averaging anywhere from $190 million $196 million, and you stepped down to $130 million in the fourth quarter. Is that all due to the gain that you had in the fourth quarter? And can you tell us exactly what the gain was, the amount of the gains in the fourth quarter?

Mark George

That was the property gain. The absence of the property gain from last year, which was $112 million.

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

Yes. No, I'm talking -- forget last year. I'm just talking the cadence of the materials and other line expense in the -- through 2019, was $190 million, and it stepped down to $60 million in the fourth quarter. I'm just trying to understand what caused the quarter sequential step down from what was $190 million per quarter through 2019 to drop to $130 million?

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

Some of that was the efficiencies that we achieved in material spending in the fourth quarter, as Mark went through. This is 1 efficiency pickup by virtue of having a smaller locomotive fleet. And a car fleet out there, where we incur lower equipment maintenance expense.

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

So what was the gains in the quarter, I guess, is the question I'm asking.

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

Mark?

Mark George

It was around $40 million -- $45 million.

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

So you were guiding at the beginning of the year for $30 million to $40 million for the full year, and you did $45 million in the fourth quarter. Is that -- am I getting that right?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

$40 million to $60 million.

Mark George

Well, we're guiding now $40 million to $60 million. I don't know what was said in the beginning of the call.

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

I mean we've always said that this is going to be lumpy and unpredictable. And now you do tend to get more real estate closings at the end of the year. I think that probably is a pattern that you see a little bit better gain in the fourth quarter. But it is -- we've produced about $40 million to $60 million, excluding one-off gains like we had in the fourth quarter of 2018. That's about what we'd like to do going forward. But it will vary by quarter from time to time.

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

Okay. So you were at $30 million to $40 million embedded in your guidance for 2019 at the beginning of the year. And now it came in, as I understand, at $40 million to $60 million, of which $45 million was included in the fourth quarter?

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

Right, right.

Mark George

Correct.

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

Okay. Got it. Okay.

Mark George

So we ended the year kind of at that closer to $60 million.

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

$60 million, okay, of which $45 million was all in the fourth quarter?

Mark George

That's correct.

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

Got it. Okay. And then on the tax side or the tax, I've got -- is it --- so '19 of retroactive tax adjustment would get your effective tax rate back up to around 22%, still trending fairly quite a bit below where -- was there anything else in the quarter versus the guidance that you were giving before, 23% to 24%? Or is that just a lower tax rate?

Mark George

Yes. We had more benefits than we assumed from the coal gains, which are tax exempt. In addition, we have the 45G tax credits that we just talked about and disclosed, but there was also higher deductions from stock-based compensation. So everything kind of just went in the right direction for us this year. So that's why the ETR ended a little bit lower than what we would typically guide.

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

Is there something that you would call out as just kind of an exceptional number because I don't mind lower taxes on lower expenses? But that tax -- retroactive tax adjustment. Is there anything else that was onetime in that quarter that would...

Mark George

No, there was nothing out-of-period in the quarter. No.

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

Okay. Okay, okay. And last question here is on the revenue -- so your revenue's flat for next year. The guidance that you had given through the year, last year was a little bit more on the optimistic side. Obviously, a lot of things happened unexpectedly. What confidence do you have that, while you're giving flat guidance? It is above your peer. Are you being a little bit more optimistic? Is there just the coal markets that you serve are just a little bit more advantageous. Can you give us a sense of what comfort you have that flat and rebounding off, I think you said Q1 will be the same as Q4, which is coming off a minus 7% base. That suggests it's going to be a pretty hefty growth rate, offset in the back half of the year.

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

Alan?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Yes. We are -- Walter, our growth is targeted towards the back half of the year, and it's reflecting the strength of our intermodal franchise and some revenue growth within merchandise, and it's about launching new products that generate revenue growth with our customers. We're confident that we're going to be able to execute it.

Operator

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

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

A question for Mike on train ways. Can you just clarify -- if you said that the second half met the target when you put anything plan. Was that the new or the old target that you were tracking against? And then if you can just comment on the level of confidence you have in meeting new target, especially if coal declines more than expected, maybe have some mix shift that goes towards the lighter intermodal or even if volumes come in lower than you would think at this point?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Yes. So that was against our 2019 goal. And the -- so for the full year, we met that goal for the back half, like we said we would on the calls with just TOP21 rolled in and drove train weight increases, particularly in the Merchandise market. So our Merchandise trains continue to be strong and growing in train length. Intermodal is not, and that's an area we have to continue to focus on. And the phase 3 of the TOP21 plan does that.

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

Okay. So despite the lower mix of coal, the key is really phase 3 in terms of building bigger and longer trains, even if volumes are flat or approximately down?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

So it's phase 3. And it's what Jim talked about, this continued optimization of the network. We continually look at trains that aren't running its size as we want them to and find ways to make them bigger and without affecting service. And we're doing that as we speak.

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

A quick follow up for Mark, if I could. Just on the CapEx. You mentioned you're taking a look at some of the line items, trying to figure out the spending level. Obviously, it's a short time in the seat for now, but just want to make sure I wasn't reading too much into that because clearly Norfolk has a heavy locomotive rebuild program, but clearly, your peers are spending, in some cases, quite a bit less from a CapEx intensity. So maybe you can just expand on that a little bit?

Mark George

Yes. Look, right now, the way we spend our CapEx budget, as Jim said, it's between 16% and 18% of revenue. Roughly 60% of that is supporting the core network. It's the maintenance of way and it's the rail replacement ties and ballast. We put roughly 20% for the locomotive upgrades. And that's, again, the DC to AC conversions. And as I've learned, this replacement approach is actually generating very reliable product that's performing very well in the field, and it's actually much cheaper than buying newer locomotives. So that's logical. And then the other 20% bucket is comprised of a lot of other things, but primarily IT spend and digital technology spend. So that's kind of how we break down our CapEx. I'm getting in, and I'm just trying to understand it because it's -- obviously, it's a big use of funds for us, and we want to just -- I want to understand the disciplines around it and just pressure test a lot of the assumptions that have been in there on the adequacy and how much we need to spend. I'm not -- we're not -- that's not to say that we're going to change the guidance anytime soon. I'm just letting you know that coming in fresh, because it was in response to that question, what are the things that surprised me, it was looking at this level of spend and as I learned the industry, I'm understanding it better, but it doesn't mean I'm not going to bring a different lens to it and push a little.

Operator

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

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

Want to go back to international intermodal. Clearly, there were some headwind pull forward in 4Q. But if I recall that actually pushed into 1Q a little bit. When should we see the inflection point of those volumes turning up? And does the uncertainty of the coronavirus actually impact you guys at all? Or is that too early to tell yet.

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

Alan?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Jason, you're absolutely correct. We did see elevated international intermodal volumes in the first couple of months of 2019. And so as the year progresses, comps will get a little bit easier for us. And then that's where we're expecting to start seeing growth. With respect to the coronavirus, it doesn't help. There's no doubt about that. We've talked to our customers about that and the level of impact that they're anticipating is unknown at this point. It's all speculation. So we're paying close attention to it as are the steamship lines that we serve.

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

Okay. And my follow up is going to be on the domestic side of things. A couple of railroads, let's call it, the last 1.5 years, pulled back a little bit on some of the lanes that they serve with PSR. Do you think that there is a need for more lanes going forward once the market does tighten up in the U.S. truckload? Or do you think the lanes that the industry currently has are good enough to service and get that freight back from the highways onto the railroads?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Well, Jason, I think there's both. I think we're going to see, as the truck market tightens, we're going to see the benefits of our powerful intermodal franchise and organic growth in the lanes that we serve. And then as I noted, we're working feverishly with our interline partners and with our customers to look at new lanes that offer value to our customers and offer value to our shareholders. So this is not static. It's a dynamic review of our overall franchise, finding areas where we can provide value, and we can support our channel partner's growth. And as I noted, we're aligned with the best channel partners in the industry. So I'm pretty confident that collaborating together, we're going to find avenues for growth.

Operator

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

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

I wanted to ask a little bit about where we should be expecting headcount to come in, in 2020? Ended the year down pretty considerably. And should we be expecting that kind of run rate level? Or should we be expecting further reductions from that from where we ended the year on headcount.

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

Mark?

Mark George

We're not going to provide a specific headcount number. We are coming down again from the -- where we're going to end 2019, for sure. But as I mentioned, we're going to keep pushing it, and then we're going to see where volume goes. As we talked about, we're expecting volume to start turning a little bit for us a little bit in the back half. And if it's not there, we're going to continue to push on employment levels. But we don't have a specific number to share with you.

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

Nothing in the budget that you could give us a sense for how much additional sort of headcount reduction there should be in the year?

Mark George

No, I mean we clearly have a budget but it is not going to be something that we talk about because we will flex, just like this year, depending on where volume is, we may go heavier.

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

So you certainly saw, David, in the fourth quarter when we had to flex we do, and we did. And we pick up the pace throughout the second half, particularly in the fourth quarter. So we will do what's necessary.

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

Okay. And then, I guess, maybe just kind of sequentially, Mark, the other expense line came in at $11 million for the fourth quarter from $95 million in 3Q, 60s in 1 and 2Q. Is there anything that explains that sort of sequential step down in the other expense line for 4Q?

Mark George

I think -- yes. it's a little bit of the land sale, is the gains that we had that were back-end loaded from the property sales that we talked about. So we had more land sales that came through in the fourth quarter compared to the prior 3.

Operator

Our 1 final question coming from the line of Jordan Alliger with Goldman Sachs.

Jordan Robert Alliger - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Just a quick question. A lot of talk on the domestic intermodal front. But I'm just curious can you talk about international, what proportion of your intermodal franchise is international, whether it be volume or revenue? And how do you think about that as we approach 2020, given still the noise around tariffs? And I'm just sort of curious also what the how that -- the international franchise actually performed in 2019? Just a relative sense for looking forward?

Alan H. Shaw - *Norfolk Southern Corporation - Executive VP & CMO*

Jordan, our International Intermodal franchise is about 35% of our overall intermodal franchise as measured by volume. As I noted earlier, it -- we're running up against some pretty tough comps to start the year with the pull forward of activity in the fourth quarter of 2018 that bled over into the first quarter of 2019. We're expecting that it will -- the comps will improve as the year progresses. But as with all of our markets, we're generally not expecting growth until the second half of the year.

Operator

This concludes our question-and-answer session. I will now turn the call back over to Mr. Squires for closing comments.

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

Thank you, everyone. We appreciate your questions this morning and look forward to talking with you again when we announce our first quarter 2020 earnings.

Operator

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