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Norfolk Southern Corp. (NSC)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to Norfolk Southern Corporation Fourth Quarter 2020 Earnings Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce Pete Sharbel, Senior Director of Investor Relations. Thank you. Mr. Sharbel, you may now begin.

Peter Sharbel

Senior Director-Investor Relations, Norfolk Southern Corp.

Thank you, and good morning, everyone. Please note that during today's call, we will make certain forward-looking statements which are subject to risks and uncertainties and may differ materially from actual results. Please refer to our annual and quarterly reports filed with the SEC for a full discussion of those risks and uncertainties we view as most important.

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

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

James A. Squires

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

Good morning, everyone, and welcome to Norfolk Southern's fourth quarter 2020 earnings call. Joining me today are Cindy Sanborn, Chief Operating Officer; Alan Shaw, Chief Marketing Officer; and Mark George, Chief Financial Officer.

I'd like to begin today by recognizing the hard work and dedication of all of our employees who persevered and adapted throughout 2020 to serve our customers and communities and enhance shareholder value. As the past year unfolded, change was one of the few constants, driven by the COVID-19 pandemic as well as a global shift in energy markets that significantly impacted our business. Our people day in and day out ensured that our railroad was positioned to succeed by delivering for our customers' changing needs, while seizing efficiency opportunities that produced record productivity levels and advanced our PSR based operating plan.

Moving to our results on slide 4. For the quarter, EPS was $2.64, and the operating ratio was an all-time record at 61.8%. Prior to summarizing the full-year results, I'll highlight two previously disclosed non-cash charges. First, recall in the first quarter, we launched a rationalization of our locomotive fleet by 703 units, which resulted in a non-cash charge of $385 million. This was possible due to the deep and lasting efficiency that we've driven into our train network through precision scheduled railroading. Next, in the third quarter we disclosed a $99 million non-cash impairment charge related to an equity method investment. I will speak to full year results, excluding both of these charges.

For the full year, revenues declined 13% as we experienced significant disruption in business levels from the dual impacts of the global pandemic and energy market changes. In response, we pressed forward with PSR initiatives

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and quickly adapted to control costs. And as a result, we more than offset the revenue decline with a 14% reduction in adjusted operating expenses. The adjusted operating ratio improved to 64.4%, which marks the fifth consecutive year of improvement.

As we managed significant volume fluctuations throughout the pandemic, we idled four additional hump operations, streamlined our resources and completed a redesign of our southern operations around Atlanta ahead of peak season. Since our launch of TOP21, we've completed a total of six hump rationalizations, and we've substantially reduced our asset requirements. Our ongoing efforts to improve fuel efficiency and resource productivity produced our best results to-date.

These actions contributed to another year of operating ratio improvement on an adjusted basis, and are especially crucial to drive profitability and efficiency even further in 2021. We see ample opportunity to effect more positive change and remain focused on closing the OR gap with the industry. Moving into 2021, we are committed to providing a superior value to shareholders and best-in-class service to customers through an efficient profitable operation, building further upon record productivity and efficiency gains to foster a platform of growth.

Increasing resilience in our service offering and creating latent capacity to grow with our customers is in lockstep with our goals to grow profitably and efficiently. This alignment is paramount as we continue to leverage our superior positioning to consumer and industrial markets that have been proven growth drivers for Norfolk Southern. We will leave no stone unturned as we drive efficiency and create value for our shareholders.

I'll now turn the call over to Cindy.

Cynthia M. Sanborn

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

Good morning. When I spoke to you last quarter, I had been at Norfolk Southern for less than two months, but I had already found a strong foundation and opportunities for us to maximize the value of our franchise. The most recent quarter has reinforced my belief in the magnitude of opportunity in front of us and that we are positioned to capture that opportunity.

During the fourth quarter, we saw volumes continue their climb from pandemic induced lows earlier in the year, so the mission of the operating team was handling more business while reducing resources and improving productivity. Our push for efficiency led to record train weight and record train length in the quarter.

These larger trains, combined with our strategy of better matching train size and locomotive horsepower, drove us to record fuel efficiency and enabled us to get the job done with a smaller workforce and a record low count of locomotives. I also have to thank the people that make up our operations team in all crafts. We achieved these records due to their hard work, and most importantly, we did so safely.

Turning to slide 7, our network performance throughout most of 2020 was strong, with many metrics at or above record performance levels even with unprecedented volume volatility. We accelerated network changes in the fourth quarter ahead of holiday peak season and as volume reached the highest point of the year.

As you can see on the slide, our network fluidity metrics came under pressure as the quarter progressed. It is important to note that implementing these network changes as soon as possible, while challenging, is a key to future success with our ongoing efficiency and growth initiatives, which I'll cover in more detail shortly. I can confidently say that we are meeting these challenges head on and have already improved fluidity in the first quarter as the black line on the graph indicates.

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We are focused on executing and improving the plan and when necessary and justified, deploying temporary resources to quickly address congested areas. For example, while we put locomotives into storage this quarter, we will use those locomotives temporarily, if needed, before returning them to inactive status. I have been very pleased with the way the team has risen to the challenge, especially during the holiday peak season when they upped their game to meet service expectations even with additional premium intermodal traffic.

Moving to slide 8, traffic coming back is both our challenge and an opportunity. We can and will add resources to meet customer needs, but first, we must explore every option to fully utilize our existing crews and locomotives. We eliminated a lot of structural costs, including indirect and supporting costs, during the pandemic and we are being very careful to keep those costs from creeping back.

Before we add a new service, the team goes through an extensive vetting process to explore the alternatives, including rebalancing traffic between existing trains and tactical extra trains. The focus is on using additional volume to help us increase the value we bring out of each locomotive and each crew start. Railcar velocity is our touchstone throughout, as we push to quickly move volumes through the network.

We have also made our organizational structure within operations more efficient during the quarter by reducing from nine to six geographic divisions and delayering our management structure to speed decision-making and ensure that communication is clear and quick. As Alan will explain, we are preparing for significant volume growth in 2021.

On slide 9, our six techniques that will help us get maximum leverage from additional traffic. Full pin is a technique used to optimally match train size with the pulling power of locomotives. While volume fluctuations can make this challenging, full pin drives fuel efficiency, controls crew starts and improve asset turns. Increasing the blending of different kinds of traffic on the same train supports full pin and minimizes additional train starts. We improved car velocity by blocking cars for the most distant possible destination, reducing yard costs by minimizing handlings.

While we have we have reshaped the network through our four recent hump yard conversions, we are successfully minimizing hiring and training costs by helping furloughed employees in one craft transfer to another. This helps both the employee and Norfolk Southern. Those craft transfers are one way we are being more agile, flexing our resources up and down in sync with traffic volumes. We adapted the plan quickly through the pandemic, and we continue to exercise that muscle memory.

Finally, we are dynamically managing our operation to handle traffic fluctuations, keeping cars moving even when volume spikes. I am confident that we can meet customer expectations with our fast, efficient network.

With that, I will turn it over to Alan.

Alan H. Shaw

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

Thank you, Cindy, and good morning, everyone. Headwinds related to COVID-19 and energy markets challenged volume in 2020, with revenue improving sequentially through the second half of the year. Throughout the recovery, we continued our focus of project-driven growth and margin improvement, supported by our market approach and service product.

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As you can see on slide 11, the dual shock of the pandemic and declining energy markets pressured volumes in 2020. However, volume in both our intermodal and industrial markets, excluding energy, returned to growth during the fourth quarter as the economy continued its recovery from the pandemic.

Turning to slide 12, full-year 2020 revenue decreased 13% and total volume declined 12%. While our business capitalized on a V-shaped recovery in consumer-driven markets, year-over-year declines persisted in energy, which accounted for more than 70% of the 2020 revenue decline. Our continued commitment to margin improvement partially mitigated these impacts, resulting in RPU less fuel increases in all three business groups during each of the last four years. The mix impact of increasing share of intermodal volume relative to decreasing energy volume resulted in the total RPU decline.

Merchandise revenue fell 11%, with almost all markets experiencing pandemic-related losses. Notably, energy-related commodities face supply and demand shocks, prompting high inventory levels and record low commodity prices. Most prominent in the second quarter, dramatic declines in manufacturing and vehicle production placed downward pressure on steel prices and production for much of the year.

Intermodal revenue recovered significantly in the second half of the year. However, first half losses resulted in a 6% revenue reduction and a 2% decline in revenue, excluding fuel, for the full year. E-commerce and consumer-driven business supported the intermodal recovery, particularly in our premium segment.

Secular declines in the coal industry accelerated during the pandemic as coal revenue and volume dropped 37% in 2020 in the face of declining low demand with product substitutes gaining market share. Utility volume fell sharply year-over-year due to sustained low natural gas prices, reduced industrial power demand and high stockpiles. Lower seaborne coal prices were a headwind entering 2020 which, coupled with the onset of COVID-19 and import restrictions, led to challenged volumes, especially in the second and third quarters.

While pandemic conditions negatively impacted revenue and volume in 2020, we maintained our focus on delivering a service product that enables our customers and Norfolk Southern to grow as the dynamic transportation environment continues to strengthen. This approach supports our strategy of providing a truck competitive, consistent and reliable service product to our customers, allowing our customers to compete, while creating operating leverage for Norfolk Southern and adding value for our shareholders.

Moving to slide 13, our fourth quarter revenue results improved sequentially and outperformed normal seasonality as the economic recovery gained momentum. Total revenue for the quarter was down 4% year-over-year as energy declines outweighed the year-over-year growth in both intermodal and merchandise, excluding its energy components. RPU declined, reflecting lower fuel surcharge revenue and the negative mix effect of higher intermodal and lower coal volume.

Within merchandise, both volume and revenue were down 5% year-over-year, driven by declines in crude oil and natural gas liquids. Crude oil shipments were heavily impacted by reduced global consumption due to COVID-19, leading to lower refinery run rates, significant storage worldwide and unfavorable price spreads.

Shipments of natural gas liquids were also down significantly due to additional pipeline capacity, coupled with lower consumption. Partially offsetting these declines were gains in soybeans from increased opportunities for export. Reflecting our long-standing focus on margin improvement, merchandise quarterly revenue per unit less fuel increased year-over-year for the 23rd consecutive quarter.

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Intermodal business levels grew meaningfully year-over-year as we leveraged our powerful franchise to secure new opportunities from the surge in e-commerce activity, record tightness in the trucking sector and recovering global demand. Excluding fuel, fourth quarter revenue increased 11% year-over-year. Domestic shipments were up 7% year-over-year, propelled by a more than 30% increase in premium shipments. Revenue per unit less fuel reached a record level in the fourth quarter, marking the 16th consecutive quarter of year-over-year growth.

Our coal franchise experienced continued declines amid low energy prices in the fourth quarter. Thermal export volume increased, which was more than offset by a 40% decline in utility tons. Our utility franchise faced continued pressure from low natural gas prices, renewable generation, and reduced manufacturing output. In total, coal volume fell 25% from the same period in 2019. Record level revenue per unit less fuel was driven by positive mix within our utility markets and volume shortfalls.

Moving to our outlook on slide 14, we are closely monitoring economic developments and the attendant impacts on our franchise. Markets have not recovered equally. The consumer-driven market recovered first and has exceeded pre-pandemic levels, while manufacturing markets have been slower to recover with existing social distancing protocols and labor force participation. Although economic uncertainty persists, current trends support optimism for our business in the coming year, with an improving manufacturing sector and expected strength in consumer spending.

With respect to the merchandise markets, we expect a steady recovery in manufacturing activity to support our customers' efforts to rebuild inventories and meet increasing demand. Total manufacturing activity is accelerating, driving opportunities across our merchandise segments. Supply chain disruptions and supplier shortages have further impacted inventory levels downward, creating additional need for increased activity in the coming months.

Prices for steel are up more than 80% year-over-year, which will lift production and trade activity. US light vehicle production is expected to exceed 2019 levels by 3% in 2021, which will support automotive volume in adjacent markets like steel and plastics. Housing remains a growth story, resulting in increases in construction activity. Growth in our agriculture and forest products segment will be led by agri fuels and food service-related markets as consumer gasoline demand returns and the service sector recovers, although most energy-related markets are expected to remain challenged.

Projected strength in consumer spending, low inventory levels, record tightness in the trucking industry and our best-in-class channel partners will continue to spur growth in our robust intermodal franchise. Goods spending is forecasted to rise 7% in 2021 due to continued pandemic induced spending patterns and high levels of personal savings, triggering increased demand for our intermodal product. Our outlook for coal remains pressured by high stockpiles that will lower utility volumes. Partially offsetting these declines will be export thermal and domestic met volumes projected to increase as the global recovery from COVID-19 continues into 2021.

In summary, we expect 2021 revenue growth as overall economic conditions improve throughout the year. We are constantly adapting to the evolving needs of our customers, providing valued transportation solutions to the marketplace. We recognize that sustainable low-carbon transportation is essential to our customers and our growth strategy. We remain committed to our efforts to improve fuel efficiency, modernize our fleet with energy management solutions and partner with our customers to prevent pollution.

Our leadership and sustainability is resonating with our customers and the markets we serve, validating these efforts. We are confident in our ability to leverage our value in the marketplace to secure new opportunities to support our customers' growth and grow our margins.

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

Mark R. George

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

Thank you, Alan, and good morning, everyone. On slide 16, you'll note Q4 2020 was free of any non-core items, meaning, the OR improvement of 240 basis points was clean. We did, in Q4 2019, report a non-operating asset impairment of $21 million that adversely impacted EPS by $0.06, and a $19 million retroactive income tax credit that aided EPS by $0.07. So with the absence of those two items, core EPS improvement this quarter was $0.10.

Moving to the fourth quarter highlights on slide 17, revenue was down 4% on volume that was down 1%, as mix and fuel surcharge headwinds continued. Against that 1% decline in volume, we drove down operating expenses by 8% in the quarter, as benefits from workforce and asset productivity continued to grow. As a result, operating income actually grew in the quarter by $22 million or 2%, and the operating ratio improved to 61.8%, a 240 basis point improvement over Q4 of 2019.

This is a record low OR for Norfolk Southern and we are well positioned to continue driving this down in 2021 and beyond. The margin improvement achieved in the fourth quarter capped off a year in which free cash flow improved by 14% to $2.1 billion, another record for NS.

Moving to a review of operating expenses on slide 18, total OpEx was down $139 million or 8%. Fuel was down $87 million, with lower pump prices contributing to $62 million of that reduction; and consumption was down $21 million, led by [ph] fewer GTMs (00:22:15) as well as a 3% improvement in fuel efficiency in the quarter.

Comp and benefits are down 7%, led mainly by employment cost, with the workforce down by 3,300 or 15%. $10 million in onetime separation costs for certain craft employees partially offset these savings. Purchased services was down $41 million or 11%, and we're making progress on the structural and semi-structural costs within this category, as well as due to the absence of detouring costs, associated with flooding in the prior year.

Depreciation increased modestly, by less than 1%, as we've been able to successfully reduce asset intensity, including within the locomotive fleet, which continues to have ample surge capacity to absorb growth. Materials were down 7% due to lower spend associated with the smaller and more productive locomotive fleet.

Lastly, gains on the sales of operating property was $11 million in the quarter, a decline of $32 million versus the prior year. So another quarter of expense reductions, far in excess of the volume decline, leaving us well-primed to deliver strong operating leverage as 2021 unfolds.

Now turning to slide 19 for the remainder of the fourth quarter P&L. Below the operating income, you'll see that other income net of $43 million is $25 million better than the prior year due to the absence of the $21 million impairment of natural resource assets in Q4 2019. We also had another quarter of healthy gains on our company-owned life insurance investments. Our effective tax rate in the quarter was just under 23%, helped by the COLI gains that are exempt from income taxes. Net income increased by 1% and EPS rose by 4% as we ramped up share repurchases to nearly $500 million in the quarter.

Now, for a look at the full year on slide 20. And to preface, I'll speak to the adjusted numbers on this slide, excluding the impacts of the two non-cash charges during the year, the $385 million locomotive rationalization and the $99 million investment impairment. Despite the unprecedented volatility in business volumes that resulted in a 13% decline in revenues, we maintained focus on our long-term operational transformation, while adapting to the market changes that were induced by the global pandemic as well as the contracting energy markets.

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In the midst of this, we produced record workforce productivity, locomotive productivity and fuel efficiency, which allowed us to more than match the revenue decline with a 14% reduction in adjusted operating expenses, while ensuring we are ready to serve, improving freight demand as the economy recovers. The adjusted operating ratio posted improvement to 64.4%, the fifth consecutive year of improvement. But there's more under the covers when we look at the 30 basis point improvement for the year.

Moving now to slide 21, you can see during the second quarter of 2020, the 29% hit to revenue on a year-over-year basis took a toll on the operating ratio, but every other quarter of the year improved in the 230 to 240 basis point range. Throughout the year, and especially during the depths of the pandemic-induced volume trough, the team really pressed forward to adapt our operating plan to the changing business environment. In fact, two of the four hump idlings during the year occurred within Q2.

And when the nationwide automotive network shut down, we completely redesigned our auto plan to absorb it into existing trains. In addition, we continued to press lower on resources and ensure that we were able to service surge in demand as economic activity increased, which is exactly what happened. We maintained a heightened sense of urgency to transform the business, while ensuring we are positioned for long-term success and further margin improvement.

Moving on to cash flow on slide 22, although 2020 cash from operations came in under the 2019 levels, spend on property additions for the year was right in line with the reduced target we set earlier in the year of $1.5 billion, which was a 26% reduction from 2019 levels. We pivoted early in the year to this reduced CapEx target at the outset of the pandemic and executed the plan while keeping priority on the health of the physical network. Thanks to these tight controls on both capital and operating expenses, free cash flow improved to a record $2.1 billion, while shareholder distributions totaled $2.4 billion. Average share count declined by 3% with over $1.4 billion of buybacks as we maintain tight focus on returning capital to shareholders while maintaining strong liquidity.

To close, we have excellent momentum on improving both our cost and asset structures while we deliver on the growth in 2021. We expect this formula to yield even greater margins and cash flow and we remain committed to delivering significant returns for our shareholders.

With that, I'll hand back over to Jim.

James A. Squires

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

Thank you, Mark. Turning to slide 24, I will wrap up with our 2021 expectations. As you heard from Alan, we expect segments related to manufacturing and consumer activity to drive growth while energy-related commodities are likely to remain challenged. We are modeling total revenues up approximately 9%, with intermodal leading the way, merchandise growing solidly and coal declining. The power of our intermodal and merchandise segments to propel us to growth despite the secular decline in coal highlights the continuity of our strategy over time.

As we move ahead, we will leverage many avenues to drive long-term volume and revenue growth, including a fast and reliable service product, the advancement of technology initiatives such as AccessNS and Rail Pulse, just to name a couple, and our steadfast commitment to being a sustainable and socially responsible corporate citizen. With this positive momentum, we expect to achieve greater than 300 basis points of all our improvement in 2021 versus our adjusted 2020 result and to end 2021 with a full year run rate of 60%.

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As we have said before, when we achieve our targets, we won't stop there. In addition, we expect capital expenditures to approximate $1.6 billion, with a dividend payout ratio of 35% to 40%, an increase versus our prior target payout ratio of one-third. As we demonstrated in 2020, we are committed to protecting liquidity while using remaining cash flow and financial leverage to repurchase shares.

We are optimistic about growth in the year ahead and we'll advance productivity initiatives to bring freight onto the railroad more profitably than ever. We know there is more improvement to be made across the organization, and we'll continue executing on our commitments to drive efficiencies and create long-term sustained value for our shareholders.

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

QUESTION AND ANSWER SECTION

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

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Q

Hey. Good morning. Thanks for taking the question. Maybe just one for Cindy on just the service levels, you mentioned that you had some challenges when you were doing the redesign in the fourth quarter, but you expect them to improve. So maybe you can give us some level of confidence as to how you're applying some of the resources tactically across the network, what sort of issues you've had to face and just how you feel about hiring in the pipeline as you start to get ready for this type of growth in 2021.

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

A

Hey, Brian, thanks for the question. So, as we went into the fourth quarter with some of our operational changes, our Southeast plan, I also referenced in my prepared remarks some organizational changes that we made. And in fact, we did reduce our locomotive fleet by about 100 locomotives during the quarter.

So, as we digested a lot of those challenges, we were starting to run a little slower and we did, in fact, inject a little bit of support from a resource perspective in temporarily. I would also add that, as we were recovering from some of the challenges that I described, we did have some COVID impacts with some of our employees out as part of the COVID protocols and also ill as individuals.

So that was how we were – kind of how I would diagnose the fourth quarter. As we come out of the fourth quarter, running through the holidays to get back on our feet, we've gotten a lot better. We are not at 2020 levels, but we are much, much better. We are continuing to tweak and take resources out in terms of consolidating trains so we still have opportunities to digest changes within the network. But as necessary, we will inject some resources in to make sure that we recover quickly from challenges that we may have.

From thinking about the volume that we're seeing, I think some of it is in unit train, and that will require resource use a little bit different than our scheduled network, but I will tell you that in our scheduled network, we still have a

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lot of opportunity to consolidate trains, make them longer and make them heavier, even on top of the [ph] gains (00:32:55) that we made in the fourth quarter.

And I could tell you that even in our intermodal fleet, for example, our intermodal train operation, we've got about 10% of our trains are operating over 10,000 feet. So we still have some opportunity to grow in that space. And that should help us manage our head count in this year to flat to down from where we exited December of 2020. So, I'm pretty confident we'll continue to make some gains there and also our locomotive fleet.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Q

Great. Thanks, Cindy, for the details there. Maybe one for Mark, looking at the gains, I think you said it was about $11 million in the quarter, looking at the cash flow, I think it implies something a little bit higher than that just looking at the gain on disposals, so maybe you can clear that up for me. And then, just give us a sense as to what you're expecting for gains in 2021 when you look at that 300 basis points of OR improvement.

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

A

Yeah. The property gains, Brian, were – in the quarter, the fourth quarter were $11 million. We ended up the year at really $26 million of gains, a little shy of where we had intended or thought. And the guidance for 2021 is to be in that $30 million to $40 million range. But you know these property gains are lumpy and they can move around. And we'll provide some transparency. And if we have bigger ones in a given quarter, we'll call them out and let you know.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Q

Got it. Thank you, Mark.

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

A

Thank you.

Operator: The next question comes from the line of Scott Group with Wolfe Research. Please proceed with your questions.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Hey, thanks. Good morning, guys. So Alan, I want to start with you. On the 9% revenue growth, can you give us directionally how much is volume versus RPU? And then, in the fourth quarter, coal RPU was really strong, was there any liquidated damages or is that just the mix? I'm just trying to understand if that's sustainable or not.

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

A

Scott, as we look into 2021, we are projecting very strong growth in both our intermodal and automotive markets as well as our merchandise ex-energy. We expect energy revenues to remain about flat. They accounted for about 75% of our revenue decline in 2020. So, we're not going to have that headwind, which is going to uncover

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the growth in the other markets. And we're targeting 9% revenue growth, upper single-digit volume growth. So modest RPU growth just because of the mix impact of intermodal leading the way.

With respect to coal, I mean, you got it right. We did have about $12 million of incremental year-over-year in volume shortfall which aided the RPU. We also had positive mix within our utility franchise in which our utility North volume, which, as you know, is shorter haul, was down about 50%, and our utility South volume was down about 30%. And then we also got some good pricing too in some of our markets as well. So all of that rolls up into the overall RPU improvement that you saw within coal.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Okay. Helpful. And then, Mark for you on the cost side. So it sounds like full year head count is going to be down a couple of percent, but maybe help us think about some of the other pieces on the cost side, I don't know, comp per employee, purchased services, depreciation, any other big items you can help us with. Thank you.

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

A

Scott, are you referring to 2021?

Scott H. Group
Analyst, Wolfe Research LLC

Q

Yes.

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

A

Or 2020?

Scott H. Group
Analyst, Wolfe Research LLC

Q

2021. Just in terms of some of the guidance you could give us on comp per employee, purchased services, any of the other pieces.

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

A

Right. So for comp per employee, you can expect the traditional year-over-year inflationary rate increases of a few percent but you're going to also have some incentive headwinds as well. Clearly, we didn't pay out on incentive compensation at target this year. We fully expect to be at or above target next year, so you'll have pressures there. In addition, you're going to have some pressures on certain variable costs like purchased services and rents as that go with volume. And we are, though however, pushing on efficiency and productivity to help mitigate some of those things.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Is there any way to just say what the headwind would be from incentive comp just going from a partial payout to a full payout?

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

I'm not going to put a finer point on that just yet, Scott, but you can probably compute that, this year, incentive comp was down and we expect that, that is going to bounce back and hopefully bounce back significantly. But we'll provide a little bit more guidance on that as we get into the year and we start to see how the trends are going.

Scott H. Group
Analyst, Wolfe Research LLC
Q

Okay. Thank you, guys.

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

Thank you.

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

Bascome Majors
Analyst, Susquehanna Financial Group LLLP
Q

Yes. Thanks for taking my question. I wanted to go back to some of the merchandise markets where the outlook is pretty constructive outside of energy. I mean we got steel prices through the roof. You mentioned auto. But could you talk with what you're hearing from your customers? I mean, are there discrete items where you have plants reopening, utilization rising? Like, how much visibility do you have into this turning into a real sequential volume acceleration versus just seeing some of the indicators in a very different backdrop from what we saw in the first six months of last year? Thank you.

Alan H. Shaw
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.
A

Yeah. Bascome, I think we've got pretty good visibility into this, at least for the next couple of quarters. You saw our merchandise ex-energy rotate into growth year-over-year during the fourth quarter, so – and we're continuing with that level of momentum. As you noted, steel prices are at like, 12-year highs, right? And so our customers are talking about adding back capacity. The corn market or I should say, the corn, wheat and soybean market, those commodity prices are about six-year highs, and then the housing market is about as strong as it's been in 14 years.

And so, you couple that with the fact that wholesale inventory levels are close to two-year lows, and there's a lot of demand for our product out there. Even in the paper market, those who make corrugated cardboard, they're sold out because of the proliferation of e-commerce. So across the board, we're seeing strength in our merchandise network which gives us a lot of confidence as we move into 2021.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP
Q

And as that grows, should we expect the traditional relationship where you're able to add cars to existing trains? Or have some of the train link gains that you've made maybe limited that normal kind of cyclical calculus that we're used to?

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

A

No, you're exactly right. Cindy highlighted that a little bit. We've got capacity for growth. Since most of our growth is going to be oriented towards consumer and manufacturing, that's generally carloads, small block shipments, and that's going to fit neatly into existing intermodal and merchandise trains. Just a data point within our intermodal franchise, we've really been working on our productivity and train weight has improved year-over-year, about 900 basis points more than train length. So right there you can visualize kind of vertical stacking of and creating more revenue density, improving productivity of crews and fuel and locomotives.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP

Q

Thank you.

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

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks, operator, morning everybody. Congrats on the results. Alan, I guess the first one's for you. If we look back at 2020 and compare the volume performance to your closest competitor, there was significant volume underperformance. And this is not a critical question, it's more of a – I'm just trying to understand what's behind that, specifically as it relates to merchandise. Sorry. [indiscernible] (00:42:03)

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

A

Yeah. Amit – I'm sorry, could you finish the last part of your question?

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. I'm just trying to understand, CSX has a lower cost structure, for now at least. I'm just trying to understand, is the volume underperformance relative to CSX over the course of 2020, specifically in merchandise, is that a pure market share shift? Or is there something beneath the numbers that maybe explains it better? And if you can also talk about how you expect that relative performance to trend over 2021.

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

A

Yeah. I mean, we talked about this a lot last year. We are fierce competitors. We're going to go out there and we're going to compete for every pound of business that's available to us, both with our Eastern rail competitor and within that $800 billion truck and logistics market. We've got a lot of confidence in our franchise. We've got a lot of confidence in our customers. And you can take a look at revenue [ph] per revenue ton mile (00:42:59) comps and you can see our focus really is on helping our customers grow and margin improvement.

Specific to merchandise, let's say that the year-over-year gap between us and our Eastern rail competitor was about 550 basis points in the fourth quarter, 400 of that was just in energy. 400 basis points. So that's over 80% of it. And I've talked about as we led into the fourth quarter that we were about to run up against the most difficult comp of the year with respect to crude oil. And that certainly played out. So, those energy headwinds that we saw

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last year which defined about close to three quarters of our overall revenue decline are not something that we expect to see this year.

We're not calling for growth there. And if that does happen, we're well positioned to handle it and to profit from it. And we are seeing some signs there that commodity prices are strengthening, and thermal coal is in pretty high demand in the worldwide market. But we're not expecting that level of headwind this year, which is why we really believe we're going to rotate into pretty strong growth, led by our intermodal and our merchandise ex-energy franchise.

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Q

Great. Okay. That's really helpful and encouraging. My second follow-up, I guess, for Cindy or Mark, when I look at the guidance it implies kind of mid-to-high 70% incremental margins, which is a really nice – a nice number. I guess, if you just break it down in terms of dollar cadence, you're basically projecting a $900 million increase in revenue and like a $200 million increase in expenses which is a very good performance.

And I think it would be helpful to, I guess, Cindy or Mark, just talk about your confidence level in terms of being able to achieve that. How much relies on price and how much relies on just blocking and tackling and be able to control the cost structure and just your overall confidence in being able to achieve that?

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

A

Sure, Amit. I'll start. Cindy can provide some color. But, yeah, look, the cost inflation, as I had mentioned, we're going to be fighting some traditional inflation in terms of wages, but we are looking to really hold head count flat or perhaps even drift down from where we ended this year, and that's largely going to be dependent upon where this incremental volume comes, as to how aggressive we can get on constricting some of those head count-related costs.

But we feel pretty good and pretty confident with our plan to manage it that way and mitigate some of the wage inflation. We do have fuel inflation in our cost as well, as well as you have normal step-up in depreciation. But other areas we're baking in some efficiency and productivity gains in multiple levels in the P&L. And I think we feel, like Cindy had talked about, we have the capacity, we can make our trains longer. Yes, when we have unit train type of traffic, we're going to have to add some crews and cost. But aside from that, Cindy, would you add anything?

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

A

No. I think that sums it up very, very well. And I think while we're very encouraged by the growth. And we want to serve our customers and have a great service product out here, if it doesn't come, we're going to take appropriate action. So we have a lot of opportunity even with – to absorb existing growth we need to consolidate trains and consolidate cars, so just focus on our car velocity initiative. But we will pivot, if we need to pivot. So the team has – we got a lot of momentum here. If you look at the results coming out of the fourth quarter and the first, a lot of momentum, and we'll drive it home.

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Q

Great. Okay. Thanks very much everybody. Good luck. Appreciate it.

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

A

Thanks, Amit.

Operator: The next question is from the line of Walter Spracklin with RBC Capital Markets. Please proceed with your questions.

Walter Spracklin
Analyst, RBC Capital Markets

Q

Thanks for taking my question. Good morning everyone.

A

[ph] Good morning (00:47:13).

Walter Spracklin
Analyst, RBC Capital Markets

Q

So I just thought I'd – yeah, just starting on some of the more administrative. The other income line that you flagged, can you – that's jumped around quite a bit quarter-to-quarter. It had an impact in the last couple of quarters as well. Can you give us some guidance as to what to expect on a general base level on a quarterly basis in that other income line going forward?

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

A

Thank you, Walter, for the question. So, look, the main driver of volatility in that line is [indiscernible] (00:47:45) returns on our company-owned life insurance investments, which are invested in a combination of both equities and fixed incomes. So it does move around quite a bit depending on market performance, and that's why you see the volatility you see. We've guided historically that other income would be in that $80 million to $100 million range, but frankly, it will move around quarter-to-quarter. And if markets deteriorate, it's going to be a potential headwind for us, but we've enjoyed pretty good healthy gains here these past couple of years.

Walter Spracklin
Analyst, RBC Capital Markets

Q

Yeah. Absolutely. And you were guiding historically for 23% to 24% tax. You've had a good run with lower taxes this year, what would be your expectation on the tax rate for 2021?

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

A

Yeah. So, you're right. We guided 23%, 24%, we're not going to change that guidance right now. We know that there is tax law being debated and whether the federal statutory rate moves up to 28%, which is what the current administration is aiming for, we don't know the timing, we don't know if there'll be some compromise at a lower rate. But our better performance than the guide, it's really driven by, in large part, the company-owned life insurances, those gains are non-tax. So that definitely provides us tailwind, which is why we've been better past couple of years than the guided rate. We're not going to bake that in and anticipate more tailwind from that here in 2021. So we're going to stick with our guide of 23% to 24%. Thanks, Walter

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

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

Thanks very much and good morning. I'll just stick to one here. There's certainly been a lot of talk across the industry about congestion in LA, Long Beach and in Chicago as a result of the import surge that we've seen. Is that having a collateral impact on Norfolk Southern? And if so, how are you working with shippers and your rail partners to alleviate that congestion?

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

A

Hey, Cherilyn. Good morning. The congestion out on the West Coast ports has limited the transcon volume that we enjoy. And it's also caused some of our channel partners to allocate more assets out there, which limit upside in the East.

And then with respect to Chicago, all the congestion that we're seeing in Chicago is largely outside of our intermodal gate and that's – with the drayage community and with warehouses as they go through pandemic protocols and regularly have difficulty getting people to work because of COVID concerns. And so that – what that does, Cherilyn, is it slows down the turn of the assets, the chassis and the boxes, which can limit upside volume as well.

So we're communicating really closely with our channel partners. We've got – we're aligned with the best in the business, and they're really good at what they do. And so we're working on solutions collaboratively in order to mitigate these impacts. And as a result, you saw that our intermodal revenue ex-fuel was up 11% year-over-year [ph] in the quarter (00:51:20).

Cherilyn Radbourne
Analyst, TD Securities, Inc.

Q

Thank you.

Operator: Next question is from the line of Allison Landry with Credit Suisse. Please proceed with your question.

Allison M. Landry
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks. Good morning. So, just clarifying on the 60% run rate by the end of the year, is this how we should think about Q4? Or would you expect this to be more of a second half run rate?

And then if you could comment on your expectations for the Q1 OR, some of the other rails have been a bit cautious on both year-over-year improvement and are also pointing to sequential deterioration that's a bit worse than normal. So is that a fair way to think about Q1? And then just if you could clarify on the run rate for the 60%.

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

A

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Allison, this is Mark. Thanks for the question. We're not going to get into the quarterly guidance for Q1, volume will play a role, obviously, volume has started strong here. But as you know, Q1 typically is the highest OR quarter that we do have. There are some seasonal cost reasons for that, whether or not – I would expect from a year-over-year perspective, we will show improvement each quarter. But sequentially, I'm not going to get into that yet until we understand where volumes roll out.

With regard to the timing of the year, it will also depend on the cadence of the volume throughout the year. I would expect to be on a glide path toward that 60% and it's too early to say, again, what quarter we're going to touch it.

Allison M. Landry
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. That helps. And then maybe, Mark, I guess, another one for you, maybe if you could just give us your thoughts on leverage and what you're targeting for 2021.

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

A

Sure, Allison. So we're basically staying fully committed to our BBB+, Baa1 credit rating with Moody's. So we're going to manage leverage in the course of the year accordingly to make sure that we work towards staying in bounds and stay committed again to our current rating. So, I'm not going to put an exact number of what that means in terms of incremental debt or necessarily deleveraging. But, just know that we're committed to be within the bounds.

Allison M. Landry
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay, great. Thank you, guys.

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

A

Thank you.

Operator: The next question comes from the line of David Ross with Stifel. Please proceed with your questions.

David G. Ross
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yes. Good morning, everyone. Having a conversation with somebody in the industry the other day who said that intermodal and PSR in his mind were incompatible, because intermodal is about accommodating imbalances and surges and PSR's goal is really to eliminate them. How do you think about intermodal and your PSR goals? And is there a friction there?

James A. Squires
Chairman, President & Chief Executive Officer, Norfolk Southern Corp.

A

Strongly disagree with that characterization of PSR as applied to an intermodal franchise. We believe that – and we have applied PSR principles to our intermodal network, and we'll continue to do so while maintaining intermodal as a growth engine. Cindy?

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

A

Yeah. I would say that PSR is really about simplifying things and having very good asset terms that can be done in any class of business you want to think about. And in absorbing volume growth into existing scheduled trains, mixing trains so that we – in some cases, while you will see some intermodal in the train, you'll also see manifest and other commodities. So, all of those are levers that you naturally pull with PSR and are completely compatible with any kind of business that we might be able to bring on to rail.

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

A

David, our intermodal franchise, as you know, is unrivaled in the East. It's a position of strength for us, and for our shareholders, and for our channel partners. PSR is about reducing complexity and running trains on time, which is exactly what you want in an intermodal network. And we already have a point-to-point intermodal network, with a lot – with very little intermediate switching.

We are very focused on our productivity initiatives within Intermodal to drive additional business into the existing train structure. And I noted earlier the fact that our train weight increase is about 900 basis points above our train length increase. And so, what that does is – what we're doing is we're just adding that additional business into the existing trains and improving our ability to double stack.

David G. Ross
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. And just as a quick follow-up on that, related to double stacking, are there any corridors left in the network where that's a problem and you can't take advantage of the double-stack capabilities?

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

A

We are double-stack capable in well over 95% of our line segments.

David G. Ross
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Excellent. Thank you.

Operator: The next question is from the line of Chris Wetherbee with Citi. Please proceed with your questions.

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.

Q

Hey, thanks. Good morning. Alan, maybe sticking on the intermodal outlook for a moment here, I guess you guys have done a pretty good job improving the yields on that business, ex-fuel over the last two years, I guess, in particular. When you look at 2021, how do you sort of balance the approach?

Obviously, truckload is going to have a very good year from a pricing standpoint. There obviously is some [ph] read across (00:57:04) to intermodal as a result of that. Are you going to be leaning in a little bit more on the volume side? Or is this still going to be a balance where you're looking to get more price out of the franchise?

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

A

Chris, we're going to continue our balanced approach. We've got long-term deals with our channel partners and we, frankly, take a long-term approach to the markets. We do not want to interject the volatility associated with the spot market into our intermodal rate base.

We do have a small percentage of business that's transactional and we are adjusting our rate plan there. But for the large part, we're taking measured rate increases. And you saw our rate increases benefit from that in 2019 in the first half of 2020 when we were in a freight recession. Overtime, what that means is that our rates are moving at a pace that's higher than changes in the spot market and a little bit higher than what's going on in the contract market.

So as a result, you should not see – expect to see any kind of significant rate increase in 2021, because, frankly, overall contract rates were slightly down in the truck market in 2020. It will support further rate improvements in 2022.

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Okay. Got it. That's helpful. I appreciate it. And then just a quick follow-up on CapEx, obviously, guiding down to around 15% of revenue. I think, thinking back to the sort of launch of PSR in the Investor Day, I think the guidance was maybe a little bit higher than that over the longer run.

So maybe trying to think about, how – what's changed since then? And maybe if this is more of a sustainable kind of run rate when you think about it as a percent of revenue? Or maybe that's not the right way to think about it. But just any sort of thoughts on CapEx, because obviously it's come down. And that's going to be a boost to free cash.

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

A

Yeah. Thanks. Yeah. We've took our CapEx down at a significant readjusted baseline level of $1.5 billion this past year. And we've talked throughout the year about the fact that we want to grow it modestly from here and really like to see revenue growth outpace the growth in CapEx. If that means growing into a smaller percentage, then so be it. And certainly, that's what the math equates to this year is that we will grow into a smaller percentage.

We want to do CapEx and budget CapEx based on logic and need, not just based on revenue-based affordability, for example. But that said, we've put this budget together and if Alan comes and says, we've got these certain projects we need to help drive growth, we will examine it. If Cindy comes and says, we got some work to do on siding expansions or to augment the network a little bit more from a maintenance way perspective, we'll examine it. So we're not going to be dogmatic, and I would like to kind of bury the 16% to 18% range from here.

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.

Q

Okay. That's helpful. Color. Appreciate the time. Thanks.

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

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Brandon R. Oglenski
Analyst, Barclays Capital, Inc.

Hey. Good morning, everyone. Thanks for taking my question. Cindy, I guess, I want to come back to the beginning of the call here. Did you explicitly say that head count could actually be down in 2021? And I guess, I just wanted to balance that against the comments that you've had with bringing back some unit train service and need for crews. So can you just maybe hash that out a little bit more?

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

Yeah. So guidance would be flat to down from where we ended 2020. So but – and to your point, some of the reason we would need to keep it flat would be the unit trains. So what that implies is that we're still consolidating and still figuring ways to make our scheduled network much more efficient and absorb the growth and provide a very solid service product for our customers. So that's our mission going forward. We're actively in it now and have been and I'm very pleased with momentum that we have there. And going forward, I think we'll see good results from it.

Brandon R. Oglenski
Analyst, Barclays Capital, Inc.

Okay. And I don't mean to be pesky here, and I know it's been a long call, but on the first quarter, you did say something about bringing back temporary resources. Is that going to have any impact on those metrics in the near-term that we need to be aware of?

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

Yeah. When I spoke about that, it was really about recovering from some of the challenges that we faced in the fourth quarter, including some COVID impacted crew districts where we had to move some temporary resources in from a head count perspective, those are back out now.

And then secondly, we had reduced locomotives in the quarter and some of the challenges that we had at the very end, we injected those for a very temporary period of time and have since pulled those out. So what I was talking about earlier in my commentary was really around the fourth quarter.

Brandon R. Oglenski
Analyst, Barclays Capital, Inc.

Got it. All right. Thank you.

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

Jonathan Chappell
Analyst, Evercore ISI

Thank you. A couple for Alan. First on coal. So you said in your outlook slide you expect coal to decline this year, which from a secular standpoint, I don't think anyone would argue with that premise. However, the comps are so easy from the middle of this year, the precipitous declines you saw, especially in second quarter. You've seen sequential volume increases as you've gone through the year and come out of the pandemic. The RPU increases exiting 2020, and even your – through a couple of weeks of 2021, the carload comparisons don't look that bad. So

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just – I understand that coal is in decline forever, but is there a reason why you couldn't just see a reprieve in 2021, given those factors I just addressed?

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

A

Hey, Jon, I hope you're right. I think the thing that gives me the largest pause is the status of stockpiles at utility plants. They're across our system, the publicly available numbers show they're pretty close to about 130 days. And so, that is really going to limit volumes for us. That's about 40% higher than they were this time last year.

So that's a headwind, right? And if – then you need manufacturing and you need commercial businesses to reopen to start creating that load for the utilities as well and natural gas seems to be stuck in the [ph] mid-twos for BTU (01:03:46). So that's an issue, too. So those are all headwinds.

Look, as we talked about it, if it returns, that's great. We're ready. And we've got a really good coal franchise and I do think there is some upside in thermal export coal. But we're not planning on it, and we're not baking it into our outlook. That's upside.

Jonathan Chappell
Analyst, Evercore ISI

Q

Okay. Understood. And then shifting to auto, you guys have had a really strong start to the year, really, real strong last several months. We're hearing some issues with chip shortages, potential near-term production issues. Obviously, you have a bit of a unique franchise there. Are you hearing any concerns from your customers about potential near-term shutdowns because of some of these equipment shortages?

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

A

Yeah. We've got a great auto team and they've done a very good job of building that franchise for us. Yeah, there are supply disruptions in basically many of the markets, if not all the markets that we serve. Semiconductors that you referenced is something that we've heard of as well. Although generally, the automakers are allocating the scarce resources to the SUVs and trucks and vans, which is predominantly what we handle in our bilevel product. But the auto volume will be upside for us this year.

Jonathan Chappell
Analyst, Evercore ISI

Q

Okay. Great. Thanks a lot Alan.

Operator: The next question is from the line of David Vernon with Bernstein. Please proceed with your questions.

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

Q

Hey. Good morning, guys. So, one thing that always stands out in terms of talking to the intermodal market and the railroads, the railroads are talking about advancing service levels in intermodal and a lot of the channel partners are frustrated with the handoffs at the terminals and things like that.

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If you think about your outlook for volume growth, do you get concerned at all that the channel and the terminal network is going to be able to handle that sort of mid to high-single-digit volume growth in the intermodal segment? And how are you set up to kind of handle that [indiscernible] (01:05:54) last peak season we had, we certainly saw some congestion across the intermodal network.

Alan H. Shaw
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.
A

Hey, David, good question. We talked about that briefly before, where the drayage community and slowdown in the processing and the warehousing has impacted street dwell and turns of equipment, chassis and containers and that is limiting the upside. However, even with that, we still delivered 11% year-over-year revenue growth in the fourth quarter ex-fuel surcharge.

And you can see that our volumes within our intermodal franchise at start the year are up double-digit. So we got a great franchise, we got great channel partners. Again, they're very good at what they do and managing complex supply chains. So, we're going to work with them on this. We're delivering that level of growth with our intermodal franchise now.

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

But I mean, I guess, is there anything you can do to advance the efficiency of that handoff operation? Do you need to think about that difference or the way you're interacting with channels differently, just to kind of unlock some additional growth potential? Or is it going to be just more kind of working with them status quo? Do you – I mean, I guess I'm just trying to figure out like, how do you unlock the potential that could be [ph] additive to (01:07:16) intermodal business, if [indiscernible] (01:07:19)

Alan H. Shaw
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.
A

It is – it really is about improved – I'm sorry, it's about improving the transparency and the visibility of what we're seeing and the assets that we share. And then, it's about channel partners working with their BCOs and the warehousing not getting – getting the chassis back into the gate.

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

All right. Thanks.

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

Jason Seidl
Analyst, Cowen & Co. LLC
Q

Thanks, operator. Good morning, everyone. Cindy, you talked a lot about taking some structural costs out of the network in 2020. So as you look at 2021 and beyond. Are there any structural costs left in your opinion? And if there are, when do you think you guys can address them?

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

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Yeah. Jason, so we talked about some of our terminal consolidations and hump conversions that have occurred over the last couple of years. You've seen us work very, very strongly prior to my arriving in that area. We have four actual humps left operating as hump yards. And so, we will continue to look at yards, and see how we can speed up cars. The real mission around terminal capability and terminal footprint is around keeping cars moving or not pushing cars into terminals, moving cars past terminals.

So, I think there's still some room there, quite a bit of room. But you've seen us pivot now a little bit more into looking at our train length and locomotive utilization with full pin. And that's going to – that's really our primary focus now. But we will always circle back and find opportunities to get the most out of our network and speed up cars, and terminals are one of the methods that we use to do that. So, there's always opportunity.

And as we think about growth and we see the growth that we're having in 2021 it's probably will look a little different than maybe what we would have thought in 2020. So we have to be very agile in looking at opportunities. And we will continue to do that. So I don't have a specific number for you, Jason, but understand it's – we're really never done with looking at structural costs and we'll pull that out every opportunity we can find it.

Jason Seidl
Analyst, Cowen & Co. LLC

Q

Well, thanks. That's helpful. A follow-up here, Alan, you talked a little bit about intermodal RPU, I just want to make sure I understand what you said. You said that really don't look for too much this year in terms of gains, but it's going to be more of 2022. Is that how we should think about it?

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

A

Yeah. As I talked about the arc of the improvements, Jason, and the fact that we didn't reflect the reduction in spot prices over the 18-month period in 2019 and the first half of 2020, overall contract rates were – in the truck market, on average were I think flat or down slightly in 2020. And so we're just – we take a long-term approach to this, because I don't want to interject that level of volatility into our rate structure or our customers, our channel partners' rate structure either, right? They need something that they can plan on ahead of time.

So, the truck market continues to improve and rate – contract rates actually improve this year, go up, which we think they will, then that would be reflected in improvements in the 2022 rate structure.

Jason Seidl
Analyst, Cowen & Co. LLC

Q

So Alan, how should we think about the cadence of your intermodal contractual pricing renewals? Like when do the bulk of them renew?

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

A

Well, I told you, I'd mentioned, Jason, that we've got long-term deals with our contract – with our channel partners.

Jason Seidl
Analyst, Cowen & Co. LLC

Q

Okay. Perfect. Appreciate the clarification, Alan.

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Alan H. Shaw
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.
A

Does that help? Okay. Take care, Jason.

Jason Seidl
Analyst, Cowen & Co. LLC
Q

Take care.

Operator: The next question is from the line of Ravi Shanker with Morgan Stanley. Please proceed with your questions.

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC
Q

Thanks. I just wanted to follow-up on that last point because I think that's a little bit of a surprise because I think most people do expect the rails to be at least sort of the beneficiaries of truck pricing tightness. Is this a new philosophy or was this the same approach that you guys had back in 2018 as well? I'm just trying to figure out if it's just a case of [ph] – I don't know if you're saying (01:12:00) the same thing, but in terms of different magnitudes. I mean, can you give us a ballpark of what we can expect 2021 and 2022 intermodal pricing to increase for you guys?

Alan H. Shaw
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.
A

Yeah. Ravi, let me be clear, we are going to benefit from the tight truck market. And you're going to see that both in volume and in intermodal and in merchandise. You've got – we're looking at really healthy growth in our merchandise ex-energy and in our intermodal volumes this year.

What I've talked about is our long-term approach to markets, and this is something that we've employed for years within our intermodal franchise, and it's – we don't want that level of volatility associated with the spot market into our rate structure. We do have a small portion of our intermodal business that's transactional and we are reassessing our rate plan to the positive there. However, for most of it, it's the rate increase is unwind over time.

And as a result, what you see is, overtime, less volatility and yet our price in intermodal exceeds the spot market and slightly exceeds the contract market. I mean contract rates were flat or slightly down on the truck market in 2020. We took rate increases. I mean, we've got 16 consecutive quarters of RPU less fuel improvements in our intermodal franchise and 23 consecutive quarters in our merchandise franchise. So we take a measured approach to this.

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC
Q

Got it. And maybe as a follow-up for Cindy, can you just give us an update on how we are thinking about deploying technology and automation across the network in the next year or three? Again, you've seen some of your peers start to commercialize things like automated train inspection portals, where are you guys with respect to rolling technologies out to the network?

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

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Yeah. Ravi, we are doing the exact same things, rolling – we do have plans around inspection portals, automated train inspection – or track inspection, excuse me, as well as mobility tools to help our employees be more effective and efficient and more time on tool, if you will, as well as [ph] data (01:14:31) analytics to help us manage through failures before they become failures and not have to wait for a failure in terms of, let's say, a switch failure or something [ph] on line or road (01:14:41), be able to predict that. So we've got a number of great projects that are in flight, and we're working very closely with our technology team here to get quick adoption and make our railroad safer and more efficient with the use of technology.

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC
Q

Very good. Thank you.

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

Justin Long
Analyst, Stephens, Inc.
Q

Thanks and good morning. I wanted to ask about truckload conversions in the network. Any commentary around the trend you're seeing there in the fourth quarter and the early part of this year? And as we think about the 2021 guidance, what's baked in from a conversion standpoint? Are you just making in market assumptions and truckload conversions would be upside to that? Or can you just help us think through that?

Alan H. Shaw
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.
A

Yeah. Good morning, Justin. So I think one way to think about our revenue growth in 2021 is it's – it's 9%, right? And so I've talked about how energy, which is pretty close to about 20% of our revenue base, is going to be flat. So, you can envision that for the rest of our market, which is generally the more truck competitive, we are seeing above 9% revenue growth. And that's above macro.

And so with that, implicit in that is the fact that we are going to continue to target that $800 billion truck and logistics market and leverage the strength of our franchise which includes our intermodal network and the fact that we've got a diverse merchandise network and we sit on top of a majority of the consumption and the manufacturing in the United States.

Justin Long
Analyst, Stephens, Inc.
Q

Okay. And then, for my second question, just a quick follow-up on coal RPU. Alan, I think you walked through some of the mix dynamics in the fourth quarter, but as we think about 2021, is your expectation that coal RPU is relatively flat sequentially with where we ended the year last year or can you help us think through that as well?

Alan H. Shaw
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.
A

Yeah. I would anticipate it's going to decline. We had a record RPU within our coal franchise in the fourth quarter. We're not calling for that. I noted that our utility South franchise, Justin, you know is a longer length of haul and generally has higher rates than utility North, outperformed utility North.

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And so as a result – typically, we talk in terms of a 50/50 mix between those two franchises, and in the fourth quarter it was about 60% utility South and 40% utility North. I anticipate that'll go back, the 50/50 moving forward. And as we've talked about, Justin, the upside really is in that export thermal market, which has a shorter length of haul than the export met market, and so that has a mix impact as well.

Justin Long
Analyst, Stephens, Inc.
Q

Okay. That's helpful. I appreciate the time.

Operator: Thank you. Our final question today is coming from the line of Jordan Alliger with Goldman Sachs. Please proceed with your questions.

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. Hi. I'm not sure if you actually referenced this directly, but on the revenue per carload, I know you talked about some individual commodities, coal, just now in intermodal. But from a total company standpoint, is the anticipation as we start the year it's still going to be a negative headwind? And then as we move into the second and the merchandise volumes industrial picks up, that's when it flips to sort of from a headwind to a tailwind as we think about having a slight positive for the full year?

Alan H. Shaw
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.
A

You're asking – I'm sorry

James A. Squires
Chairman, President & Chief Executive Officer, Norfolk Southern Corp.
A

[indiscernible] (01:18:58) RPU throughout the year.

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. RPU, yeah, as we start the year.

Alan H. Shaw
Executive Vice President & Chief Marketing Officer, Norfolk Southern Corp.
A

Oh, yeah. It's a great question, yeah, and I'm glad you asked that. Yeah. I need to make it clear that, yes, we are expecting a year-over-year decline in RPU in the first quarter. A lot of that is mix, a lot of that is fuel surcharge headwinds. And then, as you go through the year, ultimately, we'll get to a point where we've got a modest increase in RPU that is driven by – we've talked about a 9% revenue increase and a high-upper, single-digit volume increase.

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC
Q

Great. Thanks so much. That was my question.

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

James A. Squires

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

Thank you for your questions today. We look forward to talking with you again next quarter.

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

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