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Norfolk Southern Corp. (NSC)

Q2 2022 Earnings Call

CORPORATE PARTICIPANTS

Luke Nichols
Senior Director, Investor Relations at Norfolk Southern Corp., Norfolk Southern Corporation

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

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

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

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

OTHER PARTICIPANTS

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.

Jason H. Seidl
Analyst, Cowen and Company

Scott H. Group
Analyst, Wolfe Research LLC

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

Justin Long
Analyst, Stephens, Inc.

Jonathan Chappell
Analyst, Evercore Group LLC

Ken Hoexter
Analyst, Bank of America Merrill Lynch

Thomas Wadewitz
Analyst, UBS Securities LLC

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Ariel Rosa
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Brandon R. Oglenski
Analyst, Barclays Capital, Inc.

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC

Bascome Majors
Analyst, Susquehanna Financial Group LLLP

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

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

MANAGEMENT DISCUSSION SECTION

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

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

Luke Nichols

Senior Director, Investor Relations at Norfolk Southern Corp., Norfolk Southern Corporation

Thank you, and good morning, everyone. Please note that during today's call, we will make certain forward-looking statements, which are subject to risks and uncertainties and may differ materially from actual results. Please refer to our annual and quarterly reports filed with the SEC for a full discussion of those risks and uncertainties we view as most important. Our presentation slides are available at nscorp.com in the Investors section, along with a reconciliation of non-GAAP measures used today to comparable GAAP measures. A full transcript and download will be posted after the call.

Turning to slide 3. It's now my pleasure to introduce Norfolk Southern's President and Chief Executive Officer, Alan Shaw.

Alan H. Shaw

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

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

In the second quarter, we stabilized service levels, expanded our pipeline of conductor trainees and launched the next evolution of our operating plan, TOP|SPG with our signature no surprises approach.

Service is not yet where we want it to be, but I am encouraged by our progress and inspired by the commitment and shared vision of our talented team. I am privileged to spend a lot of time in the field with our hard-working craft employees and operations supervisors. I see firsthand and sincerely appreciate their daily dedication to serving our customers. We are eager to reach an agreement that keeps our people among the highest paid craft workers of any industry and recognizes their essential service to our customers, our company and the US economy.

Moving to slide 4. Thanks to the combined efforts of our team, we delivered solid financial performance in the second quarter with record revenue and earnings per share. Revenue increased 16%, as a 20% increase in revenue per unit more than offset a 3% volume decline. Expenses grew by 21% year-over-year due primarily to higher fuel prices.

Operating ratio was up 260 basis points versus last year's quarterly record. Comparisons were adversely impacted by the absence of a large property sale we called out last year as well as fuel price headwinds. Despite these headwinds, EPS improved by 5%, $3.45 per share, a second quarter record.

The steps we are taking today to restore service and implement our new TOP|SPG operating plan are making Norfolk Southern a more customer-centric operations-driven organization that will deliver long-term value for our customers and shareholders. Our TOP|SPG operating plan is part of the equation for improving service.

We named this iteration SPG because it creates a platform for consistent service, continuous productivity improvement and smart growth for our customers, Norfolk Southern and our shareholders. There is no doubt we have an enviable value proposition to compete in today's logistics marketplace and where markets are heading. At the conclusion of our prepared remarks, I'll share a few insights on how we will unlock that value.

I'll now turn the discussion to Cindy for an update on operations and a detailed look at how our company is aligned around restoring service and creating a safe, efficient and reliable product that meets our customers' needs and supports their growth. Cindy?

Cynthia M. Sanborn

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

Thank you, Alan, and good morning, everyone. Turning to slide 6, in the second quarter, our team continued to face a challenging operational environment as we worked to stabilize service levels, drive productivity gains and increase our T&E workforce.

Crew starts were down 3% in the quarter and volumes also down 3% and flat gross ton miles. Similar to what I discussed last quarter, we continue to make gains in crew productivity. However, we would have preferred to run additional crew starts that were limited by staffing challenges.

As we promote more of the conductor trainees currently in our pipeline, we will see additional highly productive crew starts that will support more volume and further increases to the record train size we have produced this year.

Despite the ongoing decision to keep a portion of our surge locomotive fleet active to promote service recovery, we produced another all-time record for fuel efficiency, driven by our multipronged strategy to reduce consumption.

This strategy includes the DC to AC conversion program, data-driven solutions to idle reduction and small but powerful investments in friction modification technology, just to name a few components. We expect to drive even better results as we execute on that strategy and enhance the fluidity of our network.

Moving on to slide 7. Train speed and terminal dwell remain challenged in the quarter. But we are really encouraged by the improvements we're seeing here in July. We are pulling every lever to restore service levels and delivering for our customers is our top priority. We have a long way to go, and our workforce is dedicated to getting the job done.

I'm going to speak over the next few slides about the plan for accomplishing this. Turning to slide 8, which is an update on our T&E staffing progress. We're maintaining a very strong pipeline of conductor trainees. And even more encouraging, as you can see that in July, we're really making progress on getting those employees qualified more than offsetting ongoing attrition. And the impact on our network is being felt.

We are continuing to start classes weekly and expect this momentum to continue. I will note that the labor market is still very challenging, particularly in certain locations. We're taking advantage of every option to get folks where we need them, including go teams, transfers, sign-on and attendance bonuses, retirement deferral and referral incentives and more.

We're also examining how we can adjust our operation to best align resources with demand. An example of this is that two of our major terminals, Macon and Bellevue, recall that both of these former hump yards were converted to flat switching in 2020.

Switching demand has increased in both locations since that time, and we have begun the process of resuming conventional hump operations at both facilities to provide the capacity we need to most expeditiously and efficiently serve our customers with negligible upstart our ongoing costs.

Having the ability to return to humping operations as demand dictates is an example of resiliency we now have in our network and a lever we can pull to improve service. We are excited about the talented individuals joining us to help move the economy, and we are confident we will continue to make progress on our staffing priorities.

On slide 9, I am very happy with the progress we've made on our safety initiatives and translating that to fewer injuries and train accidents. Especially with large numbers of new employees starting out in the field, this reinforces that all of our employees, tenured and new alike are laser-focused on running a safe operation, providing a critical foundation for the future.

Now moving to slide 10. I'll talk about the progress we've made with rolling out the latest evolution of our operating plan, TOP|SPG. As a reminder, TOP is an acronym building on the legacy of Thoroughbred Operating Plans. And as Alan noted earlier, SPG signifies the equal prominence of the three pillars: service, productivity and growth.

Late in the second quarter, we launched the plan, which was focused on creating more balance and executability within our network. We looked at how our business, freight flows and train composition have changed over the last few years and then couple that with a deep-dive on how each of our terminals and routes can best handle the business. We took a fresh approach to balancing the number of crews and locomotives flowing across our core routes.

I've spoken before about the benefits of distributed power locomotives on longer trains, and as we're creating longer trains, we rebuilt the plan for when and where we apply distributed power. We looked at prior and prospective train consolidations and weighed what it would take to continue launching and landing longer trains both from a time and resource perspective and made holistic decisions about what is best for service, productivity and growth.

As we go forward, we will increase the service frequency in several of our core intermodal markets while simplifying the role of each terminal particularly where we have more than one terminal in each market. This will allow us to drive even more value from our intermodal franchise and will promote executability and growth.

Our bulk strategy has a long-term focus. In recent years, we've made solid progress on train consolidations and to a lesser degree, blending with other traffic types. Now we're putting added emphasis on identifying how we can take the remaining unit train network and add an incremental 10, 20 or 30 cars to each train.

Moving to slide 11 to discuss a couple of metrics that indicate the early progress we're seeing. First, our arrival train performance has seen substantial improvements here in July. With TOP|SPG we adjusted 90% of our train schedules to meet service and executability standards I described on the previous slide, and this improvement is very encouraging.

As I showed on the network update, our velocity has been improving in July, and this train performance trend reinforces that velocity is translating into trains hitting their slots at an increasing rate. One of the several reasons for this is the strong increase in the number of distributed power-trains we run each day. Team built a solid plan and is now executing it, and this is a component that will directly impact each aspect of SPG as DP trains run smoother, creating service resiliency. They are also more fuel-efficient than the shorter trains, driving productivity, and they give us a capacity dividend driving growth.

We have a long way to go to fully restoring service. These are just a few examples of where we are and further improvements will continue to be driven by three primary functions: staffing initiatives paying off; the success of TOP|SPG; and a solid execution by our field workforce.

Thank you. And I will now turn it over to Ed.

Claude E. Elkins

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

Thanks, Cindy, and good morning, everybody. Let's go to slide 13. Our results for the quarter reflect strong revenue growth amidst still recovering volume from network challenges. We achieved record revenue for the quarter of $3.3 billion. That's up 16% year-over-year on higher revenue from fuel surcharge and price improvement.

Revenue per unit was also a record and revenue per unit, excluding fuel, saw a double-digit increase from the same period last year. This revenue growth more than offset a 3% decline in overall volume, resulting from service disruptions.

Within merchandise, overall volume was down slightly as declines in steel and construction-related shipments from strained network fluidity were partially offset by gains in sand, driven by increased drilling activity in response to rising demand for natural gas, also helping to offset those declines with notable growth in our grain shipments due to rising export demand.

Merchandise revenue and revenue per unit were records for the quarter on higher revenue from fuel surcharge and price gains.

Now turning to Intermodal. Revenue, revenue per unit and revenue per unit excluding fuel, were all up double digits in the second quarter, with higher fuel surcharge, price gains and higher revenue from storage fees more than offsetting the impact of those volume declines.

International intermodal shipments were markedly down year-over-year, driven largely by a shift in our customer base away from Inland Point Intermodal or IPI, in response to ongoing supply chain challenges. Declines in international intermodal were partially offset by modest improvement in domestic shipments year-over-year due to sustained consumer demand.

Revenue growth was strongest in our coal business unit this quarter, with total revenue, revenue per unit and revenue per unit, excluding fuel, all increasing well north of 30% year-over-year in the second quarter. This growth was propelled by price gains, particularly in our export coal markets.

Coal volume in the second quarter was negatively impacted by limited supply and facility closures. Overall, our performance for the quarter reflects an improving revenue portfolio that will serve as a platform for long-term sustainable revenue growth into the future.

Moving to our outlook on slide 14. We're cautiously optimistic that the demand environment will remain strong through the end of 2022, providing opportunities for us to expand our volume and revenue base as fluidity is restored to the network.

Despite recession risks, amid record inflation and aggressive monetary policy, most economists are still forecasting GDP growth above 1% for both the third and the fourth quarters of 2022. In addition, we are beginning to see gas prices moderate nationally and unemployment remains very low, both of which bode well for consumption, which drives many of our markets.

Specific to our merchandise segment, we expect volume strength in the second half to be led by our automotive markets, where US light vehicle production is currently forecasted to be up 18% over the production levels experienced in the last six months of 2021.

Looking at commodity prices, we see mixed signals for many of our markets, but overall prices remain elevated from those pre-pandemic levels. Manufacturing activity has been a tailwind throughout 2022. However, the outlook is less certain for the remainder of the year. Lastly, we anticipate overall year-over-year improvements in most of our merchandise markets, as our service levels recover.

Within intermodal, we expect sequential volume improvement in both our domestic and international lines of business in the second half of 2022, as demand remains strong and service improvements will allow for greater throughput on our network.

Backlog demand for container movements will provide opportunities for growth in our domestic franchise. In addition, new opportunities for domestic volume growth exists in the truck and logistics market, and we're laser-focused on driving highway to rail conversions to expand our market share.

With respect to our international lines of business, increasing import activity is providing growth opportunities, although lower IPI is a limiting factor. We're also keeping a close eye on truck pricing as rates have fallen, albeit from historically very high levels.

Finally, our outlook for coal is positive for the second half of the year with growth in our utility and export markets driven by energy demand. Recent declines in export met coal prices suggest we're not likely to realize the same upside potential in RPU that we achieved in the second quarter. Market conditions support year-over-year volume growth in these markets with upside potential driven by coal supply and network fluidity.

While we recognize that uncertainty persists in the macroeconomic environment, we continue to see opportunities for volume growth in the markets that we serve. As part of our execution of our TOP|SPG operating plan, we are committed to capturing these opportunities, expanding our business by delivering the quality service that our customers need to thrive.

I'll now turn it over to Mark for an update on our financial results.

Mark R. George

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

Thank you, Ed. As Alan noted, our EPS grew $0.17 or 5% in the quarter, while the operating ratio contracted 260 basis points.

On slide 16, we reconcile some of the drivers for both of those changes. Recall the $55 million discrete property sale in Q2 of 2021 that impacted our OR by 200 basis points. Also, in Q2 last year, there was a state tax law change that impacted EPS by $0.09 and had a 220 basis point favorable impact on last year's Q2 effective tax rate.

This year we have some outsized impacts and claims related to accrual adjustments, but also an accrual related to a legal case, all totaling $16 million and that creates a 50 basis point headwind on our operating ratio and a nickel drag on EPS. That leaves a modest 10 basis point increase in core OR that was heavily impacted by 140 basis points of headwind from fuel.

Shifting to the overall reported highlights on slide 17. As Ed discussed, revenues grew 16% despite the 3% volume decline, thanks to strong RPU again this quarter. Operating expenses were up 21%, driven in large part by fuel, operating income was up 9%, but net income was flat due to tax rate compares and non-operating headwinds from company-owned life insurance investments. Despite the flat net income, EPS was up 5% from the lower share count.

Drilling into the operating expense components on slide 18, nearly two-thirds of the increase in operating expense is from higher fuel cost. Increase of material and other of $75 million is affected by the $55 million property gain we called out last year and the $16 million of items that I spoke about earlier.

Purchased services and rents are impacted by both inflation and our current service situation. The slower network speed is a critical driver impacting the higher equipment rents, while purchased services captures higher rates for our third-party lift contractors as well as our IT contractors.

Compensation and benefits is a tailwind with lower incentive accruals offsetting the cost of trainees, as well as general wage inflation. As you can imagine, the current labor negotiations are likely to play out here in the second half and may result in incremental headwinds to comp and benefits that we are unable to estimate at this time.

Shifting to the P&L, below operating income on slide 19. Other income is actually an expense in the quarter of $14 million, driven by losses on our company-owned life insurance investments. I know this line item is difficult to estimate and model. So let me provide some clarity to help you, at least directionally. This account is a collection of non-operating income and expense items that typically nets to about $15 million of income per quarter.

On top of this, we have returns on our company-owned life insurance investments. A portion of this asset, roughly $525 million, is invested in a traditional blend of equities and fixed income, and we mark-to-market each quarter. These are non-cash gains or losses. And it's important to note that neither the gains nor losses from these investments are subject to income tax. As such, the effective tax rate in this quarter was a bit higher than usual at 24.7%.

While net income was exactly flat, earnings per share increased 5% due to the accumulation of our share repurchases in the past year.

Going back to income tax for a moment, I would also like to highlight that Pennsylvania enacted legislation in July to reduce their state tax rate. And the accounting for that change will have a roughly $135 million one-time non-cash favorable adjustment to income tax expense in the third quarter.

Now turning to free cash flow on slide 20. We've generated nearly $1.2 billion in free cash flow through six months with property additions trending higher than last year, with strong progress being made on both our rail replacement program, and our DC to AC locomotive conversion program, where, as Cindy touched upon, we gain operational benefits as well as improved fuel efficiency.

Incremental inflation is also having an impact on property additions. So, I would expect CapEx to be at the high end of our $1.8 billion to $1.9 billion guidance range. Shareholder distributions are up and you'll observe here the 19% higher dividend payments through six months on top of continued strong share repurchase activity.

And with that, I'll hand it back to Alan.

Alan H. Shaw

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

Thank you, Mark. I'll conclude with an update on our outlook for the year and brief thoughts on our strategy for long-term value creation. You'll see on slide 21, our confidence in the revenue outlook has improved. The 12% plus year-over-year growth, underpinning the improved revenue outlook, a strong first half performance, continued strength in fuel surcharge revenues and better sequential volumes associated with service improvement in the back half of 2022.

Our first half operating ratio was the result of a delayed service recovery and elevated fuel prices. These headwinds will translate into a deterioration in full year operating ratio. Although we expect the back half OR to improve from the first half, as our service recovery ramps, allowing us to absorb more volume and reduce cost associated with our service challenges. As Mark mentioned, we do not know if there will be any incremental cost recorded in 2022 associated with a resolution in our labor negotiations.

Turning to slide 22. Although our focus today is on restoring service in the short term, our vision extends much further. As I complete my first 100 days as CEO, I'd like to share some insights on our future.

The work we are doing now to improve service is only the beginning. We're going to build long-term resiliency into our network, creating sustainable value for our customers. Norfolk Southern as a franchise that is built for growth, being customer-centric and operations-driven, propels Norfolk Southern to a service organization that will compete and win on operational excellence, leveraging the strengths of our powerful network to achieve above-market growth.

Our value proposition starts with the investments we've made over decades to build a robust network that faces the fastest-growing segments of the US economy. Our markets extend globally, through our strong working relationships with ports all along the East Coast, the Great Lakes and the Gulf of Mexico. We have cultivated more than 250 short line partnerships, the most of any Class I railroad, extending the reach of our network even further and creating even more options for our customers.

We have long-standing relationships with a desirable portfolio of valued customers, reflecting a diversity as broad as the US economy. Our automotive, metals, agriculture and consumer products markets are enduring strengths and our unparalleled intermodal franchise will be an increasing driver of long-term growth.

Our best-in-class channel partners and industry-leading industrial development team position us well to capitalize on the growth of e-commerce and the acceleration of onshoring as we move Norfolk Southern forward.

Leveraging the sustainability advantage of our service product will give us another compelling selling point, as more shippers prioritize scope 3 emissions reduction in the years ahead. We'll keep driving forward with industry-leading technologies, enhancing our productivity and efficiency and creating a best-in-class consumer-oriented experience that makes it easier for customers to do business with Norfolk Southern.

Consistent, convenient, cost-effective service will enable shippers to build their supply chains around the inherent advantages of our network. We will deliver the simplicity of truck with the efficiency of rail. This is how we will achieve our vision of a customer-centric, operations-driven organization and compete successfully in the $800 billion plus truck and logistics market.

When I talk to my colleagues throughout Norfolk Southern, from our headquarters to our rail yards, I am energized. Our people are passionate about serving our customers and proud of the essential role we play in moving the American economy. Our team is the reason we will be successful.

We are building a winning culture, with innovation as a core competency where people confidently bring forward their best ideas, continuously develop their skills and feel valued for their contributions. We look forward to sharing more about our strategy for long-term shareholder value creation in the months ahead.

We will now open the call to questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Thank you. And our first question will be coming from the line of Jordan Alliger with Goldman Sachs. Please proceed with your question.

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC

Q

Yeah, hi, morning. Sort of – in thinking about your look ahead to sort of the second half and the sequential improvement. Can you maybe discuss in your mind what the most critical factor is to getting that service up and in turn, volumes, is it adding more heads? Is it the new TOP|SPG plan, simply easier comps? Maybe just give some color around the critical factors as you would rank them? Thanks.

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

A

Good morning Jordan. The critical factors are already in play. We've ramped up our head count and we continue to have a very robust pipeline of conductor trainees. We've got close to 900 as of this morning. And we've implemented a new operating plan, which is already providing some benefit for us and our customers in terms of improved fluidity and service to our customers.

And so as we continue to add head count, implement our plan, we are very confident about the ability to improve service, which will allow us to accept more volume and enhance our productivity, driving OR gains.

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: The next question is 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 a follow-up on the service. We've seen the improvements in first mile trip line compliance, but they're coming off of really low levels. Is that improvement, that rate it changed, is that enough to really see substantial volume recovery or do you think you need to hit a certain level to start to bring volume back sustainably onto the network?

And then just a quick clarification. For Mark, can you talk about gain on sale in the quarter? It looks like it was about $31 million. I wanted to see if that was right and what your expectations are for the rest of the year?

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

A

Cindy, would you talk about what you're seeing with service, please?

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

A

Yes. So it's a great question, Brian. And specifically to our measure around first mile/last mile, it's a very rigorous measure and we put that in place very specifically to make sure that we were understanding what the customer is feeling. And we've had it in place for a while now, probably two years and we look back to see where service was and we had a really good level in 2019 and so that's what we're aiming towards.

And while the number on the page is percentage-wise, challenging, it's a measure that we hold ourselves to real high accountability with. And I think Ed can talk a little bit about how the customer feels and how they see the measure.

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

A

Sure and thank you, Cindy. The first thing I would say is our customers helped us develop our metrics and our targets here. Our customers want to do more business with us and they're starting to see some early greenshoots here in terms of service improvement, and we fully expect that to continue throughout the year.

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

A

And Brian, can I just clarify for you the gains? We got about – last year, as you may recall, we had $67 million of gains. We kind of called out $55 million as a more anomalous figure. And this year, right now, in Q2, we had $28 million of gains.

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

A

Brian, I'll add in addition to first mile/last mile, we're also delivering improvements in train speed and in terminal dwell as well.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Q

Mark, for the rest of the year, what should we pencil in for a normalized level of gain if you have one?

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

A

Yeah, I'm not going to really give you much more than the normal usual quarterly cadence. It can be a little bit volatile and real estate gains, obviously, can move around, even if we expect them to happen this year, they can certainly slide. So if you look so far year-to-date, we're running at about in the low $30 million range. There might be a similar amount in the back half, but probably less than that because things are moving around a little bit on us.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Q

Right. Makes sense. Okay. Thank you for the details. Appreciate it.

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

A

All right, Brian. Thanks.

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

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.

Q

Yeah, thanks. Good morning. I wanted to talk a little bit about the operating ratio outlook and understand if there's a volume assumption underlying that, can you give us a sense of sort of what you need there in terms of operating leverage to be able to hit the numbers? And then I guess, you've given us some clarity on OpEx going forward quarter-by-quarter, should we assume somewhere in the $1.9 billion is the right number sort of ex-fuel going forward still or any help around that for the back half in terms of the operating ratio and volumes would be great?

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

A

Chris, with respect to our outlook for volume, we have said we'll be flat for the year. We're down 4% year-to-date. So that suggests some sequential improvement as we move into the second half of the year, and that's going to be supported by our improving service product. Mark, do you want to comment on OpEx?

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

A

Yeah. Chris, you're exactly right in your thinking. If you look at our Q2 OpEx numbers and take away fuel, because fuel is going to be where fuel is going to be as that moves. But you look at OpEx ex-fuel in the second quarter and even maybe excluding the items that I called out, the $16 million that was somewhat anomalous, we would project that that amount would be representative of what to expect in the last two quarters on average.

So, there could be some moves within any particular account or line item in the P&L. But in aggregate, that's kind of the area that we're expecting. And if we have unexpected events, we'll call them out to you like we typically do in our quarterly calls.

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

And then with respect to the cadence of OR improvement, Mark also highlighted in his comments, the 140 basis point headwind that fuel had in the first half of the year. We do not expect that to be the case in the second half of the year.

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

We expect it to moderate...

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

Yes.

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

...as we go through the balance of the year.

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.
Q

Okay, great. Thanks very much for the time. Appreciate it.

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

Jason H. Seidl
Analyst, Cowen and Company
Q

Thanks operator. I wanted to talk a little bit about the coal RPU. I think you guys mentioned you're expecting it to step down here. I just wanted to get a little more meat on the bone. Is that just a sequential step down? Or do you think it could step down on a year-over-year basis as well?

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

Ed, would you please address that?

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

Sure. We stay very close to our customers. And of course, we're looking at these commodity prices every day. And the export prices have changed quite a bit. The fact is they're still historically high and there's still a lot of energy in the market, so to speak, but the coal indices have dropped off as a result of the rise in coal inventories ahead of sanctions on Russia, but they remain near three-year highs. So, when you think about production limitations, you think about constrained supply chains and really looks like steady demand, it should continue to support higher prices as a floor for both thermal and met coals.

We expect to see contract and spot pricing outpace where we thought we were at the beginning of the year, but we don't expect to be in those same inflated atmosphere that we thought toward the end of Q1. So, when I think about it, I do see sequential declines in the yield, that's about as far as I want to get.

Jason H. Seidl
Analyst, Cowen and Company

Q

Okay. So, it sounds like notable sequential declines, but at least for now, probably still above prior year?

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

A

Yes.

Jason H. Seidl
Analyst, Cowen and Company

Q

Okay. Thank you for the time, as always.

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

Scott H. Group
Analyst, Wolfe Research LLC

Q

Hey. Thanks. Good morning. I guess a couple of things. How much more head count do you realistically expect to add in the second half maybe, Cindy, any thoughts on restarting some of these hump yards and if that's – if there's more of them to do if that's permanent? And then Ed, I just want to follow up, your point about – was that coal RPU is going to be down sequentially or is that overall RPU that you think will be down sequentially from 2Q to 3Q? Thank you.

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

A

Yeah, Scott, I'll tackle the head count question and just say that I expect that we'll be probably about 1,000 heads higher at the end of the year compared to the end of last year and the preponderance of that is going to be in T&E first with trainees, higher trainee counts, but then also qualified T&E employees as well. And you can see our targets that we gave to the STB, our target of 7,330 I think, by November and that continues to ramp up on the qualified ranks as we get into next year. I think, we've got a target out there of over 7,500 by the time we get to May. Let me hand it off to Cindy, do you want to talk about humps.

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

A

Yeah. Thanks for the question, Scott, because I want to make sure I put that in my prepared remarks. So, I could talk a little bit more about it. We reactivated these humps to give ourselves some additional capacity that we need in the two areas served by Macon and Bellevue. The way switching demand has evolved since 2020 there's enough critical mass to justify returning them to service as hump yards. And because we idled them, which was our plan always in 2020, and we didn't eliminate their capabilities. We do not expect any upfront or ongoing cost of any substantial nature.

So we think that returning to hump yards, humping cars even for either short or long term is an example of resiliency, and it's important that we have that. And I do think – and when you think about it, the productivity gains that we generated when we idled them the first time we're going to be able to hold on to most of those. That was a lot of the thinking that went into – that was part of the thinking that went into returning them to service. And I do think we'll always evaluate. And there'll be times where we may see that we'll idle them again. So it's meant to help us do our number one goal here, which is to return our service levels.

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

A

Yeah. And let me talk about coal for a second. Yeah, we're going to see sequential improve – excuse me, sequential decline in the coal RPU. That's going to be an inevitable drag on the overall RPU for the for the rest of the year. But we continue to see strong price opportunities in our other markets, including merchandise, intermodal, auto.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Thank you.

Operator: The next question is from the line of Ben Nolan with Stifel. Please proceed with your question.

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

Q

Yeah. I appreciate it. So you guys mentioned storage fees on the intermodal side. I'm curious if you could maybe put a little context around that and then how you see that playing out in the back half of the year?

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

A

Sure. I'll take that. We had anticipated that supply chains would be improving as the year has progressed. And while we saw some improvement earlier in the year, we've seen more of the constraints really become more acute lately.

So we are anticipating that supply chains will improve throughout the rest of the year. And as they do, and fluidity improves, then we'll see those storage charges decline.

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

Q

Okay. Any context into as to how we should think about what that means in terms of order of magnitude at all?

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

A

I think, we'll see – I'm presuming and this is forecast in the future for things I don't control like supply chains. But if you see improvement, you'll see similar change in the rate of storage.

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

Q

All right. I appreciate it. Thank you.

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

Justin Long
Analyst, Stephens, Inc.

Q

Thanks. Maybe to start with one for Mark. Just thinking about the full year OR guidance, it's 100 basis points to 200 basis points worse than what you anticipated coming into the year. How much of that is fuel versus everything else?

And then, Cindy, I was wondering if you could talk about what you're seeing with attrition rates right now versus normalized levels, especially attrition rates for new employees that you've hired in the last year?

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

A

Justin, thanks. This is Mark. Certainly, a portion of it is fuel for sure. But I think the real issue here is just the volume has not come the way we expected it to come.

When we were talking about middle of the quarter there, about still having a path to our prior guidance, it was really going to require that we saw an upward inflection on volumes take hold pretty quickly and lead to some sustainable ramp. That obviously did not happen as we concluded Q2. And we're now projecting more of a gradual ramp in volumes as we're seeing service start to improve here.

And then, yes, fuel, you heard it, it's 140 basis points of headwind now in the second quarter. It's bigger than we had expected. We do think it moderates as we go through the back half of the year. We're not – we can't control that. We're not sure. We do take into account the fuel curves when we look at our projections for fuel. But certainly, fuel is an element of that change as well.

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

A

And, Justin, as far as attrition rates, globally, we're seeing about the same as we've seen all year, both from a tenured employee perspective and a new employee perspective or a conductor trainee perspective. There are clearly markets and locations where it's more challenging than others. And that's also consistent with where we've been all year.

I will say that we just recently announced that we are increasing our conductor training rates, and we think that will have a very positive impact for us both in retention as well as attraction. So, we're feeling good.

Justin Long
Analyst, Stephens, Inc.

Q

Okay. Thanks for the time.

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

A

Thank you.

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

Jonathan Chappell
Analyst, Evercore Group LLC

Q

Thank you. Good morning. Cindy, there's been this acute focus on labor, and it seems like you guys are doing a good job of ramping up pretty quickly, especially in July, and you're starting to see it in your service metrics. Norfolk specifically has had a little bit more issue with chassis over the last 12 months as well, and you guys kind of laid that out in the presentation. If we take the labor component out of it, what's the equipment situation like and what's your latent capacity that if you're appropriately resourced from a T&E perspective you can actually meet this demand, and we'll see more of an inflection in volumes?

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

A

So let me just add equipment-wise, we do – we are – I'll talk about locomotives and I'll turn it over to Ed to talk a little bit about chassis. You didn't mention locomotives, but it is important to make sure you note that in my prepared remarks, I did indicate that we're keeping our surge fleet fully activated throughout this whole process here as we recover service, and we're bringing on our DC to AC conversions, which is also allowing us some capacity from an equipment basis on locomotives. From a chassis perspective, let me turn it over to Ed for some detail.

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

A

Sure. Thank you, Cindy. We have a couple hundred in hand with more arriving each week, and we expect a significant tranche of improvement to land during the fourth quarter this year. So I think we're in pretty good shape when it comes to our chassis. We see the normal, what I would call normal course of business, sporadic disruptions associated with chassis for both other domestic partners as well as major lines.

But again, I would consider that normal course of business. Outside the gate, we are seeing supply chains impacted by the congestions of first mile last mile on the street, elevated street wells, as well as volume fluctuations associated with different ports, a lot of drayage capacity issues and, of course, available warehouse space. And if you read the papers the way I do, you see a lot of ships waiting offshore at a number of ports, which has really not shrunk very much.

Jonathan Chappell
Analyst, Evercore Group LLC

Q

Yes, definitely. Okay. Thank you, Ed. Thanks, Cindy.

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

Ken Hoexter
Analyst, Bank of America Merrill Lynch
Q

Hey. Great. Good morning. Maybe, Cindy, I just want to dig into the hump returning a little bit here. Just why bring them back? Isn't it more efficient to be flat? I guess, just from us being on the other side of the table years and years, it seems like all we heard was the first thing under precision scheduled railroading to do was to eliminate the humps to save on touching and time? And then, I guess, Alan, with that, would you consider bringing on any PSR expertise just as CN just did with Ed Harris on a consulting basis? Obviously, there's a couple of ex, I guess, PSR experts out there that are available. Is that something you would consider?

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

So, Ken, let me start with the hump. So, we really did take a really deep dive into this. And when you think about not only sort of traffic changes that have occurred since 2020, that had a big impact on it. But the other piece is the idea of switching cars beyond the hump yards and bypassing them or flats, which to reduce demand so that you can flat switching them, challenge has really been having the people to do that switching where we are moving them to serving our customers.

So the value is really in being able to have a location that you can get the switching done, it may be short term it may be longer term, we'll just see how it evolves, but that's the thinking behind it. And again, I do want to emphasize that we really consider the cost associated with it to make sure that we had a really good trade-off here. And we're really going to be able to hold on a number of the gains that we have.

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

We're confident it's not going to add cost. One of the keys to the humps is making sure that you're not running cars out of route just to have them humped. And so we saw that discipline when we closed these two hump yards during the pandemic and the volume outlook has changed. We've maintained our focus on a very efficient, balanced operating plan. We just installed a new operating plan and opening the humps just makes those switching operations more efficient. And we've got a great team. As you take a – just look around the table of the folks on this call, we're fortunate to have two folks who join us from outside of Norfolk Southern, who contributed greatly to our success.

Ken Hoexter
Analyst, Bank of America Merrill Lynch
Q

Thanks, Alan. Thanks, Cindy.

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

Yeah.

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

Thomas Wadewitz
Analyst, UBS Securities LLC
Q

Great. Yeah. Thank you. I wanted to ask a little bit more on TOP|SPG and the schedule changes. I think, Cindy, you said something like 90% of the trains you reviewed and – how should we think about the schedule changes that were made? And then also maybe if you consider that relative to the changes made a couple years ago when you originally implemented TOP? I think of those changes as being fewer train starts, longer trains. How should we think about the train schedule changes made with TOP|SPG? Is it also fewer train starts or it sounds like in intermodal might even be more train starts and some different approach. I just wondered if you could offer more perspective on what you're doing with that in terms of train starts and other changes? Thank you.

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

Sure. Thanks for the question. So just to go to a high level here, our main three objectives on TOP|SPG were to balance the network, improve its executability and increase train size. And part of the changes in the schedules were really to help us balance the network, balance the flows across the network, both cars and locomotives and make sure that we have realistic schedules that allowed trains to arrive and depart terminals. So we didn't have them bunched in or bunched out of a particular terminal.

We also, as I noted in my prepared remarks, have increased our distributed power utilization and accounting for that as trains were departing and/or working in individual terminals is a lot of the work that we've done. And the 90% of the schedules doesn't mean that we've changed them dramatically, but we've adjusted them so that we can make sure that when we operate our plan, that we don't have conflicts that prevent us from being able to execute consistently. So that's really what we were trying to achieve there.

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

It has substantially reduced the number of train meets on our network, which makes our operations more fluid and more executable by our team. And it's consistent with our no surprises approach, we involved our customers. Ed, do you want to give some perspective on the customer involvement?

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

Sure. Absolutely. The first thing our customers want. And by the way, let me just say, we are so lucky to have a great coalition of partners that we do business with every day, and they really want us to have an executable train schedule. They want to have a predictable service product. And so they have been highly collaborative with us as we've gone through the TOP|SPG process. To look at the changes that were necessary to improve the executability of our product.

And I can't say enough about the collaboration that we've had with them. And I think, we're starting to see some early results. And I think that they would say the same thing. So we're encouraged by those results, but I am most particularly encouraged by the level of the collaboration that we've enjoyed with our partners.

Thomas Wadewitz
Analyst, UBS Securities LLC
Q

So just, I guess, to be clear, should we think of this as a reduction in train starts or an increase or kind of net, not a big impact, but just more rebalancing?

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

I think as we continue to roll it out, I mean we – I noted that we started in the second half or actually it was in late second quarter. And we still have some work to do to roll it out in the intermodal space. And what you'll – what I would say relative to crew starts is we're going to improve service frequency in some of our core markets, and we're not going to be adding crew starts. And we may have a small reduction in that lane or in those lanes. But it's – we're still in the process of putting it on the railroad.

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

A

Tom, what it does is it really improves the executability of our operating plan, which means we're going to be more consistent, more reliable, more on schedule. Those are the principles of PSR. That will reduce the friction costs associated with slowness in our network.

Thomas Wadewitz
Analyst, UBS Securities LLC

Q

Okay. Great. Thanks for the time.

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

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks. Hi everyone. Appreciate the time. Hey, Mark, I just wanted to understand the cadence of the OR in the back half because volume out of the gate here in the third quarter is pretty weak? I think, it's down like 3% or something like that. Typically, we do see maybe flattish to slightly worse OR 3Q versus 2Q. I don't know if – I mean is the full year guide, the revised full year guide really contemplating kind of a big inflection in the fourth quarter or does the third quarter look a lot like the fourth quarter, if you can talk about that.

And then just for the industry, maybe this one is for Cindy and Alan. The industry has been talking about better service and more labor for a long time over the last several, several months. And we've been kind of disappointed not just with Norfolk, but I think the industry as a whole, I think it would just be helpful to understand when do you guys actually think timing-wise, we see a more pronounced inflection. We've seen some green shoots, as you mentioned or maybe a stabilization. I mean, are we talking about September, or October? Or when do you think you're at the point equipment and labor wise where we actually see some tangible inflection in the service metrics?

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

A

Yeah. I'll cover the service metrics first. We outlined our plan for the Service Transportation Board. It will be beginning of next year before we're at our targeted head count, that's going to create a big lift. We've already seen improvements in our service product with the implementation of TOP|SPG and with the onboarding of new conductors. And I think that will continue to improve as the year progresses. It won't be linear, but we should see some lift as we move out of vacation season as well in terms of the availability of our crews.

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

A

And Amit, so that leads to pretty much the volume profile as well. We'll probably see more of a ramp go into fourth quarter with more volume that should help the operating ratio, but of course, there are seasonal headwinds that typically take effect in the fourth quarter versus the third quarter that might neutralize some of that when we look at the OR progression. So, we're not going to give the quarterly guidance, but it does seem to be probably a little bit more of an upward – I'm sorry, a little bit more of a gradual improvement in the OR as we go through the balance of the year, as volumes come on mainly in the fourth quarter. The volume growth, I should say, comes on mainly in the fourth quarter.

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Q

So does that – so does that mean we take a step back before we accelerate into the fourth quarter? I'm just trying to understand, is it a slope upwards in the back half versus where you are in the second quarter or is it a step back, is it a little bit of a J curve?

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

A

No, I think we're going to – I would fully expect that we'll see sequential improvement from the second to the third quarter. I'm just – I'm not going to tell you yet whether we'll also see sequential improvement from the third quarter to the fourth quarter or if they'll be somewhat on par with one another.

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. Okay. That's very clear. Thank you very much everybody, appreciate it.

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

A

Thank you, Amit.

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

Ariel Rosa
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Yeah. Hi, good morning. So I wanted to ask just kind of a broader philosophical question. I think we've been dancing around it with a couple of questions that have been asked. But you're talking about obviously adding head count, bringing equipment back onto the network, reintroducing some of these hump yards.

Is there a point where service improvement maybe is at odds with OR improvement? And at what point do you think we can kind of see a resumption in OR improvement? And as we think about 2023 what kind of incremental margins might we be looking at as that service gets back to where you want it to be?

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

A

Ari, we fully believe that service and margin improvement are complementary. They support each other and our trajectory for service improvements and the attendant improvement in OR belies that fact. We're going to take a balanced approach. We've got balanced objectives of service, productivity and growth in our new operating plan, and that provides some sort of insight as to how we're thinking about this thing. Our priority is to improve service. As service and fluidity improve, you're going to see significant volume uptick and productivity gains, which will collectively drive margin improvement.

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

A

And Ari, I'd also remind you, in a difficult service environment like we're dealing with, there's a fair amount of incremental cost that we're absorbing to have to cope with it, whether it's incremental over time, whether it's re-crews, whether it's drayage costs, you name it, training, travel, taxi, there's a fair amount of cost right now that we're absorbing in our P&L to deal with the current service challenges. So that starts to lessen as service improves, and I think you need to keep that in mind.

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

A

Yeah. And even in my prepared remarks, I talked about the fact that both train length and train weight are up even in difficult circumstances here. So I think we'll hold on to that. And I'm very positive on being able to run a very efficient network that serves our customers extremely well.

Ariel Rosa
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Got it. Okay. Thank you for that color.

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

Brandon R. Oglenski
Analyst, Barclays Capital, Inc.

Q

Hey, good morning everyone, and thanks for taking my question. Cindy, this might sound a little naive, but I know we always focus on conductor trainees. My understanding, though, is that for engineering or to be an engineer that trains a little bit more intensive or maybe longer duration. So can you talk about your qualified engineer ranks? And is that potentially a next bottleneck or again, is that just a naive question?

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

A

It's a great question. We are – as you noted, conductors take promotion to engineers. That is our pipeline for locomotive engineers. Over the years, our investments – part of the resiliency investments we've made is to qualify more people to be locomotive engineers as conductors step them up to qualify and then step them back down to acting – and active working conductors. So we keep a buffer that is – that we've used through this time where we can step up engineers and then backfill with conductor trainees.

And I would say that we're already starting the process. Training some locomotive engineers will be next month. We will keep an eye on that and maintain that buffer that's going to be part of – as we stabilize service levels and get our conductor ranks where they need to be, that will be one of the big areas that we focus on in 2023.

Brandon R. Oglenski
Analyst, Barclays Capital, Inc.

Q

Thank you.

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

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Good morning, everyone. Cindy or Alan, can you help us understand how your customers right now are thinking about truck to rail conversion. Obviously, your service is improving, you're putting in place TOP|SPG and that helps but at the same time the truck market is loosening. And I think for now at least, shippers want like super tight fast supply chains with high turnover. So what's driving that incremental conversion and is TOP|SPG enough to do that?

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

A

Hey, Mark, why don't you talk about what you're hearing from our customers....

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

A

Sure.

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

A

...with respect to opportunities?

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

A

Absolutely. We're talking to our partners every day. And frankly, the truck prices are loosening, but our customers remind us every single day that those are from historically very high levels. And the contracts rates have stabilized. There are a number of things that our customers want, but one of them is they want to do more business with us.

Our customers have freight that they would like to put on the railroad and as our network throughput capacity improves through network velocity, they're going to do that. We have line of sight on freight that wants to move on the railroad right now, whether it's in our industrial markets, our consumer markets or energy markets. And we're confident that as the network velocity improves, our customers are going to find additional value in the product that we're able to deliver to them, and that will manifest itself in additional volumes later this year.

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC

Q

Got it. So given the incremental value proposition of rails, you guys look confident that you can push yields higher even if the truck market – even if truck pricing comes down?

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

A

We stay very, very close to that. We're always looking at what truck prices are doing. Again, contract prices have stabilized at very high levels. And we're always looking at the gap between what we believe the value that we're offering versus what a truck offers.

And we looked at a number of lanes specifically where we offer intermodal service as an example, and we're comfortable that our door-to-door pricing is very competitive against over-the-road trucking.

And let me remind everyone, including myself, there are multiple advantages to using rail versus the highway, including sustainability. We've seen a lot of our customers make commitments publicly about what it's going to take for them to reduce their greenhouse gas emissions. And when we think about the consumer packaged goods business, approximately 80% of the greenhouse gas comes from transportation. The efficiency advantage that we deliver for our customers over the long period of time is going to help them achieve those goals.

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC

Q

Very good. Thank you.

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

A

Ravi, I will add, we had – and our intermodal franchise has delivered 22 consecutive quarters of year-over-year growth in RPU ex-fuel. That's during a freight recession and during a pandemic. And so there's great value with the product that we deliver. And our focus now is on enhancing the value of that product.

Ravi Shanker
Analyst, Morgan Stanley & Co. LLC

Q

Makes sense. Thank you.

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

Bascome Majors
Analyst, Susquehanna Financial Group LLLP

Q

Mark and Alan, as you both alluded to in your prepared remarks, there's some uncertainty as to what the actual union wage increases from 2024 are ultimately going to be. Can you talk about how you have managed that uncertainty with your accruals so far? And if the actual wages come in different than those expectations, when do you true that up retroactively and communicate it to us on a go-forward basis?

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

A

Hey, Bascome. Thanks a lot for the question. This is Mark. Look, we've agreed with PEB that we weren't going to discuss publicly what our relative positions are. But I will tell you, we have accrued a level of back wages that reflects our efforts to keep our craft workers amongst the highest paid in any industry.

And obviously, if there's a settlement that is at a different level, whether that happens through the PEB or subsequent to the PEB, we will have to make an adjustment, and we will make that very, very clear in terms of disclosure to you all what the impact will be. So, again, whatever that increment is, we'll let you know. But right now, we are accruing something based upon what our expectations were.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP
Q

Thank you for that. And just to clarify, you mentioned the PEB a couple of times in your timing. Is it the PEB report that would be that trigger in your mind? Or something subsequent like a tentative agreement with a coalition or something in that vein?

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

Yeah. We have to work with the accountants to understand what the trigger event will be. So, I'm not really at liberty to pinpoint that right now on this call.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP
Q

Thank you for the time.

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

Thank you, Bascome.

Operator: Our next question comes from the line of Jeff Kauffman with Vertical Research Partners. Please proceed with your question.

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC
Q

Thank you very much, and thank you for taking my question. Just a question about the hiring process. And I know there's been a bunch this quarter. One of the complaints we had heard from some other rails is that they were seeing a problem retaining employees post training. Now you had mentioned the wage increase and some of the carrots that you had put out there.

But I guess two questions. Why has this become so problematic? Is it just that it's kind of a Gen Z, the employee wants different things and we've got to change the job kind of item? Is it more of a pay item?

And then secondly, let's say the economy slows a lot faster than we all think, just theoretically, and I know your volume forecast doesn't imply that. Do we still stay to the 1,000 employees by the end of the year?

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

Great. Well, let me start with the training retention piece. One of the challenges for our trainees when they do markup is, as a seniority-based system they will tend to get the work that others do not necessarily – they do not want, those will be the jobs that they can hold. So, as they step into that role, some find that that's not really what they're looking for. We – our training process allows us to convey that information, but sometimes it doesn't become real until you come up and you markup.

I will say in terms of what could be a solution at the national table is conductor redeployment that will allow us to have a more structured work environment for more conductors than we do today. So, that is part of what we feel like is a good solution, and we feel like it will fit the needs and demands of our workforce in the future, which is why we've got it on the table for negotiation.

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Q

Thank you, Cindy.

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

A

It's really more of a lifestyle. Jeff, it's really more of a lifestyle challenge in a very unique market where everybody is looking for talent. So you have to compete against everybody simultaneously. So labor has their choice of what they want to do. And in many cases, despite the very rich and attractive pay structure that the railroads offer, sometimes they'd rather work in a more predictable schedule in warehousing or in home construction, where they can be nearby where they live and not stay in hotels, and also just not be on call or work their shift. So we're just in a very unique environment right now where the entire labor market has their options to choose from.

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

A

And as Cindy noted, some of those work rules changes that we're proposing would directly address some of those issues that Mark articulated.

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Q

Okay. And second half of the question, I know the trainees are already in process. So were we pretty committed to that 1,000-plus employees by year-end with the STB plan or what if the world changes?

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

A

We are committed to high levels of service throughout all economic cycles, because we believe that services resiliency enhances the ability to be opportunistic during the near-term recovery and generates confidence by our customers in building supply chains around us for the long-term. As Ed noted, there are a lot of inherent advantages to our network. There's a lot of reasons that customers want to do business with us over the long-term.

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Q

Okay. Thank you.

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

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

Q

Excellent. Good morning, guys. Thanks for fitting me in here at the end. I've got two longer-term questions for you on TOP|SPG. If we're adding 1,000 heads to workforce, can you talk about maybe, Cindy, what level of volume growth you could absorb with that head count once it gets productive? I'm trying to understand whether the embedded labor productivity level in this new version of the operating plan is higher or lower than maybe what we've seen in the early days of PSR?

And then, Alan, maybe longer term on the service side, does this get us to that low to mid-80s in the first and last mile sort of service levels as you outlined for the STB? Or is it upside to that? I'm just trying to get a sense for kind of how you think about is low to mid-80s enough to drive modal conversion longer term?

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

A

Hey, David, I'll start. I mean so from TOP|SPG, I mean, I would think it's going to be a very productive operating plan. And obviously, it's not going to be static. We're going to adjust as volume adjusts and as business adjusts across our – pulling across our network, it's about balance, executability and train size, as I described. One of the areas that I mentioned in my prepared remarks in the bulk network, we have seen a lot of improvement in train size from the standpoint of combinations of trains, but we will be able to add additional cars to trains as well in our standard sets in our grain network. So I see this as an enabler from a productivity standpoint and allow us to bring on volume with a consistent operation that we will offer.

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

A

Go ahead.

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

A

Let me just add to the fact that the number of people we're adding, it requires a lot more energy and people to get that network sped up to where it needs to be. And then also that the number of people we're adding. Once we're up to speed, gives us the capacity – additional head count capacity to handle even greater volume. So I think that's the other point is the capacity dividend that a faster network provides will allow us to take on more volume.

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

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And a stable, reliable, predictable service product over a long period of time is exactly what our customers need to build their businesses around ours, and we can offer tremendous value and unlock value for them and for their customers by delivering that kind of service. And that's what we're committed to over the long-term building a high level of service that our customers need that allows them to deliver growth and value for their customers.

Operator: Thank you. This concludes the question-and-answer session. I will now turn the call back to Mr. Alan Shaw for closing comments.

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

We thank you for joining us today.

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.