Norfolk Southern Corporation (NSC)

"Post-Coal" Earnings Growth Profile Coming Into View

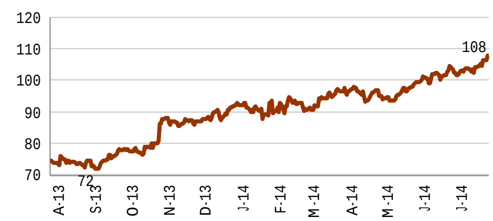
Remain Neutral-rated but looking for an entry point. 2Q14 results above consensus on accelerating volume/pricing trends. We expect both revenue and EPS growth to moderate in 2H14 as volume growth stabilizes after 2Q14's snapback and as efforts to recover network velocity continue. However, we believe a "post-coal," 10-15% sustainable annual EPS growth outlook is increasingly apparent, a critical catalyst to NSC. Raising price target to $118, which reflects 15x our forward EPS estimates, one year out.

- **2Q14 beat.** EPS of $1.79 (+22% yoy) was above recent $1.74 consensus and our $1.70 estimate. Upside largely driven by better-than-expected capture of incremental margins into accelerating 2Q14 volume growth, despite ongoing network fluidity headwinds.
- **Growth trends accelerated in 2Q14, as expected.** Overall revenue growth accelerated (to +9% yoy, from -2% in 1Q14) as volumes (+8% yoy, from -1% in 1Q14) snapped back following 1Q's weather-related issues. Yields (revenue/unit) were muted (+0.6% yoy) on mix.
- **Operating performance strong, despite ongoing network fluidity issues.** Overall operating ratio was 66.5%, improving 370 bps yoy, producing +22% yoy EBIT growth. Despite elevated costs associated with efforts to restore network fluidity, incremental margins strong (~75%).
- **Growth rates should decelerate in 2H14 as volumes normalize, but visibility to sustained 10-15% EPS growth improving.** We expect volume, revenue and EPS growth to decelerate in 2H14 from 2Q14 rates of growth as economic conditions stabilize and NSC maintains elevated expense levels to normalize network velocity. However, both revenue and EPS growth are expected to accelerate in 2015 from 2014 rates, as NSC should benefit from: 1) stabilizing coal fundamentals, 2) accelerating growth in Merchandise/Intermodal, and 3) EBIT margin expansion from solid (i.e., 50%+) incremental margins on growth.
- **Raising 2014/2015 EPS estimates.** New 2014 EPS estimate of $6.56 above recent $6.37 consensus. New 2015 EPS estimate of $7.47 above recent $7.25 consensus and reflects 53% incrementals margins and +14% EPS growth (from +12% in 2014E).
- **Remain Neutral-rated, but look for pullbacks for an entry point.** We believe a "post-coal," 10-15% sustainable annual EPS growth outlook is becoming increasingly apparent for NSC (and CSX, for that matter) beginning in 2015--a critical catalyst to the stock. Our new $118 price target reflects 15x our forward EPS estimates, one year out. Better buyers on pullbacks to the low $100s.

Norfolk Southern Corporation, headquartered in Norfolk, VA, is an $11.2 billion provider of railroad-based transportation services through its 36,000-mile network across 22 Eastern US states.

RAISING PRICE TARGET

1-Year Price Chart



Stock Data

Rating:	Neutral
Suitability:	Average Risk
Price Target/Previous:	▲$118/$114
Price (7/23/14):	$106.84
Market Cap (mil):	$33,420
Shares Out (mil):	312.8
Average Daily Vol (mil):	1.48
Dividend Yield:	2.0%

Estimates

FY Dec	2013A	2014E	2015E
Q1	1.22 A	1.17 A	
Q2	1.46 A	1.79 A	
Q3	1.53 A	1.77 E	
Q4	1.64 A	1.82 E	
Fiscal EPS	**5.86 A**	**6.56 E**	**7.47 E**
Previous Est		6.26 E	7.20 E
Fiscal P/E	18.2x	16.3x	14.3x

Chart/Table Sources: Bloomberg and Baird Data

Please refer to Appendix - Important Disclosures and Analyst Certification

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Details

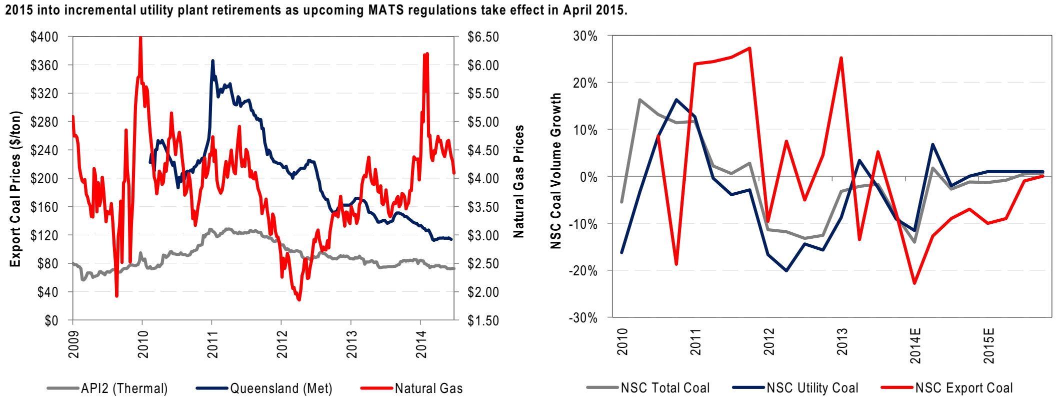
Investment perspective. 2Q14 EPS was above consensus estimates and generally within investor expectations. Volume growth accelerated (carload growth +7.9% yoy, from -1.2% in 1Q14 and +3.3% yoy in 2013) as 1Q14's weather challenges subsided and economic activity recovered. We expect volume, revenue and EPS growth to decelerate in 2H14 as economic conditions stabilize and NSC continues to commit resources to its network in an attempt to normalize network fluidity. Regardless, we believe EPS growth should accelerate in 2015 (+14% yoy, from +12% yoy in 2014E) as NSC enters a "post-coal" period in its life cycle. Coal (23% of 2013's revenue) remains a drag on overall results, with volumes estimated to be -2% yoy in 2014 despite positive Utility coal volume growth in 2Q14. However, NSC's Coal concentration has fallen in recent years (from 29% of revenue in 2010) and domestic coal volumes are showing signs of stabilization in 2014, critical to improving visibility to 10-15% "normalized" EPS growth in 2015 and beyond. NSC is well positioned to benefit from above-GDP volume growth this cycle in its Merchandise and Intermodal units, and we expect core pricing growth to remain above the pace of rail cost inflation, supporting continued margin improvement opportunity this cycle.

We remain Neutral-rated but would look for pullbacks in NSC in the low $100s or greater confidence in upside to our Merchandise volume growth or Intermodal pricing estimates as sources of potential EPS upside to become more constructive with our rating.

Estimates and valuation. Our new $118 price target reflects 15x our forward EPS estimate, one year out, a multiple consistent with our methodology used with CSX to reflect our belief that long-term EPS growth potential in each network is similar. We are raising our 2014 EPS to account for 2Q14's beat and solid incremental margins despite elevated near-term resource requirements to normalize network velocity; our new $6.56 estimate compares to recent $6.37 consensus. Our new 2015 EPS estimate of $7.47 is above recent $7.25 consensus and our previous $7.20 estimate, but reflects 53% incrementals margins and +14% EPS growth (aided in part by an easy 1Q14 weather comparison).

FIGURE 1: COAL METRICS AND VOLUME GROWTH

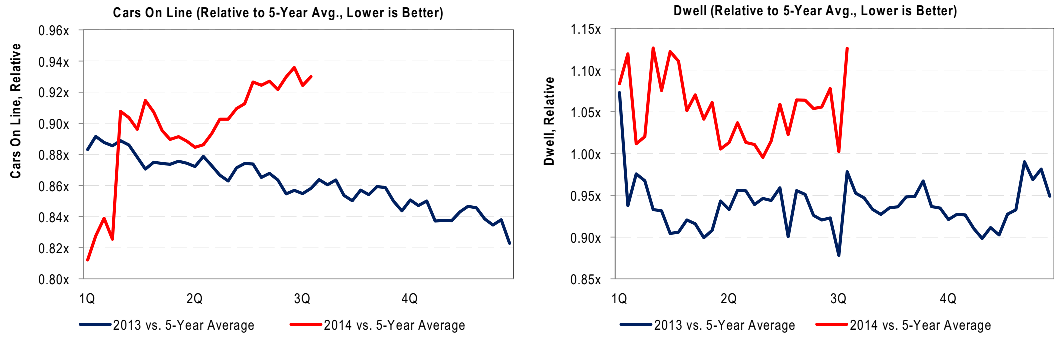
Export coal pricing fundamentals (both met and thermal) remain challenged (see left), which should lead to contracting export coal volumes for NSC into 2H15. Utility coal fundamentals are stabilizing, but we do not expect 2Q14's growth rate (+7% yoy) to carry into 2H14. We expect flattish Utility coal volumes through 2015 into incremental utility plant retirements as upcoming MATS regulations take effect in April 2015.



Source: FactSet, Bloomberg, Company data

FIGURE 2: SERVICE HAS SUFFERED IN 2014 INTO SEVERE WINTER WEATHER CONDITIONS

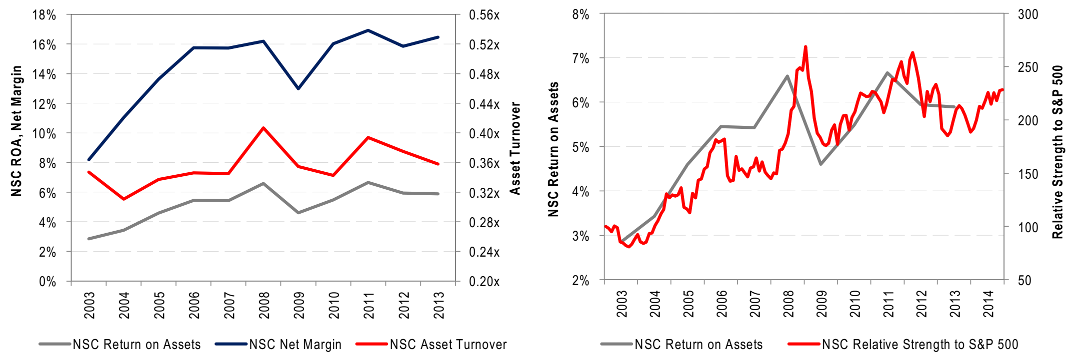
NSC's rail service metrics (measured below using Cars On Line and Terminal Dwell) remain well below prior year levels. Restoring network service will likely extend through 2H14, but continued improvement in asset velocity is critical to driving Asset Turnover and Return On Assets higher this cycle.



Source: AAR, Railroad Performance Measures

FIGURE 3: ASSET TURNOVER WILL LIKELY PLAY A LARGER ROLE IN IMPROVING ROA THIS CYCLE

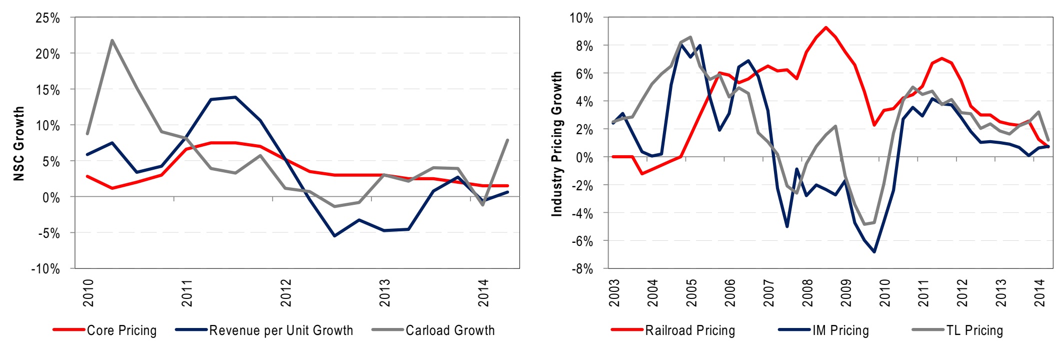
Over the past decade, NSC (and rails broadly) improved Return on Assets through improving Net (Operating) Margin; the resulting improvement in ROA correlated with the stock's relative outperformance of the market. Given a diminished pricing tailwind, Asset Turnover will be needed to drive ROA improvement. In addition, leverage from volume growth will become an increasingly important driver of leverage this cycle; we believe 50%+ incrementals are reasonable in 2015.



Source: Company data, FactSet

FIGURE 4: NSC'S CORE PRICING & VOLUME GROWTH TRENDS

In recent quarters, core pricing growth has been decelerating, while carload growth has been accelerating (left-hand chart). Truckload industry pricing growth has accelerated into 2014, which should support intermodal and broader rail pricing growth, and we similarly expect volume growth to accelerate in 2014 and 2015.



Source: Company data, ACT Research, ATA, AAR, Baird estimates

Detailed Summary of 2Q14 Results

Norfolk Southern Corporation (NSC - NYSE)
Quarterly Results and Variance Sheet

	Quarterly Results					Percent of Revenue		
	2Q14	2Q13	Chg	BAIRD	Variance	2Q14	2Q13	BAIRD
Total Revenue	3,042	2,802	9%	2,974	2%			
Compensation & Benefits	715	726	-2%	741	-3%	23.5%	25.9%	24.9%
Purchased Services and Rents	414	410	1%	417	-1%	13.6%	14.6%	14.0%
Fuel	408	391	4%	403	1%	13.4%	14.0%	13.6%
Depreciation	238	226	5%	237	0%	7.8%	8.1%	8.0%
Materials and Other	248	213	16%	217	14%	8.2%	7.6%	7.3%
Operating Expenses	2,023	1,966	3%	2,015	0%	66.5%	70.2%	67.8%
Operating Income	1,019	836	22%	959	6%	33.5%	29.8%	32.2%
Pre-Tax Income	898	737	22%	847	6%	29.5%	26.3%	28.5%
Income Tax Rate	37.4%	36.9%	1%	37.5%	0%			
Net Income	562	465	21%	529	6%	18.5%	16.6%	17.8%
EPS	$1.79	$1.46	22%	$1.70	5%			
Consensus	$1.74							
Diluted Shares	313	318	-2%	311	1%			

Source: Company reports, Baird estimates

Volume and Pricing:

SUMMARY OF FORECASTS FOR REVENUE METRICS

	Carloads (in Thousands)						Revenue Per Unit					
	Q1	Q2	Q3E	Q4E	2014E	2015E	Q1	Q2	Q3E	Q4E	2014E	2015E
Coal	**300**	**351**	**347**	**325**	**1,322**	**1,319**	**1,805**	**1,916**	**1,942**	**1,998**	**1,915**	**1,915**
Growth (%)	*-13%*	*3%*	*2%*	*1%*	*-2%*	*0%*	*-2%*	*5%*	*3%*	*3%*	*2%*	*0%*
Agricultural/Consumer/Government	147	156	149	162	614	626	2,457	2,479	2,504	2,455	2,474	2,548
Growth (%)	*-1%*	*5%*	*8%*	*1%*	*3%*	*2%*	*1%*	*0%*	*0%*	*0%*	*0%*	*3%*
Metals & Construction	150	194	190	169	702	726	2,207	2,118	2,122	2,225	2,168	2,233
Growth (%)	*-3%*	*13%*	*5%*	*5%*	*5%*	*3%*	*2%*	*4%*	*3%*	*3%*	*3%*	*3%*
Chemicals	116	122	121	124	483	507	3,820	3,730	3,938	3,847	3,834	3,978
Growth (%)	*10%*	*7%*	*7%*	*7%*	*8%*	*5%*	*3%*	*2%*	*4%*	*4%*	*3%*	*4%*
Paper/Clay/Forest	72	76	79	77	304	308	2,620	2,628	2,652	2,675	2,644	2,723
Growth (%)	*-5%*	*-1%*	*-1%*	*-1%*	*-2%*	*1%*	*3%*	*2%*	*3%*	*3%*	*3%*	*3%*
Automotive	92	110	96	107	405	422	2,455	2,469	2,514	2,500	2,485	2,559
Growth (%)	*-6%*	*3%*	*3%*	*3%*	*1%*	*4%*	*0%*	*1%*	*3%*	*3%*	*2%*	*3%*
Total Merchandise	**578**	**657**	**635**	**638**	**2,507**	**2,589**	**2,686**	**2,620**	**2,683**	**2,699**	**2,671**	**2,761**
Growth (%)	*-1%*	*7%*	*5%*	*3%*	*4%*	*3%*	*3%*	*2%*	*3%*	*3%*	*2%*	*3%*
Total Intermodal	**885**	**976**	**986**	**987**	**3,834**	**4051**	**673**	**666**	**676**	**683**	**675**	**692**
Growth (%)	*3%*	*11%*	*8%*	*7%*	*7%*	*6%*	*1%*	*0%*	*2%*	*2%*	*1%*	*3%*

Source: Company data, Baird estimates

Operational Execution:

SUMMARY OF OPERATING METRICS

	2011	2012	Q1	Q2	Q3	Q4	2013	Q1	Q2	Q3E	Q4E	2014E	2015E
Revenue Growth	17%	-1%	-2%	-3%	5%	7%	2%	-2%	9%	8%	6%	5%	6%
Volume Growth	5.2%	-0.1%	3.1%	2.2%	4.0%	3.9%	3.3%	-1.2%	7.9%	5.9%	4.7%	4.4%	3.9%
Yield Growth	11.6%	-1.1%	-4.7%	-4.6%	0.8%	2.7%	-1.5%	-0.6%	0.6%	1.7%	1.6%	0.8%	1.7%
Operating Ratio	70.7%	71.7%	74.8%	70.2%	69.9%	69.4%	71.0%	75.2%	66.5%	67.2%	66.7%	68.7%	67.6%
Train Speed	-1%	13%	3%	0%	-1%	-3%	0%	-8%	-8%				
Dwell	0%	-12%	1%	-2%	0%	1%	0%	14%	10%				
Cars On-Line		-7%	-6%	-7%	-7%	-7%	-7%	0%					
Revenue Ton-Miles	6%	-4%	5%	3%	5%	5%	4%	-1%	10%				
Gross Ton-Miles	6%	-2%	4%	3%	5%	5%	4%	-1%	8%				
Employees	6%	2%	-2%	-2%	-3%	-4%	-3%	-4%	-4%				

Source: Company data, Baird estimates

Balance Sheet and Cash Flow:

BALANCE SHEET AND CASH FLOW ($millions)

	2011	2012	Q1	Q2	Q3	Q4	2013	Q1	Q2	Q3E	Q4E	2014E	2015E
Net Income	1,916	1,749	450	465	482	513	1,910	368	562	551	563	2,044	2,291
D&A	869	922	228	228	231	235	922	238	240	242	240	960	1,000
Other	615	389	11	65	57	35	168	(19)	0	104	104	189	222
Working Capital	(173)	5	34	25	128	(109)	78	1	47	(38)	(38)	(29)	(33)
Cash Flow from Operating	**3,227**	**3,065**	**723**	**783**	**898**	**674**	**3,078**	**588**	**849**	**859**	**869**	**3,164**	**3,480**
Capital Expenditures (Gross)	(2,160)	(2,241)	(379)	(505)	(586)	(501)	(1,971)	(381)	(428)	(696)	(696)	(2,200)	(2,000)
Cash Flow from Investing	**(1,772)**	**(1,994)**	**(366)**	**(441)**	**(562)**	**(525)**	**(1,894)**	**(254)**	**(393)**	**(627)**	**(627)**	**(1,900)**	**(1,700)**
Issuance (Repayment) of Debt (net)	501	1,129	(203)	(13)	460	495	739	(100)	(113)	(400)	113	(500)	(300)
Issuance (Repurchase) of Stock (net)	(1,931)	(1,199)	22	(256)	(238)	(24)	(496)	12	(30)	(250)	(250)	(518)	(700)
Cash Flow from Financing	**(2,006)**	**(694)**	**(338)**	**(427)**	**61**	**310**	**(394)**	**(255)**	**(311)**	**(825)**	**(311)**	**(1,701)**	**(1,700)**
Ending Cash Balance	**301**	**668**	**687**	**587**	**1,004**	**1,561**	**1,561**	**1,532**	**1,667**	**1,075**	**1,006**	**1,006**	**1,086**
Ending Debt Balance	7,540	8,682	8,485	8,477	8,946	9,448	9,448	9,354	9,247	8,847	8,960	8,960	8,660
Debt / Total Cap (incl Op leases)	45%	48%	48%	47%	47%	46%	46%	45%	44%				

Source: Company data, Baird estimates

Investment Thesis

Current thoughts. 2Q14 EPS was above consensus estimates and generally within investor expectations. Volume growth accelerated (carload growth +7.9% yoy, from -1.2% in 1Q14 and +3.3% yoy in 2013) as 1Q14's weather challenges subsided and economic activity recovered. We expect volume, revenue and EPS growth to decelerate in 2H14 as economic conditions stabilize and NSC continues to commit resources to its network in an attempt to normalize network fluidity. Regardless, we believe EPS growth should accelerate in 2015 (+14% yoy, from +12% yoy in 2014E) as NSC enters a "post-coal" period in its life cycle. Coal (23% of 2013's revenue) remains a drag on overall results, with volumes estimated to be -2% yoy in 2014 despite positive Utility coal volume growth in 2Q14. However, NSC's Coal concentration has fallen in recent years (from 29% of revenue in 2010) and domestic coal volumes are showing signs of stabilization in 2014, critical to improving visibility to 10-15% “normalized” EPS growth in 2015 and beyond. NSC is well positioned to benefit from above-GDP volume growth this cycle in its Merchandise and Intermodal units, and we expect core pricing growth to remain above the pace of rail cost inflation, supporting continued margin improvement opportunity this cycle. We remain Neutral-rated but would look for pullbacks in NSC in the low $100s or greater confidence in upside to our Merchandise volume growth or Intermodal pricing estimates as sources of potential EPS upside to become more constructive with our rating.

An integral component of the US economy. The $90 billion North American railroad industry is an integral part of the transportation system and the broader economy. Rails account for 43% of US freight ton miles and roughly 10% of the $870 billion US freight spend. Rails carry freight that is the cornerstone of the US economy, including commodities, grain, industrial products, coal, and intermodal freight. Further, rails are among the most energy-efficient transportation modes and the only effective alternative to the aging and increasingly congested highway infrastructure.

Rail pricing drives opportunities for improved returns. After 25 years of falling nominal freight rates, rail pricing hit an inflection in 2004 as service improved, growth capital investments took place, and industry pricing discipline took hold. Rails historically failed to earn their cost of capital, and because long-term volume growth potential is limited (less than 2% CAGR over the past decade), sustained pricing power is key to driving better returns and incent growth capital investment. NSC has re-priced virtually all of its business since 2004, so while NSC does not have the legacy re-pricing momentum, it will benefit from above inflationary pricing as contracts renew.

Industry leader in operating efficiency and innovation. On the heels of multiple decades of uninspiring returns on capital, the improving industry return profile prompted both innovation and investment. NSC has been at the industry forefront on utilizing technology to improve operational performance and drive capital returns. NSC's Future Track initiative intends to focus on better overall operating performance through improvements in safety, fuel efficiency, workforce productivity and asset utilization while driving toward revenue growth and service improvement. We expect continued efficiencies from Future Track and continued pricing power should support a sub-70s OR during the next cycle.

Intermodal: the growth commodity. Intermodal (21% of NSC revenue) is the fastest-growing rail commodity and taking share from truck given intermodal's cost advantage. NSC has been an industry leader and has the strongest Eastern intermodal network. The company continues to benefit from its network initiatives to expand into additional markets through terminal growth as NSC leverages recent investments in its Heartland Corridor (reduce transit time from East Coast ports to Midwest), Crescent Corridor (from Boston to Austin), Patriot Corridor (improve service in New England), Meridian Speedway (shortest, fastest reefer trailer service from West Coast to Atlanta), and MidAmerica Corridor (long-term potential for the Chicago-Florida route).

Rising ROC potential and earnings performance supports above-average valuation. Historically, NSC trades at roughly 13x with a range of 12-16x. During the 2004-2008 period, Class I rails averaged 14x forward estimates (10x-16x range), while NSC averaged 13x. For the broader industry, the group should trade near a market multiple, owing to improving industry returns on capital, better earnings resilience than the market during the recession, and earnings growth in line with market expectations. Our $118 price target reflects 15x forward EPS, one year out, a premium to NSC's roughly 13x 10-year average supported by normalizing EPS growth given signs of stabilizing domestic utility coal fundamentals and anticipated Merchandise/Intermodal growth in excess of GDP supported by secular growth opportunities.

Risks & Caveats

- **A regulated industry.** Railroad legislation before Congress contains items which could increase railroad regulation and negatively impact pricing and returns.
- **Rising return on capital essential to our thesis.** Inability to achieve improving returns will limit growth capital for future investment and limit free cash flow available to investors.
- **Cyclical exposure.** Railroads earnings can be highly cyclical given the asset intensity and dependency on economic growth.
- **Mature industry.** Rails are tied to mature end markets resulting in sub-GDP long-term volume growth, which places increasing importance on the rail pricing to drive long-term earnings growth.
- **Truck competition.** We estimate that as much as 40% of rail freight is directly competitive with truck, which can exert significant pressure to rail pricing.
- **Significant coal exposure.** Coal is one of the rail's largest and most profitable commodities. Increased environment regulation pressure would negatively impact long-term coal demand. Additionally, low natural gas prices (a substitute for coal in electricity production) tend to correlate to lower coal usage.
- **Liability exposure.** As a regulated industry, Rail is forced rails to haul hazmat traffic, which has potentially significant liability.

Company Description

Norfolk Southern is the leading provider of railroad-based transportation services. NSC transports industrial goods and commodities via its 36,100-mile network throughout 22 states in the Eastern US. NSC maintains interchange agreements with other rail carriers to provide access to the Western US and Canada. NSC is the leading provider of Intermodal (21% of revenue) rail services in the East, with a presence in coal (22%), industrial products (20%) and chemicals (15%). NSC employs roughly 30,000 people, of which over 80% are represented by labor unions.

Norfolk Southern Corporation
(NSC - NYSE)

Income Statement ($millions) — **Robert W. Baird & Co., Inc.**

	2005	2006	2007	2008	2009	2010	2011	1Q12	2Q12	3Q12	4Q12	2012	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14	3Q14E	4Q14E	2014E	2015E
Revenues																							
Coal	2,115	2,330	2,315	3,111	2,263	2,719	3,458	766	755	701	657	2,879	635	626	641	641	2,543	541	672	673	650	2,536	2,530
General Merchandise	4,586	5,106	5,196	5,492	4,175	5,001	5,584	1,496	1,556	1,425	1,443	5,920	1,530	1,588	1,578	1,622	6,318	1,552	1,720	1,703	1,722	6,697	7,149
Intermodal	1,826	1,971	1,921	2,058	1,531	1,796	2,130	527	563	567	584	2,241	573	588	605	618	2,384	596	650	667	674	2,587	2,802
Total Revenue	**8,527**	**9,407**	**9,432**	**10,661**	**7,969**	**9,516**	**11,172**	**2,789**	**2,874**	**2,693**	**2,684**	**11,040**	**2,738**	**2,802**	**2,824**	**2,881**	**11,245**	**2,689**	**3,042**	**3,043**	**3,047**	**11,821**	**12,481**
Growth (%)	17%	10%	0%	13%	-25%	19%	17%	6%	0%	-7%	-4%	-1%	-2%	-3%	5%	7%	2%	-2%	9%	8%	6%	5%	6%
Expenses																							
Compensation & Benefits	2,493	2,637	2,552	2,684	2,401	2,708	2,974	786	724	724	726	2,960	780	726	735	761	3,002	740	715	746	759	2,960	3,121
Purchased Services	1,142	1,165	1,172	1,242	1,087	1,151	1,272	318	320	333	350	1,321	321	343	349	340	1,353	324	342	352	335	1,353	1,399
Equipment Rents	405	413	379	357	316	326	338	73	72	70	68	283	72	67	71	66	276	68	72	72	67	279	282
Fuel	821	1,095	1,169	1,638	725	1,079	1,589	413	390	379	395	1,577	429	391	390	403	1,613	432	408	411	414	1,665	1,711
Depreciation	774	738	775	804	837	819	862	224	229	230	233	916	227	226	230	233	916	237	238	242	240	957	1,000
Materials	315	346	359	380	309	346	408	112	95	109	92	408	101	116	100	105	422	108	124	105	102	439	451
Casualties & Other Claims	248	220	171	170	102	142	158	38	30	33	29	130	35	20	23	12	90	30	42	37	34	143	138
Other	236	236	270	292	230	269	300	80	80	84	77	321	82	77	77	80	316	83	82	80	82	326	332
Total Expense	6,434	6,850	6,847	7,567	6,007	6,840	7,901	2,044	1,940	1,962	1,970	7,916	2,047	1,966	1,975	2,000	7,988	2,022	2,023	2,044	2,033	8,122	8,434
Operating Ratio	**75.4%**	**72.8%**	**72.6%**	**71.0%**	**75.4%**	**71.9%**	**70.7%**	**73.3%**	**67.5%**	**72.9%**	**73.4%**	**71.7%**	**74.8%**	**70.2%**	**69.9%**	**69.4%**	**71.0%**	**75.2%**	**66.5%**	**67.2%**	**66.7%**	**68.7%**	**67.6%**
Expense Growth (%)	15%	6%	0%	11%	-21%	14%	16%	4%	-3%	1%	-1%	0%	0%	1%	1%	2%	1%	-1%	3%	4%	2%	2%	4%
EBITDA	2,868	3,295	3,360	3,898	2,799	3,495	4,133	969	1,163	961	947	4,040	918	1,062	1,079	1,114	4,173	904	1,257	1,240	1,254	4,655	5,047
EBIT	**2,094**	**2,557**	**2,585**	**3,094**	**1,962**	**2,676**	**3,271**	**745**	**934**	**731**	**714**	**3,124**	**691**	**836**	**849**	**881**	**3,257**	**667**	**1,019**	**998**	**1,014**	**3,698**	**4,047**
EBIT Margin	24.6%	27.2%	27.4%	29.0%	24.6%	28.1%	29.3%	26.7%	32.5%	27.1%	26.6%	28.3%	25.2%	29.8%	30.1%	30.6%	29.0%	24.8%	33.5%	32.8%	33.3%	31.3%	32.4%
Growth (%)	23%	22%	1%	20%	-37%	36%	22%	13%	7%	-22%	-11%	-4%	-7%	-10%	16%	23%	4%	-3%	22%	18%	15%	14%	9%
Other Income, net	(420)	(327)	(348)	(334)	(340)	(309)	(295)	(91)	(91)	(91)	(93)	(366)	(91)	(99)	(101)	(98)	(389)	(113)	(121)	(117)	(115)	(466)	(381)
Pretax Income	1,674	2,230	2,237	2,760	1,622	2,367	2,976	654	843	640	621	2,758	600	737	748	783	2,868	554	898	881	899	3,232	3,666
Tax Rate (%)	30.5%	33.6%	33.7%	37.5%	36.3%	35.7%	36.5%	37.3%	37.8%	37.2%	33.5%	36.6%	35.0%	36.9%	35.6%	34.5%	35.5%	33.6%	37.4%	37.4%	37.4%	36.8%	37.5%
Net Income	**1,163**	**1,481**	**1,483**	**1,726**	**1,034**	**1,523**	**1,889**	**410**	**524**	**402**	**413**	**1,749**	**390**	**465**	**482**	**513**	**1,850**	**368**	**562**	**551**	**563**	**2,044**	**2,291**
Shares Outstanding, Diluted	412	415	398	380	372	372	351	333	328	322	319	325	318	318	314	312	316	313	313	311	310	312	307
Continuing Ops EPS	**$2.82**	**$3.57**	**$3.73**	**$4.54**	**$2.76**	**$4.07**	**$5.35**	**$1.23**	**$1.60**	**$1.24**	**$1.30**	**$5.37**	**$1.22**	**$1.46**	**$1.53**	**$1.64**	**$5.86**	**$1.17**	**$1.79**	**$1.77**	**$1.82**	**$6.56**	**$7.47**
Growth (%)	29%	27%	4%	22%	-39%	48%	31%	23%	16%	-22%	-9%	0%	0%	-9%	23%	27%	9%	-4%	23%	16%	11%	12%	14%
GAAP EPS	$3.11	$3.57	$3.68	$4.52	$2.76	$4.00	$5.35	$1.23	$1.59	$1.24	$1.29	$5.38	$1.22	$1.46	$1.53	$1.64	$5.86	$1.17	$1.79	$1.77	$1.81	$6.56	$7.47
Dividend	$0.48	$0.68	$0.96	$1.22	$1.36	$1.40	$1.66	$0.47	$0.47	$0.50	$0.50	$1.94	$0.50	$0.50	$0.52	$0.52	$2.04	$0.54	$0.54	$0.57	$0.57	$2.22	$2.32
Carloads (volume)																							
Coal	3%	1%	-3%	4%	-20%	10%	4%	-12%	-12%	-14%	-13%	-13%	-4%	-4%	-2%	-8%	-5%	-13%	3%	2%	1%	-2%	0%
General Merchandise	0%	0%	-4%	-8%	-21%	14%	0%	5%	4%	-1%	1%	2%	0%	2%	6%	8%	4%	-1%	7%	5%	3%	4%	3%
Intermodal	9%	3%	-4%	-3%	-16%	16%	10%	5%	5%	5%	4%	5%	9%	5%	5%	6%	6%	3%	11%	8%	7%	7%	6%
Total	**4.3%**	**1.5%**	**-3.9%**	**-3.2%**	**-18.9%**	**13.5%**	**5.2%**	**1.1%**	**0.7%**	**-1.4%**	**-0.8%**	**-0.1%**	**3.1%**	**2.2%**	**4.0%**	**3.9%**	**3.3%**	**-1.2%**	**7.9%**	**5.9%**	**4.7%**	**4.4%**	**3.9%**
Revenue per carload (yield)																							
Coal	19%	9%	3%	29%	-9%	9%	22%	6%	-4%	-9%	-11%	-5%	-13%	-14%	-6%	4%	-8%	-2%	5%	3%	3%	2%	0%
General Merchandise	13%	12%	6%	15%	-3%	6%	11%	8%	5%	1%	2%	4%	3%	0%	4%	4%	3%	3%	2%	3%	3%	2%	3%
Intermodal	9%	4%	2%	10%	-11%	1%	8%	3%	0%	-2%	2%	1%	0%	-1%	2%	-1%	0%	1%	0%	2%	2%	1%	3%
Total	**11.7%**	**8.8%**	**4.3%**	**16.8%**	**-7.8%**	**5.2%**	**11.6%**	**5.2%**	**-0.4%**	**-5.5%**	**-3.3%**	**-1.1%**	**-4.7%**	**-4.6%**	**0.8%**	**2.7%**	**-1.5%**	**-0.6%**	**0.6%**	**1.7%**	**1.6%**	**0.8%**	**1.7%**
Expense Ratios (% Total Rev)																							
Compensation & Benefits	29.2%	28.0%	27.1%	25.2%	30.1%	28.5%	26.6%	28.2%	25.2%	26.9%	27.0%	26.8%	28.5%	25.9%	26.0%	26.4%	26.7%	27.5%	23.5%	24.5%	24.9%	25.0%	25.0%
Purchased Services	13.4%	12.4%	12.4%	11.6%	13.6%	12.1%	11.4%	11.4%	11.1%	12.4%	13.0%	12.0%	11.7%	12.2%	12.4%	11.8%	12.0%	12.0%	11.2%	11.6%	11.0%	11.4%	11.2%
Equipment Rents	4.7%	4.4%	4.0%	3.3%	4.0%	3.4%	3.0%	2.6%	2.5%	2.6%	2.5%	2.6%	2.6%	2.4%	2.5%	2.3%	2.5%	2.5%	2.4%	2.4%	2.2%	2.4%	2.3%
Fuel	9.6%	11.6%	12.4%	15.4%	9.1%	11.3%	14.2%	14.8%	13.6%	14.1%	14.7%	14.3%	15.7%	14.0%	13.8%	14.0%	14.3%	16.1%	13.4%	13.5%	13.6%	14.1%	13.7%
Depreciation	9.1%	7.8%	8.2%	7.5%	10.5%	8.6%	7.7%	8.0%	8.0%	8.5%	8.7%	8.3%	8.3%	8.1%	8.1%	8.1%	8.1%	8.8%	7.8%	7.9%	7.9%	8.1%	8.0%
Materials	3.7%	3.7%	3.8%	3.6%	3.9%	3.6%	3.7%	4.0%	3.3%	4.0%	3.4%	3.7%	3.7%	4.1%	3.5%	3.6%	3.8%	4.0%	4.1%	3.4%	3.3%	3.7%	3.6%
Casualties & Other Claims	2.9%	2.3%	1.8%	1.6%	1.3%	1.5%	1.4%	1.4%	1.0%	1.2%	1.1%	1.2%	1.3%	0.7%	0.8%	0.4%	0.8%	1.1%	1.4%	1.2%	1.1%	1.2%	1.1%
Other	2.8%	2.5%	2.9%	2.7%	2.9%	2.8%	2.7%	2.9%	2.8%	3.1%	2.9%	2.9%	3.0%	2.7%	2.7%	2.8%	2.8%	3.1%	2.7%	2.6%	2.7%	2.8%	2.7%

Source: Company reports and Robert W. Baird & Co. estimates.
Please refer to Appendix - Important Disclosures and Analyst Certification.

Benjamin J. Hartford, CFA (414) 765-3752

Norfolk Southern Corporation
(NSC - NYSE)

Balance Sheet ($mln)

	2006	2007	2008	2009	2010	2011	2012	2013	2Q14
ASSETS									
Cash and Cash Equivalents	$918	$206	$618	$1,086	$1,110	$301	$668	$1,561	$1,667
Accounts Receivable, net	992	942	870	766	807	1,022	1,109	1,024	1,122
Materials and Supplies	151	176	194	164	169	209	216	223	251
Deferred Income Taxes	186	190	149	142	145	143	167	180	161
Other Current Assets	153	161	168	88	240	76	82	87	65
Total Current	**2,400**	**1,675**	**1,999**	**2,246**	**2,471**	**1,751**	**2,242**	**3,075**	**3,266**
Investments	4,255	1,974	1,779	2,164	2,193	2,234	2,300	2,439	2,505
Net Property & Equipment	21,098	21,583	22,247	22,643	23,231	24,469	25,736	26,645	26,927
Other Assets	775	912	272	316	304	84	64	324	342
Total Assets	**28,528**	**26,144**	**26,297**	**27,369**	**28,199**	**28,538**	**30,342**	**32,483**	**33,040**
LIABILITIES & EQUITIES									
Accounts Payable & Other Liabilities	1,181	1,139	1,140	974	1,181	1,092	1,362	1,265	1,245
Income & Other Taxes	205	203	261	109	199	207	206	225	359
Other Current Liabilities	216	237	220	232	244	252	263	270	331
Current Maturities of Long-Term Debt	491	369	484	474	458	150	250	545	433
Total Current	**2,093**	**1,948**	**2,105**	**1,789**	**2,082**	**1,701**	**2,081**	**2,305**	**2,368**
Long-term Debt	6,109	5,999	6,183	6,679	6,567	7,390	8,432	8,903	8,814
Other Liabilities	4,267	2,039	2,030	1,801	1,793	2,050	2,237	1,444	1,122
Deferred Income Taxes	6,444	6,431	6,372	6,747	7,088	7,486	7,832	8,542	8,659
Shareholder's Equity	9,615	9,727	9,607	10,353	10,669	9,911	9,760	11,289	12,077
Total Liabilities and Equity	**28,528**	**26,144**	**26,297**	**27,369**	**28,199**	**28,538**	**30,342**	**32,483**	**33,040**

Balance Sheet Analysis	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2Q14**
Current Ratio	1.1	0.9	0.9	1.3	1.2	1.0	1.1	1.3	1.4
Days Sales Outstanding (DSO)	37.3	37.4	31.0	37.5	30.2	29.9	35.2	34.6	35.0
EBIT/ Interest Expense	7.8	7.4	9.3	5.8	8.7	11.1	8.5	8.4	7.9
Debt / Total Cap	41%	40%	41%	41%	40%	43%	47%	46%	43%
Debt / Total Cap (incl Op Leases)	42%	41%	42%	41%	40%	45%	48%	46%	44%
Book Value/Share	$23.19	$24.45	$25.28	$27.73	$29.17	$29.27	$30.63	$36.15	$38.61

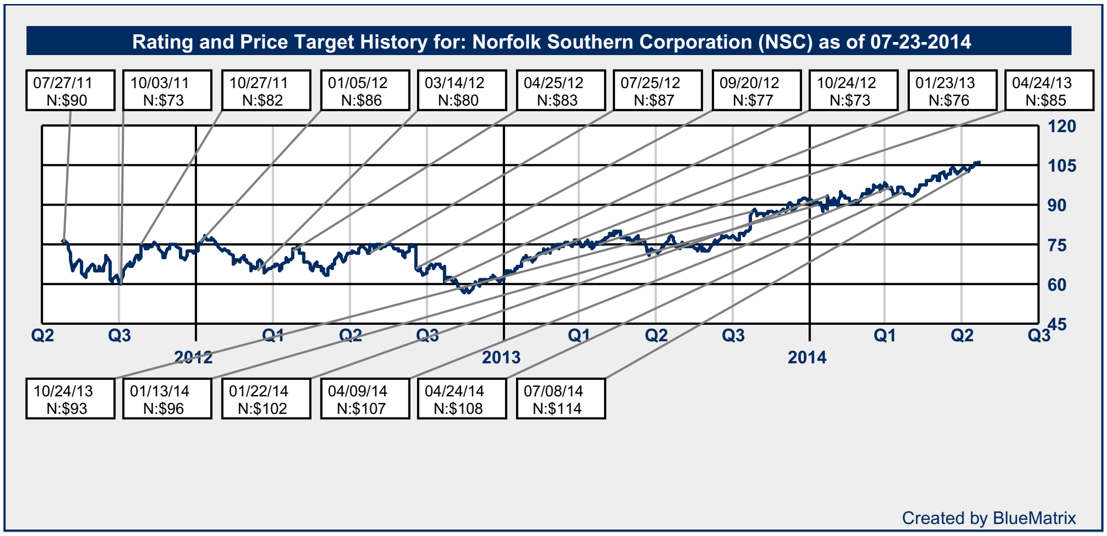
Cash Flow Statement	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014E**	**2015E**
Net Income	$1,481	$1,464	$1,716	$1,034	$1,496	$1,916	$1,749	$1,910	$2,044	$2,291
Depreciation and Amortization	750	786	815	845	826	869	922	922	960	1,000
Other	27	57	203	181	313	615	389	168	189	222
NWC Changes	(52)	26	(19)	(200)	79	(173)	5	78	(29)	(33)
Cash Flow from Ops (CFO)	**2,206**	**2,333**	**2,715**	**1,860**	**2,714**	**3,227**	**3,065**	**3,078**	**3,164**	**3,480**
Capital Expenditures	(1,059)	(1,217)	(1,449)	(1,215)	(1,373)	(2,076)	(2,049)	(1,827)	(2,100)	(1,900)
Free Cash Flow (FCF)	**1,147**	**1,116**	**1,266**	**645**	**1,341**	**1,151**	**1,016**	**1,251**	**1,064**	**1,580**
Dividends	(278)	(377)	(456)	(500)	(514)	(576)	(624)	(637)	(683)	(700)
Net Cash Flow (NCF)	**869**	**739**	**810**	**145**	**827**	**575**	**392**	**614**	**381**	**880**
FCF/Share	2.77	2.81	3.33	1.73	3.67	3.30	3.16	4.01	3.40	5.15
NCF/Share	2.10	1.86	2.13	0.39	2.26	1.65	1.22	1.97	1.22	2.87

	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**LTM**
Net Margins (NI/S)	15.7%	15.7%	16.2%	13.0%	16.0%	16.9%	15.8%	16.5%	16.8%
Assets Turnover (S/A)	0.35	0.35	0.41	0.35	0.34	0.39	0.38	0.36	0.36
Leverage (A/E)	2.87	2.83	2.71	2.69	2.64	2.76	2.99	2.98	2.86
Return on Equity	15.7%	15.3%	17.9%	12.4%	14.5%	18.4%	17.8%	17.6%	17.3%
Return on Assets	5.4%	5.4%	6.6%	4.6%	5.5%	6.7%	5.9%	5.9%	6.0%
ROC (after-tax)	11.0%	10.8%	12.0%	8.0%	10.1%	12.7%	11.8%	11.4%	11.2%

Valuation Measures	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**LTM**
Historical P/E High	16	16	17	20	16	15	15	16	-18
Historical P/E Low	11	12	9	10	11	11	11	11	-12
Historical P/FCF High - current yr	21	21	23	32	17	24	25	24	-32
Historical P/FCF Low - current yr	14	16	12	15	13	17	18	17	-21
Enterprise Value (EV)								**Recent Price:**	**($107.61)**
Equity Value	20,855	20,065	17,879	17,564	22,973	23,400	21,242	29,753	(33,639)
ST+LT Debt	6,600	6,368	6,667	7,153	7,025	7,540	8,682	9,448	9,247
Cash & Equivalents	918	206	618	1,086	1,110	301	668	1,561	1,667
Total EV	26,537	26,227	23,928	23,631	28,888	30,639	29,256	37,640	(26,059)
EBITDA	3,295	3,360	3,898	2,799	3,495	4,133	4,040	4,173	4,354
EV / EBITDA	8.1	7.8	6.1	8.4	8.3	7.4	7.2	9.0	-6.0

Source: Company reports and Robert W. Baird & Co. estimates.
Please refer to Appendix - Important Disclosures and Analyst Certification.

Appendix - Important Disclosures and Analyst Certification



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