

NORFOLK SOUTHERN CORP  
Form 10-Q  
April 27, 2012

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549  
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF**

1934 for the quarterly period ended **MARCH 31, 2012**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF**

1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-8339

**NORFOLK SOUTHERN CORPORATION**  
(Exact name of registrant as specified in its charter)

**Virginia**  
(State or other jurisdiction of incorporation)

**52-1188014**  
(IRS Employer Identification No.)

**Three Commercial Place**  
**Norfolk, Virginia**  
(Address of principal executive offices)

**23510-2191**  
(Zip Code)

**(757) 629-2680**  
(Registrant's telephone number, including area code)

**No Change**  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

[ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| <u>Class</u>                              | <u>Outstanding at March 31, 2012</u>   |
|---|--|
| Common Stock (\$1.00 par value per share) | 325,763,164 (excluding 20,320,777 shares held by the registrant's consolidated subsidiaries) |

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**PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements**

**Norfolk Southern Corporation and Subsidiaries**  
**Consolidated Statements of Income**  
**(Unaudited)**

|                                       | <b>Three Months Ended</b>                         |                    |
|---------------------------------------|---|--------------------|
|                                       | <b>March 31,</b>                                  |                    |
|                                       | <b><u>2012</u></b>                                | <b><u>2011</u></b> |
|                                       | <i>(\$ in millions, except per share amounts)</i> |                    |
| <b>Railway operating revenues</b>     | \$ 2,789  | \$ 2,620           |
| <b>Railway operating expenses:</b>    |   |                    |
| Compensation and benefits             | 786   | 765                |
| Purchased services and rents          | 391   | 383                |
| Fuel                                  | 413   | 389                |
| Depreciation                          | 224   | 211                |
| Materials and other                   | 230   | 272                |
| Total railway operating expenses      | 2,044   | 2,020              |
| <b>Income from railway operations</b> | 745   | 600                |
| Other income - net                    | 29  | 27                 |
| Interest expense on debt              | 120   | 112                |
| Income before income taxes            | 654   | 515                |
| Provision for income taxes            | 244   | 190                |
| <b>Net income</b>                     | \$ 410  | \$ 325             |

**Per share amounts:**

Net income:

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|           |    |      |    |      |
|-----------|----|------|----|------|
| Basic     | \$ | 1.24 | \$ | 0.91 |
| Diluted   |    | 1.23 |    | 0.90 |
| Dividends |    | 0.47 |    | 0.40 |

*See accompanying notes to consolidated financial statements.*

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**Norfolk Southern Corporation and Subsidiaries**  
**Consolidated Statements of Comprehensive Income**  
**(Unaudited)**

|   | <b>Three Months Ended</b> |                    |
|---|---------------------------|--------------------|
|   | <b>March 31,</b>          |                    |
|   | <b><u>2012</u></b>        | <b><u>2011</u></b> |
|   | <i>(\$ in millions)</i>   |                    |
| Net income  | \$ 410                    | \$ 325             |
| Other comprehensive income, before tax:                           |                           |                    |
| Pension and other postretirement benefits                         | 32                        | 28                 |
| Other comprehensive loss of equity investees                      | (4)                       | --                 |
| Other comprehensive income, before tax                            | 28                        | 28                 |
| Income tax expense related to items of other comprehensive income | (12)                      | (9)                |
| Other comprehensive income, net of tax                            | 16                        | 19                 |
| Total comprehensive income  | \$ 426                    | \$ 344             |

*See accompanying notes to consolidated financial statements.*

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**Norfolk Southern Corporation and Subsidiaries**  
**Consolidated Balance Sheets**  
**(Unaudited)**

|   | <b>March 31,</b>        | <b>December 31,</b> |
|---|-------------------------|---------------------|
|   | <b><u>2012</u></b>      | <b><u>2011</u></b>  |
|   | <i>(\$ in millions)</i> |                     |
| <b>Assets</b>   |                         |                     |
| Current assets:   |                         |                     |
| Cash and cash equivalents   | \$ 829                  | \$ 276              |
| Short-term investments  | 2                       | 25                  |
| Accounts receivable - net   | 1,056                   | 1,022               |
| Materials and supplies  | 228                     | 209                 |
| Deferred income taxes   | 146                     | 143                 |
| Other current assets  | 71                      | 76                  |
| Total current assets  | 2,332                   | 1,751               |
| Investments   | 2,263                   | 2,234               |
| Properties less accumulated depreciation of \$9,596 and \$9,464, respectively | 24,703                  | 24,469              |
| Other assets  | 77                      | 84                  |
| <b>Total assets</b>   | <b>\$ 29,375</b>        | <b>\$ 28,538</b>    |
| <b>Liabilities and stockholders' equity</b>                                   |                         |                     |
| Current liabilities:  |                         |                     |
| Accounts payable  | \$ 1,243                | \$ 1,092            |
| Short-term debt   | --                      | 100                 |
| Income and other taxes  | 320                     | 207                 |
| Other current liabilities   | 337                     | 252                 |
| Current maturities of long-term debt  | 32                      | 50                  |
| Total current liabilities   | 1,932                   | 1,701               |
| Long-term debt  | 7,985                   | 7,390               |
| Other liabilities   | 2,053                   | 2,050               |
| Deferred income taxes   | 7,590                   | 7,486               |



|  |               |               |
|--|---------------|---------------|
| <b>Total liabilities</b>   | 19,560        | 18,627        |
| Stockholders' equity:  |               |               |
| Common stock \$1.00 per share par value, 1,350,000,000 shares<br>authorized; outstanding 325,763,164 and 330,386,089 shares,<br>respectively, net of treasury shares | 327           | 332           |
| Additional paid-in capital   | 1,917         | 1,912         |
| Accumulated other comprehensive loss   | (1,010)       | (1,026)       |
| Retained income  | 8,581         | 8,693         |
| <b>Total stockholders' equity</b>  | 9,815         | 9,911         |
| <br><b>Total liabilities and stockholders' equity</b>  | <br>\$ 29,375 | <br>\$ 28,538 |

*See accompanying notes to consolidated financial statements.*

**Norfolk Southern Corporation and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**(Unaudited)**

|  | <b>Three Months Ended</b> |                    |
|--|---------------------------|--------------------|
|  | <b>March 31,</b>          |                    |
|  | <b><u>2012</u></b>        | <b><u>2011</u></b> |
|  | <i>(\$ in millions)</i>   |                    |
| <b>Cash flows from operating activities</b>                                |                           |                    |
| Net income   | \$ 410                    | \$ 325             |
| Reconciliation of net income to net cash provided by operating activities: |                           |                    |
| Depreciation   | 226                       | 213                |
| Deferred income taxes  | 88                        | 112                |
| Gains and losses on properties   | (1)                       | --                 |
| Changes in assets and liabilities affecting operations:                    |                           |                    |
| Accounts receivable  | (34)                      | (127)              |
| Materials and supplies   | (19)                      | (21)               |
| Other current assets   | 5                         | 19                 |
| Current liabilities other than debt  | 316                       | 27                 |
| Other - net  | 44                        | 104                |
| Net cash provided by operating activities                                  | 1,035                     | 652                |
| <b>Cash flows from investing activities</b>                                |                           |                    |
| Property additions   | (461)                     | (423)              |
| Property sales and other transactions                                      | 2                         | (10)               |
| Investments, including short-term  | (4)                       | (4)                |
| Investment sales and other transactions                                    | 27                        | 55                 |
| Net cash used in investing activities                                      | (436)                     | (382)              |
| <b>Cash flows from financing activities</b>                                |                           |                    |
| Dividends  | (155)                     | (142)              |
| Common stock issued - net  | 31                        | 32                 |
| Purchase and retirement of common stock                                    | (400)                     | (343)              |
| Proceeds from borrowings - net   | 696                       | --                 |
| Debt repayments  | (218)                     | (408)              |

|   |        |        |
|---|--------|--------|
| Net cash used in financing activities                   | (46)   | (861)  |
| Net increase (decrease) in cash and cash equivalents    | 553    | (591)  |
| <b>Cash and cash equivalents</b>                        |        |        |
| At beginning of year                                    | 276    | 827    |
| At end of period  | \$ 829 | \$ 236 |
| <b>Supplemental disclosure of cash flow information</b> |        |        |
| Cash paid during the period for:                        |        |        |
| Interest (net of amounts capitalized)                   | \$ 60  | \$ 72  |
| Income taxes (net of refunds)                           | 2      | 3      |

*See accompanying notes to consolidated financial statements.*

**Norfolk Southern Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly Norfolk Southern Corporation (Norfolk Southern) and subsidiaries' (collectively, NS) financial condition as of March 31, 2012, and December 31, 2011, and its results of operations, comprehensive income, and cash flows for the three months ended March 31, 2012 and 2011, in conformity with U.S. generally accepted accounting principles.

These Consolidated Financial Statements should be read in conjunction with the consolidated financial statements and notes included in NS' latest Annual Report on Form 10-K.

### **1. Stock-Based Compensation**

During the first quarter of 2012, a committee of non-employee directors of Norfolk Southern's Board of Directors granted stock options, restricted stock units (RSUs) and performance share units (PSUs) pursuant to the Long-Term Incentive Plan (LTIP) and granted stock options pursuant to the Thoroughbred Stock Option Plan (TSOP) as discussed below. Stock-based compensation expense was \$34 million during the first quarter of 2012 and \$42 million during the same period of 2011. The total tax effects recognized in income in relation to stock-based compensation were net benefits of \$11 million and \$14 million for the quarters ended March 31, 2012 and 2011, respectively.

#### **Stock Options**

In the first quarter of 2012, 567,300 options were granted under the LTIP and 210,300 options were granted under the TSOP. In each case, the grant price was \$75.14, which was the greater of the average fair market value of Norfolk Southern common stock (Common Stock) or the closing price of the Common Stock on the effective date of the grant, and the options have a term of ten years. The options granted under the LTIP and TSOP in 2012 may not be exercised prior to the fourth and third anniversaries of the date of grant, respectively. Holders of the 2012 options granted under the LTIP who remain actively employed receive cash dividend equivalent payments for four years in an amount equal to the regular quarterly dividends paid on Common Stock. Dividend equivalent payments are not made on TSOP options.

The fair value of each option award in 2012 was measured on the date of grant using a lattice-based option valuation model. Expected volatilities are based on implied volatilities from traded options on Common Stock and historical volatility of Common Stock. NS uses historical data to estimate option exercises and employee terminations within the valuation model. The average expected option life is derived from the output of the valuation model and represents the period of time that options granted are expected to be outstanding. The average risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. For options granted that include dividend equivalent payments, a dividend yield of zero was used. A dividend yield of 2.3% was used for LTIP options for periods where no dividend equivalent payments are made as well as for TSOP options, which do not receive dividend equivalents. The assumptions for the 2012 LTIP and TSOP grants are shown in the following table:

|                                   |           |
|-----------------------------------|-----------|
| Expected volatility range         | 27% - 29% |
| Average expected volatility       | 27%       |
| LTIP average expected option life | 8.9 years |
| TSOP average expected option life | 8.8 years |

|                                      |         |
|--------------------------------------|---------|
| Average risk-free interest rate      | 1.96%   |
| LTIP per-share grant-date fair value | \$23.84 |
| TSOP per-share grant-date fair value | \$19.55 |

For the first three months of 2012, options relating to 376,357 shares were exercised, yielding \$11 million of cash proceeds and \$6 million of tax benefit recognized as additional paid-in capital. For the first three months of 2011, options relating to 759,193 shares were exercised yielding \$20 million of cash proceeds and \$10 million of tax benefit recognized as additional paid-in capital.

## Restricted Stock Units

There were 140,000 RSUs granted in 2012, with an average grant-date fair value of \$75.14 and a five-year restriction period. The restricted stock units granted in 2012 will be settled through the issuance of shares of Common Stock.

During the first quarter of 2012, 281,900 RSUs were earned and paid out. The total related tax benefit recognized as additional paid-in capital was \$3 million in the first quarter of 2012.

During the first quarter of 2011, no RSUs were earned and paid out. The total related tax benefit recognized as additional paid-in capital was less than \$1 million in the first quarter of 2011.

## Performance Share Units

PSUs provide for awards based on achievement of certain predetermined corporate performance goals (total shareholder return, return on average invested capital and operating ratio) at the end of a three-year cycle and are paid in the form of shares of Common Stock. During the first quarter of 2012, there were 468,850 PSUs granted with a grant-date fair value of \$75.14.

During the first quarter of 2012, 782,889 PSUs were earned and paid out in shares of Common Stock. The total related tax benefit recognized as additional paid-in capital was \$11 million for the first quarter of 2012.

During the first quarter of 2011, 850,595 PSUs were earned and paid out, one-half in shares of Common Stock and one-half in cash. These PSUs had a grant-date fair value of \$50.47 per unit and a fair value at payout of \$62.75 per unit. The total related tax benefit recognized as additional paid-in capital was \$2 million for the first quarter of 2011.

## 2. Income Taxes

There have been no material changes to the balance of unrecognized tax benefits reported at December 31, 2011. NS anticipates that the Internal Revenue Service (IRS) will complete its examination of NS' 2009 and 2010 federal income tax returns by the end of 2012. NS does not expect that the resolution of the examination will have a material effect on its financial position, results of operations, or liquidity.

## 3. Earnings Per Share

|   | Basic  |             | Diluted     |             |
|---|--|-------------|-------------|-------------|
|   | Three months ended March 31,                                 |             |             |             |
|   | <u>2012</u>  | <u>2011</u> | <u>2012</u> | <u>2011</u> |
|   | <i>(\$ in millions except per share, shares in millions)</i> |             |             |             |
| Net income                              | \$ 410   | \$ 325      | \$ 410      | \$ 325      |
| Dividend equivalent payments            | (3)  | (2)         | (2)         | (2)         |
| Income available to common stockholders | 407  | 323         | 408         | 323         |
| Weighted-average shares outstanding     | 328.3  | 355.2       | 328.3       | 355.2       |
|   |  |             | 4.6         | 5.3         |

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Dilutive effect of outstanding options and share-settled awards

|  |    |      |    |       |    |       |    |      |
|--|----|------|----|-------|----|-------|----|------|
| Adjusted weighted-average shares outstanding |    |      |    | 332.9 |    | 360.5 |    |      |
| Earnings per share                           | \$ | 1.24 | \$ | 0.91  | \$ | 1.23  | \$ | 0.90 |
|  |    |      |    | 8     |    |       |    |      |

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During the first quarters of 2012 and 2011, dividend equivalent payments were made to holders of stock options and RSUs. For purposes of computing basic earnings per share, the total amount of dividend equivalent payments made to holders of stock options and RSUs were deducted from net income to determine income available to common stockholders. For purposes of computing diluted earnings per share, NS evaluates on a grant-by-grant basis those stock options and RSUs receiving dividend equivalent payments under the two-class and treasury stock methods to determine which method is the more dilutive for each award. For those grants for which the two-class method was more dilutive, net income was reduced by the amount of dividend equivalent payments on these awards to determine income available to common stockholders. The diluted calculations exclude options having exercise prices exceeding the average market price of Common Stock as follows: 0.8 million in 2012 and zero in 2011.

#### **4. Stockholders' Equity**

Common stock is reported net of shares held by consolidated subsidiaries (Treasury Shares) of Norfolk Southern. Treasury Shares at March 31, 2012 and December 31, 2011, amounted to 20,320,777 shares, with a cost of \$19 million as of the end of both periods.

#### **5. Stock Repurchase Program**

NS repurchased and retired 5.7 million shares of Common Stock in the first quarter of 2012, at a cost of \$400 million. NS repurchased and retired 5.3 million shares of Common Stock in the first quarter of 2011, at a cost of \$343 million. The timing and volume of purchases is guided by management's assessment of market conditions and other pertinent factors. Any near-term share repurchases are expected to be made with internally generated cash, cash on hand, or proceeds from borrowings. Since the beginning of 2006, NS has repurchased and retired 115.3 million shares at a total cost of \$6.6 billion.

#### **6. Investment in Conrail**

Through a limited liability company, Norfolk Southern and CSX Corporation (CSX) jointly own Conrail Inc. (Conrail), whose primary subsidiary is Consolidated Rail Corporation (CRC). NS has a 58% economic and 50% voting interest in the jointly owned entity, and CSX has the remainder of the economic and voting interests. NS' investment in Conrail was \$975 million at March 31, 2012, and \$969 million at December 31, 2011.

CRC owns and operates certain properties (the Shared Assets Areas) for the joint and exclusive benefit of Norfolk Southern Railway Company (NSR) and CSX Transportation, Inc. (CSXT). The costs of operating the Shared Assets Areas are borne by NSR and CSXT based on usage. In addition, NSR and CSXT pay CRC a fee for access to the Shared Assets Areas. "Purchased services and rents" and "Fuel" include expenses for the use of the Shared Assets Areas totaling \$36 million for the first quarter of 2012 and \$33 million for the first quarter of 2011. NS' equity in the earnings of Conrail, net of amortization, included in "Other income – net" was \$6 million for both the first quarter of 2012 and 2011.

"Accounts payable" includes \$161 million at March 31, 2012, and \$160 million at December 31, 2011, due to Conrail for the operation of the Shared Assets Areas. In addition, "Other liabilities" includes \$133 million at both March 31, 2012 and December 31, 2011, for long-term advances from Conrail, maturing 2035, that bear interest at an average rate of 4.4%.

#### **7. Debt**



In the first quarter of 2012, NS borrowed \$100 million and repaid \$200 million under its accounts receivable securitization facility. At March 31, 2012, and December 31, 2011, the amounts outstanding under the facility were \$100 million (at an average variable interest rate of 1.29%) and \$200 million (at an average variable interest rate of 1.35%), respectively. In October 2011, NS renewed its account receivable securitization facility with a 364-day term to run until October 2012.

During the first quarter of 2012, NS issued \$600 million of 3.0% senior notes due 2022.

NS has authority from its Board of Directors to issue an additional \$400 million of debt or equity securities through public or private sale.

## 8. Pensions and Other Postretirement Benefits

Norfolk Southern and certain subsidiaries have both funded and unfunded defined benefit pension plans covering principally salaried employees. Norfolk Southern and certain subsidiaries also provide specified health care and death benefits to eligible retired employees and their dependents. Under the present plans, which may be amended or terminated at NS' option, a defined percentage of health care expenses are covered, reduced by any deductibles, co-payments, Medicare payments, and in some cases, coverage provided under other group insurance policies.

|                                | <b>Three months ended March 31,</b> |                    |   |                    |
|--------------------------------|-------------------------------------|--------------------|---|--------------------|
|                                | <b><u>2012</u></b>                  | <b><u>2011</u></b> | <b><u>2012</u></b>                          | <b><u>2011</u></b> |
|                                | <b><u>Pension Benefits</u></b>      |                    | <b><u>Other Postretirement Benefits</u></b> |                    |
|                                | <i>(\$ in millions)</i>             |                    |   |                    |
| Service cost                   | \$ 8                                | \$ 7               | \$ 4  | \$ 4               |
| Interest cost                  | 22                                  | 23                 | 14  | 15                 |
| Expected return on plan assets | (34)                                | (35)               | (4)   | (4)                |
| Amortization of net losses     | 19                                  | 17                 | 13  | 11                 |
| Net cost                       | \$ 15                               | \$ 12              | \$ 27                                       | \$ 26              |

## 9. Fair Value

### Fair Value Measurements

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820-10, "*Fair Value Measurements*," established a framework for measuring fair value and a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels, as follows:

- Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that NS has the ability to access.
- Level 2 Inputs to the valuation methodology include:
- Quoted prices for similar assets or liabilities in active markets;
  - Quoted prices for identical or similar assets or liabilities in inactive markets;
  - Inputs other than quoted prices that are observable for the asset or liability;
  - Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the hierarchy is based on the lowest level of any input that is significant to the fair value measurement. At March 31, 2012 and December 31, 2011, for assets measured at fair value on a recurring basis, there were \$2 million and zero of available-for-sale securities valued under level 2 of the fair value hierarchy, respectively. There were no available-for-sale securities valued under level 1 or level 3 valuation techniques.

## Fair Values of Financial Instruments

NS has evaluated the fair values of financial instruments and methods used to determine those fair values. The fair values of “Cash and cash equivalents,” “Short-term investments,” “Accounts receivable,” “Accounts payable,” and “Short-term debt” approximate carrying values because of the short maturity of these financial instruments. The carrying value of corporate-owned life insurance is recorded at cash surrender value and, accordingly, approximates fair value. The carrying amounts and estimated fair values for the remaining financial instruments excluding investments accounted for under the equity method consisted of the following:

|  | March 31, 2012             |                       | December 31, 2011          |                       |
|--|----------------------------|-----------------------|----------------------------|-----------------------|
|  | <u>Carrying<br/>Amount</u> | <u>Fair<br/>Value</u> | <u>Carrying<br/>Amount</u> | <u>Fair<br/>Value</u> |
|  | <i>(\$ in millions)</i>    |                       |                            |                       |
| Long-term investments                        | \$ 118                     | \$ 153                | \$ 151                     | \$ 186                |
| Long-term debt, including current maturities | (8,017)                    | (9,960)               | (7,440)                    | (9,469)               |

Underlying net assets were used to estimate the fair value of investments with the exception of notes receivable, which are based on future discounted cash flows. The fair values of long-term debt were estimated based on quoted market prices or discounted cash flows using current interest rates for debt with similar terms, company rating, and remaining maturity.

The following table sets forth the fair value of long-term investment and long-term debt balances disclosed above by valuation technique level, within the fair value hierarchy (there were no level 3 valued assets or liabilities).

|  | March 31, 2012          |                |              |
|--|-------------------------|----------------|--------------|
|  | <u>Level 1</u>          | <u>Level 2</u> | <u>Total</u> |
|  | <i>(\$ in millions)</i> |                |              |
| Long-term investments                        | \$ 5                    | \$ 148         | \$ 153       |
| Long-term debt, including current maturities | (9,642)                 | (318)          | (9,960)      |

Carrying amounts of available-for-sale securities reflect immaterial unrealized holding gains on March 31, 2012 and December 31, 2011. Sales of available-for-sale securities were zero and \$55 million (which included maturities) for the three months ended March 31, 2012 and 2011, respectively.

## 10. Commitments and Contingencies

### Lawsuits

Norfolk Southern and/or certain subsidiaries are defendants in numerous lawsuits and other claims relating principally to railroad operations. When management concludes that it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, it is accrued through a charge to earnings. While the ultimate amount of liability incurred in any of these lawsuits and claims is dependent on future developments, in management’s opinion, the recorded liability is adequate to cover the future payment of such liability and claims. However, the final outcome of any of these lawsuits and claims cannot be predicted with certainty, and unfavorable or unexpected

outcomes could result in additional accruals that could be significant to results of operations in a particular year or quarter. Any adjustments to the recorded liability will be reflected in earnings in the periods in which such adjustments are known.

One of NS' customers, DuPont, has a rate reasonableness complaint pending before the Surface Transportation Board (STB) alleging that the NS tariff rates for transportation of regulated movements are unreasonable. NS disputes these allegations. Since June 1, 2009, NS has been billing and collecting from DuPont amounts based on the challenged tariff rates. Management presently expects resolution of the case to occur in 2013 and believes the estimate of reasonably possible loss will not have a material effect on NS' financial position, results of operations, or liquidity. With regard to rate cases, management records adjustments to revenues in the periods, if and when, such adjustments are probable and estimable.

On November 6, 2007, various antitrust class actions filed against NS and other Class 1 railroads in various Federal district courts regarding fuel surcharges were consolidated in the District of Columbia by the Judicial Panel on Multidistrict Litigation. NS believes the allegations in the complaints are without merit and intends to vigorously defend the cases. NS does not believe that the outcome of these proceedings will have a material effect on its financial position, results of operations, or liquidity. A lawsuit containing similar allegations against NS and four other major railroads that was filed on March 25, 2008, in the U.S. District Court for the District of Minnesota was voluntarily dismissed by the plaintiff subject to a tolling agreement entered into in August 2008.

### **Casualty Claims**

Casualty claims include employee personal injury and occupational claims as well as third-party claims, all exclusive of legal costs. To aid in valuing its personal injury liability and determining the amount to accrue with respect to such claims during the year, NS' management utilizes studies prepared by an independent consulting actuarial firm. Job-related accidental injury and occupational claims are subject to the Federal Employers' Liability Act (FELA), which is applicable only to railroads. FELA's fault-based system produces results that are unpredictable and inconsistent as compared with a no-fault workers' compensation system. The variability inherent in this system could result in actual costs being different from the liability recorded. While the ultimate amount of claims incurred is dependent on future developments, in management's opinion, the recorded liability is adequate to cover the future payments of claims and is supported by the most recent actuarial study. In all cases, NS records a liability when the expected loss for the claim is both probable and estimable.

The Consolidated Balance Sheets reflect long-term receivables for estimated recoveries from NS' insurance carriers for claims associated with the January 6, 2005, derailment in Graniteville, S.C. In the first quarter of 2011, NS received an unfavorable ruling for an arbitration claim with an insurance carrier, and was denied recovery of the contested portion (\$43 million) of the claim. As a result, NS recorded a \$43 million charge during the first quarter of 2011 for the receivables associated with the contested portion of the claim and a \$15 million charge for other receivables affected by the ruling for which recovery was no longer probable.

**Employee personal injury claims** – The largest component of casualties and other claims expense is employee personal injury costs. The independent actuarial firm engaged by NS provides quarterly studies to aid in valuing its employee personal injury liability and estimating its employee personal injury expense. The actuarial firm studies NS' historical patterns of reserving for claims and subsequent settlements, taking into account relevant outside influences. The actuary uses the results of these analyses to estimate the ultimate amount of liability, which includes amounts for incurred but unasserted claims. NS adjusts its liability quarterly based upon management's assessment and the results of the study. The estimate of loss liabilities is subject to inherent limitation given the difficulty of predicting future events such as jury decisions, court interpretations, or legislative changes and as such the actual loss may vary from the estimated liability recorded.

**Occupational claims** – Occupational claims (including asbestosis and other respiratory diseases, as well as conditions allegedly related to repetitive motion) are often not caused by a specific accident or event but rather allegedly result from a claimed exposure over time. Many such claims are being asserted by former or retired employees, some of whom have not been employed in the rail industry for decades. The independent actuarial firm provides an estimate of the occupational claims liability based upon NS' history of claim filings, severity, payments, and other pertinent facts. The liability is dependent upon management's judgments made as to the specific case reserves as well as judgments of the consulting independent actuarial firm in the periodic studies. The actuarial firm's estimate of ultimate loss includes a provision for those claims that have been incurred but not reported. This provision is derived by analyzing industry data and projecting NS' experience into the future as far as can be reasonably determined. NS adjusts its liability quarterly based upon management's assessment and the results of the study. However, it is possible

that the recorded liability may not be adequate to cover the future payment of claims. Adjustments to the recorded liability are reflected in operating expenses in the periods in which such adjustments become known.

**Third-party claims** – NS records a liability for third-party claims including those for highway crossing accidents, trespasser and other injuries, automobile liability, property damage, and lading damage. The independent actuarial firm assists with the calculation of potential liability for third-party claims, except lading damage, based upon NS' experience including number and timing of incidents, amount of payments, settlement rates, number of open claims, and legal defenses. The actuarial estimate includes a provision for claims that have been incurred but have not yet been reported. Each quarter NS adjusts its liability based upon management's assessment and the results of the study. Given the inherent uncertainty in regard to the ultimate outcome of third-party claims, it is possible that the actual loss may differ from the estimated liability recorded.

### **Environmental Matters**

NS is subject to various jurisdictions' environmental laws and regulations. It is NS' policy to record a liability where such liability or loss is probable and its amount can be estimated reasonably. Claims, if any, against third parties for recovery of cleanup costs incurred by NS are reflected as receivables (when collection is probable) in the Consolidated Balance Sheets and are not netted against the associated NS liability. Environmental engineers regularly participate in ongoing evaluations of all known sites and in determining any necessary adjustments to liability estimates. NS also has an Environmental Policy Council, composed of senior managers, to oversee and interpret its environmental policy.

NS' Consolidated Balance Sheets include liabilities for environmental exposures of \$38 million at March 31, 2012, and \$35 million at December 31, 2011 (of which \$12 million is classified as a current liability at the end of each period). At March 31, 2012, the liability represents NS' estimate of the probable cleanup and remediation costs based on available information at 143 known locations and projects. As of that date, seven sites accounted for approximately \$18 million of the liability, and no individual site was considered to be material. NS anticipates that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At 26 locations, one or more Norfolk Southern subsidiaries in conjunction with a number of other parties, have been identified as potentially responsible parties under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or comparable state statutes that impose joint and several liability for cleanup costs. NS calculates its estimated liability for these sites based on facts and legal defenses applicable to each site and not solely on the basis of the potential joint liability.

With respect to known environmental sites (whether identified by NS, the EPA or comparable state authorities), estimates of NS' ultimate potential financial exposure for a given site or in the aggregate for all such sites are necessarily imprecise because of the widely varying costs of currently available cleanup techniques, the likely development of new cleanup technologies, unpredictable contaminant recovery and reduction rates associated with available clean-up technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it), and evolving statutory and regulatory standards governing liability.

The risk of incurring environmental liability – for acts and omissions, past, present, and future – is inherent in the railroad business. Some of the commodities in NS' traffic mix, particularly those classified as hazardous materials, pose special risks that NS and its subsidiaries work diligently to minimize. In addition, several NS subsidiaries own, or have owned, land used as operating property, or which is leased and operated by others, or held for sale. Because environmental problems may exist on these properties that are latent or undisclosed, there can be no assurance that NS will not incur environmental liabilities or costs with respect to one or more of them, the amount and materiality of which cannot be estimated reliably at this time. Moreover, lawsuits and claims involving these and potentially other unidentified environmental sites and matters are likely to arise from time to time. The resulting liabilities could have a significant effect on financial position, results of operations, or liquidity in a particular year or quarter.



Based on its assessment of the facts and circumstances now known, management believes that it has recorded the probable and reasonably estimable costs for dealing with those environmental matters of which NS is aware. Further, management believes that it is unlikely that any known matters, either individually or in the aggregate, will have a material adverse effect on NS' financial position, results of operations, or liquidity.

## **Insurance**

Norfolk Southern obtains on behalf of itself and its subsidiaries insurance for potential losses for third-party liability and first-party property damages. NS is currently self-insured up to \$50 million and above \$1 billion per occurrence for bodily injury and property damage to third parties and up to \$25 million and above \$175 million per occurrence for property owned by NS or in NS' care, custody, or control.

## **Purchase Commitments**

At March 31, 2012, NS had outstanding purchase commitments totaling approximately \$481 million for long-term service contracts through 2019 as well as locomotives, track material, and freight cars, in connection with its capital programs through 2014.

## **11. New Accounting Pronouncements**

In the first quarter of 2012, NS adopted Accounting Standards Update (ASU) No. 2011-05, "*Comprehensive Income (Topic 220): Presentation of Comprehensive Income.*" This update requires that the total of comprehensive income, the components of net income, and the components of other comprehensive income be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This update does not change what items are reported in other comprehensive income or the requirement to report reclassification of items from other comprehensive income to net income.

In the first quarter of 2012, NS adopted ASU No. 2011-04, "*Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.*" This update provides clarification about the application of existing fair value measurements and disclosure requirements, and expands certain other disclosures requirements.

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Norfolk Southern Corporation:

We have reviewed the accompanying consolidated balance sheet of Norfolk Southern Corporation and subsidiaries as of March 31, 2012, and the related consolidated statements of income, comprehensive income and cash flows for the three-month periods ended March 31, 2012 and 2011. These consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Norfolk Southern Corporation and subsidiaries as of December 31, 2011, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated February 15, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2011, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/KPMG LLP  
KPMG LLP  
Norfolk, Virginia  
April 27, 2012

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Norfolk Southern Corporation and Subsidiaries  
Management's Discussion and Analysis of  
Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes.

**OVERVIEW**

Improved economic conditions helped generate continued growth in NS' general merchandise and intermodal traffic volumes. Mild winter weather resulted in above normal utility coal stockpiles which, in addition to weakened export demand, drove declines in NS' coal business. NS' first quarter net income rose from \$325 million in 2011 to \$410 million in 2012 as operating revenue growth more than offset the increases in operating expenses and income taxes. The railway operating ratio (a measure of the amount of operating revenues consumed by operating expenses) improved to 73.3%, compared with 77.1% for the first quarter of 2011.

Cash provided by operating activities for the first quarter of 2012 was \$1 billion which, along with cash on hand and proceeds from borrowings allowed for property additions, share repurchases, debt repayments, and dividends. In the first quarter of 2012, 5.7 million shares of Norfolk Southern Corporation common stock (Common Stock) were repurchased at a total cost of \$400 million. Since the beginning of 2006, NS has repurchased and retired 115.3 million shares of Common Stock at a total cost of \$6.6 billion. At March 31, 2012, cash, cash equivalents, and short-term investments totaled \$831 million.

**SUMMARIZED RESULTS OF OPERATIONS**

First quarter 2012 net income was \$410 million, up \$85 million, or 26%, compared with the same period last year. The increase was primarily the result of a \$145 million, or 24%, increase in income from railway operations (which reflects the absence of the prior year's \$58 million unfavorable insurance arbitration ruling), offset in part by increased income tax expense.

Oil prices affect NS' results of operations in a variety of ways and may have an overall favorable or unfavorable impact in any particular period. In addition to the impact of oil prices on general economic conditions, traffic volume, and supplier costs, oil prices directly affect NS' revenues through market-based fuel surcharges and contract escalators (see "Railway Operating Revenues") and also affect fuel costs (see "Railway Operating Expenses"). For the first quarter 2012, excluding the impact of decreased consumption, the increase in fuel surcharge revenue was greater than the increase in fuel expense. Future changes in oil prices may cause volatility in operating results that could be material to a particular year or quarter.

**DETAILED RESULTS OF OPERATIONS****Railway Operating Revenues**

First quarter railway operating revenues were \$2.8 billion in 2012, up \$169 million, or 6%, compared with the first quarter of 2011. As shown in the following table, the increase was the result of higher average revenue per unit (which includes the effect of \$325 million in fuel surcharges, which were up \$76 million), and higher traffic volume:

|                        | <b>First Quarter<br/>2012 vs. 2011<br/>Increase</b> |
|------------------------|---|
|                        | <i>(\$ in millions)</i>                             |
| Revenue per unit       | \$ 139  |
| Traffic volume (units) | 30  |
| Total                  | \$ 169  |

Many of NS' negotiated fuel surcharges for coal and general merchandise traffic are based on the monthly average price of West Texas Intermediate Crude Oil (WTI Average Price). These surcharges are reset the first day of each calendar month based on the WTI Average Price for the second preceding calendar month. This two-month lag in applying WTI Average Price coupled with the change in fuel prices decreased fuel surcharge revenue by approximately \$26 million in the first quarter.

One of NS' customers, DuPont, has a rate reasonableness complaint pending before the Surface Transportation Board (STB) alleging that the NS tariff rates for transportation of regulated movements are unreasonable. NS disputes these allegations. Since June 1, 2009, NS has been billing and collecting from DuPont amounts based on the challenged tariff rates. Management presently expects resolution of the case to occur in 2013 and believes the estimate of reasonably possible loss will not have a material effect on NS' financial position, results of operations, or liquidity. With regard to rate cases, management records adjustments to revenues in the periods, if and when, such adjustments are probable and estimable.

Revenues, units and average revenue per unit for NS' market groups were as follows:

|                            | <b>Revenues</b>         |                    | <b>First Quarter<br/>Units</b> |                    | <b>Revenue per Unit</b> |                    |
|----------------------------|-------------------------|--------------------|--------------------------------|--------------------|-------------------------|--------------------|
|                            | <b><u>2012</u></b>      | <b><u>2011</u></b> | <b><u>2012</u></b>             | <b><u>2011</u></b> | <b><u>2012</u></b>      | <b><u>2011</u></b> |
|                            | <i>(\$ in millions)</i> |                    | <i>(in thousands)</i>          |                    | <i>(\$ per unit)</i>    |                    |
| Coal                       | \$ 766                  | \$ 816             | 359.0                          | 406.1              | \$ 2,134                | \$ 2,009           |
| General merchandise:       |                         |                    |                                |                    |                         |                    |
| Agriculture/consumer/gov't | 370                     | 351                | 152.3                          | 155.6              | 2,429                   | 2,257              |
| Chemicals                  | 362                     | 338                | 96.0                           | 95.7               | 3,772                   | 3,532              |
| Metals and construction    | 342                     | 269                | 165.5                          | 148.4              | 2,068                   | 1,810              |
| Automotive                 | 226                     | 177                | 96.3                           | 78.6               | 2,345                   | 2,258              |
| Paper/clay/forest          | 196                     | 184                | 76.7                           | 79.9               | 2,552                   | 2,303              |

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|                     |          |          |         |         |          |          |
|---------------------|----------|----------|---------|---------|----------|----------|
| General merchandise | 1,496    | 1,319    | 586.8   | 558.2   | 2,549    | 2,364    |
| Intermodal          | 527      | 485      | 785.0   | 746.9   | 671      | 649      |
| Total               | \$ 2,789 | \$ 2,620 | 1,730.8 | 1,711.2 | \$ 1,611 | \$ 1,531 |

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**Coal**

Coal revenues decreased \$50 million, or 6%, in the first quarter, compared with the same period last year, reflecting a 12% decrease in traffic volume, offset in part by a 6% improvement in average revenue per unit. Coal tonnage by market was as follows:

|                        | <b>First Quarter</b>       |                    |
|------------------------|----------------------------|--------------------|
|                        | <b><u>2012</u></b>         | <b><u>2011</u></b> |
|                        | <i>(tons in thousands)</i> |                    |
| Utility                | 26,261                     | 31,510             |
| Export                 | 6,724                      | 7,438              |
| Domestic metallurgical | 4,572                      | 3,774              |
| Industrial             | 1,921                      | 1,825              |
| Total                  | 39,478                     | 44,547             |

Utility coal tonnage decreased 17% in the first quarter, reflecting reduced electrical demand in NS-served regions and competition from low natural gas prices. Export coal tonnage decreased 10% in the first quarter, reflecting the return of Australian supply and weaker global demand for steel production. Domestic metallurgical coal tonnage was up 21% in the first quarter, as domestic steel production remained high and a softening export coal market increased coking coal availability for the domestic market. Industrial coal tonnage was up 5% in the first quarter as a result of new business.

Coal revenues for the remainder of the year are expected to decrease compared to last year due to lower average revenue per unit and lower traffic volumes.

**General Merchandise**

General merchandise revenues increased \$177 million, or 13%, in the first quarter, compared with the same period last year, reflecting a 8% rise in average revenue per unit and a 5% increase in traffic volumes.

Agriculture, consumer products, and government volume decreased 2% for the first quarter, reflecting fewer shipments of fertilizer due to certain network classification changes. Metals and construction volume increased 12%, reflecting more shipments of iron and steel, coil steel, and scrap metal driven by increased steel and automotive production, as well as higher shipments of fractionating sand for natural gas drilling. Automotive volume grew 23%, primarily a result of increased North American light vehicle production at NS-served plants, in addition to new business. Paper, clay, and forest products volume was down 4%, reflecting fewer shipments of newsprint, pulp, and kaolin due to declining consumption, as well as lower pulpboard and wood chip volumes resulting from pricing pressures in the market.

General merchandise revenues for the remainder of the year are expected to increase compared to last year due to improved average revenue per unit and higher traffic volumes.

**Intermodal**

Intermodal revenues increased \$42 million, or 9%, in the first quarter, compared with the same period last year, reflecting a 5% growth in volumes and a 3% improvement in average revenue per unit. Domestic (which includes truckload and intermodal marketing companies' volumes) and Triple Crown Services, a service with rail-to-highway

trailers, volumes grew 13% and 4%, respectively, reflecting continued highway conversions to rail and stronger market demand. International traffic volume decreased 3% reflecting the loss of business from a shipping line.

Intermodal revenues for the remainder of the year are expected to increase, reflecting higher traffic volumes and improved average revenue per unit.



## Railway Operating Expenses

Railway operating expenses were \$2 billion, up \$24 million, or 1%, in the first quarter of 2012, compared to the same period last year, reflecting higher fuel prices, compensation and benefits, and maintenance costs. These increases were partially offset by the absence of the prior year's \$58 million unfavorable arbitration ruling, in addition to improved network fluidity in the first quarter of 2012 which tempered the effects of increased volume-related expenses.

Compensation and benefits expenses increased \$21 million, or 3%. The increase was primarily the result of higher:

- pay rates (up \$11 million),
- health and welfare benefit costs for employees (up \$6 million),
- payroll taxes (up \$6 million),
- employee activity levels (up \$5 million), and
- pension costs (up \$3 million).

These increased costs were partially offset by lower stock-based compensation (down \$8 million).

Purchased services and rents includes the costs of services provided by outside contractors, the net costs of operating joint (or leased) facilities with other railroads and the net cost of equipment rentals. This category of expenses increased

\$8 million, or 2%, reflecting increased costs associated with intermodal operations, repairs and maintenance, advertising, and professional services and consulting fees. These increased costs were partially offset by lower equipment rents.

Fuel expense, which includes the cost of locomotive fuel as well as other fuel used in railway operations, increased \$24 million, or 6%. The increase was principally the result of higher fuel prices (locomotive fuel price rose 10%) which had an impact of \$37 million, partially offset by decreased consumption (locomotive fuel consumption decreased 2%), which had an impact of \$13 million.

Materials and other expenses (including the estimates of costs related to personal injury, property damage, and environmental matters) decreased \$42 million, or 15%, reflecting the absence of the prior year's unfavorable Graniteville-related arbitration ruling, partially offset by higher costs associated with materials used for equipment and roadway repairs.

The following table shows the components of materials and other expenses:

|                             | <b>First Quarter</b>    |                    |
|-----------------------------|-------------------------|--------------------|
|                             | <b><u>2012</u></b>      | <b><u>2011</u></b> |
|                             | <i>(\$ in millions)</i> |                    |
| Materials                   | \$ 112                  | \$ 94              |
| Casualties and other claims | 38                      | 99                 |
| Other                       | 80                      | 79                 |
| Total                       | \$ 230                  | \$ 272             |

The Consolidated Balance Sheets reflect long-term receivables for estimated recoveries from NS' insurance carriers for claims associated with the January 6, 2005, derailment in Graniteville, S.C. In the first quarter of 2011, NS received an unfavorable ruling for an arbitration claim with an insurance carrier, and was denied recovery of the contested

portion

(\$43 million) of the claim. As a result, NS recorded a \$43 million charge during the first quarter of 2011 for the receivables associated with the contested portion of the claim and a \$15 million charge for other receivables affected by the ruling for which recovery was no longer probable.

**Other Income – Net**

Other income – net was \$29 million, up \$2 million from the first quarter of last year, primarily reflecting higher interest expense on uncertain tax positions (up \$3 million) offset completely by higher net returns from corporate-owned life insurance (up \$2 million) and other miscellaneous items (up \$3 million).

## Provision for Income Taxes

The effective income tax rate for the first quarter of 2012 was 37.3%, compared with 36.9% for the same period last year. The increase was primarily due to the absence of favorable reductions to unrecognized tax benefits.

In December 2010, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act increased bonus depreciation to 100 percent for the period September 2010 through the end of 2011 and allows 50 percent bonus depreciation in 2012. Bonus depreciation does not affect NS' total provision for income taxes or effective tax rate, but does significantly lower current tax expense and the related cash outflows for income taxes paid.

NS' consolidated income tax returns for 2009 and 2010 are being audited by the Internal Revenue Service (IRS) and NS expects the examinations to be completed by the end of 2012. NS does not expect that the results of the examinations will have a material effect on income tax expense.

## FINANCIAL CONDITION AND LIQUIDITY

Cash provided by operating activities, NS' principal source of liquidity, was \$1 billion for the first quarter of 2012, compared with \$652 million for the same period of 2011, reflecting an increase in accounts payable and improved operating results. NS had working capital of \$400 million at March 31, 2012, compared with \$50 million at December 31, 2011; the increase is largely the result of an increase in cash and cash equivalents, reflecting higher borrowings net of repayments during the first three months of 2012. Cash, cash equivalents, and short-term investment balances totaled \$831 million at March 31, 2012, and were invested in accordance with NS' corporate investment policy as approved by the Board of Directors. The portfolio contains securities that are subject to market risk. There are no limits or restrictions on NS' access to the assets. NS expects that cash on hand combined with cash flows from operations will be sufficient to meet its ongoing obligations. During the first quarter of 2012, NS issued \$600 million of 3.0% senior notes due 2022. Other than this item, there have been no other material changes to the information on NS' future obligations contained in NS' Form 10-K for the year ended December 31, 2011.

Cash used in investing activities was \$436 million for the first quarter of 2012, compared with \$382 million for the same period last year, primarily reflecting increased property additions.

The Crescent Corridor consists of a program of projects for infrastructure and other facility improvements geared toward creating a seamless, high-capacity intermodal route spanning 11 states from New Jersey to Louisiana and offering truck-competitive service along several major interstate highway corridors, including I-81, I-85, I-20, I-40, I-59, I-78, and

I-75. Based on the public benefits that stand to be derived in the form of highway congestion relief, NS plans to implement certain elements of the Crescent Corridor through a series of public-private partnerships. Currently, the Crescent Corridor has received or expects to receive a total of \$267 million in public capital funding commitments from the Commonwealths of Pennsylvania and Virginia, the State of Tennessee, the federal TIGER Stimulus Program and other federal funding sources related to projects in Alabama, Pennsylvania, Tennessee, and North Carolina. With respect to the private funding component, NS currently anticipates spending up to \$351 million for the substantial completion of work on these projects, which is expected in 2014, including planned investments for the remainder of 2012 of approximately \$127 million.

Cash used in financing activities was \$46 million for the first quarter of 2012 compared with \$861 million for the first quarter of 2011. The change reflected the issuance of \$600 million of senior notes in the first quarter of 2012 and lower debt repayments and maturities, offset in part by increased share repurchases. Share repurchases were 5.7 million, totaling

\$400 million in the first quarter of 2012, compared to \$343 million in the same period last year. The timing and volume of future share repurchases will be guided by management's assessment of market conditions and other pertinent factors. Any near-term purchases under the program are expected to be made with internally generated cash, cash on hand, or proceeds from borrowings. NS' total debt-to-total capitalization ratio was 45.0% at March 31, 2012, compared with 43.2% at December 31, 2011.

As of March 31, 2012, NS has authority from its Board of Directors to issue an additional \$400 million of debt or equity securities through public or private sale. NS has on file with the Securities and Exchange Commission a Form S-3 automatic shelf registration statement for well-known seasoned issuers under which securities may be issued pursuant to this authority.

NS also has in place and available a \$750 million, five-year credit agreement expiring in 2016, which provides for borrowings at prevailing rates and includes covenants. NS had no amounts outstanding under this facility at March 31, 2012, and NS is in compliance with all of its covenants. In October 2011, NS renewed its \$350 million accounts receivable securitization program with a 364-day term to run until October 2012. There was \$100 million and \$200 million outstanding under this program at March 31, 2012 and December 31, 2011, respectively.

## **APPLICATION OF CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. These estimates and assumptions may require significant judgment about matters that are inherently uncertain, and future events are likely to occur that may require management to make changes to these estimates and assumptions. Accordingly, management regularly reviews these estimates and assumptions based on historical experience, changes in the business environment, and other factors that management believes to be reasonable under the circumstances. Management regularly discusses the development, selection, and disclosures concerning critical accounting estimates with the Audit Committee of its Board of Directors. There have been no significant changes to the Application of Critical Accounting Estimates disclosure contained in NS' Form 10-K as of December 31, 2011.

## **OTHER MATTERS**

### **Labor Agreements**

More than 80% of NS' railroad employees are covered by collective bargaining agreements with various labor unions. These agreements remain in effect until changed pursuant to the Railway Labor Act. NS largely bargains nationally in concert with other major railroads, represented by the National Carriers Conference Committee (NCCC). Moratorium provisions in the labor agreements govern when the railroads and the unions may propose changes.

[The NCCC has concluded the round of bargaining that began in November 2009 and reached national agreements with all applicable labor unions. Although NS previously concluded separate agreements with each of the Brotherhood of Locomotive Engineers and Trainmen (BLET) and the American Train Dispatchers Association (ATDA) that extend through December 31, 2014, the health and welfare provisions from the national agreements apply to the BLET and ATDA. NS bargains separately with longshoremen at its Ashtabula (Ohio) Docks, who are represented by the International Longshoremen's Association (ILA) and do not participate in national bargaining. The present agreement remains in effect and no negotiations are in progress with ILA.]

### **Market Risks**

NS manages its overall exposure to fluctuations in interest rates by issuing both fixed- and floating-rate debt instruments. At March 31, 2012, NS' debt subject to interest rate fluctuations totaled \$100 million. A 1% point increase in interest rates would increase NS' total annual interest expense related to all its variable debt by \$1 million. Management considers it unlikely that interest rate fluctuations applicable to these instruments will have a material adverse affect on NS' financial position, results of operations, or liquidity.



## **Environmental Matters**

NS is subject to various jurisdictions' environmental laws and regulations. It is NS' policy to record a liability where such liability or loss is probable and its amount can be estimated reasonably. Claims, if any, against third parties for recovery of cleanup costs incurred by NS are reflected as receivables (when collection is probable) in the Consolidated Balance Sheets and are not netted against the associated NS liability. Environmental engineers regularly participate in ongoing evaluations of all known sites and in determining any necessary adjustments to liability estimates. NS also has established an Environmental Policy Council, composed of senior managers, to oversee and interpret its environmental policy.

NS' Consolidated Balance Sheets included liabilities for environmental exposures in the amount of \$38 million at March 31, 2012, and \$35 million at December 31, 2011 (of which \$12 million is classified as a current liability at the end of each period). At March 31, 2012, the liability represents NS' estimate of the probable cleanup and remediation costs based on available information at 143 known locations and projects. As of that date, seven sites accounted for \$18 million of the liability, and no individual site was considered to be material. NS anticipates that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At 26 locations, one or more NS subsidiaries in conjunction with a number of other parties, have been identified as potentially responsible parties under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, or comparable state statutes that impose joint and several liability for cleanup costs. NS calculates its estimated liability for these sites based on facts and legal defenses applicable to each site and not solely on the basis of the potential joint liability.

With respect to known environmental sites (whether identified by NS or by the EPA or comparable state authorities), estimates of NS' ultimate potential financial exposure for a given site or in the aggregate for all such sites are necessarily imprecise because of the widely varying costs of currently available cleanup techniques, the likely development of new cleanup technologies, unpredictable contaminant recovery and reduction rates associated with available clean-up technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it), and evolving statutory and regulatory standards governing liability. NS estimates its environmental remediation liability on a site-by-site basis, using assumptions and judgments that management deems appropriate for each site. As a result, it is not practical to quantitatively describe the effects of changes in these many assumptions and judgments. NS has consistently applied its methodology of estimating its environmental liabilities.

Based on its assessment of the facts and circumstances now known, management believes that it has recorded the probable and reasonably estimable costs for dealing with those environmental matters of which NS is aware. Further, management believes that it is unlikely that any known matters, either individually or in the aggregate, will have a material adverse effect on NS' financial position, results of operations, or liquidity.

## **Inflation**

In preparing financial statements, U.S. generally accepted accounting principles require the use of historical cost that disregards the effects of inflation on the replacement cost of property. NS, a capital-intensive company, has most of its capital invested in such property. The replacement cost of these assets, as well as the related depreciation expense, would be substantially greater than the amounts reported on the basis of historical cost.

## **FORWARD-LOOKING STATEMENTS**

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that may be identified by the use of words like "believe," "expect," "anticipate," "estimate," "unlikely," and "project." Forward-looking statements reflect management's good-faith evaluation of information currently available.

However, such statements are dependent on and, therefore, can be influenced by, a number of external variables over which management has little or no control, including: transportation of hazardous materials as a common carrier by rail; acts of terrorism or war; general economic conditions; competition and consolidation within the transportation industry; the operations of carriers with which NS interchanges; disruptions to NS' technology infrastructure, including computer systems; labor difficulties, including strikes and work stoppages; commercial, operating, environmental, and climate change legislative and regulatory developments; results of litigation; natural events such as severe weather, hurricanes, and floods; unavailability of qualified personnel due to unpredictability of demand for rail services; fluctuation in supplies and prices of key materials, in particular diesel fuel; and changes in securities and capital markets. For a discussion of significant risk factors applicable to NS, see Part II, Item 1A "Risk Factors." Forward-looking statements are not, and should not be relied upon as, a guarantee of future performance or results, nor will they necessarily prove to be accurate indications of the times at or by which any such performance or results will be achieved. As a result, actual outcomes and results may differ materially from those expressed in forward-looking statements. NS undertakes no obligation to update or revise forward-looking statements.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The information required by this item is included in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Market Risks."

### **Item 4. Controls and Procedures**

#### (a) Evaluation of Disclosure Controls and Procedures

Norfolk Southern's Chief Executive Officer and Chief Financial Officer, with the assistance of management, evaluated the effectiveness of NS' disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act)) as of March 31, 2012. Based on such evaluation, such officers have concluded that, as of March 31, 2012, NS' disclosure controls and procedures were effective to ensure that information required to be disclosed in NS' reports under the Exchange Act is recorded, processed, summarized, and reported, within the time period specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

#### (b) Changes in Internal Control Over Financial Reporting

During the first quarter of 2012, management did not identify any changes in NS' internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, NS' internal control over financial reporting.





## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

On November 6, 2007, various antitrust class actions filed against NS and other Class 1 railroads in various Federal district courts regarding fuel surcharges were consolidated in the District of Columbia by the Judicial Panel on Multidistrict Litigation. NS believes the allegations in the complaints are without merit and intends to vigorously defend the cases. NS does not believe that the outcome of these proceedings will have a material effect on its financial position, results of operations, or liquidity. A lawsuit containing similar allegations against NS and four other major railroads that was filed on March 25, 2008, in the U.S. District Court for the District of Minnesota was voluntarily dismissed by the plaintiff subject to a tolling agreement entered into in August 2008.

NS received a Notice of Violation (NOV) issued by the Tennessee Department of Environmental Conservation concerning soil runoff in connection with construction of an intermodal facility near Memphis, TN. Although NS will contest liability and the imposition of any penalties, this matter is described here consistent with SEC rules and requirements concerning governmental proceedings with respect to environmental laws and regulations. NS does not believe that the outcome of this proceeding will have a material effect on its financial position, results of operations, or liquidity.

### **Item 1A. Risk Factors**

The risk factors included in NS' 2011 Form 10-K remain unchanged and are incorporated herein by reference.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

| <u>Period</u>       | <u>(a) Total Number of Shares (or Units) Purchased<sup>(1)</sup></u> | <u>(b) Average Price Paid per Share (or Unit)</u> | <u>(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs<sup>(2)</sup></u> | <u>(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be Purchased Under the Plans or Programs<sup>(2)</sup></u> |
|---------------------|--|---|--|--|
| January 1-31, 2012  | 1,173,300  | \$73.56   | 1,173,300  | 14,224,645   |
| February 1-29, 2012 | 3,683,100  | \$70.21   | 3,683,100  | 10,541,545   |
| March 1-31, 2012    | 806,374  | \$68.35   | 806,374  | 9,735,171  |
| Total               | 5,662,774  |   | 5,662,774  |  |

(1) Of this amount, no shares were tendered by employees in connection with the exercise of stock options under the Long-Term Incentive Plan.

(2) On November 22, 2005, the Board of Directors authorized a share repurchase program, pursuant to which up to 50 million shares of Common Stock could be purchased through December 31, 2015. On March 27, 2007, the Board of Directors amended the program and increased the number of shares that may be repurchased to 75 million, and shortened the repurchase term by five years to December 31, 2010. On July 27, 2010, NS' Board of Directors authorized the repurchase of up to an additional 50 million shares of Common Stock through December 31, 2014.

**Item 6. Exhibits**

See Exhibit Index beginning on page 27 for a description of the exhibits filed as part of this report.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**NORFOLK SOUTHERN CORPORATION**

Registrant

Date: April 27, 2012

/s/Howard D. McFadden

Howard D. McFadden

Corporate Secretary (Signature)

Date: April 27, 2012

/s/C. H. Allison, Jr.

C. H. Allison, Jr.

Vice President and Controller

(Principal Accounting Officer) (Signature)

**EXHIBIT INDEX**

- 3(ii) The Bylaws of Norfolk Southern Corporation, as amended February 27, 2012, are incorporated herein by reference to Exhibit 3(ii) to Norfolk Southern Corporation's Form 8-K filed on February 28, 2012.
- 4.1 Indenture, dated as of March 15, 2012, between the Registrant and U.S. Bank Trust National Association, as Trustee, is incorporated herein by reference to Exhibit 4.1 to Norfolk Southern Corporation's Form 8-K filed on March 15, 2012.
- 4.2 First Supplemental Indenture, dated as of March 15, 2012, between the Registrant and U.S. Bank Trust National Association, as Trustee, is incorporated herein by reference to Exhibit 4.2 to Norfolk Southern Corporation's Form 8-K filed on March 15, 2012.
- 10.1\* Omnibus Amendment, dated as of January 17, 2011, to Pan Am Transaction Agreement dated as of May 15, 2008, and Limited Liability Company Agreement of Pan Am Southern LLC dated as of April 9, 2009.
- 10.2\* Norfolk Southern Corporation Executive Management Incentive Plan, as approved by shareholders May 13, 2010, and as further amended September 27, 2011 and April 26, 2012.
- 15\* Letter regarding unaudited interim financial information.
- 31\* Rule 13a-14(a)/15d-14(a) Certifications.
- 32\* Section 1350 Certifications.
- 101\* The following financial information from Norfolk Southern Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, formatted in Extensible Business Reporting Language (XBRL) includes (i) the Consolidated Statements of Income for each of the three-month periods ended March 31, 2012 and 2011; (ii) the Consolidated Statements of Comprehensive Income for each of the three-month periods ended March 31, 2012 and 2011; (iii) the Consolidated Balance Sheets as of March 31, 2012, and December 31, 2011; (iv) the Consolidated Statements of Cash Flows for each of the three-month periods ended March 31, 2012 and 2011; and (v) the Notes to Consolidated Financial Statements.

\* Filed herewith.