

NORFOLK SOUTHERN CORP
Form 10-Q
July 24, 2013

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 JUNE 30, 2013

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 52-1188014

(State or other jurisdiction of incorporation) (IRS Employer Identification No.)

Three Commercial Place

23510-2191

Norfolk, Virginia

(Zip Code)

(Address of principal executive offices)

(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

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

Class	Outstanding at June 30, 2013
Common Stock (\$1.00 par value per share)	311,952,780 (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)

	Second Quarter		First Six Months	
	2013	2012	2013	2012
	(\$ in millions, except per share amounts)			
Railway operating revenues	\$2,802	\$2,874	\$5,540	\$5,663
Railway operating expenses				
Compensation and benefits	726	724	1,506	1,510
Purchased services and rents	410	392	803	783
Fuel	391	390	820	803
Depreciation	226	229	453	453
Materials and other	213	205	431	435
Total railway operating expenses	1,966	1,940	4,013	3,984
Income from railway operations	836	934	1,527	1,679
Other income – net	29	31	164	60
Interest expense on debt	128	122	257	242
Income before income taxes	737	843	1,434	1,497
Provision for income taxes	272	319	519	563
Net income	\$465	\$524	\$915	\$934

Per share amounts

Net income:

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Basic	\$1.47	\$1.62	\$2.90	\$2.86
Diluted	1.46	1.60	2.87	2.82
Dividends	0.50	0.47	1.00	0.94

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income

(Unaudited)

	Second Quarter		First Six Months	
	2013	2012	2013	2012
	(\$ in millions)			
Net income	\$465	\$524	\$915	\$934
Other comprehensive income, before tax:				
Pension and other postretirement benefits	36	32	72	64
Other comprehensive income (loss) of equity investees	1	-	2	(4)
Other comprehensive income, before tax	37	32	74	60
Income tax expense related to items of other comprehensive income	(14)	(13)	(28)	(25)
Other comprehensive income, net of tax	23	19	46	35
 Total comprehensive income	 \$488	 \$543	 \$961	 \$969

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries

Consolidated Balance Sheets

(Unaudited)

	June 30, 2013	December 31, 2012
	(\$ in millions)	
Assets		
Current assets:		
Cash and cash equivalents	\$587	\$653
Short-term investments	-	15
Accounts receivable – net	1,072	1,109
Materials and supplies	228	216
Deferred income taxes	137	167
Other current assets	54	82
Total current assets	2,078	2,242
Investments	2,366	2,300
Properties less accumulated depreciation of \$10,152 and \$9,922, respectively	26,098	25,736
Other assets	63	64
Total assets	\$30,605	\$30,342
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$1,180	\$1,362
Short-term debt	-	200
Income and other taxes	284	206
Other current liabilities	304	263
Current maturities of long-term debt	47	50
Total current liabilities	1,815	2,081
Long-term debt	8,430	8,432
Other liabilities	2,198	2,237
Deferred income taxes	7,974	7,832
Total liabilities	20,417	20,582
Stockholders' equity:		
Common stock \$1.00 per share par value, 1,350,000,000 shares authorized; outstanding 311,952,780 and 314,034,174 shares, respectively, net of treasury shares	313	315

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Additional paid-in capital	1,984	1,911
Accumulated other comprehensive loss	(1,063)	(1,109)
Retained income	8,954	8,643
Total stockholders' equity	10,188	9,760
Total liabilities and stockholders' equity	\$30,605	\$30,342

See accompanying notes to consolidated financial statements.

Norfolk Southern Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

	First Six Months	
	2013	2012
	(\$ in millions)	
Cash flows from operating activities		
Net income	\$915	\$934
Reconciliation of net income to net cash provided by operating activities:		
Depreciation	456	456
Deferred income taxes	143	138
Gains on properties	(99)	(2)
Changes in assets and liabilities affecting operations:		
Accounts receivable	37	(64)
Materials and supplies	(12)	(33)
Other current assets	28	23
Current liabilities other than debt	6	162
Other – net	32	49
Net cash provided by operating activities	1,506	1,663
Cash flows from investing activities		
Property additions	(884)	(968)
Property sales and other transactions	68	15
Investments, including short-term	(7)	(12)
Investment sales and other transactions	16	33
Net cash used in investing activities	(807)	(932)
Cash flows from financing activities		
Dividends	(315)	(308)
Common stock issued – net	80	47
Purchase and retirement of common stock	(314)	(850)
Proceeds from borrowings – net	-	696
Debt repayments	(216)	(236)
Net cash used in financing activities	(765)	(651)
Net increase (decrease) in cash and cash equivalents	(66)	80
Cash and cash equivalents		
At beginning of period	653	276
At end of period	\$587	\$356

Supplemental disclosures of cash flow information

Cash paid during the period for:

Interest (net of amounts capitalized)	\$244	\$232
Income taxes (net of refunds)	238	264

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, we, us, and our) financial condition at June 30, 2013, and December 31, 2012, our results of operations and comprehensive income for the second quarters and first six months of 2013 and 2012, and our cash flows for the first six months of 2013 and 2012 in conformity with U.S. generally accepted accounting principles (GAAP).

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in our latest Annual Report on Form 10-K.

1. Stock-Based Compensation

During the first quarter of 2013, a committee of non-employee directors of our 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 \$6 million and \$7 million during the second quarters of 2013 and 2012, respectively. For the first six months of 2013 and 2012, stock-based compensation expense was \$43 million and \$41 million, respectively. The total tax effects recognized in income in relation to stock-based compensation were net benefits of \$2 million and \$3 million for the second quarters of 2013 and 2012, and net benefits of \$14 million for the first six months of both 2013 and 2012.

Stock Options

In the first quarter of 2013, 748,200 options were granted under LTIP and 268,500 options were granted under TSOP. In each case, the grant price was \$69.83, which was the greater of the average fair market value of Norfolk Southern common stock (Common Stock) or the closing price of Common Stock on the effective date of the grant, and the options have a term of ten years. The options granted under LTIP and TSOP in 2013 may not be exercised prior to the fourth and third anniversaries of the date of grant, respectively. Holders of the 2013 options granted under 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 2013 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 and historical volatility of Common Stock. Historical data is used 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 2.86% 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 2013 LTIP and TSOP grants are shown in the following table:

Expected volatility range	24% - 30%
Average expected volatility	26%
Average risk-free interest rate	1.88%
Average expected option term LTIP	9.0 years
Per-share grant-date fair value LTIP	\$20.40
Average expected option term TSOP	8.9 years
Per-share grant-date fair value TSOP	\$15.84

For the second quarter of 2013, options relating to 546,886 shares were exercised, yielding \$18 million of cash proceeds and \$7 million of tax benefit recognized as additional paid-in capital. For the second quarter of 2012, options relating to 396,939 shares were exercised, yielding \$10 million of cash proceeds and \$6 million of tax benefit recognized as additional paid-in capital.

For the first six months of 2013, options relating to 1,571,500 shares were exercised, yielding \$53 million of cash proceeds and \$20 million of tax benefit recognized as additional paid-in capital. For the first six months of 2012, options relating to 773,296 shares were exercised, yielding \$21 million of cash proceeds and \$12 million of tax benefit recognized as additional paid-in capital.

Restricted Stock Units

There were 162,000 RSUs granted in 2013, with an average grant-date fair value of \$69.83 and a five-year restriction period. The RSUs granted in 2013 will be settled through the issuance of shares of Common Stock.

No RSUs were earned or paid out in the second quarter of 2013. In the second quarter of 2012, 30,000 RSUs granted in 2007 vested, with 17,340 shares issued net of withholding taxes. During the first six months of 2013, 298,400 of the RSUs granted in 2008 vested, with 178,250 shares of Common Stock issued net of withholding taxes. For the first six months of 2012, 311,900 of the RSUs granted in 2007 vested, with 191,875 shares of Common Stock issued net of withholding taxes. The total related tax benefits recognized as additional paid-in capital were less than \$1 million for the second quarters of 2013 and 2012, and \$2 million and \$3 million for the first six months of 2013 and 2012, respectively.

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 2013, there were 550,800 PSUs granted with a grant-date fair value of \$69.83.

No PSUs were earned or paid out in the second quarters of 2013 and 2012. During the first six months of 2013, 577,585 of the PSUs granted in 2010 were earned, with 348,189 shares of Common Stock issued net of withholding taxes. For the first six months of 2012, 782,889 of the PSUs granted in 2009 were earned, with 488,957 shares of Common Stock issued net of withholding taxes. The total related tax benefits recognized as additional paid-in capital were \$5 million and \$11 million for the first six months of 2013 and 2012, respectively.

2. Income Taxes

There have been no material changes to the balance of unrecognized tax benefits reported at December 31, 2012. IRS examinations have been completed for all years prior to 2011. We expect the IRS could begin auditing our 2011 and 2012 consolidated income tax returns in early 2014.

3. Earnings Per Share

	Basic		Diluted	
	Second Quarter			
	2013	2012	2013	2012
	(\$ in millions except per share amounts, shares in millions)			
Net income	\$465	\$524	\$465	\$524
Dividend equivalent payments	(1)	(2)	(1)	-
Income available to common stockholders	464	522	464	524
Weighted-average shares outstanding	314.1	322.7	314.1	322.7
Dilutive effect of outstanding options and share-settled awards			3.7	4.8
Adjusted weighted-average shares outstanding			317.8	327.5
Earnings per share	\$1.47	\$1.62	\$1.46	\$1.60

	Basic		Diluted	
	First Six Months			
	2013	2012	2013	2012
	(\$ in millions except per share amounts, shares in millions)			
Net income	\$915	\$934	\$915	\$934
Dividend equivalent payments	(3)	(4)	(2)	(2)
Income available to common stockholders	912	930	913	932

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Weighted-average shares outstanding	314.3	325.5	314.3	325.5
Dilutive effect of outstanding options and share-settled awards			3.6	4.7
Adjusted weighted-average shares outstanding				