

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 Second Quarter | | Diluted | |
|---|---|--------|---------|--------|
| | 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 First Six Months | | Diluted | |
|---|---|-------|---------|-------|
| | 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 | | | 317.9 | 330.2 |
| Earnings per share | \$2.90 | \$2.86 | \$2.87 | \$2.82 |

During the second quarters and first six months of 2013 and 2012, dividend equivalent payments were made to holders of options and RSUs. For purposes of computing basic earnings per share, dividend equivalent payments made to holders of options and RSUs were deducted from net income to determine income available to common stockholders. For purposes of computing diluted earnings per share, we evaluate on a grant-by-grant basis those 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 grant. For those grants for which the two-class method was more dilutive, net income was reduced by dividend equivalent payments 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: zero and 0.8 million in 2013 and 2012, respectively.

4. Stockholders' Equity

Common Stock

Common Stock is reported net of shares held by our consolidated subsidiaries (Treasury Shares). Treasury Shares at June 30, 2013 and December 31, 2012, amounted to 20,320,777 shares, with a cost of \$19 million at both dates.

Accumulated Other Comprehensive Loss

“Accumulated other comprehensive loss” reported in the Consolidated Balance Sheets consisted of the following:

| | Pensions and Other | Accumulated Other Comprehensive Loss of Equity Investees | Accumulated Other Comprehensive Loss |
|--------------------------------------|--------------------------|--|---|
| Second Quarter | | | |
| March 31, 2013 | \$ (977) | \$ (109) | \$ (1,086) |
| Other comprehensive income (loss): | | | |
| Amounts reclassified into net income | 36 | (1) | 36 |
| Net gain | - | 1 | 1 |
| Tax expense | (14) | - | (14) |
| Other comprehensive income | 22 | 1 | 23 |

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| | | | |
|--------------------------------------|----------|----------|------------|
| June 30, 2013 | \$ (955) | \$ (108) | \$ (1,063) |
| First Six Months | | | |
| December 31, 2012 | \$ (999) | \$ (110) | \$ (1,109) |
| Other comprehensive income (loss): | | | |
| Amounts reclassified into net income | 72 | (1) | - |
| Net gain | - | 2 | 2 |
| Tax expense | (28) | - | (28) |
| Other comprehensive income | 44 | 2 | 46 |
| June 30, 2013 | \$ (955) | \$ (108) | \$ (1,063) |

(1) These items are included in the computation of net periodic pension and postretirement benefit costs. See Note 8, "Pensions and Other Postretirement Benefits" for additional information.

5. Stock Repurchase Program

We repurchased and retired 4.2 million and 12.3 million shares of Common Stock in the first six months of 2013 and 2012, respectively, at a cost of \$314 million and \$850 million. The timing and volume of purchases is guided by our 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, we have repurchased and retired 132.6 million shares at a total cost of \$7.8 billion.

6. Investment in Conrail

Through a limited liability company, we and CSX Corporation (CSX) jointly own Conrail Inc. (Conrail), whose primary subsidiary is Consolidated Rail Corporation (CRC). We have a 58% economic and 50% voting interest in the jointly owned entity, and CSX has the remainder of the economic and voting interests. Our investment in Conrail was \$1.0 billion at June 30, 2013, and \$996 million at December 31, 2012.

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 \$39 million and \$30 million for the second quarters of 2013 and 2012, respectively, and \$73 million and \$66 million for the first six months of 2013 and 2012, respectively. Our equity in the earnings of Conrail, net of amortization, included in "Other income – net" was \$9 million for the second quarters of both 2013 and 2012, and \$18 million and \$15 million for the first six months of 2013 and 2012, respectively.

"Accounts payable" includes \$180 million at June 30, 2013, and \$178 million at December 31, 2012, due to Conrail for the operation of the Shared Assets Areas. In addition, "Other liabilities" includes \$133 million at both June 30, 2013 and December 31, 2012, for long-term advances from Conrail, maturing 2035, that bear interest at an average rate of 4.40%.

7. Debt

In the first quarter of 2013, we repaid \$200 million under our accounts receivable securitization facility. At June 30, 2013 and December 31, 2012, the amounts outstanding under the facility were \$100 million (at an average variable interest rate of 1.24%) and \$300 million (at an average variable interest rate of 1.28%), respectively. In October 2012,

we renewed our accounts receivable securitization facility with a 364-day term to run until October 2013.

During the first quarter of 2012, we issued \$600 million of 3.00% senior notes due 2022.

We have authority from our Board of Directors to issue an additional \$600 million of debt or equity securities through public or private sale.

8. Pensions and Other Postretirement Benefits

We have both funded and unfunded defined benefit pension plans covering principally salaried employees. We also provide specified health care and death benefits to eligible retired employees and their dependents; these plans can be amended or terminated at our option. Under our health care plans, a defined percentage of health care expenses is covered, reduced by any deductibles, co-payments, Medicare payments and, in some cases, coverage provided under other group insurance policies.

| | Pension Benefits | | Other Postretirement Benefits | |
|--------------------------------|------------------|------|-------------------------------|-------|
| | Second Quarter | | | |
| | 2013 | 2012 | 2013 | 2012 |
| | (\$ in millions) | | | |
| Service cost | \$10 | \$9 | \$ 4 | \$ 4 |
| Interest cost | 21 | 22 | 12 | 13 |
| Expected return on plan assets | (36) | (35) | (4) | (3) |
| Amortization of net losses | 22 | 19 | 14 | 13 |
| Net cost | \$17 | \$15 | \$ 26 | \$ 27 |

| | Pension Benefits | | Other Postretirement Benefits | |
|--------------------------------|------------------|------|-------------------------------|-------|
| | First Six Months | | | |
| | 2013 | 2012 | 2013 | 2012 |
| | (\$ in millions) | | | |
| Service cost | \$20 | \$17 | \$ 8 | \$ 8 |
| Interest cost | 41 | 44 | 25 | 27 |
| Expected return on plan assets | (71) | (69) | (8) | (7) |
| Amortization of net losses | 44 | 38 | 28 | 26 |
| Net cost | \$34 | \$30 | \$ 53 | \$ 54 |

9. Fair Value

Fair Value Measurements

The Financial Accounting Standards Board (FASB) Accounting Standards Codifications (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 we have 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 is based on the lowest level of any input that is significant to the fair value measurement. Other than those assets and liabilities described below that approximate fair value, there were no assets or liabilities measured at fair value on a recurring basis at June 30, 2013 or December 31, 2012.

Fair Values of Financial Instruments

We have 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

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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:

| | June 30, 2013 | | December 31, 2012 | |
|--|------------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (\$ in millions) | | | |
| Long-term investments | \$147 | \$176 | \$139 | \$174 |
| Long-term debt, including current maturities | (8,477) | (10,038) | (8,482) | (10,734) |

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).

| | Level 1 | Level 2 | Total |
|--|------------------|---------|----------|
| | (\$ in millions) | | |
| June 30, 2013 | | | |
| Long-term investments | \$45 | \$131 | \$176 |
| Long-term debt, including current maturities | (9,777) | (261) | (10,038) |
| December 31, 2012 | | | |
| Long-term investments | \$41 | \$133 | \$174 |
| Long-term debt, including current maturities | (10,450) | (284) | (10,734) |

10. Commitments and Contingencies

Lawsuits

We and/or certain subsidiaries are defendants in numerous lawsuits and other claims relating principally to railroad operations. When we conclude 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 our 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 our customers, DuPont, has a rate reasonableness complaint pending before the STB alleging that our tariff rates for transportation of regulated movements are unreasonable. We dispute this allegation. Since June 1, 2009, we have been billing and collecting from DuPont amounts based on the challenged tariff rates. We presently expect resolution of the DuPont case to occur in 2014 and believe the estimate of reasonably possible loss will not have a material effect on our financial position, results of operations, or liquidity. With regard to rate cases, we record

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 us and other Class I railroads in various Federal district courts regarding fuel surcharges were consolidated in the District of Columbia by the Judicial Panel on Multidistrict Litigation. On June 21, 2012, the court certified the case as a class action. The defendant railroads have appealed such certification, and a decision by the court to either reject the appeal outright or proceed with ruling on its merits is pending. We believe the allegations in the complaints are without merit and intend to vigorously defend the cases. We do not believe the outcome of these proceedings will have a material effect on our financial position, results of operations, or liquidity. A lawsuit containing similar allegations against us 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 our personal injury liability and determining the amount to accrue with respect to such claims during the year, we utilize 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 our 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, we record a liability when the expected loss for the claim is both probable and estimable.

Employee personal injury claims – The largest component of casualties and other claims expense is employee personal injury costs. The independent actuarial firm engaged by us provides quarterly studies to aid in valuing our employee personal injury liability and estimating personal injury expense. The actuarial firm studies our historical patterns of reserving for claims and subsequent settlements, taking into account relevant outside influences. The actuarial firm uses the results of these analyses to estimate the ultimate amount of liability, which includes amounts for incurred but unasserted claims. We adjust the liability quarterly based upon our assessment and the results of the study. Our 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 our history of claim filings, severity, payments, and other pertinent facts. The liability is dependent upon judgments we make as to the specific case reserves as well as judgments of the actuarial firm in the quarterly 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 our experience into the future as far as can be reasonably determined. We adjust the liability quarterly based upon our 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 – We record a liability for third-party claims including those for highway crossing accidents, trespasser and other injuries, automobile liability, property damage, and lading damage. The actuarial firm assists us with the calculation of potential liability for third-party claims, except lading damage, based upon our experience including the 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 not reported. We adjust the liability quarterly based upon our 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

We are subject to various jurisdictions' environmental laws and regulations. We 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 we have incurred are reflected as receivables (when collection is probable) in the Consolidated Balance Sheets and are not netted against the associated liability. Environmental engineers regularly participate in ongoing evaluations of all known sites and in determining any necessary adjustments to liability estimates. We have an Environmental Policy Council, composed of senior managers, to oversee and interpret our environmental policy.

Our Consolidated Balance Sheets include liabilities for environmental exposures of \$53 million at June 30, 2013, and \$42 million at December 31, 2012 (of which \$12 million is classified as a current liability at the end of each period). At June 30, 2013, the liability represents our estimate of the probable cleanup, investigation, and remediation costs based on available information at 149 known locations and projects compared with 146 locations and projects at December 31, 2012. At June 30, 2013, ten sites accounted for \$29 million of the liability, and no individual site was considered to be material. We anticipate that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At 21 locations, one or more of our 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. We calculate our estimated liability for these sites based on facts and legal defenses applicable to each site and not solely on the basis of the potential for joint liability.

With respect to known environmental sites (whether identified by us or by the Environmental Protection Agency (EPA) or comparable state authorities), estimates of our 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, unpredictable contaminant recovery and reduction rates associated with available cleanup technologies, the likely development of new cleanup 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 our traffic mix, particularly those classified as hazardous materials, pose special risks that we work diligently to minimize. In addition, several of our 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 that are latent or undisclosed may exist on these properties, there can be no assurance that we 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 our financial position, results of operations, or liquidity in a particular year or quarter.

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

Insurance

We obtain on behalf of ourself and our subsidiaries insurance for potential losses for third-party liability and first-party property damages. We are currently self-insured up to \$50 million and above \$1.1 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 us or in our care, custody, or control.

Purchase Commitments

At June 30, 2013, we had outstanding purchase commitments totaling approximately \$487 million for locomotives, track and yard expansion projects, track material, freight cars, and vehicle fleet additions, in connection with our capital programs through 2016.

11. New Accounting Pronouncement

In the first quarter of 2013, we prospectively adopted Accounting Standards Update (ASU) No. 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." This update requires the disclosure of the effects of reclassifications out of Accumulated Other Comprehensive Loss on the respective line items in our Consolidated Statements of Income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, we are required to cross-reference other required GAAP disclosures to provide additional detail about those amounts. These disclosures can be made on the face of the financial statement that reports net income or in the notes, provided all the information is disclosed in a single location. However, an entity is prohibited from providing this information on the face of the statement that reports net income if it has items that are not reclassified in their entirety into net income. This update does not change the requirement to present the components of net income and other comprehensive income in either a single continuous statement or two separate consecutive statements, nor does it change the items currently reported in other comprehensive income.

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 June 30, 2013, the related consolidated statements of income and comprehensive income for the three-month and six-month periods ended June 30, 2013 and 2012 and the related consolidated statements of cash flows for the six month periods ended June 30, 2013 and 2012. 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, 2012, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated February 15, 2013, 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, 2012, 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
July 24, 2013

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

Norfolk Southern Corporation and Subsidiaries

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

OVERVIEW

We are one of the nation's premier transportation companies. Our Norfolk Southern Railway Company subsidiary operates approximately 20,000 miles of road in 22 states and the District of Columbia, serves every major container port in the eastern United States, and provides efficient connections to other rail carriers. We operate the most extensive intermodal network in the East and are a major transporter of coal, automotive, and industrial products.

Our second quarter net income declined to \$465 million in 2013 from \$524 million in 2012 and earnings per share decreased to \$1.46 from \$1.60 in the prior year, as our financial results were negatively impacted by lower coal revenues.

Cash provided by operating activities for the first six months of 2013 totaled \$1.5 billion, which along with cash on hand allowed for property additions, dividends, share repurchases, and debt repayments. In the first six months of 2013, we repurchased approximately 4.2 million shares of Norfolk Southern common stock (Common Stock) at a total cost of \$314 million. Since inception of our stock repurchase program in 2006, we have repurchased and retired 132.6 million shares of Common Stock at a total cost of \$7.8 billion. At June 30, 2013, cash and cash equivalents totaled \$587 million.

SUMMARIZED RESULTS OF OPERATIONS

Second quarter 2013 net income was \$465 million, down \$59 million, or 11%, compared with the same period last year. The decrease resulted from a \$98 million decline in income from railway operations, offset in part by lower income taxes. The decrease in income from railway operations reflected a \$72 million, or 3%, decline in railway operating revenues as softness in our coal business outweighed general merchandise and intermodal revenue growth.

The railway operating ratio (a measure of the amount of operating revenues consumed by operating expenses) rose to 70.2% for the second quarter of 2013, compared with 67.5% for the second quarter of 2012.

For the first six months of 2013, net income was \$915 million, down \$19 million, or 2%, compared with the same period last year, driven by lower income from railway operations, partially offset by increased nonoperating income items and decreased income tax expense. Results were favorably impacted by the recognition of the gain from the sale of certain assets to the Michigan Department of Transportation, benefiting net income by \$60 million and earnings per share by \$0.19.

Oil prices affect our results of operations in a variety of ways and can have an overall favorable or unfavorable impact in any particular period. In addition to the impact of oil prices on general economic conditions, volume, and supplier costs, oil prices directly affect our revenues through market-based fuel surcharges and contract escalators (see “Railway Operating Revenues”) and also affect fuel costs (see “Railway Operating Expenses”). For the second quarter and first six months of 2013, excluding the impact of increased consumption, the decreases in fuel surcharge revenue exceeded the decreases 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

Second quarter railway operating revenues were \$2.8 billion in 2013, down \$72 million, or 3%, compared with the second quarter of 2012. For the first six months of 2013, railway operating revenues were \$5.5 billion, down \$123 million, or 2%, compared with the same period last year. As shown in the following table, the decreases resulted from lower average revenue per unit (which includes the effects of fuel surcharges), partially offset by higher volume. Fuel surcharge revenue for the second quarters of 2013 and 2012 totaled \$306 million and \$365 million, respectively, and \$580 million and \$690 million for the first six months of 2013 and 2012, respectively.

| | Second Quarter 2013 vs. 2012 Increase (Decrease) (\$ in millions) | First Six Months 2013 vs. 2012 Increase (Decrease) (\$ in millions) |
|------------------|---|---|
| Revenue per unit | \$(134) | \$(270) |
| Volume (units) | 62 | 147 |
| Total | \$(72) | \$(123) |

Many of our negotiated fuel surcharges for coal and general merchandise shipments 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 decreased fuel surcharge revenue by approximately \$4 million for the quarter and \$27 million for the first six months of 2013. This two-month lag increased fuel surcharge revenue by approximately \$61 million for the second quarter of 2012 and \$35 million for the first six months of 2012.

One of our customers, DuPont, has a rate reasonableness complaint pending before the Surface Transportation Board (STB) alleging that our tariff rates for transportation of regulated movements are unreasonable. We dispute this allegation. Since June 1, 2009, we have been billing and collecting from DuPont amounts based on the challenged tariff rates. We presently expect resolution of the DuPont case to occur in 2014 and believe the estimate of reasonably possible loss will not have a material effect on our financial position, results of operations, or liquidity. With regard to rate cases, we record adjustments to revenues in the periods, if and when, such adjustments are probable and estimable.

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

| | Second Quarter | | | | | |
|----------------------------|------------------|---------|----------------|---------|------------------|---------|
| | Revenues | | Units | | Revenue per Unit | |
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| | (\$ in millions) | | (in thousands) | | (\$ per unit) | |
| Coal | \$626 | \$755 | 341.4 | 354.8 | \$1,833 | \$2,126 |
| General merchandise: | | | | | | |
| Chemicals | 415 | 379 | 114.0 | 98.5 | 3,642 | 3,844 |
| Agriculture/consumer/gov't | 366 | 370 | 147.9 | 150.1 | 2,475 | 2,464 |
| Metals and construction | 350 | 369 | 171.1 | 180.2 | 2,045 | 2,047 |
| Automotive | 261 | 239 | 106.4 | 98.4 | 2,456 | 2,431 |
| Paper/clay/forest | 196 | 199 | 76.4 | 76.9 | 2,570 | 2,593 |
| General merchandise | 1,588 | 1,556 | 615.8 | 604.1 | 2,580 | 2,576 |
| Intermodal | 588 | 563 | 881.0 | 840.4 | 667 | 671 |
| Total | \$2,802 | \$2,874 | 1,838.2 | 1,799.3 | 1,524 | 1,597 |

| | First Six Months | | | | | |
|----------------------------|------------------|---------|----------------|---------|------------------|---------|
| | Revenues | | Units | | Revenue per Unit | |
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| | (\$ in millions) | | (in thousands) | | (\$ per unit) | |
| Coal | \$1,261 | \$1,521 | 684.6 | 713.8 | \$1,841 | \$2,130 |
| General merchandise: | | | | | | |
| Chemicals | 809 | 741 | 220.0 | 194.5 | 3,679 | 3,808 |
| Agriculture/consumer/gov't | 727 | 740 | 295.8 | 302.4 | 2,458 | 2,446 |
| Metals and construction | 686 | 711 | 325.9 | 345.7 | 2,106 | 2,057 |
| Automotive | 505 | 465 | 205.1 | 194.7 | 2,461 | 2,388 |
| Paper/clay/forest | 391 | 395 | 153.0 | 153.6 | 2,554 | 2,573 |
| General merchandise | 3,118 | 3,052 | 1,199.8 | 1,190.9 | 2,599 | 2,563 |
| Intermodal | 1,161 | 1,090 | 1,737.4 | 1,625.4 | 668 | 671 |
| Total | \$5,540 | \$5,663 | 3,621.8 | 3,530.1 | 1,530 | 1,604 |

Coal

Coal revenues decreased \$129 million, or 17%, in the second quarter and \$260 million, or 17%, for the first six months, compared with the same periods last year. Both decreases resulted from declines in average revenue per unit (down 14% in both the second quarter and the first six months) and carload volume (down 4% in both the second quarter and the first six months).

Coal tonnage by market was as follows:

| | Second Quarter | | First Six Months | |
|------------------------|---------------------|---------------|------------------|---------------|
| | 2013 | 2012 | 2013 | 2012 |
| | (tons in thousands) | | | |
| Utility | 24,319 | 23,527 | 48,277 | 49,788 |
| Export | 7,380 | 8,530 | 15,799 | 15,254 |
| Domestic metallurgical | 4,608 | 5,019 | 8,650 | 9,591 |
| Industrial | 1,810 | 1,880 | 3,610 | 3,801 |
| Total | 38,117 | 38,956 | 76,336 | 78,434 |

Export coal tonnage decreased 13% in the second quarter, but increased 4% for the first six months as compared to the same periods of 2012. Despite increased Asian steel production, strong competition in a well-supplied global market led to weak metallurgical shipments for both periods. Notwithstanding strong global competition negatively impacting second quarter, the first six months reflected higher overall export thermal coal shipments. Domestic metallurgical coal tonnage was down 8% in the second quarter and 10% for the first six months due to the continued decline in domestic steel production and the closure of a steel plant in the second half of 2012. Industrial coal tonnage declined 4% in the second quarter and 5% for the first six months, as a result of weak demand. Utility coal tonnage improved 3% in the second quarter, but declined 3% for the first six months. Utility coal shipments in our northern region increased for both periods as higher coal burn necessitated stockpile replenishments. These increases were partially offset for the quarter and completely for the first six months by the effects of natural gas competition which reduced utility shipments in our southern region.

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

General Merchandise

General merchandise revenues increased \$32 million, or 2%, in the second quarter, compared with the same period last year, driven by a 2% increase in carload volumes and a modest improvement in average revenue per unit. For the first six months, general merchandise revenues increased \$66 million, or 2%, reflecting a 1% rise in average revenue per unit and a 1% increase in carload volumes.

Chemicals volume increased 16% in the second quarter and 13% for the first six months, largely driven by higher shipments of crude oil originated from the Bakken and Canadian oil fields.

Automotive volume grew 8% in the second quarter and 5% for the first six months, primarily a result of increased North American light vehicle production at plants we serve and new business from existing customers (including both auto parts and finished vehicles).

Metals and construction volume decreased 5% in the second quarter and 6% for the first six months, reflecting fewer iron and steel carloads (due to a steel plant closure) and reduced scrap metal shipments (led by weakening demand).

Agriculture, consumer products, and government volume decreased 1% in the second quarter and 2% for the first six months, reflecting fewer revenue movements of empty equipment, in addition to reduced shipments of soybeans and related products as domestic bean supplies tightened. These declines were partially offset by higher shipments of fertilizer due to a strong farm economy and increased planting activity. Prior year drought conditions led to more shipments of corn into the Midwest gathering markets; however, closure of an ethanol

plant during the fourth quarter of 2012 and customer sourcing changes overshadowed this improvement during the first six months.

Paper, clay, and forest products decreased modestly in the second quarter and for the first six months, reflecting fewer shipments of graphic paper due to the decline in newsprint and white paper consumption in North America. This decline was partially offset by more carloads of lumber as the housing sector continues to recover.

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

Intermodal

Intermodal revenues increased \$25 million, or 4%, in the second quarter, compared with the same period last year, reflecting a 5% increase in volumes and a 1% decrease in average revenue per unit. For the first six months, intermodal revenues increased \$71 million, or 7%, reflecting a 7% increase in carload volumes and a slight decline in average revenue per unit.

Domestic volume (including truckload and intermodal marketing companies, Triple Crown Services, and Premium business) improved 6% in the second quarter and 7% for the first six months, the result of continued highway conversions and additional business associated with the opening of new intermodal terminals.

International volume grew 2% in the second quarter and 8% for the first six months, due to growth across existing customers as the economy continued to improve.

Intermodal revenues for the remainder of the year are expected to be higher compared to last year due to higher volumes and improved average revenue per unit.

Railway Operating Expenses

Second quarter railway operating expenses were \$2.0 billion in 2013, up \$26 million, or 1%, compared to the same period last year. For the first six months, expenses were \$4.0 billion, up \$29 million, or 1%, compared to the same period last year. Both periods included higher purchased services and rents, whereas the first six months also included higher fuel expenses.

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 rose \$18 million, or 5%, in the second quarter and \$20 million, or 3%, for the first six months, driven by higher Conrail rents and services and increased roadway repair costs.

The following table shows the components of purchased services and rents expenses:

| | Second Quarter | | First Six Months | |
|--------------------|-------------------|-------|---------------------|-------|
| | 2013 | 2012 | 2013 | 2012 |
| | (\$ in millions) | | | |
| Purchased services | \$343 | \$320 | \$664 | \$638 |
| Equipment rents | 67 | 72 | 139 | 145 |
| Total | \$410 | \$392 | \$803 | \$783 |

Materials and other expenses (including the estimated costs related to personal injury, property damage, and environmental matters) increased \$8 million, or 4%, in the second quarter, but decreased \$4 million, or 1%, for the first six months. Both periods reflect increased material and supplies costs for equipment repairs and higher environmental expenses, which were offset in part for the quarter and entirely for the first six months by more favorable personal injury claims development and lower bad debt expense.

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

| | Second Quarter | | First Six Months | |
|-----------------------------|-------------------|-------|---------------------|-------|
| | 2013 | 2012 | 2013 | 2012 |
| | (\$ in millions) | | | |
| Materials | \$116 | \$95 | \$217 | \$207 |
| Casualties and other claims | 20 | 30 | 55 | 68 |
| Other | 77 | 80 | 159 | 160 |
| Total | \$213 | \$205 | \$431 | \$435 |

Compensation and benefits expense increased \$2 million in the second quarter, but decreased \$4 million for the first six months, reflecting changes in:

- pay rates (up \$16 million for the quarter and \$31 million for the first six months),
- employee activity levels (down \$7 million for the quarter and \$21 million for the first six months), and
- payroll taxes (down \$7 million for the quarter and \$14 million for the first six months).

Fuel expense, which includes the cost of locomotive fuel as well as other fuel used in railway operations, increased \$1 million for the second quarter and \$17 million, or 2%, for the first six months. The increases principally resulted from higher fuel consumption (locomotive fuel consumption was up 3% and 2% for the second quarter and first six months, respectively), which had impacts of \$11 million in the second quarter and \$20 million for the first six months, offset in part by lower fuel prices (locomotive fuel prices declined 4% and 1%, respectively), which had impacts of \$10 million and \$3 million, respectively.

Depreciation expense decreased \$3 million, or 1%, in the second quarter and was flat in the first six months. The favorable impact of the equipment depreciation study that was completed during the first quarter of 2013 was partially offset for the quarter and entirely for the first six months by the effects of an increased capital base.

Other Income – Net

Other income – net decreased \$2 million in the second quarter, but increased \$104 million for the first six months of 2013. Both periods reflect changes in:

- coal royalties (down \$6 million for the quarter and \$9 million for the first six months),
- net returns from corporate-owned life insurance (down \$2 million for the quarter, but up \$5 million for the first six months), and
- miscellaneous items (up \$6 million for the quarter and \$11 million for the first six months).

The first six months also reflected a \$97 million land sale gain in Michigan.

Provision for Income Taxes

The second quarter and year-to-date effective income tax rates were 36.9% and 36.2% in 2013, respectively, compared with 37.8% and 37.6%, respectively, for the same periods last year. Both periods benefited from tax credits that became available in 2013 as a result of the American Taxpayer Relief Act of 2012 (Act), which was enacted January 2, 2013. The lower year-to-date effective rate also reflects \$9 million in benefits we recognized in the first quarter of 2013 for certain tax credits retroactively reinstated by the Act.

Fifty-percent bonus depreciation was allowed for federal income taxes in 2012. The American Taxpayer Relief Act of 2012 extended fifty-percent bonus depreciation for 2013. While bonus depreciation does not affect our total provision for income taxes or effective rate, we expect the absence of bonus depreciation to increase current income tax expense and the related cash outflows for the payment of income taxes beginning in 2014.

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.

FINANCIAL CONDITION AND LIQUIDITY

Cash provided by operating activities, our principal source of liquidity, was \$1.5 billion for the first six months of 2013 compared with \$1.7 billion for the same period of 2012, primarily reflecting the reduction of accounts payable. We had working capital of \$263 million at June 30, 2013, compared with \$161 million at December 31, 2012, primarily reflecting lower short-term debt. Cash and cash equivalents totaled \$587 million at June 30, 2013, and were invested in accordance with our corporate investment policy as approved by our Board of Directors. The portfolio contains securities that are subject to market risk. There are no limits or restrictions on our access to the assets. We expect cash on hand combined with cash provided by operating activities will be sufficient to meet our ongoing obligations. There have been no material changes to the information on our future obligations contained in our Form 10-K for the year ended December 31, 2012.

Cash used in investing activities was \$807 million for the first six months of 2013, compared with \$932 million in the same period last year, primarily reflecting a decrease in 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, we will continue 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 \$305 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, we currently anticipate spending up to \$332 million for the substantial completion of work on these projects, which is expected in 2015. This includes planned investments of approximately \$61 million for the remainder of 2013 and approximately \$57 million thereafter through 2015. If and when capacity warrants, additional improvements and expansions beyond these amounts may be made to the Crescent Corridor.

Cash used in financing activities was \$765 million in the first six months of 2013 compared with \$651 million in the same period last year. The change includes the absence of proceeds from borrowings, offset in part by lower share repurchases. We repurchased approximately 4.2 million shares, totaling \$314 million, in the first six months of 2013, compared to 12.3 million shares, totaling \$850 million, in the same period last year. The timing and volume of future share repurchases will be guided by our 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.

Our total debt-to-total capitalization ratio was 45.4% at June 30, 2013 and 47.1% at December 31, 2012.

We have authority from our Board of Directors to issue an additional \$600 million of debt or equity securities through public or private sale. We have 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.

We also have in place and available a \$750 million, five-year credit agreement expiring in 2016, which provides for borrowings at prevailing rates and includes covenants. We had no amounts outstanding under this facility at June 30, 2013, and are in compliance with all of our covenants. In October 2012, we renewed our \$350 million accounts receivable securitization program with a 364-day term to run until October 2013. There was \$100 million and \$300 million outstanding under this program at June 30, 2013 and December 31, 2012, respectively.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP) requires us 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 us to make changes to these estimates and assumptions. Accordingly, we regularly review these estimates and assumptions based on historical experience, changes in the business environment, and other factors we believe to be reasonable under the

circumstances. We regularly discuss the development, selection, and disclosures concerning critical accounting estimates with the Audit Committee of our Board of Directors. There have been no significant changes to the application of critical accounting estimates disclosure contained in our Form 10-K at December 31, 2012.

OTHER MATTERS

Labor Agreements

More than 80% of our 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. We largely bargain 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.

We and the NCCC have concluded the round of bargaining that began in 2009 and reached agreements that extend through December 31, 2014 with all applicable labor unions. With regard to the Wheelersburg (Ohio) Terminal workers who are represented by the Brotherhood of Maintenance of Way Employees Division (BMWED), negotiations are underway and mediation under the auspices of the National Mediation Board is expected to begin in October 2013.

Market Risks

We manage overall exposure to fluctuations in interest rates by issuing both fixed- and floating-rate debt instruments. At June 30, 2013, debt subject to interest rate fluctuations totaled \$100 million. A one-percentage point increase in interest rates would increase total annual interest expense related to all variable debt by \$1 million. We consider it unlikely that interest rate fluctuations applicable to these instruments will have a material adverse effect on our financial position, results of operations, or liquidity.

Environmental Matters

We are subject to various jurisdictions' environmental laws and regulations. We 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 we have incurred, are reflected as receivables (when collection is probable) in the Consolidated Balance Sheets and are not netted against the associated liability. Environmental engineers regularly participate in ongoing evaluations of all known sites and in determining any necessary adjustments to liability estimates. We have an Environmental Policy Council, composed of senior managers, to oversee and interpret our environmental policy.

Our Consolidated Balance Sheets include liabilities for environmental exposures of \$53 million at June 30, 2013, and \$42 million at December 31, 2012 (of which \$12 million is classified as a current liability at the end of each period). At June 30, 2013, the liability represents our estimate of the probable cleanup, investigation, and remediation costs based on available information at 149 known locations and projects. At that date, ten sites accounted for \$29 million of the liability, and no individual site was considered to be material. We anticipate that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At 21 locations, one or more of our 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. We calculate our 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 us or the EPA, or comparable state authorities), estimates of our 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, unpredictable contaminant recovery and reduction rates associated with available clean-up technologies, the likely development of new cleanup 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. We estimate our environmental remediation liability on a site-by-site basis, using assumptions and judgments we deem appropriate for each site. As a result, it is not practical to quantitatively describe the effects of changes in these many assumptions and judgments. We have consistently applied our methodology of estimating our environmental liabilities.

Based on the assessment of facts and circumstances now known, we believe we have recorded the probable and reasonably estimable costs for dealing with those environmental matters of which we are aware. Further, we

believe that it is unlikely that any known matters, either individually or in the aggregate, will have a material adverse effect on our financial position, results of operations, or liquidity.

Inflation

In preparing financial statements, GAAP requires the use of historical cost that disregards the effects of inflation on the replacement cost of property. As a capital-intensive company, most of our capital is invested in long-lived assets. 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," "plan," "consider," "project," and similar references to the future. Forward-looking statements reflect our 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 we have little or no control, including: significant governmental legislation and regulation over commercial, operating and environmental matters; transportation of hazardous materials as a common carrier by rail; acts of terrorism or war; general economic conditions including, but not limited to, fluctuation and competition within the industries of our customers; climate change legislative and regulatory developments; competition and consolidation within the transportation industry; the operations of carriers with which we interchange; disruptions to our technology infrastructure, including computer systems; labor difficulties, including strikes and work stoppages; results of litigation; natural events such as severe weather, hurricanes, and floods; unpredictable 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 our business, 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. We undertake 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

Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, with the assistance of management, evaluated the effectiveness of our 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)) at June 30, 2013. Based on such evaluation, our officers have concluded that, at June 30, 2013, our disclosure controls and procedures are effective in alerting them on a timely basis to material information required to be included in our periodic filings under the Exchange Act.

Changes in Internal Control Over Financial Reporting

During the second quarter of 2013, we have not identified any changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On November 6, 2007, various antitrust class actions filed against us and other Class I railroads in various Federal district courts regarding fuel surcharges were consolidated in the District of Columbia by the Judicial Panel on Multidistrict Litigation. On June 21, 2012, the court certified the case as a class action. The defendant railroads have appealed such certification, and a decision by the court to either reject the appeal outright or proceed with ruling on its merits is pending. We believe the allegations in the complaints are without merit and intend to vigorously defend the cases. We do not believe the outcome of these proceedings will have a material effect on our financial position, results of operations, or liquidity. A lawsuit containing similar allegations against us 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.

We received a Notice of Violation (NOV) issued by the Tennessee Department of Environmental Conservation concerning soil runoff in connection with construction of the Memphis Regional Intermodal Facility in Rossville, Tennessee. Although we 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. We do not believe that the outcome of this proceeding will have a material effect on our financial position, results of operations, or liquidity.

Item 1A. Risk Factors

The risk factors included in our 2012 Form 10-K remain unchanged and are incorporated herein by reference.

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

| Period | (a) Total Number of Shares (or Units) Purchased | (b) Average Price Paid per Share (1)(or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be purchased under the Plans or Programs (2) |
|------------------|---|--|--|---|
| April 1-30, 2013 | 286,570 | \$76.23 | 283,963 | 45,828,650 |
| May 1-31, 2013 | 1,646,867 | \$78.29 | 1,644,723 | 44,183,927 |
| June 1-30, 2013 | 1,749,048 | \$74.60 | 1,749,048 | 42,434,879 |
| Total | 3,682,485 | | 3,677,734 | |

(1) Of this amount, 4,751 represents shares tendered by employees in connection with the exercise of options under the stockholder-approved Long-Term Incentive Plan.

(2) Our Board of Directors authorized a share repurchase program, pursuant to which up to 125 million shares of Common Stock could be purchased through December 31, 2014. On August 1, 2012, our Board of Directors authorized the repurchase of up to an additional 50 million shares of Common Stock through December 31, 2017.

Item 6. Exhibits

See Exhibit Index beginning on page 33 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

/s/C.H. Allison, Jr.

C. H. Allison, Jr.

Date: July 24, 2013

Vice President and Controller

(Principal Accounting Officer) (Signature)

/s/Howard D. McFadden

Date: July 24, 2013 Howard D. McFadden

Corporate Secretary (Signature)

EXHIBIT INDEX

- 10.1* Norfolk Southern Corporation Executives' Deferred Compensation Plan, as amended effective June 26, 2013.
- 10.2* Norfolk Southern Corporation Thoroughbred Stock Option Plan, as adopted effective January 26, 1999, and as amended effective July 22, 2013.
- 10.3* Norfolk Southern Corporation Long-term Incentive Plan, as approved by shareholders May 13, 2010, and as amended July 23, 2013.
- 15* Letter regarding unaudited interim financial information.
- 31-A* Rule 13a-14(a)/15d-014(a) CEO Certifications.
- 31-B* Rule 13a-14(a)/15d-014(a) CFO Certifications.
- 32* Section 1350 Certifications.

- The following financial information from Norfolk Southern Corporation's Quarterly Report on Form 10-Q for the second quarter of 2013, formatted in Extensible Business Reporting Language (XBRL) includes (i) the Consolidated Statements of Income for the second quarters and first six months of 2013 and 2012; (ii) the Consolidated Statements of Comprehensive Income for the second quarters and first six months of 2013 and 2012; (iii) the Consolidated Balance Sheets at June 30, 2013, and December 31, 2012; (iv) the Consolidated Statements of Cash Flows for the first six months of 2013 and 2012; and (v) the Notes to Consolidated Financial Statements.
- 101* Consolidated Statements of Comprehensive Income for the second quarters and first six months of 2013 and 2012; (iii) the Consolidated Balance Sheets at June 30, 2013, and December 31, 2012; (iv) the Consolidated Statements of Cash Flows for the first six months of 2013 and 2012; and (v) the Notes to Consolidated Financial Statements.

* Filed herewith.