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The following is a transcript from an investor teleconference held on January 21, 2016:

Transcript
CP Fourth Quarter Earnings Call
January 21, 2016

OTHER PARTICIPANTS

Fadi Chamoun, BMO Capital Markets
Thomas Wadewitz, UBS Securities LLC
Steve Hansen, Raymond James Ltd.
Chris Wetherbee, Citigroup Global Markets
Brandon Oglenski, Barclays Capital, Inc.
Ken Hoexter, Bank of America Merrill Lynch
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CORPORATE PARTICIPANTS

E. Hunter Harrison, Chief Executive Officer
Keith E. Creel, President & Chief Operating Officer
Mark J. Erceg, Chief Financial Officer
Nadeem Velani, VP Investor Relations

Operator: Good morning. My name is Chris, and I will be your conference operator today. At this time, I would like to welcome everyone to Canadian Pacific's Fourth Quarter 2015 Conference Call. The slides accompanying today's call are available at www.cpr.ca. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

I would now like to introduce Nadeem Velani, Vice President, Investor Relations, to begin the conference call.

Nadeem Velani

VP - Investor Relations

Thanks, Chris. Good morning and thanks for joining us. I'm proud to have with me here today Hunter Harrison, our Chief Executive Officer; Keith Creel, President and Chief Operating Officer; Mark Erceg, our Executive Vice President and Chief Financial Officer.

Before we begin, I want to remind you this presentation contains forward-looking information. Actual results may differ materially. The risks, uncertainties and other factors that could influence actual results are described on slide two, in the press release and in the MD&A filed with Canadian and U.S. regulators. This presentation also contains non-GAAP measures outlined on slide three.

The formal remarks will be followed by Q&A. In the interest of time, we would appreciate if you limit your questions to one. Also, if you have specific modeling questions, please follow-up with us after the call.

It is now my pleasure to introduce our CEO, Hunter Harrison.

E. Hunter Harrison

Chief Executive Officer

Thanks, Nadeem. Good morning to everyone, thanks for joining us. We're going to provide initially this morning a kind of abbreviated version of what we normally do because I think there's going to be a lot of interest in the Q&A activity. And I trust you have seen our press release, but there's a couple of areas that I'd like to spend a little time highlighting.

And if you look at our fourth quarter results year-over-year and look at the OR of 59.8%, which I was very pleased with what Keith and his team was able to achieve there. Some of their operating metrics are pretty outstanding and really going to service us well as we go forward and I would just remind you, some of you that they've been onboard since the initial proxy contest going back to 2012.

We talked about that we were going to 65% by mid-2016. A lot of you said it couldn't be done, well, I'm very pleased that we're ahead of schedule, and certainly not over yet in spite of the fact that we've got some challenging times here with everything that's going to affect the top line. And we're going to try to do as good a job as we think we can in providing some level of guidance today.

We also have talked to you about that we're making some pretty significant reduction, which is not all necessarily related to economic conditions to the capital spend, I think will be down. Mark will probably touch on this further, but in the range of CAD 400 million below what we have, our run rate has been, I think will give us much stronger

free cash flow that you've been looking forward to. I think, if you look – just spend a moment on full year 2015, our OR came in at 61 % and our earnings at CAD 10.10, which was up about 19% year-over-year. I think, for the last three years, we have been by far the strongest in EPS growth year-over-year performance, which will serve us well going forward.

And so let me just spend a couple of moments about some data in advance because I don't want it to get lost, and once again, in some of the Q&A activity. I think we're looking forward to in 2016 an operating ratio below 59%, and there are some wild cards there that says how far below. I think we're still, in spite of the fact of tremendous pressure on the top line, double-digit EPS growth and continue to reduce capital expenditures. So I think some of the initiatives that

Keith and his team have initiated are starting to kick in. There are some exciting things going on there that I'm very, very pleased about, so some continued efficiency and productivity improvements we're looking forward to in 2016.

And I think I've talked before about this model of ours that I think it outperforms the competition maybe even more so in hard times than it does good times. So I think that's one of the reasons that we will be able to sustain some performance that others think cannot be achieved. So, overall, there's a lot of unanswered questions out there in the market. We're happy to share with you, Mark can at the appropriate time, some of our assumptions. And if you think our assumptions are wrong, you can adjust accordingly.

But overall, I'm very pleased with the performance given, some of the challenges that we've been through and the challenges that have been extending themselves. And I have one more point I would make, if you remember back once again to the proxy contest and we talked about the two plans then. And one of the things that I was concerned about was that my plan, if you will, quote, was pretty conservative on topline revenue growth and the company was very aggressive. And I'm sorry to say I happen to be right there, but I think there's some light at the end of the tunnel. Don't ask me where, but it's there, okay.

And so, with that, let me turn it over to Keith for a moment to give some highlights on the operating performance.

Keith E. Creel

President, Chief Operating Officer

Okay. Thanks, Hunter. I'll be brief in my comments as well. So the operating metrics that we share with the group this morning, certainly, this is a story of recognizing up front the things you can't control, which is the economy. And then doing something about those that you can, which obviously is our operating performance day to day.

We finished 2015 in the face of a weak economy in the fourth quarter very strong, year-over-year very strong. This operating performance obviously is a testament to the operating model that we execute day in and day out, and also a testament to the people that execute it across this company.

The story of continually adjusting your assets, sizing the assets versus demand, it's about blocking and tackling across all facets of the operating department, as well as in the headquarter and the support function. It isn't complicated, that requires an understanding of the model first and then disciplined execution day in and day out. Essentially, simply said, less demand when you put that in conjunction with continued step improvements and productivity, must produce an environment where you got fewer assets, fewer locomotives, fewer cars, fewer people across the board. That's what drives an ability to continue to improve productivity, lower cost, provide service, and that's why we're able to reduce head count of the workforce in 2015, about 12%, and an environment where we saw about a 3% volume decline. That's why today we sit roughly with about 600 locomotive stores, which obviously is a significant delay for future capital, take us beyond 2018, and in the meantime, we're going to enjoy much lower maintenance cost as we move through the horizon.

And all this sets the stage for, to Hunter's point, a very strong operating performance in 2016, again, focusing on what we can control, which is cost control, gives me a very strong point of view and line of sight and confidence in producing a sub 59% operating ratio.

On the revenue side obviously, prudently a very different picture. This is a reflection of what we can't control. It's a similar story we've seen the last three quarters of 2015, the economic headwinds across all business segments, except for a couple of bright spots in forest products and Canadian grain. But a strong U.S. dollar combined with low commodity prices, obviously, weighed heavily against that in bulk, energy and metal.

Intermodal growth, being impacted obviously by a slowdown in the Canadian economy as well as increased trucking capacity in our short-haul lane. On the pricing side, excluding the impact of our regulated grain in 2015, we came in, as we expected, the low end of our targeted range of 3%.

Looking forward, obviously, we see strong headwinds with the economy, first half of the year 2016, but with a continued focus on our cost control, improving our service for our customers and developing our bench strength at our team, we're going to be able to convert what the economy does, provide us and poise ourselves for a strong bounce back when the economy comes back.

So, with that said, I'll turn it over to Mark for his comments.

Mark J. Erceg
Chief Financial Officer

Thanks, Keith. Good morning, everybody. As Keith just mentioned, revenues were down 4%. But as is customary, the team dug deep and found additional cost savings opportunities, which did allow us to tie last year's record OR of 59.8%. And I have to say that while a sub 60% OR during a quarter in which revenues are down is notable in and of itself, when you consider the fact that the lag on our fuel surcharge program added about 1 point to OR, and we had 2 points of OR headwind from higher pension expense and lower land sales, then this accomplishment is even more impressive and really speaks to the power of CP's precision railroading model in both good times and bad.

Now, before I touch on a couple of the key operating expense areas, please note that I'll be speaking on an FX adjusted basis because FX has been so volatile as of late. So, with that understanding, comp and benefits were CAD 333 million. That was flat versus a year ago. Within that, pension expense was a CAD 24 million headwind and higher stock-based comp and wage inflation were each up about CAD 10 million. But as Keith mentioned, employee productivity was up sharply with our end of period workforce being 12% lower, which represents a decrease of nearly 1,800 employees.

The positive trend of increased employee productivity is expected to continue going forward. So, from a modeling perspective, you should expect comp and benefits to be lower in 2016. Behind additional workforce reductions, lower stock- and incentive-based comp and a nice tailwind on the pension front, were strong asset returns, lower head count and a slight increase in the discount rate should result in pension income on our DB plan of approximately CAD 90 million this year versus what you'll recall was about CAD 32 million expense item last year.

Fuel expense was CAD 166 million during the quarter. That was down 43% year-over-year. Lower volumes accounted for CAD 21 million of the reduction and fuel productivity accounted for an additional CAD 12 million. But as of last year, lower fuel prices themselves accounted for the lion's share of the reduction at CAD 97 million. Purchased services was CAD 27.2 million, and as is typically the case, there were a number of puts and takes within this line item. But in a nutshell, the efficiencies generated through our focus on cost control, outweighs the headwind of a tough land sales comp during the quarter.

Now for 2016 and again for your modeling purposes, we do expect land sales of approximately CAD 7.5 million, which is roughly in line with our 2015 land sale number. And this reflects our progress in monetizing our real estate portfolio. So, ramping up on our quarterly P&L results, reported net income was down 29%. But when you remove the non-cash loss on U.S. dollar denominated debt and look just at the adjusted diluted earnings per share, we were up 1% at CAD 2.72 per share.

Moving quickly to cash flow and the balance sheet, I think it's important to note that for the full year, we generated record free cash flow of nearly CAD 1.2 billion, that was an increase of nearly 60% versus last year. And the increase was primarily driven by higher cash from operations and proceeds from asset sales, only partially

offset by higher CapEx of CAD 1 .5 billion.

Now if you start modeling 2016 cash flow, two things that you should keep in mind. First, with our large program spend largely behind us, train speed and other operating improvements ahead of schedule and a softer demand environment, we can now responsibly dial back on our CapEx spending. So you should expect to see about CAD 1.1 billion spend on CapEx during 2016.

Second our cash tax payments will be roughly CAD 370 million higher in 2016. Now I know that's a big number, but this is because during 2015, the company generated full taxable income, which was not offset by loss carry forwards in Canada for the first time since 2007. So, from a cash flow standpoint, the team will effectively be paying two years worth of cash taxes in 2016 because our 2015 Canadian taxes are payable in 2016 and we'll be submitting estimated monthly payments throughout the year.

With regards to the balance sheet, we've taken advantage of our improved credit rating and made significant improvement to our debt portfolio. Specifically, we've extended our weighted average maturity from 12 years to 26 years, while at the same time, reducing our weighted average coupon from 6.25% to 5.625%.

Finally, the last thought I'd like to leave you with today is that, as CFO, I take a great comfort in knowing the company's balance sheet is in very good regard. We have CAD 650 million of cash on hand, no material refinancing requirement until 2018 and an undrawn CAD 2 billion credit facility. So the company has plenty of liquidity and financial flexibility available to us as we start the New Year.

And with that, let me turn the call back to Hunter.

E. Hunter Harrison
Chief Executive Officer

Okay. Thanks, Mark and Keith. And, Chris, we'll be happy to address questions now the group might have.

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. [Operator Instructions] Y our first question comes from the line of Fadi Chamoun from BMO. Your line is open.

Fadi Chamoun
BMO Capital Markets

Q

Yes, good morning. Good results, guys, and also good guidance given the context that we're working with. I wanted to delve a little more into the volume assumption you have in your outlook for 2016. If you can walk us through a little bit, what is implied in terms of volume for 2016. And I also have a question about coal and Teck as well.

Keith E. Creel
President, Chief Operating Officer

A

Fadi, I would say this, number one, tremendous amount of uncertainty that our assumption, modestly down. We're taking a very conservative approach. I don't see any shining stars out there in the economy. But if you know something more than I do, then please share with me. But that's the assumption that we're making, so modestly down versus 2015.

Fadi Chamoun

BMO Capital Markets

Q

Okay. Modestly down I guess, we should understand that to be low single -digit basically, 1 % or 2%.

Mark J. Erceg

Chief Financial Officer

Yeah, I think that's fair.

A

Fadi Chamoun

BMO Capital Markets

Q

Okay. As far as Teck goes, I mean there's a lot of uncertainty about coal obviously. Has there been any conversation with Teck about volume pricing, as we move into 2016, 2017 and the challenges on their business, [ph] as an easing (18:39) at this point?

Keith E. Creel

President, Chief Operating Officer

You mean volume pricing relative to pressure on us to drop the price?

A

Fadi Chamoun

BMO Capital Markets

Q

Yeah.

Keith E. Creel

President, Chief Operating Officer

A

No. No, we haven't had those discussions. And as far as guidance from Teck, I think they'll come out with their true guidance in February. But right now, we're moving a lot of coal. Similar, we're assuming similar first quarter as last year, which is about 6 million metric tons, and right now, that's really all I can tell you.

We're going to do well by them. Cycle times are down. We're hitting all record lows as far as cycle times, that set records there, which is controlling the operating side of the cost and giving them a reliable supply source. And then the other encouraging fact is I've understand that they're diversifying their book of business, so not as dependent upon China with sales that they're [ph] spending over the year (19:30). So that's encouraging from my standpoint.

Fadi Chamoun

BMO Capital Markets

Q

Good. Thank you.

Operator: Your next question comes from the line of Thomas Wadewitz from UBS. Your line is open.

Thomas Wadewitz
UBS Securities LLC

Q

Yes, good morning. I wanted to see if you could give us some comments on productivity and head count, if you know it. I guess when you've had the strong improvement over the last couple years, and certainly a lot of improvement in 2015 in operating metrics and then big reductions in the head count, everything kind of move in the right way in terms of the productivity. How much further is there to go in 2016? I don't know if that – they kind of maybe velocity comment, but also head count. If you look sequentially where you are in the fourth quarter, how much more of that can go down when we look into 2016?

E. Hunter Harrison
Chief Executive Officer

A

Tom, let me make some comments on that, then Keith maybe can add to it if he would choose. If you go back once again where we started with the product [indiscernible] (20:42), we've taken I think 6,000 and 7,000 people out of the count, which has been – predominantly been high percentage, in the high 90%, through attrition because we typically have enough to workforce.

And I think with some of the operating initiatives that Keith mentioned earlier, we feel like that there are some productivity gains and efficiencies. There are probably close to 1,000 additional heads to come out potentially in 2016. So there's still room there. There's still more to accomplish. And the real emphasis here is, as Keith said, what we're focusing on and what we can control, which is execution, which is running that same efficient railroad and provide good service and that's going us service well, but there's still opportunities that you mentioned there.

Keith E. Creel
President, Chief Operating Officer

A

The only thing I would add, Tom, is I mean this is – again, it's a similar story. We invest in the railways. The number one, protect that safe operation and number two, to strategically increase our productivity across the board.

So we said that speed is one. Velocity is key to our success. As we drive train, speed up [ph] our own investments (22:16). We own fewer trains, longer trains, faster trains. You create capacity, you reduce your operating expense and reduce your need on locomotors. You reduce your need on the folks that have to maintain those locomotives.

You reduce your need on assets that drive the bottom line. So I think there are several things that we've invested in and are accomplished in 2015 which will pay benefits for us in 2016, investments in the physical plant and progressive agreements.

We've told the market about that we signed in late 2015 that will start converting in 2016 some advancement even where we don't have agreements on. We did have consolidation agreement in Chicago that allows us to benefit from utilizing prior – two employees with prior [indiscernible] (23:07) employees which work in and through the Chicago terminal where in the past, we have been isolated to only using two employees, which means that if you run out of one, you can't depend upon the other and you – it's just not a very optimal recipe for success from controlling cost or sustaining reliable service. So that scenario that will be able to mine in 2016.

So, there's several more and obviously, every year, there will have to be but that's all about improving, doing more of what you have, which means you need less from a productivity standpoint. And then, of course, if demand reduces,

then obviously I don't need the same amount of assets on a reduced demand. So it's just understanding those levers and executing and converting them day-in and day -out and that's how you drive this continued improvement in synergies and cost control.

.....
Thomas Wadewitz
UBS Securities LLC

Q

Hunter, you said there's 1,000 people, is that something that's not already started to come in fourth quarter? And is that spread across the year or is that something that happens pretty quickly in terms of timing?

.....
E. Hunter Harrison
Chief Executive Officer

A

It's certainly not a hockey stick; it's a front-end loaded, if you will. I mean, we have determined given what we see happening this year what we need and we've taken into account, as Keith mentioned, the changes in labor agreement. And this is across the board. This is labor management and everywhere. So I would think that most of that will have kicked in and there's always a little lag, but then it's kicked in by the mid second quarter for sure.

.....
Thomas Wadewitz
UBS Securities LLC

Q

Okay. Great. Thank you for the time. Appreciate it.

.....
E. Hunter Harrison
Chief Executive Officer

A

Thanks, Tom.

.....
Keith E. Creel
President, Chief Operating Officer & Director

A

Thanks, Tom.

.....
Operator: Your next question comes from the line of Steve Hansen from Raymond James. Your line is open.

.....
Steve Hansen
Raymond James Ltd.

Q

Yeah. Good morning, guys. Just a question on the reallocation of capital going forward. With the free cash flow being quite strong and CapEx coming down, just curious about the – your perspective on those share repurchases going forward here. I guess in the context of some M&A talks still ongoing and you've been relatively strong through the back half of the year, just wanting to get a sense for how that will continue going forward and whether that's accounted, if at all, in your guidance outlook.

.....
Yes, good question. I would offer a couple of things for your consideration. Obviously, you've seen throughout the year of 2015, we were aggressive buyers of our shares. We believe we were buying shares well below our intrinsic value. Clearly, there's been a little bit of market dislocation as of late, but that doesn't change our fundamental view of where this railroad can get to and will go, and therefore, it doesn't fundamentally change our view on intrinsic value.

.....
Recently, you'll see that we've had suspended our share repurchase program, so to speak, temporarily as we've been in discussions. That's the appropriate thing and the correct thing to do. We thought about 500,000 shares left under our existing authorization, which runs through the end of March. Then I think after that point in time, we would likely put forward a recommendation to the board for their consideration. But obviously having not done that yet, it wouldn't

really be appropriate for us to say much more than that other than the fact that we are very confident that our share repurchase program will service our shareholders well over the long term.

Steve Hansen

Q

Raymond James Ltd.

Okay, helpful. Excellent one. Thanks.

Operator: Your next question comes from the line of Chris Wetherbee from Citi. Your line is open.

Chris Wetherbee

Q

Citigroup Global Markets, Inc.

Hey, thanks. Good morning, guys.

E. Hunter Harrison

A

Chief Executive Officer

Hi, Chris.

Chris Wetherbee

Q

Citigroup Global Markets, Inc.

Wanted to talk a little bit about sort of the EPS growth outlook and as you guys think about the cadence of that. I'm guessing it's probably a little bit back-half loaded, but wanted to get sort of a rough sense of sort of how you're thinking about that and maybe how the currency kind of adjust to that as we go forward through the year.

Mark J. Erceg

A

Chief Financial Officer

Again, I would offer a couple of things. Currency has been all over the map as of late. Recently as [ph] 8 April of 2015 (27 :13), we were at like [ph] CAD 1 .2 (27 :15). I think we're around [ph] CAD 1 .45 (27 :17) as we sit here. We didn't give a lot of specifics on the year's guidance because the uncertainty out there is fairly achieved. So, I think we'd be somewhat irresponsible versus trying to even more exacting on the quarters.

I would simply say that we have a balanced plan. We do have some land sales that were in Q1 of 2014 and so there're some other things that will kind of come into play that might cause the people to look at things here and there. But we're going to run the railroad every day as efficiently as possible every single day, but for us who try and to get quarterly guidance in this environment, we don't think that's really very helpful.

Chris Wetherbee

Q

Citigroup Global Markets, Inc.

Yeah. No, that's helpful. And just a point of clarity on that, just when you think about for the full year, any sense what you're using -- I apologize Nadeem for somewhat modeling question-- how do you think about the benefit of FX within that context of double-digit EPS growth? Thanks.

Mark J. Erceg

A

Chief Financial Officer

Yes. Good question. Again, I wouldn't want to be overly specific because we believe that FX is tied to crude and, obviously, it's involved with the fuel surcharge program as well. And so, as different elements move up, other things move down. So, again I don't think it's our intention today to be overly exacting in that regard. If you have some specifics you want to follow up with me Nadeem after this call, please feel free to do that.

Chris Wetherbee
Citigroup Global Markets, Inc.
Thanks for the time, guys.

Q

Keith E. Creel
President, Chief Operating Officer

A

Yeah. FX is going to be more of a benefit. We assume kind of current levels in the first half than we will be in the back half. And clearly, the front half volumes are going to be tougher comps in the first half than the back half.

Chris Wetherbee
Citigroup Global Markets, Inc.
Appreciate it.

Q

Operator: Your next question comes from the line of Brandon Oglenski from Barclays. Your line is open.

Brandon Oglenski
Barclays Capital, Inc.

Q

Hey. Good morning there, everyone. And it's pretty amazing we haven't got any question on M&A yet. And I'm actually going to ask one about our business, too, as much as I'd like to ask one on the other topic. But, I guess Hunter or Keith, maybe about a year ago or maybe a little bit more, we were talking about how, as you improve velocity and the service on the network, you can get the much better growth levels in your business. And somewhat macro-agnostic, I mean at what point do you think you've reached that service level where you can start to capture greater share in your markets even though we're in this very difficult macro backdrop for commodities and the changes in currencies?

E. Hunter Harrison
Chief Executive Officer

A

Well, we're probably awful close, as we speak. We have not taken any action, pricing action. Our margins are up. And as we look out going forward, we'll have to take into consideration the net-net bottom line effect if we took some of that action that we talked about earlier. So, I think everything is working like we had seen.

Going forward, the only thing is the economy ran out on us and – but I think that's something we'll be continually reviewing as we go forward.

Keith E. Creel
President, Chief Operating Officer

A

And I would add to that that some of this business is locked up in contracts, so I know that we're having more and more contracts with – or discussions on contracts with business that we haven't enjoyed in the past that is service-sensitive.

The caution, though, that I'm pushing our marketing team with is while they had to sell service, I'm not interested in getting locked up into contracts. They're going to lock me into this downward economic cycle. So, we're pushing more the tariff pricing, which we can adopt and adjust to the market, unless the market set the rate and we've lowered our cost. And if there's a buck to be made, then we'll be playing in it.

We got the service offering. We got the cost structure that's pretty compelling.

Brandon Oglenski
Barclays Capital, Inc.
Okay. Thank you.

Q

Keith E. Creel
President, Chief Operating Officer
Thank you.

A

Operator: Y our next question comes from the line of Ken Hoexter from Bank of America. Your line is open.

Kenneth Scott Hoexter
Bank of America Merrill Lynch

Q

Hey, great. Good morning. Maybe just talk a little bit about intermodal, where it looks like volume is accelerated to the downside. Is that more just a factor of the Canadian economy or are there still share shifts that you're seeing? And I guess there's highlight on the domestic side so it's not, I guess, more on international changing of contracts. Maybe if you could talk a little bit about that. Or is that just transitioning to the trucking loose capacity industry?

Keith E. Creel
President, Chief Operating Officer & Director

A

It's the excess capacity in the industry exaggerating a comp, a very tough comp. Think about our story and what's happened in domestic intermodal, the previous two years, very strong growth. So, it's a mix of the two. Expressway is the biggest driver of that, which, of course, is our service between Montreal and Toronto short -haul. Obviously, we make a buck in there and we won't do that, but it's not the most lucrative business that we enjoy.

We've got some very creative things we're going to be doing in 2016, though, converting service. There's lanes that we haven't enjoyed a lot of business in and that's the cross-border business that we're putting a very compelling service offering out to the marketplace, both from service and the cost to do in business. So we're on the verge of some pretty exciting step there which is going to help us on the domestic side grow the business in 2016.

E. Hunter Harrison