Norfolk Southern Corporation Annual Report for 2001

Our Vision:

On the Cover:
The green signal represents "clear tracks ahead" for Norfolk Southern.

Be the safest, most customer-focused and successful transportation company in the world

Equal Opportunity Policy

Norfolk Southern Corporation's policy is to comply with all applicable laws, regulations and executive orders concerning equal opportunity and nondiscrimination and to offer employment on the basis of qualification and performance, regardless of race, religion, color, national origin, sex, age, veteran status, the presence of a disability or any other legally protected status.

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Knoxville
Charlotte
Morehead City
Memphis
Chattanooga
Columbia
Atlanta
Birmingham
Charleston
Macon
Meridian
Savannah
Dallas
Brunswick
Jacksonville
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Mobile
Miami

NORFOLK SOUTHERN SYSTEM

Norfolk Southern Railway and its Railroad Operating Subsidiaries

NS Trackage/Haulage Rights

Financial Highlights

($ in millions, except per share amounts)	2001	2000*	% Increase (Decrease)
Financial Results			
Railway operating revenues	$ 6,170	$ 6,159	—
Income from railway operations	$ 1,007	$ 633	59
Railway operating ratio	83.7%	89.7%	(7)
Income from continuing operations	$ 362	$ 172	110
Earnings per share from continuing operations — diluted	$ 0.94	$ 0.45	109
Financial Position			
Total assets	$ 19,418	$ 18,976	2
Total debt**	$ 7,632	$ 7,636	—
Stockholders' equity	$ 6,090	$ 5,824	5
Debt-to-total capitalization**	55.6%	56.7%	(2)
Stockholders' equity per share	$ 15.78	$ 15.16	4
Other Information			
Year-end stock price	$ 18.33	$ 13.31	38
Dividends per share	$ 0.24	$ 0.80	(70)
Price/earnings ratio at year end	18.9	29.6	(36)
Number of shareholders at year end	53,042	53,194	—
Shares outstanding at year end	385,831,746	384,057,473	—
Number of employees at year end	29,828	32,341	(8)

** 2000 results included costs for work-force reduction programs that reduced income from railway operations by $165 million, net income by $101 million and diluted earnings per share by 26 cents. Excluding these costs, the railway operating ratio was 87.0%. See note 11 on page 42.*
***excludes notes payable to Conrail*

Description of Business

Norfolk Southern Corporation is a Virginia-based holding company with headquarters in Norfolk. It controls a major freight railroad, Norfolk Southern Railway Company, and owns a natural resources company, Pocahontas Land Corp., and a telecommunications company, Thoroughbred Technology and Telecommunications, Inc.

Norfolk Southern links customers to worldwide markets. The railway operates approximately 21,500 route miles in 22 eastern states, the District of Columbia and the province of Ontario, serves 20 seaports and lake ports and connects with western and Canadian partners. Norfolk Southern offers the East's most extensive intermodal network and provides comprehensive transportation logistics services supported by innovative data systems and technology.

Pocahontas Land Corp. manages more than a million acres of coal resources in Alabama, Illinois, Kentucky, Tennessee, Virginia and West Virginia.

Thoroughbred Technology and Telecommunications, or "T-Cubed," installs and markets telecommunications facilities and provides related services.

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Dear Fellow Shareholders:

The cover of this report shows a green signal – clear ahead. That image conveys the state of your company today. We are in good shape and moving ahead.

In 2001, we proved that we can produce results in a difficult year, in an uncertain economy, even in the face of terrible disaster. Our company has been through a difficult period, and our people have shown they are capable of meeting the challenge of tough times.

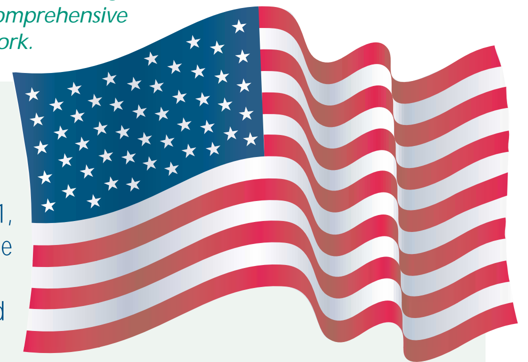
Last year in this report, I said we had work to do. To the credit of NS people, we did much of that work in 2001. Our results show significant progress. That is why I say, in spite of the bad news of 2001, we still had a good year. Not that our results are what they should be, but they are now clearly on an improving trend.

We needed to improve our network and our efficiency, and we did. We needed to improve productivity, and we did. We needed to improve financial performance, and we did.

Our statistics show real results. In this report, you can read about NS 21, our process to drive change throughout NS, and about the implementation of our new scheduled merchandise network through the Thoroughbred Operating Plan. We moved aggressively to make needed improvements and adapt quickly to changing times in 2001, despite a declining economy.

We were able to exceed last year's revenue even with 222,000

David R. Goode, Norfolk Southern chairman, president and chief executive officer, welcomes John Wesley Whitaker to the October 2001 dedication ceremony for the NS intermodal terminal near Atlanta named for Whitaker. A railroad industry civil rights pioneer, Whitaker was the first African-American locomotive engineer for Central of Georgia Railway, an NS predecessor. He later became Southern Railway's first African-American transportation officer. The Whitaker terminal – the largest intermodal facility in the East – and NS hubs at Harrisburg, Pa., and Chicago form the backbone of the East's most comprehensive intermodal network.



Sept. 11 Events Prompt Humanitarian Response

The terrorist attacks of Sept. 11, 2001, evoked the generosity and patriotism of the Thoroughbred team.

Employees donated money and blood to help the Red Cross, The Salvation Army and other organizations providing aid after terrorists crashed passenger jets into the World Trade Center towers in New York, the Pentagon in Washington and in a field outside Pittsburgh.

NS offered New York officials free transportation service for removing debris from the World Trade Center site. After President George W. Bush launched Operation Enduring Freedom, a global campaign against terrorism, NS offered enhanced benefits for employee reservists called up for active duty. Designed to help support employees and their families during the deployments, the leave benefits included a monthly income supplement of $1,500 and continued health care and life insurance benefits. The company also provided free transport of teddy bears for Manhattan schoolchildren, and boots and gloves for rescue and recovery workers in New York.

Immediately after the attacks, NS heightened security awareness throughout the system. The company is working with the rail industry through the Association of American Railroads to continue providing a safe and secure freight transportation infrastructure for the nation.

fewer carloads. By increasing revenue yields and reducing expenses, we improved our operating ratio by more than three points in an economic decline. Our earnings per share improved 37 percent, and the stock finished the year up 38 percent in the face of declining markets.

That is history – but it is also illustrative. We showed ourselves and others that NS and its people are capable of responding quickly and aggressively and making the changes necessary to produce good returns for our investors. We have a lot of work to do, but the way is now clear.

As 2002 progresses, we will have to continue to prove we can do the job through economic challenges. I believe we can and will.

Our goals for 2002 include:

- Improved service – we are completing our scheduled merchandise service network and are implementing new systems to better and more quickly monitor our performance.
- Continued improvement in productivity – we are engaged in a new phase of NS 21 that will yield additional improvements in how we do business.
- Revenue growth – we are introducing new services, highway traffic conversions and other opportunities along with our connecting partners to offer faster and better long-haul service.
- Cash flow – we again will generate cash from operations and maintain spending discipline so we can pay down debt to the benefit of all our investors.
- Fair returns – we will not rest until our shareholders are fairly compensated for their faith in owning our company.

These goals may sound like the basics. If so, that is what we have learned. There are no substitutes for discipline and hard work and concentration on improving our service offerings. Better service to our customers will be the hallmark of our endeavor and the springboard for future growth in our business.

I am hopeful that the economy will rebound this year. While we are poised for that to happen, we will run an efficient and reliable transportation network. When the economy needs us, we will have the capacity and capability. The customers, communities and shareholders we serve will benefit.

NS has been through challenges before, and we're stronger for them. I believe 2002 and beyond will give NS people the chance to show what a well-tuned transportation operation with capacity, technology and skill can produce.

January 21, 2002

Our Policies at Work

Corporate Governance

The Board of Directors established the Executive and Governance Committee in 2001 and gave the committee responsibility for monitoring corporate governance trends and practices and making recommendations to the Board concerning corporate governance issues.

At the recommendation of the Executive and Governance Committee, in 2001 each of the committees of the Board adopted a written charter to govern the responsibilities and activities of that committee. The Board of Directors is also in the process of increasing the number of independent directors on the Board and on certain key committees. Currently, the Audit Committee and Performance-Based Compensation Committee are comprised of all independent directors, and the Compensation and Nominating Committee is comprised of a majority of independent directors.

Norfolk Southern commissioned an independent review of its corporate governance practices in 2001 to compare present practices against those of other corporations and to recommend possible improvements. The report concludes that Norfolk Southern has in place a sound corporate governance structure and, with some recommended refinements, can become a leader in the field.

Principles In Practice

Norfolk Southern places a high priority on the safety of its employees, customers and the public and has the personnel, plans and policies in place to focus on accident and injury prevention. This is reflected in Norfolk Southern's being the first railroad to win a 12th consecutive E. H. Harriman Memorial Gold Medal award for safety.

Norfolk Southern is committed to protecting the quality of the environment for its employees, customers and the communities in which it operates and complying with all federal, state and local laws and regulations designed to protect the environment.

Norfolk Southern has implemented a Thoroughbred Quality program that places highest importance on meeting customer expectations by incorporating the principles of quality management into employees' daily activities. Norfolk Southern has demonstrated a commitment to continuous quality improvement by introducing the stringent Six Sigma problem-solving methodology to its operations.

As stated in the corporate vision statement, Norfolk Southern strives to be the most customer-focused company in the transportation industry and to continuously improve communication with customers and the level of customer satisfaction.

Norfolk Southern's Performance Demonstrates Strengths

Norfolk Southern strengthened operations, customer service and financial performance during 2001.

With rigorous cost controls, continual focus on providing safe and reliable freight transportation and increases in revenue yield in the face of a yearlong economic downturn, NS improved its financial position and created opportunity to handle all the anticipated growth of an eventual economic rebound.

NS employees maintained their industry leadership in safety by receiving an unprecedented 12th consecutive E.H. Harriman Memorial Gold Medal award.

Capacity enhancements – such as opening the largest intermodal terminal in the East near Atlanta – and partnerships with other rail carriers gave NS customers more service options. With the Atlanta terminal and other facility improvements, NS offers the most extensive intermodal infrastructure in the East for handling the nation's commerce and taking traffic off the interstate highway system.

NS employees maintained their industry leadership in safety by receiving an unprecedented 12th consecutive E.H. Harriman Memorial Gold Medal award.

Even as safety received top priority, facing the challenges of traffic declines across all business sectors required concentrated focus on improving financial performance.

At the beginning of the year, NS undertook several initiatives designed to improve financial strength, service reliability and operating efficiency. They included a company restructuring, a cost-reducing analysis of corporate processes called NS 21, efforts to generate greater revenues and implementation of a new Thoroughbred Operating Plan, or TOP.

NS Builds Record of Successes

These concurrent efforts scored a number of successes for Norfolk Southern during 2001.

- Productivity improvement: A renewed sense of focus drove NS people to accomplishments in service and operations in spite of the slumping economy. NS' employee count declined by 8 percent in 2001, following a 9 percent reduction in 2000. Since January 2000, employment has declined from 35,996 to 29,828. Work force productivity, measured in operating revenue per employee and ton-miles per employee, improved to its best level in five years.
- Improved efficiency through line rationalization: NS trimmed 412 miles from its rail system in 2001 through sales, leases and abandonment. This generated $5.2 million in maintenance savings annually and $1.5 million in property tax savings, while eliminating almost 650 highway-rail grade crossings. The company has under review more than 700 miles, including 485 miles in eastern North Carolina. NS plans to establish an internal business unit to manage the eastern North Carolina segment of its system.
- Enhanced service reliability through network redesign: TOP, the Thoroughbred Operating Plan, increases service consistency and reliability while reducing costs. The new train service network improves asset utilization, train velocity, terminal dwell time, routing and on-time train performance.
- A strategic sourcing initiative identified cost-saving opportunities in the company's $2 billion-plus annual bill for purchasing materials and services. Two early strategic sourcing projects – purchases of crushed stone, or ballast, and purchased services at intermodal terminals – are expected to produce approximately $4 million in savings in 2002. New strategic sourcing targets include savings in purchases of locomotive material, purchasing card costs and energy bills.

NS 21 Targets Savings

The NS 21 program to improve customer service and reduce costs worked in concert with the restructuring program.

Highlights of NS 21:

- Freight car improvement: NS reduced its freight car fleet by 12,000 cars from late 2000 to early 2002, generating more than $34 million in one-time proceeds plus recurring improvement in depreciation expense of $1.7 million annually. In addition, new information technology tools enabled the company's car management team to gain productivity improvements from the entire car fleet. Compared with 2000, freight car equipment rents decreased $32 million. Other benefits include reduced maintenance costs and less track and yard congestion.
- Reduced support facility costs: NS disposed of four underutilized or redundant facilities. The foundry and reclamation facilities at Roanoke, Va., were closed. NS sold the Birmingham, Ala., shop used for building track components, and the wheel shop at Knoxville, Tenn. Sale of the

facilities netted $6.3 million and produced ongoing savings of $1.7 million annually. Additional annual savings of $500,000 are projected as a result of plans to exit the Atlanta rail welding shop and lease the facility. The company also announced plans to close the car shop at Hollidaysburg, Pa., pending resolution of a legal challenge.

- An examination of how customers conduct business with NS brought about a number of improvements, including an Internet bill of lading process. Some 75 percent of NS customers use electronic data interchange. This, together with field training initiatives, increases billing accuracy and reduces costs of claims associated with errors.

Revenue Yield Grows

Gains in operating efficiency and service reliability in 2001 gave NS improved pricing opportunities, enabling it to post higher revenue yield. Even though carloads were down 3 percent from 2000, railway operating revenues were $11 million higher, a 3 percent improvement in revenue per car.

Aggressive industrial development efforts to locate rail-served facilities on NS lines, coupled with added infrastructure capacity and development of new services, laid the foundation for additional revenue growth.

Financial Performance Improves

NS, historically a rail industry leader in financial performance, focused on strengthening its financial position during the year.

- The company's improvements during 2001 helped to produce higher earnings per share as compared with each of the previous two years. Stock price trended upward during the year even as the economic downturn continued, and NS outperformed the S&P 500 index in 2001 by 50 percentage points.
- NS made progress in reducing debt. Long-term debt has been reduced by $427 million since the beginning of 2000, and NS' share of Conrail's long-term debt declined $235 million. The total reduction in debt obligations was $662 million, and year-end cash and short-term investments totaled $204 million.
- NS initiated three new debt offerings in 2001 to take advantage of an attractive interest rate environment and to provide more financial flexibility. The offerings enabled the company to eliminate all of its outstanding commercial paper, which stood at $1.1 billion at the end of 2000.

NS' emphasis on solid financial performance is reflected in its credit ratings, which continue to be among the best in the industry.

NS Invests in Customer Service

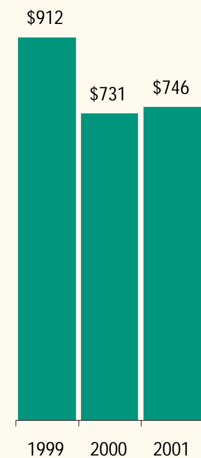
Norfolk Southern's disciplined approach in capital spending, together with other steps to improve financial performance and enhance service, are expected to position the company to achieve more rapid progress when the economy recovers.

In 2002, NS plans to spend $705 million for capital improvements. The anticipated spending includes $482 million for roadway projects and $173 million for equipment.

The largest expenditure, $366 million, will be devoted to maintaining the company's rail infrastructure – rail, crossties, ballast and bridges. Another $43 million is earmarked for marketing and industrial development initiatives to better handle coal, vehicle and intermodal traffic.

Projected equipment spending, which includes the purchase of 50 six-axle locomotives, is lower than in previous years, reflecting efficiency gains achieved in fleet management and asset utilization.

Capital Expenditures
($ Millions)



Three years of investments in customer service have culminated in development of the East's most comprehensive intermodal network, with capacity to handle traffic growth when the economy rebounds. With major infrastructure projects – such as the Whitaker intermodal terminal near Atlanta – having been completed, capital spending is projected to be $705 million in 2002.

President Signs Railroad Retirement Reform

Historic legislation passed in December and signed by President Bush modernized the Railroad Retirement system, with benefits for rail carriers, employees and retirees. Efforts by a broad coalition of rail industry labor and management helped get the measure enacted.

The reforms provide for a more secure retirement for rail workers, retirees and their spouses. The bill reduces Tier II Railroad Retirement tax rates on rail companies over a three-year period beginning in 2002 and provides for possible future adjustments in Tier II tax rates for both companies and employees. The new law also repeals the Railroad Retirement supplemental annuity tax paid by rail companies. A related provision allows for private investment of Tier II funds.

Norfolk Southern Service and Operations in 'TOP' Form

Norfolk Southern strengthened service reliability and consistency during 2001, reducing transit times for customers' freight by realigning the operating plan for merchandise traffic.

The Thoroughbred Operating Plan, or TOP, was a combined effort of Marketing, Transportation, Strategic Planning and field operations employees.

"This was a team effort from the beginning," said Mark Manion, vice president transportation services and mechanical. "The clear objective was to provide more reliable transportation to customers, while realizing improvements in asset utilization."

"We started from the premise that reducing the number of times a car is handled and the distance it travels will reduce both costs and variability, with improved shipment velocity," said Tony Ingram, vice president transportation operations.

"These added efficiencies, coupled with consistency, help boost customer confidence and drive new business opportunities," said Don Seale, senior vice president merchandise marketing.

The process began with a study of waybills, which provided an accurate database of traffic variation. From that, the team developed optimum schedules based on traffic volume and created terminal plans.

The team built car blocks, streamlined routes and tested them using modeling software. The team also developed consistent metrics to monitor performance.

"Being able to use software to test our ideas to minimize car handling and improve transit times gave us a tremendous advantage," said Ingram. "We could analyze our routes and make improvements in the plan without having to test in the field. It saved time and resources and gave us a plan to help achieve our goals."

The redesigned network of 245 trains was phased in to prevent service disruptions and to give the team opportunity to fine-tune its work.

"Incremental implementation of TOP made it seamless to our customers," said Manion.

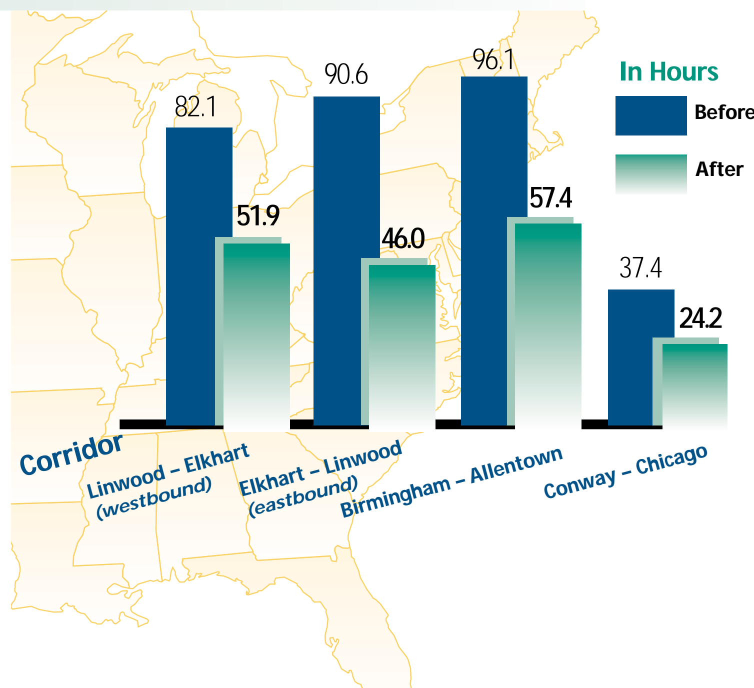
Performance monitoring takes place in a command center in Atlanta. There, team members who developed and implemented the plan keep close watch on train movements. Performance is measured by on-time departures at origins, point-to-point transit times and on-time arrival at destinations. The team has the flexibility to make changes to the plan as conditions change to ensure consistency. At year end, terminal plans were in place at all yards.

"This team and all those who have responsibility for moving trains are committed to excellence," said Dale Schaub, team leader and senior director service design and transportation planning. "We had significant early successes in reducing transit times on a number of lanes."

For example, between Birmingham, Ala., and Allentown, Pa., a major north-south route, transit time was reduced from 96.1 hours to 57.4 hours. Also, between Linwood, N.C., and Elkhart, Ind., NS reduced transit time from 82.1 hours to 51.9 hours westbound and from 90.6 hours to 46 hours eastbound.

"Our goal is to run our trains according to the planned schedule every time," said Schaub. "When we do that, we provide consistent, reliable service to our customers, and that is how NS will grow business and bring a greater return for shareholders."

Transit Comparisons



Measurements Confirm Success

The redesigned merchandise network was one of the factors contributing to dramatic improvements in Norfolk Southern's operating performance in 2001.

"Our operations reflect the success of our network redesign and the work of all our employees to improve customer service and reduce costs," said Steve Tobias, vice chairman and chief operating officer.

The NS system achieved record improvements in the key measurements of cars on line, terminal dwell time and system average train speed.

The number of cars on line – a count of rail cars on the NS system – was reduced 8.1 percent in 2001 because of better operating performance, a rail car fleet reduction and declining traffic attributed to a soft economy.

NS Employees Continue To Be the Rail Industry's Safest

Mastrangelo, King and Lowe (l-r)

Bilka

Norfolk Southern employees took top honors for the 12th consecutive year as the company received the E.H. Harriman Memorial Gold Medal Award for the best safety record among the nation's largest railroads.

Rudy Bilka of Altoona, Pa., an NS locomotive engineer, received the Harold F. Hammond Award, presented annually to a railroad employee for outstanding safety achievement. An NS employee has won the national award four of the last five years.

Contrado

Other NS employees received accolades during 2001. The Association of American Railroads presented its John H. Chafee North American Railroad Employee Environmental Excellence Award to Paul Contrado, a mechanical supervisor at Norfolk's Lamberts Point.

Three NS employees earned the Thoroughbred Award, the company's highest honor. Adam Mastrangelo and Greg Lowe of the Research and Tests Department in Roanoke won for developing "Railview," a locomotive-mounted digital video system that records information important to the investigation of highway-rail grade crossing and trespasser incidents. Randy King, a crew management analyst in Atlanta, received the award for creating a computer model that forecasts train crew requirements. The software improves NS' ability to maintain the work force required to provide consistent customer service and accommodate business growth.

Chicago Team's Pride: Knowing Customers

Customer call: Linda Myers, NS agent terminal control, and Corey Veal, NS terminal superintendent, discuss service needs of customer Tim Berens (r), Chicago terminal manager of Kinder Morgan Liquids Terminals LLC.

Knowing a diverse group of customers and anticipating their needs is the job of the Chicago Terminal customer service team.

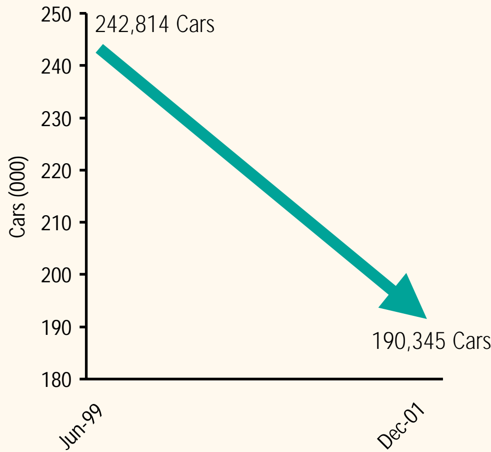
"I am very familiar with these industries, and I know these people," says Linda Myers, agent terminal control. "Knowing our customers is the best way to provide for their service needs."

Terminal Superintendent Corey Veal says each person on the 12-member team plays an active role in communicating with customers. Whether it's improving operating efficiency or getting involved in the nuts and bolts of a new project, Veal practices a team approach to customer service.

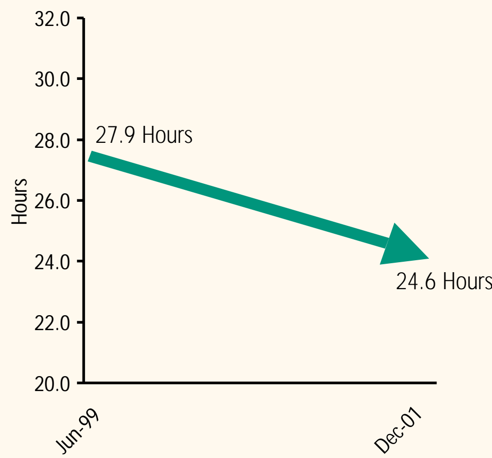
"We are always looking for input from the train crews and the yardmasters. These are the people who put the ideas into action, and we depend on them to be the eyes and ears," Veal says. "They take pride in what they can offer, and their input helps us become more efficient and productive – for our customers and NS."

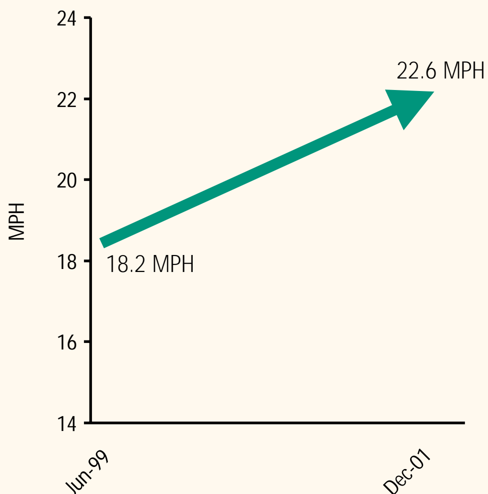
In addition to Veal and Myers, other members of the Chicago team are Rich Juram, senior terminal superintendent; Pat Damron, Walt Sailers and Mike Smith, terminal trainmasters; Ted Calhoun, John Martin and Jerry Simon, trainmasters; Frank Waggoner, assistant trainmaster; Pat Coseglia, national account manager; and George Marx, intermodal director.

Performance Improvement



These graphs show sustained three-year improvement in key operating performance measurements. A downward trend shows improvement for cars on line and system average terminal dwell. For system average train speed, higher is better.





Terminal dwell time – a measurement of time cars spend in rail yards – improved by 5.3 percent to 24.6 hours. Average system train speed improved by 9.7 percent, rising to more than 22 miles per hour. Both of these measurements of operating efficiency are better than pre-Conrail levels.

Overall on-time train performance increased 33.9 percent as compared with 2000.

Quality Processes Enhanced

In addition to strengthening operating performance, NS raised the bar in the Thoroughbred Quality process in 2001 by introducing Six Sigma problem-solving methodology.

"Six Sigma is the beginning of a new era in our quality process," said Jeff G. Yates, assistant vice president quality management. "Striving for Six Sigma quality can lead to best-in-class operations."

Six Sigma is a fact-based methodology to study problems that cause variation in the quality of service. By adopting Six Sigma methods, NS demonstrates commitment to continuous quality improvement, a requirement to comply with the new ISO 9001:2000 standard. ISO 9001 is an internationally recognized quality standard developed by the International Organization for Standardization in Geneva, Switzerland, and adopted by more than 90 countries. The company's transportation operations, major mechanical shops and a number of other areas already are certified to ISO 9002:1994 standards. They will be reregistered to reflect more recent ISO 9001:2000 standards, which require reflecting the voice of the customer in addition to a continuous improvement process. Six Sigma is that process.

More than 100 NS employees received Six Sigma training in the past year and a half. Using Six Sigma methods, NS reduced end-of-train device battery failures, which resulted in fewer train delays, and improved the locomotive overhaul process, which resulted in fewer in-service locomotive delays. Other projects are expected to result in improved customer service and cost savings.

"Six Sigma builds on what we've accomplished," said Yates. "One day it will simply be 'the way we work.'"

New Technology Enhances Service and Operations

Norfolk Southern launched important new initiatives in 2001 to develop information systems providing higher levels of service and information to customers while supporting continuous improvements in internal business processes.

On the customer service front, NS is making self-service more accessible through better e-commerce tools. NS' Thoroughbred Information System (TIS) offers a suite of secure, Web-based business applications. These include extensive shipment tracking, mileage queries, the ability to divert and reconsign equipment, performance reporting and coal shipment management.

New Customer Enhancements for 2001:

- A Bill of Lading (BOL) function that goes far beyond traditional programs. Customers receive acknowledgment that their Web-submitted BOLs have been successfully turned into waybills. They also get the price to be charged for each shipment. This unprecedented feature has resulted in a 99.5% success rate on producing waybills from Web-submitted BOLs. Customers have cited the application as the easiest to use in the industry.
- Rate Inquiry, which allows merchandise customers to use the Internet to view rates. A rate request application allows customers to request quotes for new business online through the Web. The feature permits NS to respond more quickly to requests for quotes. Requests can be tracked to ensure that customers' concerns are completely addressed.
- E-Cars, which allows customers to forecast their empty equipment requests two weeks in advance with an easy-to-use Web interface. E-Cars provides better service for the customer. By retaining the information in a database, NS has improved ability to forecast equipment demand.

By year end, some 3,000 customers were registered to use TIS. Other new features planned for 2002 will allow customers to review and pay freight bills online and receive various customized service reports.

Systems Further Strengthen Operations

Among operational systems enhancements in 2001, NS made key improvements in the core transportation system, Thoroughbred Yard Enterprise System (TYES). This helped make Central Yard Office and National Customer Service Center operations more efficient. New operational tools helped field people reduce car rent charges and provide more timely shipment status information to customers.

TYES added an automatic train reporting feature, using Automatic Equipment Identification (AEI) technology. This enhancement ensures that customers have the most current information for shipment tracing.

In 2001, NS continued aggressive use of decision support technology. Railroads produce enormous amounts of data every day. Capturing and organizing those data so they can be used effectively on a timely basis is a key NS strategy for improving service and network efficiency. Several new decision support functions provide additional support for marketing and transportation managers.

NS is an industry leader in the use of operations research (OR) techniques to enhance network performance. The Algorithmic Blocking and Classification System (ABC) automates the most efficient routing of freight traffic. In 2001, the OR group continued developing models and tools to improve network performance and equipment utilization.

Three Tools Under Development:

- Operating Plan Developer assesses the impact of operating plan changes prior to implementation
- Locomotive Routing Model forecasts network supply and demand for locomotives and recommends efficient locomotive repositioning strategies
- Car Distribution Optimization Model will help improve the car distribution process.

These and other advanced analytical tools under development will provide NS with information to better allocate resources and improve productivity.

Norfolk Southern Caps East's Most Comprehensive Intermodal Network

Norfolk Southern boosted service quality and launched new services in 2001 that position the company for growth.

The John W. Whitaker Intermodal Terminal near Atlanta opened in the summer. The terminal, named after a retired trainmaster and railroad industry civil rights pioneer, allows Norfolk Southern to offer additional services and more reliable transit times. It is a competitive transportation alternative to over-the-road shipping that helps reduce congestion on the nation's highways.

The terminal is named for John Wesley Whitaker, who after serving as one of the famed Tuskegee Airmen during World War II became NS predecessor Central of Georgia's first African-American locomotive engineer. He later was named a road foreman of engines on Southern Railway – the railroad's first African-American transportation officer.

Situated on 450 acres, the Whitaker terminal is the largest intermodal facility in the East. As a southeast crossroads for movement of containerized freight in all directions, the terminal caps NS' four-year systemwide investment of $380 million in intermodal transportation infrastructure. The Whitaker terminal and NS' Rutherford hub at Harrisburg, Pa., along with major terminals in Chicago, form the backbone of the East's most comprehensive intermodal network.

A new 70-acre intermodal facility at Maple Heights, Ohio, provides improved and expanded services for northern Ohio businesses moving goods between the Cleveland area and ports on the East Coast.

Exclusive NS service to the new Mason Intermodal Container Transfer Facility operated by the Georgia Ports Authority in Savannah offers direct rail service to the port, efficient transfer of containers between rail and ship, improved performance in key lanes and new east-west services.

NS also announced plans for a new intermodal terminal at the former Philadelphia Navy Yard that will be capable of handling 60,000 lifts annually.

Among nonintermodal investments, NS quadrupled the capacity of Enola Yard near Harrisburg, Pa., streamlining routings, enhancing quality of service and solidifying Harrisburg's position as a major freight hub for the Mid-Atlantic. Immediate benefits to customers include improved transit times and equipment utilization.

MODALGISTICS Manages Customer Supply Chain

MODALGISTICS℠ is a new business group created in 2001, pulling together existing services to provide supply chain management services for NS customers in a single package at one price, using a range of modes and information support systems.

MODALGISTICS determines the most cost-effective mix of transportation modes, supply sources and warehousing for a customer's specific distribution needs. The service tests various "what if" scenarios to compare total costs against the customer's baseline costs.

Once an optimum solution is determined, MODALGISTICS helps customers implement it – pulling together the resources of the railroad, Triple Crown Services, trucking companies, rail transfer facilities, lumber reload facilities, metals distribution centers and just-in-time rail auto parts centers. The service enables customers to realize cost savings in transportation, inventory management and capitalization.

MODALGISTICS launched a Web site in October (www.modalgistics.com) to enhance service to customers.

Industrial Development and Real Estate Post Strong Year

NS assisted with the location of 76 new industries and the expansion of another 33 in 2001. This represents an investment of $2.9 billion by NS customers and is expected to create approximately 5,144 jobs in the 19 states where the plants and expansions are located. Norfolk Southern expects these industrial development efforts to generate more than 95,000 carloads annually.

NS continued to dispose of properties in its extensive real estate holdings. In one of the largest land sales ever in the Washington, D.C., area, NS sold property in its Carlyle development in Alexandria, Va., to LCOR Alexandria, L.L.C. The land will be the site of headquarters for the United States Patent and Trademark Office and will include some 2.5 million square feet of office space and enclosed parking. With this sale, the Carlyle development has established itself as one of the premier mixed residential and commercial areas within the Washington, D.C., metropolitan area.

Pocahontas Land Celebrates 100 Years

In October, Pocahontas Land Corporation, a natural resources subsidiary of NS, celebrated its centennial anniversary.

In 1901, Norfolk and Western Railway, an NS predecessor company, acquired lands held by Flat Top Coal Land Association and vested them in its subsidiary Pocahontas Coal & Coke, which was renamed Pocahontas Land Corp. in 1939. Since 1901, 1.7 billion tons of coal have been mined from Pocahontas Land properties. Pocahontas Land has coal reserves totaling an additional 1.7 billion tons. It manages more than a million acres, and 70 percent of the current coal production of its lessees is used in electricity generation.

Through sound land management practices and leadership in reclamation efforts, Pocahontas Land has given back to the community, providing educational and recreational enrichment as well as economic opportunity for many. In 2001, the company donated land to the West Virginia Housing Development Fund to provide temporary housing for flood victims.

Southeastern intermodal crossroads: These photos show NS' John W. Whitaker Intermodal Terminal, which opened in 2001 at Austell, Ga., near Atlanta. Above, John Ring, NS yardmaster, monitors operations from the terminal's tower.

T-Cubed Develops Infrastructure

In 2001, T-Cubed, the NS telecommunications subsidiary, substantially completed construction of 1,600 miles of fiber-optic infrastructure on its corridors between Chicago and Washington; Chattanooga, Tenn., and Atlanta; and Atlanta and Jacksonville, Fla. It also negotiated and completed several transactions to provide infrastructure to telecommunications services providers.

The telecommunications industry suffered a major slowdown in 2001. However, T-Cubed continues to focus on providing fiber-optic and wireless infrastructure to a variety of telecommunications companies and plans to pursue additional transactions in 2002.

In addition, T-Cubed is exploring ways in which its assets can be used to enhance the current telecommunications infrastructure, along with opportunities to leverage existing assets for commercial purposes.

Teams Sharpen Customer Focus

No one knows a customer's service requirements like the people who deliver the service. That's why Jim Tush and Chuck Showers are on a team that regularly calls on customers to discuss and improve service.

Tush is a locomotive engineer and Showers a conductor on a nightly train that operates out of Pittsburgh's Kenny Yard. Once a month, they get together with Benny Dripps, trainmaster; Max Solomon, Pittsburgh district superintendent; and John Schaal, national account manager. The group meets with Bob Webster, vice president operating services for Transtar Logistics, a subsidiary of U.S. Steel, to discuss service to U.S. Steel's Pittsburgh area plants.

This is a customer service team, one of many throughout the system. It's a powerful tool available to both the railroad and the customer to sharpen Norfolk Southern's customer focus to a fine, competitive edge.

"We include engineers and conductors on the team because they're on the ground every day," says Schaal. "They see things we don't see. They get to know the crews at the plant, and that allows us to understand our relationship with the customer better."

Train crews know from experience what a customer's specific needs are, what can and can't be done with available equipment, what traditional practices can be eliminated or modified and what can be done that hasn't been tried. The trainmaster and superintendent bring a larger view of the railroad's operational capabilities, while the account manager is familiar with the railroad's marketing strategy. Combined with the customer representative's knowledge of the customer's commercial requirements, they make for a formidable team.

Webster says Norfolk Southern's focus on customer service "has cemented a strong relationship with U.S. Steel, to where we're dependent upon it. It's reached the point where we expect this kind of service from Norfolk Southern."

Pittsburgh team delivers service: From left, Jim Tush, locomotive engineer; Chuck Showers, conductor; Max Solomon, Pittsburgh district superintendent; Benny Dripps, trainmaster; John Schaal, national account manager; and Bob Webster, vice president operating services for Transtar Logistics, constitute the customer service team that explores how service can be improved at U.S. Steel's Irvin Works in Pittsburgh.

Charlotte Team Builds Good Will

"Customer good will is very important," says Ben Lee, locomotive engineer at Charlotte, N.C. For Lee, those are words to live by.

With his customer service team, Lee regularly calls on customers in the Charlotte area to solicit new business, regain lost business, increase business with existing customers, solve customers' problems and improve car utilization.

"And this is very important," he adds. "We even go around to the people we know can't increase their business with us just to say thank you." Many of the customers served in the Charlotte area are consumer goods warehouses.

Lee, vice general chairman Eastern Region and local chairman of the Brotherhood of Locomotive Engineers, says getting train crews involved in customer service benefits everyone. "It gives crews a feeling that they have a future here. This is one of the best things I've done in my nearly 19 years as local chairman."

He sums up his commitment to customer service with a quote from D. W. Brosnan, former Southern Railway president: "Jobs follow the freight."

Other members of the Charlotte customer service team are Dale Boatwright, yardmaster; Leon Craighead, superintendent of terminals; and Mark Bean, account manager.

Charlotte team meeting: From left, Dale Boatwright, yardmaster; Ben Lee, locomotive engineer; Leon Craighead, superintendent of terminals; Debbie Tucker and Scot Jansen, traffic managers for C&T Refinery, Inc., an NS customer; and Mark Bean, NS account manager.

Changes in traffic mix, pricing strategies and improvements in operating efficiency during 2001 enabled Norfolk Southern to improve its per-car revenue yield by 3% overall, resulting in an $11 million increase in railway operating revenues. This was achieved despite a decline in carloadings, which were 3% below 2000 as all business sectors were affected by a soft economy and further dampening of consumer spending following the Sept. 11 terrorist attacks.

A Norfolk Southern coal train near Bluefield, Va.

Coal

Coal, coke and iron ore finished the year 6% ahead in total revenues and 2% ahead on tons that totaled 178 million.

Growing demand and high natural gas prices early in the year spurred increased electricity production by coal-powered generation plants served by NS. Utilities replenished very low coal stockpiles. NS coal volumes to the important domestic utility market grew by 11%.

Per-car revenue yields increased by 6% in 2001 following a strategy of measured price increases, reduced refunds on export coal and improved per-car lading weights.

Mining problems and increased domestic coal demand caused coal prices to rise in 2001. Nevertheless, coal production in states served by NS rose by about 2.3% in 2001.

The Coal Transportation and Coal Marketing departments were combined in February 2001 to create the Coal Business Group. The new group is better able to meet customer service expectations while improving equipment utilization and yields.

Projects started during 2000 continued to grow utility volumes in 2001, and NS and its coal supply partners also took advantage of new opportunities to improve market share.

Projects planned for 2002 include a new rail spur to serve the Sammis Power plant of First Energy at Stratton, Ohio, creating an opportunity for 20,000 new carloads annually over the next five years. Also, a new shuttle train to serve increased Ohio coal production for the river utility market will lead to new traffic for NS in 2002.

Intermodal

Despite a constricted freight market in 2001, Intermodal was able to hold ground by the steady launch of new services, including:

- Improved international services from new Cleveland and Savannah terminals
- A premium transcontinental train between Southern California and the Northeast with Burlington Northern Santa Fe
- Blue Streak, a new premium service with Union Pacific that offers several levels of premium transcontinental service, including on-time-or-free guaranteed service, between Los Angeles and the Southeast
- A significantly expanded portfolio of services between the Southeast and the Northeast

- International services between the Port of New York and Montreal with Canadian Pacific.

The new services and the completion of major enhancements to the intermodal network, including the new Whitaker terminal in Austell, Ga., near Atlanta, will allow NS to handle increased traffic when the economy begins growing again. NS will launch more new intermodal services in 2002, including more premium products designed to speed the pace of converting truck traffic to rail intermodal.

General Merchandise

Highlights of 2001:

- In agriculture, a 50% improvement in cycle time for new 75-car grain trains enabled NS to handle the same amount of traffic with 200 fewer cars. The 2001 harvest saw a gain of 4,000 carloads over the previous year. Agriculture business came back strong in the fourth quarter as weather conditions improved and markets started to move, boosting fourth quarter revenues for the commodity group by 6%.
- While automotive carloadings decreased by 10% as North American vehicle production fell from a record level in 2000, automotive revenues declined only 4%, due in part to the continued redesign of the automotive mixing center network and continued market penetration in the Northern Region of NS' system. NS benefits from access to more automotive plants than any other railroad.

Revenue gains resulted from:

- New vehicle traffic moving between Detroit and St. Louis for DaimlerChrysler
- New vehicle traffic moving from Fort Wayne to Canadian destinations for General Motors
- Return of previously diverted traffic as a result of rectifying Conrail implementation service issues.

Automotive Group prospects for 2002 include:

- A new General Motors inbound vehicle distribution facility in Moraine, Ohio, that opened in fourth quarter 2001
- Expansion of the Mitsubishi assembly plant at Bloomington, Ill.
- Toyota's second plant at Princeton, Ind.
- Southeast Toyota's new vehicle distribution facility in Jacksonville, Fla., scheduled for opening in September 2002.

- In chemicals, revenues were stable despite a weak market as a result of improved pricing to meet market conditions. As a result of aggressive industrial development, NS expects new business from a new Stolt-Nielsen's bulk terminal at Braithwaite, La., a new Michelin plant at Anderson, S.C., and a new salt transload facility for American Rock Salt at Radford, Va. Another growth area is ethanol, a gasoline additive.
- In the metals market, NS' dominant market and equipment position and new business opportunities helped to partially offset market softness, enabling it to maintain a leadership role in transporting metals commodities.

Business opportunities for metals in 2001 included:

- Continued production ramp-up of new steel mills located on NS and recent success in acquiring new business
- Export sheet steel to Mexico
- Import slab steel business via East Coast ports
- Domestic slab steel and billet shipments
- Continued strength in pig iron shipments
- Steel pipe shipments to oil and gas pipeline projects.

- In the construction market, highway spending remained strong, based on increased highway construction funding from the Transportation Equity Act for the 21st Century (TEA-21). This resulted in revenue growth from sand and shipments to regional highway projects.
- In paper, clay and forest products, improved pricing and a positive change in traffic mix led to a gain of 6 percent in revenue per unit despite a soft market. Wood pulp traffic remained robust, with expansions at several tissue and towel production facilities and increased NS market share. Low pulpboard inventory levels prompted a rebound in shipments in the fourth quarter. Lumber shipments almost matched record levels of 2000 as a result of strong housing starts and low mortgage rates. NS scrap paper volume will benefit from a shift to 100% recycled paper at a large newsprint mill in Alabama.

Financial Overview

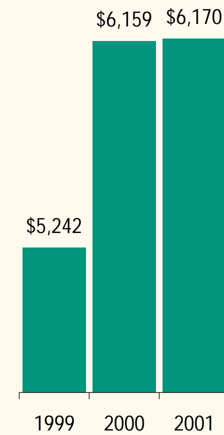
NS posted improved results in 2001, despite the challenges of a weak economy. Net income improved as a result of rigorous cost controls, increases in revenue yield and a commitment to provide safe and reliable freight transportation service.

Net income for 2001 was $375 million, or 97 cents per diluted share, and included a $13 million, or 3 cents per share, after-tax gain related to the 1998 sale of NS' motor carrier subsidiary, which was reported as discontinued operations. Income from continuing operations was $362 million, or 94 cents per share, compared with $172 million, or 45 cents per share, reported in 2000. Results in 2000 included $165 million of work-force reduction charges, which reduced net income by $101 million, or 26 cents per share.

Net income improved in 2001 as a result of a $209 million, or 26%, increase in income from railway operations. The improvement in income from operations more than offset a decline in nonoperating income that was $69 million below 2000.

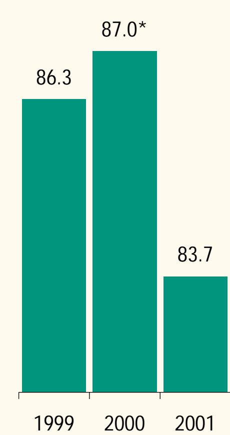
Railway operating revenues were $6.2 billion, up $11 million compared with 2000, despite 222,000 fewer carloads, or a 3% decline in traffic volume. Coal revenues increased $86 million, or 6%, reflecting improved revenue yield. Intermodal revenues were up $4 million, despite a 1% decline in traffic volume. General merchandise revenues declined $79 million, or 2%, reflecting a 7% decline in traffic volume that was partially offset by a 5% increase in revenue per unit.

Railway operating expenses were $5.2 billion, down $363 million, or 7%, compared with 2000. Excluding the work-force reduction charges in 2000, expenses were down $198 million, or 4%. The railway operating ratio improved to 83.7% in 2001, compared with 87% in 2000, excluding work-force reduction charges.



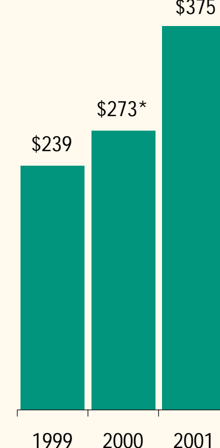
Railway operating revenues increased by $11 million in 2001 as a result of higher revenue per unit that offset a 3% decline in traffic volume.

Railway operating expenses dropped $198 million, or 4%, compared with 2000.

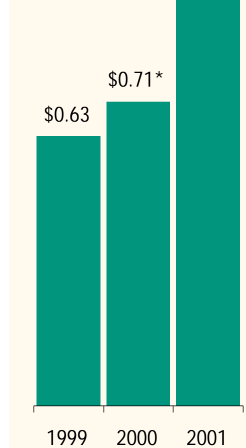


The increase in railway operating revenues, coupled with the 4% drop in railway operating expenses, produced an operating ratio of 83.7% in 2001, 3.3 percentage points better than that of 2000.

Income from railway operations increased $209 million, or 26%, in 2001, primarily because of the $198 million drop in railway operating expenses.



Net income increased $102 million, or 37%, in 2001. The improvement was principally as a result of the $209 million increase in income from railway operations, which more than offset a $69 million decline in nonoperating income.



Diluted earnings per share for 2001 were 37% higher than in 2000 as a result of higher income from railway operations, which more than offset lower nonoperating income.

** 2000 excludes work-force reduction costs of $165 million, which added 2.7 percentage points to the railway operating ratio, reduced net income by $101 million and reduced diluted earnings per share by 26 cents.*

Quarterly Financial Data

(Unaudited)

	Three Months Ended			
	March 31	June 30	Sept. 30	Dec. 31
	(In millions of dollars, except per share amounts)			
2001				
Railway operating revenues	$ 1,540	$ 1,592	$ 1,508	$ 1,530
Income from railway operations	205	282	245	275
Net income	74*	107	79	115
Earnings per share – basic and diluted	$ 0.19*	$ 0.28	$ 0.20	$ 0.30
2000				
Railway operating revenues	$ 1,508	$ 1,592	$ 1,535	$ 1,524
Income from railway operations	28	278	211	116
Net income (loss)	(48)	116	99	5
Earnings (loss) per share – basic and diluted	$ (0.12)	$ 0.30	$ 0.26	$ 0.01

* *Includes a $13 million, or 3 cents per share, after-tax gain related to the 1998 sale of NS' motor carrier subsidiary (see Note 17 on Page 48).*

Stock Price and Dividend Information

(Unaudited)

The Common Stock of Norfolk Southern Corporation, owned by 53,042 stockholders of record as of Dec. 31, 2001, is traded on the New York Stock Exchange with the symbol NSC. The following table shows the high and low sales prices and dividends per share, by quarter, for 2001 and 2000 (prices quoted in fractions have been rounded to the nearest cent).

	Quarter			
2001	1st	2nd	3rd	4th
Market price				
High	$ 18.90	$ 24.11	$ 22.60	$ 19.88
Low	13.63	15.80	13.41	15.19
Dividends per share	$ 0.06	$ 0.06	$ 0.06	$ 0.06
2000	1st	2nd	3rd	4th
Market price				
High	$ 22.75	$ 19.69	$ 19.75	$ 15.63
Low	12.69	14.19	14.13	11.94
Dividends per share	$ 0.20	$ 0.20	$ 0.20	$ 0.20

Five-Year Financial Review

Norfolk Southern Corporation and Subsidiaries

($ in millions, except per-share amounts)	2001	2000[1]	1999[2]	1998	1997
Results of operations					
Railway operating revenues	**$ 6,170**	$ 6,159	$ 5,242	$ 4,254	$ 4,249
Railway operating expenses	**5,163**	5,526	4,524	3,202	3,036
Income from railway operations	**1,007**	633	718	1,052	1,213
Other income – net	**99**	168	164	309	170
Interest expense on debt	**553**	551	531	516	385
Income from continuing operations before income taxes	**553**	250	351	845	998
Provision for income taxes	**191**	78	112	215	299
Income from continuing operations	**362**	172	239	630	699
Discontinued operations[3]	**13**	—	—	104	22
Net income	**$ 375**	$ 172	$ 239	$ 734	$ 721
Per share data					
Net income – basic	**$ 0.97**	$ 0.45	$ 0.63	$ 1.94	$ 1.91
Net income – diluted	**$ 0.97**	$ 0.45	$ 0.63	$ 1.93	$ 1.90
Dividends	**$ 0.24**	$ 0.80	$ 0.80	$ 0.80	$ 0.80
Stockholders' equity at year end	**$ 15.78**	$ 15.16	$ 15.50	$ 15.61	$ 14.44
Financial position					
Total assets	**$ 19,418**	$ 18,976	$ 19,250	$ 18,180	$ 17,350
Total long-term debt, including current maturities	**$ 7,632**	$ 7,636	$ 8,059	$ 7,624	$ 7,459
Stockholders' equity	**$ 6,090**	$ 5,824	$ 5,932	$ 5,921	$ 5,445
Other					
Capital expenditures	**$ 746**	$ 731	$ 912	$ 1,060	$ 929
Average number of shares outstanding (thousands)	**385,158**	383,358	380,606	378,749	376,593
Number of stockholders at year end	**53,042**	53,194	51,123	51,727	50,938
Average number of employees:					
Rail	**30,510**	33,344	30,897	24,185	23,323
Nonrail[3]	**384**	394	269	115	2,494
Total	**30,894**	33,738	31,166	24,300	25,817

Notes

1 2000 operating expenses include $165 million in work-force reduction costs for early retirement and separation programs. These costs reduced net income by $101 million, or 26 cents per diluted share.

2 On June 1, 1999, NS began operating a substantial portion of Conrail's properties. As a result, both its railroad route miles and the number of its railroad employees increased by approximately 50% on that date.

3 In 1998, NS sold all the common stock of its motor carrier subsidiary, North American Van Lines, Inc. (NAVL), for $207 million and recorded a $90 million pretax ($105 million, or 28 cents per diluted share, after-tax) gain. Accordingly, NAVL's results of operations, financial position and cash flows are presented as "Discontinued operations." Results in 2001 include an additional after-tax gain of $13 million, or 3 cents per diluted share, that resulted from the expiration of certain indemnities contained in the sales agreement.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes beginning on Page 32 and the Five-Year Financial Review on Page 17.

Summarized Results of Operations

2001 Compared with 2000

Net income in 2001 was $375 million, up 118%. Results in 2001 included a $13 million gain related to the 1998 sale of NS' former motor carrier subsidiary (see Note 17 on Page 48). Income from continuing operations, which excludes that gain, was $362 million, up 110%. Results in 2000 included $165 million of costs related to actions taken to reduce the size of the work force, which reduced income from continuing operations by $101 million, or 26 cents per diluted share. Excluding these costs, income from continuing operations increased $89 million, or 33%, in 2001. The improvement resulted from higher income from railway operations, which was up $209 million, or 26%, that more than offset lower nonoperating income, which was down $69 million (see Note 3 on Page 39).

Diluted earnings per share were 97 cents, up 116%. Diluted earnings per share from continuing operations were 94 cents, up 109%. Excluding the work-force reduction costs in 2000, diluted earnings per share from continuing operations were up 32%.

2000 Compared with 1999

Results for 2000 reflected the first full year of operations over Conrail's lines. On June 1, 1999 (the Closing Date), NS' railroad subsidiary (Norfolk Southern Railway Company [NSR]) began operating a substantial portion of Conrail's properties (substantially all of which comprise NSR's Northern Region) under various agreements with Pennsylvania Lines LLC (PRR), a wholly owned subsidiary of Consolidated Rail Corporation (CRC) (see Note 2 on Page 37). As a result, both the railroad route miles operated by NSR and the number of its railroad employees increased by approximately 50% on that date. Results for 1999 reflect five months (January through May) of operating the former Norfolk Southern railroad system and seven months (June through December) of operating the present system, which includes the Northern Region.

Results in 1999 were adversely affected by difficulties encountered in the assimilation of the Northern Region into NSR's existing system that resulted in system congestion, an increase in cars on line, increased terminal dwell time and reduced system velocity. These service issues and actions taken to address them increased operating expenses, primarily labor costs and equipment costs, including car hire and locomotive rentals. Moreover, revenues were lower than expected as some customers diverted traffic to other modes of transportation.

Net income in 2000 was $172 million, down 28%. Excluding the $101 million after-tax cost of the work-force reductions, net income would have been $273 million, up 14%. The increase resulted from gains from the sale of nonoperating properties (see Note 3 on Page 39) and higher income from railway operations, compared with a weak 1999.

Diluted earnings per share were 45 cents, down 29%. Excluding the effects of the work-force reduction costs, diluted earnings per share were up 13%.

Detailed Results Of Operations

Railway Operating Revenues

Railway operating revenues were $6.2 billion in both 2001 and 2000, and were $5.2 billion in 1999. Revenues in 1999 include results of operations in the Northern Region for seven months. The following table presents a three-year comparison of revenues by market group.

Railway Operating Revenues by Market Group

($ in millions)	**2001**	2000	1999
Coal	**$ 1,521**	$ 1,435	$ 1,322
General merchandise:			
Automotive	**885**	921	746
Chemicals	**752**	756	641
Metals/construction	**674**	689	567
Paper/clay/forest	**612**	630	578
Agriculture/consumer products/government	**603**	609	539
General merchandise	**3,526**	3,605	3,071
Intermodal	**1,123**	1,119	849
Total	**$ 6,170**	$ 6,159	$ 5,242

In 2001, revenues fell for all the general merchandise market groups. However, a 6% increase in coal revenues offset the effects of the lower general merchandise revenues. As shown in the following table, higher revenue yields offset the effects of lower traffic volume.

Railway Operating Revenue Variance Analysis

($ in millions)	Increases (Decreases) 2001 vs. 2000	2000 vs. 1999
Volume	**$ (200)**	$ 779
Revenue per unit/mix	**211**	138
Total	**$ 11**	$ 917

Revenue per unit increased in all market groups, principally due to rate increases, use of higher-capacity equipment and favorable changes in the mix of traffic.

In 2000, revenues increased for all market groups, reflecting a full year of handling Northern Region traffic. Revenues improved for the last seven months, a comparison that fully includes the Northern Region in both years, reflecting recovery of most of the diverted traffic and new business. However, weakness in the economy resulted in lower revenues very late in the year. Revenue per unit improved in most market groups, principally due to the effects of Northern Region traffic and increased rates. About half of the revenue per unit increase for the intermodal market group was attributable to the effects of the consolidation of Triple Crown Services Company (TCS) revenues (see discussion of intermodal revenues below).

COAL tonnage increased 2% in 2001 and revenues increased 6%. Revenue per unit increased 6%, a result of rate increases, including lower volume-related refunds on export coal shipments, gains in tonnage per car and favorable changes to the mix of traffic (less shorter-haul business). Coal, coke and iron ore revenues represented 25% of total railway operating revenues in 2001, and 83% of NS' coal shipments originated on lines it operated.

In 2000, coal tonnage increased 11%, and revenues increased 9%, reflecting a full year of Northern Region traffic. Revenue per unit declined, a result of a higher proportion of traffic with a shorter length of haul, principally attributable to a full year of Northern Region operations.

Total Coal, Coke and Iron Ore Tonnage

(In millions of tons)	**2001**	2000	1999
Utility	**133**	119	108
Export	**14**	20	18
Domestic metallurgical	**20**	25	22
Other	**11**	11	10
Total	**178**	175	158

Utility coal traffic increased 11% in 2001, reflecting higher demand for coal-fired electricity and the effects of very high natural gas prices early in the year. High demand for electricity, a volatile market for natural gas and production problems at a number of large mines in the East late in 2000 combined to increase the demand for coal early in 2001 with a resulting increase in coal prices. Utility coal traffic volume also benefited from the shifting of coal that traditionally would have been bound for export to the domestic market.

In 2000, utility coal traffic increased 11%, reflecting a full year of Northern Region operations. The effects of expanded operations were somewhat offset by coal production problems at several NS-served mines, unanticipated outages at some NS-served utility plants, large stockpiles at the beginning of the year and mild summer weather in portions of NS' service territory.

The near-term outlook for utility coal remains positive. U.S. demand for electricity continues to grow rapidly, and coal-fired generation remains the cheapest marginal source of electricity. Several underutilized coal-fired power plants are making the transition from peak-only generation to full-time generation. In addition, although natural gas prices have returned to more normal levels, the volatility of natural gas prices may improve the long-term competitive position of coal-fired generation.

Phase II of Title IV of the Clean Air Act Amendments of 1990, which imposes more stringent limits on sulfur dioxide emissions, took effect on Jan. 1, 2000. Many of the mines served by NS produce coals that satisfy Phase II requirements. In addition, substantial banks of sulfur dioxide allowances held by many NS-served utilities should continue to provide a market for other NS-served mines for many years. However, several federal environmental regulatory initiatives continued to be pursued during 2001, including "new source review" for older coal-fired plants. Many of the rules that have been promulgated to date are in litigation. If the rules survive litigation and are implemented, they could increase the cost of coal-fired generation and potentially adversely affect the value of the sulfur dioxide allowance bank.

The Bush Administration rejected in 2001 the Kyoto Protocol and withdrew U.S. participation in that process. If implemented, the proposed Kyoto limits on greenhouse gases could have put additional cost pressures on coal-fired generation. The U.S. withdrawal from the Kyoto process has renewed interest in building coal-fired generation plants.

The 1999 decision by a federal district court judge in West Virginia holding that some common mountaintop mining practices in the coal industry are illegal was overturned in April 2001 by the U.S. Fourth Circuit Court of Appeals. In January 2002, the U.S. Supreme Court refused to hear an appeal of the case.

Export coal tonnage declined 30% in 2001. The rapid rise of domestic utility coal prices early in the year enticed many foreign-market suppliers to place much of their 2001 production in the domestic utility markets. In addition, production difficulties at several large NS-served mines and flooding in West Virginia in July significantly reduced the supply of low volatile coal. The combination of these factors resulted in most of the decline in shipments of export coal. Steam coal exported through Baltimore declined 32%, and export metallurgical coals through Norfolk declined by 30%. Demand for steam coal to export strengthened in the last half of 2001; however, the strong U.S. demand limited NS' participation in this market. Demand for coking coal to export continued to soften, as steel production moved from traditional NS markets in Europe to Asia, which in recent years has been supplied by Australian or Canadian coals.

Revenues increased $86 million, or 6%, in 2001, primarily due to increased utility coal traffic volume and higher revenue per unit. This group includes utility coal, export coal, domestic metallurgical coal and industrial coal, coke and iron ore.

In 2000, export coal tonnage increased 8%, a result of a full year of access to Baltimore through the Northern Region, mitigated by lower tonnage through Norfolk. Several additional factors also adversely affected export coal traffic volume. Delayed settlements between buyers and sellers in the spring postponed shipments of some export tonnage. Foreign buyers ultimately intended to purchase additional U.S. metallurgical coal, but production capacity available for export had been diminished by two years of dramatically lower prices. Toward the end of 2000, production difficulties at several large NS-served mines significantly reduced tonnage available for export. Limited supplies overall prevented other coal producers from providing substitute coal.

Export coal tonnage is expected to continue to be limited by supply and subject to the fluctuations of the world market. While the consolidation of Australian producers should help stabilize that supply channel, new Australian production could displace U.S. volumes to Europe absent any increase in demand. Moreover, Chinese participation in Pacific Rim markets could displace Australian coals there and force that tonnage to Europe.

Domestic metallurgical coal, coke and iron ore traffic decreased 18% in 2001, due to a decline in the market for domestic steel. The softening economy and an increase in steel imports drastically cut blast furnace production, sharply reducing the demand for coking coal, iron ore and coke. The increase in imported steel also resulted in lower prices that put pressure on the U.S. steel industry and led to plant closures and bankruptcies that included some NS customers.

In 2000, domestic metallurgical coal, coke and iron ore traffic increased 17%, due to a full year of Northern Region operations. In addition, increased production in the first half of the year and gains in NS market share contributed to the higher traffic. However, the softening economy and increased steel imports diminished blast furnace production rates, sharply reducing demand for raw materials.

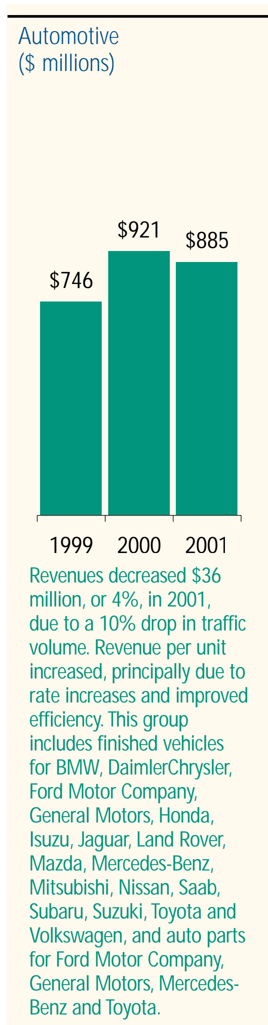
Domestic metallurgical coal, coke and iron ore traffic is expected to continue to suffer from the decline in demand for domestically produced steel. However, the United States has applied a tariff on imported coke, which has reduced its entry to the U.S. market. Moreover, the U.S. International Trade Commission has recommended that President Bush take similar action on imported steel. But long-term demand is expected to continue to decline, due to advanced technologies that allow production of steel using less coke.

Other coal traffic, principally steam coal shipped to manufacturing plants, increased 6% in 2001 and 4% in 2000. The gain in 2001 resulted from new and increased business from industrial customers. The increase in 2000 reflected a full year of handling Northern Region traffic; however, this was mitigated by the loss of some traffic to competitors.

GENERAL MERCHANDISE traffic volume (carloads) decreased 7% in 2001, and revenues decreased 2%, principally due to the effects of the weak economy. In 2000, traffic volume increased 15%, and revenues increased 17%, reflecting a full year of operating the Northern Region.

Automotive traffic volume decreased 10%, and revenues declined 4% in 2001, principally due to a 10% drop in vehicle production. Revenue per unit increased 7%, principally due to rate increases, efficiencies gained from the redesign of the mixing center network and use of higher capacity equipment.

In 2000, automotive traffic volume increased 13%, and revenues increased 23%, reflecting a full year of Northern Region operations, record vehicle production and the recapture of business diverted because of service issues after the Closing Date. The carload increase was less than the revenue increase principally due to the effects of a redesign of the mixing center network. This redesign improves vehicle velocity through the network and includes changes in traffic flows that resulted in a decline in carloads, with no corresponding decrease in revenues.

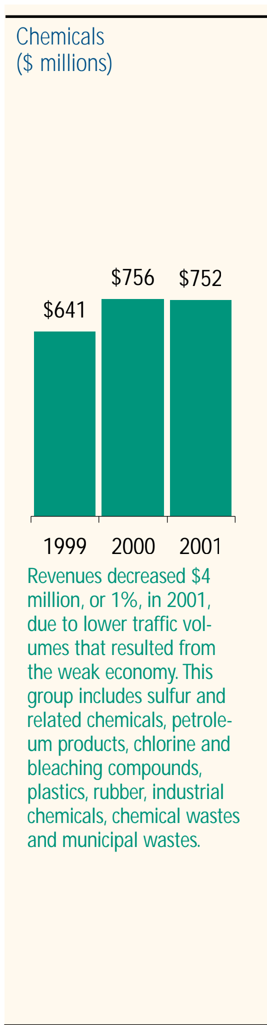


Revenues decreased $36 million, or 4%, in 2001, due to a 10% drop in traffic volume. Revenue per unit increased, principally due to rate increases and improved efficiency. This group includes finished vehicles for BMW, DaimlerChrysler, Ford Motor Company, General Motors, Honda, Isuzu, Jaguar, Land Rover, Mazda, Mercedes-Benz, Mitsubishi, Nissan, Saab, Subaru, Suzuki, Toyota and Volkswagen, and auto parts for Ford Motor Company, General Motors, Mercedes-Benz and Toyota.

Ford Motor Company, NS' largest customer, has announced potential reductions in vehicle production which could affect NS volumes. However, automotive revenues in 2002 are expected to be comparable to those of 2001, as light vehicle production is predicted to be flat.

Chemicals traffic volume decreased 5%, and revenues decreased 1% in 2001. The weak economy depressed shipments of petroleum, plastics, industrial and miscellaneous chemicals. These declines were partially offset by new business through NS' Thoroughbred Bulk Transfer (TBT) facilities that handle chemicals and bulk commodities for customers not located on NS-served lines. Revenue per unit increased due to higher rates and a favorable change in the mix of traffic (more longer-haul moves).

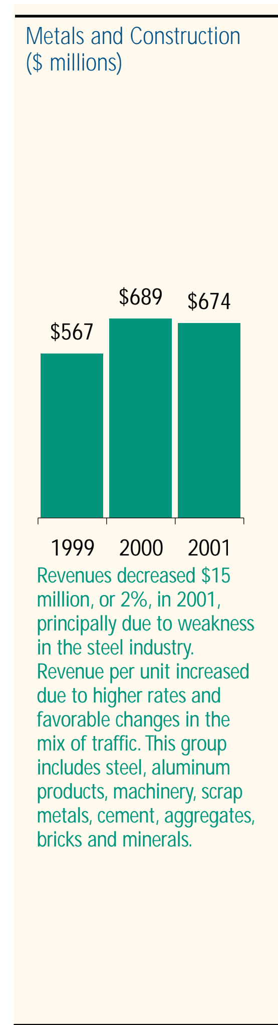
In 2000, chemicals traffic volume increased 15%, and revenues increased 18%, due to a full year of Northern Region operations and the return of traffic that had been diverted because of service issues after the Closing Date. Shipments of miscellaneous chemicals, chlorine, caustic soda and plastics continued to rebound, but sulfur carloads were down due to weak fertilizer markets. Chemicals shipments continued to increase through NS' TBT facilities.



Revenues decreased $4 million, or 1%, in 2001, due to lower traffic volumes that resulted from the weak economy. This group includes sulfur and related chemicals, petroleum products, chlorine and bleaching compounds, plastics, rubber, industrial chemicals, chemical wastes and municipal wastes.

Chemicals revenues are expected to continue to be adversely affected until the economy recovers. However, NS expects to benefit from new business and improved yields.

Metals and construction traffic volume decreased 7%, and revenues declined 2% in 2001, reflecting weakness in the steel and construction industries. The steel industry recession, which began in 2000, has resulted in excess capacity and the closing of numerous steel mills. Revenue per unit increased due to higher rates and favorable changes in the mix of traffic.



Revenues decreased $15 million, or 2%, in 2001, principally due to weakness in the steel industry. Revenue per unit increased due to higher rates and favorable changes in the mix of traffic. This group includes steel, aluminum products, machinery, scrap metals, cement, aggregates, bricks and minerals.

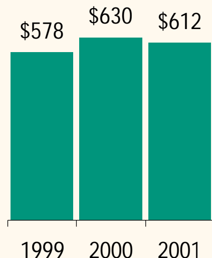
In 2000, metals and construction traffic volume increased 29%, and revenues increased 22%, reflecting a full year of operations over the expanded system. Revenue per unit declined, largely due to a change in the mix of traffic. Metals traffic benefited from increased shipments of sheet steel, imported slab steel and ferrous scrap; however,

this was tempered by a significant slowdown in the steel industry in the last half of the year. Construction traffic benefited from continued strength in housing starts and highway construction.

Metals and construction revenues are expected to suffer from the effects of a continued softness in the steel market. However, increased highway construction in NS' service area is expected to mitigate the drop in metals demand.

Paper, clay and forest products traffic volume declined 8%, and revenues decreased 3%, in 2001, primarily due to a weakened paper market. Paper shipments were adversely affected by reduced production at many NS-served paper mills, a result of sluggish newspaper advertising and soft demand for paper. Lumber traffic began the year weak, improved in late summer, but softened late in the year due to short-term weakness in housing starts. Revenue per unit increased principally due to higher rates.

Paper, Clay and Forest Products
($ millions)



Revenues decreased $18 million, or 3%, in 2001, primarily due to a weakened paper market. Revenue per unit benefited from higher rates. This group includes lumber and wood products, pulpboard and paper products, woodfibers, woodpulp, scrap paper and clay. NS serves 66 paper mills, 105 paper distribution centers and more than 100 lumber reload centers.

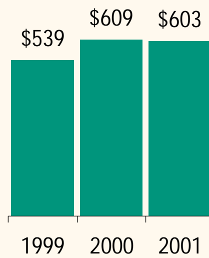
In 2000, paper, clay and forest products traffic volume increased 5%, and revenues increased 9%, principally due to the effects of a full year of Northern Region operations. Consolidation in the paper industry and a weakening paper market in the second half of the year contributed to lower carloads during the summer months and into the fall. Weak demand for paper production inputs, such as scrap paper and wood pulp, was tempered by stronger demand for newsprint and printing paper.

Paper, clay and forest products revenues are expected to continue to be adversely affected by weak demand in 2002, due to continued consolidations and little anticipated capacity expansion through 2003. NS is pursuing new business using MODALGISTICS(SM), its supply-chain focused business unit formed in February 2001.

Agriculture, consumer products and government traffic volume decreased 3%, and revenues declined 1% in 2001, primarily due to reduced shipments of fertilizer. This decline was due to soft farm demand, record high natural gas prices early in the year (which curtailed production of certain fertilizers) and increased imports. This was mitigated by traffic volume increases for grain, flour, wheat and canned goods. The revenue per unit increase was primarily due to favorable changes in the mix of traffic.

In 2000, agriculture, consumer products and government traffic volume increased 7%, and revenues increased 13%, due to the effects of a full year of Northern Region traffic and modest growth in the Southeast markets. Rate increases and more longer-haul (higher revenue-per-unit) traffic also contributed to the revenue increase. Grain traffic benefited from new shuttle-train service that improved service to new and expanded Southeast feed mills. In addition, traffic increased for Midwest grain and sweeteners and consumer goods from the West.

Agriculture, Consumer Products and Government
($ millions)



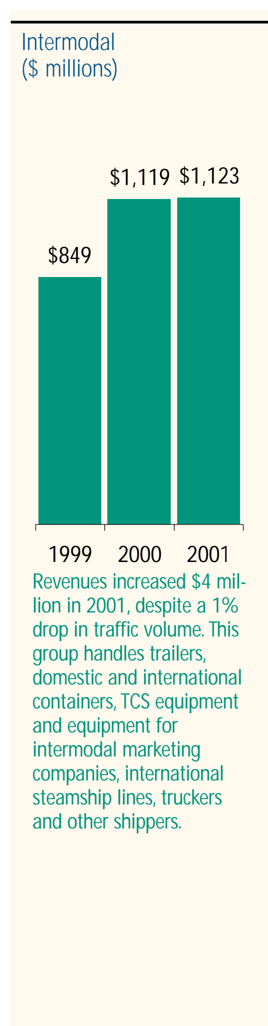
Revenues decreased $6 million, or 1%, in 2001, principally due to soft farm demand, depressed fertilizer production and increased imports. This group includes soybeans, wheat, corn, fertilizers, animal and poultry feed, food oils, flour, beverages, canned goods, sweeteners, consumer products and items for the military.

Agriculture, consumer products and government revenues in 2002 are expected to be comparable to those of 2001. Continued weakness in the fertilizer market is expected to offset gains in the Southeast feed markets and new business.

INTERMODAL traffic volume decreased 1%, but revenues increased slightly in 2001. Domestic traffic volume was up in the first half of the year, but demand increasingly weakened as the year progressed, which eroded NS' base of traffic. New business supported by the opening of three new terminals and other initiatives mitigated the effects of the weakened economy. International traffic, which accounts for about half of intermodal volume, grew slightly as U.S. imports slowed with the economy. TCS traffic volume increased 1% despite economic conditions, as it continued to benefit from reliable, trucklike service. Intermodal revenue per unit dropped later in the year, reflecting the expiration of fuel surcharges that were implemented late in 2000 and the introduction of new shorter-haul business.

In 2000, intermodal traffic volume increased 18%, and revenues increased 32%, primarily due to a full year of Northern Region traffic and the consolidation of TCS

revenues (see Note 2 on Page 37). About half of the improvement in revenue per unit resulted from the effects of consolidating TCS. Prior to June 1, 1999, NS revenues included only the amounts for rail services it performed under contract to TCS, but NS volume included most TCS units. Also contributing to the revenue-per-unit improvement were rate increases throughout the year on domestic business and the implementation of fuel surcharges later in the year. In addition, increased demand, new business and improved service contributed to the gains, as major customers, including UPS, JB Hunt, Hub Group and Maersk, increased volumes. Despite weak demand in the first quarter and the loss in December 1999 of a major customer, NS had regained its market share by the second quarter. Domestic and premium business volumes benefited from service improvements and expansion initiatives. International traffic, which accounts for about half of intermodal volume, grew 5%, notwithstanding the loss of business from a major customer. TCS traffic increased 3%, as it recovered from service shortcomings after the Closing Date.



Revenues increased $4 million in 2001, despite a 1% drop in traffic volume. This group handles trailers, domestic and international containers, TCS equipment and equipment for intermodal marketing companies, international steamship lines, truckers and other shippers.

Intermodal revenues are expected to benefit from continued improvements in service and the terminal capacity added in 2001.

Railway Operating Expenses

Railway operating expenses decreased 7% in 2001, but increased 22% in 2000. Expenses in 2000 included $165 million of costs related to actions taken to reduce the size of the work force. Excluding these costs, railway operating expenses decreased 4% in 2001, while carloads dropped 3%; and increased 19% in 2000 on carloads that were 15% higher.

The higher expense increase in 2000 reflected a full year of Northern Region operations and sharply higher diesel fuel prices.

The railway operating ratio, which measures the percentage of railway operating revenues consumed by railway operating expenses, was 83.7% in 2001, compared with 87.0% in 2000 (excluding the work-force reduction costs, which increased the ratio 2.7 percentage points) and 86.3% in 1999.

The decline in the 2001 ratio reflected the increase in revenue per unit as well as reduced expenses that resulted from gains in efficiency. The increase in the 2000 ratio reflected the effects of a full year of Northern Region operations and the sharp increase in diesel fuel prices, which more than offset the absence of the significant costs incurred in 1999 related to the service issues after the Closing Date. In addition, the ratio was adversely affected by a change in traffic mix (more resource-intensive traffic, such as automotive and intermodal) and the new traffic in the Northern Region, coupled with the decrease in export coal traffic.

The following table shows the changes in railway operating expenses summarized by major classifications.

Railway Operating Expenses

	Increases (Decreases)	
($ in millions)	**2001 vs. 2000**	2000 vs. 1999
Compensation and benefits *	**$ (220)**	$ 379
Materials, services and rents	**(1)**	171
Conrail rents and services	**(57)**	167
Depreciation	**11**	28
Diesel fuel	**(66)**	223
Casualties and other claims	**1**	4
Other	**(31)**	30
Total	**$ (363)**	$ 1,002

* Includes $165 million of work-force reduction costs in 2000.

Compensation and benefits represented 39% of total railway operating expenses and decreased 10% in 2001, but increased 20% in 2000. Both comparisons reflect the $165 million of work-force reduction costs in 2000. Excluding those costs, compensation and benefits decreased 3% in 2001, but increased 12% in 2000.

The 3% decline in 2001 reflected savings attributable to the reduced size of the work force. These savings were somewhat offset by higher wages and benefit costs for union employees, higher incentive compensation and reduced pension income.

The 12% increase in 2000 was largely attributable to the effects of a full year of expanded operations and higher wages and benefit costs for union employees. These increases were mitigated by higher pension income and the absence of the $49 million incurred in 1999 for the Special Work Incentive Program (SWIP) for union employees in the third quarter of 1999. Pension income was higher in 2000 largely due to the transfer of assets from the Conrail pension plan after the Closing Date. NS has substantial unrecognized gains related to its overfunded pension plan; amortization of these gains will continue to be included in "Compensation and benefits" expenses (see Note 11 on Page 42).

The Railroad Retirement and Survivors' Improvement Act, which took effect on Jan. 1, 2002, provides for a phased reduction of the employers' portions of Tier II Railroad Retirement payroll taxes. The phase-in calls for a reduction from 16.1% in 2001 to 15.6% in 2002, 14.2% in 2003 and 13.1% in 2004. In addition, the supplemental annuity tax was eliminated. These changes are expected to result in a $21 million reduction to payroll tax expenses in 2002. The new law allows for investment of Tier II assets in a diversified portfolio through the newly established National Railroad Retirement Investment Trust. The law also provides a mechanism for automatic adjustment of Tier II payroll taxes should the trust assets fall below a four-year reserve or exceed a six-year reserve.

Materials, services and rents includes items used for the maintenance of the railroad's lines, structures and equipment; the costs of services purchased from outside contractors, including the net costs of operating joint (or leased) facilities with other railroads; and the net cost of equipment rentals. This category of expenses decreased slightly in 2001, but increased 13% in 2000.

In 2001, the effects of lower equipment rents were largely offset by higher costs for purchased services, including expenses for software, consulting and legal fees. The increase in 2000 was mostly attributable to the effects of a full year of Northern Region operations and the consolidation of TCS and was mitigated by the absence of significant costs incurred in 1999 related to the service issues encountered after the Closing Date.

Equipment rents, which includes the cost to NS of using equipment (mostly freight cars) owned by other railroads or private owners, less the rent paid to NS for the use of its equipment, decreased 11% in 2001, but increased 22% in 2000. The decline in 2001 was principally due to shorter car cycle times that resulted in fewer car days on line and fewer freight car and locomotive leases. The 2000 increase was principally due to the effects of a full year of expanded operations but was mitigated by a favorable comparison for the last seven months, as expenses in 1999 were high due to the service issues encountered after the Closing Date.

Locomotive and equipment repair costs increased in 2001, principally due to renewed maintenance activity. This trend is expected to continue in 2002, driven by higher expenses for freight car repairs. In 2000, maintenance costs increased, reflecting a full year of Northern Region operations; however, the increase was tempered by reduced maintenance activities, a result of cost control efforts.

Conrail rents and services, a new category of expense beginning in 1999, arose from the expansion of operations on the Closing Date and amounted to $421 million in 2001, $478 million in 2000 and $311 million in 1999. This item includes amounts due to PRR and CRC for use of their operating properties and equipment and CRC's operation of the Shared Assets Areas. Also included is NS' equity in Conrail's net earnings since the Closing Date, plus the additional amortization related to the difference between NS' investment in Conrail and its underlying equity (see Note 2 on Page 37). The decline in 2001 reflected higher Conrail earnings and lower expenses in the Shared Assets Areas (see "Conrail's Results of Operations, Financial Condition and Liquidity," below). Expenses in 2000 included a full year of operations over Conrail's lines, compared with seven months in 1999.

Depreciation expense was up 2% in 2001 and 6% in 2000. Increases in both years were due to property additions, reflecting substantial levels of capital spending (see Note 1, "Properties," on Page 36 for NS' depreciation policy). A periodic review of depreciation rates is being finalized, and rates are expected to be somewhat lower.

Diesel fuel expenses decreased 14% in 2001, but increased 87% in 2000. The decline in 2001 was the result of an 8% drop in consumption and a 7% decline in the average price per gallon. Expenses in 2001 include $8 million related to the hedging program initiated in the second quarter (see "Market Risks and Hedging Activities," below and Note 16 on Page 47). The increase in 2000 expenses

resulted from a 61% rise in the average price per gallon and higher consumption that reflected a full year of Northern Region operations.

Casualties and other claims expenses (including the estimates of costs related to personal injury, property damage and environmental matters) increased slightly in 2001 and 3% in 2000.

The largest component of casualties and other claims expense is personal injury costs. In 2001, cases involving occupational injuries comprised about 31% of the total employee injury cases settled and 15% of the total settlement payments made. Injuries of this type are not generally caused by a specific accident or event, but, rather, result from a claimed exposure over time. Many such claims are being asserted by former or retired employees, some of whom have not been actively employed in the rail industry for decades. NS continues to work actively to eliminate all employee injuries and to reduce the associated costs.

The rail industry remains uniquely susceptible to litigation involving job-related accidental injury and occupational claims because of an outmoded law, the Federal Employers' Liability Act (FELA), originally passed in 1908 and applicable only to railroads. This law, which covers employee claims for job-related injuries, promotes an adversarial claims environment and produces results that are unpredictable and inconsistent. The railroads have been unsuccessful so far in efforts to persuade Congress to replace FELA with a no-fault workers' compensation system.

NS maintains substantial amounts of commercial insurance for potential third-party liability and property damage claims. It also retains reasonable levels of risk through self-insurance.

Other expenses decreased 13% in 2001, but increased 14% in 2000. The decline in 2001 was principally due to lower bad debt costs, reduced franchise and property taxes, and lower travel and employee-relocation expenses. The increase in 2000 reflected a full year of Northern Region operations and higher bad debt expense.

Other Income – Net

Other income – net was $99 million in 2001, $168 million in 2000 and $115 million in 1999 (see Note 3 on Page 39). The reduction in 2001 resulted from the absence of $101 million of gains that occurred in 2000 related to the sale of certain timber rights and gas and oil royalty and working interests. This was somewhat offset by lower interest accruals on federal income tax liabilities and a $13 million gain from a nonrecurring settlement. Results in 2001 also included an $18 million gain from a large property sale that closed in December. The increase in 2000 reflected the $101 million of gains, mitigated by the commencement of a program under which accounts receivable are sold on a revolving basis (see Note 5 on Page 40).

Income Taxes

Income tax expense in 2001 was $191 million for an effective rate of 35%, compared with effective rates of 31% in 2000 and 32% in 1999. Excluding the equity in Conrail's after-tax earnings, the effective rates were 38% in 2001 and 34% in both 2000 and 1999.

The effective rate in 2001 was higher than that of 2000 and 1999, primarily due to dispositions of tax benefits related to coal-seam gas properties. The effective rates in all three years benefited from favorable adjustments upon filing the prior year tax returns and favorable adjustments to state tax liabilities. In addition, both 2000 and 1999 benefited from investments in coal-seam gas properties.

In January 1995, the United States Tax Court issued a preliminary decision that disallowed some of the tax benefits a subsidiary of NS purchased from a third party pursuant to a safe harbor lease agreement in 1981. In January 2001, NS received payment from the third party in accordance with indemnification provisions of the lease agreement.

Discontinued Operations

Income from discontinued operations consisted of a $13 million after-tax gain related to the sale of NS' motor carrier subsidiary (see Note 17 on Page 48).

Financial Condition, Liquidity and Capital Resources

Cash provided by operating activities, NS' principal source of liquidity, was $654 million in 2001, compared with $1.3 billion in 2000 and $533 million in 1999. Results in 2000 reflect the commencement of a program under which accounts receivable are sold on a revolving basis (see Note 5 on Page 40). Excluding the infusion of cash from this program, operating cash flow declined $300 million in 2001. The decrease primarily resulted from an $88 million

reduction in the amount of accounts receivable sold, higher tax payments including amounts applicable to prior years, an increase in telecommunication receivables, bonus payments in 2001 (no such payments in 2000) and the timing of payrolls. A significant portion of payments made to PRR (which are included in "Conrail Rents and Services" and, therefore, are a use of cash in "Cash provided by operating activities") are borrowed back from a PRR subsidiary and, therefore, are a source of cash in "Proceeds from borrowings." In 2001, NS' net cash flow from these borrowings amounted to $250 million. The improvement in cash provided by operating activities in 2000 resulted primarily from favorable changes in working capital, including an improvement in collection of accounts receivable, a lengthening of accounts payable and the lack of bonus payments.

The large changes in "Accounts receivable" and "Current liabilities other than debt" in the 1999 cash flow statement primarily resulted from the commencement of operations in the Northern Region. In addition, collection of accounts receivable had slowed.

NS' working capital deficit was $1.3 billion at Dec. 31, 2001, compared with $1.0 billion at Dec. 31, 2000. The increase resulted principally from a higher amount of debt due within one year. Debt due in 2002 is expected to be paid using cash generated from operations (including sales of accounts receivable), cash on hand and proceeds from borrowings. Part of the working capital deficit at Dec. 31, 2001, arises from a $373 million balance in "Notes and accounts payable to Conrail" that is not expected to be repaid in 2002.

NS currently has the capability to increase the amount of accounts receivable being sold under the revolving sale program to meet its more immediate working capital needs. During 2001, the amount of receivables NS could sell under this program ranged from $345 million to $468 million, and the amount of receivables NS sold ranged from $300 million to $402 million. Moreover, NS has the capability to issue up to $1 billion of commercial paper (see Note 8 on Page 41); however, any reduction in its credit rating could limit NS' ability to access the commercial paper markets (see also the discussion of financing activities, below).

NS expects to generate sufficient cash flow from operations to meet its ongoing obligations. This expectation is based on a view that the economy will remain flat for the first half of 2002 and resume growth in the third and fourth quarters.

NS' contractual obligations related to its long-term debt (including capital leases), operating leases and agreements with CRC are as follows:

($ in millions)	Total	2002	2003-2004	2005-2006	2007 and Subsequent
Long-term debt and capital leases	$ 7,632	$ 605	$ 705	$ 706	$ 5,616
Operating leases	890	113	172	117	488
Agreements with CRC	775	27	62	68	618
Total	$ 9,297	$ 745	$ 939	$ 891	$ 6,722

NS also has contractual obligations to PRR as disclosed in Note 2 on Page 37. However, NS has the ability to borrow back funds from PRR to the extent they are not needed to fund contractual obligations at Conrail. As an indirect owner of Conrail, NS may need to make capital contributions, loans or advances to Conrail to fund its contractual obligations. The following table presents 58% of Conrail's contractual obligations for long-term debt (including capital leases) and operating leases.

($ in millions)	Total	2002	2003-2004	2005-2006	2007 and Subsequent
Long-term debt and capital leases	$ 705	$ 35	$ 62	$ 48	$ 560
Operating leases	369	36	61	64	208
Total	$ 1,074	$ 71	$ 123	$ 112	$ 768

NS also has two transactions not included in the balance sheets or in the previous table of its contractual obligations consisting of an accounts receivable sale program (see Note 5 on Page 40) and an operating lease covering 140 locomotives (see Note 9 on Page 42).

Under the accounts receivable sale program, NS sells without recourse undivided ownership interests in a pool of accounts receivable to two unrelated buyers. NS has no ownership interest in the buyers. The buyers issued debt to fund their initial purchase, and NS used the proceeds it received from the initial purchase primarily to pay down its outstanding debt. NS has no obligation related to the buyers' debt, and there is no existing obligation to repurchase sold receivables. Upon termination of the program, the buyers would cease purchasing new receivables and collections related to the sold receivables would be retained by the buyers.

The operating lease covering the 140 locomotives is renewable annually at NS' option and expires in 2008. The lessor is not related to NS and its owner has a substantive residual equity capital investment at risk in the entity. The

lessor owns the locomotives and issued debt to finance their purchase. NS has no obligation related to the debt. NS has the option to purchase the locomotives, but also can return them to the lessor. The return provisions of the lease are not so onerous as to preclude this option. If NS does not purchase the locomotives at the end of the maximum lease term, it is liable for any shortfall in the then fair value of the locomotives and a specified residual value. NS does not expect to be required to make any payments under this provision.

Cash used for investing activities increased slightly in 2001, but decreased slightly in 2000. Property additions were up 2% in 2001, following a large decline in 2000 that reflected the absence of significant locomotive purchases, as fleet additions were accomplished by operating lease. Investing activities in 1999 included approximately $140 million more of borrowings against the net cash surrender value of corporate-owned life insurance than in 2000. Property additions account for most of the recurring spending in this category.

The following tables show capital spending and track and equipment statistics for the past five years.

Capital Expenditures

($ in millions)	2001	2000	1999	1998	1997
Road	$ 505	$ 557	$ 559	$ 612	$ 599
Equipment	233	146	349	442	306
Other property	8	28	4	6	24
Total	$ 746	$ 731	$ 912	$ 1,060	$ 929

Capital expenditures increased 2% in 2001, but decreased 20% in 2000. Outlays in 2001 included amounts for locomotive purchases that were somewhat offset by lower expenditures for freight car purchases and roadway projects. The decline in 2000 reflected lower capital expenditures for locomotives as a result of the operating lease. In both years, spending for road included fiber-optic infrastructure that is expected to be completed in 2002 (see "Telecommunications Subsidiary," below).

Track Structure Statistics (Capital and Maintenance)

	2001	2000	1999	1998	1997
Track miles of rail installed	254	390	403	429	451
Miles of track surfaced	3,836	3,687	5,087	4,715	4,703
New crossties installed (millions)	1.5	1.5	2.3	2.0	2.2

Average Age of Owned Railway Equipment

(Years)	2001	2000	1999	1998	1997
Freight cars	25.4	24.6	23.8	23.6	23.0
Locomotives	15.7	16.1	15.4	15.4	15.3
Retired locomotives	22.4	24.5	22.7	20.6	23.3

The table above excludes equipment leased from PRR (see Note 2 on Page 37), which comprises 16% of the freight car fleet and 27% of the locomotive fleet.

The higher average age of owned locomotives in 2000 reflects the fact that locomotives leased in 2000 are not included in the statistic. The 1998 decrease in the average age of retired locomotives resulted from a disproportionate share of early retirements as well as retention of older units in anticipation of the Closing Date.

Through its coal car rebody program, which was suspended in 2000, NS converted about 29,000 hopper cars into high-capacity steel gondolas or hoppers. As a result, the remaining service life of the freight-car fleet is greater than may be inferred from the increasing average age shown in the table above.

For 2002, NS has budgeted $705 million for capital expenditures. The anticipated spending includes $482 million for roadway projects, of which $366 million is for track and bridge program work. Also included are projects for marketing and industrial development initiatives and continuing investments in intermodal infrastructure. Equipment spending of $173 million includes the purchase of 50 locomotives and upgrades to existing units, and projects related to computers and information technology, including additional security and backup systems. NS issued in February 2002 debt secured by the locomotives.

Cash provided by financing activities in 2001 was $151 million, and reflects the effects of the reduction to the dividend in January 2001. Financing activities included loan transactions with a PRR subsidiary that resulted in net borrowings of $250 million in 2001 and net repayments of $72 million in 2000 (see Note 2 on Page 37). Excluding these borrowings, debt was reduced $20 million in 2001 and $422 million in 2000. The substantial net reduction of debt in 2000 was accomplished in part with the proceeds from the sale of accounts receivable. NS' debt-to-total capitalization ratio (excluding notes payable to Conrail) at year end was 55.6% in 2001 and 56.7% in 2000.

NS currently has in place a new $1 billion, five-year credit facility, which replaced the facility that would have expired in May 2002. The new agreement provides for borrowings at prevailing rates and includes financial covenants similar to the old facility (see Note 8 on Page 41). In addition, NS has issued only $250 million of debt under its $1 billion shelf registration that became effective in April 2001.

Conrail's Results of Operations, Financial Condition and Liquidity

Through May 31, 1999, Conrail's results of operations include freight line-haul revenues and related expenses. After the Closing Date, June 1, 1999, its results reflect its new structure and operations (see Note 2 on Page 37). Currently, Conrail's major sources of operating revenues are operating fees and rents from NSR and CSXT. The composition of Conrail's operating expenses also changed.

Conrail's net income was $174 million in 2001, compared with $170 million in 2000 and $26 million in 1999 (see Note 2 on Page 37). Results in 1999 included $180 million of expenses ($121 million after taxes), principally to increase certain components of its casualty liability based on an actuarial valuation, to adjust certain litigation and environmental liabilities related to settlements and completion of site reviews and a credit adjustment related to the assumption of a lease obligation by CSX. Excluding the effects of these items, net income would have been $147 million in 1999.

The improvement in 2001 reflected lower casualties and other claims expenses, a favorable adjustment to state income tax reserves and environmental and insurance settlements in Conrail's favor. These positive items were offset in part by the absence of significant gains from the sale of property. The 2000 increase reflected a $37 million after-tax gain from a property sale and the absence of significant transition-related expenses.

Conrail's operating revenues were $903 million in 2001, $985 million in 2000 and $2.2 billion in 1999. The decline in 2001 resulted from lower revenues at Conrail's Indiana Harbor Belt subsidiary, the expiration of certain equipment leases and lower operating fees, largely because of reduced operating costs in the Shared Assets Areas. The decline in 2000 was attributable to the change in operations.

Conrail's operating expenses were $639 million in 2001, $749 million in 2000 and $2.0 billion in 1999. The decline in 2001 was primarily due to lower expenses for materials, services and rents; casualties and other claims; and compensation and benefits. The decrease in 2000 was principally due to the change in operations and the absence of the $180 million of expenses discussed above and $60 million of transition-related expenses (principally technology integration costs and employee stay bonuses).

Conrail's cash provided by operations increased $140 million, or 39%, in 2001, but decreased $34 million, or 9%, in 2000. The 2001 increase was principally due to a $50 million cash payment for transferring to a third party certain rights to license, manage and market signboard advertising on Conrail's property for 25 years and proceeds from a favorable insurance settlement. The 2000 reduction reflected the change in operations and payment of one-time items owed to NSR and CSXT. Cash generated from operations is Conrail's principal source of liquidity and is primarily used for debt repayments and capital expenditures. Debt repayments totaled $61 million in 2001 and $318 million in 2000. Capital expenditures totaled $47 million in 2001 and $220 million in 2000.

Conrail had working capital of $438 million at Dec. 31, 2001, compared with $85 million at Dec. 31, 2000, including $687 million and $323 million, respectively, of amounts receivable from NS and CSX. Conrail is not an SEC registrant and, therefore, presently cannot issue any publicly traded securities. Conrail is expected to have sufficient cash flow to meet its ongoing obligations.

NS' equity in earnings of Conrail, net of amortization, was $44 million in 2001, $21 million in 2000 and $17 million in 1999. NS' other comprehensive loss for 2001, as shown in the Consolidated Statement of Changes in Stockholders' Equity on Page 35, included $41 million for its portion of Conrail's other comprehensive loss (see Note 13 on Page 45).

Other Matters

Telecommunications Subsidiary

NS' subsidiary, Thoroughbred Technology and Telecommunications, Inc. (T-Cubed), is codeveloping fiber optic infrastructure with members of the telecommunications industry. This industry has recently experienced a severe downturn. During the second quarter, one of T-Cubed's codevelopers filed for protection under Chapter 11 of the U.S. Bankruptcy Code and foreign laws. This codeveloper

owes T-Cubed amounts for work performed on joint projects; however, based on known facts and circumstances, Management believes that such amounts ultimately will be realized. T-Cubed is engaged in contract litigation with a second codeveloper concerning the latter's obligation to purchase fiber optic infrastructure installed by T-Cubed between Cleveland, Ohio, and northern Virginia. Management expects to prevail in this litigation. The ability to collect a judgment against the codeveloper, Williams Communications, LLC, may be limited due to its declining financial condition; however, the shortfall, if any, cannot now be determined.

As a result of changes in the values of telecommunications assets, T-Cubed is monitoring its carrying amount of these assets, as required by SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of." To date, based on the known facts and circumstances, management believes that its ultimate investment in these assets will be recovered and, accordingly, no impairment has been recognized (see Note 6 on Page 40).

Labor Arbitration

Several hundred claims have been filed on behalf of NSR employees furloughed after June 1, 1999, for various periods of time, alleging that the furloughs were a result of the Conrail transaction and seeking "New York Dock" income protection benefits. One labor organization has initiated arbitration on behalf of approximately 100 of these claimants. Management believes, based on known facts and circumstances, including the availability of legal defenses, that the amount of liability for these claims should not have a material adverse effect on NS' financial position, results of operations or liquidity. Depending on the outcome of the arbitration, other claims may be filed or progressed to arbitration. Should all such claimants prevail, there could be a significant effect on results of operations in a particular quarter.

Labor Agreements

Approximately 85 percent of NS' railroad employees are covered by collective bargaining agreements with 15 different labor unions. These agreements remain in effect until changed pursuant to the Railway Labor Act. Moratorium provisions in these agreements permitted NS and the unions to propose such changes in late 1999; negotiations at the national level commenced shortly thereafter. The outcome of these negotiations is uncertain. However, agreements have been reached with the Brotherhood of Maintenance of Way Employes, which represents about 4,400 NS employees, and with the Brotherhood of Locomotive Engineers, which represents about 5,000 NS employees. In addition, a tentative national agreement (subject to ratification) has been reached with the United Transportation Union, which represents about 7,000 NS employees. The tentative national agreement reached with the International Brotherhood of Electrical Workers, which represents about 1,000 NS employees, was not ratified.

Market Risks and Hedging Activities

NS uses derivative financial instruments to reduce the risk of volatility in its diesel fuel costs and to manage its overall exposure to fluctuations in interest rates.

In 2001, NS began a program to hedge a portion of its diesel fuel consumption. The intent of the program is to assist in the management of NS' aggregate risk exposure to fuel price fluctuations, which can significantly affect NS' operating margins and profitability, through the use of one or more types of derivative instruments.

Diesel fuel costs represented 8% of NS' operating expenses for 2001. The program provides that NS will not enter into any fuel hedges with a duration of more than 36 months, and that no more than 80% of NS' average monthly fuel consumption will be hedged for each month within any 36-month period.

As of Dec. 31, 2001, through swap transactions and advance purchases, NS has hedged approximately 40% of expected 2002 diesel fuel requirements. The effect of the hedges is to yield an average cost of 70 cents per hedged gallon, including federal taxes and transportation.

A 10% decrease in diesel fuel prices would increase NS' liability related to the swaps by approximately $15 million.

NS manages its overall exposure to fluctuations in interest rates by issuing both fixed- and floating-rate debt instruments and by entering into interest-rate hedging transactions to achieve an appropriate mix within its debt portfolio.

Of NS' total debt outstanding (see Note 8 on Page 41), all is fixed-rate debt, except for most capital leases, $250 million of notes due in 2003 and $174 million of equipment obligations. As a result, NS' debt subject to interest rate exposure totaled $675 million at Dec. 31, 2001. A 1% increase in interest rates would increase NS' total annual interest expense related to all its variable

debt by approximately $7 million. Management considers it unlikely that interest rate fluctuations applicable to these instruments will result in a material adverse effect on NS' financial position, results of operations or liquidity.

The capital leases, which carry an average fixed rate of 7.1%, were effectively converted to variable rate obligations using interest rate swap agreements. On Dec. 31, 2001, the average pay rate under these agreements was 2.8%, and the average receive rate was 7.1%. During 2001, the effect of the swaps was to reduce interest expense by $3 million. A portion of the lease obligations is payable in Japanese yen. NS eliminated the associated exchange rate risk at the inception of each lease with a yen deposit sufficient to fund the yen-denominated obligation. Most of these deposits are held by foreign banks, primarily Japanese. As a result, NS is exposed to financial market risk relative to Japan. Counterparties to the interest rate swaps and Japanese banks holding yen deposits are major financial institutions believed by management to be creditworthy.

Environmental Matters

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

Operating expenses for environmental matters totaled approximately $10 million in 2001, $11 million in 2000 and $12 million in 1999, and capital expenditures totaled approximately $10 million in each of 2001 and 2000 and $8 million in 1999. Capital expenditures in 2002 are expected to be comparable to those in 2001.

NS' balance sheets included liabilities for environmental exposures in the amount of $33 million at Dec. 31, 2001, and $36 million at Dec. 31, 2000 (of which $8 million was accounted for as a current liability in each year). At Dec. 31, 2001, the liability represented NS' estimate of the probable cleanup and remediation costs based on available information at 126 identified locations. On that date, 10 sites accounted for $17 million of the liability, and no individual site was considered to be material. NS anticipates that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At some of the 126 locations, certain NS subsidiaries, usually in conjunction with a number of other parties, have been identified as potentially responsible parties by the Environmental Protection Agency (EPA) or similar state authorities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or comparable state statutes, which often impose joint and several liability for cleanup costs.

With respect to known environmental sites (whether identified by NS or by the EPA or comparable state authorities), estimates of NS' ultimate potential financial exposure for a given site or in the aggregate for all such sites are unavoidably imprecise because of the widely varying costs of currently available cleanup techniques, 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 NS' traffic mix, particularly those classified as hazardous materials, can pose special risks that NS and its subsidiaries work diligently to minimize. In addition, several NS subsidiaries own, or have owned, land used as operating property, or which is leased or may have been 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 NS will not incur environmental liabilities or costs with respect to one or more of them, the amount and materiality of which cannot be estimated reliably at this time. Moreover, lawsuits and claims involving these and other unidentified environmental sites and matters are likely to arise from time to time. The resulting liabilities could have a significant effect on financial condition, results of operations or liquidity in a particular year or quarter.

However, based on an assessment of known facts and circumstances, management believes that it is unlikely that any known matters, either individually or in the aggregate, will have a material adverse effect on NS' financial position, results of operations or liquidity.

New Accounting Pronouncement

In October 2001, the Financial Accounting Standards Board issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Statement No. 144 supersedes Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," but it retains many of the fundamental provisions of that Statement. Statement No. 144 also broadens the presentation of discontinued operations to include more disposal transactions. NS' adoption of Statement No. 144, effective Jan. 1, 2002, did not have a material effect on its financial statements.

Inflation

Generally accepted accounting principles require the use of historical cost in preparing financial statements. This approach disregards the effects of inflation on the replacement cost of property. NS, a capital-intensive company, has most of its capital invested in such 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.

Trends

Federal Economic Regulation

Efforts may be made in 2002 to reimpose unwarranted federal economic regulation on the rail industry. The Staggers Rail Act of 1980, which substantially reduced such regulation, encouraged and enabled rail carriers to innovate and to compete for business. NS and other rail carriers will oppose any efforts to reimpose unwarranted economic regulation.

Utility Deregulation

Deregulation of the electrical utility industry is expected to increase competition among electric power generators; deregulation over time would permit wholesalers and possibly retailers of electric power to sell or purchase increasing quantities of power to or from distant parties. The effects of deregulation on NS and on its customers cannot be predicted with certainty; however, NS serves a number of efficient power producers and is working diligently to ensure that its customers remain competitive in this evolving environment.

Carbon-Based Fuel

There is growing concern in some quarters that emissions resulting from burning carbon-based fuel, including coal, are contributing to global warming and causing other environmental changes. To the extent that these concerns evolve into a consensus among policy-makers, the impact could be either a reduction in the demand for coal or imposition of more stringent regulations on emissions, which might result in making coal a less economical source of power generation or make permitting of coal-fired facilities even more difficult. The revenues and net income of NSR and other railroads that move large quantities of coal could be affected adversely.

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" and "project." Forward-looking statements reflect management's good-faith evaluation of information currently available. However, such statements are dependent on and, therefore, can be influenced by, a number of external variables over which management has little or no control, including: domestic and international economic conditions; the business environment in industries that produce and consume rail freight; competition and consolidation within the transportation industry; fluctuation in prices of key materials, in particular diesel fuel; labor difficulties, including strikes and work stoppages; legislative and regulatory developments; changes in securities and capital markets; and natural events such as severe weather, floods and earthquakes. Forward-looking statements are not, and should not be relied upon as, a guaranty 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. The Company undertakes no obligation to update or revise forward-looking statements.

Consolidated Statements of Income

Norfolk Southern Corporation and Subsidiaries

	2001	2000	1999
	Years ended December 31,		
	($ in millions, except earnings per share)		
Railway operating revenues	**$ 6,170**	$ 6,159	$ 5,242
Railway operating expenses			
Compensation and benefits (Note 11)	**2,014**	2,234	1,855
Materials, services and rents	**1,444**	1,445	1,274
Conrail rents and services (Note 2)	**421**	478	311
Depreciation	**514**	503	475
Diesel fuel	**412**	478	255
Casualties and other claims	**143**	142	138
Other	**215**	246	216
Total railway operating expenses	**5,163**	5,526	4,524
Income from railway operations	**1,007**	633	718
Equity in earnings of Conrail (Note 2)	**—**	—	49
Other income – net (Note 3)	**99**	168	115
Interest expense on debt (Note 6)	**(553)**	(551)	(531)
Income from continuing operations before income taxes	**553**	250	351
Provision for income taxes (Note 4)	**191**	78	112
Income from continuing operations	**362**	172	239
Discontinued operations – Gain on sale of motor carrier, net of taxes (Note 17)	**13**	—	—
Net income	**$ 375**	$ 172	$ 239
Earnings per share (Note 14)			
Income from continuing operations – basic and diluted	**$ 0.94**	$ 0.45	$ 0.63
Net income – basic and diluted	**$ 0.97**	$ 0.45	$ 0.63

See accompanying Notes to Consolidated Financial Statements

Consolidated Balance Sheets

Norfolk Southern Corporation and Subsidiaries

	As of December 31, 2001	As of December 31, 2000
	($ in millions)	
Assets		
Current assets:		
Cash and cash equivalents	$ 204	$ —
Short-term investments	—	2
Accounts receivable, net (Note 5)	475	411
Due from Conrail (Note 2)	8	31
Materials and supplies	90	91
Deferred income taxes (Note 4)	162	182
Other current assets	108	132
Total current assets	1,047	849
Investment in Conrail (Note 2)	6,161	6,154
Properties less accumulated depreciation (Note 6)	11,208	11,105
Other assets	1,002	868
Total assets	$ 19,418	$ 18,976
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable (Note 7)	$ 848	$ 925
Income and other taxes	312	251
Notes and accounts payable to Conrail (Note 2)	373	155
Other current liabilities (Note 7)	248	259
Current maturities of long-term debt (Note 8)	605	297
Total current liabilities	2,386	1,887
Long-term debt (Note 8)	7,027	7,339
Other liabilities (Note 10)	1,089	1,131
Minority interests	45	50
Deferred income taxes (Note 4)	2,781	2,745
Total liabilities	13,328	13,152
Stockholders' equity:		
Common stock $1.00 per share par value, 1,350,000,000 shares authorized; issued 407,000,871 and 405,421,447 shares, respectively	407	405
Additional paid-in capital	423	392
Accumulated other comprehensive loss (Note 13)	(55)	(6)
Retained income	5,335	5,053
Less treasury stock at cost, 21,169,125 and 21,363,974 shares, respectively	(20)	(20)
Total stockholders' equity	6,090	5,824
Total liabilities and stockholders' equity	$ 19,418	$ 18,976

See accompanying Notes to Consolidated Financial Statements

Consolidated Statements of Cash Flows

Norfolk Southern Corporation and Subsidiaries

	2001	Years ended December 31, 2000 ($ in millions)	1999
Cash flows from operating activities			
Net income	**$ 375**	$ 172	$ 239
Reconciliation of net income to net cash provided by operating activities:			
Depreciation	**527**	517	489
Deferred income taxes	**44**	2	85
Equity in earnings of Conrail	**(44)**	(21)	(17)
Gains and losses on properties and investments	**(59)**	(160)	(62)
Income from discontinued operations	**(13)**	—	—
Changes in assets and liabilities affecting operations:			
Accounts receivable (Note 5)	**(74)**	446	(322)
Materials and supplies	**1**	9	(40)
Other current assets and due from Conrail	**46**	60	(50)
Current liabilities other than debt	**(27)**	220	259
Other – net (Note 11)	**(122)**	97	(48)
Net cash provided by operating activities	**654**	1,342	533
Cash flows from investing activities			
Property additions	**(746)**	(731)	(912)
Property sales and other transactions	**156**	137	104
Investments, including short-term	**(99)**	(77)	(126)
Investment sales and other transactions	**88**	90	343
Net cash used for investing activities	**(601)**	(581)	(591)
Cash flows from financing activities			
Dividends	**(93)**	(306)	(304)
Common stock issued – net	**14**	2	14
Proceeds from borrowings	**1,995**	1,055	1,110
Debt repayments	**(1,765)**	(1,549)	(730)
Net cash provided by (used for) financing activities	**151**	(798)	90
Net increase (decrease) in cash and cash equivalents	**204**	(37)	32
Cash and cash equivalents			
At beginning of year	**—**	37	5
At end of year	**$ 204**	$ —	$ 37
Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Interest (net of amounts capitalized)	**$ 550**	$ 543	$ 520
Income taxes	**$ 74**	$ 5	$ 16

See accompanying Notes to Consolidated Financial Statements

Consolidated Statements of Changes in Stockholders' Equity

Norfolk Southern Corporation and Subsidiaries

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Income	Treasury Stock	Total
	($ in millions, except per share amounts)					
Balance December 31, 1998	**$ 401**	**$ 296**	**$ (8)**	**$5,252**	**$ (20)**	**$ 5,921**
Comprehensive income – 1999						
Net income				239		239
Other comprehensive loss (Note 13)			(3)			(3)
Total comprehensive income						236
Dividends on Common Stock, $0.80 per share				(304)		(304)
Other (Notes 11 and 12)	3	76				79
Balance December 31, 1999	**404**	**372**	**(11)**	**5,187**	**(20)**	**5,932**
Comprehensive income – 2000						
Net income				172		172
Other comprehensive income (Note 13)			5			5
Total comprehensive income						177
Dividends on Common Stock, $0.80 per share				(306)		(306)
Other (Notes 11 and 12)	1	20				21
Balance December 31, 2000	**405**	**392**	**(6)**	**5,053**	**(20)**	**5,824**
Comprehensive income – 2001						
Net income				375		375
Other comprehensive loss (Note 13)			(49)			(49)
Total comprehensive income						326
Dividends on Common Stock, $0.24 per share				(93)		(93)
Other (Notes 11 and 12)	2	31				33
Balance December 31, 2001	**$ 407**	**$ 423**	**$ (55)**	**$5,335**	**$ (20)**	**$ 6,090**

See accompanying Notes to Consolidated Financial Statements

The following Notes are an integral part of the Consolidated Financial Statements.

1 Summary of Significant Accounting Policies

Description of Business

Norfolk Southern Corporation is a Virginia-based holding company engaged principally in the transportation of freight by rail, operating approximately 21,500 route miles primarily in the East and Midwest. These financial statements include Norfolk Southern Corporation (Norfolk Southern) and its majority-owned and controlled subsidiaries (collectively, NS) on a consolidated basis. Norfolk Southern's major subsidiary is Norfolk Southern Railway Company (NSR). All significant intercompany balances and transactions have been eliminated in consolidation.

The railroad transports raw materials, intermediate products and finished goods classified in the following market groups (percent of total railway operating revenues): coal (25%); automotive (14%); chemicals (12%); metals/construction (11%); paper/clay/forest products (10%); agriculture/consumer products/government (10%); and intermodal (18%). Ultimate points of origination or destination for some of the freight (particularly coal bound for export and intermodal containers) are outside the United States. Approximately 85% of NS' railroad employees are covered by collective bargaining agreements with 15 different labor unions.

Through a jointly owned entity, Norfolk Southern and CSX Corporation own the stock of Conrail Inc., which owns the major Northeast freight railroad. Norfolk Southern has a 58% economic and 50% voting interest in the jointly owned entity (see Note 2).

Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management reviews its estimates, including those related to the recoverability and useful lives of assets, as well as liabilities for litigation, environmental remediation, casualty claims, income taxes, pensions and postretirement benefits. Changes in facts and circumstances may result in revised estimates.

Cash Equivalents

"Cash equivalents" are highly liquid investments purchased three months or less from maturity.

Investments

Marketable equity and debt securities are reported at amortized cost or fair value, depending upon their classification as securities "held-to-maturity," "trading" or "available-for-sale." Unrealized gains and losses for investments designated as "available-for-sale," net of taxes, are recognized in "Accumulated other comprehensive loss."

Investments, where NS has the ability to exercise significant influence over but does not control the entity, are accounted for using the equity method in accordance with APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock."

Materials and Supplies

"Materials and supplies," consisting mainly of fuel oil and items for maintenance of property and equipment, are stated at the lower of average cost or market. The cost of materials and supplies expected to be used in capital additions or improvements is included in "Properties."

Properties

"Properties" are stated principally at cost and are depreciated using group depreciation. Rail is depreciated primarily on the basis of use measured by gross ton-miles. Other properties are depreciated generally using the straight-line method over the lesser of estimated service or lease lives. NS capitalizes interest on major capital projects during the period of their construction. Expenditures, including those on leased assets, that extend an asset's useful life or increase its utility are capitalized. Maintenance expense is recognized when repairs are performed. When properties other than land and nonrail assets are sold or retired in the ordinary course of business, the cost of the assets, net of sale proceeds or salvage, is charged to accumulated depreciation rather than recognized through income. Gains and losses on disposal of land and nonrail assets are included in "Other income - net" (see Note 3).

NS reviews the carrying amount of properties whenever events or changes in circumstances indicate that such carrying amount may not be recoverable based on future

undiscounted cash flows or estimated net realizable value. Assets that are deemed impaired as a result of such review are recorded at the lower of carrying amount or fair value.

Revenue Recognition

Revenue is recognized proportionally as a shipment moves from origin to destination. Refunds due in accordance with transportation contracts are recorded as a reduction to revenues during the life of the contract, based on management's best estimate of projected liability.

Derivatives

NS does not engage in the trading of derivatives. NS uses derivative financial instruments to reduce the risk of volatility in its diesel fuel costs and in the management of its mix of fixed and floating-rate debt. Management has determined that these derivative instruments qualify as either fair-value or cash-flow hedges, having values that highly correlate with the underlying hedged exposures and have designated such instruments as hedging transactions. Credit risk related to the derivative financial instruments is considered to be minimal and is managed by requiring high credit standards for counterparties and periodic settlements.

Required Accounting Changes

Effective Jan. 1, 2001, NS adopted Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities " (see Note 16).

Reclassifications

Certain amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the 2001 presentation.

2 Investment in Conrail and Operations Over Its Lines

Overview

Norfolk Southern and CSX Corporation (CSX) jointly own Conrail Inc. (Conrail), whose primary subsidiary is Consolidated Rail Corporation (CRC), the major freight railroad in the Northeast. From May 23, 1997, the date Norfolk Southern and CSX completed their acquisition of Conrail stock, until June 1, 1999, Conrail's operations continued substantially unchanged while Norfolk Southern and CSX awaited regulatory approvals and prepared for the integration of the respective Conrail routes and assets to be leased to their railroad subsidiaries, NSR and CSX Transportation, Inc. (CSXT). From time to time, Norfolk Southern and CSX, as the indirect owners of Conrail, may need to make capital contributions, loans or advances to Conrail.

Operations of Conrail's Lines

On June 1, 1999 (the Closing Date), NSR and CSXT began operating as parts of their respective rail systems the separate Conrail routes and assets leased to them pursuant to operating and lease agreements.

The Operating Agreement between NSR and Pennsylvania Lines LLC (PRR), a wholly owned subsidiary of CRC, governs substantially all nonequipment assets to be operated by NSR and has an initial 25-year term, renewable at the option of NSR for two five-year terms. Payments under the Operating Agreement are subject to adjustment every six years to reflect changes in values. NSR also has leased or subleased for varying terms from PRR a number of equipment assets. Costs necessary to operate and maintain the PRR assets, including leasehold improvements, are borne by NSR. CSXT has entered into comparable arrangements, for the operation and use of certain other CRC routes and assets, with another wholly owned CRC subsidiary.

NSR and CSXT also have entered into agreements with CRC governing other properties that continue to be owned and operated by CRC (the Shared Assets Areas). NSR and CSXT pay CRC a fee for joint and exclusive access to the Shared Assets Areas. In addition, NSR and CSXT pay, based on usage, the costs incurred by CRC to operate the Shared Assets Areas.

Future minimum lease payments due to PRR under the Operating Agreement and lease agreements and to CRC under the Shared Assets Areas (SAA) agreements are as follows:

($ in millions)	PRR Oper. Agmt.	PRR Lease Agmts.	SAA Agmts.
2002	$ 196	$ 131	$ 27
2003	217	109	30
2004	238	93	32
2005	246	72	34
2006	246	57	34
2007 and subsequent years	4,530	171	618
Total	$ 5,673	$ 633	$ 775

Operating lease expense related to the agreements, which is included in "Conrail rents and services," amounted to $467 million in 2001, $502 million in 2000 and $273 million in 1999.

On the Closing Date, both NS' railroad route miles and its railroad employees increased approximately 50 percent. NSR and CSXT now provide substantially all rail freight services on Conrail's route system, perform most services incident to customer freight contracts and employ the majority of Conrail's former work force. As a result, NSR receives all freight revenues and incurs all expenses on the PRR lines.

Investment in Conrail

NS is applying the equity method of accounting to its investment in Conrail in accordance with APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock."

NS is amortizing the excess of the purchase price over Conrail's net equity using the principles of purchase accounting, based primarily on the estimated remaining useful lives of Conrail's property and equipment, including the related deferred tax effect of the differences in tax and accounting bases for certain assets. At Dec. 31, 2001, the difference between NS' investment in Conrail and its share of Conrail's underlying net equity was $3.8 billion.

NS' consolidated balance sheet at Dec. 31, 2001, includes $80 million of liabilities related to the Conrail transaction, principally for contractual obligations to Conrail employees imposed by the Surface Transportation Board when it approved the transaction. Through Dec. 31, 2001, NS had paid $109 million of such costs.

Effective June 1, 1999, NS' consolidated financial statements include the consolidated financial position and results of Triple Crown Services Company (TCS), a partnership in which subsidiaries of NS and PRR are partners.

Related-Party Transactions

Until the Closing Date, NSR and CRC had transactions with each other in the customary course of handling interline traffic. As of Dec. 31, 2001, substantially all of the amounts receivable or payable related to these transactions had been satisfied.

NS provides certain general and administrative support functions to Conrail, the fees for which are billed in accordance with several service-provider arrangements and totaled $6 million in 2001, $7 million in 2000 and $10 million in 1999.

"Conrail rents and services," a new line on the income statements beginning June 1, 1999, includes: (1) expenses for amounts due to PRR and CRC for use by NSR of operating properties and equipment, operation of the Shared Assets Areas and continued operation of certain facilities during a transition period; and (2) NS' equity in the earnings of Conrail, net of amortization.

"Notes and accounts payable to Conrail" includes $301 million at Dec. 31, 2001, and $51 million at Dec. 31, 2000, of interest-bearing loans made to NS by a PRR subsidiary that are payable on demand. The interest rate for these loans is variable and was 2.45% at Dec. 31, 2001. Also included is $72 million at Dec. 31, 2001, and $104 million at Dec. 31, 2000, due to PRR and CRC related to expenses included in "Conrail rents and services," as discussed above.

Summary Financial Information — Conrail

The following summary financial information should be read in conjunction with Conrail's audited financial statements, included as an exhibit to NS' Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Through May 31, 1999, Conrail's results of operations include freight line-haul revenues and related expenses. After the Closing Date, June 1, 1999, its results reflect its new structure and operations. Currently, Conrail's major sources of operating revenues are from NSR and CSXT. The composition of Conrail's operating expenses also has changed.

Summarized Consolidated Statements of Income — Conrail

($ in millions)	2001	2000	1999
Operating revenues	$ 903	$ 985	$ 2,174
Operating expenses	639	749	2,046
Operating income	264	236	128
Other – net	(6)	31	(83)
Income before income taxes	258	267	45
Provision for income taxes	84	97	19
Net income	$ 174	$ 170	$ 26

Note: Conrail's results for 2000 included gains from the sale of property that had been written up to fair market value in the allocation of NS' investment in Conrail. Accordingly, the gains related to that fair-value write-up, totaling $17 million after taxes, were excluded in determining NS' equity in Conrail's net income. Conrail's results in 1999 included after-tax expenses of $121 million, principally: (1) to increase certain components of its casualty reserves based on an actuarial valuation, (2) to adjust certain litigation and environmental reserves related to settlements and completion of site reviews and (3) to adjust a credit related to the assumption of a lease obligation by CSX. These 1999 items were considered in the allocation of NS' investment in Conrail to the fair values of Conrail's assets and liabilities and, accordingly, were excluded in determining NS' equity in Conrail's net income.

Summarized Consolidated Balance Sheets — Conrail

($ in millions)	December 31, 2001	2000
Assets:		
Current assets	$ 846	$ 520
Noncurrent assets	7,236	7,540
Total assets	$ 8,082	$ 8,060
Liabilities and stockholders' equity:		
Current liabilities	$ 408	$ 435
Noncurrent liabilities	3,569	3,643
Stockholders' equity	4,105	3,982
Total liabilities and stockholders' equity	$ 8,082	$ 8,060

Note: Current assets include demand notes and receivables from NS and CSX totaling $687 million at Dec. 31, 2001, and $323 million at Dec. 31, 2000. Current liabilities include amounts payable to NS and CSX totaling $12 million at Dec. 31, 2001, and $31 million at Dec. 31, 2000.

3 Other Income — Net

($ in millions)	2001	2000	1999
Income from natural resources:			
Royalties from coal	$ 52	$ 55	$ 59
Gains from sale of timber, oil and gas rights and interests	—	101	—
Nonoperating depletion and depreciation	(13)	(13)	(14)
Subtotal	39	143	45
Gains from sale of properties and investments	59	59	62
Rental income	40	40	34
Interest income	15	11	8
Other interest expense	1	(39)	(30)
Sale of accounts receivable (Note 5)	(17)	(23)	—
Taxes on nonoperating property	(11)	(9)	(7)
Corporate-owned life insurance – net	6	—	(3)
Equity in undistributed earnings of partnerships	(8)	3	1
Charitable contributions	(4)	(4)	—
Other – net	(21)	(13)	5
Total	$ 99	$ 168	$ 115

"Other current assets" in the Consolidated Balance Sheets includes prepaid interest on corporate-owned life insurance borrowings of $45 million at Dec. 31, 2001, and $43 million at Dec. 31, 2000.

4 Income Taxes

Provision for Income Taxes

($ in millions)	2001	2000	1999
Current:			
Federal	$ 125	$ 65	$ 18
State	22	11	9
Total current taxes	147	76	27
Deferred:			
Federal	35	1	78
State	9	1	7
Total deferred taxes	44	2	85
Provision for income taxes	$ 191	$ 78	$ 112

Reconciliation of Statutory Rate to Effective Rate

Total income taxes as reflected in the Consolidated Statements of Income differ from the amounts computed by applying the statutory federal corporate tax rate as follows:

	2001		2000		1999	
($ in millions)	Amount	%	Amount	%	Amount	%
Federal income tax at statutory rate	$194	35	$ 87	35	$123	35
State income taxes, net of federal tax benefit	20	4	8	3	10	3
Equity in earnings of Conrail	(16)	(3)	(7)	(3)	(6)	(2)
Corporate-owned life insurance	(3)	—	(2)	(1)	1	—
Other – net	(4)	(1)	(8)	(3)	(16)	(4)
Provision for income taxes	$191	35	$ 78	31	$112	32

Deferred Tax Assets and Liabilities

Certain items are reported in different periods for financial reporting and income tax purposes. Deferred tax assets and liabilities are recorded in recognition of these differences.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

($ in millions)	December 31, 2001	2000
Deferred tax assets:		
Reserves, including casualty and other claims	$ 158	$ 158
Employee benefits	75	104
Retiree health and death benefit obligation	137	139
Taxes, including state and property	221	200
Other	22	28
Total gross deferred tax assets	613	629
Less valuation allowance	(18)	(12)
Net deferred tax asset	595	617
Deferred tax liabilities:		
Property	(3,126)	(3,117)
Other	(88)	(63)
Total gross deferred tax liabilities	(3,214)	(3,180)
Net deferred tax liability	(2,619)	(2,563)
Net current deferred tax asset	162	182
Net long-term deferred tax liability	$ (2,781)	$ (2,745)

Except for amounts for which a valuation allowance has been provided, management believes the other deferred tax assets will be realized. The total valuation allowance increased $6 million in 2001, $3 million in 2000 and $6 million in 1999.

Internal Revenue Service (IRS) Reviews

Consolidated federal income tax returns have been examined and Revenue Agent Reports have been received for all years up to and including 1996. The consolidated federal income tax returns for 1997, 1998 and 1999 are being audited by the IRS. Management believes that adequate provision has been made for any additional taxes and interest thereon that might arise as a result of IRS examinations.

5 Accounts Receivable

Beginning in May 2000, a bankruptcy-remote special purpose subsidiary of NS sold without recourse undivided ownership interests in a pool of accounts receivable totaling approximately $700 million. Upon commencement of this program, NS received cash proceeds of $460 million. The buyers have a priority collection interest in the entire pool of receivables and, as a result, NS has retained credit risk to the extent the pool exceeds the amount sold. NS services and collects the receivables on behalf of the buyers; however, no servicing asset or liability has been recognized because the benefits of servicing are estimated to be just adequate to compensate NS for its responsibilities. Payments collected from sold receivables can be reinvested in new accounts receivable on behalf of the buyers. Should NS' credit rating drop below investment grade, the buyers have the right to discontinue this reinvestment.

At Dec. 31, 2001 and 2000, $300 million and $388 million, respectively, had been sold under this arrangement and, therefore, are not included in "Accounts receivable, net," on the consolidated balance sheet. The fees associated with the sale, which are based on the buyers' financing costs, are included in "Other income – net" (see Note 3). NS' retained interest, which is included in "Accounts receivable, net," is recorded at fair value using estimates of dilution based on NS' historical experience. These estimates are adjusted regularly based on NS' actual experience with the pool, including defaults and credit deterioration. NS has historically experienced very low levels of default. If historical dilution percentages were to increase one percentage point, the value of NS' retained interest would be reduced by approximately $7 million.

NS' allowance for doubtful accounts was $5 million at Dec. 31, 2001, and $7 million at Dec. 31, 2000.

6 Properties

($ in millions)	December 31, 2001	2000	Depreciation Rate for 2001
Railway property:			
Road	**$ 10,452**	$ 10,078	3.0%
Equipment	**5,559**	5,588	4.1%
Other property	**632**	653	3.2%
	16,643	16,319	
Less: Accumulated depreciation	**5,435**	5,214	
Net properties	**$ 11,208**	$ 11,105	

Included in properties are approximately $110 million in telecommunications assets consisting of fiber optic conduit. Because of the significant economic downturn in the telecommunications industry during the year, NS evaluated the recoverability of these assets at Dec. 31, 2001. Based on known facts and circumstances, management believes that its ultimate investment in these assets, which is expected to total approximately $130 million upon completion of the network, will be recovered.

Equipment includes $474 million at Dec. 31, 2001 and 2000, of assets recorded pursuant to capital leases. Other property includes the costs of obtaining rights to natural resources of $341 million at Dec. 31, 2001 and 2000.

Capitalized Interest

Total interest cost incurred on debt in 2001, 2000 and 1999 was $570 million, $569 million and $546 million, respectively, of which $17 million, $18 million and $15 million was capitalized.

7 Current Liabilities

($ in millions)	December 31, 2001	2000
Accounts payable:		
Accounts and wages payable	$ 385	$ 427
Casualty and other claims	192	223
Equipment rents payable – net	130	134
Vacation liability	118	117
Other	23	24
Total	$ 848	$ 925
Other current liabilities:		
Interest payable	$ 118	$ 131
Accrued Conrail-related costs (Note 2)	35	47
Liabilities for forwarded traffic	35	40
Retiree health and death benefit obligation (Note 11)	24	24
Derivative instruments	17	—
Other	19	17
Total	$ 248	$ 259

8 Debt

Long-Term Debt

($ in millions)	December 31, 2001	2000
Notes at average rates and maturities as follows:		
6.69%, maturing 2002 to 2006	$ 1,500	$ 1,450
7.20%, maturing 2007 to 2011	1,750	1,450
8.10%, maturing 2017 to 2021	800	800
7.54%, maturing 2027 to 2031	1,500	800
7.05%, maturing 2037	750	750
7.90%, maturing 2097	350	350
Commercial paper	—	1,132
Equipment obligations at an average rate of 5.9%, maturing to 2014	579	473
Capitalized leases at an average rate of 2.8%, maturing to 2015	316	343
Other debt at an average rate of 6.6%, maturing to 2019	119	119
Discounts and premiums, net	(32)	(31)
Total long-term debt	7,632	7,636
Current maturities	(605)	(297)
Long-term debt less current maturities	$ 7,027	$ 7,339
Long-term debt maturities subsequent to 2002 are as follows:		
2003	$ 357	
2004	348	
2005	401	
2006	305	
2007 and subsequent years	5,616	
Total	$ 7,027	

Each holder of a 2037 note may require NS to redeem all or part of the note at face value, plus accrued and unpaid interest, on May 1, 2004.

The railroad equipment obligations and the capitalized leases are secured by liens on the underlying equipment.

Certain lease obligations require the maintenance of yen-denominated deposits, which are pledged to the lessor to satisfy yen-denominated lease payments. These deposits are included in "Other assets" on the balance sheet and totaled $78 million at Dec. 31, 2001, and $90 million at Dec. 31, 2000.

Shelf Registration

NS filed on Form S-3 a shelf registration statement with the Securities and Exchange Commission covering the issuance of up to $1 billion of securities. As of Dec. 31, 2001, NS had issued $250 million of debt under this shelf registration.

Commercial Paper and Credit Agreement

NS has the ability to issue commercial paper backed by a $1 billion credit agreement that expires in 2006. At Dec. 31, 2001, NS had no commercial paper outstanding. At Dec. 31, 2000, $1,132 million of commercial paper was outstanding and was classified as long-term because NS had the ability, through a previous credit agreement, to convert this obligation into longer-term debt. Any borrowings under the credit agreement are contingent on the continuing effectiveness of the representations and warranties made at the inception of the agreement.

Debt Covenants

NS is subject to various financial covenants with respect to its debt and under its credit agreement, including a minimum net worth requirement, a maximum leverage ratio restriction and certain restrictions on issuance of further debt. At Dec. 31, 2001, NS was in compliance with all debt covenants.

9 Lease Commitments

NS is committed under long-term lease agreements, which expire on various dates through 2067, for equipment, lines of road and other property. The following amounts do not include payments to PRR under the Operating Agreement and lease agreements or to CRC under the SAA agreements (see Note 2). Future minimum lease payments and operating lease expense, other than to PRR and CRC, are as follows:

($ in millions)	Operating Leases	Capital Leases
2002	$ 113	$ 47
2003	97	49
2004	75	48
2005	65	51
2006	52	57
2007 and subsequent years	488	123
Total	$ 890	375
Less imputed interest on capital leases at an average rate of 7.1%		59
Present value of minimum lease payments included in debt		$ 316

Operating Lease Expense

($ in millions)	2001	2000	1999
Minimum rents	$ 149	$ 167	$ 118
Contingent rents	55	61	61
Total	$ 204	$ 228	$ 179

During 2000, NS entered into an operating lease for 140 locomotives, which is renewable annually at NS' option, has a maximum term of eight years and includes purchase options. Because the fixed, noncancellable term of the lease is one year, future minimum lease payments in the table above do not include amounts related to this lease. However, operating lease expense for 2001 in the table above does include $18 million related to this lease. If NS does not purchase the locomotives at the end of the maximum lease term, it is liable for any shortfall in the then fair value of the locomotives and a specified residual value. NS does not expect to be required to make any payments under this provision.

10 Other Liabilities

($ in millions)	December 31, 2001	2000
Retiree health and death benefit obligation (Note 11)	$ 291	$ 291
Casualty and other claims	265	262
Deferred compensation	147	148
Net pension obligations (Note 11)	79	83
Accrued Conrail-related costs (Note 2)	46	72
Other	261	275
Total	$ 1,089	$ 1,131

11 Pensions and Other Postretirement Benefits

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

Early Retirement Programs in 2000

During 2000, NS offered two voluntary early retirement programs to its salaried employees. The principal incentives offered in these programs were enhanced pension benefits, the cost for most of which will be paid from NS' overfunded pension plan. A February program was accepted by 919 of 1,180 eligible employees, and a December program was accepted by 370 of 846 eligible employees. The total cost of these programs, which is included in "Compensation and benefits," was $133 million. The resulting noncash reduction to NS' pension plan asset is included in "Other - net" in the Consolidated Statement of Cash Flows.

($ in millions)	Pension Benefits 2001	Pension Benefits 2000	Other Benefits 2001	Other Benefits 2000
Change in benefit obligations				
Benefit obligation at beginning of year	**$ 1,312**	$ 1,058	**$ 445**	$ 340
Cost of early retirement benefits	**—**	119	**—**	14
Service cost	**15**	18	**14**	15
Interest cost	**94**	79	**33**	27
Amendment	**6**	21	**—**	—
Legislative changes	**(19)**	—	—	—
Actuarial (gains) losses	**36**	120	**21**	79
Benefits paid	**(120)**	(103)	**(34)**	(30)
Benefit obligation at end of year	**1,324**	1,312	**479**	445
Change in plan assets				
Fair value of plan assets at beginning of year	**1,999**	2,072	**126**	152
Actual return on plan assets	**(74)**	30	**(8)**	(5)
Employer contribution	**7**	8	**34**	9
401(h) account transfer	**(14)**	(8)	**—**	—
Benefits paid	**(120)**	(103)	**(34)**	(30)
Fair value of plan assets at end of year	**1,798**	1,999	**118**	126
Funded status	**474**	687	**(361)**	(319)
Unrecognized initial net asset	**—**	(3)	**—**	—
Unrecognized (gain) loss	**(142)**	(478)	**46**	4
Unrecognized prior service cost (benefit)	**30**	47	**—**	—
Net amount recognized	**$ 362**	$ 253	**$ (315)**	$ (315)
Amounts recognized in the Consolidated Balance Sheets consist of:				
Prepaid benefit cost	**$ 426**	$ 315	**$ —**	$ —
Accrued benefit liability	**(79)**	(83)	**(315)**	(315)
Accumulated other comprehensive income	**15**	21	**—**	—
Net amount recognized	**$ 362**	$ 253	**$ (315)**	$ (315)

Of the pension plans included above, the unfunded pension plans were the only plans with an accumulated benefit obligation in excess of plan assets. These plans' accumulated benefit obligations were $79 million at Dec. 31, 2001, and $83 million at Dec. 31, 2000. These plans' projected benefit obligations were $89 million at Dec. 31, 2001 and 2000. Because of the nature of such plans, there are no plan assets.

NS received Section 401(h) account transfers, from pension assets, of $14 million in 2001 and $8 million in 2000 as reimbursement for medical payments for retirees.

Legislative changes primarily resulting from the December 2001 amendment to the Railroad Retirement Act ("The Act") increased benefits payable to certain retirees covered by The Act. Since employees' pension benefits paid by NS are offset by a portion of benefits paid under The Act, the amendment served to reduce NS' obligation by approximately $19 million at Dec. 31, 2001.

During 2001, NS amended its qualified and nonqualified pension plans to enhance benefits to certain NS employees. The amendments increased the pension benefit obligation by $6 million at Dec. 31, 2001.

During 2000, NS amended its qualified pension plan to allow for the payment of qualifying disability benefits. The amendment increased the pension benefit obligation by $21 million at Dec. 31, 2000.

Pension and other postretirement benefit costs are determined based on actuarial valuations that reflect appropriate assumptions as of the measurement date, ordinarily the beginning of each year. The funded status of the plans is determined using appropriate assumptions as of each year end. During 1999, NS received assets from the Conrail pension plan and assumed certain related liabilities. As a result, the measurement dates for determining pension costs were Jan. 1, 1999, and Aug. 31, 1999; the costs reflect discount rates of 6.75% and 7.75%, respectively, and other assumptions appropriate at those dates. A summary of the major assumptions follows:

	2001	2000	1999
Funded status:			
Discount rate	**7.25%**	7.50%	7.75%
Future salary increases	**5%**	5%	5%
Pension cost:			
Discount rate	**7.50%**	7.75%	6.75%
Return on assets in plans	**10%**	10%	10%
Future salary increases	**5%**	5%	5%

Pension and Other Postretirement Benefit Costs Components

($ in millions)	2001	2000	1999
Pension benefits			
Service cost	**$ 15**	$ 18	$ 17
Interest cost	**94**	79	73
Cost of early retirement programs	**—**	119	—
Expected return on plan assets	**(202)**	(192)	(152)
Amortization of prior service cost	**4**	4	4
Amortization of initial net asset	**(3)**	(7)	(7)
Recognized net actuarial (gain) loss	**(24)**	(38)	(22)
Net cost (benefit)	**$ (116)**	$ (17)	$ (87)
Other postretirement benefits			
Service cost	**$ 14**	$ 15	$ 11
Interest cost	**33**	27	23
Cost of early retirement programs	**—**	14	—
Expected return on plan assets	**(13)**	(14)	(12)
Amortization of prior service cost	**—**	—	(12)
Recognized net actuarial (gain) loss	**—**	(4)	(2)
Net cost	**$ 34**	$ 38	$ 8

For measurement purposes, increases in the per capita cost of covered health care benefits were assumed to be 7.0% for 2002 and 6.0% for 2003. It is assumed the rate will decrease gradually to an ultimate rate of 5.0% for 2004 and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported in the financial statements. To illustrate, a one-percentage-point change in the assumed health care cost trend would have the following effects:

	One percentage point	
($ in millions)	Increase	Decrease
Increase (decrease) in:		
Total service and interest cost components	$ 5	$ (4)
Postretirement benefit obligation	$ 42	$ (36)

Under collective bargaining agreements, NS and certain subsidiaries participate in a multi-employer benefit plan, which provides certain postretirement health care and life insurance benefits to eligible union employees. Premiums under this plan are expensed as incurred and amounted to $10 million in 2001, $7 million in 2000 and $5 million in 1999.

401(k) Plans

Norfolk Southern and certain subsidiaries provide 401(k) savings plans for employees. Under the plans, NS matches a portion of employee contributions, subject to applicable limitations. Since 1999, NS has issued shares of Common Stock to fund its contributions. NS' expenses under these plans were $11 million in 2001 and $12 million in both 2000 and 1999.

In November 1999, NS issued and contributed to eligible participants' accounts approximately 2 million shares of Norfolk Southern Common Stock in connection with a temporary special work incentive program available to its unionized employees during much of the third quarter of 1999. The cost of the program, which was charged to compensation and benefits expenses, was $49 million.

12 Stock-Based Compensation

Under the stockholder-approved Long-Term Incentive Plan (LTIP), a committee of nonemployee directors of the Board may grant stock options, stock appreciation rights (SARs), restricted stock and performance share units (PSUs), up to a maximum 88,025,000 shares of Norfolk Southern Common Stock (Common Stock). Under the Board-approved Thoroughbred Stock Option Plan (TSOP), the committee may grant stock options up to a maximum of 6,000,000 shares of Common Stock. Options may be granted for a term not to exceed 10 years, but may not be exercised prior to the first anniversary of the date of grant. Options are exercisable at the fair market value of Common Stock on the date of grant.

The LTIP also permits the payment — on a current or a deferred basis and in cash or in stock — of dividend equivalents on shares of Common Stock covered by options or PSUs in an amount commensurate with dividends paid on Common Stock. Tax absorption payments also are authorized in amounts estimated to equal the federal and state income taxes applicable to shares of Common Stock issued subject to a share retention agreement.

Accounting Method

NS applies APB Opinion 25 and related interpretations in accounting for awards made under the plans. Accordingly, grants of PSUs, restricted stock, dividend equivalents, tax absorption payments and SARs result in charges to net income, while grants of stock options have no effect on net income. Related compensation costs were $20 million in 2001, $5 million in 2000 and $2 million in 1999. NS recognized additional paid-in capital of $1 million in 2001, none in 2000 and $4 million in 1999 related to the tax benefit generated by stock option exercises.

Had such compensation costs been determined in accordance with SFAS 123, net income would have been $358 million in 2001, $149 million in 2000 and $210 million in 1999; and basic and diluted earnings per share would have been $0.93 in 2001, $0.39 in 2000 and $0.55 in 1999. These pro forma amounts include compensation costs as calculated using the Black-Scholes option-pricing model, with average expected option lives of five years for 2001 and 2000 grants and four years for 1999 grants; average risk-free interest rates of 5.1% in 2001, 6.8% in 2000 and 5.2% in 1999; average stock-price volatilities of 39% in 2001, 33% in 2000 and 21% in 1999; and dividend yields of 2% in 2001 and 3% in 2000 and 1999. These assumptions produce per-share grant-date fair values of $5.48 in 2001, $5.22 in 2000 and $5.12 in 1999.

Stock Option Activity

	Option Shares	Weighted Average Exercise Price
Balance 12/31/98	13,059,048	$25.48
Granted	9,150,400	30.09
Exercised	(859,085)	17.10
Canceled	(234,000)	29.84
Balance 12/31/99	21,116,363	27.77
Granted	7,705,800	16.94
Exercised	(273,813)	13.95
Canceled	(427,400)	26.84
Balance 12/31/00	28,120,950	24.96
Granted	6,985,000	15.48
Exercised	(1,079,902)	16.58
Canceled	(612,525)	26.51
Balance 12/31/01	33,413,523	$23.21

Of the total options outstanding at Dec. 31, 2001, 26 million were vested and have a weighted-average exercise price of $25.25.

Stock Options Outstanding

Exercise Price Range			Exercise Price Weighted Average	Number Outstanding at 12/31/01	Weighted Average Remaining Contractual Life
$ 15.48	to	$ 16.94	$ 16.22	14,143,232	8.6 years
18.81	to	21.08	20.56	2,691,350	1.8 years
24.31	to	27.69	26.83	7,821,600	5.7 years
29.46	to	33.25	32.10	8,757,341	6.3 years
$ 15.48	to	$ 33.25	$ 23.21	33,413,523	6.8 years

Performance Share Units

PSUs provide for awards based on achievement of certain predetermined corporate performance goals at the end of a three-year cycle. PSU grants and average grant-date fair market values were 817,500 and $15.48 in 2001; 937,500 and $16.94 in 2000; and 850,000 and $27.72 in 1999, respectively. PSUs may be paid in the form of shares of Common Stock, cash or any combination thereof. Shares earned and issued may be subject to share retention agreements and held by NS for up to five years.

Shares Available and Issued

Shares of stock available for future grants and issued in connection with all features of the LTIP and TSOP are as follows:

	2001	2000	1999
Available for future grants 12/31:			
LTIP	**30,816,365**	2,554,584	10,512,997
TSOP	**2,535,000**	2,488,700	2,349,600
Shares of Common Stock issued:			
LTIP	**1,146,346**	395,626	1,086,288
TSOP	—	—	—

13 Stockholders' Equity

Accumulated Other Comprehensive Loss

"Accumulated other comprehensive loss" reported in the Consolidated Statements of Changes in Stockholders' Equity consisted of the following:

($ in millions)	Balance at Beginning of Year	Net Gain (Loss)	Reclassification Adjustments	Balance at End of Year
December 31, 2001				
Unrealized gains on securities	$ 7	$ (1)	$ —	$ 6
Cash flow hedges	—	(16)	5	(11)
Minimum pension liability	(13)	(37)	—	(50)
Accumulated other comprehensive loss	$ (6)	$ (54)	$ 5	$ (55)
December 31, 2000				
Unrealized gains on securities	$ 2	$ 5	$ —	$ 7
Minimum pension liability	(13)	—	—	(13)
Accumulated other comprehensive loss	$ (11)	$ 5	$ —	$ (6)

"Other comprehensive income (loss)" reported in the Consolidated Statements of Changes in Stockholders' Equity consisted of the following:

($ in millions)	Pretax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Year ended 12/31/01			
Net gain (loss) arising during the year:			
Cash flow hedges	$ (27)	$ 11	$ (16)
Less reclassification adjustments	8	(3)	5
Subtotal	(19)	8	(11)
Unrealized gains (losses) on securities	(1)	—	(1)
Minimum pension liability	(35)	(2)	(37)
Other comprehensive income (loss)	$ (55)	$ 6	$ (49)
Year ended 12/31/00			
Net gain (loss) arising during the year:			
Unrealized gains (losses) on securities	$ 7	$ (2)	$ 5
Other comprehensive income (loss)	$ 7	$ (2)	$ 5
Year ended 12/31/99			
Net gain (loss) arising during the year:			
Unrealized gains (losses) on securities	$ (6)	$ 1	$ (5)
Minimum pension liability	2	—	2
Other comprehensive income (loss)	$ (4)	$ 1	$ (3)

In 2001, Conrail recorded a $70 million loss in other comprehensive income related to an increase in its minimum pension liability. NS' "Other comprehensive loss" for 2001 and its "Accumulated other comprehensive loss" at Dec. 31, 2001, include $41 million arising from this Conrail adjustment.

Undistributed Earnings of Equity Investees

"Retained income" includes undistributed earnings of equity investees, principally attributable to NS' equity in the earnings of Conrail, of $355 million at Dec. 31, 2001; $351 million at Dec. 31, 2000; and $330 million at Dec. 31, 1999.

14 Earnings Per Share

The following table sets forth the calculation of basic and diluted earnings per share:

($ in millions except per share, shares in millions)	2001	2000	1999
Basic earnings per share:			
Income available to common stockholders for basic and diluted computations	$ 375	$ 172	$ 239
Weighted-average shares outstanding	385	383	381
Basic earnings per share	$ 0.97	$ 0.45	$ 0.63
Diluted earnings per share:			
Weighted-average shares outstanding per above	385	383	381
Dilutive effect of outstanding options, PSUs and SARs (as determined by the application of the treasury stock method)	1	—	1
Adjusted weighted-average shares outstanding	386	383	382
Diluted earnings per share	$ 0.97	$ 0.45	$ 0.63

These calculations exclude options the exercise price of which exceeded the average market price of Common Stock as follows: in 2001, 20 million in the fourth quarter, 19 million in each of the third and second quarters, and 28 million in the first quarter; in 2000, 28 million in the fourth, third and first quarters, and 20 million in the second quarter; and in 1999, 17 million in the fourth quarter, 9 million in the third quarter, 7 million in the second quarter and 5 million in the first quarter.

There are no adjustments to "Net income" or "Income from continuing operations" for the diluted earnings per share computations.

15 Fair Values of Financial Instruments

The fair values of "Cash and cash equivalents," "Short-term investments," "Accounts receivable," and "Accounts payable" approximate carrying values because of the short maturity of these financial instruments. The fair value of corporate-owned life insurance approximates carrying value. The carrying amounts and estimated fair values for the remaining financial instruments, excluding derivatives (see Note 16) and investments accounted for under the equity method in accordance with APB Opinion No. 18, consisted of the following at Dec. 31:

	2001		2000	
($ in millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments	$ 44	$ 51	$ 49	$ 56
Notes receivable	93	98	93	93
Long-term debt	(7,632)	(8,067)	(7,636)	(7,809)

Quoted market prices were used to determine the fair value of marketable securities; underlying net assets were used to estimate the fair value of other investments. The fair values of notes receivable are based on future discounted cash flows. The fair values of 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.

Carrying amounts of marketable securities reflect unrealized holding gains of $10 million on Dec. 31, 2001, and $11 million on Dec. 31, 2000. Sales of "available-for-sale" securities were immaterial for years ended Dec. 31, 2001 and 2000.

16 Derivative Financial Instruments

On Jan. 1, 2001, NS adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133), as amended by Statement of Financial Accounting Standards No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" (SFAS 138). The Statements establish accounting and reporting standards for derivative instruments and hedging activities, requiring that all derivatives be recognized in the financial statements as either assets or liabilities and that they be measured at fair value. Changes in fair value are recorded as adjustments to the assets or liabilities being hedged in "Other comprehensive income," or in current earnings, depending on whether the derivative is designated and qualifies for hedge accounting, the type of hedge transaction represented and the effectiveness of the hedge. The adoption of SFAS 133 and SFAS 138 resulted in the recognition of a $5 million asset and a $5 million increase in long-term debt as of Jan. 1, 2001.

NS uses derivative financial instruments to reduce the risk of volatility in its diesel fuel costs and to manage its overall exposure to fluctuations in interest rates. NS does not engage in the trading of derivatives. Management has determined that its derivative financial instruments qualify as either fair-value or cash-flow hedges, having values that highly correlate with the underlying hedged exposures, and has designated such instruments as hedging transactions. Credit risk related to the derivative financial instruments is considered to be minimal and is managed by requiring high credit standards for counterparties and periodic settlements.

Diesel Fuel Hedging

In the second quarter of 2001, NS began a program to hedge a portion of its diesel fuel consumption. The intent of the program is to assist in the management of NS' aggregate risk exposure to fuel price fluctuations, which can significantly affect NS' operating margins and profitability. In order to minimize this risk, NS instituted a continuous hedging strategy for a portion of its estimated future fuel needs by entering into a series of forward purchases and swaps in order to lock in the purchase prices of some of its diesel fuel. Hedges are placed each month by competitive bid among selected counterparties. The goal of this hedging strategy is to average fuel costs over an extended period of time while minimizing the incremental cost of hedging.

The program provides that NS will not enter into any fuel hedges with a duration of more than 36 months, and that no more than 80 percent of NS' average monthly fuel consumption will be hedged for each month within any 36-month period. Diesel fuel costs represented 8%, 9% and 6% of NS' operating expenses for the years ended Dec. 31, 2001, 2000 and 1999, respectively.

NS entered into two types of diesel fuel derivative transactions in 2001. Management has designated these derivative instruments as cash-flow hedges of the exposure to variability in expected future cash flows attributable to fluctuations in diesel fuel prices. In 2001, NS purchased eight monthly call options at a strike price of 84 cents per gallon of Nymex No. 2 heating oil. The cost of the monthly options, which expired serially through Dec. 31, 2001, was amortized as a component of diesel fuel expense. Because the price of diesel fuel did not reach the strike price at any time during the period the options were outstanding, NS did not record any benefit related to these transactions. During 2001, NS entered into 222 fuel swaps for approximately 370 million gallons at an average price of approximately 68 cents per gallon of Nymex No. 2 heating oil. As of Dec. 31, 2001, outstanding swaps covered approximately 32 percent and 21 percent of estimated fuel purchases for the years 2002 and 2003, respectively.

NS' fuel hedging activity resulted in a net increase in 2001 diesel fuel expense of $8 million. Ineffectiveness related to the use of diesel fuel hedges in 2001 was less than $1 million.

Interest Rate Hedging

NS manages its overall exposure to fluctuations in interest rates by issuing both fixed and floating-rate debt instruments, and by entering into interest rate hedging transactions. NS had $251 million, or 3.5%, and $280 million, or 4.3%, of its fixed rate debt portfolio hedged at Dec. 31, 2001 and Dec. 31, 2000, respectively, using interest rate swaps that qualify for and are designated as fair-value hedge transactions. These swaps have been effective in hedging the changes in fair value of the related debt arising from changes in interest rates and, accordingly, there has been no impact on earnings resulting from ineffectiveness associated with these derivative transactions.

Fair Values

The fair values of NS' diesel fuel derivative instruments at Dec. 31, 2001, were determined based upon current fair market values as quoted by third party dealers. Fair values of interest rate swaps were determined based upon the present value of expected future cash flows discounted at the appropriate implied spot rate from the spot rate yield curve. Fair value adjustments are noncash transactions and, accordingly, are excluded from the Consolidated Statement of Cash Flows. At Dec. 31, 2001, "Accumulated other comprehensive loss," a component of "Stockholders' equity," includes $15 million (pretax) relating to the decrease in the fair value of the derivative fuel hedging transactions that will terminate within the next 12 months.

The asset and liability positions of NS' outstanding derivative financial instruments were as follows:

($ in millions)	December 31, 2001	2000
Interest rate hedges:		
Gross fair market asset position	$ 12	$ 5
Gross fair market (liability) position	—	—
Fuel hedges:		
Gross fair market asset position	—	—
Gross fair market (liability) position	(19)	—
Total net asset (liability) position	$ (7)	$ 5

17 Discontinued Operations — Motor Carrier

On March 28, 1998, NS sold all the common stock of North American Van Lines, Inc. (NAVL), its motor carrier subsidiary. Results in 2001 include an additional after-tax gain of $13 million, or 3 cents per share, that resulted from the expiration of certain indemnities contained in the sales agreement.

18 Commitments and Contingencies

Lawsuits

Norfolk Southern and certain subsidiaries are defendants in numerous lawsuits and other claims relating principally to railroad operations. When management concludes that it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, it is accrued through a charge to expenses. An accrual is not made when management's best estimate, based on known facts and circumstances, is that it is unlikely that a loss has been incurred.

Presently, there are two cases involving labor issues and contractual obligations of a fiber optic codeveloper where the aggregated range of loss could be from nothing to $75 million. Management believes that NS will prevail in these cases. The ability to collect a judgment against the codeveloper, Williams Communications, LLC, may be limited due to its declining financial condition; however, the shortfall, if any, cannot now be determined. Unfavorable outcomes on these cases could result in accruals that could be significant to results of operations in a particular year or quarter.

Casualty Claims

NS is generally self-insured for casualty claims. Claims in excess of self-insurance levels are insured up to excess coverage limits. The casualty claims liability is determined actuarially, based upon claims filed and an estimate of claims incurred but not yet reported. While the ultimate amount of claims incurred is dependent on future developments, in management's opinion, the recorded liability is adequate to cover the future payments of claims. However, it is possible that the recorded liability may not be adequate to cover the future payment of claims. Adjustments to the recorded liability will be reflected in operating expenses in the periods in which such adjustments are known.

Environmental Matters

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

NS' balance sheets included liabilities for environmental exposures in the amount of $33 million at Dec. 31, 2001, and $36 million at Dec. 31, 2000 (of which $8 million was accounted for as a current liability in each year). At Dec. 31, 2001, the liability represented NS' estimate of the probable cleanup and remediation costs based on available information at 126 identified locations. On that date, 10 sites accounted for $17 million of the liability, and no individual site was considered to be material. NS anticipates that much of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At some of the 126 locations, certain NS subsidiaries, usually in conjunction with a number of other parties, have been identified as potentially responsible parties by the Environmental Protection Agency (EPA) or similar state authorities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or comparable state statutes, which often impose joint and several liability for cleanup costs.

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

The risk of incurring environmental liability — for acts and omissions, past, present and future — is inherent in the railroad business. Some of the commodities in NS' traffic mix, particularly those classified as hazardous materials, can pose special risks that NS and its subsidiaries work diligently to minimize. In addition, several NS subsidiaries own, or have owned, land used as operating property, or which is leased or may have been leased and operated by others, or held for sale. Because environmental problems may exist on these properties that are latent or undisclosed, there can be no assurance that NS will not incur environmentally related 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 other now-unidentified environmental sites and matters are likely to arise from time to time. The resulting liabilities could have a significant effect on financial condition, results of operations or liquidity in a particular year or quarter.

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

Purchase Commitments

NSR had outstanding purchase commitments of approximately $150 million in connection with its 2002 capital program. NS has forward fuel purchase commitments in the first quarter of 2002 covering 38 million gallons of fuel at an average cost of 62 cents per gallon, which includes federal taxes.

Change-In-Control Arrangements

Norfolk Southern has compensation agreements with officers and certain key employees that become operative only upon a change in control of the Corporation, as defined in those agreements. The agreements provide generally for payments based on compensation at the time of a covered individual's involuntary or other specified termination and for certain other benefits.

Debt Guarantees

As of Dec. 31, 2001, certain Norfolk Southern subsidiaries are contingently liable as guarantors with respect to $8 million of indebtedness of related entities.

Report of Management

January 21, 2002

To the Stockholders
Norfolk Southern Corporation:

Management is responsible for the preparation and content of the financial statements included in this annual report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reflect management's judgments and estimates concerning effects of events and transactions that are accounted for or disclosed. The financial information contained in other sections of this annual report is consistent with that contained in the financial statements.

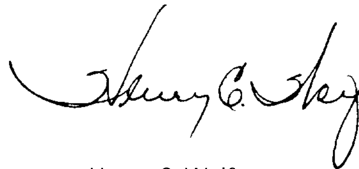
Norfolk Southern Corporation and its subsidiaries maintain accounting systems that are supported by internal accounting controls. These systems and controls provide reasonable assurance that assets are safeguarded and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. The concept of reasonable assurance is based on the recognition that the cost of a system of internal accounting control should not exceed its benefits. A staff of experienced and highly trained internal auditors conducts audit procedures designed to test compliance with internal controls. Results of audit efforts and actions are communicated to appropriate management, including the Chairman, President and Chief Executive Officer, and to the Audit Committee of the Board of Directors.

Norfolk Southern Corporation and its subsidiaries have established their intent to maintain the highest standards of ethical conduct in all their business activities. Internal accounting and operating control policies, as well as a corporate code of conduct, are documented and communicated to all levels of management. Adherence to these policies and procedures and this code is continuously being evaluated by a thorough, coordinated effort of internal audit staff and independent auditors.

The Audit Committee of the Board of Directors is composed solely of independent nonemployee directors. The Committee meets periodically with the Vice President-Internal Audit and the independent auditors to review and discuss audit findings and other accounting and financial matters. Matters reviewed include the annual audit plan and the accounting policies of Norfolk Southern Corporation and its subsidiaries, conflict of interest policy, internal control systems, and financial operations and reporting.

KPMG LLP, a firm of independent public accountants, has been engaged to audit and render an opinion on the consolidated financial statements. As independent auditors, they also provide an objective, outside review of management's report of operating results and financial condition. Working with the internal auditors, they review internal accounting controls and make tests as appropriate of the data included in the financial statements.

David R. Goode
Chairman, President and
Chief Executive Officer



Henry C. Wolf
Vice Chairman and
Chief Financial Officer

John P. Rathbone
Senior Vice President and
Controller

The Stockholders and Board of Directors
Norfolk Southern Corporation:

We have audited the accompanying consolidated balance sheets of Norfolk Southern Corporation and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Norfolk Southern Corporation and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Norfolk, Virginia
January 21, 2002

Board of Directors and Officers

David R. Goode

Gerald L. Baliles

Carroll A. Campbell Jr.

Gene R. Carter

Alston D. Correll

Landon Hilliard

Steven F. Leer

Jane Margaret O'Brien

Harold W. Pote

J. Paul Reason

Board of Directors *as of Feb. 1, 2002*

Gerald L. Baliles, 61, of Richmond, Va., is a partner in the law firm of Hunton & Williams, a business law firm with offices in several major U.S. cities and international offices in Bangkok, Brussels, London, Warsaw and Hong Kong. His Board service began in 1990; his current term expires in 2002.

Carroll A. Campbell Jr., 61, of Georgetown, S.C., is retired president and chief executive officer of the American Council of Life Insurers. His Board service began in 1996; his current term expires in 2003.

Gene R. Carter, 62, of Alexandria, Va., is executive director and chief executive officer of the Association for Supervision and Curriculum Development, among the world's largest international education associations. His Board service began in 1992; his current term expires in 2002.

Alston D. Correll, 60, of Atlanta, Ga., is chairman, chief executive officer and president of Georgia-Pacific Corporation. His Board service began in 2000; his current term expires in 2004.

David R. Goode, 61, of Norfolk, Va., is chairman, president and chief executive officer of Norfolk Southern Corporation. He joined Norfolk and Western Railway in 1965 and was named CEO of Norfolk Southern in 1992. His Board service began in 1992; his current term expires in 2003.

Landon Hilliard, 62, of New York City, is a partner in Brown Brothers Harriman & Co., a private bank in New York City. His Board service began in 1992; his current term expires in 2004.

Steven F. Leer, 49, of St. Louis, is president and chief executive officer of Arch Coal, Inc., the nation's second largest coal producer. His Board service began in 1999; his current term expires in 2002.

Jane Margaret O'Brien, 48, of St. Mary's City, Md., is president of St. Mary's College of Maryland. Her Board service began in 1994; her current term expires in 2004.

Harold W. Pote, 55, of New York City, is regional banking group executive of JPMorganChase & Co. His Board service began in 1988; his current term expires in 2003.

J. Paul Reason, Admiral, USN, retired, 61, of Norfolk, Va., is president and chief operating officer of Metro Machine Corporation, a ship repair company. His Board service began Jan. 22, 2002; his current term expires in 2002.

Officers *as of Feb. 1, 2002*

David R. Goode, chairman, president and chief executive officer
L.I. Prillaman, vice chairman and chief marketing officer
Stephen C. Tobias, vice chairman and chief operating officer
Henry C. Wolf, vice chairman and chief financial officer
Charles W. Moorman, president T-Cubed, Inc.
John F. Corcoran, senior vice president Public Affairs
John W. Fox Jr., senior vice president Coal Services
James A. Hixon, senior vice president Administration
Henry D. Light, senior vice president Law
James W. McClellan, senior vice president Planning
Kathryn B. McQuade, senior vice president Financial Planning
John P. Rathbone, senior vice president and controller
Stephen P. Renken, senior vice president and chief information officer
John M. Samuels, senior vice president Operations Planning and Support
Donald W. Seale, senior vice president Merchandise Marketing
James E. Carter Jr., vice president Internal Audit
Cindy C. Earhart, vice president Information Technology
Robert C. Fort, vice president Public Relations
William A. Galanko, vice president Taxation
Robert E. Huffman, vice president Intermodal Operations
Tony L. Ingram, vice president Transportation Operations
H. Craig Lewis, vice president Corporate Affairs
Mark R. MacMahon, vice president Labor Relations
Bruno Maestri, vice president Public Affairs
Mark D. Manion, vice president Transportation Services and Mechanical
Robert E. Martínez, vice president Marketing Services and International
Michael R. McClellan, vice president Intermodal Marketing
Thomas H. Mullenix Jr., vice president Human Resources
Richard W. Parker, vice president Real Estate
William J. Romig, vice president and treasurer
Daniel D. Smith, president NS Development
Charles J. Wehrmeister, vice president Safety and Environmental
Gary W. Woods, vice president Engineering
Dezora M. Martin, corporate secretary

In Memoriam
Gary Lane

The Norfolk Southern family lost a valued colleague with the death Jan. 17, 2002, of J. Gary Lane, senior vice president law and chief legal officer. Among his many contributions during 23 years of service, Mr. Lane helped guide Norfolk Southern through the Conrail transaction and expansion into the Northeast. We will miss his leadership, wise counsel and friendship.

Stockholder Information

Common Stock

Ticker symbol: NSC
Newspaper listing: NorflkSo

Common stock of Norfolk Southern Corporation is listed and traded on the New York Stock Exchange.

Annual Meeting

May 9, 2002, at 10 a.m. CDT
Bank One
Ten South Dearborn St.
Bank One Auditorium, Plaza Level
Chicago, Ill.

Publications

Upon written request, the Corporation's annual report to the Securities and Exchange Commission on Form 10-K for the fiscal year ended Dec. 31, 2001, and its quarterly reports on Form 10-Q will be furnished free to stockholders. Write to: Public Relations Department, Norfolk Southern Corporation, Three Commercial Place, Norfolk, Va. 23510-9227.

A Notice and Proxy Statement/Annual Meeting of Stockholders are furnished to stockholders in advance of the annual meeting.

A toll-free telephone number — (800) 531-6757 — is available for information.

Dividends

At its January 2002 meeting, the Corporation's Board of Directors declared a quarterly dividend of 6 cents per share on its common stock, payable on March 11, 2002, to stockholders of record on Feb. 1, 2002.

Norfolk Southern Corporation pays quarterly dividends on its common stock, usually on or about March 10, June 10, Sept. 10 and Dec. 10. The Corporation has paid 78 consecutive quarterly dividends since its inception in 1982.

Financial Inquiries

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(757) 629-2650

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Director Investor Relations
Norfolk Southern Corporation
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(757) 629-2861

Corporate Offices

Executive offices

Norfolk Southern Corporation
Three Commercial Place
Norfolk, Va. 23510-9227
(757) 629-2600

Regional offices

110 Franklin Road, SE
Roanoke, Va. 24042

99 Spring St., SW
Atlanta, Ga. 30303

Account Assistance

For assistance with lost stock certificates, transfer requirements and the Dividend Reinvestment Plan, contact:

Registrar and Transfer Agent
The Bank of New York
63 Madison Ave., 8th Floor*
New York, N.Y. 10016
(866) 272-9472
**Temporary address*

For assistance with address changes, dividend checks and direct deposit of dividends, contact:

Assistant Corporate Secretary-
Stockholder Records
Norfolk Southern Corporation
Three Commercial Place
Norfolk, Va. 23510-9219
(800) 531-6757

Dividend Reinvestment Plan

Stockholders whose names appear on their stock certificates (not a street or broker name) are eligible to participate in the Dividend Reinvestment Plan.

The Plan provides a convenient, economical and systematic method of acquiring additional shares of the Corporation's common stock by permitting eligible stockholders of record to reinvest dividends.

The Plan's administrator is The Bank of New York. For additional information, dial (866) 272-9472.

Annual Report Requests

(800) 531-6757

World Wide Web Address

www.nscorp.com

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