STB FD 33388 6-23-97 A 180274V7F 10/13

Consolidated Statements of Cash Flows
Norfolk Southern Corporation and Subsidiaries

	1996	1995	1994
	Years ended December 31, ($ in millions)		
Cash flows from operating activities:			
Net income	**$ 770.4**	$ 712.7	$ 667.8
Reconciliation of net income to net cash provided by operating activities:			
Special charge payments	**(18.0)**	(29.3)	(41.9)
Depreciation	**429.2**	413.5	403.8
Deferred income taxes	**97.1**	66.7	112.7
Nonoperating gains and losses on properties and investments	**(56.8)**	(71.8)	(17.0)
Changes in assets and liabilities affecting operations:			
Accounts receivable	**(0.8)**	28.1	(12.9)
Materials and supplies	**(1.3)**	0.2	8.4
Other current assets	**(9.1)**	1.4	(17.8)
Current liabilities other than debt	**(5.5)**	84.2	55.5
Other — net	**(0.5)**	31.7	(14.3)
Net cash provided by operating activities	**1,204.7**	1,237.4	1,144.3
Cash flows from investing activities:			
Property additions	**(688.2)**	(658.9)	(712.9)
Property sales and other transactions	**131.1**	129.5	86.1
Investments	**(82.0)**	(67.1)	(58.7)
Investment sales and other transactions	**37.8**	36.9	272.0
Short-term investments — net	**65.6**	(8.3)	(74.4)
Net cash used for investing activities	**(535.7)**	(567.9)	(487.9)
Cash flows from financing activities:			
Dividends	**(283.7)**	(273.5)	(262.7)
Common stock issued — net	**28.6**	19.1	9.8
Purchase and retirement of common stock	**(389.4)**	(338.2)	(344.8)
Proceeds from long-term borrowings	**209.6**	7.6	41.4
Debt repayments	**(92.6)**	(73.8)	(123.6)
Net cash used for financing activities	**(527.5)**	(658.8)	(679.9)
Net increase (decrease) in cash and cash equivalents	**141.5**	10.7	(23.5)
Cash and cash equivalents:			
At beginning of year	**67.7**	57.0	80.5
At end of year	**$ 209.2**	$ 67.7	$ 57.0
Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Interest (net of amounts capitalized)	**$ 127.5**	$ 119.4	$ 114.3
Income taxes	**$ 324.1**	$ 282.9	$ 226.4

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Stockholders' Equity
Norfolk Southern Corporation and Subsidiaries

	Common Stock	Other Capital	Retained Income	Treasury Stock	Total
			($ in millions)		
Balance December 31, 1993	**$ 145.7**	**$ 417.1**	**$4,078.5**	**$ (20.6)**	**$4,620.7**
Net income — 1994			667.8		667.8
Dividends on common stock $1.92 per share			(262.7)		(262.7)
Purchase and retirement of common stock	(5.5)	(16.3)	(327.8)		(349.6)
Other	0.2	9.6	(1.2)		8.6
Balance December 31, 1994	**140.4**	**410.4**	**4,154.6**	**(20.6)**	**4,684.8**
Net income — 1995			712.7		712.7
Dividends on common stock $2.08 per share			(273.5)		(273.5)
Purchase and retirement of common stock	(4.8)	(14.3)	(314.8)		(333.9)
Other	0.7	34.8	3.4		38.9
Balance December 31, 1995	**136.3**	**430.9**	**4,282.4**	**(20.6)**	**4,829.0**
Net income — 1996			770.4		770.4
Dividends on common stock $2.24 per share			(283.7)		(283.7)
Purchase and retirement of common stock	(4.6)	(14.8)	(365.7)		(385.1)
Other	0.7	46.0	0.3		47.0
Balance December 31, 1996	**$ 132.4**	**$ 462.1**	**$4,403.7**	**$ (20.6)**	**$4,977.6**

See accompanying notes to consolidated financial statements.

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, primarily in the Southeast and Midwest, and the operation of a motor carrier providing household moving and specialized freight handling services in the United States and Canada. The consolidated financial statements include Norfolk Southern Corporation (Norfolk Southern) and its majority-owned and controlled subsidiaries (collectively NS). The major subsidiaries are Norfolk Southern Railway Company and North American Van Lines, Inc. (NAVL). All significant intercompany balances and transactions have been eliminated in consolidation.

Rail freight consists of raw materials, intermediate products and finished goods classified in the following market groups: coal, paper/forest, chemicals, automotive, agriculture, metals/construction and intermodal. All groups are approximately equal in size based on revenues except for coal, which accounts for almost one third of total railway operating revenues. Ultimate destinations for some of the freight and a portion of the coal shipped are outside the United States.

Use of Estimates

The preparation of financial statements in conformity 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. Actual results could differ from those 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 held-to-maturity, trading or available-for-sale securities. At December 31, 1996 and 1995, all "Short-term investments," consisting primarily of United States government and federal agency securities, were designated as available for sale. Accordingly, unrealized gains and losses, net of taxes, are recognized in "Stockholders' equity."

Materials and Supplies

"Materials and supplies," consisting mainly of fuel oil and items for maintenance of property and equipment, are stated at average cost. 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 primarily depreciated on the basis of use measured by gross ton miles. The effect of this method is to depreciate these assets over 42 years on average. Other properties are depreciated generally using the straight line method over estimated service lives at annual rates that range from 1% to 25%. In 1996, the overall depreciation rate averaged 2.8% for roadway and 4.1% for equipment. NS capitalizes interest on major capital projects during the period of their construction. Maintenance expense is recognized when repairs are performed. When properties, other than land and non-rail 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 non-rail assets are included in other income (see Note 2).

Revenue Recognition

Revenue is recognized proportionally as a shipment moves from origin to destination.

Earnings Per Share

The number reported as "Earnings per share" in any period is computed by dividing net income by the weighted average number of common shares outstanding during that period. Decreases in the number of shares outstanding are the result of stock purchase programs as described in Note 13.

Required Accounting Changes

1996 – Effective January 1, 1996, NS adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" (SFAS 121). SFAS 121 establishes the accounting and reporting requirements for recognizing and measuring impairment of long-lived assets either to be held and used or to be held for disposal. SFAS 121 did not have a material effect on NS' financial statements.

In October 1995, the FASB issued Statement No. 123, "Accounting for Stock-Based Compensation" (SFAS 123). This standard, effective for fiscal years beginning after December 15, 1995, defines a fair-value-based method of accounting for stock-based compensation plans. However, the standard also allows measurement of compensation cost using the intrinsic-value-based method of accounting prescribed in Accounting Principles Board Opinion No. 25 (APB 25). Companies that choose to retain APB 25 for measurement purposes are required to provide certain additional footnote disclosures. NS has elected to continue recording stock-based compensation costs based on APB 25 and to provide additional disclosures.

2 Other Income — Net

($ in millions)	1996	1995	1994
Interest income	$ 22.5	$ 27.9	$ 25.5
Royalties from coal	58.8	58.6	61.0
Gains from sale of properties and investments	56.8	41.3	17.0
Gain from partial redemption of partnership interest	—	30.5	—
Rental income	20.1	20.8	19.6
Corporate-owned life insurance — net	5.6	7.1	7.7
Other interest expense	(31.1)	(23.5)	(19.7)
Non-rail depletion and depreciation	(11.0)	(10.2)	(11.6)
Taxes on nonoperating property	(8.4)	(6.9)	(8.2)
Other — net	2.3	(3.8)	(6.1)
Total	$115.6	$141.8	$ 85.2

3 Income Taxes

Provision for Income Taxes ($ in millions)	1996	1995	1994
Current:			
Federal	$ 287.8	$282.6	$226.4
State	41.6	52.7	42.1
Total current taxes	329.4	335.3	268.5
Deferred:			
Federal	79.2	57.8	99.0
State	17.9	8.9	13.7
Total deferred taxes	97.1	66.7	112.7
Provision for income taxes	$ 426.5	$402.0	$381.2

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:

	1996		1995		1994	
($ in millions)	Amount	%	Amount	%	Amount	%
Federal income tax at statutory rate	$418.9	35.0	$390.1	35.0	$367.2	35.0
State income taxes, net of federal tax benefit	38.6	3.2	40.0	3.6	36.1	3.4
Corporate-owned life insurance	(15.4)	(1.3)	(17.0)	(1.5)	(10.5)	(1.0)
Other — net	(15.6)	(1.3)	(11.1)	(1.0)	(11.6)	(1.1)
Provision for income taxes	$426.5	35.6	$402.0	36.1	$381.2	36.3

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 1992. The consolidated federal income tax returns for 1993 and 1994 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 these examinations.

Tax Benefit Leases

In January 1995, the United States Tax Court issued a preliminary decision that would disallow some of the tax benefits a subsidiary of NS purchased from a third party pursuant to a safe harbor lease agreement in 1981. Management continues to believe that NS ultimately should incur no loss from this decision, because the lease agreement provides for full indemnification if any such disallowance is sustained.

3 INCOME TAXES (CONTINUED)

DEFERRED TAX ASSETS AND LIABILITIES

Certain items are reported in different periods for financial reporting and income tax purposes. Deferred tax assets and liabilities were 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 were as follows:

($ in millions)	December 31, 1996	1995
Deferred tax assets:		
Reserves, including casualty and other claims	$ 172.0	$ 189.3
Employee benefits	187.5	196.1
Retiree health and death benefit obligation	147.4	148.3
Taxes, including state and property	179.7	170.3
Other	79.8	59.1
Total gross deferred tax assets	766.4	763.1
Less valuation allowance	(2.1)	(1.5)
Net deferred tax assets	764.3	761.6
Deferred tax liabilities:		
Property	(2,902.9)	(2,821.5)
Other	(114.1)	(94.4)
Total gross deferred tax liabilities	(3,017.0)	(2,915.9)
Net deferred tax liability	(2,252.7)	(2,154.3)
Net current deferred tax assets	158.9	144.7
Net long-term deferred tax liability	$ (2,411.6)	$ (2,299.0)

Except for amounts for which a valuation allowance is provided, Management believes the deferred tax assets will be realized. The net change in the total valuation allowance was a $0.6 million increase for 1996, a $0.1 million increase for 1995 and a $9.5 million decrease for 1994.

4 INVESTMENTS

($ in millions)	December 31, 1996	1995
Corporate-owned life insurance at net cash surrender value	$ 211.5	$ 175.2
Marketable equity securities	6.4	5.2
Other	56.8	51.3
Total	$ 274.7	$ 231.7

5 PROPERTIES

($ in millions)	December 31, 1996	1995
Transportation property:		
Road	$ 8,488.7	$ 8,235.7
Equipment	4,848.0	4,775.7
Other property	591.2	573.7
	13,927.9	13,585.1
Less: Accumulated depreciation	4,398.8	4,326.3
Net properties	$ 9,529.1	$ 9,258.8

CAPITALIZED INTEREST

Total interest cost incurred on debt in 1996, 1995 and 1994 was $127.6 million, $127.4 million and $119.4 million, respectively, of which $11.9 million, $14.0 million and $17.8 million was capitalized.

6 DEBT

COMMERCIAL PAPER PROGRAM

NS' commercial paper debt totaled $516.1 million and $518.0 million as of December 31, 1996 and 1995, respectively.

Commercial paper debt is due within one year, but $500 million has been classified as long-term because NS has the ability through a revolving credit back-up facility to convert this obligation into longer term debt. NS intends to refinance the commercial paper either by issuing additional commercial paper or by replacing commercial paper notes with long-term debt.

The credit facility provides for interest on borrowings at prevailing rates and contains customary financial covenants, including an initial minimum net worth requirement of $4.0 billion.

In connection with the tender offer to purchase up to 8.2 million shares of Conrail stock, NS has arranged for additional commercial paper debt (see Note 15).

SHORT-TERM DEBT

($ in millions)	December 31, 1996	1995
Commercial paper notes	$ 16.1	$ 18.0
Other notes	27.2	27.2
Subsidiaries' credit lines	0.7	—
Total	$ 44.0	$ 45.2

Shelf Registration

In 1991, NS filed with the Securities and Exchange Commission a shelf registration statement on Form S-3 covering the issuance of up to $750 million principal amount of unsecured debt securities. Through the end of 1996, $700 million principal amount of debt has been issued and sold under this shelf registration. These notes are not redeemable prior to maturity and are not entitled to any sinking fund.

($ in millions)	December 31, 1996	1995
9% notes issued March 1991, due March 1, 2021	$ 250	$ 250
7.875% notes issued February 1992, due February 15, 2004	250	250
7.4% notes issued September 1996, due September 15, 2006	100	—
7.22% notes issued September 1996, due September 15, 2006	100	—
Total	$ 700	$ 500

Capital Lease Obligations

During 1996 and 1995, an NS rail subsidiary entered into capital leases covering new locomotives. The related capital lease obligations totaling $107.8 million in 1996 and $104.5 million in 1995 were reflected in the Consolidated Balance Sheets as debt and, because they were non-cash transactions, were excluded from the Consolidated Statements of Cash Flows. The lease obligations carry an average stated interest rate of 6.5% for those entered into in 1996 and 8.4% for those entered into in 1995. All were converted to variable rate obligations using interest rate swap agreements. The interest rates on these obligations are based on the six-month London Interbank Offered Rate and are reset every six months with changes in interest rates accounted for as an adjustment of interest expense over the terms of the leases. As a result, NS is exposed to the market risk associated with fluctuations in interest rates. To date, while such rate fluctuations have been nominal, their effects have been favorable. Counterparties to the interest rate swap agreements are major financial institutions believed by Management to be credit-worthy. NS' use of interest rate swaps has been limited to those discussed above.

Long-Term Debt

($ in millions)	December 31, 1996	1995
Railroad equipment obligations at an average rate of 7.9% maturing to 2009	$ 396.4	$ 444.6
Notes at an average rate of 8.1% maturing to 2021	700.0	500.0
Commercial paper classified as long-term debt at an average rate of 5.4%	500.0	500.0
Capitalized leases at an average rate of 5.9% maturing to 2015	197.0	100.9
Other debt at an average rate of 8.7% maturing to 2015	62.9	93.5
Total long-term debt	1,856.3	1,639.0
Less: Current maturities	56.0	85.7
Long-term debt less current maturities	$ 1,800.3	$ 1,553.3
Long-term debt matures as follows:		
1998	$ 114.6	
1999	127.2	
2000	57.7	
2001	51.8	
2002 and subsequent years	1,449.0	
Total	$ 1,800.3	

A substantial portion of NS' properties and certain investments in affiliated companies are pledged as collateral for much of the secured debt.

7 Current Liabilities

($ in millions)	December 31, 1996	1995
Accounts payable:		
Accounts and wages payable	$ 349.6	$ 385.2
Casualty and other claims	199.6	197.4
Vacation liability	76.8	74.4
Equipment rents payable — net	60.9	62.0
Other	22.0	13.8
Total	$ 708.9	$ 732.8
Other current liabilities:		
Prepaid amounts on forwarded traffic	$ 62.7	$ 69.7
Accrued acquisition costs (Note 15)	60.7	—
Interest payable	38.9	42.8
Retiree health and death benefit obligation (Note 11)	23.7	25.3
Other	16.7	13.5
Total	$ 202.7	$ 151.3

Notes to Consolidated Financial Statements

8 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. Future minimum lease payments are as follows:

($ in millions)	Operating Leases	Capital Leases
1997	$ 64.4	$ 28.6
1998	56.3	28.6
1999	42.1	28.6
2000	35.9	28.5
2001	33.7	28.0
2002 and subsequent years	643.2	143.1
Total	$ 875.6	285.4
Less imputed interest on capital leases at an average rate of 7.4%		88.4
Present value of minimum lease payments included in debt		$ 197.0

Operating Lease Expense

($ in millions)	1996	1995	1994
Minimum rents	**$ 77.4**	$ 67.8	$ 56.1
Contingent rents	**38.3**	36.0	45.4
Total	**$ 115.7**	$103.8	$101.5

9 Other Liabilities

	December 31,	
($ in millions)	1996	1995
Casualty and other claims	**$ 274.2**	$ 286.5
Net pension obligation (Note 10)	**89.2**	102.2
Retiree health and death benefit obligation (Note 11)	**306.6**	307.4
Other	**317.1**	269.4
Total	**$ 987.1**	$ 965.5

10 Pension Plans

Norfolk Southern and certain subsidiaries have defined benefit pension plans that principally cover salaried employees. Pension benefits are based primarily on years of creditable service with NS and compensation rates near retirement. Contributions to the plans are made on the basis of not less than the minimum funding standards set forth in the Employee Retirement Income Security Act of 1974, as amended. Assets in the plans consist mainly of common stocks.

Pension Cost (Benefit) Components

($ in millions)	1996	1995	1994
Service cost-benefits earned during the year	**$ 14.5**	$ 11.5	$ 12.5
Interest cost on projected benefit obligation	**69.6**	68.0	62.6
Actual return on assets in plans	**(174.9)**	(263.4)	(17.0)
Net amortization and deferral	**85.4**	177.0	(62.8)
Net pension benefit	**(5.4)**	(6.9)	(4.7)
Cost of early retirement benefits	**—**	23.4	—
Total	**$ (5.4)**	$ 16.5	$ (4.7)

Pension cost is determined based on an actuarial valuation that reflects appropriate assumptions as of the beginning of each year. The funded status of the plans is determined using appropriate assumptions as of each year end. A summary of the major assumptions follows:

	1996	1995	1994
Discount rate for determining funded status	**7.75%**	7.25%	8.50%
Future salary increases	**5.25%**	6%	6%
Return on assets in plans	**9%**	9%	9%

The funded status of the plans and the amounts reflected in the accompanying balance sheets were as follows:

	December 31,			
	1996		1995	
($ in millions)	Funded Plans	Unfunded Plans	Funded Plans	Unfunded Plans
Actuarial present value of benefit obligations:				
Vested benefits	**$ 784.3**	**$ 58.9**	$ 812.5	$ 51.7
Non-vested benefits	**8.1**	**—**	6.6	0.3
Accumulated benefit obligation	**792.4**	**58.9**	819.1	52.0
Effect of expected future salary increases	**68.9**	**5.6**	115.3	11.5
Projected benefit obligation	**861.3**	**64.5**	934.4	63.5
Fair value of assets in plans	**1,191.0**	**—**	1,088.8	—
Funded status	**329.7**	**(64.5)**	154.4	(63.5)
Unrecognized initial net asset	**(29.4)**	**—**	(35.9)	—
Unrecognized (gain) loss	**(336.9)**	**21.0**	(169.2)	21.5
Unrecognized prior service cost	**(11.8)**	**2.7**	(12.8)	3.3
Net pension liability included in the balance sheets	**$ (48.4)**	**$ (40.8)**	$ (63.5)	$ (38.7)

Early Retirement Program in 1995

During 1995, NS completed a voluntary early retirement program for certain salaried employees. The principal benefit for those who participated in this program was enhanced pension benefits, which are reflected in the accumulated benefit obligation. The charge for the 272 employees who accepted the offer is included in "Compensation and benefits" expense and totaled $33.6 million (including $8.3 million related to postretirement benefits other than pensions).

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. NS' expenses under these plans were $8.1 million, $7.0 million and $5.1 million in 1996, 1995 and 1994, respectively.

11 Postretirement Benefits Other Than Pensions

Norfolk Southern and certain subsidiaries 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, co-payments, Medicare payments and, in some cases, coverage provided by other group insurance policies. The cost of such health care coverage to a retiree may be determined, in part, by the retiree's years of creditable service with NS prior to retirement. Death benefits are determined based on various factors, including, in some cases, salary at time of retirement.

NS continues to fund benefit costs principally on a pay-as-you-go basis. However, in 1991, NS established a Voluntary Employee Beneficiary Association (VEBA) account to fund a portion of the cost of future health care benefits for retirees. NS last made a corporate contribution of $10 million in 1994 to the VEBA.

Effective January 1, 1994, NS amended the attribution period for postretirement health care benefits. The amendment generally provides for benefits to be determined ratably over a 10-year period based on creditable service commencing at age 45, or from date of hire if employment began after age 45. The amendment reduced the accumulated postretirement health care benefit obligation by $90 million, which will be amortized as a reduction in annual cost on a pro rata basis over a six-year period.

A summary of the postretirement benefit cost follows:

($ in millions)	**1996**	1995	1994
Service cost-benefits attributable to service during the year	**$ 11.1**	$ 10.2	$ 14.5
Interest cost on accumulated postretirement benefit obligation	**25.1**	28.6	25.0
Actual return on plan assets	**(13.7)**	(17.6)	—
Net amortization and deferral	**(5.2)**	0.9	(14.6)
Net postretirement benefit cost	**$ 17.3**	$ 22.1	$ 24.9
Cost of early retirement benefits	**—**	8.3	—
Total	**$ 17.3**	$ 30.4	$ 24.9

The following table sets forth these plans' total accumulated postretirement benefit obligation, reconciled with the accrued postretirement benefit obligation:

	December 31,			
	1996		1995	
($ in millions)	**Health Care Benefits**	**Death Benefits**	Health Care Benefits	Death Benefits
Accumulated postretirement benefit obligation:				
Retirees	**$ 170.2**	**$ 83.1**	$ 225.6	$ 83.8
Fully eligible active plan participants	**23.0**	**7.2**	23.9	8.0
Other active plan participants	**46.4**	**12.1**	52.7	12.8
Total	**239.6**	**102.4**	302.2	104.6
Plan assets at fair value	**85.8**	**—**	72.1	—
Funded status	**(153.8)**	**(102.4)**	(230.1)	(104.6)
Unrecognized loss (gain)	**(23.7)**	**(2.6)**	59.4	4.1
Unrecognized prior service cost (benefit)	**(47.7)**	**(0.1)**	(61.5)	—
Accrued postretirement benefit obligation	**$(225.2)**	**$(105.1)**	$(232.2)	$(100.5)

For measurement purposes, a 10.4% increase in the per capita cost of covered health care benefits was assumed for 1997. The rate was assumed to decrease gradually to an ultimate rate of 5.5% and remain at that level for 2005 and thereafter. The health care cost trend rate has a significant effect on the amounts reported in the financial statements. To illustrate, increasing the assumed trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1996, by about $27 million and the aggregate of the service and interest cost

11 Postretirement Benefits Other Than Pensions (continued)

components of net postretirement benefit cost for the year 1996 by about $4 million.

The weighted-average discount rate used in determining the accumulated postretirement benefit obligation, the salary increase assumption and the long-term rate of return on plan assets are the same as those used for the pension plans (see table of rate assumptions in Note 10).

The VEBA trust holding the plan assets is not expected to be subject to federal income taxes, as the assets are invested entirely in trust-owned life insurance.

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 $3.6 million, $3.7 million and $4.8 million in 1996, 1995 and 1994, respectively.

12 Long-Term Incentive Plan

Under the stockholder-approved Long-Term Incentive Plan, a committee of non-employee directors of the Board may grant stock options, stock appreciation rights (SARs) and performance share units (PSUs), up to a maximum 17,675,000 shares of Norfolk Southern 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 Norfolk Southern Common Stock on the date of grant.

The plan 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 granted after December 31, 1989, in an amount commensurate with dividends paid on common stock. Tax absorption payments, in an amount estimated to equal the federal and state income taxes applicable to shares of common stock issued subject to a share retention agreement, also are authorized.

Plan participants surrendered, without cash or other consideration, all outstanding SARs granted after 1988 because of regulations issued by the Securities and Exchange Commission in 1991. Future grants of SARs are not anticipated at this time. SARs outstanding as of each year end were: 32,648 in 1996; 46,562 in 1995; and 74,519 in 1994.

Accounting Method

NS applies APB Opinion 25 and related interpretations in accounting for awards made under the plan. Accordingly, SARs, PSUs, tax absorption and dividend equivalents result in charges to earnings, while stock options have no effect on earnings. Compensation costs were $35.4 million, $42.9 million and $14.3 million for 1996, 1995 and 1994, respectively. Had compensation cost been determined based on SFAS 123 using the Black-Scholes option-pricing model, net income would have been reduced no more than $10 million in each year.

Based on current and anticipated use of stock-based compensation, it is not envisioned that the effect of SFAS 123's accounting provisions would be material in any future period.

Stock Option Activity

	Option Shares	Weighted Average Exercise Price
Balance 12/31/93	2,895,407	$ 47.44
Granted	703,750	72.94
Exercised	(93,383)	35.37
Surrendered for SAR	(7,472)	26.63
Cancelled	—	—
Balance 12/31/94	3,498,302	52.94
Granted	718,250	62.50
Exercised	(656,743)	43.82
Surrendered for SAR	(13,440)	23.94
Cancelled	(3,750)	69.46
Balance 12/31/95	3,542,619	56.66
Granted	685,000	78.06
Exercised	(549,581)	53.87
Surrendered for SAR	(5,000)	22.25
Cancelled	(46,859)	58.85
Balance 12/31/96	3,626,179	$ 61.15

Except for those granted during the year, all outstanding options were exercisable at December 31. The difference between the weighted average exercise prices for all outstanding options and those exercisable at December 31 was not significant.

Stock Options Outstanding

Exercise Price				Number	Weighted Average
Range			Weighted Average	Outstanding at 12/31/96	Remaining Contractual Life
$22.25			$22.25	56,620	0.9 years
33.06	to	42.75	38.84	747,359	3.3 years
56.44	to	72.94	64.63	2,149,200	6.8 years
78.06			78.06	673,000	9.1 years
$22.25	to	$78.06	$61.15	3,626,179	6.4 years

PERFORMANCE SHARE UNITS

PSUs were added to the Long-Term Incentive Plan as approved in 1989 and amended in 1995. PSUs entitle participants to earn shares of common stock at the end of a three-year performance cycle based upon achievement of certain predetermined corporate performance goals. PSU grants and grant-date fair values were 200,400 and $78.06 in 1996; 252,500 and $62.50 in 1995; and 163,000 and $72.94 in 1994, respectively. 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 or issued in connection with all features of the Long-Term Incentive Plan were as follows:

	1996	1995	1994
Available for future grants 12/31	**6,325,584**	7,143,126	2,060,796
Shares of common stock issued	**690,872**	807,760	190,060

13 STOCK PURCHASE PROGRAMS

Since 1987, the Board of Directors has authorized the purchase and retirement of up to 95 million shares of common stock. Purchases under the programs have been made with internally generated cash, and with proceeds from the sale of commercial paper notes and from the issuance of long-term debt.

Since the first purchases in December 1987 and through October 22, 1996, NS had purchased and retired 68,545,000 shares of its common stock under these programs at a cost of $3.2 billion.

On October 23, 1996, NS announced that the stock purchase program had been suspended (see also Note 15). Future purchase decisions are dependent on the outcome of the proposed Conrail acquisition, the economy, cash needs and alternative investment opportunities.

14 FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair values of "Cash and cash equivalents," "Short-term investments," "Accounts receivable," "Short-term debt" and "Accounts payable" approximate carrying values because of the short maturity of these financial instruments.

The fair value of long-term "Investments" approximated $353 million and $297 million at December 31, 1996 and 1995, respectively (see Note 4 for carrying values of "Investments"). The fair value of corporate-owned life insurance approximates carrying value. Quoted market prices were used to determine the fair value of marketable equity securities which are recorded at fair value. Marketable securities reflect $3.4 million and $3.5 million of unrealized holding gains at December 31, 1996 and 1995, respectively. Underlying net assets were used to estimate the fair value of other investments; however, if any such investment was sold after the end of the year, its sale price determined its fair value for these purposes.

The fair value of "Long-term debt," including current maturities, approximated $1.95 billion at December 31, 1996, and $1.77 billion at December 31, 1995. 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 (see Note 6 for carrying values of "Long-term debt"). The fair value of interest rate swaps is immaterial.

15 COMMITMENTS AND CONTINGENCIES

PROPOSED ACQUISITION OF CONRAIL

On October 23, 1996, NS announced its intention to commence an all-cash tender offer for all shares of Conrail Inc. (Conrail), a Pennsylvania corporation. On October 24, 1996, Atlantic Acquisition Corporation, a Pennsylvania corporation and a wholly owned subsidiary of NS, offered to purchase all outstanding shares of Conrail's common stock and Series A ESOP Convertible Junior Preferred Stock (collectively, the Shares), including, in each case, the associated Common Stock Purchase Rights, at a price of $100 per Share—approximately $9.1 billion in the aggregate. Shares tendered in the offer or acquired in any subsequent merger would be held in a voting trust pending regulatory approval by the STB. The offer followed the October 15 announcement that Conrail had entered into a merger agreement with CSX Corporation (CSX), whereby Conrail stockholders would receive $92.50 in cash per Share for up to 40 percent of their Shares and receive CSX common stock for the balance of their Shares. On November 6, 1996, CSX and Conrail

15 COMMITMENTS AND CONTINGENCIES (CONTINUED)

announced that CSX had raised the cash portion of its offer to $110 per Share and left unchanged the ratio pursuant to which certain Conrail stockholders would receive shares of CSX common stock. On November 8, 1996, NS announced that it had increased its all-cash offer to $110 per Share—approximately $10.0 billion in the aggregate. On December 19, 1996, CSX and Conrail announced that CSX was adding preferred stock (convertible into CSX common stock) to its offer—a feature said to be worth $16 per Share. On December 20, NS increased its all-cash offer to $115 per Share—approximately $11 billion in the aggregate—and on January 13, 1997, NS announced that it would offer to purchase up to 8.2 million Shares (approximately 9.9%), the approximate maximum number of Shares NS can buy without triggering Conrail's current anti-takeover defenses, for $115 per Share, if Conrail stockholders disapproved at a special meeting certain management recommendations designed to facilitate the merger with CSX.

At that special meeting on January 17, 1997, Conrail stockholders did disapprove those recommendations. Accordingly, on January 22, 1997, NS amended its pending all-cash tender offer by reducing the number of Shares sought to 8.2 million; on February 11, 1997, it acquired 8.2 million Shares for a total of $943 million, pursuant to that amended offer. These Shares have been placed in a voting trust and under certain circumstances might have to be sold at a loss. The Conrail board repeatedly has affirmed its commitment to a merger with CSX.

On February 12, 1997, NS commenced a second tender offer for the remaining Conrail Shares. NS' second tender offer is conditioned upon, among other things, the valid tender of at least Shares sufficient, with those already owned by NS, to constitute at least a majority of the Shares on a fully diluted basis, Subchapter 25F of Pennsylvania's Business Corporation Law not being applicable to the offer, Conrail's Rights Agreement (or poison pill) having been redeemed or otherwise made inapplicable to NS' tender offer, the merger agreement between CSX and Conrail having been terminated in accordance with its terms or otherwise, and other conditions. NS has received a favorable opinion from the STB regarding the use of a voting trust and has obtained sufficient financing commitments (see below).

The STB has proposed a schedule for handling Conrail control applications which could result in an STB decision in late 1997 or early 1998. If the STB does not approve NS' application or if NS deems any conditions imposed by the STB too onerous, NS would have the right and obligation to sell all Conrail Shares held in the voting trust. Such a disposition could result in a significant loss.

Through December 31, 1996, NS had incurred $76 million of costs associated with the proposed acquisition. These costs, most of which are debt commitment fees, are reflected in the Consolidated Balance Sheet in "Other assets" and, for the portion accrued, in "Other current liabilities" (see Note 7).

DEBT COMMITMENTS

In connection with the proposed acquisition of Conrail, NS has secured debt commitments sufficient for the tender offer and subsequent merger. The commitments expire on August 1, 1997, except for a portion of a revolving credit facility expiring on August 1, 1998. The total commitment fees will approximate $200 million if the entire facility is used. At December 31, 1996, $57 million of commitment fees had been incurred.

In connection with the purchase of the 8.2 million Shares, NS arranged for additional commercial paper debt in an aggregate amount not to exceed $1.0 billion. All or part of this amount could be refinanced either by issuing additional commercial paper or through drawing on the debt commitment that has been arranged in connection with the all-cash $115 per share tender offer for all Shares.

LAWSUITS

Norfolk Southern and certain subsidiaries are defendants in numerous lawsuits relating principally to railroad operations. While the final outcome of these lawsuits cannot be predicted with certainty, it is the opinion of Management, after consulting with its legal counsel, that the amount of NS' ultimate liability will not materially affect NS' consolidated financial position.

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 can be reasonably estimated. Claims, if any, against third parties for recovery of clean-up costs incurred by NS are reflected as receivables in the balance sheet and are not netted against the associated NS liability. Environmental engineers participate in ongoing evaluations of all identified sites, and—after consulting with counsel—any necessary adjustments to initial liability estimates are made. NS also has established an Environmental Policy Council, composed of senior managers, to oversee and interpret its environmental policy.

As of December 31, 1996, NS' balance sheet included a reserve for environmental exposures in the amount of $53 million (of which $12 million is accounted for as a current liability), which is NS' estimate of the probable costs at 111 identified locations based on available information. On that date, nine sites accounted for $19 million of the reserve, and no individual site was considered to be material. NS anticipates that the majority of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At many of the 111 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 clean-up 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 clean-up techniques, the likely development of new clean-up technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it) and evolving statutory and regulatory standards governing liability.

The risk of incurring environmental liability—for acts and omissions, past, present and future—is inherent in the railroad business. Some of the commodities, particularly those classified as hazardous materials, in NS' traffic mix can pose special risks that NS and its subsidiaries work diligently to minimize. In addition, several NS subsidiaries own, or have owned in the past, land holdings used as operating property, or which are leased or may have been leased and operated by others, or held for sale. Because certain conditions may exist on these properties related to environmental problems that are latent or undisclosed, there can be no assurance that NS will not incur liabilities or costs with respect to one or more of them, the amount and materiality of which cannot be estimated reliably now. 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 and, after consulting with its legal counsel, Management believes that it has recorded the probable costs based on available information for those environmental matters of which the Corporation is aware. Further, Management believes that it is unlikely that any identified matters, either individually or in aggregate, will have a material adverse effect on NS' financial position, results of operations or liquidity.

Change-in-Control Arrangements

Norfolk Southern has compensation agreements with officers and certain key employees, which 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.

Capital Expenditure Commitment

In connection with a long-term transportation contract entered into during 1996, NS has committed to construct and operate four motor vehicle distribution centers. These facilities are scheduled for completion in 1998.

Debt Guarantees

As of December 31, 1996, certain Norfolk Southern subsidiaries are contingently liable as guarantors with respect to $50.7 million of indebtedness of related entities.

Independent Auditors' Report

KPMG Peat Marwick LLP

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, 1996 and 1995, 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, 1996. 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 generally accepted auditing standards. 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, 1996 and 1995, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1996, in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

Norfolk, Virginia
January 28, 1997, except as to the second and third paragraphs of Note 15, which are as of February 12, 1997

Board and Management Changes

At NS' annual meeting in May 1996, three NS directors were re-elected to three-year terms. They are **Gerald L. Baliles**, a partner in the law firm of Hunton & Williams; **Gene R. Carter**, executive director of the Association for Supervision and Curriculum Development; and **E. B. Leisenring, Jr.**, chairman of the Philadelphia Contributionship.

Arnold B. McKinnon, retired NS chairman and chief executive officer, was re-elected to a one-year term. **Robert E. McNair**, chairman of McNair Law Firm, P.A., retired from the board in line with NS' retirement policy for directors.

In July, the board elected **Carroll A. Campbell, Jr.**, former governor of South Carolina, to fill a vacancy. Campbell is president and chief executive officer of the American Council of Life Insurance.

In January, NS announced the election of **James C. Bishop, Jr.**, then vice president-Law, to succeed John S. Shannon as executive vice president-Law. Shannon retired effective March 1, 1996.

In March, **William C. Wooldridge**, then NS' general counsel-corporate, was elected vice president-Law, succeeding Bishop.

In November, **Harold C. Mauney, Jr.**, then vice president-Quality Management, was elected to the new position of vice president-Operations Planning and Budget. **Rashe W. Stephens, Jr.**, then assistant vice president-Public Affairs, was elected vice president-Quality Management, succeeding Mauney. Also, **Robert C. Fort** was elected vice president-Public Relations, succeeding Magda A. Ratajski, who resigned to run her own international consulting firm.

Quarterly Financial Data

(Unaudited)

	Three Months Ended			
	March 31	June 30	Sept. 30	Dec. 31
	(In millions of dollars except per share amounts)			
1996				
Transportation operating revenues	$1,161.5	$1,217.3	$1,211.3	$1,179.9
Income from operations	261.0	310.5	315.7	309.8
Net income	168.1	199.5	202.3	200.5
Earnings per share	$ 1.31	$ 1.57	$ 1.61	$ 1.60
1995				
Transportation operating revenues	$1,138.7	$1,190.2	$1,183.9	$1,155.2
Income from operations	249.1	290.1	292.1	255.0
Net income	170.7	181.2	183.9	176.9
Earnings per share	$ 1.29	$ 1.38	$ 1.40	$ 1.37

Stock Price and Dividend Information

(Unaudited)

The common stock of Norfolk Southern Corporation, owned by 50,748 stockholders of record as of December 31, 1996, 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 1996 and 1995.

	Quarter			
1996	**1st**	**2nd**	**3rd**	**4th**
Market Price				
High	$ 88	$ 89 7/8	$ 91 3/4	$ 96 5/8
Low	76 3/8	80	78 3/8	84 5/8
Dividends per share	$ 0.56	$ 0.56	$ 0.56	$ 0.56

1995	**1st**	**2nd**	**3rd**	**4th**
Market Price				
High	$ 68 1/8	$ 68 1/2	$ 77 3/8	$ 81 5/8
Low	60 1/2	62 3/4	67 1/8	72 1/4
Dividends per share	$ 0.52	$ 0.52	$ 0.52	$ 0.52

Board of Directors

Seated, left to right: E.B. Leisenring, Jr., Arnold B. McKinnon, Gene R. Carter, Gerald L. Baliles, Landon Hilliard and T. Marshall Hahn. Back row, left to right: David R. Goode, Carroll A. Campbell, Jr., Jane Margaret O'Brien, L.E. Coleman and Harold W. Pote.

Gerald L. Baliles, 56, 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 Brussels, Warsaw, and Hong Kong. His Board service began in 1990; his current term expires in 1999.

Carroll A. Campbell, Jr., 56, of Washington, D.C., is president and chief executive officer of the American Council of Life Insurance. His Board service began in July 1996; his current term expires in 1997.

Gene R. Carter, 57, of Alexandria, Va., is executive director 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 1999.

L.E. Coleman, 66, of Grantham, N.H., is retired chairman and chief executive officer of The Lubrizol Corporation, a diversified specialty chemical company. A former director of Norfolk and Western Railway (1980-82), his NS Board service began in 1982; his current term expires in 1998.

David R. Goode, 56, of Norfolk, Va., is chairman, president and chief executive officer of Norfolk Southern. 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 1997.

T. Marshall Hahn, Jr., 70, of Atlanta, Ga., is honorary chairman of the board of Georgia-Pacific Corporation, a manufacturer and distributor of building products, pulp and paper products, and chemicals. His Board service began in 1985; his current term expires in 1998.

Landon Hilliard, 57, of New York, N.Y., 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 1998.

E.B. Leisenring, Jr., 71, of Philadelphia, Pa., is chairman of the Philadelphia Contributionship, the nation's oldest insurance company. A former director of Southern Railway (1961-82), his NS Board service began in 1982; his current term expires in 1999.

Arnold B. McKinnon, 69, of Norfolk, Va., retired as NS' chairman and chief executive officer in 1992. He began his railroad service in 1951 with Southern Railway and was a director from 1979-82. His NS Board service began in 1986; his current term expires in 1997.

Jane Margaret O'Brien, 43, 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 1998.

Harold W. Pote, 50, of New York, N.Y., is a partner of The Beacon Group, a private investment partnership. His Board service began in 1988; his current term expires in 1997.

Committees of the Board
Audit: Coleman, chairman; Baliles, Carter, Hilliard, Pote

Compensation and Nominating: Leisenring, chairman; Coleman, Hahn

Executive: McKinnon, chairman; Goode, Hahn, Leisenring

Pension: Hahn, chairman; Campbell, Leisenring, O'Brien, Pote

Officers

(As of February 1, 1997)

David R. Goode, 56
Chairman, President and Chief Executive Officer, 31 years' service
James C. Bishop, Jr., 60
Executive Vice President-Law, 29 years' service
R. Alan Brogan, 56
Executive Vice President-Transportation Logistics, 32 years' service
L.I. Prillaman, 53
Executive Vice President-Marketing, 26 years' service
Stephen C. Tobias, 52
Executive Vice President-Operations, 27 years' service
Henry C. Wolf, 54
Executive Vice President-Finance, 24 years' service
William B. Bales, 61
Senior Vice President-International, 34 years' service
Paul N. Austin, 53
Vice President-Personnel, 29 years' service
John F. Corcoran, 56
Vice President-Public Affairs, 34 years' service
David A. Cox, 60
Vice President-Properties, 40 years' service
Thomas L. Finkbiner, 44
Vice President-Intermodal, 9 years' railroad service
Robert C. Fort, 52
Vice President-Public Relations, 19 years' service
John W. Fox, Jr., 49
Vice President-Coal Marketing, 27 years' service
Thomas J. Golian, 63
Vice President, 46 years' service
James L. Granum, 60
Vice President-Public Affairs, 34 years' service
James A. Hixon, 43
Vice President-Taxation, 12 years' service
Jon L. Manetta, 58
Vice President-Transportation and Mechanical, 41 years' service
Harold C. Mauney, Jr., 58
Vice President-Operations Planning and Budget, 35 years' service
Donald W. Mayberry, 53
Vice President-Research and Tests, 32 years' service
James W. McClellan, 57
Vice President-Strategic Planning, 22 years' service
Kathryn B. McQuade, 40
Vice President-Internal Audit, 16 years' service
Charles W. Moorman, 44
Vice President-Information Technology, 21 years' service
Philip R. Ogden, 56
Vice President-Engineering, 33 years' service
John P. Rathbone, 44
Vice President and Controller, 15 years' service
William J. Romig, 52
Vice President and Treasurer, 19 years' service
Donald W. Seale, 44
Vice President-Merchandise Marketing, 20 years' service
Robert S. Spenski, 62
Vice President-Labor Relations, 31 years' service
Rashe W. Stephens, Jr., 55
Vice President-Quality Management, 27 years' service
William C. Wooldridge, 53
Vice President-Law, 23 years' service
Dezora M. Martin, 49
Corporate Secretary, 24 years' service

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Glossary of Terms

Bulk transfer — the transfer of bulk products, such as plastic pellets or liquid sweeteners, from one mode of transportation to another. Bulk transfer permits off-rail shippers and receivers of varied commodities to combine rail's long-haul efficiencies with truck's convenient door-to-door delivery.

Capitalized costs — expenditures that have future benefit and thus are recorded as assets.

Car utilization — ways to measure railcar productivity. Among the measures are how much freight a car hauled and how many trips it made in a specified period of time.

Carload — a shipment of not less than five tons of one commodity.

Class I railroad — a railroad having operating revenues of more than $255.9 million annually.

Connecting carrier — a railroad with a physical connection with another.

Container — a large, weatherproof box designed for shipping freight in bulk by rail, truck, or steamship.

Cycle time — the length of time consumed by a freight car from one loading to the next.

Debt-to-total-capitalization ratio — the percentage of total capital that is debt. Total capital is the combination of long-term debt, short-term debt, current maturities of long-term debt, and stockholders' equity.

Distribution center — a centrally located warehouse where goods shipped long distances by rail are loaded onto trucks for short-haul delivery to receivers, or vice versa. Also called a reload center, it combines the economies of rail with the flexibility of truck pickup and delivery.

Double-stack containers — containers that can be stacked one atop another on a flatcar.

Flatcar — an open car without sides or roof.

Grade crossing — that point at which a roadway intersects a rail line.

Gross ton-mile — the movement of the combined weight of cars and their contents a distance of one mile.

Hopper — an open-top car with pockets, or hoppers, opening on the underside of the car for unloading bulk commodities.

Hump yard — a regional gathering point where freight is classified and forwarded to final destinations. The three components are a receiving yard, a classification yard, in which railcars are pushed over a hump to various classification tracks, and a forwarding yard.

Intermodal service — freight moving via at least two different modes of transport. Intermodal service generally involves the shipment of containers and trailers by rail, truck, barge, or ship.

Less-than-truckload (LTL) — the quantity of freight that's less than that required for application of a trailerload rate.

Line capacity — the maximum number of trains that can operate safely and reliably over a given segment of track during a given period of time.

Line-haul service — the movement over the tracks of a carrier from one city to another, not including the switching service.

Main line — primary rail line over which trains operate between terminals. It excludes sidings, and yard and industry tracks.

Multilevel car — a long flatcar designed with one or more deck levels in addition to the car's main deck; used to haul new automobiles and trucks.

Net ton-mile — the movement of a ton of freight one mile.

Operating ratio — the percentage of revenues that goes into operating the railroad. It is calculated by dividing railway operating expenses by railway operating revenues.

Return on equity — net income divided by average stockholders' equity.

Revenue ton-mile — the movement of a ton of freight one mile for revenue.

Right-of-way — the property owned by a railroad over which tracks have been laid.

Subsidiary — a company owned by another company that controls a majority of its stock.

Switching — movement of freight cars between two nearby locations or trains. Switching is a term typically associated with activities that occur in a railcar classification yard or terminal.

Terminal — a railroad facility used for handling freight and the receiving, classifying, assembling, and dispatching of trains.

Through freight train — an express freight train between major terminals.

Total return to stockholders — stock-price change plus reinvested dividends expressed as a percentage of the purchase price of the stock.

Trackage rights — rights obtained by one railroad to operate its trains over the tracks of another railroad.

Trailer — a cargo-carrying highway vehicle without automotive power.

Unit train — a freight train that moves carloads of a single product between two points. By unloading on arrival and returning promptly for another load, such trains cut costs because they eliminate intermediate stops in yards and reduce cycle times.

Yard — a system of tracks branching from a common track. Yards are used for switching, making up trains, and storing cars.

Norfolk Southern 1996 Annual Report Reader Survey

Dear Investor:

Thank you for reading the Norfolk Southern 1996 Annual Report. Your opinions are important to us and will help us improve our ability to serve you. Please take a few minutes to tell us what you think about the annual report by answering the following questions. When you have completed the survey, please drop it in the mail. The postage is prepaid.

1 *When reading the annual report, individuals have different information needs. Please rate the sections of the annual report that you found most helpful by circling the appropriate number. When making your assessments, consider the overall quality, communication effectiveness, and readability of the section.*

	Very Poor	Poor	Fair	Good	Excellent
Financial Highlights	1	2	3	4	5
Chairman's Letter to Stockholders	1	2	3	4	5
System Map	1	2	3	4	5
Narratives on Employee Commitment, Customer Service, Innovation, and Efficiency	1	2	3	4	5
1996: The Year in Review	1	2	3	4	5
Financial Overview	1	2	3	4	5
Financial Statements	1	2	3	4	5
Management's Discussion and Analysis	1	2	3	4	5
Glossary of Terms	1	2	3	4	5
Stockholder Information	1	2	3	4	5

2 *Please rate the annual report on the following characteristics:*

	Very Poor	Poor	Fair	Good	Excellent
Appearance/design	1	2	3	4	5
Organization/ease of locating information	1	2	3	4	5
Readability	1	2	3	4	5
Use of charts/graphs	1	2	3	4	5
Helping you understand Norfolk Southern	1	2	3	4	5
Use of photographs	1	2	3	4	5
Showing how Norfolk Southern is positioned for the future	1	2	3	4	5

3 *Taken as a whole, please rate the report by circling the number below that best describes your overall impression of this report and how it compares to other annual reports you receive.*

	Very Poor	Poor	Fair	Good	Excellent
Overall, I feel the 1996 report is:	1	2	3	4	5

4 *What information would you like included in future reports?*

5 *What do you dislike about this report?*

6 *Please check the box that best describes you:*

- ☐ I personally own the stock in my own name and have the certificates
- ☐ I personally own the stock through an employee stock plan
- ☐ I personally own the stock; however, my broker keeps the certificates
- ☐ I am a financial security analyst following the company
- ☐ I am an investment manager
- ☐ I am a customer of Norfolk Southern
- ☐ I am a potential stockholder

7 *Comments*

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Thank you for reading the 1996 Annual Report and for answering our survey.

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NORFOLK, VA 23510-2191

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.

Stockholders of record at year-end: 50,748

Shares outstanding at year-end: 125,097,374, excluding treasury stock

DIVIDENDS

At its January 1997 meeting, the Corporation's Board of Directors increased the March quarterly dividend to 60 cents per share on its common stock.

Norfolk Southern Corporation pays quarterly dividends on its common stock, usually on or about March 10, June 10, September 10, and December 10. The Corporation has paid 58 consecutive quarterly dividends since its inception in 1982.

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. The Plan permits eligible stockholders of record to reinvest dividends from Corporation stock in shares of Norfolk Southern Corporation.

The Plan's administrator is The Bank of New York. For additional information, dial (800) 524-4458.

ANNUAL MEETING OF STOCKHOLDERS

May 8, 1997, at 10 a.m. EDT
The Conference Center-Williamsburg Lodge
South England Street
Williamsburg, Virginia

PUBLICATIONS

Upon written request, the Corporation's annual report to the Securities and Exchange Commission on Form 10-K for the fiscal year ended December 31, 1996, and its quarterly reports on Form 10-Q will be furnished to stockholders free of charge; write to: Public Relations Department, Norfolk Southern Corporation, 110 Franklin Road, S.E., Roanoke, Virginia 24042-0043.

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 — provides access to information previously published in the quarterly Stockholder Newsletter.

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Norfolk, Virginia 23510-2191
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Roanoke, Virginia 24042

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Atlanta, Georgia 30303

North American Van Lines, Inc.

5001 U.S. Highway 30 West
Post Office Box 988
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STOCKHOLDER 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
101 Barclay Street-12W
New York, New York 10286-1002
(800) 524-4458

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

Assistant Corporate Secretary-
Stockholder Records
Norfolk Southern Corporation
Three Commercial Place, Box 219
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NORFOLK SOUTHERN CORPORATION
THREE COMMERCIAL PLACE
NORFOLK, VIRGINIA 23510-2191

"AMERICA'S MOST ADMIRED RAILROAD"

Norfolk Southern was named "America's Most Admired Railroad" in FORTUNE®'s 15th annual Corporate Reputations Survey, as reported in that magazine's March 3, 1997, issue.

Overall, the Thoroughbred placed 41st among 431 FORTUNE® 1000 companies in 49 industries.

Companies were rated by 13,000 senior executives, outside directors and financial security analysts on innovation; quality of management; value as a long-term investment; community and environmental responsibility; ability to attract, develop, and keep talented people; quality of products or services; financial soundness; and use of corporate assets.

This is the third time in four years that NS has been first in the railroad category.

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NORFOLK SOUTHERN RAILWAY COMPANY

Annual Report

Serial Preferred Stock Information

There are 10,000,000 shares of no par value serial preferred stock authorized. This stock may be issued in series from time to time at the discretion of the Board of Directors with any series having such voting and other powers, designations, dividends and other preferences as deemed appropriate at the time of issuance.

The $2.60 Cumulative Preferred Stock, Series A (Series A Stock), of which 1,197,027 shares were issued and 1,096,907 shares were held other than by subsidiaries as of February 29, 1996, has no par value but has a $50 per share stated value. As indicated in the title, the stock pays a dividend of $2.60 per share annually, payable quarterly on March 15, June 15, September 15 and December 15. Dividends on this stock are cumulative and in preference to dividends on all other classes of stock. Except for any shares held by Norfolk Southern Railway Company subsidiaries and/or in a fiduciary capacity, each share is entitled to one vote per share on all matters, voting as a single class with holders of other stock. Should dividends become delinquent for six quarters, this class of stock, voting as a class, may elect two directors so long as any default in dividend payments continues. The stock is redeemable at the option of Norfolk Southern Railway Company at $50 per share plus accrued dividends. On liquidation, the stock is entitled to $50 per share plus accrued dividends before any amounts are paid on any other class of stock.

In June 1989, Norfolk Southern Corporation (NS) announced that it intended to purchase up to 250,000 shares of the outstanding Series A Stock during the subsequent two-year period. In May 1991, NS extended the previously announced stock purchase program through 1993. In March 1994, NS announced that it would continue purchasing up to 250,000 shares of the Series A Stock through 1996. As of February 29, 1996, NS had purchased 131,128 shares of Series A Stock at a total cost of $4,778,767; as of the same date, NS held a total of 131,223 shares.

Stock Transfer Agent and Registrar

The Bank of New York
101 Barclay Street - 12W
New York, NY 10286-1002
(800) 524-4458

Form 10-K

Norfolk Southern Railway Company will mail a copy of the Annual Report to the Securities and Exchange Commission (Form 10-K) to interested persons upon written request to:

Public Relations Department
Norfolk Southern Corporation
110 Franklin Road, SE
Roanoke, VA 24042-0043

Description of Business

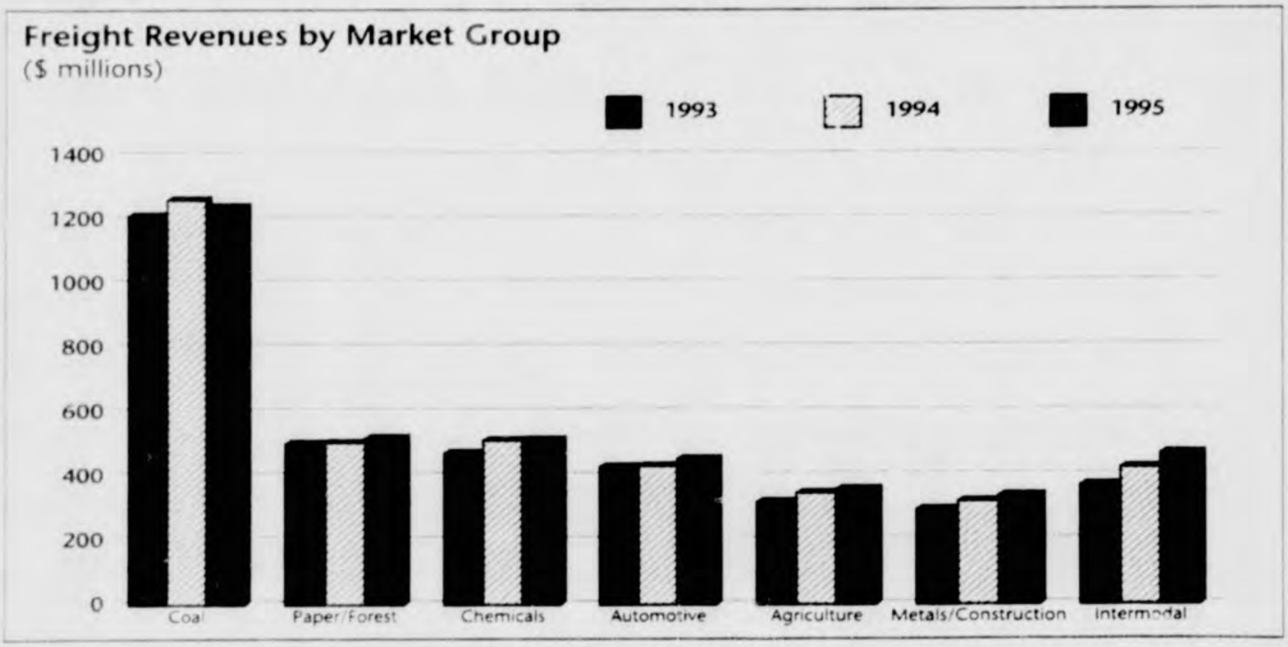
On June 1, 1982, Southern Railway Company (SR) and Norfolk and Western Railway Company consummated a consolidation under the control of Norfolk Southern Corporation (NS). Following the consolidation, a number of general management functions were combined thereby increasing coordination of sales, marketing and other customer service functions. Effective December 31, 1990, SR's name was changed to "Norfolk Southern Railway Company," and NS contributed all the common stock of Norfolk and Western Railway Company to Norfolk Southern Railway Company. All the common stock of Norfolk Southern Railway Company is owned by NS.

Norfolk Southern Railway Company, together with its consolidated subsidiaries (collectively, NS Rail), is engaged primarily in the transportation of freight by rail. The railroad system's lines extend over more than 14,500 miles of road in 20 states, primarily in the Southeast and Midwest, and the Province of Canada. As of December 31, 1995, NS Rail owned or leased 2,113 diesel locomotives, 96,928 freight cars and 4,168 rail-highway trailers.

NS Rail's lines carry raw materials, intermediate products and finished goods primarily in the Southeast and Midwest and to and from the rest of the United States and parts of Canada. These lines so transport overseas freight through several Atlantic and Gulf Coast ports. Atlantic ports served by NS Rail include: Charleston, S.C.; Jacksonville, Fla.; Morehead City, N.C.; Norfolk, Va.; and Savannah and Brunswick, Ga. Gulf Coast ports served include Mobile, Ala., and New Orleans, La.

NS Rail's lines reach most of the larger industrial and trading centers the Southeast and Midwest, with the exception of those in central and southern Florida. Atlanta, Ga., Birmingham, Ala., New Orleans, Memphis, Tenn., St. Louis, Mo., Kansas City, Mo., Chicago, Ill., Detroit, Mich., Cincinnati, Ohio, Buffalo, N.Y., Norfolk, Charleston, Savannah and Jacksonville are among the leading centers originating and terminating freight traffic on the system. In addition, a haulage arrangement with Florida East Coast Railway allows NS Rail to provide single-line service to and from South Florida, including the port cities of Miami, West Palm Beach and Fort Lauderdale. The system's lines also reach many individual industries, mines (in western Virginia, eastern Kentucky and southern West Virginia) and businesses located in smaller communities in its service area. The traffic corridors carrying the heaviest volumes of freight include those from the Appalachian coal fields of Virginia, West Virginia and Kentucky to Norfolk and Sandusky, Ohio; Buffalo to Chicago and Kansas City; Chicago to Jacksonville (via Cincinnati, Chattanooga, Tenn., and Atlanta); and Washington, D.C./Hagerstown, Md., to New Orleans (via Atlanta and Birmingham).

Buffalo, Chicago, Hagerstown, Jacksonville, Kansas City, Memphis, New Orleans and St. Louis are major gateways for interterritorial system traffic.



NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Five-Year Financial Review

	1995	1994	1993[1]	1992	1991[2]
			($ in millions)		
Results of operations:					
Railway operating revenues	[redacted]	$ 3,918.1	$ 3,727.6	$ 3,709.1	$ 3,598.0
Railway operating expenses	[redacted]	2,869.2	2,805.9	2,781.7	3,287.2
Income from railway operations	[redacted]	1,048.9	921.7	927.4	310.8
Other income – net	[redacted]	46.6	57.6	49.5	70.2
Interest expense on debt	[redacted]	28.3	32.3	44.6	48.4
Income before income taxes	[redacted]	1,067.2	947.0	932.3	332.6
Provision for income taxes	[redacted]	385.2	412.8	325.8	102.0
Income before accounting changes	[redacted]	682.0	534.2	606.5	230.6
Cumulative effect of accounting changes	[redacted]	—	247.8	—	—
Net income	[redacted]	$ 682.0	$ 782.0	$ 606.5	$ 230.6
Financial Position:					
Total assets	[redacted]	$ 10,289.2	$ 9,760.4	$ 9,675.5	$ 9,358.0
Total long-term debt, including current maturities	[redacted]	$ 539.8	$ 604.9	$ 714.5	$ 735.0
Stockholders' equity	[redacted]	$ 5,440.5	$ 5,184.9	$ 4,784.3	$ 4,449.5
Other:					
Capital expenditures	[redacted]	$ 639.6	$ 629.2	$ 617.1	$ 663.1
Number of stockholders at year-end	[redacted]	3,281	3,517	3,725	3,952
Average number of employees[3]	[redacted]	24,710	25,531	25,650	27,366

[1] *1993 results include a $60.8 million increase in the provision for income taxes reflecting a 1% increase in the federal income tax rate (see Note 4). The cumulative effect of accounting changes (see Note 1) increased 1993 earnings by $247.8 million.*

[2] *1991 railway operating expenses include a $483 million special charge, primarily comprised of costs for labor force reductions. This charge reduced net income by $303 million.*

[3] *The employee count includes Norfolk Southern Corporation's employees whose primary duties relate to rail operations.*

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 10 and the Five-Year Financial Review on page 2.

SUMMARIZED RESULTS OF OPERATIONS

1995 Compared with 1994

Net income in 1995 was a record $701.7 million , up 3% over 1994 earnings of $682.0 million. Excluding a $20.4 million after-tax charge for an early retirement program in 1995, net income would have been $722.1 million, up 6%. These results were driven primarily by improved income from railway operations, up $48.0 million, or 5% (excluding the early retirement charge). Railway operating revenues increased $93.7 million, or 2%, while railway operating expenses, excluding the early retirement charge, were up $45.7 million, or 2%. Nonoperating income of $43.3 million was about even with last year (see Note 3). Interest expense on debt was up $4.7 million, largely due to a lower level of capitalized interest.

1994 Compared with 1993

Net income was $682.0 million in 1994, compared with $782.0 million in 1993. However, 1993 net income was increased by $247.8 million, related to the implementation of required accounting changes (see Note 1), and reduced by $51.6 million for the prior years' effect of a federal income tax rate increase (see Note 4). Excluding the effects of the 1993 accounting changes and the tax rate increase, 1993 net income was $585.8 million, and 1994 net income was up 16%.

Income from railway operations produced most of the improvement, increasing $127.2 million, or 14%. These results reflected a 5% increase in railway operating revenues (largely due to higher traffic volume) combined with only a 2% increase in railway operating expenses. Nonoperating income was $46.6 million, compared with $57.6 million in 1993, principally a result of reduced gains on sales of property.

Railway Operating Revenues and Expenses
($ millions)
■ Revenues
■ Expenses

DETAILED RESULTS OF OPERATIONS

Railway Operating Revenues

Railway operating revenues were $4.01 billion in 1995, compared with $3.92 billion in 1994 and $3.73 billion in 1993. The $93.7 million improvement in 1995, compared with 1994, was largely attributable to increases in the intermodal ($44.9 million), automotive ($22.0 million) and metals/construction ($18.1 million) market groups. The $190.5 million improvement in 1994, compared with 1993, was primarily attributable to increases in the intermodal, coal and chemicals market groups.

The following table presents a three-year comparison of revenues by market group.

RAILWAY OPERATING REVENUES BY MARKET GROUP

($ in millions)	1995	1994	1993
Coal	$ 1,240.3	$ 1,262.5	$ 1,213.3
Paper/forest	519.8	505.4	502.7
Chemicals	513.5	512.2	472.9
Automotive	454.1	432.1	429.5
Agriculture	359.0	347.5	319.7
Metals/construction	339.5	321.4	296.1
Intermodal	470.5	425.6	371.9
Freight revenues	3,896.7	3,806.7	3,606.1
Other, principally switching and demurrage	115.1	111.4	121.5
Total	$ 4,011.8	$ 3,918.1	$ 3,727.6

Traffic volume changes in 1995 were mixed, with improvements in automotive, agriculture, metals/construction and intermodal partially offset by declines in the other three market groups. Traffic volume increased or remained steady for all market groups in 1994. These volume gains accounted for most of the revenue improvement in 1995 and all the improvement in 1994 as illustrated by the following table.

RAILWAY OPERATING REVENUE VARIANCE ANALYSIS
INCREASES (DECREASES)

($ in millions)	1995 vs. 1994	1994 vs. 1993
Traffic volume	$ 62.6	$ 195.1
Revenue per unit	31.1	(4.6)
Total	$ 93.7	$ 190.5

Average revenue per unit rose in 1995 due to moderate rate increases. The revenue per unit variance in 1994 was principally attributable to growth in shorter haul and double-stack business, both of which generally have lower average rates.

Coal traffic volume declined 1%, and revenues were down 2%, from 1994. In 1995, coal revenues represented 31% of total railway operating revenues, and 91% of coal shipments originated on NS Rail's lines. As shown in the following table, coal tonnage by type remained stable in 1995, compared with 1994. However, utility coal tonnage in 1994 increased significantly.

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

Total Coal Tonnage (in millions of tons)	1995	1994	1993
Utility	69.1	70.2	60.6
Export	25.8	25.2	25.7
Steel	18.9	18.8	20.5
Other	8.2	8.9	8.8
Total	122.0	123.1	115.6

Utility coal traffic had been expected to grow in 1995, but instead decreased slightly due to moderate weather throughout much of the NS Rail service region during the first half of the year and to sustained periods of maximum generation from several southeastern nuclear power plants. The mild weather pattern actually began in third-quarter 1994, causing a number of NS Rail's utility customers to start 1995 with high coal inventories. However, inventories began to normalize, as seasonal weather returned to the service region in midsummer, and nuclear plants began to power down for refueling and repairs in third-quarter 1995. Compliance with Phase I of the Clean Air Act Amendments, which took effect on January 1, 1995, increased shipments of both NS Rail- and foreign-line-originated, low-sulfur coal. A significant proportion of the mines served by NS Rail produce coal which satisfies both Phase I and the more stringent Phase II requirements, which take effect January 1, 2000.

In 1994, utility coal traffic was up early in the year as a result of bitter weather and the resulting depletion of coal stockpiles. The pace at which 1994 outperformed 1993 slowed as the weather normalized. New movements of western coal into Georgia also contributed to the 1994 increase.

The near-term outlook for utility coal is favorable, as most NS Rail-served utilities began 1996 with normal or somewhat low inventory levels. The long-term outlook is less certain due to the deregulation and ongoing restructuring of the utility industry, although low-sulfur coal traffic should increase, with the approach of the Phase II deadline of the Clean Air Act.

Export coal traffic in 1995 benefited from the continued recovery of the European steel-producing economy. Demand from other parts of the world also improved. Brazil, Belgium, France, Romania and Japan took increased amounts of NS Rail coal. In addition, NS Rail began handling metallurgical coal for steel production in Mexico. Congestion and high barge rates on the Mississippi River caused an increase in movements to NS Rail's coal piers in Norfolk, Va.

Export coal traffic at the beginning of 1994 reflected the poor demand also seen in 1993. Shipments remained somewhat depressed as a result of the weak European economy and strong competition from other producing countries. Economic recovery in Europe and Japan improved demand for steel and electricity, and the coal supply-demand situation tightened during 1994. As a result, delivery times were longer and prices rose during 1994.

A recent softening in world demand for steel could limit near-term growth in export metallurgical coal shipments. However, demand for export steam coal is increasing, and NS Rail is working to increase participation in this market.

Steel coal domestic traffic was up slightly in 1995 due to completion of extended coke oven work at one facility and continued strong demand for domestic coke for making steel. In 1994, traffic was reduced by the closing of one coke battery. Advanced technologies that allow production of steel with little or no coke could cause this market to decline slowly over the long term. However, NS Rail could participate in the movement of non-coking coal used by technologies such as pulverized coal injection.

Other coal consists of traffic for industries which burn coal to generate energy used in manufacturing processes and often for the production of electricity for in-plant use and outside sales. Lower demand for electricity due to mild weather, as discussed above, continued to affect this market in 1995. In addition, some industries switched to natural gas as a fuel source. This market is expected to remain stable in coming years, as growth through innovative packaged delivery services offsets some additional loss to natural gas.

MERCHANDISE traffic volume rose 5%, and revenues increased by $112.2 million, or 4%, compared with 1994. Merchandise traffic volume in 1994 increased 8%, and revenues increased by $151.4 million, or 6%, compared with 1993. All six market groups comprising merchandise traffic reported increased revenues in 1995 over 1994 and in 1994 over 1993.

Paper/forest traffic declined 1%; however, revenues were up 3%, compared with 1994. Paper and pulpwood products traffic was even with 1994, while lumber traffic suffered from weak housing starts in 1995. For 1994, paper/forest volume and revenues were about even with 1993, reflecting weak paper production, severe winter weather and floods in south Georgia. Some of the weakness in paper was offset by a gain in lumber traffic due, in part, to the opening of five new lumber distribution centers in 1994. Moderate growth is expected for 1996 based on the anticipated completion of several woodchip mills and an improvement in housing starts.

Chemicals traffic and revenues showed little change compared with 1994. Increases for general chemicals were overshadowed by weakness in the plastics and fertilizer markets. However, 1994 showed a 9% traffic increase and an 8% revenue increase, compared with 1993. The demand for chemicals increased in 1994, and shipments of fertilizer and plastics were stronger than in prior years. A resumption of moderate growth is expected for 1996, if the fertilizer and plastics markets strengthen and demand for liquefied petroleum gas grows.

Automotive traffic rose 3%, and revenues—their highest in NS Rail's history—increased 5% over 1994. This growth occurred even though some plants served by NS Rail were shut down or operating at reduced capacity. These effects were mitigated by strong production at selected plants that produce popular cars and trucks. In 1994, automotive traffic had remained steady, and revenues increased 1%, compared with 1993, due to retooling downtime at four plants. Moderate growth is expected to continue in 1996, as plant retoolings are completed and new plants come on line. The GM plant at Wentzville, Mo., should resume production early in 1996 after remaining down for two years. NS Rail also should see more traffic from the expanded Toyota plant at Georgetown, Ky.; from BMW's new facility at Greer, S.C.; and in 1997, from the Mercedes plant under construction in Tuscaloosa, Ala.

Agriculture traffic rose 2%, and revenues increased 3%, compared with a strong 1994. This growth was driven by a 6% increase in grain and soybean traffic, a result of higher shipments from the Midwest to the Southeast primarily for the poultry industry.

Agriculture traffic in 1994 rose 7%, and revenues increased 9%. This performance reflected record corn and soybean harvests and improved car utilization through greater use of 50- and 100-car unit trains. This market group is expected to continue to grow as poultry consumption increases, with a commensurate rise in demand for feed grain. Industrial development efforts may bring several new feed mills on line.

Metals/construction traffic rose slightly, and revenues were up 6%. Most of the revenue increase was in the steel and aluminum markets, driven by strong demand, improved pricing and traffic from a new steel mini-mill in Butler, Ind. These results were partially offset by reduced demand for construction products, reflecting postponement of some highway projects and general weakness in residential construction. Metals/construction traffic in 1994 was strong, with both volume and revenues increasing 9%, compared with 1993. Most of the revenue gain was in shipments of steel due to exceptionally strong industry demand. Increased housing starts and new projects, such as at the Chesapeake Bay Bridge Tunnel, may improve construction traffic in 1996. Moderate growth is expected for metals.

Intermodal volume rose 12%, and revenues increased 11%. Although intermodal traffic levels nationwide declined in 1995, NS Rail intermodal achieved record levels of volume, revenue and profitability, led by container shipments in both domestic and international service. During 1995, a seven-year agreement with Hanjin Shipping Company was signed under which NS Rail will handle nearly all of Hanjin's international container business in NS Rail's territory east of the Mississippi River. EMP, the container equipment-sharing arrangement with Union Pacific and Conrail, contributed significantly to domestic growth. Almost all the increase in international container business was attributable to new services, thereby increasing NS Rail's market share. Domestic business was augmented by growth in the trucking segment, as both truckload and less-than-truckload companies increased their use of NS Rail intermodal. Additionally, intermodal marketing companies increased their business on NS Rail. Service and facility improvements are expected to result in a further market share increase in 1996.

Intermodal traffic in 1994 rose 13%, and revenues increased 14%, compared with 1993. As was the case in 1995, the 1994 growth in intermodal was led by an increase in container business. The export container segment improved, as the economies in Europe recovered and countries in the Asia/Pacific region experienced rapid growth in production. Revenues from domestic container movements also improved, as NS Rail increased its market share. Much of this growth was related to aggressive facility and transit-time improvements, including expanding or upgrading five terminal facilities.

Railway Operating Expenses

Railway operating expenses in 1995 totaled $2.95 billion, an increase of $79.3 million. However, 1995 expenses included a $33.6 million charge for an early retirement program (see Note 12). Excluding the early retirement charge, 1995 railway operating expenses were up only $45.7 million, or 2%, on a 3% increase in traffic volume. Similarly, railway operating expenses in 1994 were $2.87 billion, a 2% increase, compared with 1993, despite a 7% increase in traffic volume.

Railway Operating Ratio

* Excludes special charge

As a result, the ***NS Rail railway operating ratio*** which measures the percentage of revenues consumed by expenses, was a record 72.7 in 1995 (excluding the early retirement charge) and continues to be the best among the major railroads in the United States.

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

Railway Operating Expenses ($ in millions)	Increases (Decreases) 1995 vs. 1994	1994 vs. 1993
Compensation and benefits	**$ 108.9***	$ (17.7)
Materials, services and rents	**(45.4)**	27.0
Depreciation	**22.3**	12.7
Diesel fuel	**1.5**	9.0
Casualties and other claims	**(13.7)**	16.5
Other	**5.7**	15.8
Total	**$ 79.3**	$ 63.3

**Includes $33.6 million early retirement charge.*

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

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

Compensation and benefits, which represents about half of total railway operating expenses, increased 8% in 1995 and declined 1% in 1994.

The 1995 increase was principally a result of: (1) the early retirement charge of $33.6 million; (2) higher wages; (3) increased performance-based compensation accruals, particularly those linked to the NS stock price, which rose nearly $19 per share in 1995; and (4) higher health care costs for agreement employees.

The 1994 decline was principally due to (1) lower accruals for performance-based compensation plans as a result of a lower stock price; (2) reduced accruals for postretirement benefits resulting from a change in the benefit plan's creditable service period (see Note 13); (3) the expiration of the Railroad Retirement Repayment Tax in June 1993; (4) the effect of the early retirement program in 1993 (see Note 12); and (5) productivity improvements as a result of continuing reductions in train crew sizes.

Materials, services and rents consists of items used for the maintenance of the railroad's lines, structures and equipment; the cost 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 decreased 7% in 1995 but increased 4% in 1994.

The 1995 decrease of $45.4 million reflected initiatives to improve asset utilization that resulted in (1) the re-engineering of rail-line and freight-car maintenance practices that reduced repair and maintenance expenses and facilitated the closure of two repair facilities; (2) reduced locomotive repair costs due to older locomotives' being replaced with new units; (3) disposition of excess freight cars (see "Cash used for investing activities" on page 8), resulting in a reduction in the number of freight cars to be maintained; and (4) short-term leasing of certain older locomotives to other railroads, which reduced net equipment rental expense. Also contributing to the improvement was a decline in equipment rental expenses, resulting from the partial deprescription (deregulation by the ICC) of car-hire rates among railroads, which began in 1994. These favorable results were somewhat offset by increased expenses related to the 12% growth in intermodal traffic.

The 1994 increase of $27.0 million was principally due to higher joint-facility and leased-road costs and to increased locomotive repair costs, resulting mostly from higher traffic volume. However, a decrease in other railroads' use of NS Rail's facilities also contributed to the increase in joint-facilities expense. Partially offsetting these increases was a decline in equipment rent expenses resulting from the partial deprescription of car-hire rates.

Depreciation expense (see Note 1 "Properties" for NS Rail's depreciation policy) was up 6% in 1995 and 4% in 1994. The increases in both periods were due to property additions, reflecting substantial levels of capital spending over the last several years.

Diesel fuel costs rose 1% in 1995 and 5% in 1994. The 1995 increase was primarily due to a small increase in the average price paid for diesel fuel. Because even fuel-efficient locomotives consume substantial quantities of diesel fuel, a slight price increase translates into large cost increases. The increase in 1994 diesel fuel costs was entirely driven by higher consumption, a result of a 7% increase in carloadings. On average, fuel prices in 1994 were slightly lower than in 1993.

Casualties and other claims (including estimates of costs related to personal injury, property damage and environmental matters) decreased 10% in 1995 but increased 14% in 1994 over 1993. Both of these fluctuations primarily were attributable to environmental cleanup costs in 1994 associated with a tankcar leak.

The largest component of "Casualties and other claims" is personal injury expense. Although there has been a favorable trend in the number of accidental injuries since 1990, much of the financial benefit from this decline unfortunately has been offset by higher costs related to non-accidental "occupational" claims and by an increase in the cost of third-party injury claims arising from accidents at grade crossings. NS Rail is actively involved in efforts to reduce the risk of all accidents and is placing particular emphasis on programs involving grade-crossing safety.

The rail industry remains uniquely susceptible to 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 employees' claims for on-the-job injuries, produces results that are unpredictable and inconsistent, at a far greater cost to the rail industry than the no-fault workers' compensation system to which non-rail competitors are universally subject. The railroads have been unsuccessful so far in efforts to persuade Congress to replace the FELA with a no-fault workers' compensation system.

Other expenses increased 4% in 1995, and increased 12% in 1994. The 1995 increase was due to higher sales, use and franchise taxes. The 1994 increase was due to favorable property tax settlements in 1993 and to higher relocation expenses in 1994 related to new job assignments following the early retirement program in 1993.

Income Taxes

Income tax expense in 1995 was $371.9 million for an effective rate of 34.6%, compared with an effective rate of 36.1% in 1994 and 43.6% in 1993. Absent the federal income tax rate increase in 1993 (see Note 4), income tax expense that year would have been $352.0 million for an effective rate of 37.2%.

The below statutory rate in 1995 results from investments in corporate-owned life insurance and adjustment of intercompany tax liabilities for affiliates no longer in the NS consolidated group. The below statutory rate in 1994 was due to favorable adjustments resulting from settlement of federal income tax years 1988 and 1989 and a favorable adjustment upon filing the 1993 tax returns. Deferred tax expense was an unusually high proportion of total tax expense in 1994. A corresponding reduction is reflected in 1994 current tax expense for the effects of expenditures that affect book and tax accounts in different years, primarily in the areas of compensation and property. In 1993, current tax expense increased and deferred tax expense decreased because of tax payments made in anticipation of Revenue Agent Reports for the 1988-1989 federal tax audit (see Note 4 for the components of income tax expense).

Accounting Changes and New Accounting Pronouncements

1994 – Effective January 1, 1994, NS Rail adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115). The principal result was a significant write-up of NS Rail's investment in NS stock. This non-cash adjustment had no income statement effect and increased "Investments" and "Stockholders' equity" in the December 31, 1994, Consolidated Balance Sheet by $417.5 million and $253.1 million, respectively (see Note 1).

1993 – Effective January 1, 1993, NS Rail adopted required accounting for postretirement benefits other than pensions, postemployment benefits and income taxes (see Note 1 for a discussion of these accounting changes). The net cumulative effect of these non-cash adjustments increased 1993 net income by $247.8 million.

New Accounting Pronouncements – In March 1995, the Financial Accounting Standards Board (FASB) issued Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" (SFAS 121). This standard establishes the accounting and reporting requirements for recognizing and measuring impairment of long-lived assets to be either held and used or held for disposal. SFAS 121 is effective for years beginning after December 15, 1995. NS Rail does not expect SFAS 121 to have a material effect on its financial statements.

In October 1995, the FASB issued Statement No. 123, "Accounting for Stock-Based Compensation" (SFAS 123). This standard defines a fair-value-based method of accounting for stock-based compensation plans. However, the standard also allows measurement of compensation cost using the intrinsic-value-based method of accounting prescribed in Accounting Principles Board Opinion No. 25 (APB 25). Companies that choose to retain APB 25 for measurement will be required to provide pro forma footnote disclosures effective for 1996 financial statements. NS Rail expects to continue recording stock-based compensation costs attributable to the NS Long-Term Incentive Plan based on APB 25 and, beginning in 1996, to provide the pro forma disclosures required under SFAS 123.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Financial Condition refers to the assets, liabilities and stockholders' equity of an organization (see Consolidated Balance Sheets on page 11). **Liquidity** refers to the ability of an organization to generate adequate amounts of cash, principally from operating results or through borrowing power, to meet its short-term and long-term cash requirements (see Consolidated Statements of Cash Flows on page 12). **Capital Resources** refers to the ability of an organization to raise funds through the sale of either debt or equity (stock) securities.

($ in millions)	**1995**	1994	1993	1992	1991
Cash and short-term investments	**$230.0**	$180.9	$152.0	$ 64.0	$137.3
Current assets to current liabilities	**1.0**	1.1	1.3	1.2	1.1
Debt to total capitalization	**9.6%**	9.4%	10.9%	13.4%	14.6%
Return on average stockholders' equity	**13.0%***	12.8%	12.0%*	13.1%	11.6%*

** Excluding unusual items: in 1995, the early retirement charge; in 1993, the cumulative effects of required accounting changes and the prior years' effect of the federal income tax rate increase; and in 1991, the special charge.*

Cash provided by operating activities, which is NS Rail's principal source of liquidity, increased $96.4 million, or 8%, in 1995, compared with 1994 and $289.4 million, or 33%, in 1994, compared with 1993. Since the NS consolidation in 1982, cash provided by operating activities has been sufficient to fund dividend requirements, debt repayments and a significant portion of capital spending. The improvement in 1995 was primarily a result of increased income from operations (excluding the early retirement charge, a non-cash item) and improved billing and collection of receivables. The 1994 increase was largely attributable to increased income from operations and to lower income tax payments.

Implementation of the labor portion of the 1991 special charge also contributed to the fluctuations in cash provided by operations. In 1995, 1994 and 1993, $29.3 million, $41.9 million and $36.1 million, respectively, were for such labor costs. In 1993, failure to reach agreement on terms for certain further savings led to a partial reversal of the 1991 special charge (see Note 15). Looking ahead, the labor portion of the special charge is expected to require approximately $30 million in 1996 to achieve productivity gains permitted by the agreements. NS Rail regards this cash outflow as an investment because, in view of the high cost of labor and fringe benefits, these payments produce significant future savings.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

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

In 1995, it is estimated that NS Rail's expenses were reduced by $160 million as a result of these programs and, upon full implementation, there should be additional savings of about $10 million per year.

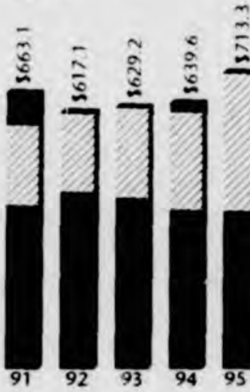
Cash **used for investing activities** increased 13% in 1995, compared with 1994, and was up 45% in 1994, compared with 1993. The higher uses in 1995 and 1994 were due to significant advances made to NS. The other significant use of cash was for property additions, largely for railway projects. The following tables show capital spending, track and equipment statistics for the past five years.

CAPITAL EXPENDITURES ($ in millions)	1995	1994	1993	1992	1991
Road	**$379.5**	$382.3	$411.0	$425.1	$392.8
Equipment	**332.6**	235.0	218.1	187.8	193.1
Other property	**1.2**	22.3	0.1	4.2	77.2
Total	**$713.3**	$639.6	$629.2	$617.1	$663.1
TRACK STRUCTURE STATISTICS (CAPITAL AND MAINTENANCE)					
Track miles of rail installed	**403**	480	574	660	679
Miles of track surfaced	**4,668**	4,760	5,048	5,690	5,646
New crossties installed (millions)	**2.0**	1.7	1.6	1.9	1.9
AVERAGE AGES OF RAILWAY EQUIPMENT (IN YEARS)					
Freight cars	**22.0**	21.9	21.3	20.9	20.2
Locomotives	**15.7**	15.8	15.1	14.5	14.2
Retired locomotives	**22.6**	23.6	24.7	24.0	27.1

Since 1988, NS Rail has rebodied more than 20,500 coal cars and plans to continue that program at the rate of about 3,200 cars per year for the next several years. This work, performed at NS Rail's Roanoke Car Shop, converts hopper cars into high-capacity steel gondolas or hoppers. As a result, the remaining service life of the freight car fleet is greater than is inferable from the increasing average age shown in the table above.

Efforts to hold down capital spending while increasing business are ongoing as NS Rail seeks to maximize utilization of its assets. In this connection, NS Rail began an orderly disposition of up to 17,000 freight cars in October 1994. Through the end of 1995, 7,272 of these cars were sold, with proceeds of $42 million included in "Property sales and other transactions" in the Consolidated Statements of Cash Flows. In 1993, this line item reflected proceeds from large land sales (see Note 3).

Capital Expenditures
($ millions)
■ Other Property
Equipment
■ Road



For 1996, NS Rail is planning $667 million of capital spending. NS Rail anticipates that a portion of its locomotive acquisitions will be financed using capitalized leases similar to the 1995 leases (see Note 8). In 1996, equipment financing needs are expected to be somewhat lower than in 1995, as proceeds from the sale of freight cars may be used for some locomotive acquisitions. Barring unforeseen events, total capital spending is expected to continue to be similar to the 1995 level.

In 1994, large borrowings on corporate-owned life insurance, reflected in "Investment sales and other transactions" in the Consolidated Statements of Cash Flows, offset much of the use of cash for intercompany advances and property additions that year.

Cash used for financing activities increased 2% in 1995, compared with 1994, and was 2% greater in 1994, compared with 1993. The increase in 1995 was primarily attributable to a higher rate of dividends paid on common stock; 1994 had included the maturity of a large mortgage (see Note 8 for debt maturities).

Hedging Activities

NS Rail has entered into hedging transactions relating to diesel fuel purchases and interest rate swaps. No agreements related to the diesel fuel hedges were settled from 1993 through 1995, and outstanding agreements at December 31, 1995, were less than $5 million. As discussed under "Capital Leases" in Note 8, NS Rail has made limited use of interest rate swaps in connection with certain equipment financings.

ENVIRONMENTAL MATTERS

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

Operating expenses for environmental protection totaled approximately $13 million in 1995 and are anticipated to increase somewhat in 1996. Capital expenditures for environmental projects amounted to approximately $8 million in 1995 and are expected to be at the same level in 1996. As of December 31, 1995, NS Rail's balance sheet included a reserve for environmental exposures in the amount of $44 million (of which $12 million is accounted for as a current liability), which is NS Rail's present best estimate of ultimate liability at 96 identified locations. On that date, eight sites accounted for $16 million of the reserve, and no individual site was considered to be material. NS Rail 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 many of the 96 locations, NS Rail and/or certain of its 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 clean-up costs.

At one such site, the EPA alleged in 1995 that The Alabama Great Southern Railroad Company ("AGS"), a subsidiary of NS Rail, is responsible, along with several other entities believed to be financially solvent, for past and future clean-up and monitoring costs at the Bayou Bonfouca NPL Superfund site located in Slidell, La. Liability will be contested. Because the amount of any liability that the EPA may assert against NS Rail or AGS is not known, the materiality of such amount to NS Rail's financial position, results of operation or liquidity in a particular quarter or year cannot be assessed at this time. The EPA has indicated that it has expended or expects to expend a total of approximately $132 million at the site.

With respect to known environmental sites (whether identified by NS Rail or by the EPA or comparable state authorities), estimates of NS Rail's 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 clean-up techniques, the likely development of new clean-up technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it) and evolving statutory and regulatory standards governing liability.

The risk of incurring environmental liability—for acts and omissions, past, present and future—is inherent in the railroad business. Some of the commodities, particularly those classified as hazardous materials, in NS Rail's traffic mix can pose special risks that NS Rail works diligently to minimize. In addition, NS Rail owns or has owned in the past land holdings used as operating property, or which are leased or may have been leased and operated by others, or held for sale. Because certain conditions may exist on these properties related to environmental problems that are latent or undisclosed, there can be no assurance that NS Rail will not incur liabilities or costs with respect to one or more of them, the amount and materiality of which cannot be estimated reliably now. 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 and, after consulting with its legal counsel, Management believes that it has recorded appropriate estimates of liability for those environmental matters of which NS Rail is aware. Further, Management believes that it is unlikely that any identified matters, either individually or in aggregate, will have a material adverse effect on NS Rail's financial position, results of operations or liquidity.

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 Rail, a capital-intensive company, has approximately $12.8 billion 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.

INDUSTRY TRENDS

- A tentative settlement was reached with the United Transportation Union, which represents the largest number of employees in the railroad industry. The settlement requires ratification by the members before acceptance. The negotiation of this settlement demonstrated that national handling produces the quickest path to agreement. Negotiations with the other unions are progressing.

- NS Rail and other railroads are continuing to seek opportunities to share traffic routes and facilities, furthering the goals of providing seamless service to customers and maximizing efficiency of the respective railroads.

- NS Rail is closely monitoring recent merger and consolidation activities within the railroad industry in light of its own long-term strategic objectives to protect the interests of its stockholders.

- NS Rail and the rail industry are continuing their efforts to replace the FELA with no-fault workers' compensation laws comparable to those covering employees in other industries.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Consolidated Statements of Income

	Years ended December 31, 1995	1994	1993
		($ in millions)	
Railway operating revenues	[redacted]	$ 3,918.1	$ 3,727.6
Railway operating expenses:	[redacted]		
Compensation and benefits (Notes 12, 13 and 15)	[redacted]	1,371.1	1,388.8
Materials, services and rents	[redacted]	668.6	641.6
Depreciation	[redacted]	360.6	347.9
Diesel fuel	[redacted]	188.3	179.3
Casualties and other claims	[redacted]	135.0	118.5
Other	[redacted]	145.6	129.8
Railway operating expenses	[redacted]	2,869.2	2,805.9
Income from railway operations	[redacted]	1,048.9	921.7
Other income – net (Note 3)	[redacted]	46.6	57.6
Interest expense on debt (Note 6)	[redacted]	28.3	32.3
Income before income taxes	[redacted]	1,067.2	947.0
Provision for income taxes (Note 4):	[redacted]		
Income taxes	[redacted]	385.2	361.2
Adjustment of net deferred tax liability for federal rate increase	[redacted]	—	51.6
Total income taxes	[redacted]	385.2	412.8
Income before accounting changes	[redacted]	682.0	534.2
Cumulative effect on years prior to 1993 of changes in accounting principles (Note 1) for:	[redacted]		
Income taxes	[redacted]	—	470.4
Postretirement benefits other than pensions; and postemployment benefits—net of taxes	[redacted]	—	(222.6)
Net income	[redacted]	$ 682.0	$ 782.0

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Consolidated Balance Sheets

	As of December 31, 1995	1994
	($ in millions)	
Assets		
Current assets:		
Cash and cash equivalents	[redacted]	$ 33.8
Short-term investments (Note 14)	[redacted]	147.1
Accounts receivable net of allowance for doubtful accounts of $2.8 million and $5.4 million, respectively	[redacted]	552.7
Materials and supplies	[redacted]	58.5
Deferred income taxes (Note 4)	[redacted]	91.1
Other current assets	[redacted]	89.8
Total current assets	[redacted]	973.0
Due from NS – net (Note 2)	[redacted]	201.7
Investments (Notes 5 and 14)	[redacted]	598.4
Properties less accumulated depreciation (Note 6)	[redacted]	8,493.4
Other assets	[redacted]	22.7
Total assets	[redacted]	$ 10,289.2
Liabilities and stockholders' equity		
Current liabilities:		
Short-term debt (Note 8)	[redacted]	$ 27.2
Accounts payable (Note 7)	[redacted]	529.3
Income and other taxes	[redacted]	119.1
Other current liabilities (Note 7)	[redacted]	118.0
Current maturities of long-term debt (Note 8)	[redacted]	65.8
Total current liabilities	[redacted]	859.4
Long-term debt (Note 8)	[redacted]	474.0
Other liabilities (Note 10)	[redacted]	868.2
Minority interests	[redacted]	2.1
Deferred income taxes (Note 4)	[redacted]	2,645.0
Total liabilities	[redacted]	4,848.7
Stockholders' equity:		
Serial preferred stock (Note 11)	[redacted]	54.8
Common stock (Note 11)	[redacted]	166.7
Other capital	[redacted]	515.0
Unrealized gain on marketable securities (Note 14)	[redacted]	253.1
Retained income	[redacted]	4,450.9
Total stockholders' equity	[redacted]	5,440.5
Total liabilities and stockholders' equity	[redacted]	$ 10,289.2

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Consolidated Statements of Cash Flows

	Years ended December 31,		
	1995	1994	1993
		($ in millions)	
Cash flows from operating activities:	[redacted]		
Net income	[redacted]	$ 682.0	$ 782.0
Reconciliation of net income to net cash provided by operating activities:	[redacted]		
Net cumulative effect of changes in accounting principles	[redacted]	—	(247.8)
Special charge payments	[redacted]	(41.9)	(36.1)
Depreciation	[redacted]	361.3	348.7
Deferred income taxes	[redacted]	114.2	92.9
Nonoperating gains on property sales	[redacted]	(7.8)	(31.9)
Changes in assets and liabilities affecting operations:	[redacted]		
Accounts receivable	[redacted]	(29.8)	(25.9)
Materials and supplies	[redacted]	7.4	5.9
Other current assets	[redacted]	(12.5)	(8.0)
Current liabilities other than debt	[redacted]	6.7	(23.4)
Other – net	[redacted]	74.8	8.6
Net cash provided by operating activities	[redacted]	1,154.4	865.0
Cash flows from investing activities:	[redacted]		
Property additions	[redacted]	(639.6)	(629.2)
Property sales and other transactions	[redacted]	52.9	80.3
Investment purchases	[redacted]	(45.9)	(86.3)
Investment sales and other transactions	[redacted]	249.2	8.0
Due from NS – net (Note 2)	[redacted]	(394.2)	97.0
Short-term investments – net	[redacted]	1.0	(6.0)
Net cash used for investing activities	[redacted]	(776.6)	(536.2)
Cash flows from financing activities:	[redacted]		
Dividends (Note 2)	[redacted]	(279.4)	(276.6)
Proceeds from long-term borrowings	[redacted]	41.4	38.5
Long-term debt repayments	[redacted]	(108.3)	(99.9)
Net cash used for financing activities	[redacted]	(346.3)	(338.0)
Net increase (decrease) in cash and cash equivalents	[redacted]	31.5	(9.2)
Cash and cash equivalents:	[redacted]		
At beginning of year	[redacted]	2.3	11.5
At end of year	[redacted]	$ 33.8	$ 2.3
Supplemental disclosures of cash flow information	[redacted]		
Cash paid during the year for:	[redacted]		
Interest (net of amounts capitalized)	[redacted]	$ 49.1	$ 58.4
Income taxes	[redacted]	$ 252.2	$ 337.1

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Consolidated Statements of Changes in Stockholders' Equity

	Serial Preferred Stock	Common Stock	Other Capital	Unrealized Gain on Marketable Securities	Retained Income	Total
			($ in millions)			
Balance December 31, 1992	**$ 54.9**	**$ 166.7**	**$ 515.0**	**$ —**	**$ 4,047.7**	**$ 4,784.3**
Net income – 1993					782.0	782.0
Cash dividends:						
Serial preferred stock, $2.60 per share					(2.9)	(2.9)
Common stock, $16.42 per share					(273.7)	(273.7)
Non-cash dividends on common stock (Note 2)					(104.7)	(104.7)
Other	(0.1)					(0.1)
Balance December 31, 1993	**54.8**	**166.7**	**515.0**	**—**	**4,448.4**	**5,184.9**
Net income – 1994					682.0	682.0
Cash dividends:						
Serial preferred stock, $2.60 per share					(2.9)	(2.9)
Common stock, $16.59 per share					(276.5)	(276.5)
Non-cash dividends on common stock (Note 2)					(400.1)	(400.1)
Unrealized gain on investments (Note 14)				253.1		253.1
Balance December 31, 1994	**54.8**	**166.7**	**515.0**	**253.1**	**4,450.9**	**5,440.5**
Net income – 1995					701.7	701.7
Cash dividends:						
Serial preferred stock, $2.60 per share					(2.9)	(2.9)
Common stock, $17.31 per share					(288.6)	(288.6)
Non-cash dividends on common stock (Note 2)					(300.0)	(300.0)
Contribution from NS (Note 2)			10.5			10.5
Unrealized gain on investments (Note 14)				84.2		84.2
Balance December 31, 1995	**$ 54.8**	**$ 166.7**	**$ 525.5**	**$ 337.3**	**$ 4,561.1**	**$ 5,645.4**

See accompanying notes to consolidated financial statements.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

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 Railway Company, together with its consolidated subsidiaries (collectively, NS Rail), is engaged principally in the transportation of freight by rail, primarily in the Southeast and Midwest. The consolidated financial statements include Norfolk Southern Railway Company, Norfolk and Western Railway Company and their majority-owned and controlled subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation (see Note 16 for the Norfolk and Western Railway Company and Subsidiaries (NW) summarized consolidated financial information).

Rail freight consists of raw materials, intermediate products and finished goods classified in the following market groups: coal, paper/forest, chemicals, automotive, agriculture, metals/construction and intermodal. All groups are approximately equal in size based on revenues except for coal, which accounts for about one third of railway revenues. Ultimate destinations for some of the freight and a portion of the coal shipped are outside the United States.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and 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. Actual results could differ from those estimates.

Cash Equivalents

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

Investments

"Investments" are reported at amortized cost or fair value depending upon their classification as held-to-maturity, trading or available-for-sale securities in accordance with SFAS No. 115 (see "Required Accounting Changes" at right).

Materials and Supplies

"Materials and supplies," consisting mainly of fuel oil and items for maintenance of property and equipment, are stated at average cost. 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 primarily depreciated on the basis of use measured by gross ton miles. The effect of this method is to write off these assets over 42 years on average. Other properties are depreciated generally using the straight-line method over estimated service lives at annual rates that range from 1% to 20%. In 1995, the overall depreciation rate averaged 2.7% for roadway and 4.0% for equipment. NS Rail capitalizes interest on major capital projects during the period of their construction. Maintenance expense is recognized when repairs are performed. When properties, other than land and non-rail 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 non-rail assets are included in other income (see Note 3).

Revenue Recognition

Revenue is recognized proportionally as a shipment moves from origin to destination.

Required Accounting Changes

1994 – Effective January 1, 1994, NS Rail adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115), which addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities. The implementation of SFAS 115 increased "Investments," the deferred tax liability and "Stockholders' equity" at December 31, 1994, and had no impact on earnings. The total unrealized holding gain on NS Rail's investments classified as "available for sale," net of the related deferred taxes, is reflected as a separate component of "Stockholders' equity" in the Consolidated Balance Sheets (see also Note 14).

1993 – Effective January 1, 1993, NS Rail adopted Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (SFAS 106), and Statement of Financial Accounting Standards No. 112, "Employers' Accounting for Postemployment Benefits" (SFAS 112). SFAS 106 requires accrual of the cost of specified health care and death benefits over an employee's creditable service period rather than, as was the previously prevailing practice, accounting for such expenses on a pay-as-you-go basis. SFAS 112 requires recognition of the cost of benefits payable to former or inactive employees after employment but before retirement on an accrual basis. For NS Rail, such postemployment benefits consist principally of obligations under the long-term disability plan. NS Rail recognized the effects of these changes in accounting on the immediate recognition basis. The cumulative effect on years prior to 1993 of adopting SFAS 106 and 112 increased pretax expenses $336.3 million ($208.4 million after-tax), and $22.8 million ($14.2 million after-tax), respectively (see also Note 13).

Also effective January 1, 1993, NS Rail adopted Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (SFAS 109). SFAS 109 requires a liability approach for measuring deferred tax assets and liabilities based on differences between the financial statement and tax bases of assets and liabilities at each balance sheet date using enacted tax rates in effect when those differences are expected to reverse. The cumulative effect on years prior to 1993 of adopting SFAS 109 increased net income $470.4 million (see also Note 4).

2. Related Parties

General

NS is the parent holding company of NS Rail. The costs of functions performed by NS are allocated to NS Rail. Rail operations are coordinated at the holding company level by the NS Executive Vice President-Operations.

Non-cash Dividends

In December 1995 and 1994, NS Rail declared and issued to NS non-cash dividends of $300.0 million and $400.1 million, respectively, which were settled by reduction of NS Rail's interest-bearing advances due from NS.

On April 1, 1993, NS Rail declared and issued to NS a $104.7 million non-cash dividend representing the net assets of several non-railroad subsidiaries. These subsidiaries, principally involved in real estate, produce a small amount of rental income which are no longer part of NS Rail's results.

Non-cash dividends are excluded from the Consolidated Statements of Cash Flows.

Intercompany Accounts

	December 31, 1995		1994	
($ in millions)	Balance	Average Interest Rate	Balance	Average Interest Rate
Due from NS:				
Advances	[redacted]	[redacted]	$ 336.3	2.6%
Due to NS:				
Notes	[redacted]	[redacted]	134.6	5.7%
Due from NS-net	[redacted]		$ 201.7	

During 1995 and 1993, NW issued notes for $75.5 million and $112.6 million, respectively, to an NS subsidiary for the purchase of a portfolio of short-term investments. These non-cash transactions were excluded from the Consolidated Statement of Cash Flows.

Interest is applied to certain advances at the average NS yield on short-term investments and to the notes at specified rates. Included in interest income is $17.8 million, $15.6 million and $6.7 million in 1995, 1994 and 1993, respectively, related to amounts due from NS.

Transfer of Investment from NS

In December 1995, NS transferred its $10.5 million equity interest in a nonoperating subsidiary to Norfolk Southern Railway Company. This transfer was recorded at historical cost and was reflected as a contribution to capital.

Intercompany Federal Income Tax Accounts

In accordance with the NS Tax Allocation Agreement, intercompany federal income tax accounts are recorded between companies in the NS consolidated group. At December 31, 1995 and 1994, NS Rail had intercompany federal income tax payables (which are included in "Deferred income taxes" in the Consolidated Balance Sheets) of $254.7 million and $261.0 million, respectively.

Cash Required for NS Stock Purchase Program and NS Debt

Since 1987, the NS Board of Directors has authorized the purchase and retirement of up to 65 million shares of NS common stock. Purchases under the programs have been made with internally generated cash and with proceeds from the sale of NS commercial paper notes and from the issuance of NS long-term debt.

Since the first purchases in December 1987 and through December 31, 1995, NS has purchased and retired 63,932,000 shares of its common stock under these programs at a cost of $2.9 billion. On January 23, 1996, the NS Board authorized a new program to acquire up to 30 million additional shares of common stock. Future purchases are dependent on market conditions, the economy, cash needs and alternative investment opportunities.

Consistent with the earlier purchases, a significant portion of the funding for future NS stock purchases, either in the form of direct cash or cash used for debt service, will come from NS Rail through intercompany advances or dividends to NS.

3. Other Income – Net

($ in millions)	[redacted]	1994	1993
Interest income (Note 2)	[redacted]	$ 34.4	$ 15.7
Rental income	[redacted]	18.0	18.6
Dividends from NS	[redacted]	13.9	13.5
Gains from sales of properties	[redacted]	7.8	31.9
Corporate-owned life insurance – net	[redacted]	7.9	10.8
Other interest expense	[redacted]	(24.9)	(26.7)
Taxes on nonoperating property	[redacted]	(3.7)	(4.2)
Other – net	[redacted]	(6.8)	(2.0)
Total	[redacted]	$ 46.6	$ 57.6

4. Income Taxes

Provision for Income Taxes

($ in millions)		1994	1993
Current:	[redacted]		
Federal	[redacted]	$ 236.0	$ 279.6
State	[redacted]	35.0	40.3
Total current taxes	[redacted]	271.0	319.9
Deferred:	[redacted]		
Federal	[redacted]	95.2	26.4
State	[redacted]	19.0	14.9
Adjustment of net deferred tax liability for federal rate increase	[redacted]	—	51.6
Total deferred taxes	[redacted]	114.2	92.9
Provision for income taxes	[redacted]	$ 385.2	$ 412.8

1993 Federal Income Tax Rate Increase

In August 1993, Congress enacted the Revenue Reconciliation Act of 1993, which increased the federal corporate income tax rate from 34% to 35%, retroactive to January 1, 1993. The tax rate increase had two components that, as required by SFAS 109, were recognized in 1993 earnings.

The first component relates to the increased income tax rate's effect on 1993 earnings, which increased the provision for income taxes and reduced net income by $9.2 million. The second component increased the provision for the net deferred tax liability in the Consolidated Balance Sheet, which reduced that year's net income by $51.6 million.

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:

($ in millions)	1995		1994		1993	
	Amount	%	Amount	%	Amount	%
Federal income tax at statutory rate	[redacted]	[redacted]	$ 373.5	35.0	$ 331.5	35.0
State income taxes, net of federal tax benefit	[redacted]	[redacted]	35.1	3.3	35.8	3.8
Corporate-owned life insurance	[redacted]	[redacted]	(10.6)	(1.0)	(8.7)	(0.9)
Dividend and equity income	[redacted]	[redacted]	(4.7)	(0.4)	(5.0)	(0.5)
Other – net	[redacted]	[redacted]	(8.1)	(0.8)	7.6	0.7
	[redacted]	[redacted]	385.2	36.1	361.2	38.1
Adjustment of net deferred tax liability for federal rate increase	[redacted]	[redacted]	—	—	51.6	5.5
Provision for income taxes	[redacted]	[redacted]	$ 385.2	36.1	$ 412.8	43.6

Inclusion in Consolidated Return

NS Rail is included in the consolidated federal income tax return of NS. The provision for current income taxes in the Consolidated Statements of Income reflects NS Rail's portion of NS' consolidated tax provision. Tax expense or tax benefit is recorded on a separate company basis whether or not such benefit would be currently available on a separate company basis.

Deferred Tax Assets and Liabilities

Certain items are reported in different periods for financial reporting and income tax purposes. Deferred tax assets and liabilities were recorded in recognition of these differences in accordance with SFAS 109.

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

($ in millions)	December 31, 1995	1994
Deferred tax assets:		
Reserves, including casualty and other claims	[redacted]	$ 163.7
Employee benefits	[redacted]	144.7
Postretirement benefits other than pension and postemployment benefits	[redacted]	132.1
Taxes, including state and property	[redacted]	154.5
Other	[redacted]	1.4
Total gross deferred tax assets	[redacted]	596.4
Less valuation allowance	[redacted]	(0.6)
Net deferred tax assets	[redacted]	595.8
Deferred tax liabilities:	[redacted]	
Property	[redacted]	(2,679.8)
Unrealized holding gains	[redacted]	(164.4)
Other	[redacted]	(44.5)
Total gross deferred tax liabilities	[redacted]	(2,888.7)
Intercompany federal tax payable–net	[redacted]	(261.0)
Net deferred tax liability	[redacted]	(2,553.9)
Net current deferred tax assets	[redacted]	91.1
Net long-term deferred tax liability	[redacted]	$ (2,645.0)

Except for amounts for which a valuation allowance is provided, Management believes the deferred tax assets will be realized. The valuation allowance for deferred tax assets as of January 1, 1993, was $3.4 million. The net change in the total valuation allowance was a $0.1 million decrease for 1995, a $1.4 million decrease for 1994 and a $1.4 million decrease for 1993.

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 1989. The consolidated federal income tax returns for 1990 through 1992 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 these examinations.

Tax Benefit Leases

In January 1995, the United States Tax Court issued a preliminary decision that would disallow some of the tax benefits a subsidiary of NS Rail purchased from a third party pursuant to a safe harbor lease agreement in 1981. Management continues to believe that NS Rail ultimately should incur no loss from this decision, because the lease agreement provides for full indemnification if any such disallowance is sustained.

5. Investments

($ in millions)	December 31, 1995	1994
Marketable equity securities at fair value (Note 14)	[redacted]	$ 439.7
Corporate-owned life insurance at net cash surrender value	[redacted]	140.1
Other	[redacted]	18.6
Total	[redacted]	$ 598.4

6. Properties

($ in millions)	December 31, 1995	1994
Transportation property:		
Road	[redacted]	$ 7,934.4
Equipment	[redacted]	4,440.0
Other property	[redacted]	84.5
	[redacted]	12,458.9
Less: Accumulated depreciation	[redacted]	3,965.5
Net properties	[redacted]	$ 8,493.4

Capitalized Interest

Total interest cost incurred on debt in 1995, 1994 and 1993 was $47.0 million, $46.1 million and $53.9 million, respectively, of which $14.0 million, $17.8 million and $21.6 million was capitalized.

7. Current Liabilities

($ in millions)	December 31, 1995	1994
Accounts payable:		
Accounts and wages payable	[redacted]	$ 217.2
Casualty and other claims	[redacted]	164.1
Vacation liability	[redacted]	71.0
Equipment rents payable – net	[redacted]	67.0
Other	[redacted]	10.0
Total	[redacted]	$ 529.3
Other current liabilities:	[redacted]	
Prepaid amounts on forwarded traffic	[redacted]	$ 72.8
Interest payable	[redacted]	20.0
Retiree health and death benefit obligation (Note 13)	[redacted]	21.5
Other	[redacted]	3.7
Total	[redacted]	$ 118.0

8. Debt

Short-Term Debt

Short-term debt consists of $27.2 million of notes assumed in connection with the 1990 acquisition of a coal terminal facility.

Capital Leases

During the first quarter of 1995, NS Rail entered into capital leases covering new locomotives. The related capital lease obligations totaling $104.5 million were reflected in the Consolidated Balance Sheet as debt and, because they were non-cash transactions, were excluded from the Consolidated Statement of Cash Flows. The lease obligations carry an average stated interest rate of 8.4% but were converted to variable rate obligations using interest rate swap agreements. The interest rates on these obligations are based on the six-month London Interbank Offered Rate and are reset every six months with changes in interest rates accounted for as an adjustment of interest expense. As a result, NS Rail is exposed to the market risk associated with fluctuations in interest rates. To date, while such rate fluctuations have been nominal, their effects have been favorable. Counterparties to the interest rate swap agreements are major financial institutions believed by Management to be credit-worthy. NS Rail's use of interest rate swaps has been limited to those discussed above.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES
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Notes to Consolidated Financial Statements

8. Debt (continued)

Long-Term Debt

($ in millions)	December 31, 1995	1994
Equipment obligations at an average rate of 7.9% maturing to 2009	[redacted]	$ 497.2
Capitalized leases at an average rate of 6.5% maturing to 2015		2.0
Mortgage bonds at an average rate of 4.2% maturing to 2003		33.9
Other debt at an average rate of 5.9% maturing to 2015		6.7
Total long-term debt		539.8
Less: Current maturities		65.8
Long-term debt less current maturities		$ 474.0

Long-term debt matures as follows:	
1997	$ 47.4
1998	48.0
1999	119.4
2000	49.3
2001 and subsequent years	230.6
Total	$ 494.7

A substantial portion of NS Rail's properties and certain investments in affiliated companies are pledged as collateral for much of the debt.

9. Lease Commitments

NS Rail is committed under long-term lease agreements, which expire on various dates through 2067, for equipment, lines of road and other property. Future minimum lease payments are as follows:

($ in millions)	Operating Leases	Capital Leases
1996	$ 48.2	$ 15.0
1997	47.6	14.9
1998	42.5	14.9
1999	31.7	14.9
2000	30.6	14.8
2001 and subsequent years	577.8	80.5
Total	$ 778.4	155.0
Less imputed interest on capital leases at an average rate of 8.4%		54.1
Present value of minimum lease payments included in debt		$ 100.9

Operating Lease Expense

($ in millions)	[redacted]	1994	1993
Minimum rents		$ 46.7	$ 33.5
Contingent rents		45.4	36.1
Total		$ 92.1	$ 69.6

10. Other Liabilities

($ in millions)	December 31, 1995	1994
Casualty and other claims	[redacted]	$ 264.2
Net pension obligation (Note 12)		84.8
Retiree health and death benefit obligation (Note 13)		277.9
Other		241.3
Total		$ 868.2

11. Stock

Preferred

There are 10,000,000 shares of no par value serial preferred stock authorized. This stock may be issued in series from time to time at the discretion of the Board of Directors with any series having such voting and other powers, dividends and other preferences as deemed appropriate at the time of issuance. At December 31, 1995 and 1994, 1,197,027 shares of $2.60 Cumulative Preferred Stock, Series A (Series A Stock) were issued, and 1,096,907 shares were held other than by subsidiaries. The Series A Stock has a $50 per share stated value. The Series A Stock is callable at any time at $50 per share plus accrued dividends and has one vote per share on all matters, voting as a single class with holders of other stock.

In June 1989, NS announced that it intended to purchase up to 250,000 shares of the outstanding Series A Stock during the subsequent two-year period. In May 1991, NS extended the previously announced stock purchase program through 1993. In March 1994, NS announced that it would continue purchasing up to 250,000 shares of the Series A Stock through 1996. NS had purchased 122,828 shares at a total cost of approximately $4.4 million as of December 31, 1995. NS purchased the shares in regular brokerage transactions on the open market at prevailing prices. At year end 1995 and 1994, NS held 122,923 shares and 94,022 shares, respectively.

Preference

There are 10,000,000 shares of no par value serial preference stock authorized. None of these shares has been issued.

Common

There are 50,000,000 shares of no par value common stock with a stated value of $10 per share authorized. NS owns all 16,668,997 shares issued and outstanding at December 31, 1995 and 1994.

12. Pension Plans

NS Rail's defined benefit pension plans, which principally cover salaried employees, are part of NS' retirement plans. Pension benefits are based primarily on years of creditable service with NS and its participating subsidiary companies and compensation rates near retirement. Contributions to the plans are made on the basis of not less than the minimum funding standards set forth in the Employee Retirement Income Security Act of 1974, as amended. Assets in the plans consist mainly of common stocks. The following data relate principally to NS Rail's portion of the combined NS plans, since no separate NS Rail data are available.

Pension Cost (Benefit) Components

($ in millions)	[redacted]	1994	1993
Service cost-benefits earned during the year	[redacted]	$ 10.2	$ 10.7
Interest cost on projected benefit obligation	[redacted]	59.9	58.6
Actual return on assets in plan	[redacted]	(16.6)	(105.6)
Net amortization and deferral	[redacted]	(62.9)	27.9
Net pension benefit	[redacted]	(9.4)	(8.4)
Cost of early retirement benefits	[redacted]	—	38.7
Total	[redacted]	$ (9.4)	$ 30.3

Pension cost is determined based on an actuarial valuation that reflects appropriate assumptions as of the beginning of each year. The funded status of the plans is determined using appropriate assumptions as of each year-end. A summary of the major assumptions follows:

	[redacted]	1994	1993
Discount rate for determining funded status	[redacted]	8.50%	7.25%
Future salary increases	[redacted]	6%	6%
Return on assets in plans	[redacted]	9%	9%

The funded status of the plans and the amounts reflected in the accompanying balance sheets were as follows:

	December 31,			
	1995		1994	
($ in millions)	Funded Plans	Unfunded Plans	Funded Plans	Unfunded Plans
Actuarial present value of benefit obligations:				
Vested benefits	[redacted]	[redacted]	$ 626.5	$ 40.6
Non-vested benefits	[redacted]	[redacted]	—	—
Accumulated benefit obligation	[redacted]	[redacted]	626.5	40.6
Effect of expected future salary increases	[redacted]	[redacted]	92.1	9.0
Projected benefit obligation	[redacted]	[redacted]	718.6	49.6
Fair value of assets in plans	[redacted]	[redacted]	871.4	—
Funded status	[redacted]	[redacted]	152.8	(49.6)
Unrecognized initial net asset	[redacted]	[redacted]	(43.7)	—
Unrecognized (gain) loss	[redacted]	[redacted]	(162.3)	10.1
Unrecognized prior service cost	[redacted]	[redacted]	3.6	4.3
Net pension liability included in the balance sheets	[redacted]	[redacted]	$ (49.6)	$ (35.2)

Early Retirement Programs

During 1995 and 1993, NS completed voluntary early retirement programs for salaried employees. The principal benefit for those who participated in these programs was enhanced pension benefits, which are reflected in the accumulated benefit obligation. The charge for these programs is included in "Compensation and benefits" expense and was $33.6 million in 1995 (including $8.3 million related to postretirement benefits other than pensions) and $42.4 million in 1993. The 1995 program was accepted by 265 employees; the 1993 program, by 378 employees.

401(k) Plans

NS Rail provides 401(k) savings plans for employees. Under the plans, NS Rail matches a portion of the employee contributions, subject to applicable limitations. NS Rail's expenses under these plans were $6.9 million, $5.0 million and $5.1 million in 1995, 1994 and 1993, respectively.

13. Postretirement Benefits Other Than Pensions

NS Rail provides 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 Rail's option, a defined percentage of health care expenses is covered, reduced by any deductibles, co-payments, Medicare payments and, in some cases, coverage provided by other group insurance policies. The cost of such health care coverage to a retiree may be determined, in part, by the retiree's years of creditable service with NS Rail prior to retirement. Death benefits are determined based on various factors, including, in some cases, salary at time of retirement.

NS Rail continues to fund benefit costs principally on a pay-as-you-go basis. However, in 1991, NS Rail established a Voluntary Employee Beneficiary Association (VEBA) account to fund a portion of the cost of future health care benefits for retirees. NS Rail last made a corporate contribution of $16 million in 1994 to the VEBA.

Effective January 1, 1994, NS Rail amended the attribution period for postretirement health care benefits. The amendment generally provides for benefits to be determined ratably over a 10-year period based on creditable service commencing at age 45, or from date of hire if employment began after age 45. The amendment reduced the accumulated postretirement health care benefit obligation by $80 million, which will be amortized as a reduction in annual cost on a pro rata basis over a six-year period.

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

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Notes to Consolidated Financial Statements

13. Postretirement Benefits Other Than Pensions (continued)

A summary of the postretirement benefit cost follows:

($ in millions)	[redacted]	1994	1993
Service cost-benefits attributable to service during the year	[redacted]	$ 13.1	$ 6.4
Interest cost on accumulated postretirement benefit obligation	[redacted]	23.8	27.0
Actual return on plan assets	[redacted]	—	(1.9)
Net amortization and deferral	[redacted]	(13.9)	(0.7)
Net postretirement benefit cost	[redacted]	23.0	30.8
Cost of early retirement benefits	[redacted]	—	—
Total	[redacted]	$ 23.0	$ 30.8

The following table sets forth these plans' total accumulated postretirement benefit obligation, reconciled with the accrued postretirement benefit obligation:

	December 31, 1995		1994	
($ in millions)	Health Care Benefits	Death Benefits	Health Care Benefits	Death Benefits
Accumulated postretirement benefit obligation:				
Retirees	[redacted]		$ 159.8	$ 76.6
Fully eligible active plan participants			11.7	4.5
Other active plan participants			32.0	11.0
Total			203.5	92.1
Plan assets at fair value			54.5	—
Funded status			(149.0)	(92.1)
Unrecognized loss (gain)			11.1	(4.1)
Unrecognized prior service cost (benefit)			(65.3)	—
Accrued postretirement benefit obligation			$ (203.2)	$ (96.2)

For measurement purposes, an 11% increase in the per capita cost of covered health care benefits was assumed for 1996. The rate was assumed to decrease gradually to an ultimate rate of 5.5% and remain at that level for 2005 and thereafter. The health care cost trend rate has a significant effect on the amounts reported in the financial statements. To illustrate, increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1995, by about $33 million and the aggregate of the service and interest cost components of net postretirement benefit cost for the year 1995 by about $4 million.

The weighted-average discount rate used in determining the accumulated postretirement benefit obligation, the salary increase assumption and the long-term rate of return on plan assets are the same as those used for the pension plans (see table of rate assumptions in Note 12).

The VEBA trust holding the plan assets is not expected to be subject to federal income taxes, as the assets are invested entirely in trust-owned life insurance.

Under collective bargaining agreements, NS Rail and certain subsidiaries participate in a multiemployer 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 $3.7 million, $4.8 million and $5.3 million in 1995, 1994 and 1993, respectively.

14. Fair Values of Financial Instruments

The fair values of "Cash and cash equivalents," "Short-term investments," "Accounts receivable," "Short-term debt" and "Accounts payable" approximate carrying values because of the short maturity of these financial instruments. "Short-term investments," which are designated as "available for sale," are reported at fair value in accordance with SFAS 115 (see Note 1).

The fair value of long-term "Investments" approximated $837 million and $658 million at December 31, 1995 and 1994, respectively. Quoted market prices were used to determine the fair value of marketable securities which, beginning in 1994 (see Note 1, "Required Accounting Changes"), were recorded at fair value. Carrying value adjustments, which are non-cash transactions, are not included in the Consolidated Statement of Cash Flows. Underlying net assets were used to estimate the fair value of non-marketable investments. For the remaining investments, consisting principally of corporate-owned life insurance, the carrying value approximates fair value (see Note 5 for carrying values of "Investments").

Under SFAS 115, NS Rail increased the reported carrying value of short-term and long-term investments classified as "available for sale" as follows:

	[redacted]	December 31, 1994	
($ in millions)		Short-term Securities	Equity Securities
Cost		$ 201.7	$ 20.6
Gross unrealized holding gain (loss)		(1.6)	419.1
Fair value		$ 200.1	$ 439.7

The short-term securities are principally U.S. Treasury securities. Equity securities consist almost entirely of 7,252,634 shares of NS Common Stock.

The change in the unrealized holding gain (loss) was \$138.8 million for 1995 and \$(77.0) million for 1994. These changes primarily reflect changes in the NS stock price. As a result, stockholder's equity increased \$84.2 million in 1995 and decreased \$46.9 million in 1994.

The fair value of "Long-term debt," including current maturities, approximated \$606 million at December 31, 1995, and \$543 million at December 31, 1994. 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 (see Note 8 for carrying values of "Long-term debt").

15. Partial Reversal of Special Charge in 1993

Included in 1991 results was a \$483 million special charge for labor force reductions and asset write-downs. However, based on NS Rail's success in eliminating reserve board positions in 1992 and 1993, and on events occurring in the third quarter of 1993, the accrual included in the 1991 special charge related to labor was reduced by \$46 million, which was reflected as a credit in "Compensation and benefits" expenses. The principal factor contributing to the reversal was the failure in 1993 to reach agreement on terms for certain further labor savings. Accordingly, it became apparent that a surplus existed in the labor portion of the provision established in the 1991 special charge.

16. NW—Summarized Consolidated Financial Information

NW is operated as an integral part of NS Rail. Revenues are allocated to NW based on actual traffic movements as determined by revenue ton miles within market groups. Expenses are allocated to NW based on appropriate criteria for the type of expense. The costs of functions performed by NS, the parent holding company of NS Rail, are also allocated to its rail operating subsidiaries.

Norfolk and Western Railway Company and Subsidiaries
Summarized Consolidated Statements of Income

(\$ in millions)	Years ended December 31, 1995	1994	1993
Railway operating revenues	[redacted]	\$ 1,858.1	\$ 1,853.6
Railway operating expenses	[redacted]	1,382.7	1,414.5
Income from railway operations	[redacted]	475.4	439.1
Other–net	[redacted]	25.8	36.5
Income before income taxes	[redacted]	501.2	475.6
Provision for income taxes:			
Income taxes	[redacted]	175.1	181.1
Adjustment of net deferred tax liability for federal rate increase	[redacted]	—	23.7
Total income taxes	[redacted]	175.1	204.8
Income before accounting changes	[redacted]	326.1	270.8
Cumulative effects on years prior to 1993 of changes in accounting principles for:			
Income taxes	[redacted]	—	207.3
Postretirement benefits other than pensions; and postemployment benefits - net of taxes	[redacted]	—	(115.7)
Net income	[redacted]	\$ 326.1	\$ 362.4

Norfolk and Western Railway Company and Subsidiaries
Summarized Consolidated Balance Sheets

(\$ in millions)	As of December 31, 1995	1994
Assets		
Current assets	[redacted]	\$ 330.0
Noncurrent assets	[redacted]	4,439.6
Total assets	[redacted]	\$ 4,769.6
Liabilities and Stockholder's Equity		
Current liabilities	[redacted]	178.6
Noncurrent liabilities	[redacted]	1,590.0
Stockholder's equity	[redacted]	3,001.0
Total liabilities and stockholder's equity	[redacted]	\$ 4,769.6

Effective January 1, 1994, NW adopted Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115). See Note 1 for a discussion of this new accounting pronouncement. The effect on NW, principally due to the changing market value of its investment in NS stock, was a change in the unrealized holding gain (loss) of \$18.9 million for 1995 and \$(13.9) million for 1994. As a result, stockholder's equity increased \$11.8 million in 1995 and decreased \$8.7 million in 1994.

Effective January 1, 1993, NW adopted SFAS 106, "Employers' Accounting for Postretirement Benefits Other than Pensions"; SFAS 109, "Accounting for Income Taxes," and SFAS 112, "Employers' Accounting for Postemployment Benefits." See Note 1 for a discussion of these pronouncements (see NW's Consolidated Statement of Income for the cumulative effects of these changes).

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

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Notes to Consolidated Financial Statements

17. Contingencies

Lawsuits

Norfolk Southern Railway Company and certain subsidiaries are defendants in numerous lawsuits relating principally to railroad operations. While the final outcome of these lawsuits cannot be predicted with certainty, it is the opinion of Management, after consulting with its legal counsel, that the amount of NS Rail's ultimate liability will not materially affect NS Rail's consolidated financial position.

Debt Guarantees

As of December 31, 1995, NS Rail and certain subsidiaries are contingently liable as guarantors with respect to $66 million of indebtedness of related entities.

Change-in-Control Arrangements

Norfolk Southern has compensation agreements with officers and certain key employees, which become operative only upon a change in control of NS, 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.

Environmental Matters

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

As of December 31, 1995, NS Rail's balance sheet included a reserve for environmental exposures in the amount of $44 million (of which $12 million is accounted for as a current liability), which is NS Rail's present best estimate of ultimate liability at 96 identified locations. On that date, eight sites accounted for $16 million of the reserve, and no individual site was considered to be material. NS Rail anticipates that the majority of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At many of the 96 locations, NS Rail and/or certain of its 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 clean-up costs.

With respect to known environmental sites (whether identified by NS Rail or by the EPA or comparable state authorities), estimates of NS Rail's 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 clean-up techniques, the likely development of new clean-up technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it) and evolving statutory and regulatory standards governing liability.

The risk of incurring environmental liability—for acts and omissions, past, present and future—is inherent in the railroad business. Some of the commodities, particularly those classified as hazardous materials, in NS Rail's traffic mix can pose special risks that NS Rail works diligently to minimize. In addition, NS Rail owns, or has owned in the past, land holdings used as operating property, or which are leased or may have been leased and operated by others, or held for sale. Because certain conditions may exist on these properties related to environmental problems that are latent or undisclosed, there can be no assurance that NS Rail will not incur liabilities or costs with respect to one or more of them, the amount and materiality of which cannot be estimated reliably now. 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 and, after consulting with its legal counsel, Management believes that it has recorded appropriate estimates of liability for those environmental matters of which NS Rail is aware. Further, Management believes that it is unlikely that any identified matters, either individually or in aggregate, will have a material adverse effect on NS Rail's financial position, results of operations or liquidity.

Independent Auditors' Report

KPMG Peat Marwick LLP

The Stockholders and Board of Directors
Norfolk Southern Railway Company:

We have audited the accompanying consolidated balance sheets of Norfolk Southern Railway Company and subsidiaries (a majority-owned subsidiary of Norfolk Southern Corporation) as of December 31, 1995 and 1994, 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, 1995. 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 generally accepted auditing standards. 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 Railway Company and subsidiaries as of December 31, 1995 and 1994, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1995, in conformity with generally accepted accounting principles.

As discussed in Note 1, the Company changed its methods of accounting in 1994 by adopting the provisions of the Financial Accounting Standards Board's Statement 115, Accounting for Certain Investments in Debt and Equity Securities, and in 1993 by adopting the provisions of the Financial Accounting Standards Board's Statement 109, Accounting for Income Taxes; Statement 106, Employers' Accounting for Postretirement Benefits Other Than Pensions; and Statement 112, Employers' Accounting for Postemployment Benefits.

KPMG Peat Marwick LLP

Norfolk, Virginia
January 23, 1996

NORFOLK SOUTHERN RAILWAY COMPANY AND SUBSIDIARIES

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Quarterly Financial Data (Unaudited)

	Three Months Ended			
	March 31	June 30	Sept. 30	Dec. 31
	($ in millions, except per share amounts)			
1995				
Railway operating revenues	$ 999.2	$ 1,016.4	$ 996.0	$ 1,000.2
Income from railway operations	250.4	284.3	277.9	250.7
Net income	153.3	180.3	193.9	174.2
Dividends per serial preferred share	$ 0.65	$ 0.65	$ 0.65	$ 0.65
1994				
Railway operating revenues	$ 942.3	$ 997.8	$ 975.8	$ 1,002.2
Income from railway operations	226.5	275.0	266.2	281.2
Net income	152.2	177.4	164.7	187.7
Dividends per serial preferred share	$ 0.65	$ 0.65	$ 0.65	$ 0.65

Listing of Officers

David R. Goode
President and Chief Executive Officer
Norfolk, Virginia

Paul N. Austin
Vice President-Personnel
Norfolk, Virginia

William B. Bales
Vice President
Roanoke, Virginia

James C. Bishop, Jr.
Vice President-Law
Norfolk, Virginia

R. Alan Brogan
Vice President-Transportation Logistics
Fort Wayne, Indiana

David A. Cox
Vice President-Properties
Norfolk, Virginia

Thomas L. Finkbiner
Vice President-Intermodal
Norfolk, Virginia

J. W. Fox, Jr.
Vice President-Coal Marketing
Roanoke, Virginia

Thomas J. Golian
Vice President
Norfolk, Virginia

James A. Hixon
Vice President-Taxation
Norfolk, Virginia

Jon L. Manetta
Vice President-Transportation &
Mechanical
Norfolk, Virginia

Harold C. Mauney, Jr.
Vice President-Quality Management
Norfolk, Virginia

Donald W. Mayberry
Vice President-Research and Tests
Roanoke, Virginia

James W. McClellan
Vice President-Strategic Planning
Norfolk, Virginia

Kathryn B. McQuade
Vice President-Internal Audit
Roanoke, Virginia

Charles W. Moorman
Vice President-Information Technology
Norfolk, Virginia

Phillip R. Ogden
Vice President-Engineering
Atlanta, Georgia

L. I. Prillaman
Vice President and Chief Traffic Officer
Norfolk, Virginia

John P. Rathbone
Vice President and Controller
Norfolk, Virginia

William J. Romig
Vice President
Norfolk, Virginia

Donald W. Seale
Vice President-Merchandise Marketing
Norfolk, Virginia

Robert S. Spenski
Vice President-Labor Relations
Norfolk, Virginia

Stephen C. Tobias
Vice President-Operations
Norfolk, Virginia

John R. Turbyfill
Vice President
Norfolk, Virginia

D. Henry Watts
Vice President
Norfolk, Virginia

Henry C. Wolf
Vice President-Finance
Norfolk, Virginia

Sandra T. Pierce
Corporate Secretary
Norfolk, Virginia

Ronald E. Sink
Treasurer
Roanoke, Virginia

Board of Directors

David R. Goode
Chairman, President and Chief
Executive Officer
Norfolk Southern Corporation
Norfolk, Virginia

D. Henry Watts
Vice Chairman
Norfolk Southern Corporation
Norfolk, Virginia

James C. Bishop, Jr.
Executive Vice President-Law
Norfolk Southern Corporation
Norfolk, Virginia

L. I. Prillaman
Executive Vice President-Marketing
Norfolk Southern Corporation
Norfolk, Virginia

Stephen C. Tobias
Executive Vice President-Operations
Norfolk Southern Corporation
Norfolk, Virginia

Henry C. Wolf
Executive Vice President-Finance
Norfolk Southern Corporation
Norfolk, Virginia

Norfolk Southern Railway Company
Three Commercial Place
Norfolk, Virginia 23510-2191

NORFOLK SOUTHERN RAILWAY COMPANY

Annual Report to Stockholders 1996

Norfolk Southern Railway Company and Subsidiaries

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Serial Preferred Stock Information

There are 10,000,000 shares of no par value serial preferred stock authorized. This stock may be issued in series from time to time at the discretion of the Board of Directors with any series having such voting and other powers, designations, dividends and other preferences as deemed appropriate at the time of issuance.

The $2.60 Cumulative Preferred Stock, Series A (Series A Stock), of which 1,197,027 shares were issued and 1,096,907 shares were held other than by subsidiaries as of December 31, 1996, has no par value but has a $50 per share stated value. As indicated in the title, the stock pays a dividend of $2.60 per share annually, payable quarterly on March 15, June 15, September 15 and December 15. Dividends on this stock are cumulative and in preference to dividends on all other classes of stock. Except for any shares held by Norfolk Southern Railway Company subsidiaries and/or in a fiduciary capacity, each share is entitled to one vote per share on all matters, voting as a single class with holders of other stock. Should dividends become delinquent for six quarters, this class of stock, voting as a class, may elect two directors so long as any default in dividend payments continues. The stock is redeemable at the option of Norfolk Southern Railway Company at $50 per share plus accrued dividends. On liquidation, the stock is entitled to $50 per share plus accrued dividends before any amounts are paid on any other class of stock.

In June 1989, Norfolk Southern Corporation (NS) announced its intention to purchase up to 250,000 shares of the outstanding Series A Stock during the subsequent two-year period. Since then, NS extended the stock purchase program through 1996. As of December 31, 1996, NS had purchased 176,608 shares of Series A Stock at a total cost of $6.7 million; as of the same date, NS held a total of 176,703 shares.

Stock Transfer Agent and Registrar

The Bank of New York
101 Barclay Street - 12W
New York, NY 10286-1002
(800) 524-4458

Form 10-K

Norfolk Southern Railway Company will mail a copy of the Annual Report to the Securities and Exchange Commission (Form 10-K) to interested persons upon written request to:

Public Relations Department
Norfolk Southern Corporation
110 Franklin Road, SE
Roanoke, VA 24042-0043

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Description of Business

On June 1, 1982, Southern Railway Company (SR) and Norfolk and Western Railway Company consummated a consolidation under the control of Norfolk Southern Corporation (NS). Following the consolidation, a number of general management functions were combined thereby increasing coordination of sales, marketing and other customer service functions. Effective December 31, 1990, SR's name was changed to "Norfolk Southern Railway Company," and NS contributed all the common stock of Norfolk and Western Railway Company to Norfolk Southern Railway Company. All the common stock of Norfolk Southern Railway Company is owned by NS.

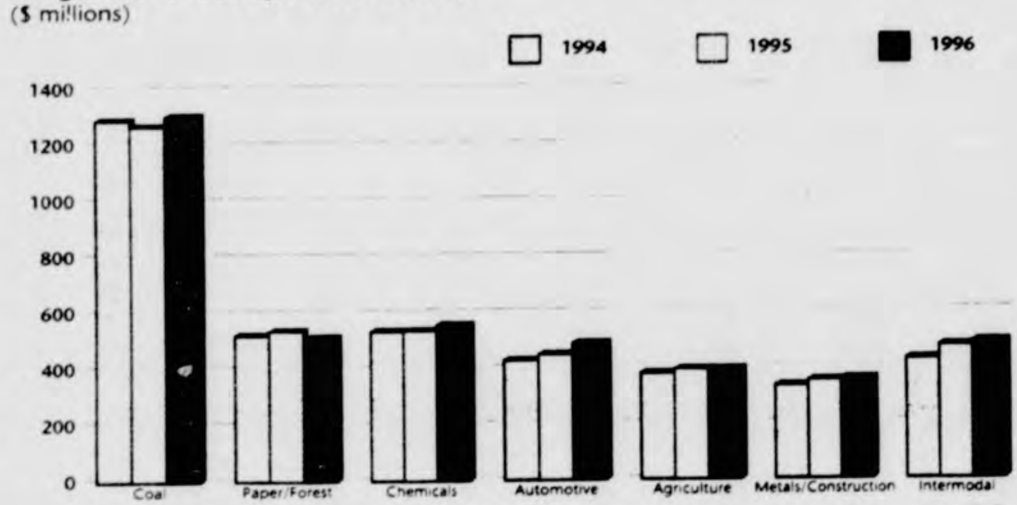
Norfolk Southern Railway Company, together with its consolidated subsidiaries (collectively, NS Rail), is engaged primarily in the transportation of freight by rail. The railroad system's lines extend over more than 14,300 miles of road in 20 states, primarily in the Southeast and Midwest, and the Province of Ontario, Canada. As of December 31, 1996, NS Rail owned or leased 2,158 diesel locomotives, 90,657 freight cars and 5,529 rail-highway trailers and containers.

NS Rail's lines carry raw materials, intermediate products and finished goods primarily in the Southeast and Midwest and to and from the rest of the United States and parts of Canada. These lines also transport overseas freight through several Atlantic and Gulf Coast ports. Atlantic ports served by NS Rail include: Charleston, S.C.; Jacksonville, Fla.; Morehead City, N.C.; Norfolk, Va.; and Savannah and Brunswick, Ga. Gulf Coast ports served include Mobile, Ala., and New Orleans, La.

NS Rail's lines reach most of the larger industrial and trading centers of the Southeast and Midwest, with the exception of those in central and southern Florida. Atlanta, Ga., Birmingham, Ala., New Orleans, Memphis, Tenn., St. Louis, Mo., Kansas City, Mo., Chicago, Ill., Detroit, Mich., Cincinnati, Ohio, Buffalo, N.Y., Norfolk, Charleston, Savannah and Jacksonville are among the leading centers originating and terminating freight traffic on the system. In addition, a haulage arrangement with Florida East Coast Railway allows NS Rail to provide single-line service to and from South Florida, including the port cities of Miami, West Palm Beach and Fort Lauderdale. The system's lines also reach many individual industries, mines (in western Virginia, eastern Kentucky and southern West Virginia) and businesses located in smaller communities in its service area. The traffic corridors carrying the heaviest volumes of freight include those from the Appalachian coal fields of Virginia, West Virginia and Kentucky to Norfolk and Sandusky, Ohio; Buffalo to Chicago and Kansas City; Chicago to Jacksonville (via Cincinnati, Chattanooga, Tenn., and Atlanta); and Washington, D.C./Hagerstown, Md., to New Orleans (via Atlanta and Birmingham).

Buffalo, Chicago, Hagerstown, Jacksonville, Kansas City, Memphis, New Orleans and St. Louis are major gateways for interterritorial system traffic.

Freight Revenues by Market Group
($ millions)



2 Norfolk Southern Railway Company and Subsidiaries

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Five-Year Financial Review

	1996	1995	1994	1993[1]	1992
			($ in millions)		
Results of operations:					
Railway operating revenues	**$ 4,101.0**	$ 4,011.8	$ 3,918.1	$ 3,727.6	$ 3,709.1
Railway operating expenses	**2,936.3**	2,948.5	2,869.2	2,805.9	2,781.7
Income from railway operations	**1,164.7**	1,063.3	1,048.9	921.7	927.4
Other income – net	**39.1**	43.3	46.6	57.6	49.5
Interest expense on debt	**33.9**	33.0	28.3	32.3	44.6
Income before income taxes	**1,169.9**	1,073.6	1,067.2	947.0	932.3
Provision for income taxes	**401.4**	371.9	385.2	412.8	325.8
Income before accounting changes	**768.5**	701.7	682.0	534.2	606.5
Cumulative effect of accounting changes	—	—	—	247.8	—
Net income	**$ 768.5**	$ 701.7	$ 682.0	$ 782.0	$ 606.5
Financial Position:					
Total assets	**$ 11,053.3**	$ 10,752.3	$ 10,289.2	$ 9,760.4	$ 9,675.5
Total long-term debt, including current maturities	**$ 597.9**	$ 574.4	$ 539.8	$ 604.9	$ 714.5
Stockholders' equity	**$ 5,771.8**	$ 5,645.4	$ 5,440.5	$ 5,184.9	$ 4,784.3
Other:					
Capital expenditures	**$ 754.0**	$ 713.3	$ 639.6	$ 629.[illegible]	$ 617.1
Number of stockholders at year-end	**2,763**	3,025	3,281	3,517	3,725
Average number of employees[2]	**23,361**	24,488	24,710	25,531	25,650

[1] *1993 results include a $60.8 million increase in the provision for income taxes reflecting a 1% increase in the federal income tax rate. The cumulative effect of accounting changes increased 1993 earnings by $247.8 million. The change in accounting for income taxes increased net income by $470.4 million, with a corresponding reduction in deferred taxes. The changes in accounting for postretirement and postemployment benefits decreased net income by $222.6 million.*

[2] *The employee count includes Norfolk Southern Corporation's employees whose primary duties relate to rail operations.*

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes beginning on page 12 and the Five-Year Financial Review on page 2.

SUMMARIZED RESULTS OF OPERATIONS

1996 Compared with 1995

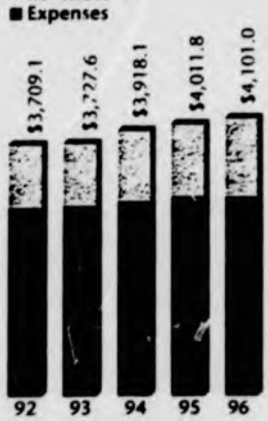
Net income in 1996 was $768.5 million, an increase of 10%. However, results in 1995 were affected by a $33.6 million early retirement charge, which reduced net income by $20.4 million.

Absent the effects of that charge, 1996 net income was up 6%. The improvement was due to increased income from railway operations of $67.8 million, or 6%, reflecting higher operating revenues, up 2%, and generally flat operating expenses, up less than 1% (excluding the early retirement charge).

1995 Compared with 1994

Net income in 1995 was $701.7 million, up 3%. Excluding the 1995 early retirement charge, net income rose 6%. These results were driven primarily by improved income from railway operations, up $48.0 million, or 5% (excluding the early retirement charge). Railway operating revenues increased 2%, while railway operating expenses, excluding the early retirement charge, were up 2%. Interest expense on debt was up $4.7 million, largely due to a lower level of capitalized interest.

Railway Operating Revenues and Expenses
($ millions)
Revenues
Expenses



DETAILED RESULTS OF OPERATIONS

Railway Operating Revenues

Railway operating revenues were $4.1 billion in 1996, compared with $4.0 billion in 1995 and $3.9 billion in 1994. The $89.2 million improvement in 1996, compared with 1995, was the result of improvements in all market groups except paper/forest and agriculture. The $93.7 million improvement in 1995, compared with 1994, was primarily attributable to increases in the intermodal, automotive and metals/construction market groups.

The following table presents a three-year comparison of revenues by market group.

Railway Operating Revenues by Market Group

($ in millions)	1996	1995	1994
Coal	$1,304.7	$1,267.8	$1,290.2
Chemicals	555.9	536.5	534.7
Paper/forest	513.0	537.3	521.8
Automotive	488.7	449.1	429.0
Agriculture	393.3	393.7	379.5
Metals/construction	358.0	353.1	334.2
Intermodal	487.4	474.3	428.7
Total	$4,101.0	$4,011.8	$3,918.1

Note: Revenues previously reported as "Other railway revenues" (principally switching and demurrage) have been reclassified into each of the commodity groups.

In 1996, increases in coal, automotive, intermodal and chemicals traffic offset decreases in the remaining market groups. For 1995 improvements in automotive, agriculture, metals/construction and intermodal traffic offset declines in the other groups. The traffic volume gains in both years accounted for most of the revenue improvement as shown in the table below. Average revenue per unit rose in both 1996 and 1995 due to moderate rate increases.

Railway Operating Revenue Variance Analysis
Increases (Decreases)

($ in millions)	1996 vs. 1995	1995 vs. 1994
Traffic volume	$ 72.6	$ 62.6
Revenue per unit	16.6	31.1
Total	$ 89.2	$ 93.7

COAL traffic volume increased 4%, and revenues increased 3% in 1996, primarily due to increased utility and export coal tonnage. Coal revenues represented almost 32% of total railway operating revenues in 1996, and 90% of coal shipments originated on NS Rail's lines. Coal traffic volume declined 1%, and revenues were down 2% in 1995, compared with 1994, as coal tonnage by type remained relatively stable.

Total Coal, Coke and Iron Ore Tonnage

(in millions of tons)	1996	1995	1994
Utility	74.7	70.3	71.6
Export	27.0	25.8	25.2
Steel	20.6	22.1	21.6
Other	7.9	6.9	7.5
Total	130.2	125.1	125.9

Note: Certain prior year amounts have been reclassified to conform to the current year presentation.

Utility coal traffic increased 6% in 1996, compared with 1995. Several utility customers in the NS Rail service region shifted more generation to coal-fired plants, as many nuclear power plants experienced downtime. In addition, NS Rail gained market share at several Southeastern utilities.

In 1995, utility coal traffic decreased slightly due to moderate weather throughout much of the NS Rail service region during the first half of the year and to sustained periods of maximum generation from several Southeastern nuclear power plants. Partially mitigating these declines were increased shipments of both NS Rail- and foreign-line-originated, low-sulfur coal related to utilities' compliance with Phase I of the Clean Air Act Amendments, which took effect on January 1, 1995.

The near-term outlook for utility coal is positive, as a significant number of the mines served by NS Rail produce coals that satisfy both Phase I and the more stringent Phase II requirements, which take effect on January 1, 2000. However, adoption of tighter restrictions on nitrous oxide particulate emissions, as proposed by the Environmental Protection Agency, could impose added cost burdens on some coal-fired plants.

Utilities in the Southeast, NS Rail's largest steam coal market, are expected to increase their demand for Central Appalachian coal. Utility deregulation is likely to affect the structure and development of that market. Specifically, it is widely anticipated that U.S. utilities will have greater flexibility in selling electricity to, and buying it from, other regional markets. At present, however, transmission line capacity is somewhat strained on the lines leading to and from the Southeastern U.S., and resistance by environmentalists and the high cost of adding new line capacity could deter its development. Less certain is the outlook for demand for Central Appalachian coal from utilities in the Midwest, as the delivered cost of Western coal tends to be lower. However, NS Rail expects to participate in the movement of any Western coal that displaces NS Rail-originated deliveries.

Export coal traffic increased 5% in 1996, compared with 1995, as NS Rail benefited from increased steam coal exports to Italy and greater metallurgical shipments to Germany, a result of reduced subsidies to German coal producers that enhanced the competitiveness of U.S. coal. Increased exports of U.S. coal to Brazil also contributed to the improvement.

Export coal traffic increased 2% in 1995, benefiting from the continued recovery of European steel production. Demand from other parts of the world also improved. Brazil, Belgium, France, Romania and Japan took increased amounts of NS Rail coal. In addition, NS Rail began handling metallurgical coal for steel production in Mexico. Congestion and high barge rates on the Mississippi River caused an increase in movements over NS Rail's coal piers in Norfolk, Va.

Metallurgical coal exports are expected to experience slight to modest growth through the year 2000, as continued reductions in European government subsidies to coal producers should benefit NS Rail-served exporters. A gradual decline is projected in the long term, as new steel making technologies replace those requiring coking coal. Demand for export steam coal is expected to increase, and NS Rail is working to increase its participation in this market.

Steel coal domestic traffic was down 7%, as aggressive producer pricing of higher volatile metallurgical coals not located on NS Rail's lines resulted in a loss of traffic. In 1995, traffic was up 2% due to completion of extended coke oven work at one facility and continued strong demand for domestic coke for making steel. Advanced technologies that allow production of steel with little or no coke could cause this market to decline slowly over the long term. However, NS Rail could participate in the movement of non-coking coal used by technologies such as pulverized coal injection.

Other coal traffic, primarily steam coal shipped to manufacturing plants, increased 14% in 1996, compared with 1995, reflecting gains from other modes of transportation and more seasonal weather conditions in 1996. Traffic volume declined 8% in 1995, compared with 1994, resulting from lower demand for in-plant use of electricity due to mild weather. In addition, some industries have switched to natural gas as a fuel source. This market is expected to remain stable in coming years, as growth through innovative packaged delivery services offsets losses from natural gas conversions.

MERCHANDISE traffic volume in 1996 decreased slightly, compared with 1995, as increases in automotive, intermodal and chemicals traffic were more than offset by declines in the remaining commodity groups. However, increased average revenues for most commodity groups resulted in a 2% improvement in revenues. In 1995, merchandise traffic volume increased 5%, driven by increases in intermodal, automotive and agriculture traffic. Merchandise revenues in 1995 increased 4%, compared with 1994.

Chemicals traffic and revenues grew 3% and 4%, respectively, for 1996. Fertilizer and plastics markets strengthened during 1996, which resulted in increased traffic and revenues for these two groups. In addition, the harsh winter resulted in greater movements of liquid petroleum gas, and industrial chemicals remained strong throughout the year. These 1996 results compared favorably with relatively flat carloads and revenues in 1995, as increases for general chemicals were overshadowed by weakness in the plastics and fertilizer markets. The chemicals market group is expected to continue to show moderate growth through 1997, as NS Rail expands its Thoroughbred Bulk Distribution facilities and chemicals production nationwide is expected to increase.

Paper/forest traffic and revenues each declined 5% in 1996, due to the overall downturn in the paper and forest products industry. Early in 1995, the paper industry enjoyed record price levels and associated volumes, but growth slowed and inventories of paper products swelled in late 1995 and into 1996. To correct the inventory problems, many large paper producers operated mills well below capacity and shut down mills to balance capacity with demand. This compares to a 1% decrease in volume and a 3% increase in revenues for 1995. Paper and pulpwood products traffic in 1995 was about even with 1994, while lumber traffic suffered from weak housing starts. These markets are expected to begin a slight turnaround by mid-1997.

Automotive traffic rose 8%, and revenues increased 9%, both the highest in this group's history. Auto parts provided the majority of the growth as volume increased 21%, while vehicle traffic increased 3%. NS Rail opened two just-in-time (JIT) rail centers at Hagerstown, Md., and near Buffalo, N.Y., in 1996 for distribution of vehicle parts for GM. Also, GM awarded NS Rail another JIT rail center to be constructed in 1997 near Dayton, Ohio. These three centers are expected to handle over 23,000 carloads annually by 1998. 1996 also marked the first time in several years that all NS Rail-served assembly plants were on-line. GM's Wentzville, Mo., assembly plant returned to production early in the year after a two-year retooling, and GM's Doraville, Ga., plant returned midyear from a one-year retooling. In 1996, BMW's new plant at Greer, S.C., reached full production. In 1995, automotive traffic increased 4%, and revenues were up 5%. Strong production at selected plants that produce popular cars and trucks mitigated the effects of several plants' being shut down or operated at reduced capacity.

Good market growth is expected in 1997, supported by the new JIT rail centers, full production levels at existing plants, the start of production at the new Mercedes plant in Tuscaloosa, Ala., and the expansion of Toyota's plant in Georgetown, Ky. Supporting long-term growth, Ford awarded NS Rail a 12-year contract in 1996 to handle approximately 3 million new vehicles annually through four mixing centers to be built in 1997. When operational in 1998, NS Rail expects to increase its motor vehicle business with Ford by 60%. In addition, Toyota's new Princeton, Ind., truck plant may add to 1998-1999 traffic. For the automotive industry as a whole, annual production increases are forecast through 2002, as transplants bring production to North America, exports continue to rise and the Mexican and Canadian economies improve.

Agriculture traffic declined 4% and revenues were flat in 1996. Despite strong demand for feed grains in the Southeast, grain traffic suffered, as poor crops and strong export demand left NS Rail receivers competing for limited supplies. Slight average revenue growth occurred, resulting primarily from longer hauls, as receivers reached farther west for grain supplies. In 1995, agriculture traffic rose 2%, and revenues increased 4%, due to higher grain shipments from the Midwest to the Southeast poultry industry.

Moderate growth is expected in 1997, as 1996 crops should provide abundant supplies throughout the year, and demand from the poultry market for feed grain continues to grow. Also for 1997, a full year of new business is expected from two feed mills which were ramping up production in 1996, and from a new major grain elevator located on a line purchased during 1996 from Conrail.

Metals/construction traffic declined 2%, but revenues were up 1% for 1996. Construction carloads fell behind in early 1996 due to inclement weather and were flat the rest of the year; however, higher average revenues more than offset the volume decline. In the metals market, NS Rail's shipments remained strong due to a healthy domestic steel market, which has added capacity through improved efficiency at integrated mills and new mini-mills. In 1995, metals/construction traffic was up slightly, and revenues increased 6%, as increases in the steel and aluminum markets were somewhat offset by reduced demand for construction products.

Moderate growth is expected for 1997. New steel production facilities in Decatur, Ala., and Memphis, Tenn., are expected to contribute to growth in late 1997. Although construction starts are expected to decrease in 1997 versus 1996, projects already begun, such as at the Chesapeake Bay Bridge Tunnel, the opening of new cement terminals and the expansion of various on-line plants, are expected to produce moderate growth for construction in 1997 and beyond.

Intermodal traffic volume increased 5% and revenues increased 3%, both reaching record levels in 1996, driven by increased domestic container and Triple Crown Services Company (TCSC) volume.

EMP, the container equipment-sharing arrangement with Union Pacific and Conrail, contributed significantly to domestic growth. International container volume declined only slightly, despite an industry slowdown that began in the spring and lasted until the fall. NS Rail's overall market share improved slightly due to new international business and the continued domestic container and TCSC growth.

Intermodal volume rose 12%, and revenues increased 11% in 1995. Although intermodal traffic levels nationwide declined in 1995, NS Rail intermodal achieved record levels of volume, revenues and profitability, led by container shipments in both domestic and international service.

During 1995, a seven-year agreement with Hanjin Shipping Company was signed under which NS Rail will handle nearly all of Hanjin's international container business in NS Rail's territory east of the Mississippi River.

EMP contributed significantly to domestic growth. Almost all the increase in international container business was attributable to new services, thereby increasing NS Rail's market share. Domestic business also was augmented by growth in the trucking segment, as both truckload and less-than-truckload companies increased their use of NS Rail intermodal. Additionally, intermodal marketing companies increased their business on NS Rail.

NS Rail's intermodal volume is expected to remain strong, resulting from continued domestic container and TCSC volume growth and the recovery in the international market. Higher wages in the trucking industry may encourage shippers to use NS Rail's intermodal and TCSC networks. In addition, growth of steamship companies' use of Suez Canal services may have a positive impact on international container shipments into and out of Southeast ports.

Railway Operating Expenses

Railway operating expenses in 1996 decreased slightly; however, 1995's expenses included a $33.6 million charge for an early retirement program (see Note 12). Excluding that early retirement charge, railway operating expenses increased 1%, despite a 2% increase in traffic volume. Railway operating expenses in 1995 were up 3% (up 2%, excluding the early retirement charge) on a 3% increase in traffic volume.

Railway Operating Ratio

As a result, the *NS Rail railway operating ratio*, which measures the percentage of railway revenues consumed by expenses, was a record 71.6 in 1996, compared with 73.5 (72.7 excluding the early retirement charge) in 1995 and 73.2 in 1994. NS Rail's railway operating ratio continues to be the best among the major railroads in the United States.

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

Railway Operating Expenses ($ in millions)	Increases (Decreases) 1996 vs. 1995	1995 vs. 1994
Compensation and benefits	$ (81.3)*	$ 108.9 *
Materials, services and rents	6.3	(45.4)
Depreciation	20.1	22.3
Diesel fuel	43.6	1.5
Casualties and other claims	2.1	(13.7)
Other	(3.0)	5.7
Total	$ (12.2)	$ 79.3

**Includes the $33.6 million early retirement charge in 1995.*

Compensation and benefits, which represents about half of total railway operating expenses, decreased 5% in 1996 and increased 8% in 1995. Excluding the 1995 early retirement charge, compensation and benefits expenses were down 3% in 1996 and up 5% in 1995.

The 1996 decrease (excluding the effect of the 1995 early retirement charge) was principally attributable to: (1) reduced employment resulting from the 1995 early retirement program and productivity improvements due to ongoing reductions in train crew sizes and train efficiencies and (2) lower costs for fringe benefits, principally medical costs for salaried employees. These decreases were somewhat offset by increases attributable to higher volume and increased wage rates resulting from new labor agreements.

The 1995 increase was primarily a result of: (1) higher wages; (2) increased performance-based compensation accruals, particularly those linked to the market price of NS stock, which rose nearly $19 per share in 1995; and (3) higher health care costs for agreement employees.

As of the end of 1996, NS Rail had negotiated labor agreements with all of its unions, except the American Train Dispatchers which represents about 200 employees. The accords with the 12 other union organizations, which include compensation settlements in line with other major industries, will not be due for change until after January 1, 2000.

Materials, services and rents includes items used for the maintenance of the railroads' 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 increased 1% in 1996 and decreased 7% in 1995.

The increase in 1996 resulted from higher intermodal expenses due to increased volume, as well as higher equipment rent costs, that more than offset lower locomotive and car repair costs.

Equipment rents, which represent the cost to NS Rail of using equipment (mostly freight cars) owned by other railroads or private owners, less the rent paid to NS Rail for the use of its equipment, were up 10% in 1996. This increase was due to a variety of factors, including increased intermodal container traffic, lower receipts from short-term leases of locomotives to various railroads and increased freight car leases to meet customer requirements. These increased costs were somewhat offset by lower net costs for multilevel equipment.

Locomotive repair costs continued to be reduced as a result of the replacement of older units with newer ones. NS Rail expects to acquire 120 new locomotives in 1997. Freight car repair costs continued to benefit from the effects of initiatives launched in 1995 to improve asset utilization that resulted in the re-engineering of maintenance practices, facilitating the closure of two repair facilities in 1995 and the disposition of 17,000 excess freight cars, which was substantially completed in 1996.

The decrease in "Materials, services and rents" in 1995 reflected initial results from the initiatives to improve asset utilization, as well as reduced locomotive repair costs and lower net equipment rental expense. The reduction in equipment rents in 1995 was due to the short-term leasing of certain older locomotives to other railroads and the deregulation of car-hire rates among railroads, which began in 1994. These favorable results were somewhat offset by increased expenses related to the 12% growth in intermodal traffic.

Depreciation expense (see Note 1, "Properties," for NS Rail's depreciation policy) was up 5% in 1996 and 6% in 1995. Both increases were due to property additions, reflecting substantial levels of capital spending over the last several years.

Diesel fuel costs rose 23% in 1996, but were up less than 1% in 1995. The increase in 1996 was due to a 20% increase in the average price per gallon, as prices reached levels unseen since 1991 during and following the Persian Gulf Crisis. Consumption was up 3% on a similar increase in carloadings. The 1995 increase was primarily due to a small increase in the average price per gallon.

Casualties and other claims (including estimates of costs related to personal injury, property damage and environmental matters) increased 2% in 1996, but declined 10% in 1995. In 1996, higher accruals for environmental remediation costs more than offset reduced accruals for personal injury liabilities and the effects of a nonrecurring liability insurance premium refund. The 1995 decrease was primarily attributable to environmental costs in 1994 associated with a tankcar leak.

The largest component of "Casualties and other claims" is personal injury expense. NS Rail continued to benefit from a reduction in the number of reportable injuries in 1996; however, as in prior years, much of that benefit was offset by an increase in the cost of third-party injury claims and by the continuing costs associated with the handling of non-accidental "occupational" claims. NS Rail continues to work actively to reduce the risk of all accidents.

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 employees' claims for on-the-job injuries, promotes an adversarial claim settlement environment and produces results that are unpredictable and inconsistent, at far greater cost to the rail industry than the no-fault workers' compensation system to which non-rail competitors are universally subject. The railroads have been unsuccessful so far in efforts to persuade Congress to replace FELA with a no-fault workers' compensation system.

Other expenses were down 2% in 1996, but were up 4% in 1995. The 1995 increase was due to higher sales, use and franchise taxes.

NS Rail expects to complete work to make its software year-2000 compliant by the end of 1998. It is anticipated that the total cost of conversion will not be material to NS Rail's financial statements.

Income Taxes

Income tax expense in 1996 was $401.4 million for an effective rate of 34.3%, compared with an effective rate of 34.6% in 1995 and 36.1% in 1994.

The effective rates in 1996 and 1995 were below the statutory federal and state rates as a result of investments in corporate-owned life insurance and coal-seam gas properties and from favorable adjustments upon filing the prior year tax returns. In addition, 1996 benefited from favorable adjustments resulting from settlement of federal income tax years 1990-1992. The effective rate in 1994 also was below the statutory federal and state rates due to favorable adjustments resulting from settlement of federal income tax years 1988 and 1989, an adjustment to the valuation allowance for deferred tax assets and a favorable adjustment upon filing the 1993 tax return. Deferred tax expense was an unusually high portion of total tax expense in 1994. A corresponding reduction is reflected in 1994's current tax expense for the effects of expenditures that affect book and tax accounts in different years, primarily in the areas of compensation and property.

Accounting Changes and New Accounting Pronouncements

As discussed in Note 1 under "Required Accounting Changes," effective January 1, 1996, NS Rail adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" (SFAS 121), which had no material effect on NS Rail's financial statements.

Effective January 1, 1994, NS Rail adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115). The principal result was a significant write-up of NS Rail's investment in NS stock. This non-cash adjustment had no income statement effect but increased "Investments" and "Stockholders' equity" in the Consolidated Balance Sheets (see also Note 14).

On October 10, 1996, the AICPA issued Statement of Position 96-1, "Environmental Remediation Liabilities" (SOP 96-1), which is effective for fiscal years beginning after December 15, 1996. SOP 96-1 provides guidance with respect to recognition and measurement of environmental remediation liabilities and disclosure of such liabilities in financial statements. SOP 96-1 is not expected to have a material effect on NS Rail's financial statements.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Financial condition refers to the assets, liabilities and stockholders' equity of an organization (see Consolidated Balance Sheets on page 13). Liquidity refers to the ability of an organization to generate adequate amounts of cash, principally from operating results or through borrowing power, to meet its short-term and long-term cash requirements (see Consolidated Statements of Cash Flows on page 14). Capital resources refers to the ability of an organization to raise funds through the sale of either debt or equity (stock) securities.

($ in millions)	1996	1995	1994	1993	1992
Cash and short-term investments	**$315.5**	$230.0	$180.9	$152.0	$ 64.0
Current assets to current liabilities	**1.2**	1.0	1.1	1.3	1.2
Debt to total capitalization	**9.8%**	9.6%	9.4%	10.9%	13.4%
Return on average stockholders' equity	**13.5%**	13.0%*	12.8%	12.0%*	13.1%

** Excluding unusual items: In 1995, the early retirement charge; and, in 1993, the cumulative effects of required accounting changes and the prior years' effect of the federal income tax rate increase.*

Cash provided by operating activities, NS Rail's principal source of liquidity, decreased $49.9 million, or 4%, in 1996 and increased $96.4 million, or 8%, in 1995. Since the consolidation in 1982, cash provided by operating activities has been sufficient to fund dividend requirements, debt repayments and a significant portion of capital spending. The decrease in 1996 was largely attributable to lump-sum wage payments associated with labor contract settlements and higher income tax payments related to the settlement of federal income tax years 1990-1992. The improvement in 1995 was primarily a result of increased income from operations (excluding the early retirement charge, a non-cash item) and improved billing and collection of receivables.

Cash used for investing activities decreased 7% in 1996 and was up 56% in 1995. Property additions account for most of the spending in this category. In 1994, large borrowings on corporate-owned life insurance offset much of the use of cash for property additions in that year.

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

Capital Expenditures

($ in millions)	1996*	1995*	1994	1993	1992
Road	**$428.4**	$379.5	$382.3	$411.0	$425.1
Equipment	**325.6**	332.6	235.0	218.1	187.8
Other property	**—**	1.2	22.3	0.1	4.2
Total	**$754.0**	$713.3	$639.6	$629.2	$617.1

** Includes non-cash equipment expenditures of $1[illegible]7.8 million in 1996 and $104.5 million in 1995 (see Note 8 o[illegible] page 19).*

Track Structure Statistics (Capital and Maintenance)

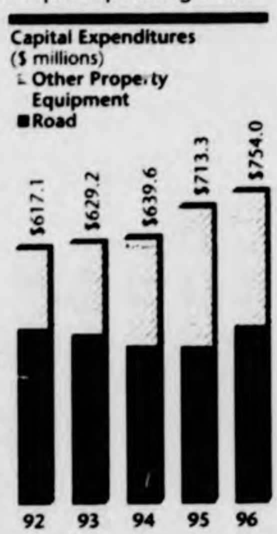
	1996	1995	1994	1993	1992
Track miles of rail installed	**401**	403	480	574	660
Miles of track surfaced	**4,686**	4,668	4,760	5,048	5,690
New crossties installed (millions)	**1.9**	2.0	1.7	1.6	1.9

Average Age of Railway Equipment

(Years)	1996	1995	1994	1993	1992
Freight cars	**22.3**	22.0	21.9	21.3	20.9
Locomotives	**15.4**	15.7	15.8	15.1	14.5
Retired locomotives	**24.4**	22.6	23.6	24.7	24.0

Since 1988, NS Rail has rebodied about 23,000 coal cars and plans to continue that program, although at a slower rate, in 1997. This work, performed at NS Rail's Roanoke Car Shop, converts 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.

Efforts to hold down capital spending while increasing business are ongoing as NS Rail seeks to maximize utilization of its assets. In this connection, NS Rail began an orderly disposition of approximately 17,000 freight cars in October 1994. This was substantially completed in 1996 with total proceeds of $92 million included in "Property sales and other transactions" in the 1996 and 1995 Consolidated Statements of Cash Flows. In 1996, this line item also reflected proceeds from large land sales (see Note 3).



For 1997, NS Rail is planning $781 million of capital spending. Barring unforeseen events, total capital spending is expected to continue to be similar to 1995 and 1996 levels.

Cash used for financing activities decreased 18% in 1996 and 14% in 1995. The higher uses in 1995 and 1994 were due to significant advances made to NS. In addition, 1994 debt repayments were high due to the maturity of a large mortgage.

Hedging Activities

As discussed under "Capital Leases" in Note 8, NS Rail has made limited use of interest rate swaps in connection with certain equipment financings.

PROPOSED ACQUISITION OF CONRAIL BY NS

As discussed in Note 16, NS commenced an all-cash tender offer for all Shares of Conrail Inc. (Conrail), on October 24, 1996, in response to the October 15, 1996, announcement that Conrail had entered into a merger agreement with CSX. The full terms and conditions of the tender offer and certain other disclosures are set forth in documents filed by NS with the Securities and Exchange Commission on October 24, November 8 and December 20, 1996, and January 22 and February 12, 1997.

On February 11, 1997, NS acquired 8.2 million Shares of Conrail stock (approximately 9.9%), representing the approximate maximum number of Shares NS can buy without triggering Conrail's current anti-takeover defenses, at a cost of $115 per Share, or $943 million in the aggregate. The purchase was financed with commercial paper backed by a portion of the debt commitments secured for the transaction. These Conrail Shares have been placed in a voting trust and under certain circumstances might have to be sold at a loss.

NS expects future cash flows of the merged entity would be sufficient to service and retire the acquisition and related debt. However, as a result of the proposed transaction and the related debt commitments, NS has been placed on the credit watch list of two major rating agencies. Furthermore, in connection with the acquisition of 8.2 million Conrail Shares, some of NS' and NS Rail's debt ratings have already been downgraded.

The Conrail board repeatedly has affirmed its commitment to a merger with CSX. Absent significant asset divestitures, the combined CSX-Conrail system would have almost 70% of the total NS Rail, Conrail and CSX rail revenues, putting NS Rail at a significant competitive disadvantage. NS intends to pursue its tender offer and expects to file an application for control of Conrail with the Surface Transportation Board (STB).

ENVIRONMENTAL MATTERS

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

Operating expenses for environmental protection totaled approximately $25 million in 1996 and are anticipated to increase somewhat in 1997. Capital expenditures for environmental projects amounted to approximately $6 million in 1996 and are expected to be at the same level in 1997. As of December 31, 1996, NS Rail's balance sheet included a reserve for environmental exposures in the amount of $53 million (of which $12 million is accounted for as a current liability), which is NS Rail's estimate of the probable costs based on available information at 111 identified locations. On that date, nine sites accounted for $19 million of the reserve, and no individual site was considered to be material. NS Rail 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 many of the 111 locations, NS Rail and/or certain of its 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 clean-up costs.

At one such site, the EPA alleged in 1995 that The Alabama Great Southern Railroad Company (AGS), a subsidiary of NS Rail, is responsible, along with several other entities believed to be financially solvent, for past and future clean-up and monitoring costs at the Bayou Bonfouca NPL Superfund site located in Slidell, La. The EPA bases its claim of NS Rail's responsibility primarily on the alleged activities in the 1880s of a company not at the time owned or controlled by an NS Rail subsidiary, but acquired in 1916. Liability has been contested. Because the amount of liability that the EPA may assert against NS Rail or AGS is not known, the materiality of such amount to NS Rail's financial position, results of operation or liquidity in a particular quarter or year cannot be assessed at this time. The EPA has indicated that it has expended or expects to expend a total of approximately $130 million at the site.

With respect to known environmental sites (whether identified by NS Rail or by the EPA or comparable state authorities), estimates of NS Rail's 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 clean-up techniques, the likely development of new clean-up technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it) and evolving statutory and regulatory standards governing liability.

The risk of incurring environmental liability—for acts and omissions, past, present and future—is inherent in the railroad business. Some of the commodities, particularly those classified as hazardous materials, in NS Rail's traffic mix can pose special risks that NS Rail and its subsidiaries work diligently to minimize. In addition, NS Rail owns, or has owned in the past, land holdings used as operating property, or which are leased or may have been leased and operated by others, or held for sale. Because certain conditions may exist on these properties related to environmental problems that are latent or undisclosed, there can be no assurance that NS Rail will not incur liabilities or costs with respect to one or more of them, the amount and materiality of which cannot be estimated reliably now. 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 and, after consulting with its legal counsel, Management believes that it has recorded the probable costs based on available information for those environmental matters of which the Corporation is aware. Further, Management believes that it is unlikely that any identified matters, either individually or in aggregate, will have a material adverse effect on NS Rail's financial position, results of operations or liquidity.

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 Rail, a capital-intensive company, has approximately $13 billion 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

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

■ *FELA*—NS Rail and the rail industry are continuing their efforts to replace the FELA with no-fault workers' compensation laws comparable to those covering employees in other industries.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Annual Report contain forward-looking statements that are based on current expectations, estimates and projections. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed in such forward-looking statements.

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Norfolk Southern Railway Company and Subsidiaries

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Consolidated Statements of Income

	Years ended December 31, 1996	1995	1994
	($ in millions)		
Railway operating revenues	**$ 4,101.0**	$ 4,011.8	$ 3,918.1
Railway operating expenses:			
Compensation and benefits (Note 12)	**1,398.7**	1,480.0	1,371.1
Materials, services and rents	**629.5**	623.2	668.6
Depreciation	**403.0**	382.9	360.6
Diesel fuel	**233.4**	189.8	188.3
Casualties and other claims	**123.4**	121.3	135.0
Other	**148.3**	151.3	145.6
Railway operating expenses	**2,936.3**	2,948.5	2,869.2
Income from railway operations	**1,164.7**	1,063.3	1,048.9
Other income – net (Note 3)	**39.1**	43.3	46.6
Interest expense on debt (Note 6)	**33.9**	33.0	28.3
Income before income taxes	**1,169.9**	1,073.6	1,067.2
Provision for income taxes (Note 4)	**401.4**	371.9	385.2
Net income	**$ 768.5**	$ 701.7	$ 682.0

See accompanying notes to consolidated financial statements.

Norfolk Southern Railway Company and Subsidiaries

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Consolidated Balance Sheets

	As of December 31, 1996	1995
	($ in millions)	
Assets		
Current assets:		
Cash and cash equivalents	$ **172.1**	$ 49.3
Short-term investments (Note 14)	**143.4**	180.7
Accounts receivable net of allowance for doubtful accounts of $3.6 million and $2.8 million, respectively	**545.7**	542.1
Materials and supplies	**61.2**	59.8
Deferred income taxes (Note 4)	**95.3**	98.8
Other current assets	**119.8**	92.1
Total current assets	**1,137.5**	1,022.8
Due from NS – net (Note 2)	**—**	186.8
Investments (Notes 5 and 14)	**870.7**	771.0
Properties less accumulated depreciation (Note 6)	**9,014.9**	8,750.4
Other assets	**30.2**	21.3
Total assets	$ **11,053.3**	$ 10,752.3
Liabilities and stockholders' equity		
Current liabilities:		
Short-term debt (Note 8)	$ **27.2**	$ 27.2
Accounts payable (Note 7)	**549.8**	567.2
Income and other taxes	**158.3**	179.4
Due to NS – net (Note 2)	**64.9**	—
Other current liabilities (Note 7)	**109.0**	124.3
Current maturities of long-term debt (Note 8)	**54.3**	79.7
Total current liabilities	**963.5**	977.8
Long-term debt (Note 8)	**543.6**	494.7
Other liabilities (Note 10)	**886.0**	870.8
Minority interests	**2.4**	2.3
Deferred income taxes (Note 4)	**2,886.0**	2,761.3
Total liabilities	**5,281.5**	5,106.9
Stockholders' equity:		
Serial preferred stock (Note 11)	**54.8**	54.8
Common stock (Note 11)	**166.7**	166.7
Other capital	**525.5**	525.5
Unrealized gain on marketable securities (Note 14)	**397.8**	337.3
Retained income	**4,627.0**	4,561.1
Total stockholders' equity	**5,771.8**	5,645.4
Total liabilities and stockholders' equity	$ **11,053.3**	$ 10,752.3

See accompanying notes to consolidated financial statements.

14 Norfolk Southern Railway Company and Subsidiaries

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Consolidated Statements of Cash Flows

	1996	1995	1994
	Years ended December 31, ($ in millions)		
Cash flows from operating activities:			
Net income	**$ 768.5**	$ 701.7	$ 682.0
Reconciliation of net income to net cash provided by operating activities:			
Special charge payments	**(18.0)**	(29.3)	(41.9)
Depreciation	**404.2**	383.8	361.3
Deferred income taxes	**89.4**	43.2	114.2
Nonoperating gains on property sales	**(25.5)**	(8.7)	(7.8)
Changes in assets and liabilities affecting operations:			
Accounts receivable	**(3.6)**	10.6	(29.8)
Materials and supplies	**(1.4)**	(1.3)	7.4
Other current assets	**(13.5)**	(2.3)	(12.5)
Current liabilities other than debt	**(33.6)**	104.5	6.7
Other – net	**34.4**	48.6	74.8
Net cash provided by operating activities	**1,200.9**	1,250.8	1,154.4
Cash flows from investing activities:			
Property additions	**(646.2)**	(608.8)	(639.6)
Property sales and other transactions	**96.0**	80.4	52.9
Investment purchases	**(59.7)**	(65.6)	(45.9)
Investment sales and other transactions	**22.0**	29.4	249.2
Short-term investments – net	**36.1**	(31.3)	1.0
Net cash used for investing activities	**(551.8)**	(595.9)	(382.4)
Cash flows from financing activities:			
Dividends (Note 2)	**(288.6)**	(291.5)	(279.4)
Due to/from NS – net (Note 2)	**(162.3)**	(285.1)	(394.2)
Proceeds from long-term borrowings	**9.6**	7.6	41.4
Long-term debt repayments	**(85.0)**	(70.4)	(108.3)
Net cash used for financing activities	**(526.3)**	(639.4)	(740.5)
Net increase in cash and cash equivalents	**122.8**	15.5	31.5
Cash and cash equivalents:			
At beginning of year	**49.3**	33.8	2.3
At end of year	**$ 172.1**	$ 49.3	$ 33.8
Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Interest (net of amounts capitalized)	**$ 66.7**	$ 48.9	$ 49.1
Income taxes	**$ 351.3**	$ 272.5	$ 252.2

See accompanying notes to consolidated financial statements.

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Norfolk Southern Railway Company and Subsidiaries

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Consolidated Statements of Changes in Stockholders' Equity

	Serial Preferred Stock	Common Stock	Other Capital	Unrealized Gain on Marketable Securities	Retained Income	Total
			($ in millions)			
Balance December 31, 1993	**$ 54.8**	**$ 166.7**	**$ 515.0**	**$ —**	**$4,448.4**	**$ 5,184.9**
Net income – 1994					682.0	682.0
Cash dividends:						
Serial preferred stock, $2.60 per share					(2.9)	(2.9)
Common stock, $16.59 per share					(276.5)	(276.5)
Non-cash dividends on common stock (Note 2)					(400.1)	(400.1)
Unrealized gain on investments				253.1		253.1
Balance December 31, 1994	**54.8**	**166.7**	**515.0**	**253.1**	**4,450.9**	**5,440.5**
Net income – 1995					701.7	701.7
Cash dividends:						
Serial preferred stock, $2.60 per share					(2.9)	(2.9)
Common stock, $17.31 per share					(288.6)	(288.6)
Non-cash dividends on common stock (Note 2)					(300.0)	(300.0)
Contribution from NS (Note 2)			10.5			10.5
Unrealized gain on investments (Note 14)				84.2		84.2
Balance December 31, 1995	**54.8**	**166.7**	**525.5**	**337.3**	**4,561.1**	**5,645.4**
Net income – 1996					768.5	768.5
Cash dividends:						
Serial preferred stock, $2.60 per share					(2.9)	(2.9)
Common stock, $17.14 per share					(285.7)	(285.7)
Non-cash dividends on common stock (Note 2)					(414.0)	(414.0)
Unrealized gain on investments (Note 14)				60.5		60.5
Balance December 31, 1996	**$ 54.8**	**$ 166.7**	**$ 525.5**	**$ 397.8**	**$4,627.0**	**$ 5,771.8**

See accompanying notes to consolidated financial statements.

Norfolk Southern Railway Company and Subsidiaries

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

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 Railway Company, together with its consolidated subsidiaries (collectively, NS Rail), is engaged principally in the transportation of freight by rail, primarily in the Southeast and Midwest. The consolidated financial statements include Norfolk Southern Railway Company, Norfolk and Western Railway Company and their majority-owned and controlled subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation (see Note 15 for the Norfolk and Western Railway Company and Subsidiaries (NW) summarized consolidated financial information).

Rail freight consists of raw materials, intermediate products and finished goods classified in the following market groups: coal, chemicals, paper/forest, automotive, agriculture, metals/construction and intermodal. All groups are approximately equal in size based on revenues except for coal, which accounts for almost one third of total railway operating revenues. Ultimate destinations for some of the freight and a portion of the coal shipped are outside the United States.

Use of Estimates

The preparation of financial statements in conformity 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. Actual results could differ from those 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 held-to-maturity, trading or available-for-sale securities. At December 31, 1996 and 1995, all "Short-term investments," consisting primarily of United States government and federal agency securities and all marketable equity securities consisting principally of NS stock, were designated as available for sale. Accordingly, unrealized gains and losses, net of taxes, are recognized in "Stockholders' equity" (see also Note 14).

Materials and Supplies

"Materials and supplies," consisting mainly of fuel oil and items for maintenance of property and equipment, are stated at average cost. 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 primarily depreciated on the basis of use measured by gross ton miles. The effect of this method is to depreciate these assets over 42 years on average. Other properties are depreciated generally using the straight-line method over estimated service lives at annual rates that range from 1% to 20%. In 1996, the overall depreciation rate averaged 2.8% for roadway and 4.0% for equipment. NS Rail capitalizes interest on major capital projects during the period of their construction. Maintenance expense is recognized when repairs are performed. When properties, other than land and non-rail 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 non-rail assets are included in other income (see Note 3).

Revenue Recognition

Revenue is recognized proportionally as a shipment moves from origin to destination.

Required Accounting Changes

1996 – Effective January 1, 1996, NS Rail adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" (SFAS 121). SFAS 121 establishes the accounting and reporting requirements for recognizing and measuring impairment of long-lived assets either to be held and used or to be held for disposal. SFAS 121 did not have a material effect on NS Rail's financial statements.

1994 – Effective January 1, 1994, NS Rail adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115), which addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities. The implementation of SFAS 115 increased "Investments," the deferred tax liability and "Stockholders' equity" at December 31, 1994, and had no impact on earnings. The total unrealized holding gain on NS Rail's investments classified as "available for sale," net of the related deferred taxes, is reflected as a separate component of "Stockholders' equity" in the Consolidated Balance Sheets (see also Note 14).

2. Related Parties

General

NS is the parent holding company of NS Rail. The costs of functions performed by NS are allocated to NS Rail. Rail operations are coordinated at the holding company level by the NS Executive Vice President-Operations.

Non-cash Dividends

In 1996, 1995 and 1994, NS Rail declared and issued to NS non-cash dividends of $414.0 million, $300.0 million and $400.1 million, respectively, which were settled by reduction of NS Rail's interest-bearing advances due from NS.

Non-cash dividends are excluded from the Consolidated Statements of Cash Flows.

Intercompany Accounts

	December 31,			
	1996		1995	
($ in millions)	Balance	Average Interest Rate	Balance	Average Interest Rate
Due from NS:				
Advances	**$155.6**	**4.1%**	$407.1	3.4%
Due to NS:				
Notes	**220.5**	**6.1%**	220.3	6.6%
Due (to) from NS – net	**$(64.9)**		$186.8	

During 1995, NW issued notes for $75.5 million to an NS subsidiary for the purchase of a portfolio of short-term investments. This non-cash transaction was excluded from the Consolidated Statement of Cash Flows.

Interest is applied to certain advances at the average NS yield on short-term investments and to the notes at specified rates. Included in interest income is $13.9 million, $17.8 million and $15.6 million in 1996, 1995 and 1994, respectively, related to amounts due from NS.

Transfer of Investment from NS

In December 1995, NS transferred its $10.5 million equity interest in a nonoperating subsidiary to Norfolk Southern Railway Company. This transfer was recorded at historical cost and was reflected as a contribution to capital.

Intercompany Federal Income Tax Accounts

In accordance with the NS Tax Allocation Agreement, intercompany federal income tax accounts are recorded between companies in the NS consolidated group. At December 31, 1996 and 1995, NS Rail had long-term intercompany federal income tax payables (which are included in "Deferred income taxes" in the Consolidated Balance Sheets) of $292.5 million and $254.7 million, respectively.

Cash Required for NS Stock Purchase Program and NS Debt

Since 1987, the NS Board of Directors has authorized the purchase and retirement of up to 95 million shares of NS common stock. Purchases under the programs have been made with internally generated cash, and with proceeds from the sale of NS commercial paper notes and from the issuance of NS long-term debt.

Since the first purchases in December 1987 and through October 22, 1996, NS had purchased and retired 68,545,000 shares of its common stock under these programs at a cost of $3.2 billion.

On October 23, 1996, NS announced that the stock purchase program had been suspended (see also Note 16). Future purchase decisions are dependent on the outcome of the proposed Conrail acquisition, the economy, cash needs and alternative investment opportunities.

Consistent with the earlier purchases, a significant portion of the funding for future NS stock purchases, either in the form of direct cash or cash used for debt service, will come from NS Rail through intercompany advances or dividends to NS. In addition, some of the costs associated with the proposed Conrail acquisition (see Note 16, "Proposed Acquisition of Conrail by NS" and "NS Debt Commitments") are likely to be funded by NS Rail.

3. Other Income – Net

($ in millions)	1996	1995	1994
Interest income (Note 2)	$ 29.9	$ 36.3	$ 34.4
Rental income	18.2	18.5	18.0
Dividends from NS	16.2	15.1	13.9
Gains from sales of properties	25.5	8.7	7.8
Corporate-owned life insurance – net	6.0	7.4	7.9
Other interest expense	(44.1)	(32.2)	(24.9)
Taxes on nonoperating property	(3.7)	(2.4)	(3.7)
Other – net	(8.9)	(8.1)	(6.8)
Total	$ 39.1	$ 43.3	$ 46.6

4. Income Taxes

Provision for Income Taxes

($ in millions)	1996	1995	1994
Current:			
Federal	$277.7	$286.3	$236.0
State	34.3	42.4	35.0
Total current taxes	312.0	328.7	271.0
Deferred:			
Federal	72.7	35.1	95.2
State	16.7	8.1	19.0
Total deferred taxes	89.4	43.2	114.2
Provision for income taxes	$401.4	$371.9	$385.2

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:

($ in millions)	1996		1995		1994	
	Amount	%	Amount	%	Amount	%
Federal income tax at statutory rate	$409.5	35.0	$375.8	35.0	$373.5	35.0
State income taxes, net of federal tax benefit	33.1	2.8	32.7	3.0	35.1	3.3
Corporate-owned life insurance	(15.5)	(1.3)	(17.1)	(1.6)	(10.6)	(1.0)
Other – net	(25.7)	(2.2)	(19.5)	(1.8)	(12.8)	(1.2)
Provision for income taxes	$401.4	34.3	$371.9	34.6	$385.2	36.1

Inclusion in Consolidated Return

NS Rail is included in the consolidated federal income tax return of NS. The provision for current income taxes in the Consolidated Statements of Income reflects NS Rail's portion of NS' consolidated tax provision. Tax expense or tax benefit is recorded on a separate company basis.

Deferred Tax Assets and Liabilities

Certain items are reported in different periods for financial reporting and income tax purposes. Deferred tax assets and liabilities were 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 were as follows:

($ in millions)	December 31, 1996	1995
Deferred tax assets:		
Reserves, including casualty and other claims	$ 148.3	$ 161.6
Employee benefits	147.7	158.7
Retiree health and death benefit obligation	137.2	138.1
Taxes, including state and property	163.1	157.1
Other	1.1	1.2
Total gross deferred tax assets	597.4	616.7
Less valuation allowance	(0.6)	(0.5)
Net deferred tax assets	596.8	616.2
Deferred tax liabilities:		
Property	(2,839.0)	(2,760.3)
Unrealized holding gains	(220.0)	(219.0)
Other	(36.0)	(44.7)
Total gross deferred tax liabilities	(3,095.0)	(3,024.0)
Intercompany federal tax payable – net	(292.5)	(254.7)
Net deferred tax liability	(2,790.7)	(2,662.5)
Net current deferred tax assets	95.3	98.8
Net long-term deferred tax liability	$(2,886.0)	$(2,761.3)

Except for amounts for which a valuation allowance is provided, Management believes the deferred tax assets will be realized. The net change in the total valuation allowance was a $0.1 million increase for 1996, a $0.1 million decrease for 1995 and a $1.4 million decrease for 1994.

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 1992. The consolidated federal income tax returns for 1993 and 1994 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 these examinations.

Tax Benefit Leases

In January 1995, the United States Tax Court issued a preliminary decision that would disallow some of the tax benefits a subsidiary of NS Rail purchased from a third party pursuant to a safe harbor lease agreement in 1981. Management continues to believe that NS Rail ultimately should incur no loss from this decision, because the lease agreement provides for full indemnification if any such disallowance is sustained.

5. Investments

($ in millions)	December 31, 1996	1995
Marketable equity securities at fair value (Note 14)	**$ 639.0**	$ 576.2
Corporate-owned life insurance at net cash surrender value	**213.2**	176.6
Other	**18.5**	18.2
Total	**$ 870.7**	$ 771.0

6. Properties

($ in millions)	December 31, 1996	1995
Transportation property:		
Road	**$ 8,405.0**	$ 8,151.7
Equipment	**4,664.7**	4,586.8
Other property	**79.3**	84.2
	13,149.0	12,822.7
Less: Accumulated depreciation	**4,134.1**	4,072.3
Net properties	**$ 9,014.9**	$ 8,750.4

Capitalized Interest

Total interest cost incurred on debt in 1996, 1995 and 1994 was $45.8 million, $47.0 million and $46.1 million, respectively, of which $11.9 million, $14.0 million and $17.8 million was capitalized.

7. Current Liabilities

($ in millions)	December 31, 1996	1995
Accounts payable:		
Accounts and wages payable	**$227.4**	$255.3
Casualty and other claims	**165.4**	163.6
Vacation liability	**75.0**	72.5
Equipment rents payable – net	**60.9**	62.0
Other	**21.1**	13.8
Total	**$549.8**	$567.2
Other current liabilities:		
Prepaid amounts on forwarded traffic	**$ 62.7**	$ 69.7
Interest payable	**14.4**	23.7
Retiree health and death benefit obligation (Note 13)	**23.2**	24.5
Other	**8.7**	6.4
Total	**$109.0**	$124.3

8. Debt

Short-Term Debt

Short-term debt consists of $27.2 million of notes assumed in connection with the 1990 acquisition of a coal terminal facility.

Capital Lease Obligations

During 1996 and 1995, NS Rail entered into capital leases covering new locomotives. The related capital lease obligations totaling $107.8 million in 1996 and $104.5 million in 1995 were reflected in the Consolidated Balance Sheets as debt and, because they were non-cash transactions, were excluded from the Consolidated Statements of Cash Flows. The lease obligations carry an average stated interest rate of 6.5% for those entered into in 1996 and 8.4% for those entered into in 1995. All were converted to variable rate obligations using interest rate swap agreements. The interest rates on these obligations are based on the six-month London Interbank Offered Rate and are reset every six months with changes in interest rates accounted for as an adjustment of interest expense over the terms of the leases. As a result, NS Rail is exposed to the market risk associated with fluctuations in interest rates. To date, while such rate fluctuations have been nominal, their effects have been favorable. Counterparties to the interest rate swap agreements are major financial institutions believed by Management to be credit-worthy. NS Rail's use of interest rate swaps has been limited to those discussed above.

Norfolk Southern Railway Company and Subsidiaries

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Notes to Consolidated Financial Statements

8. Debt (continued)

Long-Term Debt

	December 31,	
($ in millions)	**1996**	1995
Equipment obligations at an average rate of 7.8% maturing to 2009	**$392.9**	$439.5
Capitalized leases at an average rate of 5.9% maturing to 2015	**197.0**	100.9
Other debt at an average rate of 5.4% maturing to 2015	**8.0**	34.0
Total long-term debt	**597.9**	574.4
Less: Current maturities	**54.3**	79.7
Long-term debt less current maturities	**$543.6**	$494.7

Long-term debt matures as follows:	
1998	**$ 55.5**
1999	**127.2**
2000	**57.7**
2001	**51.8**
2002 and subsequent years	**251.4**
Total	**$543.6**

A substantial portion of NS Rail's properties and certain investments in affiliated companies are pledged as collateral for much of the debt.

9. Lease Commitments

NS Rail is committed under long-term lease agreements, which expire on various dates through 2067, for equipment, lines of road and other property. Future minimum lease payments are as follows:

($ in millions)	Operating Leases	Capital Leases
1997	$ 53.6	$ 28.6
1998	49.3	28.6
1999	37.4	28.6
2000	31.9	28.5
2001	30.3	28.0
2002 and subsequent years	637.0	143.1
Total	$ 839.5	285.4
Less imputed interest on capital leases at an average rate of 7.4%		88.4
Present value of minimum lease payments included in debt		$ 197.0

Operating Lease Expense

($ in millions)	**1996**	1995	1994
Minimum rents	**$ 64.7**	$ 58.9	$ 46.7
Contingent rents	**38.3**	36.0	45.4
Total	**$103.0**	$ 94.9	$ 92.1

10. [illegible]

	December 31,	
($ in millions)	**1996**	1995
Casualty and other claims	**$247.3**	$257.3
Net pension obligation (Note 12)	**81.9**	93.9
Retiree health and death benefit obligation (Note 13)	**283.2**	283.5
Other	**273.6**	236.1
Total	**$886.0**	$870.8

11. [illegible]

Preferred

There are 10,000,000 shares of no par value serial preferred stock authorized. This stock may be issued in series from time to time at the discretion of the Board of Directors with any series having such voting and other powers, dividends and other preferences as deemed appropriate at the time of issuance. At December 31, 1996 and 1995, 1,197,027 shares of $2.60 Cumulative Preferred Stock, Series A (Series A Stock) were issued, and 1,096,907 shares were held other than by subsidiaries. The Series A Stock has a $50 per share stated value. The Series A Stock is callable at any time at $50 per share plus accrued dividends and has one vote per share on all matters, voting as a single class with holders of other stock.

In June 1989, NS announced its intention to purchase up to 250,000 shares of the outstanding Series A Stock during the subsequent two-year period. Since then, NS extended the stock purchase program through 1996. NS had purchased 176,608 shares at a total cost of approximately $6.7 million as of December 31, 1996. NS purchased the shares in regular brokerage transactions on the open market at prevailing prices. At year end 1996 and 1995, NS held 176,703 shares and 122,923 shares, respectively.

Preference

There are 10,000,000 shares of no par value serial preference stock authorized. None of these shares has been issued.

Common

There are 50,000,000 shares of no par value common stock with a stated value of $10 per share authorized. NS owns all 16,668,997 shares issued and outstanding at December 31, 1996 and 1995.

12. Pension Plans

NS Rail's defined benefit pension plans, which principally cover salaried employees, are part of NS' retirement plans. Pension benefits are based primarily on years of creditable service with NS and its participating subsidiary companies and compensation rates near retirement. Contributions to the plans are made on the basis of not less than the minimum funding standards set forth in the Employee Retirement Income Security Act of 1974, as amended. Assets in the plans consist mainly of common stocks. The following data relate principally to NS Rail's portion of the combined NS plans.

Pension Cost (Benefit) Components

($ in millions)	1996	1995	1994
Service cost-benefits earned during the year	$ 12.3	$ 9.6	$ 10.2
Interest cost on projected benefit obligation	67.1	65.1	59.9
Actual return on assets in plan	(170.3)	(257.0)	(16.6)
Net amortization and deferral	83.4	172.1	(62.9)
Net pension benefit	(7.5)	(10.2)	(9.4)
Cost of early retirement benefits	—	23.4	—
Total	$ (7.5)	$ 13.2	$ (9.4)

Pension cost is determined based on an actuarial valuation that reflects appropriate assumptions as of the beginning of each year. The funded status of the plans is determined using appropriate assumptions as of each year end. A summary of the major assumptions follows:

	1996	1995	1994
Discount rate for determining funded status	7.75%	7.25%	8.50%
Future salary increases	5.25%	6%	6%
Return on assets in plans	9%	9%	9%

The funded status of the plans and the amounts reflected in the accompanying balance sheets were as follows:

	December 31, 1996		1995	
($ in millions)	Funded Plans	Unfunded Plans	Funded Plans	Unfunded Plans
Actuarial present value of benefit obligations:				
Vested benefits	$ 758.6	$ 58.8	$ 788.2	$ 50.8
Non-vested benefits	1.2	—	0.1	—
Accumulated benefit obligation	759.8	58.8	788.3	50.8
Effect of expected future salary increases	68.1	5.6	115.3	11.5
Projected benefit obligation	827.9	64.4	903.6	62.3
Fair value of assets in plans	1,157.7	—	1,060.6	—
Funded status	329.8	(64.4)	157.0	(62.3)
Unrecognized initial net asset	(30.2)	—	(36.9)	—
Unrecognized (gain) loss	(343.3)	20.9	(179.2)	20.9
Unrecognized prior service cost	2.1	3.2	2.8	3.8
Net pension liability included in the balance sheets	$ (41.6)	$ (40.3)	$ (56.3)	$ (37.6)

Early Retirement Program in 1995

During 1995, NS completed a voluntary early retirement program for certain salaried employees. The principal benefit for those who participated in this program was enhanced pension benefits, which are reflected in the accumulated benefit obligation. The charge for the 272 employees who accepted the offer is included in "Compensation and benefits" expense and totaled $33.6 million (including $8.3 million related to postretirement benefits other than pensions).

401(k) Plans

NS Rail provides 401(k) savings plans for employees. Under the plans, NS Rail matches a portion of employee contributions, subject to applicable limitations. NS Rail's expenses under these plans were $8.0 million, $6.9 million and $5.0 million in 1996, 1995 and 1994, respectively.

13. Postretirement Benefits Other Than Pensions

NS Rail provides specified health care and death benefits to eligible retired employees and their dependents by participating in welfare benefit plans sponsored by NS. 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, co-payments, Medicare payments and, in some cases, coverage provided by other group insurance policies. The cost of such health care coverage to a retiree may be determined, in part, by the retiree's years of creditable service with NS and its participating subsidiary companies prior to retirement. Death benefits are determined based on various factors, including, in some cases, salary at time of retirement.

NS Rail continues to fund benefit costs principally on a pay-as-you-go basis. However, in 1991, NS established a Voluntary Employee Beneficiary Association (VEBA) account to fund a portion of the cost of future health care benefits for its retirees and those of its participating subsidiary companies. The last corporate contribution to the VEBA was $10 million in 1994.

Effective January 1, 1994, NS amended the attribution period for postretirement health care benefits. The amendment generally provides for benefits to be determined ratably over a 10-year period based on creditable service commencing at age 45, or from date of hire if employment began after age 45. The amendment reduced the accumulated postretirement health care benefit obligation by $80 million, which will be amortized as a reduction in annual cost on a pro rata basis over a six-year period.

A summary of the postretirement benefit cost follows:

($ in millions)	1996	1995	1994
Service cost-benefits attributable to service during the year	$ 10.0	$ 9.1	$ 13.1
Interest cost on accumulated postretirement benefit obligation	24.1	27.2	23.8
Actual return on plan assets	(13.7)	(17.5)	—
Net amortization and deferral	(4.0)	1.9	(13.9)
Net postretirement benefit cost	16.4	20.7	23.0
Cost of early retirement benefits	—	8.3	—
Total	$ 16.4	$ 29.0	$ 23.0

The following table sets forth these plans' total accumulated postretirement benefit obligation, reconciled with the accrued postretirement benefit obligation:

	December 31, 1996		1995	
($ in millions)	Health Care Benefits	Death Benefits	Health Care Benefits	Death Benefits
Accumulated postretirement benefit obligation:				
Retirees	$ 162.8	$ 82.3	$ 216.1	$ 82.8
Fully eligible active plan participants	20.6	7.0	21.4	7.8
Other active plan participants	41.8	11.9	47.3	12.6
Total	225.2	101.2	284.8	103.2
Plan assets at fair value	85.8	—	72.1	—
Funded status	(139.4)	(101.2)	(212.7)	(103.2)
Unrecognized loss (gain)	(26.7)	(2.3)	52.2	4.7
Unrecognized prior service cost (benefit)	(36.8)	—	(49.0)	—
Accrued postretirement benefit obligation	$(202.9)	$(103.5)	$(209.5)	$ (98.5)

For measurement purposes, a 10.4% increase in the per capita cost of covered health care benefits was assumed for 1997. The rate was assumed to decrease gradually to an ultimate rate of 5.5% and remain at that level for 2005 and thereafter. The health care cost trend rate has a significant effect on the amounts reported in the financial statements. To illustrate, increasing the assumed trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1996, by about $25 million and the aggregate of the service and interest cost components of net postretirement benefit cost for the year 1996 by about $4 million.

The weighted-average discount rate used in determining the accumulated postretirement benefit obligation, the salary increase assumption and the long-term rate of return on plan assets are the same as those used for the pension plans (see table of rate assumptions in Note 12).

The VEBA trust holding the plan assets is not expected to be subject to federal income taxes, as the assets are invested entirely in trust-owned life insurance.

Under collective bargaining agreements, NS Rail and certain subsidiaries participate in a multiemployer 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 $3.6 million, $3.7 million and $4.8 million in 1996, 1995 and 1994, respectively.

14. Fair Values of Financial Instruments

The fair values of "Cash and cash equivalents," "Short-term investments," "Accounts receivable," "Short-term debt" and "Accounts payable" approximate carrying values because of the short maturity of these financial instruments.

The fair value of long-term "Investments" approximated $943 million and $837 million at December 31, 1996 and 1995, respectively (see Note 5 for carrying values of "Investments"). The fair value of corporate-owned life insurance approximates carrying value. Quoted market prices were used to determine the fair value of marketable securities which, beginning in 1994 (see Note 1, "Required Accounting Changes"), were recorded at fair value. Carrying value adjustments, which are non-cash transactions, are not included in the Consolidated Statement of Cash Flows. Underlying net assets were used to estimate the fair value of other investments.

Under SFAS 115, NS Rail increased the reported carrying value of short-term and long-term investments classified as "available for sale" as follows:

	December 31,			
	1996		1995	
($ in millions)	Short-term Securities	Equity Securities	Short-term Securities	Equity Securities
Cost	$ 335.0	$ 20.6	$ 242.2	$ 20.6
Gross unrealized holding gain (loss)	(0.6)	618.4	0.7	555.6
Fair value	$ 334.4	$ 639.0	$ 242.9	$ 576.2

The short-term securities are principally U.S. Treasury securities. Equity securities consist almost entirely of 7,252,634 shares of NS Common Stock.

The change in the unrealized holding gain was $61.5 million for 1996 and $138.8 million for 1995. These changes primarily reflect changes in the NS stock price. As a result, stockholder's equity increased $60.5 million in 1996 and $84.2 million in 1995.

The fair value of "Long-term debt," including current maturities, approximated $627 million at December 31, 1996, and $606 million at December 31, 1995. 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 (see Note 8 for carrying values of "Long-term debt"). The fair value of interest rate swaps is immaterial.

15. NW—Summarized Consolidated Financial Information

NW is operated as an integral part of NS Rail. Revenues are allocated to NW based on actual traffic movements as determined by revenue ton miles within market groups. Expenses are allocated to NW based on appropriate criteria for the type of expense. The costs of functions performed by NS, the parent holding company of NS Rail, are also allocated to its rail operating subsidiaries.

Norfolk and Western Railway Company and Subsidiaries
Summarized Consolidated Statements of Income

	Years ended December 31,		
($ in millions)	1996	1995	1994
Railway operating revenues	$ 1,958.6	$ 1,911.3	$ 1,858.1
Railway operating expenses	1,351.6	1,402.6	1,382.7
Income from railway operations	607.0	508.7	475.4
Other – net	49.8	38.8	25.8
Income before income taxes	656.8	547.5	501.2
Provision for income taxes	228.4	186.8	175.1
Net income	$ 428.4	$ 360.7	$ 326.1

15. NW—Summarized Consolidated Financial Information (continued)

Norfolk and Western Railway Company and Subsidiaries
Summarized Consolidated Balance Sheets

($ in millions)	As of December 31, 1996	1995
Assets		
Current assets	$ 353.4	$ 298.3
Noncurrent assets	5,631.2	4,778.2
Total assets	$ 5,984.6	$ 5,076.5
Liabilities and Stockholder's Equity		
Current liabilities	$ 205.7	$ 246.2
Noncurrent liabilities	1,812.5	1,603.9
Stockholder's equity	3,966.4	3,226.4
Total liabilities and stockholder's equity	$ 5,984.6	$ 5,076.5

On August 1, 1996, NS Rail transferred 5,294,931 shares of NS stock to NW as a contribution to capital. The transfer was recorded at historical cost, and in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," unrealized appreciation was recognized which increased "Noncurrent assets" $478.2 million, "Noncurrent liabilities" $167.4 million, and "Stockholder's equity" $310.8 million.

16. Commitments and Contingencies

Proposed Acquisition of Conrail by NS

On October 23, 1996, NS announced its intention to commence an all-cash tender offer for all shares of Conrail Inc. (Conrail), a Pennsylvania corporation. On October 24, 1996, Atlantic Acquisition Corporation, a Pennsylvania corporation and a wholly owned subsidiary of NS, offered to purchase all outstanding shares of Conrail's common stock and Series A ESOP Convertible Junior Preferred Stock (collectively, the Shares), including, in each case, the associated Common Stock Purchase Rights, at a price of $100 per Share—approximately $9.1 billion in the aggregate. Shares tendered in the offer or acquired in any subsequent merger would be held in a voting trust pending regulatory approval by the STB. The offer followed the October 15 announcement that Conrail had entered into a merger agreement with CSX Corporation (CSX), whereby Conrail stockholders would receive $92.50 in cash per Share for up to 40 percent of their Shares and receive CSX common stock for the balance of their Shares. On November 6, 1996, CSX and Conrail announced that CSX had raised the cash portion of its offer to $110 per Share and left unchanged the ratio pursuant to which certain Conrail stockholders would receive shares of CSX common stock. On November 8, 1996, NS announced that it had increased its all-cash offer to $110 per Share—approximately $10.0 billion in the aggregate. On December 19, 1996, CSX and Conrail announced that CSX was adding preferred stock (convertible into CSX common stock) to its offer—a feature said to be worth $16 per Share. On December 20, NS increased its all-cash offer to $115 per Share—approximately $11 billion in the aggregate—and on January 13, 1997, NS announced that it would offer to purchase up to 8.2 million Shares (approximately 9.9%), the approximate maximum number of Shares NS can buy without triggering Conrail's current anti-takeover defenses, for $115 per Share, if Conrail stockholders disapproved at a special meeting certain management recommendations designed to facilitate the merger with CSX.

At that special meeting on January 17, 1997, Conrail stockholders did disapprove those recommendations. Accordingly, on January 22, 1997, NS amended its pending all-cash tender offer by reducing the number of Shares sought to 8.2 million; on February 11, 1997, it acquired 8.2 million Shares for a total of $943 million, pursuant to that amended offer. These Shares have been placed in a voting trust and under certain circumstances might have to be sold at a loss. The Conrail Board repeatedly has affirmed its commitment to a merger with CSX.

On February 12, 1997, NS commenced a second tender offer for the remaining Conrail Shares. NS' second tender offer is conditioned upon, among other things, the valid tender of at least Shares sufficient, with those already owned by NS, to constitute at least a majority of the Shares on a fully diluted basis, Subchapter 25F of Pennsylvania's Business Corporation Law not being applicable to the offer, Conrail's Rights Agreement (or poison pill) having been redeemed or otherwise made inapplicable to NS' tender offer, the merger agreement between CSX and Conrail having been terminated in accordance with its terms or otherwise, and other conditions. NS has received a favorable opinion from the STB regarding the use of a voting trust and has obtained sufficient financing commitments (see "NS Debt Commitments").

The STB has proposed a schedule for handling Conrail control applications which could result in an STB decision in late 1997 or early 1998. If the STB does not approve NS' application or if NS deems any conditions imposed by the STB too onerous, NS would have the right and obligation to sell all Conrail Shares held in the voting trust. Such a disposition could result in a significant loss.

Through December 31, 1996, NS had incurred $76 million of costs associated with the proposed acquisition.

NS Debt Commitments

In connection with the proposed acquisition of Conrail, NS has secured debt commitments sufficient for the tender offer and subsequent merger. The commitments expire on August 1, 1997, except for a portion of a revolving credit facility expiring on August 1, 1998. The total commitment fees will approximate $200 million if the entire facility is used. At December 31, 1996, NS had incurred $57 million of commitment fees.

In connection with the purchase of the 8.2 million Shares, NS arranged for commercial paper debt in an aggregate amount not to exceed $1.0 billion. All or part of this amount could be refinanced either by issuing additional commercial paper or through drawing on the debt commitment that has been arranged in connection with the all-cash $115 per share tender offer for all Shares.

Lawsuits

Norfolk Southern Railway Company and certain subsidiaries are defendants in numerous lawsuits relating principally to railroad operations. While the final outcome of these lawsuits cannot be predicted with certainty, it is the opinion of Management, after consulting with its legal counsel, that the amount of NS Rail's ultimate liability will not materially affect NS Rail's consolidated financial position.

Environmental Matters

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

As of December 31, 1996, NS Rail's balance sheet included a reserve for environmental exposures in the amount of $53 million (of which $12 million is accounted for as a current liability), which is NS Rail's estimate of the probable costs at 111 identified locations based on available information. On that date, nine sites accounted for $19 million of the reserve, and no individual site was considered to be material. NS Rail anticipates that the majority of this liability will be paid out over five years; however, some costs will be paid out over a longer period.

At many of the 111 locations, Norfolk Southern Railway and/or certain of its 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 clean-up costs.

With respect to known environmental sites (whether identified by NS Rail or by the EPA or comparable state authorities), estimates of NS Rail's 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 clean-up techniques, the likely development of new clean-up technologies, the difficulty of determining in advance the nature and full extent of contamination and each potential participant's share of any estimated loss (and that participant's ability to bear it) and evolving statutory and regulatory standards governing liability.

16. Commitments and Contingencies (continued)

The risk of incurring environmental liability—for acts and omissions, past, present and future—is inherent in the railroad business. Some of the commodities, particularly those classified as hazardous materials, in NS Rail's traffic mix can pose special risks that NS Rail and its subsidiaries work diligently to minimize. In addition, NS Rail owns, or has owned in the past, land holdings used as operating property, or which are leased or may have been leased and operated by others, or held for sale. Because certain conditions may exist on these properties related to environmental problems that are latent or undisclosed, there can be no assurance that NS Rail will not incur liabilities or costs with respect to one or more of them, the amount and materiality of which cannot be estimated reliably now. 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 and, after consulting with its legal counsel, Management believes that it has recorded the probable costs based on available information for those environmental matters of which the Corporation is aware. Further, Management believes that it is unlikely that any identified matters, either individually or in aggregate, will have a material adverse effect on NS Rail's financial position, results of operations or liquidity.

Change-in-Control Arrangements

Norfolk Southern has compensation agreements with officers and certain key employees, which 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.

Capital Expenditure Commitment

In connection with a long-term transportation contract entered into during 1996, NS Rail has committed to construct and operate four motor vehicle distribution centers. These facilities are scheduled for completion in 1998.

Debt Guarantees

As of December 31, 1996, NS Rail and certain of its subsidiaries are contingently liable as guarantors with respect to $48.7 million of indebtedness of related entities.

KPMG Peat Marwick LLP

The Stockholders and Board of Directors
Norfolk Southern Railway Company:

We have audited the accompanying consolidated balance sheets of Norfolk Southern Railway Company and subsidiaries (a majority-owned subsidiary of Norfolk Southern Corporation) as of December 31, 1996 and 1995, 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, 1996. 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 generally accepted auditing standards. 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 Railway Company and subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1996, in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

Norfolk, Virginia
January 28, 1997, except as to the second and third paragraphs of Note 16, which are as of February 12, 1997

28 Norfolk Southern Railway Company and Subsidiaries

(A Majority-Owned Subsidiary of Norfolk Southern Corporation)

Quarterly Financial Data *(Unaudited)*

	Three Months Ended			
	March 31	June 30	Sept. 30	Dec. 31
	($ in millions, except per share amounts)			
1996				
Railway operating revenues	$ 1,016.7	$ 1,038.0	$ 1,020.1	$ 1,026.2
Income from railway operations	261.8	300.0	300.3	302.6
Net income	163.1	190.6	208.8	206.0
Dividends per serial preferred share	$ 0.65	$ 0.65	$ 0.65	$ 0.65
1995				
Railway operating revenues	$ 999.2	$ 1,016.4	$ 996.0	$ 1,000.2
Income from railway operations	250.4	284.3	277.9	250.7
Net income	153.3	180.3	193.9	174.2
Dividends per serial preferred share	$ 0.65	$ 0.65	$ 0.65	$ 0.65

Listing of Officers

David R. Goode
President and Chief Executive Officer
Norfolk, Virginia

Paul N. Austin
Vice President-Personnel
Norfolk, Virginia

William B. Bales
Vice President
Roanoke, Virginia

James C. Bishop, Jr.
Vice President-Law
Norfolk, Virginia

R. Alan Brogan
Vice President-Transportation Logistics
Fort Wayne, Indiana

David A. Cox
Vice President-Properties
Norfolk, Virginia

Thomas L. Finkbiner
Vice President-Intermodal
Norfolk, Virginia

John. W. Fox, Jr.
Vice President-Coal Marketing
Roanoke, Virginia

Thomas J. Golian
Vice President
Norfolk, Virginia

James A. Hixon
Vice President-Taxation
Norfolk, Virginia

Jon L. Manetta
Vice President-Transportation & Mechanical
Norfolk, Virginia

Harold C. Mauney, Jr.
Vice President-Operations Planning and Budget
Norfolk, Virginia

Donald W. Mayberry
Vice President-Research and Tests
Roanoke, Virginia

James W. McClellan
Vice President-Strategic Planning
Norfolk, Virginia

Kathryn B. McQuade
Vice President-Internal Audit
Roanoke, Virginia

Charles W. Moorman
Vice President-Information Technology
Norfolk, Virginia

Phillip R. Ogden
Vice President-Engineering
Atlanta, Georgia

L. I. Prillaman
Vice President and Chief Traffic Officer
Norfolk, Virginia

John P. Rathbone
Vice President and Controller
Norfolk, Virginia

William J. Romig
Vice President
Norfolk, Virginia

Donald W. Seale
Vice President-Merchandise Marketing
Norfolk, Virginia

R. W. Stephens, Jr.
Vice President-Quality Management
Norfolk, Virginia

Robert S. Spenski
Vice President-Labor Relations
Norfolk, Virginia

Stephen C. Tobias
Vice President-Operations
Norfolk, Virginia

Henry C. Wolf
Vice President-Finance
Norfolk, Virginia

William C. Wooldridge
Vice President
Norfolk, Virginia

Sandra T. Pierce
Corporate Secretary
Norfolk, Virginia

Ronald E. Sink
Treasurer
Roanoke, Virginia

Board of Directors

David R. Goode
Chairman, President and Chief Executive Officer
Norfolk Southern Corporation
Norfolk, Virginia

James C. Bishop, Jr.
Executive Vice President-Law
Norfolk Southern Corporation
Norfolk, Virginia

Jon L. Manetta
Vice President-Transportation & Mechanical
Norfolk Southern Corporation
Norfolk, Virginia

L. I. Prillaman
Executive Vice President-Marketing
Norfolk Southern Corporation
Norfolk, Virginia

Stephen C. Tobias
Executive Vice President-Operations
Norfolk Southern Corporation
Norfolk, Virginia

Henry C. Wolf
Executive Vice President-Finance
Norfolk Southern Corporation
Norfolk, Virginia

Norfolk Southern Railway Company
Three Commercial Place
Norfolk, Virginia 23510-2191

"First and foremost, we absolutely need to make major advances in SAFETY.

Second, we must GROW this business.

Third, optimum ASSET UTILIZATION is central not only to achieving a competitive cost structure, but also to assuring that our track network, our shops, our freight cars and our locomotives are deployed in a manner that produces superior service.

Fourth, we recognize that the development of our PEOPLE — ensuring that they are properly trained and properly placed where our customers need them — is essential to giving us the opportunity to compete in today's environment."

CONRAIL INC. 1995 ANNUAL REPORT

CONRAIL

To be the SAFEST carrier. • To provide total CUSTOMER SATISFACTION as measured by the customer. • To DEVELOP EMPLOYEES to fully and responsibly meet the changing needs of our customers and shareholders. • To achieve an operating ratio and ASSET UTILIZATION that provides a superior return on assets. • To achieve GROWTH that will support our investments.

GOALS

Table of Contents

Eleven Year Financial Summary

($ In Millions Except Per Share)	1995[1]	1994[2]	1993[3]	1992	1991[5]	1990[6]	1989[5]	1988	1987[7]	1986	1985
Revenues	$3,686	$3,733	$3,453	$3,345	$3,252	$3,372	$3,411	$3,490	$3,247	$3,144	$3,208
Operating Income (Loss)	456	606	591	534	(261)	427	198	482	417	403	397
Net Income (Loss)	264	324	160	282	(207)	247	148	306	299	431	442
Per Common Share[4]											
Primary	3.19	3.90	1.82	3.28	(2.70)	2.55	1.09	2.22	2.17	3.27	3.41
Fully Diluted	2.94	3.56	1.70	2.99	(2.70)	2.39	1.09	2.22	2.17	3.27	3.41
Dividends Per Common Share[4]	1.60	1.40	1.20	1.00	.85	.75	.65	.55	.25	–	–
Capital Expenditures	$ 494	$ 508	$ 650	$ 491	$ 398	$ 381	$ 678	$ 577	$ 472	$ 578	$ 574
Average Freight Employees	23,510	24,833	25,406	25,380	25,852	27,787	31,574	32,816	33,437	35,476	37,706
At December 31											
Cash and Temporary Cash Investments	$ 73	$ 43	$ 38	$ 40	$ 135	$ 153	$ 502	$ 666	$ 632	$ 847	$ 910
Working Capital (Deficit)	36	(76)	(13)	(489)	(286)	(216)	153	398	426	733	754
Total Assets	8,424	8,322	7,948	7,315	7,096	7,245	7,471	7,224	6,796	6,776	6,568
Long-Term Debt	1,911	1,940	1,959	1,577	1,637	1,680	857	850	826	1,705	1,690
Redeemable Preferred Stock	–	–	–	–	–	–	–	–	–	2,330	2,323
Stockholders' Equity	2,977	2,925	2,784	2,748	2,661	2,929	4,044	4,043	3,825	1,784	1,559

1 Net income includes the effect of a one-time asset disposition charge and a one-time tax benefit related to a decrease in a state income tax rate. See Notes 2 and 6 to the Consolidated Financial Statements.

2 Net income includes the effects of a one-time charge for a non-union employee voluntary retirement program and related costs. See Note 9 to the Consolidated Financial Statements.

3 Net income includes the effects of an estimated net loss on the disposition of a subsidiary, the increase in the federal corporate income tax rate, and the adoption of required changes in accounting for income taxes and postretirement benefits other than pensions. See Notes 1, 6, 7 and 10 to the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

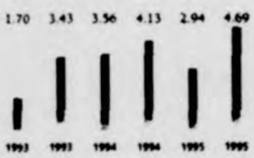
4 Includes the effects of a 1992 two-for-one common stock split.

5 A 1991 special charge of $719 million reduced net income by $447 million. A 1989 special charge of $234 million reduced net income by $147 million.

6 In 1990, the Company completed a financial restructuring plan which included a Dutch auction tender offer, the establishment of an employee stock ownership plan for non-union employees and a related open market common stock purchase program.

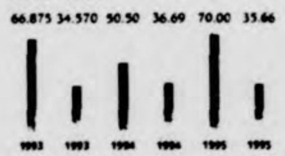
7 The Company's financial position and results of operations after 1986 were significantly affected by changes resulting from the sale of the U.S. Government's 85% ownership of the Company's common stock.

NET INCOME PER COMMON SHARE
$ Per Share



Fully diluted
Fully diluted without one-time charges and the one-time tax benefit in 1995

COMMON STOCK MARKET PRICE (YEAR END) VS. BOOK VALUE
$ Per share



Market price per common share
Book value per common share

DIVIDENDS PER COMMON SHARE
$ Per share

Corporate Highlights

March

- The **Board of Directors elects David M. LeVan as Chief Executive Officer**, succeeding James A. Hagen, who retires as Chief Executive Officer. Hagen continues as Chairman of the Board.

May

- Conrail and Norfolk Southern launch **north-south intermodal service** via Harrisburg and Hagerstown. The comprehensive service connects Conrail-served markets in Massachusetts and the New York-New Jersey area with NS points, including Birmingham, Huntsville, Jacksonville, Memphis, Miami and New Orleans.

July

- A $3.2 million modernization of Collinwood Yard in Cleveland expands capacity for Conrail's **growing multi-level network** for transporting new vehicles from assembly plants and ports to dealer distribution facilities. Volume over the multi-level network keeps growing with improved transit times and better use of the specialized multi-level cars.
- The Board of Directors approves the company's **eighth consecutive annual dividend increase**. The quarterly dividend increase of $.05 per common share (to $.425 per share) produced an eight-year compound annual growth rate of 16 percent.

September

- Conrail completes the **largest engineering project in its history**, the $97 million program to create a route across Pennsylvania for intermodal trains carrying double-stack containers. A related project opens to double-stacks the North Jersey-Harrisburg-Hagerstown route used by the Conrail-Norfolk Southern north-south service.
- Conrail and the Fraternal Order of Police (FOP), representing more than 300 police officers, reach **agreement** on a new, five-year labor contract. Under the contract later ratified by the organization, FOP members are converted from hourly pay to salaried status, become eligible for annual bonuses tied to company financial goals and become eligible for a company match in the 401(k) savings plan.
- The U.S. Department of Defense presents Conrail with its Corporate Recognition Award for outstanding and continued **support of the Guard and Reserve** program.

October

- New York City firemen answer the school bell in Sayreville, New Jersey, for the first-ever Association of American Railroads East Coast **tank car safety school**. Previously, the program was held only at AAR's Pueblo, Colorado, facility. Conrail supplies many of the instructors for the program and donates much of the equipment. Conrail sponsors the program along with the New Jersey State Police Office of Emergency Management.

November

- Canadian National (CN) and Conrail replace paper with the **electronic exchange of billing information** for rating and billing of interline movements. The start-up makes Conrail and CN the first two roads to successfully communicate as part of the Rate EDI Network being developed by the rail industry.

December

- Conrail takes delivery of the first of 28 new 5,000-horsepower locomotives, **the most powerful in rail freight service in America**. Two SD80-MAC units, which are built by General Motors' Electro-Motive Division, can replace as many as four existing locomotives.
- The nation's largest railroads, including Conrail, **reach a tentative agreement with the largest union** of railroad employees—the United Transportation Union—on a five-year contract.

January 1996

- Realignment of functions in the operating department is introduced to improve the company's **ability to recognize, understand, and quickly adapt** to the changing conditions driving our customers' freight transportation decisions. The changes are aimed at improving how Conrail designs, plans and delivers freight service, how it uses resources and how it develops its people.

- Conrail announces an **expanded partnership program with short line railroads.** Under the program, Conrail's relationship with participating short lines will be much like the commercial relationship between major airlines and independently owned and operated commuter airlines. The program takes advantage of each of our strengths: the short lines' ability to deliver local service to small shippers, and Conrail's ability to provide efficient service on long-haul routes and manage commercial aspects of the transportation transaction.

- Conrail announces the selection of about 1,800 miles of lightly used rail lines for sale to other operators, especially short lines participating in the new partnership. The decision to **expand the short line network** through additional line sales comes after more than a year of study. Conrail does not anticipate any other significant line sales beyond these in the foreseeable future.

February 1996

- Planning begins for a **double-stack clearance program** on the route between Albany, New York, and Boston, Massachusetts, following approval by Governor William F. Weld and the Massachusetts legislature to assist in funding the effort. The state will invest $110 million for improvements on lines owned by Conrail, the Boston & Maine, and the Providence & Worcester. Conrail will invest $23 million of its own funds for the work in the Commonwealth plus an additional $4 million to allow double-stack operations between the Massachusetts/New York state line and Selkirk Yard near Albany.

- Early retirement and separation programs are instituted to eliminate 900 non-union positions. The programs will help the company achieve its strategic business plan by **linking staffing levels to changing work process needs**, and bringing staff levels in line with those of other large railroads.

- **James A. Hagen announces he will retire as Chairman** following the May 15 annual shareholders meeting. President and Chief Executive Officer **David M. LeVan will assume the additional title of Chairman.**

- Burlington Northern Santa Fe, Norfolk Southern and Conrail introduce the North American Container System (NACS). For intermodal shippers, the NACS containers will allow restriction-free interchange of containers among the three railroads. The railroads expect **improved equipment utilization**, which will benefit both customers and the carriers.

- Continuing efforts to educate motorists on the dangers of trying to beat trains at grade crossings are credited with helping achieve a **20 percent reduction in accidents in 1995** compared to 1994.

- The Chemical Manufacturers Association accepts Conrail as a participant in its **Responsible Care Program.** Membership commits Conrail to continually improving its health, safety and environmental performance, and to involving the public in that process.

March 1996

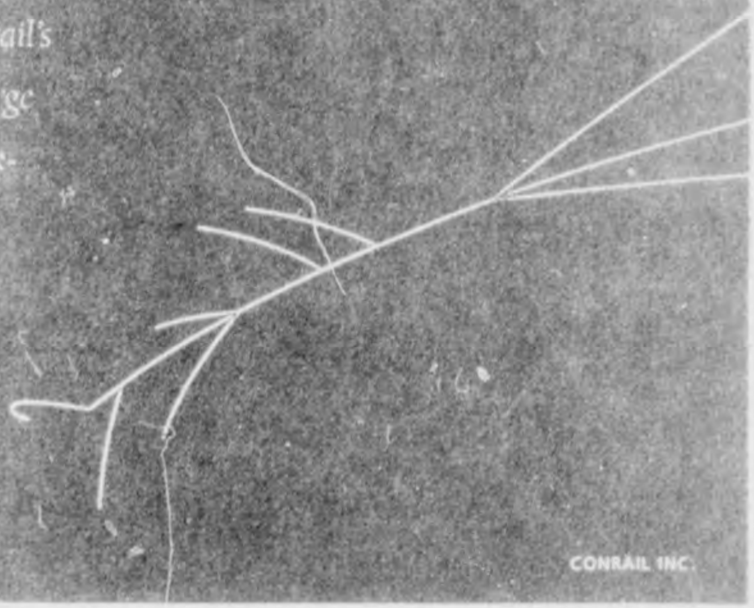
- Conrail files with the Surface Transportation Board comments and testimony in **opposition to the Union Pacific-Southern Pacific merger**, unless it is conditioned on divestiture of the eastern half of the Southern Pacific's lines and assets.

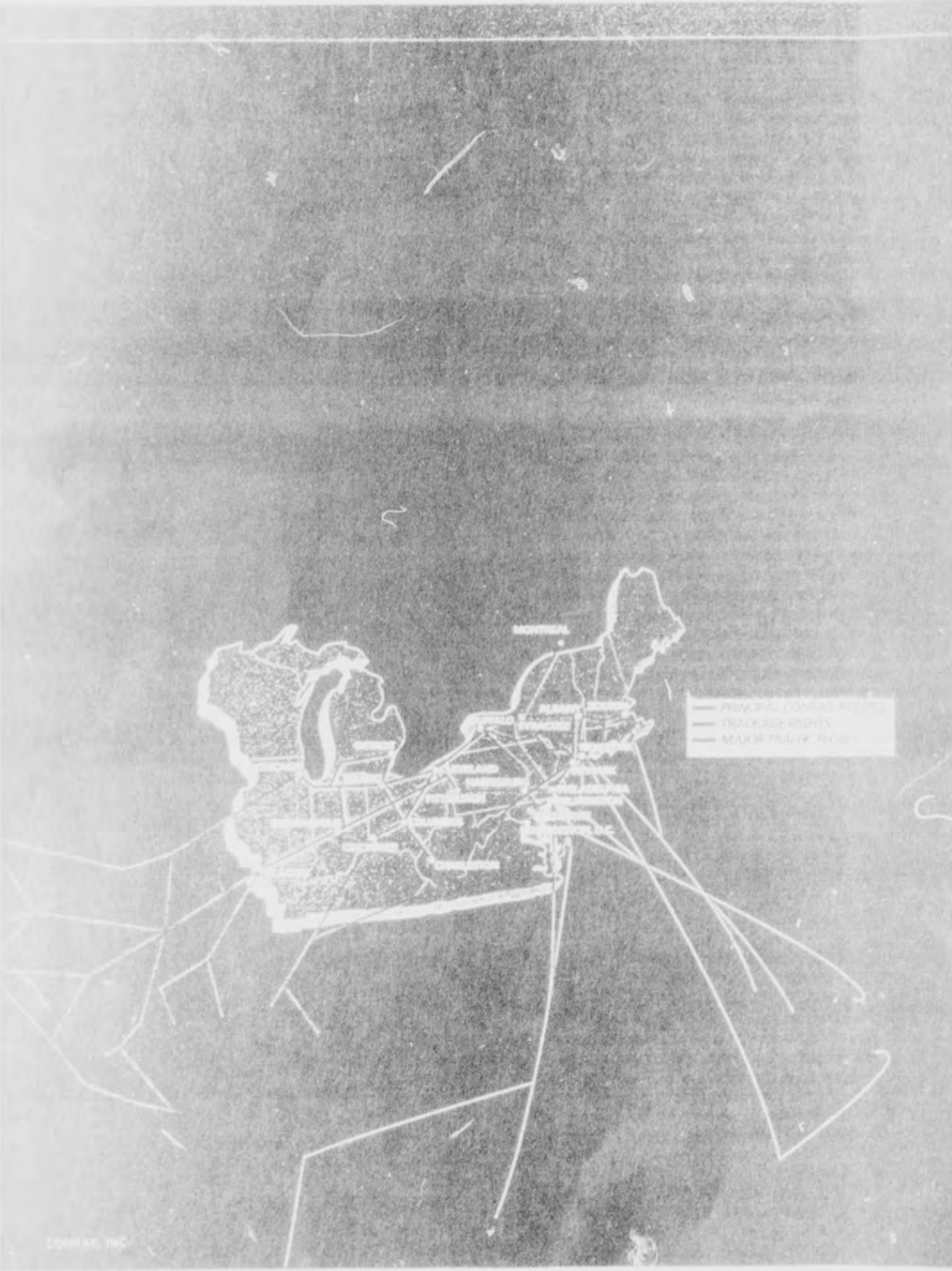
Conrail operates over a rail **NETWORK OF APPROXIMATELY 11,000 ROUTE MILES**, *with a fleet of* **2,100 LOCOMOTIVES and 52,800 FREIGHT CARS**. *Conrail had an average of* **23,510 EMPLOYEES in 1995**. *Conrail is dedicated exclusively to freight transportation service.*

As the major freight railroad **SERVING AMERICA'S NORTHEAST-MIDWEST REGION**, *Conrail serves a concentrated population and industrial base, and provides customers with access to a substantial market for* **CONSUMER DURABLE AND NON-DURABLE GOODS AND RAW MATERIALS** *used in manufacturing and electric power generation. Conrail is one of the largest rail* **TRANSPORTERS OF INTERMODAL AND AUTOMOTIVE TRAFFIC** *in the nation.*

For a growing number of customers, Conrail provides **ECONOMICAL LONG-HAUL SERVICE** *to strategically located distribution centers, where customers use trucks for local* **DELIVERY OF STEEL, CHEMICALS, FOOD,** *and* **FOREST PRODUCTS**.

HEADQUARTERED IN PHILADELPHIA, *Conrail maintains access to the* **MAJOR PORTS** *throughout its region, including* **PHILADELPHIA, NEW YORK/NEW JERSEY, BALTIMORE, BOSTON** *and* **CLEVELAND**. *Conrail's connections with other railroads, barge operators, steamship lines, and trucking companies create* **ACCESS TO MARKETS THROUGHOUT THE UNITED STATES AND AROUND THE WORLD.**




MONTREAL
PRINCIPAL CONRAIL ROUTES
TRACKAGE RIGHTS
MAJOR TRAFFIC FLOWS
CONRAIL, INC.

To Our Shareholders

Conrail's ability to keep costs in line with business levels during 1995 contributed to a sound financial performance. We are encouraged by the actions our people took to adjust our operating plan in the face of declining freight traffic through the year. Because of those efforts, we continued to make significant progress toward our long-term goal of providing a superior return on assets and increasing shareholder value.

James A. Hagen,
Chairman of the Board

David M. LeVan,
President and Chief Executive Officer

While we are pleased with our financial progress, there is an event which stands out as more significant, and that was the tragic train collision late in the year in Effingham, Illinois, which resulted in the death of three employees. This was particularly disheartening in a year when all of us put so much effort into the paramount goal of improving safety. And although in 1995 we achieved a 35 percent reduction in personal injuries, an event of this magnitude diminishes that accomplishment. We are redoubling our efforts in 1996, so that safety remains the number one priority of every employee every day.

Our goal for 1996 is to cut injuries in half. Among the activities that will help us reach that goal are these:

- For 1996, we'll recognize individual and team safety achievements with awards of Conrail stock.
- We've tied management incentive compensation to safety performance in 1996.
- Once again this year, we are dedicating a million dollars to each operating division and our system shops to allow them to respond immediately to safety concerns raised by our employees; and we'll continue the increased training effort begun last year.

We can take satisfaction in our accomplishments as a whole only if our safety goal is accomplished in full.

With regard to our 1995 traffic and revenue performance, the 5.4 percent decrease in freight volume in 1995 resulted from a weak economy and over-capacity in the trucking industry. However, revenue per unit improved across all of our service groups — Intermodal, Automotive, Unit Train and CORE — so that the overall decline in revenue for the year was only 1.3 percent.

For 1996, our goal is to deliver sound growth, with projected increases of 3.5 to 4.5 percent in line haul revenues. It's clear that the economy alone will not produce that level of growth. To deliver on our growth plan, we are counting on a broad range of initiatives designed to increase market share, particularly in intermodal (trailers and containers on flatcars), coal, steel, petrochemicals, and food and agricultural products. All of these initiatives build on the strength of our franchise—one of the richest, most densely populated consumer markets in the world—the development of new products targeted to customer needs, and a bedrock of steadily improving service quality.

Some examples of these initiatives:

- A major source of intermodal growth is expected to come from our package and less-than-truckload (LTL) business, as the LTL industry accelerates its conversion from highway to rail based on our superior service and economics.
- We also expect continued growth from the domestic truckload carriers, again, as we demonstrate our ability to move their trailers and containers with economies superior to highway movement and without compromising service quality.
- Our double-stack service (containers stacked two high on flatcars) should be aided by the clearance project we completed across Pennsylvania in the fall of 1995, giving us two east-west routes able to accommodate these taller, more efficient trains.
- We expect to continue to capitalize on the fundamental strength of our franchise by serving new markets through efforts such as the north-south intermodal service we launched with Norfolk Southern in May 1995, which links key Conrail-served points in Massachusetts and the New York metropolitan area with key markets in the South. In February of this year, we launched a new Conrail service to Kansas City in conjunction with the Gateway Western Railway. This service is designed for both our international customers who want to reach as far Midwest as they can from North Atlantic ports, and domestic customers looking for opportunities to move goods to the Northeast.
- We expect strength in our coal business in 1996 as a result of increased production of competitive, Conrail-origin coal, and by sustaining 1995 record levels of export coal.

Continued on page 8

For 1995, Conrail's **NET INCOME WAS $264 MILLION** *compared with $324 million for 1994, including special charges and non-recurring items in both years. Excluding the special charges and non-recurring items,*

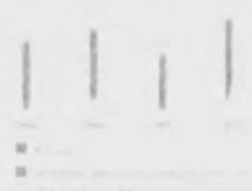
FINANCIAL SUMMARY

Conrail would have earned $419 million ($4.69 per share, fully diluted basis) for 1995, an **INCREASE OF NEARLY 12 PERCENT IN NET INCOME** *and* **14 PERCENT IN EARNINGS PER SHARE** *when compared with $375 million ($4.13 per share, fully diluted basis) in net income for 1994.*

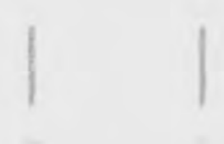
Freight volume (freight cars and intermodal trailers/containers) decreased 5.4 percent and operating revenues decreased 1.3 percent compared with 1994, primarily due to weakness in the economy. In the face of declining volume, Conrail adjusted its operating plan and produced a sound financial performance for the year. **CONRAIL'S OPERATING RATIO** *(operating expenses as a percent of revenues)* **DECREASED TO 79.9 PERCENT FROM 81.5 PERCENT IN 1994** *(excluding special charges and non-recurring items in both years) for the second largest annual decrease in operating ratio in Conrail's history.*

Please turn to the Financial Review section of this report, beginning on page 9, for a detailed discussion of financial results.

NET INCOME



REVENUES



UNITS (FREIGHT CARS AND INTERMODAL TRAILERS AND CONTAINERS)

Continued from page 6

- Our steel business should be helped by additions to our fleet, including coil steel cars and gondolas, and by planned improvements in gondola utilization so that we get more trips per car out of the fleet. In addition, two new mini-mills will open at Conrail-served points this year.

- Petrochemicals growth is expected as a result of new Conrail-served facilities.

- In grain, a weak 1995 local harvest is expected to increase rail shipments from the Midwest to Conrail-served markets in the East.

- The planned sale of about 1,800 route miles to short line partners will both enhance Conrail's focus on the most productive parts of its own system and create a stronger platform for growth through the independently owned and operated short lines.

So there are a number of positives in the picture for 1996, all of them well-suited to our franchise, many of them resulting from initiatives under way in 1995, and all of them attainable with the commitment we've made to continuously improving asset utilization, service quality and customer satisfaction.

For 1996, we know we've got to raise the bar on service quality. Our customers require consistent conformance to their expectations in the service we offer them. We've committed ourselves to a fixed schedule operation they can count on. In January 1996, we reorganized our operating department so that our resources are focused on the processes that matter most to meeting that requirement — specifically, to obtain optimum utilization of freight cars and locomotives, make our interchange processes with other railroads more efficient, and simplify and speed the flow of freight across our network.

Although winter storms wreaked havoc on our operations early this year, with an effect that will be difficult to overcome in the first quarter, achieving our growth goals for the year depends on demonstrating that we consistently deliver the service we promise. We have the people, the measures and the accountability in place to ensure continued improvement in our service, which is essential to accomplishing the revenue improvement we're looking for in 1996.

In sum, Conrail's business strategy in 1996 and beyond is premised on growth. We can grow only by recognizing that we are in business to help our customers grow. And we can succeed in that strategy only through initiatives in the four focus areas under which we've organized our management effort: Safety, Growth, Asset Utilization and Employee Development and Productivity.

First and foremost, we absolutely need to make major advances in safety. We cannot be satisfied without safety being every employee's number one priority, every day. Second, we must grow this business. We are well-positioned to achieve our growth goals by raising our service levels, by giving our customers the specific service products they need to grow, and by extending the strength of our franchise to new markets. Third, optimum asset utilization is central not only to achieving a competitive cost structure, but also to assuring that our track network, our shops, our freight cars and our locomotives are deployed in a manner that produces superior service. Fourth, we recognize that the development of our people — ensuring that they are properly trained and that they are placed where our customers need them — is essential to giving us the opportunity to compete in today's environment.

As we are successful in these key areas, Conrail's goal is to establish itself as the premier transportation partner to its customers, and thereby deliver superior financial results and shareholder value.

We are confident that we have the employees to do the job. The safety record, the service and the growth will not occur without their talent, their drive and their leadership.

Jim Hagen

James A. Hagen,
Chairman of the Board

Dave LeVan

David M. LeVan,
President and
Chief Executive Officer

March 6, 1996

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

1995 REVENUE DISTRIBUTION
by Service Group

Overview

Conrail's net income for 1995 was $264 million, compared with $324 million for 1994 and $160 million for 1993. The results for 1995 include the effects of a $285 million asset disposition charge ($176 million after income taxes) and the recognition of a $21 million reduction in income taxes related to a decrease in a state tax rate (see Notes 2 and 6 to the Consolidated Financial Statements). Without these items, net income for 1995 would have been $419 million.

The results for 1994 include a one-time charge of $51 million (net of tax benefits of $33 million) relating to a non-union early retirement program and related costs (see Note 9 to the Consolidated Financial Statements). Results for 1993 include one-time after-tax charges of $74 million for the adoption of required changes in accounting for income taxes and postretirement benefits other than pensions; the estimated net loss on the disposition of its subsidiary, Concord Resources Group, Inc., $50 million; and the one-time effects on deferred taxes of the increase in the federal tax rate, $34 million (see Notes 1,6,7 and 10 to the Consolidated Financial Statements). Absent the one-time charges, Conrail's net income for 1994 and 1993 would have been $375 million and $318 million, respectively.

Traffic volumes and operating revenues decreased 5.4% and 1.3%, respectively, in 1995 compared with 1994. However, continued emphasis on cost reduction and productivity improvement enabled Conrail to achieve an operating ratio (operating expenses as a percent of revenues) of 79.9%, excluding the asset disposition charge, which was worse than its 1995 operating ratio goal of 79.5%. The 1994 operating ratio was 81.5% excluding the early retirement program charge.

In 1994, traffic volume and operating revenues increased 8.3% and 8.1%, respectively, over 1993, while operating expenses were 6.3% higher (excluding the early retirement program charge).

1996 Outlook

Conrail expects the economy to grow at a slower pace in 1996 than in 1995. Conrail's outlook for 1996 is based on assumptions of 2.2% growth in real gross domestic product, as measured on a "1987 prices" basis, and 2.5% growth in industrial production. Conrail projects line haul revenue growth of between 3.5% to 4.5% in 1996, and expects to achieve this growth primarily through increasing its market share in the Intermodal, Unit Train and CORE Service Groups. Within the CORE Service Group, market share growth is projected in steel, petrochemicals and food and agriculture products. Conrail's market share growth plans are based on the implementation of new service initiatives, and its achievement of these growth estimates is highly dependent upon the success of these initiatives. Conrail's operating ratio goal for 1996 is 77.5%. Conrail's ability to meet this goal is dependent upon continuing emphasis on cost reduction programs, in addition to the projected growth in revenues. This goal has been made more challenging by severe winter weather in the first quarter of 1996, which has increased operating costs and reduced traffic volume below the levels originally projected for the quarter.

On February 21, 1996, the Board of Directors approved a voluntary early retirement program and voluntary separation program for eligible members of the non-union workforce with the goal of eliminating 900 non-union positions. Eligible employees have until April 23, 1996 to apply for the programs. In the event the 900 position goal is not achieved through the voluntary programs, the Company expects to obtain the additional reductions through non-voluntary separation programs.

The costs of the programs are expected to be recorded in the second quarter of 1996, and are expected to have a material effect on the income statement in that quarter. The programs will not have a significant effect on the Company's cash position as the majority of the costs will be paid from the Company's overfunded pension plan (see Notes 7 and 12 to the Consolidated Financial Statements).

1995 Asset Disposition Charge

The fourth quarter 1995 asset disposition charge resulted from a review of Conrail's route system and other assets to determine those that no longer effectively and economically support current and expected operations. As a result of this review, Conrail identified approximately 1,800 miles of rail lines that will be candidates for sale. These dispositions are expected to provide proceeds substantially less than net book value. Certain other operating assets identified for disposition, primarily yards and sidetracks, have also been written down to estimated net realizable value. Accordingly, the asset disposition charge of $285 million represents the expected loss on rail line and other asset dispositions. Conrail estimates that net cash proceeds from the disposition of these assets will be approximately $50 million. Conrail's goal is to have sales agreements in place on many of the lines during 1996 and on most of the lines by the end of 1997.

Results of Operations

1995 Compared with 1994

Net income for 1995 was $264 million ($3.19 per share, primary and $2.94 per share, fully diluted) compared with 1994 net income of $324 million ($3.90 per share, primary and $3.56 per share, fully diluted). Excluding the one-time charges (see "Overview") in both years and the one-time tax benefit in 1995, Conrail's net income would have been $419 million ($5.16 per share, primary and $4.69 per share, fully diluted) for 1995 and $375 million ($4.54 per share, primary and $4.13 per share, fully diluted) for 1994.

Operating revenues (primarily freight line haul revenues, but also including switching, demurrage and incidental revenues) decreased $47 million, or 1.3%, from $3,733 million in 1994 to $3,686 million in 1995. A 5.4% decrease in traffic volume in units (freight cars and intermodal trailers and containers) resulted in a $191 million decrease in revenues which was partially offset by an increase in average revenue per unit that increased revenues by $140 million. The improvement in average revenue per unit resulted from increases in average rates, $117 million, and a favorable traffic mix, $23 million. Traffic volume decreases were experienced by three of the four service groups, with only Automotive showing a slight volume increase of .8%. Traffic volume declines for the other service groups were as follows: Intermodal, 7.3%; Unit Train, 5.4%; and CORE, 5.1%. Within the CORE Service Group, traffic volume declines were also experienced by each of the commodity groups: Food and Agriculture, 8.2%; Petrochemicals, 4.6%; Metals, 4.0%; and Forest and Manufactured Products, 3.9%. Other revenues increased $4 million.

Operating expenses increased $103 million, or 3.3%, from $3,127 million in 1994 to $3,230 million in 1995. The following table sets forth the operating expenses for the two years:

(In Millions)	**1995**	1994	Increase (Decrease)
Compensation and benefits	**$1,249**	$1,260	$ (11)
Fuel	**168**	188	(20)
Material and supplies	**167**	203	(36)
Equipment rents	**355**	381	(26)
Depreciation and amortization	**293**	278	15
Casualties and insurance	**175**	184	(9)
Other	**538**	549	(11)
Asset disposition charge	**285**		285
Early retirement program		84	(84)
	$3,230	$3,127	$103

Compensation and benefits costs decreased $11 million, or .9%, as a result of a 5.3% reduction in employment levels, which exceeded the increases in wage rates and fringe benefit costs. Compensation and benefits as a percent of revenues was 33.9% in 1995 compared with 33.7% in 1994.

Fuel costs decreased $20 million, or 10.6%, as a result of greater use of newer fuel efficient locomotives, lower average fuel prices and lower traffic volume.

The decrease of $36 million, or 17.7%, in material and supplies costs was primarily attributable to a lower level of repair and maintenance expenditures related to lower traffic volume.

Equipment rents decreased $26 million, or 6.8%, primarily as a result of fewer foreign cars on Conrail's lines and improved equipment utilization, partially offset by the increased costs associated with new operating leases for equipment.

Depreciation and amortization increased $15 million, or 5.4%, due to asset additions and increased depreciation rates for track structure as a result of a depreciation study required by the former Interstate Commerce Commission.

Casualties and insurance decreased $9 million, or 4.9%. The cost reduction attributable to an approximate 35% decline in the number of employee injuries was largely offset by the escalating costs to settle claims as well as the continuing increase in the number and cost of occupational claims.

Conrail recorded an asset disposition charge of $285 million in 1995 (see Note 2 to the *Consolidated Financial Statements*) and a one-time pre-tax charge of $84 million in 1994 for the non-union voluntary early retirement program and related costs (see Note 9 to the Consolidated Financial Statements).

Conrail's operating ratio was 87.6% for 1995, compared with 83.8% for 1994. Without the $285 million asset disposition charge in 1995 and the $84 million charge for the early retirement program in 1994, the operating ratios for 1995 and 1994 would have been 79.9% and 81.5%, respectively.

Other income, net, increased $12 million, or 10.2%, primarily due to an $8 million gain from a property sale completed during the second quarter of 1995.

The Company's effective income tax rate for 1995 was 32.7% compared with 39.1% for 1994. The lower rate reflects the effect of a $21 million reduction in income taxes resulting from a decrease in a state income tax rate enacted during the second quarter of 1995 (see Note 6 to the Consolidated Financial Statements).

COMPENSATION AND BENEFITS AND OPERATING RATIO (%)

■ Compensation and benefits ratio

OPERATING RATIO

■ Actual

■ Without *one-time charges* in 1994 and 1995

1994 Compared with 1993

Net income for 1994 was $324 million ($3.90 per share, primary and $3.56 per share, fully diluted) compared with 1993 net income of $160 million ($1.82 per share, primary and $1.70 per share, fully diluted). Excluding the one-time charges (see "Overview"), Conrail's net income would have been $375 million ($4.54 per share, primary and $4.13 per share, fully diluted) for 1994 and $318 million ($3.78 per share, primary and $3.43 per share, fully diluted) for 1993.

Operating revenues increased $280 million, or 8.1%, from $3,453 million in 1993 to $3,733 million in 1994. An 8.3% increase in traffic volume in units resulted in a $274 million increase in revenues that was partially offset by a slight decrease in average revenue per unit which reduced revenues by $8 million. The decrease in average revenue per unit was caused by an unfavorable traffic mix which reduced revenues by $46 million, substantially offset by increases in average rates which increased revenues by $38 million. Traffic volume increases were experienced by each of the four service groups: Intermodal, 17.3%; Automotive, 10.0%; Unit Train, 3.9%; and CORE, 1.5%. Within the CORE Service Group, Metals increased 4.5%, Forest and Manufactured Products increased 3.1%, Petrochemicals increased .5%, and Food and Agriculture decreased 2.0%. Switching, demurrage and incidental revenues increased $14 million.

Operating expenses increased $265 million, or 9.3%, from $2,862 million in 1993 to $3,127 million in 1994. The following table sets forth the operating expenses for the two years:

(In Millions)	1994	1993	Increase (Decrease)
Compensation and benefits	**$1,260**	$1,229	$ 31
Fuel	**188**	178	10
Material and supplies	**203**	194	9
Equipment rents	**381**	305	76
Depreciation and amortization	**278**	284	(6)
Casualties and insurance	**184**	131	53
Other	**549**	541	8
Early retirement program	**84**		84
	$3,127	$2,862	$265

Compensation and benefits costs increased $31 million, or 2.5%, primarily due to increased wage rates which were partially offset by reduced fringe benefits costs and lower employment levels. Compensation and benefits as a percent of revenues was 33.7% in 1994 compared with 35.6% in 1993.

The increase of $76 million, or 24.9%, in equipment rents reflects the effects of increased traffic volume and new operating leases, as well as the effects of crowded serving yards and train delays experienced primarily in the first half of 1994.

Casualties and insurance costs increased $53 million, or 40.5%. While the number of injuries for the year was about the same as in 1993, the cost per claim to settle injuries has continued to escalate. The costs related to occupational claims and the number of those claims also increased.

In the first quarter of 1994, Conrail incurred a one-time pre-tax charge of $84 million for the non-union voluntary early retirement program and related costs (see Note 9 to the Consolidated Financial Statements).

Conrail's operating ratio was 83.8% for 1994, compared with 82.9% for 1993. Without the $84 million one-time charge for the early retirement program, the operating ratio for 1994 would have been 81.5%.

Liquidity and Capital Resources

Conrail's cash and cash equivalents increased $30 million, from $43 million at December 31, 1994 to $73 million at December 31, 1995. Cash generated from operations, principally from its wholly-owned subsidiary, Consolidated Rail Corporation ("CRC"), and borrowings are Conrail's principal sources of liquidity and are used primarily for capital expenditures, debt service, and dividends. Operating activities provided cash of $773 million in 1995, compared with $697 million in 1994 and $504 million in 1993. Issuance of long-term debt provided cash of $85 million in 1995. The principal uses of cash in 1995 were for property and equipment acquisitions, $415 million, cash dividends on preferred and common stock, $150 million, payment of long-term debt including capital lease and equipment obligations, $134 million, and the repurchase of common stock, $92 million.

Working capital (current assets less current liabilities) of $36 million existed at December 31, 1995, compared with a $76 million deficiency at December 31, 1994. The improvement in working capital is primarily related to an increase in deferred tax assets in 1995 (see Note 6 to the Consolidated Financial Statements). Management believes that Conrail's financial position allows it sufficient access to credit sources on investment grade terms, and, if necessary, additional intermediate or long-term debt could be issued for additional working capital requirements.

In July 1994, the Board of Directors authorized a fourth common stock repurchase program of up to $100 million. In December 1995, this program was completed at a total of 1,664,053 shares. In April 1995, the Company's Board of Directors approved an additional $250 million multi-year stock repurchase program. At December 31, 1995, Conrail had acquired 20,000 shares for approximately $1 million under this program.

During 1995, CRC issued an additional $128 million of commercial paper and repaid $151 million. Of the $189 million outstanding at December 31, 1995, $100 million is classified as long-term debt since it is expected to be refinanced through subsequent issuances of commercial paper and is supported by the long-term portion of the $500 million uncollateralized bank credit agreement.

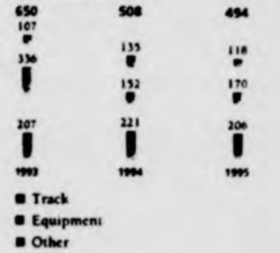
At December 31, 1995, $312 million remains available to Conrail and CRC under a 1993 shelf registration statement whereby CRC can issue debt securities and Conrail can issue both convertible debt and equity securities.

In June 1995, CRC issued $110 million of 6.76% Pass Through Certificates, Series 1995-A, due 2015, to finance the acquisition of equipment. Of these Certificates, $55 million are direct obligations of CRC secured by the acquired equipment. The remaining $55 million of Certificates were issued to finance equipment that CRC will utilize under a capital lease, and while such certificates are not direct obligations of, or guaranteed by CRC, the amounts payable by CRC under the lease will be sufficient to pay principal and interest on the Certificates.

In June 1995, CRC issued $30 million of 6.3% Medium-Term Notes maturing in 1999.

During 1995, CRC borrowed and repaid $130 million under its uncollateralized bank credit agreement at interest rates ranging from 6.0% to 6.4% during the year. At December 31, 1995, no amount was outstanding under this agreement.

CAPITAL EXPENDITURES
$ in millions



Capital Expenditures

Capital expenditures totaled $494 million, $508 million and $650 million in 1995, 1994 and 1993, respectively. Of these totals, Conrail directly financed $126 million in 1995, $57 million in 1994 and $232 million in 1993. In addition, the proceeds of notes and debentures sold in those years, $30 million, $65 million, and $329 million, respectively, were available to fund capital expenditures.

Conrail identified 1,800 miles of underutilized rail lines and other assets for sale or disposal which are expected to provide proceeds substantially less than the net book value of such assets. The Company has provided for such deficiencies in its 1995 asset disposition charge (see Note 2 to the Consolidated Financial Statements and "1995 Asset Disposition Charge"). Although these disposals will eliminate the need for future capital expenditures on these lines and improve Conrail's cash position in the year of disposition, the extent of the effect on cash will depend on the final terms of the sales agreements.

In response to lower than expected traffic and revenues, Conrail reduced its planned capital expenditures for 1995 from $550 million to $494 million. Capital expenditures for 1996 are expected to be approximately $450 million.

Inflation

Generally accepted accounting principles require the use of historical costs in preparing financial statements. This approach does not consider the effects of inflation on the costs of replacing assets. The replacement cost of Conrail's property and equipment is substantially higher than its historical cost basis. Similarly, depreciation expense on a replacement cost basis would be substantially in excess of the amount recorded under generally accepted accounting principles.

Environmental Matters

Conrail's operations and property are subject to various federal, state and local laws regulating the environment. CRC is a party to numerous proceedings brought by regulatory agencies and private parties under federal, state and local laws, including Superfund laws, and has also received inquiries from governmental agencies with respect to other potential environmental issues. As of December 31, 1995, CRC had received, together with other companies, notices of its involvement as a potentially responsible party or requests for information under the Superfund laws with respect to cleanup and/or removal costs due to its status as an alleged transporter, generator or property owner at 130 locations throughout the country. However, based on currently available information, Conrail believes CRC may have some potential responsibility at only 56 of these sites. Due to the number of parties involved at many of these sites, the wide range of costs of the possible remediation alternatives, changing technology and the length of time over which these matters develop, it is not always possible to estimate CRC's liability for the costs associated with the assessment and remediation of contaminated sites. At December 31, 1995, Conrail had accrued $64 million for estimated future environmental expenses. Although Conrail's operating results and liquidity could be significantly affected in any quarterly or annual reporting period in which CRC was held principally liable in certain of these actions, Conrail believes the ultimate liability for these matters will not materially affect its financial condition. (See Note 12 to the Consolidated Financial Statements).

Conrail spent $14 million, $8 million and $7 million in 1995, 1994 and 1993, respectively, for environmental remediation and related costs and anticipates spending approximately $10 million in 1996. In addition, Conrail's capital expenditures for environmental control and abatement projects were approximately $6 million in 1995, $5 million in 1994 and $2 million in 1993, and are anticipated to be approximately $8 million in 1996.

Conrail has an Environmental Quality group, the mission of which is to institute and promote compliance with environmentally sound operating practices and to monitor and assess the status of sites where liability under environmental laws may exist.

Other Matters

During 1995, CRC reached an agreement with approximately 300 of its employees represented by the Fraternal Order of Police. In addition, a tentative agreement was reached with approximately 4,000 of its employees represented by the United Transportation Union through negotiations carried on by the National Carriers' Committee, of which CRC is a member.

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements that involve risks and uncertainties that may cause actual results to differ, including but not limited to the effect of economic conditions, competition, regulation and weather on Conrail's operations, customers, service and prices, and other factors discussed elsewhere in this report and, from time to time, in other reports filed with the Securities and Exchange Commission.

Report of Management

The Stockholders
Conrail Inc.

Management is responsible for the preparation, integrity and objectivity of the Company's financial statements. The financial statements are prepared in conformity with generally accepted accounting principles and include amounts based on management's best estimates and judgment. The financial information contained in other sections of this annual report is consistent with that contained in the financial statements.

The Company maintains a system of internal accounting controls and procedures which is continually reviewed and supported by written policies and guidelines and supplemented by a corporate staff of internal auditors. The system provides reasonable assurance that assets are safeguarded against loss from unauthorized use and that the books and records reflect the transactions of the Company and are reliable for the preparation of financial statements. The concept of reasonable assurance recognizes that the cost of a system of internal accounting controls should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

The Company's financial statements are audited by its independent accountants. Their audit is conducted in accordance with generally accepted auditing standards and includes a study and evaluation of the Company's system of internal accounting controls to determine the nature, timing and extent of the auditing procedures required for expressing an opinion on the Company's financial statements.

The Board of Directors pursues its oversight responsibilities for the financial statements and corporate conduct through its Audit and Ethics Committees. Each Committee consists of Directors who are not employees of the Company. The Audit Committee recommends the appointment of the independent accountants, and meets several times a year with management, the internal auditors and the independent accountants. The independent accountants and internal auditors have unrestricted access to the Audit Committee to discuss audit scope, the results of their audits, the adequacy of internal accounting controls and financial reporting. The Ethics Committee meets several times a year with management to review matters of public interest, including safety, equal employment and compliance with environmental regulations.

David M. LeVan

David M. LeVan
President and
Chief Executive Officer

H. W. Brown

H. William Brown
Senior Vice President–
Finance and Administration

January 22, 1996

Report of Independent Accountants

The Stockholders and Board of Directors
Conrail Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Conrail Inc. and subsidiaries at December 31, 1995 and 1994, and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above. The consolidated financial statements of Conrail Inc. and subsidiaries for the year ended December 31, 1993 were audited by other independent accountants whose report dated January 24, 1994 expressed an unqualified opinion on those statements.

As discussed in Note 1 to the consolidated financial statements, the Company changed its methods for accounting for income taxes and postretirement benefits other than pensions in 1993.

Price Waterhouse LLP

Price Waterhouse LLP
Thirty South Seventeenth Street
Philadelphia, Pennsylvania 19103

January 22, 1996,
except as to paragraphs five and six of Note 12, which are as of February 21, 1996

Consolidated Statements of Income

($ In Millions Except Per Share Data)	1995	1994	1993
	Years ended December 31,		
Revenues	$3,686	$3,733	$3,453
Operating expenses			
Way and structures	485	499	492
Equipment	766	815	703
Transportation	1,324	1,379	1,283
General and administrative	370	350	384
Asset disposition charge (Note 2)	285		
Early retirement program (Note 9)		84	
Total operating expenses	3,230	3,127	2,862
Income from operations	456	606	591
Interest expense	(194)	(192)	(185)
Loss on disposition of subsidiary (Note 10)			(80)
Other income, net (Note 11)	130	118	114
Income before income taxes and the cumulative effect of changes in accounting principles	392	532	440
Income taxes (Note 6)	128	208	206
Income before the cumulative effect of changes in accounting principles	264	324	234
Cumulative effect of changes in accounting principles (Notes 1, 6 and 7)			(74)
Net income	$ 264	$ 324	$ 160
Income per common share (Note 1)			
Before the cumulative effect of changes in accounting principles			
Primary	$ 3.19	$ 3.90	$ 2.74
Fully diluted	2.94	3.56	2.51
Cumulative effect of changes in accounting principles			
Primary			(.92)
Fully diluted			(.81)
Net income per common share			
Primary	$ 3.19	$ 3.90	$ 1.82
Fully diluted	2.94	3.56	1.70
Ratio of earnings to fixed charges (Note 1)	2.51x	3.19x	2.98x

See accompanying notes.

Consolidated Balance Sheets

($ In Millions)	December 31, 1995	1994
ASSETS		
Current assets		
Cash and cash equivalents	$ 73	$ 43
Accounts receivable	614	646
Deferred tax assets (Note 6)	333	249
Material and supplies	158	164
Other current assets	28	23
Total current assets	1,206	1,125
Property and equipment, net (Note 3)	6,408	6,498
Other assets	810	699
Total assets	$8,424	$8,322
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Short-term borrowings	89	112
Current maturities of long-term debt (Note 5)	181	130
Accounts payable	113	119
Wages and employee benefits	183	169
Casualty reserves	110	103
Accrued and other current liabilities (Note 4)	494	568
Total current liabilities	1,170	1,201
Long-term debt (Note 5)	1,911	1,940
Casualty reserves	217	212
Deferred income taxes (Note 6)	1,393	1,203
Special income tax obligation (Note 6)	440	513
Other liabilities	316	328
Total liabilities	5,447	5,397
Commitments and contingencies (Note 12)		
Stockholders' equity (Note 8)		
Preferred stock (no par value; 15,000,000 shares authorized; no shares issued)		
Series A ESOP convertible junior preferred stock (no par value; 10,000,000 shares authorized; 9,770,993 and 9,821,358 shares issued and outstanding, respectively)	282	283
Unearned ESOP compensation	(233)	(243)
Common stock ($1 par value; 250,000,000 shares authorized; 85,392,392 and 80,409,598 shares issued, respectively; 82,094,675 and 78,620,434 shares outstanding, respectively)	85	80
Additional paid-in capital	2,187	1,848
Employee benefits trust (4,706,665 shares) at market	(329)	
Retained earnings	1,176	1,056
	3,168	3,024
Treasury stock, at cost (3,297,717 and 1,789,164 shares, respectively)	(191)	(99)
Total stockholders' equity	2,977	2,925
Total liabilities and stockholders' equity	$8,424	$8,322

See accompanying notes.

Consolidated Statements of Stockholders' Equity

($ In Millions Except Per Share Data)	Series A Preferred Stock	Unearned ESOP Compensation	Common Stock	Additional Paid-in Capital	Employee Benefits Trust	Retained Earnings	Treasury Stock
Balance, January 1, 1993	$287	$(263)	$83	$1,888		$ 903	$(150)
Amortization		10					
Net income						160	
Common dividends, $1.20 per share						(96)	
Preferred dividends, $2.165 per share						(21)	
Common shares acquired							(64)
Exercise of stock options			1	20			
Common shares reclassified as unissued			(4)	(107)		(98)	209
Other	(1)			18		9	
Balance, December 31, 1993	286	(253)	80	1,819		857	(5)
Amortization		10					
Net income						324	
Common dividends, $1.40 per share						(111)	
Preferred dividends, $2.165 per share						(21)	
Common shares acquired							(94)
Exercise of stock options				14			
Other	(3)			15		7	
Balance, December 31, 1994	283	(243)	80	1,848		1,056	(99)
Amortization		10					
Net income						264	
Common dividends, $1.60 per share						(129)	
Preferred dividends, $2.165 per share						(21)	
Common shares acquired							(92)
Exercise of stock options				6			
Establishment of employee benefits trust			5	245	$(250)		
Employee benefits trust transactions, net				84	(79)		
Other	(1)			4		6	
Balance, December 31, 1995	$282	$(233)	$85	$2,187	$(329)	$1,176	$(191)

See accompanying notes.

Consolidated Statements of Cash Flows

($ In Millions)	1995	1994	1993
	Years ended December 31,		
Cash flows from operating activities			
Net income	$ 264	$ 324	$ 160
Adjustments to reconcile net income to net cash provided by operating activities:			
Asset disposition charge	285		
Early retirement program		84	
Loss on disposition of subsidiary			80
Cumulative effect of accounting changes			74
Depreciation and amortization	293	278	284
Deferred income taxes	108	150	221
Special income tax obligation	(73)	(62)	(50)
Gains from sales of property	(27)	(18)	(20)
Pension credit	(43)	(46)	(43)
Changes in:			
Accounts receivable	32	(2)	(52)
Accounts and wages payable	8	41	(15)
Settlement of tax audit			(51)
Other	(74)	(52)	(84)
Net cash provided by operating activities	773	697	504
Cash flows from investing activities			
Property and equipment acquisitions	(415)	(490)	(566)
Proceeds from disposals of properties	38	32	23
Other	(59)	(23)	(45)
Net cash used in investing activities	(436)	(481)	(588)
Cash flows from financing activities			
Repurchase of common stock	(92)	(94)	(64)
Net proceeds from (repayments of) short-term borrowings	(23)	33	(48)
Proceeds from long-term debt	85	114	485
Payment of long-term debt	(134)	(158)	(195)
Dividends on common stock	(129)	(111)	(96)
Dividends on Series A preferred stock	(21)	(16)	(21)
Proceeds from stock options and other	7	21	21
Net cash provided by (used in) financing activities	(307)	(211)	82
Increase (decrease) in cash and cash equivalents	30	5	(2)
Cash and cash equivalents			
Beginning of year	43	38	40
End of year	$ 73	$ 43	$ 38

See accompanying notes.

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Industry
Conrail Inc. ("Conrail") is a holding company of which the principal subsidiary is Consolidated Rail Corporation ("CRC"), a freight railroad which operates within the northeast and midwest United States and the Province of Quebec.

Principles of Consolidation
The consolidated financial statements include Conrail and majority-owned subsidiaries. Investments in 20% to 50% owned companies are accounted for by the equity method.

Cash Equivalents
Cash equivalents consist of commercial paper, certificates of deposit and other liquid securities purchased with a maturity of three months or less, and are stated at cost which approximates market value.

Material and Supplies
Material and supplies consist mainly of fuel oil and items for maintenance of property and equipment, and are valued at the lower of cost, principally weighted average, or market.

Property and Equipment
Property and equipment are recorded at cost. Depreciation is provided using the composite straight-line method. The cost (net of salvage) of depreciable property retired or replaced in the ordinary course of business is charged to accumulated depreciation and no gain or loss is recognized.

Revenue Recognition
Revenue is recognized proportionally as a shipment moves on the Conrail system from origin to destination.

Earnings Per Share
Primary earnings per share are based on net income adjusted for the effects of preferred dividends net of income tax benefits, divided by the weighted average number of shares outstanding during the period, including the dilutive effect of stock options. Fully diluted earnings per share assume conversion of Series A ESOP Convertible Junior Preferred Stock ("ESOP Stock") into Conrail common stock. Net income amounts applicable to fully diluted earnings per share have been adjusted by the increase, net of income tax benefits, in ESOP-related expenses assuming conversion of all ESOP Stock to common stock. Shares in the Conrail Employee Benefits Trust are not considered outstanding for computing earnings per share. The weighted average number of shares of common stock outstanding during each of the most recent three years are as follows:

	1995	1994	1993
Primary weighted average shares	78,733,947	79,674,781	80,646,495
Fully diluted weighted average shares	88,702,712	89,562,721	90,835,982

Ratio of Earnings to Fixed Charges
Earnings used in computing the ratio of earnings to fixed charges represent income before income taxes plus fixed charges, less equity in undistributed earnings of 20% to 50% owned companies. Fixed charges represent interest expense together with interest capitalized and a portion of rent under long-term operating leases representative of an interest factor.

New Accounting Standards
Effective January 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" ("SFAS 106") (Note 7) and Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109") (Note 6). As a result, the Company recorded cumulative after tax charges of $22 million and $52 million for SFAS 106 and SFAS 109, respectively.

During 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (SFAS 121) and SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), which are both effective in 1996. The Company has decided to adopt only the disclosure provisions of SFAS 123 in 1996. The Company has also determined that SFAS 121 will not have a material effect on its financial statements.

Use of Estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates.

2. Asset Disposition Charge

Included in 1995 operating expenses is an asset disposition charge of $285 million, which reduced net income by $176 million. The asset disposition charge resulted from a review of the Company's route system and other operating assets to determine those that no longer effectively and economically support current and expected operations. The Company identified and has committed to sell 1,800 miles of rail lines that are expected to provide proceeds substantially less than net book value. In addition, other assets, principally yards and side tracks, identified for disposition have been written down to estimated net realizable value.

3. Property and Equipment

	December 31,	
(In Millions)	**1995**	1994
Roadway	**$ 6,828**	$ 6,764
Equipment	**1,213**	1,171
Less: Accumulated depreciation	**(1,572)**	(1,571)
Allowance for disposition	**(439)**	(241)
	6,030	6,123
Capital leases (primarily equipment)	**908**	988
Accumulated amortization	**(530)**	(613)
	378	375
	$ 6,408	$ 6,498

Conrail acquired equipment and incurred related long-term debt under various capital leases of $71 million in 1995, $8 million in 1994 and $75 million in 1993. As part of the 1995 (Note 2) and 1991 asset dispositions, the Company recorded allowances for disposition for the sale or abandonment of certain under-utilized rail lines and other facilities.

4. Accrued and Other Current Liabilities

	December 31,	
(In Millions)	**1995**	1994
Freight settlements due others	**$ 54**	$ 55
Equipment rents (primarily car hire)	**71**	76
Unearned freight revenue	**56**	74
Property and corporate taxes	**66**	78
Other	**247**	285
	$494	$568

5. Long-Term Debt

Long-term debt outstanding, including the weighted average interest rates at December 31, 1995, is composed of the following:

	December 31,	
(In Millions)	**1995**	1994
Capital leases	**$ 489**	$ 488
Medium-term notes payable, 6.16%, due 1996 to 1999	**208**	228
Notes payable, 9.75%, due 2000	**250**	250
Debentures payable, 7.88%, due 2043	**250**	250
Debentures payable, 9.75%, due 2020	**544**	544
Equipment and other obligations, 6.43%	**251**	210
Commercial paper, 5.90%	**100**	100
	2,092	2,070
Less current portion	**(181)**	(130)
	$1,911	$1,940

Using current market prices when available, or a valuation based on the yield to maturity of comparable debt instruments having similar characteristics, credit rating and maturity, the total fair value of the Company's long-term debt, including the current portion, but excluding capital leases, is $1,870 million and $1,601 million at December 31, 1995 and 1994, respectively, compared with carrying values of $1,603 million and $1,582 million at December 31, 1995 and 1994, respectively.

The Company's noncancelable long-term leases generally include options to purchase at fair value and to extend the terms. Capital leases have been discounted at rates ranging from 3.09% to 14.26% and are collateralized by assets with a net book value of $378 million at December 31, 1995.

Minimum commitments, exclusive of executory costs borne by the Company, are:

(In Millions)	Capital Leases	Operating Leases
1996	$ 102	$ 127
1997	92	109
1998	84	100
1999	75	84
2000	58	76
2001 - 2017	269	576
Total	680	$1,072
Less interest portion	(191)	
Present value	$ 489	

Operating lease rent expense was $130 million in 1995, $118 million in 1994 and $88 million in 1993.

In June 1993, the Company and CRC filed a shelf registration statement on Form S-3 to enable CRC to issue up to $500 million in debt securities or the Company to issue up to $500 million in convertible debt and equity securities. The remaining balance under this shelf registration was $312 million at December 31, 1995.

In June 1995, CRC issued $110 million of 6.76% Pass Through Certificates, Series 1995-A, due 2015, to finance the acquisition of equipment. Of these Certificates, $55 million are direct obligations of CRC secured by the acquired equipment. The remaining $55 million of Certificates were issued to finance equipment that CRC will utilize under a capital lease, and while such certificates are not direct obligations of, or guaranteed by CRC, the amounts payable by CRC under the lease will be sufficient to pay principal and interest on the Certificates.

In June 1995, CRC issued $30 million of 6.3% Medium-Term Notes maturing in 1999.

Equipment and other obligations mature in 1996 through 2043 and are collateralized by assets with a net book value of $279 million at December 31, 1995. Maturities of long-term debt other than capital leases and commercial paper are $114 million in 1996, $64 million in 1997, $44 million in 1998, $44 million in 1999, $264 million in 2000 and $973 million in total from 2001 through 2043.

CRC had $189 million of commercial paper outstanding at December 31, 1995. Of the total amount outstanding, $100 million is classified as long-term since it is expected to be refinanced through subsequent issuances of commercial paper and is supported by the long-term credit facility mentioned below.

CRC maintains a $500 million uncollateralized bank credit agreement with a group of banks which is used for general corporate purposes and to support CRC's commercial paper program. The agreement has a five year maturity and requires interest to be paid on amounts borrowed at rates based on various defined short-term rates and an annual maximum fee of .125% of the facility amounts. The agreement contains, among other conditions, restrictive covenants relating to a debt ratio and consolidated tangible net worth.

During 1995, CRC borrowed $130 million under its uncollateralized bank credit agreement at interest rates ranging from 6.0% to 6.4%, and repaid $130 million during the year. At December 31, 1995, no amount was outstanding under this agreement.

Interest payments were $177 million in 1995, $174 million in 1994 and $164 million in 1993.

6. Income Taxes

The provisions for income taxes are composed of the following:

(In Millions)	**1995**	1994	1993
Current			
Federal	**$ 78**	$104	$ 25
State	**15**	16	10
	93	120	35
Deferred			
Federal	**110**	125	189
State	**(2)**	25	32
	108	150	221
Special income tax obligation			
Federal	**(61)**	(53)	(42)
State	**(12)**	(9)	(8)
	(73)	(62)	(50)
	$128	$208	$206

Effective January 1, 1993, the Company adopted the provisions of SFAS 109 which requires a liability approach for measuring deferred tax assets and liabilities based on differences between the financial statement and tax bases of assets and liabilities at each balance sheet date using enacted tax rates in effect when those differences are expected to reverse. As a result, the Company recorded a cumulative adjustment of $52 million.

In conjunction with the public sale in 1987 of the 85% of the Company's common stock owned by the U.S. Government, federal legislation was enacted which resulted in a reduction of the tax basis of certain of the Company's assets, particularly property and equipment, thereby substantially decreasing tax depreciation deductions and increasing future federal income tax payments. Also, net operating loss and investment tax credit carryforwards were cancelled. As a result of the sale-related transactions, a special income tax obligation was recorded in 1987 based on an estimated effective federal and state income tax rate of 37.0%.

As a result of a decrease in a state income tax rate enacted during the second quarter of 1995, income tax expense for 1995 was reduced by $21 million representing the effects of adjusting deferred income taxes and the special income tax obligation for the rate decrease as required by SFAS 109.

As a result of the increase in the federal corporate income tax rate from 34% to 35% enacted August 10, 1993, and effective January 1, 1993, income tax expense for 1993 was increased by $38 million, of which $34 million related to the effects of adjusting deferred income taxes and the special income tax obligation for the rate increase.

During 1993, the Company reached a settlement with the Internal Revenue Service ("IRS") related to the audit of the Company's consolidated federal income tax returns for the fiscal years 1987 through 1989. Under the settlement, the Company paid $51 million, including interest, all of which had been provided for in years prior to 1993. The Company's consolidated federal income tax returns for the fiscal years 1990 through 1992 are currently being examined by the IRS. Federal and state income tax payments were $109 million in 1995, $80 million in 1994 and $39 million in 1993 (excluding tax settlement).

Reconciliations of the U.S. statutory tax rates with the effective tax rates follow:

	1995	1994	1993
Statutory tax rate	**35.0%**	35.0%	35.0%
State income taxes, net of federal benefit	**3.5**	3.9	5.1
Effect of federal tax increase on deferred taxes			7.7
Effect of state tax decrease on deferred taxes	**(5.3)**		
Other	**(.5)**	.2	(1.0)
Effective tax rate	**32.7%**	39.1%	46.8%

Significant components of the Company's special income tax obligation and deferred income tax liabilities and (assets) are as follows:

	December 31,	
(In Millions)	**1995**	1994
Current assets (primarily accounts receivable)	**$ (27)**	$ (33)
Current liabilities (primarily accrued liabilities and casualty reserves)	**(265)**	(175)
Tax benefits related to disposition of subsidiary	**(30)**	(30)
Net operating loss carryforwards	**(11)**	(11)
Current deferred tax asset, net	**$ (333)**	**$ (249)**
Noncurrent liabilities:		
Property and equipment	**1,936**	1,923
Other long-term assets (primarily prepaid pension asset)	**67**	62
Miscellaneous	**66**	50
	2,069	2,035
Noncurrent assets:		
Nondeductible reserves and other liabilities	**(144)**	(151)
Tax benefit transfer receivable	**(33)**	(38)
Alternative minimum tax credits	**(38)**	(75)
Miscellaneous	**(21)**	(55)
	(236)	(319)
Special income tax obligation and deferred income tax liabilities, net	**$1,833**	**$1,716**

7. Employee Benefits

Pension Plans

The Company and certain subsidiaries maintain defined benefit pension plans which are noncontributory for all non-union employees and generally contributory for participating union employees. Benefits are based primarily on credited years of service and the level of compensation near retirement. Funding is based on the minimum amount required by the Employee Retirement Income Security Act of 1974.

Pension credits include the following components:

(In Millions)	1995	1994	1993
Service cost - benefits earned during the period	$ 8	$ 8	$ 8
Interest cost on projected benefit obligation	51	48	46
Return on plan assets - actual	(254)	(10)	(124)
- deferred	167	(77)	42
Net amortization and deferral	(15)	(15)	(15)
	$ (43)	$(46)	$ (43)

The funded status of the pension plans and the amounts reflected in the balance sheets are as follows:

(In Millions)	1995	1994
Accumulated benefit obligation ($603 million and $526 million vested, respectively)	$ 609	$ 530
Market value of plan assets	1,168	982
Projected benefit obligation	(726)	(594)
Plan assets in excess of projected benefit obligation	442	388
Unrecognized prior service cost	50	44
Unrecognized transition net asset	(120)	(139)
Unrecognized net gain	(157)	(117)
Net prepaid pension cost	$ 215	$ 176

The assumed weighted average discount rates used in 1995 and 1994 are 7.0% and 8.5%, respectively, and the rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligation as of December 31, 1995 and 1994 is 6.0%. The expected long-term rate of return on plan assets (primarily equity securities) in 1995 and 1994 is 9.0%.

Savings Plans

The Company and certain subsidiaries provide 401(k) savings plans for union and non-union employees. Under the Non-union ESOP, 100% of employee contributions are matched in the form of ESOP Stock for the first 6% of a participating employee's base pay. There is no Company match provision under the union employee plan. Savings plan expense was $4 million in 1995 and $5 million in 1994 and 1993.

In connection with the Non-union ESOP, the Company issued 9,979,562 of the authorized 10 million shares of its ESOP Stock to the Non-union ESOP in exchange for a 20 year promissory note with interest at 9.55% from the Non-union ESOP in the principal amount of $288 million. In addition, unearned ESOP compensation of $288 million was recognized as a charge to stockholders' equity coincident with the Non-union ESOP's issuance of its $288 million promissory note to the Company. The debt of the Non-union ESOP was recorded by the Company and offset against the promissory note from the Non-union ESOP. Unearned ESOP compensation is charged to expense as shares of ESOP Stock are allocated to participants. The number of allocated ESOP shares outstanding at December 31, 1995 was approximately 2.2 million shares. An amount equivalent to the preferred dividends declared on the ESOP Stock partially offsets compensation and interest expense related to the Non-union ESOP.

In 1994, the ESOP's promissory note to the Company was refinanced. As part of the refinancing, the interest rate was decreased to 8.0%, from the original 9.55%, and accrued interest of $21 million was capitalized as part of the principal balance of the promissory note.

The Company is obligated to make dividend payments at a rate of 7.51% on the ESOP Stock and additional contributions in an aggregate amount sufficient to enable the Non-union ESOP to make the required interest and principal payments on its note to the Company.

Interest expense incurred by the Non-union ESOP on its debt to the Company was $24 million in 1995, $30 million in 1994 and $29 million in 1993. Compensation expense related to the Non-union ESOP was $10 million in 1995, 1994 and 1993. Preferred dividends of $21 million were declared in 1995, 1994 and 1993. Preferred dividend payments of $21 million, $16 million and $21 million were made in 1995, 1994 and 1993, respectively. The Company received debt service payments from the Non-union ESOP of $31 million in 1995, $21 million in 1994, and $26 million in 1993.

Postretirement Benefits Other Than Pensions

The Company provides health and life insurance benefits to certain retired non-union employees. Certain non-union employees are eligible for retiree medical benefits, while substantially all non-union employees are eligible for retiree life insurance benefits. Generally, company-provided health care benefits terminate when individuals reach age 65.

Retiree life insurance plan assets consist of a retiree life insurance reserve held in the Company's group life insurance policy. There are no plan assets for the retiree health benefits plan.

Effective January 1, 1993, the Company adopted SFAS 106, which requires that the cost of retiree benefits other than pensions be accrued during the period of employment rather than when benefits are paid. The Company elected the immediate recognition method allowed under the statement and accordingly recorded a cumulative, one-time charge of

$22 million (net of tax benefits of $14 million). This accrual was in addition to the remaining balance of $21 million which had been accrued for postretirement health benefits for employees who participated in the Companys 1989 non-union voluntary retirement program.

The following sets forth the plans' funded status reconciled with amounts reported in the Company's balance sheets:

(In Millions)	1995 Medical Plan	1995 Life Insurance Plan	1994 Medical Plan	1994 Life Insurance Plan
Accumulated postretirement benefit obligation:				
Retirees	$38	$19	$38	$15
Fully eligible active plan participants	5	1	3	1
Other active plan participants		5	1	4
Accumulated benefit obligation	43	25	42	20
Market value of plan assets		(7)		(6)
Accumulated benefit obligation in excess of plan assets	43	18	42	14
Unrecognized gains and (losses)	1	(1)	1	3
Accrued benefit cost recognized in the Consolidated Balance Sheet	$44	$17	$43	$17
Net periodic postretirement benefit cost, primarily interest cost	$ 4	$ 1	$ 4	$ 1

A 10 percent rate of increase in per capita costs of covered health care benefits was assumed for 1996, gradually decreasing to 6 percent by the year 2006. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1995 by $3 million and would have an immaterial effect on the net periodic postretirement benefit cost for 1995. Discount rates of 7.0% and 8.5% were used to determine the accumulated postretirement benefit obligations for both the medical and life insurance plans in 1995 and 1994, respectively. The assumed rate of compensation increase was 5.0% in both 1995 and 1994.

Retiree medical benefits are funded by a combination of Company and retiree contributions. Retiree life insurance benefits are provided by insurance companies whose premiums are based on claims paid during the year.

8. Capital Stock

Preferred Stock

The Company is authorized to issue 25 million shares of preferred stock with no par value. The Board of Directors has the authority to divide the preferred stock into series and to determine the rights and preferences of each.

The Company cannot pay dividends on its common stock unless full cumulative dividends have been paid on its ESOP Stock, and no distributions can be made to the holders of common stock upon liquidation or dissolution of the Company unless the holders of the ESOP Stock have received a cash liquidation payment of $28.84375 per share, plus unpaid dividends up to the date of such payment. The ESOP Stock is convertible into an equivalent number of shares of common stock based on their respective market values at the date of conversion. The ESOP Stock is entitled to one vote per share, voting together as a single class with common stock on all matters.

Employee Benefits Trust

In June 1995, the Company issued approximately 4.7 million shares of its common stock to the Conrail Employee Benefits Trust (the "Trust") in exchange for a promissory note of $250 million at an interest rate of 6.9%. The Trust will be used to fund certain employee benefits and other forms of compensation over its fifteen-year term. The amount representing unearned employee benefits is recorded as a deduction from stockholders' equity and is reduced as benefits and compensation are paid through the release of shares from the Trust. The shares owned by the Trust are valued at the closing market price as of the end of each reporting period, with the corresponding changes in the balance of the Trust reflected in additional paid-in capital. Shares held by the Trust are not considered outstanding for earnings per share computations until released by the Trust, but do have voting and dividend rights.

Common Stock Repurchase Program

In July 1994, the Board of Directors authorized a fourth common stock repurchase program of up to $100 million. In December 1995, this program was completed at a total of 1,664,053 shares.

In April 1995, the Company's Board of Directors approved an additional $250 million multi-year stock repurchase program. At December 31, 1995, the Company had acquired 20,000 shares for approximately $1 million under this program.

The activity and status of treasury stock follow:

	1995	1994	1993
Shares, beginning of year	1,789,164	83,745	3,690,002
Acquired	1,508,553	1,705,419	1,181,322
Reclassified as authorized but unissued			(4,787,579)
Shares, end of year	3,297,717	1,789,164	83,745

Stock Plans

The Company's 1987 and 1991 Long-Term Incentive Plans authorize the granting to officers and key employees of up to 4 million and 3.2 million shares of common stock, respectively, through stock options, stock appreciation rights, and awards of restricted or performance shares. A stock option is exercisable for a specified term commencing after grant at a price not less than the fair market value of the stock on the date of grant. The vesting of awards made pursuant to these plans is contingent upon one or more of the following: continued employment, passage of time or financial and other performance goals.

The Company has granted phantom shares and restricted stock under its non-union employee bonus plans to eligible employees who elect to defer all or a portion of their annual bonus in a given year. The number of shares granted depends on the length of the deferral period. Grants are made at the market price of the Company's common stock at the date of grant. The Company has granted 87,529 shares and 317,028 shares of phantom and restricted stock, respectively, under its non-union employee bonus plans through December 31, 1995. The Company has also granted 68,896 performance shares under its 1991 Long-Term Incentive Plan through December 31, 1995. Compensation expense related to these plans was $3 million in 1995.

In May 1995, the Company's shareholders approved the Conrail Senior Executive Performance Plan (the "Plan") under which certain senior executive officers of Conrail will be eligible to receive annual bonus awards, payable in cash or common stock, upon the satisfaction of certain performance criteria. No awards have been granted under the Plan as of December 31, 1995.

The activity and status of stock options under the incentive plans follow:

	Non-qualified Stock Options	
	Option Price Per Share	Shares Under Option
Balance, January 1, 1993	$14.000 - $45.125	2,870,878
Granted	$49.375 - $60.500	73,027
Exercised	$14.000 - $53.875	(928,822)
Cancelled	$31.813 - $45.125	(48,762)
Balance, December 31, 1993	$14.000 - $60.500	1,966,321
Granted	$52.188 - $66.938	23,988
Exercised	$14.000 - $51.375	(507,450)
Cancelled	$42.625 - $60.500	(118,904)
Balance, December 31, 1994	$14.000 - $66.938	1,363,955
Granted	$50.688 - $68.563	516,757
Exercised	$14.000 - $53.875	(200,940)
Cancelled	$42.625 - $53.875	(123,560)
Balance, December 31, 1995	$14.000 - $68.563	1,556,212
Exercisable, December 31, 1995	$14.000 - $57.875	799,476
Available for future grants December 31, 1994		1,678,293
December 31, 1995		1,188,193

Stock Rights

In 1989, the Company declared a dividend of one common share purchase right (the "Right") on each outstanding share of common stock. The Rights are not exercisable or transferable apart from the common stock until the occurrence of certain events arising out of an actual or potential acquisition of 10% or more of the Company's common stock, and would at such time provide the holder with certain additional entitlements. If the Rights become exercisable, each Right will entitle stockholders to purchase one share of common stock at an exercise price of $205.00, as amended in 1995. In September 1995, a dividend of one Right for each share of ESOP Stock was declared, which was paid on October 2, 1995. At the Company's option, the Rights are redeemable prior to becoming exercisable at one-half cent ($.005) per Right at September 2005, as amended in 1995, and do not have any voting privileges or rights to receive dividends.

9. 1994 Early Retirement Program

During the first quarter of 1994, the Company recorded a charge of $51 million (after tax benefits of $33 million) for a non-union employee voluntary early retirement program and related costs. The majority of the cost of the early retirement program is being paid from the Company's overfunded pension plan.

10. Disposition of Subsidiary

In 1993, the Company committed to a plan for the disposition of its investment in Concord Resources Group, Inc. ("Concord"). Pursuant to this plan, the Company recorded the estimated loss of $80 million in 1993 for the disposition of its investment, including $19 million for operating losses expected to be incurred during the phase-out period and disposition costs. The Company also recorded estimated federal tax benefits of $30 million relating to the disposition.

In June 1995, the Company completed the disposition of the last of two major waste disposal facilities of Concord. The dispositions had no financial statement impact.

11. Other Income, Net

(In Millions)	1995	1994	1993
Interest income	$ 33	$ 34	$ 39
Rental income	57	53	56
Property sales	27	18	20
Other, net	13	13	(1)
	$130	$118	$114

12. Commitments and Contingencies

Environmental

The Company is subject to various federal, state and local laws and regulations regarding environmental matters. CRC is a party to various proceedings brought by both regulatory agencies and private parties under federal, state and local laws, including Superfund laws, and has also received inquiries from governmental agencies with respect to other potential environmental issues. At December 31, 1995, CRC has received, together with other companies, notices of its involvement as a potentially responsible party or requests for information under the Superfund laws with respect to cleanup and/or removal costs due to its status as an alleged transporter, generator or property owner at 130 locations. However, based on currently available information, the Company believes CRC may have some potential responsibility at only 56 of these sites. Due to the number of parties involved at many of these sites, the wide range of costs of possible remediation alternatives, the changing technology and the length of time over which these matters develop, it is often not possible to estimate CRC's liability for the costs associated with the assessment and remediation of contaminated sites.

Although the Company's operating results and liquidity could be significantly affected in any quarterly or annual reporting period if CRC were held principally liable in certain of these actions, at December 31, 1995, the Company had accrued $64 million, an amount it believes is sufficient to cover the probable liability and remediation costs that will be incurred at Superfund sites and other sites based on known information and using various estimating techniques. The Company believes the ultimate liability for these matters will not materially affect its consolidated financial condition.

The Company spent $14 million in 1995, $8 million in 1994 and $7 million in 1993 for environmental remediation and related costs and anticipates spending approximately $10 million in 1996. In addition, the Company's capital expenditures for environmental control and abatement projects were approximately $6 million in 1995 and $5 million in 1994, and are anticipated to be approximately $8 million in 1996.

The Environmental Quality group is charged with promoting the Company's compliance with laws and regulations affecting the environment and instituting environmentally sound operating practices. The department monitors the status of the sites where the Company is alleged to have liability and continually reviews the information available and assesses the adequacy of the recorded liability.

Non-union Voluntary Retirement and Separation Programs

On February 21, 1996, the Board of Directors approved a voluntary early retirement program and voluntary separation program for eligible members of the non-union workforce with the goal of eliminating 900 non-union positions. Eligible employees have until April 23, 1996 to apply for the programs. In the event the 900 position goal is not achieved through the voluntary programs, the Company expects to obtain the additional reductions through non-voluntary separation programs.

The costs of the programs are expected to be recorded in the second quarter of 1996, and are expected to have a material effect on the income statement in that quarter. The programs will not have a significant effect on the Company's cash position as the majority of the costs will be paid from the Company's overfunded pension plan (Note 7).

Other

The Company is involved in various legal actions, principally relating to occupational health claims, personal injuries, casualties, property damage and damage to lading. The Company has recorded liabilities on its balance sheet for amounts sufficient to cover the expected payments for such actions.

The Company may be contingently liable for approximately $81 million at December 31, 1995 under indemnification provisions related to sales of tax benefits.

CRC had an average of 22,631 employees in 1995, approximately 86% of whom are represented by 14 different labor organizations and are covered by 22 separate collective bargaining agreements. The Company was engaged in collective bargaining at December 31, 1995 with labor organizations representing approximately 84% of its labor force. CRC has reached an agreement with its employees represented by the Fraternal Order of Police and has reached a tentative agreement with its employees represented by the United Transportation Union through negotiations carried on by the National Carriers' Committee, of which CRC is a member.

In 1994, Locomotive Management Services, a general partnership of which CRC holds a fifty percent interest, issued approximately $96 million of Equipment Trust Certificates to fund 100% of the purchase price of 60 new locomotives. While the principal and interest payments on the certificates will be fully guaranteed by CRC, through a sharing agreement with its partner, CRC's portion of the guarantee is reduced to approximately $80 million.

13. Condensed Quarterly Data (Unaudited)

	First		Second		Third		Fourth	
($ In Millions Except Per Share)	1995	1994	1995	1994	1995	1994	1995	1994
Revenues	$889	$847	$923	$951	$923	$949	$951	$986
Income (loss) from operations	114	(32)	180	189	208	194	(46)	255
Net income (loss)	55	(32)	123	101	115	106	(30)	149
Net income (loss) per common share:								
Primary	.66	(.45)	1.52	1.24	1.44	1.29	(.43)	1.84
Fully diluted	.61	(.45)	1.37	1.12	1.31	1.17	(.43)	1.66
Ratio of earnings to fixed charges	2.39x	–	3.42x	3.84x	4.02x	4.04x	–	4.61x
Dividends per common share	.375	.325	.375	.325	.425	.375	.425	.375
Market prices per common share (New York Stock Exchange)								
High	57 3/8	69 1/4	56 1/4	59 1/8	70 1/4	58 5/8	74 3/8	55 1/4
Low	50 1/2	56 1/2	51 1/8	50 3/8	55 1/8	48 3/8	65 1/2	48 1/4

As a result of a decrease in a state income tax rate enacted during the second quarter of 1995, income tax expense was reduced by $21 million representing the effects of adjusting deferred income taxes and the special income tax obligation for the rate decrease as required under SFAS 109 (Note 6). Without this one-time tax benefit, the Company's net income for the quarter would have been $102 million ($1.25 and $1.14 per share, primary and fully diluted, respectively). During the fourth quarter of 1995, an asset disposition charge reduced income from operations by $285 million and adversely affected the quarter's net income by $176 million (Note 2). Without the asset disposition charge, net income would have been $146 million ($1.82 and $1.65 per share, primary and fully diluted, respectively) for the fourth quarter of 1995. After the asset disposition charge, earnings were insufficient by $58 million to cover fixed charges for the quarter.

During the first quarter of 1994, the Company recorded a charge of $51 million (after tax benefits of $33 million) for a non-union employee voluntary retirement program and related costs (Note 9). Without this one-time charge, the Company's net income per common share for the quarter would have been $.20, primary and $.19, fully diluted. After this one-time charge, earnings were insufficient by $56 million to cover fixed charges for the quarter.

Corporate Officers

David M. LeVan, 50
President and Chief Executive Officer
Present position since March 16, 1995. Served as President and Chief Operating Officer between September 1994 and March 1995. Served as Executive Vice President between November 1993 and September 1994. Served as Senior Vice President–Operations between July 1992 and November 1993. Served as Senior Vice President-Operating Systems and Strategy between November 1991 and June 1992. Served as Senior Vice President–Corporate Systems between November 1990 and November 1991.

Cynthia A. Archer, 42
Senior Vice President–Intermodal Service Group
Present position since May 1995. Served as General Manager–Transportation and Customer Service of the Harrisburg Division between February 1994 and May 1995. Served as Assistant Vice President–Food and Agriculture between September 1993 and January 1994. Served as Director–Intermodal Business Development between September 1991 and August 1993.

H. William Brown, 57
Senior Vice President–Finance and Administration
Present position since April 1992. Served as Senior Vice President–Finance between April 1986 and April 1992.

Ronald J. Conway, 52
Senior Vice President–Operations
Present position since November 1994. Served as Vice President–Operations between September 1994 and November 1994. Served as Vice President–Transportation between July 1994 and September 1994. Served as Vice President–Intermodal Service Group between November 1993 and July 1994. Served as Assistant Vice President–Petrochemicals and Minerals between April 1992 and November 1993. Served as General Manager–Philadelphia Division between 1989 and April 1992.

Timothy P. Dwyer, 46
Senior Vice President–Unit Train Service Group
Present position since November 1994. Served as Vice President–Unit Train Service Group between November 1993 and November 1994. Served as General Manager–Philadelphia Division between April 1992 and November 1993. Served as Assistant Vice President–Metals between 1989 and April 1992.

Frank H. Nichols, 49
Senior Vice President–Organizational Performance
Present position since May 1995. Served as Vice President–Human Resources between February 1993 and May 1995. Served as Assistant Vice President–Finance between November 1988 and February 1993.

John P. Sammon, 45
Senior Vice President–CORE Service Group
Present position since November 1994. Served as Vice President–Intermodal between July 1994 and November 1994. Served as Assistant Vice President- Intermodal between January 1988 and July 1994.

George P. Turner, 54
Senior Vice President–Automotive Service Group
Present position since November 1994. Served as Vice President–Automotive Service Group between November 1993 and November 1994. Served as Assistant Vice President–Automotive between April 1992 and November 1993. Served as Assistant Vice President–Petrochemicals and Minerals between March 1990 and April 1992.

Bruce B. Wilson, 60
Senior Vice President–Law
Present position since April 1987.

Lucy S.L. Amerman, 45
*Vice President–Risk Management**
Present position since July 1994. Served as Assistant Vice President–Claims and Litigation between April 1994 and July 1994. Served as General Counsel–Litigation between March 1990 and March 1994.

Dennis A. Arouca, 44
*Vice President–Labor Relations**
Present position since May 1994. Served as Partner in the law firm of Pepper Hamilton & Scheetz between February 1986 and May 1994.

John T. Bielan, Jr., 48
*Vice President–Continuous Quality Improvement**
Present position since March 1992. Served as Assistant Vice President–Automotive between April 1989 and March 1992.

Gerald T. Gates, 42
*Vice President–Customer Support**
Present position since January 1996. Served as Vice President–Transportation between November 1994 and January 1996. Served as Vice President–Mechanical between November 1993 and November 1994. Served as Assistant Vice President–Operations Planning and Administration between July 1992 and November 1993. Served as General Manager–Indianapolis Division between September 1990 and July 1992.

Hugh J. Kiley, 43
*Vice President–Service Design & Planning**
Present position since January 1996. Served as Assistant Vice President–Performance and Process Management between November 1994 and January 1996. Served as Assistant Vice President–Program Management between May 1994 and November 1994. Served as General Manager–National Customer Service Center between November 1990 and May 1994.

Craig R. MacQueen, 43
*Vice President - Corporate Communications**
Present position since June 1995. Served as Assistant Vice President–Public Affairs between September 1992 and June 1995. Served as Executive Director–Public Affairs between November 1990 and August 1992.

Donald W. Mattson, 53
Vice President–Controller
Present position since April 1994. Served as Vice President–Treasurer between May 1993 and April 1994. Served as Vice President–Controller between August 1988 and May 1993.

John A. McKelvey, 44
*Vice President–Service Delivery**
Present position since January 1996. Served as Vice President–Materials and Purchasing between April 1994 and January 1996. Served as Vice President–Controller between May 1993 and March 1994. Served as Vice President–Treasurer between 1988 and May 1993.

William B. Newman, Jr., 45
*Vice President and Washington Counsel**
Present position since 1981.

Timothy T. O'Toole, 40
Vice President and Treasurer
Present position since April 1994. Served as Vice President and General Counsel between May 1989 and April 1994.

Lester M. Passa, 42
*Vice President–Logistics and Corporate Strategy**
Present position since March 1995. Served as Assistant Vice President–Strategic Planning between February 1993 and March 1995. Served as Director–Intermodal Planning between October 1991 and January 1993.

Albert M. Polinsky, 49
*Vice President–Information Systems**
Present position since April 1994. Served as Assistant Vice President–Program Management between December 1993 and March 1994. Served as Assistant Vice President–Marketing Services between April 1992 and December 1993. Served as Director–Information Services between March 1990 and April 1992.

Richard S. Pyson, 54
*Vice President–Operations Services**
Present position since January 1996. Served as Vice President–Engineering between November 1994 and January 1996. Served as Vice President between July 1994 and November 1994. Served as Vice President–Transportation between April 1992 and July 1994. Served as Vice President–Engineering between March 1991 and March 1992.

John M. Samuels, 52
*Vice President–Operating Assets**
Present position since January 1996. Served as Vice President–Mechanical between November 1994 and January 1996. Served as Vice President–Engineering between April 1992 and November 1994. Served as Vice President–Continuous Quality Improvement between April 1990 and March 1992.

Allan Schimmel, 55
Corporate Secretary
Present position since July 1980.

* Officer of Consolidated Rail Corporation, principal subsidiary of Conrail Inc.

Board of Directors

James A.Hagen[1]
Chairman of the Board of Directors, Conrail Inc.
Finance*

E. Bradley Jones
Retired Chairman and Chief Executive Officer, LTV Steel Co.
Ethics
Nominating*

H. Furlong Baldwin
Chairman and Chief Executive Officer, Mercantile Bankshares Corporation
Compensation
Finance

David M. LeVan[1]
President and Chief Executive Officer, Conrail Inc.
Finance

Claude S. Brinegar
Retired Vice Chairman, Unocal Corporation
Audit
Nominating

David B. Lewis
Chairman, Lewis, White & Clay
Audit*
Finance

Daniel B. Burke
Retired President and Chief Executive Officer, Capital Cities/ABC, Inc.
Ethics
Nominating

John C. Marous
Retired Chairman and Chief Executive Officer, Westinghouse Electric Corporation
Compensation
Finance

Kathleen Foley Feldstein
President, Economics Studies, Inc.
Ethics*
Finance

Raymond T. Schuler
Retired Vice Chairman, President and Chief Executive Officer, The Business Council of New York State, Inc.
Audit
Nominating

Roger S. Hillas
Retired Chairman and Chief Executive Officer, Meritor Saving Bank
Compensation*
Finance

David H. Swanson
President and Chief Executive Officer Countrymark Cooperative, Inc.
Audit
Nominating

* Committee Chair
1 Effective May 15, 1996, James A. Hagen will retire as a Director and Chairman of the Board. Effective May 15, 1996, David M. LeVan will also become Chairman of the Board and Chair of the Finance Committee.

Corporate Information

Stock Transfer Agent and Registrar
First Chicago Trust Company of New York
P.O. Box 2500, Jersey City, NJ 07303-2500

Stock Exchange Listings
Conrail Inc. Common Stock is listed on the New York and Philadelphia stock exchanges. (The trading symbol is CRR).

Dividends
Common stock dividends of $.375 per share were declared on each of February 15, 1995 and May 17, 1995, and dividends of $.425 per share were declared on each of July 19, 1995 and November 15, 1995.

Shareholders
As of March 1, 1996, there were 20,083 holders of record of Conrail Inc. Common Stock.

Dividend Reinvestment Program
Conrail provides a common stock dividend reinvestment plan for shareholders as a convenient method of investing Company dividends. During the Second Quarter of 1996, Conrail will implement a DirectSERVICE™ Shareholder Investment Program for current shareholders and any individual investors wishing to become Conrail shareholders. This program, which will contain a dividend reinvestment feature, provides other flexible options to meet a variety of individual investment objectives.

Conrail Shareholder Direct®
Conrail offers a corporate information service called Conrail Shareholder Direct.® This service enables shareholders to listen to and receive copies of earnings and dividend information, recent press releases and other corporate information. Shareholders can access Conrail Shareholder Direct® at any time by dialing, toll free, 1-800-215-RAIL.

Shareholder Inquiries
Communications concerning stock transfer, dividend disbursement, change of address, loss of a stock certificate, or non-receipt of a dividend check should be directed to:
First Chicago Trust Company of New York
P.O. Box 2500, Jersey City, NJ 07303-2500
(201) 324-0498 http://www.fctc.com

All other inquiries should be directed to:
Office of the Corporate Secretary, Conrail Inc.
2001 Market Street, P.O. Box 41422
Philadelphia, PA 19101-1422
(215) 209-2000

Financial Investors and Security Analysts
Financial investors and analysts requiring interviews, financial reports, general information or any other publications should direct requests to:
Thomas J. McFadden, Assistant Treasurer, Conrail Inc.
2001 Market Street, P.O. Box 41425, Philadelphia, PA 19101-1425
(215) 209-5592

SEC Form 10-K
A copy of the Company's 1995 Annual Report on Form 10-K, filed with the Securities and Exchange Commission, may be obtained by contacting the Office of the Corporate Secretary.

Conrail Web Site
www.conrail.com

Annual Meeting
Wednesday, May 15, 1996, 9:30 A.M.
The Academy of Music Hall
1420 Locust Street, Philadelphia, PA

CONRAIL

We are an equal employment opportunity/affirmative action employer committed to work force diversity. We select people for employment and promotion on the basis of their ability, without regard to race, color, religion, sex, age, sexual orientation, national origin or disability.

CONRAIL INC.

1996 Annual Report

CONRAIL®

TABLE OF CONTENTS

ELEVEN YEAR FINANCIAL SUMMARY

($ In Millions Except Per Share)	**1996**[1]	1995[2]	1994[3]	1993[4]	1992	1991[6]	1990[7]	1989[6]	1988	1987[8]	1986
Revenues	**$3,714**	$3,686	$3,733	$3,453	$3,345	$3,252	$3,372	$3,411	$3,490	$3,247	$3,144
Operating Income (Loss)	**601**	456	606	591	534	(261)	427	198	482	417	403
Net Income (Loss)	**342**	264	324	160	282	(207)	247	148	306	299	431
Per Common Share[5]											
Primary	**4.25**	3.19	3.90	1.82	3.28	(2.70)	2.55	1.09	2.22	2.17	3.27
Fully Diluted	**3.89**	2.94	3.56	1.70	2.99	(2.70)	2.39	1.09	2.22	2.17	3.27
Dividends Per Common Share[5]	**1.80**	1.60	1.40	1.20	1.00	.85	.75	.65	.55	.25	–
Capital Expenditures	**$ 478**	$ 494	$ 508	$ 650	$ 491	$ 398	$ 381	$ 678	$ 577	$ 472	$ 578
Average Freight Employees	**21,280**	23,510	24,833	25,406	25,380	25,852	27,787	31,574	32,816	33,437	35,476
At December 31											
Cash and Temporary Cash Investments	**$ 30**	$ 73	$ 43	$ 38	$ 40	$ 135	$ 153	$ 502	$ 666	$ 632	$ 847
Working Capital (Deficit)	**25**	36	(76)	(13)	(489)	(286)	(216)	153	398	426	733
Total Assets	**8,402**	8,424	8,322	7,948	7,315	7,096	7,245	7,471	7,224	6,796	6,776
Long-Term Debt	**1,876**	1,911	1,940	1,959	1,577	1,637	1,680	857	850	826	1,705
Redeemable Preferred Stock	**-**	–	–	–	–	–	–	–	–	–	2,330
Stockholders' Equity	**3,107**	2,977	2,925	2,784	2,748	2,661	2,929	4,044	4,043	3,825	1,784

1 Net income includes the effects of a one-time charge for non-union employee voluntary early retirement and separation programs and related costs and expenses incurred as a result of the proposed merger with CSX. See Notes 2 and 3 to the Consolidated Financial Statements.

2 Net income includes the effect of a one-time asset disposition charge and a one-time tax benefit related to a decrease in a state income tax rate. See Notes 10 and 7 to the Consolidated Financial Statements.

3 Net income includes the effects of a one-time charge for a non-union employee voluntary retirement program and related costs. See Note 11 to the Consolidated Financial Statements.

4 Net income includes the effects of an estimated net loss on the disposition of a subsidiary, $50 million, the increase in the federal corporate income tax rate, $34 million, and the adoption of required changes in accounting for income taxes and postretirement benefits other than pensions, $74 million.

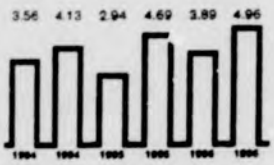
5 Includes the effects of a 1992 two-for-one common stock split.

6 A 1991 special charge of $719 million reduced net income by $447 million. A 1989 special charge of $234 million reduced net income by $147 million.

7 In 1990, the Company completed a financial restructuring plan which included a Dutch auction tender offer, the establishment of an employee stock ownership plan for non-union employees and a related open market common stock purchase program.

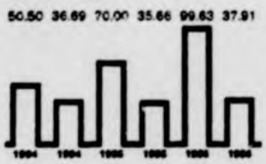
8 The Company's financial position and results of operations after 1986 were significantly affected by changes resulting from the sale of the U.S. Government's 85% ownership of the Company's common stock.

NET INCOME PER COMMON SHARE
$ Per Share



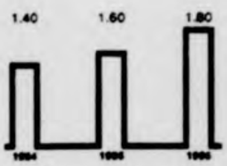
Fully diluted
Fully diluted without one-time charges and merger costs in 1996 and the one-time tax benefit in 1995

COMMON STOCK MARKET PRICE (YEAR END) vs. BOOK VALUE
$ Per Share



Market price per common share
Book value per common share

DIVIDENDS PER COMMON SHARE
$ Per Share



CORPORATE HIGHLIGHTS

March

Detroit shippers gain direct access to the leading hub for North Atlantic intermodal shipments when Conrail begins double-stack service between the Motor City and the Port of New York-New Jersey. The five-day a week service to the Port's on-dock ExpressRail container facility is especially attractive to exporters of automotive parts and related equipment.

April

The annual Corporate Conference begins its two-day program on April 1, the date of Conrail's 20th anniversary. Among other activities, the conference honors nine labor-management teams from across the system for their efforts in promoting safety, customer satisfaction, employee development, asset utilization and growth.

Conrail's double-stack network expands to include The Ports of Philadelphia and Camden with the start of service to the AmeriPort facility. With the new service, Philadelphia becomes one of only two Northeastern ports with the ability to handle full high-cubic capacity double-stack trains. The $97 million program to create a double-stack route across Pennsylvania completed the previous fall – the largest engineering project in Conrail's history – makes the service possible.

Several existing short line partners join Conrail in introducing Conrail Express, a feeder system similar to that used by major airlines serving smaller markets through commuter airlines. Conrail Express coordinates the efforts of Conrail and short lines more closely than ever before to improve service and enhance growth opportunities for customers and communities on light density lines. By the end of the year, about 20 short lines and regional railroads operate under the Conrail Express banner.

Applications to participate in the voluntary separation and voluntary retirement programs announced earlier in February are accepted from over 840 employees.

May

Conrail recognizes shippers for their role in the safe delivery of hazardous material products at the annual "Conrail Diamond Drop Award For Flawless Shipping" ceremony. Twenty-six customers earn the award by shipping at least 1,000 carloads of hazardous materials in a year without a single shipper-caused incident. When the award program started in 1988, only seven shippers earned the honor.

David M. LeVan is elected Chairman of Conrail, succeeding James A. Hagen, who retires immediately following the annual shareholders' meeting.

After permits are obtained, full scale construction begins for the $43 million Shire Oaks project, a critical element in Conrail's coal industry growth strategy. The project will significantly improve efficiency, asset utilization and capacity in serving Pittsburgh Seam producers in southwestern Pennsylvania and nearby West Virginia. The new facilities will funnel unit trains to and from the mines and will also handle related car inspection and repair activities. The work also includes installation of advanced communication and signal systems along the Monongahela Line, which connects the mines and Shire Oaks with the rest of Conrail's system. Although the project will not be completed until September 1997, Conrail and customers begin to reap benefits from the project as track capacity is expanded throughout 1996.

Export Express begins with non-stop service from Chicago to the ExpressRail facility at the Port Newark-Port Elizabeth marine terminal. Export Express offers the quickest transit time in the rail industry for Atlantic exports, making the Chicago-North Jersey run in 32 hours with stops only for crew changes and locomotive refueling.

June

To entice shipments from highway to rail, Conrail reduces prices for westbound boxcar shipments of canned, packaged and bottled goods. The new "Every Day Low Pricing" program offers shippers savings of about 50 percent from what truckers charge. The additional westbound backhaul traffic will help Conrail make better use of the boxcar fleet.

July
Conrail's attempt to acquire the eastern lines of the Southern Pacific Railroad ends as the Surface Transportation Board approves the Union Pacific-Southern Pacific merger without requiring divestiture of those eastern lines.

National agreements between the rail industry and several major unions avert the possibility of a national rail work stoppage.

Operation Lifesaver Express takes to the rails to visit the New York State Fair. It is one of a number of trips by the special train this spring and summer through Indiana, New York, Ohio, and Pennsylvania to emphasize the need for greater public safety awareness at railroad-highway crossings. Joining Conrail and Operation Lifesaver officials on the trips are local and regional public safety and law enforcement representatives.

September
With the start of the new academic year, seven additional colleges offer the Associates Degree in Railroad Management sponsored by Conrail for its employees. By the start of the January 1997 semester, the program will have enrolled more than 200 Conrail employees at 13 different campuses in Indiana, New Jersey, Ohio, and Pennsylvania.

New TRACNET multipurpose training centers introduced at three major yards and corporate headquarters also foster employee education, growth and development. The centers offer a variety of training programs, including instructor-led, self-paced distance-learning and multimedia computer-based courses.

October
Conrail and CSX agree to a pro-competitive, strategic merger-of-equals. The new transportation company will offer much more extensive single-line rail service opportunities to shippers and receivers in 22 states. Eight days later, Norfolk Southern announces a hostile offer for Conrail.

A new monthly record for intermodal volume is set: more than 162,600 trailer and container shipments, an 8.1 percent increase over the 150,400 shipments in October 1994. Along with the general increase in economic activity, a steady stream of new intermodal products – including service extensions into Kansas City and Minneapolis – contributes to the record.

Helping to handle that increased intermodal volume (and attract more business) is a new hub serving the Pittsburgh area. The new terminal at Pitcairn completes the network of facilities necessary to support the double-stack route across Pennsylvania opened in 1995.

January 1997
Conrail and Guilford Rail System launch DownEast Express, direct intermodal service linking Maine to U.S. markets in the Midwest and Southeast. DownEast Express, originating at Waterville in central Maine, connects Maine shippers to markets that previously had been available only by truck.

March 1997
Conrail and CSX amend their merger agreement, increasing the consideration to $115 in cash per Conrail share. Conrail shareholders will receive, no later than June 2, 1997, $115 in cash per Conrail share through a CSX tender offer. All the Conrail stock acquired by CSX in the tender offer will be placed in a voting trust pending the outcome of the Surface Transportation Board's regulatory review. It is anticipated that CSX and Norfolk Southern will negotiate an appropriate division of Conrail's assets.

FINANCIAL SUMMARY

NET INCOME
$ in millions

- Actual
- Without one-time charges and merger costs in 1996 and the one-time tax benefit in 1995

REVENUES
$ in millions

UNITS
(FREIGHT CARS AND INTERMODAL TRAILERS AND CONTAINERS)
in thousands

For 1996, Conrail's net income was $342 million compared with $264 million for 1995, including unusual items. Excluding the unusual items, Conrail would have earned $435 million ($4.96 per share, fully diluted basis) for 1996, an increase of nearly four percent in net income and nearly six percent in earnings per share when compared with $419 million ($4.69 per share, fully diluted basis) in net income for 1995 also excluding the unusual items.

Freight volume (freight cars and intermodal trailers/containers) increased 2.1 percent in 1996 and operating revenues increased 0.75 percent. After beginning the year with increased costs due to severe winter weather, Conrail finished 1996 on a strong note, with three consecutive quarters of record results in net income, earnings per share and operating ratio (operating expenses as a percentage of revenues). The operating ratio decreased to 79.7 percent for 1996 from 79.9 for 1995 (excluding unusual items in both years).

Please turn to the Management's Discussion and Analysis section of this report, beginning on page 6, for a detailed discussion of financial results.

TO OUR SHAREHOLDERS

Nothing defines the qualities of Conrail and its people better than their response after severe winter weather hit Conrail hard last year. The most striking image from that winter: a 122-car train, trapped for two days after ice floes jumped the banks along a two-mile stretch of the Susquehanna River in Pennsylvania. But to Conrail people, winter is just another challenge. We dug in, dug out, and earned the appreciation of our customers by keeping the freight moving.

Those extraordinary efforts, necessarily, led to extraordinary costs. With the same extraordinary level of dedication and perseverance that triumphed over the ice, Conrail emerged from that wintry first quarter to post three consecutive quarters of record financial results in net income, earnings per share and operating ratio.

That is an achievement of which our employees, our company, and our shareholders, can be justly proud.

Dedication and perseverance have been hallmarks of Conrail since its founding. They continue today as strong as ever. Others may lose sight of long-term goals to become subsumed by the crisis of the day or week or month. Not Conrail. The Company and its people have maintained a steady course. That continuity of focus has led to a return to shareholders of more than 640 percent since our inception in 1987 as a public company. That return is 750 percent when reinvested dividends are considered.

The dedication and perseverance of Conrail employees has helped build long-term economic value for all of our constituencies: shareholders, customers, employees and the communities we serve. But dedication and perseverance alone could not maintain Conrail's identity as an independent company. Although Conrail's board and management would have preferred for the system to remain intact through a strategic merger-of-equals with CSX, circumstances prevented that from happening. However, we succeeded in negotiating the best possible transaction for all of Conrail's constituencies.

Throughout the transition process, Conrail will maintain its focus on the need for continued improvement in safety, growth, asset utilization, and employee development and productivity.

The same combination of dedication and perseverance that helped Conrail emerge from the winter of 1995-96 stronger than ever is necessary to continue making significant strides in safety. Last year, lost-time employee injuries dropped more than 20 percent when compared to 1995. This achievement is disappointing only in the context of the lofty goals we set for ourselves.

We can be no less demanding this year. For 1997, our goal is again to reduce injuries by 50 percent. Management is committed to helping our employees achieve this goal, and we will use all the tools we have available to meet and exceed it. These tools include extensive programs to: recognize and reward safe behavior; align management incentive compensation with work group safety achievements; and train employees in safe work practices.

A critical aspect of our safety and other risk management programs is to educate managers and employees alike to the cost-of-risk concept, and to help them identify it in their activities.

As good as Conrail has been at driving down its costs and using its assets more effectively, we have also applied our dedication and perseverance to delivering consistent service and a continuous stream of new products.

New product offerings, consistent service and continued improvement in safety all rely on the qualities and capabilities of our people. They not only made possible our financial recovery following last winter's storms, but have powered Conrail's success in overcoming many of the challenges the Company has faced over the years.

Conrail's presence on the rail transportation scene has been short, but its impact has been large. Our people took a long neglected plant and turned it into a first-class railroad. Our people led the fight for the Staggers Rail Act of 1980 and deregulation – a fight which finally let railroads compete with trucks and allowed railroads to begin the remarkable renaissance that today makes them vital contributors to our nation's economy. Our people fought off the federal government's attempt to sell Conrail to the Norfolk Southern in the mid-1980s – and allowed Conrail to demonstrate that Eastern railroading could deliver real value to our shareholders and our shippers. In short, our people made Conrail. To them, I say thank you and well done!

Although Conrail's name will disappear from the ranks of operating railroads, the achievements of Conrail's people, and their rich legacy to the industry and our corporate successors, will not be forgotten.

Dave LeVan

David M. LeVan
Chairman, President and Chief Executive Officer
March 8, 1997

Overview

Conrail's net income for 1996 was $342 million, compared with $264 million for 1995 and $324 million for 1994. Results for 1996 include a one-time charge of $83 million (net of $52 million of tax benefits) related to voluntary separation programs and related costs and merger-related expenses of $10 million (net of $6 million of tax benefits) incurred in connection with the proposed merger with CSX Corporation ("CSX") (see Notes 3 and 2, respectively, to the Consolidated Financial Statements). Without these charges, net income for 1996 would have been $435 million.

The results for 1995 include the effects of a $285 million asset disposition charge ($176 million after income taxes) and the recognition of a $21 million reduction in income taxes related to a decrease in a state tax rate (see Notes 10 and 7, respectively, to the Consolidated Financial Statements). Results for 1994 include a one-time charge of $51 million (net of tax benefits of $33 million) for a non-union early retirement program and related costs (see Note 11 to the Consolidated Financial Statements). Absent the one-time items, Conrail's net income for 1995 and 1994 would have been $419 million and $375 million, respectively.

Traffic volumes and operating revenues increased 2.1% and .8%, respectively, in 1996 compared with 1995. Lower than anticipated revenue growth and higher than expected operating expenses resulted in an operating ratio (operating expenses as a percent of revenues) of 83.8%. Excluding the voluntary separation programs charge and merger-related costs, Conrail's operating ratio was 79.7% compared with the Company's 1996 operating ratio goal of 77.5%. The difficult operating conditions caused by severe weather experienced over most of the Company's service area during the first quarter of 1996, higher fuel prices and declines in equipment utilization all contributed to the increase in operating expenses in 1996 as compared with those that were planned for 1996. The 1995 operating ratio, excluding the asset disposition charge, was 79.9%.

For 1995 versus 1994, traffic volume and operating revenues decreased 5.4% and 1.3%, respectively, while operating expenses, excluding one-time charges, decreased 3.2%.

Proposed Merger

On October 14, 1996, Conrail, CSX and a subsidiary of CSX entered into an Agreement and Plan of Merger (as amended, the "Merger Agreement"), pursuant to which Conrail was to be merged with a subsidiary of CSX in a merger-of-equals transaction.

On October 24, 1996, Norfolk Southern Corporation ("Norfolk") commenced an unsolicited tender offer for all outstanding Conrail voting stock at $100 per share in cash. Norfolk has since increased its offer to $115 per share in cash.

On November 20, 1996, CSX concluded its first tender offer and purchased approximately 19.9% of Conrail's outstanding shares for $110 per share.

On December 18, 1996, CSX and Conrail entered into a second amendment to the Merger Agreement (the "Second Amendment") that would, among other things, (i) increase the consideration payable pursuant to the merger, (ii) accelerate the consummation of the merger to immediately following the receipt of applicable shareholder approvals and prior to Surface Transportation Board ("STB") approval and (iii) extend until December 31, 1998, an exclusivity period during which the Conrail Board agreed not to withdraw or modify its recommendations of the CSX transactions, approve or recommend any takeover proposal or cause Conrail to enter into any agreement related to any takeover proposal.

On January 13, 1997, Norfolk issued a press release announcing that it would offer to purchase shares representing 9.9% of the outstanding shares for $115 per share, in the event that Conrail shareholders did not approve a proposal to opt out of a Pennsylvania statute (the "Opt Out Proposal") at the meeting of shareholders to be held on January 17, 1997 (the "Special Shareholders Meeting").

On January 17, 1997, Conrail shareholders voted at the Special Shareholders Meeting against the Opt Out Proposal.

On February 4, 1997, the amended Norfolk tender offer expired, and Norfolk subsequently purchased approximately 8.2 million shares pursuant thereto.

On March 7, 1997, Conrail and CSX entered into a Third Amendment (the "Third Amendment") to the Merger Agreement. Pursuant to the Third Amendment, (i) the price per share has been increased from $110 to $115, and the number of shares to be purchased in the tender offer has been increased to all outstanding shares. The tender offer is scheduled to close April 18, 1997 (subject to extension by CSX to June 2, 1997 whether or not the conditions have been satisfied), (ii) the consideration paid per share in the merger for all remaining outstanding shares following consummation of the offer has been increased to $115 in cash and (iii) the conditions to the offer relating to certain provisions of Pennsylvania law becoming inapplicable to Conrail and relating pending governmental actions or proceedings have been deleted.

The Third Amendment also provides that CSX will have sole control over the regulatory approval process and will be free to conduct by itself discussions with other railroads, including Norfolk, relating to competitive issues raised by the CSX transactions, and to enter into any resulting agreement. It is anticipated that CSX and Norfolk will negotiate an appropriate division of Conrail's assets; however, neither the pending CSX tender offer nor the merger is conditioned on CSX's reaching an agreement with Norfolk.

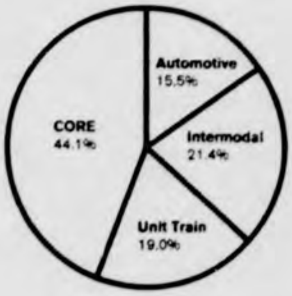
Pursuant to the Third Amendment, three members of Conrail's Board of Directors approved by CSX shall be invited to join the CSX Board of Directors and a transition team will be established, the leadership of which will include senior executive officers of CSX and Conrail to ensure the orderly operation of Conrail during the regulatory approval process and an orderly transition thereafter.

Under the Third Amendment, Conrail and CSX agreed to reduce from December 31, 1998 to December 31, 1997 the period of time during which the Conrail Board is prohibited from (i) withdrawing or modifying, or publicly proposing to withdraw or modify, its approval or recommendation of the CSX transactions, in a manner adverse to CSX, (ii) approving or recommending, or publicly proposing to approve or recommend, any competing proposal or (iii) causing Conrail to enter into any agreement related to any such competing proposal.

Under the Merger Agreement as amended, Conrail may terminate the Merger Agreement in the event that after June 2, 1997, CSX fails to consummate the tender offer for any reason other than the non-occurrence of any condition to the tender offer. In the event that CSX fails to consummate the tender offer under such circumstances, Conrail will be entitled to exercise any additional remedies it may have.

The full terms and conditions of the CSX and Norfolk offers and Conrail's position with respect to the CSX and Norfolk offers are set forth in documents filed by Conrail with the Securities and Exchange Commission.

1996 REVENUE DISTRIBUTION
by Service Group



1997 Outlook

Conrail expects the economy to grow in 1997 at about the same growth rate experienced in 1996. Conrail's 1997 plans are based on assumptions of 2.2% growth in real gross domestic product and 3.4% growth in industrial production. Conrail's outlook for 1997 includes line haul revenue growth of between 2.5% and 3.5%. Conrail's operating ratio goal for 1997 is 78.5%.

Voluntary Separation Programs

During the second quarter of 1996, the Company recorded a charge of $135 million (before tax benefits of $52 million) consisting of $102 million in termination benefits to be paid to non-union employees participating in the voluntary retirement and separation programs ("voluntary separation programs") and losses of $33 million on non-cancelable leases for office space no longer required as a result of the reduction in the Company's workforce. Over 840 applications were accepted from eligible employees under the voluntary separation programs. Approximately $90 million of the termination benefits are being paid from the Company's overfunded pension plan.

Results of Operations

1996 Compared with 1995

Net income for 1996 was $342 million ($4.25 per share, primary and $3.89 per share, fully diluted) compared with 1995 net income of $264 million ($3.19 per share, primary and $2.94 per share, fully diluted). Excluding the unusual items (see "Overview") in both years, Conrail's net income would have been $435 million ($5.45 per share, primary and $4.96 per share, fully diluted) for 1996 and $419 million ($5.16 per share, primary and $4.69 per share, fully diluted) for 1995.

Operating revenues (primarily freight line haul revenues, but also including switching, demurrage and incidental revenue) increased $28 million, or .8%, to $3,714 million in 1996 from $3,686 million in 1995. A 2.1% increase in traffic volume in units (freight cars and intermodal trailers and containers) resulted in a $74 million increase in revenues. Average revenue per unit decreased revenues by $42 million due to an unfavorable traffic mix. A traffic volume increase of 7.6% was experienced by the Intermodal Service Group while traffic volume for the Unit Train Service Group remained unchanged. The Automotive and CORE service groups experienced traffic volume declines of 1.7% and 1.6%, respectively. Within the CORE Service Group, traffic volume declines were experienced by three of the four commodity groups: Forest and Manufactured Products, 5.3%; Food and Agriculture, 2.8%; and Petrochemicals, 2.5%. Metals experienced a traffic increase of 4.0%.

Operating expenses (including one-time charges and merger-related costs in 1996 and the asset disposition charge in 1995) decreased $117 million, or 3.6%, from $3,230 million in 1995 to $3,113 million in 1996. The following table sets forth the operating expenses for the two years:

(In Millions)	**1996**	1995	Increase (Decrease)
Compensation and benefits	**$1,206**	$1,249	$ (43)
Fuel	**202**	168	34
Material and supplies	**175**	167	8
Equipment rents	**382**	355	27
Depreciation and amortization	**283**	293	(10)
Casualties and insurance	**176**	175	1
Other	**554**	538	16
Voluntary separation programs	**135**		135
Asset disposition charge		285	(285)
	$3,113	$3,230	$117

Compensation and benefits decreased $43 million, or 3.4%, as a result of reductions in employment levels and other employee-related costs. These decreases were partially offset by increased wage rates due to new labor agreements, increased train crew costs and overtime caused by adverse weather conditions experienced during the first quarter of 1996. Compensation and benefits as a percent of revenues was 32.5% in 1996 as compared with 33.9% in 1995.

Fuel costs increased $34 million, or 20.2%, due mostly to higher fuel prices.

Equipment rents increased $27 million, or 7.6%, primarily as a result of declines in equipment utilization and increased car hire rates.

Other operating expenses increased $16 million, or 3.0%, primarily due to $16 million of costs incurred in connection with the proposed merger with CSX (see Note 2 to the Consolidated Financial Statements).

Conrail recorded a one-time pre-tax charge of $135 million in 1996 for the voluntary separation programs and related costs (see Note 3 to the Consolidated Financial Statements) and an asset disposition charge of $285 million in 1995 (see Note 10 to the Consolidated Financial Statements).

Conrail's operating ratio was 83.8% for 1996, compared with 87.6% for 1995. Without the one-time charges recorded in 1996 and 1995 and the merger-related costs incurred in 1996, the operating ratios would have been 79.7% and 79.9%, respectively.

Other income decreased $18 million, or 13.8%, from $130 million in 1995 to $112 million in 1996 primarily due to decreases in rental income and lesser gains from sales of property.

The Company's effective income tax rate for 1996 was 35.6% compared with 32.7% for 1995. The lower effective rate in 1995 is primarily caused by a $21 million reduction in income taxes as a result of a decrease in state income taxes (see Note 7 to the Consolidated Financial Statements).

COMPENSATION AND BENEFITS AND OPERATING RATIO (%)

Compensation and benefits ratio
OPERATING RATIO
Actual
Without one-time charges and merger costs in 1996

1995 Compared with 1994

Net income for 1995 was $264 million ($3.19 per share, primary and $2.94 per share, fully diluted) compared with 1994 net income of $324 million ($3.90 per share, primary and $3.56 per share, fully diluted). Excluding the one-time charges (see "Overview") in both years and the one-time tax benefit in 1995, Conrail's net income would have been $419 million ($5.16 per share, primary and $4.69 per share, fully diluted) for 1995 and $375 million ($4.54 per share, primary and $4.13 per share, fully diluted) for 1994.

Operating revenues decreased $47 million, or 1.3%, from $3,733 million in 1994 to $3,686 million in 1995. A 5.4% decrease in traffic volume in units resulted in a $191 million decrease in revenues which was partially offset by an increase in average revenue per unit that increased revenues by $140 million. The improvement in average revenue per unit resulted from increases in average rates, $117 million, and a favorable traffic mix, $23 million. Traffic volume decreases were experienced by three of the four service groups, with only Automotive showing a slight volume increase of .8%. Traffic volume declines for the other service groups were as follows: Intermodal, 7.3%; Unit Train, 5.4%; and CORE, 5.1%. Within the CORE Service Group, traffic volume declines were also experienced by each of the commodity groups: Food and Agriculture, 8.2%; Petrochemicals, 4.6%; Metals, 4.0%; and Forest and Manufactured Products, 3.9%.

Operating expenses increased $103 million, or 3.3%, from $3,127 million in 1994 to $3,230 million in 1995. The following table sets forth the operating expenses for the two years:

(In Millions)	1995	1994	Increase (Decrease)
Compensation and benefits	**$1,249**	$1,260	$ (11)
Fuel	**168**	188	(20)
Material and supplies	**167**	203	(36)
Equipment rents	**355**	381	(26)
Depreciation and amortization	**293**	278	15
Casualties and insurance	**175**	184	(9)
Other	**538**	549	(11)
Asset disposition charge	**285**		285
Early retirement program		84	(84)
	$3,230	$3,127	$ 103

Compensation and benefits costs decreased $11 million, or .9%, as a result of a 5.3% reduction in employment levels, which exceeded the increases in wage rates and fringe benefit costs. Compensation and benefits as a percent of revenues was 33.9% in 1995 compared with 33.7% in 1994.

Fuel costs decreased $20 million, or 10.6%, as a result of greater use of newer fuel efficient locomotives, lower average fuel prices and lower traffic volume.

The decrease of $36 million, or 17.7%, in material and supplies costs was primarily attributable to a lower level of repair and maintenance expenditures related to lower traffic volume.

Equipment rents decreased $26 million, or 6.8%, primarily as a result of fewer foreign cars on Conrail's lines and improved equipment utilization, partially offset by the increased costs associated with new operating leases for equipment.

Depreciation and amortization increased $15 million, or 5.4%, due to asset additions and increased depreciation rates for track structure as a result of a depreciation study required by the former Interstate Commerce Commission.

Conrail recorded an asset disposition charge of $285 million in 1995 (see Note 10 to the Consolidated Financial Statements) and a one-time pre-tax charge of $84 million in 1994 for the non-union voluntary early retirement program and related costs (see Note 11 to the Consolidated Financial Statements).

Conrail's operating ratio was 87.6% for 1995, compared with 83.8% for 1994. Without the $285 million asset disposition charge in 1995 and the $84 million charge for the early retirement program in 1994, the operating ratios for 1995 and 1994 would have been 79.9% and 81.5%, respectively.

Other income, net, increased $12 million, or 10.2%, primarily due to an $8 million gain from a property sale completed during the second quarter of 1995.

The Company's effective income tax rate for 1995 was 32.7% compared with 39.1% for 1994. The lower rate reflects the effect of a $21 million reduction in income taxes resulting from a decrease in a state income tax rate enacted during the second quarter of 1995 (see Note 7 to the Consolidated Financial Statements).

Liquidity and Capital Resources

Conrail's cash and cash equivalents decreased $43 million, from $73 million at December 31, 1995 to $30 million at December 31, 1996. Cash generated from operations, principally from its wholly-owned subsidiary, Consolidated Rail Corporation ("CRC"), and borrowings are Conrail's principal sources of liquidity and are used primarily for capital expenditures, debt service, and dividends. Operating activities provided cash of $669 million in 1996, compared with $773 million in 1995 and $697 million in 1994. In 1996, loans from and redemptions of insurance policies provided cash of $95 million and issuance of long-term debt provided cash of $26 million. The principal uses of cash in 1996 were for property and equipment acquisitions, $387 million, payment of long-term debt including capital lease and equipment obligations, $184 million, cash dividends on preferred and common stock, $171 million, and the repurchase of common stock, $156 million.

Working capital (current assets less current liabilities) of $25 million existed at December 31, 1996, compared with $36 million at December 31, 1995. Management believes that Conrail's financial position allows it sufficient access to credit sources on investment grade terms, and, if necessary, additional intermediate or long-term debt could be issued for additional working capital requirements.

In April 1995, the Company's Board of Directors approved a $250 million multi-year stock repurchase program. During 1996, the Company acquired 2,225,738 shares for $156 million under this program. As a result of the proposed merger agreement with CSX (see Note 2 to the Consolidated Financial Statements), the Company will not make any additional stock repurchases under this program.

During 1996, CRC issued an additional $139 million of commercial paper and repaid $129 million. Of the $199 million outstanding at December 31, 1996, $100 million is classified as long-term debt since it is expected to be refinanced through subsequent issuances of commercial paper and is supported by the $500 million uncollateralized bank credit agreement.

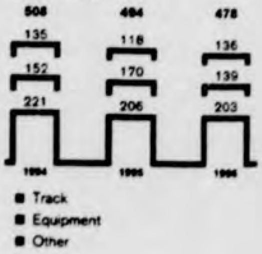
At December 31, 1996, $312 million remains available to Conrail and CRC under a 1993 shelf registration statement whereby CRC can issue debt securities and Conrail can issue both convertible debt and equity securities.

In April 1996, CRC issued $50 million of Pass-Through Certificates at a rate of 6.96% to finance equipment. Although the certificates are not direct obligations of, or guaranteed by CRC, amounts payable under related capital leases will be sufficient to pay principal and interest on the certificates.

In July 1996, CRC issued $26 million of 1996 Equipment Trust Certificates, Series A, with interest rates ranging from 6.0% to 7.48%, maturing annually from 1997 to 2011. The certificates were issued to finance approximately 85% of the purchase price of twenty locomotives.

In June 1996, CRC borrowed $69 million against the cash surrender value of the company-owned life insurance policies which it maintains on certain of its non-union employees. The Company also redeemed the remaining excess cash surrender value of $26 million. Both transactions resulted in an increase of $95 million in cash in 1996.

CAPITAL EXPENDITURES
$ in millions



Capital Expenditures

Capital expenditures totaled $478 million, $494 million and $508 million in 1996, 1995 and 1994, respectively. Of these totals, Conrail directly financed $108 million in 1996, $126 million in 1995 and $57 million in 1994.

Capital expenditures for 1997 are expected to be approximately $550 million.

Inflation

Generally accepted accounting principles require the use of historical costs in preparing financial statements. This approach does not consider the effects of inflation on the costs of replacing assets. The replacement cost of Conrail's property and equipment is substantially higher than its historical cost basis. Similarly, depreciation expense on a replacement cost basis would be substantially in excess of the amount recorded under generally accepted accounting principles.

Environmental Matters

Conrail's operations and property are subject to various federal, state and local laws regulating the environment. CRC is a party to numerous proceedings brought by regulatory agencies and private parties under federal, state and local laws, including Superfund laws, and has also received inquiries from governmental agencies with respect to other potential environmental issues. As of December 31, 1996, CRC had received, together with other companies, notices of its involvement as a potentially responsible party or requests for information under the Superfund laws with respect to cleanup and/or removal costs due to its status as an alleged transporter, generator or property owner at 135 locations throughout the country. However, based on currently available information, Conrail believes CRC may have some potential responsibility at only 61 of these sites. Due to the number of parties involved at many of these sites, the wide range of costs of the possible remediation alternatives, changing technology and the length of time over which these matters develop, it is not always possible to estimate CRC's liability for the costs associated with the assessment and remediation of contaminated sites. At December 31, 1996, Conrail had accrued $55 million for estimated future environmental expenses. Although Conrail's operating results and liquidity could be significantly affected in any quarterly or annual reporting period in which CRC was held principally liable in certain of these actions, Conrail believes the ultimate liability for these matters will not materially affect its financial condition. (See Note 13 to the Consolidated Financial Statements).

Conrail spent $11 million, $14 million and $8 million in 1996, 1995 and 1994, respectively, for environmental remediation and related costs and anticipates spending an amount comparable to that spent in 1996 during 1997. In addition, Conrail's capital expenditures for environmental control and abatement projects were approximately $6 million in 1996 and 1995, and $5 million in 1994, and are anticipated to be approximately $10 million in 1997.

Conrail has an Environmental Quality Department, the mission of which is to institute and promote compliance with environmentally sound operating practices and to monitor and assess the status of sites where liability under environmental laws may exist.

Other Matters

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements that involve risks and uncertainties that may cause actual results to differ, including but not limited to the effect of economic conditions, competition, regulation and weather on Conrail's operations, customers, service and prices, and other factors discussed elsewhere in this report and, from time to time, in other reports filed with the Securities and Exchange Commission.

STB FD 33388 6-23-97 A 180274V7F 12/13

REPORT OF MANAGEMENT

The Stockholders
Conrail Inc.

Management is responsible for the preparation, integrity and objectivity of the Company's financial statements. The financial statements are prepared in conformity with generally accepted accounting principles and include amounts based on management's best estimates and judgment. The financial information contained in other sections of this annual report is consistent with that contained in the financial statements.

The Company maintains a system of internal accounting controls and procedures which is continually reviewed and supported by written policies and guidelines and supplemented by a corporate staff of internal auditors. The system provides reasonable assurance that assets are safeguarded against loss from unauthorized use and that the books and records reflect the transactions of the Company and are reliable for the preparation of financial statements. The concept of reasonable assurance recognizes that the cost of a system of internal accounting controls should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

The Company's financial statements are audited by its independent accountants. Their audit is conducted in accordance with generally accepted auditing standards and includes a study and evaluation of the Company's system of internal accounting controls to determine the nature, timing and extent of the auditing procedures required for expressing an opinion on the Company's financial statements.

The Board of Directors pursues its oversight responsibilities for the financial statements and corporate conduct through its Audit and Ethics Committees. Each Committee consists of Directors who are not employees of the Company. The Audit Committee recommends the appointment of the independent accountants, and meets several times a year with management, the internal auditors and the independent accountants. The independent accountants and internal auditors have unrestricted access to the Audit Committee to discuss audit scope, the results of their audits, the adequacy of internal accounting controls and financial reporting. The Ethics Committee meets several times a year with management to review matters of public interest, including safety, equal employment and compliance with environmental regulations.

David M. LeVan

David M. LeVan
Chairman, President and
Chief Executive Officer

T O'Toole

Timothy T. O'Toole
Senior Vice President - Finance

January 21, 1997

REPORT OF INDEPENDENT ACCOUNTANTS

The Stockholders and Board of Directors
Conrail Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Conrail Inc. and subsidiaries at December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Price Waterhouse LLP
Thirty South Seventeenth Street
Philadelphia, Pennsylvania 19103

January 21, 1997,
except as to Note 2, which is as of March 7, 1997

CONSOLIDATED STATEMENTS OF INCOME

	Years ended December 31,		
($ In Millions Except Per Share Data)	**1996**	1995	1994
Revenues	**$3,714**	$3,686	$3,733
Operating expenses			
Way and structures	**462**	485	499
Equipment	**803**	766	815
Transportation	**1,385**	1,324	1,379
General and administrative	**328**	370	350
Voluntary separation programs (Note 3)	**135**		
Asset disposition charge (Note 10)		285	
Early retirement program (Note 11)			84
Total operating expenses	**3,113**	3,230	3,127
Income from operations	**601**	456	606
Interest expense	**(182)**	(194)	(192)
Other income, net (Note 12)	**112**	130	118
Income before income taxes	**531**	392	532
Income taxes (Note 7)	**189**	128	208
Net income	**$ 342**	$ 264	$ 324
Net income per common share (Note 1)			
Primary	**$ 4.25**	$ 3.19	$ 3.90
Fully diluted	**3.89**	2.94	3.56
Ratio of earnings to fixed charges (Note 1)	**3.19x**	2.51x	3.19x

See accompanying notes.

CONSOLIDATED BALANCE SHEETS

	December 31,	
($ In Millions)	**1996**	1995
ASSETS		
Current assets		
Cash and cash equivalents	**$ 30**	$ 73
Accounts receivable	**630**	614
Deferred tax assets (Note 7)	**293**	333
Material and supplies	**139**	158
Other current assets	**25**	28
Total current assets	**1,117**	1,206
Property and equipment, net (Note 4)	**6,590**	6,408
Other assets	**695**	810
Total assets	**$8,402**	$8,424
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Short-term borrowings	**99**	89
Current maturities of long-term debt (Note 6)	**130**	181
Accounts payable	**135**	113
Wages and employee benefits	**143**	183
Casualty reserves	**141**	110
Accrued and other current liabilities (Note 5)	**444**	494
Total current liabilities	**1,092**	1,170
Long-term debt (Note 6)	**1,876**	1,911
Casualty reserves	**190**	2[illegible]
Deferred income taxes (Note 7)	**1,478**	1,393
Special income tax obligation (Note 7)	**346**	440
Other liabilities	**313**	316
Total liabilities	**5,295**	5,447
Commitments and contingencies (Note 13)		
Stockholders' equity (Notes 2 and 9)		
Preferred stock (no par value; 15,000,000 shares authorized; no shares issued)		
Series A ESOP convertible junior preferred stock (no par value; 10,000,000 shares authorized; 7,303,920 and 9,770,993 shares issued and outstanding, respectively)	**211**	282
Unearned ESOP compensation	**(222)**	(233)
Common stock ($1 par value; 250,000,000 shares authorized; 87,768,428 and 85,392,392 shares issued, respectively; 82,244,973 and 82,094,675 shares outstanding, respectively)	**88**	85
Additional paid-in capital	**2,404**	2,187
Employee benefits trust, at market (3,394,988 and 4,706,665 shares, respectively)	**(384)**	(329)
Retained earnings	**1,357**	1,176
	3,454	3,168
Treasury stock, at cost (5,523,455 and 3,297,717 shares, respectively)	**(347)**	(191)
Total stockholders' equity	**3,107**	2,977
Total liabilities and stockholders' equity	**$8,402**	$8,424

See accompanying notes.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

($ In Millions Except Per Share Data)	Series A Preferred Stock	Unearned ESOP Compensation	Common Stock	Additional Paid-in Capital	Employee Benefits Trust	Retained Earnings	Treasury Stock
Balance, January 1, 1994	$286	$(253)	$80	$1,819		$ 857	$ (5)
Amortization		10					
Net income						324	
Common dividends, $1.40 per share						(111)	
Preferred dividends, $2.165 per share						(21)	
Common shares acquired							(94)
Exercise of stock options				14			
Other	(3)			15		7	
Balance, December 31, 1994	283	(243)	80	1,848		1,056	(99)
Amortization		10					
Net income						264	
Common dividends, $1.60 per share						(129)	
Preferred dividends, $2.165 per share						(21)	
Common shares acquired							(92)
Exercise of stock options				6			
Establishment of employee benefits trust			5	245	$(250)		
Employee benefits trust transactions, net				84	(79)		
Other	(1)			4		6	
Balance, December 31, 1995	282	(233)	85	2,187	(329)	1,176	(191)
Amortization		11					
Net income						342	
Common dividends, $1.80 per share						(146)	
Preferred dividends, $2.165 per share						(20)	
Common shares acquired							(156)
Exercise of stock options				29	53		
Employee benefits trust transactions, net				128	(116)		
Effects of voluntary separation programs	(8)				8		
Effects of CSX tender offer (Note 2)	(63)		3	60			
Other						5	
Balance, December 31, 1996	$211	$(222)	$88	$2,404	$(384)	$1,357	$(347)

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

($ In Millions)	1996	1995	1994
	Years ended December 31,		
Cash flows from operating activities			
Net income	**$ 342**	$ 264	$ 324
Adjustments to reconcile net income to net cash provided by operating activities:			
Voluntary separation programs	**135**		
Asset disposition charge		285	
Early retirement program			84
Depreciation and amortization	**283**	293	278
Deferred income taxes	**183**	108	150
Special income tax obligation	**(94)**	(73)	(62)
Gains from sales of property	**(24)**	(27)	(18)
Pension credit	**(46)**	(43)	(46)
Changes in:			
Accounts receivable	**(16)**	32	(2)
Accounts and wages payable	**(18)**	8	41
Settlement of tax audit	**(39)**		
Other	**(37)**	(74)	(52)
Net cash provided by operating activities	**669**	773	697
Cash flows from investing activities			
Property and equipment acquisitions	**(387)**	(415)	(490)
Proceeds from disposals of properties	**34**	38	32
Other	**(46)**	(59)	(23)
Net cash used in investing activities	**(399)**	(436)	(481)
Cash flows from financing activities			
Repurchase of common stock	**(156)**	(92)	(94)
Net proceeds from (repayments of) short-term borrowings	**10**	(23)	33
Proceeds from long-term debt	**26**	85	114
Payment of long-term debt	**(184)**	(134)	(158)
Loans from and redemptions of insurance policies	**95**		
Dividends on common stock	**(146)**	(129)	(111)
Dividends on Series A preferred stock	**(25)**	(21)	(16)
Proceeds from stock options and other	**67**	7	21
Net cash used in financing activities	**(313)**	(307)	(211)
Increase (decrease) in cash and cash equivalents	**(43)**	30	5
Cash and cash equivalents			
Beginning of year	**73**	43	38
End of year	**$ 30**	$ 73	$ 43

See accompanying notes.

1. Summary of Significant Accounting Policies

Industry
Conrail Inc. ("Conrail") is a holding company of which the principal subsidiary is Consolidated Rail Corporation ("CRC"), a freight railroad which operates within the northeast and midwest United States and the Province of Quebec.

Principles of Consolidation
The consolidated financial statements include Conrail and majority-owned subsidiaries. Investments in 20% to 50% owned companies are accounted for by the equity method.

Cash Equivalents
Cash equivalents consist of commercial paper, certificates of deposit and other liquid securities purchased with a maturity of three months or less, and are stated at cost which approximates market value.

Material and Supplies
Material and supplies consist mainly of fuel oil and items for maintenance of property and equipment, and are valued at the lower of cost, principally weighted average, or market.

Property and Equipment
Property and equipment are recorded at cost. Depreciation is provided using the composite straight-line method. The cost (net of salvage) of depreciable property retired or replaced in the ordinary course of business is charged to accumulated depreciation and no gain or loss is recognized.

Asset Impairment
Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Expected future cash flows from the use and disposition of long-lived assets are compared to the current carrying amounts to determine the potential impairment loss.

Revenue Recognition
Revenue is recognized proportionally as a shipment moves on the Conrail system from origin to destination.

Earnings Per Share
Primary earnings per share are based on net income adjusted for the effects of preferred dividends net of income tax benefits, divided by the weighted average number of shares outstanding during the period, including the dilutive effect of stock options. Fully diluted earnings per share assume conversion of Series A ESOP Convertible Junior Preferred Stock ("ESOP Stock") into Conrail common stock. Net income amounts applicable to fully diluted earnings per share have been adjusted by the increase, net of income tax benefits, in ESOP-related expenses assuming conversion of all ESOP Stock to common stock. Shares in the Conrail Employee Benefits Trust are not considered outstanding for computing earnings per share. The weighted average number of shares of common stock outstanding during each of the most recent three years are as follows:

	1996	1995	1994
Primary weighted average shares	**77,628,825**	78,733,947	79,674,781
Fully diluted weighted average shares	**87,325,575**	88,702,712	89,562,721

Ratio of Earnings to Fixed Charges
Earnings used in computing the ratio of earnings to fixed charges represent income before income taxes plus fixed charges, less equity in undistributed earnings of 20% to 50% owned companies. Fixed charges represent interest expense together with interest capitalized and a portion of rent under long-term operating leases representative of an interest factor.

New Accounting Standards
During 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (SFAS 121) and SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), which are both effective in 1996. The Company has decided to adopt only the disclosure provisions of SFAS 123 in 1996 and continues to apply APB Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25) and related interpretations in accounting for its stock-based compensation plans. The Company adopted SFAS 121 in the first quarter of 1996 and determined that it did not have a material effect on its financial statements.

Use of Estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates.

2. Proposed Merger
On October 14, 1996, Conrail, CSX Corporation ("CSX") and a subsidiary of CSX entered into an Agreement and Plan of Merger (as amended, the "Merger Agreement"), pursuant to which Conrail was to be merged with a subsidiary of CSX in a merger-of-equals transaction.

On October 24, 1996, Norfolk Southern Corporation ("Norfolk") commenced an unsolicited tender offer for all outstanding Conrail voting stock at $100 per share in cash. Norfolk has since increased its offer to $115 per share in cash.

On November 20, 1996, CSX concluded its first tender offer and purchased approximately 19.9% of Conrail's outstanding shares for $110 per share.

On December 18, 1996, CSX and Conrail entered into a second amendment to the Merger Agreement (the "Second Amendment") that would, among other things, (i) increase the consideration payable pursuant to the merger, (ii) accelerate the consummation of the merger to immediately following the receipt of applicable shareholder approvals and prior to Surface Transportation Board ("STB") approval and (iii) extend until December 31, 1998, an exclusivity period during which the Conrail Board agreed not to withdraw or modify its recommendations of the CSX transactions, approve or recommend any takeover proposal or cause Conrail to enter into any agreement related to any takeover proposal.

On January 13, 1997, Norfolk issued a press release announcing that it would offer to purchase shares representing 9.9% of the outstanding shares for $115 per share, in the event that Conrail shareholders did not approve a proposal to opt out of a Pennsylvania statute (the "Opt Out Proposal") at the meeting of shareholders to be held on January 17, 1997 (the "Special Shareholders Meeting").

On January 17, 1997, Conrail shareholders voted at the Special Shareholders Meeting against the Opt Out Proposal.

On February 4, 1997, the amended Norfolk tender offer expired, and Norfolk subsequently purchased approximately 8.2 million shares pursuant thereto.

On March 7, 1997, Conrail and CSX entered into a Third Amendment (the "Third Amendment") to the Merger Agreement. Pursuant to the Third Amendment, (i) the price per share has been increased from $110 to $115, and the number of shares to be purchased in the tender offer has been increased to all outstanding shares. The tender offer is scheduled to close April 18, 1997 (subject to extension by CSX to June 2, 1997 whether or not the conditions have been satisfied), (ii) the consideration paid per share in the merger for all remaining outstanding shares following consummation of the offer has been increased to $115 in cash and (iii) the conditions to the offer relating to certain provisions of Pennsylvania law becoming inapplicable to Conrail and relating pending governmental actions or proceedings have been deleted.

The Third Amendment also provides that CSX will have sole control over the regulatory approval process and will be free to conduct by itself discussions with other railroads, including Norfolk, relating to competitive issues raised by the CSX transactions, and to enter into any resulting agreement. It is anticipated that CSX and Norfolk will negotiate an appropriate division of Conrail's assets; however, neither the pending CSX tender offer nor the merger is conditioned on CSX's reaching an agreement with Norfolk.

Pursuant to the Third Amendment, three members of Conrail's Board of Directors approved by CSX shall be invited to join the CSX Board of Directors and a transition team will be established, the leadership of which will include senior executive officers of CSX and Conrail to ensure the orderly operation of Conrail during the regulatory approval process and an orderly transition thereafter.

Under the Third Amendment, Conrail and CSX agreed to reduce from December 31, 1998 to December 31, 1997 the period of time during which the Conrail Board is prohibited from (i) withdrawing or modifying, or publicly proposing to withdraw or modify, its approval or recommendation of the CSX transactions, in a manner adverse to CSX, (ii) approving or recommending, or publicly proposing to approve or recommend, any competing proposal or (iii) causing Conrail to enter into any agreement related to any such competing proposal.

Under the merger agreement as amended, Conrail may terminate the Merger Agreement in the event that after June 2, 1997, CSX fails to consummate the tender offer for any reason other than the nonoccurrence of any condition to the tender offer. In the event that CSX fails to consummate the tender offer under such circumstances, Conrail will be entitled to exercise any additional remedies it may have.

The full terms and conditions of the CSX and Norfolk offers and Conrail's position with respect to the CSX and Norfolk offers are set forth in documents filed by Conrail with the Securities and Exchange Commission.

Pending approval by the STB, 100% of Conrail's voting stock will by held by CSX in a voting trust. The combination of the railroad operations of the two companies is contingent upon the approval of the merger by the STB.

3. Voluntary Separation Programs

During the second quarter of 1996, the Company recorded a charge of $135 million (before tax benefits of $52 million) consisting of $102 million in termination benefits to be paid to non-union employees participating in the voluntary retirement and separation programs ("voluntary separation programs") and losses of $33 million on non-cancelable leases for office space no longer required as a result of the reduction in the Company's workforce. Over 840 applications were accepted from eligible employees under the voluntary separation programs. Approximately $90 million of the termination benefits are being paid from the Company's overfunded pension plan.

4. Property and Equipment

(In Millions)	December 31, 1996	1995
Roadway	**$ 7,021**	$ 6,828
Equipment	**1,231**	1,213
Less: Accumulated depreciation	**(1,654)**	(1,572)
Allowance for disposition	**(408)**	(439)
	6,190	6,030
Capital leases (primarily equipment)	**908**	908
Accumulated amortization	**(508)**	(530)
	400	378
	$ 6,590	$ 6,408

Conrail acquired equipment and incurred related long-term debt under various capital leases of $82 million in 1996, $71 million in 1995 and $8 million in 1994. In 1995 (Note 10) and 1991, the Company recorded allowances for disposition for the sale or abandonment of certain under-utilized rail lines and other facilities.

5. Accrued and Other Current Liabilities

(In Millions)	December 31, 1996	1995
Freight settlements due others	**$ 48**	$ 54
Equipment rents (primarily car hire)	**74**	71
Unearned freight revenue	**79**	56
Property and corporate taxes	**49**	66
Other	**194**	247
	$444	$494

6. Long-Term Debt

Long-term debt outstanding, including the weighted average interest rates at December 31, 1996, is composed of the following:

(In Millions)	December 31, 1996	1995
Capital leases	**$ 491**	$ 489
Medium-term notes payable, 6.70%, due 1997 to 1999	**109**	208
Notes payable, 9.75%, due 2000	**250**	250
Debentures payable, 7.88%, due 2043	**250**	250
Debentures payable, 9.75%, due 2020	**544**	544
Equipment and other obligations, 6.55%	**262**	251
Commercial paper, 5.53%	**100**	100
	2,006	2,092
Less current portion	**(130)**	(181)
	$1,876	$1,911

Using current market prices when available, or a valuation based on the yield to maturity of comparable debt instruments having similar characteristics, credit rating and maturity, the total fair value of the Company's long-term debt, including the current portion, but excluding capital leases, is $1,685 million and $1,870 million at December 31, 1996 and 1995, respectively, compared with carrying values of $1,515 million and $1,603 million at December 31, 1996 and 1995, respectively.

The Company's noncancelable long-term leases generally include options to purchase at fair value and to extend the terms. Capital leases have been discounted at rates ranging from 3.09% to 14.26% and are collateralized by assets with a net book value of $400 million at December 31, 1996.

Minimum commitments, exclusive of executory costs borne by the Company, are:

(In Millions)	Capital Leases	Operating Leases
1997	$ 107	$115
1998	96	104
1999	86	87
2000	64	76
2001	57	68
2002 - 2017	273	523
Total	683	$973
Less interest portion	(192)	
Present value	$ 491	

Operating lease rent expense was $127 million in 1996, $130 million in 1995 and $118 million in 1994.

In June 1993, the Company and CRC filed a shelf registration statement on Form S-3 to enable CRC to issue up to $500 million in debt securities or the Company to issue up to $500 million in convertible debt and equity securities. The remaining balance under this shelf registration was $312 million at December 31, 1996.

In April 1996, CRC issued $50 million of Pass-Through Certificates at a rate of 6.96% to finance equipment. Although the certificates are not direct obligations of, or guaranteed by CRC, amounts payable under related capital leases will be sufficient to pay principal and interest on the certificates.

In July 1996, CRC issued $26 million of 1996 Equipment Trust Certificates, Series A, with interest rates ranging from 6.0% to 7.48%, maturing annually from 1997 to 2011. The certificates were used to finance approximately 85% of the purchase price of twenty locomotives.

In June 1996, CRC borrowed $69 million against the cash surrender value of the company-owned life insurance policies which it maintains on certain of its non-union employees.

Equipment and other obligations mature in 1997 through 2043 and are collateralized by assets with a net book value of $253 million at December 31, 1996. Maturities of long-term debt other than capital leases and commercial paper are $65 million in 1997, $46 million in 1998, $46 million in 1999, $266 million in 2000, $17 million in 2001 and $975 million in total from 2002 through 2043.

CRC had $199 million of commercial paper outstanding at December 31, 1996. Of the total amount outstanding, $100 million is classified as long-term since it is expected to be refinanced through subsequent issuances of commercial paper and is supported by the long-term credit facility mentioned below.

CRC maintains a $500 million uncollateralized bank credit agreement with a group of banks which is used for general corporate purposes and to support CRC's commercial paper program. The agreement matures in 2000 and requires interest to be paid on amounts borrowed at rates based on various defined short-term rates and an annual maximum fee of .125% of the facility amounts. The agreement contains, among other conditions, restrictive covenants relating to a debt ratio and consolidated tangible net worth. During 1996, CRC had no borrowings under this agreement.

Interest payments were $170 million in 1996, $177 million in 1995 and $174 million in 1994.

7. Income Taxes

The provisions for income taxes are composed of the following:

(In Millions)	**1996**	1995	1994
Current			
Federal	**$ 90**	$ 78	$104
State	**10**	15	16
	100	93	120
Deferred			
Federal	**151**	110	125
State	**32**	(2)	25
	183	108	150
Special income tax obligation			
Federal	**(80)**	(61)	(53)
State	**(14)**	(12)	(9)
	(94)	(73)	(62)
	$189	$128	$208

In conjunction with the public sale in 1987 of the 85% of the Company's common stock then owned by the U.S. Government, federal legislation was enacted which resulted in a reduction of the tax basis of certain of the Company's assets, particularly property and equipment, thereby substantially decreasing tax depreciation deductions and increasing future federal income tax payments. Also, net operating loss and investment tax credit carryforwards were canceled. As a result of the sale-related transactions, a special income tax obligation was recorded in 1987 based on an estimated effective federal and state income tax rate of 37.0%.

As a result of a decrease in a state income tax rate enacted during 1995, income tax expense for that year was reduced by $21 million representing the effects of adjusting deferred income taxes and the special income tax obligation for the rate decrease as required by SFAS 109, "Accounting for Income Taxes" (SFAS 109).

In November 1996, the Company reached a settlement with the Internal Revenue Service related to the audit of the Company's consolidated federal income tax returns for the fiscal years 1990 through 1992. The Company made a payment of $39 million pending resolution of the final interest determination related to the settlement. Federal and state income tax payments were $145 million in 1996 (excluding tax settlement), $109 million in 1995 and $80 million in 1994.

Reconciliations of the U.S. statutory tax rates with the effective tax rates are as follows:

	1996	1995	1994
Statutory tax rate	**35.0%**	35.0%	35.0%
State income taxes, net of federal benefit	**3.4**	3.5	3.9
Effect of state tax decrease on deferred taxes		(5.3)	
Other	**(2.8)**	(.5)	.2
Effective tax rate	**35.6%**	32.7%	39.1%

Significant components of the Company's special income tax obligation and deferred income tax liabilities and (assets) are as follows:

	December 31,	
(In Millions)	**1996**	1995
Current assets (primarily accounts receivable)	**$ (9)**	$ (27)
Current liabilities (primarily accrued liabilities and casualty reserves)	**(245)**	(265)
Tax benefits related to disposition of subsidiary	**(30)**	(30)
Net operating loss carryforwards	**(9)**	(11)
Current deferred tax asset, net	**$ (293)**	$ (333)
Noncurrent liabilities:		
Property and equipment	**1,939**	1,936
Other long-term assets (primarily prepaid pension asset)	**92**	67
Miscellaneous	**98**	66
	2,129	2,069
Noncurrent assets:		
Nondeductible reserves and other liabilities	**(174)**	(144)
Tax benefit transfer receivable	**(36)**	(33)
Alternative minimum tax credits		(38)
Miscellaneous	**(95)**	(21)
	(305)	(236)
Special income tax obligation and deferred income tax liabilities, net	**$1,824**	$1,833

8. Employee Benefits

Pension Plans

The Company and certain subsidiaries maintain defined benefit pension plans which are noncontributory for all non-union employees and generally contributory for participating union employees. Benefits are based primarily on credited years of service and the level of compensation near retirement. Funding is based on the minimum amount required by the Employee Retirement Income Security Act of 1974.

Pension credits include the following components:

(In Millions)	1996	1995	1994
Service cost - benefits earned during the period	**$ 9**	$ 8	$ 8
Interest cost on projected benefit obligation	**51**	51	48
Return on plan assets – actual	**(138)**	(254)	(10)
– deferred	**47**	167	(77)
Net amortization and deferral	**(15)**	(15)	(15)
	$ (46)	$ (43)	$ (46)

The funded status of the pension plans and the amounts reflected in the balance sheets are as follows:

(In Millions)	1996	1995
Accumulated benefit obligation ($655 million and $603 million vested, respectively)	**$ 661**	$ 609
Market value of plan assets	**1,187**	1,168
Projected benefit obligation	**(734)**	(726)
Plan assets in excess of projected benefit obligation	**453**	442
Unrecognized prior service cost	**36**	50
Unrecognized transition net asset	**(90)**	(120)
Unrecognized net gain	**(231)**	(157)
Net prepaid pension cost	**$ 168**	$ 215

The assumed weighted average discount rates used in 1996 and 1995 are 7.5% and 7.0%, respectively, and the rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligation as of December 31, 1996 and 1995 is 6.0%. The expected long-term rate of return on plan assets (primarily equity securities) in 1996 and 1995 is 9.0%.

Savings Plans

The Company and certain subsidiaries provide 401(k) savings plans for union and non-union employees. Under the Non-union ESOP, 100% of employee contributions are matched in the form of ESOP Stock for the first 6% of a participating employee's base pay. There is no Company match provision under the union employee plan. Savings plan expense was $4 million in 1996 and 1995, and $5 million in 1994

In connection with the Non-union ESOP, the Company issued 9,979,562 of the authorized 10 million shares of its ESOP Stock to the Non-union ESOP in exchange for a 20 year promissory note with interest at 9.55% from the Non-union ESOP in the principal amount of $288 million. In addition, unearned ESOP compensation of $288 million was recognized as a charge to stockholders' equity coincident with the Non-union ESOP's issuance of its $288 million promissory note to the Company. The debt of the Non-union ESOP was recorded by the Company and offset against the promissory note from the Non-union ESOP. Unearned ESOP compensation is charged to expense as shares of ESOP Stock are allocated to participants. Approximately 2.7 million ESOP shares have been cumulatively allocated to participants through December 31, 1996, and a portion of these shares have been tendered to CSX (Note 2). An amount equivalent to the preferred dividends declared on the ESOP Stock partially offsets compensation and interest expense related to the Non-union ESOP.

In 1994, the ESOP's promissory note to the Company was refinanced. As part of the refinancing, the interest rate was decreased to 8.0%, from the original 9.55%, and accrued interest of $21 million was capitalized as part of the principal balance of the promissory note.

The Company is obligated to make dividend payments at a rate of 7.51% on the ESOP Stock and additional contributions in an aggregate amount sufficient to enable the Non-union ESOP to make the required interest and principal payments on its note to the Company.

Interest expense incurred by the Non-union ESOP on its debt to the Company was $24 million in 1996 and 1995, and $30 million in 1994. Compensation expense related to the Non-union ESOP was $11 million in 1996, and $10 million in 1995 and 1994. Preferred dividends of $20 million were declared in 1996, and $21 million in 1995 and 1994. Preferred dividend payments of $25 million, $21 million and $16 million were made in 1996, 1995 and 1994, respectively. The Company received debt service payments from the Non-union ESOP of $40 million in 1996, $31 million in 1995 and $21 million in 1994.

Postretirement Benefits Other Than Pensions

The Company provides health and life insurance benefits to certain retired non-union employees. Certain non-union employees are eligible for retiree medical benefits, while substantially all non-union employees are eligible for retiree life insurance benefits. Generally, company-provided health care benefits terminate when individuals reach age 65.

Retiree life insurance plan assets consist of a retiree life insurance reserve held in the Company's group life insurance policy. There are no plan assets for the retiree health benefits plan.

The following sets forth the plans' funded status reconciled with amounts reported in the Company's balance sheets:

(In Millions)	1996 Medical Plan	1996 Life Insurance Plan	1995 Medical Plan	1995 Life Insurance Plan
Accumulated postretirement benefit obligation:				
Retirees	**$ 44**	**$ 20**	$ 38	$ 19
Fully eligible active plan participants	**1**		5	1
Other active plan participants		**3**		5
Accumulated benefit obligation	**45**	**23**	43	25
Market value of plan assets		**(10)**		(7)
Accumulated benefit obligation in excess of plan assets	**45**	**13**	43	18
Unrecognized gains and (losses)	**(1)**	**2**	1	(1)
Accrued benefit cost recognized in the Consolidated Balance Sheet	**$ 44**	**$ 15**	$ 44	$ 17
Net periodic postretirement benefit cost, primarily interest cost	**$ 3**	**$ 1**	$ 4	$ 1

An 8 percent rate of increase in per capita costs of covered health care benefits was assumed for 1997, gradually decreasing to 6 percent by the year 2007. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1996 by $2 million and would have an immaterial effect on the net periodic postretirement benefit cost for 1996. Discount rates of 7.5% and 7.0% were used to determine the accumulated postretirement benefit obligations for both the medical and life insurance plans in 1996 and 1995, respectively.

The assumed rate of compensation increase was 6.0% in 1996 and 5.0% in 1995.

Retiree medical benefits are funded by a combination of Company and retiree contributions. Retiree life insurance benefits are provided by insurance companies whose premiums are based on claims paid during the year.

9. Capital Stock

Preferred Stock

The Company is authorized to issue 25 million shares of preferred stock with no par value. The Board of Directors has the authority to divide the preferred stock into series and to determine the rights and preferences of each.

The Company cannot pay dividends on its common stock unless full cumulative dividends have been paid on its ESOP Stock, and no distributions can be made to the holders of common stock upon liquidation or dissolution of the Company unless the holders of the ESOP Stock have received a cash liquidation payment of $28.84375 per share, plus unpaid dividends up to the date of such payment. The ESOP Stock is convertible into an equivalent number of shares of common stock based on their respective market values at the date of conversion. The ESOP Stock is entitled to one vote per share, voting together as a single class with common stock on all matters.

As a result of the CSX tender offer related to the proposed merger (Note 2), 2.2 million shares of ESOP Stock have been converted to common shares as a result of being removed from the Non-union ESOP 401(k) savings plan.

Employee Benefits Trust

In 1995, the Company issued approximately 4.7 million shares of its common stock to the Conrail Employee Benefits Trust (the "Trust") in exchange for a promissory note of $250 million at an interest rate of 6.9%. The Trust is being used to fund certain employee benefits and other forms of compensation over its fifteen-year term. The amount representing unearned employee benefits is recorded as a deduction from stockholders' equity and is reduced as benefits and compensation are paid through the release of shares from the Trust. The shares owned by the Trust are valued at the closing market price as of the end of each reporting period, with corresponding changes in the balance of the Trust reflected in additional paid-in capital. The Trust has sold shares of Conrail common stock in connection with the CSX and Norfolk tender offers (Note 2) and has used the proceeds to repurchase shares of Conrail common stock in the open market. Shares held by the Trust are not considered outstanding for earnings per share computations until released by the Trust, but do have voting and dividend rights.

Common Stock Repurchase Program

In April 1995, the Board of Directors approved a $250 million multi-year stock repurchase program. During 1996, the Company acquired 2,225,738 shares for approximately $156 million under this program. At December 31, 1996, approximately $93 million remained available from this authorization; however, as a result of the proposed merger with CSX Corporation (Note 2), the Company will not make any additional stock repurchases under this program.

The activity and status of treasury stock follow:

	1996	1995	1994
Shares, beginning of year	**3,297,717**	1,789,164	83,745
Acquired	**2,225,738**	1,508,553	1,705,419
Shares, end of year	**5,523,455**	3,297,717	1,789,164

Stock Plans

The Company's stock-based compensation plans as of December 31, 1996 are described below. The Company applies APB 25 and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its fixed stock option plans. SFAS 123 was issued in 1995 and, if fully adopted, would change the method of recognition of costs on plans similar to those of the Company. Adoption of SFAS 123 is optional; however, the required pro forma disclosures as if the Company had adopted the cost recognition requirements under SFAS 123 in 1996 and 1995 are presented below.

The Company's 1987 and 1991 Long-Term Incentive Plans authorize the granting to officers and key employees of up to 4 million and 6.6 million shares of common stock, respectively, through stock options, stock appreciation rights, phantom stock and awards of restricted or performance shares. A stock option is exercisable for a specified term commencing after grant at a price not less than the fair market value of the stock on the date of grant. The vesting of awards made pursuant to these plans is contingent upon one or more of the following: continued employment, passage of time or financial and other performance goals.

Effective November 1996, the Company's Board of Directors authorized the automatic vesting of all unvested stock options outstanding in connection with the Merger Agreement between CSX and the Company (Note 2).

The activity and status of stock options under the incentive plans follow:

	Non-qualified Stock Options	
	Option Price Per Share	Shares Under Option
Balance, January 1, 1994	$ 14.000 - $60.500	1,966,321
Granted	$ 52.188 - $66.938	23,988
Exercised	$ 14.000 - $51.375	(507,450)
Cancelled	$ 42.625 - $60.500	(118,904)
Balance, December 31, 1994	$ 14.000 - $66.938	1,363,955
Granted	$ 50.688 - $68.563	516,757
Exercised	$ 14.000 - $53.875	(200,940)
Cancelled	$ 42.625 - $53.875	(123,560)
Balance, December 31, 1995	$ 14.000 - $68.563	1,556,212
Granted	$ 68.563 - $96.063	551,038
Exercised	$ 14.000 - $73.250	(1,268,085)
Cancelled	$ 42.625 - $70.031	(3,984)
Balance, December 31, 1996	$ 14.000 - $96.063	835,181
Exercisable, December 31, 1996	$ 14.000 - $74.188	831,481
Available for future grants December 31, 1995		1,188,193
December 31, 1996		3,969,317

The weighted average exercise prices of options granted during 1996 and 1995 are $70.130 per share and $51.204 per share, respectively. The weighted average exercise prices of options exercised during 1996 and 1995 are $48.32 per share and $31.16 per share, respectively. The average remaining maximum terms of options is not considered meaningful given the events that have occurred as a result of the proposed merger with CSX (Note 2).

The fair value of each option granted during 1996 is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: (1) dividend yield of 2.43%, (2) expected volatility of 25.25%, (3) risk-free interest rate of 5.51%, and (4) expected life of 4 years. The weighted average fair value of options granted during 1996 and 1995 is $16.00 per share and $13.12 per share, respectively.

Had the compensation cost for the Company's 1996 and 1995 grants for stock-based compensation plans been determined consistent with SFAS 123, the Company's net income, primary earnings per share and fully diluted earnings per share for 1996 and 1995 would approximate the pro forma amounts below ($ in millions except per share data):

(In Millions)	**1996**	1995
Net income as reported	**$ 342**	$ 264
Net income pro forma	**335**	262
Primary earnings per share	**$4.25**	$3.19
Primary earnings per share pro forma	**4.16**	3.16
Fully diluted earnings per share	**$3.89**	$2.94
Fully diluted earnings per share pro forma	**3.81**	2.92

The Company has granted phantom shares and restricted stock under its non-union employee bonus plans to eligible employees who elect to defer all or a portion of their annual bonus in a given year. The number of shares granted depends on the length of the deferral period. Grants are made at the market price of the Company's common stock at the date of grant. The Company has granted 148,749 shares and 337,329 shares of phantom and restricted stock, respectively, under its non-union employee bonus plans through December 31, 1996. The Company has also granted 73,344 performance shares under its 1991 Long-Term Incentive Plan through December 31, 1996. Compensation expense related to these plans was $2 million in 1996 and $3 million in 1995. The weighted-average fair value for the phantom shares and restricted stock granted during 1996 and 1995 was $68.02 per share and $52.88 per share, respectively.

Stock Rights

In 1989, the Company declared a dividend of one common share purchase right (the "Right") on each outstanding share of common stock. The Rights are not exercisable or transferable apart from the common stock until the occurrence of certain events arising out of an actual or potential acquisition of 10% or more of the Company's common stock, and would at such time provide the holder with certain additional entitlements. However, under the terms of the Merger Agreement (Note 2) the CSX tender offer does not constitute an event that would result in the Rights becoming exercisable. In 1995, a dividend of one Right for each share of ESOP Stock was declared and paid. The exercise price of the Rights is $205. The Rights may be redeemed by the Company prior to becoming exercisable at one-half cent ($.005) per Right and have no voting or dividend rights.

10. Asset Disposition Charge

Included in 1995 operating expenses is an asset disposition charge of $285 million, which reduced net income by $176 million. The asset disposition charge resulted from a review of the Company's route system and other operating assets to determine those that no longer effectively and economically supported current and expected operations. The Company identified and has committed to sell 1,800 miles of rail lines that are expected to provide proceeds substantially less than net book value. In addition, other assets, principally yards and side tracks, identified for disposition were written down to estimated net realizable value (See Note 1 "Asset Impairment").

11. 1994 Early Retirement Program

During 1994, the Company recorded a charge of $84 million, which reduced net income by $51 million, for a non-union employee voluntary early retirement program and related costs. The majority of the cost of the early retirement program is being paid from the Company's overfunded pension plan.

12. Other Income, Net

(In Millions)	1996	1995	1994
Interest income	**$ 29**	$ 33	$ 34
Rental income	**50**	57	53
Property sales	**23**	27	18
Other, net	**10**	13	13
	$112	$130	$118

13. Commitments and Contingencies

Environmental

The Company is subject to various federal, state and local laws and regulations regarding environmental matters. CRC is a party to various proceedings brought by both regulatory agencies and private parties under federal, state and local laws, including Superfund laws, and has also received inquiries from governmental agencies with respect to other potential environmental issues. At December 31, 1996, CRC has received, together with other companies, notices of its involvement as a potentially responsible party or requests for information under the Superfund laws with respect to cleanup and/or removal costs due to its status as an alleged transporter, generator or property owner at 135 locations. However, based on currently available information, the Company believes CRC may have some potential responsibility at only 61 of these sites. Due to the number of parties involved at many of these sites, the wide range of costs of possible remediation alternatives, the changing technology and the length of time over which these matters develop, it is often not possible to estimate CRC's liability for the costs associated with the assessment and remediation of contaminated sites.

Although the Company's operating results and liquidity could be significantly affected in any quarterly or annual reporting period if CRC were held principally liable in certain of these actions, at December 31, 1996, the Company had accrued $55 million, an amount it believes is sufficient to cover the probable liability and remediation costs that will be incurred at Superfund sites and other sites based on known information and using various estimating techniques. The Company believes the ultimate liability for these matters will not materially affect its consolidated financial condition.

The Company spent $11 million in 1996, $14 million in 1995 and $8 million in 1994 for environmental remediation and related costs and anticipates spending an amount comparable to that spent in 1996 during 1997. In addition, the Company's capital expenditures for environmental control and abatement projects were approximately $6 million in 1996 and 1995, and $5 million in 1994, and are anticipated to be approximately $10 million in 1997.

The Environmental Quality Department is charged with promoting the Company's compliance with laws and regulations affecting the environment and instituting environmentally sound operating practices. The department monitors the status of the sites where the Company is alleged to have liability and continually reviews the information available and assesses the adequacy of the recorded liability.

Other

The Company is involved in various legal actions, principally relating to occupational health claims, personal injuries, casualties, property damage and damage to lading. The Company has recorded liabilities on its balance sheet for amounts sufficient to cover the expected payments for such actions.

The Company may be contingently liable for approximately $63 million at December 31, 1996 under indemnification provisions related to sales of tax benefits.

CRC had an average of 20,761 employees in 1996, approximately 87% of whom are represented by 14 different labor organizations and are covered by 22 separate collective bargaining agreements. The Company was engaged in collective bargaining at December 31, 1996 with labor organizations representing approximately 22% of its labor force.

In 1994, Locomotive Management Services, a general partnership of which CRC holds a fifty percent interest, issued $96 million of Equipment Trust Certificates to fund the purchase price of 60 new locomotives. While principal and interest payments on certificates will be fully guaranteed by CRC, through a sharing agreement with its partner, CRC's portion of the guarantee is reduced to approximately $48 million, effective January 1, 1997, with the Company's purchase of twenty of the locomotives.

CRC has received three adverse jury verdicts related to railroad crossing accidents in Ohio that include significant punitive damage awards that collectively approximate $30 million. CRC believes the punitive damage awards in those cases are improper and that it has meritorious defenses, which it plans to pursue on appeal. The Company is not presently able to reasonably estimate the ultimate outcome of these cases, and accordingly, no expense for such awards has been recorded as of December 31, 1996.

As part of the Merger Agreement (Note 2), the Company may be a party to certain stock purchase options or, under certain circumstances, be required to pay substantial termination fees.

14. Condensed Quarterly Data (Unaudited)

($ In Millions Except Per Share)	First **1996**	First 1995	Second **1996**	Second 1995	Third **1996**	Third 1995	Fourth **1996**	Fourth 1995
Revenues	**$889**	$889	**$949**	$923	**$933**	$923	**$943**	$951
Income (loss) from operations	**69**	114	**54**	180	**235**	208	**243**	(46)
Net income (loss)	**31**	55	**26**	123	**138**	116	**147**	(30)
Net income (loss) per common share:								
Primary	**.36**	.66	**.30**	1.52	**1.74**	1.44	**1.86**	(.43)
Fully diluted	**.35**	.61	**.29**	1.37	**1.58**	1.31	**1.70**	(.43)
Ratio of earnings to fixed charges	**1.75x**	2.39x	**1.57x**	3.42x	**4.77x**	4.02x	**4.91x**	–
Dividends per common share	**.425**	.375	**.425**	.375	**.475**	.425	**.475**	.425
Market prices per common share (New York Stock Exchange)								
High	**77¼**	57⅝	**73¼**	56¼	**74⅝**	70¼	**100⅞**	74⅜
Low	**67⅝**	50½	**66¼**	51⅛	**63⅜**	55⅛	**68½**	65½

During the second quarter of 1996, the Company recorded a one-time charge of $135 million for the non-union employee voluntary early retirement and separation programs and related costs, which reduced net income by $83 million (Note 3). Without this charge, net income would have been $109 million for the quarter ($1.37 and $1.25 per share, primary and fully diluted, respectively).

As a result of a decrease in a state income tax rate enacted during the second quarter of 1995, income tax expense was reduced by $21 million representing the effects of adjusting deferred income taxes and the special income tax obligation for the rate decrease as required under SFAS 109 (Note 7). Without this one-time tax benefit, the Company's net income for the quarter would have been $102 million ($1.25 and $1.14 per share, primary and fully diluted, respectively). During the fourth quarter of 1995, an asset disposition charge reduced income from operations by $285 million and adversely affected the quarter's net income by $176 million (Note 10). Without the asset disposition charge, net income would have been $146 million ($1.82 and $1.65 per share, primary and fully diluted, respectively) for the fourth quarter of 1995. After the asset disposition charge, earnings were insufficient by $58 million to cover fixed charges for the quarter.

CORPORATE OFFICERS

David M. LeVan, 51
Chairman, President and Chief Executive Officer
Present position since May 1996. Served as President and Chief Executive Officer between March 1995 and May 1996. Served as President and Chief Operating Officer between September 1994 and March 1995. Served as Executive Vice President between November 1993 and September 1994. Served as Senior Vice President – Operations between July 1992 and November 1993. Served as Senior Vice President – Operating Systems and Strategies between November 1991 and July 1992.

Cynthia A. Archer, 43
Senior Vice President – Intermodal Service Group
Present position since May 1995. Served as General Manager – Transportation and Customer Service of the Harrisburg Division between February 1994 and May 1995. Served as Assistant Vice President – Food and Agriculture between September 1993 and January 1994. Served as Director – Intermodal Business Development between September 1991 and August 1993.

Ronald J. Conway, 53
Senior Vice President – Operations
Present position since November 1994. Served as Vice President – Operations between September 1994 and November 1994. Served as Vice President – Transportation between July 1994 and September 1994. Served as Vice President – Intermodal Service Group between November 1993 and July 1994. Served as Assistant Vice President – Petrochemicals and Minerals between April 1992 and November 1993.

Timothy P. Dwyer, 47
Senior Vice President – Unit Train Service Group
Present position since November 1994. Served as Vice President – Unit Train Service Group between November 1993 and November 1994. Served as General Manager – Philadelphia Division between April 1992 and November 1993.

John A. McKelvey, 45
Senior Vice President – Finance
Present position since February 1997. Served as Vice President-Service Delivery between January 1996 and February 1997. Served as Vice President – Materials and Purchasing between April 1994 and January 1996. Served as Vice President – Controller between May 1993 and March 1994. Served as Vice President – Treasurer between 1988 and May 1993.

Frank H. Nichols, 50
Senior Vice President – Organizational Performance
Present position since May 1995. Served as Vice President – Human Resources between February 1993 and May 1995. Served as Assistant Vice President – Finance between November 1988 and February 1993.

Timothy T. O'Toole, 41
Senior Vice President – Law and Government Affairs
Present position since February 1997. Served as Senior Vice President – Finance between April 1996 and February 1997. Served as Vice President and Treasurer between April 1994 and April 1996. Served as Vice President and General Counsel between May 1989 and April 1994.

Lester M. Passa, 43
Senior Vice President – Automotive Service Group
Present position since February 1997. Served as Vice President – Logistics and Corporate Strategy between March 1995 and February 1997. Served as Assistant Vice President – Corporate Strategy between February 1993 and March 1995. Served as Director – Intermodal Planning between October 1991 and January 1993.

John P. Sammon, 46
Senior Vice President – CORE Service Group
Present position since November 1994. Served as Vice President – Intermodal between July 1994 and November 1994. Served as Assistant Vice President – Intermodal between January 1988 and July 1994.

George P. Turner, 55
Senior Vice President – Merger Transition
Present position since February 1997. Served as Senior Vice President – Automotive Service Group between November 1994 and February 1997. Served as Vice President – Automotive Service Group between November 1993 and November 1994. Served as Assistant Vice President – Automotive between April 1992 and November 1993.

Bruce B. Wilson, 61
Senior Vice President – Merger
Present position since February 1997. Served as Senior Vice President – Law between April 1987 and February 1997.

Lucy S.L. Amerman, 46
*Vice President – Risk Management**
Present position since July 1994. Served as Assistant Vice President – Claims and Litigation between April 1994 and July 1994. Served as General Counsel – Litigation between March 1990 and March 1994.

Dennis A. Arouca, 45
*Vice President – Labor Relations**
Present position since May 1994. Served as Partner in the law firm of Pepper Hamilton & Scheetz between February 1986 and May 1994.

Gerald T. Gates, 43
*Vice President – Customer Support**
Present position since January 1996. Served as Vice President – Transportation between November 1994 and January 1996. Served as Vice President – Mechanical between December 1993 and November 1994. Served as Assistant Vice President – Operations Planning and Administration between July 1992 and November 1993. Served as General Manager – Indianapolis Division between September 1990 and July 1992.

Hugh J. Kiley, 44
*Vice President – Service Design & Planning**
Present position since January 1996. Served as Assistant Vice President – Performance and Process Management between November 1994 and January 1996. Served as Assistant Vice President – Program Management between May 1994 and November 1994. Served as General Manager – National Customer Service Center between November 1990 and May 1994.

Craig R. MacQueen, 44
*Vice President – Corporate Communications**
Present position since June 1995. Served as Assistant Vice President – Public Affairs between September 1992 and June 1995. Served as Executive Director – Public Affairs between November 1990 and August 1992.

Donald W. Mattson, 54
Vice President – Controller
Present position since April 1994. Served as Vice President – Treasurer between May 1993 and April 1994. Served as Vice President – Controller between August 1988 and May 1993.

Thomas J. McFadden, 42
*Treasurer**
Present position since May 1996. Served as Assistant Treasurer – Investor Relations and Finance between June 1994 and May 1996. Served as Director – Project Financing between July 1990 and June 1994.

James D. McGeehan, 48
Corporate Secretary
Present position since May 1996. Served as Assistant Corporate Secretary between December 1980 and May 1996.

William B. Newman, Jr., 46
*Vice President and Washington Counsel**
Present position since 1981.

Albert M. Polinsky, 50
*Vice President – Information Systems**
Present position since April 1994. Served as Assistant Vice President – Program Management between December 1993 and March 1994. Served as Assistant Vice President – Marketing Services between April 1992 and December 1993.

John M. Samuels, 53
*Vice President – Operating Assets**
Present position since January 1996. Served as Vice President – Mechanical between November 1994 and January 1996. Served as Vice President – Engineering between April 1992 and November 1994.

Gary M. Spiegel, 46
*Vice President – Service Delivery**
Present position since February 1997. Served as Assistant Vice President – Train Operations between August 1994 and February 1997. Served as General Manager – Transportation and Customer Service between April 1992 and August 1994.

**Indicates an officer of Consolidated Rail Corporation only.*

BOARD OF DIRECTORS

David M. LeVan
Chairman, President and Chief Executive Officer,
Conrail Inc.

Finance*

H. Furlong Baldwin
Chairman and Chief Executive Officer,
Mercantile Bankshares Corporation

Compensation
Finance

Claude S. Brinegar
Retired Vice Chairman,
Unocal Corporation

Audit
Nominating

Daniel B. Burke
Retired President and Chief Executive Officer,
Capital Cities/ABC, Inc.

Ethics
Nominating

Kathleen Foley Feldstein
President,
Economics Studies, Inc.

Ethics*
Finance

Roger S. Hillas
Retired Chairman and Chief Executive Officer,
Meritor Savings Bank

Compensation*
Finance

E. Bradley Jones
Retired Chairman and Chief Executive Officer,
LTV Steel Co.

Ethics
Nominating*

David B. Lewis
Chairman,
Lewis, Clay & Munday

Audit*
Finance

John C. Marous
Retired Chairman and Chief Executive Officer,
Westinghouse Electric Corporation

Compensation
Finance

Gail J. McGovern
Executive Vice President, Consumer Markets
AT&T

Ethics

Raymond T. Schuler
Retired Vice Chairman, President, and
Chief Executive Officer,
The Business Council of New York State, Inc.

Audit
Nominating

David H. Swanson
President and Chief Executive Officer
Countrymark Cooperative, Inc.

Audit
Nominating

* *Committee Chair*

CORPORATE INFORMATION

Stock Transfer Agent and Registrar
First Chicago Trust Company of New York
P.O. Box 2500, Jersey City, NJ 07303-2500

Stock Exchange Listings
Conrail Inc. Common Stock is listed on the New York and Philadelphia stock exchanges. (The trading symbol is CRR).

Dividends
Common stock dividends of $.425 per share were declared on each of February 21, 1996 and May 15, 1996, and dividends of $.475 per share were declared on each of July 17, 1996 and November 20, 1996.

Shareholders
As of March 1, 1997, there were 18,377 holders of record of Conrail Inc. Common Stock.

Shareholder Investment Program
Conrail makes available a DirectSERVICE™ Shareholder Investment Program for current shareholders and any individual investors wishing to become Conrail shareholders. This program, which will contain a dividend reinvestment feature, provides other flexible options to meet a variety of individual investment objectives. For additional information related to this DirectSERVICE™ Program, interested individuals can contact First Chicago Trust Company of New York by dialing, toll free, 1-800-446-2617.

Conrail Shareholder Direct®
Conrail offers a corporate information service called Conrail Shareholder Direct® This service enables shareholders to listen to and receive copies of earnings and dividend information, recent press releases and other corporate information. Shareholders can access Conrail Shareholder Direct® at any time by dialing, toll free, 1-800-215-RAIL.

Shareholder Inquiries
Communications concerning stock transfer, dividend disbursement, change of address, loss of a stock certificate, or non-receipt of a dividend check should be directed to:
First Chicago Trust Company of New York
P.O. Box 2500, Jersey City, NJ 07303-2500
(201) 324-0498 http://www.fctc.com

All other inquiries should be directed to:
Office of the Corporate Secretary, Conrail Inc.
2001 Market Street, P.O. Box 41416
Philadelphia, PA 19101-1416
(215) 209-2000

Financial Investors and Security Analysts
Financial investors and analysts requiring interviews, financial reports, general information or any other publications should direct requests to:
Thomas J. Conroy, Assistant Treasurer, Conrail Inc.
2001 Market Street, P.O. Box 41407, Philadelphia, PA 19101-1407
(215) 209-5592

SEC Form 10-K
A copy of the Company's 1996 Annual Report on Form 10-K, filed with the Securities and Exchange Commission, may be obtained by contacting the Office of the Corporate Secretary.

Conrail Web Site
www.conrail.com

Annual Meeting
Friday, December 19, 1997, 9:30 A.M.

CONRAIL®

We are an equal employment opportunity/affirmative action employer committed to work force diversity. We select people for employment and promotion on the basis of their ability, without regard to race, color, religion, sex, age, sexual orientation, national origin or disability.

FORM 10-Q

Securities and Exchange Commission
Washington, D.C. 20549

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarter ended March 28, 1997

Commission File Number: 1-8022

CSX CORPORATION

(Exact name of registrant as specified in its charter)

Virginia	62-1051971
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

901 East Cary Street
Richmond, Virginia 23219
(Address of principal executive offices)
Registrant's telephone number, including area code (804) 782-1400

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of March 28, 1997: 217,662,928 shares.

CSX CORPORATION
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 28, 1997
INDEX

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CSX CORPORATION AND SUBSIDIARIES
Consolidated Statement of Earnings
(Millions of Dollars, Except Per Share Amounts)

	(Unaudited) Quarters Ended	
	March 28, 1997	March 29, 1996
Operating Revenue	$ 2,567	$ 2,514
Operating Expense	2,243	2,218
Operating Income	324	296
Other Income (Expense)	(7)	(12)
Interest Expense	84	60
Earnings before Income Taxes	233	224
Income Tax Expense	82	78
Net Earnings	$ 151	$ 146
Earnings Per Share	$ .70	$ .69
Average Common Shares Outstanding (Thousands)	217,227	210,964
Common Shares Outstanding (Thousands)	217,663	211,512
Cash Dividends Paid Per Common Share	$ .26	$ .26

See accompanying Notes to Consolidated Financial Statements.

CSX CORPORATION AND SUBSIDIARIES
Consolidated Statement of Cash Flows
(Millions of Dollars)

	(Unaudited) Quarters Ended	
	March 28, 1997	March 29, 1996
OPERATING ACTIVITIES		
Net Earnings	$ 151	$ 146
Adjustments to Reconcile Net Earnings to Net Cash Provided		
Depreciation	159	156
Deferred Income Taxes	17	14
Productivity/Restructuring Charge Payments	(15)	(23)
Other Operating Activities	14	(52)
Changes in Operating Assets and Liabilities		
Accounts Receivable	(23)	(20)
Other Current Assets	(3)	(38)
Accounts Payable	(89)	(58)
Other Current Liabilities	(14)	(156)
Net Cash Provided (Used) by Operating Activities	197	(31)
INVESTING ACTIVITIES		
Property Additions	(189)	(338)
Proceeds from Property Dispositions	3	24
Short-Term Investments - Net	41	(44)
Purchases of Long-Term Marketable Securities	(18)	–
Proceeds from Sales of Long-Term Marketable Securities	8	89
Other Investing Activities	(25)	12
Net Cash Used by Investing Activities	(180)	(257)
FINANCING ACTIVITIES		
Short-Term Debt - Net	(48)	284
Long-Term Debt Issued	5	57
Long-Term Debt Repaid	(51)	(120)
Dividends Paid	(57)	(55)
Other Financing Activities	3	3
Net Cash Provided (Used) by Financing Activities	(148)	169
Net Decrease in Cash and Cash Equivalents	(131)	(119)
CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS		
Cash and Cash Equivalents at Beginning of Period	368	320
Cash and Cash Equivalents at End of Period	237	201
Short-Term Investments at End of Period	273	380
Cash, Cash Equivalents and Short-Term Investments at End of Period	$ 510	$ 581

See accompanying Notes to Consolidated Financial Statements.

CSX CORPORATION AND SUBSIDIARIES
Consolidated Statement of Financial Position
(Millions of Dollars)

	(Unaudited) March 28, 1997	December 27, 1996
ASSETS		
Current Assets		
Cash, Cash Equivalents and Short-Term Investments	$ 510	$ 682
Accounts Receivable	924	894
Materials and Supplies	243	229
Deferred Income Taxes	145	139
Other Current Assets	119	128
Total Current Assets	1,941	2,072
Properties-Net	11,924	11,906
Investment in Conrail	1,955	1,965
Affiliates and Other Companies	362	345
Other Long-Term Assets	706	677
Total Assets	$ 16,888	$ 16,965
LIABILITIES		
Current Liabilities		
Accounts Payable	$ 1,053	$ 1,189
Labor and Fringe Benefits Payable	444	499
Casualty, Environmental and Other Reserves	298	306
Current Maturities of Long-Term Debt	143	101
Short-Term Debt	287	335
Other Current Liabilities	346	327
Total Current Liabilities	2,571	2,757
Casualty, Environmental and Other Reserves	716	715
Long-Term Debt	4,243	4,331
Deferred Income Taxes	2,743	2,720
Other Long-Term Liabilities	1,488	1,447
Total Liabilities	11,761	11,970
SHAREHOLDERS' EQUITY		
Common Stock, $1 Par Value	218	217
Other Capital	1,470	1,433
Retained Earnings	3,546	3,452
Minimum Pension Liability	(107)	(107)
Total Shareholders' Equity	5,127	4,995
Total Liabilities and Shareholders' Equity	$ 16,888	$ 16,965

See accompanying Notes to Consolidated Financial Statements.

CSX CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)
(All Tables in Millions of Dollars, Except Per Share Amounts)

NOTE 1. BASIS OF PRESENTATION

In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary to present fairly the company's financial position as of March 28, 1997 and December 27, 1996, the results of its operations and its cash flows for the quarters ended March 28, 1997 and March 29, 1996, such adjustments being of a normal recurring nature.

Earnings per share are based on the weighted average of common shares outstanding for the quarters ended March 28, 1997 and March 29, 1996. Dilution for these periods, which could result if all outstanding common stock equivalents were exercised, is not significant.

While the company believes that the disclosures presented are adequate to make the information not misleading, it is suggested that these financial statements be read in conjunction with the financial statements and the notes included in the company's latest Annual Report and Form 10-K.

Beginning with the quarter ended June 28, 1996, the company changed its earnings presentation to exclude non-transportation activities from operating revenue and expense. These activities, principally real estate and resort operations, are now included in "Other Income (Expense)." Prior-year data have been reclassified to conform to the new presentation.

NOTE 2. FISCAL REPORTING PERIODS

The company's fiscal year is composed of 52 weeks ending on the last Friday in December. The financial statements presented are for the 13-week quarters ended March 28, 1997 and March 29, 1996, and the fiscal year ended December 27, 1996.

NOTE 3. ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board (FASB) has issued Statement No. 128 "Earnings per Share," which establishes new guidelines for the calculation of and disclosures regarding earnings per share. The company will adopt the provisions of Statement No. 128 during the fourth quarter of 1997 and at that time will be required to present basic and diluted earnings per share and to restate all prior periods. There will be no impact on the calculation of basic earnings per share for the quarters ended March 28, 1997 and March 29, 1996. Diluted earnings per share is not expected to differ materially from basic earnings per share.

The FASB also issued Statement No. 129 "Disclosure of Information About Capital Structure," which the company will adopt during the fourth quarter of 1997. The company does not expect that adoption of the disclosure requirements of this pronouncement will have a material impact on its financial statements.

NOTE 4. JOINT ACQUISITION OF CONRAIL, INC.

At March 28, 1997, the company held shares equivalent to approximately 19.9% of the aggregate outstanding common and ESOP Preferred stock (the Conrail shares) of Conrail, Inc. (Conrail). The shares were acquired in November 1996 pursuant to a merger agreement entered into by the two companies in October 1996 and subsequent tender offer. The merger agreement was subsequently modified, including an amendment on March 7, 1997 to increase the price to be paid for the remaining outstanding Conrail shares to $115 cash per share and to permit the company to negotiate with Norfolk Southern Corporation (Norfolk Southern) on a division of the Conrail rail system. On April 8, 1997, the company and Norfolk Southern announced an agreement to form a jointly-owned entity to acquire all outstanding Conrail shares for $115 cash per share. The agreement provides for the company to contribute $4.3 billion for its 42% share of the acquisition and for Norfolk Southern to contribute $5.9 billion for its 58% share, including the investments already held by each company. The jointly-owned entity is expected to complete its tender offer for the remaining Conrail shares in May 1997 and to place all Conrail shares in a voting trust pending approval of the proposed transaction by the Surface Transportation Board (STB). The joint STB application is expected to be filed shortly after acquisition of the remaining Conrail shares is completed.

At March 28, 1997, the company has accounted for its 19.9% investment in Conrail using the cost method. Upon acquiring its additional interest in Conrail through the jointly-owned entity and until STB approval and release of the Conrail shares from the voting trust, the company will account for the investment using the equity method.

During the quarter ended March 28, 1997, the company incurred net costs before income taxes of $24 million with respect to its investment in Conrail shares. These net costs, principally interest on debt issued to acquire the investment less dividends received on the shares, reduced net earnings by $16 million, 7 cents per share.

NOTE 5. ACCOUNTS RECEIVABLE

The company has sold, directly and through Trade Receivables Participation Certificates (Certificates), ownership interests in designated pools of accounts receivable originated by CSX Transportation, Inc. (CSXT), its rail unit.

During 1993, $200 million of Certificates were issued at 5.05%, due September 1998. The Certificates represent undivided interests in a master trust holding an ownership interest in a revolving pool of rail freight accounts receivable. At March 28, 1997 and December 27, 1996, the Certificates were collateralized by $249 million and $248 million, respectively, of accounts receivable held in the master trust.

In addition, the company has a revolving agreement with a financial institution to sell with recourse on a monthly basis an undivided percentage ownership interest in designated pools of freight and other accounts receivable. The agreement provides for the sale of up to $200 million in accounts receivable and expires in September 1998.

The company has retained the responsibility for servicing and collecting accounts receivable held in trust or sold. At March 28, 1997 and December 27, 1996, accounts receivable have been reduced by $372 million, representing Certificates and accounts receivable sold. The net costs associated with sales of Certificates and receivables were $7 million for each of the quarters ended March 28, 1997 and March 29, 1996.

The company adopted FASB Statement No. 125 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" during the first quarter of 1997. Adoption of the pronouncement, which established new guidelines for accounting and disclosure related to transfers of trade accounts receivable and other financial assets, did not have a material impact on the company's financial statements.

(All Tables in Millions of Dollars, Except Per Share Amounts)

NOTE 6. OPERATING EXPENSE

	Quarters Ended	
	March 28, 1997	March 29, 1996
Labor and Fringe Benefits	$ 795	$ 794
Materials, Supplies and Other	614	618
Building and Equipment Rent	284	289
Inland Transportation	237	229
Depreciation	156	153
Fuel	157	135
Total	$ 2,243	$ 2,218

NOTE 7. OTHER INCOME (EXPENSE)

	Quarters Ended	
	March 28, 1997	March 29, 1996
Interest Income	$ 12	$ 12
Income from Real Estate and Resort Operations[1]	(7)	(8)
Net Costs for Accounts Receivable Sold	(7)	(7)
Minority Interest	(10)	(8)
Net Loss on Investment Transactions	-	(2)
Equity Earnings of Other Affiliates	1	2
Income from Investment in Conrail - Net	5	-
Miscellaneous	(1)	(1)
Total	$ (7)	$ (12)

[1] Gross revenue from real estate and resort operations was $17 million and $13 million for the quarters ended March 28, 1997 and March 29, 1996, respectively.

NOTE 8. COMMITMENTS AND CONTINGENCIES

Although the company obtains substantial amounts of commercial insurance for potential losses for third-party liability and property damage, reasonable levels of risk are retained on a self-insurance basis. A portion of the insurance coverage, $25 million limit above $100 million per occurrence from rail and certain other operations, is provided by a company partially owned by CSX.

The company has been advised that activities of a subsidiary that administered student loans and that was sold by the company in 1992 are under review to determine whether, and to what extent, damages should be asserted against the company for government insurance payments on uncollected loans related to alleged processing deficiencies or errors that may have occurred prior to the time the subsidiary was sold. The company believes it has no material liability for any claim that might be asserted, but the final outcome of the review and the amount of potential damages are not yet reasonably estimable. Based upon information currently available to the company, it is believed any adverse outcome will not be material to the company's results of operations or financial position.

CSXT is a party to various proceedings involving private parties and regulatory agencies related to environmental issues. CSXT has been identified as a potentially responsible party (PRP) at approximately 111 environmentally impaired sites that are or may be subject to remedial action under the Federal Superfund statute (Superfund) or similar state statutes. A number of these proceedings are based on allegations that CSXT, or its railroad predecessors, sent hazardous substances to the facilities in question for disposal. Such proceedings arising under Superfund or similar state statutes can involve numerous other waste generators and disposal companies and seek to allocate or recover costs associated with site investigation and cleanup, which could be substantial.

CSXT is involved in a number of administrative and judicial proceedings and other clean-up efforts at approximately 271 sites, including the sites addressed under the Federal Superfund statute or similar state statutes, at which it is participating in the study and/or clean-up of alleged environmental contamination. The assessment of the required response and remedial costs associated with most sites is extremely complex. Cost estimates are based on information available for each site, financial viability of other PRPs, where available, and existing technology, laws and regulations. CSXT's best estimates of the allocation method and percentage of liability when other PRPs are involved are based on assessments by consultants, agreements among PRPs, or determinations by the U.S. Environmental Protection Agency or other regulatory agencies.

At least once each quarter, CSXT reviews its role, if any, with respect to each such location, giving consideration to the nature of CSXT's alleged connection to the location (e.g., generator, owner or operator), the extent of CSXT's alleged connection (e.g., volume of waste sent to the location and other relevant factors), the accuracy and strength of evidence connecting CSXT to the location, and the number, connection and financial position of other named and unnamed PRPs at the location. The ultimate liability for remediation can be difficult to determine with certainty because of the number and creditworthiness of PRPs involved. Through the assessment process, CSXT monitors the creditworthiness of such PRPs in determining ultimate liability.

Based upon such reviews and updates of the sites with which it is involved, CSXT has recorded, and reviews at least quarterly for adequacy, reserves to cover estimated contingent future environmental costs with respect to such sites. The recorded liabilities for estimated future environmental costs at March 28, 1997, and December 27, 1996, were $115 million and $117 million, respectively. These recorded liabilities include amounts representing CSXT's estimate of unasserted claims, which CSXT believes to be immaterial. The liability has been accrued for future costs for all sites where the company's obligation is probable and where such costs can be reasonably estimated. The liability includes future costs for remediation and restoration of sites as well as any significant ongoing monitoring costs, but excludes any anticipated insurance recoveries. The majority of the March 28, 1997 environmental liability is expected to be paid out over the next five to seven years, funded by cash generated from operations.

The company does not currently possess sufficient information to reasonably estimate the amounts of additional liabilities, if any, on some sites until completion of future environmental studies. In addition, latent conditions at any given location could result in exposure, the amount and materiality of which cannot presently be reliably estimated. Based upon information currently available, however, the company believes that its environmental reserves are adequate to accomplish remedial actions to comply with present laws and regulations, and that the ultimate liability for these matters will not materially affect its overall results of operations and financial condition.

A number of legal actions, other than environmental, are pending against CSX and certain subsidiaries in which claims are made in substantial amounts. While the ultimate results of environmental investigations, lawsuits and claims involving the company cannot be predicted with certainty, management does not currently expect that resolution of these matters will have a material adverse effect on the consolidated financial position, results of operations and cash flows of the company.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

On April 8, 1997, the company and Norfolk Southern entered into an agreement providing for the joint acquisition and division of Conrail. This landmark agreement is outlined in more detail under "Joint CSX/Norfolk Southern Acquisition of Conrail" in this section.

RESULTS OF OPERATIONS

The company reported net earnings for the quarter ended March 28, 1997, of $151 million, 70 cents per share, versus net earnings of $146 million, 69 cents per share, for the same period in 1996. Net earnings for the quarter rose 3% over the 1996 first quarter results.

Excluding net costs of $24 million pretax and $16 million after tax relating to CSX's 19.9% investment in Conrail, earnings would have been $167 million, 77 cents per share, for the 1997 quarter. These costs were principally interest on debt issued to acquire the investment, less dividends received on the Conrail stock.

Operating revenue for the first quarter of 1997 rose to $2.6 billion, vs. $2.5 billion in the 1996 period. Operating expense of $2.2 billion remained level with the prior-year quarter. Operating income was $324 million, 9% higher than 1996's first quarter.

Rail Unit Results

The company's rail unit achieved record quarterly operating income of $282 million, 19% above last year's first quarter, and 15% above the prior first-quarter record set in 1995. Total rail operating revenue of $1.25 billion exceeded 1996's weather-affected first-quarter results by $52 million.

Shipments of coal, the unit's largest commodity, rose 9% to 41.5 million tons, reflecting higher utility coal traffic. Coal revenue increased 5% over 1996. Total merchandise traffic rose 4%, due to strong demand overall. Major contributors to the increase included: autos and parts (up 14%); minerals (up 11%); metals (up 9%) and chemicals (up 6%).

Rail operating expense for the quarter increased 1% to $965 million.

RAIL OPERATING INCOME
(Millions of Dollars)

	Quarters Ended March 28, 1997	Quarters Ended March 29, 1996	Percent Change
Operating Revenue			
Merchandise	$ 826	$ 789	5 %
Coal	389	370	5 %
Other	32	36	(11)%
Total	1,247	1,195	4 %
Operating Expense	965	959	1 %
Operating Income	$ 282	$ 236	19 %
Operating Ratio	77.4%	80.3%	

RESULTS OF OPERATIONS, Continued

Container Shipping Unit Results

Despite ongoing rate pressures in major trade lanes, the container-shipping unit achieved its second-best first quarter. Operating income totaled $41 million, compared with 1996's first-quarter record $52 million. During the quarter, the unit continued to focus on stringent cost control and productivity improvements.

Strength in global trade resulted in a 10% increase in total volume - 33% in the Americas trade lane, 16% in the Asia/Middle East/Europe (A.M.E.), and 14% in the Atlantic. Operating revenue declined 1% over the prior-year quarter to $1 billion, reflecting rate pressures in the major trade lanes.

While handling greater volume, operating expense of $909 million was held level with the 1996 period. This reflects the combined benefits of cost-cutting measures to date and strategic initiatives.

Other Unit Results

Performance at the company's barge unit was significantly affected by adverse weather conditions along the river system. The unit's first-quarter operating income totaled $2 million, compared with last year's record of $18 million. Severe flooding and ice resulted in increased operating costs and reduced shipments. Traffic is expected to rebound when the flooding subsides.

The company's intermodal unit achieved operating income of $5 million, vs. $3 million in the 1996 quarter. Although revenue decreased 3% due to changes in traffic mix, better margins were achieved as a result of network redesign and rationalization measures implemented in 1996.

The contract logistics unit continued its rapid growth, with revenue rising 30% to $92 million and operating income reaching $6 million.

FINANCIAL CONDITION

Cash, cash equivalents and short-term investments totaled $510 million at March 28, 1997, a decrease of $172 million since December 27, 1996. The primary source of cash and cash equivalents during the quarter was business operations. Cash and cash equivalents were primarily used by property additions, repayment of long-term debt, and payment of dividends.

During the first quarter of 1997, net investing activities consumed $180 million of cash and cash equivalents compared with $257 million consumed in the first quarter of 1996. The change in cash used by investing activities was primarily due to lower property additions compared to the quarter ended March 29, 1996.

Financing activities used $148 million of cash and cash equivalents for the quarter ended March 28, 1997, a $317 million increase from 1996's first quarter. The change was primarily due to a reduction in short-term debt levels.

The working capital deficit decreased $55 million during the quarter ended March 28, 1997. The decrease was primarily due to reductions in accounts payable and labor and fringe benefits payable, partially offset by a decrease in cash, cash equivalents and short-term investments. A working capital deficit is not unusual for the company and does not indicate a lack of liquidity. The company continues to maintain adequate current assets to satisfy current liabilities when they are due and has sufficient liquidity and financial resources to manage its day-to-day cash needs.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION, CONTINUED

FINANCIAL DATA

	(Millions of Dollars)	
	March 28, 1997	December 27, 1996
Cash, Cash Equivalents and Short-Term Investments	$ 510	$ 682
Commercial Paper Outstanding - Short-Term	287	335
Commercial Paper Outstanding - Long-Term	2,300	2,300
Working Capital (Deficit)	(630)	(685)
Current Ratio	0.8	0.8
Debt Ratio	45 %	46 %
Ratio of Earnings to Fixed Charges	2.8 x	4.0 x

OUTLOOK

Each of the company's transportation units anticipates overall favorable performance over the remainder of 1997, compared to 1996. The company expects modest economic growth and robust demand for transportation services. CSX also plans to remain focused on customer service, safety and cost control throughout its units in order to enhance core earning power and increase shareholder returns.

Following on its record first quarter results, the rail unit expects to continue on that same positive trend into the second quarter. Revenue is expected to improve in 1997 propelled by strength in merchandise and coal traffic. The rail unit, through the National Carriers Conference Committee, now has agreements with all labor organizations signed and in effect.

The container-shipping unit anticipates increased volume and permanent cost reductions to mitigate the difficult rate environment. Improving the mix of higher margin freight will remain an ongoing priority.

The barge unit will closely monitor the weather situation as it will continue to have a negative impact on its operations in the second quarter. The intermodal unit forecasts overall improvement compared to prior year levels attributable to its network redesign implemented in 1996. The contract logistics company expects its growth to continue throughout the year, based upon increased demand for its services.

JOINT CSX/NORFOLK SOUTHERN ACQUISITION OF CONRAIL

CSX/Norfolk Southern Agreement

On April 8, 1997, the company and Norfolk Southern Corporation entered into an agreement providing for their joint acquisition of Conrail and the division of its routes and other assets. Conrail is a holding company of which the principal subsidiary is Consolidated Rail Corporation, a Class I freight railroad that operates approximately 10,500 route miles in the Northeast and Midwest of the United States and the Province of Quebec, Canada, and which possesses superior access to certain major northeast markets, including the New York and Boston metropolitan areas. Norfolk Southern owns an eastern Class I freight railroad, Norfolk Southern Railway Company.

Under the CSX/Norfolk Southern agreement, the company and Norfolk Southern will acquire all outstanding shares of Conrail not already owned by them for $115 in cash per share through a jointly-owned acquisition entity. The company and Norfolk Southern will each possess 50% of the voting and management rights of the acquisition entity, and non-voting equity will be apportioned between the parties to achieve overall economic allocations of 42% for CSX and 58% for Norfolk Southern. Following approval by the STB as described below, Conrail's assets will be segregated within Conrail, and the company and Norfolk Southern will each benefit from the operation of a specified portion of the Conrail routes and other assets through the use of various operating arrangements, and certain Conrail assets will be operated for the joint benefit of the company and Norfolk Southern.

The acquisition of the Conrail shares will be effected under a pending tender offer initiated by the company in December 1996 and amended in April 1997 to include Norfolk Southern as a co-bidder (the joint tender offer) and a subsequent cash merger. The estimated aggregate cost of the joint tender offer, the merger and the shares of Conrail already acquired by the company and Norfolk Southern is approximately $10.2 billion. Pursuant to the CSX/Norfolk Southern agreement, the company will bear 42%, or approximately $4.3 billion, and Norfolk Southern will bear 58%, or approximately $5.9 billion, of such cost. These totals include approximately $2 billion previously spent by the company and $1 billion previously spent by Norfolk Southern to acquire approximately 30%, in aggregate, of Conrail's shares.

The scheduled closing for the joint tender offer for the remaining outstanding Conrail shares is May 23, 1997. However, the closing may be extended, to a date not later than June 2, 1997, if certain conditions in the original merger agreement, dated as of October 14, 1996 by and among Conrail, the company and Green Acquisition Corp. (a wholly-owned subsidiary of the company), as amended, are satisfied. The joint tender offer is not subject to any financing condition but is conditioned, among other things, on the valid tender of shares constituting, together with Conrail shares already owned by CSX and Norfolk Southern, at least a majority of the outstanding Conrail shares on a fully-diluted basis. Conrail shares purchased in the joint tender offer will, together with all Conrail shares previously purchased by the company and Norfolk Southern, be deposited into a voting trust pending STB approval of the joint acquisition, control and division of Conrail. Upon closing, the joint tender offer will be followed by a merger in which all Conrail Shares not tendered for purchase in the joint tender offer will be converted into the right to receive $115 per share in cash.

Joint CSX/Norfolk Southern STB Application

While the obligation to purchase Conrail shares by the company and Norfolk Southern in the joint tender offer is not subject to any regulatory condition, the exercise of control over Conrail by the acquiring companies remains subject to a number of conditions and approvals, including approval by the STB, which has the authority to modify contract terms and impose additional conditions, including with respect to divestitures, grants of trackage rights and other terms of continuing operations. Subject to the STB's authorization of an accelerated filing date, the company and Norfolk Southern plan to file a joint application with the STB in June 1997 for control and division of Conrail and for such other matters as may be required to be approved by the STB. The joint STB application will address traffic flows, operations and related matters; will outline the capital investments each company plans to make in new connections and facilities and to increase capacity on critical routes; and will detail operating savings and other public benefits resulting from the transaction. The application also will contain certain historical and pro forma financial information required by the STB. The company and Norfolk Southern have asked the STB to consider the joint application on an expedited schedule that would result in an STB decision in early 1998. Under current law, the STB must rule within approximately sixteen months from the filing date of the joint application. No assurance can be given with respect to the receipt of STB approval or the modifications or conditions that may be imposed in connection therewith.

Proposed Division of Conrail Routes

Until the date the company and Norfolk Southern are permitted by the STB to assume control over Conrail (the Control Date), Conrail will continue to be managed by its current Board of Directors and management. After the Control Date, Conrail will segregate its assets primarily into two groups to facilitate their separate operation pursuant to leasing, operating, partnership or other similar arrangements. The remaining assets and liabilities of Conrail, including joint facilities, generally will either be shared or allocated ratably between the company and Norfolk Southern according to their respective 42% and 58% economic allocations. In arriving at the proposed division of Conrail and these percentages, the acquiring companies negotiated with a view toward producing the best fits with their existing systems and optimizing service to their respective customers.

The acquisition by the company of the Conrail shares and the right to use the assets allocated to or shared by the company pursuant to the CSX/Norfolk Southern agreement and the liabilities allocated to or shared by it pursuant to that agreement will be hereinafter referred to as the "Transaction." Many of the terms of the Transaction will be detailed in further definitive documentation that is currently being negotiated between CSX and Norfolk Southern.

For additional information regarding the Transaction and the CSX/Norfolk Southern agreement, reference is made to the company's Tender Offer Statement on Schedule 14D-1, together with exhibits thereto, initially filed with the Securities and Exchange Commission on December 6, 1996, as amended. In addition, pursuant to the Securities Exchange Act of 1934, the company will be required to file under cover of Form 8-K certain historical financial statements and pro forma financial statements giving effect to the Transaction no later than 75 days after the consummation of the joint tender offer.

Financing Arrangements

The company estimates that it will require $2.3 billion to purchase its portion of the outstanding Conrail shares pursuant to the joint tender offer. The company paid approximately $2 billion to acquire about 20% of Conrail's shares in November 1996. At that time, the company arranged a five-year $4.8 billion bank credit facility to finance an acquisition of Conrail and to meet general working capital needs. The company intends to utilize the capital markets to raise substantially all of the remaining funds needed for its contribution under the joint tender offer. Those securities will be sold in private placements and will not be registered under the Securities Act of 1933. Therefore, such securities may not be offered or sold in the United States without registration or exemption.

Such financings are expected to result in the company's having outstanding a combination of long-term debt with staggered maturities, trust preferred securities and commercial paper. The company expects its long-term debt levels (including the company's portion of Conrail debt and excluding trust preferred securities) to peak in 1998 at approximately $6.5 billion, with related interest charges (including interest payments on the company's portion of Conrail debt) to peak at approximately $500 million. While definitive documentation is not complete, the company and Norfolk Southern contemplate that payments to Conrail under operating or similar arrangements and through capital contributions to the jointly-owned acquisition entity will be sufficient to pay obligations on Conrail's outstanding debt instruments. The agreement between the company and Norfolk Southern provides that such debt will be shared ratably according to their respective 42% and 58% percentages.

Broadest Geographic Network in Eastern United States

The Transaction will significantly enhance the company's position as a leading global transportation company. The company will remain the largest railroad in the eastern United States and become the third largest railroad in the nation, measured in terms of route miles and ton-miles.

The company, as a result of the Transaction, will be adding approximately 3,500 route miles, or 19%, to its rail network, and sharing with Norfolk Southern approximately 1,200 additional route miles. The company will have approximately 22,000 route miles in 22 states, the District of Columbia, and the Provinces of Ontario and Quebec, Canada, and will provide direct access to virtually every major metropolitan area east of the Mississippi River and to eleven of the largest east coast and gulf ports.

Enhanced Operating Efficiencies and Revenue Growth

Management expects the integration of Conrail operations resulting from the Transaction to add approximately $1.6 billion, or 15%, to the company's annual revenue beginning in the first twelve months following consolidation. Management believes that the Transaction will also result in growth of the company's rail revenue base through expansion of single-line service and the company's ability to compete more effectively on certain routes along which large quantities of goods are now transported by truck. Single-line service is preferred by shippers over joint-line service because of lower transaction costs, reduced delays, less damage from interchange operations and single-carrier accountability. The addition of Conrail lines to the company's rail network also will improve operational efficiency through better asset utilization. Optimization of train sizes, increased length of haul, improved backhauls, shorter routes to many destinations and fewer empty movements are all expected to produce cost reductions for the combined rail network. Other significant savings will be achieved through the realization of economies of scale, rationalization of administrative and other overhead expenses and consolidation of duplicative facilities. Specific plans for achieving these cost savings following the Control Date are currently under development and will be more specifically identified in the STB application.

Financial Effects

The company expects that the benefits from the Transaction will begin to build from the Control Date and should be largely realized within a three-year period thereafter. It is anticipated that STB approval will be granted in early 1998. Therefore, for the purposes of the following discussion, Year 1, Year 2 and Year 3 roughly correspond to 1998, 1999 and 2000, respectively. Based on joint efforts of the company and Conrail to identify potential cost savings, management currently estimates that the Transaction will lead to quantifiable pre-tax benefits from increased traffic and cost efficiencies of approximately $75 million, $170 million and $240 million annually in Years 1, 2 and 3, respectively, compared to the separate operation of the company and its share of Conrail. These benefits include estimated incremental operating income of $25 million, $54 million and $75 million expected through increased traffic in Years 1, 2 and 3, respectively. The remaining pre-tax benefits will be in the form of operating cost savings, with $50 million, $116 million and $165 million expected to be realized in Years 1, 2 and 3, respectively. Further, management expects a reduction in the requirement for annual capital expenditures of approximately $12 million, $28 million and $40 million in Years 1, 2 and 3, respectively.

Management estimates that the company will, in Years 1 and 2, incur one-time transitional capital expenditures in connection with the integration of operations. Those are expected to be $310 million in Year 1 and $178 million in Year 2.

The overall purchase price paid by the company is expected to exceed the historical book value of the net Conrail assets acquired by the company by approximately $3.5 billion. Although purchase accounting adjustments will not be finalized until the Transaction is completed, a substantial portion of the excess purchase price is expected to be allocated to specific assets and liabilities acquired, with the remainder allocated to goodwill. On an aggregate basis, the excess purchase price is expected to be amortized over a period of approximately 40 years.

Because of the time required to obtain necessary regulatory and other approvals, the company does not expected integrated operations to have a significant effect on operating and financial results prior to fiscal 1998. The primary impact of the proposed Transaction on net earnings prior to the integration of operations is likely to be the after-tax effect of the company's share of Conrail's net earnings, reported under the equity method of accounting, less interest on debt incurred to acquire and hold Conrail shares. Net cash flow prior to operational integration is expected to be reduced by interest payments on such debt, partially offset by Conrail dividends. The average interest rate in 1996 on debt incurred to acquire Conrail shares was approximately 5.6%. The degree of negative impact on net earnings and net cash flow during 1997 will depend primarily on the net earnings reported by Conrail and the average interest rate and timing of interest payments on the related debt.

THE ABOVE ESTIMATES AND FORECASTS ARE BASED UPON NUMEROUS ESTIMATES AND ASSUMPTIONS ABOUT COMPLEX ECONOMIC AND OPERATING FACTORS WITH RESPECT TO INDUSTRY PERFORMANCE, GENERAL BUSINESS AND ECONOMIC CONDITIONS AND OTHER MATTERS THAT CANNOT BE PREDICTED ACCURATELY AND THAT ARE SUBJECT TO CONTINGENCIES OVER WHICH THE COMPANY HAS NO CONTROL. SUCH FORWARD LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER IMPORTANT FACTORS THAT COULD CAUSE THE ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS OF THE COMPANY TO DIFFER MATERIALLY FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD LOOKING STATEMENTS. CERTAIN OF THOSE RISKS, UNCERTAINTIES AND OTHER IMPORTANT FACTORS THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY INCLUDE: (A) FUTURE ECONOMIC CONDITIONS IN THE MARKETS IN WHICH THE COMPANY AND CONRAIL OPERATE; (B) FINANCIAL MARKET CONDITIONS; (C) INFLATION RATES; (D) CHANGING COMPETITION; (E) CHANGES IN THE ECONOMIC REGULATORY CLIMATE IN THE UNITED STATES RAILROAD INDUSTRY; (F) THE ABILITY TO ELIMINATE DUPLICATIVE ADMINISTRATIVE FUNCTIONS; AND (G) ADVERSE CHANGES IN APPLICABLE LAWS, REGULATIONS OR RULES GOVERNING ENVIRONMENTAL, TAX OR ACCOUNTING MATTERS. THESE FORWARD LOOKING STATEMENTS SPEAK ONLY AS OF THE DATE OF THIS FILING. THE COMPANY DISCLAIMS ANY OBLIGATION OR UNDERTAKING TO DISSEMINATE ANY UPDATES OR REVISIONS TO ANY FORWARD LOOKING STATEMENT CONTAINED HEREIN TO REFLECT ANY CHANGE IN THE COMPANY'S EXPECTATIONS WITH REGARD THERETO OR ANY CHANGE IN EVENTS, CONDITIONS OR CIRCUMSTANCES ON WHICH ANY SUCH STATEMENT IS BASED.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

1. (10.1) 1987 Long-Term Performance Stock Plan

2. (27) Financial Data Schedule

(b) Reports on Form 8-K

1. None.

Signature

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

CSX CORPORATION
(Registrant)

By: /s/JAMES L. ROSS
James L. Ross
Vice President and Controller
(Principal Accounting Officer)

Dated: April 24, 1997

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended **MARCH 31, 1997**

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from -------- to --------

Commission file number 1-8339

NORFOLK SOUTHERN CORPORATION

(Exact name of registrant as specified in its charter)

Virginia	**52-1188014**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
Three Commercial Place Norfolk, Virginia	**23510-2191**
(Address of principal executive offices)	Zip Code

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

No Change

(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. (X) Yes ( ) No

The number of shares outstanding of each of the registrant's classes of Common Stock, as of the last practicable date:

Class	Outstanding as of April 30, 1997
Common Stock (par value $1.00)	125,454,372 shares (excluding 7,252,634 shares held by registrant's consolidated subsidiaries)

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES (NS)

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Consolidated Statements of Income
(In millions of dollars except per share amounts)
(Unaudited)

	Three Months Ended March 31, 1997	Three Months Ended March 31, 1996
TRANSPORTATION OPERATING REVENUES:		
Railway:		
Coal	$ 326.1	$ 323.8
General merchandise	594.2	574.1
Intermodal	125.7	118.8
Total railway	1,046.0	1,016.7
Motor carrier (Note 6)	203.7	198.3
Total transportation operating revenues	1,249.7	1,215.0
TRANSPORTATION OPERATING EXPENSES:		
Railway:		
Compensation and benefits	361.9	377.3
Materials, services and rents	169.4	151.9
Depreciation	102.9	100.3
Diesel fuel	62.7	55.4
Casualties and other claims	29.0	34.7
Other	38.6	35.2
Total railway	764.5	754.8
Motor carrier (Note 6)	199.6	199.2
Total transportation operating expenses	964.1	954.0
Income from operations	285.6	261.0
Other income (expense):		
Interest income	6.3	5.8
Interest expense on debt (Note 4)	(38.4)	(27.6)
Charge for credit facility costs (Note 3)	(77.2)	--
Other - net	22.2	27.6
Total other income (expense)	(87.1)	5.8
Income before income taxes	198.5	266.8
Provision for income taxes	70.7	98.7
NET INCOME	$ 127.8	$ 168.1
Per share amounts (Note 5):		
Net income	$ 1.02	$ 1.31
Dividends	0.60	0.56

See accompanying notes to consolidated financial statements.

Item 1. Financial Statements. (continued)

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets
(In millions of dollars)
(Unaudited)

	March 31, 1997	December 31, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 139.5	$ 209.2
Short-term investments	185.7	194.2
Accounts receivable - net	748.7	704.3
Materials and supplies	64.8	63.0
Deferred income taxes	139.5	158.9
Other current assets	108.8	127.2
Total current assets	1,387.0	1,456.8
Investments (Note 2)	1,266.1	274.7
Properties less accumulated depreciation	9,677.6	9,529.1
Other assets (Note 3)	101.6	155.8
TOTAL ASSETS	$ 12,432.3	$ 11,416.4
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short-term debt	$ 27.2	$ 44.0
Accounts payable	679.0	708.9
Income and other taxes	217.7	178.7
Other current liabilities	161.9	202.7
Current maturities of long-term debt	56.0	56.0
Total current liabilities	1,141.8	1,190.3
Long-term debt (Note 4)	2,843.6	1,800.3
Other liabilities	959.7	987.1
Minority interests	49.7	49.5
Deferred income taxes	2,392.5	2,411.6
TOTAL LIABILITIES	7,387.3	6,438.8
Stockholders' equity:		
Common stock $1.00 per share par value	132.7	132.4
Additional paid in capital	488.1	462.1
Retained income	4,444.8	4,403.7
Less treasury stock at cost, 7,252,634 shares	(20.6)	(20.6)
TOTAL STOCKHOLDERS' EQUITY	5,045.0	4,977.6
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 12,432.3	$ 11,416.4

See accompanying notes to consolidated financial statements.

Item 1. Financial Statements. (continued)

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In millions of dollars)
(Unaudited)

	Three Months Ended March 31, 1997	Three Months Ended March 31, 1996
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 127.8	$ 168.1
Reconciliation of net income to net cash provided by operating activities:		
Charge for credit facility costs (Note 3)	77.2	--
Depreciation	107.8	105.6
Deferred income taxes	7.5	13.9
Nonoperating gains and losses on properties and investments	(10.4)	(15.9)
Changes in assets and liabilities affecting operations:		
Accounts receivable	(44.4)	(31.1)
Materials and supplies	(1.8)	(2.3)
Other current assets	7.2	12.1
Current liabilities other than debt	18.7	67.7
Other - net	(18.2)	2.4
Net cash provided by operating activities	271.4	320.5
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property additions (Note 4)	(229.5)	(163.0)
Property sales and other transactions	17.5	24.0
Investment in Conrail	(959.2)	--
Investments, including short-term	(119.2)	(83.4)
Investment sales and other transactions	102.8	81.5
Net cash used for investing activities	(1,187.6)	(140.9)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividends	(75.1)	(71.9)
Common stock issued - net	9.7	11.2
Purchase and retirement of common stock	--	(108.6)
Commercial paper proceeds (Note 4)	993.1	--
Credit facility costs paid (Note 3)	(70.9)	--
Proceeds from long-term borrowings (Note 4)	1.2	5.6
Debt repayments	(11.5)	(11.8)
Net cash provided by (used for) financing activities	846.5	(175.5)
Net increase (decrease) in cash and cash equivalents	(69.7)	4.1
CASH AND CASH EQUIVALENTS:*		
At beginning of year	209.2	67.7
At end of period	$ 139.5	$ 71.8

Item 1. Financial Statements. (continued)

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In millions of dollars)
(Unaudited)

	Three Months Ended March 31, 1997	1996
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest (net of amounts capitalized)	$ 52.2	$ 43.1
Income taxes	$ 4.3	$ 2.7

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

See accompanying notes to consolidated financial statements.

Item 1. Financial Statements. (continued)

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements

1. In the opinion of Management, the accompanying unaudited interim financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position as of March 31, 1997, and the results of operations and cash flows for the three months ended March 31, 1997, and 1996.

   While Management believes that the disclosures presented are adequate to make the information not misleading, these consolidated financial statements should be read in conjunction with the financial statements and notes included in the Corporation's latest Annual Report on Form 10-K.

2. Commitments and Contingencies

   Except as discussed below, there have been no significant changes since year-end 1996 in the matters as discussed in NOTE 15, COMMITMENTS AND CONTINGENCIES, and NOTE 16, EVENTS SUBSEQUENT TO THE DATE OF THE INDEPENDENT AUDITORS' REPORT-CONRAIL DEVELOPMENTS, appearing in the NS Annual Report on Form 10-K for 1996, Notes to Consolidated Financial Statements, beginning on page 76.

   JOINT ACQUISITION OF CONRAIL INC. (CONRAIL)

   On February 11, 1997, pursuant to its tender offer as then amended, NS purchased 8.2 million Conrail shares at $115 in cash per share, or $943 million in the aggregate.

   On April 8, 1997, NS and CSX Corporation (CSX) entered into an agreement ("Agreement") providing for a joint acquisition of Conrail. The two companies will form a jointly owned entity to acquire all outstanding shares of Conrail, not currently held by NS or CSX, for $115 in cash per share, pursuant to a tender offer scheduled to expire May 23, 1997, followed by a second-step merger. Following the joint acquisition of the Conrail shares and receipt of all required regulatory approvals, most of the assets and liabilities of Conrail are expected to be allocated between NS and CSX pursuant to leasing, operating, partnership or other arrangements yet to be negotiated by NS and CSX. NS will contribute $5.9 billion for its 58 percent share of the purchase price of the Conrail shares, and CSX will contribute $4.3 billion for its 42 percent share (including amounts previously paid by NS and CSX to acquire Conrail shares).

   Conrail tender offer and merger shares purchased previously by NS and CSX, and Conrail shares jointly purchased will be placed in a joint voting trust pending STB approval. NS and CSX intend to file a joint application with the Surface Transportation Board (STB) in June 1997 seeking approval of the proposed acquisition of Conrail. The approval of the STB, while expected, cannot be assumed and is not likely to be effective prior to April 1, 1998.

   NS intends to account for its investment in Conrail using the equity method of accounting following consummation of the joint acquisition

Item 1. Financial Statements. (continued)

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements

2. Commitments and Contingencies (continued)

JOINT ACQUISITION OF CONRAIL INC. (CONRAIL) (continued)

and during the period Conrail shares are held in a voting trust--a period that will extend at least until the effective date of the STB's decision approving the transactions contemplated by the Agreement (if such approval is obtained). The method of accounting for the investment in Conrail subsequent to the voting trust being dissolved will depend on the ownership arrangement that is ultimately negotiated between NS and CSX, and approved by the STB, and the determination of whether and how controlling financial interests will be established for selected assets, liabilities and operations of Conrail. Additionally, the terms of leases, operating, partnership and other arrangements, yet to be negotiated, will impact the accounting. It is also expected that some of the assets and operations of Conrail will remain subject to joint control by NS and CSX and thus will continue to be accounted for using the equity method of accounting post STB approval.

The Conrail shares purchased on February 11, 1997, were financed with commercial paper debt (see Note 4, "Commercial Paper"). During the second quarter of 1997, NS intends to finance the remaining approximately $5 billion cost of the Conrail transaction by accessing both public and private markets by issuing commercial paper and term debt.

DEBT COMMITMENTS

Following the April 8, 1997, Agreement with CSX, NS terminated all but $1.65 billion of the commitments available under a $13.0 billion credit agreement dated February 10, 1997, as amended. The February credit agreement provided financing for NS' then-proposed acquisition of all Conrail shares. NS has begun negotiating a new credit agreement to provide a bank facility of up to $7.0 billion. During the second quarter of 1997, NS intends to finance the remaining approximately $5 billion cost of the Conrail transaction by accessing both public and private markets by issuing commercial paper and term debt. NS has entered into certain agreements to hedge its exposure to changes in interest rates. The total notional amount of such contracts and agreements is $1.25 billion. As a result, NS is exposed to the market risk associated with interest rate fluctuations until the contracts and agreements are terminated. NS expects to terminate them when the term debt is issued and account for any gain or loss, which is not expected to be material, as a component of interest expense over the life of the term debt. Counterparties to the contracts and agreements are major financial institutions believed by Management to be creditworthy.

Item 1. Financial Statements. (continued)

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements

3. Charge for Credit Facility Costs

NS recorded a $77.2 million pretax charge in the first quarter of 1997 for the direct costs, principally loan commitment fees, of having secured and maintained certain now-terminated commitments under the February credit agreement (see Note 2, "Debt Commitments"). This charge reduced first-quarter net income by $49.7 million, or $0.40 per share.

4. Long-Term Debt

SHELF REGISTRATIONS

On January 22, 1997, and on March 27, 1997, NS filed with the Securities and Exchange Commission shelf registration statements on Form S-3 covering the issuance of up to $1.25 billion and $3.0 billion, respectively, principal amount of any combination of debt or equity securities.

COMMERCIAL PAPER

In February 1997, NS issued $1.0 billion of commercial paper debt to finance its purchase of 8.2 million Conrail shares (see Note 2, "Joint Acquisition of Conrail Inc."). The debt has been classified as long-term because NS has the ability, through a revolving back-up facility, to convert this obligation into longer-term debt. NS intends to refinance the commercial paper either by issuing additional commercial paper or by replacing commercial paper notes with long-term debt.

CAPITAL LEASE OBLIGATIONS

During the first quarters of 1997 and 1996, an NS rail subsidiary entered into capital leases covering new locomotives. The related capital lease obligations totaling $44.7 million in 1997 and $74.4 million in 1996 were reflected in the Consolidated Balance Sheets as debt and, because they were non-cash transactions, were excluded from the Consolidated Statements of Cash Flows. The lease obligations carry stated interest rates of 6.83 percent for the lease entered into in 1997, and between 6.20 percent and 6.75 percent for those entered into in 1996. All were converted to variable rate obligations using interest rate swap agreements. The interest rates on these obligations are based on the six-month London Interbank Offered Rate and are reset every six months with realized gains or losses accounted for as an adjustment of interest expense over the terms of the leases. As a result, NS is exposed to the market risk associated with fluctuations in interest rates. To date, the effects of the rate fluctuations have been favorable and not material. Counterparties to the interest rate swap agreements are major financial institutions believed by Management to be creditworthy.

Item 1. Financial Statements. (continued)

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements

5. Earnings Per Share

"Earnings per share" is computed by dividing net income by the weighted average number of common shares outstanding as follows:

	Three Months Ended March 31, 1997	Three Months Ended March 31, 1996
	(In thousands)	
Average number of shares outstanding	125,255	128,215

The decrease in the average number of shares outstanding is a result of the stock purchase program which was suspended on October 23, 1996.

6. Reclassification of Motor Carrier Revenues and Expenses

Motor carrier revenues and expenses have been reclassified to conform to a change in presentation made in the first quarter of 1997 from a net basis to a gross basis. Certain motor carrier expenses previously reported net in revenues have been reclassified to motor carrier expenses to conform with recent industry reporting practices. Motor carrier operating income is not affected by this change in presentation, and first-quarter 1996 has been reclassified to conform to the 1997 presentation.

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

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Management's Discussion and Analysis of Financial Condition
and Results of Operations

RESULTS OF OPERATIONS

Net Income

"Net income" for the first quarter of 1997 was $127.8 million, a decrease of $40.3 million, or 24 percent, compared with first-quarter 1996. Included in 1997's results was a $77.2 million ($49.7 million after-tax) charge for costs related to the February credit agreement which had been established and maintained to purchase all Conrail shares (see Note 3). Excluding the charge, first-quarter net income was $177.5 million, up $9.4 million, or 6 percent, compared with the same period last year. A $24.6 million, or 9 percent, increase in operating income more than offset a $15.7 million decrease in nonoperating income (excluding the charge for credit facility costs) that principally resulted from higher interest expense.

Railway Operating Revenues

Railway operating revenues were a record $1.05 billion for the first quarter, a $29.3 million, or 3 percent, increase, compared with the same period last year. As shown in the table below, the improvement was the result of increased traffic volume.

	First Quarter 1997 vs. 1996 Increase (Decrease) (In millions of dollars)
Traffic volume (carloads)	$42.3
Revenue per unit	(13.0)
	$29.3

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

Revenues and carloads for the commodity groups were as follows:

	Revenues 1997	Revenues 1996	Carloads 1997	Carloads 1996
	($ in millions)		(in thousands)	
Coal	$ 326.1	$ 323.8	327.7	319.6
Chemicals	147.2	141.1	100.6	96.6
Paper/forest	134.8	129.7	114.7	109.8
Automotive	123.8	118.3	92.1	83.8
Agriculture	99.2	101.6	91.0	93.1
Metals/construction	89.2	83.4	87.2	82.7
General merchandise	594.2	574.1	485.6	466.0
Intermodal	125.7	118.8	342.2	319.2
Total	$ 1,046.0	$ 1,016.7	1,155.5	1,104.8

Coal

First-quarter coal revenues of $326.1 million were $2.3 million, or 1 percent, higher than first-quarter 1996. The improvement was due to a 3 percent increase in carloads resulting from increased export, coke and utility tonnage. Export coal tonnage rose 9 percent, led by increased shipments to Japan, Brazil and Turkey. Steel coal tonnage also improved, supported by new coke business that more than offset declines in the domestic metallurgical coal market resulting from inventory adjustments, shipment timing and some lost market share. Utility tonnage improved 2 percent despite strong carloadings late in the first quarter of 1996.

Coal revenues for all of 1997 are expected to compare favorably with those of 1996.

General Merchandise

General merchandise revenues were $594.2 million in the first quarter, increasing $20.1 million, or 4 percent, compared with the same period last year. All commodity groups except agriculture posted carload and revenue gains. Leading the improvement was the chemicals group, up $6.1 million, or 4 percent, reflecting increased traffic volume, a result of strong demand for plastics, chloral-alkali and miscellaneous chemicals. Metals/construction revenues posted a $5.8 million, or 7 percent, increase on a 5 percent increase in traffic volume. Growth was broad based with revenue increases reported for most metals and construction commodities. Automotive revenues increased $5.5 million, or 5 percent, as traffic volume increased 10 percent. This growth was supported by improved demand for both parts and finished automobiles despite a mid-March strike at one GM plant and unscheduled downtime at two Ford plants. Lower average revenues per car, the result of shorter length of haul and a shift in traffic mix among customers, offset

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

some of the volume improvement. Paper/forest revenues improved $5.1 million, or 4 percent, compared with a weak first quarter last year. Agriculture revenues declined $2.4 million, or 2 percent, due to softness in the export grain market.

General merchandise revenues are expected to continue to show improvement for the remainder of the year.

Intermodal

Intermodal revenues were $125.7 million in the first quarter, a $6.9 million, or 6 percent, increase, compared with the same period last year. Traffic volume increased 7 percent, due to strong unit increases in international and domestic containers, and double-digit growth in Triple Crown Services Company volume.

NS' intermodal traffic is expected to continue the first-quarter's positive growth trend for the remainder of this year.

Railway Operating Expenses

First-quarter railway operating expenses were $764.5 million, up $9.7 million, or 1 percent, compared with last year's first quarter, despite a 5 percent increase in carloadings.

The largest increase was in materials, services and rents expense, up $17.5 million, or 12 percent. Higher equipment rents resulted from a change in the mix of received and forwarded traffic, new freight car leases (mainly covered hoppers and some box cars), and the absence this year of income from leased locomotives. Purchased services expense was also higher due to increased automotive and intermodal handling costs resulting from increased traffic volume.

Diesel fuel expense increased $7.3 million, or 13 percent, due almost entirely to increased price per gallon--average prices in the first quarter were 12 percent higher than a year ago. As the quarter progressed, however, fuel prices did decline.

The largest decrease was in compensation and benefits expense, which was down $15.4 million, or 4 percent, due to lower accruals for stock-based compensation and favorable experience in employee benefit costs.

Casualties and other claims expense decreased $5.7 million, or 16 percent. Higher environmental remediation expenses last year and lower personal injury costs this year resulting from favorable claims experience were responsible for the improvement.

The 3 percent increase in railway operating revenues, combined with only a 1 percent increase in railway operating expenses, produced a railway operating ratio for the first quarter of 73.1 percent, a first-quarter record, surpassing last year's record of 74.2 percent by more than one percentage point.

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

Motor Carrier Operating Revenues

First-quarter motor carrier operating revenues were $203.7 million, a $5.4 million, or 3 percent, increase, compared with last year's first quarter. The improvement was principally due to gains in the High Value Products Division, including increased logistics business.

Effective April 11, 1997, NAVL's largest revenue-producing agent terminated its relationship with NAVL. Management expects to retain over half of the revenues produced by this agent in 1997 and beyond. The loss of this agent is not expected to have a material effect on NS' financial statements.

Motor Carrier Operating Expenses

Motor carrier operating expenses were $199.6 million in the first quarter, slightly above those of the same period last year, which were adversely affected by harsh weather. However, this year's expenses were reduced due to a favorable litigation settlement.

Other Income (Expense)

Total other income and expense for the first quarter was an expense of $87.1 million, compared with income of $5.8 million in the first quarter of last year. Included in this year's expense was a $77.2 million pretax charge to write off the costs incurred to establish and maintain a $13.0 billion credit facility in connection with the tender offer for all Conrail shares (see Note 2, "Joint Acquisition of Conrail Inc.," and Note 3). Interest expense increased $10.8 million, or 39 percent, in the first quarter, compared with the same period last year. The increase reflects the cost of borrowings to acquire the 8.2 million Conrail shares in mid-February, and the $200 million of medium-term notes issued last September.

FINANCIAL CONDITION AND LIQUIDITY

	March 31, 1997	December 31, 1996
	(Dollars in millions)	
Cash and short-term investments	$325.2	$403.4
Working capital	$245.2	$266.5
Current assets to current liabilities	1.2	1.2
Debt to total capitalization	36.7%	27.6%

CASH PROVIDED BY OPERATING ACTIVITIES is NS' principal source of liquidity and was sufficient to cover most of the cash outflows for dividends, debt repayments and capital spending (see Consolidated Statements of Cash Flows on page 5). The decline in cash provided by operations, compared with the first quarter of last year, was primarily attributable to a decrease in operating accounts payable, compared with an increase in the same period last year.

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

CASH USED FOR INVESTING ACTIVITIES increased substantially due to the February purchase of 8.2 million Conrail shares for $115 per share in cash (see Note 2, "Joint Acquisition of Conrail Inc."). The increase in property additions in the first quarter of 1997, compared with last year, is the result of increased roadway additions and the purchase of some locomotives in 1997 using cash, instead of capital leases.

CASH PROVIDED BY FINANCING ACTIVITIES in the first quarter of 1997 included proceeds from the sale of commercial paper to finance the purchase of 8.2 million Conrail shares (see Note 2, "Joint Acquisition of Conrail Inc.," and Note 4, "Commercial Paper"). Included also is $70.9 million of credit facility costs paid related to certain now-terminated commitments under credit agreements which were in place to support the tender offer for all Conrail shares (see Note 3). NS is negotiating a new credit agreement to provide a bank facility of up to $7.0 billion. During the second quarter of 1997, NS intends to finance the remaining approximately $5 billion cost of the Conrail transaction by accessing both public and private markets by issuing commercial paper and term debt. NS has entered into certain agreements to hedge its exposure to changes in interest rates. The total notional amount of such contracts and agreements is $1.25 billion. As a result, NS is exposed to the market risk associated with interest rate fluctuations until the contracts and agreements are terminated. NS expects to terminate them when the term debt is issued and account for any gain or loss, which is not expected to be material, as a component of interest expense over the life of the term debt. Counterparties to the contracts and agreements are major financial institutions believed by Management to be creditworthy. In view of the amount of debt NS will incur to finance its portion of the Conrail transaction, both major credit rating agencies have downgraded their ratings on NS debt.

JOINT ACQUISITION OF CONRAIL

On April 8, 1997, NS and CSX announced that they had entered into an Agreement providing for the joint acquisition of all outstanding Conrail shares not already owned by them for $115 in cash per share. The Agreement followed several months of attempts by each of NS and CSX to acquire all of Conrail. In connection therewith, NS' tender offer to acquire Conrail shares was terminated and CSX's tender offer to acquire Conrail shares was amended, among other things, to include NS as co-bidder and to extend its expiration date to May 23, 1997.

The estimated total cost of the joint acquisition and of the Conrail shares already acquired by NS and CSX is approximately $10.2 billion, before transaction expenses. Pursuant to the Agreement, NS will bear 58 percent of that total cost (or approximately $5.9 billion), and CSX will bear 42 percent of such cost, in each case taking into consideration amounts previously paid by each of NS and CSX to acquire Conrail shares.

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

NS and CSX will have, respectively, a 58 percent and a 42 percent economic interest in--and each will exercise a 50 percent voting interest in--the entity formed to acquire Conrail shares. Under the Agreement and subject to STB approval, NS will operate routes and assets (or rights therein or thereto) that generated approximately 58 percent of Conrail's 1995 revenues, pursuant to leasing, operating partnerships or other arrangements to be negotiated and implemented between NS and CSX. Each of NS and CSX will have the right to appoint 50 percent of that entity's directors and will be entitled to appoint full-time Co-Chief Executive Officers.

Under the Agreement, it is expected that in some form, yet to be determined, NS will have primary operating interest in Conrail lines between Chicago and Cleveland, Ohio, and between Cleveland and northern New Jersey, via Pittsburgh and Harrisburg, Pennsylvania. In addition, NS will operate the Conrail line serving the metropolitan New York area between northern New Jersey and Buffalo through Binghamton, New York, and another between Buffalo and Harrisburg, Pennsylvania. NS will also operate most Conrail lines in Michigan, Maryland, Delaware and Pennsylvania, and will operate the routes between Toledo and Detroit, between Columbus and Cincinnati and between Columbus and Charleston, West Virginia. NS and CSX will jointly operate certain Conrail assets in major terminal areas such as Detroit and northern and southern New Jersey. NS and CSX will also share access to certain lines in Philadelphia and Indianapolis, and to the rail lines serving the Monongahela coal fields in southwestern Pennsylvania.

NS and CSX intend to file a joint application with the STB in June of 1997 seeking approval of the Conrail acquisition. NS and CSX have requested a 255-day STB review period. However, other interested parties have requested either a 365-day review period or the maximum period permitted under the statute--16 months. Therefore, even under the accelerated schedule requested by NS and CSX, an STB decision is not likely prior to March 1, 1998, and could be delayed until as late as October 1998 if the maximum statutory period is used.

Conrail shares purchased previously by NS and CSX, and Conrail shares purchased in the joint acquisition will be placed in a joint voting trust pending STB approval. NS intends to account for its investment in Conrail using the equity method of accounting following consummation of the joint acquisition and during the period Conrail shares are held in a voting trust--a period that will extend at least until the effective date of the STB's decision approving the transactions contemplated by the Agreement (if such approval is obtained). The method of accounting for the investment in Conrail subsequent to the voting trust being dissolved will depend on the ownership arrangement that is ultimately negotiated between NS and CSX, and approved by the STB, and the determination of whether and how controlling financial interests will be established for selected assets, liabilities and operations of Conrail. Additionally, the terms of leases, operating, partnership and other arrangements, yet to be negotiated, will impact the accounting. It is also expected that some of the assets and operations of Conrail will remain subject to joint control by NS and CSX and thus will continue to be accounted for using the equity method of accounting post STB approval.

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

NS has identified a number of synergies related to the transaction which its management believes can be achieved and that are estimated to yield operating income in nominal dollars of about $71 million in 1998, $236 million in 1999 and $399 million by the year 2000. For 1996, NS' and Conrail's most recent full year, combined operating income, reflecting 58 percent of Conrail's operating income adjusted for non-recurring charges, was $1.6 billion. The synergy estimates reflect anticipated operating expense savings and revenue enhancements and do not include any one-time costs to achieve such improvements. Expense savings are expected to result from, among other things, reduced general and administrative expenses, improved equipment utilization and maintenance, improved use of rail yards and routes, more efficient purchasing of material and equipment coupled with maintenance-of-way efficiencies, and more efficient transportation operations. Revenue enhancements are expected to result from net new business (single-line service, new coal traffic and the diversion of truck traffic to rail). NS anticipates the synergies from the transaction will result in accretion in NS' earnings per share of about 6 percent in 1999, 15 percent in 2000 and more than 17 percent thereafter. NS expects the acquisition to be dilutive to earnings by approximately 2 percent in 1997 and 3 percent in 1998.

The foregoing estimates of cost savings, synergies, and projected earnings per share are "forward-looking" and inherently subject to significant uncertainties and contingencies, many of which are beyond the control of NS, including: (a) future economic conditions in the markets in which NS and Conrail operate; (b) financial market conditions; (c) inflation rates; (d) changing competition and the effects of new and increased competition in the areas served by NS and Conrail; (e) changes in the economic regulatory climate in the United States railroad industry; (f) NS' ability to eliminate or reduce duplicative administrative and other functions and facilities following the transaction; (g) labor uncertainties and NS' ability to implement anticipated labor savings; (h) unanticipated environmental and other situations relating to Conrail assets; (i) NS' ability to integrate certain Conrail assets, including its information technology systems, within NS' systems; and (j) adverse changes in applicable laws, regulations or rules governing environmental, tax or accounting matters. There can be no assurance that the estimated savings, revenue increases, synergies or projected earnings per share will be achieved; actual savings, revenue increases, synergies and earnings per share may vary materially from those estimated. The inclusion of such estimates herein should not be regarded as an indication or affirmation that NS or any other party considers such estimates an accurate prediction of future events.

CLASS ACTION SUIT

Norfolk Southern Corporation is the defendant in a class action suit filed in federal district court in Birmingham, Alabama, on behalf of African-American employees who allege that, since December 16, 1989, the Corporation has discriminated against them in promotion to nonagreement positions because of their race. Trial began on May 12. While the outcome of this matter cannot be predicted, Management's current assessment, based on all known facts and circumstances and other available factors, is that the result is unlikely to have a material adverse effect on NS' financial position, results of operation or liquidity.

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

NEW ACCOUNTING PRONOUNCEMENTS

Effective January 1, 1997, NS adopted AICPA Statement of Position 96-1, "Environmental Remediation Liabilities." The statement provides guidance with respect to recognition and measurement of environmental remediation liabilities and disclosure of such liabilities in financial statements. The impact to NS of adopting the standards of this statement was not material to the Corporation's financial position, results of operations or liquidity.

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings per Share," which establishes standards for computing and presenting earnings per share and is effective for financial statements issued for periods ending after December 15, 1997. Implementation of SFAS No. 128 is not expected to have a material effect on NS' financial statements.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

As was more particularly described most recently in Item 3, Legal Proceedings, of the Corporation's Annual Report on Form 10-K(405) for the fiscal year ending December 31, 1996, NS, CSX, Conrail and certain individuals were parties (both plaintiffs and defendants) to a variety of actions, suits, counterclaims and other legal proceedings growing out of NS' and CSX's efforts to acquire all of Conrail.

Pursuant to the Agreement, CSX and NS have entered into a stipulation (the "Stipulation") providing for the dismissal with prejudice of NS' claims against CSX and of CSX's counterclaims against NS. As Conrail is not a party to the Agreement, the Stipulation does not cover NS' claims against defendants other than CSX or Conrail's counterclaims against NS. However, in the Agreement, CSX has agreed to request, under CSX's Merger Agreement with Conrail, the dismissal with prejudice of all claims and litigation against NS following the merger with Conrail. Accordingly, NS anticipates that Conrail's counterclaims against NS and NS' claims against defendants other than CSX will be dismissed with prejudice upon effectuation of the merger with Conrail. In the interim, CSX has agreed, in the Agreement, to request that Conrail join in a stay or similar adjournment of the pending claims.

The ultimate effect of these undertakings is expected to be the termination with prejudice of all legal proceedings between and among the parties, including individual defendants, concerning the acquisition of Conrail.

This matter has been reported previously by NS in Part I, Item 3, of its Annual Report on Form 10-K(405) for the fiscal year ending December 31, 1996, and in Part II, Item 1, of its Form 10-Q report for the quarter ending September 30, 1996.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits:

Computation of Per Share Earnings

Financial Data Schedule

(b) Reports on Form 8-K:

A report on Form 8-K dated February 5, 1997 (date of earliest event reported) was filed on February 14, 1997, reporting that a wholly owned subsidiary of NS had accepted for payment 8.2 million shares of Conrail tendered pursuant to its tender offer and that NS had arranged for the issuance and sale, through private placement, of $1.0 billion of commercial paper.

SIGNATURES

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

NORFOLK SOUTHERN CORPORATION
(Registrant)

Date: May 14, 1997

/s/ Dezora M. Martin
Dezora M. Martin
Corporate Secretary (Signature)

Date: May 14, 1997

/s/ John P. Rathbone
John P. Rathbone
Vice President and Controller
(Principal Accounting Officer) (Signature)

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES

INDEX TO EXHIBITS

EXHIBIT 11, Page 1 of 2

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Computation of Per Share Earnings
(In millions except per share amounts)

	Three Months Ended March 31, 1997	Three Months Ended March 31, 1996
COMPUTATION FOR STATEMENTS OF INCOME		
Net income per statements of income	$ 127.8	$ 168.1
Weighted average number of shares outstanding	125.3	128.2
Primary earnings per share	$ 1.02	$ 1.31
ADDITIONAL PRIMARY COMPUTATION		
Net income per statements of income	$ 127.8	$ 168.1
Adjustment to weighted average number of shares outstanding:		
Weighted average number of shares outstanding per primary computation above	125.3	128.2
Dilutive effect of outstanding options, stock appreciation rights (SARs) and performance share units (PSUs) (as determined by the application of the treasury stock method)(1)	1.0	1.4
Weighted average number of shares outstanding, as adjusted	126.3	129.6
Primary earnings per share, as adjusted(2):	$ 1.01	$ 1.30

(1) See Note 12 of Notes to Consolidated Financial Statements in Norfolk Southern's 1996 Annual Report on Form 10-K for a description of the Long-Term Incentive Plan.

(2) These calculations are submitted in accordance with Regulation S-K, item 601(b)(11) although not required by footnote 2 to paragraph 14 of APB Opinion No. 15 because they result in dilution of less than 3 percent.

EXHIBIT 11, Page 2 of 2

NORFOLK SOUTHERN CORPORATION AND SUBSIDIARIES
Computation of Per Share Earnings
(In millions except per share amounts)

	Three Months Ended March 31, 1997	1996
FULLY DILUTED COMPUTATION		
Net income per statements of income	$ 127.8	$ 168.1
Adjustment to increase earnings to requisite level to earn maximum PSUs, net of tax effect	7.7	16.8
Net income, as adjusted	$ 135.5	$ 184.9
Adjustment to weighted average number of shares outstanding, as adjusted for additional primary calculation:		
Weighted average number of shares outstanding, as adjusted per additional primary computation on page 1	126.3	129.6
Additional dilutive effect of outstanding options and SARs (as determined by the application of the treasury stock method using period end market price)	--	0.1
Additional shares issuable at maximum level for PSUs	0.1	0.1
Weighted average number of shares, as adjusted	126.4	129.8
Fully diluted earnings per share(3):	$ 1.07	$ 1.42

(3) These calculations are submitted in accordance with Regulation S-K, item 601(b)(11) although they are contrary to paragraph 40 of APB Opinion No. 15 because they produce an anti-dilutive result.

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STB FD 33388 6-23-97 A 180274V7F 13/13

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(X) Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 1997
or

( ) Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ----- to -----

Commission file number 1-12184

CONRAIL INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-2728514
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

2001 Market Street, Philadelphia, Pennsylvania 19101
(Address of principal executive offices)
(Zip Code)

(215) 209-4000
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Yes X No ----

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

Number of shares of common stock outstanding (as of April 30, 1997)
83,344,079

CONRAIL INC.

INDEX

PART I. FINANCIAL INFORMATION
CONRAIL INC.

Item 1. Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

($ In Millions Except Per Share Data)

	Quarters ended March 31,	
	1997	1996
Revenues	$906	$889
Operating expenses		
Way and structures	124	140
Equipment	202	219
Transportation	354	362
General and administrative	110	99
Total operating expenses	790	820
Income from operations	116	69
Interest expense	(45)	(47)
Other income, net	27	28
Income before income taxes	98	50
Income taxes	37	19
Net income	$ 61	$ 31
Net income per common share		
Primary	$ .74	$ .36
Fully diluted	.70	.35
Dividends per common share	$.475	$.425
Weighted average number of shares used in computing earnings per share (thousands)		
Primary	80,025	78,002
Fully diluted	86,842	87,759
Ratio of earnings to fixed charges	2.52x	1.75x

See accompanying notes.

CONRAIL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

($ In Millions)	March 31, 1997	December 31, 1996
ASSETS		
Current assets		
Cash and cash equivalents	$ 32	$ 30
Accounts receivable	662	630
Deferred tax assets	293	293
Material and supplies	141	139
Other current assets	34	25
Total current assets	1,162	1,117
Property and equipment, net	6,599	6,590
Other assets	709	695
Total assets	$8,470	$8,402
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Short-term borrowings	65	99
Current maturities of long-term debt	82	130
Accounts payable	148	135
Wages and employee benefits	167	143
Casualty reserves	140	141
Accrued and other current liabilities	476	444
Total current liabilities	1,078	1,092
Long-term debt	1,889	1,876
Casualty reserves	195	190
Deferred income taxes	1,520	1,478
Special income tax obligation	330	346
Other liabilities	306	313
Total liabilities	5,318	5,295
Stockholders' equity		
Series A ESOP convertible junior preferred stock	183	211
Unearned ESOP compensation	(221)	(222)
Common stock	89	88
Additional paid-in capital	2,430	2,404
Employee benefits trust	(357)	(384)
Retained earnings	1,376	1,357
	3,500	3,454
Treasury stock	(348)	(347)
Total stockholders' equity	3,152	3,107
Total liabilities and stockholders' equity	$8,470	$8,402

See accompanying notes.

CONRAIL INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

($ In Millions)

	Quarters ended March 31, 1997	1996
Cash flows from operating activities	$170	$ 121
Cash flows from investing activities		
Property and equipment acquisitions	(41)	(18)
Other	(4)	(16)
Net cash used in investing activities	(45)	(34)
Cash flows from financing activities		
Net proceeds from(repayment of) short-term borrowings	(34)	45
Payment of long-term debt	(63)	(97)
Repurchase of common stock	-	(41)
Dividends paid on common stock	(40)	(35)
Dividends paid on preferred stock	(3)	(10)
Other	17	5
Net cash used in financing activities	(123)	(133)
Increase (decrease) in cash and cash equivalents	2	(46)
Cash and cash equivalents		
Beginning of period	30	73
End of period	$ 32	$ 27

See accompanying notes.

CONRAIL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The unaudited financial statements contained herein present the consolidated financial position of Conrail Inc. (the "Company") as of March 31, 1997 and December 31, 1996, and the consolidated results of operations and cash flows for the three-month periods ended March 31, 1997 and 1996. In the opinion of management, these financial statements include all adjustments, consisting of normal recurring adjustments, necessary to present fairly the results for the interim periods included.

The rules and regulations of the Securities and Exchange Commission permit certain information and footnote disclosures, ordinarily required by generally accepted accounting principles, to be condensed or omitted from interim financial reports. Accordingly, the financial statements included herein should be read in conjunction with the audited financial statements and notes for the year ended December 31, 1996, presented in the Company's Annual Report on Form 10-K.

2. In January 1997, Consolidated Rail Corporation ("CRC") assumed $31 million of Equipment Trust Certificates, at an interest rate of 8.31%, due 2012, to finance the lease buyout of 20 locomotives from Locomotive Management Services, a general partnership of which CRC holds a fifty percent interest.

3. Effective April 1, 1997, the Company's Board of Directors authorized the vesting of all stock options and performance shares outstanding in connection with the proposed acquisition of the Company by CSX Corporation and Norfolk Southern Corporation. The vesting of the performance shares will result in an $18 million charge to operating expenses in April 1997, while the vesting of stock options will not have an income statement effect.

4. During February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, "Earnings per Share" (SFAS 128), which establishes new standards for computing and presenting earnings per share ("EPS"). SFAS 128 replaces the presentation of primary EPS with a presentation of basic EPS. It also requires dual presentation of basic and diluted EPS on the face of the income statement for all entities with a complex capital structure. This Statement is effective for financial statements issued for periods ending after December 15, 1997, with earlier application not permitted. The EPS included in the Company's financial statements is computed in accordance with APB Opinion No. 15, "Earnings per Share". However, had the Company adopted the provisions of SFAS 128 in the first quarter of 1997, basic EPS and diluted EPS would be approximately the same as the current computations of primary EPS and fully diluted EPS, respectively, included in the Company's financial statements.

5. Information regarding contingent liabilities and litigation was included in Note 13 to Consolidated Financial Statements and Part I, Item 3 - Legal Proceedings in the Company's Annual Report on Form 10-K for the year ended December 31, 1996. There have been no material developments with respect to these matters during the first three months of 1997, except as disclosed in the Annual Report on Form 10-K or elsewhere herein.

REPORT OF INDEPENDENT ACCOUNTANTS

The Stockholders and Board of Directors of
Conrail Inc.

We have reviewed the accompanying condensed consolidated balance sheet of Conrail Inc. and its subsidiaries (the "Company") as of March 31, 1997 and the related condensed consolidated statements of income and cash flows for the three months ended March 31, 1997 and March 31, 1996. This financial information is the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in conformity with generally accepted accounting principles.

We previously audited in accordance with generally accepted auditing standards, the consolidated balance sheet as of December 31, 1996, and the related consolidated statements of income, of stockholders' equity and of cash flows for the year then ended (not presented herein), and in our report dated January 21, 1997, except as to Note 2 to the consolidated financial statements, which is as of March 7, 1997, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 1996, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

Price Waterhouse LLP

PRICE WATERHOUSE LLP
Thirty South Seventeenth Street
Philadelphia, PA 19103

April 16, 1997

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

Results of Operations

Overview

Net income for Conrail Inc. ("Conrail" or "the Company") for the first quarter of 1997 was $61 million ($.74 per share, primary and $.70 per share, fully diluted basis) compared with net income of $31 million ($.36 per share, primary and $.35 per share, fully diluted basis) for the first quarter of 1996. Included in net income for the first quarter of 1997 were merger-related costs of $14 million (net of $8 million of tax benefits). Without these costs, net income would have been $75 million ($.91 and $.86 per share, primary and fully diluted, respectively).

Traffic volume and revenues for the first quarter of 1997 increased 4.9% and 1.9%, respectively, as compared with the first quarter of 1996. Operating expenses, excluding merger-related costs of $22 million, decreased $52 million, or 6.3%, for the first three months of 1997 as compared with the comparable period for 1996. The Company's operating expenses for the first quarter of 1996 were unfavorably affected by difficult operating conditions caused by severe weather experienced over most of the Company's service area. The increase in revenues and decrease in operating expenses resulted in an operating ratio (operating expenses as a percent of revenues) of 87.2% (84.7% excluding merger-related costs) for the first quarter of 1997 as compared with 92.3% for the first quarter of 1996.

Proposed Merger

On April 8, 1997, Conrail and CSX Corporation ("CSX") entered into the Fourth Amendment (the "Fourth Amendment") to the Merger Agreement (as amended through the Fourth Amendment, the "Merger Agreement") which facilitated CSX and Norfolk Southern Corporation ("NSC") entering into an agreement with respect to their joint acquisition of the Company as contemplated by the Third Amendment to the Merger Agreement, dated as of March 7, 1997. The terms of the CSX-NSC Agreement are embodied in a letter agreement dated as of April 8, 1997 (the "CSX/NSC Letter Agreement").

The CSX/NSC Letter Agreement provides, among other things, (i) for the termination of the NSC's outstanding offer to purchase Conrail shares and the dismissal of litigation between CSX and NSC, (ii) that the Company will, after the effective time of its merger into a wholly-owned subsidiary of CSX, become a direct or indirect jointly-owned subsidiary of CSX and NSC, (iii) that CSX and NSC will jointly acquire, for $115 in cash, all Conrail shares not already owned by CSX and NSC through a tender offer scheduled to close on May 23, 1997 and subsequent merger, and (iv) that the Company is expected to continue to be managed by its existing Board of Directors until the requisite approval of the Surface Transportation Board is obtained, at which time CSX and NSC will be separately allocated certain of the Company's railroad assets and will jointly operate certain other railroad operations of the Company.

The Fourth Amendment also provides that, following April 8, 1997, the Company's Board of Directors will not declare, and the Company will not pay, any dividend on the Company's capital stock with a record date on or prior to May 30, 1997.

In light of the pending acquisition of Conrail by CSX and NSC, Standard & Poor's rating agency has downgraded Consolidated Rail Corporation's ("CRC") long-term unsecured debt to BBB and its secured equipment trust certificates to A, while affirming CRC's A1 commercial paper rating. Moody's Investors Service has rated CRC's long-term unsecured debt as Baa2, its secured equipment trust certificates as A1 and its commercial paper as P-2.

First Quarter 1997 compared with First Quarter 1996

Net income for the first quarter of 1997 was $61 million as compared with net income for the first quarter of 1996 of $31 million.

Operating revenues (primarily freight and line-haul revenues, but also including switching, demurrage and incidental revenues) increased $17 million, or 1.9%, from $889 million in the first quarter of 1996 to $906 million in the first quarter of 1997. A 4.9% increase in traffic volume in units (freight cars and intermodal trailers and containers) resulted in a $41 million increase in revenues. However, a decline in average revenue per unit decreased revenues by $22 million for the quarter, due to decreases in average rates, $14 million, and an unfavorable traffic mix, $8 million.

Operating expenses decreased $30 million, or 3.7%, from $820 million in the first quarter of 1996 to $790 million in the first quarter of 1997. The following table sets forth the operating expenses for the two periods:

($ In Millions)	First Quarter 1997	1996	Increase (Decrease)
Compensation and benefits	$313	$344	$(31)
Fuel	57	50	7
Material and supplies	49	60	(11)
Equipment rents	92	98	(6)
Depreciation and amortization	73	71	2
Casualties and insurance	39	48	(9)
Other	167	149	18
	$790	$820	$(30)

Compensation and benefits decreased $31 million, or 9.0%, primarily as a result of reductions in employment levels and other employee-related costs, as well as lower accruals for wage increases and less weather-related overtime costs occurring during the first quarter of 1997 as compared with the same period of 1996. Compensation and benefits as a percent of revenues was 34.6% in the first quarter of 1997 as compared with 38.7% in the first quarter of 1996.

Fuel costs increased $7 million, or 14.0%, as a result of higher average fuel prices during the first quarter of 1997 as compared with the same quarter of 1996. Fuel prices are expected to decline during the remainder of 1997.

The decline in material and supplies costs of $11 million, or 18.3%, was mostly attributable to a higher level of expenditures for repairs and maintenance of locomotives and freight cars in the first quarter of 1996 due to adverse weather conditions and an increase in the allocation of material used in capital vs. maintenance projects in the first quarter of 1997.

Casualties and insurance costs decreased $9 million, or 18.8%, primarily due to reductions in employee injuries and loss and damage claims.

Other expenses increased $18 million, or 12.1%, primarily as a result of merger-related costs of $22 million incurred in connection with the proposed acquisition of the Company by CSX and NSC.

The Company's operating ratio was 87.2% for the first quarter of 1997 compared with 92.3% for the first quarter of 1996. Excluding the merger-related costs, the operating ratio for the first quarter of 1997 would have been 84.7%.

Liquidity and Capital Resources

The Company's cash and cash equivalents increased $2 million in the first quarter of 1997, from $30 million at December 31, 1996 to $32 million at March 31, 1997. Cash generated from operations, primarily from its wholly-owned subsidiary, CRC, and borrowings have been the Company's principal sources of liquidity and are used primarily for capital expenditures, debt service and dividends. In the first quarter of 1997, operating activities provided cash of $170 million.

The principal uses of cash during the quarter were for: property and equipment acquisitions, $41 million; payment of long-term debt, $63 million; and cash dividends on common and preferred stock, $43 million.

Working capital (current assets less current liabilities)of $84 million existed at March 31, 1997 as compared with $25 million at December 31, 1996.

During the first quarter of 1997, CRC issued $45 million of commercial paper and repaid $79 million. At March 31, 1997, $165 million of commercial paper remained outstanding, of which $100 million is classified as long-term debt since it is expected to be refinanced through subsequent issuances of commercial paper and is supported by a long-term credit facility.

In January 1997, CRC assumed $31 million of Equipment Trust Certificates, at an interest rate of 8.31%, due 2012, to finance the lease buyout of 20 locomotives from Locomotive Management Services, a general partnership of which CRC holds a fifty percent interest.

Other Matters

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements that involve risks and uncertainties that may cause actual results to differ, including but not limited to the effect of economic conditions, competition, regulation and weather on Conrail's operations, customers, service and prices, and other factors discussed elsewhere in this report and, from time to time, in other reports filed with the Securities and Exchange Commission.

PART II. OTHER INFORMATION

CONRAIL INC.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

11 Statement of earnings per share computations.

12 Computations of the ratio of earnings to fixed charges.

15 Letter re unaudited interim financial information from Price Waterhouse LLP.

27 Financial data schedule.

(b) Reports on Form 8-K

None

SIGNATURES

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

CONRAIL INC.
Registrant

T. O'Toole

Timothy T. O'Toole
Senior Vice President - Law

J. A. McKelvey

John A. McKelvey
Senior Vice President - Finance
(Principal Financial Officer)

Date: May 9, 1997

EXHIBIT INDEX

Exhibit No.	
11	Statement of earnings per share computations.
12	Computations of the ratio of earnings to fixed charges.
15	Letter re unaudited interim financial information from Price Waterhouse LLP.
27	Financial data schedule.

Exhibit 11

CONRAIL INC.

EARNINGS PER SHARE COMPUTATIONS

($ In Millions Except Per Share)

	Quarters ended March 31, 1997	Quarters ended March 31, 1996
Net income		
Primary		
Net income	$61	$31
Dividends declared on Series A ESOP convertible junior preferred stock (ESOP Stock), net of tax benefits	(2)	(3)
	$59	$28
Fully diluted		
Net income	61	31
Nondiscretionary adjustment (1)	-	(1)
	$61	$30
Weighted average number of shares (2)		
Primary		
Weighted average number of common shares outstanding	79,586,743	77,286,233
Effect of shares issuable under employee stock compensation plans	437,758	716,213
	80,024,501	78,002,446
Fully diluted		
Weighted average number of common shares outstanding	79,586,743	77,286,233
ESOP Stock	6,782,269	9,756,470
Effect of shares issuable under employee stock compensation plans	473,088	716,213
	86,842,100	87,758,916
Net income per common share		
Primary	$.74	$.36
Fully diluted	.70	.35

CONRAIL INC.
EARNINGS PER SHARE COMPUTATIONS

Notes: 1. Represents the increase, net of income tax benefits, in ESOP-related expenses assuming conversion of all ESOP Stock to common stock.

2. Shares held by the Employee Benefits Trust (the "Trust") are not considered outstanding for earnings per share computations until issued by the Trust.

Exhibit 12

CONRAIL INC.

COMPUTATIONS OF THE RATIO OF EARNINGS TO FIXED CHARGES

($ In Millions)

	Quarters ended March 31, 1997	1996
Earnings		
Pre-tax income	$ 98	$ 50
Add:		
Interest expense	45	47
Rental expense interest factor	16	14
Less equity in undistributed earnings of 20-50% owned companies	(5)	(4)
Earnings available for fixed charges	$154	$107
Fixed charges		
Interest expense	45	47
Rental expense interest factor	16	14
Fixed charges	$ 61	$ 61
Ratio of earnings to fixed charges	2.52x	1.75x

For purposes of computing the ratio of earnings to fixed charges, earnings represent income before income taxes plus fixed charges, less equity in undistributed earnings of 20% to 50% owned companies. Fixed charges represent interest expense together with interest capitalized and a portion of rent under long-term operating leases representative of an interest factor.

Thirty South Seventeenth Street
Philadelphia, PA 19103-4094
Telephone 215 575 5000

Price Waterhouse LLP

Exhibit 15

May 9, 1997

Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Dear Sirs:

We are aware that Conrail Inc. has incorporated by reference our report dated April 16, 1997 (issued pursuant to the provisions of Statement on Auditing Standards No. 71) in the following documents:

- Registration Statement on Form S-8 No. 33-19155
- Registration Statement on Form S-8 No. 33-44140
- Registration Statement on Form S-8 No. 33-57717
- Registration Statement on Form S-8 No. 33-60445
- Registration Statement on Form S-8 No. 333-6513
- Prospectus constituting part of Registration Statement on Form S-3 No. 33-64670
- Prospectus constituting part of Registration Statement on Form S-3 No. 33-62929.

We are also aware of our responsibilities under the Securities Act of 1933 and that pursuant to Rule 436(c) our report dated April 16, 1997 shall not be considered part of a registration statement prepared or certified by us or a report prepared or certified by us within the meaning of Sections 7 and 11 of the Securities Act of 1933.

Yours very truly,

Price Waterhouse LLP

PRICE WATERHOUSE LLP

Exhibit 27

CONRAIL INC.
FINANCIAL DATA SCHEDULE
($ In Millions Except Per Share)

THIS SCHEDULE CONTAINS SUMMARY INFORMATION EXTRACTED FROM FORM 10-Q AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FORM 10-Q.

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