

CSX CORP
Form 10-Q
July 19, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended June 29, 2012

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 1-8022

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.)

500 Water Street, 15th Floor, Jacksonville, FL

32202

(904) 359-3200

(Address of principal executive offices)

(Zip
Code)

(Telephone number, including area
code)

No Change

(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one)

Large Accelerated Filer

Accelerated Filer

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Non-accelerated Filer

Smaller Reporting Company

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

There were 1,039,988,670 shares of common stock outstanding on June 29, 2012 (the latest practicable date that is closest to the filing date).

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CSX CORPORATION
 FORM 10-Q
 FOR THE QUARTERLY PERIOD ENDED JUNE 29, 2012
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CSX CORPORATION

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENTS (Unaudited)

(Dollars in millions, except per share amounts)

	Second Quarters		Six Months	
	2012	2011	2012	2011
Revenue	\$3,012	\$3,019	\$5,978	\$5,829
Expense				
Labor and Fringe	744	764	1,514	1,529
Materials, Supplies and Other	550	557	1,092	1,087
Fuel	410	431	854	833
Depreciation	263	246	520	489
Equipment and Other Rents	102	95	199	192
Total Expense	2,069	2,093	4,179	4,130
Operating Income	943	926	1,799	1,699
Interest Expense	(139	)(134	)(283	)(274
Other Income - Net (Note 8)	5	—	9	5
Earnings Before Income Taxes	809	792	1,525	1,430
Income Tax Expense (Note 9)	(297	)(286	)(564	)(529
Net Earnings	\$512	\$506	\$961	\$901
Per Common Share (Note 2)				
Net Earnings Per Share, Basic	\$0.49	\$0.46	\$0.92	\$0.81
Net Earnings Per Share, Assuming Dilution	\$0.49	\$0.46	\$0.92	\$0.81
Average Shares Outstanding (In millions)	1,041	1,102	1,044	1,105
Average Shares Outstanding, Assuming Dilution (In millions)	1,043	1,109	1,046	1,112
Cash Dividends Paid Per Common Share	\$0.14	\$0.12	\$0.26	\$0.21

CONSOLIDATED COMPREHENSIVE INCOME STATEMENTS

Total Comprehensive Earnings (Note 1)	\$529	\$519	\$987	\$925
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See accompanying notes to consolidated financial statements.

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CSX CORPORATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

(Dollars in millions, except per share amounts)

	(Unaudited) June 29, 2012	December 30, 2011	
ASSETS			
Current Assets			
Cash and Cash Equivalents	\$642	\$783	
Short-term Investments	41	523	
Accounts Receivable - Net (Note 1)	1,136	1,129	
Materials and Supplies	256	240	
Deferred Income Taxes	172	182	
Other Current Assets	125	78	
Total Current Assets	2,372	2,935	
Properties	34,616	33,704	
Accumulated Depreciation	(8,984)	(8,730))
Properties - Net	25,632	24,974	
Investment in Conrail	687	678	
Affiliates and Other Companies	496	493	
Other Long-term Assets	402	393	
Total Assets	\$29,589	\$29,473	
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current Liabilities			
Accounts Payable	\$1,055	\$1,147	
Labor and Fringe Benefits Payable	434	541	
Casualty, Environmental and Other Reserves (Note 4)	171	167	
Current Maturities of Long-term Debt (Note 7)	508	507	
Income and Other Taxes Payable	228	129	
Other Current Liabilities	179	196	
Total Current Liabilities	2,575	2,687	
Casualty, Environmental and Other Reserves (Note 4)	327	352	
Long-term Debt (Note 7)	8,581	8,734	
Deferred Income Taxes	7,896	7,601	
Other Long-term Liabilities	1,315	1,631	
Total Liabilities	20,694	21,005	
Common Stock \$1 Par Value	1,040	1,049	
Other Capital	11	6	
Retained Earnings	8,679	8,275	
Accumulated Other Comprehensive Loss (Note 1)	(849)	(875))
Noncontrolling Interest	14	13	
Total Shareholders' Equity	8,895	8,468	
Total Liabilities and Shareholders' Equity	\$29,589	\$29,473	

Certain prior year data has been reclassified to conform to the current presentation.

See accompanying notes to consolidated financial statements.

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CSX CORPORATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED CASH FLOW STATEMENTS (Unaudited)

(Dollars in millions)

	Six Months 2012	2011	
OPERATING ACTIVITIES			
Net Earnings	\$961	\$901	
Adjustments to Reconcile Net Earnings to Net Cash Provided by Operating Activities:			
Depreciation	520	489	
Deferred Income Taxes	300	280	
Contributions to Qualified Pension Plans	(275))—	
Other Operating Activities	(61)	) (10)
Changes in Operating Assets and Liabilities:			
Accounts Receivable	2	(121)
Other Current Assets	(70)	) (64)
Accounts Payable	(81)	) 35	
Income and Other Taxes Payable	118	76	
Other Current Liabilities	(123)	) (1)
Net Cash Provided by Operating Activities	1,291	1,585	
INVESTING ACTIVITIES			
Property Additions	(1,223	) (945)
Purchase of Short-term Investments	(58	) (8)
Proceeds from Sales of Short-term Investments	546	42	
Other Investing Activities	6	(18)
Net Cash Used in Investing Activities	(729	) (929)
FINANCING ACTIVITIES			
Long-term Debt Issued (Note 7)	300	600	
Long-term Debt Repaid (Note 7)	(455	) (570)
Dividends Paid	(270	) (228)
Stock Options Exercised (Note 3)	10	24	
Shares Repurchased	(300	) (528)
Other Financing Activities	12	6	
Net Cash Used in Financing Activities	(703	) (696)
Net Decrease in Cash and Cash Equivalents	(141	) (40)
CASH AND CASH EQUIVALENTS			
Cash and Cash Equivalents at Beginning of Period	783	1,292	
Cash and Cash Equivalents at End of Period	\$642	\$1,252	

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

See accompanying notes to consolidated financial statements.

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CSX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. Nature of Operations and Significant Accounting Policies

Background

CSX Corporation (“CSX”), and together with its subsidiaries (the “Company”), based in Jacksonville, Florida, is one of the nation's leading transportation companies. The Company provides rail-based transportation services including traditional rail service and the transport of intermodal containers and trailers.

CSX's principal operating subsidiary, CSX Transportation, Inc. (“CSXT”), provides an important link to the transportation supply chain through its approximately 21,000 route mile rail network, which serves major population centers in 23 states east of the Mississippi River, the District of Columbia and the Canadian provinces of Ontario and Quebec. The Company's intermodal business, also part of CSXT, links customers to railroads via trucks and terminals.

Other entities

In addition to CSXT, the Company's subsidiaries include CSX Intermodal Terminals, Inc. (“CSX Intermodal Terminals”), Total Distribution Services, Inc. (“TDSI”), Transflo Terminal Services, Inc. (“Transflo”), CSX Technology, Inc. (“CSX Technology”) and other subsidiaries. CSX Intermodal Terminals owns and operates a system of intermodal terminals, predominantly in the eastern United States and also performs drayage services (the pickup and delivery of intermodal shipments) for certain CSXT customers and trucking dispatch operations. TDSI serves the automotive industry with distribution centers and storage locations. Transflo connects non-rail served customers to the many benefits of rail by transferring products from rail to trucks. Today, the biggest Transflo markets are chemicals and agriculture, such as minerals and ethanol. CSX Technology and other subsidiaries provide support services for the Company.

CSX's other holdings include CSX Real Property, Inc., a subsidiary responsible for the Company's real estate sales, leasing, acquisition and management and development activities. These activities are classified in other income - net because they are not considered to be operating activities by the Company. Results of these activities fluctuate with the timing of non-operating real estate transactions.

Basis of Presentation

In the opinion of management, the accompanying consolidated financial statements contain all normal, recurring adjustments necessary to fairly present the following:

- Consolidated income statements for the quarters and six months ended June 29, 2012 and July 1, 2011;
- Consolidated comprehensive income statements for the quarters and six months ended June 29, 2012 and July 1, 2011;
- Consolidated balance sheets at June 29, 2012 and December 30, 2011; and
- Consolidated cash flow statements for the six months ended June 29, 2012 and July 1, 2011.

Pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”), certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been omitted from these interim financial statements. CSX suggests that these financial statements be read in conjunction with the audited financial statements and the notes

included in CSX's most recent annual report on Form 10-K and any subsequently filed current reports on Form 8-K.

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. Nature of Operations and Significant Accounting Policies, continued

Fiscal Year

CSX follows a 52/53 week fiscal reporting calendar with the last day of each reporting period ending on a Friday:

• The second fiscal quarters of 2012 and 2011 consisted of 13 weeks ending on June 29, 2012 and July 1, 2011, respectively.

• The six month periods of 2012 and 2011 consisted of 26 weeks ending on June 29, 2012 and July 1, 2011, respectively.

• Fiscal year 2012 and 2011 will each consist of 52 weeks ending on December 28, 2012 and December 30, 2011, respectively.

Except as otherwise specified, references to “second quarter(s)” or “six months” indicate CSX’s fiscal periods ending June 29, 2012 and July 1, 2011, and references to “year-end” indicate the fiscal year ended December 30, 2011.

Comprehensive Earnings

CSX reports comprehensive earnings or loss in accordance with the Comprehensive Income Topic in the Accounting Standards Codification (“ASC”). Total comprehensive earnings are defined as all changes in shareholders' equity during a period, other than those resulting from investments by and distributions to shareholders (e.g., issuance of equity securities and dividends). Generally, for CSX, total comprehensive earnings equals net earnings plus or minus adjustments for pension and other post-retirement liabilities. Total comprehensive earnings represent the activity for a period net of tax and were \$529 million and \$519 million for second quarters 2012 and 2011, respectively, and \$987 million and \$925 million for six months 2012 and 2011, respectively.

While total comprehensive earnings is the activity in a period and is largely driven by net earnings in that period, accumulated other comprehensive income or loss (“AOCI”) represents the cumulative balance of other comprehensive income or loss, net of tax, as of the balance sheet date. For CSX, AOCI is primarily the cumulative balance related to pension and other post-retirement adjustments and reduced overall equity by \$849 million and \$875 million as of the end of second quarter 2012 and December 2011, respectively.

See the New Accounting Pronouncements section below for information related to the change in presentation requirements.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts on uncollectible amounts related to freight receivables, government reimbursement receivables, claims for damages and other various receivables. The allowance is based upon the credit worthiness of customers, historical experience, the age of the receivable and current market and economic conditions. Uncollectible amounts are charged against the allowance account. Allowance for doubtful accounts of \$44 million and \$43 million is included in the consolidated balance sheets as of the end of second quarter 2012 and December 2011, respectively.

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. Nature of Operations and Significant Accounting Policies, continued

New Accounting Pronouncements

In 2011, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update to the Comprehensive Income Topic in the ASC aimed at increasing the prominence of items reported in other comprehensive income in the financial statements. This requirement became effective for CSX beginning with the first quarter 2012 10-Q filing. This update required companies to present comprehensive income in a single statement below net income or in a separate statement of comprehensive income immediately following the income statement. This update required retrospective application for all periods presented.

Other Items

Share repurchases

CSX did not repurchase any shares in the second quarter of 2012. As of June 2012, the Company had remaining authority of \$434 million under the \$2 billion share repurchase program which is expected to be used to complete purchases by the end of 2012, assuming sound market and business conditions.

Amortization of Gain from Property Disposition

In November 2011, the Company sold approximately 61 miles of operating rail corridor to the Florida Department of Transportation. As part of the transaction, the Company received \$173 million in proceeds and will receive up to \$259 million in government grants for a total of \$432 million. This agreement also obligated the Company to invest a total of \$500 million in routine capital expenditures and maintenance related to transportation capacity, facilities or equipment in Florida, including diversion and relocation costs related to this transaction within the eight year period following the transaction.

In accordance with the Real Estate Sales Topic in the ASC, the sale of real estate resulted in a deferred gain of \$146 million upon conveyance. The deferred gain is recognized into income ratably as the investment obligation is fulfilled. The Company recognized a gain of \$20 million and \$39 million in the second quarter and six months period ended June 2012, respectively. This gain is included in materials, supplies and other in the consolidated income statements. The deferred gain balance included in the consolidated balance sheets is presented in the table below.

(Dollars in Millions)	Deferred gain as of	
	June 2012	December 2011
Current portion, included in Other Current Liabilities	\$84	\$95
Long term portion, included in Other Long-Term Liabilities	9	37
Total	\$93	\$132

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 2. Earnings Per Share

The following table sets forth the computation of basic earnings per share and earnings per share, assuming dilution:

	Second Quarters		Six Months	
	2012	2011	2012	2011
Numerator (Dollars in millions):				
Net Earnings	\$512	\$506	\$961	\$901
Denominator (Units in millions):				
Average Common Shares Outstanding	1,041	1,102	1,044	1,105
Other Potentially Dilutive Common Shares ^(a)	2	7	2	7
Average Common Shares Outstanding, Assuming Dilution	1,043	1,109	1,046	1,112
Net Earnings Per Share, Basic	\$0.49	\$0.46	\$0.92	\$0.81
Net Earnings Per Share, Assuming Dilution	\$0.49	\$0.46	\$0.92	\$0.81

(a) Other potentially dilutive common shares include convertible debt, stock options, common stock equivalents and performance units granted under a long-term management incentive compensation plan.

Basic earnings per share is based on the weighted-average number of shares of common stock outstanding. Earnings per share, assuming dilution, is based on the weighted-average number of shares of common stock outstanding adjusted for the effects of common stock that may be issued as a result of the following types of potentially dilutive instruments:

- convertible debt;
- employee stock options; and
- other equity awards, which include long-term incentive awards.

The Earnings Per Share Topic in the ASC requires CSX to include additional shares in the computation of earnings per share, assuming dilution. The additional shares included in diluted earnings per share represent the number of shares that would be issued if all of the above potentially dilutive instruments were converted into CSX common stock.

When calculating diluted earnings per share, the Earnings Per Share Topic in the ASC requires CSX to include the potential shares that would be outstanding if all outstanding stock options were exercised. This is offset by shares CSX could repurchase using the proceeds from these hypothetical exercises to obtain the common stock equivalent. This number is different from outstanding stock options, which is included in Note 3, Share-Based Compensation. All stock options were dilutive for the periods presented; therefore, no stock options were excluded from the diluted earnings per share calculation.

Diluted shares outstanding are not impacted when debentures are converted into CSX common stock because those shares were already included in the diluted shares calculation. Shares outstanding for basic earnings per share, however, are impacted on a weighted-average basis when conversions occur. During second quarters 2012 and 2011, approximately \$1 million and \$5 million of face value convertible debentures were converted into 137 thousand and 528 thousand shares of CSX common stock, respectively. As of the end of second quarter 2012, approximately \$2

million of convertible debentures at face value remained outstanding, which are convertible into approximately 250 thousand shares of CSX common stock.

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 3. Share-Based Compensation

Under CSX's share-based compensation plans, awards primarily consist of performance grants, restricted stock awards, restricted stock units, stock options and stock grants for directors. CSX has not granted stock options since 2003. Awards granted under the various programs are determined and approved by the Compensation Committee of the Board of Directors or, in certain circumstances, by the Chief Executive Officer for awards to management employees other than senior executives. The Board of Directors approves awards granted to the Company's non-management directors upon recommendation of the Governance Committee.

In May 2012, approximately 1.3 million performance units were granted to key members of management under a new long-term incentive plan ("LTIP") adopted under the CSX Stock and Incentive Award Plan. This LTIP provides for a three-year cycle ending in fiscal year 2014. Similar to the two existing plans, the financial target upon which payments are based is operating ratio, which is defined as operating expenses divided by operating revenue and is calculated excluding certain non-recurring items. Grants were made in performance units, with each unit being equivalent to one share of CSX common stock, and payouts will be made in CSX common stock. The payout range for participants will be between 0% and 200% of the original grant based upon CSX's attainment of pre-established operating ratio targets for fiscal year 2014. Payouts to certain senior executive officers are subject to a reduction of up to 30% at the discretion of the Compensation Committee of the Board of Directors based upon Company performance against certain CSX strategic initiatives.

Additionally, as part of the 2012 LTIP, the Company granted approximately 433 thousand time-based restricted stock units to key members of management. The restricted stock units vest three years after the date of grant and participants receive cash dividend equivalents on the unvested shares during the restriction period. These awards are time-based and support retention objectives.

For information related to the Company's other outstanding long-term incentive compensation, see CSX's most recent annual report on Form 10-K.

Total pre-tax expense associated with all share-based compensation and the related income tax benefit are as follows:

(Dollars in millions)	Second Quarters		Six Months	
	2012	2011	2012	2011
Share-Based Compensation Expense	\$4	\$11	\$4	\$22
Income Tax Benefit	1	4	1	8

The following table provides information about stock options exercised and expired.

(In thousands)	Second Quarters		Six Months	
	2012	2011	2012	2011
Number of Stock Options Exercised	319	675	1,618	3,954
Number of Stock Options Expired	—	21	15	21

As of December 2009, all outstanding options were vested, and therefore, there will be no future expense related to these options. As of the end of second quarter 2012, CSX had approximately 2.5 million stock options outstanding.

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 4. Casualty, Environmental and Other Reserves

Casualty, environmental and other reserves are considered critical accounting estimates due to the need for significant management judgments. They are provided for in the consolidated balance sheets as follows:

(Dollars in millions)	June 29, 2012			December 30, 2011		
	Current	Long-term	Total	Current	Long-term	Total
Casualty:						
Personal Injury	\$93	\$156	\$249	\$93	\$168	\$261
Occupational	6	34	40	6	37	43
Asbestos	11	52	63	11	57	68
Total Casualty	110	242	352	110	262	372
Environmental	39	42	81	31	52	83
Other ^(a)	22	43	65	26	38	64
Total	\$171	\$327	\$498	\$167	\$352	\$519

(a) Separation liabilities and freight rate dispute reserves have been reclassified to other current and long-term liabilities.

These liabilities are accrued when estimable and probable in accordance with the Contingencies Topic in the ASC. Actual settlements and claims received could differ. The final outcome of these matters cannot be predicted with certainty. Considering the legal defenses currently available, the liabilities that have been recorded and other factors, it is the opinion of management that none of these items, when finally resolved, will have a material effect on the Company's financial condition, results of operations or liquidity. Should a number of these items occur in the same period, however, they could have a material effect on the Company's financial condition, results of operations or liquidity in that particular period.

Casualty

Casualty reserves represent accruals for personal injury, occupational injury and asbestos claims. During 2010, the Company increased its self-insured retention amount for these claims from \$25 million to \$50 million per injury for claims occurring on or after June 1, 2010. Currently, no individual claim is expected to exceed the self-insured retention amount. In accordance with the Contingencies Topic in the ASC, to the extent the value of an individual claim exceeds the self-insured retention amount, the Company would present the liability on a gross basis with a corresponding receivable for insurance recoveries. These reserves fluctuate based upon the timing of payments as well as changes in independent third-party estimates, which are reviewed by management. Actual results may vary from estimates due to the number, type and severity of the injury, costs of medical treatments and uncertainties in litigation. Most of the claims relate to CSXT unless otherwise noted below. Defense and processing costs, which historically have been insignificant and are anticipated to be insignificant in the future, are not included in the recorded liabilities.

Personal Injury

Personal injury reserves represent liabilities for employee work-related and third-party injuries. Work-related injuries for CSXT employees are primarily subject to the Federal Employers' Liability Act ("FELA"). In addition to FELA liabilities, current or former employees of other CSX subsidiaries are covered by various state workers' compensation laws, the Federal Longshore and Harbor Workers' Compensation Program or the Maritime Jones Act.

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 4. Casualty, Environmental and Other Reserves, continued

CSXT retains an independent actuarial firm to assist management in assessing the value of personal injury claims. An analysis is performed by the independent actuarial firm quarterly and is reviewed by management. The methodology used by the actuary includes a development factor to reflect growth or reduction in the value of these personal injury claims. It is based largely on CSXT's historical claims and settlement experience.

Occupational and Asbestos

Occupational claims arise from allegations of exposures to certain materials in the workplace, such as solvents, soaps, chemicals (collectively referred to as "irritants") and diesel fuels (like exhaust fumes) or allegations of chronic physical injuries resulting from work conditions, such as repetitive stress injuries, carpal tunnel syndrome and hearing loss. The Company is also party to a number of asbestos claims by current or former employees alleging exposure to asbestos in the workplace.

An analysis of occupational claims is performed quarterly by an independent third-party actuarial firm and reviewed by management. Management performs a quarterly review of asserted asbestos claims, and an analysis is performed annually by an independent third-party specialist and reviewed by management. The objective of the occupational and asbestos claims analyses performed by the third-party actuarial firm and specialist (the "third-party specialists") is to determine the number of incurred but not reported ("IBNR") claims. The third party specialists analyze CSXT's historical claim filings, settlement amounts, and dismissal rates to determine future anticipated claim filing rates and average settlement values for occupational and asbestos claims reserves. The potentially exposed population is estimated by using CSX's employment records and industry data. From this analysis, the third-party specialists provide an estimate of the IBNR claims liability.

Environmental

The Company is a party to various proceedings related to environmental issues, including administrative and judicial proceedings involving private parties and regulatory agencies. The Company has been identified as a potentially responsible party at approximately 263 environmentally impaired sites. Many of these are, or may be, subject to remedial action under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, or CERCLA, also known as the Superfund Law, or similar state statutes. Most of these proceedings arose from environmental conditions on properties used for ongoing or discontinued railroad operations. A number of these proceedings, however, are based on allegations that the Company, or its predecessors, sent hazardous substances to facilities owned or operated by others for treatment, recycling or disposal. In addition, some of the Company's land holdings were leased to others for commercial or industrial uses that may have resulted in releases of hazardous substances or other regulated materials onto the property and could give rise to proceedings against the Company.

In any such proceedings, the Company is subject to environmental clean-up and enforcement actions under the Superfund Law, as well as similar state laws that may impose joint and several liability for clean-up and enforcement costs on current and former owners and operators of a site without regard to fault or the legality of the original conduct. These costs could be substantial.

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 4. Casualty, Environmental and Other Reserves, continued

In accordance with the Asset Retirement and Environmental Obligations Topic in the ASC, the Company reviews its role with respect to each site identified at least quarterly, giving consideration to a number of factors such as:

- type of clean-up required;
- nature of the Company's alleged connection to the location (e.g., generator of waste sent to the site or owner or operator of the site);
- extent of the Company's alleged connection (e.g., volume of waste sent to the location and other relevant factors); and
- number, connection and financial viability of other named and unnamed potentially responsible parties at the location.

Based on the review process, the Company has recorded amounts to cover contingent anticipated future environmental remediation costs with respect to each site to the extent such costs are estimable and probable. The recorded liabilities for estimated future environmental costs are undiscounted. 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. Payments related to these liabilities are expected to be made over the next several years.

Currently, the Company does not possess sufficient information to reasonably estimate the amounts of additional liabilities, if any, on some sites until completion of future environmental studies. In addition, conditions that are currently unknown could, at any given location, result in additional exposure, the amount and materiality of which cannot presently be reliably estimated. Based upon information currently available, however, the Company believes its environmental reserves are adequate to cover remedial actions to comply with present laws and regulations.

Other

Other reserves include liabilities for various claims, such as longshoremen disability claims, and claims for property, automobile and general liability. Separation liabilities and freight rate dispute reserves have been reclassified to other current and long-term liabilities.

NOTE 5. Commitments and Contingencies

Insurance

The Company maintains numerous insurance programs with substantial limits for property damage (which includes business interruption) and third-party liability. A certain amount of risk is retained by the Company on each of the liability and property programs. The Company has a \$25 million retention per occurrence for the non-catastrophic property program (such as a derailment) and a \$50 million retention per occurrence for the liability and catastrophic property programs (such as hurricanes and floods).

While the Company believes its current insurance coverage is adequate to cover its damages, future claims could exceed existing insurance coverage or insurance may not continue to be available at commercially reasonable rates.

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 5. Commitments and Contingencies, continued

Legal

The Company is involved in litigation incidental to its business and is a party to a number of legal actions and claims, various governmental proceedings and private civil lawsuits, including, but not limited to, those related to environmental and hazardous material exposure matters, FELA claims by employees, other personal injury claims and disputes and complaints involving certain transportation rates and charges. Some of the legal proceedings include claims for compensatory as well as punitive damages and others are, or are purported to be, class actions. While the final outcome of these matters cannot be reasonably determined, considering, among other things, the legal defenses available and liabilities that have been recorded along with applicable insurance, it is currently the opinion of CSX management that none of these pending items will have a material adverse effect on the Company's financial condition, results of operations or liquidity. An unexpected adverse resolution of one or more of these items, however, could have a material adverse effect on the Company's financial condition, results of operations or liquidity in that particular period.

The Company is able to estimate a range of possible loss for certain legal proceedings for which a loss is reasonably possible in excess of reserves established. The Company has estimated this range to be \$2 million to approximately \$14 million in aggregate at June 29, 2012. This estimated aggregate range is based upon currently available information and is subject to significant judgment and a variety of assumptions. Accordingly, the Company's estimate will change from time to time, and actual losses may vary significantly from the current estimate.

Fuel Surcharge Antitrust Litigation

In May 2007, class action lawsuits were filed against CSXT and three other U.S.-based Class I railroads alleging that the defendants' fuel surcharge practices relating to contract and unregulated traffic resulted from an illegal conspiracy in violation of antitrust laws. The suits seek unquantified treble damages allegedly sustained by purported class members as well as attorneys' fees and other relief. In November 2007, the class action lawsuits were consolidated and are now pending in federal court in the District of Columbia.

On June 21, 2012, the court certified the case as a class action. The decision was not a ruling on the merits of plaintiffs' claims, rather a decision to allow the plaintiffs to seek to prove the case as a class. The defendant railroads have petitioned the appeals court to review the certification decision. CSXT believes that its fuel surcharge practices were arrived at and applied lawfully and that the case is without merit. Accordingly, the Company intends to defend itself vigorously. However, penalties for violating antitrust laws can be severe, and an unexpected adverse decision on the merits could have a material adverse effect on the Company's financial condition, results of operations or liquidity in that particular period or for the full year.

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NOTE 6. Employee Benefit Plans

The Company sponsors defined benefit pension plans principally for salaried, management personnel. For employees hired on or before December 31, 2002, the plans provide eligible employees with retirement benefits based predominantly on years of service and compensation rates near retirement. For employees hired in 2003 or thereafter, benefits are determined based on a cash balance formula, which provides benefits by utilizing interest and pay credits based upon age, service and compensation.

In addition to these plans, the Company sponsors a self-insured, post-retirement medical plan and a life insurance plan that provide benefits to full-time, salaried, management employees, hired prior to January 1, 2003, upon their retirement if certain eligibility requirements are met. Medicare-eligible retirees are covered by a health reimbursement arrangement, which is an employer-funded account that can be used for reimbursement of eligible medical expenses. Non-Medicare eligible retirees will continue to be covered by the existing self-insured program. The life insurance plan is non-contributory.

The Company engages independent actuaries to compute the amounts of liabilities and expenses relating to these plans subject to the assumptions that the Company selects. These amounts are reviewed by management. The following table describes the components of expense / (income) related to net benefit expense:

(Dollars in millions)	Pension Benefits				
	Second Quarters		Six Months		
	2012	2011	2012	2011	
Service Cost	\$11	\$10	\$22	\$20	
Interest Cost	30	30	61	60	
Expected Return on Plan Assets	(42)(40) (81)(79)
Amortization of Net Loss	21	18	41	36	
Total Expense	\$20	\$18	\$43	\$37	
	Other Post-retirement Benefits				
(Dollars in millions)	Second Quarters		Six Months		
	2012	2011	2012	2011	
	Service Cost	\$1	\$1	\$2	\$2
Interest Cost	4	3	8	6	
Amortization of Net Loss	3	2	5	3	
Amortization of Prior Service Costs	(1)(1) (1)(1)
Total Expense	\$7	\$5	\$14	\$10	

Qualified pension plan obligations are funded in accordance with prescribed regulatory requirements and with an objective of meeting minimum funding requirements necessary to avoid restrictions on flexibility of plan operation and benefit payments. During first quarter 2012, the Company made a contribution of \$275 million to its qualified pension plans, of which \$25 million was the required minimum contribution. At this time, the Company anticipates that no further contributions to its qualified pension plans will be required in 2012. For further details, see Note 8, Employee Benefit Plans, in CSX's most recent annual report on Form 10-K.

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NOTE 7. Debt and Credit Agreements

Total activity related to long-term debt as of the end of second quarter 2012 was as follows:

(Dollars in millions)	Current Portion	Long-term Portion	Total
Long-term debt as of December 2011	\$507	\$8,734	\$9,241
2012 activity:			
Long-term debt issued	—	300	300
Long-term debt repaid	(455	)—	(455
Reclassifications	457	(457)—
Capital lease additions	—	7	7
Debt conversions to CSX stock	(1	)—	(1
Discount and premium activity	—	(3	) (3
Long-term debt as of the end of second quarter 2012	\$508	\$8,581	\$9,089

For fair value information related to the Company's long-term debt, see Note 9, Fair Value Measurements.

Debt Issuance

During first quarter 2012, CSX issued \$300 million of 4.4% notes due 2043. These notes are included in the consolidated balance sheets under long-term debt and may be redeemed by the Company at any time. The net proceeds from the issuance were used primarily in connection with a \$275 million contribution to the Company's qualified pension plan.

Credit Facility

CSX has a \$1 billion unsecured, revolving credit facility backed by a diverse syndicate of banks. This facility expires in September 2016, and as of the date of this filing, the Company has no outstanding balances under this facility. The facility allows borrowings at floating (LIBOR-based) interest rates, plus a spread, depending upon CSX's senior unsecured debt ratings. LIBOR is the London Interbank Offered Rate which is a daily reference rate based on the interest rates at which banks offer to lend unsecured funds. As of second quarter 2012, CSX was in compliance with all covenant requirements under this facility.

Receivables Securitization Facility

The Company's \$250 million receivables securitization facility has a 364-day term and expires in June 2013. The Company's intention is to continue to renew this facility prior to its expiration. The purpose of this facility is to provide an alternative to commercial paper and a low cost source of short-term liquidity. As of the date of this filing, the Company has no outstanding balances under this facility.

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CSX CORPORATION

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NOTE 8. Other Income - Net

The Company derives income from items that are not considered operating activities. Income from these items is reported net of related expense. Other income - net consisted of the following:

(Dollars in millions)	Second Quarters		Six Months	
	2012	2011	2012	2011
Interest Income	\$1	\$1	\$3	\$2
Income from Real Estate	2	5	8	8
Miscellaneous Income (Expense)	2	(6	) (2	)(5
Total Other Income - Net	\$5	\$—	\$9	\$5

NOTE 9. Income Taxes

During second quarter 2012, the Company recorded an income tax benefit of \$9 million, or \$0.01 per share, as a result of the resolution of certain tax matters as well as changes in state legislation. During second quarter 2011, the Company recorded a net income tax benefit of \$14 million, or just over \$0.01 per share, primarily as a result of changes in state legislation.

There have been no material changes to the balance of unrecognized tax benefits during second quarter 2012.

NOTE 10. Fair Value Measurements

The Financial Instruments Topic in the ASC requires disclosures about fair value of financial instruments in annual reports as well as in quarterly reports. For CSX, this statement applies to certain investments and long-term debt. Disclosure of the fair value of pension plan assets is only required annually. Also, this rule clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value and requires additional disclosures about the use of fair value measurements.

Various inputs are considered when determining the value of the Company's investments, pension plan assets and long-term debt. The inputs or methodologies used for valuing securities are not necessarily an indication of the risk associated with investing in these securities. These inputs are summarized in the three broad levels listed below.

Level 1 - observable market inputs that are unadjusted quoted prices for identical assets or liabilities in active markets

Level 2 - other significant observable inputs (including quoted prices for similar securities, interest rates, credit risk, etc.)

Level 3 - significant unobservable inputs (including the Company's own assumptions in determining the fair value of investments)

The valuation methods described below may produce a fair value calculation that is not indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

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CSX CORPORATION

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NOTE 10. Fair Value Measurements, continued

Investments

The Company's investment assets, valued with the assistance of a third-party trustee, consist of certificates of deposits, corporate bonds, U.S. government securities and auction rate securities and are carried at fair value on the consolidated balance sheet per the Fair Value Measurements and Disclosures Topic in the ASC. There are several valuation methodologies used for those assets as described below.

• Certificates of Deposit (Level 2): Valued by discounting the related cash flows based on current yields of similar instruments with comparable durations.

• Corporate Bonds and U.S. Treasury Obligations (Level 2): Valued using price evaluations reflecting the bid and/or ask sides of the market for a similar investment as of the last day of the fiscal period.

• Auction Rate Securities (Level 3): Valued using a discounted cash flow model, because there is currently no active market for trading.

The Company's investment assets are carried at fair value on the consolidated balance sheets as summarized in the tables below. Additionally, the amortized cost basis of these investments was \$178 million and \$643 million as of June 29, 2012 and December 30, 2011, respectively.

(Dollars in Millions)	June 2012				December 2011			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Certificates of Deposit	\$—	\$—	\$—	\$—	\$—	\$477	\$—	\$477
Corporate Bonds	—	131	—	131	—	98	—	98
U.S. Treasury Obligations	—	33	—	33	—	53	—	53
Auction Rate Securities	—	—	15	15	—	—	15	15
Total investments at fair value	\$—	\$164	\$15	\$179	\$—	\$628	\$15	\$643

These investments have the following maturities:

(Dollars in millions)	June 29, 2012	December 30, 2011
Less than 1 year	\$41	\$523
1 - 2 years	39	32
2 - 5 years	79	73
Greater than 5 years	20	15
Total	\$179	\$643

Long-term Debt

Long-term debt is reported at carrying amount on the consolidated balance sheets and is the Company's only financial instrument with fair values significantly different from their carrying amounts. The majority of the Company's long-term debt is valued with the assistance of an independent third party who utilizes closing transactions, market quotes or market values of comparable debt. For those instruments not valued by the third party, the fair value has been estimated by applying market rates of similar instruments to the scheduled contractual debt payments and maturities. These market rates are provided by the same third party. All of the inputs used to determine the fair value of the Company's long-term debt are Level 2 inputs.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 10. Fair Value Measurements, continued

The fair value of outstanding debt fluctuates with changes in a number of factors. Such factors include, but are not limited to, interest rates, market conditions, values of similar financial instruments, size of the transaction, cash flow projections and comparable trades. Fair value will exceed carrying value when the current market interest rate is lower than the interest rate at which the debt was originally issued. The fair value of a company's debt is a measure of its current value under present market conditions. It does not impact the financial statements under current accounting rules.

The fair value and carrying value of the Company's long-term debt is as follows:

(Dollars in millions)	June 29, 2012	December 30, 2011
Long-term Debt Including		
Current Maturities:		
Fair Value	\$ 10,621	\$ 10,708
Carrying Value	\$ 9,089	\$ 9,241

NOTE 11. Summarized Consolidating Financial Data

In 2007, CSXT sold secured equipment notes maturing in 2023, and in 2008, CSXT sold additional secured equipment notes maturing in 2014 in registered public offerings. CSX has fully and unconditionally guaranteed the notes. In connection with the notes, the Company is providing the following condensed consolidating financial information in accordance with SEC disclosure requirements. Each entity in the consolidating financial information follows the same accounting policies as described in the consolidated financial statements, except for the use of the equity method of accounting to reflect ownership interests in subsidiaries which are eliminated upon consolidation and the allocation of certain expenses of CSX incurred for the benefit of its subsidiaries.

Condensed consolidating financial information for the obligor, CSXT, and parent guarantor, CSX, is as follows:

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 11. Summarized Consolidating Financial Data, continued

Consolidating Income Statements

(Dollars in millions)

Second Quarter 2012	CSX Corporation	CSX Transportation	Eliminations and Other	Consolidated
Revenue	\$—	\$2,995	\$17	\$3,012
Expense	(89)	)2,192	(34)	)2,069
Operating Income	89	803	51	943
Equity in Earnings of Subsidiaries	557	—	(557))—
Interest (Expense) / Benefit	(125)	) (17)	) 3	(139)
Other Income / (Expense) - Net	(1)	) 1	5	5
Earnings Before Income Taxes	520	787	(498)	) 809
Income Tax (Expense) / Benefit	(8)	) (270)	) (19)	) (297)
Net Earnings	\$512	\$517	\$(517)	) \$512
Total Comprehensive Earnings	\$529	\$518	\$(518)	) \$529
Second Quarter 2011	CSX Corporation	CSX Transportation	Eliminations and Other	Consolidated
Revenue	\$—	\$3,003	\$16	\$3,019
Expense	(68)	)2,222	(61)	)2,093
Operating Income	68	781	77	926
Equity in Earnings of Subsidiaries	540	2	(542))—
Interest (Expense) / Benefit	(121)	) (22)	) 9	(134)
Other Income / (Expense) - Net	1	—	(1))—
Earnings Before Income Taxes	488	761	(457)	) 792
Income Tax (Expense) / Benefit	18	(275)	) (29)	) (286)
Net Earnings	\$506	\$486	\$(486)) \$506
Total Comprehensive Earnings	\$519	\$485	\$(485)) \$519

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CSX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 11. Summarized Consolidating Financial Data, continued

Consolidating Income Statements

(Dollars in millions)

Six Months Ended June 29, 2012	CSX Corporation	CSX Transportation	Eliminations and Other	Consolidated
Revenue	\$—	\$5,945	\$33	\$5,978
Expense	(176)	)4,421	(66)	)4,179
Operating Income	176	1,524	99	1,799
Equity in Earnings of Subsidiaries	1,034	(1	)(1,033)—
Interest (Expense) / Benefit	(255	)(36	)8	(283
Other Income / (Expense) - Net	(2	)4	7	9
Earnings Before Income Taxes	953	1,491	(919	)1,525
Income Tax (Expense) / Benefit	8	(533	)(39	)(564
Net Earnings	\$961	\$958	\$(958	)\$961
Total Comprehensive Earnings	\$987	\$956	\$(956	)\$987
Six Months Ended July 1, 2011	CSX Corporation	CSX Transportation	Eliminations and Other	Consolidated
Revenue	\$—	\$5,797	\$32	\$5,829
Expense	(133	)4,364	(101	)4,130
Operating Income	133	1,433	133	1,699
Equity in Earnings of Subsidiaries	972	3	(975)—
Interest (Expense) / Benefit	(247	)(45	)18	(274
Other Income / (Expense) - Net	3	2	—	5
Earnings Before Income Taxes	861	1,393	(824	)1,430
Income Tax (Expense) / Benefit	40	(516	)(53	)(529
Net Earnings	\$901	\$877	\$(877	)\$901
Total Comprehensive Earnings	\$925	\$877	\$(877	)\$925