CSX CORP
Form 10-Q
July 19, 2012

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 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 (X) 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 (X) 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 (X) Accelerated Filer ( )

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 (X)
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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FOR THE QUARTERLY PERIOD ENDED JUNE 29, 2012
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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

See accompanying notes to consolidated financial statements.

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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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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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(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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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.

	Deferred gain as of	
(Dollars in Millions)	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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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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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:

	Second Quarters		Six Months	
(Dollars in millions)	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.

	Second Quarters		Six Months	
(In thousands)	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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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:

	June 29, 2012			December 30, 2011		
(Dollars in millions)	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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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.

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.

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:

	Pension Benefits			
(Dollars in millions)	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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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:

	Second Quarters		Six Months	
(Dollars in millions)	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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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.

	June 2012				December 2011			
(Dollars in Millions)	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.

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
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(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

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

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CSX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 11. Summarized Consolidating Financial Data, continued

Consolidating Balance Sheet
(Dollars in millions)

As of Second Quarter 2012	CSX Corporation	CSX Transportation	Eliminations and Other	Consolidated
ASSETS				
Current Assets				
Cash and Cash Equivalents	$405	$160	$77	$642
Short-term Investments	—	—	41	41
Accounts Receivable - Net	9	531	596	1,136
Receivable from Affiliates	1,071	1,509	(2,580)	—
Materials and Supplies	—	256	—	256
Deferred Income Taxes	20	153	(1)	172
Other Current Assets	18	100	7	125
Total Current Assets	1,523	2,709	(1,860)	2,372
Properties	8	32,777	1,831	34,616
Accumulated Depreciation	(8)	(7,997)	(979)	(8,984)
Properties - Net	—	24,780	852	25,632
Investments in Conrail	—	—	687	687
Affiliates and Other Companies	(39)	578	(43)	496
Investments in Consolidated Subsidiaries	18,212	—	(18,212)	—
Other Long-term Assets	184	277	(59)	402
Total Assets	$19,880	$28,344	$(18,635)	$29,589
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current Liabilities				
Accounts Payable	$102	$925	$28	$1,055
Labor and Fringe Benefits Payable	35	370	29	434
Payable to Affiliates	2,351	446	(2,797)	—
Casualty, Environmental and Other Reserves	—	155	16	171
Current Maturities of Long-term Debt	400	107	1	508
Income and Other Taxes Payable	(22)	236	14	228
Other Current Liabilities	(1)	177	3	179
Total Current Liabilities	2,865	2,416	(2,706)	2,575
Casualty, Environmental and Other Reserves	—	256	71	327
Long-term Debt	7,507	1,074	—	8,581
Deferred Income Taxes	(143)	7,965	74	7,896
Other Long-term Liabilities	770	624	(79)	1,315
Total Liabilities	$10,999	$12,335	$(2,640)	$20,694
Shareholders' Equity				

Common Stock, $1 Par Value	1,040	181	(181)	1,040
Other Capital	11	5,668	(5,668)	11
Retained Earnings	8,679	10,219	(10,219)	8,679
Accumulated Other Comprehensive Loss	(849)	(81)	81	(849)
Noncontrolling Interest	—	22	(8)	14
Total Shareholders' Equity	8,881	16,009	(15,995)	8,895
Total Liabilities and Shareholders' Equity	$19,880	$28,344	$(18,635)	$29,589

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CSX CORPORATION
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(Unaudited)

NOTE 11. Summarized Consolidating Financial Data, continued
Consolidating Balance Sheet
(Dollars in millions)

As of December 2011	CSX Corporation	CSX Transportation	Eliminations and Other	Consolidated
ASSETS				
Current Assets				
Cash and Cash Equivalents	$549	$154	$80	$783
Short-term Investments	475	—	48	523
Accounts Receivable - Net	4	468	657	1,129
Receivable from Affiliates	1,025	1,772	(2,797)	—
Materials and Supplies	—	240	—	240
Deferred Income Taxes	10	173	(1)	182
Other Current Assets	17	64	(3)	78
Total Current Assets	2,080	2,871	(2,016)	2,935
Properties	8	31,958	1,738	33,704
Accumulated Depreciation	(8)	(7,795)	(927)	(8,730)
Properties - Net	—	24,163	811	24,974
Investments in Conrail	—	—	678	678
Affiliates and Other Companies	(39)	574	(42)	493
Investment in Consolidated Subsidiaries	17,519	—	(17,519)	—
Other Long-term Assets	176	109	108	393
Total Assets	$19,736	$27,717	$(17,980)	$29,473
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current Liabilities				
Accounts Payable	$114	$978	$55	$1,147
Labor and Fringe Benefits Payable	41	458	42	541
Payable to Affiliates	2,566	374	(2,940)	—
Casualty, Environmental and Other Reserves	—	151	16	167
Current Maturities of Long-term Debt	400	105	2	507
Income and Other Taxes Payable	(60)	189	—	129
Other Current Liabilities	(1)	194	3	196
Total Current Liabilities	3,060	2,449	(2,822)	2,687
Casualty, Environmental and Other Reserves	—	284	68	352
Long-term Debt	7,609	1,124	1	8,734
Deferred Income Taxes	(246)	7,800	47	7,601
Other Long-term Liabilities	858	667	106	1,631
Total Liabilities	$11,281	$12,324	$(2,600)	$21,005
Shareholders' Equity				
Common Stock, $1 Par Value	1,049	181	(181)	1,049
Other Capital	6	5,652	(5,652)	6

Retained Earnings	8,275	9,618	(9,618)	8,275
Accumulated Other Comprehensive Loss	(875)	(79)	79	(875)
Noncontrolling Minority Interest	—	21	(8)	13
Total Shareholders' Equity	8,455	15,393	(15,380)	8,468
Total Liabilities and Shareholders' Equity	$19,736	$27,717	$(17,980)	$29,473

CSX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 11. Summarized Consolidating Financial Data, continued
Consolidating Cash Flow Statements
(Dollars in millions)

Six months ended June 29, 2012	CSX Corporation	CSX Transportation	Eliminations and Other	Consolidated
Operating Activities				
Net Cash Provided by (Used in) Operating Activities	$37	$1,445	$(191)	$1,291
Investing Activities				
Property Additions	—	(1,130)	(93)	(1,223)
Purchases of Short-term Investments	(50)	—	(8)	(58)
Proceeds from Sales of Short-term Investments	525	—	21	546
Other Investing Activities	(3)	97	(88)	6
Net Cash Provided by (Used in) Investing Activities	472	(1,033)	(168)	(729)
Financing Activities				
Long-term Debt Issued	300	—	—	300
Long-term Debt Repaid	(400)	(54)	(1)	(455)
Dividends Paid	(270)	(357)	357	(270)
Stock Options Exercised	10	—	—	10
Shares Repurchased	(300)	—	—	(300)
Other Financing Activities	7	5	—	12
Net Cash Provided by (Used in) Financing Activities	(653)	(406)	356	(703)
Net Increase (Decrease) in Cash and Cash Equivalents	(144)	6	(3)	(141)
Cash and Cash Equivalents at Beginning of Period	549	154	80	783
Cash and Cash Equivalents at End of Period	$405	$160	$77	$642

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NOTE 11. Summarized Consolidating Financial Data, continued

Consolidating Cash Flow Statements
(Dollars in millions)

Six months ended July 1, 2011	CSX Corporation	CSX Transportation	Eliminations and Other	Consolidated
Operating Activities				
Net Cash Provided by (Used in) Operating Activities	$518	$1,270	$(203)	$1,585
Investing Activities				
Property Additions	—	(864)	(81)	(945)
Purchases of Short-term Investments	—	—	(8)	(8)
Proceeds from Sales of Short-term Investments	—	—	42	42
Other Investing Activities	(16)	(95)	93	(18)
Net Cash Provided by (Used in) Investing Activities	(16)	(959)	46	(929)
Financing Activities				
Long-term Debt Issued	600	—	—	600
Long-term Debt Repaid	(507)	(61)	(2)	(570)
Dividends Paid	(231)	(170)	173	(228)
Stock Options Exercised	24	—	—	24
Shares Repurchased	(528)	—	—	(528)
Other Financing Activities	28	(8)	(14)	6
Net Cash Provided by (Used in) Financing Activities	(614)	(239)	157	(696)
Net Increase (Decrease) in Cash and Cash Equivalents	(112)	72	—	(40)
Cash and Cash Equivalents at Beginning of Period	1,100	118	74	1,292
Cash and Cash Equivalents at End of Period	$988	$190	$74	$1,252

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CSX CORPORATION
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

STRATEGIC OVERVIEW

CSX provides rail-based freight transportation services including traditional rail service and the transport of intermodal containers and trailers. The Company and the rail industry provide customers with access to an expansive and interconnected transportation network that plays a key role in North American commerce and is critical to the economic success and global competitiveness of the United States. America is once again poised for a period of growth in manufacturing, as the economy continues to recover. The U.S. demand to move more goods by rail is expected to rise along with the need to reduce highway congestion and greenhouse gas emissions. CSX and freight railroads are the best way to meet this demand while reducing environmental impacts. CSX can move a ton of freight almost 500 miles on one gallon of fuel and, on average, over three times more fuel efficiently than trucks. Also, one rail car can move the equivalent of 3 truckloads which aids in alleviating highway congestion.

CSX's network is positioned to reach nearly two-thirds of Americans, who account for the majority of the nation's consumption of goods. Through this network, the Company transports a diverse portfolio of products and commodities to meet the country's needs. These products range from energy sources like coal and ethanol, to automobiles, chemicals, building materials, paper, metals, grains and consumer products. The Company categorizes these products into three primary lines of business: merchandise, coal and intermodal. CSX's transportation solutions connect industries across the United States with each other and with global markets by meeting the transportation needs of port facilities, energy producers, manufacturers, industrial producers, construction companies, farmers and feed mills, wholesalers and retailers and the United States armed forces.

CSX services are delivered by dedicated employees whose jobs cannot be exported overseas. Railroad jobs are among some of the nation's highest paying. In 2011, CSX continued its job creation efforts by hiring more than 4,000 new employees, which was comprised primarily of operations employees, that will carry forward with this legacy.

Strategic Growth Initiatives

As CSX continues to strengthen its core business, the Company is focusing on three key strategic growth initiatives related to intermodal, export coal and an initiative to enhance customer service quality also known to CSX as Total Service Integration. The Company believes these initiatives will allow it to capture additional domestic and international volume, while improving service offerings to its customers in a cost-effective manner.

Intermodal

The Company's intermodal business is an economical, environmentally-friendly alternative to transporting freight on highways via truck. CSX is capitalizing on this opportunity by building new terminals and increasing network capacity. Construction of a new intermodal terminal in Louisville, Kentucky and major terminal expansion projects in Worcester, Massachusetts and Columbus, Ohio are currently underway. These investments are in addition to the Company's new Northwest Ohio intermodal terminal that became operational a year ago. This high-capacity terminal, which is part of CSX's National Gateway initiative discussed below, expands service offerings to customers as well as improves market access to and from east coast ports.

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Export Coal

Economic expansion in developing countries has generated a growth cycle in export coal demand. Demand for coal in these countries is expected to remain high due to rising consumption as they become more urbanized, which is increasing the need for electric power generation and steel production. These increases in global coal demand are likely to be met by shipments from coal producing countries, including the U.S. In addition to the Company's ready access to large U.S. coal suppliers and multiple port facilities, CSX continues to enhance the capacity and operating efficiency of its export coal network, which favorably positions the Company to capitalize on this growth opportunity. This export coal demand is expected to partially offset the current weakness in domestic utility coal volume that has resulted from low natural gas prices, high coal stockpiles and environmental regulation. Although the Company expects long-term growth in the export coal market, CSX export traffic volumes will be subject to a high degree of volatility as a result of changes in the global economy and competition from foreign coal producers.

Total Service Integration

CSX's Total Service Integration (“TSI”) initiative, which was launched in 2006, supports growth by improving service, optimizing train size, and increasing asset utilization for unit train shipments from origin to destination. CSX is now advancing this initiative to enhance service quality for customers who ship by the carload. This program, TSI Carload, focuses where the customer is impacted most - during the first and last mile of service. These enhancements aim to improve service levels and reliability of rail transportation over other modes of transportation. These improvements to operational processes, customer communication and service will better align the Company's operating capabilities with customers' needs.

Balanced Approach to Capital Deployment

CSX remains highly committed to delivering value to shareholders through a balanced approach to deploying capital that includes investments in infrastructure, dividend growth and share repurchases. In 2011, the Company invested $2.3 billion to further enhance the capacity, quality, safety and flexibility of its network. Included in this amount is approximately $100 million of investments related to reimbursable public-private partnerships where reimbursements may not be fully received in a given year. In addition, CSX continues to return value to its shareholders in the form of dividends and share repurchases. The Company has increased its quarterly cash dividend nine times over the last six years which represents a 35 percent compounded annual growth rate. Also during 2011, CSX announced a new $2 billion share repurchase authority expected to be completed by the end of 2012 based on market and business conditions. While delivering shareholder value through this balanced approach to capital deployment, the Company remains committed to an improving investment grade credit profile.

Public-Private Partnerships

Expanding capacity on U.S. rail networks will provide substantial public benefits including job creation, increased business activity at U.S. ports, reduced highway congestion and lower air emissions. Therefore, CSX and its government partners are working jointly to invest in multi-year rail infrastructure projects such as the National Gateway. This initiative is a public-private partnership which will increase intermodal capacity on key corridors between Mid-Atlantic ports and the Midwest. Current projects related to the National Gateway include the expansion of the Virginia Avenue Tunnel in Washington, D.C. and construction for double-stack train clearances in Ohio, West Virginia, Pennsylvania, Maryland and the District of Columbia.

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CSX is engaged in another major partnership initiative with the Commonwealth of Massachusetts to expand freight and commuter rail service. Currently, CSX provides service to and from New England. To further improve that service offering to customers, CSX is expanding its intermodal terminal footprint in Worcester, Massachusetts and, with the Commonwealth, is clearing the route from Worcester to the New York state line for double-stack intermodal service. As part of this initiative, CSX intends to sell the Commonwealth its corridor between Boston and Worcester. The Commonwealth intends to expand commuter rail service in the greater Boston area.

Additionally, CSX has entered into a transaction with the state of Florida to help alleviate highway congestion through a new commuter rail operation known as SunRail. CSX sold the state a portion of its track for its new commuter rail and will invest the proceeds in additional freight rail capacity and infrastructure within the state. This includes a new automotive and intermodal facility in central Florida.

In summary, these long-term investments discussed above provide a foundation for volume growth and productivity improvement, enhanced customer service and continued advancements in the safety and reliability of operations. To continue these types of investments, the Company must be able to operate in an environment in which it can generate adequate returns and drive shareholder value. CSX will continue to advocate for a fair and balanced regulatory environment to ensure that the value of the Company's rail service would be reflected in any potential new legislation or policies.

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Second Quarter 2012 Highlights

- Revenue decreased $7 million to $3.0 billion.
- Expenses decreased $24 million or 1% to $2.1 billion.
- Operating income increased $17 million or 2% to $943 million, an all-time record.
- Operating ratio improved to 68.7%, an all-time record.

	Second Quarters		Six Months	
(In thousands)	2012	2011	2012	2011
Volume	1,640	1,646	3,242	3,238
(In millions)				
Revenue	$3,012	$3,019	$5,978	$5,829
Expense	2,069	2,093	4,179	4,130
Operating Income	$943	$926	$1,799	$1,699
Operating Ratio	68.7 %	69.3 %	69.9 %	70.9 %

The Company achieved year-over-year revenue growth in many markets driven by higher yields and fuel recovery although domestic utility coal volume continues to face challenges resulting from low natural gas prices and high stockpiles. These declines in domestic utility coal were offset by volume growth in the export coal, intermodal and automotive markets.

Overall, expenses decreased year over year reflecting productivity gains and resource adjustments to adapt to changing business conditions. Fuel costs decreased as a result of the reduction in locomotive fuel consumption as well as in the average price per gallon for locomotive fuel of 2%. Labor and fringe expense decreased primarily driven by lower incentive compensation costs. Partially offsetting these decreases was the increase in depreciation driven by an increase in the asset base.

For additional information, refer to Results of Operations discussed on pages 32 through 36.

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In addition to the financial highlights described above, the Company measures and reports safety and service performance. The Company strives for continuous improvement in these measures through training, initiatives and investment. For example, the Company's safety and train accident prevention programs rely on broad employee involvement. The programs utilize operating rules training, compliance measurement, root cause analysis and communication that are intended to create a safer environment for employees and the public. Continued capital investment in the Company's assets, including track, bridges, signals, equipment and detection technology also supports safety performance.

The Company routinely collaborates with the Federal Railroad Administration ("FRA") and industry organizations as well as federal, state and local governments on the development and implementation of safety programs and initiatives. For example, CSX, Operation Lifesaver, Inc., the U.S. Department of Transportation and other major railroads from across the country have partnered in the Common Sense campaign to reduce the number of injuries and deaths around tracks and trains. In addition to these initiatives, CSXT also has an ongoing public safety program to clear-cut trees and vegetation at public passive highway-rail intersections (crossings with no flashing lights or gates) to improve the public's ability to discern rail hazards.

At CSX, operational success is built on employee commitment to customer service while at the same time maintaining a constant focus on safety. During second quarter 2012, both key safety measures improved significantly versus 2011. The FRA reportable personal injury frequency index improved 27 percent year over year to a record 0.66 showing extraordinary employee dedication to the Company's safety initiative. The reported FRA train accident frequency rate improved 21 percent year over year to 1.81.

Network reliability and service were strong during the second quarter 2012. On-time originations improved from 68 percent to 89 percent, and on-time arrivals improved from 56 percent to 78 percent. Average train velocity increased 13 percent to 22.4 miles per hour, while dwell improved 11 percent to 23.2 hours.

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Operating Statistics (Estimated)

		Second Quarters		
		2012	2011	Improvement/ (Decline)
Safety and Service Measurements	FRA Personal Injury Frequency Index	0.66	0.90	27%
	FRA Train Accident Rate	1.81	2.28	21%
	On-Time Train Originations	89 %	68 %	31%
	On-Time Destination Arrivals	78 %	56 %	39%
	Dwell	23.2	26.0	11%
	Cars-On-Line	189,974	208,572	9%
	Train Velocity	22.4	19.8	13%
				Increase/(Decrease)
Resources	Route Miles	21,007	21,046	—%
	Locomotives (owned and long-term leased)	4,163	4,073	2%
	Freight Cars (owned and long-term leased)	70,000	67,060	4%

Key Performance Measures Definitions

FRA Personal Injury Frequency Index - Number of FRA-reportable injuries per 200,000 man-hours.

FRA Train Accident Rate - Number of FRA-reportable train accidents per million train-miles.

On-Time Train Originations - Average percent of scheduled road trains that depart the origin yard on-time or ahead of schedule.

On-Time Destination Arrivals - Average percent of scheduled road trains that arrive at the destination yard on-time to two hours late (30 minutes for intermodal trains).

Dwell - Average amount of time in hours between car arrival at and departure from the yard. It does not include cars moving through the yard on the same train.

Cars-On-Line - An average count of all cars on the network (does not include locomotives, cabooses, trailers, containers or maintenance equipment).

Train Velocity - Average train speed between terminals in miles per hour (does not include locals, yard jobs, work trains or passenger trains).

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FINANCIAL RESULTS OF OPERATIONS

	Second Quarters				Six Months			
	2012	2011	$ Change	% Change	2012	2011	$ Change	% Change
Revenue	$3,012	$3,019	$(7)	—%	$5,978	$5,829	$149	3%
Expense								
Labor and Fringe	744	764	20	3	1,514	1,529	15	1
Materials, Supplies and Other	550	557	7	1	1,092	1,087	(5)	—
Fuel	410	431	21	5	854	833	(21)	(3)
Depreciation	263	246	(17)	(7)	520	489	(31)	(6)
Equipment and Other Rents	102	95	(7)	(7)	199	192	(7)	(4)
Total Expense	2,069	2,093	24	1	4,179	4,130	(49)	(1)
Operating Income	943	926	17	2	1,799	1,699	100	6
Interest Expense	(139)	(134)	(5)	(4)	(283)	(274)	(9)	(3)
Other Income - Net	5	—	5	—	9	5	4	80
Income Tax Expense	(297)	(286)	(11)	(4)	(564)	(529)	(35)	(7)
Net Earnings	$512	$506	$6	1	$961	$901	$60	7%
Earnings Per Diluted Share	$0.49	$0.46	$0.03	7%	$0.92	$0.81	$0.11	14%
Operating Ratio	68.7%	69.3%	60	bps	69.9%	70.9%	100	bps

Volume and Revenue (Unaudited)
Volume (Thousands of units); Revenue (Dollars in millions); Revenue Per Unit (Dollars)
Second Quarters

	Volume			Revenue			Revenue Per Unit		
	2012	2011	% Change	2012	2011	% Change	2012	2011	% Change
Agricultural									
Agricultural Products	101	109	(7)%	$261	$273	(5)%	$2,584	$2,505	2%
Phosphates and Fertilizers	79	80	(1)	125	119	6	1,582	1,488	8
Food and Consumer	25	27	(7)	68	70	(3)	2,720	2,593	5
Industrial									
Chemicals	120	119	1	430	413	4	3,583	3,471	2
Automotive	111	87	27	302	226	34	2,721	2,598	5
Metals	67	68	(1)	163	158	3	2,433	2,324	4
Housing and Construction									
Emerging Markets	106	117	(10)	178	179	—	1,679	1,530	10
Forest Products	71	70	1	184	174	6	2,592	2,486	5
Total Merchandise	680	677	1	1,711	1,612	6	2,516	2,381	6
Coal	331	388	(14)	820	958	(14)	2,477	2,469	—
Intermodal	629	581	8	408	369	10	649	635	2

Other	—	—	—	73	80	(9)	—	—	—
Total	1,640	1,646	— %	$3,012	$3,019	— %	$1,837	$1,834	— %

(a) 2011 intermodal revenue has been reduced by $7 million for the quarter ended July 1, 2011 from what was previously reported to correct for certain interline business and the corresponding intermodal revenue per unit has been reduced for this as well. The offsetting adjustment is presented in other revenue.

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Second Quarter 2012 Results of Operations

The Company achieved year-over-year revenue growth in most markets although domestic utility coal volume continues to face challenges resulting from low natural gas prices and high stockpiles. The volume decline in domestic utility coal was offset by volume growth in the export coal, intermodal and automotive markets. Additionally, with the exception of coal which was flat, revenue per unit increased in all markets reflecting higher yields and fuel recovery.

Merchandise

Agricultural

Agricultural Products - Volume decreased due to reduced shipments of ethanol and corn. Ethanol shipments declined as a result of reduced gasoline demand and limitations at storage facilities due to over-production. Corn shipments to the Southeast for animal feed were lower due to substitution from a strong local wheat crop.

Phosphates and Fertilizers - Fertilizer shipments declined as the expectation of moderating prices for finished phosphate products (which include crop nutrients) resulted in delayed purchases.

Food and Consumer - Volume decreased with lower shipments of appliances driven by intermodal conversions partially offset by strength in refrigerated products shipments due to highway-to-rail conversions resulting from tight truck capacity.

Industrial

Chemicals - Volume growth was driven by oil and gas-related markets (which include frac sand and petroleum oil) resulting from the increase in shale drilling activity.

Automotive - Automotive volume grew as North American light vehicle production increased 25% year-over-year to support the continuing recovery of the automotive market.

Metals - Volume declined primarily due to scrap shipments related to weak exports as a result of lower global demand. The decline was likely increased by purchasing delays attributable to expectations for future reduction in scrap prices. These trends were partially offset by growth in finished steel products from strong demand in energy markets for products such as pipe and steel bars.

Housing and Construction

Emerging Markets - Volume declined due to reduced shipments of aggregates (which include crushed stone, sand and gravel) resulting from the completion of several major construction projects. Shipments of salt also declined from higher stockpiles due to the milder winter weather.

Forest Products - Volume improved mostly due to recovering demand for housing and construction.

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Coal
Shipments of utility coal declined primarily driven by low natural gas prices and utility stockpiles above target levels. This decrease was partially offset by higher export shipments of U.S. thermal coal.

Intermodal

Domestic growth was driven by new customers, benefits of new capacity and highway conversions. International growth was driven by a new customer.

Expense

Expenses in the quarter decreased $24 million from last year's second quarter. Significant variances are described below.

Labor and Fringe expense decreased $20 million primarily due to the following:

- Incentive compensation expenses were $18 million lower reflecting the award payouts on existing plans.
- Volume related and various other costs were $10 million lower due to increased network efficiency.
- Offsetting these decreases, hiring and training expenses were $8 million higher related to increased headcount as the Company continues to hire ahead of attrition.

Materials, Supplies and Other expense decreased $7 million primarily due to the following:

- Recognition of $20 million of the deferred gain from the November 2011 sale of an operating rail corridor to the state of Florida.
- Various other costs were lower by $6 million, mostly related to improved asset utilization and the impact of lower equipment repair costs.
- Offsetting these decreases, inflation-related expenses increased $12 million.
- Volume-related expenses were $7 million higher due to terminal costs related to the strengthening of the intermodal, export coal and automotive businesses.

Fuel expense decreased $21 million primarily due to volume and a 2% decrease in the average price per gallon for locomotive fuel.

Depreciation expense increased $17 million due to a larger asset base.

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Consolidated Results of Operations

Interest Expense

Interest expense increased $5 million to $139 million primarily due to higher average debt balances partially offset by lower interest rates.

Other Income - Net

Other income-net increased $5 million to $5 million primarily due to lower non-operating expenses.

Income Tax Expense

Income tax expense increased $11 million to $297 million primarily due to higher earnings in second quarter 2012.

Net Earnings

Net earnings increased $6 million to $512 million and earnings per diluted share increased $0.03 to $0.49 driven by the after-tax impact of business results as discussed above.

Volume and Revenue (Unaudited)