FINAL TRANSCRIPT

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CSX - Q3 2007 CSX Corporation Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the CSX Corporation third quarter 2007 earnings call. As a reminder, today's call is being recorded. During this call, all participants will be in a listen-only mode.

For opening remarks and introductions, I would like to turn the call over to Mr. David Baggs, Assistant Vice President of Investor Relations for CSX Corporation.

David Baggs - *CSX Corporation - Assistant VP, IR*

Thank you, and good morning, everyone. Again, welcome to CSX Corporation's third quarter 2007 earnings presentation. The presentation material that we'll review this morning, along with our quarterly financial report and our safety and service measurements, are available on our Web site at CSX.com under the investor section. In addition, following the presentation this morning, a Webcast and podcast replay will be available. Here representing CSX this morning are Michael Ward, the company's Chairman, President, and Chief Executive Officer; Tony Ingram, Chief Operating Officer; Clarence Gooden; Sales and Marketing Officer; and Oscar Munoz, Chief Financial Officer.

Before we begin the formal part of our program, let me remind everyone that the presentation and other statements made by the company contain forward-looking statements, and actual performance could differ materially from the results anticipated by these forward-looking statements. With that let me return the presentation over to CSX Corporation's Chairman, President, and Chief Executive Officer, Michael Ward. Michael?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Thank you, David, and good morning, everyone. The third quarter results we announced yesterday show the continued leadership ability of our team to help solve America's pressing transportation problems while driving better safety and service for our customers, and higher productivity and value for the shareholders.

If I could just take a moment here, I realize that many of you are interested in the letter we received yesterday from the Children's Investment Fund. I can assure you that the board values the opinion of all its shareholders and is reviewing the letter. In the meantime, we remain focused on being safer, providing better service, and being more productive. Our focus on these and every other aspect of operating the railroad is the reason we were able to continue delivering strong results in spite of some weakness in parts of the economy. We think this says a great deal about the sustainability of our businesses and the relentless drive of our team.

The company continues to increase its core earning power. Earnings per share from continuing operations were up 24% from last year, when you factor out insurance recoveries and tax settlements. The higher service levels and the clear advantage of riding our rails versus other modes of transportation are supporting continued strength in pricing as we provide value to our customers. Our service transportation businesses generated record third quarter revenue of $2.5 billion, a 3% increase over 2006, and record third quarter operating income. Higher revenue per unit and productivity gains enabled us to deliver a 78% operating ratio for the quarter. And we're going to build on our service improvements and further strengthen our focus on cost as we drive towards a mid to low 70s operating ratio by 2010.

Safety and service levels are at historical highs for our company. Safety, as we've told you before, is the bedrock of our operations, and it's a core value of our company. As we continue to get significantly better in an industry that is among the best in safety, we will learn from incidents like the one last week in Painesville, Ohio. We're thankful that no one was injured, and we are grateful to the citizens for their patience as we work through with local officials to mitigate this situation as quickly as possible.

As I mentioned earlier, the economic challenges we are facing in several markets are simply a reality that we are dealing with. We believe the issues are temporal and see strong evidence of a robust transportation environment long-term. Our board and management team recognize the need to invest for the future, even as we continue to return capital to our shareholders through our dividend and share repurchase programs. Our disciplined strategy of investing to meet America's growing transportation needs is consistent with our industry peers, who as a group invested nearly $7 billion last year in infrastructure capital. We're proud that our financial results, total shareholder returns, and our commitment to returning capital to the shareholders lead the industry.

CSX continues to perform well versus its peers and the transportation industry in general. Over the past three years, our shareholders have seen returns in the top 10% of all S&P 500 companies. We believe that CSX has delivered superior performance and the company has demonstrated a commitment to meaningful enhancement of shareholder value in the future. Now, let me turn the presentation over to Tony, who will discuss how we are making our operations increase to the next level.

Tony Ingram - *CSX Corporation - COO*

Thank you, Michael. Good morning, everyone.

Our consistent model of leadership, discipline, and execution is producing great results. First, safety remains at all-time highs. Most recent FRA data shows that CSX ranked in the top two and the positive trends will continue. Productivity is also improving, working to help offset inflation and drive the operating ratio lower. We're running the plan and key service measures improved across the board. Customers rated CSX number one in overall satisfaction in a recent third-party survey.

Now, let's look at the results in more detail. Slide 7 shows the excellent trends in safety continued in the third quarter. In the yellow box, you see personal injuries at 1.24 for the quarter, an improvement of 17% versus 2006. Average frequency for the rolling 12 months increased to 1.24. Train accidents were 2.79 for the quarter and improved 14% compared to the prior year. For the rolling 12 months, they improved 19% to 2.98. These results reflect our strong commitment to safety and reaching even higher levels of performance.

Now let's look to on-time train performance, a key driver of service reliability. On-time originations increased to 83% in the quarter, another all-time high for CSX. For the rolling 12 months, performance improved to 78%. On-time arrivals were 76% for the quarter and improved to 69% for the rolling 12 months. The train network is running well, and our focus on planned execution is producing results. The positive trend will continue as we build on this success.

Looking at slide 9, our asset productivity continues to improve. On average, dwell was 22 hours in the quarter, about 10% improvement versus 2006. The positive trend continues on a rolling 12 months. Our terminals are running to plan every day and remain fluid. Cars online remain at good levels, averaging 221,000 cars for the quarter. Lower volume combined with improved car turns pushed the car counts down.

Now, let's look at another measure of network performance velocity. Velocity improved to 21.4 miles per hour in the third quarter and 20.4 for the rolling 12 months. Improvement in average velocity is very positive, but stable velocity performance is also important. In the end, this leads to more consistent service for our customer. Better planned execution combined with focused capacity investments is producing this steady improvement.

Turning to slide 11, we are driving productivity gains and helped to push the operating ratio lower. First, better is cheaper, the network is more efficient, and the most evidence is in car hire. Oscar will discuss the details later. Second, in this period of lower volume, we are adjusting the operating plan. This drives reduction in resources and manpower levels. In addition, structured teams are delivering a pipeline of productivity projects. For an example, we're using GPS technology to improve asset utilization, train handling, and fuel efficiency. Finally, as we discussed at the investor conference, our TSI initiative will improve both customer service and network productivity.

Wrapping up on slide 12, our plan is working and we will continue to build on the solid foundation with leadership, discipline, and execution. The great momentum you see in safety, service, and reliability will continue. We can achieve even better results. Finally, we're driving productivity with a structured and disciplined approach to push the operating ratio even lower. Now, let me turn the presentation over to Clarence to review the sales and marketing results.

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Thank you, Tony, and good morning, everyone.

The third quarter again proved that working with our customers in a free market environment is the best way to sustain a vibrant rail industry and global competitive advantage for our customers. This morning, I will highlight our results, the primary driver of those results, and offer insights on what we see ahead for the remainder of 2007. CSX achieved another successful quarter of revenue growth despite the continued volume weakness. Revenues increased over 3% to a third quarter record of $2.5 billion, exceeding the prior year by $83 million, as yield improvements more than offset the impacts of lower volumes. These yield improvements continue to reflect the superior value we are providing our customers through improved service. This builds on our success in delivering uninterrupted quarterly revenue growth for more than five years.

Now let's look at pricing on the next slide. Price continues to driver revenue per unit growth. The line on this chart reflects the year-over-year change in total revenue per unit, which includes the impact of price, fuel, and mix. During the third quarter, overall revenue per unit increased 8%. The bars on the chart reflect the increase in price on a same-store sales basis, which excludes the impact from fuel and mix. Same-store sales are defined as shipments with the same customers, same commodities, and car types, shipped between the same origin and destination. These shipments represent approximately 75% of our total traffic base.

Same-store sales price increases were 6.5% for the quarter, and is consistent with our 6 to 7% target for 2007. Based on the value that we are providing to our customers through improved service, we expect the momentum to continue. In 2008, we expect to deliver 5 to 6% in same-store sale price increases, which is consistent with previous guidance. Future pricing gains are critical for CSX and the entire industry, for us to continue to invest in our networks and to meet the long-term demand for rail transportation.

Now let's look at the markets. Quarterly merchandise revenue of nearly $1.3 billion increased by over 3%. This growth was driven by stronger yields in all markets as revenue per unit increased almost 9%, more than offsetting the weakness in volumes. We saw the most significant volume declines in our forest products and food and consumer markets, where the softness in the housing sector reduced shipments of lumber, building products, and roofing granules. We had the most significant revenue gains in phosphates, agricultural products, and chemicals. The volume declines were more than offset by yield improvements, again reflecting our strong service product.

Reviewing the results in coal, quarterly coal revenues improved to $650 million, an increase of nearly 8%. Continued strong demand for export coal during the quarter nearly offset declines in shipments to utilities as eastern coal utility stockpiles remained at target levels. Revenue per unit increased 10% in the quarter and we expect the favorable pricing environment to continue as we reprice long-term contracts to current market levels.

Now turning to the automotive results, quarterly automotive revenue of nearly $200 million increased 8%. The increase in production of light vehicles more than offset the decline in SUV volumes. Pricing actions resulted in an increase in revenue per unit of 6%, and the pricing outlook remains favorable going forward. Long-term, we are well-positioned within our diverse portfolio of business with the Big Three and will continue to be supplemented with additional growth from the new domestics.

Turning to our intermodal results, quarterly intermodal revenue of $337 million declined 7%, driven by a mix in lower volume as declines in international traffic more than offset the increases in domestic traffic. Overall, revenue per unit decreased 1% due to the mix impacts from shorter haul but profitable traffic. However, the same-store sales price for intermodal increased more than 3% for the quarter. From a volume perspective, international traffic was down 17% due to losses across a few accounts and slower import growth from Asian markets. New shorter haul train services into and out of Atlanta and Chambersburg, Pennsylvania, as well as other new dedicated train services drove growth in domestic traffic by more than 10%. These new services will continue to be a catalyst for growth going forward.

Now let's take a look at the revenue outlook for the fourth quarter. Overall, our fourth quarter revenue outlook is positive. Pricing strength will continue to be the key driver across all markets. We remain committed to providing excellent service and value for our customers and we will not sacrifice price for short-term volume gains. As you can see in the near-term, revenue is expected to be favorable in six of our ten markets, neutral in one, and unfavorable in three.

Coal, coke, and iron ore revenues are expected to remain strong due to the strength in the export market and the favorable pricing environment. While the outlook for the auto market is neutral, the revenue outlook for merchandise is generally favorable, although continued softness in the housing sector will impact volume and revenue in the forest products and the food and consumer markets. The fourth quarter outlook for intermodal is unfavorable, although we see continuing benefits from improved operations and our new services. Thank you very much and let me turn the presentation over to Oscar to review our financial results.

Oscar Munoz - *CSX Corporation - CFO*

Thank you, Clarence, and good morning, everyone. Yesterday, CSX reported earnings per share of $0.91, included $0.24 from discontinued operations. Michael mentioned this morning, and as you can see on slide 22, we recorded $0.67 from continuing operations, which represents a decrease of $0.04 from the prior year. Start at the top of the slide and work our way down, in this quarter we saw Surface Transportation operating income of $552 million, reflecting the improved operating performance and this team's focus on delivering consistent financial results. Below the line, other income decreased $8 million reflecting lower real estate and resort income. Next, interest expense increased $5 million as we issued $1 billion of incremental debt in early September. Finally, our income taxes are a $84 million higher, primarily due to a prior year benefit.

Turn to the next slide, and let's look at our results on a more comparable basis. After removing the prior-year insurance gain that income tax benefits, EPS from continuing operations increased $0.13 or 24% on a comparable basis. Looking at operating income after removing the gain on insurance recoveries for both years, our surface transportation businesses increased earnings $77 million or 16%. Now let's walk through the details of our results on the next slide. As Clarence just discussed, we have seen more than five years of uninterrupted topline growth. In total, continued strength in yields more than offset our decline in volume, resulting in over 3% or $83 million in revenue growth for the quarter.

This topline growth, combined with our stronger operations and our improved productivity and lower volumes resulted in a $77 million or 16% improvement in operating income. Same drivers improved the company's operating ratio of 240 basis points to 78%. This performance continues our industry-leading momentum that we've established over the last three years, and as we've improved our operating ratio nearly 1,000 basis points, it positions us for our driver towards a mid- to low 70s OR by 2010.

Now let me review our expenses in more detail, starting with labor and fringe. As you can see on slide 25, our labor costs increased only 1% or $10 million, primarily driven by inflation of $24 million. Partially offsetting this increase was a reduction in train crew head count, reflecting our continued focus on productivity and cost control. On a full-year basis, we continue to expect our labor and fringe benefits to increase less than inflation as we achieve our productivity objectives.

Moving to the next slide, MS&O which increased 1% or only $6 million over the last year, as we talked about before, this is a line item that fluctuates from quarter to quarter. Our safety performance, volume, collection activities, and other items can all have an impact on these results. In this particular quarter, inflation was mostly offset by a decrease in costs associated with our reduction in train accidents, which was a 14% reductions. This reflects the continued improvement in our safety performance and all associated costs.

Let's talk about fuel on the next slide. Overall, fuel increased 2% or $5 million versus last year. The $0.16 increase in the average fuel price per gallon resulted in $22 million of additional cost. This was partially offset by a decline in volume and ton miles and by the continued focus on fuel efficiencies. In the third quarter alone, improvements in fuel efficiency reduced fuel costs by $10 million compared to the prior year.

Now let me talk about rent on the next slide. As Tony mentioned earlier, the continued improvement in operational fluidity has significantly increased our asset utilization. This, combined with lower volumes in our merchandise and intermodal markets resulted in a 14% or $19 million decline in rents. On a go-forward basis, you should expect our rent expense to move with our business volumes and continue to benefit from the improvements in asset utilization. On the next slide, let me review the remaining expenses. All other expenses increased 1% versus prior year. The main driver was depreciation, which is higher due to our net increase and our capital asset base and was partially offset by lower Surface Transportation services.

Now if I can, let me update you on where we stand on our share repurchase program. In slide 30, during the third quarter we repurchased $882 million, or just over 20 million shares of our common stock. To date we have completed slightly over half of our current $3 billion program and remain on track to finish the program by the end of 2008. In total, our share repurchase program represents approximately 15% of the company's current market cap, and is consistent with our balanced approach of investing in the business, returning value to share owners through share repurchases and dividends.

Wrapping up, these results represent a record third quarter operating income and were driven by solid revenue growth and improved operational productivity, reinforcing our view of the company's long-term prospects. As a reminder, our long-term financial targets are to deliver double digit growth in operating income and earnings per share through 2010, growing off a record 2007 base. This financial growth is supported by nearly $5 billion of investment over the next three years as we continue to capitalize on the long-term secular trends in the industry.

With that let me turn it back over to Michael for his closing remarks.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Thank you, Oscar. Well, we've come a long way, both as an industry and as a company. You're seeing us make the transition from a cyclical company, largely at the mercy of economic swings to a company that can manage through periods of softness and still deliver exceptional results for shareholders. America needs railroads more than ever, and railroads are stepping up to the challenge.

It's no secret to any of you that just as the industry is beginning to turn the corner financially, there are those who would like to turn the clock back to the days of regulation. In 1980, one out of every four rail miles in this country was owned by a company in bankruptcy. Today, railroads are paying their own way, investing heavily in the future of our essential service and rewarding shareholders. In September I told you I was optimistic that good policy would prevail. After the recent hearings in Washington, I remain optimistic. I believe policymakers are going to recognize the risk that reregulation would pose, particularly with respect to investment in America's rail system. At the same time, the federal agencies that regulate railroads are becoming increasingly active in addressing concerns of our industry, and I believe that there's a growing sentiment that the railroad should be allowed to continue working without re-regulation legislation.

Because we believe that what comes out of Washington will be balanced, and because we believe in ourselves and the long-term transportation environment, we are investing nearly $5 billion in our network over the next three years. These investments will help keep America's rail system strong and safe while ensuring that shareholder value is sustained over the long haul. That's how the free market system works in this and every other industry. Our investments turn into value when we create better service for our customers. That is happening. It's happening because of the investment we make and because of our employees who meet the needs of our customers every day. So we have a vibrant enterprise, investments are being made, customers are being served, employees and communities are safer than ever.

And shareholders are benefiting too. In the past three years, you've benefited in a big way. Your investment has grown because of the performance of our company has caused the share price to increase significantly, and you've been rewarded because of our balanced approach to creating value. This includes long-term investments I just described, along with our repurchase and dividend strategies. We know we're creating value, real and lasting value.

It's telling that a 180-year-old U.S. rail system, the best rail freight system in the world, holds the key to so many modern problems facing our country. Our employees and our investments are making the solutions possible. And those solutions will continue to reward shareholders for many years to come. With that, we'll take your questions.

David Baggs - *CSX Corporation - Assistant VP, IR*

We'll turn it back over to Verizon to go ahead and have everyone queue up for Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you. (OPERATOR INSTRUCTIONS) Thank you. Our first question comes from Edward Wolfe from Bear Stearns.

Ed Wolfe - *Bear Stearns - Analyst*

Yes. This is a question, I guess, for Tony. Can you talk a little bit about where you are on the spectrum of improving on all these service metrics? Clearly, with weaker volumes, that's got to help, I would think, velocity and dwell and recrews and some other things, and yet you've been steadily improving for a while now. So can you talk to how much the environment is helping and how much further and how much longer you can continue to have these kind of improvements?

Tony Ingram - *CSX Corporation - COO*

Ed, you've noted the issues that we've tried to address with the volume. The volume is, as we put it in our model, our ONE Plan is able to readjust the trains, we try to maintain a certain car length for our trains. We'll continue that. Our people are improving, our supervisors are improving, our training efforts are improving. I think 50 to 60% of the improvements you see will be on an ongoing basis because that's through our discipline and leadership program along with some of the capital investments we've made will continue to help us improve our operations. So there's some upside as we continue here. Of course, volume affects it. We're always more efficient with bigger trains and more volume, but we think we've got the technology with our ONE Plan to adjust and stay as close to this as we go forward.

Ed Wolfe - *Bear Stearns - Analyst*

Am I wrong, then, in assuming that less volume is sometimes helpful as you try -- I mean, it seems like your metrics have done better when your volume has actually been a little bit less.

Tony Ingram - *CSX Corporation - COO*

Well, less volume is never good, but we tried to adjust to it, but it does create some capacity at times when there's less volume and you're able to reduce trains and slots instead of the sizes of trains, yes, it will help you on your --

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Ed, this is Michael. As we look back to 2004, it was a similar period where we had similar amounts of gross ton miles, which is the key work characteristic there. And if you look at the two periods, a significant improvement in all of the key operating measures. So while the volume does increase a little bit sequentially, if you look at the base operations of now versus 2004, there's a marked difference with the leadership that Tony's been bringing to the operating team.

Ed Wolfe - *Bear Stearns - Analyst*

I'm not denying there's not a big improvement, I'm just trying to understand in terms of degree, how we should think about that as volume comes back I'm guessing, a little bit less on some of those.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

There'll be a little bit less, but I think most of it has been driven by the cultural change and the discipline around the ONE Plan.

Ed Wolfe - *Bear Stearns - Analyst*

Okay. Clarence, I think you noted 3% pricing for intermodal same-store. Can you break that down between domestic and international in (inaudible) ?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

I don't have it broken down, Ed, between domestic and international, here in front of me. I can get those numbers for you.

Ed Wolfe - *Bear Stearns - Analyst*

Directionally, I'm guessing domestic is a bit stronger than international; is that fair?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

That's fair.

Ed Wolfe - *Bear Stearns - Analyst*

Just bigger picture, Michael, you talked a little bit about the rail rereg and that you're confident that cooler heads will reprevail. It looks like the safety bill is going to make its way on the to the house floor this week possibly. What's your sense that the impact from a bill like that might have on CSX and the other railroads?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

As you know, there's two very different versions, the House version and the Senate version. I think obviously they'll have to go into reconciliation here and it'll be a little easier to judge that once we know that reconciliation is. I think we believe that the Senate version is a probably more appropriate for our industry. We see most of the things in there that we can probably live with those and will help improve the safety and most of the other railroads feel the same way.

Ed Wolfe - *Bear Stearns - Analyst*

Thank you for the time. I appreciate it.

Operator

Thank you. Our next question comes from Mr. Tom Wadewitz from JPMorgan.

Tom Wadewitz - *JPMorgan - Analyst*

Yes, good morning. I wanted to ask a bit about productivity in terms of where are you on head count reduction with respect to where the volume level is on the railroad? Is there a bit of a lag where we might see an acceleration in head count reduction looking forward, or is it kind of 1.5% reduction in head count and that's reasonable to expect for the next couple of quarters if volume remains soft?

Oscar Munoz - *CSX Corporation - CFO*

Hey, Tom, it's Oscar. I think the process that we go through -- that Tony goes through, primarily, with his organization is to look forward with volumes and adjust both the hiring and the furlough aspect of our future business. So depending on how volumes will work, we'll continue to pull that lever. I don't want to give a specific fact or figure, because again it will depend on volumes and we're trying to stay relatively flexible on that, but what you did see this quarter is a pretty significant reduction and we should see that holding through the end of the year, certainly.

Tom Wadewitz - *JPMorgan - Analyst*

So you wouldn't say that there's a lag in how that comes in? You kind of had nice productivity on head count and that kind of continues?

Oscar Munoz - *CSX Corporation - CFO*

No, I don't think there's a lag. I think we get the benefit as we do it.

Tom Wadewitz - *JPMorgan - Analyst*

Right, okay. One kind of a broader strategic question, when one of the points that your favorite shareholder highlighted, I guess TCI highlighted yesterday. From an operational perspective, there may be room for longer-term to conversion with the other rails and you had very significant improvement to this point, but is there an opportunity for kind of a step change action, whether it's changing some of the terminal network or whether it's kind of broadly revisiting a ONE Plan where you look at the train schedule and blocking and so forth. Is there potentially a big step change driver of improvement, or is that not realistic? You have shown very good continued process improvement, but I'm just trying to get a sense if you think there's a big step out there further in the future.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Tom, this is Michael. As you know, we did have a pretty big step change there about a year ago and since then you've saw strong, continued improvement. I think that's what we could expect to continue to see. Tony and his team continuing to drive the strong improvements as we get better around our discipline around the ONE Plan, was I don't see any big step function change that's out there on the horizon.

Tom Wadewitz - *JPMorgan - Analyst*

And just in terms of the terminal network, you think that's pretty much where it needs to be? You're comfortable with what it looks like?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Yes.

Tom Wadewitz - *JPMorgan - Analyst*

Okay. Thanks for the time.

Operator

Thank you. Our next question comes from Mr. John Barnes from BB&T Capital Markets.

John Barnes - *BB&T Capital Markets - Analyst*

Good morning, guys. Two questions. One, as you look at this persistent industry-wide volume weakness and hearing from all modes of transport, things obviously look a little bit weaker right now. Have you guys given any further thought to your CapEx budget? I know you laid it out at your analyst meeting, but how quickly can you modify it if this volume kind of stays at these levels and we don't see any marked improvement in carloads going forward? How quickly can you make adjustments to that CapEx and what would end up happening with those dollars if you weren't spending them on expansion CapEx?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

John, as you know, a lot of those investments we're making are one to sustain the current safety and infrastructure we have, but secondly to prepare for future growth. We don't think that these short-term issues really portend long-term issues. And we are making these investments really for the long-term. So as you saw in this quarter, even in this weaker environment, we had very good results. We anticipate we will continue to do so and generate the cash flow to be able to make the capital investments for the future, obviously continue to pay our dividend, and our share repurchase program. Our three legs of our balanced approach and we anticipate we'll be able to continue to do that and build long-term value.

John Barnes - *BB&T Capital Markets - Analyst*

Okay. The other thing was -- my other question was, you guys are ahead of where I projected you would be on the share buyback at this point. I think you're to be applauded for that. What's your thinking as you get into '08 and you begin to exhaust the current authorization? I'm just kind of curious as to what your thinking is on a go-forward basis. Do you do something more methodical on a share repurchase authorization on a go-forward basis, or do you think you're coming back out with another $3 billion type of authorization at the end of this one?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

John, I think we take one step at a time. We have a current $3 billion program out there that we're working on, and when that program is finished we will once again look at all the factors and decide what actions we take. It's really not appropriate to discuss that at this point.

John Barnes - *BB&T Capital Markets - Analyst*

All right, guys. Thanks for your time.

Operator

Thank you. Our next question comes from Scott Flower from Banc of America Securities.

Scott Flower - *Banc of America - Analyst*

Yeah. Good morning, all.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Good morning.

Scott Flower - *Banc of America - Analyst*

Actually a couple questions for Clarence. First and second quarter, Clarence, did mix have a more favorable or less favorable impact on revenue per unit for you?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

It had a more favorable.

Scott Flower - *Banc of America - Analyst*

More favorable? Demonstrably or just a little bit?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Just a little bit.

Scott Flower - *Banc of America - Analyst*

Okay. And then on your fuel surcharge, have you been able to -- maybe I need to step back. Where are you in terms of coverage of your fuel surcharge and has that been moving up this year? Can you give me some sense of where that stands?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Yes, it's been moving up this year. We're now at about 85% coverage with either fuel surcharge or RCAFU. We renew no contracts without fuel surcharge.

Scott Flower - *Banc of America - Analyst*

And how much is that year over year, 5 or 10 percentage points roughly, or less than that?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Somewhere in that range.

Scott Flower - *Banc of America - Analyst*

Okay, all right. Thanks very much.

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Thanks, Scott.

Operator

Thank you. Our next question comes from Chris Weatherby from Merrill Lynch.

Chris Weatherby - *Merrill Lynch - Analyst*

Hey, good morning. It's Chris Weatherby in for Ken Hoexter. Just touching back on the intermodal side for a minute, just curious if you could comment on the bit of the backslide we saw on the OR for intermodal. Obviously volumes were a bit weak and pricing non mix-adjusted was a bit weaker as we saw international go negative. Was wondering if you could comment a bit on how we see the run rate going forward. You had a big improvement last quarter, a bit of a decline this quarter. Where do we see that going?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Our revenue declined reflects some of the lower international volumes and the change in mix, for example where we had three now new shorter haul services, one to Chambersburg, Pennsylvania, two to Marion, Ohio, and three with the BNSF into Atlanta. We do expect intermodal to begin to grow again in 2008 as we lap some of these losses. That increase up to an 81.3 operating ratio, which is a slight increase. We do operate, as you're aware, a fixed impact of trains that will be impacted by the cost side to some extent by the amount of volume that we can put on it, but we didn't see the rise as a dramatic rise and we are very cognizant of what those cost of operating that fixed network are and we're working very closely with Tony's team to take out the cost, not only from the standpoint of crew costs and train start costs, but from the standpoint of equipment costs.

Chris Weatherby - *Merrill Lynch - Analyst*

Okay. As far as -- you had mentioned a customer loss. Anything you can share with us on that that's not too sensitive? Was it a redeployment of assets to different lanes or something competitive?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

It was some competitive moves and they were not service related and I don't want to get into the specifics of the customers, because the customers themselves like to keep those things confidential.

Chris Weatherby - *Merrill Lynch - Analyst*

Of course. Fair enough. Then switching gears a bit to the buyback. As you guys had mentioned, you got a decent amount done in the quarter. Debt increased a bit more than we were looking for, your debt to cap around 46, debt to EBITDA around 2.25 times. Where do you think you can stay -- what's the target level keeping in mind you guys have mentioned you want to stay investment grade? A little over 2 times debt to EBITDA a good level for you guys or can you increase that a bit?

Oscar Munoz - *CSX Corporation - CFO*

It's Oscar. I think what we've said pretty consistently on the leverage is about a 50% target level and I think we're still staying with that.

Chris Weatherby - *Merrill Lynch - Analyst*

Okay. And then I guess just real quick. The way you guys look at ROIC. Just thinking about it on a replacement cost basis, obviously ROIC are coming up and looking pretty solid. Where do you think you stand on a replacement cost basis? I'm sure you guys have done the analysis. I'm just kind of curious, is it half that level, somewhere in between, higher, lower?

Oscar Munoz - *CSX Corporation - CFO*

What industry looks at their ROIC on a replacement cost basis? I don't know of any industry that does that and I think we'll probably continue to follow the normal traditions of the way people calculate ROIC. As we continue to improve our profitability, the overall return is going to continue to increase.

Chris Weatherby - *Merrill Lynch - Analyst*

Okay. All right. Fair enough. Thank you very much.

Operator

Thank you. Our next question comes from Mr. William Greene from Morgan Stanley.

William Greene - *Morgan Stanley - Analyst*

Oscar, I'm wondering if you can talk about the free cash flow projection you talked about at the investor day in 2007. Has that changed in all given the volume trends, or how you did in the third quarter?

Oscar Munoz - *CSX Corporation - CFO*

No, not at all. I think we said the 100 plus a while ago and that's still our target for this year.

William Greene - *Morgan Stanley - Analyst*

Okay. And then for Clarence, can you talk a little bit about coal? How long do you think it will be before maybe the utility stockpiles reach a point where we can start to see more meaningful growth in that category?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Obviously it's weather-dependent and generation-dependent and generation and the numbers that came out yesterday for industrial production were actually down. So I'm hoping for a cold winter. I just don't know how to answer you other than that, William.

William Greene - *Morgan Stanley - Analyst*

Okay. So basically not a lot of visibility until we see some colder weather there. And then on intermodal, can we just talk a little bit about the short haul move. Can you give us a sense for how much of the growth in the volume there is due to the short haul move and then we can get a sense of what the RPU is, or how to think about this going forward?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

I can't on the RPU, but I can tell you a significant amount of volume, specifically in the domestic side was in the short haul moves in the Birmingham to Atlanta lane, in the St. Louis to Marion, Ohio, lane, and then in a lesser extent from the Chicago to Chambersburg lane.

William Greene - *Morgan Stanley - Analyst*

Thanks for your help.

Operator

Our next question comes from Gary Chase from Lehman Brothers.

Gary Chase - *Lehman Brothers - Analyst*

Good morning, guys. Just a quick one for Clarence. Or maybe Michael. When you look at that 2008 goal that you've got out there, the 5 to 6% in same-store sales, is there any way to give us some flavor for what falls into the following buckets? You've got escalation on existing contracts, you've got the rollover of contracts that are rolling to current market rates, and then is there -- I guess, is there a third bucket? Is there an assumption that the market continues to grow in terms of the overall base line? I guess, how important is that last component to the 5 to 6?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Well, I would tell you that in the rollover area, there's about 25 to 35% is rollover. I would tell you that there is a fairly significant amount that is already renegotiated that will start and kick in on January 1. And I would tell you that the escalation factor would make up the rest.

Gary Chase - *Lehman Brothers - Analyst*

Okay. So there's not much expectation for the market reality changing. It's really kind of here today. It's just a matter of it playing out on the P&L; is that fair?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

I think that's fair.

Gary Chase - *Lehman Brothers - Analyst*

And could I just ask a question of Tony as well, just a follow-up to one of the earlier questions. Obviously understand you've had some beneficial impact from some of the operating initiatives that you've put in place and volume has been helpful also. Can we think about volume growth of 2 to 3% with continued improvement, understanding you'll keep driving the operational improvements, but there'll be some offset with volume challenge. Is that a reasonable goal?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

I think that's reasonable. We still have some capacity on our trains to absorb something like that.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

And continue to improve.

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

And continue to improve at the same time.

Gary Chase - *Lehman Brothers - Analyst*

But you think you could do low single digit growth and see those service metrics keep moving in the right direction?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

As far as the service metrics, yes. Yes, we could see them continuously improve with that kind of growth.

Gary Chase - *Lehman Brothers - Analyst*

Okay. Thanks, guys.

Operator

Thank you. Next question, John Larkin from Stifel Nicolaus.

John Larkin - *Stifel Nicolaus - Analyst*

It's actually Stifel Nicolaus, but thank you anyway. Good morning, everybody.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Good morning, John.

John Larkin - *Stifel Nicolaus - Analyst*

I thought I heard Clarence mention that you had done a survey or some independent party had done a survey that indicated that CSX showed up as number one in service. Could you give us a little bit more detail on that, what parameters were measured and who were you compared against, and who did the analysis?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

This is Clarence. Actually, Tony mentioned that, but the survey was done by J.D. Power and Associates and we have been doing that since 2002. We started out of in 2002 in not as good as shape as we would have liked to have been. For this year, for two consecutive quarters, we've been ranked in that survey by our customers in the top position. We surveyed more than 10,000 customers, there's 15 different parameters from order fulfillment to service to contract negotiations to customer service to sales rep to consistency of transit that are measured in that.

John Larkin - *Stifel Nicolaus - Analyst*

Are you compared just to your geographic competitor or more broadly to the whole industry?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

More broadly, to the whole industry, including trucking.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

John, the other thing I would add to that, this is not a completely scientific thing. It's polling our customers and asking if they use the other roads and if so what's they're experience to the other roads.

John Larkin - *Stifel Nicolaus - Analyst*

So there might be some bias towards giving you higher ratings?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

No, I think most of the big customers use most of the big railroads.

John Larkin - *Stifel Nicolaus - Analyst*

Okay.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

But I want to let you know this is not some nationwide survey, although it's a very broad one as Clarence indicated.

John Larkin - *Stifel Nicolaus - Analyst*

Would it be possible to maybe make a summary available that to the sell side or wall Street in general?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Actually, John, we've kept that internally here so that we can use it to better ourselves, to try to improve as we go forward.

John Larkin - *Stifel Nicolaus - Analyst*

Okay. Well, congratulations on the big improvement there. Secondly, the state of Florida is one of the two reasons, I guess in the country, along with southern California, that has been most hard hit by overbuilding in the housing market. Given that you are the primary railroad in thestate of Florida, how much of the volume softness can be traced to the state of Florida and will that make your volume recovery a little more difficult going forward since it may take a little more longer to absorb all the excess housing inventory there?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

John, obviously we've looked at the housing market in Florida and California to your point very closely. 25% of the foreclosures in this country have occurred in Florida, 25% in California, 32% of the homes bought in Florida in the last three years were not -- were primary residences, meaning two-thirds were not. There's a glut of houses on the market. It impacts our aggregate materials, it impacts our consumer goods, refrigerators, washers, dryers. We've been trying to quantify what that number is for some period of time. It's difficult to quantify it not only from the standpoint of the basic raw building materials of building the house, but it also starts to impact imports with furnitures, appliances from overseas. But I would tell you that it is not a pretty picture and it does have an impact on what our volume growth is.

John Larkin - *Stifel Nicolaus - Analyst*

Okay. Thank you. Then on the regulatory front, I think you made your viewpoint pretty clear on the prospects for reregulation. You talked a little bit about your thoughts on how cost of capital ought to be calculated and that sort of thing. There's another issue out there, and that's the streamlined process for smaller shippers to contest rate cases. I think if I'm not mistaken, DuPont is kind of working their way through that process now as kind of almost a test case. Any thoughts on whether that process will have any negative impact going forward?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

As you know, John, that's a pretty new process and you're right that DuPont is going to be sort of a test case on that. These are just part of the business. The challenges that DuPont has given is only on seven moves out of the hundreds of moves they have with us and probably only represents about 5% of our revenues with him. They're a good customer, we like DuPont, but we think our prices are fair and competitive and we're going to go through that STB process with them. As you know, the front end of that is a mediation process, which we will engage with them and perhaps it gets solved then, perhaps it doesn't, but we think it's a process we'll have to see how it works going forward and there's really not enough knowledge yet about it to tell how it works.

John Larkin - *Stifel Nicolaus - Analyst*

Would you anticipate a lot of additional customers maybe availing themselves of this new process over the next couple of years?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Well, we have not seen a lot. We have these DuPont cases. I don't think there's any other small shippers cases filed against any class 1 railroad. So it doesn't appear at this point to be a flood of cases coming through the door.

John Larkin - *Stifel Nicolaus - Analyst*

One final one for Clarence. I know that J.B. Hunt, who some might say would be the leader in intermodal in the U.S. currently have been deriving a lot of its growth in the east in lanes that heretofore were thought to be too short to support quality competitive intermodal operations. But that's where their focus is and I know that they have been chatting with you a little bit, at least. Any thought about whether there might be an opportunity to capture some of that business, perhaps into the New England area or Florida or other areas where you might have an advantage over brand X?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Well, we're talking to customers everyday about any opportunity we can get, John, and we never, never say no. It's always yes if.

John Larkin - *Stifel Nicolaus - Analyst*

But there's no reason -- you have no exclusive agreement with Schneider or anything that would preclude you from doing business with J.B. Hunt?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

No, sir.

John Larkin - *Stifel Nicolaus - Analyst*

All righty. Thanks very much.

Operator

Thank you. Next question comes from Jason Seidl from Credit Suisse.

Jason Seidl - *Credit Suisse - Analyst*

Thank you. Morning, gentleman. A couple quick questions. Clarence, you mentioned, obviously, that international intermodal is much weaker than the domestic side. When should we look for comps start getting easier for the international side?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Second half of 2008, Jason.

Jason Seidl - *Credit Suisse - Analyst*

Second half? Okay. And when we look at the pricing, and I know you don't have it there, but if you break it down, is pricing on the domestic side X some of your new product offerings, is that still up? Are you still seeing pricing gains X the new product offerings?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

No. The new product offerings, we wouldn't be able to compare on a year-over-year basis because they weren't there last year. So we're pricing to the market, and as you know that market has got a lot of capacity in it right now, so it's a very difficult pricing environment in those new intermodal markets.

Jason Seidl - *Credit Suisse - Analyst*

But despite that, on the existing moves, you saw about a 3% move overall. 3% even in domestic?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Even in domestic.

Jason Seidl - *Credit Suisse - Analyst*

Okay. Fair enough. Fair enough. That's good. Last question, obviously you brought up the TCI letter. Obviously, you had another letter there from the UTU when seemed to be -- continued to be a bit disgruntled, and it's not only with you guys, it's with the rest of the railroads out there. Do you see the situation with the UTU improving, or do you think this is something that's going to be ongoing?

Michael Ward - *CSX Corporation - Chairman, President, CEO*

They've been on a campaign against the entire industry for more than a year now as part of their negotiating strategies around the current round of negotiations. We've reached agreement with all other major unions at this point and we would like to continue the dialogue with the UTU, we think there's a clear pattern out there and we hope we'll be able to engage them at some point in the near future. We think it's pretty clear we've reached agreement with most other unions and we should be able to do the same with UTU. Obviously they have a harsh rhetoric around this entire issue that hopefully they'll be able to get over.

Jason Seidl - *Credit Suisse - Analyst*

Okay. Thank you. Clarence, if I can just come back for a minute, just so I can clarify something you said before to answer a question. You said that 25 to 35% of the business is rollover and then you said a significant amount is locked up that starts January 1. When you say significant amount, are you talking about over 50%?

Oscar Munoz - *CSX Corporation - CFO*

No. I would be talking in the 25 to 30% category there.

Jason Seidl - *Credit Suisse - Analyst*

25 to 30% category. Okay, then -- okay, perfect. Thank you so much.

Operator

Our next question comes from Mr. Jason Steinberg from Goldman Sachs.

Jason Steinberg - *Goldman Sachs - Analyst*

Two questions. On the intermodal, on the international customer that you lost, want to know if that customer is still a customer of CSX, and as a second part, if any other customers you had an indication were making similar decisions or looking at a similar decision process that led to that customer loss, otherwise are there potential for future customer losses in the future?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

We haven't -- we don't know of any that we have potential losses in the future. Yes, the customer is still a customer of CSX, a very good one, I might add, and we expect to do more business with that customer in the future.

Jason Steinberg - *Goldman Sachs - Analyst*

So maybe you can provide us a little bit more detail there in terms of the decision that customer made. Was it not to serve certain ports or was it to stop in certain lanes, if they are still a customer, or did they just not ship with you in a given quarter?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

They shifted some lanes over to a competitive mode of transportation.

Jason Steinberg - *Goldman Sachs - Analyst*

Thank you very much. And then one question in terms of your fourth quarter outlook that the slide you put up with your expectations for the different end markets, can you give a little color in terms of how much -- those markets where you're favorable or not favorable, what impact pricing has versus your volume of fourth quarter?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Well, we think that the intermodal volumes will be down for the fourth quarter, as a result of some of the lower international volume and it's due to some of those customer losses we mentioned earlier as well as a continued slowing of the Asian import growth. We expect the automotive volumes will be down for the fourth quarter. Chrysler, for example, closing some plants on a temporary basis just this week. Overall, on our merchandise side, we expect the volume to be down. We expect volume gains in some of our commodities, phosphates would be an example, fertilizers, medicals, and chemicals, but they'll be more than offset by the losses in the housing area. And we talk about coal earlier, but just to reiterate, we expect the fourth quarter volumes will be flat due to the weather issues and being offset a little bit by the export demand growth and our steam coal and we expect in all of those areas that our pricing in the fourth quarter will continue to be very strong and very robust.

Jason Steinberg - *Goldman Sachs - Analyst*

It sounds like to summarize more of the same in the fourth quarter that we saw in 3Q?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

Yes.

Jason Steinberg - *Goldman Sachs - Analyst*

Thank you very much.

Operator

Thank you. Our last question for today comes from Mr. Edward Wolfe from Bear Stearns.

Ed Wolfe - *Bear Stearns - Analyst*

Yep. Just two quick follow-ups.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Welcome back, Ed.

Ed Wolfe - *Bear Stearns - Analyst*

Is this a new conference call or is it the same day? Clarence, could you -- the volume comps get a bit easier as we go back this quarter quarter and certainly into first quarter. When would you expect right now that we would expect to see positive volume comps, if you don't want to talk about CSX, for the group generally?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

I think in CSX's case, I think the second half of 2008. It's based on a lot of factors, it's the unknown in the housing, it's the unknown impact on the economy of the fourth quarter's results, higher oil prices, it's the unknown for the coal business of what the weather is going to do over the next couple of quarters. I don't think the bottom's going to fall out of it, but I don't think you're going to see the type growth that you and I want to see.

Ed Wolfe - *Bear Stearns - Analyst*

I'm guessing you see the same for the industry, CSX aren't doing something different or comps aren't different for somebody else?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

I don't want to speak for the industry, because as soon as I do that, I will have said something that I'm not qualified to say.

Ed Wolfe - *Bear Stearns - Analyst*

Okay. But do you see something specific to CSX that's going to get you positive in the second half of '08, or is it just your sense that at that point, visibility's got to get better at some point?

Clarence Gooden - *CSX Corporation - EVP, Chief Commercial Officer*

It's just a sense.

Ed Wolfe - *Bear Stearns - Analyst*

Okay. Second question, Oscar, real quick, any thoughts yet to CapEx in '08? Is there a little bit of extra pressure on you guys right now with the regulators watching so closely the continue to spend the money and invest at this point?

Oscar Munoz - *CSX Corporation - CFO*

I'll take the numeric part of the question. I think what we've talked about is about a 1.6 level of spending in 2008.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Ed, this is Michael. I think there is no measure on the regulatory side, but there's pressure we're putting on ourselves to continue to improve our infrastructure and prepare for the future that's going to make us want to continue spending at the levels that Oscar mentioned.

Ed Wolfe - *Bear Stearns - Analyst*

Okay. Thanks, guys.

Michael Ward - *CSX Corporation - Chairman, President, CEO*

Well, thank you for your attendance at our call today.

Operator

Thank you, ladies and gentlemen, this concludes this conference call. We thank you for participation in today's conference call and ask that you please disconnect your line at this time. Thank you.