FINAL TRANSCRIPT

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CSX - CSX Corporation First-Quarter 2006 Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to CSX Corporation's first-quarter 2006 earnings call. As a reminder, today's call is being recorded. During this presentation, all participants will be in a listen-only mode. Afterward, a question-and-answer session will be conducted.

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

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

Good morning, everyone, and again welcome to CSX Corporation's first-quarter 2006 earnings presentation. We apologize this morning for the late start. There appeared to be some technical issues this morning with our conference provider that kept us from meeting our on-time performance objectives for today, but we will get caught up here very quickly.

Before we do get started this morning, let me point out the presentation material that we will be reviewing this morning, along with the CSX Flash and our quarterly safety and service measurements, are available on our website at csx.com, under Investors. In addition, following the presentation, 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, our Chief Operating Officer; Clarence Gooden, our Sales and Marketing Officer; and Oscar Munoz, our Chief Financial Officer.

Before we begin the formal part of our presentation, let me take a moment to remind everyone that the presentation and other statements made by the Company contain forward-looking statements and actual performance could differ materially from those results anticipated by these forward-looking statements.

With that, let me turn the presentation over to CSX Corporation's Chairman, President, and Chief Executive Officer, Michael Ward.

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

Thank you, David. Good morning, everyone. Today we're delighted to bring you good news on many fronts. First, we reported record first-quarter results as the renaissance in our industry and our company continues to unfold. Next, we are gaining strong momentum with our ONE Plan. This is a very good story and one that we expect will get better. And finally, we are still on track with the expansion plans which we outlined last August.

Starting with our financial results, we announced first-quarter earnings per share of $1.06, a 56% increase from continuing operations versus last year. This increase was the ninth consecutive quarter of continuous, consistent improvement in our Surface Transportation businesses, with a record operating income of $487 million. This represents a 39% increase over last year's record quarter.

Demand and pricing conditions helped us achieve record revenues of $2.3 billion. The rate environment continues to be favorable, as demand and pricings remain strong across nearly all markets.

On the volume front, while we experienced some weakness in the first quarter, we saw growth in most of our markets, including coal, automotive, agriculture, and emerging markets, reflecting strong overall economic conditions. Clarence will review the details with you in a moment.

Looking at the ONE Plan, we are very encouraged by our momentum in improving the reliability and the efficiency of our operations. Every key measure in operations saw solid and substantial improvement in the first quarter. As Tony will discuss in greater detail, these results reflect the actions that we have taken to improve the leadership, discipline, and execution at CSX.

On top of our progress in operating the railroad better, the team has remained diligently focused on delivering our capacity expansions on-time, with many of those projects already underway. o at this point I would like to turn over to Tony to discuss both our operating improvements and our capacity expansions. Tony?

Tony Ingram - *CSX Corporation - COO*

Thank you, Michael, and good morning, everyone. Today I'm going to talk about three operating areas that drive value. They are the same things we talked about last quarter and will talk about next quarter.

First, I have told you that safety and leadership go hand-in-hand. Our leaders are stepping up. Our people are coming to work with a winning attitude.

Second, the ONE Plan is working. We are getting the discipline, we are executing better, we are turning the assets and we are getting the trains there on time.

Third, we told you at our August investors' conference that we are going to build a network for growth. That work is right on schedule.

Now let's look at our safety performance. On slide 7, you see very positive safety results. Injuries for the 13 weeks, or the average for the first quarter, improved to 1.38. That drove the improvement we continue to see on a rolling 12 months. Train accidents are another great story, down more than 28% from the first quarter of 2005 over the first quarter of 2006, and a 20% improvement on a rolling 12 months.

In both of these areas, our people recognize the challenge, feel the momentum, and are making progress. That is what we want. Let me say it this way -- in the train business, safety and leadership are one and the same. In my experience, when safety improves, good things happen.

This brings me to slide number 8. More trains are leaving on time and arriving on time. Originations improved to 74% in the quarter and are up to 57% over a rolling 12-month period. We have the same kind of trend in arrivals. The team has embraced the ONE Plan and things are falling in place. The best news is that our customers are getting better service, and that is what it is all about. We still have a way to go, but we are encouraged by the progress.

On slide 9, you see our network is getting fluid and we are making better use of the assets. Dwell time and cars online improved greatly. On average, we improved our dwell time to under 27 hours in the first quarter, and the trend is favorable over a rolling 12 months. Cars online went down to 224,000, and again the trend is favorable on a rolling 12 months. As we keep working on our execution and discipline, we should see these measures continue to improve.

Slide 10 shows velocity. This measures average train speed on the network. First-quarter velocity averaged 20 miles per hour. This drove our rolling 12-month average to 19.4 miles per hour, as we trend back up from the Katrina period.

The summary here is that things that are improving on the railroad -- safety, service, and asset utilization. This is by design. This team believes the improvements can be sustained, and that is most important thing for our customer and shareholder.

Let's turn to slide 11. Last August, we announced plans to expand our network capacity in places where we can grow and improve service. Over the next two years, we will complete around 60 expansion projects. These mainly involve building or improving sitings to handle more traffic. The first 20 are on schedule and will be completed in 2006.

These investments are in two key corridors, the Southeastern corridor, serving the growing markets in the South, and the I-90 corridor that connects Chicago to the markets in the Northeast. This slide and the next two slides are about those first 20 projects. This slide shows projects on the upper end of the Southeastern corridor between Chicago and Nashville. All of these are underway and will be wrapped up this year.

Slides 12 shows active expansion projects on the lower end of the Southeastern corridor between Atlanta and Waycross, Georgia. All but one of these projects will be completed and in service by the end of the third quarter.

Slide 13 shows our two projects on the river line between Albany and New York City. These will be completed by year-end. So we are right on schedule to complete the first 20 projects. Again, there are 40 more projects that we will complete in 2007. Some of these projects will start later this year.

Looking ahead to slide 14, the safety momentum will continue. The ONE Plan is making us more reliable, fluid, and efficient, and we expect that to continue. And our capacity investments will stay on schedule. In summary, I am encouraged by what we are seeing. Consistency is the key. We are going to keep building on our foundation with leadership, discipline, and execution.

With that, I will turn it over to Clarence Gooden, Executive Vice President of Sales and Marketing.

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Thank you, Tony, and good morning, everyone. Once again, we continued to see strong demand for rail traffic and a growing economy in 2006. As you can see on the chart at the right, demand for transportation is still near the record levels achieved over the last two years.

The full-year outlook remains strong. GDP is forecasted around 3.3%, while industrial production is forecasted around 3.9%. The Institute of Supply Management index was 55.2% for March. That is the 22nd consecutive month of expansion. Export and import volumes growth is expected to continue in the high single digits and both are expected to stay strong versus the 2005 levels.

During the first quarter, revenues of $2.3 billion exceeded the prior year by $223 million, representing a new quarterly record for total Surface Transportation revenue at CSX. Revenue growth during the quarter was led by the merchandise and coal markets, though all major markets experienced revenue growth. Overall volume was down 1% from a year ago, principally reflecting declines in the short-haul phosphate and in intermodal traffic, as I will discuss in a moment. We also experienced continued strength in yield improvement.

As you can see on the next slide, in the first quarter of 2006, revenue per unit grew 12%, driven by our continued focus on yield and our fuel surcharge program. This represents our highest percentage revenue per unit improvement during the quarter.

Revenue per unit gains were strongest in the merchandise market at 15%, followed by coal and automotive 10% and 9%, respectively. Intermodal also achieved 4% revenue per unit improvement. During the first quarter, the drivers of this revenue per unit increase were 45% due to price, 35% due to fuel surcharge, and 20% due to mix.

The environment continues to be favorable for pricing, with strong transportation demand, tight transportation supply, and the growing economy. Moving forward, we will continue our momentum in improving yield.

Quarterly merchandise revenue of over $1.1 billion increased 11% on a volume decrease of 4%. This represented the 16th consecutive quarter of year-over-year merchandise revenue growth. Merchandise markets recorded stronger yields in all markets, as revenue per unit increased 15%. Volume in merchandise markets decreased nearly 4% and was largely driven by the declines in our phosphate and fertilizer market.

As you can see, the merchandise volumes grew in four of the seven markets. Our most significant decline was registered in our phosphates and fertilizer segment, where reduced international demand for phosphate rock led to a 29,000 carload decline in short-haul phosphate shipments. As a result, plants around our Bone Valley operation shut down and curtailed shipments. Excluding these phosphate declines, overall merchandise volumes would have been favorable.

In addition, our focus on yield and an increase in longer-haul domestic volumes offset the volumes decline in the short-haul phosphate market, holding this segment's revenue constant versus last year.

Also, shedding of low-margin traffic and reduced demand for transportation also negatively impacted the volumes in our forest products, yet the growth continues in our other markets. In our agricultural products, improvement in our grain unit train service contributed to growth, as did the strong demand for ethanol shipments. Strong demand for movements of aggregate products and municipal waste drove the emerging market volumes up 8% for the first quarter.

While volume expectations in merchandise are mixed, we expect to see overall volume growth in the second half of 2006, as service continues to improve.

Quarterly coal revenue of $579 million increased over 14% on a volume increase of 4%. Strong demand existed in the coal market, and the growth was strongest in the utility and river markets, due to continued rebuilding of inventories and increased supply. Revenue per car increased 10% and we believe that the favorable environment for pricing will continue in coal. The 2006 revenue and volume outlook remains favorable, as electrical generation demand remains strong, utility inventories remain below target levels, and alternative fuels are expected to remain expensive.

Now looking at our automotive results, quarterly automotive revenue of $231 million increased over 11% on a volume increase of 2%. Continued efforts to improve yield in this market resulted in a revenue per unit increase of 9%. North American light vehicle production was favorable year-over-year in the first quarter, and at the end of the first quarter, field inventory levels were 69 days, which was flat year-over-year and near the target levels.

Moving forward, Hyundai rail shipments at the CSX-served Montgomery, Alabama plant are expected to continue to grow. Yet the production for the Big Three is expected to continue to decline, more than offsetting the growth that we are receiving from the new domestic producers. As a result, the outlook for the remainder of the year is slightly unfavorable.

Quarterly intermodal revenue of $334 million increased 2% on a volume decrease of 2%. Overall revenue per unit increased 4%, largely due to increased price and fuel surcharge that more than offset the mix-related impacts from the loss of transcontinental traffic. Volume decline was driven by reductions in transcontinental and off-core traffic, the shedding of low-margin traffic, and divergence to truck.

Operating income in the first quarter was up 19%. First quarter 2006 represented the sixth consecutive quarter of year-over-year operating income improvement. We are extremely pleased with these positive bottom-line results and expect them to continue as we grow the volume in the second half of 2006.

So how are we going to grow? Our service levels on our intermodal network triangle remain near 90%. Our key service lanes have train capacity for growth, while trucking capacity is expected to remain tight. CSX Intermodal will leverage the improvements in service to grow the volume in the remainder of 2006.

Finally in summary, demand and growth remain strong for rail transportation. The favorable pricing environment continues due to strong growth in demand, high fuel prices, and tight transportation supply. And we believe that service improvements will drive our volume growth. Thank you and let me introduce Oscar Munoz, our Chief Financial Officer.

Oscar Munoz - *CSX Corporation - CFO*

Thank you, Clarence, and good morning, everyone. As Michael mentioned, our results mark the ninth consecutive quarter in which we have improved. In this first quarter, we saw operating income of $487 million, an increase of $136 million from the prior year, reflecting stronger revenue gains, improved operating performance, and continued cost control.

Consolidated operating income increased $142 million due to our Surface Transportation results and the increase in Other operating income of $6 million. This $6 million was primarily driven by a gain the sale of equipment from our former container shipping business.

Next, and looking below the line, you can see Other income was essentially flat. Moving down the page, interest expense was lower by $16 million for the quarter, primarily due to the $1 billion debt reduction that we executed in the second quarter of last year. Income taxes increased $66 million in the quarter due to our improved financial results. Going forward, as we constantly remind everyone of, our effective tax rate is approximately 38%. Overall, our earnings from continuing operations were $245 million, or $1.06 per share, an increase of 56% over 2005.

Moving to the next slide, let me take you through the details of our Surface Transportation results. Top-line growth was 11%, largely reflecting yield strength and increased fuel surcharge coverage. While we saw a slight decline in volume, primarily due to a reduction in our short-haul phosphate business as Clarence discussed, we did see an overall favorable mix impact in revenue for the quarter.

Moving to the cost side, let me talk about total expenses, which increased $87 million, or 5%, for the quarter. The main driver of this increase was fuel, which increased $74 million, or 41%. Excluding fuel, total expenses were up less than 1%, as the improvements from operations and the related productivity gains nearly offset the inflationary pressures.

The net result for the quarter was a 39% increase in operating income and a 79.1 operating ratio. This is a 420 basis point improvement in our operating ratio from prior year, and this follows on the heels of the significant margin improvement we saw over the course of 2005. Clearly, we are pleased this performance, and as you know, we recently updated our long-term operating ratio target from the mid to high 70s that we had said earlier to the mid 70s.

Now let me discuss our expenses in more detail over the next few slides. On side 29, labor and fringe benefits increased $24 million, or 3% over last year. This was driven by wage and benefit inflation of $13 million and by approximately $14 million in higher costs associated with our year-over-year headcount increase of over 800 train crew employees, as we continue to hire ahead of attrition.

Other labor and fringe expenses increases were more than offset by improved productivity in our train operations, as overtime and other crew expenses were reduced with our improved operational fluidity.

Move to the next side, let me review our Material, Supplies and Other, or MS&O expenses. These expenses were lower the last year by $9 million as material and other inflation was largely offset by productivity gains. The improvements in operations fluidity had a direct impact on locomotive utilization, reducing those related expenses. In addition, our improving trend in train accidents helped lower freight loss and damage costs. Lastly, intermodal costs decreased year-over-year, primarily as a result of expenses in last year's first quarter related to sales tax and other items.

Now let's talk about fuel on the next slide. Overall, fuel increased $74 million, or 41%, versus last year, largely driven by increasing fuel prices. For the first quarter, our gross cost per gallon of diesel rose to $1.83. In addition, our hedge benefit was $16 million lower year-over-year due to our declining hedge position. Partially offsetting our higher fuel cost were gains in locomotive fuel efficiency.

Now if we move to the next slide, I will update you on the value of our hedge positions for the balance of 2006. This slide, slide 32, shows the historical and projected financial value of our remaining hedges. As you can see, our hedge value is declining and will completely expire by the end of the third quarter this year.

In the first quarter of '06, we were 25% hedged and saw a $35 million hedge benefit. For the second quarter of 2006, we are 12% hedged and expect an approximate $18 million hedge benefit. That benefit declines to approximately $1 million for the third quarter.

Now moving on, let me review more of our productivity story and our rent expense. Overall, rents declined 8%, or $11 million, driven by a reduction in rail car lease expense. This was a direct result of the improvement in operational fluidity, which drove improvements in shipment cycle time and reduced the numbers of cars online.

On the next slide, let me review the remaining expenses. All other expenses increased $9 million. The primary driver was depreciation, which was higher due to a net increase in our capital asset base.

So to wrap up and as I mentioned, this quarter was a record for operating income, driven by solid revenue growth, improved fluidity in our network, and continued productivity gains. The financial benefits related to our solid operating performance and the strong transportation environment is expected to continue. We are on track to generate $300 million plus in the free cash flow for the year after the $1.4 billion in planned capital investments that we announced earlier.

In short, we will continue to maintain a focus on delivering consistent and continuous improvement in the quarters ahead. Now with that, let me turn it back over to Michael for his closing remarks.

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

Thank you, Oscar. Two years ago we outlined a strategy to capitalize on the evolving transportation marketplace, to achieve revenue growth, to strengthen the reliability of our operations, and to develop a performance-driven culture to fully leverage the reach of our transportation network. Clearly, the momentum is strong across those objectives today.

What's more, that momentum is occurring in a market environment that remains vibrant. As the operating team continues to improve the execution of the ONE Plan, we will see better service and better productivity. Our first-quarter operating ratio of 79% is an indication of what better execution does for us.

Better performance will also allow us to further leverage and build on our network, to add volume to our story, and to deliver double-digit growth for our shareholders over the next five years. It is exciting for me to show the Company's results, as well as its vision and conviction about the ever more compelling role for railroads in the business infrastructure of this country.

As we demonstrated in 2005 and again in the first quarter, we will continue to build our service and our infrastructure to deliver for our customers and our nation as they grow and evolve. This is an exciting future for the country, the rail industry, and for CSX.

So with that, I will be glad to take your questions. For the benefit of all the participants, if you could please identify your company affiliation and yourself before you ask your question, we would appreciate it.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Ken Hoexter, Merrill Lynch.

Ken Hoexter - *Merrill Lynch - Analyst*

Just phenomenal results. Great to see the ONE Plan working. Just a couple of questions. Can you break down, Oscar, what you think the weather and fuel surcharge really aided for the first-quarter upside relative to expectations versus just pure internal improvement?

Then secondly, I just want understand if you continue to get rid of so much of the intermodal traffic, should we then begin to see yields start to show a better improvement as that starts to wrap up after the middle of the year? Thanks a lot.

Oscar Munoz - *CSX Corporation - CFO*

Thank you, Ken. I'll take the questions --. I think your question on the winter, probably the whole industry enjoyed some tailwind from the mild winter in this first quarter. And while it is difficult to fully quantify, I would estimate it favorably impacted CSX in the first quarter by I would say $20 million to $25 million.

And with regards to fuel, I think we had the number in the presentation -- we had 35 in the hedge benefit and approximately 4% of the price increase was due to that.

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Ken, this is Clarence Gooden. The yields in the intermodal was mainly driven by the transcontinental business. And what you're seeing happening now in the transcontinental business is less transloading on the West Coast into domestic boxes from the international boxes; and that in turn is driving down those eastbound volumes, which in turn is driving down those yields. So you can expect to see that trend, in my opinion here, continue in the second half of the year on that transcontinental volume.

Now our overall volume, we expect to be up in our intermodal business in the second half of this year.

Ken Hoexter - *Merrill Lynch - Analyst*

Great. One last follow-up for Oscar. You readjusted your long-term, which was -- I get a three-year to five-year target on your OR to the mid 70s. Can you talk conceptually about where you think that can go with -- as Tony gets the railroad running more and more efficiently, can we see that getting to a low 70s result ultimately? Or can you even get to the -- kind of see end levels into the 60s? Can you talk a little about that conceptually?

Oscar Munoz - *CSX Corporation - CFO*

I appreciate the company with regard to that, but we are not going to provide any additional guidance at this particular time. So we will keep you posted on our continuing and consistent improvement across all areas.

Ken Hoexter - *Merrill Lynch - Analyst*

Great. Thanks for your time.

Operator

John Barnes, BB&T Capital Markets.

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

Congratulations on the number. Are we going to see some inflection point? I know you're trying to hire to stay ahead of your attrition. You also brought some employees on, I guess, for this capacity expansion. Do we see some inflection point in the near term where headcount begins to reverse itself again and we see a decline trend there or are we still a couple years out from seeing that?

Oscar Munoz - *CSX Corporation - CFO*

John, Oscar. With regards to headcount, I think for the course of this year, I would expect it to increase from the current place that you see it another roughly 500 people over the course of this year. And no guidance on future years, but I think generally as we hire ahead of attrition and build our engineering workforce for the capacity projects that we are working, that using a 35,000 number is from what you see on our documents is probably not a bad estimate to use for the remainder of this year.

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

Okay. Then as the hedges roll off, what percent do you expect of your business to be covered by either surcharge or RCAF by the time we get closer to when the hedges roll off? I'll give you through the third quarter. As you go into fourth quarter, completely naked on fuel, where do you think you are on coverage of surcharge and RCAF?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

John, this is Clarence Gooden. On the fuel surcharge, we'll be somewhere between 56 and 59% on fuel surcharge coverage. And you could add another 20 to 25% on top of that for RCAF coverage.

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

Okay, all right. Clarence, last question, just on carload growth in general in the back half, are you sticking with your guidance that we're going to see flat in the second and then acceleration in total carload growth in the back half of this year?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

John, I am. The only caveat I'd give you there is the phosphate business that you saw in the first quarter this year was down 29,000 loads. Now that's short-haul freight, relatively low in revenue, and that trend will continue throughout the year. But the rest of the business we expect to see grow.

Oscar Munoz - *CSX Corporation - CFO*

We're expecting 2 to 3% overall growth for the entire year.

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

All right, very good. Again, congratulations on the number. Thanks for your time.

Operator

(OPERATOR INSTRUCTIONS) Edward Wolfe, Bear, Stearns.

Edward Wolfe - *Bear, Stearns - Analyst*

Tony, in regards to the network, can you talk a little bit about two potential impacts on the network and how that might impact some of the metrics going forward? One, the impact of New Orleans being back up mostly since February and what that means going forward; and two, the capacity expansion and whether -- so far you haven't seen impact, at least certainly from your metrics, it doesn't look that way. At some point in the year as you do some of these major projects, could you see some impact on speed or on dwell time?

Tony Ingram - *CSX Corporation - COO*

First of all, let me address New Orleans. As most of you know, we got back up and running after January. So after the first 31 to 35 days of the year, we have been operating everything back on its normal route, which reduced the congestion around Atlanta and Nashville and going through Memphis. And that should help us improve our velocity and our fluidity going through there.

The other issue that you asked about is the capacity. Our capacity projects will be coming on primarily during the third and fourth quarter. So we think we will have some improvement here in the third and fourth quarters. It's pretty hard to tell at this point exactly what that's going to deliver, but we are expecting some improvement from it.

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

And you'll recall, Ed, those expansions were for two purposes, one to improve the reliability and recoverability of our network, which I think is the (indiscernible) line you'll see that improve. It's also to help us handle the additional growth we are expecting to see. So as we put the 60 projects in, you'll see that gradually helping both the recoverability and the growth.

Edward Wolfe - *Bear, Stearns - Analyst*

But you don't see a temporary step back in terms of hindrance as you connect the sitings or anything like that? You just expect to see the gradual improvement as you improve capacity?

Tony Ingram - *CSX Corporation - COO*

No, we have programmed our work, what we call our curfew work, along with siting connections with other projects that we've got in the area to eliminate as much interruption as possible.

Edward Wolfe - *Bear, Stearns - Analyst*

Okay. Oscar, the 12% yield I think you said 4 percentage points of that, give or take, was fuel. What is the other 8% between pricing and mix?

Oscar Munoz - *CSX Corporation - CFO*

I'd look at it as a kind of 5, 4, 3. Five price, four fuel surcharge, and three mix. And that is the short-haul phosphate mix that Clarence discussed.

Edward Wolfe - *Bear, Stearns - Analyst*

Okay. I noticed the headcount, the 34,000 employees that you reported, how many of those are being capitalized on the projects?

Oscar Munoz - *CSX Corporation - CFO*

Of the 34, roughly 20% are engineering. Most of those are [OE]. So I don't have a direct answer. It is probably 2000 or 3000 people.

Edward Wolfe - *Bear, Stearns - Analyst*

Does that fluctuate throughout the year?

Oscar Munoz - *CSX Corporation - CFO*

No, our engineering gains are pretty static. We are -- some of the higher -- you'll notice on our headcount report, we actually increased 1300 people. 800 are train crew employees. The remaining 500 or so are engineering. Those predominately -- of those engineering people, those are predominately being capitalized. So to your question on fluctuation, it is going to increase a little bit more than that number as we build these projects.

Edward Wolfe - *Bear, Stearns - Analyst*

Okay. But the headcount that you talked about, 500 more people throughout the year, those are expensed employees you are talking about?

Oscar Munoz - *CSX Corporation - CFO*

Roughly. The additional 500 from here will be roughly half and half -- half operating expense, half capital.

Edward Wolfe - *Bear, Stearns - Analyst*

One last question for Clarence. You talked about the scope of the fuel surcharge expanding as you go out over the year a little bit. Is that fairly evenly throughout the next three quarters or is that back-end loaded -- how should we look at that -- or front-end loaded?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Fairly evenly through the next three quarters.

Edward Wolfe - *Bear, Stearns - Analyst*

Thanks a lot, guys, for the time.

Operator

Morgan Stanley, Jim Valentine.

Jim Valentine - *Morgan Stanley - Analyst*

Great quarter. Clarence, I was wondering if you could help us maybe understand the 5, 5.5% price increase that you got in terms of base rate increases. And then I'm thinking about it in three buckets, how much it came from accelerating rates in the spot market, how much came from accelerated rates with your long-term contractual business, and then how much came from just possibly you had a larger number of long-term contracts roll over early in the quarter or late in the fourth quarter?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Well, let me see if I can get that straight here for you, Jim. The first thing is that those rate increases when you see the 5%, that's averaged over the entire portfolio business. So those rate increases were higher than 5% on a single transaction (multiple speakers) basis.

Secondly, most of it came from contracts that was being renewed either on time or, in some cases, we accelerated and renewed some contracts early. So it was mostly from contract renewals.

Jim Valentine - *Morgan Stanley - Analyst*

Good. The second question I had regards fuel surcharge. And I try not to get into these really detailed number-oriented questions, but that is the area where you beat our number the most, in that -- Clarence, you had mentioned 35% of your yield increase came from fuel surcharge. That implies you had about 90 million from there. And a year ago in the first quarter, we estimate you hit about 80 million.

So you take about $170 million of fuel surcharge you collected in the quarter, which is great -- that's fantastic. That would be about 100% of your fuel inflation above that all-important kind of $0.75 a gallon that I've heard people in the industry talk about is the base threshold surcharges kick in. So if you're at -- near 100% here, I guess one question I have is how did you do that so well and so quickly?

And the second is that there has been talk in the industry about the fuel surcharge program. Are there any thoughts about you changing it to maybe make it more of a weight or distance-based, just given some of the issues with the STB?

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

Jim, this is Michael. Let me tackle that question if you don't mind. As you know, we've had this you'll surcharge program for several years now, and our purpose really in this is to try offset the higher cost of the fuel. And to date, we haven't really done that. And as we expand the coverage, we obviously will start approaching closer to that. But at this point we have not been overrecovering historically on this fuel surcharge mechanism.

As you know -- I think we are all well aware -- there are hearings at the STB on this, and I think they occur fairly soon. And I think where I would like to be on this is we are optimistic that as we look at these hearings, we're going to find, one, that we are not overrecovering over the last few years, and that there is going to be support for the need for the railroads to continue to recover the escalating cost of the fuel, as is occurring in the other transportation sectors.

Obviously, as well look at this over time, if we do get to the point where we are approaching overrecovering, then we will take action to re-examine the program, because our intention is not to make money off of this.

Jim Valentine - *Morgan Stanley - Analyst*

Right. So you don't see yourself changing. Regardless of the STB case, I'm just curious -- because BN even a year ago was this thought of they'll go to weight and distance-based. Any thought on changing your program more like that?

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

No, we're sticking with our current program at this time, Jim.

Operator

Gary Chase, Lehman Brothers.

Gary Chase - *Lehman Brothers - Analyst*

Just a couple quick ones for you. When you think about where you are with ONE Plan and the implications of a couple to 3% volume growth this year and then volume growth next year, what kind of cost leverage do you think we can expect out of the business as you expand it? You've been experiencing operating improvement, but without the benefit of volume gain. How should be thinking about how that leverages out going forward?

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

Well, I think, Gary, you're beginning to see some of that now, where you are seeing the two in combination. Because if you exclude what happened in that first market, we did the growth overall in our markets. So you are combining that with the improved efficiencies that Tony and his team are creating, you're starting to see that leverage.

So I think we're going to continue to see that as we add those first increments, that can largely be added to existing trains. As Clarence mentioned, there is excess capacity on some of our existing intermodal trains. We can add that volume fairly efficiently. Even to some of our merchandise trains, there is ability to add cars. So I think in the near-term we're going to see a pretty good fall-through as we grow the revenues.

Gary Chase - *Lehman Brothers - Analyst*

Okay. I wonder, Clarence, if you can shed any light on what is going on in terms of long-term escalation in core rates in the contracts that you are renegotiating. Can you give us any sense of the magnitude of core escalation that you're able to build into those as they roll?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Well, I don't want to get into any specifics for obvious competitive reasons, but I would tell you this -- we are getting low double-digit increases in prices in our long-term contracts.

Gary Chase - *Lehman Brothers - Analyst*

Okay. Thanks a lot, guys.

Operator

Jason Seidl, Credit Suisse.

Jason Seidl - *Credit Suisse - Analyst*

I'm glad to see that your service was better than your conference call providers.

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

Thank you, Jason. We weren't happy with that this morning, but we got there.

Jason Seidl - *Credit Suisse - Analyst*

I'm much happier with your rail performance, that's for sure. A quick question here for Clarence. You mentioned on slide 24 that your key intermodal service lanes have train capacity for growth. Can you give us an idea about how much capacity you think there is going to be available in the back half of this year and in 2007?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Yes, sir. It's about 35% capacity on those trains. They're operating today at around 65% capacity.

Jason Seidl - *Credit Suisse - Analyst*

And do you feel that is going to be enough going forward, given the fact that you have demarketed some of the freight and that we are again approaching historic highs for energy costs, and people tend to switch to more intermodal freight when energy costs go up?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Let me give you two answers on that. The first one is I think that's going to be enough capacity for us this year. The second answer is I'd love to be wrong and have to add capacity.

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

And as we do see that growth, we can add trains to our (multiple speakers) capacity.

Oscar Munoz - *CSX Corporation - CFO*

This is Oscar. And certainly with our earning power resurgence, we are able to invest those monies strategically.

Jason Seidl - *Credit Suisse - Analyst*

Next question is more for Tony, and this is more of a conceptual question. Obviously, we have had to have some sort of an internal change there at CSX, I think, with the workforce and believing in the ONE Plan. How important do you think posting first-quarter results like this is for morale at the railroad on sort of the local level?

Tony Ingram - *CSX Corporation - COO*

That's great for anybody. As you know, we have got our team together. Our team together has been now about nine months out in the field. Their momentum is going. They like to see the results. Things are improving for them and they feel pretty good that they can deliver these kinds of results that you are seeing today.

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

I was also going to say that that's just the day-to-day, seeing the numbers, having the stability and the improvement, and I think you are seeing a lot of excitement about what the ONE Plan can do for us in the field.

Jason Seidl - *Credit Suisse - Analyst*

Thanks for the time, gentleman.

Operator

John Larkin, Stifel Nicolaus.

John Larkin - *Stifel, Nicolaus - Analyst*

Just had a question regarding all of the puts and takes we have working here as we transition out of the first quarter into the second quarter and then into the second half of the year. We have got the hedges kind of rolling off. We've got fuel surcharges rolling on. We have the normal seasonal improvement as we go out of the first quarter into the second quarter. Maybe that is less pronounced due to the good weather in the first quarter. You are going to be trying to latch onto some volume growth in the second half of the year.

In terms of the operating ratio, which was outstanding in the first quarter, given all of those puts and takes, would we expect that to remain about the same as it was in the first quarter going forward, with the lack of fuel hedges being kind of the drag on it? Or is it possible it could improve as we move through the year?

Unidentified Company Representative

John, you, I think, hit that very well. There's lots of moving parts in that equation. I guess we really do like the progress we've seen here in the first quarter. And I know you don't like this answer, but we've really been about continuous, consistent improvement, and I think that's where we're going to stick at this point, rather than try to predict where that operating ratio will end up for the year.

But we do believe as we add these expansions and see that better improvement, the ONE Plan better reliability, we feel very good that we're going to be able to move forward and deliver some good ORs. But we really don't want to try to predict what it will be for the year.

John Larkin - *Stifel, Nicolaus - Analyst*

Just a couple of marketing question for Clarence to finish up. I noticed that export coal was down a bit. What is your longer run outlook on export coal?

And then secondly, I know a lot of the railroads are putting a lot of emphasis on marketing to the truckload carriers as they struggle with their driver recruiting and retention issues. Have you focused on the truckload carriers as a target market opportunity?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

John, on the export coal, we still see a very strong, vibrant market in the export coal. We even had some shipments, for the first time in a long time this first quarter, of steam coal going to Europe because of the unusually cold weather that we had in Europe this winter. So we see that market still very strong.

On the truckload carriers, the answer is yes. We have a couple of deals that we are working actively on now with some major national truckload carriers, so we are targeting that market.

John Larkin - *Stifel, Nicolaus - Analyst*

Thank you very much.

Operator

Jordan Alliger, Deutsche Bank.

Jordan Alliger - *Deutsche Bank Securities - Analyst*

Just a quick follow-up on the intermodal, which it appears, given the comments on capacity and what have you, that the growth is ready to resume. I guess my question is do we start to see some of that resumption here in the second quarter? And with the 35 percent available capacity, do you think you could get the intermodal carloads up more in line with what the broader industry has been growing as you move through the year?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Jordan, let me give you two answers on that one also. First, you'll see some improvement in the second quarter, but you'll see the preponderance of the improvement in the third and fourth quarters.

Number two is a lot of the growth that you have seen in a lot of the intermodal business nationwide has been in the international segment of the marketplace. And that is mostly due to -- that growth occurs because of long-term contracts that you have with the steamship carriers. So I would not expect to see a lot of movement in that particular area for us.

Jordan Alliger - *Deutsche Bank Securities - Analyst*

Okay. And just a follow-up, I think, to a question much earlier in the call on the intermodal yields. I did not quite follow sort of the discussion on the yields, I think which were up about 4% in the quarter, and the expectation for those yields going forward. If you could just reiterate that for me, that would be helpful. Thanks.

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Sure. We have a contractual arrangement with some Western carriers in which we get line-haul revenue from the West Coast to the East Coast. And so those carry fairly high revenue per unit charges. When that business declines or when that mix changes, where there's less of that business and more of the East Coast based business, that takes those yields levels down.

And the West to East traffic in general in the U.S. is down in the first quarter of this year, mainly due to the fact that international containers are not being transloaded to the degree that they were in the past on the West Coast.

Jordan Alliger - *Deutsche Bank Securities - Analyst*

Okay, so you would expect sort of that mix effect to linger then at this point for the time being?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

I think it's going to continue at least, as far as I can see, for the rest of this year.

Jordan Alliger - *Deutsche Bank Securities - Analyst*

Great. Thank you very much.

Operator

A.G. Edwards, Donald Broughton.

Donald Broughton - *A.G. Edwards - Analyst*

I've got couple of esoteric operating questions. We heard you have reduced the number of sort yards, or the number of yards you are actually doing sorting in. Can you tell us about this initiative and what improvements it has yielded?

Tony Ingram - *CSX Corporation - COO*

I don't know where that information came from. We have not taken any yards out of service.

Donald Broughton - *A.G. Edwards - Analyst*

All right. Let's look at the improvements in dwell time and train speeds. Clarence, help me out. How do I know -- Tony, maybe you would be the right guy -- how do I know that what I'm seeing is true operating improvements and not just a direct reflection of the lower volume and the lower cars online?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

I think part of it is if you just look at the gross ton miles, which is probably the best measure of work. We actually had more gross ton miles this year than we did last year in the first quarter. So actually, the work being performed is higher and yet the velocity and dwell have improved. So I don't think it is a volume question at all.

Donald Broughton - *A.G. Edwards - Analyst*

Gross ton miles is going to be up slightly because of mix, though, because you have more carloads -- you lost less carload volume than intermodal volume, right?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Yes, but if you think about on a railroad, the real unit of work is a gross ton mile, moving a ton of product one mile. That is really the work activity, not so much the carload. So the actual work activity being required was higher, yet we still saw those improvements in the velocity, the dwell and the productivity.

Donald Broughton - *A.G. Edwards - Analyst*

Interesting point. Nice quarter, gentlemen.

Operator

A follow-up from Edward Wolfe.

Edward Wolfe - *Bear, Stearns - Analyst*

Clarence, you had said to me or maybe it was Oscar that 3% of the yield was related to mix. And I am just wondering, if I recall last quarter there was really 0% of the yield attributed to mix. What has changed? I'm (technical difficulty) understanding is that an ongoing change in the mix?

Clarence Gooden - *CSX Corporation - EVP, Sales & Marketing Officer*

Just to reiterate the numbers, they were 45, 35, and 20. And the biggest change in the mix was in the phosphate business. The short-haul business that went away in Florida, which was nearly 29,000 loads -- I mean, that is a big number -- changed that total mix in that phosphate business. And the remaining phosphate business that we had was long-haul business, and in fact that part of the phosphate business was up. That is the biggest single driver of mix.

Edward Wolfe - *Bear, Stearns - Analyst*

So if the export phosphate remains weak, then you expect the mix to continue, and if he doesn't then we shouldn't see that, basically?

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

You may get other mix impacts depending what the market does, but I think generally that is true, Ed. And I think Clarence noted that we're going to continue to see that impact throughout the year, but maybe declining a little bit on a year-over-year basis on the phosphor. So yes, probably continue to be that phosphor mix in there throughout the rest of the year.

Edward Wolfe - *Bear, Stearns - Analyst*

Okay, thanks. That's helpful.

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

Everyone, thank you for your participation today. We appreciate your interest in our Company. Thank you.

Operator

That does conclude teleconference for today. We would like to thank everyone for your participation and have a wonderful day.