Company Name: CSX
Company Ticker: CSX US
Date: 2018-07-17
Event Description: Q2 2018 Earnings Call

Market Cap: 56,407.78
Current PX: 64.44
YTD Change($): +9.43
YTD Change(%): +17.142

Bloomberg Estimates - EPS
Current Quarter: 0.840
Current Year: 3.317
Bloomberg Estimates - Sales
Current Quarter: 2931.941
Current Year: 11853.364

Q2 2018 Earnings Call

Company Participants

- Kevin Boone
- James M. Foote
- Frank A. Lonegro

Other Participants

- Amit Mehrotra
- Ken Hoexter
- Brandon R. Oglenski
- Thomas Wadewitz
- Chris Wetherbee
- Scott H. Group
- Brian P. Ossenbeck
- Matthew Reustle
- Allison M. Landry
- J. David Scott Vernon
- Justin Long
- Walter Spracklin
- Ravi Shanker
- Benjamin J. Hartford
- Bascome Majors
- Cherilyn Radbourne

MANAGEMENT DISCUSSION SECTION

Kevin Boone

Non-GAAP Financial Measures

On slide 2 is our forward-looking disclosure, followed by our non-GAAP disclosure on slide 3

James M. Foote

Business Highlights

Opening Remarks

- In order to get started, I guess, first way to kick it off is, the press release that we put out says it all
  - Record financial results
- These results are due to the hard work of all CSX employees, who I could tell you, are really excited about what has been accomplished

- We will all celebrate a little bit tonight, and then expect to work tomorrow to continue to drive change to fully realize the potential of this company

Safety

- Before I turn to the slides, let me comment on a couple of key initiatives
- First, safety, we intend to be the safest railroad
- In May, our new Chief Safety Officer, Jim Schwichtenberg joined the company
- Schwich comes to us with 20 years of railroad experience, including almost 10 years with the FRA
- I am confident that he could bring new approaches that will drive improvement in our safety performance

DEKRA

- Also in May, we engaged DEKRA, a highly-regarded expert in helping companies improve their safety performance
- A comprehensive safety assessment is underway, and I expect positive changes to materialize as a result
- The entire organization is committed to being the best in safety

Executive Appointment

- Second, we recently announced the appointment of Mark Wallace as EVP, Sales and Marketing
- I've known Mark for a long time
- And his ability to lead combined with more than 20 years of scheduled railroading experience will allow our sales and marketing team to work more effectively with our customers, and drive profitable growth
  - Diana Sorfleet will take over most of Mark's former portfolio assuming increased responsibility as EVP and Chief Administrative Officer
- Diana in her role as CSX's Chief Human Resources Officer has been a big part of our transformation by driving a more productive and engaged workforce
- Her new responsibilities, which will now include technology and labor relations, provide a significant opportunity to drive a more focused organization

Q2 Results

EPS, Tax Rate and Operating Ratio

- Now, to get to the slide, let's to slide 5, and start with our results
- Two words, I think, sum up everything: great performance
- Just like Q1, there's nothing unusual in these numbers
- They're very straightforward
- EPS increased 58% to $1.01 vs. last year's adjusted EPS of $0.64

- The new lower tax rate and lower share count down 6% contributed to this significant y-over-y increase
- Our operating ratio improved 490BPS to a record 58.6% compared to last year's adjusted OR of 63.5%
- Clearly, the lowest ever for CSX, and I believe the lowest ever by a U.S. railroad
- The significant y-over-y improvement in our results was driven by 6% top line growth combined with price and lower costs, pretty much across the board with the exception of fuel

Revenue

- Revenue increased 6% as price, fuel surcharge, supplemental revenues and a 2% increase in volume all contributed to positive growth this quarter
- Similar to recent trends, we did see slight improvement in pricing this quarter, excluding coal

Chemicals

- Quick look on the next slide on the business segments, each were – which were positively impacted by higher fuel and price
- In chemicals, strength in industrial products, plastics and crude-by-rail was partially offset by our fly ash losses which we discussed last quarter
- Auto saw strength based on North American U.S. light truck production, which was up 5%
- In forest products, lumber, panels, wallboard and paper products all increased in the quarter

Metals

- In metals, shipments of sheet steel and construction-related steel products drove increases
- Fertilizers, revenues as I have mentioned previously were mainly lower due to the Plant City facility closure last year
- And in the coal markets, export coal remained very good during the quarter, and show healthy gains; utility coal continued to weaken

intermodal

- On the intermodal side of the business, growth continued to come from the international markets with domestic relatively flat on a y-over-y basis because of the line rationalizations that we went through in the fall of 2017
- Other revenue declined due to $58mm liquidated damages, which was in last year's results, which did not repeat this year
- Excluding that item, we saw gains in supplemental revenue, including demurrage
  - We continue to work with customers to create a more fluid network, especially as we approach the fall peak season

Key Operating Metrics

- On slide 7, let's take a quick look at some of the key operating metrics that this team is focused on

- Train velocity increased y-over-y and on a sequential basis
- Terminal dwell saw an 11% y-over-y and 7% sequential improvement
  - While we drove improved velocity in dwell, train length increased on both a y-over-y basis 13%, and sequentially 5%

Asset Efficiency

- Let me tell you, improving all three of these metrics at the same time is no easy task
- Finally, car miles per day showed low-double-digit improvement in both a y-over-y and sequential basis
  - This is a good measure of asset efficiency and our ability to effectively turn our assets
- The improvements we saw on these metrics clearly translated into our financial results

Frank A. Lonegro

Financial Highlights

Revenue and Same-Store Sales Pricing

- Turning to slide 9, I'll walk you through the summary income statement
- Reported revenue was up 6% in Q2, driven by 2% more volume, higher fuel recoveries and solid core pricing gains across all major markets
- Same-store sales pricing, which reflects y-over-y increases for stable traffic improved sequentially in Q2
- Pricing for merchandise and intermodal contracts that renewed in Q2 were strong, exceeding same-store sales pricing growth

Other Revenue

- Other revenue was down y-over-y, the benefit of higher demurrage and storage charges mostly offset the cycling of $58mm in liquidated damages from the prior year
- Note that we now expect other revenue to remain in the $130mm to $140mm per quarter range for the remainder of the year

Expenses

- Moving to expenses
- Total operating expenses were 8% lower in Q2 or 2% lower after normalizing for last year's restructuring charge
- Overall, labor and fringe savings of $82mm or 11% y-over-y were driven by an 11% reduction in average head count
  - This smaller labor footprint spans both the operating and G&A departments

Volume Growth

- On the operating side, y-over-y improvements of 7% in velocity and 13% in train length drove more efficient use of our train crews and rolling stock
- Even with 2% volume growth, train and engine employee road starts were down 9%, while yard and local starts also fell 9%
- And the level of recruits, a signal of network fluidity dropped by 15%

Mechanical

- Shifting to mechanical
- The active locomotive count was down 13%, reflecting our ability to keep over 600 locomotives in storage despite higher volumes
- The smaller fleet along with freight car repair efficiencies helped drive an 18% decrease in our mechanical craft workforce
- We recently aligned the engineering function to a regional structure we have for mechanical and transportation, which will also yield head count and other efficiencies moving forward

G&A Head Count

- Our G&A head count continues to decline as we look for every opportunity to absorb attrition
- Over the past year, we have eliminated unnecessary layers of management yielding a structure that is cost effective, that enables rapid communication and decision-making across our network

MS&O

- MS&O expense was down 5% against the prior year
- As you look at the y-over-y comparisons in MS&O, recall that we are cycling at $55mm gain from a favorable legal judgment in Q2 2017
  - This year, results benefited from $37mm of real estate gains as we continue to make headway in monetizing our surplus real estate portfolio
- These gains are consistent with our guidance to achieve $300mm of cumulative real estate sales through 2020

Operational Perspective

- From an operational perspective, many of the key drivers of labor expense favorability also yielded savings in MS&O in the quarter as lower asset and resource levels help drive down MS&O expense
- Material savings attributed to the smaller locomotive fleet, complemented by our decision to store units that are less reliable
- The decisions we've made around storage, combined with additional fleet reliability efforts drove a 33% y-over-y improvement in our Locomotive Out of Service measure, and further reduced costs related to materials and contracted services

Non-Labor Cost

- Looking at non-labor cost associated with our train crews, the reduction in road crew starts combined with better network fluidity yielded lower hotel and taxi costs
- Additionally, MS&O continues to benefit from our efforts to streamline contractors and consultants, particularly in our technology department
- Consistent with our prior guidance, we remain on track to reduce our total workforce by 2,000 resources by the end of 2018

Other Expense Items

- Looking at the other expense items
- Depreciation increased slightly as the benefit of asset sales mostly offset the impact of capital investments
- Yield expense was up primarily due to a 36% increase in the per gallon price, though we were pleased to achieve record fuel efficiency in the quarter

Volume Growth

- We will continue to drive further fuel savings through continued improvement in network fluidity, train length increases, and the use of fuel optimization technologies
- Higher equipment rent expense is mainly attributed to volume growth
  - These volume-related increases were partially offset by improving car cycle times across most markets

Equity Earnings

- Equity earnings were favorable due to improved performance at our affiliates in addition to a non-recurring benefit from an affiliate's property sale in the quarter
- Given the recent strong performance, we now expect core equity earnings of affiliates of $20mm to $25mm in Q3 and Q4
- Lastly, just as a reminder, we are cycling 2017's restructuring charges

Interest Expense and Tax Rate

- Looking below the line, interest expense increased primarily due to the additional debt we issued earlier this year, partially offset by a lower weighted average coupon rate
- Tax expense was lower y-over-y, even with higher pre-tax earnings, given the benefits of the new lower corporate tax rate
- Our effective tax rate was 23.3% in the quarter, slightly lower than our prior guidance, mainly due to a one-time benefit from state legislative changes

Operating Income

- Going forward, absent one-time events, we expect our effective rate to be around 24.5% for the back-half of the year

- Closing out the P&L, as Jim highlighted in his opening remarks, CSX delivered record operating income of nearly $1.3B, and record operating ratio of 58.6%

YTD Capital Investments

- Turning to the cash side of the equation on slide 10, YTD capital investments were lower by 14% and keep us on track for our three-year $4.8B capital target
- The reduced capital intensity of the scheduled railroading model, the substantial core earnings progress detailed on the prior slide, and the benefits of tax reform help drive a nearly $600mm increase in YTD adjusted FCF.

FCF

- Significant improvements in FCF generation combined with higher leverage enabled us to nearly double our shareholder returns compared to H1 2017
- We have now completed approximately $2B of the current $5B buyback authority, and remain on pace to complete the program by the end of Q1 2019
- As we stated at our investor conference, CSX will continue to evaluate cash deployment and shareholder returns on an annual basis

Management Team

- In closing, I will reiterate the three key priorities that drive this management team on a daily basis:
  - Ensuring the safety of our employees and communities
  - Delivering great service for our customers
  - And appropriately rewarding our shareholders

James M. Foote

Q2 Highlights

Performance

- Turning to the last slide, number 12
- Well, we’ve achieved a lot in a very short period of time; we are far from where I believe we can go
- As many of you know, we just rolled out our trip plan compliance a few months ago
- We’re in the early stages of driving improvement in this metric, and there is significant opportunity there to get better

Trip Plans

- Trip plans are so important as we think about delivering even better customer service and asset efficiency
- It allows us to track every car and container on our network and identify in a very discrete level, where we may have a problem

- This allows us to know why something happened so we can react and more importantly fix any problems so it does not repeat

Cars Online

- I mentioned velocity and dwell earlier
- Clearly, to be the best, we have more room to improve
- Our train speed specifically, we have significant opportunity to improve as we remain below the industry leaders
- Our dwell is better than the industry average, but again, there is significant runway for opportunity before we can call ourselves the best
- Cars online continue to be a focus of this team
  - We are in the business of moving cars, and the more efficient we get, the less cars we need to move the same volume
- Returning cars faster, it also frees up capacity for us to take on additional business

Fuel Efficiency

- Finally, fuel efficiency
- Diesel prices are up, so this becomes even more important
- There are many ways to drive improvement in this area
- Fuel alone this quarter was $270mm in costs, so we are in the $1B run rate range for the full year
- These are big dollars
- From Trip Optimizer to distributed power, we will use all of these to drive improvement and lower costs

Revenue

- Now, on revenue
- We are raising our full-year guidance from up slightly to up mid-single-digits
- At some investor conferences, I said we were trending to be a little better than where we thought we would be at that time of the year
- This slightly higher outlook is a reflection of a number of factors, including our belief that export coal strength will continue, higher fuel prices will remain, and a healthy economic backdrop
- Obviously, there are factors we cannot control, mainly the economy that can provide some variability as we get into the back half and fourth quarter specifically
  - But this is how we see it today

Business Model

- In closing, we have shown a relentless focus on executing our business model

- But let me assure you, we have an eye on the horizon to develop long-term sustainable growth
- Our business practices are new to CSX employees, but are becoming part of our DNA as we work hard every day with the goal of becoming the best run railroad in North America

QUESTION AND ANSWER SECTION

<Q - Amit Mehrotra>: Jim, the OR, obviously, in Q2 is below the target that you set for 2020. Fully understand the nuances and seasonality and the risks around the macro, but would it be fair to characterize the 2020 target as conservative based on what the team's achieved so far? And if so, what do you feel maybe is the structural limits of where you can take that OR over that time period? Thanks.

<A - James M. Foote>: Well, over the time period what we laid out just three months ago when I stood up there and said we had a target of 60% in three years, and I think everybody in that room kind of thought, I was crazy, that we'd never be able to get there. And it's only – we're only two quarters in. So we're not – clearly not changing our guidance here, and what we think is achievable. And as I said, we have a lot, a lot of work to do. And we got a lot of help this quarter from coal.

So, if things continue to align – they continue to stay, I have confidence that we can hit a number, 60%, which everybody, I think – thinks is extremely, extremely impressive. So there's no change in the short period of time from what we laid out just a quarter ago.

<Q - Amit Mehrotra>: All right. Okay. And just kind of related to that as my follow-up, your comments at the end there with respect to where you are in implementing PSR, and just a lot more room to go in terms of low-hanging fruit on the cost side, in particular, I would imagine. Can you just talk about where PSR is not represented in the network today? I guess, some of the new initiatives that you're taking on, specifically on the intermodal franchise in terms of implementing scheduled railroading, that strategy on that particular business. If you can talk about some of the places where it's not represented, and the opportunity there more concretely in terms of reductions in dwell time or things like that, that'd be great?

<A - James M. Foote>: Oh, one answer, intermodal. Our intermodal network needs a ton of work in order to become the efficient part of our system that it needs to be. And we are just really beginning to get in there and start to figure out how to rationalize that big part of our business, so we can become much more efficient and have a much better product for our customers.

<Q - Amit Mehrotra>: And is that – should we be watching origin dwell time yields in that business? I mean, how should we monitor looking outside in terms of your progress there?

<A - James M. Foote>: I mean, all of our – yeah, it'll be reflected at all of our metrics. Again, our terminal dwells are pretty good, but we have a network franchise here that to a large degree is dysfunctional. And it is the product for many, many, many, many years CSX having a standalone intermodal entity.

So we need to kind of go forward and reconfigure the franchise and make sure that it is properly and appropriately integrated into the rail company, so we can achieve the benefits of operating more effectively and efficiently. So we are at very, very early stages, a lot of work to do in that area, and in every other area as I said. Yeah, we had some great results, and we did that – we're not – we don't have the highest velocity, we don't have the lowest dwells. So we have a lot of opportunity ahead of us to get even better.

<Q - Amit Mehrotra>: Yeah. It makes us seem just how fixed you are, so conservative, but I will – those are my two. So I'll leave it there. Congrats again. Appreciate it.

<Q - Ken Hoexter>: That's a phenomenal job on the operating ratio so quickly. But Jim, I guess, on the on-time originations and arrivals, both are down y-over-y. But you noted the calculation has changed in the details, but the results were restated to conform. Why are they down given the network improvement, and how everything's accelerated on the network?

<A - James M. Foote>: We're pretty comfortable – obviously, we'd like to be better on the originations. We depart our trains pretty close on schedule. We don't get them across to the network as effectively as we should. We depart – if we give ourselves, which we don't, but if you did, from accounting standpoint, give yourself a couple of hours of flexibility on either end, we depart in the high 90% our trains to schedule.

And we get to destination again, with that two hour cushion over a three day operating period in the 80% range, that's not acceptable. You know what, that always comes up with – for a number of different reasons. And so, we need to just continue to be able to work to eliminate the causes of failures. And that's why our trip plan compliance is in the kind of 60% range; we need to get that up to 100%. And when the trains fail to arrive on time, we miss the connections, and therefore we're off the trip plan.

So all of those things need to improve, and a lot of it has to do with culture, with people, recognize that there's going to be a failure, and they go above and beyond the call of duty to make sure that we get the box to make the connection on the next train, as I've said many times. What does a UPS employees do when he sees that a box is not going to get in the truck? He runs behind the truck down the road, and makes sure that he gets the box on the truck. Our guys kind of wave to the train, see you later, and the car runs a day later. So it's culture, and it's all kinds of changes that we need to take place in order to get better.

<Q - Ken Hoexter>: Wonderful. Thank you. And if I can get the follow-up on pricing. Frank, you mentioned that pricing accelerated on a pure pricing basis. Are there levels you can talk to especially given how tight the truck market is, can you be any more specific in terms of, are you seeing it growing – going 100BPS, 200BPS up on a sequential y-over-y basis from where you were?

<A - Frank A. Lonegro>: Yeah. Ken, I think you probably know the answer to that question. I think, what we're trying to help you understand is, the environment is a strong environment, and that's why we're seeing the contract renewals coming higher than the same-store sales pricing. I think, the last public number we have out there is in Q3 of 2017, at 2.2% for merchandising intermodal. What we can say is that, we have seen sequential improvement every quarter since then in same-store sales, and the discretionary renewals in Q1 were better than that, and the discretionary renewals in Q2 were better than that.

<Q - Brandon R. Oglenski>: I don't know if Mark is on the call, but I guess, for Jim or Mark, it seems the improvement here is coming maybe a bit faster as the first two questions kind of alluded to. I mean, does this in any way change your philosophy on the revenue outlook?

I think, at the Analyst Day you were saying, look maybe we'll get a little bit of growth in 2018, but obviously you're seeing a bit more now. Does that because of the changes you've made in the network, is the market that much stronger, and now with the lower cost basis, that changes dynamic on focusing between price and volume at all?

<A - James M. Foote>: As I said at the Investor Day, and as I said basically ever since I've been here, number one, I don't differentiate in the implementation of scheduled railroading, that you ignore your customer and that don't focus on growing the top line as you implement your operational changes. You do that at the same time.

And we have been working to improve the quality of our service and work with our customers to grow our business throughout the last six months, and I would say pretty favorable results and responses from our customers. They went from when I showed up here to hating me to now on occasion even buying me a drink. So we made great improvements in our customer relationships. And so – but I don't see a differentiation here.

I also don't look at this as, oh, you're a price leader or a price taker. We're focused on volume. We're focused on price. We're focused on growing our business with long-term sustainable profitable business that people recognize, that we have differentiated ourselves in the marketplace. We have a better product to sell to our customers, and our customers recognize that, by working with us and paying us more because we're a better quality product, they can save money in their business. That's our strategy. That's our strategy to grow the business, and that has been our strategy since day one, and will continue into the future.

<Q - Thomas Wadewitz>: I'm sure everybody is going to refer to that, but they're obviously very impressive. Let's see, what do you think about OR in H2? I mean, you're sub-60% in second quarter. It probably implies, the number is ought to go up in H2. Is it pretty reasonable to think, you'll be sub-60% in H2 as well, or is there anything in terms of maybe no incentive comp, there's a tailwind, there would be headwind or anything else we ought to consider when we think about H2 OR relative to the really strong results in second quarter?

<A - James M. Foote>: Sure, Tom. From a seasonality standpoint, Q2 for CSX is always the best. So, one would assume that, that's going to always be the best this year too. Going forward into H2, number one, the way we account for our vacations, we have a disproportionate amount of labor expense associated with vacations in H2. We have around 3% wage increase in H2. So those are headwinds that we have planned for, and have expected all along.

And then the most reliable variable is the weather here in Q4, which is a new phenomenon for me and Mark, where you've got a hurricane in Florida and the Gulf, while you're worrying about freezing rain in Atlanta, and snow in Chicago, and along Lake Erie. So we always seem to have weather that makes it more difficult for us to operate in Q3 and fourth – I mean, fourth quarter. So those are the kind of things that we look at, and say it is totally rational, and what we believe to be the case that our expenses in the third and fourth quarter will be higher than the second. I can tell you that they'll be lower than they were last year. How about that?

<Q - Thomas Wadewitz>: Okay. Sure that's fair. I appreciate the color on that. Let me ask you also, you made a comment on the intermodal network. It seems to imply, you might simplify it further. I don't know if that's accurate or not. But how do you think about the potential changes to get the intermodal network right? Is that simplifying the flow, fewer touches? And what might be the timing for that? Is that something that you can do pretty quickly? Or is that something you need to kind of plan and execute over multiple quarters and maybe you see that result in 2019?

<A - James M. Foote>: I think, as I said earlier, Tom, we're just starting to really peel this back and understand what changes we need to make. Obviously, last year, I mean, it was well talked about when Hunter closed that – changed the philosophy and got rid of the hub-and-spoke. That was about 7% of the volume that was taken off the railroad. And at that point in time, it was my belief that a large part of that rationalization of intermodal has been accomplished. Well, that's not the case.

But we're going to take it very methodically. We are going to have very good and open communication with our customers about what it is we're trying to accomplish. And it involves train design changes. It involves terminals and potential terminal consolidations. And we will do this very methodically and logically and appropriately, and do it – being fully aware of the fact that we are looking at a peak season this year, which everybody is indicating us, is going to be very strong. So we're not going to do anything that's going screw up the railroad. So if it takes a little longer than a quarter or two, I'm fine with that.

<Q - Chris Wetherbee>: Wanted to touch a little bit on sort of the revenue and volume outlooks, you're taking the revenue numbers up. I think some of that is driven by what you're saying on the other line. But how do you think about the sort of volume outlook, and maybe sort of queuing up the competitive environment? You brought the OR down arguably a lot faster than most of us had expected. Does that open up new opportunities? Do you see some of that in H2? How do you kind of think about those opportunities going forward?

<A - James M. Foote>: I believe that the operating ratio is a reflection of the efficiency of our service, which in my mind means that we continually improve the product that we offer to our customers. We are not working diligently to drive down the operating ratio so that we can be the price leader in the marketplace.

So I think, as I said last time, we don't get stickers and bonus points for volume. And therefore, to the extent that we can sell our products as a superior product in the marketplace, we fully intend to do that. Clearly, we have as much flexibility as we want to if there are unique opportunities in the marketplace where a customer to us is not interested in quality of service, but is only interested in price. And it makes sense for us to – being the low-cost provider to pursue that business, we can do that, too.

So we have all the flexibility in the world to pursue whatever business segments we want. Our principal objective here is to be a better run network that has a differentiated service product in the marketplace that demands a higher price for that than we can grow business at the extent of truck, which we already know the customer is paying 15% to 20% more for, so why discount your better quality product when you know you can go save the customer money by having a service that's more truck like.

<Q - Chris Wetherbee>: Okay. Okay, so it sounds like there might be opportunity there on the volume side, that's helpful. And then, getting a little bit more specifically, you think about export coal as we look out into the back half of the year, I know this is a tough commodity to predict. But you've given us some help in the past in terms of what you expect, any changes to sort of that high 30mm ton number that we've talked about for 2018 as we look out to H2?

<A - James M. Foote>: Yeah, in H2, I mean, clearly, one of the reasons that we have talked now about higher volumes is because export coal has been better in H1, and appears that it will be better in H2 – slightly better in H2 than what we originally expected. Frank, maybe you have some further comment on that?

<A - Frank A. Lonegro>: Yeah. So we were at about 22mm tons in H1, if the framework holds as Jim mentioned in his opening remarks, and we see the indices hold at [ph] 200 and 100 (00:36:46) or higher on the met and thermal index, you could see that same run rate prevail in H2. So early to mid-40s would be probably a decent range for you.

<Q - Scott H. Group>: So wanted to follow up on intermodal and what you've been talking about. Jim, maybe give us some perspective, where is this OR relative to the rest of the business? Are we 1,000BPS behind, maybe 2,000BPS behind? If you can maybe directionally give us some color there. And once you've got it all optimized the way you want to, how close do you think intermodal margins can be to the rest of the business?

<A - James M. Foote>: Well, as I think I tried to portray, we have a lot of areas in intermodal where we can make improvements. And we don't describe the various – the business segments in great detail in terms of what's more profitable than the other, you've been on this business long enough, you know which one's up.

I could tell you, when I did this at CN, and we got involved in – did the same thing at CN, we fixed the merchandise business, and then we went over and started fixing the intermodal, and intermodal at CN was a basket case.

When we were done fixing it over a couple of year period, the average profitability of our intermodal business there was better than the corporate average. So we got a ton of work to do, and I couldn't be happier that Mark's here to do it. And we'll just keep updating you. But it's going to be slow. It's going to be gradual, and it's going to be a process that works for our customers as well.

<Q - Scott H. Group>: Okay. That makes sense. And then just real quick some number questions. The raise in the other revenue guidance, is that because customers are not changing behavior or you're rolling it out to more customers? And then, do you have any way to – $70mm of real estate in H1, any way to put a range on what you think is realistic for H2?

<A - Frank A. Lonegro>: Hey, Scott. On other revenue, I'd say it's two things: one the behavioral changes that we're looking for obviously through the increases in the rates and the [ph] reduction of three days (00:39:40), it just isn't happening as quickly as maybe we thought it was three months ago or was going to three months ago. So that's – I think the answer on that one, we did roll out some additional policies effective July 1, so that then bleeds into the run rate there.

On the real estate side, yeah, you're right, we had about $70mm in H1. so we had a good first quarter, a good second quarter. You all probably saw, a line sale that was announced with OmniTRAX a couple of weeks ago. That combined with some smaller transactions that we may close in Q3, I'd say will have a good third quarter, not unlike what we saw in Q1 and Q2.

<Q - Brian P. Ossenbeck>: Just wanted to talk about the domestic coal side for just a bit, I would say the volumes were a challenge this quarter, remains a challenge for H1. Are you seeing anything from structural competition from new gas-fired power plants, gas pipelines going further down South especially into Florida? And do you still have the confidence that there's going to be no material retirements of coal-fired plants this year or through the next couple of years through 2020?

<A - Frank A. Lonegro>: Hey, Brian, Frank. I think the utility story has largely stayed the same. Nat gas is $2.75-ish, which isn't all that helpful to the environment, though stockpiles in the South had come down pretty significantly. The cooling degree days are up y-over-y. We're just not seeing the burn rates go up in coal quite yet, but a lengthy hot summer and a cold winter would certainly help those. In terms of your structural competition, again, we don't know of any plant closures that are going to impact us significantly in the next couple of years that are new. Clearly, we have a couple that are going to roll off, we knew about those, we've adjusted our outlooks for those, but nothing new.

<Q - Brian P. Ossenbeck>: Okay, thank you. If you can give us a quick update on the lease and license, I guess, the wires and pipes, the other ancillary revenues. Are those things that you're starting to be able to monetize it or is that something that'll start to pick up in the back half or 2019? Thank you.

<A - Frank A. Lonegro>: Brian both. We've had an ongoing business of licenses and lease that utilize or cross-over the quarter. Mark and his team have been increasing those over time, and we'll continue to deliver and are on track to deliver the $300mm guidance that we gave you at the investor conference over three years.

<Q - Matthew Reustle>: You're obviously ahead of schedule on the network improvement, and that's boosted the 2018 revenue outlook. Does that also raise a potential for revenue in 2019 and 2020? And I guess, the real question is, does your 4% revenue CAGR target increase beyond the 2018 bump that you're guiding to now?

<A - James M. Foote>: I would say at this point in time no, for the two principal reasons that I talked about. One is, one of the most significant reasons that we're looking at higher – have looked at higher volume and revenue in H1 was export coal. And one of the principal reasons we're talking about being more optimistic for H2 is because of export coal. And I don't know at this point in time if anybody could tell you what the future is beyond the December 31 of 2018 what export coal is going to do. So it's a little premature for us to start saying that, that's going on.

And at the second time I'm – and because we are in the early stages of this network reconfiguration in intermodal, I don't know what implications that might have on revenue growth in intermodal at this time. So I just have to stick with, hey, here's where we are today, what we think the rest of this year looks like in terms of being mid-single-digits. And for now, we're in the same mode looking at 2019 and 2020 about where we were three months ago.

<Q - Matthew Reustle>: Got it. That's...

<A - James M. Foote>: Feels like three years ago, but it was only three months ago.

<Q - Matthew Reustle>: No, that makes a lot of sense; makes a lot of sense. And second question, just still early days on trade and tariffs, but can you talk about high-level, where you see your business sensitive? Are you hearing or seeing anything from your customers in terms of talking about adjustments relative to the tariffs? Any color on that is helpful.

<A - James M. Foote>: Well again, there's so much noise swirling around about tariffs. In terms of the specific impacts on CSX today, from any kind of tariff activity, clearly, first was steel. And from a steel standpoint, both finished steel out and ore business in, we have seen some positive as a result of the U.S. steel manufacturers kicking-off production. The second area where there have been some real activities involve export soybeans. Our export grain business in total is around $30mm. About a third of that is soybean. And so in the grand scheme of things, in terms of soybeans going to China, it's really not a factor at all for us.

And then, the third area which again, has not had any real activity, but again a lot of noise about it, is both NAFTA and Europe in terms of tariffs on imported autos. We are not impacted in terms of imported autos from Mexico. We would clearly watch carefully, if anything were to be put on imported vehicles from Canada, but nothing has happened there, yet.

And in terms of European imports coming in through the East Coast ports, normally they don't touch rail anyway. So not much of an impact at all right now. And our customers continue despite the fact again that there's much discussion that this could lead to an economic downturn, our customers continue to be very optimistic about the future.

<Q - Allison M. Landry>: Maybe that was a good segue into my somewhat pessimistic question. But how are you thinking about CSX's ability to turn what have historically been fixed costs into variable costs in a downturn? And is the network at a point where if volumes dried up tomorrow, you'd still be able to generate significant OR improvement?

<A - James M. Foote>: Well, that is pessimistic [ph] and on such a (00:47:54) happy occasion for us here, but I'll try to deal with that. And it's not something that Frank and I don't talk about on a regular basis here, and having myself been through it a couple of times, when all of a sudden, yeah, your volumes just go away. And again, because of all the speculation and interest in the media about tariffs and trade wars and what could or what could that. So we're always doing recession scenarios here about, what if this and what if that.

Clearly, as we get better, and as we get a better handle on our operations, we will be able to more quickly respond and make appropriate adjustments to our variable costs in the event of volume decline. And you always had the wherewithal at your fingertips to reduce your fixed costs to a degree, meaning, fixed labor, it's just how much you need to do in order to do that.

Depending upon what kind of a economic decline scenario you came up with, I guess, my thoughts are, if we, again, assuming a severe decline, if we were able to maintain our plan, and at least the status quo, we would be able to – we'd be doing a very good job. If it's a minor thing, then it's probably a minor thing, and we continue to stick with the program, and see what we could do to make our numbers.

<Q - Allison M. Landry>: Okay. That was helpful. And then, as my follow-up, if you think about the disparity between your service metrics and your competitor, and within the context of your earlier comments about pricing for a better service product, do you expect to pull the growth lever perhaps earlier than what we saw at CP and/or CN?

<A - James M. Foote>: Again, we never pushed the growth lever the other direction. We're always in the growth mode. And again, through a lot of this, I wasn't present here, but many – or the people that work here, [ph] and Frank were (00:50:37), it was tough to grow when your railroad wasn't running, and products that – cars that should have been across your network in three to four days were taking three to four weeks.

So that's difficult to say, I'm in a growth mode at that period of time. Once the service has improved, and where the service is today, we are always looking to get business from – more business from current customers, the business back from the former customers, all of that. But it is – again, it is our philosophy that we want to be the premium service provider in the marketplace and get paid for it.

<Q - J. David Scott Vernon>: Jim or Frank, could you help us – you mentioned earlier in the call that coal helped you out a little bit in the quarter. Is there any way you can help us to mention, how much coal has contributed to the y-over-y sort of profit development of the company in H1 this year? What I'm just wondering is, how much of the very, very aggressive improvement in operating income you'd chalk up to kind of PSR vs. how much of it you'd chalk up to help from the commodity markets?

<A - Frank A. Lonegro>: Obviously, it's helped from a lot of different areas, precision railroading is clearly one, when you look at the levels of efficiency that you're seeing, the head count reductions that you're seeing, the asset reductions that you're seeing, I mean those produces build dollars and significant dollars.

If you look at the point that Jim made around export coal, just to dimensionalize it, we moved a little over 11mm tons in Q2 this year, and last year, we moved a little over 8mm tons. So you can get a feel for the uptick in export coal.

At the same time, we saw some reduction in utility coals. So you got to net those two things out, they're both good pieces of business for us. We want to move them both. But there's a whole lot more that's happening in our company other than coal.

<Q - J. David Scott Vernon>: I totally agree with that, but I guess, I was just wondering if there may be an indication you can give us for directionally how much export coal rates have moved up on a y-over-y basis in relation to domestic coal rates?

<A - Frank A. Lonegro>: Well, we generally follow the indices. We don't follow them one for one. So when you see them – when you see the forward curves move up, generally speaking our pricing is going to follow that, again not one for one. The highs on the benchmarks are going be higher than our price; and the lows on the benchmark going to be lower than our price, but we generally are going to follow those.

When you look at it on RPU basis, you can get a feel for what the export RPU is, and what the domestic RPU is. There are times when the export's higher, there are times when the domestic is higher, but it's really going to depend on what those external benchmarks are. But again, there's a lot more happening here, and I don't want you to lose sight of that by focusing on coal.

<Q - J. David Scott Vernon>: Yeah. And absolutely not losing sight, and I'm just trying to get you to tell us what happened to the export coal RPU which...

<A - Frank A. Lonegro>: No.

<Q - J. David Scott Vernon>: ...we're not going to get to.

<A - James M. Foote>: You're not going to get that from me, you're not going to get that from Frank.

<Q - J. David Scott Vernon>: Well, we can always get it from the guys at [ph] Parker Host (00:54:05). But let me ask you a quick follow-up question, Frank. When you think about the gains you had in the MS&O from idling some of the spare locomotives, is there a chunk of that, that maybe snaps back as you start to run a little bit hotter and leaner? Or is it all just pure kind of – you should run rate these levels on the cost side going forward?

<A - Frank A. Lonegro>: Well, remember you got real estate in that line item. So be careful about run rating real estate on a reported basis. I'll try to give you some intel on Q3. But when you look at what we're doing, the smaller locomotive fleet is clearly a driver. You've got contractor and consultant eliminations which are rolling through that line. You've got, as I mentioned in my opening remarks, less hotel and taxi costs. You've got G&A, fewer people obviously, spend less money on the MS&O line. So as long as you're seeing those things stay the same, excluding the real estate piece, I think, you can run rate those.

<Q - Justin Long>: Wanted to start and ask about head count. Do you have any updated thoughts on where head count will end this year? Just curious, if your expectations have changed, and based on how the network has performed during H1 2018, and what seems to be a better than expected start as it relates to volumes, is there any change to the expectation for head count that you're targeting in 2020 as well?

<A - James M. Foote>: No. In terms of this year, we're right on – again we're slightly ahead of where we – the run rate to get to the 2,000 reduction, but that was planned for, as I said earlier, because of vacations and other purposes that we would have an accelerated pace in H1. So we're right on target to hit the number for this year, and nothing has changed in terms of the number for the three year plan.

<Q - Justin Long>: Okay. That's helpful. And maybe to circle back on the increased revenue guidance for 2018 as well, is there a way to help us think about, how you would allocate this increase between; one, a better outlook for export coal; and two, a better outlook for everything else? I'm just curious if that split is 75%, 25%? Or how you would quantify that?

<A - James M. Foote>: We're not getting into the specific volume details by the various commodity groups. I'm trying to come up with a more simplistic way to answer that. I think, if you look at our coal business in Q2, and I think that's a relatively good run rate, again, we had a great, we just got – not to tell you, we had a great second quarter with strong export demand, and weak utility demand.

That's kind of a norm for us for this year, but we expect that kind of run rate to continue in H2. So that will give you some guidance in terms of volume from coal, and the rest of it is going to come primarily from merchandise, which is again across the board. All of these various commodities that I talked about metals, forest products, blah, blah, blah, blah were all relatively strong in Q2. That's just reflection of good markets, and customers recognizing that we've got a good service product.

And so that's kind of the – I would say that, that will give you a better run rate view of what we think the top line is going to do. And then, as both Frank and I mentioned, you'd layer in continued reasonable pricing environment, continued recognition of supplemental revenues from the demurrage policies that we are now – policies that were in existence for many, many years, but now we're collecting on.

And then thirdly, a little bit more fuel surcharge, because price on fuel's going to get up. And I think Q2 will give you a pretty good understanding of why we think that H2 is going to be a little bit better than what we originally expected.

Second quarter was a little bit better than we expected. [indiscernible] (00:58:59) talking about that early in the quarter, when I said, we're going to be a pitch better. And then now we came in with a 6% growth. And so, if things stayed the way they are right now, I think that leads us down the road of giving you a pretty good way to get to a general view of how you get to mid-single-digit top line growth for the year.

<Q - Walter Spracklin>: I want to come back, Jim, to your answer to a previous question with regards to exactly that, the trends you've been noting in the back half of the year have picked up. And I think, what you said just now is that, it wasn't all just due to coal, there was other factors, due to better pricing and better volume in other areas. I'm just curious as to why that wouldn't change your view into 2019. Why would it all stop as of December 31? Wouldn't there be a carryover in H1 next year even if commissions remain, that will lap easier comps that would give you a bit of better lift into next year? Just curious as to why you wouldn't expect it to continue more than just six months.

<A - James M. Foote>: For the two reasons I said: one, I don't have a clue what coal's going to be like in 2019 and 2020. And I don't know what the implications are to our intermodal franchise by some of the work we have to do there. So the uncertainties surrounding those two big components of my business give me pause to say that, oh, this is the new norm for 2019 and 2020. I need to get a little bit further down the road this year to have a better – more of a clearer view of the year after.

<Q - Walter Spracklin>: Okay. And just on the pricing environment, can you talk to us a bit about kind of the cadence in the negotiations you have now vs. one month ago vs. three months ago vs. six months ago, particularly where trucking comes into play on your intermodal franchise, or where you come head-to-head with your competitor? Are you finding that, is there anything capacity constraints that are allowing for the movement of price to come in a little bit easy – not easy, but easier than it might have one, three or six months ago?

<A - James M. Foote>: Well, six months ago we had our hat in our hand telling everybody how sorry we were for not running a very good railroad. So the environment for us right now compared to where we were at the end of last year is dramatically different.

In terms of the pricing environment, and the capacity environment, it's a good time to be in the railroad business. It's a good time to be in transportation business. Price is no secret, that the pricing environment is strong for everybody.

As I said, and again, but as I said earlier, we are in this to grow the top line through long-term sustainable profitable growth. I don't play in the spot market. I'm not worried about volume. I'm not worried about highway to rail awards, that kind of stuff. Long-term sustainable profitable growth where we provide value to our customers and our channel partners and everybody in the marketplace is our strategy, and that is what's going to make CSX the best.

<Q - Walter Spracklin>: If I could sneak one last one here. In terms of when you sit down with Mark now in his new role, what do you guys talk about as your kind of objective number one, I think, you alluded is that the intermodal franchise, or is there something else that you want to kind of zero in on as his number one objective as he starts the role?

<A - James M. Foote>: One of Mark's strengths and one the reasons I'm so excited about Mark taking over the job besides the fact that he's a really bright guy, he's got great relationship skills, and we need to develop long-term solid relationships again with our customers. There's been a lot of turnover here at the senior management of this company. We hear this all the time. We don't know who to call. We don't know who you guys are. You got a whole new team there. What am I supposed to do? Who do I call if something goes wrong? So number one, fix intermodal, but two, to start build that, the long-term relationships that CSX should have. And I'm totally confident that Mark's going to do an exceptional job in that area.

Not to say that, the guy that runs our Merchandise Group, Michael Rutherford and his team are doing a phenomenal job in that area. But again, I know, Mark and I've been around him for a long time, and I think that's where he can do some great work for us.

<Q - Ravi Shanker>: A couple of follow-ups here. Just on the intermodal and your comments on the tons of work you still need there, and eventually getting that up to an above-average margin profile. Can you just help us understand how much of that is fairly basic blocking and tackling that can be achieved pretty easily vs. maybe bigger, longer-term initiatives like yard automation or something?

<A - James M. Foote>: Oh, this is blocking and tackling. This is just running a good railroad. I'd like to be in a position where we were running so well that we could start to look at ways to adopt the new technologies to help us run things better. We're a long way from that. This is just basic core fixing a bunch of broken windows.

<Q - Ravi Shanker>: All right. Understood. And just a follow-up on IM when you think of auto as an end market, is that primarily in your autos volumes or do you also have smaller auto components or something running through intermodal?

<A - James M. Foote>: We have auto parts. We have auto parts in our intermodal, especially imported parts. And we have auto parts in boxcars and merchandise service, racks, frames et cetera. But the primary volumes that are in finished vehicles that are moving in tri-levels and bi-levels.

<Q - Ravi Shanker>: Got it. Is there any way to quantify your overall auto's exposure in terms of volumes kind of combined across segments?

<A - James M. Foote>: We could – not off the top of my head. But if you get [ph] to ask with Kevin (01:06:44) we can see, if we can try to come up with some way for you to pump some percentage. For every vehicle, how much moves in a kind of a general percentage, for every finished vehicle what's the percentage of a car kind of a thing; we might be able to come up with something to give you guidance on that.

<Q - Benjamin J. Hartford>: Real quick, Jim, what are – in the context of intermodal, and the work that needs to be done there, as you think about the back half of 2018 and through 2019, whatever the plan may end up being in terms of volume growth, what do you think the box count needs within UMAX, specifically are going to be to support growth? Will it grow in line with volumes? Or is there enough opportunity as you work through that network and improve velocity that perhaps that fleet size does not need to grow to be able to satisfy volume growth targets?

<A - James M. Foote>: Yeah. Under the current scenario, I don't anticipate us maybe any investment in boxes for UMAX.

<Q - Bascome Majors>: Frank, years ago in the prior regime, you guys used to make some directional comments around the profitability of different commodity groups. I know, putting hard numbers to that was declined earlier on this call. But I am curious with the overall profitability of the franchise moving up 12, 13 points in less than two years here, has the directional sort of contribution of the various revenue groups that you do, has that changed dramatically? I'm just curious if we're kind of in a new game as to – vs. the historic playbook of what's the best business for you, and what's not?

<A - Frank A. Lonegro>: Bascome, the – a rising tide lifts all boats; clearly in a good pricing environment, in a good efficiency environment, you're going to expand your margins. When we look at the rack and stack of profitability, I could show you intermodal moves that are at the top, and I could show you coal moves that are more towards the bottom, and merchandise run through the same spectrum. So we've got a good portfolio of business. Obviously, when you see a 58.6% operating ratio across, that portfolio must be pretty good and we're going to continue to optimize it and drive that long-term profitable growth that Jim mentioned.

<Q - Cherilyn Radbourne>: Just wondering if you could speak to some of the mix dynamics in the quarter, RTM is up 7% vs. 2% to carload growth would suggest a pretty big shift. So maybe you could just give us some color there?

<A - James M. Foote>: Ton-miles up 7%, Frank?

<A - Frank A. Lonegro>: Yeah. So I think what you're seeing is, what we did with some of the network changes last year as we close terminals et cetera, we probably introduced some outer route miles, and we're now pulling those down pretty significantly. Ed and his team are working on that. I think you'll see that continue to come down in that disparity that you mentioned. I think we'll get a lot closer as we go forward.

<Q - Cherilyn Radbourne>: Okay. And then maybe just a quick follow-up on the whole intermodal discussion, as you continue to reposition that network, do you continue to be able to leverage the benefits of a hot trucking market from a volume and a pricing standpoint?

<A - James M. Foote>: A good time to be in the railroad business, and it's even better time to be in the railroad intermodal business. So, yes, just take a look at it, as I said earlier, we took 7% of our business off the network last year, and reflected it. So people are looking for capacity. We want to be able to provide that service and capacity to our customers. We just want to make sure that we have a rational footprint of an intermodal network, when we are going into the marketplace and selling a product to our customers. And that's just going to take us some time to straighten that out. And then we are going to be there doing whatever we can to help out again, our channel partners principally, who work with us, who want to use intermodal to reduce their costs as well as the growth that's coming with some of our other partners, as their volumes grow enormously with the growth of e-commerce.

So this is a good time for us to be here. We just need to make sure we fix it. And that's what we're embarking upon doing. And look at what we've done already with the company in terms of making improvements. And this is just one more area where we're going to take all of our efforts and initiatives and tap into the brainpower of guys like Wallace and Harris and make intermodal a huge franchise.