CSX CORP
Form 10-Q
October 18, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017
OR
( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________
Commission File Number
1-8022
CSX CORPORATION
(Exact name of registrant as specified in its charter)

Virginia		62-1051971
(State or other jurisdiction of incorporation or organization)		(I.R.S. Employer Identification No.)
500 Water Street, 15th Floor, Jacksonville, FL	32202	(904) 359-3200
(Address of principal executive offices)	(Zip Code)	(Telephone number, including area code)

No Change
(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes (X) No ( )
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes (X) No ( )
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer", "accelerated filer” and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one)
Large Accelerated Filer (X) Accelerated Filer ( ) Non-accelerated Filer ( ) Smaller Reporting Company ( )
Emerging growth company ( )

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ( )

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ( ) No (X)
There were 893,723,083 shares of common stock outstanding on September 30, 2017 (the latest practicable date that is closest to the filing date).

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FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2017
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CSX CORPORATION

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
CONSOLIDATED INCOME STATEMENTS (Unaudited)
(Dollars in millions, except per share amounts)

	Third Quarters		Nine Months	
	2017	2016	2017	2016
Revenue	$2,743	$2,710	$8,545	$8,032
Expense				
Labor and Fringe	717	762	2,249	2,307
Materials, Supplies and Other	516	507	1,573	1,576
Depreciation	331	321	978	953
Fuel	205	174	621	496
Equipment and Other Rents	97	105	282	315
Restructuring Charge (Note 1)	1	—	296	—
Total Expense	1,867	1,869	5,999	5,647
Operating Income	876	841	2,546	2,385
Interest Expense	(132)	(139)	(406)	(423)
Other Income - Net	6	13	19	28
Earnings Before Income Taxes	750	715	2,159	1,990
Income Tax Expense	(291)	(260)	(828)	(734)
Net Earnings	$459	$455	$1,331	$1,256
Per Common Share (Note 2)				
Net Earnings Per Share, Basic	$0.51	$0.48	$1.45	$1.32
Net Earnings Per Share, Assuming Dilution	$0.51	$0.48	$1.45	$1.32
Average Shares Outstanding (In millions)	902	942	916	952
Average Shares Outstanding, Assuming Dilution (In millions)	906	943	919	953
Cash Dividends Paid Per Common Share	$0.20	$0.18	$0.58	$0.54

CONSOLIDATED COMPREHENSIVE INCOME STATEMENTS (Unaudited)
(Dollars in millions, except per share amounts)

	Third Quarters		Nine Months	
	2017	2016	2017	2016
Total Comprehensive Earnings (Note 10)	$467	$465	$1,410	$1,282

See accompanying notes to consolidated financial statements.

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ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS
(Dollars in millions)

	(Unaudited) September 30, 2017	December 30, 2016
ASSETS		
Current Assets:		
Cash and Cash Equivalents	$ 591	$ 603
Short-term Investments	113	417
Accounts Receivable - Net (Note 1)	981	938
Materials and Supplies	392	407
Other Current Assets	95	122
Total Current Assets	2,172	2,487
Properties	44,105	43,227
Accumulated Depreciation	(12,526)	(12,077)
Properties - Net	31,579	31,150
Investment in Conrail	864	840
Affiliates and Other Companies	642	619
Other Long-term Assets	316	318
Total Assets	$ 35,573	$ 35,414
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	$ 905	$ 806
Labor and Fringe Benefits Payable	601	545
Casualty, Environmental and Other Reserves (Note 4)	122	115
Current Maturities of Long-term Debt (Note 7)	19	331
Income and Other Taxes Payable	322	129
Other Current Liabilities	106	114
Total Current Liabilities	2,075	2,040
Casualty, Environmental and Other Reserves (Note 4)	253	259
Long-term Debt (Note 7)	11,788	10,962
Deferred Income Taxes - Net	9,789	9,596
Other Long-term Liabilities	766	863
Total Liabilities	24,671	23,720
Shareholders' Equity:		
Common Stock, $1 Par Value	894	928
Other Capital	227	138
Retained Earnings	10,327	11,253
Accumulated Other Comprehensive Loss (Note 10)	(561)	(640)
Noncontrolling Interest	15	15
Total Shareholders' Equity	10,902	11,694
Total Liabilities and Shareholders' Equity	$ 35,573	$ 35,414

See accompanying notes to consolidated financial statements.

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ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED CASH FLOW STATEMENTS (Unaudited)
(Dollars in millions)

	Nine Months	
	2017	2016
OPERATING ACTIVITIES		
Net Earnings	$1,331	$1,256
Adjustments to Reconcile Net Earnings to Net Cash Provided by Operating Activities:		
Depreciation	978	953
Restructuring Charge	296	—
Cash Payments for Restructuring Charge	(147)	—
Deferred Income Taxes	161	312
Other Operating Activities	(13)	(51)
Changes in Operating Assets and Liabilities:		
Accounts Receivable	(78)	68
Other Current Assets	47	(58)
Accounts Payable	102	94
Income and Other Taxes Payable	180	(25)
Other Current Liabilities	4	(61)
Net Cash Provided by Operating Activities	2,861	2,488
INVESTING ACTIVITIES		
Property Additions	(1,462)	(1,590)
Purchase of Short-term Investments	(645)	(410)
Proceeds from Sales of Short-term Investments	957	1,070
Other Investing Activities	71	37
Net Cash Used In Investing Activities	(1,079)	(893)
FINANCING ACTIVITIES		
Long-term Debt Issued (Note 7)	850	—
Long-term Debt Repaid (Note 7)	(332)	(19)
Dividends Paid	(530)	(513)
Shares Repurchased	(1,763)	(778)
Other Financing Activities	(19)	(310)
Net Cash Used in Financing Activities	(1,794)	(1,620)
Net Decrease in Cash and Cash Equivalents	(12)	(25)
CASH AND CASH EQUIVALENTS		
Cash and Cash Equivalents at Beginning of Period	603	628
Cash and Cash Equivalents at End of Period	$591	$603

See accompanying notes to consolidated financial statements.

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CSX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. Nature of Operations and Significant Accounting Policies

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

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

After a merger on July 1, 2017 with CSX Real Property, Inc., a former wholly-owned CSX subsidiary, CSXT is now responsible for the Company's real estate sales, leasing, acquisition and management and development activities. In addition, as substantially all real estate sales, leasing, acquisition and management and development activities are focused on supporting railroad operations, all results of these activities are included in operating income beginning in 2017. Previously, the results of these activities were classified as operating or non-operating based on the nature of the activity and were not material for any periods presented.

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

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

- Consolidated income statements for the nine months ended September 30, 2017 and September 23, 2016;
- Consolidated comprehensive income statements for the nine months ended September 30, 2017 and September 23, 2016;
- Consolidated balance sheets at September 30, 2017 and December 30, 2016; and
- Consolidated cash flow statements for the nine months ended September 30, 2017 and September 23, 2016.

Pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"), certain information and disclosures normally included in the notes to the annual financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been omitted from these interim financial statements. CSX suggests that these financial statements be read in conjunction with the audited financial statements and the notes included in CSX's most recent annual report on Form 10-K and any subsequently filed current reports on Form 8-K.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

Fiscal Year
Through the second quarter 2017, CSX followed a 52/53 week fiscal reporting calendar with the last day of each reporting period ending on a Friday. On July 7, 2017 the Board of Directors of CSX approved a change in the fiscal reporting calendar from a 52/53 week year ending on the last Friday of December to a calendar year ending on December 31 each year, effective beginning with fiscal third quarter 2017. Related to the change in the fiscal calendar:

- Fiscal year 2017 commenced on December 31, 2016, as the fiscal year 2016 ended on December 30, 2016 under the 52/53 week fiscal calendar.
- The third quarter 2017 commenced on July 1, 2017, as the second quarter 2017 ended on June 30, 2017 under the 52/53 week fiscal calendar, and ended on September 30, 2017. Third quarter 2017 includes one more day of business results than third quarter 2016.
- The fourth quarter 2017 will commence on October 1, 2017 and end on December 31, 2017. Fourth quarter 2017 will include six fewer days of business results than fourth quarter 2016, which contained an extra week under the 52/53 week fiscal calendar.
- Fiscal year 2017 will include 366 days of activity, five fewer days than fiscal year 2016, which was a 53 week fiscal year that began on December 26, 2015 and ended December 30, 2016.

The Company does not expect that this change will materially impact comparability of the Company’s financial results for fiscal year 2016 and fiscal year 2017. Accordingly, the change to a calendar fiscal year will be made on a prospective basis and operating results for prior periods will not be adjusted. The Company will not be required to file a transition report because this change is not deemed a change in fiscal year for purposes of reporting subject to Rule 13a-10 or Rule 15d-10 of the Securities Exchange Act of 1934 as the new fiscal year commences with the end of the prior fiscal year end and within seven days of the prior fiscal year end.

Except as otherwise specified, references to “third quarter(s)” or “nine months” indicate CSX's fiscal periods ending September 30, 2017 and September 23, 2016, and references to "year-end" indicate the fiscal year ended December 30, 2016.

Allowance for Doubtful Accounts
The Company maintains an allowance for doubtful accounts on uncollectible amounts related to freight receivables, government reimbursement receivables, claims for damages and other various receivables. The allowance is based upon the creditworthiness of customers, historical experience, the age of the receivable and current market and economic conditions. Uncollectible amounts are charged against the allowance account. Allowance for doubtful accounts of $24 million and $33 million is included in the consolidated balance sheets as of September 30, 2017 and December 30, 2016, respectively.

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

New Accounting Pronouncements
In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") Compensation - Stock Compensation: Scope of Modification Accounting, which provides clarity on what changes to share-based awards are considered substantive and require modification accounting to be applied. This update is required beginning with first quarter 2018 and should be applied prospectively to award modifications after the effective date. The Company early adopted this standard update in second quarter 2017 and will apply it prospectively to any award modifications after the adoption date. The Company does not regularly modify the terms and conditions of share-based awards and does not believe this standard update will have a material effect on its financial condition, results of operations or liquidity.

In March 2017, the FASB issued ASU Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires that only the service cost component of net periodic benefit costs be recorded as compensation cost in the operating expense section of the income statement. All other components of net periodic benefit cost (interest cost, expected return on plan assets and amortization of net loss) will be presented in other income - net. This standard update is effective beginning with the first quarter 2018 and must be applied retrospectively. The Company does not believe this standard update will have a material effect on its financial condition, results of operations or liquidity.

In March 2017, the FASB issued ASU Simplifying the Test for Goodwill Impairment, which eliminates step two, the calculation of the implied fair value of goodwill, from the goodwill impairment test. Impairment will be quantified in step one of the test as the amount by which the carrying amount exceeds the fair value. This standard update is effective beginning first quarter 2020 and must be applied prospectively. The Company does not believe this standard update will have a material effect on its financial condition, results of operations or liquidity.

In May 2014, the FASB issued ASU Revenue from Contracts with Customers, which supersedes previous revenue recognition guidance. The new standard requires that a company recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration the company expects to receive in exchange for those goods or services. Companies will need to use more judgment and estimates than under the guidance currently in effect, including estimating the amount of variable revenue to recognize over each identified performance obligation. Additional disclosures will be required to help users of financial statements understand the nature, amount and timing of revenue and cash flows arising from contracts. CSX will adopt this standard update in first quarter 2018 and plans to use a modified retrospective method of adoption.

The FASB has also issued several amendments to the revenue standard, including clarification on accounting for principal versus agent considerations (i.e., reporting gross versus net), licenses of intellectual property and identifying performance obligations. These amendments do not change the core principle of the standard, but provide clarity and implementation guidance.

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

The Company is currently finalizing its review of the impact of adopting this new guidance and has developed a comprehensive implementation plan. In-depth reviews of commercial contracts have been completed and changes to processes and internal controls to meet the standard’s reporting and disclosure requirements have been identified and are being implemented. At this time, the Company does not believe this standard update will have a material effect on its financial condition, results of operations or liquidity. Freight revenue will continue to be recognized ratably over transit time. Additionally, the disaggregated revenue information required to be disclosed under this standard update is similar to the information currently included in the Results of Operations section of Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

In February 2016, the FASB issued ASU, Leases, which will require lessees to recognize most leases on their balance sheets as a right-of-use asset with a corresponding lease liability, and lessors to recognize a net lease investment. Additional qualitative and quantitative disclosures will also be required. This standard update is effective for CSX beginning with the first quarter 2019 and will be adopted using a modified retrospective method. Changes to processes and internal controls to meet the standard’s reporting and disclosure requirements have been identified and are being implemented. Software has been implemented that will assist in the recognition of additional assets and liabilities to be included on the balance sheet related to leases currently classified as operating leases with durations greater than twelve months, with certain allowable exceptions. The Company continues to evaluate the expected impact of this standard update on disclosures, but does not anticipate any material changes to operating results or liquidity.

Other Items
Management Workforce Reduction
Through an involuntary separation program with enhanced benefits to further its strategic objectives, CSX reduced its management workforce by approximately 950 employees during 2017. The Company has been focused on driving efficiencies through process improvement and responding to business mix shifts. These management reductions were designed to further streamline general and administrative and operating support functions to speed decision making and further control costs. In April 2017, the involuntary separation program was essentially completed. This program extends separation benefits for certain members of management that could result in additional charges through first quarter 2018. The majority of separation benefits are paid from general corporate funds while certain benefits are paid through CSX’s qualified pension plans.

Reimbursement Arrangements
In June 2017, the Company and the Company's President and Chief Executive Officer, E. Hunter Harrison, executed a letter agreement providing for certain reimbursement arrangements. Pursuant to the letter agreement, the Company made a reimbursement payment to MR Argent Advisor LLC ("Mantle Ridge") of $55 million for funds previously paid to Mr. Harrison by Mantle Ridge. Further, the Company assumed Mantle Ridge’s obligation to pay Mr. Harrison, prior to March 15, 2018, a lump sum cash amount of $29 million in respect of other forfeited compensation from his previous employer, Canadian Pacific Railway Limited (“CP”). The Company also assumed Mantle Ridge’s tax indemnification obligations to Mr. Harrison, which enables him to remain in the same after-tax position as if he had not: (i) forfeited such compensation and benefits earned from CP; and (ii) received $55 million from Mantle Ridge.

CSX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

The ownership position of Mantle Ridge, a CSX shareholder, is detailed in the Company's Proxy Statement on Schedule 14A filed on April 20, 2017 and subsequent Form 4 filings with the SEC. The Vice-Chairman of CSX's Board of Directors, Paul C. Hilal, founded and controls Mantle Ridge and each of its related entities. At the Company's 2017 annual meeting of shareholders held on June 5, 2017, the Company's shareholders approved, on an advisory basis, with approximately 93 percent of the vote, the Company undertaking such reimbursement arrangements.

Restructuring Charge
In first quarter 2017, the former CEO and President of the Company announced their retirements, and the terms of their unvested equity awards were modified to permit prorated vesting through May 31, 2018. The total restructuring charge includes costs related to the management workforce reduction, reimbursement arrangements, the proration of equity awards and other advisory costs related to the leadership transition. Future charges related to this restructuring are not expected to be material. Expenses related to the management workforce reduction and other costs are shown in the following table.

(Dollars in millions)	2017 First Quarter	2017 Second Quarter	2017 Third Quarter	Year-to-Date
Severance	$81	$ 10	$ —	$ 91
Pension, Other Post-retirement Benefit and Other Non-cash Charges	68	10	—	78
Relocation	6	2	—	8
Subtotal Management Workforce Reduction	$155	$ 22	$ —	$ 177
Reimbursement Arrangements	—	84	—	84
Non-cash Executive Equity Awards Proration	8	16	—	24
Other Charges Including Fees Related to Shareholder Matters	10	—	1	11
Total Restructuring Charge	$173	$ 122	$ 1	$ 296

Charges and payments related to the management workforce reduction and other costs are shown in the following table.

(Dollars in millions)	2017 Charges	2017 Payments	Non-cash Items	Liability 9/30/2017
Severance	$ 91	$ (77)	—	$ 14
Pension, Other Post-retirement Benefit and Other Non-cash Charges [(a)]	78	—	(78)	—
Relocation	8	(4)	—	4
Subtotal Management Workforce Reduction	$ 177	$ (81)	$ (78)	$ 18
Reimbursement Arrangements	84	(55)	—	29
Non-cash Executive Equity Awards Proration	24	—	(24)	—
Other Charges Including Fees Related to Shareholder Matters	11	(11)	—	—
Total Restructuring Charge	$ 296	$ (147)	$ (102)	$ 47

[(a)] The majority of non-cash items are related to certain benefits paid through CSX's qualified pension plans.

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NOTE 2. Earnings Per Share

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

	Third Quarters		Nine Months	
	2017	2016	2017	2016
Numerator (Dollars in millions):				
Net Earnings	$459	$455	$1,331	$1,256
Dividend Equivalents on Restricted Stock	—	—	(1)	(1)
Net Earnings, Attributable to Common Shareholders	$459	455	$1,330	1,255
Denominator (Units in millions):				
Average Common Shares Outstanding	902	942	916	952
Other Potentially Dilutive Common Shares	4	1	3	1
Average Common Shares Outstanding, Assuming Dilution	906	943	919	953
Net Earnings Per Share, Basic	$0.51	$0.48	$1.45	$1.32
Net Earnings Per Share, Assuming Dilution	$0.51	$0.48	$1.45	$1.32

Basic earnings per share is based on the weighted-average number of shares of common stock outstanding. Earnings per share, assuming dilution, is based on the weighted-average number of shares of common stock equivalents outstanding adjusted for the effects of common stock that may be issued as a result of potentially dilutive instruments. CSX's potentially dilutive instruments are made up of equity awards, which include long-term incentive awards, and employee stock options.

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

When calculating diluted earnings per share, this rule requires CSX to include the potential shares that would be outstanding if all outstanding stock options were exercised. This number is different from outstanding stock options, which is included in Note 3, Share-Based Compensation, because it is offset by shares CSX could repurchase using the proceeds from these hypothetical exercises to obtain the common stock equivalent. Approximately 10 million and 2.4 million of total average outstanding stock options for the third quarters ended September 30, 2017 and September 23, 2016, respectively, were excluded from the diluted earnings per share calculation because their effect was antidilutive.

Share Repurchases
In July 2017, the Board of Directors approved an additional $500 million of share repurchase authority under the share repurchase program announced in April 2017, bringing the total program size to $1.5 billion. As of October 2, 2017, the Company had completed all share repurchases under this program.

During the third quarters of 2017 and 2016, the Company repurchased approximately $1 billion, or 20 million shares, and $263 million, or 10 million shares, respectively. During the nine months of 2017 and 2016, the Company repurchased $1.8 billion, or 35 million shares, and $778 million, or 30 million shares, respectively.

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NOTE 2. Earnings Per Share, continued

Management's assessment of market conditions and other factors guides the timing and volume of repurchases. Future share repurchases are expected to be funded by cash on hand, cash generated from operations and debt issuances. Shares are retired immediately upon repurchase. In accordance with the Equity Topic in the ASC, the excess of repurchase price over par value is recorded in retained earnings. Generally, retained earnings is only impacted by net earnings and dividends.

NOTE 3. Share-Based Compensation

Under CSX's share-based compensation plans, awards consist of performance units, restricted stock awards, restricted stock units and stock options for management and stock grants for directors. Awards granted under the various programs are determined and approved by the Compensation Committee of the Board of Directors or, in certain circumstances, by the Chief Executive Officer for awards to management employees other than senior executives. The Board of Directors approves awards granted to the Company's non-management directors upon recommendation of the Governance Committee.

Share-based compensation expense is measured using the fair value of the award on the grant date and is recognized on a straight-line basis over the service period of the respective award. Total pre-tax expense associated with share-based compensation and its related income tax benefit is shown in the table below. The year over year increase in expense related to performance units and stock options is primarily due to modifications to the terms of awards (see Equity Award Modifications below) and higher expected award payouts.

	Third Quarters		Nine Months	
(Dollars in millions)	2017	2016	2017	2016
Share-Based Compensation Expense				
Performance Units	$ 3	$ 5	$41	$ 9
Stock Options	14	2	47	5
Restricted Stock Units and Awards	2	2	11	8
Stock Awards for Directors	—	—	2	2
Total Share-Based Compensation Expense	$ 19	$ 9	$101	$ 24
Income Tax Benefit	$ 7	$ 3	$32	$ 9

Long-term Incentive Plan
In February 2017, the Company granted approximately 600 thousand performance units to certain employees under a new long-term incentive plan ("LTIP") for the years 2017 through 2019, which was adopted under the CSX Stock and Incentive Award Plan. Payouts of performance units for the cycle ending with fiscal year 2019 will be based on the achievement of goals related to both operating ratio and return on assets in each case excluding non-recurring items as disclosed in the Company's financial statements. The cumulative operating ratio and average return on assets over the plan period will each comprise 50% of the payout and will be measured independently of the other.

Grants were made in performance units, with each unit representing the right to receive one share of CSX common stock, and payouts will be made in CSX common stock. The payout range for participants will be between 0% and 200% of the target awards depending on Company performance against predetermined goals. Payouts for certain executive officers are subject to downward adjustment by up to 30% based upon total shareholder return relative to specified comparable groups.

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NOTE 3. Share-Based Compensation, continued

Stock Options
Also, in February 2017, the Company granted approximately 1.3 million stock options along with the corresponding LTIP. The fair value of stock options on the date of grant was $12.54 per option which was calculated using the Black-Scholes valuation model. Stock options have been granted with ten-year terms and vest three years after the date of grant. The exercise price for stock options granted equals the closing market price of the underlying stock on the date of grant. These awards are time-based and are not based upon attainment of performance goals.

Restricted Stock Units
Finally, in February 2017, the Company granted approximately 300 thousand restricted stock units along with the corresponding LTIP. The restricted stock units vest three years after the date of grant. Participants receive cash dividend equivalents on the unvested shares during the restriction period. These awards are time-based and are not based upon attainment of performance goals. For information related to the Company's other outstanding long-term incentive compensation, see CSX's most recent annual report on Form 10-K.

CEO Stock Option Award
In March 2017, the Company granted 9 million stock options to the incoming CEO at a fair value of $12.88 per option calculated using the Black-Scholes valuation model. These options were granted with a ten-year term and an exercise price equal to the closing market price of the underlying stock on the date of grant. Half of the options, or 4.5 million, will vest on the CEO's service anniversary in equal annual installments over four years. The other half will vest based on achievement of performance targets related to both operating ratio and earnings before interest, taxes, depreciation and amortization adjusted for certain items.

Fair Value of All Stock Option Awards
No stock option awards were granted during third quarters 2017 and 2016. The fair values of all stock option awards during the nine months ended September 30, 2017, including those granted along with 2017 - 2019 LTIP and the CEO stock option award, were estimated at the grant date with the following weighted average assumptions:

	Nine Months	
	2017	2016
Weighted-average grant date fair value	$12.83	$4.68
Stock options valuation assumptions:		
Annual dividend yield	1.5 %	3.0 %
Risk-free interest rate	2.2 %	1.4 %
Annualized volatility	27.1 %	27.3 %
Expected life (in years)	6.3	6.5
Other pricing model inputs:		
Weighted-average grant-date market price of CSX stock (strike price)	$49.60	$24.13

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NOTE 3. Share-Based Compensation, continued

Equity Award Modifications
The terms of performance units, restricted stock units and stock options granted as part of the Company's long-term share-based compensation plans typically require participants to be employed through the final day of the respective performance or vesting period as applicable, except in the case of death, disability or retirement. As part of an enhanced severance benefit under the management streamlining and realignment initiative discussed in Note 1, unvested performance units, restricted stock units and stock options for separated employees not eligible for retirement were permitted to vest on a pro-rata basis.

Additionally, the terms of unvested equity awards for the former CEO and President were modified prior to their retirements on March 6, 2017 to permit prorated vesting through May 31, 2018. The terms were modified in exchange for each agreeing to serve in an advisory capacity upon request until May 31, 2017, and waiving various rights and claims, including the cancellation of their respective change of control agreements with the Company.

Award modifications impacted approximately 70 employees and resulted in an increase to share-based compensation expense for revaluation of the affected awards of $31 million for the nine months ended September 30, 2017. No significant award modifications took place in third quarter 2017.

NOTE 4. Casualty, Environmental and Other Reserves

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

	September 30, 2017			December 30, 2016		
(Dollars in millions)	Current	Long-term	Total	Current	Long-term	Total
Casualty:						
Personal Injury	$45	$ 120	$165	$46	$ 124	$170
Occupational[(a)]	4	55	59	7	52	59
Total Casualty	49	175	224	53	176	229
Environmental	43	46	89	42	53	95
Other	30	32	62	20	30	50
Total	$122	$ 253	$375	$115	$ 259	$374

(a) Occupational reserves include asbestos-related diseases and occupational injuries.

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

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NOTE 4. Casualty, Environmental and Other Reserves, continued

Casualty
Casualty reserves of $224 million and $229 million as of September 30, 2017 and December 30, 2016, respectively, represent accruals for personal injury, occupational disease and occupational injury claims. The Company's self-insured retention amount for these claims is $50 million per occurrence. Currently, no individual claim is expected to exceed the self-insured retention amount. In accordance with the Contingencies Topic in the ASC, to the extent the value of an individual claim exceeds the self-insured retention amount, the Company would present the liability on a gross basis with a corresponding receivable for insurance recoveries. These reserves fluctuate based upon the timing of payments as well as changes in estimate. Actual results may vary from estimates due to the number, type and severity of the injury, costs of medical treatments and uncertainties in litigation. Most of the Company's casualty claims relate to CSXT unless otherwise noted below. Defense and processing costs, which historically have been insignificant and are anticipated to be insignificant in the future, are not included in the recorded liabilities.

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

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

Occupational
Occupational reserves represent liabilities for occupational disease and injury claims. Occupational disease claims arise primarily from allegations of exposure to asbestos in the workplace. Occupational injury claims arise from allegations of exposure to certain other materials in the workplace, such as solvents, soaps, chemicals (collectively referred to as "irritants") and diesel fuels (like exhaust fumes) or allegations of chronic physical injuries resulting from work conditions, such as repetitive stress injuries.

The greatest possible exposure to asbestos for employees resulted from work conducted in and around steam locomotive engines that were largely phased out beginning around the 1950s. Other types of exposures, however, including exposure from locomotive component parts and building materials, continued until these exposures were substantially eliminated by 1985. Diseases associated with asbestos typically have long latency periods (amount of time between exposure to asbestos and the onset of the disease) which can range from 10 to 40 years after exposure.

Management reviews asserted asbestos claims quarterly. Unasserted or incurred but not reported ("IBNR") asbestos claims are analyzed by a third-party specialist and reviewed by management annually. CSXT's historical claim filings, settlement amounts, and dismissal rates are analyzed to determine future anticipated claim filing rates and average settlement values for asbestos claims reserves. The potentially exposed population is estimated by using CSXT's employment records and industry data. From this analysis, the specialist estimates the IBNR claims liabilities.

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NOTE 4. Casualty, Environmental and Other Reserves, continued

Environmental
Environmental reserves were $89 million and $95 million as of September 30, 2017 and December 30, 2016, respectively. The Company is a party to various proceedings related to environmental issues, including administrative and judicial proceedings involving private parties and regulatory agencies. The Company has been identified as a potentially responsible party at approximately 219 environmentally impaired sites. Many of these are, or may be, subject to remedial action under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"), also known as the Superfund Law, or similar state statutes. Most of these proceedings arose from environmental conditions on properties used for ongoing or discontinued railroad operations. A number of these proceedings, however, are based on allegations that the Company, or its predecessors, sent hazardous substances to facilities owned or operated by others for treatment, recycling or disposal. In addition, some of the Company's land holdings were leased to others for commercial or industrial uses that may have resulted in releases of hazardous substances or other regulated materials onto the property and could give rise to proceedings against the Company.

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

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

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

Based on the review process, the Company has recorded amounts to cover contingent anticipated future environmental remediation costs with respect to each site to the extent such costs are reasonably estimable and probable. The recorded liabilities for estimated future environmental costs are undiscounted. The liability includes future costs for remediation and restoration of sites as well as any significant ongoing monitoring costs, but excludes any anticipated insurance recoveries. Payments related to these liabilities are expected to be made over the next several years. Environmental remediation costs are included in materials, supplies and other on the consolidated income statement.

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

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NOTE 4. Casualty, Environmental and Other Reserves, continued

Other
Other reserves of $62 million and $50 million as of September 30, 2017 and December 30, 2016, respectively, include liabilities for various claims, such as property, automobile and general liability. Also included in other reserves are longshoremen disability claims related to a previously owned international shipping business (these claims are in runoff) as well as claims for current port employees.

NOTE 5. Commitments and Contingencies

Purchase Commitments
CSXT has a commitment under a long-term maintenance program agreement that covers a portion of CSXT’s fleet of locomotives. The program costs are based on the maintenance cycle for each covered locomotive, which is determined by the asset's age and type. Expected future costs may change as required maintenance schedules are revised and locomotives are placed into or removed from service. Under CSXT’s current obligations, the agreement will expire no earlier than 2031. On August 9, 2017, the Company exercised certain rights under the agreement, which resulted in a reduction of the locomotive fleet covered from 50% as of December 30, 2016 to an estimated 34% of locomotives beginning August 2018. As a result, the total remaining payments decreased from approximately $5.0 billion at December 30, 2016 to an estimated $1.7 billion at September 30, 2017.

Insurance
The Company maintains numerous insurance programs with substantial limits for property damage (which includes business interruption) and third-party liability. A certain amount of risk is retained by the Company on each of the property and liability programs. The Company has a $25 million retention per occurrence for the non-catastrophic property program (such as a derailment) and a $50 million retention per occurrence for the liability and catastrophic property programs (such as hurricanes and floods). While the Company believes its insurance coverage is adequate, future claims could exceed existing insurance coverage or insurance may not continue to be available at commercially reasonable rates.

Legal
The Company is involved in litigation incidental to its business and is a party to a number of legal actions and claims, various governmental proceedings and private civil lawsuits, including, but not limited to, those related to fuel surcharge practices, tax matters, environmental and hazardous material exposure matters, FELA and labor claims by current or former employees, other personal injury or property claims and disputes and complaints involving certain transportation rates and charges. Some of the legal proceedings include claims for compensatory as well as punitive damages and others are, or are purported to be, class actions. While the final outcome of these matters cannot be reasonably determined, considering, among other things, the legal defenses available and liabilities that have been recorded along with applicable insurance, it is currently the opinion of management that none of these pending items is likely to have a material adverse effect on the Company's financial condition, results of operations or liquidity. An unexpected adverse resolution of one or more of these items, however, could have a material adverse effect on the Company's financial condition, results of operations or liquidity in that particular period.
The Company is able to estimate a range of possible loss for certain legal proceedings for which a loss is reasonably possible in excess of reserves established. The Company has estimated this range to be $2 million to $116 million in aggregate at September 30, 2017. This estimated aggregate range is based upon currently available information and is subject to significant judgment and a variety of assumptions. Accordingly, the Company's estimate will change from time to time, and actual losses may vary significantly from the current estimate.

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NOTE 5. Commitments and Contingencies, continued

Fuel Surcharge Antitrust Litigation
In May 2007, class action lawsuits were filed against CSXT and three other U.S.-based Class I railroads alleging that the defendants' fuel surcharge practices relating to contract and unregulated traffic resulted from an illegal conspiracy in violation of antitrust laws. In November 2007, the class action lawsuits were consolidated in federal court in the District of Columbia, where they are now pending. The suit seeks treble damages allegedly sustained by purported class members as well as attorneys' fees and other relief. Plaintiffs are expected to allege damages at least equal to the fuel surcharges at issue.

In June 2012, the District Court certified the case as a class action. The decision was not a ruling on the merits of plaintiffs' claims, but rather a decision to allow the plaintiffs to seek to prove the case as a class. The defendant railroads petitioned the U.S. Court of Appeals for the D.C. Circuit for permission to appeal the District Court's class certification decision. In August 2013, the D.C. Circuit issued a decision vacating the class certification decision and remanded the case to the District Court to reconsider its class certification decision. On October 10, 2017, the District Court issued an order denying class certification. The District Court had delayed proceedings on the merits of the case pending the outcome of the class certification remand proceedings, and has not yet issued a further schedule in light of the order denying class certification.

CSXT believes that its fuel surcharge practices were arrived at and applied lawfully and that the case is without merit. Accordingly, the Company intends to defend itself vigorously. However, penalties for violating antitrust laws can be severe, and resolution of this matter or an unexpected adverse decision on the merits could have a material adverse effect on the Company's financial condition, results of operations or liquidity in that particular period.

Environmental
CSXT is indemnifying Pharmacia LLC (formerly known as Monsanto Company) for certain liabilities associated with real estate located in Kearny, New Jersey along the Lower Passaic River (the “Property”). The Property, which was formerly owned by Pharmacia, is now owned by CSXT. CSXT's indemnification and defense duties arise with respect to several matters. The U.S. Environmental Protection Agency ("EPA"), using its CERCLA authority, seeks cleanup and removal costs and other damages associated with the presence of hazardous substances in the 17-mile Lower Passaic River Study Area (the "Study Area”). CSXT, on behalf of Pharmacia, and a significant number of other potentially responsible parties are together conducting a Remedial Investigation and Feasibility Study of the Study Area pursuant to an Administrative Settlement Agreement and Order on Consent with the EPA.

In March 2016, EPA issued its Record of Decision detailing the agency’s mandated remedial process for the lower 8 miles of the Study Area, which was based on a Focused Feasibility Study. EPA has estimated that it will take the potentially responsible parties approximately ten years to complete the work. At a later date, EPA will select a remedy for the remainder of the Study Area and is expected to again seek the participation of private parties to implement the selected remedy using EPA’s CERCLA authority to compel such participation, if necessary.

CSXT is also defending and indemnifying Pharmacia in a cooperative natural resource damages assessment process related to the Property. Based on currently available information, the Company does not believe any indemnification or remediation costs potentially allocable to CSXT with respect to the Property and the Study Area would be material to the Company's financial condition, results of operations or liquidity.

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NOTE 6. Employee Benefit Plans

The Company sponsors defined benefit pension plans principally for salaried, management personnel. For employees hired prior to January 1, 2003, the plans provide eligible employees with retirement benefits based predominantly on years of service and compensation rates near retirement. For employees hired in 2003 or thereafter, benefits are determined based on a cash balance formula, which provides benefits by utilizing interest and pay credits based upon age, service and compensation.

In addition to these plans, the Company sponsors a post-retirement medical plan and a life insurance plan that provide certain benefits to full-time, salaried, management employees, hired prior to January 1, 2003, upon their retirement if certain eligibility requirements are met. Eligible retirees who are age 65 years or older (Medicare-eligible) are covered by a health reimbursement arrangement, which is an employer-funded account that can be used for reimbursement of eligible medical expenses. Eligible retirees younger than 65 years (non-Medicare eligible) are covered by a self-insured program partially funded by participating retirees. The life insurance plan is non-contributory.

The Company engages independent actuaries to compute the amounts of liabilities and expenses relating to these plans subject to the assumptions that the Company determines are appropriate based on historical trends, current market rates and future projections. These amounts are reviewed by management. The following table describes the components of expense / (income) related to net benefit expense recorded in labor and fringe on the income statement.

	Pension Benefits			
(Dollars in millions)	Third Quarters		Nine Months	
	2017	2016	2017	2016
Service Cost	$8	$12	$28	$36
Interest Cost	23	29	69	89
Expected Return on Plan Assets	(43)	(39)	(128)	(118)
Amortization of Net Loss	10	12	31	36
Net Periodic Benefit Cost	$(2)	$14	$—	$43
Special Termination Benefits - Management Workforce Reduction/Curtailment	—	—	57	—
Total Expense	$(2)	$14	$57	$43

	Other Post-retirement Benefits
(Dollars in millions)	