KANSAS CITY SOUTHERN
Form 10-Q
October 16, 2015
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2015

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 1-4717

KANSAS CITY SOUTHERN
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	44-0663509 (I.R.S. Employer Identification No.)
427 West 12th Street, Kansas City, Missouri (Address of principal executive offices)	64105 (Zip Code)

816.983.1303
(Registrant’s 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 ý 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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 ý Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Class	October 9, 2015
Common Stock, $0.01 per share par value	109,136,453 Shares

Table of Contents

Kansas City Southern and Subsidiaries
Form 10-Q
September 30, 2015
Index

Table of Contents

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Kansas City Southern and Subsidiaries
Consolidated Statements of Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In millions, except share and per share amounts) (Unaudited)			
Revenues	$631.9	$677.5	$1,820.8	$1,934.6
Operating expenses:				
Compensation and benefits	112.7	125.2	338.3	351.3
Purchased services	57.0	64.2	172.1	183.2
Fuel	78.5	109.2	237.0	320.8
Equipment costs	31.2	28.4	90.2	89.6
Depreciation and amortization	71.4	65.0	210.7	190.8
Materials and other	61.2	56.1	178.0	165.4
Lease termination costs	—	—	9.6	38.3
Total operating expenses	412.0	448.1	1,235.9	1,339.4
Operating income	219.9	229.4	584.9	595.2
Equity in net earnings of unconsolidated affiliates	5.0	5.0	14.4	16.6
Interest expense	(21.9)	(17.9)	(58.2)	(54.5)
Debt retirement costs	—	—	—	(6.6)
Foreign exchange loss	(30.0)	(12.5)	(52.1)	(4.1)
Other expense, net	(1.1)	(0.4)	(3.1)	(3.7)
Income before income taxes	171.9	203.6	485.9	542.9
Income tax expense	40.0	65.2	140.6	180.3
Net income	131.9	138.4	345.3	362.6
Less: Net income attributable to noncontrolling interest	0.3	0.3	1.1	1.0
Net income attributable to Kansas City Southern and subsidiaries	131.6	138.1	344.2	361.6
Preferred stock dividends	0.1	0.1	0.2	0.2
Net income available to common stockholders	$131.5	$138.0	$344.0	$361.4
Earnings per share:				
Basic earnings per share	$1.20	$1.25	$3.12	$3.28
Diluted earnings per share	$1.20	$1.25	$3.12	$3.27
Average shares outstanding (in thousands):				
Basic	109,692	110,182	110,109	110,141
Potentially dilutive common shares	209	259	203	271
Diluted	109,901	110,441	110,312	110,412

See accompanying notes to consolidated financial statements.

Table of Contents

Kansas City Southern and Subsidiaries
Consolidated Statements of Comprehensive Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In millions) (Unaudited)			
Net income	$131.9	$138.4	$345.3	$362.6
Other comprehensive loss:				
Amortization of prior service credit, net of tax of $(0.1) million, less than $(0.1) million and $(0.1) million, respectively	—	(0.1)	(0.1)	(0.1)
Foreign currency translation adjustments, net of tax of $(0.5) million, $(0.2) million, $(0.8) million and $(0.2) million, respectively	(0.8)	(0.2)	(1.3)	(0.2)
Other comprehensive loss	(0.8)	(0.3)	(1.4)	(0.3)
Comprehensive income	131.1	138.1	343.9	362.3
Less: Comprehensive income attributable to noncontrolling interest	0.3	0.3	1.1	1.0
Comprehensive income attributable to Kansas City Southern and subsidiaries	$130.8	$137.8	$342.8	$361.3

See accompanying notes to consolidated financial statements.

Table of Contents

Kansas City Southern and Subsidiaries
Consolidated Balance Sheets

	September 30, 2015	December 31, 2014
	(In millions, except share and per share amounts)	
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$116.6	$348.0
Accounts receivable, net	196.3	181.6
Materials and supplies	127.7	111.0
Deferred income taxes	69.8	100.1
Other current assets	71.1	77.6
Total current assets	581.5	818.3
Investments	40.0	36.4
Property and equipment (including concession assets), net	7,616.5	7,154.7
Other assets	84.5	81.6
Total assets	$8,322.5	$8,091.0
LIABILITIES AND EQUITY		
Current liabilities:		
Debt due within one year	$25.3	$24.8
Short-term borrowings	—	450.1
Accounts payable and accrued liabilities	440.1	423.9
Total current liabilities	465.4	898.8
Long-term debt	2,319.5	1,841.0
Deferred income taxes	1,210.4	1,156.3
Other noncurrent liabilities and deferred credits	142.9	130.8
Total liabilities	4,138.2	4,026.9
Commitments and contingencies	—	—
Stockholders' equity:		
$25 par, 4% noncumulative, preferred stock, 840,000 shares authorized, 649,736 shares issued, 242,170 shares outstanding	6.1	6.1
$.01 par, common stock, 400,000,000 shares authorized; 123,352,185 shares issued; 109,136,453 and 110,392,330 shares outstanding at September 30, 2015 and December 31, 2014, respectively	1.1	1.1
Additional paid-in capital	958.7	949.8
Retained earnings	2,913.3	2,801.7
Accumulated other comprehensive loss	(4.6)	(3.2)
Total stockholders' equity	3,874.6	3,755.5
Noncontrolling interest	309.7	308.6
Total equity	4,184.3	4,064.1
Total liabilities and equity	$8,322.5	$8,091.0

See accompanying notes to consolidated financial statements.

Table of Contents

Kansas City Southern and Subsidiaries
Consolidated Statements of Cash Flows

	Nine Months Ended September 30,	
	2015	2014
	(In millions) (Unaudited)	
Operating activities:		
Net income	$345.3	$362.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	210.7	190.8
Deferred income taxes	87.9	96.6
Equity in net earnings of unconsolidated affiliates	(14.4)	(16.6)
Share-based compensation	11.8	6.2
Excess tax benefit from share-based compensation	(5.3)	(3.0)
Distributions from unconsolidated affiliates	7.8	15.8
Debt retirement costs	—	6.6
Changes in working capital items:		
Accounts receivable	(12.5)	(8.5)
Materials and supplies	(15.3)	(0.6)
Other current assets	15.8	9.5
Accounts payable and accrued liabilities	48.1	32.9
Other, net	(8.7)	(10.5)
Net cash provided by operating activities	671.2	681.8
Investing activities:		
Capital expenditures	(522.8)	(403.5)
Purchase or replacement of equipment under operating leases	(143.0)	(302.2)
Property investments in MSLLC	(7.2)	(25.6)
Proceeds from disposal of property	4.2	6.2
Other, net	(25.2)	2.3
Net cash used for investing activities	(694.0)	(722.8)
Financing activities:		
Proceeds from short-term borrowings	9,605.5	11,502.7
Repayment of short-term borrowings	(10,056.6)	(11,191.8)
Proceeds from issuance of long-term debt	538.7	175.0
Repayment of long-term debt	(59.6)	(502.8)
Dividends paid	(104.0)	(85.7)
Shares repurchased	(136.3)	—
Debt costs	(5.8)	(4.4)
Excess tax benefit from share-based compensation	5.3	3.0
Proceeds from employee stock plans	4.2	1.3
Net cash used for financing activities	(208.6)	(102.7)
Cash and cash equivalents:		
Net decrease during each period	(231.4)	(143.7)
At beginning of year	348.0	429.5

At end of period	$116.6	$285.8

See accompanying notes to consolidated financial statements.

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements
For purposes of this report, “KCS” or the “Company” may refer to Kansas City Southern or, as the context requires, to one or more subsidiaries of Kansas City Southern.

1. Basis of Presentation
In the opinion of the management of KCS, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal and recurring adjustments) necessary to fairly present the results for interim periods in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”). Pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”), certain information and note disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. The results of operations for the three and nine months ended September 30, 2015, are not necessarily indicative of the results to be expected for the full year ending December 31, 2015.

2. New Accounting Pronouncements
In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers, which requires companies to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration it expects to be entitled in exchange for those goods or services. The new standard will become effective for the Company beginning with the first quarter 2018 and can be adopted either retrospectively to each prior reporting period presented or as a cumulative effect adjustment as of the date of adoption. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.
In April 2015, the FASB issued ASU No. 2015-03, Interest—Imputation of Interest, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance of debt issuance costs are not affected by the amendments in this update. The standard will be effective for the Company beginning in the first quarter of 2016, with early adoption permitted, and requires the Company to apply the new guidance on a retrospective basis on adoption. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.

3. Earnings Per Share Data
Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share adjusts basic earnings per common share for the effects of potentially dilutive common shares, if the effect is not anti-dilutive. Potentially dilutive common shares include the dilutive effects of shares issuable under the stock option and performance award plans.
The following table reconciles the basic earnings per share computation to the diluted earnings per share computation (in millions, except share and per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income available to common stockholders for purposes of computing basic and diluted earnings per share	$131.5	$138.0	$344.0	$361.4
Weighted-average number of shares outstanding (in thousands):				

Basic shares	109,692	110,182	110,109	110,141
Effect of dilution	209	259	203	271
Diluted shares	109,901	110,441	110,312	110,412
Earnings per share:				
Basic earnings per share	$1.20	$1.25	$3.12	$3.28
Diluted earnings per share	$1.20	$1.25	$3.12	$3.27
Potentially dilutive shares excluded from the calculation (in thousands):				
Stock options excluded as their inclusion would be anti-dilutive	95	—	60	76

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

4. Lease Termination Costs

During the nine months ended September 30, 2015 and 2014, the Company purchased $143.0 million and $300.8 million, respectively, of equipment under existing operating leases and replacement equipment as certain operating leases expired. For the nine months ended September 30, 2015 and 2014, the Company recognized $9.6 million and $38.3 million, respectively, of lease termination costs (included in operating expenses), due to the early termination of certain operating leases and the related purchase of the equipment. The Company did not incur lease termination costs during the third quarters of 2015 or 2014.

5. Property and Equipment (including Concession Assets)

Property and equipment, including concession assets, and related accumulated depreciation and amortization are summarized below (in millions):

	September 30, 2015	December 31, 2014
Land	$218.1	$216.8
Concession land rights	141.2	141.2
Road property	6,693.4	6,294.7
Equipment	2,281.5	1,979.9
Technology and other	170.0	160.9
Construction in progress	162.6	241.5
Total property	9,666.8	9,035.0
Accumulated depreciation and amortization	2,050.3	1,880.3
Property and equipment (including concession assets), net	$7,616.5	$7,154.7

Concession assets, net of accumulated amortization of $519.8 million and $483.1 million, totaled $2,040.9 million and $2,007.6 million at September 30, 2015 and December 31, 2014, respectively.

6. Fair Value Measurements

Assets and liabilities recognized at fair value are required to be classified into a three-level hierarchy. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value in its entirety requires judgment and considers factors specific to the asset or liability.

The Company's derivative financial instruments are measured at fair value on a recurring basis and consist of foreign currency forward and option contracts, which are classified as Level 2 instruments. The Company determines the fair value of its derivative financial instrument positions based upon pricing models using inputs observed from actively quoted markets, the contract terms, market currency exchange rates, and in the case of option contracts, volatility, the risk-free interest rate and the time to expiration. The fair value of the foreign currency derivative instruments was a liability of $43.1 million and $4.3 million at September 30, 2015 and December 31, 2014, respectively.

The Company's short-term financial instruments include cash and cash equivalents, accounts receivable, accounts payable and short-term borrowings. The carrying value of the short-term financial instruments approximates their fair value.

The fair value of the Company's debt is estimated using quoted market prices when available. When quoted market prices are not available, fair value is estimated based on current market interest rates for debt with similar maturities and credit quality. The fair value of the Company's debt was $2,331.4 million and $1,884.1 million at September 30, 2015 and December 31, 2014, respectively. The carrying value was $2,344.8 million and $1,865.8 million at September 30, 2015 and December 31, 2014, respectively. If the Company's debt were measured at fair value, the fair value measurements of the individual debt instruments would have been classified as either Level 1 or Level 2 in the fair value hierarchy.

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

7. Derivative Instruments

The Company enters into derivative transactions in certain situations based on management's assessment of current market conditions and perceived risks. Management intends to respond to evolving business and market conditions and in doing so, may enter into such transactions as deemed appropriate.

Credit Risk. As a result of the use of derivative instruments, the Company is exposed to counterparty credit risk. The Company manages this risk by limiting its counterparties to large financial institutions which meet the Company's credit rating standards and have an established banking relationship with the Company. As of September 30, 2015, the Company did not expect any losses as a result of default of its counterparties.

Foreign Currency Derivative Instruments. The Company's Mexican subsidiaries have net U.S. dollar-denominated liabilities (primarily debt) which, for Mexican income tax purposes, are subject to periodic revaluation based on changes in the value of the Mexican peso against the U.S. dollar. This revaluation creates fluctuations in the Company's Mexican income tax expense and the amount of income taxes paid in Mexico. The Company enters into foreign currency derivative contracts to hedge its exposure to this risk.

In the first quarter of 2015, the Company entered into foreign currency forward contracts with an aggregate notional amount of $300.0 million. These contracts mature on January 15, 2016, and obligate the Company to purchase a total of Ps.4,480.4 million at a weighted-average exchange rate of Ps.14.93 to each U.S. dollar. In the first half of 2015, the Company also entered into several foreign currency option contracts known as zero-cost collars. These contracts involve the Company's purchase of a Mexican peso call option and a simultaneous sale of a Mexican peso put option, with equivalent U.S. dollar notional amounts for each option and no net cash premium paid by the Company. Zero-cost collar contracts with an aggregate notional amount of $80.0 million will mature on January 15, 2016. The zero-cost collar contracts have a weighted-average Mexican peso call rate of Ps.15.11 to each U.S. dollar and a weighted-average Mexican peso put rate of Ps.15.90 to each U.S. dollar.

In December 2014, the Company entered into foreign currency forward contracts with an aggregate notional amount of $300.0 million. These contracts matured on January 15, 2015, and obligated the Company to purchase a total of Ps.4,364.7 million at a weighted-average exchange rate of Ps.14.55 to each U.S. dollar. During January 2015, the Company entered into offsetting contracts with an aggregate notional amount of $298.8 million. These offsetting contracts matured on January 15, 2015, and obligated the Company to sell a total of Ps.4,364.7 million at a weighted-average exchange rate of Ps.14.61 to each U.S. dollar. During September 2015, zero-cost collar contracts with an aggregate notional amount of $50.0 million matured resulting in a cash payment of $4.3 million.

The Company has not designated any of the foreign currency derivative contracts as hedging instruments for accounting purposes. The Company measures the foreign currency derivative contracts at fair value each period and recognizes any change in fair value in foreign exchange loss within the consolidated statements of income.

The following table presents the fair value of derivative instruments included in the consolidated balance sheets (in millions):

	Derivative Liabilities		
	Balance Sheet Location	September 30, 2015	December 31, 2014
Derivatives not designated as hedging instruments:			
Foreign currency forward contracts	Accounts payable and accrued liabilities	$37.3	$4.3
Foreign currency zero-cost collar contracts	Accounts payable and accrued liabilities	5.8	—
Total derivative liabilities		$43.1	$4.3

9

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

The following table presents the amounts included in the consolidated statements of income (in millions):

	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative			
		Three months ended September 30,		Nine months ended September 30,	
		2015	2014	2015	2014
Derivatives not designated as hedging instruments:					
Foreign currency forward contracts	Foreign exchange loss	$(17.9)	$(10.1)	$(34.2)	$(1.4)
Foreign currency zero-cost collar contracts	Foreign exchange loss	(7.0)	—	(10.1)	—
Total		$(24.9)	$(10.1)	$(44.3)	$(1.4)

8. Short-Term Borrowings

Commercial Paper. The commercial paper programs of The Kansas City Southern Railway Company (“KCSR”) and Kansas City Southern de Mexico, S.A. de C.V. (“KCSM”) generally serve as the primary means of short-term funding. During the third quarter of 2015, the Company used a portion of the proceeds from the 4.95% senior notes issued on July 27, 2015 (the “4.95% Senior Notes”) to repay the outstanding commercial paper issued by KCSR. As of September 30, 2015, KCSR and KCSM had no commercial paper outstanding.

Short-Term Borrowing. On October 22, 2014, Kansas City Southern International Investments, S.A. de C.V. (“KCSII”), a wholly-owned subsidiary of the Company, KCSR, and certain other subsidiaries of the Company that guaranty KCSR’s Second Amended and Restated Credit Agreement dated as of November 21, 2012 (together with the Company and KCSR, the “Guarantors”), entered into a Credit Agreement (the "KCSII Credit Agreement") with The Bank of Tokyo-Mitsubishi UFJ, Ltd., as lender ("BTM"). Pursuant to the terms of the KCSII Credit Agreement, BTM agreed to extend credit in an aggregate principal amount of up to $300.0 million, with repayment due 90 days after the borrowing date of each loan. KCSII borrowed $100.0 million on October 22, 2014, and borrowed an additional $200.0 million on December 15, 2014. The loans had a weighted-average interest rate of 1.49% and were repaid during the first quarter of 2015 using available cash.

9. Long-Term Debt

4.95% Senior Notes. On July 27, 2015, KCSR issued $500.0 million principal amount of senior unsecured notes due August 15, 2045, which bear interest semiannually at a fixed annual rate of 4.95%. The 4.95% Senior Notes were issued at a discount to par value, resulting in a $1.3 million discount and a yield to maturity of 4.967%. The net proceeds from the offering were used to repay the outstanding commercial paper issued by KCSR, for the repurchase of shares of KCS common stock and for other general corporate purposes. The 4.95% Senior Notes are redeemable at KCSR’s option, in whole or in part, prior to February 15, 2045, by paying the greater of either (i) 100% of the principal amount of the 4.95% Senior Notes to be redeemed or (ii) the sum of the present values of the remaining scheduled payments of principal and interest (exclusive of interest accrued to the date of redemption) discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the then-current U.S. Treasury rate plus 30 basis points, plus accrued interest to but excluding the redemption date. On or after February 15, 2045, the 4.95% Senior Notes may be redeemed at KCSR’s option, in whole or in part, at any time at a redemption price equal to 100% of the principal amount, plus any accrued and unpaid interest.

The 4.95% Senior Notes are unconditionally guaranteed, jointly and severally, by KCS and certain domestic subsidiaries of KCS that guarantee the KCSR credit agreement (the “Note Guarantors”). The 4.95% Senior Notes and the note guarantees rank pari passu in right of payment with KCSR’s, KCS’s and the Note Guarantors’ existing and future unsecured, unsubordinated obligations. In addition, the 4.95% Senior Notes include certain covenants which are customary for these types of debt instruments issued by borrowers with similar credit ratings.

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

10. Equity

The following tables summarize the changes in equity (in millions):

	Three Months Ended September 30, 2015			Three Months Ended September 30, 2014		
	Kansas City Southern Stockholders' Equity	Noncontrolling Interest	Total Equity	Kansas City Southern Stockholders' Equity	Noncontrolling Interest	Total Equity
Beginning balance	$3,888.1	$ 309.4	$4,197.5	$3,535.1	$ 306.7	$3,841.8
Net income	131.6	0.3	131.9	138.1	0.3	138.4
Other comprehensive loss	(0.8)	—	(0.8)	(0.3)	—	(0.3)
Dividends on common stock	(36.0)	—	(36.0)	(30.9)	—	(30.9)
Dividends on $25 par preferred stock	(0.1)	—	(0.1)	(0.1)	—	(0.1)
Share repurchases	(115.7)	—	(115.7)	—	—	—
Options exercised and stock subscribed, net of shares withheld for employee taxes	2.9	—	2.9	1.9	—	1.9
Excess tax benefit from share-based compensation	0.9	—	0.9	0.5	—	0.5
Share-based compensation	3.7	—	3.7	1.8	—	1.8
Ending balance	$3,874.6	$ 309.7	$4,184.3	$3,646.1	$ 307.0	$3,953.1

	Nine Months Ended September 30, 2015			Nine Months Ended September 30, 2014		
	Kansas City Southern Stockholders' Equity	Noncontrolling Interest	Total Equity	Kansas City Southern Stockholders' Equity	Noncontrolling Interest	Total Equity
Beginning balance	$3,755.5	$ 308.6	$4,064.1	$3,370.6	$ 306.0	$3,676.6
Net income	344.2	1.1	345.3	361.6	1.0	362.6
Other comprehensive loss	(1.4)	—	(1.4)	(0.3)	—	(0.3)
Dividends on common stock	(108.9)	—	(108.9)	(92.7)	—	(92.7)
Dividends on $25 par preferred stock	(0.2)	—	(0.2)	(0.2)	—	(0.2)
Share repurchases	(136.3)	—	(136.3)	—	—	—
Options exercised and stock subscribed, net of shares withheld for employee taxes	4.6	—	4.6	(2.1)	—	(2.1)
Excess tax benefit from share-based compensation	5.3	—	5.3	3.0	—	3.0
Share-based compensation	11.8	—	11.8	6.2	—	6.2
Ending balance	$3,874.6	$ 309.7	$4,184.3	$3,646.1	$ 307.0	$3,953.1

Share Repurchase Program

In May 2015, the Company announced a share repurchase program of up to $500.0 million, which expires on June 30, 2017. Management's assessment of market conditions, available liquidity and other factors will determine the timing and volume of repurchases. Share repurchases are expected to be funded by cash on hand, cash generated from operations and debt. During the third quarter of 2015, KCS repurchased 1,236,094 shares of common stock for $115.7 million at an average price of $93.57 per share. During the nine months ended September 30, 2015, KCS repurchased

1,458,225 shares of common stock for $136.3 million at an average price of $93.44 per share. The excess of repurchase price over par value is allocated between additional paid-in capital and retained earnings.

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

Cash Dividends on Common Stock

On August 3, 2015, the Company's Board of Directors declared a cash dividend of $0.330 per share payable on October 7, 2015, to common stockholders of record as of September 14, 2015. The aggregate amount of the dividends declared for the three and nine months ended September 30, 2015 was $36.0 million and $108.9 million, respectively. The following table presents the amount of cash dividends declared per common share by the Company's Board of Directors:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Cash dividends declared per common share	$0.330	$0.280	$0.990	$0.840

11. Commitments and Contingencies

Concession Duty. Under KCSM's 50-year railroad concession from the Mexican government (the "Concession"), which could expire in 2047 unless extended, KCSM pays concession duty expense of 1.25% of gross revenues. For the three and nine months ended September 30, 2015, the concession duty expense, which is recorded within materials and other in operating expenses, was $4.1 million and $11.8 million, respectively, compared to $4.2 million and $11.8 million for the same periods in 2014.

Litigation. The Company is a party to various legal proceedings and administrative actions, all of which, except as set forth below, are of an ordinary, routine nature and incidental to its operations. Included in these proceedings are various tort claims brought by current and former employees for job-related injuries and by third parties for injuries related to railroad operations. KCS aggressively defends these matters and has established liability provisions, which management believes are adequate to cover expected costs. Although it is not possible to predict with certainty the outcome of any legal proceeding, in the opinion of management, other than those proceedings described in detail below, such proceedings and actions should not, individually, or in the aggregate, have a material adverse effect on the Company's consolidated financial statements.

On April 15, 2014, a putative securities class action lawsuit was filed in the United States District Court for the Western District of Missouri against the Company and certain of its current and former officers and directors. The securities class action was styled as Gross v. Kansas City Southern, et al., 4:14-cv-00345-BCW. On April 16, 2014, the first of two shareholder derivative actions purportedly brought on behalf of the Company (which was named as a "nominal defendant") was filed in the United States District Court for the Western District of Missouri against certain of the Company's current and former directors and officers. The first derivative action was styled as Webster v. Starling, et al., 4:14-cv-00349-BCW. The second derivative action was filed on June 6, 2014, and was styled as Lerner v. Starling, et al., 4:14-cv-00509-BCW. The complaints alleged, among other things, that the Company made misrepresentations or omitted to disclose certain facts in connection with its volume guidance for fiscal year 2013. Pursuant to a joint agreement between the parties, these cases were dismissed by the District Court on June 30, 2015. These disputes were resolved without payment by the Company.

Environmental Liabilities. The Company's U.S. operations are subject to extensive federal, state and local environmental laws and regulations. The major U.S. environmental laws to which the Company is subject include, among others, the Federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA," also known as the Superfund law), the Toxic Substances Control Act, the Federal Water Pollution Control Act, and the Hazardous Materials Transportation Act. CERCLA can impose joint and several liabilities for cleanup and investigation costs, without regard to fault or legality of the original conduct, on current and predecessor owners and operators of a site, as well as those who generate, or arrange for the disposal of, hazardous substances. The Company does not believe that compliance with the requirements imposed by the environmental legislation will impair its competitive capability or result in any material additional capital expenditures, operating or maintenance costs. The Company is, however, subject to environmental remediation costs as described in the following paragraphs.

The Company's Mexico operations are subject to Mexican federal and state laws and regulations relating to the protection of the environment through the establishment of standards for water discharge, water supply, emissions, noise pollution, hazardous substances and transportation and handling of hazardous and solid waste. The Mexican government may bring administrative and criminal proceedings, impose economic sanctions against companies that violate environmental laws, and temporarily or even permanently close non-complying facilities.

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

The risk of incurring environmental liability is inherent in the railroad industry. As part of serving the petroleum and chemicals industry, the Company transports hazardous materials and has a professional team available to respond to and handle environmental issues that might occur in the transport of such materials.
The Company performs ongoing reviews and evaluations of the various environmental programs and issues within the Company's operations, and, as necessary, takes actions intended to limit the Company's exposure to potential liability. Although these costs cannot be predicted with certainty, management believes that the ultimate outcome of identified matters will not have a material adverse effect on the Company's consolidated financial statements.
Personal Injury. The Company's personal injury liability is based on semi-annual actuarial studies performed on an undiscounted basis by an independent third party actuarial firm and reviewed by management. This liability is based on personal injury claims filed and an estimate of claims incurred but not yet reported. Actual results may vary from estimates due to the number, type and severity of the injury, costs of medical treatments and uncertainties in litigation. Adjustments to the liability are reflected within operating expenses in the period in which changes to estimates are known. Personal injury claims in excess of self-insurance levels are insured up to certain coverage amounts, depending on the type of claim and year of occurrence. The personal injury liability as of September 30, 2015, was based on an updated actuarial study of personal injury claims through May 31, 2015, and review of the last four months' experience.
The personal injury liability activity was as follows (in millions):

	Nine Months Ended September 30,	
	2015	2014
Balance at beginning of year	$29.3	$31.2
Accruals	5.6	6.6
Change in estimate	(3.5)	(0.7)
Payments	(4.0)	(6.0)
Balance at end of period	$27.4	$31.1

Certain Disputes with Ferromex. KCSM and Ferrocarril Mexicano, S.A. de C.V. ("Ferromex") use certain trackage rights, haulage rights and interline services (the "Services") provided by each other. The rates to be charged after January 1, 2009, were agreed to pursuant to the Trackage Rights Agreement, dated February 9, 2010 (the "Trackage Rights Agreement"), between KCSM and Ferromex. The rates payable for these Services for the period beginning in 1998 through December 31, 2008, are still not resolved. If KCSM cannot reach an agreement with Ferromex for rates applicable for Services which were provided prior to January 1, 2009, which are not subject to the Trackage Rights Agreement, the Mexican Secretaría de Comunicaciones y Transportes ("Secretary of Communications and Transportation" or "SCT") is entitled to set the rates in accordance with Mexican law and regulations. KCSM and Ferromex both initiated administrative proceedings seeking a determination by the SCT of the rates that KCSM and Ferromex should pay each other in connection with the Services. The SCT issued rulings in 2002 and 2008 setting the rates for the Services and both KCSM and Ferromex challenged these rulings. Although KCSM and Ferromex have challenged these matters based on different grounds and these cases continue to evolve, management believes the amounts recorded related to these matters are adequate. While the outcome of these matters cannot be predicted with certainty, the Company does not believe that, when resolved, these disputes will have a material effect on its consolidated financial statements.
Tax Contingencies. Tax returns filed in the U.S. for periods after 2011 and in Mexico for periods after 2009 remain open to examination by the taxing authorities. Internal Revenue Service (the "IRS") examinations have been completed and settled for the 2011 and 2012 U.S. federal tax returns. The Servicio de Administración Tributaria (the "SAT"), the Mexican equivalent of the IRS, is currently examining the KCSM 2009 and 2010 tax returns and the 2012 and 2013 tax returns of KCSM Servicios, S.A. de C.V., a wholly-owned subsidiary of KCS. The Company is litigating a Value

Added Tax (“VAT”) audit assessment from the SAT for KCSM for the year ended December 31, 2005. The Company believes it is more likely than not that it will prevail in challenging the KCSM 2005 assessment. While the outcome of this matter cannot be predicted with certainty, the Company does not believe, when resolved, that this dispute will have a material effect on its consolidated financial statements. However, an unexpected adverse resolution could have a material effect on the consolidated financial statements in a particular quarter or fiscal year.

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

NAFTA Rail, S. de R.L. de C.V. (NAFTA), a wholly-owned subsidiary of KCS, recorded a receivable from the SAT for VAT paid by NAFTA in connection with NAFTA's purchase of locomotives. NAFTA subsequently collected VAT in connection with leasing these locomotives, and offset the resulting VAT payable against the existing VAT receivable. The SAT issued a resolution in 2013 which denied this offset, and assessed payment. NAFTA litigated this resolution and in January 2015 a Mexican tax court issued a favorable ruling by dismissing the SAT resolution. The SAT appealed this tax court decision in February 2015. In June 2015, the SAT appeal was dismissed by the court. This court decision validates NAFTA's ability to offset VAT payables against the existing VAT receivable.

KCSM has not historically assessed VAT on international import transportation services provided to its customers based on a written ruling that KCSM obtained from the SAT in 2008 stating that such services were exempt from VAT (the "2008 Ruling"). Notwithstanding the 2008 Ruling, in December 2013, the SAT unofficially informed KCSM of an intended implementation of new criteria effective as of January 1, 2014, pursuant to which VAT would be assessed on all international import transportation services on the portion of the services provided within Mexico. Additionally, in November 2013, the SAT filed an action to nullify the 2008 Ruling, potentially exposing the application of the new criteria to open tax years. In February 2014, KCSM filed an action opposing the SAT's nullification action. While the SAT's unofficial communication to KCSM is not enforceable and the 2008 Ruling continues to be in effect, KCSM notified its customers in December 2013 of the potential assessment of VAT on international import transportation services; however, implementation of any VAT assessment will depend on future developments and any guidance published by the SAT. Due to the pass-through nature of VAT assessed on services provided to customers, the Company does not believe any ultimate requirement to assess VAT on international import transportation services will have a significant effect on its consolidated financial statements. However, unexpected adverse implementation criteria imposed by the SAT for open tax years could have a material effect on the consolidated financial statements of the Company in a particular quarter or fiscal year.

Mexican Legislation. In January 2015, the Mexican Regulatory Railroad Service Law was published and became effective. While the Company continues to evaluate the Mexican government's implementation of this legislation, the Company does not believe it will have a material effect on its consolidated financial statements.

Contractual Agreements. In the normal course of business, the Company enters into various contractual agreements related to commercial arrangements and the use of other railroads' or governmental entities' infrastructure needed for the operations of the business. The Company is involved or may become involved in certain disputes involving transportation rates, product loss or damage, charges, and interpretations related to these agreements. While the outcome of these matters cannot be predicted with certainty, the Company does not believe that, when resolved, these disputes will have a material effect on its consolidated financial statements.

Credit Risk. The Company continually monitors risks related to economic changes and certain customer receivables concentrations. Significant changes in customer concentration or payment terms, deterioration of customer creditworthiness or further weakening in economic trends could have a significant impact on the collectability of the Company's receivables and its operating results. If the financial condition of the Company's customers were to deteriorate and result in an impairment of their ability to make payments, additional allowances may be required. The Company has recorded provisions for uncollectability based on its best estimate at September 30, 2015.

Panama Canal Railway Company ("PCRC") Guarantees and Indemnities. At September 30, 2015, the Company had issued and outstanding $5.4 million under a standby letter of credit to fulfill its obligation to fund fifty percent of the debt service reserve and liquidity reserve established by PCRC in connection with the issuance of the 7.0% Senior Secured Notes due November 1, 2026 (the "PCRC Notes"). Additionally, KCS has pledged its shares of PCRC as security for the PCRC Notes.

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

12. Geographic Information

The Company strategically manages its rail operations as one reportable business segment over a single coordinated rail network that extends from the Midwest and Southeast portions of the United States south into Mexico and connects with other Class I railroads. Financial information reported at this level, such as revenues, operating income and cash flows from operations, is used by corporate management, including the Company's chief operating decision-maker, in evaluating overall financial and operational performance, market strategies, as well as the decisions to allocate capital resources.

The Company's strategic initiatives, which drive its operational direction, are developed and managed at the Company's headquarters and targets are communicated to its various activity centers. The activity centers are responsible for executing the overall corporate strategy and operating plan established by corporate management as a coordinated system. The role of each region is to manage the operational activities and monitor and control costs over the coordinated rail network.

The following tables provide information by geographic area (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
Revenues	2015	2014	2015	2014
U.S.	$336.4	$363.8	$935.7	$1,032.9
Mexico	295.5	313.7	885.1	901.7
Total revenues	$631.9	$677.5	$1,820.8	$1,934.6

Property and equipment (including concession assets), net	September 30, 2015	December 31, 2014
U.S.	$4,582.0	$4,311.0
Mexico	3,034.5	2,843.7
Total property and equipment (including concession assets), net	$7,616.5	$7,154.7

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

13. Condensed Consolidating Financial Information

As of September 30, 2015, KCSR had outstanding $500.0 million principal amount of 4.95% Senior Notes due August 15, 2045, $450.0 million principal amount of 4.30% Senior Notes due May 15, 2043, and $200.0 million principal amount of 3.85% Senior Notes due November 15, 2023, which are unsecured obligations of KCSR, and are also jointly and severally and fully and unconditionally guaranteed on an unsecured senior basis by KCS and certain wholly-owned domestic subsidiaries. The 4.95% Senior Notes were registered under KCS's shelf registration filed and automatically effective as of November 20, 2014. KCSR filed a registration statement on Form S-4 with the Securities and Exchange Commission (the "SEC") in connection with an exchange offer with respect to the 4.30% Senior Notes and the 3.85% Senior Notes, which was declared effective on May 28, 2014. As a result, the Company is providing the accompanying condensed consolidating financial information (in millions) pursuant to SEC Regulation S-X Rule 3-10 "Financial statements of guarantors and issuers of guaranteed securities registered or being registered."

CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended September 30, 2015					
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	$—	$302.7	$9.5	$ 329.2	$ (9.5)	$ 631.9
Operating expenses	0.8	199.4	9.6	211.7	(9.5)	412.0
Operating income (loss)	(0.8)	103.3	(0.1)	117.5	—	219.9
Equity in net earnings (losses) of unconsolidated affiliates	121.1	(1.2)	1.0	4.5	(120.4)	5.0
Interest expense	—	(22.6)	—	(9.6)	10.3	(21.9)
Foreign exchange loss	—	—	—	(30.0)	—	(30.0)
Other income (expense), net	10.2	(1.0)	—	—	(10.3)	(1.1)
Income before income taxes	130.5	78.5	0.9	82.4	(120.4)	171.9
Income tax expense (benefit)	(1.1)	30.6	0.3	10.2	—	40.0
Net income	131.6	47.9	0.6	72.2	(120.4)	131.9
Less: Net income attributable to noncontrolling interest	—	—	0.3	—	—	0.3
Net income attributable to Kansas City Southern and subsidiaries	131.6	47.9	0.3	72.2	(120.4)	131.6
Other comprehensive loss	(0.8)	—	—	(1.3)	1.3	(0.8)
Comprehensive income attributable to Kansas City Southern and subsidiaries	$130.8	$47.9	$0.3	$ 70.9	$ (119.1)	$ 130.8

16

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME - (Continued)

	Three Months Ended September 30, 2014					
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	$—	$327.4	$12.7	$ 348.2	$ (10.8)	$ 677.5
Operating expenses	1.6	228.5	10.4	218.4	(10.8)	448.1
Operating income (loss)	(1.6)	98.9	2.3	129.8	—	229.4
Equity in net earnings (losses) of unconsolidated affiliates	131.0	(0.1)	1.2	4.4	(131.5)	5.0
Interest expense	(0.1)	(20.6)	—	(9.6)	12.4	(17.9)
Foreign exchange loss	—	—	—	(12.5)	—	(12.5)
Other income (expense), net	12.4	(0.3)	—	(0.1)	(12.4)	(0.4)
Income before income taxes	141.7	77.9	3.5	112.0	(131.5)	203.6
Income tax expense	3.6	29.8	1.4	30.4	—	65.2
Net income	138.1	48.1	2.1	81.6	(131.5)	138.4
Less: Net income attributable to noncontrolling interest	—	—	0.3	—	—	0.3
Net income attributable to Kansas City Southern and subsidiaries	138.1	48.1	1.8	81.6	(131.5)	138.1
Other comprehensive loss	(0.3)	(0.1)	—	(0.5)	0.6	(0.3)
Comprehensive income attributable to Kansas City Southern and subsidiaries	$137.8	$48.0	$1.8	$ 81.1	$ (130.9)	$ 137.8

	Nine Months Ended September 30, 2015					
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	$—	$835.5	$30.4	$ 982.7	$ (27.8)	$ 1,820.8
Operating expenses	3.8	581.9	27.7	650.3	(27.8)	1,235.9
Operating income (loss)	(3.8)	253.6	2.7	332.4	—	584.9
Equity in net earnings (losses) of unconsolidated affiliates	320.3	(0.9)	3.3	13.0	(321.3)	14.4
Interest expense	0.1	(62.3)	—	(29.6)	33.6	(58.2)
Foreign exchange loss	—	—	—	(52.1)	—	(52.1)
Other income (expense), net	33.4	(2.8)	—	(0.1)	(33.6)	(3.1)
Income before income taxes	350.0	187.6	6.0	263.6	(321.3)	485.9
Income tax expense	5.8	72.4	2.3	60.1	—	140.6
Net income	344.2	115.2	3.7	203.5	(321.3)	345.3
Less: Net income attributable to noncontrolling interest	—	—	1.1	—	—	1.1
Net income attributable to Kansas City Southern and subsidiaries	344.2	115.2	2.6	203.5	(321.3)	344.2
Other comprehensive loss	(1.4)	—	—	(2.1)	2.1	(1.4)
Comprehensive income attributable to Kansas City Southern and subsidiaries	$342.8	$115.2	$2.6	$ 201.4	$ (319.2)	$ 342.8

17

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME - (Continued)

	Nine Months Ended September 30, 2014					
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	$—	$913.7	$36.4	$ 1,015.5	$ (31.0)	$ 1,934.6
Operating expenses	6.7	674.7	30.4	659.7	(32.1)	1,339.4
Operating income (loss)	(6.7)	239.0	6.0	355.8	1.1	595.2
Equity in net earnings of unconsolidated affiliates	346.5	0.5	3.3	14.9	(348.6)	16.6
Interest expense	(0.1)	(62.9)	—	(29.5)	38.0	(54.5)
Debt retirement costs	—	(2.7)	—	(3.9)	—	(6.6)
Foreign exchange loss	—	—	—	(4.1)	—	(4.1)
Other income (expense), net	37.9	0.1	—	(2.6)	(39.1)	(3.7)
Income before income taxes	377.6	174.0	9.3	330.6	(348.6)	542.9
Income tax expense	16.0	66.7	3.6	94.0	—	180.3
Net income	361.6	107.3	5.7	236.6	(348.6)	362.6
Less: Net income attributable to noncontrolling interest	—	—	1.0	—	—	1.0
Net income attributable to Kansas City Southern and subsidiaries	361.6	107.3	4.7	236.6	(348.6)	361.6
Other comprehensive loss	(0.3)	—	—	(0.4)	0.4	(0.3)
Comprehensive income attributable to Kansas City Southern and subsidiaries	$361.3	$107.3	$4.7	$ 236.2	$ (348.2)	$ 361.3

CONDENSED CONSOLIDATING BALANCE SHEETS

	September 30, 2015					
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Assets:						
Current assets	$2.7	$266.4	$8.3	$ 307.7	$ (3.6)	$ 581.5
Investments	—	3.9	—	36.1	—	40.0
Investments in consolidated subsidiaries	2,925.0	(6.6)	475.2	—	(3,393.6)	—
Property and equipment (including concession assets), net	—	3,635.5	188.4	3,792.6	—	7,616.5
Other assets	1.5	55.4	—	27.6	—	84.5
Total assets	$2,929.2	$3,954.6	$671.9	$ 4,164.0	$ (3,397.2)	$ 8,322.5
Liabilities and equity:						
Current liabilities	$(975.8)	$1,076.4	$111.6	$ 256.8	$ (3.6)	$ 465.4
Long-term debt	0.2	1,197.3	0.1	1,121.9	—	2,319.5
Deferred income taxes	16.9	871.6	133.8	188.1	—	1,210.4
Other liabilities	3.7	98.0	0.1	41.1	—	142.9
Stockholders' equity	3,884.2	711.3	116.6	2,556.1	(3,393.6)	3,874.6
Noncontrolling interest	—	—	309.7	—	—	309.7
Total liabilities and equity	$2,929.2	$3,954.6	$671.9	$ 4,164.0	$ (3,397.2)	$ 8,322.5

18

Table of Contents

Kansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

CONDENSED CONSOLIDATING BALANCE SHEETS - (Continued)

	December 31, 2014					
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Assets:						
Current assets	$2.7	$281.7	$6.0			