

KANSAS CITY SOUTHERN  
Form 10-Q  
July 22, 2011  
Table of Contents

**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 June 30, 2011

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)*

**427 West 12th Street,**

**Kansas City, Missouri**  
*(Address of principal executive offices)*

**44-0663509**  
*(I.R.S. Employer  
Identification No.)*

**64105**  
*(Zip Code)*

**816.983.1303**

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*(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  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  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  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

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

| Class                                    | Outstanding at July 14, 2011 |
|--|------------------------------|
| Common Stock, \$0.01 per share par value | 109,816,933 Shares           |

**Table of Contents**

**Kansas City Southern**

**Form 10-Q**

**June 30, 2011**

**Index**

|   | <b>Page</b> |
|---|-------------|
| <b>PART I FINANCIAL INFORMATION</b>   |             |
| <b>Item 1. <u>Financial Statements</u></b>  | 3           |
| <u>Introductory Comments</u>  | 3           |
| <u>Consolidated Statements of Income Three and six months ended June 30, 2011 and 2010</u>                  | 4           |
| <u>Consolidated Balance Sheets June 30, 2011 and December 31, 2010</u>                                      | 5           |
| <u>Consolidated Statements of Cash Flows Six months ended June 30, 2011 and 2010</u>                        | 6           |
| <u>Notes to Consolidated Financial Statements</u>   | 7           |
| <b>Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b> | 23          |
| <b>Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u></b>                            | 32          |
| <b>Item 4. <u>Controls and Procedures</u></b>   | 33          |
| <b>PART II OTHER INFORMATION</b>  |             |
| <b>Item 1. <u>Legal Proceedings</u></b>   | 34          |
| <b>Item 1A. <u>Risk Factors</u></b>   | 34          |
| <b>Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>                           | 34          |
| <b>Item 3. <u>Defaults upon Senior Securities</u></b>   | 34          |
| <b>Item 4. <u>(Removed and Reserved)</u></b>  | 34          |
| <b>Item 5. <u>Other Information</u></b>   | 34          |
| <b>Item 6. <u>Exhibits</u></b>  | 35          |
| <b><u>SIGNATURES</u></b>  | 36          |

**Table of Contents**

**Kansas City Southern**

**Form 10-Q**

**June 30, 2011**

**PART I FINANCIAL INFORMATION**

**Item 1. *Financial Statements*  
Introductory Comments**

The unaudited Consolidated Financial Statements included herein have been prepared by Kansas City Southern, pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). As used herein, KCS or the Company may refer to Kansas City Southern or, as the context requires, to one or more subsidiaries of Kansas City Southern. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ( U.S. GAAP ) have been condensed or omitted, pursuant to such rules and regulations. The Company believes that the disclosures are adequate to enable a reasonable understanding of the information presented. The Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Form 10-Q should be read in conjunction with the consolidated financial statements and the related notes, as well as Management's Discussion and Analysis of Financial Condition and Results of Operations, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. Results for the three and six months ended June 30, 2011 are not necessarily indicative of the results expected for the full year ending December 31, 2011.

**Table of Contents****Kansas City Southern****Consolidated Statements of Income**

|  | Three Months Ended                                |          | Six Months Ended |          |
|--|---|----------|------------------|----------|
|  | June 30,  |          | June 30,         |          |
|  | 2011  | 2010     | 2011             | 2010     |
|  | (In millions, except share and per share amounts) |          |                  |          |
|  | (Unaudited)                                       |          |                  |          |
| Revenues   | \$ 534.9  | \$ 461.6 | \$ 1,023.5       | \$ 897.9 |
| Operating expenses:  |   |          |                  |          |
| Compensation and benefits  | 104.4   | 93.7     | 204.8            | 184.4    |
| Purchased services   | 54.8  | 48.0     | 102.9            | 92.9     |
| Fuel   | 92.0  | 69.1     | 171.5            | 129.9    |
| Equipment costs  | 42.7  | 41.3     | 84.1             | 80.0     |
| Depreciation and amortization                                    | 45.5  | 46.9     | 91.2             | 92.7     |
| Materials and other  | 43.9  | 35.4     | 89.6             | 82.6     |
| Total operating expenses   | 383.3   | 334.4    | 744.1            | 662.5    |
| Operating income   | 151.6   | 127.2    | 279.4            | 235.4    |
| Equity in net earnings of unconsolidated affiliates              | 5.3   | 4.6      | 8.9              | 11.0     |
| Interest expense   | (32.4)  | (41.9)   | (65.5)           | (86.3)   |
| Debt retirement costs  | (10.3)  | (32.5)   | (10.3)           | (47.4)   |
| Foreign exchange gain (loss)                                     | 0.4   | (1.4)    | 0.3              | 1.2      |
| Other income, net  |   | 1.0      | 1.7              | 1.5      |
| Income before income taxes                                       | 114.6   | 57.0     | 214.5            | 115.4    |
| Income tax expense   | 42.9  | 19.6     | 78.7             | 43.8     |
| Net income   | 71.7  | 37.4     | 135.8            | 71.6     |
| Less: Net income (loss) attributable to noncontrolling interest  | 0.9   |          | 1.0              | (1.1)    |
| Net income attributable to Kansas City Southern and subsidiaries | 70.8  | 37.4     | 134.8            | 72.7     |
| Preferred stock dividends  | 0.1   | 2.8      | 1.5              | 5.5      |
| Net income available to common stockholders                      | \$ 70.7   | \$ 34.6  | \$ 133.3         | \$ 67.2  |
| Earnings per share:  |   |          |                  |          |
| Basic earnings per share   | \$ 0.65   | \$ 0.35  | \$ 1.25          | \$ 0.69  |
| Diluted earnings per share                                       | \$ 0.64   | \$ 0.34  | \$ 1.23          | \$ 0.68  |
| Average shares outstanding ( <i>in thousands</i> ):              |   |          |                  |          |
| Basic  | 109,428   | 99,907   | 106,858          | 97,946   |
| Potentially dilutive common shares                               | 382   | 459      | 2,918            | 514      |
| Diluted  | 109,810   | 100,366  | 109,776          | 98,460   |

See accompanying notes to consolidated financial statements.



**Table of Contents**

**Kansas City Southern**  
**Consolidated Balance Sheets**

|   | June 30,<br>2011<br>(In millions, except share amounts)<br>(Unaudited) | December 31,<br>2010 |
|---|--|----------------------|
| <b>ASSETS</b>   |  |                      |
| Current assets:   |  |                      |
| Cash and cash equivalents   | \$ 156.0   | \$ 85.4              |
| Accounts receivable, net  | 195.8  | 160.0                |
| Materials and supplies  | 115.4  | 101.4                |
| Deferred income taxes   | 136.3  | 138.2                |
| Other current assets  | 58.0   | 91.2                 |
| Total current assets  | 661.5  | 576.2                |
| Investments   | 48.8   | 46.4                 |
| Restricted funds  | 14.7   | 22.0                 |
| Property and equipment (including concession assets), net   | 4,994.1  | 4,902.4              |
| Other assets  | 106.6  | 93.9                 |
| Total assets  | \$ 5,825.7   | \$ 5,640.9           |
| <b>LIABILITIES AND EQUITY</b>   |  |                      |
| Current liabilities:  |  |                      |
| Debt due within one year  | \$ 18.2  | \$ 18.1              |
| Accounts payable and accrued liabilities  | 387.6  | 403.0                |
| Total current liabilities   | 405.8  | 421.1                |
| Long-term debt  | 1,614.6  | 1,621.6              |
| Deferred income taxes   | 730.1  | 654.5                |
| Other noncurrent liabilities and deferred credits   | 221.8  | 230.0                |
| Total liabilities   | 2,972.3  | 2,927.2              |
| 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                  |
| Series D cumulative convertible perpetual preferred stock, \$1 par, 5.125%, 210,000 shares authorized and issued at December 31, 2010; 209,995 shares outstanding with a liquidation preference of \$1,000 per share at December 31, 2010                   |  | 0.2                  |
| \$.01 par, common stock, 400,000,000 shares authorized; 123,352,185 and 116,352,298 shares issued at June 30, 2011 and December 31, 2010, respectively; 109,789,846 and 102,648,845 shares outstanding at June 30, 2011 and December 31, 2010, respectively | 1.1  | 1.0                  |
| Paid-in capital   | 881.6  | 877.2                |
| Retained earnings   | 1,679.9  | 1,548.0              |
| Accumulated other comprehensive loss  | (0.9)  | (1.4)                |
| Total stockholders' equity  | 2,567.8  | 2,431.1              |
| Noncontrolling interest   | 285.6  | 282.6                |

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|                              |            |            |
|------------------------------|------------|------------|
| Total equity                 | 2,853.4    | 2,713.7    |
| Total liabilities and equity | \$ 5,825.7 | \$ 5,640.9 |

See accompanying notes to consolidated financial statements.



**Table of Contents****Kansas City Southern****Consolidated Statements of Cash Flows**

|   | <b>Six Months Ended<br/>June 30,</b> |                |
|---|--------------------------------------|----------------|
|   | <b>2011</b>                          | <b>2010</b>    |
|   | <b>(In millions)<br/>(Unaudited)</b> |                |
| <b>Operating activities:</b>  |                                      |                |
| Net income  | \$ 135.8                             | \$ 71.6        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                      |                |
| Depreciation and amortization   | 91.2                                 | 92.7           |
| Deferred income taxes   | 77.2                                 | 42.9           |
| Equity in undistributed earnings of unconsolidated affiliates                     | (8.9)                                | (11.0)         |
| Share-based compensation  | 5.3                                  | 4.5            |
| Excess tax benefit from share-based compensation                                  |                                      | (15.5)         |
| Deferred compensation   | 11.0                                 | 3.2            |
| Distributions from unconsolidated affiliates                                      | 6.6                                  | 10.5           |
| Cash payments related to hurricane damage   | (1.1)                                |                |
| Insurance proceeds related to hurricane damage                                    | 21.7                                 |                |
| Gain on sale of assets  | (0.2)                                | (0.4)          |
| Debt retirement costs   | 10.3                                 | 47.4           |
| Changes in working capital items:   |                                      |                |
| Accounts receivable   | (43.8)                               | (36.5)         |
| Materials and supplies  | (13.8)                               | 0.4            |
| Other current assets  | 11.2                                 | 5.9            |
| Accounts payable and accrued liabilities  | (7.3)                                | 23.5           |
| Other, net  | (26.3)                               | (18.9)         |
| <b>Net cash provided by operating activities</b>                                  | <b>268.9</b>                         | <b>220.3</b>   |
| <b>Investing activities:</b>  |                                      |                |
| Capital expenditures  | (171.8)                              | (120.9)        |
| Acquisition of an intermodal facility, net of cash acquired                       |                                      | (25.0)         |
| Property investments in MSLLC   | (24.2)                               | (10.5)         |
| Insurance proceeds related to hurricane damage                                    | 8.3                                  |                |
| Proceeds from disposal of property  | 4.9                                  | 3.5            |
| Other, net  | 8.7                                  | 7.5            |
| <b>Net cash used for investing activities</b>                                     | <b>(174.1)</b>                       | <b>(145.4)</b> |
| <b>Financing activities:</b>  |                                      |                |
| Proceeds from issuance of long-term debt  | 200.0                                | 295.7          |
| Repayment of long-term debt   | (209.6)                              | (589.0)        |
| Proceeds from common stock issuance   |                                      | 214.9          |
| Debt costs  | (12.9)                               | (40.4)         |
| Proceeds from employee stock plans  | 1.2                                  | 0.7            |
| Excess tax benefit from share-based compensation                                  |                                      | 15.5           |
| Preferred stock dividends paid  | (2.9)                                | (5.5)          |
| <b>Net cash used for financing activities</b>                                     | <b>(24.2)</b>                        | <b>(108.1)</b> |

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|  |          |         |
|--|----------|---------|
| Cash and cash equivalents:                 |          |         |
| Net increase (decrease) during each period | 70.6     | (33.2)  |
| At beginning of year                       | 85.4     | 117.5   |
| At end of period                           | \$ 156.0 | \$ 84.3 |

See accompanying notes to consolidated financial statements.

**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements****1. Accounting Policies, Interim Financial Statements and Basis of Presentation**

In the opinion of the management of KCS, the accompanying unaudited consolidated financial statements contain all adjustments necessary for a fair presentation of the results for interim periods. All adjustments made were of a normal and recurring nature. Certain information and footnote disclosure 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, 2010. The results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the results to be expected for the full year ending December 31, 2011. Certain prior year amounts have been reclassified to conform to the current year presentation.

**2. Recent Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board (the "FASB") issued new guidance on the presentation of comprehensive income, which eliminates the option for entities to present components of other comprehensive income ("OCI") as a part of the statement of changes in stockholders' equity and requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance. Additionally, the standard does not affect the calculation or reporting of earnings per share. This standard is effective for the Company beginning the first quarter of 2012.

**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. Nonvested stock awards granted to employees and officers are included in weighted average shares as they are earned for purposes of computing basic earnings per common share. 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 upon the conversion of preferred stock to common stock and shares issuable under the Stock Option and Performance Award Plan. During the first quarter of 2011, the Company converted all of the remaining outstanding Cumulative Convertible Perpetual Preferred Stock, Series D, into 6,999,887 shares of common stock.

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 |         | Six Months Ended |         |
|--|--------------------|---------|------------------|---------|
|  | June 30,           |         | June 30,         |         |
|  | 2011               | 2010    | 2011             | 2010    |
| Net income available to common stockholders for purposes of computing basic earnings per share   | \$ 70.7            | \$ 34.6 | \$ 133.3         | \$ 67.2 |
| Effect of dividends on conversion of convertible preferred stock                                 |                    |         | 1.4              |         |
| Net income available to common stockholders for purposes of computing diluted earnings per share | \$ 70.7            | \$ 34.6 | \$ 134.7         | \$ 67.2 |
| Weighted-average number of shares outstanding (in thousands):                                    |                    |         |                  |         |
| Basic shares   | 109,428            | 99,907  | 106,858          | 97,946  |
| Effect of dilution   | 382                | 459     | 2,918            | 514     |
| Diluted shares   | 109,810            | 100,366 | 109,776          | 98,460  |

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|                            |         |         |         |         |
|----------------------------|---------|---------|---------|---------|
| Basic earnings per share   | \$ 0.65 | \$ 0.35 | \$ 1.25 | \$ 0.69 |
| Diluted earnings per share | \$ 0.64 | \$ 0.34 | \$ 1.23 | \$ 0.68 |

**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)**

Potentially dilutive shares excluded from the calculation (*in thousands*):

|   | Three Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |       |
|---|--------------------------------|-------|------------------------------|-------|
|   | 2011                           | 2010  | 2011                         | 2010  |
| Stock options which effect on diluted earnings per share is anti-dilutive | 97                             | 205   | 101                          | 205   |
| Convertible preferred stock which is anti-dilutive                        |                                | 7,000 |                              | 7,000 |

**4. Hurricane Alex**

Hurricane Alex made landfall on June 30, 2010, causing widespread damage and flooding in central and northeastern Mexico. The hurricane resulted in extensive damage to Kansas City Southern de México, S.A. de C.V.'s track and bridge infrastructures, and also caused multiple track-related incidents and significantly disrupted the Company's rail service.

The Company maintains a comprehensive insurance program intended to cover such events. The property and casualty insurance program covers loss or damage to Company property and third party property over which the Company has custody and control and covers losses associated with business interruption. This program has combined coverage for both property damage and business interruption and has a self-insured retention amount of \$10.0 million for flood related losses. In addition, the Company also maintains a general liability insurance program. This program had a self-insured retention of \$1.0 million in Mexico at the time of Hurricane Alex. The Company's policy limits are in excess of the hurricane losses incurred.

Hurricane Alex affected revenues as customers were required to use alternate carriers or modes of transportation until rail service was restored. The Company estimated that resulting lost revenues in the third quarter of 2010 were approximately \$40.0 million before related avoided costs. In addition, the Company incurred losses related to property damage and incremental expenses of \$36.2 million. The \$36.2 million of incurred losses related to property damage and incremental expense was offset by a receivable for probable insurance recoveries. Effective July 7, 2011, the Company settled the portion of the insurance claim related to the property and casualty program, including business interruption for \$66.0 million before the related self-insured retention of \$10.0 million. Through June 30, 2011, the Company has received \$40.0 million of insurance proceeds related to the property and casualty claim (see table below) and expects to receive final settlement proceeds of \$16.0 million in the third quarter of 2011. The \$19.8 million of proceeds in excess of the receivable will be recognized as a gain on insurance recovery within operating expenses in the third quarter of 2011.

As of June 30, 2011, \$40.0 million of insurance proceeds were collected in the following periods (*in millions*):

| Period Received          | Amount Collected |
|--------------------------|------------------|
| Fourth quarter 2010      | \$ 10.0          |
| First quarter 2011       | 15.0             |
| Second quarter 2011      | 15.0             |
| Total proceeds collected | \$ 40.0          |

On July 5, 2011, the Company received \$3.0 million of insurance proceeds for the portion of the insurance claim related to general liability. The Company expects to settle the general liability insurance claim during the third quarter of 2011, and related proceeds will be recognized as a gain on insurance recovery within operating expenses when all contingencies have been resolved, which generally occurs at the time of final settlement.



**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)****5. Property and Equipment (including Concession Assets)**

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

|  | December 31,<br>June 30,<br>2011 | December 31,<br>December 31,<br>2010 |
|--|----------------------------------|--------------------------------------|
| Land   | \$ 176.8                         | \$ 177.0                             |
| Concession land rights   | 141.2                            | 141.2                                |
| Road property  | 5,100.7                          | 4,939.1                              |
| Equipment  | 679.3                            | 678.1                                |
| Technology and other   | 126.1                            | 121.9                                |
| Construction in progress   | 150.8                            | 143.5                                |
| <b>Total property</b>  | <b>6,374.9</b>                   | <b>6,200.8</b>                       |
| Accumulated depreciation and amortization                        | 1,380.8                          | 1,298.4                              |
| <b>Property and equipment (including concession assets), net</b> | <b>\$ 4,994.1</b>                | <b>\$ 4,902.4</b>                    |

Concession assets, net of accumulated amortization of \$323.2 million and \$305.3 million, totaled \$1,826.5 million and \$1,800.1 million at June 30, 2011 and December 31, 2010, respectively.

**6. Fair Value Measurements**

The Company's short-term financial instruments include cash and cash equivalents, accounts receivable, and accounts payable. 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 \$1,721.9 million and \$1,739.8 million at June 30, 2011 and December 31, 2010, respectively. The carrying value was \$1,632.8 million and \$1,639.7 million at June 30, 2011 and December 31, 2010, respectively.

**7. Long-Term Debt**

On May 6, 2011, pursuant to an offer to purchase, Kansas City Southern de México, S.A. de C.V. (KCSM), a wholly-owned subsidiary of KCS, commenced a cash tender offer for all of its 7<sup>5</sup>/<sub>8</sub>% Senior Notes due December 1, 2013 (the 7<sup>7</sup>/<sub>8</sub>% Senior Notes) and, pursuant to a separate offer to purchase, KCSM commenced a cash tender offer for all of its 7<sup>3</sup>/<sub>8</sub>% Senior Notes due June 1, 2014 (the 7<sup>7</sup>/<sub>8</sub>% Senior Notes). Through June 7, 2011, KCSM purchased and redeemed the remaining \$32.4 million of the 7<sup>5</sup>/<sub>8</sub>% Senior Notes and all of the outstanding \$165.0 million of the 7<sup>3</sup>/<sub>8</sub>% Senior Notes using the proceeds received from the issuance of \$200.0 million principal amount of 6<sup>1</sup>/<sub>8</sub>% senior unsecured notes due June 15, 2021 (the 6<sup>1</sup>/<sub>8</sub>% Senior Notes) and cash on hand. The Company recorded debt retirement costs of \$10.3 million in the second quarter of 2011.

On May 20, 2011, KCSM issued \$200.0 million principal amount of 6<sup>1</sup>/<sub>8</sub>% Senior Notes, at par, bearing interest semiannually at a fixed annual rate of 6<sup>1</sup>/<sub>8</sub>%. KCSM used proceeds from the issuance of the 6<sup>1</sup>/<sub>8</sub>% Senior Notes and cash on hand to purchase and redeem the 7<sup>5</sup>/<sub>8</sub>% Senior Notes and 7<sup>3</sup>/<sub>8</sub>% Senior Notes as discussed above, and pay all fees and expenses incurred in connection with the 6<sup>1</sup>/<sub>8</sub>% Senior Notes offering and the tender offers. The 6<sup>1</sup>/<sub>8</sub>% Senior Notes are redeemable at KCSM's option, in whole or in part, on and after June 15, 2016, at the following

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redemption prices (expressed as percentages of principal amount) if redeemed during the 12-month period commencing on June 15 of the following years, plus any accrued and unpaid interest to the date of redemption: 2016 103.063%, 2017 102.042%, 2018 101.021% and 2019 100.000%. In addition, KCSM may redeem up to 35% of the 6<sup>1</sup>/<sub>8</sub>% Senior Notes at a redemption price equal to 106.125% any time prior to June 15, 2014 from the proceeds of the sale of KCSM's capital stock or the capital stock of KCS and the notes are redeemable, in whole but not in part, at KCSM's option at their principal amount, plus any accrued unpaid interest in the event of certain changes in the Mexican withholding tax rate.

The 6<sup>1</sup>/<sub>8</sub>% Senior Notes are denominated in dollars and are unsecured, unsubordinated obligations, rank *pari passu* in right of payment with KCSM's existing and future unsecured, unsubordinated obligations, and are senior in right of payment to KCSM's



**Table of Contents**

**Kansas City Southern**

**Notes to Consolidated Financial Statements (Continued)**

future subordinated indebtedness. In addition, the 6<sup>1</sup>/<sub>8</sub>% Senior Notes include certain covenants which are customary for these types of debt instruments and borrowers with similar credit ratings. The 6<sup>1</sup>/<sub>8</sub>% Senior Notes contain certain covenants that, among other things, prohibit or restrict KCSM from taking certain actions, including KCSM's ability to incur debt, pay dividends or make other distributions in respect of its stock, issue guarantees, enter into certain transactions with affiliates, make restricted payments, sell certain assets, create liens, engage in sale-leaseback transactions and engage in mergers, divestitures and consolidations. However, these limitations are subject to a number of important qualifications and exceptions.

**8. Conversion of Cumulative Convertible Perpetual Preferred Stock, Series D**

During the first quarter of 2011, the Company converted all of the remaining outstanding 209,995 shares of the 5.125% Cumulative Convertible Perpetual Preferred Stock, Series D, into 6,999,887 shares of KCS common stock.

On May 5, 2011, the Company's Restated Certificate of Incorporation was amended to eliminate the Series D Preferred Stock and change the status to undesignated preferred stock of the Company.

**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)****9. Equity**

The following table summarizes the changes in equity (*in millions*):

|   | Noncontrolling<br>Three Months Ended June 30, 2011 |                            |                 | Noncontrolling<br>Three Months Ended June 30, 2010 |                            |                 |
|---|--|----------------------------|-----------------|--|----------------------------|-----------------|
|   | Kansas City<br>Southern<br>Stockholders<br>Equity  | Noncontrolling<br>Interest | Total<br>Equity | Kansas City<br>Southern<br>Stockholders<br>Equity  | Noncontrolling<br>Interest | Total<br>Equity |
| Beginning balance   | \$ 2,495.9   | \$ 282.7                   | \$ 2,778.6      | \$ 2,082.0   | \$ 281.7                   | \$ 2,363.7      |
| Comprehensive income:   |  |                            |                 |  |                            |                 |
| Net income  | 70.8   | 0.9                        | 71.7            | 37.4   |                            | 37.4            |
| Unrealized gain on cash<br>flow hedges, net of tax of<br>less than \$0.1 million  |  |                            |                 | 0.1  |                            | 0.1             |
| Reclassification<br>adjustment from cash<br>flow hedges included in<br>net income, net of tax of<br>\$0.7 million         |  |                            |                 | 0.9  |                            | 0.9             |
| Amortization of prior<br>service credit, net of tax<br>of less than \$(0.1) million                                       | (0.1)  |                            | (0.1)           |  |                            |                 |
| Cumulative translation<br>adjustment - FTVM, net<br>of tax of less than \$0.1<br>million and less than<br>\$(0.1) million | 0.1  |                            | 0.1             | (0.2)  |                            | (0.2)           |
| Comprehensive income  | 70.8   | 0.9                        | 71.7            | 38.2   |                            | 38.2            |
| Contribution from<br>noncontrolling interest  |  | 2.0                        | 2.0             |  |                            |                 |
| Common stock issued   |  |                            |                 | 214.9  |                            | 214.9           |
| Dividends on \$25 par<br>preferred stock  | (0.1)  |                            | (0.1)           |  |                            |                 |
| Dividends on series D<br>cumulative preferred<br>stock  |  |                            |                 | (2.8)  |                            | (2.8)           |
| Options exercised and<br>stock subscribed, net of<br>shares withheld for<br>employee taxes                                | (0.1)  |                            | (0.1)           | (0.3)  |                            | (0.3)           |
| Tax benefit from<br>share-based compensation  |  |                            |                 | 3.8  |                            | 3.8             |
| Share-based<br>compensation   | 1.3  |                            | 1.3             | 1.3  |                            | 1.3             |

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|                |    |         |    |       |    |         |    |         |    |       |    |         |
|----------------|----|---------|----|-------|----|---------|----|---------|----|-------|----|---------|
| Ending balance | \$ | 2,567.8 | \$ | 285.6 | \$ | 2,853.4 | \$ | 2,337.1 | \$ | 281.7 | \$ | 2,618.8 |
|----------------|----|---------|----|-------|----|---------|----|---------|----|-------|----|---------|

**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)**

|   | Noncontrolling<br>Six Months Ended June 30, 2011  |                            |                 | Noncontrolling<br>Six Months Ended June 30, 2010  |                            |                 |
|---|---|----------------------------|-----------------|---|----------------------------|-----------------|
|   | Kansas City<br>Southern<br>Stockholders<br>Equity | Noncontrolling<br>Interest | Total<br>Equity | Kansas City<br>Southern<br>Stockholders<br>Equity | Noncontrolling<br>Interest | Total<br>Equity |
| Beginning balance   | \$ 2,431.1  | \$ 282.6                   | \$ 2,713.7      | \$ 2,043.0  | \$ 282.8                   | \$ 2,325.8      |
| Comprehensive income:   |   |                            |                 |   |                            |                 |
| Net income (loss)   | 134.8   | 1.0                        | 135.8           | 72.7  | (1.1)                      | 71.6            |
| Unrealized loss on cash<br>flow hedges, net of tax of<br>\$(0.2) million  |   |                            |                 | (0.3)   |                            | (0.3)           |
| Reclassification<br>adjustment from cash flow<br>hedges included in net<br>income, net of tax of \$0.2<br>million and \$1.3 million | 0.2   |                            | 0.2             | 1.8   |                            | 1.8             |
| Amortization of prior<br>service credit, net of tax of<br>less than \$(0.1) million   | (0.1)   |                            | (0.1)           |   |                            |                 |
| Cumulative translation<br>adjustment - FTVM, net<br>of tax of \$0.1 million   | 0.4   |                            | 0.4             | 0.2   |                            | 0.2             |
| Comprehensive income<br>(loss)  | 135.3   | 1.0                        | 136.3           | 74.4  | (1.1)                      | 73.3            |
| Contribution from<br>noncontrolling interest  |   | 2.0                        | 2.0             |   |                            |                 |
| Common stock issued   |   |                            |                 | 214.9   |                            | 214.9           |
| Conversion of series D<br>cumulative convertible<br>preferred stock   | (0.2)   |                            | (0.2)           |   |                            |                 |
| Common stock issued for<br>conversion of series D<br>cumulative convertible<br>preferred stock                                      | 0.2   |                            | 0.2             |   |                            |                 |
| Dividends on \$25 par<br>preferred stock  | (0.2)   |                            | (0.2)           | (0.1)   |                            | (0.1)           |
| Dividends on series D<br>cumulative preferred stock   | (2.7)   |                            | (2.7)           | (5.4)   |                            | (5.4)           |
| Options exercised and<br>stock subscribed, net of<br>shares withheld for<br>employee taxes  | (1.0)   |                            | (1.0)           | (9.7)   |                            | (9.7)           |
| Tax benefit from<br>share-based compensation  |   |                            |                 | 15.5  |                            | 15.5            |
| Share-based compensation  | 5.3   |                            | 5.3             | 4.5   |                            | 4.5             |
| Ending balance  | \$ 2,567.8  | \$ 285.6                   | \$ 2,853.4      | \$ 2,337.1  | \$ 281.7                   | \$ 2,618.8      |



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**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)****10. Commitments and Contingencies**

*Concession Duty.* Under KCSM's 50-year railroad concession from the Mexican government (the "Concession"), the Mexican government has the right to receive a payment from KCSM equivalent to 0.5% of KCSM's gross revenue during the first 15 years of the Concession period and, beginning on June 24, 2012, 1.25% of KCSM's gross revenue for the remaining years of the Concession period. For the three and six months ended June 30, 2011, the concession duty expense, which is recorded within operating expenses, was \$1.3 million and \$2.4 million, respectively, compared to \$1.1 million and \$2.1 million for the same periods in 2010.

*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 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 financial condition and liquidity. However, a material adverse outcome in one or more of these proceedings could have a material adverse impact on the results of operations in a particular quarter or fiscal year.

*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 below.

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 and impose economic sanctions against companies that violate environmental laws, and temporarily or even permanently close non-complying facilities.

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. Additionally, the Company is a partner in the Responsible Care® program and, as a result, has initiated additional environmental, health and safety management system programs and has been certified by an outside professional auditing company in the American Chemistry Council's Responsible Care Management System®. 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 position or cash flows.

*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 June 30, 2011 is based on an updated actuarial study of personal injury claims through May 31, 2011 and review of the last month's experience. For the six months ended June 30, 2011 and 2010, the Company recorded a \$9.2 million and a \$12.4 million reduction in personal injury liability due to changes in estimates as a result of the Company's continuing favorable claims development and settlement experience.



**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)**

The personal injury liability activity was as follows (*in millions*):

|                              | 2011<br>Six Months Ended<br>2011 | 2011<br>Six Months Ended<br>2010 |
|------------------------------|----------------------------------|----------------------------------|
| Balance at beginning of year | \$ 62.2                          | \$ 86.9                          |
| Accruals                     | 5.4                              | 9.9                              |
| Change in estimate           | (9.2)                            | (12.4)                           |
| Payments                     | (9.7)                            | (8.8)                            |
| Balance at end of period     | \$ 48.7                          | \$ 75.6                          |

*Settlement Agreement.* On February 9, 2010, (i) KCSM and (ii) *Ferrocarril Mexicano, S.A. de C.V.* (*Ferromex*), *Ferrosur, S.A. de C.V.* (*Ferrosur*), *Minera México, S.A. de C.V.*, *Infraestructura y Transportes Ferroviarios, S.A. de C.V.*, *Infraestructura y Transportes México, S.A. de C.V.*, *Líneas Ferroviarias de México, S.A. de C.V.*, *Grupo Ferroviario Mexicano, S.A. de C.V.*, and *Grupo México, S.A.B. de C.V.* (jointly, the *Ferromex Parties*) entered into a Settlement Agreement (the *Settlement Agreement*).

Pursuant to the Settlement Agreement, the parties agreed to completely, definitively and irrevocably terminate (i) certain disputes, procedures and controversies among KCSM and the Ferromex Parties, in connection with the merger between Ferromex and Ferrosur, including KCSM's involvement in such procedures as an interested party; and (ii) the lawsuit filed against KCSM and the Mexican Government in connection with several disputes, procedures and controversies before judicial authorities with respect to the acquisition of the shares of *Ferrocarril del Noreste, S.A. de C.V.* (now KCSM) by *Grupo Transportación Ferroviaria Mexicana, S.A. de C.V.*, in 1997 (the *Settlement Procedures*). The parties waived their rights to any future actions derived from or related to the Settlement Procedures. Further, the parties did not settle or agree to settle any disputes, controversies or procedures other than the Settlement Procedures.

Under the Settlement Agreement, Ferrosur agreed to grant KCSM certain trackage and switching rights within Veracruz, México, and switching rights in the Puebla-Tlaxcala zone. In a related agreement, the parties further agreed to amend the *Ferrocarril y Terminal del Valle de México, S.A. de C.V.* (*FTVM*) by-laws to, among other changes, grant certain veto and voting rights to KCSM at the shareholders' and the board of directors' levels.

In November 2005, Ferromex acquired control of and merged with Ferrosur creating Mexico's largest railway, though such merger had been previously rejected by the *Comisión Federal de Competencia* (Mexican Antitrust Commission or *COFECO*). The Settlement Agreement provides that if *COFECO* does not authorize the merger of Ferromex and Ferrosur, the Settlement Agreement shall be terminated twelve months after the relevant resolution of the Governmental Authority is issued or when the unwinding is effective, whichever is later. On May 12, 2010, the Administrative and Fiscal Federal Court annulled the decision of *COFECO* and approved the merger between Ferromex and Ferrosur. On October 21, 2010, *COFECO* filed an appeal with the Collegiate Circuit Federal Court and on March 25, 2011, the Collegiate Circuit Federal Court dismissed the appeal and the merger between Ferromex and Ferrosur is considered final.

*Certain Disputes with Ferromex.* KCSM and 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 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.



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In addition, KCSM is currently involved in judicial, civil and administrative proceedings and negotiations with Ferromex regarding the rates payable to each other for the Services for the periods prior to January 1, 2009. 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.

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**Table of Contents**

**Kansas City Southern**

**Notes to Consolidated Financial Statements (Continued)**

While the outcome of these matters cannot be predicted with certainty, the Company does not believe, when finally resolved, that these disputes will have a material effect on its results of operations or financial condition. However, an unexpected adverse resolution could have a material effect on the results of operations in a particular quarter or fiscal year.

*SCT Sanction Proceedings.* In April 2006, the SCT initiated proceedings against KCSM, claiming that KCSM had failed to make certain minimum capital investments projected for 2004 and 2005 under its five-year business plan filed with the SCT prior to its April 2005 acquisition by KCS (collectively, the Capital Investment Proceedings). KCSM responded to the SCT by providing evidence in support of its investments and explaining why it believes sanctions were not appropriate. On March 24, 2011, the Company received a favorable resolution from the Tax and Administration Court and the Company considers this matter resolved.

On July 23, 2008, the SCT delivered notice to KCSM of proceedings against KCSM, claiming, among other things, that KCSM refused to grant Ferromex access to certain trackage over which Ferromex alleges it has trackage rights on six different occasions and thus denied Ferromex the ability to provide service to a Mexican subsidiary of a large U.S. Auto Manufacturer at this location. On August 13, 2008, KCSM filed a response to the SCT. On July 15, 2010, the SCT resolved to consolidate these six sanction proceedings into a single proceeding, determining that the actions that motivated the underlying claims constitute a single occasion. On August 19, 2010, Ferromex filed an appeal which KCSM considers to be without merit. Management believes that even if KCSM were to be found liable, a single sanction would be imposed and could be challenged in the Administrative and Fiscal Federal Court. A single sanction makes it more likely that any unfavorable resolution will not have a material impact on KCSM's results of operations. However, if KCSM is ultimately sanctioned by the SCT for generic sanctions on five occasions over the term of the Concession, KCSM could be subject to possible future SCT action seeking revocation of the Concession.

*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, when finally resolved, that these disputes will have a material effect on its results of operations or financial condition. However, an unexpected adverse resolution could have a material effect on the results of operations in a particular quarter or fiscal year.

*Credit Risk.* The Company continually monitors risks related to the economic changes and certain customer receivables concentrations. Significant changes in customer concentration or payment terms, deterioration of customer credit-worthiness or further weakening in economic trends could have a significant impact on the collectability of the Company's receivables and operating results. If the financial condition of the Company's customers were to deteriorate, resulting 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 June 30, 2011.

*Income Tax.* Tax returns filed in the U.S. from 2007 through the current year and in Mexico from 2004 through the current year remain open to examination by the taxing authorities. The 2004 and 2005 Mexico tax returns are currently under examination. The Company believes that an adequate provision has been made for any adjustment (tax and interest) that will be due for all open years. However, an unexpected adverse resolution could have a material effect on the results of operations in a particular quarter or fiscal year.

*Panama Canal Railway Company (PCRC) Guarantees and Indemnities.* The Company has issued four irrevocable standby letters of credit totaling approximately \$1.5 million to fulfill the Company's fifty percent guarantee of additional equipment loans. The Company agreed to fund fifty percent of any debt service reserve or liquidity reserve required from PCRC, reserves which were established by PCRC in connection with the issuance of the 7.0% Senior Secured Notes due November 1, 2026 (the Notes). At June 30, 2011, the Company has issued a related standby letter of credit in the amount of \$3.9 million. Additionally, KCS has pledged its shares of PCRC as security for the Notes.

**11. 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.

**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)**

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. Corporate management is responsible for, among others, KCS's marketing strategy, the oversight of large cross-border customer accounts, overall planning and control of infrastructure and rolling stock, the allocation of capital resources based upon growth and capacity constraints over the coordinated network, and other functions such as financial planning, accounting, and treasury.

The role of each region is to manage the operational activities and monitor and control costs over the coordinated rail network. Such cost control is required to ensure that pre-established efficiency standards set at the corporate level are attained. The activity centers are responsible for executing the overall corporate strategy and operating plan established by corporate management as a coordinated system.

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

|                       | 2011               |                 | 2011              |                 |
|-----------------------|--------------------|-----------------|-------------------|-----------------|
|                       | Three Months Ended |                 | Six Months Ended  |                 |
|                       | June 30,           |                 | June 30,          |                 |
| Revenues              | 2011               | 2010            | 2011              | 2010            |
| U.S.                  | \$ 288.2           | \$ 254.8        | \$ 558.6          | \$ 500.3        |
| Mexico                | 246.7              | 206.8           | 464.9             | 397.6           |
| <b>Total revenues</b> | <b>\$ 534.9</b>    | <b>\$ 461.6</b> | <b>\$ 1,023.5</b> | <b>\$ 897.9</b> |

|  | June 30,          | December 31,      |
|--|-------------------|-------------------|
|  | 2011              | 2010              |
| <b>Property and equipment (including concession assets), net</b>       |                   |                   |
| U.S.   | \$ 2,706.6        | \$ 2,626.2        |
| Mexico   | 2,287.5           | 2,276.2           |
| <b>Total property and equipment (including concession assets), net</b> | <b>\$ 4,994.1</b> | <b>\$ 4,902.4</b> |

**12. Condensed Consolidating Financial Information**

The Kansas City Southern Railway Company ( KCSR ), a wholly-owned subsidiary of KCS, has outstanding \$275.0 million principal amount of 8.0% Senior Notes due June 1, 2015 and \$123.5 million principal amount of 13.0% Senior Notes due December 15, 2013, which are unsecured obligations of KCSR, and which are also jointly and severally and fully and unconditionally guaranteed on an unsecured senior basis by KCS and certain wholly-owned domestic subsidiaries. As a result, the following condensed consolidating financial information (*in millions*) has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10. Financial statements of guarantors and issuers of guaranteed securities registered or being registered. The 8.0% Senior Notes were registered by means of an amendment to KCS's shelf registration statement. The 13.0% Senior Notes were registered under KCS's shelf registration statement.

Table of Contents

## Kansas City Southern

## Notes to Consolidated Financial Statements (Continued)

## CONDENSED CONSOLIDATING STATEMENTS OF INCOME

|   | <b>Three Months Ended June 30, 2011</b> |             |                                   |                                       |                                      |                             |
|---|---|-------------|-----------------------------------|---------------------------------------|--------------------------------------|-----------------------------|
|   | <b>Parent</b>                           | <b>KCSR</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated<br/>KCS</b> |
| Revenues  | \$                                      | \$ 255.5    | \$ 5.2                            | \$ 281.7                              | \$ (7.5)                             | \$ 534.9                    |
| Operating expenses  | 1.2                                     | 191.6       | 7.1                               | 191.5                                 | (8.1)                                | 383.3                       |
| Operating income (loss)   | (1.2)                                   | 63.9        | (1.9)                             | 90.2                                  | 0.6                                  | 151.6                       |
| Equity in net earnings (losses) of unconsolidated affiliates            | 66.9                                    | (0.1)       |                                   | 40.6                                  | (102.1)                              | 5.3                         |
| Interest expense  | (0.1)                                   | (22.5)      |                                   | (20.4)                                | 10.6                                 | (32.4)                      |
| Debt retirement costs   |   |             |                                   | (10.3)                                |                                      | (10.3)                      |
| Foreign exchange gain   |   |             |                                   | 0.4                                   |                                      | 0.4                         |
| Other income, net   | 9.6                                     | 0.9         |                                   | 0.8                                   | (11.3)                               |                             |
| Income (loss) before income taxes                                       | 75.2                                    | 42.2        | (1.9)                             | 101.3                                 | (102.2)                              | 114.6                       |
| Income tax expense (benefit)  | 4.5                                     | 16.6        | (0.8)                             | 22.6                                  |                                      | 42.9                        |
| Net income (loss)   | 70.7                                    | 25.6        | (1.1)                             | 78.7                                  | (102.2)                              | 71.7                        |
| Less: Net income attributable to noncontrolling interest                |   |             |                                   | 0.9                                   |                                      | 0.9                         |
| Net income (loss) attributable to Kansas City Southern and subsidiaries | \$ 70.7                                 | \$ 25.6     | \$ (1.1)                          | \$ 77.8                               | \$ (102.2)                           | \$ 70.8                     |

|   | <b>Three Months Ended June 30, 2010</b> |             |                                   |                                       |                                      |                             |
|---|---|-------------|-----------------------------------|---------------------------------------|--------------------------------------|-----------------------------|
|   | <b>Parent</b>                           | <b>KCSR</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated<br/>KCS</b> |
| Revenues  | \$                                      | \$ 224.4    | \$ 3.6                            | \$ 239.9                              | \$ (6.3)                             | \$ 461.6                    |
| Operating expenses  | 1.3                                     | 163.0       | 6.1                               | 171.4                                 | (7.4)                                | 334.4                       |
| Operating income (loss)   | (1.3)                                   | 61.4        | (2.5)                             | 68.5                                  | 1.1                                  | 127.2                       |
| Equity in net earnings (losses) of unconsolidated affiliates            | 35.3                                    | (0.1)       |                                   | 20.5                                  | (51.1)                               | 4.6                         |
| Interest expense  |   | (25.1)      | 0.3                               | (26.6)                                | 9.5                                  | (41.9)                      |
| Debt retirement costs   |   | (15.8)      |                                   | (16.7)                                |                                      | (32.5)                      |
| Foreign exchange loss   |   |             |                                   | (1.4)                                 |                                      | (1.4)                       |
| Other income, net   | 9.1                                     | 1.2         |                                   | 1.8                                   | (11.1)                               | 1.0                         |
| Income (loss) before income taxes                                       | 43.1                                    | 21.6        | (2.2)                             | 46.1                                  | (51.6)                               | 57.0                        |
| Income tax expense (benefit)  | 4.9                                     | 8.6         | (0.8)                             | 6.9                                   |                                      | 19.6                        |
| Net income (loss)   | 38.2                                    | 13.0        | (1.4)                             | 39.2                                  | (51.6)                               | 37.4                        |
| Less: Net income attributable to noncontrolling interest                |   |             |                                   |                                       |                                      |                             |
| Net income (loss) attributable to Kansas City Southern and subsidiaries | \$ 38.2                                 | \$ 13.0     | \$ (1.4)                          | \$ 39.2                               | \$ (51.6)                            | \$ 37.4                     |



**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING STATEMENTS OF INCOME (Continued)**

|   | Six Months Ended June 30, 2011 |          |                           |                               |                              |                     |
|---|--------------------------------|----------|---------------------------|-------------------------------|------------------------------|---------------------|
|   | Parent                         | KCSR     | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>KCS |
| Revenues  | \$                             | \$ 496.8 | \$ 9.8                    | \$ 531.8                      | \$ (14.9)                    | \$ 1,023.5          |
| Operating expenses  | 2.2                            | 377.1    | 13.4                      | 367.5                         | (16.1)                       | 744.1               |
| Operating income (loss)   | (2.2)                          | 119.7    | (3.6)                     | 164.3                         | 1.2                          | 279.4               |
| Equity in net earnings (losses) of unconsolidated affiliates            | 126.0                          | (0.2)    |                           | 77.7                          | (194.6)                      | 8.9                 |
| Interest expense  | (0.1)                          | (45.3)   |                           | (41.3)                        | 21.2                         | (65.5)              |
| Debt retirement costs   |                                |          |                           | (10.3)                        |                              | (10.3)              |
| Foreign exchange gain   |                                |          |                           | 0.3                           |                              | 0.3                 |
| Other income, net   | 19.4                           | 3.1      |                           | 1.7                           | (22.5)                       | 1.7                 |
| Income (loss) before income taxes                                       | 143.1                          | 77.3     | (3.6)                     | 192.4                         | (194.7)                      | 214.5               |
| Income tax expense (benefit)  | 8.4                            | 30.5     | (1.4)                     | 41.2                          |                              | 78.7                |
| Net income (loss)   | 134.7                          | 46.8     | (2.2)                     | 151.2                         | (194.7)                      | 135.8               |
| Less: Net income attributable to noncontrolling interest                |                                |          |                           | 1.0                           |                              | 1.0                 |
| Net income (loss) attributable to Kansas City Southern and subsidiaries | \$ 134.7                       | \$ 46.8  | \$ (2.2)                  | \$ 150.2                      | \$ (194.7)                   | \$ 134.8            |
|   | Six Months Ended June 30, 2010 |          |                           |                               |                              |                     |
|   | Parent                         | KCSR     | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>KCS |
| Revenues  | \$                             | \$ 441.4 | \$ 7.6                    | \$ 461.8                      | \$ (12.9)                    | \$ 897.9            |
| Operating expenses  | 2.4                            | 326.1    | 12.8                      | 335.8                         | (14.6)                       | 662.5               |
| Operating income (loss)   | (2.4)                          | 115.3    | (5.2)                     | 126.0                         | 1.7                          | 235.4               |
| Equity in net earnings of unconsolidated affiliates                     | 67.1                           | 3.3      |                           | 29.8                          | (89.2)                       | 11.0                |
| Interest expense  | (0.1)                          | (52.5)   | 0.3                       | (54.6)                        | 20.6                         | (86.3)              |
| Debt retirement costs   |                                | (15.8)   |                           | (31.6)                        |                              | (47.4)              |
| Foreign exchange gain   |                                |          |                           | 1.2                           |                              | 1.2                 |
| Other income, net   | 19.4                           | 2.2      |                           | 2.7                           | (22.8)                       | 1.5                 |
| Income (loss) before income taxes                                       | 84.0                           | 52.5     | (4.9)                     | 73.5                          | (89.7)                       | 115.4               |
| Income tax expense (benefit)  | 10.5                           | 20.8     | (1.8)                     | 14.3                          |                              | 43.8                |
| Net income (loss)   | 73.5                           | 31.7     | (3.1)                     | 59.2                          | (89.7)                       | 71.6                |
| Less: Net loss attributable to noncontrolling interest                  |                                |          |                           | (1.1)                         |                              | (1.1)               |
| Net income (loss) attributable to Kansas City Southern and subsidiaries | \$ 73.5                        | \$ 31.7  | \$ (3.1)                  | \$ 60.3                       | \$ (89.7)                    | \$ 72.7             |





**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING BALANCE SHEETS**

|  | June 30, 2011     |                   |                           |                               |                              |                     |
|--|-------------------|-------------------|---------------------------|-------------------------------|------------------------------|---------------------|
|  | Parent            | KCSR              | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>KCS |
| <b>Assets:</b>   |                   |                   |                           |                               |                              |                     |
| Current assets   | \$ 1.0            | \$ 240.2          | \$ 3.6                    | \$ 430.3                      | \$ (13.6)                    | \$ 661.5            |
| Investments  |                   | 26.9              |                           | 21.9                          |                              | 48.8                |
| Investments in consolidated subsidiaries                     | 1,982.7           | (0.1)             | 1.9                       | 1,779.0                       | (3,763.5)                    |                     |
| Restricted funds   |                   |                   |                           | 14.7                          |                              | 14.7                |
| Property and equipment (including concession assets),<br>net |                   | 1,887.7           | 212.9                     | 2,893.5                       |                              | 4,994.1             |
| Other assets   | 1.4               | 62.2              |                           | 89.5                          | (46.5)                       | 106.6               |
| <b>Total assets</b>  | <b>\$ 1,985.1</b> | <b>\$ 2,216.9</b> | <b>\$ 218.4</b>           | <b>\$ 5,228.9</b>             | <b>\$ (3,823.6)</b>          | <b>\$ 5,825.7</b>   |
| <b>Liabilities and equity:</b>                               |                   |                   |                           |                               |                              |                     |
| Current liabilities  | \$ (580.6)        | \$ 655.3          | \$ 134.0                  | \$ 201.5                      | \$ (4.4)                     | \$ 405.8            |
| Long-term debt   | 0.2               | 703.1             | 0.4                       | 910.9                         |                              | 1,614.6             |
| Deferred income taxes  | (7.2)             | 502.2             | 76.7                      | 158.4                         |                              | 730.1               |
| Other liabilities  | 4.3               | 133.7             | 0.4                       | 139.1                         | (55.7)                       | 221.8               |
| Stockholders' equity   | 2,568.4           | 222.6             | 6.9                       | 3,533.4                       | (3,763.5)                    | 2,567.8             |
| Noncontrolling interest                                      |                   |                   |                           | 285.6                         |                              | 285.6               |
| <b>Total liabilities and equity</b>                          | <b>\$ 1,985.1</b> | <b>\$ 2,216.9</b> | <b>\$ 218.4</b>           | <b>\$ 5,228.9</b>             | <b>\$ (3,823.6)</b>          | <b>\$ 5,825.7</b>   |
| <b>December 31, 2010</b>                                     |                   |                   |                           |                               |                              |                     |
|  | Parent            | KCSR              | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>KCS |
| <b>Assets:</b>   |                   |                   |                           |                               |                              |                     |
| Current assets   | \$ 0.5            | \$ 212.6          | \$ 3.9                    | \$ 390.2                      | \$ (31.0)                    | \$ 576.2            |
| Investments  |                   | 28.2              |                           | 18.2                          |                              | 46.4                |
| Investments in consolidated subsidiaries                     | 1,855.8           | 1.7               | 1.9                       | 1,708.7                       | (3,568.1)                    |                     |
| Restricted funds   |                   |                   |                           | 22.0                          |                              | 22.0                |
| Property and equipment (including concession assets),<br>net |                   | 1,829.3           | 213.7                     | 2,859.4                       |                              | 4,902.4             |
| Other assets   | 1.4               | 52.1              |                           | 88.1                          | (47.7)                       | 93.9                |
| <b>Total assets</b>  | <b>\$ 1,857.7</b> | <b>\$ 2,123.9</b> | <b>\$ 219.5</b>           | <b>\$ 5,086.6</b>             | <b>\$ (3,646.8)</b>          | <b>\$ 5,640.9</b>   |
| <b>Liabilities and equity:</b>                               |                   |                   |                           |                               |                              |                     |
| Current liabilities  | \$ (562.8)        | \$ 631.7          | \$ 131.4                  | \$ 233.3                      | \$ (12.5)                    | \$ 421.1            |
| Long-term debt   | 0.2               | 704.1             | 0.4                       | 916.9                         |                              | 1,621.6             |
| Deferred income taxes  | (15.6)            | 462.6             | 78.2                      | 129.3                         |                              | 654.5               |
| Other liabilities  | 4.2               | 150.1             | 0.3                       | 141.6                         | (66.2)                       | 230.0               |
| Stockholders' equity   | 2,431.7           | 175.4             | 9.2                       | 3,382.9                       | (3,568.1)                    | 2,431.1             |
| Noncontrolling interest                                      |                   |                   |                           | 282.6                         |                              | 282.6               |

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|                              |            |            |          |            |              |            |
|------------------------------|------------|------------|----------|------------|--------------|------------|
| Total liabilities and equity | \$ 1,857.7 | \$ 2,123.9 | \$ 219.5 | \$ 5,086.6 | \$ (3,646.8) | \$ 5,640.9 |
|------------------------------|------------|------------|----------|------------|--------------|------------|

**Table of Contents****Kansas City Southern****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS**

|  | Six Months Ended June 30, 2011 |          |                           |                               |                              |                     |
|--|--------------------------------|----------|---------------------------|-------------------------------|------------------------------|---------------------|
|  | Parent                         | KCSR     | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>KCS |
| <b><i>Operating activities:</i></b>      |                                |          |                           |                               |                              |                     |
| Net cash provided                        | \$ 1.7                         | \$ 100.2 | \$ 5.4                    | \$ 161.7                      | \$ (0.1)                     | \$ 268.9            |
| <b><i>Investing activities:</i></b>      |                                |          |                           |                               |                              |                     |
| Capital expenditures                     |                                | (86.7)   | (5.3)                     | (79.8)                        |                              | (171.8)             |
| Property investments in MSLLC            |                                |          |                           | (24.2)                        |                              | (24.2)              |
| Other investing activities               |                                | 1.1      |                           | 20.7                          | 0.1                          | 21.9                |
| Net cash used                            |                                | (85.6)   | (5.3)                     | (83.3)                        | 0.1                          | (174.1)             |
| <b><i>Financing activities:</i></b>      |                                |          |                           |                               |                              |                     |
| Proceeds from issuance of long-term debt |                                |          |                           | 200.0                         |                              | 200.0               |
| Repayment of long-term debt              |                                | (2.8)    | (0.1)                     | (206.7)                       |                              | (209.6)             |
| Other financing activities               | (1.7)                          |          |                           | (12.9)                        |                              | (14.6)              |
| Net cash used                            | (1.7)                          | (2.8)    | (0.1)                     | (19.6)                        |                              | (24.2)              |
| <b><i>Cash and cash equivalents:</i></b> |                                |          |                           |                               |                              |                     |
| Net increase                             |                                | 11.8     |                           | 58.8                          |                              | 70.6                |
| At beginning of year                     | 0.1                            |          |                           |                               |                              |                     |