

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

KANSAS CITY SOUTHERN

Form S-3/A

October 23, 2003

As filed with the Securities and Exchange Commission on October 23, 2003

Registration No. 333-107573

=====

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 3 TO
FORM S-3
REGISTRATION STATEMENT UNDER THE
SECURITIES ACT OF 1933

KANSAS CITY SOUTHERN
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

44-0663509
(IRS Employer
Identification No.)

427 WEST 12th STREET
KANSAS CITY, MISSOURI 64105
(816) 983-1303
(Address, Including Zip Code, and Telephone Number, Including Area Code,
of Registrant's Principal Executive Offices)

JAY M. NADLMAN, ESQ.
427 WEST 12TH STREET
KANSAS CITY, MISSOURI 64105
(816) 983-1384
(Name, Address, Including Zip Code, and Telephone Number, Including Area Code
of Agent for Service)

Copy to:
JOHN F. MARVIN, ESQ.
DIANE M. BONO, ESQ.
SONNENSCHNAIN NATH & ROSENTHAL LLP
4520 MAIN STREET, SUITE 1100
KANSAS CITY, MISSOURI 64111
(816) 460-2400

Approximate date of commencement of proposed sale to the public: From time
to time after this registration statement becomes effective.

If the only securities being registered on this form are being offered
pursuant to dividend or interest reinvestment plans, please check the following
box. []

If any of the securities being registered on this form are to be offered on
a delayed or continuous basis pursuant to Rule 415 under the Securities Act of
1933, other than securities offered only in connection with dividend or interest
reinvestment plans, check the following box. [X]

If this form is filed to register additional securities for an offering
pursuant to Rule 462(b) under the Securities Act, check the following box and

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

list the Securities Act registration statement number of earlier effective registration statement for the same offering. []

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. []

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. The selling stockholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

PRELIMINARY PROSPECTUS

Subject to Completion, Dated October 23, 2003

400,000 Shares of
KANSAS CITY SOUTHERN
4.25% REDEEMABLE CUMULATIVE CONVERTIBLE PERPETUAL PREFERRED STOCK, SERIES C
(LIQUIDATION PREFERENCE \$500 PER SHARE)
AND
13,389,120 SHARES OF COMMON STOCK (PAR VALUE \$0.01 PER SHARE)
ISSUABLE UPON CONVERSION OF THE
REDEEMABLE CUMULATIVE CONVERTIBLE PERPETUAL PREFERRED STOCK, SERIES C

This prospectus relates to the offering for resale of Kansas City Southern's 4.25% Redeemable Cumulative Convertible Perpetual Preferred Stock, Series C (liquidation preference \$500 per share), or "Series C Preferred Stock," and the shares of our common stock (including attached preferred stock purchase rights) issuable upon conversion of the Series C Preferred Stock. The Series C Preferred Stock was offered to qualified institutional buyers in reliance on Rule 144A in transactions exempt from the registration requirements of the Securities Act of 1933, through the initial purchasers, Morgan Stanley & Co. Incorporated and Deutsche Bank Securities Inc. This prospectus will be used by selling securityholders to resell their shares of Series C Preferred Stock and shares of our common stock issuable upon conversion of their Series C Preferred Stock. We will not receive any proceeds from sales by the selling

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

securityholders.

CONVERTIBILITY OF THE SERIES C PREFERRED STOCK

Holders may convert their Series C Preferred Stock into 33.4728 shares of our common stock only under certain circumstances related to: (i) the trading price of our common stock; (ii) a credit rating downgrade; (iii) the trading price per share of the Series C Preferred Stock; (iv) redemption of the Series C Preferred Stock; and (v) the occurrence of certain corporate transactions. The conversion rate may be adjusted upon the occurrence of certain events. There is no established trading market for the Series C Preferred Stock and we do not intend to list the Series C Preferred Stock on any national securities exchange. Our common stock is listed and traded on the New York Stock Exchange under the symbol "KSU." On October 22, 2003, the closing sale price of our common stock was \$12.80.

REDEMPTION OR REPURCHASE OF SERIES C PREFERRED STOCK

Subject to certain conditions, on or after May 20, 2008, we will have the option to redeem some or all of the shares of Series C Preferred Stock at a redemption price of 100% of the liquidation preference, plus accumulated and unpaid dividends, including special dividends, if any, to the redemption date. Under certain circumstances, we may be required to purchase shares of the Series C Preferred Stock at the option of the holder at a price equal to 100% of the liquidation preference plus any accumulated and unpaid dividends, including special dividends, if any, to, but excluding, the purchase date.

 INVESTING IN OUR SERIES C PREFERRED STOCK OR COMMON STOCK INVOLVSS RISKS. PLEASE READ CAREFULLY THE SECTION ENTITLED "RISK FACTORS" BEGINNING ON PAGE 12.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRRIMINAL OFFENSE.

THE DATE OF THIS PROSEPECTUS IS _____, 2003

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus.

TABLE OF CONTENTS

	PAGE

About this Prospectus.....	i
Prospectus Summary.....	1
Risk Factors.....	12
Use of Proceeds.....	35
Business	35
Description of the Acquisition.....	37

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

Description of the Series C Preferred Stock.....	52
Description of KCS Capital Stock.....	68
Description of Class A Convertible Common Stock.....	72
Certain United States Federal Tax Considerations.....	76
Selling Securityholders.....	79
Plan of Distribution.....	83
Financial Statements of Grupo TFM.....	85
Pro Forma Financial Information.....	86
Legal Matters.....	97
Experts	97
Where You Can Find More Information.....	97
Forward-Looking Statements.....	98

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission, or SEC, utilizing a "shelf" registration process or continuous offering process. Under this shelf registration process, the selling securityholders may, from time to time, sell the securities described in this prospectus in one or more offerings. This prospectus provides you with a general description of the securities which may be offered by the selling securityholders. Each time a selling securityholder sells securities, the selling securityholder is required to provide you with this prospectus and, in certain cases, a prospectus supplement containing specific information about the selling securityholder and the terms of the securities being offered. That prospectus supplement may include additional risk factors or other special considerations applicable to those securities. Any prospectus supplement may also add, update, or change information in this prospectus. If there is any inconsistency between the information in this prospectus and any prospectus supplement, you should rely on the information in that prospectus supplement. You should read both this prospectus and any prospectus supplement together with additional information described under "Where You Can Find More Information."

UNLESS WE HAVE INDICATED OTHERWISE, REFERENCES IN THIS PROSPECTUS TO "KCS" MEAN KANSAS CITY SOUTHERN (FORMERLY KANSAS CITY SOUTHERN INDUSTRIES, INC.) AND REFERENCES TO THE "COMPANY," "WE," "US," "OUR," AND SIMILAR TERMS REFER TO KCS AND OUR CONSOLIDATED SUBSIDIARIES, EXCLUDING THE DISCONTINUED OPERATIONS OF ITS FORMER FINANCIAL SERVICES BUSINESS STILWELL FINANCIAL, INC. (NOW KNOWN AS JANUS CAPITAL GROUP INC. ("JANUS")). UNLESS THE CONTEXT OTHERWISE REQUIRES, REFERENCES IN THIS PROSPECTUS TO "KCSR" MEAN THE KANSAS CITY SOUTHERN RAILWAY COMPANY, THE PRINCIPAL SUBSIDIARY OF KCS, AND INCLUDES FOR ALL PERIODS PRESENTED THE GATEWAY WESTERN RAILWAY COMPANY, WHICH WAS MERGED INTO KCSR EFFECTIVE OCTOBER 1, 2001. REFERENCES TO "TFM" AND "TEX-MEX" MEAN TFM, S.A. de C.V. AND THE TEXAS-MEXICAN RAILWAY COMPANY, RESPECTIVELY, AFFILIATES OF KCS. REFERENCES TO "GRUPO TFM" AND "MEXRAIL" MEAN GRUPO TRANSPORTACION FERROVIARIA MEXICANA, S.A. DE C.V. AND MEXRAIL, INC., RESPECTIVELY, THE PARENT COMPANIES OF TFM AND TEX-MEX, RESPECTIVELY. REFERENCES TO "GRUPO TMM" MEAN GRUPO TMM, S.A. (THE SURVIVING ENTITY IN A MERGER OF TRANSPORTACION MARITIMA MEXICANA, S.A. DE C.V. AND THE FORMER GRUPO SERVIA, S.A. DE C.V. AND WHICH, AFTER A REORGANIZATION THAT ELIMINATED THE VARIABLE PORTION OF GRUPO TMM, S.A. DE C.V. CAPITAL STOCK, BECAME A FIXED CAPITAL CORPORATION WITH THE NAME GRUPO TMM, S.A.), CURRENTLY A JOINT VENTURE PARTNER AND THE LARGEST SHAREHOLDER OF GRUPO TFM. REFERENCES TO "TMM HOLDINGS" AND "MULTIMODAL" MEAN TMM HOLDINGS, S.A. DE C.V. AND TMM MULTIMODAL, S.A. DE C.V., RESPECTIVELY, SUBSIDIARIES OF GRUPO TMM. REFERENCES TO "KARA SUB" MEAN KARA SUB, INC., A WHOLLY-OWNED SUBSIDIARY OF KCS. REFERENCES TO "NAFTA" MEAN THE NORTH AMERICAN FREE TRADE AGREEMENT.

PROSPECTUS SUMMARY

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

This summary may not contain all the information that may be important to you. You should read this entire prospectus and the documents to which we have referred you before making an investment decision. You should carefully consider the information set forth under "Risk Factors." In addition, certain statements include forward-looking information which involves risks and uncertainties. See "Forward-Looking Statements."

OUR COMPANY

We, along with our subsidiaries and affiliates, own and operate a uniquely positioned North American rail network strategically focused on the growing north/south freight corridor that connects key commercial and industrial markets in the central United States with major industrial cities in Mexico. KCS's principal subsidiary, KCSR, which was founded in 1887, is one of seven Class I railroads in the United States (railroads with annual revenues of at least \$250 million, as indexed for inflation). Our rail network (KCSR, TFM and Tex-Mex) is comprised of approximately 6,000 miles of main and branch lines. We have further expanded our rail network through marketing alliances and strategic alliances.

Our expanded network includes:

- o KCSR, which operates approximately 3,100 miles of main and branch lines running on a north/south axis from Kansas City, Missouri to the Gulf of Mexico and on an east/west axis from Meridian, Mississippi to Dallas, Texas (our "Meridian Speedway") and from Kansas City to East St. Louis, Illinois and Springfield, Illinois;
- o our affiliates, TFM, which operates approximately 2,650 miles of main and branch lines running from the U.S./Mexico border at Laredo, Texas to Mexico City and serves most of Mexico's principal industrial cities and three of its major shipping ports, and Tex-Mex, which operates a 160-mile rail line extending from Laredo to Corpus Christi, Texas;
- o a marketing agreement with Norfolk Southern Railway Company ("Norfolk Southern") that allows us to gain incremental traffic volume between the southeast and the southwest United States and a marketing agreement with I&M Rail Link, now known as IC&E, that provides us with access to Minneapolis and Chicago and to originations of corn and other grain in Iowa, Minnesota and Illinois;
- o a strategic alliance with Canadian National Railway Company ("CN") and Illinois Central Corporation ("IC," and together with CN, "CN/IC"), through which we have created a contiguous rail network of approximately 25,000 miles of main and branch lines connecting Canada, the United States and Mexico;
- o a joint marketing alliance, entered into in April 2002 with The Burlington Northern and Santa Fe Railway Company ("BNSF") aimed at promoting cooperation, revenue growth and extending market reach, principally to enhance chemical, grain and forest product traffic for both railroads in the United States and Canada. The marketing alliance is also expected to improve operating efficiencies for both carriers in key market areas, as well as provide customers with expanded service options; and
- o our affiliate, the Panama Canal Railway Company ("PCRC"), which holds the concession to operate the Panama Canal Railway, a 47-mile railroad located adjacent to the Panama Canal. This railroad has been reconstructed for the purpose of performing freight and passenger

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

operations. Its wholly-owned subsidiary, Panarail Tourism Company ("PTC"), operates a commuter and tourist railway service over the lines of the Panama Canal Railway.

COMPANY INFORMATION

KCS is incorporated in Delaware. Our principal executive offices are located at 427 West 12th Street, Kansas City, Missouri 64105. Our telephone number is 816-983-1303.

PROPOSED ACQUISITION

GENERAL

Since 1997, pursuant to a joint venture agreement, and other agreements, entered into by KCS and Grupo TMM, subsidiaries of KCS and Grupo TMM have owned, along with Mexican governmental agencies, interests in Grupo TFM, which is the owner of 80% of the voting stock of TFM. TFM holds the concession to operate, and operates, a major rail system in Mexico, formerly known as the "Northeast Rail Lines". In 1995, KCS acquired from Grupo TMM 49% of the stock of Mexrail, owner of 100% of the voting stock of Tex-Mex. Mexrail also owns the northern half of the international railway bridge at Laredo, Texas. Tex-Mex operates a 160 mile rail line from Laredo to Corpus Christi, Texas, which connects with the KCSR through trackage rights over the Union Pacific Railroad between Robbstown, Texas and Beaumont, Texas. In March, 2002, KCS and Grupo TMM sold their interests in Mexrail to TFM, with KCS receiving approximately \$31.4 million for its 49% interest in Mexrail. The structure of this ownership prior to the execution of the Acquisition Agreement (defined below) (with intermediate subsidiaries, other than KCSR, eliminated), including imputed ownership from TFM's ownership of 24.6% of Grupo TFM, appears in the following diagram:

[Organizational chart type diagram appears here showing ownership of Grupo TFM by KCS (46.6%, indirectly through its 100% ownership of KCSR) and Grupo TMM (48.5%) (including in both cases imputed ownership from TFM's ownership of 24.6% of Grupo TFM), Grupo TFM's ownership of 80% of TFM (with the other 20% held by the Mexican Government), TFM's ownership of 100% of Mexrail and Mexrail's ownership of 100% of Tex-Mex]

On April 20, 2003, KCS and Grupo TMM entered into separate agreements for the acquisition by KCS of control of TFM and Mexrail. On May 9, 2003, pursuant to the terms of a stock purchase agreement for KCS to acquire control of Mexrail (the "Stock Purchase Agreement"), KCS acquired from Grupo TMM (through its subsidiary, TFM) 51% of the shares of Mexrail for approximately \$32.7 million. KCS deposited the Mexrail shares into a voting trust pending resolution of KCS's

application to the Surface Transportation Board ("STB") seeking authority to exercise common control over Tex-Mex and KCS's other rail companies, KCSR and the Gateway Eastern Railway Company ("Gateway Eastern"). See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements" and "Description of the Acquisition--Regulatory Matters." On September 30, 2003, in accordance with the terms of the Stock Purchase Agreement, TFM reacquired the 51% interest in Mexrail from KCS at the purchase price paid to TFM by KCS in May 2003. Upon the repurchase of these Mexrail shares by TFM, the Stock Purchase Agreement automatically terminated. See "--Recent Developments," "Description of the Acquisition--Recent Developments," and "Description of the

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

Acquisition--Summary of the Acquisition Agreement and Related Agreements--The Stock Purchase Agreement."

Pursuant to the agreement for the acquisition of control of TFM (the "Acquisition") entered into on April 20, 2003 by KCS with Grupo TMM and other parties (the "Acquisition Agreement"), KCS will acquire all of the interest of Grupo TMM (held by its subsidiary, Multimodal) in Grupo TFM for \$200 million in cash and 18,000,000 shares of a new class of common securities of KCS, to be designated "Class A Convertible Common Stock." Grupo TFM owns an 80% economic interest in TFM and all of the shares of stock with full voting rights of TFM (the "TFM Voting Stock"). KCS has the right to elect to pay up to \$80 million of the cash portion of the purchase price by delivering up to 6,400,000 shares of KCS Class A Convertible Common Stock or KCS common stock. KCS and Grupo TMM are in dispute over Grupo TMM's attempt to terminate the Acquisition Agreement. See "--Recent Developments," "Description of the Acquisition--Recent Developments."

The following diagram illustrates the ownership structure resulting if the acquisition of TFM is completed (eliminating intermediate subsidiaries)

[Organizational chart type diagram appears here showing ownership by KCS (to be renamed "NAFTA Rail") of 100% of Grupo TFM, as well as KCS's 100% ownership of KCSR); Grupo TFM's ownership of 80% of TFM (with the other 20% held by the Mexican Government and footnoted with the information in (1) below), TFM's ownership of 100% of Mexrail and Mexrail's ownership of 100% of Tex-Mex]

(1) Limited Voting. Mexican government has certain "put" rights discussed under "Risk Factors--KCS Risk Factors--Risks Related to Our Business--We may be required to make additional investments in TFM" and "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--Agreement of Assignment and Assumption of Rights, Duties and Obligations."

In addition, provided the Acquisition has occurred and neither KCS nor any of its subsidiaries has purchased TFM shares held by the Mexican government upon exercise of the Mexican government's right to compel purchase of those shares (referred to as the "Put"), KCS will be obligated to pay to Grupo TMM an additional amount (referred to as the "VAT Contingency Payment") of up to \$180 million in cash in the event that a pending Value Added Tax claim (referred to as the "VAT Claim") against the Mexican government by TFM is successfully resolved and the amount received is greater than the purchase price of the Put. See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--The Acquisition Agreement--VAT Contingency Payment." Upon completion of the Acquisition, KCS will assume Grupo TMM's obligations to make any payment upon the exercise by the Mexican government of the Put and will indemnify Grupo TMM and its affiliates, and their respective officers, directors, employees and shareholders, against obligations or liabilities relating thereto. See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--Agreement of Assignment and Assumption of Rights, Duties and Obligations."

In connection with the Acquisition, KCS will enter into a consulting agreement with a consulting company organized by Jose Serrano Segovia pursuant to which it will provide consulting services to KCS in connection with the portion of the business of KCS in Mexico for a period of three years. As consideration for the services, the consulting company will receive an annual

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

fee of \$600,000 per year and a grant of 2,100,000 shares of restricted stock of KCS. The restricted stock will vest over a period of time subject to certain conditions. The consulting agreement may be extended for an additional year at the option of KCS, upon delivery of an additional 525,000 shares of restricted stock. See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--Consulting Agreement."

The obligations of KCS and Grupo TMM to complete the Acquisition are subject to a number of conditions. See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--The Acquisition Agreement--Conditions to Obligations to Complete the Acquisition."

RECENT DEVELOPMENTS

DISPUTE OVER ACQUISITION AGREEMENT

On August 18, 2003, Grupo TMM shareholders purportedly voted not to approve the sale of Grupo TMM's interests in Grupo TFM to KCS. On August 23, 2003, Grupo TMM sent a notice to KCS claiming to terminate the Acquisition Agreement, because the Grupo TMM shareholders had failed to approve the Acquisition Agreement.

On August 27, 2003, KCS announced that it had received notice from the Mexican Foreign Investment Commission of its decision to close the proceeding with respect to KCS's application to acquire control of Grupo TFM and, thus, TFM, without prejudice to refile in the event the dispute is resolved between KCS and Grupo TMM over whether the Acquisition Agreement remains in effect.

On August 29, 2003, KCS delivered to Grupo TMM a formal notice of dispute, referred to as the Notice of Dispute, pursuant to the Acquisition Agreement. This initiated a 60-day negotiation period between the parties. If the parties are unable to resolve the disputes within that period of time, KCS intends to initiate a binding arbitration in accordance with the terms of the Acquisition Agreement. In addition, on August 29, 2003, KCS filed a complaint in the

Delaware Chancery Court alleging that Grupo TMM had breached the Acquisition Agreement and seeking a final order requiring Grupo TMM not to sell Grupo TFM or take other actions outside of the ordinary course of business, so as to preserve the assets and business of TFM while the parties follow the dispute resolution procedures provided for in the Acquisition Agreement. The Notice of Dispute and complaint point out that the Acquisition Agreement does not provide that a negative shareholder vote by Grupo TMM shareholders is a basis for termination, and KCS maintains that the Acquisition Agreement is still valid and remains in effect until December 31, 2004.

On September 2, 2003, KCS filed in the Delaware Court of Chancery a motion for a preliminary injunction to preserve the parties' positions while KCS seeks to resolve its dispute over Grupo TMM's attempt to terminate the Acquisition Agreement. KCS asked for an expedited hearing on its motion for a preliminary injunction.

On September 15, 2003, KCS confirmed that negotiations with Grupo TMM have begun under the dispute resolution process contained in the Acquisition Agreement for Grupo TMM's interest in Grupo TFM. One meeting was held to discuss negotiations, but no further meetings have been held.

On October 22, 2003, KCS announced that Chancellor William B. Chandler III of the Delaware Court of Chancery has, in a ruling from the bench, stated his intention to grant KCS' motion seeking a preliminary injunction to preserve the parties' positions pending resolution of KCS' dispute with Grupo TMM.

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

REPURCHASE OF MEXRAIL SHARES BY TFM

On August 29, 2003, KCS received a demand for TFM to repurchase from KCS shares of Mexrail sold to KCS in May 2003. On September 23, 2003, the STB issued a decision finding no need to rule on the transfer back to TFM of the 51% interest in Mexrail that KCS acquired on May 9, 2003. The effect of the decision was to allow TFM to reacquire the shares in accordance with the Stock Purchase Agreement and KCS has abided by that agreement. The repurchase of Mexrail by TFM on September 30, 2003 returned 100% ownership of Mexrail to TFM and the Stock Purchase Agreement automatically terminated. The repurchase price was the price KCS paid TFM in May.

NOTICE OF TERMINATION OF JOINT VENTURE AGREEMENT

In addition, KCS acknowledged receipt from Grupo TMM of a notice to terminate a joint venture agreement between the parties entered into in 1995. Pursuant to such notice, the joint venture agreement will terminate on December 1, 2003. The joint venture agreement provides that upon its termination, the joint venture shall be liquidated and any assets held in the name of the joint venture shall be distributed proportionally to KCS and Grupo TMM. There are no significant assets held by the joint venture and KCS does not expect the termination of the joint venture agreement to have a material adverse effect on KCS.

STB REVIEW STATUS

On September 23, 2003, the STB entered an order asking all interested parties to file comments by September 30, 2003 addressing whether "in light of recent developments" the STB should continue with the procedural schedule, which called for a decision on the merits to be issued by October 17, 2003. On September 30, 2003, KCS filed comments with the STB suggesting that STB precedent establishes that the STB has sufficient jurisdiction to rule on control applications even where closing on the underlying transaction has been put in doubt. In the alternative, KCS argued that the matter should be held in abeyance, rather than dismissed, until the arbitration is completed. On October 8, 2003, the STB issued an order suspending the procedural schedule pending a resolution of the uncertainties that now surround KCS's efforts to acquire control of Tex-Mex, and requiring KCS to file status reports regarding developments in its efforts to acquire control of TFM and Tex-Mex.

THE OFFERING

On May 5, 2003, we completed a private offering of the Series C Preferred Stock. We entered into a registration rights agreement with the initial purchasers in the private offering in which we agreed, for the benefit of the holders of the Series C Preferred Stock, to file a registration statement with the SEC by August 3, 2003 with respect to resales of the Series C Preferred Stock and common stock issued upon the conversion of the Series C Preferred Stock. We also agreed to use our best efforts to cause the shelf registration statement to be declared effective under the Securities Act of 1933 by November 1, 2003 and to keep the shelf registration statement effective until the earlier of (i) the sale to the public pursuant to Rule 144 (or any similar provision then in force, but not Rule 144A) under the Securities Act or the registration statement of which this prospectus forms a part of all the securities registered thereunder, and (ii) the expiration of the holding period applicable to such securities held by persons that are not our affiliates under Rule 144(k) under the Securities Act or any successor provision, subject to permitted exceptions.

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

Securities offered..... 400,000 shares of Series C Preferred Stock.

Liquidation preference..... \$500 per share of Series C Preferred Stock.

Dividends..... Holders of Series C Preferred Stock are entitled to receive, when, as and if, declared by our board of directors, out of funds legally available therefor, cash dividends at the rate of 4.25% per annum payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year, commencing August 15, 2003. Dividends on the Series C Preferred Stock will be cumulative from the date of initial issuance. Accumulated but unpaid dividends cumulate dividends at the annual rate of 4.25%.

We will also pay "special dividends" if we fail to comply with certain obligations under the registration rights agreement discussed above.

For so long as the Series C Preferred Stock remains outstanding, (1) we will not declare, pay or set apart funds for the payment of any dividend or other distribution with respect to any junior stock or parity stock and (2) neither we, nor any of our subsidiaries will, subject to certain exceptions, redeem, purchase or otherwise acquire for consideration junior stock or parity stock through a sinking fund or otherwise, in each case unless we have paid or set apart funds for the payment of all accumulated and unpaid dividends, including special dividends, if any, with respect to the shares of Series C Preferred Stock and any parity stock for all preceding dividend periods. See "Description of the Series Preferred Stock-- Dividends."

Conversion..... A holder may convert its Series C Preferred Stock into a number of shares of our common stock equal to the conversion rate only under the following circumstances:

- o in any fiscal quarter commencing after June 30, 2003 if the closing sale price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is more than 110% of the initial conversion price (initially 110% of \$14.9375, or \$16.4313);
- o after the earlier of (1) the date the Series C Preferred Stock is assigned a credit rating by both Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. and its successors ("S&P") and Moody's Investor Services and its

successors ("Moody's") and (2) May 31, 2003, during any period in which the credit rating assigned to the Series C Preferred Stock by S&P is below CCC, or the credit rating assigned to the Series C Preferred Stock by Moody's is below Caa3, or no rating is assigned to the Series C Preferred Stock by either S&P or Moody's or any rating is suspended or withdrawn by either S&P or Moody's;

- o during the five business day period after any five consecutive trading day period in which the trading price per share of Series C Preferred Stock for each day of that period was less than 98% of the product of the closing sale price of our common stock and the conversion rate on each such day;
- o if the Series C Preferred Stock has been called for redemption; or
- o upon the occurrence of certain corporate transactions described under "Description of the Series C Preferred Stock--Conversion Rights--Conversion Upon Occurrence of Certain Corporate Transactions."

For each share of Series C Preferred Stock surrendered for conversion, a holder will receive 33.4728 shares of our common stock. This represents an initial conversion price of \$14.9375 per share of common stock. The conversion rate may be adjusted for certain reasons, but will not be adjusted for accumulated and unpaid dividends or special dividends, if any. Upon conversion, holders will not receive any cash payment representing accumulated dividends, if any. Instead, accumulated dividends, if any, will be deemed paid by the common stock received by holders on conversion.

Optional redemption.....We may not redeem any shares of Series C Preferred Stock at any time before May 20, 2008. On or after May 20, 2008, we may redeem some or all of the Series C Preferred Stock at a redemption price equal to 100% of the liquidation preference, plus accumulated but unpaid dividends, including special dividends, if any, to the redemption date, but only if the closing sale price of our common stock for 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date we give the redemption notice exceeds 135% of the conversion price of the Series C Preferred Stock, subject to adjustment in a number of circumstances as described under "Description of the Series C Preferred Stock--Adjustments to the Conversion Rate." We may choose to pay the redemption price in cash,

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

common stock, or a combination of cash and common stock. If we elect to pay all or a portion of the redemption price in shares of common stock, the common stock will be valued at a discount of 2.5% below the average of the closing sale prices for the five trading days ending on the third trading day prior to the redemption date. The terms of our debt instruments and/or bank facilities currently restrict our ability to redeem shares of Series C Preferred Stock for cash.

If full cumulative dividends on the Series C Preferred Stock have not been paid, the Series C Preferred Stock may not be redeemed and we may not purchase or acquire any shares of Series C Preferred Stock otherwise than pursuant to a purchase or exchange offer made on the same terms to all holders of Series C Preferred Stock.

The Series C Preferred Stock is not subject to any mandatory redemption or sinking fund provision.

Fundamental change..... If we become subject to a fundamental change, each holder of shares of Series C Preferred Stock will have the right to require us to purchase any or all of its shares at a purchase price equal to 100% of the liquidation preference, plus accumulated and unpaid dividends, including special dividends, if any, to the date of purchase. We may choose to pay the purchase price in cash, common stock, or a combination of cash and common stock. If we elect to pay all or a portion of the purchase price in shares of common stock, the common stock will be valued at a discount of 2.5% below the average of the closing sale prices for the five trading days ending on the third trading day prior to the purchase date. Our ability to purchase all or a portion of Series C Preferred Stock for cash is subject to our obligation to repay or repurchase any outstanding debt required to be repaid or repurchased in connection with a fundamental change and to any contractual restrictions then contained in our debt. If, following a fundamental change, we are prohibited from paying the purchase price of the Series C Preferred Stock in cash under the terms of our debt instruments, but are not prohibited under applicable law from paying such purchase price in shares of our common stock, we will pay the purchase price of the Series C Preferred Stock in shares of our common stock.

Voting rights..... Holders of Series C Preferred Stock do not have any voting rights except as set forth below, as specifically provided for in our restated certificate of incorporation or as otherwise from time to time required by law. Whenever (1) dividends on the Series C Preferred Stock or any

other class or series of stock ranking on a parity with the Series C Preferred Stock with respect to the payment of dividends are in arrears for dividend periods, whether or not consecutive, containing in the aggregate a number of days equivalent to six calendar quarters, or (2) we fail to pay the redemption price on the date shares of Series C Preferred Stock are called for redemption or the purchase price on the purchase date for shares of Series C Preferred Stock following a fundamental change, then, in each case, the holders of Series C Preferred Stock (voting separately as a class with all other series of Series C Preferred Stock upon which like voting rights have been conferred and are exercisable) will be entitled to vote for the election of two of the authorized number of our directors at the next annual meeting of stockholders and at each subsequent meeting until all dividends accumulated on the Series C Preferred Stock have been fully paid or set apart for payment. The term of office of all directors elected by the holders of Series C Preferred Stock will terminate immediately upon the termination of the rights of the holder of Series C Preferred Stock to vote for directors. Holders of shares of Series C Preferred Stock will have one vote for each share of Series C Preferred Stock held.

Ranking..... The Series C Preferred Stock are, with respect to dividend rights and rights upon liquidation, winding up or dissolution:

- o junior to all our existing and future debt obligations;
- o junior to our \$25 par value preferred stock and each other class or series of our capital stock other than (a) our common stock and any other class or series of our capital stock the terms of which provide that such class or series will rank junior to the Series C Preferred Stock and (b) any other class or series of our capital stock the terms of which provide that such class or series will rank on a parity with the Series C Preferred Stock;
- o on a parity with any other class or series of our capital stock the terms of which provide that such class or series will rank on a parity with the Series C Preferred Stock;
- o senior to our common stock and any other class or series of our capital stock the terms of which provide that such class or series will rank junior to the Series C Preferred Stock; and
- o effectively junior to all of our

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

subsidiaries' (i) existing and future liabilities and (ii) capital stock held by others.

Trading..... We do not intend to list the Series C Preferred Stock on any national securities exchange.

NYSE symbol for our common stock..... Our common stock is traded on the New York Stock Exchange under the symbol "KSU."

On September 24, 2003, KCS announced that its Board of Directors declared a cash dividend of \$5.3125 per share on its outstanding Series C Preferred Stock. The dividend will be payable on November 17, 2003, to stockholders of record at the close of business on November 3, 2003.

RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS

For purposes of determining the ratio of earnings to combined fixed charges and preferred dividends, earnings are defined as (i) the sum of (a) pretax income from continuing operations before adjustment for minority interests in consolidated subsidiaries or income or loss from equity investees, (b) fixed charges, (c) amortization of capitalized interest, (d) distributed income of equity investees, and (e) our share of pretax losses of equity investees for which charges arising from guarantees are included in fixed charges, less (ii) the sum of (x) interest capitalized, (y) preference security dividend requirements of consolidated subsidiaries, and (z) the minority interest in pretax income of subsidiaries that have not incurred fixed charges. Fixed charges consist of interest (whether expensed or capitalized), amortized premiums, discounts and capitalized expenses related to indebtedness, and estimate of the interest within rental expense, and preference security dividend requirements of consolidated subsidiaries. Preference security dividend consists of the amount of pretax earnings that is required to pay the dividends on outstanding preference securities.

	SIX MONTHS ENDED JUNE 30,	YEAR ENDED DECEMBER		
	2003	2002	2001	2000
Ratio of earnings to combined fixed charges and preferred dividends	0.95	1.28	1.07	1.03

The ratio of earnings to fixed charges for June 30, 2003 would have been 1:1 if a deficiency of \$1.7 million was eliminated.

RISK FACTORS

An investment in the Series C Preferred Stock or the underlying common stock involves certain risks that a potential investor should carefully evaluate

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

prior to making an investment in the Series C Preferred Stock. See "Risk Factors."

RISK FACTORS

KCS RISK FACTORS

RISKS RELATED TO THE SERIES C PREFERRED STOCK

THE SERIES C PREFERRED STOCK RANKS JUNIOR TO ALL OF OUR LIABILITIES AND TO OUR \$25 PAR VALUE PREFERRED STOCK.

The Series C Preferred Stock ranks junior to all of our liabilities. The Series C Preferred Stock also ranks junior to our \$25 par value preferred stock ("Preferred Stock"). In the event of our bankruptcy, liquidation or winding-up, our assets will be available to pay obligations on the Series C Preferred Stock, including the purchase of your shares of the Series C Preferred Stock for cash upon a change in control, only after all our indebtedness and other liabilities and our Preferred Stock have been paid. In addition, the Series C Preferred Stock will effectively rank junior to all existing and future liabilities of our subsidiaries and any capital stock of our subsidiaries held by others. The rights of holders of the Series C Preferred Stock to participate in the distribution of assets of our subsidiaries will rank junior to the prior claims of that subsidiary's creditors and any other equity holders. As of March 31, 2003, we had total consolidated liabilities of approximately \$1.3 billion. Consequently, if we are forced to liquidate our assets to pay our creditors, we may not have sufficient assets remaining to pay amounts due on any or all of the Series C Preferred Stock then outstanding. We and our subsidiaries may incur substantial amounts of additional debt and other obligations that will rank senior to the Series C Preferred Stock.

WE MAY NOT BE ABLE TO PAY THE PURCHASE PRICE OF THE SERIES C PREFERRED STOCK IN CASH UPON A FUNDAMENTAL CHANGE. WE ALSO COULD BE PREVENTED FROM PAYING DIVIDENDS ON SHARES OF THE SERIES C PREFERRED STOCK.

In the event of a fundamental change you will have the right to require us to purchase all your shares of Series C Preferred Stock. We may pay the purchase price in cash, shares of our common stock, or a combination thereof. However, we may not have sufficient cash to purchase your shares of Series C Preferred Stock upon a fundamental change or may in certain circumstances either be forced to pay the purchase price in shares of our common stock or may be unable to pay the purchase price in cash or may be legally prohibited from paying the purchase price in shares of our common stock.

Under the terms of our current debt instruments we are prohibited from paying the purchase price of the Series C Preferred Stock in cash. Even if the terms of the instruments governing our indebtedness allow us to pay cash dividends and to redeem and purchase the Series C Preferred Stock in cash, we can only make such payments from legally available funds, as determined by our board of directors, and such funds may not be available to pay cash dividends to you or to redeem or purchase your shares of Series C Preferred Stock.

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

In addition, because we are a holding company, our ability to purchase the Series C Preferred Stock for cash or to pay dividends on the Series C Preferred Stock may be limited by restrictions on our ability to obtain funds for such repurchase through dividends from our subsidiaries.

YOU MAY BE UNABLE TO CONVERT THE SERIES C PREFERRED STOCK INTO OUR COMMON STOCK AND, IF YOU ARE ABLE AND DO CONVERT, YOU WILL EXPERIENCE IMMEDIATE DILUTION.

You may convert your shares of Series C Preferred Stock into common stock only if (1) the closing sale price of our common stock reaches, or the trading price of the Series C Preferred Stock falls below, specified thresholds, (2) the Series C Preferred Stock is called for redemption, (3) specified corporate transactions have occurred or (4) upon certain credit downgrade events. Your inability to convert the Series C Preferred Stock may adversely affect its value.

If you convert your shares of Series C Preferred Stock into shares of common stock, you will experience immediate dilution because the per share

conversion price of the Series C Preferred Stock immediately after this offering will be higher than the net tangible book value per share of the outstanding common stock. In addition, you will also experience dilution when and if we issue additional shares of common stock, which we may be required to issue pursuant to the Acquisition or related ancillary agreements or otherwise issue pursuant to options, warrants, our stock option plan or other employee or director compensation plans.

THE PRICE OF OUR COMMON STOCK, AND THEREFORE OF THE SERIES C PREFERRED STOCK, MAY FLUCTUATE SIGNIFICANTLY, WHICH MAY MAKE IT DIFFICULT FOR YOU TO RESELL THE SERIES C PREFERRED STOCK, OR COMMON STOCK ISSUABLE UPON CONVERSION OF THE SERIES C PREFERRED STOCK, WHEN YOU WANT OR AT PRICES YOU FIND ATTRACTIVE.

The price of our common stock on the New York Stock Exchange constantly changes. We expect that the market price of our common stock will continue to fluctuate. Because the Series C Preferred Stock is convertible into our common stock, volatility or depressed prices for our common stock could have a similar effect on the trading price of the Series C Preferred Stock. Holders who have received common stock upon conversion will also be subject to the risk of volatility and depressed prices.

Our stock price can fluctuate as a result of a variety of factors, many of which are beyond our control. These factors include:

- o quarterly variations in our operating results;
- o operating results that vary from the expectations of management, securities analysts and investors;
- o changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- o developments generally affecting our industry;
- o announcements by us or our competitors of significant contracts, acquisitions, joint marketing relationships, joint ventures or capital commitments;
- o announcements by third parties of significant claims or proceedings against us;

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

- o our dividend policy;
- o future sales of our equity or equity-linked securities;
- o our dispute with Grupo TMM over Grupo TMM's attempt to terminate the Acquisition Agreement; and
- o general domestic and international economic conditions.

In addition, the stock market in general has experienced extreme volatility that has often been unrelated to the operating performance of a particular company. These broad market fluctuations may adversely affect the market price of our common stock.

THE TRADING PRICE FOR THE SERIES C PREFERRED STOCK WILL BE DIRECTLY AFFECTED BY THE TRADING PRICES FOR OUR COMMON STOCK, WHICH IS IMPOSSIBLE TO PREDICT.

The price of our common stock could be affected by possible sales of our common stock by investors who view the Series C Preferred Stock as a more attractive means of equity participation in KCS and by hedging or arbitrage activity that may develop involving the common stock. The arbitrage could, in turn, affect the trading prices of the Series C Preferred Stock.

OUR RIGHTS AGREEMENT AND AMENDED CHARTER DOCUMENTS MAY MAKE IT HARDER FOR OTHERS TO OBTAIN CONTROL OF US EVEN IF SOME STOCKHOLDERS MIGHT CONSIDER SUCH A DEVELOPMENT FAVORABLE, WHICH MAY ADVERSELY AFFECT OUR STOCK PRICE.

Our rights agreement and provisions of our amended and restated certificate of incorporation and our by-laws may delay, inhibit or prevent someone from gaining control of us through a tender offer, business combination, proxy contest or some other method even if some of our stockholders might believe a change in control is desirable.

ISSUANCE OF CLASS A CONVERTIBLE COMMON STOCK AND COMMON STOCK IN CONNECTION WITH THE ACQUISITION COULD CAUSE THE PRICE OF OUR COMMON STOCK TO FALL.

Under the terms of the Acquisition Agreement, KCS, at its option, may elect to pay up to \$80 million of the \$200 million cash consideration for the Grupo TFM shares by delivering a number of shares of common stock or Class A Convertible Common Stock determined by dividing the amount that KCS elects to pay other than in cash by \$12.50. Assuming KCS elects to pay \$80 million in this manner, KCS would deliver 6,400,000 shares. In addition, shares of KARA Sub purchased by Multimodal during the course of the Acquisition shall be automatically converted into 18,000,000 shares of our Class A Convertible Common Stock upon the successful completion of the Acquisition. The Class A Convertible Common Stock will be convertible into an equal number of shares of common stock at any time, upon the option of holders, and mandatorily, upon the occurrence of certain conditions.

In connection with the Acquisition, KCS will enter into a consulting agreement pursuant to which 2,100,000 shares of restricted common stock will be granted to the consulting firm. The restricted common stock, subject to certain performance conditions under the consulting agreement, will vest over the course of three years following the date the Acquisition is consummated. If KCS, in its sole discretion, chooses to extend the consulting agreement at the end of its three-year term, an additional 525,000 shares of restricted common stock will be

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

granted and will immediately vest.

KCS will, pursuant to a registration rights agreement, be obligated to register the shares of common stock issued upon conversion of the Class A Convertible Common Stock, pursuant to the Acquisition Agreement to the extent that KCS elects to pay a portion of the cash consideration through the issuance of shares of common stock, pursuant to the consulting agreement, or otherwise acquired by Grupo TMM, TMM Holdings, Multimodal, certain Grupo TMM stockholders or any of their respective affiliates upon the exercise of pre-emptive rights in compliance with the Stockholders' Agreement.

We cannot predict whether any actual or potential increase in availability of our common stock for sale as a result of these transactions will adversely affect the market price of our common stock.

OUR ABILITY TO PAY DIVIDENDS MAY BE LIMITED, AND WE DO NOT ANTICIPATE PAYING CASH DIVIDENDS ON OUR COMMON STOCK IN THE FORESEEABLE FUTURE.

We are restricted in our ability to pay dividends to the holders of our common stock by the terms of our outstanding Series C Preferred Stock and our credit facilities and senior notes. In the future, we may agree to further restrictions on our ability to pay dividends. In addition, to maintain our credit ratings, we may be limited in our ability to pay dividends so that we can maintain an appropriate level of debt. During the first quarter of 2000, our board of directors suspended our common stock dividends. We do not anticipate making any cash dividend payments to our common stockholders for the foreseeable future.

SUBSTANTIAL SALES OF OUR COMMON STOCK COULD ADVERSELY AFFECT OUR STOCK PRICE. SALES OF SUBSTANTIAL AMOUNTS OF OUR COMMON STOCK IN THE PUBLIC MARKET COULD ADVERSELY AFFECT THE PREVAILING MARKET PRICE OF OUR COMMON STOCK.

Commencing July 29, 2003, an additional 5,384,883 shares beneficially owned by our executive officers and directors became freely tradeable upon the expiration of agreements not to sell such shares, subject to compliance with Rule 144 under the Securities Act of 1933. In addition, as of June 30, 2003, we had 1,188,020 remaining shares of common stock reserved for issuance under our stock option plan. Sales of common stock by stockholders upon expiration of the lock-up agreements, exercise of their options, or the perception that such sales could occur, may adversely affect the market price of our common stock.

WE HAVE PROVISIONS IN OUR CHARTER, BYLAWS AND RIGHTS AGREEMENT THAT COULD DETER, DELAY OR PREVENT A THIRD PARTY FROM ACQUIRING US AND THAT COULD DEPRIVE YOU OF AN OPPORTUNITY TO OBTAIN A TAKEOVER PREMIUM FOR SHARES OF OUR COMMON STOCK.

We have provisions in our charter and bylaws that may delay or prevent unsolicited takeover bids from third parties. These provisions may deprive our stockholders of an opportunity to sell their shares at a premium over prevailing market prices. For example, our restated certificate of incorporation provides for a classified board of directors. It further provides that the vote of 70% of the shares entitled to vote in the election of directors is required to amend our restated certificate of incorporation to increase the number of directors to more than eighteen, abolish cumulative voting for directors and abolish the classification of the board. The same vote requirement is imposed by our restated certificate of incorporation on certain transactions involving mergers, consolidations, sales or leases of assets with or to certain owners of more than 5% of our outstanding stock entitled to vote in the election of directors. Our

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

bylaws provide that a stockholder must provide us with advance written notice of its intent to nominate a director or raise a matter at an annual meeting. In addition, we have adopted a rights agreement which under certain circumstances would significantly impair the ability of third parties to acquire control of us without prior approval of our board of directors.

RISKS RELATED TO OUR BUSINESS

WE MAY BE REQUIRED TO MAKE ADDITIONAL INVESTMENTS IN TFM.

The Mexican government has the right to sell its 20% interest in TFM through a public offering on October 31, 2003 (or prior to October 31, 2003, with the consent of Grupo TFM). If, on October 31, 2003, the Mexican government has not sold all of its capital stock in TFM, Grupo TFM is obligated to purchase the capital stock at the initial share price paid by Grupo TFM plus interest computed at the Mexican Base Rate, published by Banco de Mexico. In the event that Grupo TFM does not purchase the Mexican government's 20% interest in TFM, Grupo TMM, and we, or either of us alone, will be obligated to purchase the Mexican government's remaining interest in TFM. If the Acquisition is completed, we will be solely responsible for purchasing the Mexican government's 20% interest in TFM. If we had been required to purchase this interest as of June 30, 2003, the total purchase price would have been approximately \$490.9 million and as of that date, based on publicly available financial information about Grupo TMM, Grupo TMM did not appear to have the financial resources to complete its share of the purchase. Grupo TMM disclosed in its Form 20-F for the year ended December 31, 2002, that it did not at the time of the filing have sufficient resources to acquire the Mexican government's interest if required to do so.

WE ARE VULNERABLE TO INCREASES IN FUEL COSTS AND DECREASES IN FUEL SUPPLIES. ANY SIGNIFICANT INCREASE IN THE COST OF FUEL, OR SEVERE DISRUPTION OF FUEL SUPPLIES, WOULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OEPRATIONS AND FINANCIAL CONDITION.

We incur substantial fuel costs in our railroad operations. During the three-year period ended December 31, 2002, locomotive fuel expenses represented an average of 8.7% of KCSR's total operating costs. Fuel costs are affected by traffic levels, efficiency of operations and equipment, and petroleum market conditions. The supply and cost of fuel is subject to market conditions and is influenced by numerous factors beyond our control, including general economic conditions, world markets, government programs and regulations and competition. Fuel represented 7.7% of total KCSR operating costs in 2002. We attempt to minimize the effects of fuel price fluctuations through forward purchase contracts and hedging agreements, but cannot guarantee that those arrangements will be beneficial to us. Any significant increase in the cost of fuel could have a material adverse effect on our business, results of operations and financial condition. During the first quarter of 2003, average fuel prices were 43% higher than in the first quarter of 2002. Our operations, as well as those of our competitors, could also be affected by any limitation in the fuel supply or by any imposition of mandatory allocation or rationing regulations. In the event of a severe disruption of fuel supplies resulting from supply shortages, political unrest, war or otherwise, the operations of rail and truck carriers, including us, could be adversely affected.

ONE OF OUR COAL CUSTOMERS ACCOUNTS FOR APPROXIMATELY 11% OF KCS'S TOTAL

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

REVENUES.

Our largest coal customer, Southwestern Electric Power Company ("SWEPCO"), a subsidiary of American Electric Power Company, Inc., accounted for approximately 64% of our coal revenues and approximately 11% of KCS's total revenues for the year ended December 31, 2002. The loss of all or a significant part of SWEPCO's business, or a service outage at one or both of SWEPCO's facilities that we serve, could materially adversely affect our financial condition and results of operations.

WE ARE SUBJECT TO EXTENSIVE RAILROAD INDUSTRY REGULATION AND RELY UPON UNIONIZED LABOR.

Labor relations in the U.S. railroad industry are subject to extensive governmental regulation under the Railway Labor Act. Railroad industry personnel are covered by the Railroad Retirement Act instead of the Social Security Act and by the Federal Employers' Liability Act rather than state workers' compensation systems. These federal labor regulations are often more burdensome and expensive than regulations governing other industries and may place us at a competitive disadvantage relative to other industries that are not subject to these regulations.

Approximately 84% of KCSR employees are covered under various collective bargaining agreements. Periodically, the collective bargaining agreements with the various unions become eligible for re-negotiation. In 1996, national labor contracts governing KCSR were negotiated with all major railroad unions, including the United Transportation Union ("UTU"), the Brotherhood of Locomotive Engineers, the Transportation Communications International Union ("TCU"), the Brotherhood of Maintenance of Way Employees ("BMWE"), and the International Association of Machinists and Aerospace Workers. In August 2002, a new labor contract was reached with the UTU. The provisions of this agreement include the use of remote control locomotives in and around terminals and retroactive application of wage increases back to July 1, 2002. Also, a new labor contract has been reached with the TCU which was signed on January 23, 2003. A new labor contract was reached with the BMWE effective May 31, 2001. Formal negotiations to enter into new agreements are in progress with the other unions and the 1996 labor contracts will remain in effect until new agreements are reached. The wage increase elements of these new agreements may have retroactive application. Management has reached new agreements with all but one of the unions relating to the former Gateway Western. Gateway Western was merged into KCSR on October 1, 2001. Similarly, management has reached new agreements with all but one of the unions relating to the former MidSouth Railroad ("MidSouth") employees (MidSouth was merged into KCSR on January 1, 1994). Discussions with these unions are ongoing. The provisions of the various labor agreements generally include periodic general wage increases, lump-sum payments to workers and greater work

rule flexibility, among other provisions. Management does not expect that the negotiations or the resulting labor agreements will have a material impact on our consolidated results of operations, financial condition or cash flows.

We may be subject to work stoppages in the future as a result of labor disputes and may be subject to terms and conditions in amended or future labor agreements that could have a material adverse affect on our results of operations, financial position and cash flows. Railroads continue to be restricted by certain remaining restrictive work rules, and are thus prevented from achieving optimum productivity with existing technology and systems.

UTILITY INDUSTRY DEREGULATION MAY REDUCE OUR COAL FREIGHT REVENUES OR MARGINS.

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

Historically, coal has been an important commodity handled by us. In 2002, coal revenues comprised approximately 18.1% of KCSR's total carload revenues, all of which result from deliveries to utility customers. The utility industry is undergoing a process of deregulation which will likely cause utilities to become more competitive and thus more aggressive in negotiating with coal transportation companies to reduce costs. This could create downward pressure on utility coal transportation rates and increase service requirements. Additionally, there can be no assurance that negotiated coal transportation rates will remain at current levels in the future. Continuing competitive pressures, lower coal transportation rates and declining margins could have a material adverse effect on our business, financial condition and results of operations.

Utilities will also have greater flexibility in selling electricity to, and buying electricity from, other regional markets. This could have a material adverse effect on our utility customers if such customers are not able to compete effectively with new utility companies that enter their respective markets. As a result, the pattern of coal shipments in a particular market may shift to an alternative utility company that does not use us to deliver its coal requirements. While we are working to help our utility customers remain competitive in this evolving environment, changes in the pattern of coal movements could have a material adverse impact on our business, financial condition and results of operations.

IF THE PROPOSED MERGER OF TWO MEXICAN TRUNK LINE RAILROADS IS CONSUMMATED, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON THE VALUE OF OUR INVESTMENT IN GRUPO TFM.

Grupo Carso, S.A. de C.V. and Grupo Mexico, S.A. de C.V. announced their intention to merge the Mexican main line railroads, Ferrosur, S.A. de C.V. ("Ferrosur") and Ferrocarril Mexicano, S.A. de C.V. ("Ferromex"). Ferrosur and Ferromex are two of the three main line railroads created out of the privatization of the Mexican National Railway System. Our affiliate, TFM, is the third. Approval of the proposed merger was denied by the Mexican Federal Competition Commission, as was Ferrosur-Ferromex's motion to reconsider. Ferromex has filed an appeal (amparo) from the decision of the Mexican Federal Competition Commission's decision that is still pending before the courts. Should the decision of the Mexican Federal Competition Commission be reversed on grounds that allow the proposed merger to go forward, and should the proposed merger be consummated, it could have a material adverse effect on the value of our investment in Grupo TFM.

WE MAY BE ADVERSELY AFFECTED BY CHANGES IN GENERAL ECONOMIC, WEATHER OR OTHER CONDITIONS.

Our operations may be adversely affected by changes in the economic conditions of the industries and geographic areas that produce and consume the freight that we transport. The relative strength or weakness of the United States economy as well as various international and regional economies also affects the businesses served by us. Grupo TFM, Panama Canal Railway Company and Panarail Tourism Company are more directly affected by their respective local economy. Historically, a stronger economy has resulted in improved results for our rail transportation operations. Conversely, when the economy has slowed, results have been less favorable. Our revenues may be affected by prevailing economic conditions and, if an economic slowdown or recession occurs in our key markets, the volume of rail shipments is likely to be reduced. Additionally, our operations may be affected by adverse weather conditions. A weak harvest in the Midwest, for example, may substantially reduce the volume of business we

traditionally handle for our agricultural products customers. Additionally, many

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

of the goods and commodities we carry experience cyclical demand. Our results of operations can be expected to reflect this cyclical demand because of the significant fixed costs inherent in railroad operations. Our operations may also be affected by natural disasters or terrorist acts. Significant reductions in our volume of rail shipments due to economic, weather or other conditions could have a material adverse effect on our business, financial condition and results of operations.

OUR OPERATING RESULTS AND FINANCIAL CONDITION WILL DEPEND ON EXECUTION OF OUR BUSINESS STRATEGY. IF WE FAIL TO EXECUTE OUR BUSINESS STRATEGY, IT MAY NEGATIVELY IMPACT OUR FINANCIAL CONDITION.

Our operating results and financial condition will depend in large measure on our ability to successfully execute our business strategy. Our business strategy includes capitalizing on NAFTA trade to generate traffic and increase revenues, exploiting our domestic opportunities, establishing new and expanding existing strategic alliances and marketing agreements, and providing superior customer service. Successful implementation of this strategy depends on many factors, including factors beyond our control. There can be no assurance that we will be able to implement our strategy on a timely basis or at all or that, if implemented, such strategy will achieve the desired results.

WE COMPETE AGAINST OTHER RAILROADS, TRUCK CARRIERS AND OTHER MODES OF TRANSPORTATION.

If we are unable to compete successfully, it could have a material adverse effect on our business, financial condition and results of operations.

Our rail operations compete against other railroads, many of which are much larger and have significantly greater financial and other resources than us. Since 1994, there has been significant consolidation among major North American rail carriers. As a result of this consolidation, the railroad industry is now dominated by a few "mega-carriers." We believe that our revenues were negatively affected by the merger of Burlington Northern, Inc. and Santa Fe Pacific Corporation in 1995 (forming BNSF), the merger of the Union Pacific Railroad Company ("UP") with the Chicago and North Western Transportation Company in 1995 and the merger of the UP and the Southern Pacific Rail Corporation in 1996, which led to diversions of rail traffic away from our lines. We also regard the larger western railroads (BNSF and UP), in particular, as significant competitors to our operations and prospects because of their substantial resources.

Truck carriers have eroded the railroad industry's share of total transportation revenues. Changing regulations, subsidized highway improvement programs and favorable labor regulations have improved the competitive position of trucks in the United States as an alternative mode of surface transportation for many commodities. In the United States, the trucking industry generally is more cost and transit-time competitive than railroads for short-haul distances. We are also subject to competition from barge lines and other maritime shipping. Mississippi and Missouri River barge traffic, among others, compete with us in the transportation of bulk commodities such as grains, steel and petroleum products.

Increased competition has resulted in downward pressure on freight rates. Competition with other railroads and other modes of transportation is generally based on the rates charged, the quality and reliability of the service provided and the quality of the carrier's equipment for certain commodities. Continuing competitive pressures and declining margins could have a material adverse effect on our business, financial condition and results of operations.

OUR BUSINESS STRATEGY, OPERATIONS AND GROWTH RELY SIGNIFICANTLY ON JOINT VENTURES AND OTHER STRATEGIC ALLIANCES.

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

Operation of our integrated rail network and our plans for growth and expansion rely significantly on joint ventures and other strategic alliances. Unless the Acquisition is consummated, we will continue to hold an indirect interest in two strategically significant railroad companies, Tex-Mex through TFM and TFM through our minority interest in Grupo TFM. As a minority

shareholder, we are not in a position to control operations, strategies or financial decisions without the concurrence of Grupo TMM, the largest shareholder in Grupo TFM. In addition, conflicts have arisen in the past and may arise in the future between our business objectives and those of Grupo TMM. We are currently in a dispute with Grupo TMM over Grupo TMM's attempt to terminate the Acquisition Agreement. We cannot assure that this dispute will be resolved in our favor. If the Acquisition is not consummated, resolution of any future conflicts in our favor may be difficult or impossible given our minority ownership position. We do maintain supermajority rights, which provide us with the ability to block certain actions proposed by Grupo TMM at Grupo TFM. Our ownership interests in these companies are subject to restrictions on disposition. KCS received notice from Grupo TMM to terminate a joint venture agreement between the parties entered into in 1995. Pursuant to such notice, that joint venture agreement will terminate on December 1, 2003. This joint venture agreement provides that upon its termination, the joint venture shall be liquidated and any assets held in the name of the joint venture shall be distributed proportionally to KCS and Grupo TMM. There are no significant assets held by the joint venture and KCS does not expect the termination of the joint venture agreement to have a material adverse effect on KCS.

Our operations are dependent on interchange, trackage rights, haulage rights and marketing agreements with other railroads and third parties that enable us to exchange traffic and utilize trackage we do not own. These agreements extend our network and provide strategically important rail links to Mexico, the northern Midwest United States and Canada. Our ability to provide comprehensive rail service to our customers depends in large part upon our ability to maintain these agreements with other railroads and third parties. The termination of these agreements could adversely affect our business, financial condition and results of operations. There can be no assurance that these agreements will be renewed after their expiration and the failure to renew any of them could adversely affect our business, financial condition and results of operations. In addition, we are dependent in part upon the financial health and efficient performance of other railroads. For example, much of Tex-Mex's traffic moves over the UP's lines via trackage rights, and a significant portion of our grain shipments originate with Iowa, Chicago & Eastern Railroad Corporation ("IC&E" - formerly I&M Rail Link, LLC) pursuant to our marketing agreement with it. BNSF is our largest partner in the interchange of rail traffic. There can be no assurance that we will not be materially affected adversely by operational or financial difficulties of other railroads.

OUR SUCCESS WILL DEPEND UPON OUR ABILITY TO RETAIN AND ATTRACT QUALIFIED MANAGEMENT PERSONNEL.

Our operations and the continued execution of our business strategy are dependent upon the continued employment of our senior management team. Recruiting, motivating and retaining qualified management personnel, particularly those with expertise in the railroad industry, are vital to our operations and ultimate success. There is substantial competition for qualified management personnel and there can be no assurance that we will be able to attract or retain qualified personnel. The loss of key personnel or the failure to hire qualified personnel could materially adversely affect our business and financial results.

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

OUR MEXICAN INVESTMENT SUBJECTS US TO POLITICAL AND ECONOMIC RISKS.

As of December 31, 2002, we had invested approximately \$300 million in Grupo TFM. If the Acquisition is consummated, our investment in Mexico will be materially increased. Our investment in Mexico involves a number of risks. The Mexican government exercises significant influence over the Mexican economy and its actions could have a significant impact on TFM. Our Mexican investment may also be adversely affected by currency fluctuations, price instability, inflation, interest rates, regulations, taxation, cultural differences, social instability, labor disputes and other political, social and economic developments in or affecting Mexico. Moreover, TFM's commercial success is heavily dependent on expected increases in U.S.-Mexico trade and will be strongly influenced by the effect of NAFTA on such trade. Downturns in either of the U.S. or Mexican economies or in trade between the United States and Mexico would be likely to adversely impact TFM's business, financial condition and results of operations. There can be no assurances that the various risks

associated with operating in Mexico can be effectively and economically mitigated by TFM. Additionally, no assurances can be given that the value of these investments will not become impaired.

TFM holds the concession to operate Mexico's Northeast Rail Lines (the "Concession") for 50 years, beginning in 1997, and, subject to certain conditions, has a 50-year extension option. The Concession is subject to certain mandatory trackage rights and is only exclusive for 30 years. Additionally, the Mexican government may revoke exclusivity after 20 years if it determines that there is insufficient competition and may terminate the Concession as a result of certain conditions or events, including (1) TFM's failure to meet its operating and financial obligations with regard to the Concession under applicable Mexican law, (2) a statutory appropriation by the Mexican government for reasons of public interest and (3) liquidation or bankruptcy of TFM. TFM's assets and its rights under the Concession may also be seized temporarily by the Mexican government. Revocation or termination of the Concession would materially adversely affect TFM's operations and its ability to make payments on its debt. Further, even though TFM would be entitled to compensation for a statutory appropriation or temporary seizure, any such compensation might be insufficient to cover TFM's losses. The loss of the Concession would materially adversely impact TFM's business, financial condition and results of operations which, in turn, would materially adversely impact the value of and return on our investment in Grupo TFM and our ability to market our U.S. operations on the basis of our access to Mexican locations. Currently, Grupo TFM is limited in the amount of dividends it may pay because of debt covenants. An absence of dividends from Grupo TFM will, or limited dividends may, negatively impact our ability to obtain a current cash return on our investment in Grupo TFM.

Under the Concession, TFM is obligated to grant and is entitled to receive certain trackage rights. The compensation for use of the trackage rights has been under discussion since the granting of the Concession. As TFM and Ferromex were unable to reach an agreement concerning compensation, the Ministry of Communications and Transports, or "Ministry of Transportation," issued its ruling on March 13, 2002 setting the compensation to be paid by each of TFM and Ferromex for use of the mandatory trackage rights. On April 15, 2002, the Ministry of Transportation rejected TFM's petition seeking reconsideration of its trackage rights decision. TFM has appealed to an administrative court both the Ministry of Transportation's rejection of its petition seeking reconsideration and the Ministry of Transportation's underlying decision on trackage rights compensation. TFM also requested and obtained a suspension of the effectiveness of the Ministry of Transportation's ruling pending resolution of its appeal. An adverse trackage rights compensation decision could negatively impact our investment in Grupo TFM.

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

OUR PANAMANIAN INVESTMENT SUBJECTS US TO POLITICAL AND ECONOMIC RISKS.

We have entered into a joint venture with Mi-Jack Products, Inc. ("Mi-Jack"--a private U.S. company located in Illinois), through which we own 50% of the common stock of the Panama Canal Railway Company ("PCRC"), which owns all of the common stock of Panarail Tourism Company ("PTC"). As of December 31, 2002, we had invested approximately \$19.9 million in the PCRC, comprised of \$12.9 million in equity and \$7.0 million in subordinated loans. PCRC operates a railroad between Panama City and Colon, Panama, while PTC operates a tourist and commuter railway service in conjunction with and over the lines of the PCRC. Our investment in PCRC has risks associated with operating in Panama, including, among others, cultural differences, varying labor and operating practices, political risk and differences between the U.S. and Panamanian economies. There can be no assurances that the risks associated with operating in Panama can be effectively and economically mitigated by PCRC. Additionally, no assurances can be given that the value of our investment in PCRC will not become impaired. Further, KCS is a guarantor to the International Finance Corporation ("IFC") for up to \$5.6 million of deferred principal payments on behalf of PCRC and, if PCRC terminates the concession contract without the consent of the IFC, a guarantor for up to 50% of the outstanding senior loans of PCRC. The senior loans had an outstanding balance of approximately \$45 million at December 31, 2002. KCSR is also a guarantor for up to \$2.1 million of equipment loans from Transamerica Corporation.

WE ARE SUBJECT TO REGULATION BY FEDERAL, STATE AND LOCAL REGULATORY AGENCIES. OUR FAILURE TO COMPLY WITH VARIOUS FEDERAL, STATE AND LOCAL REGULATIONS COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

In addition to safety, health and other regulations, generally our U.S. rail subsidiaries, like other rail common carriers, are subject to regulation by the Surface Transportation Board, the Federal Railroad Administration, the Occupational Safety and Health Administration, state departments of transportation and other state and local regulatory agencies. Government regulation of the railroad industry is a significant determinant of the competitiveness and profitability of railroads. While deregulation of rates and services in the United States has substantially increased the flexibility of railroads to respond to market forces, the deregulated environment has also resulted in highly competitive rates. Material noncompliance by us with these various regulatory requirements or changes in regulation of the industry through legislative, administrative, judicial or other action could have a material adverse effect on our business, financial condition and results of operations, including limitations on our operating activities until compliance with applicable requirements is completed.

ENVIRONMENTAL LIABILITIES COULD REQUIRE US TO INCUR MATERIAL COSTS AND TEMPORARILY SUSPEND ANY OPERATIONS THAT ARE FOUND TO VIOLATE ENVIRONMENTAL LAWS.

Our operations are subject to extensive federal, state and local environmental laws and regulations concerning, among other things, emissions to the air, discharges to waters, waste management, hazardous substance transportation, handling and storage, decommissioning of underground storage tanks and soil and groundwater contamination. Those laws and regulations can (1) impose substantial fines and criminal sanctions for violations, (2) require us to upgrade equipment or make operational changes to limit pollution emissions or decrease the likelihood of accidental hazardous substance releases or (3) temporarily prohibit us from conducting operations if those operations violate applicable requirements. We incur, and expect to continue to incur, significant environmental compliance costs, including, in particular, costs necessary to

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

maintain compliance with requirements governing our chemical and hazardous material shipping operations, our refueling operations and our repair facilities.

Many of our current and former properties are or have been used for industrial purposes, including, for example, hazardous material storage, waste disposal and treatment, foundry operations, drum reconditioning services and chemical treatment of wood products. Accordingly, we also are subject to potentially material liabilities relating to the investigation and cleanup of contaminated properties, and to claims alleging personal injury or property damage as the result of exposures to, or releases of, hazardous substances. Such liabilities could relate to properties that we owned or operated in the past, as well as any of our currently owned or operated properties. Such liabilities also could relate to third-party sites to which we or our predecessors sent waste for treatment or disposal, or which otherwise were affected by our operations. For example, we are conducting investigation and cleanup activities at several properties which we own or which we or our predecessors owned or operated in the past. We also are investigating and remediating several third-party sites that were affected by spills from our rail car operations and have been identified as a potentially responsible party at several third-party disposal sites to which we sent waste and other materials in the past. In addition, we are a defendant in a class action lawsuit alleging personal injuries and property damage from a chemical rail car explosion in 1995.

Although we have recorded liabilities for estimated environmental remediation and other environmental costs, actual expenditures or liabilities could exceed estimated amounts and could have a material adverse effect on our consolidated results of operations or financial position. New laws and regulations, stricter enforcement of existing requirements, new spills, releases or violations or the discovery of previously unknown contamination could require us to incur costs or become the basis for new or increased liabilities that could have a material adverse effect on our business, results of operations or financial condition.

WE MAY SUFFER A CATASTROPHE, COLLISION, PROPERTY LOSS, SERVICE INTERRUPTION OR TERRORIST ACT.

The operation of any railroad carries with it an inherent risk of catastrophe, collision and property loss. In the course of train operations, service interruptions, derailments, spills, explosions, leaks, other environmental events, cargo loss or damage and business interruption resulting from adverse weather conditions or natural phenomena could result in loss of revenues, increased liabilities or increased costs. Significant environmental mishaps can cause serious bodily injury, death and extensive property damage, particularly when such accidents occur in heavily populated areas. We maintain insurance (including self-insurance) consistent with industry practice against accident-related risks involved in the operation of our business. However, there can be no assurance that such insurance would be sufficient to cover the cost of damages suffered by us or damages to others or that such insurance will continue to be available at commercially reasonable rates. Moreover, our insurance coverage for events occurring prior to 1996 did not extend to punitive damage awards, which are increasingly being levied in civil cases related to environmental accidents.

While we maintain terrorism coverage under certain of our liability insurance policies, we do not maintain such coverage under our property damage insurance policies and do not otherwise maintain insurance coverage for

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

terrorist acts. Recently, the U.S. Department of Transportation issued a warning about possible terrorist attacks on rail and transit systems in the U.S. There can be no assurance that any accident, natural disaster or terrorist act would not cause a significant interruption in our operations or materially adversely affect our business, financial condition and results of operations.

WE MAY BE UNABLE TO COMPLETE THE ACQUISITION.

On August 18, 2003, Grupo TMM shareholders purportedly voted not to approve the sale of Grupo TMM's interests in Grupo TFM to KCS. On August 23, 2003, Grupo TMM sent a notice to KCS claiming to terminate the Acquisition Agreement, because the Grupo TMM shareholders had failed to approve the Acquisition Agreement. On August 29, 2003, KCS delivered to Grupo TMM a Notice of Dispute, which initiated a 60-day negotiation period between the parties. If the parties are unable to resolve the disputes within that period of time, KCS intends to initiate binding arbitration in accordance with the terms of the Acquisition Agreement. In addition on August 29, 2003, KCS filed a complaint in the Delaware Chancery Court alleging that Grupo TMM had breached the Acquisition Agreement. The Notice of Dispute and complaint point out that the Acquisition Agreement does not provide that a negative shareholder vote by Grupo TMM shareholders is a basis for termination, and KCS maintains that the Acquisition Agreement is still valid and remains in effect until December 31, 2004. On September 2, 2003, KCS filed in the Delaware Court of Chancery a motion for preliminary injunction to preserve the parties' positions while KCS seeks to resolve its dispute over Grupo TMM's attempt to terminate the Acquisition Agreement. KCS has asked for an expedited hearing on its motion for a preliminary injunction. However, there can be no assurance that the parties will resolve their disputes relating to the Acquisition Agreement, or that the arbitrators or the courts will resolve the disputes, in favor of KCS.

Even if disputes relating to the Acquisition Agreement are resolved in favor of KCS, the consummation of the Acquisition is subject to a number of conditions, including among others, that Grupo TMM obtain consent of the holders of its outstanding 2003 notes and 2006 notes. Grupo TMM has disclosed in its Form 20-F for the fiscal year ended December 31, 2002 that it sought consents in connection with its recent exchange offers but was not successful in obtaining such consents. There can be no assurance that Grupo TMM will be able to obtain such consents or that the other conditions to the Acquisition will be satisfied. If the Acquisition is not consummated, the value of our investment in Grupo TFM may become impaired.

As of June 30, 2003, KCS has recorded deferred costs of approximately \$4.6 million related to the transaction, which have been reflected in our consolidated balance sheet pending completion of the Acquisition. We expect that we will incur and defer additional costs related to the Acquisition. If we are unable to complete the Acquisition, these deferred costs would be reflected as a charge to earnings in our consolidated income statement in the period in which such determination is made.

TFM RISK FACTORS

TFM'S SUBSTANTIAL INDEBTEDNESS COULD ADVERSELY AFFECT ITS FINANCIAL POSITION AND ITS ABILITY TO MEET ITS OBLIGATIONS UNDER ITS DEBT SECURITIES AND TO OPERATE ITS BUSINESS.

TFM has a significant amount of debt and significant debt service obligations. As of December 31, 2002, TFM had total outstanding indebtedness of \$1,023.1 million, consisting of senior unsecured indebtedness under its

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

outstanding notes and debentures, obligations under capital leases and its new bank facilities (its commercial paper program and its term loan facility). TFM has no secured indebtedness. Under U.S. GAAP, TFM's shareholders' equity was \$1,133.9 million as of December 31, 2002, resulting in a debt to equity ratio of 92.2%. In addition, TFM may incur more debt, subject to the restrictions contained in the indentures governing the existing notes and the outstanding notes and the credit agreements governing its new commercial paper program and term loan facility.

TFM's substantial indebtedness could interfere with its ability to pay interest and principal on its debt and may have important consequences for its operations and capital expenditure requirements, including the following:

- o TFM will have to dedicate a substantial portion of its cash flow from operations to the payment of principal, premium, if any, or interest on its debt, which will reduce funds available for other purposes;
- o TFM may not be able to fund capital expenditures, working capital and other corporate requirements;
- o TFM may not be able to obtain additional financing, or to obtain it at acceptable rates;
- o TFM's ability to adjust to changing market conditions and to withstand competitive pressures could be limited, and it may be vulnerable to additional risk if there is a downturn in general economic conditions or its business;
- o TFM may be exposed to risks in exchange rate fluctuations, because any devaluation of the peso would cause the cost of TFM's dollar-denominated debt to increase; and
- o TFM may be at a competitive disadvantage compared to its competitors that have less debt and greater operating and financing flexibility than it does.

In addition, the notes issued under TFM's new commercial paper program generally have maturities of less than 180 days, so it must either repay them or refinance them by issuing and selling new commercial paper notes on an ongoing basis. TFM's commercial paper program terminates on September 17, 2004 (unless extended), so it must either repay, replace, refinance or extend the program at that time. TFM may be unable to refinance its commercial paper program or it may not have sufficient cash to repay this debt when it becomes due. These events could result in a default under the respective indentures governing the existing notes and the outstanding notes as well as the agreements governing TFM's commercial paper program.

FAILURE TO COMPLY WITH RESTRICTIVE COVENANTS IN TFM'S EXISTING CONTRACTUAL ARRANGEMENTS COULD ACCELERATE ITS REPAYMENT OBLIGATIONS UNDER ITS DEBT.

The indentures relating to TFM's outstanding notes, and the credit agreements relating to TFM's bank facilities, contain a number of restrictive covenants, and any additional financing arrangements it enters into may contain additional restrictive covenants. The credit agreements relating to TFM's bank facilities contain covenants that are more restrictive than those contained in the indentures relating to the existing notes and the outstanding notes, including certain financial covenants which require TFM to maintain specified

financial ratios. Any breach of these covenants could result in a default under the indentures and the credit agreements. These covenants restrict or prohibit

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

many actions, including TFM's ability to:

- o incur debt;
- o create or suffer to exist liens;
- o make prepayments of particular debt;
- o pay dividends;
- o make investments;
- o engage in transactions with stockholders and affiliates;
- o sell assets; and
- o engage in mergers and consolidations or in sale-leaseback transactions.

If TFM fails to comply with these restrictive covenants, its obligation to repay the existing notes and the exchange notes or its other debt may be accelerated. In addition, a default under these covenants could affect TFM's ability to refinance its commercial paper program.

TFM MAY BE UNABLE TO GENERATE SUFFICIENT CASH TO SERVICE OR REFINANCE ITS DEBT.

TFM's ability to satisfy its obligations under its debt in the future will depend upon its future performance, including its ability to increase revenues significantly and control expenses. TFM's future operating performance depends upon prevailing economic, financial, business and competitive conditions and other factors, many of which are beyond TFM's control.

We cannot assure you that TFM's business will generate sufficient cash flow from operations, that currently anticipated revenues and operating performance will be realized or that future borrowings will be available to TFM in amounts sufficient to pay its debt or to fund its other liquidity needs.

If TFM's cash flow from operations is insufficient to satisfy its obligations, it may take specific actions, including delaying or reducing capital expenditures, attempting to refinance its debt at or prior to its maturity or, in the absence of such refinancing, attempting to sell assets quickly in order to make up for any shortfall in payments under circumstances that might not be favorable to getting the best price for the assets, or seeking additional equity capital. TFM's ability to refinance its debt and take other actions will depend on, among other things, its financial condition at the time, the restrictions in the instruments governing its debt and other factors, including market conditions, beyond TFM's control. TFM may be unable to take any of these actions on satisfactory terms or in a timely manner. Further, any of these actions may not be sufficient to allow TFM to meet its debt obligations. In addition, TFM's debt agreements and, upon consummation of the Acquisition, our debt agreements, will limit TFM's ability to take certain of these actions. TFM's failure to successfully undertake any of these actions or to earn enough revenues to pay its debts, or significant increases in the peso cost to service its dollar-denominated debt, could materially and adversely affect TFM's business or operations.

TFM'S BUSINESS IS CAPITAL INTENSIVE AND IT MUST MAKE SIGNIFICANT ADDITIONAL CAPITAL EXPENDITURES; FAILURE TO MAKE SUCH ADDITIONAL CAPITAL EXPENDITURES COULD RESULT IN THE REVOCATION OF TFM'S CONCESSION.

TFM's business is capital intensive and requires substantial ongoing expenditures for, among other things, improvements to roadway, structures and

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

technology, acquisitions, leases and repair of equipment and maintenance of its rail system. TFM's failure to make necessary capital expenditures could impair

its ability to accommodate increases in traffic volumes or service its existing customers. In addition, TFM's railroad Concession from the Mexican government requires it to make investments and undertake capital projects, including capital projects described in a business plan filed every five years with the Mexican government. TFM may defer capital expenditures with respect to its five-year business plan with the permission of the Secretaria de Comunicaciones y Transportes (Ministry of Communications and Transport or "Ministry of Transportation"). However, the Ministry of Transportation might not grant this permission, and TFM's failure to comply with its commitments in its business plan could result in the Mexican government revoking the Concession.

In 2000, 2001 and 2002, TFM made capital expenditures of \$66.9 million, \$85.2 million and \$89.4 million, which represented 9.6%, 11.8% and 12.5% of its transportation revenues for each of those years, respectively. These capital expenditures include the expenses TFM expects to incur for the rehabilitation and improvement of its secondary rail lines and the construction of new intermodal terminals near the manufacturing plants of its automotive customers. TFM has funded, and expects to continue to fund, capital expenditures with funds from operating cash flows and vendor financing. TFM may not be able to generate sufficient cash flows from its operations or obtain sufficient funds from external sources to fund its capital expenditure requirements. Also, additional financing may not be available to TFM. If financing is available, it may not be obtainable on terms acceptable to TFM and within the limitations contained in the indentures and other agreements relating to TFM's debt. If TFM is unable to complete its planned capital improvements projects, TFM's ability to accommodate increases in its traffic volumes or service its existing customers may be limited or impaired, and the Mexican government could revoke TFM's Concession.

SIGNIFICANT COMPETITION FROM TRUCKS AND OTHER RAILROADS, AS WELL AS LIMITED COMPETITION FROM THE SHIPPING INDUSTRY, COULD ADVERSELY AFFECT TFM'S FUTURE FINANCIAL PERFORMANCE.

TFM faces significant competition from trucks and other rail carriers as well as limited competition from the shipping industry in its freight operations. The trucking industry is TFM's primary competition. In the past, the trucking industry has significantly eroded the railroad's market share of Mexico's total overland freight transportation. In some circumstances, the trucking industry can provide effective rate and service competition because trucking requires substantially smaller capital investments and maintenance expenditures, and allows for more frequent and flexible scheduling.

NAFTA called for Mexican trucks to have unrestricted access to highways in the U.S. border states by 1995 and full access to all U.S. highways by January 2000. In February 2001, a NAFTA tribunal ruled in an arbitration between the United States and Mexico that the United States must allow Mexican trucks to cross the border and operate on U.S. highways. However, the United States has not followed the timetable because of concerns over Mexico's trucking safety standards. On March 14, 2002, as part of its agreement under NAFTA, the U.S. Department of Transportation issued safety rules that allow Mexican truckers to apply for operating authority to transport goods beyond the 20-mile commercial zones along the U.S.-Mexico border. These safety rules require Mexican carriers seeking to operate in the United States to pass, among other things, safety inspections, obtain valid insurance with a U.S. registered insurance company, conduct alcohol and drug testing for drivers and obtain a U.S. Department of Transportation identification number. Mexican commercial vehicles with authority to operate beyond the commercial zones will be permitted to enter the United

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

States only at commercial border crossings and only when a certified motor carrier safety inspector is on duty. Given these recent developments, we cannot assure you that truck transport between Mexico and the United States will not increase substantially in the future. Such an increase could affect TFM's ability to continue converting traffic to rail from truck transport because it may result in an expansion of the availability, or an improvement of the quality, of the trucking services offered in Mexico. Since a key element of TFM's business strategy is to recapture market share lost to the trucking industry, its inability to successfully convert traffic to rail from truck transport would materially impair its ability to achieve its strategic objectives. There can be no assurance that TFM will have the ability to continue to convert traffic from truck to rail transport or that TFM will retain the customers that it has already converted. For example, in 2000 TFM lost a significant amount of the business it derived from a major customer, as this customer increased the use of trucks in its product distribution network.

In addition to trucks, TFM faces significant competition in some industry segments from other railroads, in particular Ferromex, which operates the Pacific-North Rail Lines. In particular, TFM has experienced, and continues to experience, competition from Ferromex with respect to the transport of grain, minerals and steel products. The rail lines operated by Ferromex run from Guadalajara and Mexico City to four U.S. border crossings west of Laredo, Texas, providing a potential alternative to TFM's routes for the transport of freight from those cities to the U.S. border. Ferromex directly competes with TFM in some areas of its service territory, including Tampico, Saltillo, Monterrey and Mexico City. Also in direct competition for traffic to and from southeastern Mexico is Ferrosur, which operates the Southeast Rail Lines. Ferrosur, like TFM, serves Mexico City, Puebla and Veracruz.

Ferromex and Ferrosur are privately owned companies that may have greater financial resources than TFM. Among other things, this advantage may give them greater ability to reduce freight prices. Price reductions by competitors would make TFM's freight services less competitive, and we cannot assure you that TFM would be able to match these rate reductions. For example, TFM has experienced, and continues to experience, aggressive price competition from Ferromex in freight rates for agricultural products which has adversely affected its results of operations. TFM's ability to respond to competitive measures by decreasing its prices without adversely affecting its gross margins and operating results will depend on, among other things, TFM's ability to reduce its operating costs. TFM's failure to respond to competitive pressures, and particularly price competition, in a timely manner would have a material adverse effect on its results of operations.

Under TFM's Concession, TFM must grant to Ferromex the right to operate over a north-south portion of our rail lines between Ramos Arizpe near Monterrey and the city of Queretaro that constitutes over 600 kilometers of its main track. Using these trackage rights, Ferromex may be able to compete with TFM over its rail lines for traffic between Mexico City and the United States. TFM's Concession also requires it to grant rights to use certain portions of its tracks to Ferrosur and the "belt railroad" operated in the greater Mexico City area by the Ferrocarril y Terminal del Valle de Mexico, S.A. de C.V. ("Mexico City Railroad and Terminal"), thereby providing Ferrosur with more efficient access to certain Mexico City industries. As a result of having to grant trackage rights to other railroads, TFM must incur additional maintenance costs and also lose the flexibility of using its tracks at all times.

Ferromex and Ferrosur announced that they agreed to the acquisition of Ferrosur by Ferromex. TFM filed a notice with the Mexican Federal Competition Commission objecting to the proposed acquisition on the grounds that it limits competition. Approval of the proposed merger was denied by the Mexican Federal

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

Competition Commission, as was Ferrosur-Ferromex's motion to reconsider. Ferromex has filed an appeal (amparo) from the decision of the Mexican Federal Competition Commission's decision that is still pending before the courts. Should the decision of the Mexican Federal Competition Commission be reversed on grounds that allow the proposed merger to go forward, and should the proposed merger be consummated, the resulting railroad would operate the largest rail system in Mexico, and we cannot assure you that this would not have a material adverse effect on TFM's operations, particularly on the revenues generated by its route between Mexico City and the port of Veracruz.

In addition, in recent years, there has been significant consolidation among major North American rail carriers. The resulting merged railroads could attempt to use their size and pricing power to block other railroads' access to efficient gateways and routing options that are currently and have been historically available. We cannot assure you that further consolidation will not have an adverse effect on TFM.

TFM also faces limited competition from the shipping industry with respect to some products, including chemicals transported by barges and vessels from Gulf of Mexico ports in Texas and Louisiana.

THE RATES FOR TRACKAGE RIGHTS SET BY THE MINISTRY OF TRANSPORTATION MAY NOT ADEQUATELY COMPENSATE TFM.

Pursuant to TFM's Concession, it is required to grant rights to use portions of its tracks to Ferromex, Ferrosur and the Mexico City Railroad and Terminal. Applicable law stipulates that Ferromex, Ferrosur and the Mexico City Railroad and Terminal are required to grant to TFM rights to use portions of their tracks.

TFM's Concession classifies trackage rights as short trackage rights and long-distance trackage rights. Although all of these trackage rights have been granted under TFM's Concession, no railroad has actually operated under the long-distance trackage rights because the means of setting rates for usage and other related terms of usage have not been agreed upon. Under the Ley Reglamentaria del Servicio Ferroviario (Law Regulating Railroad Services or "Mexican railroad services law and regulations"), the rates that TFM may charge for rights to use its tracks must be agreed upon in writing between TFM and the party to which those rights are granted. However, if TFM cannot reach an agreement on rates with rail carriers entitled to trackage rights on its rail lines, the Ministry of Transportation is entitled to set the rates using criteria including:

- o the costs of infrastructure maintenance and traffic control relating to the portion of TFM's lines to be used by the other rail operator;
- o the increment in costs due to interference with TFM's operations;
- o the amortized capital investments, including the value of the Concession, directly related to the affected lines; and
- o a reasonable profit calculated with reference to international railroad standards and reflecting investment conditions in Mexico.

TFM and Ferromex have not been able to agree upon the rates each of them is required to pay the other for interline services and haulage and trackage rights. Therefore, in accordance with its rights under the Mexican railroad

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

services law and regulations, in February 2001, TFM initiated an administrative proceeding requesting a determination of such rates by the Ministry of Transportation.

In September 2001, Ferromex filed a legal claim against TFM relating to the payments that TFM and Ferromex are required to make to each other for interline services and trackage and haulage rights. TFM has indicated it believes that this legal claim is without merit, and that the payments for interline services and trackage and haulage rights owed to TFM by Ferromex exceed the amount of payments that Ferromex claims TFM owes to Ferromex for such services and rights. Accordingly, TFM has indicated it believes that the outcome of this legal claim will not have a material adverse effect on the financial condition of TFM. On September 25, 2002, the third civil court of Mexico City rendered its judgment in TFM's favor. Ferromex has appealed the judgment, and we cannot predict whether TFM will ultimately prevail.

In connection with the Ferromex claim, Ferromex temporarily prevented TFM from using certain short trackage rights which TFM has over a portion of its route running from Celaya to Silao, which is the site of a General Motors plant from where TFM transports finished vehicles to the border crossing at Nuevo Laredo. Ferromex was subsequently ordered by the court to resume giving TFM access, and in October 2001, TFM filed a counterclaim against Ferromex relating to these actions.

In March 2002, the Ministry of Transportation issued its ruling in response to TFM's request, establishing a rate to be charged for trackage rights using the criteria set forth in the Mexican railroad services law and regulations. TFM is appealing the ruling on the grounds that it fails to establish rates for interline service and because TFM disagrees with the methodology applied to the criteria in calculating the trackage rights rates. TFM also requested and obtained a suspension of the effectiveness of the ruling pending resolution of its appeal.

We cannot predict whether TFM will ultimately prevail in this proceeding and whether the rates TFM is ultimately allowed to charge will be adequate to compensate TFM. TFM has indicated it believes that, even if the rates established in the ruling go into effect and TFM and Ferromex begin using the long-distance trackage rights over each other's rail line, this will not have a material adverse effect on TFM's results of operations. However, we cannot guarantee that TFM's competitors' usage of its rail lines will not result in TFM losing business or that its losses will be offset by revenues generated from the payments for the rights to use its tracks. The occurrence of any of these events could have a material adverse effect on TFM's results of operations. A separate ruling was issued confirming TFM's right to the Celaya-Silao stretch of Ferromex track.

RECENT TERRORIST ACTIVITIES AND GEOPOLITICAL EVENTS AND THEIR CONSEQUENCES COULD ADVERSELY AFFECT TFM'S OPERATIONS.

As a result of the terrorist attacks in the United States on September 11, 2001, and the recent war involving, among others, the United States and Iraq, there has been increased short-term market volatility, and there may be long-term effects on U.S. and world economies and markets.

Terrorist attacks may negatively affect TFM's operations. The continued threat of terrorism within the United States and abroad and the potential for military action and heightened security measures in response to such threat may cause significant disruption to commerce throughout the world, including restrictions on cross-border transport and trade. In addition, related political events may cause a lengthy period of uncertainty that may adversely affect TFM's

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

business. There can be no assurance that there will not be further large-scale terrorist attacks. Political and economic instability in other regions of the world, including the United States and Canada, may also result and could negatively impact TFM's operations. The consequences of terrorism and the responses thereto are unpredictable, and could have an adverse effect on TFM's operations.

DOWNTURNS IN GLOBAL ECONOMIC CONDITIONS, IN THE U.S. ECONOMY, IN U.S.-MEXICO TRADE OR IN CERTAIN CYCLICAL INDUSTRIES IN WHICH TFM'S CUSTOMERS OPERATE COULD ADVERSELY AFFECT ITS BUSINESS AND RESULTS OF OPERATIONS.

TFM believes that traffic that crosses the U.S. border on its rail lines generates the majority of its freight revenue. As a result, the level and timing of TFM's business activity is, and will continue to be, strongly influenced by the level of U.S.-Mexican trade and the effects of NAFTA or other international trade agreements on such trade. Downturns in global economic conditions, in the U.S. or Mexican economy or in trade between the United States and Mexico will likely have adverse effects on TFM's business and results of operations. Mexican exports to the United States of manufactured goods, beer, metals and minerals, automobiles, chemical and petrochemical products and other products, many of which TFM transports, are an important element of U.S.-Mexico trade. In addition, a significant portion of TFM's business consists of imports into Mexico from the United States. The level of TFM's business activity depends heavily on the U.S. and Mexican economies and markets, the relative competitiveness of Mexican and U.S. products at any given time and existing and new tariffs or other barriers to trade. For example, the recent downturn in the U.S. economy has had an adverse effect on TFM's revenues in all product categories, particularly in the automotive and industrial segments. This downturn may continue and could worsen, thereby having a material adverse effect on TFM's results of operations and its ability to meet its debt service obligations as described above.

Some of TFM's customers operate in industries that experience cyclicity, including the oil and gas, automotive and agricultural sectors. Any downturn in these sectors due to the effects of cyclicity, or otherwise, could have a material adverse effect on TFM's operating results. Also, some of the products TFM transports have had a historical pattern of price cyclicity which has typically been influenced by the general economic environment and by industry capacity and demand. For example, global steel and petrochemical prices have decreased in the past. We cannot assure you that prices and demand for these products will not decline in the future, adversely affecting those industries and, in turn, TFM's financial results.

Fluctuations in the peso-dollar exchange rate could lead to shifts in the types and volumes of Mexican imports and exports. Although a decrease in the level of exports of some of the commodities that TFM transports to the United

States may be offset by a subsequent increase in imports of other commodities TFM hauls into Mexico and vice versa, any offsetting increase might not occur on a timely basis, if at all. Future developments in U.S.-Mexico trade beyond TFM's control may result in a reduction of freight volumes or in an unfavorable shift in the mix of products and commodities it transports.

POTENTIAL LABOR DISRUPTIONS COULD ADVERSELY AFFECT TFM'S FINANCIAL CONDITION AND ITS ABILITY TO MEET ITS OBLIGATIONS UNDER ITS DEBT.

Approximately 73% of TFM's employees are covered by a labor agreement. The compensation terms of the labor agreement are subject to renegotiation on an annual basis and all other terms are renegotiated every two years. TFM may not be able to negotiate these provisions favorably under its labor agreement, and

Edgar Filing: KANSAS CITY SOUTHERN - Form S-3/A

strikes, boycotts or other disruptions could occur. These potential disruptions could have a material adverse effect on TFM's financial condition and results of operations and on its ability to meet its payment obligations under its debt.

THE MEXICAN GOVERNMENT MAY REVOKE OR RESTRICT TFM'S ABILITY TO EXPLOIT ITS CONCESSION UNDER A NUMBER OF CIRCUMSTANCES.

Under the Concession and Mexican law, TFM may freely set its rates for rail freight services unless the Mexican Antitrust Commission determines that there is no effective competition, taking into account alternative