

KANSAS CITY SOUTHERN  
Form 10-Q  
July 17, 2015  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q

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

or  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-4717

KANSAS CITY SOUTHERN  
(Exact name of registrant as specified in its charter)  
Delaware  
(State or other jurisdiction of incorporation or organization)

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

427 West 12th Street,  
Kansas City, Missouri  
(Address of principal executive offices)  
816.983.1303

64105  
(Zip Code)

(Registrant's telephone number, including area code)  
No Change  
(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

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

Class	July 14, 2015
Common Stock, \$0.01 per share par value	110,360,097 Shares



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## PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements

Kansas City Southern and Subsidiaries  
Consolidated Statements of Income

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
	(In millions, except share and per share amounts)			
	(Unaudited)			
Revenues	\$585.8	\$649.7	\$1,188.9	\$1,257.1
Operating expenses:				
Compensation and benefits	108.0	115.5	225.6	226.1
Purchased services	57.0	63.8	115.1	119.0
Fuel	77.5	107.7	158.5	211.6
Equipment costs	29.9	29.5	59.0	61.2
Depreciation and amortization	70.8	63.9	139.3	125.8
Materials and other	55.8	55.1	116.8	109.3
Lease termination costs	—	8.4	9.6	38.3
Total operating expenses	399.0	443.9	823.9	891.3
Operating income	186.8	205.8	365.0	365.8
Equity in net earnings of unconsolidated affiliates	5.0	5.9	9.4	11.6
Interest expense	(17.7)	(17.9)	(36.3)	(36.6)
Debt retirement costs	—	—	—	(6.6)
Foreign exchange gain (loss)	(10.5)	5.3	(22.1)	8.4
Other expense, net	(1.2)	(2.8)	(2.0)	(3.3)
Income before income taxes	162.4	196.3	314.0	339.3
Income tax expense	50.2	66.1	100.6	115.1
Net income	112.2	130.2	213.4	224.2
Less: Net income attributable to noncontrolling interest	0.4	0.4	0.8	0.7
Net income attributable to Kansas City Southern and subsidiaries	111.8	129.8	212.6	223.5
Preferred stock dividends	—	—	0.1	0.1
Net income available to common stockholders	\$111.8	\$129.8	\$212.5	\$223.4
Earnings per share:				
Basic earnings per share	\$1.01	\$1.18	\$1.93	\$2.03
Diluted earnings per share	\$1.01	\$1.18	\$1.92	\$2.02
Average shares outstanding (in thousands):				
Basic	110,334	110,160	110,322	110,121
Potentially dilutive common shares	181	237	200	277
Diluted	110,515	110,397	110,522	110,398

See accompanying notes to consolidated financial statements.



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Consolidated Statements of Comprehensive Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(In millions)			
	(Unaudited)			
Net income	\$112.2	\$130.2	\$213.4	\$224.2
Other comprehensive loss:				
Amortization of prior service credit, net of tax of less than \$(0.1) million	—	—	(0.1)	) —
Foreign currency translation adjustments, net of tax of \$(0.2) million and \$(0.3) million, respectively	(0.2	) —	(0.5	) —
Other comprehensive loss	(0.2	) —	(0.6	) —
Comprehensive income	112.0	130.2	212.8	224.2
Less: Comprehensive income attributable to noncontrolling interest	0.4	0.4	0.8	0.7
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$111.6	\$129.8	\$212.0	\$223.5
See accompanying notes to consolidated financial statements.				

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Consolidated Balance Sheets

	June 30, 2015	December 31, 2014
	(In millions, except share and per share amounts) (Unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$50.9	\$348.0
Accounts receivable, net	195.3	181.6
Materials and supplies	134.1	111.0
Deferred income taxes	71.2	100.1
Other current assets	72.0	77.6
Total current assets	523.5	818.3
Investments	36.6	36.4
Property and equipment (including concession assets), net	7,419.1	7,154.7
Other assets	73.1	81.6
Total assets	\$8,052.3	\$8,091.0
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Debt due within one year	\$25.2	\$24.8
Short-term borrowings	291.9	450.1
Accounts payable and accrued liabilities	384.1	423.9
Total current liabilities	701.2	898.8
Long-term debt	1,828.5	1,841.0
Deferred income taxes	1,179.4	1,156.3
Other noncurrent liabilities and deferred credits	145.7	130.8
Total liabilities	3,854.8	4,026.9
Commitments and contingencies	—	—
Stockholders' equity:		
\$25 par, 4% noncumulative, preferred stock, 840,000 shares authorized, 649,736 shares issued, 242,170 shares outstanding	6.1	6.1
\$.01 par, common stock, 400,000,000 shares authorized; 123,352,185 shares issued; 110,325,301 and 110,392,330 shares outstanding at June 30, 2015 and December 31, 2014, respectively		1.1
Additional paid-in capital	962.1	949.8
Retained earnings	2,922.6	2,801.7
Accumulated other comprehensive loss	(3.8	) (3.2
Total stockholders' equity	3,888.1	3,755.5
Noncontrolling interest	309.4	308.6
Total equity	4,197.5	4,064.1
Total liabilities and equity	\$8,052.3	\$8,091.0

See accompanying notes to consolidated financial statements.





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Consolidated Statements of Cash Flows

	Six Months Ended June 30,	
	2015	2014
	(In millions)	
	(Unaudited)	
Operating activities:		
Net income	\$213.4	\$224.2
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	139.3	125.8
Deferred income taxes	54.2	58.4
Equity in net earnings of unconsolidated affiliates	(9.4)	(11.6)
Share-based compensation	8.1	4.4
Excess tax benefit from share-based compensation	(4.4)	(2.5)
Distributions from unconsolidated affiliates	7.8	15.8
Debt retirement costs	—	6.6
Changes in working capital items:		
Accounts receivable	(11.7)	(12.4)
Materials and supplies	(23.2)	(4.3)
Other current assets	15.6	3.2
Accounts payable and accrued liabilities	4.8	(10.6)
Other, net	3.0	(0.7)
Net cash provided by operating activities	397.5	396.3
Investing activities:		
Capital expenditures	(360.2)	(268.0)
Purchase or replacement of equipment under operating leases	(61.3)	(294.3)
Property investments in MSLLC	(3.9)	(24.8)
Proceeds from disposal of property	2.7	3.6
Other, net	(20.8)	3.9
Net cash used for investing activities	(443.5)	(579.6)
Financing activities:		
Proceeds from short-term borrowings	8,409.6	5,081.5
Repayment of short-term borrowings	(8,568.6)	(4,761.1)
Proceeds from issuance of long-term debt	40.0	175.0
Repayment of long-term debt	(52.3)	(495.4)
Dividends paid	(67.5)	(54.8)
Shares repurchased	(20.6)	—
Debt costs	—	(4.1)
Excess tax benefit from share-based compensation	4.4	2.5
Proceeds from employee stock plans	3.9	0.4
Net cash used for financing activities	(251.1)	(56.0)
Cash and cash equivalents:		
Net decrease during each period	(297.1)	(239.3)
At beginning of year	348.0	429.5

At end of period	\$50.9	\$190.2
See accompanying notes to consolidated financial statements.		

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## Kansas City Southern and Subsidiaries

## Notes to Consolidated Financial Statements

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

## 1. Basis of Presentation

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

## 2. New Accounting Pronouncements

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

## 3. Earnings Per Share Data

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share adjusts basic earnings per common share for the effects of potentially dilutive common shares, if the effect is not anti-dilutive. Potentially dilutive common shares include the dilutive effects of shares issuable under the stock option and performance award plans.

The following table reconciles the basic earnings per share computation to the diluted earnings per share computation (in millions, except share and per share amounts):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net income available to common stockholders for purposes of computing basic and diluted earnings per share	\$ 111.8	\$ 129.8	\$ 212.5	\$ 223.4
Weighted-average number of shares outstanding (in thousands):				
Basic shares	110,334	110,160	110,322	110,121

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Effect of dilution	181	237	200	277
Diluted shares	110,515	110,397	110,522	110,398
Earnings per share:				
Basic earnings per share	\$1.01	\$1.18	\$1.93	\$2.03
Diluted earnings per share	\$1.01	\$1.18	\$1.92	\$2.02

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

Stock options excluded as their inclusion would be anti-dilutive	125	67	74	52
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Notes to Consolidated Financial Statements—(Continued)

## 4. Lease Termination Costs

During the six months ended June 30, 2015 and 2014, the Company purchased \$61.3 million and \$297.3 million, respectively, of equipment under existing operating leases and replacement equipment as certain operating leases expired. The Company did not incur lease termination costs for the three months ended June 30, 2015, and for the three months ended June 30, 2014, recognized \$8.4 million of lease termination costs (included in operating expenses) due to the early termination of certain operating leases and the related purchase of the equipment. For the six months ended June 30, 2015 and 2014, the Company recognized \$9.6 million and \$38.3 million, respectively, of lease termination costs.

## 5. Property and Equipment (including Concession Assets)

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

	June 30, 2015	December 31, 2014
Land	\$217.8	\$216.8
Concession land rights	141.2	141.2
Road property	6,519.1	6,294.7
Equipment	2,146.5	1,979.9
Technology and other	170.5	160.9
Construction in progress	202.6	241.5
Total property	9,397.7	9,035.0
Accumulated depreciation and amortization	1,978.6	1,880.3
Property and equipment (including concession assets), net	\$7,419.1	\$7,154.7

Concession assets, net of accumulated amortization of \$501.4 million and \$483.1 million, totaled \$2,010.7 million and \$2,007.6 million at June 30, 2015 and December 31, 2014, respectively.

## 6. Fair Value Measurements

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

The Company's derivative financial instruments are measured at fair value on a recurring basis and consist of foreign currency forward and option contracts, which are classified as Level 2 instruments. The Company determines the fair value of its derivative financial instrument positions based upon pricing models using inputs observed from actively quoted markets, the contract terms, market currency exchange rates, and in the case of option contracts, volatility, the risk-free interest rate and the time to expiration. The fair value of the foreign currency derivative instruments was a liability of \$22.5 million and \$4.3 million at June 30, 2015 and December 31, 2014, respectively.

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

The fair value of the Company's debt is estimated using quoted market prices when available. When quoted market prices are not available, fair value is estimated based on current market interest rates for debt with similar maturities and credit quality. The fair value of the Company's debt was \$1,838.7 million and \$1,884.1 million at June 30, 2015 and December 31, 2014, respectively. The carrying value was \$1,853.7 million and \$1,865.8 million at June 30, 2015 and December 31, 2014, respectively. If the Company's debt were measured at fair value, the fair value measurements of the individual debt instruments would have been classified as either Level 1 or Level 2 in the fair value hierarchy.

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Notes to Consolidated Financial Statements—(Continued)

## 7. Derivative Instruments

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

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

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

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

Zero-cost collar contracts with an aggregate notional amount of \$50.0 million and \$80.0 million will mature on September 28, 2015 and January 15, 2016, respectively. The zero-cost collar contracts have a weighted-average Mexican peso call rate of Ps.15.79 to each U.S. dollar and a weighted-average Mexican peso put rate of Ps.15.16 to each U.S. dollar.

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

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

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

	Derivative Liabilities		
	Balance Sheet Location	June 30, 2015	December 31, 2014
Derivatives not designated as hedging instruments:			
Foreign currency forward contracts	Accounts payable and accrued liabilities	\$ 19.4	\$ 4.3
Foreign currency zero-cost collar contracts	Accounts payable and accrued liabilities	3.1	—
Total derivative liabilities		\$ 22.5	\$ 4.3





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Notes to Consolidated Financial Statements—(Continued)

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

	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative			
		Three months ended June 30, 2015		Six months ended June 30, 2015	
Derivatives not designated as hedging instruments:					
Foreign currency forward contracts	Foreign exchange gain (loss)	\$(6.9 )	\$5.5	\$(16.3 )	\$8.7
Foreign currency zero-cost collar contracts	Foreign exchange gain (loss)	(2.4 )	—	(3.1 )	—
Total		\$(9.3 )	\$5.5	\$(19.4 )	\$8.7

## 8. Short-Term Borrowings

Commercial Paper. The commercial paper programs of The Kansas City Southern Railway Company (“KCSR”) and Kansas City Southern de Mexico, S.A. de C.V. (“KCSM”) generally serve as the primary means of short-term funding. As of June 30, 2015, KCSR had \$291.9 million of commercial paper outstanding at a weighted-average interest rate of 0.720% and KCSM had no commercial paper outstanding.

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

## 9. Equity

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

	Three Months Ended June 30, 2015			Three Months Ended June 30, 2014		
	Kansas City Southern Stockholders’ Equity		Noncontrolling Interest Equity	Kansas City Southern Stockholders’ Equity		Noncontrolling Interest Equity
Beginning balance	\$3,829.5	\$ 309.0	\$4,138.5	\$3,433.0	\$ 306.3	\$3,739.3
Net income	111.8	0.4	112.2	129.8	0.4	130.2
Other comprehensive loss	(0.2 )	—	(0.2 )	—	—	—
Dividends on common stock	(36.5 )	—	(36.5 )	(30.9 )	—	(30.9 )
Dividends on \$25 par preferred stock	—	—	—	—	—	—
Share repurchases	(20.6 )	—	(20.6 )	—	—	—
Options exercised and stock subscribed, net of shares	(0.4 )	—	(0.4 )	0.2	—	0.2

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withheld for employee taxes

Excess tax benefit from share-based compensation	0.8	—	0.8	0.1	—	0.1
Share-based compensation	3.7	—	3.7	2.9	—	2.9
Ending balance	\$3,888.1	\$ 309.4	\$4,197.5	\$3,535.1	\$ 306.7	\$3,841.8

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## Kansas City Southern and Subsidiaries

## Notes to Consolidated Financial Statements—(Continued)

	Six Months Ended June 30, 2015			Six Months Ended June 30, 2014		
	Kansas City		Total Equity	Kansas City		Total Equity
	Southern Stockholders' Equity	Noncontrolling Interest		Southern Stockholders' Equity	Noncontrolling Interest	
Beginning balance	\$3,755.5	\$ 308.6	\$4,064.1	\$3,370.6	\$ 306.0	\$3,676.6
Net income	212.6	0.8	213.4	223.5	0.7	224.2
Other comprehensive loss	(0.6	) —	(0.6	) —	—	—
Dividends on common stock	(72.9	) —	(72.9	) (61.8	) —	(61.8
Dividends on \$25 par preferred stock	(0.1	) —	(0.1	) (0.1	) —	(0.1
Share repurchases	(20.6	) —	(20.6	) —	—	—
Options exercised and stock subscribed, net of shares withheld for employee taxes	1.7	—	1.7	(4.0	) —	(4.0
Excess tax benefit from share-based compensation	4.4	—	4.4	2.5	—	2.5
Share-based compensation	8.1	—	8.1	4.4	—	4.4
Ending balance	\$3,888.1	\$ 309.4	\$4,197.5	\$3,535.1	\$ 306.7	\$3,841.8

## Share Repurchase Program

In May 2015, the Company announced a share repurchase program of up to \$500.0 million, which expires on June 30, 2017. Management's assessment of market conditions, available liquidity and other factors will determine the timing and volume of repurchases. Future share repurchases are expected to be funded by cash on hand, cash generated from operations and debt. During the second quarter of 2015, KCS repurchased 222,131 shares of common stock for \$20.6 million at an average price of \$92.71 per share under this program. The excess of repurchase price over par value is allocated between additional paid-in capital and retained earnings.

## Cash Dividends on Common Stock

On May 8, 2015, the Company's Board of Directors declared a cash dividend of \$0.330 per share payable on July 8, 2015, to common stockholders of record as of June 8, 2015. The aggregate amount of the dividends declared for the three and six months ended June 30, 2015 was \$36.5 million and \$72.9 million, respectively.

The following table presents the amount of cash dividends declared per common share by the Company's Board of Directors:

	Three Months Ended		Six Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Cash dividends declared per common share	\$0.330	\$0.280	\$0.660	\$0.560

## 10. Commitments and Contingencies

**Concession Duty.** Under KCSM's 50-year railroad concession from the Mexican government (the "Concession"), which could expire in 2047 unless extended, KCSM pays concession duty expense of 1.25% of gross revenues. For the three and six months ended June 30, 2015, the concession duty expense, which is recorded within materials and other in operating expenses, was \$3.9 million and \$7.7 million, respectively, compared to \$4.0 million and \$7.6 million for the same periods in 2014.

**Litigation.** The Company is a party to various legal proceedings and administrative actions, all of which, except as set forth below, are of an ordinary, routine nature and incidental to its operations. Included in these proceedings are various tort claims brought by current and former employees for job-related injuries and by third parties for injuries

related to railroad operations. KCS aggressively defends these matters and has established liability provisions, which management believes are adequate to cover expected costs. Although it is not possible to predict with certainty the outcome of any legal proceeding, in the opinion of management, other than those proceedings described in detail below, such proceedings and actions should not, individually, or in the aggregate, have a material adverse effect on the Company's consolidated financial statements.

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Notes to Consolidated Financial Statements—(Continued)

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

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

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

The risk of incurring environmental liability is inherent in the railroad industry. As part of serving the petroleum and chemicals industry, the Company transports hazardous materials and has a professional team available to respond to and handle environmental issues that might occur in the transport of such materials.

The Company performs ongoing reviews and evaluations of the various environmental programs and issues within the Company’s operations, and, as necessary, takes actions intended to limit the Company’s exposure to potential liability. Although these costs cannot be predicted with certainty, management believes that the ultimate outcome of identified matters will not have a material adverse effect on the Company’s consolidated financial statements.

**Personal Injury.** The Company’s personal injury liability is based on semi-annual actuarial studies performed on an undiscounted basis by an independent third party actuarial firm and reviewed by management. This liability is based on personal injury claims filed and an estimate of claims incurred but not yet reported. Actual results may vary from estimates due to the number, type and severity of the injury, costs of medical treatments and uncertainties in litigation. Adjustments to the liability are reflected within operating expenses in the period in which changes to estimates are known. Personal injury claims in excess of self-insurance levels are insured up to certain coverage amounts, depending on the type of claim and year of occurrence. The personal injury liability as of June 30, 2015, was based on an updated actuarial study of personal injury claims through May 31, 2015, and review of the June 2015 experience. The personal injury liability activity was as follows (in millions):

	Six Months Ended June 30,	
	2015	2014
Balance at beginning of year	\$29.3	\$31.2
Accruals	4.4	4.4

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Change in estimate	(3.5	)	(0.7	)
Payments	(3.2	)	(3.8	)
Balance at end of period	\$27.0		\$31.1	

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Notes to Consolidated Financial Statements—(Continued)

Certain Disputes with Ferromex. KCSM and Ferrocarril Mexicano, S.A. de C.V. (“Ferromex”) use certain trackage rights, haulage rights and interline services (the “Services”) provided by each other. The rates to be charged after January 1, 2009, were agreed to pursuant to the Trackage Rights Agreement, dated February 9, 2010 (the “Trackage Rights Agreement”), between KCSM and Ferromex. The rates payable for these Services for the period beginning in 1998 through December 31, 2008, are still not resolved. If KCSM cannot reach an agreement with Ferromex for rates applicable for Services which were provided prior to January 1, 2009, which are not subject to the Trackage Rights Agreement, the Mexican Secretaría de Comunicaciones y Transportes (“Secretary of Communications and Transportation” or “SCT”) is entitled to set the rates in accordance with Mexican law and regulations. KCSM and Ferromex both initiated administrative proceedings seeking a determination by the SCT of the rates that KCSM and Ferromex should pay each other in connection with the Services. The SCT issued rulings in 2002 and 2008 setting the rates for the Services and both KCSM and Ferromex challenged these rulings. Although KCSM and Ferromex have challenged these matters based on different grounds and these cases continue to evolve, management believes the amounts recorded related to these matters are adequate. While the outcome of these matters cannot be predicted with certainty, the Company does not believe that, when resolved, these disputes will have a material effect on its consolidated financial statements.

Tax Contingencies. Tax returns filed in the U.S. for periods after 2010 and in Mexico for periods after 2008 remain open to examination by the taxing authorities. Internal Revenue Service (the “IRS”) examinations have been completed and settled for the 2011 and 2012 U.S. federal tax returns. The Servicio de Administración Tributaria (the “SAT”), the Mexican equivalent of the IRS, is currently examining the KCSM 2009 and 2010 tax returns and the 2012 and 2013 tax returns of KCSM Servicios, S.A. de C.V., a wholly-owned subsidiary of KCS. The Company is litigating a Value Added Tax (“VAT”) audit assessment from the SAT for KCSM for the year ended December 31, 2005. The Company believes it is more likely than not that it will prevail in challenging the KCSM 2005 assessment. While the outcome of this matter cannot be predicted with certainty, the Company does not believe, when resolved, that this dispute will have a material effect on its consolidated financial statements. However, an unexpected adverse resolution could have a material effect on the consolidated financial statements in a particular quarter or fiscal year.

NAFTA Rail, S. de R.L. de C.V. (NAFTA), a wholly-owned subsidiary of KCS, recorded a receivable from the SAT for VAT paid by NAFTA in connection with NAFTA’s purchase of locomotives. NAFTA subsequently collected VAT in connection with leasing these locomotives, and offset the resulting VAT payable against the existing VAT receivable. The SAT issued a resolution in 2013 which denied this offset, and assessed payment. NAFTA litigated this resolution and in January 2015 a Mexican tax court issued a favorable ruling by dismissing the SAT resolution. The SAT appealed this tax court decision in February 2015. In June 2015, the SAT appeal was dismissed by the court. This court decision validates NAFTA’s ability to offset VAT payables against the existing VAT receivable. KCSM has not historically assessed VAT on international import transportation services provided to its customers based on a written ruling that KCSM obtained from the SAT in 2008 stating that such services were exempt from VAT (the “2008 Ruling”). Notwithstanding the 2008 Ruling, in December 2013, the SAT unofficially informed KCSM of an intended implementation of new criteria effective as of January 1, 2014, pursuant to which VAT would be assessed on all international import transportation services on the portion of the services provided within Mexico. Additionally, in November 2013, the SAT filed an action to nullify the 2008 Ruling, potentially exposing the application of the new criteria to open tax years. In February 2014, KCSM filed an action opposing the SAT’s nullification action. While the SAT’s unofficial communication to KCSM is not enforceable and the 2008 Ruling continues to be in effect, KCSM notified its customers in December 2013 of the potential assessment of VAT on international import transportation services; however, implementation of any VAT assessment will depend on future developments and any guidance published by the SAT. Due to the pass-through nature of VAT assessed on services provided to customers, the Company does not believe any ultimate requirement to assess VAT on international import transportation services will have a significant effect on its consolidated financial statements. However, unexpected adverse implementation criteria imposed by the SAT for open tax years could have a material effect on the

consolidated financial statements of the Company in a particular quarter or fiscal year.

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

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



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## Kansas City Southern and Subsidiaries

## Notes to Consolidated Financial Statements—(Continued)

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

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

**11. Geographic Information**

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

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

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Revenues				
U.S.	\$287.4	\$344.0	\$599.3	\$669.1
Mexico	298.4	305.7	589.6	588.0
Total revenues	\$585.8	\$649.7	\$1,188.9	\$1,257.1
Property and equipment (including concession assets), net			June 30,	December 31,
			2015	2014
U.S.			\$4,455.4	\$4,311.0
Mexico			2,963.7	2,843.7
Total property and equipment (including concession assets), net			\$7,419.1	\$7,154.7

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Notes to Consolidated Financial Statements—(Continued)

## 12. Condensed Consolidating Financial Information

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

## CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME

Three Months Ended June 30, 2015

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$254.7	\$10.9	\$ 329.7	\$ (9.5 )	\$ 585.8
Operating expenses	1.8	185.3	9.4	212.0	(9.5 )	399.0
Operating income (loss)	(1.8 )	69.4	1.5	117.7	—	186.8
Equity in net earnings of unconsolidated affiliates	107.4	0.1	1.1	4.5	(108.1 )	5.0
Interest expense	(0.1 )	(19.5 )	—	(9.5 )	11.4	(17.7 )
Foreign exchange loss	—	—	—	(10.5 )	—	(10.5 )
Other income (expense), net	11.4	(1.2 )	—	—	(11.4 )	(1.2 )
Income before income taxes	116.9	48.8	2.6	102.2	(108.1 )	162.4
Income tax expense	5.1	18.7	1.0	25.4	—	50.2
Net income	111.8	30.1	1.6	76.8	(108.1 )	112.2
Less: Net income attributable to noncontrolling interest	—	—	0.4	—	—	0.4
Net income attributable to Kansas City Southern and subsidiaries	111.8	30.1	1.2	76.8	(108.1 )	111.8
Other comprehensive loss	(0.2 )	—	—	(0.4 )	0.4	(0.2 )
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$111.6	\$30.1	\$1.2	\$ 76.4	\$ (107.7 )	\$ 111.6



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Notes to Consolidated Financial Statements—(Continued)

## CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME - (Continued)

Three Months Ended June 30, 2014

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$302.3	\$12.3	\$ 345.4	\$ (10.3 )	\$ 649.7
Operating expenses	4.2	219.3	10.1	221.1	(10.8 )	443.9
Operating income (loss)	(4.2 )	83.0	2.2	124.3	0.5	205.8
Equity in net earnings of unconsolidated affiliates	127.0	0.3	1.1	5.5	(128.0 )	5.9
Interest expense	—	(20.8 )	—	(9.7 )	12.6	(17.9 )
Foreign exchange gain	—	—	—	5.3	—	5.3
Other income (expense), net	12.5	—	—	(2.3 )	(13.0 )	(2.8 )
Income before income taxes	135.3	62.5	3.3	123.1	(127.9 )	196.3
Income tax expense	5.5	23.9	1.3	35.4	—	66.1
Net income	129.8	38.6	2.0	87.7	(127.9 )	130.2
Less: Net income attributable to noncontrolling interest	—	—	0.4	—	—	0.4
Net income attributable to Kansas City Southern and subsidiaries	129.8	38.6	1.6	87.7	(127.9 )	129.8
Other comprehensive income	—	0.1	—	0.1	(0.2 )	—
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$129.8	\$38.7	\$1.6	\$ 87.8	\$ (128.1 )	\$ 129.8

Six Months Ended June 30, 2015

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$532.8	\$20.9	\$ 653.5	\$ (18.3 )	\$ 1,188.9
Operating expenses	3.0	382.5	18.1	438.6	(18.3 )	823.9
Operating income (loss)	(3.0 )	150.3	2.8	214.9	—	365.0
Equity in net earnings of unconsolidated affiliates	199.2	0.3	2.3	8.5	(200.9 )	9.4
Interest expense	0.1	(39.7 )	—	(20.0 )	23.3	(36.3 )
Foreign exchange loss	—	—	—	(22.1 )	—	(22.1 )
Other income (expense), net	23.2	(1.8 )	—	(0.1 )	(23.3 )	(2.0 )
Income before income taxes	219.5	109.1	5.1	181.2	(200.9 )	314.0
Income tax expense	6.9	41.8	2.0	49.9	—	100.6
Net income	212.6	67.3	3.1	131.3	(200.9 )	213.4
Less: Net income attributable to noncontrolling interest	—	—	0.8	—	—	0.8
Net income attributable to Kansas City Southern and subsidiaries	212.6	67.3	2.3	131.3	(200.9 )	212.6
Other comprehensive loss	(0.6 )	—	—	(0.8 )	0.8	(0.6 )
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$212.0	\$67.3	\$2.3	\$ 130.5	\$ (200.1 )	\$ 212.0



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Notes to Consolidated Financial Statements—(Continued)

## CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME - (Continued)

Six Months Ended June 30, 2014

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$586.3	\$23.7	\$ 667.3	\$ (20.2 )	\$ 1,257.1
Operating expenses	5.1	446.2	20.0	441.3	(21.3 )	891.3
Operating income (loss)	(5.1 )	140.1	3.7	226.0	1.1	365.8
Equity in net earnings of unconsolidated affiliates	215.5	0.6	2.1	10.5	(217.1 )	11.6
Interest expense	—	(42.3 )	—	(19.9 )	25.6	(36.6 )
Debt retirement costs	—	(2.7 )	—	(3.9 )	—	(6.6 )
Foreign exchange gain	—	—	—	8.4	—	8.4
Other income (expense), net	25.5	0.4	—	(2.5 )	(26.7 )	(3.3 )
Income before income taxes	235.9	96.1	5.8	218.6	(217.1 )	339.3
Income tax expense	12.4	36.9	2.2	63.6	—	115.1
Net income	223.5	59.2	3.6	155.0	(217.1 )	224.2
Less: Net income attributable to noncontrolling interest	—	—	0.7	—	—	0.7
Net income attributable to Kansas City Southern and subsidiaries	223.5	59.2	2.9	155.0	(217.1 )	223.5
Other comprehensive income	—	0.1	—	0.1	(0.2 )	—
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$223.5	\$59.3	\$2.9	\$ 155.1	\$ (217.3 )	\$ 223.5

## CONDENSED CONSOLIDATING BALANCE SHEETS

June 30, 2015

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
<b>Assets:</b>						
Current assets	\$3.0	\$225.3	\$5.8	\$ 303.6	\$ (14.2 )	\$ 523.5
Investments	—	3.9	—	32.7	—	36.6
Investments in consolidated subsidiaries	2,804.9	(4.9 )	474.0	—	(3,274.0 )	—
Property and equipment (including concession assets), net	—	3,509.7	190.1	3,719.3	—	7,419.1
Other assets	1.6	42.3	—	29.2	—	73.1
Total assets	\$2,809.5	\$3,776.3	\$669.9	\$ 4,084.8	\$ (3,288.2 )	\$ 8,052.3
<b>Liabilities and equity:</b>						
Current liabilities	\$(1,108.8 )	\$1,465.5	\$110.5	\$ 248.2	\$ (14.2 )	\$ 701.2
Long-term debt	0.2	699.4	0.1	1,128.8	—	1,828.5
Deferred income taxes	16.7	847.5	133.6	181.6	—	1,179.4
Other liabilities	3.7	100.5	0.1	41.4	—	145.7
Stockholders' equity	3,897.7	663.4	116.2	2,484.8	(3,274.0 )	3,888.1
Noncontrolling interest	—	—	309.4	—	—	309.4
Total liabilities and equity	\$2,809.5	\$3,776.3	\$669.9	\$ 4,084.8	\$ (3,288.2 )	\$ 8,052.3



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Notes to Consolidated Financial Statements—(Continued)

## CONDENSED CONSOLIDATING BALANCE SHEETS - (Continued)

	December 31, 2014					
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Assets:						
Current assets	\$2.7	\$281.7	\$6.0	\$ 562.5	\$ (34.6 )	\$ 818.3
Investments	—	3.9	—	32.5	—	36.4
Investments in consolidated subsidiaries	2,616.0	(4.3 )	471.3	—	(3,083.0 )	—
Property and equipment (including concession assets), net	—	3,385.5	193.3	3,575.9	—	7,154.7
Other assets	1.6	45.2	—	34.8	—	81.6
Total assets	\$2,620.3	\$3,712.0	\$670.6	\$ 4,205.7	\$ (3,117.6 )	\$ 8,091.0
Liabilities and equity:						
Current liabilities	\$(1,156.0 )	\$1,484.7	\$115.6	\$ 489.1	\$ (34.6 )	\$ 898.8
Long-term debt	0.2	701.0	0.2	1,139.6	—	1,841.0
Deferred income taxes	7.3	835.8	132.0	181.2	—	1,156.3
Other liabilities	3.7	94.4	0.7	32.0	—	130.8
Stockholders' equity	3,765.1	596.1	113.5	2,363.8	(3,083.0 )	3,755.5
Noncontrolling interest	—	—	308.6	—	—	308.6
Total liabilities and equity	\$2,620.3	\$3,712.0	\$670.6	\$ 4,205.7	\$ (3,117.6 )	\$ 8,091.0

## CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2015					
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Operating activities:						
Net cash provided	\$80.1	\$48.1	\$0.6	\$ 278.5	\$ (9.8 )	\$ 397.5
Investing activities:						
Capital expenditures	—	(208.9 )	(0.9 )	(150.4 )	—	(360.2 )
Purchase or replacement of equipment under operating leases	—	—	—	(61.3 )	—	(61.3 )
Property investments in MSLLC	—	—	—	(3.9 )	—	(3.9 )
Other investing activities	(0.4 )	(2.3 )	(0.4 )	(15.8 )	0.8	(18.1 )
Net cash used	(0.4 )	(211.2 )	(1.3 )	(231.4 )	0.8	(443.5 )
Financing activities:						
Proceeds from short-term borrowings	—	8,409.6	—	—	—	8,409.6
Repayment of short-term borrowings	—	(8,268.6 )	—	(300.0 )	—	(8,568.6 )
Proceeds from issuance of long-term debt	—	—	—	40.0	—	40.0
Repayment of long-term debt	—	(1.6 )	(0.1 )	(50.6 )	—	(52.3 )
Dividends paid	(67.5 )	—	—	(9.8 )	9.8	(67.5 )
Shares repurchased	(20.6 )	—	—	—	—	(20.6 )
Other financing activities	8.3	—	0.4	0.4	(0.8 )	8.3
Net cash provided (used)	(79.8 )	139.4	0.3	(320.0 )	9.0	(251.1 )
Cash and cash equivalents:						
Net decrease	(0.1 )	(23.7 )	(0.4 )	(272.9 )	—	(297.1 )



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At beginning of year	0.2	29.0	0.5	318.3	—	348.0
At end of period	\$0.1	\$5.3	\$0.1	\$ 45.4	\$ —	\$ 50.9

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Notes to Consolidated Financial Statements—(Continued)

## CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS - (Continued)

Six Months Ended June 30, 2014

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Operating activities:						
Net cash provided	\$52.3	\$106.9	\$0.8	\$ 242.3	\$ (6.0 )	\$ 396.3
Investing activities:						
Capital expenditures	—	(180.3 )	(0.7 )	(88.5 )	1.5	(268.0 )
Purchase or replacement of equipment under operating leases	—	(196.1 )	—	(98.2 )	—	(294.3 )
Property investments in MSLLC	—	—	—	(24.8 )	—	(24.8 )
Other investing activities	(0.7 )	8.5	(0.5 )	0.5	(0.3 )	7.5
Net cash used	(0.7 )	(367.9 )	(1.2 )	(211.0 )	1.2	(579.6 )
Financing activities:						
Proceeds from short-term borrowings	—	5,081.5	—	—	—	5,081.5
Repayment of short-term borrowings	—	(4,761.1 )	—	—	—	(4,761.1 )
Proceeds from issuance of long-term debt	—	175.0	—	—	—	175.0
Repayment of long-term debt	—	(421.9 )	(0.1 )	(73.4 )	—	(495.4 )
Dividends paid	(54.8 )	—	—	(6.0 )	6.0	(54.8 )
Other financing activities	2.9	(1.0 )	0.5	(2.4 )	(1.2 )	(1.2 )
Net cash provided (used)	(51.9 )	72.5	0.4	(81.8 )	4.8	(56.0 )
Cash and cash equivalents:						
Net decrease	(0.3 )	(188.5 )	—	(50.5 )	—	(239.3 )
At beginning of year	0.4	196.1	0.2	232.8	—	429.5
At end of period	\$0.1	\$7.6	\$0.2	\$ 182.3	\$ —	\$ 190.2

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The discussion below, as well as other portions of this Form 10-Q, contain forward-looking statements that are not based upon historical information. Readers can identify these forward-looking statements by the use of such verbs as “expects,” “anticipates,” “believes” or similar verbs or conjugations of such verbs. Such forward-looking statements are based upon information currently available to management and management’s perception thereof as of the date of this Form 10-Q. However, such statements are dependent on and, therefore, can be influenced by, a number of external variables over which management has little or no control, including: competition and consolidation within the transportation industry; the business environment in industries that produce and use items shipped by rail; loss of the rail concession of Kansas City Southern’s subsidiary, Kansas City Southern de México, S.A. de C.V.; the termination of, or failure to renew, agreements with customers, other railroads and third parties; interest rates; access to capital; disruptions to the Company’s technology infrastructure, including its computer systems; natural events such as severe weather, hurricanes and floods; market and regulatory responses to climate change; credit risk of customers and counterparties and their failure to meet their financial obligations; legislative and regulatory developments and disputes; rail accidents or other incidents or accidents on KCS’s rail network or at KCS’s facilities or customer facilities involving the release of hazardous materials, including toxic inhalation hazards; fluctuation in prices or availability of key materials, in particular diesel fuel; dependency on certain key suppliers of core rail equipment; changes in securities and capital markets; availability of qualified personnel; labor difficulties, including strikes and work stoppages; insufficiency of insurance to cover lost revenue, profits or other damages; acts of terrorism or risk of terrorist activities; war or risk of war; domestic and international economic conditions; political and economic conditions in Mexico and the level of trade between the United States and Mexico; increased demand and traffic congestion; the outcome of claims and litigation involving the Company or its subsidiaries; and other factors affecting the operation of the business. For more discussion about each risk factor, see Part II Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, which is on file with the U.S. Securities and Exchange Commission (File No. 1-4717) and Part I Item 1A — “Risk Factors” in the Form 10-K and any updates contained herein. Readers are strongly encouraged to consider these factors when evaluating forward-looking statements. Forward-looking statements should not be read as a guarantee of future performance or results and will not necessarily be accurate indications of the timing when, or by which, such performance or results will be achieved. As a result, actual outcomes or results could materially differ from those indicated in forward-looking statements. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements.

This discussion is intended to clarify and focus on Kansas City Southern’s (“KCS” or the “Company”) results of operations, certain changes in its financial position, liquidity, capital structure and business developments for the periods covered by the consolidated financial statements included under Item 1 of this Form 10-Q. This discussion should be read in conjunction with those consolidated financial statements and the related notes and is qualified by reference to them.

Critical Accounting Policies and Estimates

The Company’s discussion and analysis of its financial position and results of operations is based upon its consolidated financial statements. The preparation of these consolidated financial statements requires estimation and judgment that affect the reported amounts of revenue, expenses, assets and liabilities. The Company bases its estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the accounting for assets and liabilities that are not readily apparent from other sources. If the estimates differ materially from actual results, the impact on the consolidated financial statements may be material. The Company’s critical accounting policies are disclosed in the 2014 Annual Report on Form 10-K.

Overview

The Company is engaged in the freight rail transportation business, operating a coordinated rail network under one reportable business segment. The primary operating subsidiaries of the Company consist of the following: The Kansas City Southern Railway Company (“KCSR”), Kansas City Southern de México, S.A. de C.V. (“KCSM”), Meridian

Speedway, LLC (“MSLLC”), and The Texas Mexican Railway Company (“TexMex”). The Company generates revenues and cash flows by providing customers with freight delivery services within its regions, and throughout North America through connections with other Class I rail carriers. Customers conduct business in a number of different industries, including chemical and petroleum products, industrial and consumer products, agriculture and mineral products, energy products, automotive products and intermodal transportation. Appropriate eliminations and reclassifications have been recorded in preparing the consolidated financial statements.

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## Second Quarter Analysis

Revenues decreased 10% for the three months ended June 30, 2015, as compared to the same period in 2014, due to a 6% decrease in carload/unit volumes and a 4% decrease in revenue per carload/unit. Revenue per carload/unit decreased due to the weakening of the Mexican peso against the U.S. dollar and lower fuel surcharge, resulting from lower U.S. fuel prices. Energy revenue decreased by 46% due to lower volumes in utility coal as a result of lower natural gas prices. Low crude oil prices have resulted in lower than expected crude oil volume growth and in reduced frac sand and metals volumes due to the significant decline in new U.S. drilling operations. In addition, the Company also experienced service-related issues, which negatively affected revenue in certain commodities. Due to the uncertainty around energy-related markets, foreign exchange impacts and U.S. fuel prices, the Company withdrew its 2015 revenue and volume guidance on May 14, 2015.

Operating expenses decreased \$44.9 million during the three months ended June 30, 2015, as compared to the same period in 2014, due to lower U.S. fuel prices, the weakening of the Mexican peso against the U.S. dollar and lower lease termination costs. Expense reductions resulting from U.S. fuel prices and the weakening Mexican peso largely offset the revenue reductions driven by these same macroeconomic factors. Expense reductions were partially offset by increased depreciation expense. Operating expenses as a percentage of revenues was 68.1% for the three months ended June 30, 2015, compared to 68.3% for the same period in 2014.

The Company reported quarterly earnings of \$1.01 per diluted share on consolidated net income of \$111.8 million for the three months ended June 30, 2015, compared to earnings of \$1.18 per diluted share on consolidated net income of \$129.8 million for the same period in 2014, due to decreased operating income.

In May 2015, the Company announced a share repurchase program of up to \$500.0 million, which expires on June 30, 2017. Management's assessment of market conditions, available liquidity and other factors will determine the timing and volume of repurchases. Future share repurchases are expected to be funded by cash on hand, cash generated from operations and debt. During the second quarter of 2015, KCS repurchased 222,131 shares of common stock for \$20.6 million at an average price of \$92.71 per share under this program.

## Results of Operations

The following summarizes KCS's consolidated income statement components (in millions):

	Three Months Ended		Change Dollars
	June 30, 2015	2014	
Revenues	\$585.8	\$649.7	\$(63.9 )
Operating expenses	399.0	443.9	(44.9 )
Operating income	186.8	205.8	(19.0 )
Equity in net earnings of unconsolidated affiliates	5.0	5.9	(0.9 )
Interest expense	(17.7 )	(17.9 )	0.2
Foreign exchange gain (loss)	(10.5 )	5.3	(15.8 )
Other expense, net	(1.2 )	(2.8 )	1.6
Income before income taxes	162.4	196.3	(33.9 )
Income tax expense	50.2	66.1	(15.9 )
Net income	112.2	130.2	(18.0 )
Less: Net income attributable to noncontrolling interest	0.4	0.4	—
Net income attributable to Kansas City Southern and subsidiaries	\$111.8	\$129.8	\$(18.0 )

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	Six Months Ended		Change
	June 30, 2015	2014	
Revenues	\$1,188.9	\$1,257.1	\$(68.2 )
Operating expenses	823.9	891.3	(67.4 )
Operating income	365.0	365.8	(0.8 )
Equity in net earnings of unconsolidated affiliates	9.4	11.6	(2.2 )
Interest expense	(36.3 )	(36.6 )	0.3
Debt retirement costs	—	(6.6 )	6.6
Foreign exchange gain (loss)	(22.1 )	8.4	(30.5 )
Other expense, net	(2.0 )	(3.3 )	1.3
Income before income taxes	314.0	339.3	(25.3 )
Income tax expense	100.6	115.1	(14.5 )
Net income	213.4	224.2	(10.8 )
Less: Net income attributable to noncontrolling interest	0.8	0.7	0.1
Net income attributable to Kansas City Southern and subsidiaries	\$212.6	\$223.5	\$(10.9 )

## Revenues

The following summarizes revenues (in millions), carload/unit statistics (in thousands) and revenue per carload/unit:

	Revenues			Carloads and Units			Revenue per Carload/Unit		
	Three Months			Three Months			Three Months		
	Ended June 30, 2015	2014	% Change	Ended June 30, 2015	2014	% Change	Ended June 30, 2015	2014	% Change
Chemical and petroleum	\$116.0	\$115.1	1 %	62.8	64.2	(2 %)	\$1,847	\$1,793	3 %
Industrial and consumer products	144.6	156.2	(7 %)	82.8	89.3	(7 %)	1,746	1,749	—
Agriculture and minerals	104.5	114.9	(9 %)	58.9	60.3	(2 %)	1,774	1,905	(7 %)
Energy	44.2	81.4	(46 %)	51.9	73.5	(29 %)	852	1,107	(23 %)
Intermodal	97.9	98.7	(1 %)	250.0	254.5	(2 %)	392	388	1 %
Automotive	55.0	59.6	(8 %)	30.8	31.8	(3 %)	1,786	1,874	(5 %)
Carload revenues, carloads and units	562.2	625.9	(10 %)	537.2	573.6	(6 %)	\$1,047	\$1,091	(4 %)
Other revenue	23.6	23.8	(1 %)						
Total revenues (i)	\$585.8	\$649.7	(10 %)						

(i) Included in revenues:

Fuel surcharge	\$55.8	\$86.9
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	Revenues			Carloads and Units			Revenue per Carload/Unit		
	Six Months Ended			Six Months Ended			Six Months Ended		
	June 30,			June 30,			June 30,		
	2015	2014	% Change	2015	2014	% Change	2015	2014	% Change
Chemical and petroleum	\$230.8	\$220.3	5 %	125.0	122.0	2 %	\$1,846	\$1,806	2 %
Industrial and consumer products	290.6	305.3	(5 %)	163.9	172.9	(5 %)	1,773	1,766	—
Agriculture and minerals	210.1	228.3	(8 %)	115.7	119.0	(3 %)	1,816	1,918	(5 %)
Energy	110.8	159.6	(31 %)	117.7	145.8	(19 %)	941	1,095	(14 %)
Intermodal	192.9	186.7	3 %	493.3	488.7	1 %	391	382	2 %
Automotive	109.4	112.0	(2 %)	61.8	60.5	2 %	1,770	1,851	(4 %)
Carload revenues, carloads and units	1,144.6	1,212.2	(6 %)	1,077.4	1,108.9	(3 %)	\$1,062	\$1,093	(3 %)
Other revenue	44.3	44.9	(1 %)						
Total revenues (i)	\$1,188.9	\$1,257.1	(5 %)						

(i) Included in revenues:

Fuel surcharge \$123.3 \$165.2

Freight revenues include revenue for transportation services and fuel surcharges. For the three months ended June 30, 2015, revenues and carload/unit volumes decreased 10% and 6%, respectively, compared to the same period in 2014. For the six months ended June 30, 2015, revenues and carload/unit volumes decreased 5% and 3%, respectively, compared to the same period in 2014. Energy revenue decreased 46% and 31% for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014, driven by lower volumes in utility coal due to lower natural gas prices. Low crude oil prices have resulted in lower than expected crude oil volume growth and in reduced frac sand and metals volumes due to the significant decline in new U.S. drilling operations. In addition, the Company also experienced service-related issues, which negatively affected revenue in certain commodities. Revenue per carload/unit decreased 4% and 3% for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014, due to the weakening of the Mexican peso against the U.S. dollar and lower fuel surcharge, partially offset by positive pricing impacts.

KCS's fuel surcharges are a mechanism to adjust revenue based upon changing fuel prices. Fuel surcharges are calculated differently depending on the type of commodity transported. For most commodities, fuel surcharge is calculated using a fuel price from a prior time period that can be up to 60 days earlier. In a period of volatile fuel prices or changing customer business mix, changes in fuel expense and fuel surcharge may differ.

The following discussion provides an analysis of revenues by commodity group:

Revenues by commodity group  
for the three months ended  
June 30, 2015

Chemical and petroleum. Revenues increased \$0.9 million for the three months ended June 30, 2015, compared to the same period in 2014, due to a 3% increase in revenue per carload/unit, partially offset by a 2% decrease in carload/unit volumes. Revenues increased \$10.5 million for the six months ended June 30, 2015, compared to the same period in 2014, due to a 2% increase in revenue per carload/unit and carload/unit volumes. Petroleum volumes increased as a result of new business and plastics volumes increased due to

lower commodity prices. Chemical volumes decreased in the second quarter of 2015 as a result of moving soda ash earlier in 2015 than in 2014. Revenue per carload/unit increased due to positive pricing impacts, partially offset by lower fuel surcharge and the weakening of the Mexican peso against the U.S. dollar.

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for the three months ended  
June 30, 2015

Industrial and consumer products. Revenues decreased \$11.6 million for the three months ended June 30, 2015, compared to the same period in 2014, due to a 7% decrease in carload/unit volumes. Revenues decreased \$14.7 million for the six months ended June 30, 2015, compared to the same period in 2014, due to a 5% decrease in carload/unit volumes. Metals and scrap volumes decreased due to the decline in new drilling operations in the U.S., higher imports from foreign sources and lower steel prices. Revenue per carload/unit was flat as positive pricing impacts were offset by lower fuel surcharge and the weakening of the Mexican peso against the U.S. dollar.

Agriculture and minerals. Revenues decreased \$10.4 million for the three months ended June 30, 2015, compared to the same period in 2014, due to a 7% decrease in revenue per carload/unit and a 2% decrease in carload/unit volumes. Revenues decreased \$18.2 million for the six months ended June 30, 2015, compared to the same period in 2014, due to a 5% decrease in revenue per carload/unit and a 3% decrease in carload/unit volumes. Service-related issues contributed to decreased grain volumes in the first half of 2015. In addition, grain volumes decreased as the Company benefited from business opportunities during the first quarter of 2014 as a result of weather-related U.S. rail network congestion. Revenue per carload/unit decreased due to lower fuel surcharge and the weakening of the Mexican peso against the U.S. dollar.

Energy. Revenues decreased \$37.2 million for the three months ended June 30, 2015, compared to the same period in 2014, due to a 29% decrease in carload/unit volumes and a 23% decrease in revenue per carload/unit. Revenues decreased \$48.8 million for the six months ended June 30, 2015, compared to the same period in 2014, due to a 19% decrease in carload/unit volumes and a 14% decrease in revenue per carload/unit. Volumes decreased as low natural gas prices have reduced the demand for utility coal and the decline in new drilling operations in the U.S. has reduced the demand for frac sand. These decreases were partially offset by increased crude oil volumes due to new business. Revenue per carload/unit decreased due to shorter average length of haul and lower fuel surcharge.

Intermodal. Revenues decreased \$0.8 million for the three months ended June 30, 2015, compared to the same period in 2014, due to a 2% decrease in carload/unit volumes, partially offset by a 1% increase in revenue per carload/unit. Revenues increased \$6.2 million for the six months ended June 30, 2015, compared to the same period in 2014, due to a 2% increase in revenue per carload/unit and a 1% increase in carload/unit volumes. Revenue per carload/unit increased due to positive pricing impacts, partially offset by lower fuel surcharge. Volume growth driven by trans-Pacific imports via the Port of Lazaro Cardenas was partially offset by lower volumes in the second quarter of 2015 due to service-related issues.

Automotive. Revenues decreased \$4.6 million for the three months ended June 30, 2015, compared to the same period in 2014, due to a 5% decrease in revenue per carload/unit and a 3% decrease in carload/unit volumes. Revenues

decreased \$2.6 million for the six months ended June 30, 2015, compared to the same period in 2014, due to a 4% decrease in revenue per carload/unit, partially offset by a 2% increase in carload/unit volumes. Revenue per carload/unit decreased due to the weakening of the Mexican peso against the U.S. dollar, partially offset by positive pricing impacts. Volumes decreased in the second quarter of 2015 due to service-related issues.

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## Operating Expenses

Operating expenses, as shown below (in millions), decreased \$44.9 million and \$67.4 million for the three and six months ended June 30, 2015, respectively, compared to the same period in 2014, due to lower U.S. fuel prices, the weakening of the Mexican peso against the U.S. dollar and lower lease termination costs. These decreases were partially offset by increased depreciation expense.

	Three Months Ended			
	June 30, 2015	2014	Change Dollars	Percent
Compensation and benefits	\$108.0	\$115.5	\$(7.5 )	(6 %)
Purchased services	57.0	63.8	(6.8 )	(11 %)
Fuel	77.5	107.7	(30.2 )	(28 %)
Equipment costs	29.9	29.5	0.4	1 %
Depreciation and amortization	70.8	63.9	6.9	11 %
Materials and other	55.8	55.1	0.7	1 %
Lease termination costs	—	8.4	(8.4 )	(100 %)
Total operating expenses	\$399.0	\$443.9	\$(44.9 )	(10 %)
	Six Months Ended			
	June 30, 2015	2014	Change Dollars	Percent
Compensation and benefits	\$225.6	\$226.1	\$(0.5 )	—
Purchased services	115.1	119.0	(3.9 )	(3 %)
Fuel	158.5	211.6	(53.1 )	(25 %)
Equipment costs	59.0	61.2	(2.2 )	(4 %)
Depreciation and amortization	139.3	125.8	13.5	11 %
Materials and other	116.8	109.3	7.5	7 %
Lease termination costs	9.6	38.3	(28.7 )	(75 %)
Total operating expenses	\$823.9	\$891.3	\$(67.4 )	(8 %)

Compensation and benefits. Compensation and benefits decreased \$7.5 million and \$0.5 million for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014, due to the weakening of the Mexican peso against the U.S. dollar, partially offset by annual salary rate increases and growth in headcount.

Compensation and benefits decreased for the three months ended June 30, 2015 due to lower incentive compensation.

Purchased services. Purchased services expense decreased \$6.8 million and \$3.9 million for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014, due to the renegotiation of a maintenance contract, lower corporate expenses and the weakening of the Mexican peso against the U.S. dollar. For the six months ended June 30, 2015, these decreases were partially offset by higher expense as a result of the timing of track maintenance activities.

Fuel. Fuel expense decreased \$30.2 million and \$53.1 million for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014, due to lower diesel fuel prices, the effects of the weakening of the Mexican peso against the U.S. dollar and lower consumption. The average price per gallon, including the effects of the weakening of the Mexican peso against the U.S. dollar, was \$2.50 and \$2.48 for the three and six months ended June 30, 2015, respectively, compared to \$3.12 and \$3.11 for the same periods in 2014.

Equipment costs. Equipment costs increased \$0.4 million for the three months ended June 30, 2015, compared to the same period in 2014, due to longer cycle times as a result of service-related issues, offset by lower lease expense as a result of the purchase of equipment under existing operating leases and replacement equipment as certain operating leases expired during 2014. Equipment costs decreased \$2.2 million for the six months ended June 30, 2015, compared to the same period in 2014, due to lower lease expense as a result of the purchase of equipment under existing operating leases and replacement equipment as certain operating leases expired during 2014, partially offset by longer cycle times as a result of service-related issues.

Depreciation and amortization. Depreciation and amortization expense increased \$6.9 million and \$13.5 million for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014, due to a larger asset base, including the purchase of equipment under existing operating leases and replacement equipment as certain operating leases expired.

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Materials and other. Materials and other expense increased \$0.7 million and \$7.5 million for the three and six months ended June 30, 2015, compared to the same periods in 2014, due to increased derailment expense, materials and supplies and property taxes. These increases were offset by lower employee expenses and by a \$3.5 million reduction in personal injury expense recognized during the second quarter of 2015, compared to an increase of \$0.6 million for the same period in 2014, as a result of changes in estimates.

Lease termination costs. Lease termination costs were \$9.6 million for the six months ended June 30, 2015, compared to \$8.4 million and \$38.3 million for the three and six months ended June 30, 2014, respectively, due to the early termination of certain operating leases and the related purchase of the equipment. The Company did not incur lease termination costs for the three months ended June 30, 2015.

Non-Operating Income and Expenses

Equity in net earnings of unconsolidated affiliates. Equity in net earnings from unconsolidated affiliates decreased \$0.9 million and \$2.2 million for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014. Equity in net earnings from the operations of Panama Canal Railway Company decreased due to lower container volumes. Equity in net earnings from the operations of Ferrocarril y Terminal del Valle de Mexico, S.A. de C.V. decreased due to higher operating expenses.

Interest expense. Interest expense was relatively flat for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014. During the three and six months ended June 30, 2015, the average debt and commercial paper balances were \$2,133.2 million and \$2,171.6 million, respectively, compared to \$2,130.3 million and \$2,117.4 million for the same periods in 2014. Average interest rates during the three and six months ended June 30, 2015 were 3.2% and 3.3%, respectively, compared to 3.3% and 3.4% for the same periods in 2014.

Debt retirement costs. The Company did not incur debt retirement costs during 2015 and during the three months ended June 30, 2014. For the six months ended June 30, 2014 debt retirement costs were \$6.6 million, related to the call premiums, original issue discounts and write-off of unamortized debt issuance costs associated with the Company's various debt redemption activities.

Foreign exchange gain (loss). For the three and six months ended June 30, 2015, foreign exchange loss was \$10.5 million and \$22.1 million, respectively, compared to a foreign exchange gain of \$5.3 million and \$8.4 million for the same periods in 2014. Foreign exchange gain (loss) includes the re-measurement and settlement of monetary assets and liabilities denominated in Mexican pesos and the gain (loss) on foreign currency derivative contracts.

For the three and six months ended June 30, 2015, the re-measurement and settlement of monetary assets and liabilities denominated in Mexican pesos resulted in a foreign exchange loss of \$1.2 million and \$2.7 million, respectively, compared to a foreign exchange loss of \$0.2 million and \$0.3 million for the same periods in 2014. The Company enters into foreign currency derivative contracts to hedge its net exposure to fluctuations in the Mexican cash tax obligation due to changes in the value of the Mexican peso against the U.S. dollar. For the three and six months ended June 30, 2015, foreign exchange loss on foreign currency derivative contracts was \$9.3 million and \$19.4 million, respectively, compared to a gain of \$5.5 million and \$8.7 million for the same periods in 2014.

Other expense, net. Other expense, net decreased \$1.6 million and \$1.3 million for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014, due to lower miscellaneous fees.



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Income tax expense. Income tax expense decreased \$15.9 million and \$14.5 million for the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014, due to lower pre-tax income and a lower effective tax rate. The components of the effective tax rates for the three and six months ended June 30, 2015, compared to the same periods in 2014, are as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Statutory rate in effect	35.0	% 35.0	% 35.0	% 35.0
Tax effect of:				
Difference between U.S. and foreign tax rate	(2.9	% (3.3	% (2.9	% (3.3
State and local income tax provision, net	1.3	% 1.3	% 1.3	% 1.3
Foreign exchange (i)	(3.4	% 1.1	% (2.3	% 0.7
Other, net	0.9	% (0.4	% 0.9	% 0.2
Effective tax rate	30.9	% 33.7	% 32.0	% 33.9

Mexican income taxes are paid in Mexican pesos, and as a result, the effective income tax rate reflects fluctuations in the value of the Mexican peso against the U.S. dollar measured by the forward exchange rate. Most significantly, any gain or loss from the revaluation of net U.S. dollar-denominated monetary liabilities (primarily debt) into Mexican pesos is included in Mexican taxable income under Mexican tax law. As a result, a strengthening of the Mexican peso against the U.S. dollar for the reporting period will generally increase the Mexican cash tax obligation and the effective income tax rate, and a weakening of the Mexican peso against the U.S. dollar for the reporting period will generally decrease the Mexican cash tax obligation and the effective tax rate. To hedge its exposure to this risk, the Company enters into foreign currency derivative contracts, which are measured at fair value each period and any change in fair value is recognized in foreign exchange gain (loss) within the consolidated statements of income as described above. Refer to Note 7 Derivative Instruments for more information.

## Liquidity and Capital Resources

### Overview

The Company focuses its cash and capital resources on investing in the business, shareholder returns and optimizing its capital structure.

The Company believes, based on current expectations, that cash and other liquid assets, operating cash flows, access to debt and equity capital markets, and other available financing resources will be sufficient to fund anticipated operating expenses, capital expenditures, debt service costs, dividends, share repurchases and other commitments in the foreseeable future. The Company's current financing instruments contain restrictive covenants which limit or preclude certain actions; however, the covenants are structured such that the Company has sufficient flexibility to conduct its operations. The Company was in compliance with all of its debt covenants as of June 30, 2015.

Though KCS's cash flows from operations are expected to be sufficient to fund operations, capital expenditures, debt service and dividends, the Company may, from time to time, incur debt to refinance existing indebtedness, purchase equipment under operating leases, repurchase shares or fund equipment additions or new investments.

During the first half of 2015, the Company invested \$325.2 million in capital expenditures and purchased \$61.3 million of equipment under existing operating leases and replacement equipment as certain operating leases expired. In May 2015, the Company announced a share repurchase program of up to \$500.0 million, which expires on June 30, 2017. Management's assessment of market conditions, available liquidity and other factors will determine the timing and volume of repurchases. Future share repurchases are expected to be funded by cash on hand, cash generated from operations and debt. During the second quarter of 2015, KCS repurchased 222,131 shares of common stock for \$20.6 million at an average price of \$92.71 per share under this program.

During the first and second quarters of 2015, the Company's Board of Directors declared quarterly cash dividends on its common stock of \$0.33 per share (total of \$72.9 million). Subject to the discretion of the Board of Directors, capital availability and a determination that cash dividends continue to be in the best interest of its stockholders, the

Company intends to pay a quarterly dividend on an ongoing basis.

During the fourth quarter of 2014, the Company borrowed \$300.0 million under a new credit agreement with The Bank of Tokyo-Mitsubishi UFJ, Ltd, which was used to reduce commercial paper borrowings and for general corporate purposes. The borrowings were repaid in the first quarter of 2015 using available cash. For additional discussion of the agreements representing the

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indebtedness of KCS, see “Note 9, Short-Term Borrowings” and “Note 10, Long-Term Debt” in the “Notes to the Consolidated Financial Statements” section of the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

On June 30, 2015, total available liquidity (the unrestricted cash balance plus revolving credit facility and commercial paper program availability) was \$408.9 million. As of June 30, 2015, the total cash and cash equivalents held outside of the U.S. in foreign subsidiaries was \$34.3 million. The Company expects that this cash will be available to fund operations without incurring additional taxes.

Historically, the Company has been able to defer any significant U.S. federal income tax payments due to bonus depreciation. Bonus depreciation was enacted under federal tax law for qualified capital expenditures made during the years 2008 through 2014. If bonus depreciation is not extended for 2015, the Company estimates that operating cash outflows related to the payment of U.S. federal income taxes would increase by approximately \$50.0 million in 2016. KCS’s operating results and financing alternatives can be unexpectedly impacted by various factors, some of which are outside of its control. For example, if KCS were to experience a reduction in revenues or a substantial increase in operating costs or other liabilities, its earnings could be significantly reduced, increasing the risk of non-compliance with debt covenants. Additionally, the Company is subject to external factors impacting debt and equity capital markets and its ability to obtain financing under reasonable terms is subject to market conditions. Volatility in capital markets and the tightening of market liquidity could impact KCS’s access to capital. Further, KCS’s cost of debt can be impacted by independent rating agencies which assign debt ratings based on certain factors including competitive position, credit measurements such as interest coverage and leverage ratios, and liquidity.

## Cash Flow Information

Summary cash flow data follows (in millions):

	Six Months Ended	
	June 30,	
	2015	2014
Cash flows provided by (used for):		
Operating activities	\$397.5	\$396.3
Investing activities	(443.5)	(579.6)
Financing activities	(251.1)	(56.0)
Net decrease in cash and cash equivalents	(297.1)	(239.3)
Cash and cash equivalents beginning of year	348.0	429.5
Cash and cash equivalents end of period	\$50.9	\$190.2

Cash flows from operating activities increased \$1.2 million for the six month period ended June 30, 2015, compared to the same period in 2014, due to increased cash inflows from working capital items resulting mainly from the timing of certain payments. This increase was partially offset by distributions from unconsolidated affiliates received in the first quarter of 2014. Net cash used for investing activities decreased \$136.1 million, compared to the same period in 2014, due to a \$233.0 million decrease in expenditures for the purchase or replacement of equipment under existing operating leases, partially offset by a \$92.2 million increase in capital expenditures. Additional information regarding capital expenditures is provided below. During 2015, net financing cash outflows were \$251.1 million due to the net repayment of short-term borrowings of \$159.0 million, the payment of dividends of \$67.5 million, the net repayment of long-term debt of \$12.3 million and the repurchase of common stock shares of \$20.6 million. During 2014, net financing cash outflows were \$56.0 million due to the net repayment of \$320.4 million of long term debt and the payment of dividends of \$54.8 million, partially offset by the net proceeds from short-term borrowings of \$320.4 million.

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## Capital Expenditures

KCS has funded, and expects to continue to fund capital expenditures with operating cash flows and short and long-term debt.

The following table summarizes capital expenditures by type (in millions):

	Six Months Ended	
	June 30,	
	2015	2014
Roadway capital program	\$ 148.6	\$ 132.3
Locomotives and freight cars	115.4	90.0
Capacity	42.9	16.9
Information technology	12.9	10.1
Other	5.4	5.8
Total capital expenditures (accrual basis)	325.2	255.1
Change in capital accruals	35.0	12.9
Total cash capital expenditures	\$360.2	\$268.0
Purchase or replacement of equipment under operating leases		
Locomotives	\$—	\$76.3
Freight cars	61.3	221.0
Total purchase or replacement of equipment under operating leases (accrual basis)	61.3	297.3
Change in capital accruals	—	(3.0 )
Total cash purchase or replacement of equipment under operating leases	\$61.3	\$294.3

Generally, the Company's capital program consists of capital replacement and equipment. For 2015, internally generated cash flows and short-term borrowings are expected to fund cash capital expenditures, which are currently estimated to be between \$650.0 million and \$670.0 million. In addition, the Company is continuously reviewing its equipment under operating leases. Any additional purchase or replacement of equipment under operating leases during 2015 is expected to be funded with internally generated cash flows, short and/or long-term debt.

## Other Matters

Approximately 80% of KCSR employees are covered by collective bargaining agreements. KCSR participates in industry-wide bargaining as a member of the National Carriers' Conference Committee. Long-term settlement agreements were reached and ratified during 2011 and the first half of 2012 covering all of the participating unions. These agreements will be in effect through December 2015.

KCSM Servicios, S.A. de C.V. ("KCSM Servicios"), a wholly owned subsidiary of KCS, provides employee services to KCSM, and KCSM pays KCSM Servicios market-based rates for these services. KCSM Servicios' union employees are covered by one labor agreement, which was signed on April 16, 2012, between KCSM Servicios and the Sindicato de Trabajadores Ferrocarrileros de la República Mexicana ("Mexican Railroad Union"), for an indefinite period of time, for the purpose of regulating the relationship between the parties. Approximately 80% of KCSM Servicios employees are covered by this labor agreement. The compensation terms under this labor agreement are subject to renegotiation on an annual basis and all other benefits are subject to negotiation every two years. The union labor negotiations with the Mexican Railroad Union have not historically resulted in any strike, boycott or other disruption in KCSM's business operations. On July 1, 2015, the negotiation of compensation terms and all other benefits was initiated with the Mexican Railroad Union. The anticipated resolution of this negotiation is not expected to have a material impact to the consolidated financial statements.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

There was no material change during the quarter from the information set forth in Part II, Item 7A. “Quantitative and Qualitative Disclosure about Market Risk” in the Annual Report on Form 10-K for the year ended December 31, 2014.

Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures

As of the end of the period for which this Quarterly Report on Form 10-Q is filed, the Company’s Chief Executive Officer and Chief Financial Officer have each reviewed and evaluated the effectiveness of the Company’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company’s current disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company’s management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting

There have not been any changes in the Company’s internal control over financial reporting that occurred during the second quarter of 2015 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

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## PART II — OTHER INFORMATION

## Item 1. Legal Proceedings

For information related to the Company's legal proceedings, see Note 10, Commitments and Contingencies under Part I, Item 1 of this quarterly report on Form 10-Q.

## Item 1A. Risk Factors

There were no material changes during the quarter to the Risk Factors disclosed in Item 1A — "Risk Factors" in our annual report on Form 10-K for the year ended December 31, 2014.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs <sup>(1)</sup>	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be purchased under the Plans or Programs <sup>(1)</sup>
April 2015	—	\$—	—	\$500,000,000
May 2015	75,000	\$91.90	75,000	\$493,107,725
June 2015	147,131	\$93.13	147,131	\$479,405,375
Total	222,131		222,131	

On May 14, 2015, the Company announced that the Board of Directors approved a share repurchase program, (1) pursuant to which up to \$500 million in shares of Common Stock could be purchased through June 30, 2017.

## Item 3. Defaults upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit No.	Description of Exhibits Filed with this Report
31.1	Principal Executive Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 31.1.
31.2	Principal Financial Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 31.2.
32.1	Principal Executive Officer's Certification furnished Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 32.1.
32.2	Principal Financial Officer's Certification furnished Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 32.2.
101	The following unaudited financial information from Kansas City Southern's Quarterly Report on Form 10-Q for the quarter ended June 30, 2015, formatted in XBRL (Extensible Business Reporting Language) includes: (i) Consolidated Statements of Income for the three and six months ended June 30, 2015 and 2014, (ii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2015 and 2014, (iii) Consolidated Balance Sheets as of June 30, 2015 and December 31, 2014, (iv) Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and 2014, and (v) the Notes to Consolidated Financial Statements.
Exhibit No.	Description of Exhibits Incorporated by Reference
10.1	Kansas City Southern Annual Incentive Plan, amended and restated effective as of January 1, 2015, filed as Exhibit 10.1 to the Company's Form 8-K, filed on May 8, 2015 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.1.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized and in the capacities indicated on July 17, 2015.

Kansas City Southern

/s/ MICHAEL W. UPCHURCH

Michael W. Upchurch  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)

/s/ MARY K. STADLER

Mary K. Stadler  
Senior Vice President and Chief Accounting Officer  
(Principal Accounting Officer)