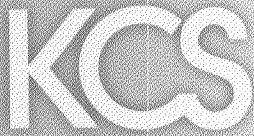




# KANSAS CITY SOUTHERN



2012 ANNUAL REPORT



**Kansas City Southern** is a transportation holding company with two primary subsidiaries. The Kansas City Southern Railway Company is one of seven Class I railroads operating in the United States. Kansas City Southern de México, SA. de C.V. is one of two large regional railroads in Mexico. KCS also owns 50% of the Panama Canal Railway Company in Panama. The combined North American rail network comprises approximately 6,300 route miles that link commercial and industrial markets in the United States and Mexico.

## 2012 FINANCIAL HIGHLIGHTS

Dollars in millions, except share and per share amounts. Years ended December 31.

	2012	2011	2010	2009
<b>OPERATIONS</b>				
Revenues	\$ 2,238.6	\$ 2,098.3	\$ 1,814.8	\$ 1,480.2
Operating income	715.9	611.6	486.5	266.8
Net income attributable to Kansas City Southern and subsidiaries	377.3	330.3	180.2	67.1
<b>PER COMMON SHARE</b>				
Earnings per diluted share	\$ 3.43	\$ 3.00	\$ 1.67	\$ 0.60
<b>CLOSING STOCK PRICE RANGES</b>				
Common - High	\$ 83.82	\$ 69.17	\$ 49.98	\$ 34.13
Common - Low	62.54	46.00	29.70	12.62
4% Non-Cumulative Preferred - High	26.40	26.25	23.75	22.40
4% Non-Cumulative Preferred - Low	23.68	22.03	19.88	17.24
<b>FINANCIAL CONDITION</b>				
Total assets	\$ 6,395.9	\$ 6,145.1	\$ 5,627.9	\$ 5,415.5
Total debt	1,607.8	1,639.1	1,639.7	1,980.0
Total stockholders' equity	3,096.6	2,764.5	2,431.1	2,043.0
Total equity	3,400.7	3,058.7	2,713.7	2,325.8
<b>COMMON STOCKHOLDER INFORMATION AT YEAR END</b>				
Stockholders of record	3,002	3,537	3,994	4,390
Shares outstanding (in thousands)	110,131	109,911	102,649	96,213
Diluted shares (in thousands)	110,080	109,830	107,534	93,649

## LETTER TO OUR STOCKHOLDERS

**In 2012, Kansas City Southern (KCS) reported revenues of \$2.2 billion, up 7% from 2011. Carloads climbed to 2.1 million, a 5% increase. Operating income grew to \$716 million, 17% higher than the previous year. And KCS reported an operating ratio of 68%, a 2.9 point improvement over 2011's operating ratio.**

All the above are Company records. Despite unusual weather conditions that negatively affected our grain and utility coal business, KCS' two primary railroad subsidiaries, The Kansas City Southern Railway Company (KCSR) and Kansas City Southern de Mexico, S.A. de C.V. (KCSM), performed exceptionally well.

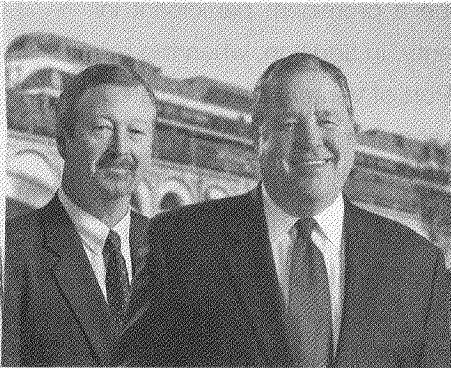
A company's success is never defined by the performance of just one department or division, but rather by a combination of departments working together to achieve common goals. Given 2012's climatic and economic challenges, it would have been impossible for KCS to attain the record earnings that it did without the close coordination of our Operations, Marketing and Finance teams, both in the U.S. and Mexico.

### Operations

Probably no statistic better illustrates the contribution of Operations than the fact that KCS moved 5% more freight in 2012 while keeping headcount flat. Overall system train velocity and intermodal train speeds improved – again, all while moving a record volume of freight over our system.

A characteristic of the KCS Operations team that is particularly impressive is its ability to adapt swiftly to emerging challenges and opportunities. KCS remains committed to not only controlling headcount but also having very few management levels. There are many advantages to this streamlined organizational structure, not the least being the elimination of bureaucratic red tape from the decision-making process. In the case of our Operations team, the absence of bureaucracy allows them to be nimble and rapidly redeploy equipment, personnel and capital resources as situations dictate.

This ability to react quickly and efficiently was clearly evident in 2012. For example, when a combination of unseasonably warm winter weather and historically low natural gas prices resulted in a precipitous drop in the demand for utility coal, KCS Operations immediately redeployed locomotives to other areas of the system that were experiencing strong traffic flows. Similarly, in the



**David L. Starling**  
President  
& Chief Executive Officer  
Kansas City Southern

**Michael R. Haverty**  
Executive Chairman  
Kansas City Southern

third and fourth quarters, when a serious drought devastated much of the nation's corn crop, thereby reducing KCS grain volumes, equipment was moved rapidly to serve other business sectors. No locomotives were put in storage, and our asset utilization remained high. While the unusual conditions cost the Company revenue, through the efficient redirection of equipment and personnel, KCS was able to reduce operating expenses and thus achieve record profitability.

Most important, KCS remains steadfastly committed to operating a safe railroad for our employees, customers and the communities we serve. In 2012, KCSR was recognized for the sixth consecutive year for best-in-class safety.

### **Marketing**

Just as important to KCS' record year was the contribution of our Sales & Marketing department. Transportation analysts and investors have correctly labeled KCS as a growth company with an abundance of business expansion opportunities. There is no question that we benefit from geography as KCS serves some of the most rapidly growing commercial areas in North America. KCSM operates through the heart of Mexico's burgeoning industrial centers and KCSR serves Port Arthur and other Gulf of Mexico locations that are experiencing dramatic growth spurred by new crude oil discoveries in the U.S. and Canada.

Yes, location is important, but so is having the right people in the right places with the right mission to turn potential opportunities into real business. While new business opportunities are widespread throughout KCS' commodity groups, five areas stood out in 2012 as being exceptional: automotive, cross-border intermodal, crude oil, frac sand and traffic out of the Port of Lázaro Cárdenas. Collectively, these areas grew by 39% and went from representing

13% of total freight revenues in 2011 to 17% in 2012.

Automotive revenues grew by 25% as both U.S. and foreign car manufacturers continued to increase production in Mexico, and KCS grew its market share of finished auto business. Four new auto plants are scheduled to begin production in Mexico in 2014. With its efficient cross-border rail service, as well as its direct access to the Port of Lázaro Cárdenas, KCS will be a prominent participant in serving these new plants. In addition, when the rail connection with the Port of Veracruz is completed, KCSM will have the opportunity to move finished vehicles to that Port's busy automotive export facility.

In the 2011 annual report, we discussed the evolution of KCS' international intermodal corridor, over which we provide the only single-line, cross-border intermodal service. We pointed out that our cross-border container traffic over the corridor grew by 56% over the prior year. The pace of growth accelerated in 2012, with volumes increasing by 88%. Impressive, yes, but what really gets our attention is the size of the available market and the vast potential for future growth of this business.

KCS now estimates that every year almost 3 million truckloads cross the border between the U.S. and Mexico in markets that we could serve. These trucks come from areas that KCS, working with its intermodal trucking partners, could serve directly or in partnership with other railroads. Given the price, security and efficiency advantages of rail over truck in terms of cross-border transit, an ever-growing percentage of the total business is likely to continue to convert to intermodal. Even at the current exceptionally high growth rate, KCS still has less than 2% of the addressable market, which suggests that we have the opportunity to enjoy considerable growth in this business sector for many years.

The U.S.'s growing energy sector has also provided

exciting growth opportunities for KCS. It wasn't many years ago that the idea of the U.S. ever becoming energy independent seemed more of a pipe dream than a reality. That has definitely changed. In 2012, the International Energy Agency issued a report which projects that the U.S. could attain energy independence as soon as 2030, and could displace Saudi Arabia as the world's largest oil producer by 2020.

The main catalyst for turning what once seemed a fantasy into a very real possibility has been the development of new frac drilling technologies that have led to the discovery of previously untapped crude oil resources in the U.S. and western Canada. What makes this important for railroads is that the demand for crude oil to make refined chemical and petroleum products is so great that energy analysts have come to believe that it can be met only through a combination of both pipelines and rail service.

By virtue of KCS' location in the Gulf region, where we directly serve some of the largest refineries and crude storage and distribution facilities in the world, we are experiencing triple-digit volume growth in the movement of crude oil.

Currently, refineries in the Port Arthur area require more than a million barrels of crude per day, and the demand continues to grow. Working with its rail partners, KCS is moving crude from the Bakken Region (North Dakota), western Canada, and the Eagle Ford area in west Texas.

Our industry also plays a key role in supporting new shale drilling sites by delivering critical input products. The new drilling technologies that have opened up new crude and natural gas resources require vast amounts of frac sand. The movement of frac sand, predominantly from the upper Midwest to the Southwest, accounted for another of KCS' most dramatic 2012 growth areas, as volumes grew

by 20%. Again working with other railroads, KCS provides frac sand for drilling sites for both oil (Eagle Ford and Permian Basin) and natural gas (Haynesville).

Another important growth area in 2012 was traffic from the Port of Lázaro Cárdenas, which, has been the fastest-growing container port in North America. Over the past three years, KCS' volumes in and out of Lázaro Cárdenas have increased at a compounded annual growth rate of 28%.

Lázaro Cárdenas is emerging as a preferred Pacific port to serve central Mexico, especially for goods coming from Asia. KCS is also seeing expanded volume growth from Lázaro Cárdenas into the U.S., particularly to the Houston market. When the Hutchison Port Terminal facility is completely built out, it will have an approximate 2.6 million TEU capacity. The Mexican government has awarded a second port concession at Lázaro Cárdenas to APM Terminals. This facility is projected to have an annual throughput capacity of 4.1 million TEUs. As the sole railroad serving Lázaro Cárdenas, KCS business in and out of the port will grow steadily, as both container facilities expand and as the recently opened bulk and motor vehicle concessions ramp up.

## **Finance**

In 2012, outstanding progress was made in continuing to strengthen the Company's balance sheet and maximize cash flows. Executing on the Finance strategy, KCS used the proceeds of a new term loan to retire \$275 million of KCSR's outstanding 8% senior notes. This action generated approximately \$17 million in annual pre-tax interest expense savings. Since the end of 2009, KCS has reduced its debt by \$372 million and its annual pre-tax interest expense by \$73 million.

Throughout the year, Finance maintained an active dialogue with credit rating agencies to keep them

fully apprised of company results and developments. These efforts facilitate the continued progress toward KCS' objective of achieving investment-grade ratings from the agencies which, once accomplished, will enable KCS to issue debt with lower interest costs, longer maturities and less restrictive covenants.

During the year, the Company established a relationship with Fitch and received investment-grade ratings from that agency for KCSR and KCSM. Moody's upgraded the KCSR rating to investment-grade and the KCSM rating to one notch below investment grade. Finally, KCSR and KCSM attained ratings upgrades from Standard & Poor's, putting each entity one notch below investment grade.

Both KCSR's and KCSM's credit facilities were amended to extend maturities, incorporate more favorable covenants and allow for conversion from secured obligations to unsecured when investment-grade ratings are attained from two of the three primary rating agencies. In the fourth quarter of 2012, KCSR received the second investment grade rating and its credit facility was converted to unsecured.

Perhaps the most profound testament to KCS' strengthened financial position is the initiation of a quarterly cash dividend on the Company's common stock by our board of directors in March 2012. To have arrived at a point where that decision could be made is a validation of our corporate strategy, which has turned a vision of a unique rail franchise linking two countries and two economies into a successful reality.

While KCS is still, first and foremost, a growth company that is committed to financially supporting its multiple new business opportunities, the Company's cash flow and balance sheet afford us the opportunity to return some of our profits back to our stockholders. In January 2013, the board of

directors approved a 10% increase in the dividend on KCS common stock to \$0.215 per share.

## Summary

We head into 2013 with sustained conviction in our ever-expanding growth opportunities and our ability to execute as a team at a high level in any environment. Undoubtedly, this past year offered challenges to our utility coal and grain business. However, the fact that we produced record top-line and bottom-line results in the face of those challenges speaks to the strength of our organization and our employees.

When we look beyond 2013, our outlook and conviction in KCS' growth thesis continues to be strong. Our strategically located, single-line rail network between the U.S. and Mexico is in place and poised to take advantage of the opportunities that we see ahead. Near-sourcing to North America, particularly Mexico, is a reality and we believe the rate at which companies open manufacturing plants in areas that we serve will only accelerate. In the U.S., the shifting dynamics of our country's energy sector offer a host of opportunities for crude-by-rail and KCS has the opportunity to benefit from these emerging markets for several years to come. We believe that these, plus other exciting business growth opportunities add up to a franchise that can continue to deliver growth to its stockholders beyond 2013.

As always, we very much appreciate the ongoing support of our stockholders and remain committed to operating the Company in a manner that sustains and expands KCS' extraordinary business growth opportunities.

*Michael R. Hamity*  
*[Signature]*

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-4717

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

**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*  
**427 West 12th Street,  
Kansas City, Missouri**  
*(Address of principal executive offices)*



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

**64105**  
*(Zip Code)*

**816.983.1303**

*(Registrant's telephone number, including area code)*

**None**

*(Former name, former address and former fiscal year, if changed since last report)*

**Securities registered pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of Each Exchange on Which Registered
Preferred Stock, Par Value \$25 Per Share, 4%, Noncumulative	New York Stock Exchange
Common Stock, \$.01 Per Share Par Value	New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

The aggregate market value of common stock held by non-affiliates of the registrant was \$7.51 billion at June 30, 2012. There were 110,154,639 shares of \$.01 par common stock outstanding at January 28, 2013.

**DOCUMENTS INCORPORATED BY REFERENCE**

Kansas City Southern's Definitive Proxy Statement for the 2013 Annual Meeting of Stockholders which will be filed no later than 120 days after December 31, 2012, is incorporated by reference in Parts III.

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**KANSAS CITY SOUTHERN**  
**2012 FORM 10-K ANNUAL REPORT**

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## Item 1. *Business*

### COMPANY OVERVIEW

Kansas City Southern, a Delaware corporation, is a holding company with domestic and international rail operations in North America that are strategically focused on the growing north/south freight corridor connecting key commercial and industrial markets in the central United States with major industrial cities in Mexico. As used herein, “KCS” or the “Company” may refer to Kansas City Southern or, as the context requires, to one or more subsidiaries of Kansas City Southern. KCS and its subsidiaries had approximately 6,110 employees on December 31, 2012.

The Kansas City Southern Railway Company (“KCSR”), which was founded in 1887, is a U.S. Class I railroad. KCSR serves a ten-state region in the midwest and southeast regions of the United States and has the shortest north/south rail route between Kansas City, Missouri and several key ports along the Gulf of Mexico in Alabama, Louisiana, Mississippi, and Texas.

KCS controls and owns all of the stock of Kansas City Southern de México, S.A. de C.V. (“KCSM”). Through its 50-year concession from the Mexican government (the “Concession”), which could expire in 2047 unless extended, KCSM operates a key commercial corridor of the Mexican railroad system and has as its core route the most strategic portion of the shortest, most direct rail passageway between Mexico City and Laredo, Texas and serves most of Mexico’s principal industrial cities and three of its major seaports. Laredo is a principal international gateway through which more than half of all rail and truck traffic between the United States and Mexico crosses the border. KCSM’s rail lines provide exclusive rail access to the United States and Mexico border crossing at Nuevo Laredo, Tamaulipas, the largest rail freight interchange point between the United States and Mexico. Under the Concession, KCSM has the right to control and operate the southern half of the rail bridge at Laredo, Texas, which spans the Rio Grande River between the United States and Mexico. The Company also controls the northern half of this bridge through its ownership of Mexrail, Inc., (“Mexrail”).

KCSM provides exclusive rail access to the Port of Lazaro Cardenas on the Pacific Ocean. The Mexican government is developing the port at Lazaro Cardenas principally to serve Mexican markets and as an alternative to the U.S. west coast ports. KCSM is the sole provider of rail service to this port, which provides an alternate route for Asian and South American traffic bound for North America.

The Company wholly owns Mexrail which, in turn, wholly owns The Texas Mexican Railway Company (“Tex-Mex”). Tex-Mex owns a 157-mile rail line extending from Laredo, Texas to the port city of Corpus Christi, Texas, which connects the operations of KCSR with KCSM. Through its ownership of Mexrail, the Company owns the northern half of the rail bridge at Laredo, Texas.

The KCS coordinated rail network (KCSR, KCSM and Tex-Mex) comprises approximately 6,300 route miles extending from the midwest and southeast portions of the United States south into Mexico and connects with all other Class I railroads, providing shippers with an effective alternative to other railroad routes and giving direct access to Mexico and the southeast and southwest United States through alternate interchange hubs.

Panama Canal Railway Company (“PCRC”), an unconsolidated joint venture company owned equally by KCS and Mi-Jack Products, Inc. (“Mi-Jack”), was awarded a concession from the Republic of Panama to reconstruct and operate the Panama Canal Railway, a 47-mile railroad located adjacent to the Panama Canal that provides international container shipping companies with a railway transportation option in lieu of the Panama Canal. The concession was awarded in 1998 for an initial term of 25 years with an automatic renewal for an additional 25 year term. The Panama Canal Railway is a north-south railroad traversing the Isthmus of Panama between the Atlantic and Pacific Oceans. PCRC’s wholly-owned subsidiary, Panarail Tourism Company (“Panarail”), operates and promotes commuter and tourist passenger service over the Panama Canal Railway.

Other subsidiaries and affiliates of KCS include the following:

- Meridian Speedway, LLC (“MSLLC”), a seventy percent-owned consolidated affiliate that owns the former KCSR rail line between Meridian, Mississippi and Shreveport, Louisiana, which is the portion of the KCSR rail line between Dallas, Texas and Meridian known as the “Meridian Speedway.” Norfolk Southern Corporation (“NS”) through its wholly-owned subsidiary, The Alabama Great Southern Railroad Company, owns the remaining thirty percent of MSLLC.
- Pabtex, Inc., a wholly-owned and consolidated owner of a bulk materials handling facility with deep-water access to the Gulf of Mexico at Port Arthur, Texas that stores and transfers petroleum coke from rail cars to ships, primarily for export;

- Trans-Serve, Inc. (doing business as Superior Tie and Timber), a wholly-owned and consolidated operator of a railroad wood-tie treatment facility;
- TransFin Insurance, Ltd., a wholly-owned and consolidated captive insurance company providing property, general liability and certain other insurance coverage to KCS and its subsidiaries and affiliates;
- KCSM Servicios, S.A. de C.V. (“KCSM Servicios”), a wholly-owned and consolidated provider of employee services to KCSM.
- Southern Capital Corporation, LLC (“Southern Capital”), a fifty percent-owned unconsolidated affiliate that leases locomotives and other equipment;
- Ferrocarril y Terminal del Valle de México, S.A. de C.V. (“FTVM”), a twenty-five percent-owned unconsolidated affiliate that provides railroad services as well as ancillary services in the greater Mexico City area; and
- PTC-220, LLC (“PTC-220”), a fourteen percent-owned unconsolidated affiliate that holds the licenses to large blocks of radio spectrum and other assets for the deployment of positive train control.

## MARKETS SERVED

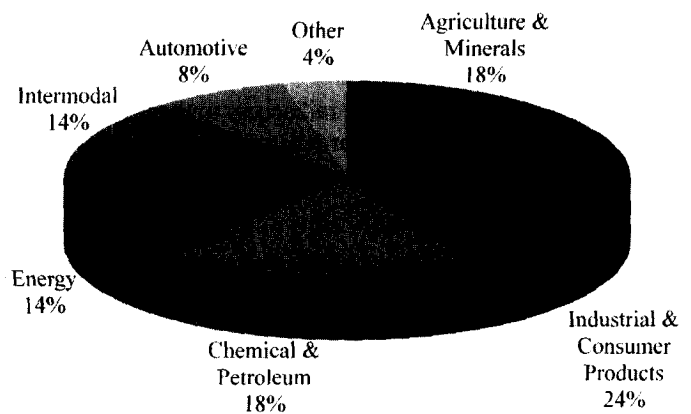
*Chemical and petroleum.* This sector includes products such as plastics, other petroleum refined products and miscellaneous chemicals. KCS transports these products to markets in the midwest, southeast and northeast United States and throughout Mexico through interchanges with other rail carriers. The products within the chemicals and plastics channels are used in the automotive, housing and packaging industries as well as in the production of other chemicals and plastic products. KCS hauls petroleum products across its network and as petroleum refineries have continued to increase their refining capacity, they have coordinated with KCS to develop additional long-term storage opportunities which complement a fluid freight railroad operation.

*Industrial and consumer products.* This sector includes metals and ores such as iron, steel, zinc and copper. The majority of metals, minerals and ores mined, and steel produced in Mexico are consumed within Mexico. The volume of Mexican steel exports fluctuates based on global market prices. Higher-end finished products such as steel coils are used by Mexican manufacturers in automobiles, household appliances, the oil and gas industry, and other consumer goods which are imported to the United States through Nuevo Laredo and through the seaports served by KCS’s rail network. KCS also transports steel coils from U.S. based mini-mills in Mississippi and Alabama to Texas and Mexico for appliance and automotive applications.

This sector also serves paper mills directly and indirectly through its various short-line connections. KCS’s rail lines run through the heart of the southeast United States timber-producing region. Additionally, KCS is uniquely positioned to serve many important paper mills in the southeast United States whose products are increasing in demand due to a general growth of consumer goods and industrial production in central Mexico.

*Agriculture and minerals.* The agriculture and minerals sector consists primarily of grain and food products. Shipper demand for agriculture products is affected by competition among sources of grain and grain products, as well as price fluctuations in international markets for key commodities. In the United States, KCS’s rail lines receive and originate shipments of grain and grain products for delivery to feed mills serving the poultry industry. KCS currently serves feed mills along its rail lines throughout the midwest and southeast United States, and through its marketing agreements, KCS has access to sources of corn and other grain in the Midwest. United States export grain shipments and Mexico import grain shipments include primarily corn, wheat, and soybeans transported to Mexico via Laredo and to the Gulf of Mexico. Over the long term, export grain shipments to Mexico are expected to increase as a result of Mexico’s reliance on grain imports and KCS’s coordinated

**2012 Revenues  
Business Mix**



rail network is well positioned to meet these increases in demand. Food products consist mainly of soybean meal, grain meal, oils, canned goods, distillers dried grains, corn syrup and sugar. Other shipments consist of a variety of products including ores, minerals, clay and glass used across North America.

*Energy.* The energy business includes coal, frac sand, petroleum coke and crude oil. KCS hauls unit trains (trains transporting a single commodity from one source to one destination) of coal for nine electric generating plants in the central United States. The coal originates from the Powder River Basin in Wyoming and is interchanged to KCS at Kansas City, Missouri. Coal mined in the midwest United States is transported in non-unit trains to industrial consumers such as paper mills, steel mills, and cement companies. KCS transports petroleum coke from refineries in the United States to cement companies in Mexico as well as to vessels for international distribution through the Pabtex export terminal located in Port Arthur, Texas. Frac sand originating primarily in Wisconsin, Illinois or Iowa is delivered to transloads located in northeast Texas, northern Louisiana, and south Texas for distribution to gas and oil wells in the region. Crude oil originating in Canada, North Dakota, Colorado, and west Texas is delivered to U.S. Gulf Coast refineries and tank farms in Texas and Louisiana.

*Intermodal.* The intermodal freight business consists primarily of hauling freight containers or truck trailers on behalf of steamship lines, motor carriers, and intermodal marketing companies with rail carriers serving as long-distance haulers. KCS serves and supports the U.S. and Mexican markets, as well as cross border traffic between the U.S. and Mexico. In light of the importance of trade between Asia and North America, the Company believes the Port of Lazaro Cardenas continues to be a strategically beneficial location for ocean carriers, manufacturers and retailers. Equally important, the increase in foreign direct investment in Mexico has pushed the KCS Mexico/U.S. cross border corridor to emerge as an increasingly important tool for NAFTA freight flow. The Company also provides premium service to customers over its line from Dallas through the Meridian Speedway — a critical link in creating the most direct route between the southwest and southeast/northeast U.S.

*Automotive.* KCS provides rail transportation to every facet of the automotive industry supply chain, including automotive manufacturers, assembly plants and distribution centers throughout North America. Several U.S. automakers have moved assembly plants into central Mexico to take advantage of access to lower costs, which has driven a shift in production and distribution patterns from the U.S. to Mexico. In addition, KCS transports finished vehicles imported and exported to and from Asia through a distribution facility at the Port of Lazaro Cardenas. As the automotive industry shifts production and distribution patterns, KCS is poised to serve the automotive industry's evolving transportation requirements.

## **GOVERNMENT REGULATION**

The Company's United States operations are subject to federal, state and local laws and regulations generally applicable to all businesses. Rail operations are also subject to the regulatory jurisdiction of the Surface Transportation Board ("STB") of the U.S. Department of Transportation ("DOT"), the Federal Railroad Administration of the DOT, the Occupational Safety and Health Administration ("OSHA"), as well as other federal and state regulatory agencies. The STB has jurisdiction over disputes and complaints involving certain rates, routes and services, the sale or abandonment of rail lines, applications for line extensions and construction, and consolidation or merger with, or acquisition of control of, rail common carriers. DOT and OSHA each has jurisdiction under several federal statutes over a number of safety and health aspects of rail operations, including the transportation of hazardous materials. In 2008, the President of the United States signed the Rail Safety Improvement Act of 2008 into law, which, among other things, revises hours of service for train and certain other employees and mandates implementation of positive train control at certain locations by the end of 2015. Positive train control is a technology designed to help prevent train-to-train collisions, overspeed derailments, incursions into rail work zones, and entry into main line track if a switch is misaligned at certain locations, including main line track where toxic inhalation hazard or poison inhalation hazard movements occur or where passenger operations occur. In addition, the Rail Safety Improvement Act of 2008 addresses safety at rail crossings, increases the number of safety related employees of the Federal Railroad Administration, and increases fines that may be levied against railroads for safety violations. State agencies regulate some aspects of rail operations with respect to health and safety in areas not otherwise regulated by federal law.

KCS's subsidiaries are subject to extensive federal, state and local environmental regulations. These laws cover discharges to water, air emissions, toxic substances, and the generation, handling, storage, transportation and disposal of waste and hazardous materials. These regulations have the effect of increasing the costs, risks and liabilities associated with rail operations. Environmental risks are also inherent in rail operations, which frequently involve transporting chemicals and other hazardous materials.

Primary regulatory jurisdiction for the Company's Mexican operations is overseen by the Mexican Secretaría de Comunicaciones y Transportes ("Secretary of Communications and Transportation" or "SCT"). The SCT establishes regulations concerning railway safety and operations, and is responsible for resolving disputes between railways and between railways and customers. In addition, KCSM must register its maximum rates with the SCT and make regular reports to the SCT on investment and traffic volumes. See Note 1 to the Consolidated Financial Statements in Item 8 of this Form 10-K "Description of the Business — *The KCSM Concession*."

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

Noncompliance with applicable legal provisions may result in the imposition of fines, temporary or permanent shutdown of operations or other injunctive relief, criminal prosecution or, with respect to KCSM, the termination of the Concession. KCS maintains environmental provisions which are believed by management to be appropriate with respect to known and existing environmental contamination of its properties which KCS may be responsible to remedy. In addition, KCS's subsidiaries are party to contracts and other legally binding obligations by which previous owners of certain facilities now owned by KCS are responsible to remedy contamination of such sites remaining from their previous ownership. There are currently no material legal or administrative proceedings pending against the Company with respect to any environmental matters and management does not believe that continued compliance with environmental laws will have any material adverse effect on the Company's consolidated financial statements. KCS cannot predict the effect, if any, that unidentified environmental matters or the adoption of additional or more stringent environmental laws and regulations would have on the Company's consolidated financial statements.

## COMPETITION

The Company competes against other railroads, many of which are much larger and have significantly greater financial and other resources. The railroad industry is dominated by a few very large carriers. The larger western railroads (BNSF Railway Company and Union Pacific Railroad Company), in particular, are significant competitors of KCS because of their substantial resources and competitive routes.

In November 2005, Ferrocarril Mexicano, S.A. de C.V. ("Ferromex") acquired control of and merged with Ferrosur S.A. de C.V. ("Ferrosur"). In March 2011, the Comisión Federal de Competencia (Mexican Antitrust Commission or "COFECO") approved the merger between Ferromex and Ferrosur. These merged operations are much larger than KCSM, serving most of the major ports and cities in Mexico and together own fifty percent of FTVM, which serves industries located within Mexico City.

The ongoing impact of past and future rail consolidation is uncertain. However, KCS believes that its investments and strategic alliances continue to competitively position the Company to attract additional rail traffic throughout its rail network.

The Company is subject to competition from motor carriers, barge lines and other maritime shipping, which compete across certain routes in KCS's operating areas. In the past, truck carriers have generally eroded the railroad industry's share of total transportation revenues. Intermodal traffic and certain other traffic face highly price sensitive competition, particularly from motor carriers. However, rail carriers, including KCS, have placed an emphasis on competing in the intermodal marketplace and working with motor carriers to provide end-to-end transportation of products.

While deregulation of U.S. freight rates has enhanced the ability of railroads to compete with each other and with alternative modes of transportation, this increased competition has generally resulted in downward pressure on freight rates since deregulation. Competition with other railroads and other modes of transportation is generally based on the rates charged, the quality and reliability of the service provided and the quality of the carrier's equipment for certain commodities.

## RAIL SECURITY

The Company and its rail subsidiaries have made ongoing, multi-disciplinary efforts since the terrorist attacks on the United States on September 11, 2001, to continue securing the Company's assets and personnel against the risk of terrorism and other security risks. Many of the specific measures the Company utilizes for these efforts are required to be kept confidential through arrangements with government agencies, such as the Department of Homeland Security ("DHS"), or through jointly-

developed and implemented strategies and plans with connecting carriers. To protect the confidentiality and sensitivity of the efforts the Company has made to safeguard against terrorism and other security incidents, the following paragraphs will provide only a general overview of some of these efforts. KCSR and KCSM utilize a security plan based on an industry wide security plan developed by Association of American Railroads (“AAR”) members which focuses on comprehensive risk assessments in five areas — hazardous materials; train operations; critical physical assets; military traffic; and information technology and communications. The security plan is kept confidential, with access to the plan tightly limited to members of management with direct security and anti-terrorism implementation responsibilities. KCSR and KCSM participate with other AAR members in periodic drills under the industry plan to test and refine its various provisions.

The Company’s security activities range from periodically mailing each employee a security awareness brochure (which is also posted under the “Employees” tab on the Company’s internet website, [www.kcsouthern.com](http://www.kcsouthern.com)) to its ongoing implementation of security plans for rail facilities in areas labeled by the DHS as High Threat Urban Areas (“HTUAs”). The Company’s other activities to bolster security against terrorism include, but are not limited to, the following:

- Conferring regularly with other railroads’ security personnel and with industry experts on security issues;
- Routing shipments of certain chemicals, which might be toxic if inhaled, pursuant to federal regulations;
- Initiating a series of over 20 voluntary action items agreed to between AAR and DHS as enhancing security in the rail industry;
- Conducting constant and targeted security training as part of the scheduled training for operating employees and managers;
- Developing a multi-layered security model using high-speed digital imaging, system velocity, covert and overt security filters to mitigate the risk of illicit activity;
- Measuring key security metrics to ensure positive risk mitigation and product integrity trends;
- Implementation of a Tactical Intelligence Center by KCSM, training core members in new technology helping to prevent, detect, deter and respond to illicit activities; and
- Deployment of an array of non-intrusive technologies including, but not limited to, digital video surveillance and analytics as part of an intelligent video security solution, including a Closed Circuit Television platform with ge-fencing for intrusion detection, to allow for remote viewing access to monitor ports of entry, intermodal and rail yards.

In addition, the Company utilizes dedicated security personnel with extensive law enforcement backgrounds to oversee the ongoing and increasingly complex security efforts of the Company in both the United States and Mexico. Some members of this security force are also members of the Federal Bureau of Investigation’s Joint Terrorism Task Force, providing added value to the Company in developing and implementing anti-terrorism and other security initiatives.

While the risk of theft and vandalism is higher in Mexico, KCSM remains among the safest methods of transportation for freight shipments in Mexico. KCSM’s record in rail safety is due in large part to the implementation of a multi-layered, safety and security process throughout the KCSM network. In addition to having its own internal system, the process is connected to, and supported by a high level of federal, state and local law enforcement. A primary focus of this effort involves maintaining constant due diligence, active vigilance and train velocity, which reduces the likelihood for incidents to occur.

## **RAILWAY LABOR ACT**

Labor relations in the U.S. railroad industry are subject to extensive governmental regulation under the Railway Labor Act (“RLA”). Under the RLA, national labor agreements are renegotiated on an industry-wide scale when they become open for modification, but their terms remain in effect until new agreements are reached or the RLA’s procedures (which include mediation, cooling-off periods, and the possibility of presidential intervention) are exhausted. Contract negotiations with the various unions generally take place over an extended period of time and the Company rarely experiences work stoppages during negotiations. Wages, health and welfare benefits, work rules and other issues have traditionally been addressed during these negotiations.

## COLLECTIVE BARGAINING

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 union employees are covered by one labor agreement, which was signed on June 23, 1997, between KCSM and the Sindicato de Trabajadores Ferrocarrileros de la República Mexicana ("Mexican Railroad Union"), for a term of fifty years, 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. As a result of the labor agreement signed on April 19, 2012, compensation terms for the period from July 1, 2012 through June 30, 2013, were finalized. Additionally, this labor agreement enabled KCS to complete an organizational restructuring whereby employees of KCSM became employees of KCSM Servicios. KCSM Servicios provides employee services to KCSM, and KCSM pays KCSM Servicios market-based rates for these services. The union labor negotiation with the Mexican Railroad Union has not historically resulted in any strike, boycott or other disruption in KCSM's business operations.

## EXECUTIVE OFFICERS OF KCS AND SUBSIDIARIES

All executive officers are elected annually and serve at the discretion of the Board of Directors. All of the executive officers have employment agreements with KCS and/or its subsidiaries. The mailing address of the principal executive officers other than Mr. Zozaya is P.O. Box 219335, Kansas City, Missouri 64121. Mr. Zozaya's mailing address is Montes Urales No. 625, Col. Lomas de Chapultepec, C.P. 11000, Mexico D.F.

*Michael R. Haverty* — Executive Chairman of the Board — 68 — Served in this capacity since August 1, 2010. Mr. Haverty has been a director of KCS since May 1995 and has served as Chairman of the Board of KCS since January 1, 2001. From July 12, 2000 until July 31, 2010, Mr. Haverty served as Chief Executive Officer of KCS. Mr. Haverty served as President of KCS from July 2000 to June 2006. Mr. Haverty served as Executive Vice President of KCS from May 1995 until July 2000, and as President and Chief Executive Officer of KCSR from 1995 to 2005 and as a director of KCSR since 1995. He has served as Chairman of the Board of KCSR since 1999. Since April 1, 2005, Mr. Haverty has served as Chairman of the Board of KCSM. Mr. Haverty has served as a director of the PCRC since 1996 and as Co-Chairman of the Board of Directors of that company since 1999. Mr. Haverty has served as Co-Chairman of Panarail since 2000.

*David L. Starling* — President and Chief Executive Officer — 63 — Served in this capacity since August 1, 2010. Mr. Starling has been a director of KCS since May 6, 2010. He served as President and Chief Operating Officer of KCS from July 1, 2008 through August 1, 2010. Mr. Starling has also served as a Director, President and Chief Executive Officer of KCSR since July 1, 2008. He has also served as Vice Chairman of the Board of Directors of KCSM since September 2009. Mr. Starling has served as Vice Chairman of the Board of Directors of PCRC and Panarail since July 2008. Prior to joining KCS, Mr. Starling served as President and Director General of PCRC from 1999 through June 2008.

*David R. Ebbrecht* — Executive Vice President and Chief Operating Officer — 46 — Served in this capacity since August 2012. He served as Executive Vice President of Operations from March 2011 until August 2012. Mr. Ebbrecht served as Senior Vice President of Operations of KCSR from August 2009 until March 2011. He served as Vice President of Transportation of KCSR from March 2008 until August 2009. From January 2007 until March 2008, Mr. Ebbrecht served as Assistant Vice President in various departments for KCSR including logistics, business development and operations. He joined KCSR in January 2001. Prior to joining KCSR, Mr. Ebbrecht served in various leadership positions at CSX Corporation, Inc.

*Warren K. Erdman* — Executive Vice President — Administration and Corporate Affairs — 54 — Served in this capacity since April 2010. Mr. Erdman served as Executive Vice President — Corporate Affairs from October 2007 until April 2010. He served as Senior Vice President — Corporate Affairs of KCS and KCSR from January 2006 to September 2007. Mr. Erdman served as Vice President — Corporate Affairs of KCS from April 15, 1997 to December 31, 2005 and as Vice President — Corporate Affairs of KCSR from May 1997 to December 31, 2005. Prior to joining KCS, Mr. Erdman served as Chief of Staff to United States Senator Kit Bond of Missouri from 1987 to 1997.

*Patrick J. Ottensmeyer* — Executive Vice President Sales and Marketing — 55 — Served in this capacity since October 16, 2008. Mr. Ottensmeyer joined KCS in May 2006 as Executive Vice President and Chief Financial Officer. Prior to

joining KCS, Mr. Ottensmeyer served as Chief Financial Officer of Intranasal Therapeutics, Inc. from 2001 to May 2006. From 2000 to 2001, he served as Corporate Vice President Finance and Treasurer for Dade-Behring Holdings, Inc. From 1993 to 1999, Mr. Ottensmeyer served as Vice President Finance and Treasurer at Burlington Northern Santa Fe Corporation and BNSF Railway and their predecessor companies.

*Michael W. Upchurch* — Executive Vice President and Chief Financial Officer — 52 — Served in this capacity since October 16, 2008. Mr. Upchurch joined KCS in March 2008 as Senior Vice President Purchasing and Financial Management. Prior to joining KCS, Mr. Upchurch served as Senior Vice President Finance of Red Development LLC, from December 2007 through February 2008. From September 2006 through December 2007, Mr. Upchurch worked as an independent consultant providing financial consulting services. From 1990 through September 2006, Mr. Upchurch served in various senior financial leadership positions at Sprint Nextel Corporation and its predecessor, Sprint Corporation, including Senior Vice President Financial Operations, Senior Vice President Finance Sprint Business Solutions and Senior Vice President Finance Long Distance Division.

*José Guillermo Zozaya Delano* — President and Executive Representative — KCSM — 60 — Served in this position since April 20, 2006. Mr. Zozaya has 35 years of experience in law and government relations, most recently as the legal and government relations director for ExxonMobil México, S.A. de C.V., where he spent nine years prior to joining KCSM.

*John E. Derry* — Senior Vice President Human Resources — 45 — Served in this capacity since July 2008. He served as Vice President of Human Resources from February 2008 until July 2008. Mr. Derry joined KCS from YRC Worldwide, Inc. where he served in various Human Resource functions from January 2004 to February 2008. From September 2006 to February 2008, Mr. Derry served as Vice President of Human Resources for Yellow Transportation. Prior to joining YRC Worldwide, Inc. Mr. Derry spent 17 years with General Mills Inc. in various operations, labor relations and human resource roles.

*Michael J. Naatz* — Senior Vice President and Chief Information Officer — 47 — Served in this capacity since May 7, 2012. Prior to joining KCS, Mr. Naatz served as President of USF Holland, a YRC Worldwide, Inc. (“YRCW”) company, from 2011 to May 2012. From 2010 to 2011, Mr. Naatz served as President and Chief Customer Officer - Customer Care Division at YRCW. From 2008 to 2010, he served as Executive Vice President and Chief Information & Service Officer at YRCW. From 2005 to 2007, he served as President-Enterprise Services Division at YRCW. From 1994 to 2005, he held various leadership positions with USF Corporation.

*Mary K. Stadler* — Senior Vice President and Chief Accounting Officer — 53 — Served in this capacity since March 2, 2009. From April 1990 through August 2008, Ms. Stadler served in various finance leadership positions at Sprint Nextel Corporation and its predecessor, Sprint Corporation, including Vice President — Finance Operations and most recently served as its Vice President — Assistant Controller.

*William J. Wochner* — Senior Vice President and Chief Legal Officer — 65 — Served in this capacity since February 2007. He served as Vice President and Interim General Counsel from December 2006 to January 2007. From September 2006 to December 2006, Mr. Wochner served as Vice President and Associate General Counsel. From March 2005 to September 2006, Mr. Wochner served as Vice President Sales and Marketing/Contracts for KCSR. From February 1993 to March 2005, Mr. Wochner served as Vice President and General Solicitor of KCSR.

There are no arrangements or understandings between the executive officers and any other person pursuant to which the executive officer was or is to be selected as an officer of KCS, except with respect to the executive officers who have entered into employment agreements designating the position(s) to be held by the executive officer.

None of the above officers is related to another, or to any of the directors of KCS, by family.

#### **AVAILABLE INFORMATION**

KCS’s website ([www.kcsouthern.com](http://www.kcsouthern.com)) provides at no cost KCS’s Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, and amendments to those reports, as soon as reasonably practicable after the electronic filing of these reports is made with the Securities and Exchange Commission. In addition, KCS’s corporate governance guidelines, ethics and legal compliance policy, and the charters of the Audit Committee, the Finance Committee, the Nominating and Corporate Governance Committee and the Compensation and Organization Committee of the Board of Directors are available on KCS’s website. These guidelines, policies and charters are available in print without charge to any stockholder requesting them. Written requests for these materials may be made to the Corporate Secretary, P.O. Box 219335,

Kansas City, Missouri 64121-9335 (or if by express delivery to 427 West 12th Street, Kansas City, Missouri 64105). From time to time, KCS publicly designates material information by posting it on the website, [kcsouthern.com/investors](http://kcsouthern.com/investors), in lieu of press releases.

See Item 8, Financial Statements and Supplementary Data — Note 1 “Description of the Business” and Note 17 “Geographic Information” for more information on the description and general development of the Company’s business and financial information about geographic areas.

#### **Item 1A. Risk Factors**

***The price of KCS’s common stock may fluctuate significantly, which may make it difficult for investors to resell common stock when they choose to or at prices they find attractive.***

The price of KCS’s common stock on the New York Stock Exchange (“NYSE”), listed under the ticker symbol “KSU”, constantly changes. The Company expects that the market price of its common stock will continue to fluctuate.

The Company’s stock price may fluctuate as a result of a variety of factors, many of which are beyond KCS’s control. These factors include, but are not limited to:

- quarterly variations in operating results;
- operating results that vary from the expectations of management, securities analysts, ratings agencies and investors;
- changes in expectations as to future financial performance, including financial estimates by management, securities analysts, ratings agencies and investors;
- developments generally affecting the railroad industry;
- announcements by KCS or its competitors of significant contracts, acquisitions, joint marketing relationships, joint ventures or capital commitments;
- the assertion or resolution of significant claims or proceedings involving KCS;
- KCS’s dividend policy and limitations on the payment of dividends;
- future sales of KCS’s equity or equity-linked securities;
- the issuance of common stock in payment of dividends on preferred stock or upon conversion of preferred stock or convertible debt; and
- general domestic and international economic conditions including the availability of short- and long-term financing.

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

***KCS’s ability to pay cash dividends on its common stock may be limited.***

KCS has agreed in the past, and may agree in the future, to limitations on its ability to pay cash dividends on its common stock. In addition, to maintain its credit ratings, the Company may be limited in its ability to pay cash dividends on its common stock so that it can maintain an appropriate level of liquidity or debt.

***Sales of substantial amounts of KCS’s common stock in the public market could adversely affect the prevailing market price of the common stock.***

As of December 31, 2012, there were 6,038,091 shares of common stock issued or reserved for issuance under the 1991 Amended and Restated Stock Option and Performance Award Plan, the 2008 Stock Option and Performance Award Plan and the 2009 Employee Stock Purchase Plan, and 1,909,898 shares of common stock held by executive officers and directors outside those plans. Sales of common stock by employees upon exercise of their options, sales by executive officers and directors subject to compliance with Rule 144 under the Securities Act, and sales of common stock that may be issued upon conversion of the outstanding preferred stock, or the perception that such sales could occur, may adversely affect the market price of KCS’ common stock.



***KCS has provisions in its charter and bylaws that could deter, delay or prevent a third party from acquiring a controlling interest in KCS and that could deprive an investor of an opportunity to obtain a takeover premium for shares of KCS's common stock.***

KCS has provisions in its charter and bylaws that may delay or prevent unsolicited takeover bids from third parties, including provisions providing for a classified board. The bylaws provide that a stockholder must give the Company advance written notice of its intent to nominate a director or raise a matter at an annual meeting. These provisions may deprive KCS's stockholders of an opportunity to sell their shares at a premium over prevailing market prices.

***KCS competes against other railroads and other transportation providers.***

The Company's domestic and international operations are subject to competition from other railroads, particularly Union Pacific Railroad Company ("UP") and BNSF Railway Company ("BNSF") in the United States and Ferromex and Ferrosur in Mexico, as well as from truck carriers, barge lines, and other maritime shippers. Many of KCS's rail competitors are much larger and have significantly greater financial and other resources than KCS, which may enable rail competitors to reduce rates and make KCS's freight services less competitive. KCS's ability to respond to competitive pressures by matching rate reductions and decreasing rates without adversely affecting gross margins and operating results will depend on, among other things, the ability to reduce operating costs. KCS's failure to respond to competitive pressures, and particularly rate competition, in a timely manner could have a material adverse effect on the Company's consolidated financial statements.

The railroad industry is dominated by a few large carriers. These larger railroads could attempt to use their size and pricing power to block other railroads' access to efficient gateways and routing options that are currently and have historically been available. In addition, if there is future consolidation in the railroad industry in the United States or Mexico, there can be no assurance that it will not have an adverse effect on the Company's consolidated financial statements.

Trucking, maritime, and barge competitors, while able to provide rate and service competition to the railroad industry, are able to use public rights-of-way, require substantially smaller capital investment and maintenance expenditures than railroads and allow for more frequent and flexible scheduling. Continuing competitive pressures, any reduction in margins due to competitive pressures, future improvements that increase the quality of alternative modes of transportation in the locations in which the Company operates, or legislation or regulations that provide motor carriers with additional advantages, such as increased size of vehicles and reduced weight restrictions, could result in downward pressure on freight rates, which in turn could have a material adverse effect on the Company's consolidated financial statements.

A central part of KCS's growth strategy is based upon the conversion of truck traffic to rail. There can be no assurance the Company will succeed in its efforts to convert traffic from truck to rail transport or that the customers already converted will be retained. If the railroad industry in general is unable to preserve its competitive advantages vis-à-vis the trucking industry, revenue growth could be adversely affected. Additionally, revenue growth could be affected by, among other factors, an expansion in the availability, or an improvement in the quality, of the trucking services offered by carriers resulting from regulatory and administrative interpretations and implementation of certain provisions of the North American Free Trade Agreement ("NAFTA"), and KCS's inability to grow its existing customer base and capture additional cargo transport market share because of competition from the shipping industry and other railroads.

***KCSM's Mexican Concession is subject to revocation or termination in certain circumstances which would prevent KCSM from operating its railroad and would have a material adverse effect on the Company's consolidated financial statements.***

KCSM operates under the Concession granted by the Mexican government in June 1997, which is renewable for an additional period of up to 50 years, subject to certain conditions. The Concession gives KCSM exclusive rights to provide freight transportation services over its rail lines for the first 30 years of the 50-year Concession, subject to certain trackage and haulage rights granted to other concessionaires. The SCT, which is principally responsible for regulating railroad services in Mexico, has broad powers to monitor KCSM's compliance with the Concession, and it can require KCSM to supply it with any technical, administrative and financial information it requests. Among other obligations, KCSM must comply with the investment commitments established in its business plan, which forms an integral part of the Concession, and must update the plan every five years. The SCT treats KCSM's business plans confidentially. The SCT also monitors KCSM's compliance with efficiency and safety standards established in the Concession. The SCT reviews, and may amend, these standards every five years.

The Mexican Railroad Services Law and regulations provide the Mexican government certain rights in its relationship with KCSM under the Concession, including the right to take over the management of KCSM and its railroad in certain extraordinary cases, such as imminent danger to national security. In the past, the Mexican government has used such power with respect to other privatized industries, including the telecommunications industry, to ensure continued service during labor disputes. In addition, under Article 47 of the Mexican Railroad Services Law and its regulations, the SCT, in consultation with COFECO, reserves the right to set service rates if it determines that effective competition does not exist in the Mexican railroad industry. COFECO, however, has not published guidelines regarding the factors that constitute a lack of competition. It is therefore unclear under what particular circumstances COFECO would deem a lack of competition to exist. If the SCT intervenes and sets service rates, the rates it sets may be too low to allow KCSM to operate profitably.

Under the Concession, KCSM has the right to operate its rail lines, but it does not own the land, roadway or associated structures. If the Mexican government legally terminates the Concession, it would own, control, and manage such public domain assets used in the operation of KCSM's rail lines. All other property not covered by the Concession, including all locomotives and railcars otherwise acquired, would remain KCSM's property. In the event of early termination, or total or partial revocation of the Concession, the Mexican government would have the right to cause the Company to lease all service-related assets to it for a term of at least one year, automatically renewable for additional one-year terms up to five years. The amount of the rent would be determined by experts appointed by KCSM and the Mexican government. The Mexican government must exercise this right within four months after early termination or revocation of the Concession. In addition, the Mexican government would also have a right of first refusal with respect to certain transfers by KCSM of railroad equipment within 90 days after revocation of the Concession.

The Mexican government may also temporarily seize control of KCSM's rail lines and its assets in the event of a natural disaster, war, significant public disturbance or imminent danger to the domestic peace or economy. In such a case, the SCT may restrict KCSM's ability to exploit the Concession in such manner as the SCT deems necessary under the circumstances, but only for the duration of any of the foregoing events. Mexican law requires that the Mexican government pay compensation if it effects a statutory appropriation for reasons of the public interest. With respect to a temporary seizure due to any cause other than international war, the Mexican Railroad Services Law and regulations provide that the Mexican government will indemnify an affected concessionaire for an amount equal to damages caused and losses suffered. However, these payments may not be sufficient to compensate KCSM for its losses and may not be made timely.

The SCT may revoke the Concession if KCSM is sanctioned on three distinct occasions for unjustly interrupting the operation of its rail lines or for charging tariffs higher than the tariffs it has registered with the SCT. In addition, the SCT may revoke the Concession if, among other things, KCSM is sanctioned on five distinct occasions because KCSM restricts the ability of other Mexican rail operators to use its rail lines; KCSM fails to make payments for damages caused during the performance of services; KCSM fails to comply with any term or condition of the Mexican Railroad Services Law and regulations or the Concession; KCSM fails to make the capital investments required under its five-year business plan filed with the SCT; or KCSM fails to maintain an obligations compliance bond and insurance coverage as specified in the Mexican Railroad Services Law and regulations. In addition, the Concession would revoke automatically if KCSM changes its nationality or assigns or creates any lien on the Concession, or if there is a change in control of KCSM without the SCT's approval. The SCT may also terminate the Concession as a result of KCSM's surrender of its rights under the Concession, or for reasons of public interest or upon KCSM's liquidation or bankruptcy. If the Concession is terminated or revoked by the SCT for any reason, KCSM would receive no compensation and its interest in its rail lines and all other fixtures covered by the Concession, as well as all improvements made by it, would revert to the Mexican government. Revocation or termination of the Concession would prevent KCSM from operating its railroad and would materially adversely affect the Mexican operations and the ability to make payments on KCSM's debt as well as materially adversely affect the Company's consolidated financial statements.

***KCS's business strategy, operations and growth rely significantly on agreements with other railroads and third parties.***

Operation of KCS's rail network and its plans for growth and expansion rely significantly on agreements with other railroads and third parties, including joint ventures and other strategic alliances, as well as interchange, trackage rights, haulage rights and marketing agreements with other railroads and third parties that enable KCS to exchange traffic and utilize trackage the Company does not own. KCS's ability to provide comprehensive rail service to its customers depends in large part upon its ability to maintain these agreements with other railroads and third parties, and upon the performance of the obligations under the agreements by the other railroads and third parties. The termination of, or the failure to renew, these agreements could adversely affect KCS's consolidated financial statements. KCS is also dependent in part upon the financial strength and

efficient performance of other railroads. There can be no assurance that KCS will not be materially adversely affected by operational or financial difficulties of other railroads.

***KCSM's operations are subject to certain trackage rights, haulage rights and interline service agreements with another Mexican rail carrier, some of which are in dispute.***

Through KCSM's Concession from the Mexican government, KCSM is required to grant short and long distance trackage rights to Ferromex. Applicable law stipulates that Ferromex similarly is required to grant to KCSM rights to use portions of their tracks. These trackage rights have been granted under the Concession. The rates to be charged for use of the Trackage Rights after January 1, 2009, were agreed to by KCSM and Ferromex pursuant to the Trackage Rights Agreement, dated February 9, 2010. The Trackage Rights Agreement did not establish rates that may be charged for the right to use the trackage rights for the periods beginning in 1998 through December 31, 2008.

If KCSM cannot reach an agreement with Ferromex for rates applicable for services provided prior to January 1, 2009, which are not subject to the Trackage Rights Agreement, the SCT is entitled to set the rates in accordance with Mexican law and regulations, which rates may not adequately compensate KCSM. KCSM is currently involved in legal proceedings with the SCT and discussions with Ferromex regarding the amounts payable to each other for trackage rights, interline services and haulage rights for periods prior to January 1, 2009. Certain of these disputes continue under litigation. Any resolution of such procedures adverse to KCSM could have a material adverse effect on its consolidated financial statements in a particular quarter or fiscal year.

***KCS's flexibility to operate its business could be impacted by provisions in its debt obligations.***

KCS's debt instruments contain covenants which restrict or prohibit certain actions ("negative covenants"), including, but not limited to, KCS's ability to incur debt, create or suffer to exist liens, engage in mergers and consolidations and sell certain assets. The KCSM revolving credit facility contains additional negative covenants, including but not limited to, KCSM's ability to freely deploy proceeds in excess of pre-defined thresholds from insurance settlements or asset sales, make certain investments, engage in transactions with stockholders and affiliates, or engage in sale-leaseback transactions. The first of the aforementioned additional negative covenants terminates upon conversion of KCSM's revolving credit facility from secured to unsecured upon KCSM's attainment of investment grade credit ratings from at least two of the three primary rating agencies. KCS's debt instruments also contain covenants requiring KCS to, among other things, maintain specified financial ratios ("affirmative covenants"). Failure to comply with these negative and affirmative covenants could result in an event of default that, if not cured or waived, could restrict the Company's access to liquidity and have a material adverse effect on the Company's business or prospects. If the Company does not have enough cash to service its debt or fund other liquidity needs, KCS may be required to take actions such as requesting a waiver from lenders, reducing or delaying capital expenditures, selling assets, restructuring or refinancing all or part of the existing debt, or seeking additional equity capital. KCS cannot assure that any of these remedies can be effected on commercially reasonable terms or at all.

***A downturn in the debt capital markets or a downgrade of the Company's credit ratings may increase the cost of borrowing and make financing difficult to obtain.***

Events in the financial markets may have an adverse impact on the debt capital markets and, as a result, credit may become more expensive and difficult to obtain. Lenders may impose more stringent restrictions on the terms of credit and there may be a general reduction in the amount of credit available in the markets in which KCS conducts business. Also, the Company and its securities are rated by Standard & Poor's Rating Services ("S&P"), Moody's Investors Service ("Moody's") and Fitch Ratings ("Fitch"). These ratings impact the Company's cost of funds and its access to the debt capital markets. The negative impact of tightening credit markets, adverse changes in the debt capital markets generally and/or a downgrade of the Company's credit ratings may have a material adverse effect on KCS's consolidated financial statements resulting from, but not limited to, an inability to finance capital expansion on favorable terms, if at all, reduced liquidity as a result of limited alternatives to refinance short-term debt, increased financing costs and/or financial terms with increasingly restrictive covenants.

***KCS's business is capital intensive.***

The Company's business is capital intensive and requires substantial ongoing expenditures for, among other things, additions and improvements to roadway, structures and technology, acquisitions, and maintenance and repair of equipment and

the rail system. KCS's failure to make necessary capital expenditures to maintain its operations could impair its ability to serve existing customers, accommodate increases in traffic volumes or result in increased derailments.

KCSM's Concession from the Mexican government requires KCSM to make investments and undertake capital projects. If KCSM fails to make such capital investments, KCSM's business plan commitments with the Mexican government may be at risk, requiring KCSM to seek waivers of its business plan. There is no assurance that such waivers, if requested, would be granted by the SCT. KCSM may defer capital expenditures under its business plan with the permission of the SCT. However, the SCT might not grant this permission, and any failure by KCSM to comply with the capital investment commitments in its business plan could result in sanctions imposed by the SCT, and could result in revocation of the Concession if sanctions are imposed on five distinct occasions. The Company cannot assure that the Mexican government would grant any such permission or waiver. If such permission or waiver is not obtained in any instance and KCSM is sanctioned, its Concession might be at risk of revocation, which would materially adversely affect KCS's consolidated financial statements. See "KCSM's Mexican Concession is subject to revocation or termination in certain circumstances".

KCS has funded, and expects to continue to fund capital expenditures with operating cash flows, debt and equipment leases. KCS may not be able to generate sufficient cash flows from its operations or obtain sufficient funds from external sources to fund capital expenditure requirements. Even if financing is available, it may not be obtainable on acceptable terms and within the limitations contained in the indentures and other agreements relating to KCS's existing debt.

***KCS is dependent on certain key suppliers of core rail equipment.***

KCS relies on a limited number of suppliers of core rail equipment (including locomotives, rolling stock equipment, rail and ties). The capital intensive nature and complexity of such equipment creates high barriers of entry for any potential new suppliers. If any of KCS's suppliers discontinue production or experience capacity or supply shortages, this could result in increased costs or difficulty in obtaining rail equipment and materials, which could have a material adverse effect on KCS's consolidated financial statements.

***KCS depends on the stability, availability and security of its information technology systems to operate its business.***

KCS relies on information technology in all aspects of its business. A significant disruption or failure of its information technology systems, including its computer hardware, software and communications equipment, could result in service interruptions, safety failures, security failures, regulatory compliance failures or other operational difficulties.

The security risks associated with information technology systems have increased in recent years because of the increased sophistication and activities of perpetrators of cyber attacks. A failure in or breach of KCS's information technology security systems, or those of its third party service providers, as a result of cyber attacks or unauthorized access to its network could disrupt KCS's business, result in the disclosure or misuse of confidential or proprietary information, increase its costs and/or cause losses. KCS also confronts the risk that a terrorist or other third parties may seek to use its property, including KCS's information technology systems, to inflict major harm.

KCS continually takes steps to make appropriate enhancements to its information technology systems; however, KCS's systems may be vulnerable to disruption, failure or unauthorized access which could have a material adverse effect on KCS's consolidated financial statements.

***KCS's business may be adversely affected by changes in general economic, weather or other conditions.***

KCS's operations may be adversely affected by changes in the economic conditions of the industries and geographic areas that produce and consume the freight that KCS transports. The relative strength or weakness of the United States and Mexican economies affects the businesses served by KCS. Prolonged negative changes in domestic and global economic conditions or disruptions of either or both of the financial and credit markets, including the availability of short and long-term debt financing, may affect KCS, as well as the producers and consumers of the commodities that KCS transports and may have a material adverse effect on KCS's consolidated financial statements.

The transportation industry is highly cyclical, generally tracking the cycles of the world economy. Although transportation markets are affected by general economic conditions, there are numerous specific factors within each particular market that may influence operating results. Some of KCS's customers do business in industries that are highly cyclical, including the oil and gas, automotive, housing and agriculture industries. Any downturn in these industries could have a

material adverse effect on operating results. Also, some of the products transported have had a historical pattern of price cyclicality which has typically been influenced by the general economic environment and by industry capacity and demand. KCS cannot assure that prices and demand for these products will not decline in the future, adversely affecting those industries and, in turn, the Company's consolidated financial statements.

Traffic congestion experienced in the U.S. or Mexican railroad system may result in overall traffic congestion which would impact the ability to move traffic to and from Mexico and adversely affect KCS's operations. This system congestion may also result in certain equipment shortages. Any similar congestion experienced by railroads in Mexico could have an adverse effect on the Company's consolidated financial statements. In addition, the growth of cross border traffic in recent years has contributed to congestion on the international bridge at the Nuevo Laredo-Laredo border gateway, which is expected to continue in the near future. This may adversely affect KCS's consolidated financial statements.

The Company's operations may also be affected by natural disasters or adverse weather conditions. The Company operates in and along the Gulf of Mexico, and its facilities may be adversely affected by hurricanes, floods and other extreme weather conditions that could also adversely affect KCS's shipping, agricultural, chemical and other customers. Significant reductions in the volume of rail shipments due to economic, weather, or other conditions could have a material adverse effect on KCS's consolidated financial statements.

***KCS's business may be affected by market and regulatory responses to climate change.***

KCS's operations may be adversely affected by restrictions, caps, taxes, or other controls on emissions of greenhouse gases, including diesel exhaust. Restrictions on emissions could also affect KCS's customers that use commodities that KCS transports to produce energy, use significant amounts of energy in producing or delivering the commodities KCS transports, or manufacture or produce goods that consume significant amounts of energy or burn fossil fuels, including coal-fired power plants, chemical producers, farmers and food producers, and automakers and other manufacturers. Significant cost increases, government regulation, or changes of consumer preferences for goods or services relating to alternative sources of energy or emissions reductions could materially affect the markets for the commodities KCS transports, which in turn could have a material adverse effect on KCS's consolidated financial statements. Government incentives encouraging the use of alternative sources of energy could also affect certain customers and their respective markets for certain commodities KCS transports in an unpredictable manner that could alter traffic patterns, including, for example, the impacts of ethanol incentives on farming and ethanol producers. Any of these factors, individually or in conjunction with one or more of the other factors, or other unforeseen impacts of climate change could have a material adverse effect on KCS's consolidated financial statements.

***KCS is exposed to the credit risk of its customers and counterparties and their failure to meet their financial obligations could adversely affect KCS's consolidated financial statements.***

KCS's business is subject to credit risk including the risk that a customer or counterparty will fail to meet its obligations when due. Customers and counterparties that owe the Company money may default on their obligations to the Company due to bankruptcy, lack of liquidity, operational failure or other reasons. Although the Company has procedures for reviewing its credit exposures to specific customers and counterparties to address present credit concerns, default risk may arise from events or circumstances that are difficult to detect or foresee. Some of the Company's risk management methods depend upon the evaluation of information regarding markets, clients or other matters that are publicly available or otherwise accessible by the Company. That information may not, in all cases, be accurate, complete, up-to-date or properly evaluated. In addition, concerns about, or a default by, one customer or counterparty could lead to significant liquidity problems, losses or defaults by other customers or counterparties, which in turn could adversely affect the Company. The Company may be materially and adversely affected in the event of a significant default by its customers and counterparties.

***KCS's business is subject to legislation enacted by Congress and state legislatures, and is subject to regulation by international, federal, state and local regulatory agencies, including environmental, health, safety laws, and regulations and tax that could require KCS to incur material costs or liabilities.***

KCS is subject to legislation enacted by Congress and by state legislatures, and is subject to regulation by international, federal, state and local regulatory agencies with respect to railroad operations including the U.S. Department of Transportation, Surface Transportation Board, Federal Railroad Administration, Environmental Protection Agency, Department of Homeland Security and others in the United States, the SCT in Mexico, as well as a variety of health, safety, labor, environmental, and other matters. Government regulation of the railroad industry is a significant determinant of the competitiveness and profitability of railroads.

Additional or new economic regulation by Congress or by the Surface Transportation Board in current or future proceedings could change the regulatory framework within which the Company operates which could materially change the Company's business and have an adverse effect on the Company's consolidated financial statements.

As part of the Rail Safety Improvement Act of 2008 in the United States, Class I railroad carriers and passenger and commuter rail operators must implement positive train control (a technology designed to help prevent train-to-train collisions, overspeed derailments, incursions into rail work zones, and entry into main line track if a switch is misaligned) at certain locations (including main line track where toxic inhalation hazard or poison inhalation hazard movements occur or where passenger operations occur) by the end of 2015, which will add to operating costs, increase the number of employees the Company employs and require KCS to make significant investments in new safety technology.

KCS's inadvertent failure or inability to comply with applicable laws and regulations could have a material adverse effect on the Company's consolidated financial statements and operations, including limitations on operating activities until compliance with applicable requirements is achieved. These government agencies may change the legislative or regulatory framework within which the Company operates without providing any recourse for any adverse effects on the Company's business that occur as a result of such change. Additionally, some of the regulations require KCS to obtain and maintain various licenses, permits and other authorizations. Any failure to maintain these licenses, permits, and other authorizations could adversely affect KCS's business.

From time to time, certain KCS facilities have not been in compliance with environmental, health and safety laws and regulations and there can be no assurance that KCS will always be in compliance with such laws and regulations in the future. Environmental liability under federal and state law in the United States can also extend to previously owned or operated properties, leased properties and properties owned by third parties, as well as to properties currently owned and used by the Company. Environmental liabilities may also arise from claims asserted by adjacent landowners or other third parties. Given the nature of its business, the Company incurs, and expects to continue to incur, environmental compliance costs, including, in particular, costs necessary to maintain compliance with requirements governing chemical and hazardous material shipping operations, refueling operations and repair facilities. KCS presently has environmental investigation and remediation obligations at certain sites, and will likely incur such obligations at additional sites in the future. Liabilities accrued for environmental costs represent the Company's best estimate of the probable future obligation for the remediation and settlement of these sites. Although the recorded liability is the best estimate of all probable costs, clean-up costs may exceed such estimates, due to various factors such as evolving environmental laws and regulations, changes in technology, the extent of other parties' participation, developments in environmental surveys and studies, and the extent of corrective action that may ultimately be required. New laws and regulations, stricter enforcement of existing requirements, accidental spills, releases or violations or the discovery of previously unknown contamination could require KCS to incur costs or subject KCS to liabilities that could have a material adverse effect on KCS's consolidated financial statements.

The Company's Mexican operations are subject to Mexican federal and state laws and regulations relating to the protection of the environment, including standards for, among other things, water discharge, water supply, emissions, noise pollution, hazardous substances and transportation and handling of hazardous and solid waste. Under applicable Mexican law and regulations, administrative and criminal proceedings may be brought and economic sanctions imposed against companies that violate environmental laws, and non-complying facilities may be temporarily or permanently closed. KCSM is also subject to the laws of various jurisdictions and international conferences with respect to the discharge of materials into the environment and to environmental laws and regulations issued by the governments of each of the Mexican states in which KCSM's facilities are located. The terms of KCSM's Concession from the Mexican government also impose environmental compliance obligations on KCSM. The Company cannot predict the effect, if any, that unidentified environmental matters or the adoption of additional or more stringent environmental laws and regulations would have on KCS's consolidated financial statements. Failure to comply with any environmental laws or regulations may result in the termination of KCSM's Concession or in fines or penalties that may affect profitability.

KCS is subject to income taxes as well as non-income based taxes, in both the United States and Mexico. Changes in tax rates, enactment of new tax laws, and revisions of tax regulations could have a material adverse effect on the Company's consolidated financial statements. Additionally, the final determination of tax audits, claims or litigation could differ from what is reflected in KCS's financial statements.

***KCS, as a common carrier by rail, is required by United States and Mexican laws to transport hazardous materials, which could expose KCS to significant costs and claims.***

Under United States federal statutes and applicable Mexican laws, KCS's common carrier responsibility requires it to transport hazardous materials. Any rail accident or other incident or accident on KCS's network, facilities, or at the facilities of KCS's customers involving the release of hazardous materials, including toxic inhalation hazard (or TIH) materials, could involve significant costs and claims for personal injury, property damage, and environmental penalties and remediation in excess of the Company's insurance coverage for these risks, which could have a material adverse effect on KCS's consolidated financial statements.

***KCS's business is vulnerable to rising fuel costs and disruptions in fuel supplies. Any significant increase in the cost of fuel that is not adequately covered by fuel surcharges, or severe disruption of fuel supplies, would have a material adverse effect on KCS's consolidated financial statements.***

KCS incurs substantial fuel costs in its railroad operations and these costs represent a significant portion of its transportation expenses. Significant price increases for fuel may have a material adverse effect on operating results. If KCS is unable to recapture its costs of fuel from its customers, operating results could be materially adversely affected. In addition, a severe disruption of fuel supplies resulting from supply shortages, political unrest, a disruption of oil imports, weather events, war, or otherwise, and the resulting impact on fuel prices could materially adversely affect KCS's consolidated financial statements.

KCS currently meets, and expects to continue to meet, fuel requirements for its Mexican operations almost exclusively through purchases at market prices from PEMEX Refinaci3n ("PEMEX"), the national oil company of Mexico, a government-owned entity exclusively responsible for the distribution and sale of diesel fuel in Mexico. KCSM is party to a fuel supply contract with PEMEX of indefinite duration based on market prices. Either party may terminate the contract upon 30 days written notice to the other at any time. If the fuel contract is terminated and KCSM is unable to acquire diesel fuel from alternate sources on acceptable terms, the Mexican operations could be materially adversely affected.

***Market fluctuations could adversely impact KCS's operating results as it hedges certain transactions.***

From time to time, KCS may use various financial instruments to reduce its exposure to various market risks, including interest rates, foreign currency, and fuel and commodity prices. While these financial instruments reduce the Company's exposure to changes in market risks, the use of such instruments may ultimately limit the Company's ability to benefit from favorable changes in underlying rates or prices due to amounts fixed at the time of entering into the hedge agreement.

***The loss of key personnel could negatively affect business.***

KCS's success substantially depends on its ability to attract and retain key members of the senior management team and the principals of its foreign subsidiaries. Recruiting, motivating, and retaining qualified management personnel, particularly those with expertise in the railroad industry, are vital to operations and success. There is substantial competition for qualified management personnel and there can be no assurance that KCS will always be able to attract or retain qualified personnel. Employment agreements with senior management are terminable at any time by either party. If KCS loses one or more of these key executives or principals, its ability to successfully implement its business plans and the value of its common stock could be materially adversely affected.

***A majority of KCS's employees belong to labor unions. Strikes or work stoppages could adversely affect operations.***

The Company is a party to collective bargaining agreements with various labor unions in the United States and Mexico. As of December 31, 2012, approximately 80% of KCSR and KCSM Servicios employees were covered by labor contracts subject to collective bargaining. The Company may be subject to, among other things, strikes, work stoppages or work slowdowns as a result of disputes under these collective bargaining agreements and labor contracts or KCS's potential inability to negotiate acceptable contracts with these unions. In the United States, because such agreements are generally negotiated on an industry-wide basis, determination of the terms and conditions of labor agreements have been and could continue to be beyond KCS's control. KCS may, therefore, be subject to terms and conditions in industry-wide labor agreements that could have a material adverse effect on its consolidated financial statements. If the unionized workers in the United States or Mexico were to engage in a strike, work stoppage or other slowdown; if other employees were to become unionized or if the terms and conditions in future labor agreements were renegotiated, KCS could experience a significant disruption of its operations and

higher ongoing labor costs. Although the U.S. Railway Labor Act imposes restrictions on the right of United States railway workers to strike, there is no law in Mexico imposing similar restrictions on the right of railway workers in that country to strike.

***KCS faces possible catastrophic loss and liability, and its insurance may not be sufficient to cover its damages or damages to others.***

The operation of any railroad carries with it an inherent risk of catastrophe, mechanical failure, collision, and property loss. In the course of KCS's operations, spills or other environmental mishaps, cargo loss or damage, business interruption due to political developments, as well as labor disputes, strikes and adverse weather conditions, could result in a loss of revenues or increased liabilities and costs. Collisions, environmental mishaps, or other accidents can cause serious bodily injury, death and extensive property damage, particularly when such accidents occur in heavily populated areas. Additionally, KCS's operations may be affected from time to time by natural disasters such as earthquakes, volcanoes, floods, hurricanes or other storms. The occurrence of a major natural disaster could have a material adverse effect on KCS's consolidated financial statements. The Company maintains insurance that is consistent with industry practice against the accident-related risks involved in the conduct of its business, property damage and business interruption due to natural disasters. However, this insurance is subject to a number of limitations on coverage, depending on the nature of the risk insured against. This insurance may not be sufficient to cover KCS's damages or damages to others, and this insurance may not continue to be available at commercially reasonable rates. In addition, KCS is subject to the risk that one or more of its insurers may become insolvent and would be unable to pay a claim that may be made in the future. Even with insurance, if any catastrophic interruption of service occurs, KCS may not be able to restore service without a significant interruption to operations which could have an adverse effect on KCS's consolidated financial statements.

***KCS's business may be affected by future acts of terrorism, war or other acts of violence or crime.***

Terrorist attacks, such as an attack on the Company's chemical transportation activities, any government response thereto and war or risk of war may adversely affect KCS's consolidated financial statements. These acts may also impact the Company's ability to raise capital or its future business opportunities. KCS's rail lines and facilities could be direct targets or indirect casualties of acts of terror, which could cause significant business interruption and damage to KCS's property. In recent years, there have been reported incidents of train-related robberies in Mexico, including incidents involving KCSM's trains and infrastructure. Other acts of violence or crime could also adversely affect the Company's business.

As a result, acts of terrorism or war or acts of crime or violence could result in increased costs and liabilities and decreased revenues for KCS. In addition, insurance premiums charged for some or all of the applicable coverage currently maintained by KCS could increase dramatically or certain coverage may not be adequate to cover losses or may not be available in the future.

***KCS's ownership of KCSM and operations in Mexico subject it to economic and political risks.***

The Mexican government has exercised, and continues to exercise, significant influence over the Mexican economy. Accordingly, Mexican governmental actions concerning the economy and state-owned enterprises could have a significant impact on Mexican private sector entities in general and on KCSM's operations in particular. KCS cannot predict the impact that the political landscape, including multiparty rule, will have on the Mexican economy. Furthermore, KCS's consolidated financial statements and prospects may be affected by currency fluctuations, inflation, interest rates, regulation, taxation and other political, social and economic developments in or affecting Mexico.

The Mexican economy in the past has suffered balance of payment deficits and shortages in foreign exchange reserves. Although Mexico has imposed foreign exchange controls in the past, there are currently no exchange controls in Mexico. Pursuant to the provisions of NAFTA, if Mexico experiences serious balance of payment difficulties or the threat of such difficulties in the future, Mexico would have the right to impose foreign exchange controls on investments made in Mexico, including those made by United States and Canadian investors. Any restrictive exchange control policy could adversely affect KCS's ability to obtain U.S. dollars or to convert Mexican pesos ("pesos" or "Ps.") into dollars for purposes of making interest and principal payments due on indebtedness, to the extent KCS may have to effect those conversions, and could adversely affect the Company's investment in KCSM. This could have a material adverse effect on KCS's consolidated financial statements.



Presidential and federal congress elections in Mexico were held resulting in a change in administration in December 2012. KCSM cannot predict whether changes in Mexican government policy will result from the change in administration; however, changes in laws, public policies and government programs could be enacted, which could have an adverse effect on the Company's consolidated financial statements.

Mexican national politicians are currently focused on certain regional, political and social tensions, and reforms regarding fiscal policies, gas, electricity, social security, and oil have not been and may not be approved. The social and political situation in Mexico could adversely affect the Mexican economy, which in turn could have a material adverse effect on KCS's consolidated financial statements.

***Downturns in the United States economy or in trade between the United States and Asia or Mexico and fluctuations in the peso-dollar exchange rates would likely have adverse effects on KCS's consolidated financial statements.***

The level and timing of KCS's Mexican business activity is heavily dependent upon the level of United States-Mexican trade and the effects of NAFTA on such trade. The Mexican operations depend on the United States and Mexican markets for the products KCSM transports, the relative position of Mexico and the United States in these markets at any given time, and tariffs or other barriers to trade. Downturns in the United States or Mexican economies or in trade between the United States and Mexico would likely have adverse effects on KCS's consolidated financial statements and the Company's ability to meet debt service obligations. In addition, KCS has invested significant amounts in developing its intermodal operations, including the Port of Lazaro Cardenas, in part to provide Asian importers with an alternative to the west coast ports of the United States, and the level of intermodal traffic depends, to an extent, on the volume of Asian shipments routed through Lazaro Cardenas. Reduction in trading volumes, which may be caused by factors beyond KCS's control, including increased government regulations in light of recent concerns regarding the safety and quality of Asian-manufactured products, may adversely affect KCS's consolidated financial statements.

Also, fluctuations in the peso-dollar exchange rates could lead to shifts in the types and volumes of Mexican imports and exports. Although a decrease in the level of exports of some of the commodities that KCSM transports to the United States may be offset by a subsequent increase in imports of other commodities KCSM hauls into Mexico and vice versa, any offsetting increase might not occur on a timely basis, if at all. Future developments in United States-Mexican trade beyond the Company's control may result in a reduction of freight volumes or in an unfavorable shift in the mix of products and commodities KCSM carries.

Severe devaluation or depreciation of the peso may result in disruption of the international foreign exchange markets and may limit the ability to transfer pesos or to convert pesos into U.S. dollars for the purpose of making timely payments of interest and principal on the non-peso denominated indebtedness. Although the Mexican government currently does not restrict, and for many years has not restricted, the right or ability of Mexican or foreign persons or entities to convert pesos into U.S. dollars or to transfer foreign currencies out of Mexico, the Mexican government could, as in the past, institute restrictive exchange rate policies that could limit the ability to transfer or convert pesos into U.S. dollars or other currencies for the purpose of making timely payments of the U.S. dollar-denominated debt and contractual commitments. Devaluation or depreciation of the peso against the U.S. dollar may also adversely affect U.S. dollar prices for KCS's securities.

Fluctuations in the peso-dollar exchange rates also have an effect on KCS's consolidated financial statements. A devaluation of the peso would cause reported peso-denominated revenues and expenses to decrease, and would increase reported foreign exchange loss due to the Company's net monetary assets that are peso-denominated. Exchange rate variations also affect the calculation of taxes under Mexican income tax law, and an appreciation of the peso would cause an increase in the Company's reported income tax provision and effective income tax rate.

***Mexico may experience high levels of inflation in the future which could adversely affect KCS's consolidated financial statements.***

Mexico has a history of high levels of inflation and may experience high inflation in the future. During most of the 1980s and during the mid and late 1990s, Mexico experienced periods of high levels of inflation. The annual rates of inflation for the last three years, as measured by changes in the National Consumer Price Index, as provided by Banco de México, were 3.6% in 2012, 3.8% in 2011 and 4.4% in 2010. A substantial increase in the Mexican inflation rate would have the effect of increasing some of KCSM's costs, which could adversely affect its consolidated financial statements. High levels of inflation may also affect the balance of trade between Mexico and the United States, and other countries, which could adversely affect KCSM's consolidated financial statements.

***KCS may be subject to various claims and litigation that could have a material adverse effect on KCS's consolidated financial statements.***

The Company may be exposed to the potential of various claims and litigation related to labor and employment, personal injury, commercial disputes, freight loss and other property damage, and other matters that arise in the normal course of business. Any material changes to litigation trends or a catastrophic rail accident or series of accidents involving any or all of property damage, personal injury, and environmental liability could have a material adverse effect on KCS's consolidated financial statements.

**Item 1B. *Unresolved Staff Comments***

None.

**Item 2. *Properties***

***Track Configuration***

KCSR operates over a railroad system consisting of approximately 3,100 route miles in ten states extending from the midwest and southeast portions of the United States south to the Mexican border, and approximately 475 miles of trackage rights that permit KCSR to operate its trains with its crews over other railroads' tracks.

Under its Concession from the Mexican government, KCSM has the right to operate approximately 3,200 route miles, but does not own the land, roadway, or associated structures, and additionally has approximately 700 miles of trackage rights. The Concession requires KCSM to make investments as described in a business plan filed every five years with the Mexican government. See Item 1A, "Risk Factors — KCSM's Mexican Concession is subject to revocation or termination in certain circumstances which would prevent KCSM from operating its railroad and would have a material adverse effect on the Company's consolidated financial statements."

***Equipment Configuration***

As of December 31, 2012 and 2011, KCS leased and owned the following units of equipment:

	2012		2011	
	Leased	Owned	Leased	Owned
Locomotives	295	615	295	628
<i>Rolling stock:</i>				
Box cars	5,564	918	5,714	1,031
Hoppers	4,436	1,179	4,644	872
Gondolas	3,194	940	3,114	1,229
Auto racks	1,824	100	1,869	—
Tank cars	663	15	661	15
Flat cars (intermodal and other)	561	242	605	501
Total	16,242	3,394	16,607	3,648
<b><u>Average Age (in Years) of Leased and Owned Locomotives:</u></b>			<b>2012</b>	<b>2011</b>
Road locomotives			13.0	13.7
All locomotives			19.7	20.0

***Property and Facilities***

KCS operates numerous facilities, including terminals for intermodal and other freight, rail yards for train-building, switching, storage-in-transit (the temporary storage of customer goods in rail cars prior to shipment) and other activities; offices to administer and manage operations; dispatch centers to direct traffic on the rail network; crew quarters to house train crews along the rail line; and shops and other facilities for fueling, maintenance, and repair of locomotives and maintenance of freight cars and other equipment.

### ***Capital Expenditures***

The Company's cash capital expenditures for the three years ended December 31, 2012, 2011, and 2010, and planned 2013 capital expenditures are included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Capital Expenditures". See also Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates — Capitalization, Depreciation and Amortization of Property and Equipment (including Concession Assets)" regarding the Company's policies and guidelines related to capital expenditures.

### **Item 3. *Legal Proceedings***

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. For more information on legal proceedings, see Item 1A, "Risk Factors — KCS may be subject to various claims and litigation that could have a material adverse effect on KCS's consolidated financial statements," Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates — Provision for Personal Injury Claims," and — "Other Matters — Litigation," and Item 8, "Financial Statements and Supplementary Data — Note 14 Commitments and Contingencies".

### **Item 4. *Mine Safety Disclosures***

Not applicable.

## Part II

### Item 5. *Market for KCS's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

#### **Market Information**

The Company's common stock is traded on the New York Stock Exchange under the ticker symbol "KSU". The following table presents for the quarters indicated the dividends declared and the high and low sales price of the Company's common and preferred stock.

	<u>Fourth</u>	<u>Third</u>	<u>Second</u>	<u>First</u>
<b>2012</b>				
<i>Dividends per share:</i>				
Common stock	\$ 0.195	\$ 0.195	\$ 0.195	\$ 0.195
\$25 par preferred stock	0.250	0.250	0.250	0.250
 <i>Stock price ranges:</i>				
\$25 par preferred:				
— High	\$ 26.50	\$ 27.00	\$ 26.00	\$ 29.33
— Low	25.15	25.00	24.81	22.80
Common:				
— High	\$ 84.16	\$ 83.95	\$ 79.50	\$ 74.98
— Low	72.80	65.86	61.36	64.07
 <b>2011</b>				
<i>Dividends per share:</i>				
\$25 par preferred stock	\$ 0.250	\$ 0.250	\$ 0.250	\$ 0.250
\$1 par series D preferred stock	—	—	—	12.810
 <i>Stock price ranges:</i>				
\$25 par preferred:				
— High	\$ 27.17	\$ 24.74	\$ 24.31	\$ 23.85
— Low	22.61	22.90	22.85	21.87
Common:				
— High	\$ 70.48	\$ 62.78	\$ 59.50	\$ 56.98
— Low	47.12	45.63	50.27	47.14

#### **Dividend Policy**

*Common Stock.* Under the terms of a previous credit agreement completed in 2006, KCS was prohibited from paying cash dividends on its common stock. During 2011, KCS entered into an amended and restated credit agreement (the "2011 KCSR Credit Agreement") which allowed KCS to pay cash dividends on its common stock, as well as other payments, in an amount up to and including the "Available Basket Amount" as defined in the agreement. In March 2012, KCS began declaring a quarterly cash dividend on its common stock. In November 2012, KCSR entered into an amended and restated credit agreement which removed the Available Basket Amount restriction on the Company's ability to pay cash dividends on its common stock. Any declaration and payment of dividends to holders of the Company's common stock are at the discretion of the Board of Directors, which depends on many factors, including the Company's financial condition, earnings, capital requirements and other factors that the Board of Directors deems relevant. Subject to these qualifications, the Company expects to continue to pay dividends on an ongoing basis.

#### **Holdings**

There were 2,987 record holders of KCS common stock on January 28, 2013; however, the number of actual holders of KCS common stock is greater due to the practice of brokerage firms registering many shares for clients in the brokerage firm's name.

***Securities Authorized for Issuance Under Equity Compensation Plans***

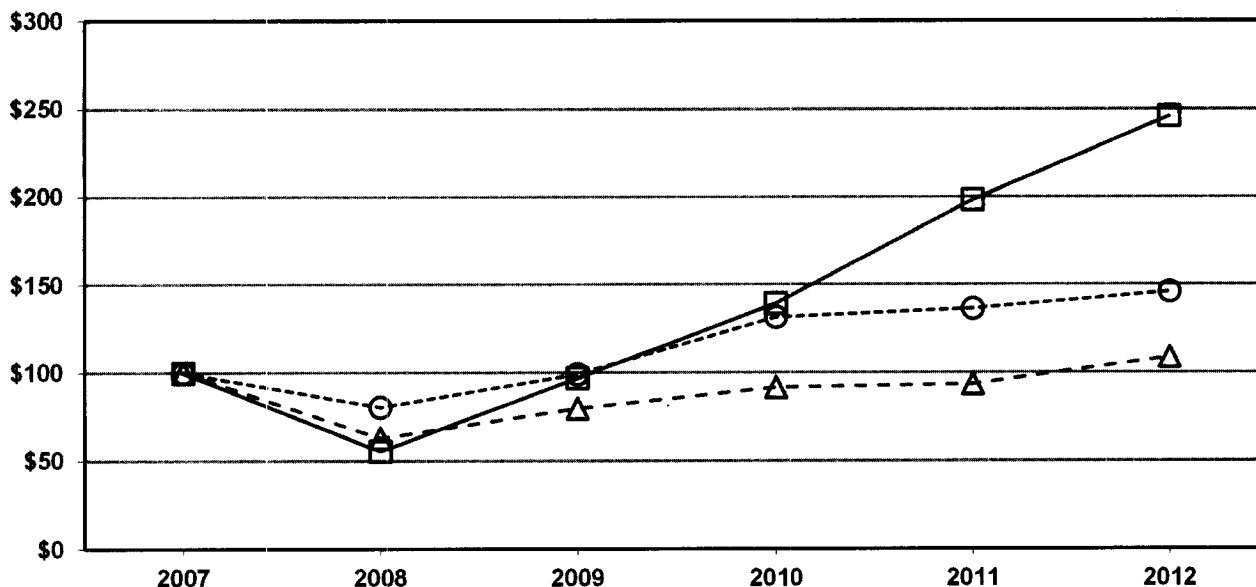
See Part III, Item 12, "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" for information about securities authorized for issuance under KCS's equity compensation plans.

The Company maintains a 401(k) profit sharing plan, which is designed to meet the requirements of qualification under Section 401(a) of the Internal Revenue Code. Participants have the ability to direct the investment of their plan accounts among various investment alternatives, one of which is a KCS common stock fund. KCS registered 660,000 shares of common stock for issuance under the plan pursuant to a Form S-8 Registration Statement filed in December 2000. Since that time the third party record keeper for the plan has changed several times. Because certain of the record keepers cannot provide detailed records of the actual shares sold under the plan, KCS is unable to determine whether more than 660,000 shares have been purchased since the Form S-8 was originally filed. However, even if this share limit were exceeded, the Company does not believe the excess amount to be material. The Company filed a new Form S-8 on February 13, 2012 to register additional shares for use under the plan.

**Performance Graph**

The following graph shows the changes in value over the five years ended December 31, 2012, of an assumed investment of \$100 in: (i) KCS's common stock; (ii) the stocks that comprise the Dow Jones U.S. Industrial Transportation Index(1); and (iii) the stocks that comprise the S&P 500 Index(2). The table following the graph shows the value of those investments on December 31 for each of the years indicated. The values for the assumed investments depicted on the graph and in the table have been calculated assuming that any cash dividends are reinvested.

**COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN  
Among Kansas City Southern, the S&P 500 Index  
and the Dow Jones U.S. Industrial Transportation Index**



■ Kansas City Southern
▲ S&P 500
● Dow Jones US Industrial Transportation

	2007	2008	2009	2010	2011	2012
Kansas City Southern	100.00	55.49	96.97	139.41	198.11	245.74
S&P 500	100.00	63.00	79.67	91.67	93.61	108.59
Dow Jones U.S. Industrial Transportation	100.00	80.43	98.93	131.35	136.47	145.83

- (1) The Dow Jones U.S. Industrial Transportation Index is a registered trademark of Dow Jones & Co., Inc., an independent company.
- (2) The S&P 500 is a registered trademark of the McGraw-Hill Companies, Inc. The S&P 500 Index reflects the weighted average market value for 500 companies whose shares are traded on the New York Stock Exchange, American Stock Exchange and the Nasdaq Stock Market.

**Item 6. Selected Financial Data**

The selected financial data below (*in millions, except per share amounts*) should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included under Item 7 of this Form 10-K as well as the consolidated financial statements and the related notes.

	2012	2011	2010	2009	2008
<b>Earnings From Continuing Operations</b>					
Revenues	\$ 2,238.6	\$ 2,098.3	\$ 1,814.8	\$ 1,480.2	\$ 1,852.1
Operating expenses (i) (ii)	1,522.7	1,486.7	1,328.3	1,213.4	1,464.7
Operating income	\$ 715.9	\$ 611.6	\$ 486.5	\$ 266.8	\$ 387.4
Net income	\$ 379.4	\$ 331.9	\$ 180.0	\$ 68.1	\$ 182.1
Earnings per common share:					
Basic	\$ 3.44	\$ 3.04	\$ 1.69	\$ 0.60	\$ 1.99
Diluted	3.43	3.00	1.67	0.60	1.84
<b>Financial Position</b>					
Total assets	\$ 6,395.9	\$ 6,145.1	\$ 5,627.9	\$ 5,415.5	\$ 5,394.7
Total debt obligations, including current portion	1,607.8	1,639.1	1,639.7	1,980.0	2,086.1
Total stockholders’ equity	3,096.6	2,764.5	2,431.1	2,043.0	1,896.6
Total equity	3,400.7	3,058.7	2,713.7	2,325.8	2,170.3
<b>Other Data Per Common Share</b>					
Cash dividends declared per common share	\$ 0.780	\$ —	\$ —	\$ —	\$ —

- (i) During 2012, the Company recognized a pre-tax gain of \$43.0 million within operating expenses for the elimination of a deferred statutory profit sharing liability, net as a result of the organizational restructuring during the period.
- (ii) During 2011, the Company recognized a pre-tax gain of \$25.6 million within operating expenses for insurance recoveries related to 2010 hurricane damage.

## **Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations***

The following is a discussion of Kansas City Southern's 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 8 of this Form 10-K. This discussion should be read in conjunction with the included consolidated financial statements, the related notes, and other information included in this report. Certain prior year amounts have been reclassified to conform to the current year presentation.

### **CAUTIONARY INFORMATION**

The discussions set forth in this Annual Report on Form 10-K may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. In addition, management may make forward-looking statements orally or in other writings, including, but not limited to, in press releases, quarterly earnings calls, executive presentations, in the annual report to stockholders and in other filings with the Securities and Exchange Commission. 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. These statements involve a number of risks and uncertainties. Actual results could materially differ from those anticipated by such forward-looking statements. Such differences could be caused by a number of factors or combination of factors including, but not limited to, the factors identified below and those discussed under Item 1A of this Form 10-K, "Risk Factors." Readers are strongly encouraged to consider these factors and the following factors when evaluating any forward-looking statements concerning the Company:

- fluctuations in the market price for the Company's common stock;
- KCS's dividend policy and limitations on its ability to pay dividends on its common stock;
- KCS's potential need for and ability to obtain additional financing;
- KCS's ability to successfully implement its business strategy, including the strategy to convert customers from using trucking services to rail transportation services;
- the impact of competition, including competition from other rail carriers, trucking companies and maritime shippers in the United States and Mexico;
- United States, Mexican and global economic, political and social conditions;
- the effects of the North American Free Trade Agreement, or NAFTA, on the level of trade among the United States, Mexico and Canada;
- uncertainties regarding the litigation KCS faces and any future claims and litigation;
- the effects of employee training, stability of the existing information technology systems, technological improvements and capital expenditures on labor productivity, operating efficiencies and service reliability;
- the adverse impact of any termination or revocation of KCSM's Concession by the Mexican government;
- legal or regulatory developments in the United States, Mexico or Canada;
- KCS's ability to generate sufficient cash, including its ability to collect on its customer receivables, to pay principal and interest on its debt, meet its obligations and fund its other liquidity needs;
- the effects of adverse general economic conditions affecting customer demand and the industries and geographic areas that produce and consume the commodities KCS carries;
- material adverse changes in economic and industry conditions, including the availability of short and long-term financing, both within the United States and Mexico and globally;
- natural events such as severe weather, fire, floods, hurricanes, earthquakes or other disruptions to the Company's operating systems, structures and equipment or the ability of customers to produce or deliver their products;
- market and regulatory responses to climate change;
- disruption in fuel supplies, changes in fuel prices and the Company's ability to assess fuel surcharges;
- KCS's ability to attract and retain qualified management personnel;
- changes in labor costs and labor difficulties, including work stoppages affecting either operations or customers' abilities to deliver goods for shipment;



- credit risk of customers and counterparties and their failure to meet their financial obligations;
- the outcome of claims and litigation, including those related to environmental contamination, personal injuries, and occupational illnesses arising from hearing loss, repetitive motion and exposure to asbestos and diesel fumes;
- acts of terrorism, violence or crime or risk of such activities;
- war or risk of war;
- political and economic conditions in Mexico and the level of trade between the United States and Mexico; and
- legislative, regulatory, or legal developments involving taxation, including enactment of new foreign, federal or state income or other tax rates, revisions of controlling authority, and the outcome of tax claims and litigation.

Forward-looking statements reflect the information only as of the date on which they are made. The Company does not undertake any obligation to update any forward-looking statements to reflect future events, developments, or other information. If KCS does update one or more forward-looking statements, no inference should be drawn that additional updates will be made regarding that statement or any other forward-looking statements.

## **CORPORATE OVERVIEW**

Kansas City Southern, a Delaware corporation, is a transportation holding company that has railroad investments in the U.S., Mexico and Panama. In the U.S., the Company serves the central and south central U.S. Its international holdings serve northeastern and central Mexico and the port cities of Lazaro Cardenas, Tampico and Veracruz, and a fifty percent interest in Panama Canal Railway Company provides ocean-to-ocean freight and passenger service along the Panama Canal. KCS's North American rail holdings and strategic alliances are primary components of a NAFTA railway system, linking the commercial and industrial centers of the U.S., Canada and Mexico. Its principal subsidiaries and affiliates include the following:

- The Kansas City Southern Railway Company ("KCSR"), a wholly-owned subsidiary;
- Kansas City Southern de México, S.A. de C.V. ("KCSM"), a wholly-owned subsidiary;
- Mexrail, Inc. ("Mexrail"), a wholly-owned consolidated subsidiary; which, in turn, wholly owns The Texas Mexican Railway Company ("Tex-Mex");
- Meridian Speedway, LLC ("MSLLC"), a seventy percent-owned consolidated affiliate;
- KCSM Servicios, S.A. de C.V. ("KCSM Servicios"), a wholly-owned subsidiary;
- Panama Canal Railway Company ("PCRC"), a fifty percent-owned unconsolidated affiliate, that provides international container shipping companies with a railway transportation option in lieu of the Panama Canal and the operations of PCRC's wholly-owned subsidiary, Panarail Tourism Company ("Panarail");
- Southern Capital Corporation, LLC ("Southern Capital"), a fifty percent-owned unconsolidated affiliate that owns and leases locomotives and other equipment;
- Ferrocarril y Terminal del Valle de México, S.A. de C.V. ("FTVM"), a twenty-five percent-owned unconsolidated affiliate that provides railroad services as well as ancillary services in the greater Mexico City area; and
- PTC-220, LLC ("PTC-220"), a fourteen percent-owned unconsolidated affiliate that holds the licenses to large blocks of radio spectrum and other assets for the deployment of positive train control.

## **EXECUTIVE SUMMARY**

### ***2012 Financial Overview***

In 2012, the Company recognized record-high volumes and revenues. Record-breaking revenues of \$2.2 billion were driven by strong growth in automotive and intermodal traffic. As revenues grew in most of the business units during the year, the Company's continued focus on operating expense control resulted in operating expenses as a percentage of revenues of 68.0%.

Revenues in 2012 increased 7% over 2011, driven primarily by positive pricing impacts, increased carloads/unit volumes and fuel surcharge, partially offset by the effect of fluctuations in the value of the Mexican peso against the U.S. dollar for revenues denominated in Mexican pesos. Operating expenses increased 2% compared to the same period in 2011 due primarily to higher diesel fuel prices and volumes. In addition, in 2011, the Company recognized a \$25.6 million pre-tax gain on

insurance recoveries within operating expenses as a result of the settlement of an insurance claim related to the 2010 hurricane damage. These increases were partially offset by a \$43.0 million net reduction to operating expense due to the elimination of a deferred statutory profit sharing liability as a result of the organizational restructuring in the second quarter of 2012 and the effect of fluctuations in the value of the Mexican peso against the U.S. dollar for operating expenses denominated in Mexican pesos.

KCSM's revenues and operating expenses are affected by fluctuations in the value of the Mexican peso against the U.S. dollar. Based on the volume of revenue and expense transactions denominated in Mexican pesos, revenue and expense fluctuations generally offset, with insignificant net impacts to operating income.

The Company reported 2012 earnings of \$3.43 per diluted share on consolidated net income attributable to Kansas City Southern and subsidiaries of \$377.3 million for the year ended December 31, 2012, compared to annual earnings of \$3.00 per diluted share on consolidated net income attributable to Kansas City Southern and subsidiaries of \$330.3 million for 2011.

During 2012, the Company's Board of Directors declared quarterly cash dividends of \$0.195 per share on its common stock.

During the past three years, KCS has consistently focused on opportunities to refinance or repay outstanding debt and strengthen its financial position. These efforts reduced interest expense for the year ended December 31, 2012 by \$28.7 million compared to the prior year. Additionally during 2012, the Company further strengthened its financial position and flexibility by amending its KCSR and KCSM revolver facilities which extended the maturity dates, eliminated or modified a number of restrictive covenants in its facilities in order to achieve consistency between its facilities and firms with investment grade ratings, and allows for the facilities to convert from secured to unsecured obligations upon attainment of investment grade credit ratings. In the fourth quarter of 2012, the KCSR credit facility converted from a secured to an unsecured obligation.

## RESULTS OF OPERATIONS

### *Year Ended December 31, 2012, compared with the Year Ended December 31, 2011*

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

	2012	2011	Change Dollars
Revenues	\$ 2,238.6	\$ 2,098.3	\$ 140.3
Operating expenses	1,522.7	1,486.7	36.0
Operating income	715.9	611.6	104.3
Equity in net earnings of unconsolidated affiliates	19.3	18.2	1.1
Interest expense	(100.4)	(129.1)	28.7
Debt retirement costs	(20.1)	(38.7)	18.6
Foreign exchange gain (loss)	2.7	(9.2)	11.9
Other income (expense), net	(1.0)	2.2	(3.2)
Income before income taxes	616.4	455.0	161.4
Income tax expense	237.0	123.1	113.9
Net income	379.4	331.9	47.5
Less: Net income attributable to noncontrolling interest	2.1	1.6	0.5
Net income attributable to Kansas City Southern and subsidiaries	<u>\$ 377.3</u>	<u>\$ 330.3</u>	<u>\$ 47.0</u>

## 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		
	2012	2011	% Change	2012	2011	% Change	2012	2011	% Change
Chemical and petroleum	\$ 410.3	\$ 396.3	4%	246.8	252.1	(2%)	\$ 1,662	\$ 1,572	6%
Industrial and consumer products	551.1	503.6	9%	336.1	326.6	3%	1,640	1,542	6%
Agriculture and minerals	400.5	415.6	(4%)	218.9	238.6	(8%)	1,830	1,742	5%
Energy (i)	312.8	317.4	(1%)	292.4	312.0	(6%)	1,070	1,017	5%
Intermodal	306.5	251.8	22%	914.2	798.8	14%	335	315	6%
Automotive	174.4	139.2	25%	103.7	85.6	21%	1,682	1,626	3%
Carload revenues, carloads and units	2,155.6	2,023.9	7%	2,112.1	2,013.7	5%	\$ 1,021	\$ 1,005	2%
Other revenue	83.0	74.4	12%						
Total revenues (ii)	<u>\$ 2,238.6</u>	<u>\$ 2,098.3</u>	<u>7%</u>						

(ii) Included in revenues:

Fuel surcharge	<u>\$ 282.1</u>	<u>\$ 244.6</u>
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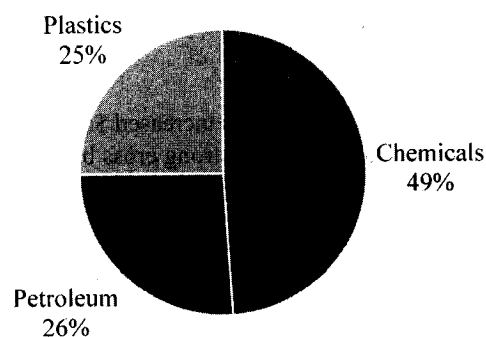
(i) Effective January 1, 2012, the Company established the Energy commodity group, which includes the previous Coal commodity group and certain amounts previously included within the Agriculture and minerals and Chemical and petroleum commodity groups. Prior period amounts have been reclassified to conform to the current year presentation.

Freight revenues include both revenue for transportation services and fuel surcharges. For the year ended December 31, 2012, revenues increased \$140.3 million compared to the prior year, primarily due to positive pricing impacts, increased carloads/unit volumes and fuel surcharge, partially offset by the effect of fluctuations in the value of the Mexican peso against the U.S. dollar for revenues denominated in Mexican pesos. Revenue per carload/unit increased by 2% for the year ended December 31, 2012, compared to the prior year, reflecting commodity mix.

KCS's fuel surcharge is 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:

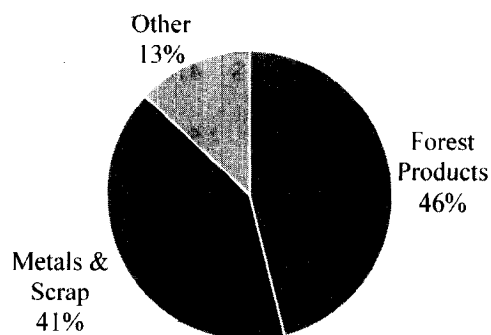
**Revenues by commodity group for 2012**



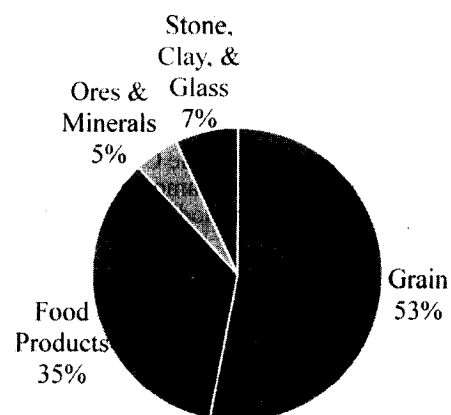
*Chemical and petroleum.* Revenues increased \$14.0 million for the year ended December 31, 2012, compared to 2011, primarily due to increases in pricing and fuel surcharge, partially offset by decreases in volume and fluctuations in the value of the Mexican peso against the U.S. dollar. Revenues increased due to positive pricing impacts for plastics, gases and chemicals used to manufacture glass and other industrial products. Petroleum volumes decreased primarily due to a customer's lost business.

**Revenues by commodity group for 2012**

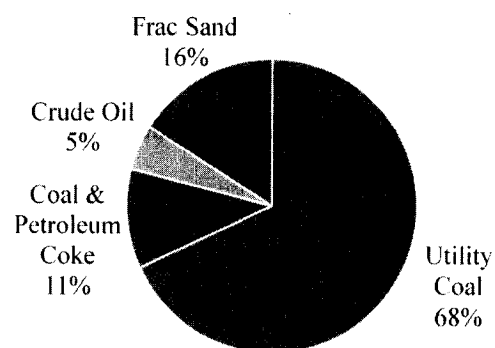
*Industrial and consumer products.* Revenues increased \$47.5 million for the year ended December 31, 2012, compared to 2011, primarily due to increases in pricing, volume and fuel surcharge. Metals and scrap revenues grew primarily due to increases in pricing and high demand for slab and steel coil driven by strength in the automotive and oil and gas industries. Paper product revenue increased primarily due to improved pricing.



*Agriculture and minerals.* Revenues decreased \$15.1 million for the year ended December 31, 2012, compared to 2011, primarily due to decreases in volume and fluctuations in the value of the Mexican peso against the U.S. dollar, partially offset by increases in pricing and fuel surcharge. Food products volumes decreased due to lost cross border corn syrup business and lower dried distillers grain volume. In addition, ores and minerals volumes decreased primarily due to a customer's lost business and grain volumes decreased primarily as a result of the severe drought conditions experienced in the United States.



*Energy.* Revenues decreased \$4.6 million for the year ended December 31, 2012, compared to 2011, primarily due to a decrease in volume and fluctuations in the value of the Mexican peso against the U.S. dollar, partially offset by increases in pricing and fuel surcharge. Utility coal revenues decreased due to a reduction in demand as a result of utility maintenance outages, historic low natural gas prices and a warmer than average winter. Frac sand volumes and pricing increased as a result of new business and a strong demand due to higher crude oil prices. Crude oil volume increased as a result of higher demand for domestic crude oil delivered by rail.



*Intermodal.* Revenues increased \$54.7 million for the year ended December 31, 2012, compared to 2011, primarily due to increases in volume due to strong cross border auto parts business, conversion of truck traffic to rail and Trans-Pacific imports via the Port of Lazaro Cardenas.

*Automotive.* Revenues increased \$35.2 million for the year ended December 31, 2012, compared to 2011, primarily due to increases in volume and pricing, partially offset by fluctuations in the value of the Mexican peso against the U.S. dollar. The increase was driven by strong year over year growth in North American automobile sales for Original Equipment Manufacturers, increased import/export volume through the Port of Lazaro Cardenas and increased length of haul through new cross border vehicle routings.

## Operating Expenses

Operating expenses, as shown below (*in millions*), increased \$36.0 million for the year ended December 31, 2012, when compared to the same period in 2011, primarily due to the gain on insurance recoveries recognized in 2011 related to the 2010 hurricane damage, higher diesel fuel prices and carload/unit volumes. These increases were partially offset by the elimination of the deferred Mexican statutory profit sharing liability as a result of the organizational restructuring in 2012. In addition, increases in operating expenses for the year ended December 31, 2012, compared to the same period in 2011, were partially offset by the fluctuations in the value of the Mexican peso against the U.S. dollar for operating expenses denominated in Mexican pesos.

	2012	2011	Change	
			Dollars	Percent
Compensation and benefits	\$ 430.5	\$ 423.8	\$ 6.7	2%
Purchased services	219.8	204.8	15.0	7%
Fuel	359.6	346.5	13.1	4%
Equipment costs	167.1	172.0	(4.9)	(3%)
Depreciation and amortization	198.8	186.2	12.6	7%
Materials and other	189.9	179.0	10.9	6%
Elimination of deferred statutory profit sharing liability, net	(43.0)	—	(43.0)	100%
Gain on insurance recoveries related to hurricane damage	—	(25.6)	25.6	(100%)
Total operating expenses	<u>\$ 1,522.7</u>	<u>\$ 1,486.7</u>	<u>\$ 36.0</u>	<u>2%</u>

*Compensation and benefits.* Compensation and benefits increased \$6.7 million for the year ended December 31, 2012, compared to 2011, primarily due to increased incentive compensation expense, annual salary and benefit rate increases and increased carload/unit volumes. These increases were partially offset by reduced Mexican statutory profit sharing expense as a result of the organizational restructuring in the second quarter of 2012, and the fluctuations in the value of the Mexican peso against the U.S. dollar.

*Purchased services.* Purchased services increased \$15.0 million for the year ended December 31, 2012, compared to 2011, due to higher joint facility income recognized in the second half of 2011 as a result of non-recurring usage of certain trackage rights and increases in volume-sensitive costs, primarily joint facility expenses and security services.

*Fuel.* Fuel expense increased \$13.1 million for the year ended December 31, 2012, compared to 2011, primarily due to higher diesel fuel prices and higher consumption. These increases were partially offset by the fluctuations in the value of the Mexican peso against the U.S. dollar and improved fuel efficiency. The net average fuel price per gallon increased by approximately 4% in 2012 as compared to 2011.

*Equipment costs.* Equipment costs decreased \$4.9 million for the year ended December 31, 2012, compared to 2011, primarily due to lower locomotive lease expense due to the acquisition of 75 locomotives during the third quarter of 2011, which were previously leased by the Company under an operating lease agreement. This decrease was partially offset by an increase in the use of other railroads' freight cars due to increased traffic volumes.

*Depreciation and amortization.* Depreciation and amortization increased \$12.6 million for the year ended December 31, 2012, compared to 2011, primarily due to a larger asset base.

*Materials and other.* Materials and other increased \$10.9 million for the year ended December 31, 2012, compared to 2011, primarily due to the recognition of a larger reduction in the personal injury liability during the year ended December 31, 2011, as compared to the same period in 2012, and increases in concession duty expense, employee expenses, bulk-handling facility expense and property tax expense. These increases were partially offset by lower casualty expense. KCSM paid concession duty expense of 0.5% of gross revenues for the first 15 years of the Concession period, and on June 24, 2012, KCSM began paying 1.25% of gross revenues, which is effective for the remaining years of the Concession.

*Elimination of deferred statutory profit sharing liability, net.* As a result of the organizational restructuring in the second quarter of 2012, KCSM's obligation to pay Mexican statutory profit sharing terminated as of May 1, 2012, and accordingly, KCSM recognized a \$43.0 million net reduction to operating expense. This reduction includes the elimination of \$47.8 million of the deferred Mexican statutory profit sharing liability, net of \$4.8 million of transaction costs.

*Gain on insurance recoveries related to hurricane damage.* In the third quarter of 2011, the Company settled its insurance claims related to the 2010 hurricane damage and recognized a \$25.6 million gain on insurance recoveries which primarily represented the recovery of lost profits and the replacement value of property in excess of its carrying value, net of the self-insured retentions.

### ***Non-Operating Expenses***

*Equity in net earnings of unconsolidated affiliates.* Equity in net earnings from unconsolidated affiliates increased \$1.1 million for the year ended December 31, 2012, compared to 2011. Significant components of this change were as follows:

- Equity in earnings of Southern Capital increased by \$0.6 million for the year ended December 31, 2012, compared to 2011, primarily due to increased gain on sale of assets.
- Equity in earnings of FTVM increased by \$0.4 million for the year ended December 31, 2012, compared to 2011, primarily due to an increase in volumes.

*Interest expense.* Interest expense decreased \$28.7 million for the year ended December 31, 2012, compared to 2011, primarily due to lower average interest rates as a result of the Company's refinancing activities and the redemption of the 13.0% senior unsecured notes due December 15, 2013 (the "13.0% Senior Notes") on December 15, 2011.

*Debt retirement costs.* Debt retirement costs were \$20.1 million and \$38.7 million for the years ended December 31, 2012 and 2011, respectively. During the fourth quarter of 2012, KCSR and KCSM entered into amended and restated credit agreements and recognized \$2.1 million in debt issuance costs related to the amended credit agreements. On June 1, 2012, the Company redeemed the remaining \$100.3 million principal amount of the outstanding 8.0% Senior Notes due June 1, 2015 (the "8.0% Senior Notes"), issued by KCSR, and recognized debt retirement costs of \$5.1 million related to the call premium and the write-off of unamortized debt issuance costs. On February 24, 2012, KCSR purchased \$174.7 million principal amount of the 8.0% Senior Notes, and recognized debt retirement costs of \$12.9 million related to the tender premium and the write-off of unamortized debt issuance costs. On December 15, 2011, the Company redeemed all of the outstanding \$123.5 million aggregate principal amount of the 13.0% Senior Notes and recognized \$24.5 million in debt retirement costs related to the call premium and the write-off of unamortized debt issuance costs. On July 12, 2011, KCSR entered into an amended and restated credit agreement and wrote off \$3.9 million in unamortized debt issuance costs related to the previous credit agreement. During 2011, KCSM purchased and redeemed the remaining \$32.4 million principal amount of its 7<sup>3</sup>/<sub>8</sub>% senior unsecured notes due December 1, 2013 (the "7<sup>3</sup>/<sub>8</sub>% Senior Notes") and all of the outstanding \$165.0 million aggregate principal amount of its 7<sup>3</sup>/<sub>8</sub>% senior unsecured notes due June 1, 2014 (the "7<sup>3</sup>/<sub>8</sub>% Senior Notes"). KCSM recognized associated debt retirement cost of \$10.3 million related to the call and tender premiums and the write-off of unamortized debt issuance costs.

*Foreign exchange.* Fluctuations in the value of the Mexican peso against the U.S. dollar for the years ended December 31, 2012 and 2011 resulted in a foreign exchange gain of \$2.7 million and a foreign exchange loss of \$9.2 million, respectively.

*Other income (expense), net.* Other income (expense), net, decreased \$3.2 million for the year ended December 31, 2012 compared to the same period in 2011, primarily due to lower miscellaneous income.

*Income tax expense.* Income tax expense increased \$113.9 million for the year ended December 31, 2012, compared to 2011, due to higher pre-tax income and a higher effective tax rate primarily due to foreign exchange rate fluctuations. The increase in the effective tax rate was partially offset by the reduction of a deferred tax asset valuation allowance in 2012 related to state net operating losses. The effective income tax rate was 38.4% and 27.1% for the years ended December 31, 2012 and 2011, respectively.

**Year Ended December 31, 2011, compared with the Year Ended December 31, 2010**

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

	2011	2010	Change Dollars
Revenues	\$ 2,098.3	\$ 1,814.8	\$ 283.5
Operating expenses	1,486.7	1,328.3	158.4
Operating income	611.6	486.5	125.1
Equity in net earnings of unconsolidated affiliates	18.2	19.7	(1.5)
Interest expense	(129.1)	(158.1)	29.0
Debt retirement costs	(38.7)	(68.3)	29.6
Foreign exchange gain (loss)	(9.2)	4.7	(13.9)
Other income, net	2.2	4.7	(2.5)
Income before income taxes	455.0	289.2	165.8
Income tax expense	123.1	109.2	13.9
Net income	331.9	180.0	151.9
Less: Net income (loss) attributable to noncontrolling interest	1.6	(0.2)	1.8
Net income attributable to Kansas City Southern and subsidiaries	<u>\$ 330.3</u>	<u>\$ 180.2</u>	<u>\$ 150.1</u>

**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		
	2011	2010	% Change	2011	2010	% Change	2011	2010	% Change
Chemical and petroleum	\$ 396.3	\$ 362.2	9%	252.1	248.5	1%	\$ 1,572	\$ 1,458	8%
Industrial and consumer products	503.6	426.7	18%	326.6	309.9	5%	1,542	1,377	12%
Agriculture and minerals	415.6	405.5	2%	238.6	251.4	(5%)	1,742	1,613	8%
Energy (i)	317.4	263.2	21%	312.0	300.1	4%	1,017	877	16%
Intermodal	251.8	194.2	30%	798.8	678.4	18%	315	286	10%
Automotive	139.2	97.7	42%	85.6	71.1	20%	1,626	1,374	18%
Carload revenues, carloads and units	2,023.9	1,749.5	16%	2,013.7	1,859.4	8%	\$ 1,005	\$ 941	7%
Other revenue	74.4	65.3	14%						
Total revenues (ii)	<u>\$ 2,098.3</u>	<u>\$ 1,814.8</u>	<u>16%</u>						

(ii) Included in revenues:

Fuel surcharge	<u>\$ 244.6</u>	<u>\$ 156.1</u>
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(i) Effective January 1, 2012, the Company established the Energy commodity group, which includes the previous Coal commodity group and certain amounts previously included within the Agriculture and minerals and Chemical and petroleum commodity groups. Prior period amounts have been reclassified to conform to the current year presentation.

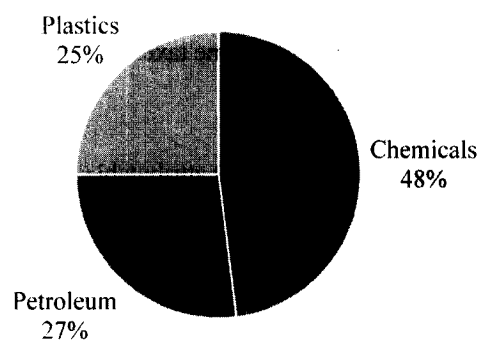
Freight revenues include both revenue for transportation services and fuel surcharges. For the year ended December 31, 2011, revenues increased \$283.5 million compared to the prior year, primarily due to positive pricing impacts, increase in carload/unit volumes and increased fuel surcharge. The effect of fluctuations in the value of the Mexican peso against the U.S. dollar was not significant.

KCS's fuel surcharge is 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 as much as 60 days earlier. In a period of volatile fuel prices or changing customer business mix, changes in fuel expense and fuel surcharge may significantly differ.

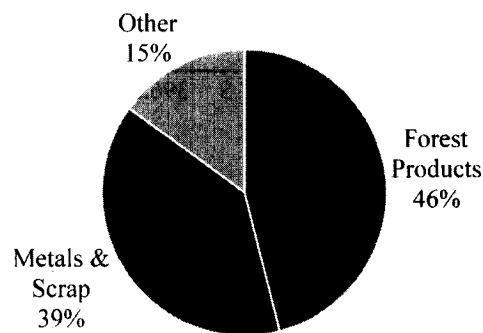
The following discussion provides an analysis of revenues by commodity group:

**Revenues by commodity group for 2011**

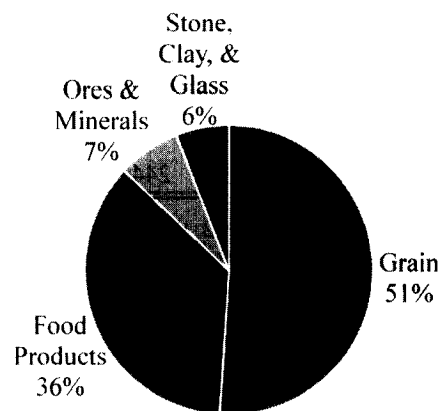
*Chemical and petroleum.* Revenues increased \$34.1 million for the year ended December 31, 2011, compared to 2010, primarily due to increases in pricing, fuel surcharges, and volume. In the first three quarters of the year, petroleum revenues increased due to a Mexican government initiated oil export program that began in 2010 and effectively increased length of haul. Additionally, petroleum revenues increased due to higher volumes of crude oil refined in the Gulf due to increased demand from domestic oil sources. During this time period, revenues increased in plastics and chemicals used to manufacture glass and paint as a result of continuing growth in the automotive industry. However, volumes in the fourth quarter of 2011 were impacted due to temporary customer outages and inventory destocking.



*Industrial and consumer products.* Revenues increased \$76.9 million for the year ended December 31, 2011, compared to 2010, primarily due to increases in pricing, volume and fuel surcharge. Metals and scrap business growth was primarily due to increased demand for slab and steel coil driven by continuing growth in the automotive industry and appliance manufacturing, as well as increases in demand for pipe. Paper product revenue increased primarily due to increased rail market share as truck capacity tightened. Additionally, the general economic recovery has increased demand for paper-based packaging.

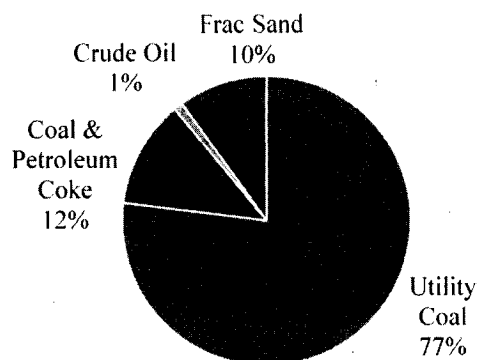


*Agriculture and minerals.* Revenues increased \$10.1 million for the year ended December 31, 2011, compared to 2010, primarily due to increases in pricing and fuel surcharge. These increases were partially offset by a decrease in grain volume and average length of haul in the first quarter of 2011 as traffic patterns shifted due to a decline in cross border traffic into Mexico as availability of crops from a strong Mexico harvest was sufficient to meet the local demand.





**Revenues by commodity group for 2011**



*Energy.* Revenues increased \$54.2 million for the year ended December 31, 2011, compared to 2010, primarily due to increases in pricing, fuel surcharge and volume. Revenues to existing electric generation customers increased due to re-pricing of coal contracts in the second half of 2010.

*Intermodal.* Revenues increased \$57.6 million for the year ended December 31, 2011, compared to 2010, primarily due to increases in volume. Growth was driven by increased domestic and cross border business, conversion of truck traffic to rail and South American/trans-Pacific container volume.

*Automotive.* Revenues increased \$41.5 million for the year ended December 31, 2011, compared to 2010, primarily due to increases in volume and pricing. The volume increase was driven by strong year over year growth in North American automobile sales for Original Equipment Manufacturers, new cross border vehicle routings, increased import/export volume through the Port of Lazaro Cardenas and the shipment of new automobile models.

**Operating Expenses**

Operating expenses, as shown below (*in millions*), increased \$158.4 million for the year ended December 31, 2011, when compared to the same period in 2010, primarily due to higher volumes, increases in fuel prices and compensation and benefit rates. These increases were partially offset by the gain on insurance recoveries related to the 2010 hurricane damage recognized in 2011. The effect of fluctuations in the value of the Mexican peso against the U.S. dollar was not significant.

	2011	2010	Change	
			Dollars	Percent
Compensation and benefits	\$ 423.8	\$ 369.3	\$ 54.5	15%
Purchased services	204.8	189.1	15.7	8%
Fuel	346.5	263.6	82.9	31%
Equipment costs	172.0	162.4	9.6	6%
Depreciation and amortization	186.2	184.9	1.3	1%
Materials and other	179.0	159.0	20.0	13%
Gain on insurance recoveries related to hurricane damage	(25.6)	—	(25.6)	100%
<b>Total operating expenses</b>	<b>\$ 1,486.7</b>	<b>\$ 1,328.3</b>	<b>\$ 158.4</b>	<b>12%</b>

*Compensation and benefits.* Compensation and benefits increased \$54.5 million for the year ended December 31, 2011, compared to 2010, primarily due to annual salary and benefit rate increases and increased carload/unit volumes. In addition, in the third quarter of 2010, the Company recorded a decrease of \$6.2 million in its postemployment benefit obligations as a result of the completion of negotiations with the Mexican labor union.

*Purchased services.* Purchased services increased \$15.7 million for the year ended December 31, 2011, compared to 2010, due to increases in volume-sensitive costs, primarily locomotive maintenance expense, freight car repairs, truck and terminal services, security and an increase in track structure maintenance expense. These increases were partially offset by higher net joint facility income in the second half of 2011 as a result of non-recurring usage of certain trackage rights.

*Fuel.* Fuel expense increased \$82.9 million for the year ended December 31, 2011, compared to 2010, primarily due to higher diesel fuel prices as the net average fuel price per gallon increased by approximately 22%, and higher consumption due to an increase in carload/unit volumes.

*Equipment costs.* Equipment costs increased \$9.6 million for the year ended December 31, 2011, compared to 2010 primarily due to the increase in the use of other railroads' freight cars due to increased traffic volumes. These increases were partially offset by lower locomotive lease expense primarily due to the acquisition of 75 locomotives during the third quarter of 2011, which were previously leased by the Company under an operating lease agreement.

*Depreciation and amortization.* Depreciation and amortization increased \$1.3 million for the year ended December 31, 2011, compared to 2010, primarily due to a larger asset base offset by changes in depreciation rates on certain locomotives and road assets based on reassessment of the adequacy of the accumulated depreciation provisions, asset usage and replacement patterns, which were effective October 1, 2010.

*Materials and other.* Materials and other increased \$20.0 million for the year ended December 31, 2011, compared to 2010, primarily due to higher materials and supplies expense and casualty expense.

*Gain on insurance recoveries related to hurricane damage.* In the third quarter of 2011, the Company settled its insurance claims related to the 2010 hurricane damage and recognized a \$25.6 million gain on insurance recoveries which primarily represents the recovery of lost profits and the replacement value of property in excess of its carrying value, net of the self-insured retentions.

#### ***Non-Operating Expenses***

*Equity in net earnings of unconsolidated affiliates.* Equity in earnings from unconsolidated affiliates decreased \$1.5 million for the year ended December 31, 2011, compared to 2010. Significant components of this change were as follows:

- Equity in earnings of PCRC increased by \$2.7 million for the year ended December 31, 2011, compared to 2010, primarily due to an increase in container volume attributable to the improvement in the economy.
- Equity in earnings of Southern Capital decreased by \$3.5 million for the year ended December 31, 2011, compared to 2010, primarily due to recognizing a gain on sale of railcars and other equipment in 2010.
- KCSM's equity in earnings of FTVM decreased by \$0.4 million for the year ended December 31, 2011, compared to 2010, primarily due to higher operating expenses.

*Interest expense.* Interest expense decreased \$29.0 million for the year ended December 31, 2011, compared to 2010, primarily due to lower average interest rates and average debt balances. For the years ended December 31, 2011 and 2010, the average debt balances were \$1,656.7 million and \$1,787.5 million, respectively.

*Debt retirement costs.* Debt retirement costs were \$38.7 million and \$68.3 million for the years ended December 31, 2011 and 2010, respectively. On December 15, 2011, the Company redeemed all of the outstanding \$123.5 million aggregate principal amount of the 13.0% Senior Notes and recognized \$24.5 million in debt retirement costs related to the call premium and the write-off of unamortized debt issuance costs. On July 12, 2011, KCSR entered into an amended and restated credit agreement and wrote off \$3.9 million in unamortized debt issuance costs related to the previous credit agreement. During 2011, KCSM purchased and redeemed the remaining \$32.4 million principal amount of its 7<sup>5</sup>/<sub>8</sub>% Senior Notes and all of the outstanding \$165.0 million aggregate principal amount of its 7<sup>3</sup>/<sub>8</sub>% Senior Notes. KCSM recognized associated debt retirement cost of \$10.3 million related to the call and tender premiums and the write-off of unamortized debt issuance costs. On December 20, 2010, KCSM purchased \$142.6 million principal amount of the 7<sup>5</sup>/<sub>8</sub>% Senior Notes and \$31.9 million principal amount of the 12<sup>1</sup>/<sub>2</sub>% senior unsecured notes due April 1, 2016 (the "12<sup>1</sup>/<sub>2</sub>% Senior Notes") and recognized debt retirement costs of \$19.0 million related to the tender premiums and the write-off of unamortized debt issuance costs and original issue discount. On September 30, 2010, KCSM redeemed the remaining \$63.7 million principal amount of the 9<sup>3</sup>/<sub>8</sub>% senior unsecured notes due May 1, 2012 (the "9<sup>3</sup>/<sub>8</sub>% Senior Notes") and recognized debt retirement costs of \$1.9 million related to the call premium and the write-off of unamortized debt issuance costs. On June 4, 2010 the Company redeemed \$66.5 million principal amount of the 13.0% Senior Notes issued by KCSR, \$70.0 million principal amount of the 12<sup>1</sup>/<sub>2</sub>% Senior Notes issued by KCSM and \$100.0 million principal amount of the 9<sup>3</sup>/<sub>8</sub>% Senior Notes issued by KCSM, and paid \$19.7 million of call premiums and other expenses related to the redemptions. In addition, the Company wrote-off \$12.8 million of unamortized debt issuance costs and original issue discounts associated with the redemption of the notes. In the first quarter of 2010, KCSM

purchased \$296.3 million of the 9<sup>3</sup>/<sub>8</sub>% Senior Notes. The Company recorded debt retirement costs of \$14.9 million related to the tender premium and the write-off of unamortized debt issuance costs.

*Foreign exchange.* Fluctuations in the value of the Mexican peso against the U.S. dollar for the years ended December 31, 2011 and 2010 resulted in a foreign exchange loss of \$9.2 million and a foreign exchange gain of \$4.7 million, respectively.

*Other income, net.* Other income, net, decreased \$2.5 million for the year ended December 31, 2011 compared to the same period in 2010, primarily due to lower gains on sale of land and miscellaneous income.

*Income tax expense.* Income tax expense increased \$13.9 million for the year ended December 31, 2011, compared to 2010, due to higher pre-tax income partially offset by a lower effective income tax rate. The effective income tax rate was 27.1% and 37.8% for the years ended December 31, 2011 and 2010, respectively. The decrease in the effective tax rate was due to foreign exchange rate fluctuations, partially offset by the recognition of a tax benefit in 2010 for the reduction of a deferred tax asset valuation allowance in Mexico.

## LIQUIDITY AND CAPITAL RESOURCES

### Overview

In recent years, KCS has improved its financial strength and flexibility by decreasing leverage, extending debt maturities, increasing liquidity and reducing interest expense and preferred stock dividends. In 2012, KCS completed an amendment to its KCSR and KCSM credit facilities which extended the maturity dates, eliminated or modified a number of restrictive covenants in its facilities in order to achieve consistency between its facilities and firms with investment grade ratings, and allows for the facilities to convert from secured to unsecured obligations upon attainment of investment grade credit ratings.

Though KCS's cash flows from operations are sufficient to fund operations, capital expenditures, debt service and dividends, the Company may, from time to time, use external sources of cash (principally bank debt, public and private debt, and leases) to refinance existing indebtedness and to fund new investments and equipment additions. On December 31, 2012, total available liquidity (the unrestricted cash balance plus revolving credit facility availability) was \$467.3 million, compared to available liquidity at December 31, 2011 of \$422.4 million. As of December 31, 2012, the total cash and cash equivalents held outside of the U.S. in foreign subsidiaries was \$38.7 million. This cash is available to fund company operations without incurring additional income taxes.

During 2012, the Company's Board of Directors declared quarterly cash dividends of \$0.195 per share on its common stock. On January 28, 2013, the Company's Board of Directors declared a cash dividend of \$0.215 per share payable on April 3, 2013, to common stockholders of record as of March 11, 2013. 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.

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 and other commitments in the foreseeable future.

KCS's primary sources of liquidity are cash flows generated from operations, borrowings under its revolving credit facilities and access to debt and equity capital markets. Although KCS has had adequate access to the capital markets, the financial terms under which funding has been obtained contain restrictive covenants which limit or preclude certain actions, including among others, creating or suffering to exist additional liens, selling certain assets, and engaging in mergers and consolidations transactions. The KCSM revolving credit facility contains additional negative covenants, including but not limited to, KCSM's ability to freely deploy proceeds in excess of pre-defined thresholds from insurance settlements or asset sales, make certain investments, engage in transactions with stockholders and affiliates, or engage in sale-leaseback transactions. The first of the aforementioned negative covenants terminates upon conversion of KCSM's revolving credit facility from secured to unsecured upon KCSM's attainment of investment grade credit ratings from at least two of the three primary rating agencies. Though these covenants may restrict or prohibit certain activities, the covenants contain a number of qualifications, thresholds and exceptions that provide the Company with what management believes is a sufficient degree of flexibility to conduct its operations. The Company was in compliance with all of its debt covenants as of December 31, 2012.

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 credit measurements such as interest coverage and leverage ratios, liquidity and competitive position.

Three credit rating agencies provide their views of the Company's outlook and ratings. In the third quarter of 2012, Fitch Ratings ("Fitch") initiated coverage of KCS and KCSR and assigned an investment grade rating to the KCSR Credit Agreement. Fitch also assigned an investment grade Issuer Default Rating ("IDR") to KCS and KCSR. In addition, Fitch upgraded KCSM's IDR and senior unsecured debt rating to investment grade. Standard & Poor's Rating Services ("S&P") rates the unsecured KCSR Credit Agreement and secured KCSM Agreement as investment grade but the remaining debt, preferred stock and corporate credit of KCS, KCSR and KCSM as non-investment grade. In the fourth quarter of 2012, Moody's Investor Service ("Moody's") upgraded KCSR's senior unsecured debt to investment grade, assigned an investment grade rating to the unsecured KCSR Credit Agreement, and upgraded the rating on the secured KCSM Agreement to investment grade. Moody's rates the remaining debt and corporate credit of KCSM as non-investment grade. Ratings and outlooks change from time to time and can be found on the websites of S&P, Moody's and Fitch.

### ***Cash Flow Information and Contractual Obligations***

Summary cash flow data follows (*in millions*):

	2012	2011	2010
Cash flows provided by (used for):			
Operating activities	\$ 673.2	\$ 638.0	\$ 496.3
Investing activities	(551.9)	(510.4)	(311.5)
Financing activities	(121.1)	(140.6)	(216.9)
Net increase (decrease) in cash and cash equivalents	0.2	(13.0)	(32.1)
Cash and cash equivalents beginning of year	72.4	85.4	117.5
Cash and cash equivalents end of year	<u>\$ 72.6</u>	<u>\$ 72.4</u>	<u>\$ 85.4</u>

During 2012, cash and cash equivalents increased \$0.2 million as increased cash flows from operating activities were used to fund investing activities, to refinance and reduce outstanding debt and to pay dividends on common stock. During 2011, cash and cash equivalents decreased \$13.0 million, as increased cash flows from operating activities were used to fund investing activities and to refinance and reduce outstanding debt.

*Operating Cash Flows.* Net operating cash flows for 2012 increased \$35.2 million to \$673.2 million. The increase in operating cash flows was primarily a result of increased net income. The increase was partially offset by insurance proceeds of \$40.2 million related to hurricane damage received during 2011. Net operating cash flows for 2011 increased \$141.7 million to \$638.0 million. The increase in operating cash flows was primarily a result of increased net income from positive pricing impacts, higher carload/unit volumes and the receipt of insurance proceeds related to the 2010 hurricane damage. These increases were partially offset by changes in working capital items, resulting mainly from the timing of certain payments and receipts.

*Investing Cash Flows.* Net investing cash outflows were \$551.9 million and \$510.4 million during 2012 and 2011, respectively. This \$41.5 million increase was primarily due to an increase in capital expenditures and insurance proceeds related to the 2010 hurricane damage received during 2011. Insurance proceeds recognized in investing cash flows were related to proceeds from property damage. All other insurance proceeds related to hurricane damage were recognized in operating cash flows. Net investing cash outflows for 2011 increased \$198.9 million as compared to 2010, primarily due to an increase in capital expenditures, partially offset by the insurance proceeds relating to the 2010 hurricane damage and the acquisition of an intermodal facility in 2010.

**Financing Cash Flows.** Financing cash inflows were generated from the issuance of long-term debt, proceeds from common stock offerings and proceeds from the issuance of common stock under employee stock plans. Financing cash outflows were used for the repayment of debt, the payment of dividends and the payment of debt costs. Financing cash flows for 2012, 2011, and 2010 are discussed in more detail below:

- Net financing cash outflows for 2012 were \$121.1 million. During 2012, the Company paid dividends of \$86.1 million, repaid \$375.9 million of outstanding debt and paid \$22.1 million in debt costs. During the same period, the Company received net proceeds of \$329.6 million from additional term loan advances and financing completed in 2012 for locomotives purchased in the fourth quarter of 2011.
- Net financing cash outflows for 2011 were \$140.6 million. During 2011, the Company repaid \$653.3 million of outstanding debt and paid \$36.6 million in debt costs. During the same period, the Company received net proceeds of \$550.0 million from the issuance of the KCSM 6 1/8% Senior Notes, refinancing of the KCSR Term Loan Facility and borrowings under the KCSR revolving credit facility.
- Net financing cash outflows for 2010 were \$216.9 million. During 2010, the Company repaid \$839.7 million of outstanding debt and paid \$65.1 million in debt costs. During the same period, the Company received net proceeds of \$214.9 million from a common stock offering and \$480.7 million from the issuance of the KCSM 8.0% and 6 5/8% Senior Notes.

**Contractual Obligations.** The following table outlines the material obligations and commitments as of December 31, 2012 (in millions):

	Payments Due by Period				More than 5 years
	Total	Less Than 1 Year	1-3 Years	3-5 Years	
Long-term debt (including interest and capital lease obligations)	\$ 2,150.7	\$ 150.0	\$ 343.5	\$ 457.4	\$ 1,199.8
Operating leases	715.7	118.3	198.3	139.9	259.2
Obligations due to uncertainty in income taxes	3.6	—	—	1.7	1.9
Capital expenditure obligations (i)	643.3	111.5	248.7	283.1	—
Other contractual obligations (ii)	616.3	178.3	177.4	116.3	144.3
<b>Total</b>	<b>\$ 4,129.6</b>	<b>\$ 558.1</b>	<b>\$ 967.9</b>	<b>\$ 998.4</b>	<b>\$ 1,605.2</b>

- (i) Capital expenditure obligations include minimum capital expenditures under the KCSM Concession agreement and other regulatory requirements.
- (ii) Other contractual obligations include purchase commitments and certain maintenance agreements.

In the normal course of business, the Company enters into long-term contractual commitments for future goods and services needed for the operations of the business. Such commitments are not in excess of expected requirements and are not reasonably likely to result in performance penalties or payments that would have a material adverse effect on the Company's liquidity. Such commitments are not included in the above table.

The Company is party to eighteen utilization leases covering 2,446 railcars where car hire revenue as defined in the lease agreements is shared between the lessor and the Company. The leases expire at various times through 2024. Amounts that may be due to lessors under these utilization leases vary from month to month based on car hire rental with the minimum monthly cost to the Company being zero. Accordingly, the utilization leases have been excluded from contractual obligations above.

The SCT requires KCSM to submit a five year capital expenditures plan every five years. The next five year plan was submitted in 2012 for the years 2013 — 2017. KCSM expects to continue capital spending at current levels in future years and will continue to have capital expenditure obligations past 2017, which are not included in the table above.

#### **Off-Balance Sheet Arrangements**

On November 2, 2007, PCRC completed an offering of \$100.0 million of 7.0% senior secured notes due November 1, 2026 (the "Notes"). The Notes are senior obligations of PCRC, secured by certain assets of PCRC. KCS has pledged its shares

of PCRC as security for the Notes. The Notes are otherwise non-recourse to KCS. The Company has agreed, along with Mi-Jack Products, Inc. (“Mi-Jack”), the other 50% owner of PCRC, to each fund one-half of any debt service reserve or liquidity reserve (reserves which are required to be established by PCRC in connection with the issuance of the Notes). As of December 31, 2012, the Company’s portion of these reserves was \$5.3 million. The Company has issued a standby letter of credit in the amount of \$5.3 million. The Company also has issued two irrevocable standby letters of credit totaling approximately \$0.4 million to fulfill the Company’s fifty percent guarantee of additional equipment loans at PCRC.

### **Capital Expenditures**

KCS has funded, and expects to continue to fund capital expenditures with operating cash flows, debt and equity financing and equipment leases.

The following table summarizes capital expenditures by type for the years ended December 31, 2012, 2011, and 2010 respectively (*in millions*):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Roadway capital program	\$ 293.7	\$ 273.8	\$ 224.9
Locomotive acquisitions (ii)	71.1	173.7	—
Equipment (i)	67.6	15.7	12.8
Capacity	51.4	25.7	10.1
Information technology	8.6	14.3	12.0
Other	30.3	87.5	60.0
Total capital expenditures (accrual basis)	<u>522.7</u>	<u>590.7</u>	<u>319.8</u>
Locomotives financed under operating lease buyout (ii)	—	(91.1)	—
Change in capital accruals	17.3	(4.6)	(32.5)
Total cash capital expenditures	<u>\$ 540.0</u>	<u>\$ 495.0</u>	<u>\$ 287.3</u>

- (i) In 2012, KCSR paid \$19.6 million to purchase 315 jumbo covered hoppers that were previously leased under an operating lease.
- (ii) In 2011, KCSM entered into five loan agreements with General Electric Capital Corporation (“GE”) to finance approximately 88% of the purchase price of seventy-five locomotives. These locomotives were previously leased by KCSM under an operating lease.

Generally, the Company’s capital program consists of capital replacement. For 2013, internally generated cash flows are expected to fund cash capital expenditures which are currently estimated to be between \$500.0 million and \$525.0 million.

### **Property Statistics**

The following table summarizes certain property statistics as of December 31:

	<u>2012 (i)</u>	<u>2011 (i)</u>	<u>2010</u>
Track miles of rail installed	133	125	81
Cross ties installed	996,789	777,930	762,228

- (i) The increase in the track miles of rail and cross ties installed in 2012 and 2011 primarily reflects the increase in maintenance and capacity expansion activities.

## Debt and Capital Structure

The following table summarizes the components of the capital structure (*in millions*):

	2012	2011
Debt due within one year	\$ 60.2	\$ 36.3
Long-term debt	1,547.6	1,602.8
Total debt	1,607.8	1,639.1
Total equity	3,400.7	3,058.7
Total debt plus total equity	\$ 5,008.5	\$ 4,697.8

### KCSR Debt

*Revolving Credit Facility and Term Loans.* On July 12, 2011, KCS together with KCSR and certain subsidiaries named therein as guarantors (the “Subsidiary Guarantors”), entered into an amended and restated credit agreement (the “2011 KCSR Credit Agreement”) with various lenders. The 2011 KCSR Credit Agreement provided KCSR with (i) a five-and-one-half year \$300.0 million term loan credit facility (the “Term Loan Facility”) and (ii) a five-year \$200.0 million revolving credit facility consisting of a revolving facility up to \$200.0 million (the “Revolving Facility”), a letter of credit facility of \$25.0 million (the “Letter of Credit Facility”) and a swing line facility of up to \$15.0 million (the “Swing Line Facility”). The Letter of Credit Facility and the Swing Line Facility each constitute usage under the Revolving Facility.

On February 24, 2012, KCS, KCSR and certain other subsidiaries of the Company that guaranty the 2011 KCSR Credit Agreement entered into Amendment No. 1 and Additional Term Advance Agreement (“Amendment No. 1”), which provided for additional Term A advances to KCSR in an aggregate principal amount of \$275.0 million (the “Term Loan A-2”) on substantially the same terms as those applicable to the existing Term Loan Facility under the 2011 KCSR Credit Agreement. KCSR borrowed \$175.0 million of the Term Loan A-2 on February 24, 2012 and borrowed the remaining \$100.0 million of Term Loan A-2 on June 1, 2012. The proceeds of the \$275.0 million of borrowings under the Term Loan A-2 and available cash were used to redeem all of KCSR’s 8.0% senior unsecured notes due June 1, 2015 (the “8.0% Senior Notes”).

On November 21, 2012, KCS, KCSR and certain other subsidiaries of the Company that guaranty the 2011 KCSR Credit Agreement entered into a second amended and restated credit agreement (the “2012 KCSR Credit Agreement”), which eliminated or modified a number of restrictive covenants in KCSR’s facilities in order to achieve consistency between KCSR and firms with investment grade credit ratings. The amendment also included a “fall-away collateral” provision whereby KCSR’s facilities would convert from secured to unsecured obligations if investment grade senior unsecured debt ratings were assigned by at least two of the three primary rating agencies. On November 21, 2012, subsequent to the closing of the 2012 KCSR Credit Agreement, KCSR’s senior unsecured debt rating was upgraded to investment grade by Moody’s Investor Service (“Moody’s”). This action, combined with investment grade ratings previously assigned to KCSR by Fitch Ratings (“Fitch”), triggered the “fall-away collateral” provision and KCSR facilities became unsecured obligations. In the event that KCSR’s senior unsecured debt ratings subsequently fall below investment grade at all three primary rating agencies, collateral would be re-pledged and the facilities would revert to secured obligations. The amendment also incorporates a change in the pricing grid for the Term Loan Facility and the Revolving Facility in the event that KCSR achieves a senior unsecured debt rating of BBB/Baa2 or higher by at least two of the three primary rating agencies. In that event, the floating interest rates paid by KCSR on the Term Loan Facility and the Revolving Facility would thereafter be determined by KCSR’s senior unsecured credit rating rather than by KCSR’s leverage ratio as is the case currently. Depending on KCSR’s credit rating during the life of the 2012 KCSR Credit Agreement, the margin KCSR would pay above the London Interbank Offered Rate (“LIBOR”) at any point would be equal to or lower than the currently-applicable margin of 1.50%. This provision does not affect the interest rate on the Term Loan A-2, which remains fixed at the LIBOR plus a margin of 1.25% regardless of KCSR’s leverage ratio or credit rating. In addition to the amendment, KCSR extended the maturities of its Revolving Facility from July 15, 2016, to November 15, 2017, and the Term Loan Facility and Term Loan A-2 from January 15, 2017 to May 15, 2018. KCSR is required to make quarterly principal payments on the term loan facilities.

KCS and KCSR gave certain representations and warranties that are customary for credit agreements of this type. The 2012 KCSR Credit Agreement also contains affirmative and negative covenants that are customary for credit agreements of this type, including financial maintenance covenants related to a leverage ratio and an interest coverage ratio as defined in the 2012

KCSR Credit Agreement. Similarly, events of default under the 2012 KCSR Credit Agreement are customary for transactions of this type and include, without limitation, non-payment of obligations; breach of any representation or warranty; non-performance of covenants and obligations; default on other indebtedness; certain judgments rendered; a change in control shall occur; bankruptcy or insolvency of KCS, KCSR, any restricted subsidiary or any Subsidiary Guarantor; and an impairment of security (if any). The occurrence of an event of default could result in the acceleration of the repayment of any outstanding principal balance of the term loan facilities and the Revolving Facility.

During the first quarter of 2012, the Company repaid the December 31, 2011 outstanding balance of \$50.0 million on KCSR's revolving credit facility. As of December 31, 2012, KCSR had \$194.7 million available under the Revolving Facility, with no outstanding borrowings and a \$5.3 million standby letter of credit issued and outstanding.

*8.0% Senior Notes.* On May 30, 2008, KCSR issued \$275.0 million principal amount of 8.0% Senior Notes due June 1, 2015, which bore interest semiannually at a fixed annual rate of 8.0%. The 8.0% Senior Notes were redeemable in whole or in part prior to June 1, 2012 by paying the greater of either 101% of the principal amount or the principal amount plus a "make whole" premium and in whole or in part on and after June 1, 2012, at the following redemption prices (expressed as a percentage of principal amount) plus any accrued and unpaid interest: 2012 —104%, 2013 — 102% and 2014 — 100%.

On January 25, 2012, pursuant to an offer to purchase and related solicitation of consents, KCSR commenced a cash tender offer for all of its \$275.0 million outstanding aggregate principal amount of 8.0% Senior Notes, and a consent solicitation to amend the related indenture (the "Proposed Amendments") to eliminate substantially all of the restrictive covenants contained therein. In conjunction with receiving the requisite consents, on February 13, 2012, the Company entered into the First Supplemental Indenture to effect the Proposed Amendments, which became operative on February 24, 2012.

On February 24, 2012, KCSR purchased \$174.7 million principal amount of the tendered 8.0% Senior Notes in accordance with the terms and conditions of the tender offer set forth in the offer to purchase using the proceeds received under Amendment No. 1 to the 2011 KCSR Credit Agreement, and available cash. On June 1, 2012, KCSR redeemed the remaining \$100.3 million principal amount of the 8.0% Senior Notes using additional proceeds received under Amendment No. 1 to the 2011 KCSR Credit Agreement and cash on hand, at a redemption price of 104% of the principal amount.

*13.0% Senior Notes.* On December 18, 2008, KCSR issued \$190.0 million principal amount of 13.0% senior unsecured notes due December 15, 2013, (the "13.0% Senior Notes") which bore interest semiannually at a fixed annual rate of 13.0%. The 13.0% Senior Notes were issued at a discount to par value, resulting in a \$22.0 million discount and a yield to maturity of 16.5%. On June 4, 2010, the Company redeemed \$66.5 million principal amount of the 13.0% Senior Notes pursuant to a provision which allowed KCSR to redeem up to 35% of the 13.0% Senior Notes at any time prior to December 15, 2010 at par value plus coupon from the proceeds of any sale of capital stock in KCSM or KCS. This followed KCS's offering of 5.8 million shares for net proceeds of \$214.9 million in May 2010. On December 15, 2011, the Company used available cash to redeem all of the outstanding \$123.5 million aggregate principal amount of the 13.0% Senior Notes at a redemption price of 113% of the principal amount.

*KCSR RRIF Loan Agreement.* On February 21, 2012, KCSR, as borrower, entered into a financing agreement with the United States of America represented by the Secretary of Transportation acting through the Administrator of the Federal Railroad Administration ("FRA").

The financing agreement provides KCSR with a 25-year, \$54.6 million loan under the Railroad Rehabilitation and Improvement Financing Program (the "KCSR RRIF Loan"). The proceeds of the KCSR RRIF Loan were used to reimburse KCSR for 80% of the purchase price of thirty new locomotives (the "Locomotives") acquired by KCSR in the fourth quarter of 2011. The outstanding principal balance bears interest at 2.96% per annum. KCSR is required to make quarterly principal and interest payments on the KCSR RRIF Loan commencing March 15, 2012, except for the first payment that was comprised solely of interest accrued from the date the funds were advanced to KCSR, which was February 24, 2012.

The obligations under the financing agreement are secured by a first priority security interest in the Locomotives and certain related rights. In addition, the Company has agreed to guarantee repayment of the amounts due under the financing agreement and certain related agreements.

The financing agreement contains representations, warranties, covenants and events of default that are similar to those contained in other KCSR debt agreements. The occurrence of an event of default could result in the acceleration of the repayment of any outstanding principal balance of the KCSR RRIF Loan.



### ***Tex-Mex Debt***

*RRIF Loan Agreement.* On June 28, 2005, Tex-Mex entered into an agreement with the FRA to borrow \$50.0 million to be used for infrastructure improvements in order to accommodate growing freight rail traffic related to the NAFTA corridor. The note bears interest at 4.29% annually and the principal balance amortizes quarterly with a final maturity of July 13, 2030. The loan was made under the Railroad Rehabilitation and Improvement Financing Program administered by the FRA. The loan is guaranteed by Mexrail, which has issued a Pledge Agreement in favor of the lender equal to the gross revenues earned by Mexrail on per-car fees on traffic crossing the International Rail Bridge in Laredo, Texas. In addition, the Company has agreed to guarantee the scheduled principal payment installments due to the FRA from Tex-Mex under the loan agreement on a rolling five-year basis.

### ***KCSM Debt***

*Revolving Credit Facility.* On August 30, 2010, KCSM entered into a secured credit agreement (the “2010 KCSM Credit Agreement”) with various lenders and other institutions which provided KCSM with a three-year \$100.0 million revolving credit facility consisting of (i) a revolving facility in an amount up to \$100.0 million (the “2010 Revolving Facility”) and, (ii) a letter of credit and a swing line facility in an amount up to \$10.0 million each.

On September 30, 2011, KCSM entered into an amended and restated credit agreement (the “2011 KCSM Credit Agreement”) with various financial institutions. The 2011 KCSM Credit Agreement increased the revolving credit facility to \$200.0 million and extended the maturity to September 30, 2016. The 2011 KCSM Credit Agreement included (i) a revolving credit facility up to \$200.0 million (the “KCSM Revolving Facility”), (ii) a letter of credit facility up to \$15.0 million (the “KCSM Letter of Credit Facility”), and (iii) a swing line facility up to \$15.0 million (the “KCSM Swing Line Facility”). The KCSM Letter of Credit Facility and the KCSM Swing Line Facility each constitute usage under the KCSM Revolving Facility.

On November 29, 2012, KCSM entered into an amended and restated credit agreement (the “2012 KCSM Credit Agreement”) with various financial institutions, which amended and restated the 2011 KCSM Credit Agreement and eliminated or modified a number of restrictive covenants in KCSM’s facility in order to achieve consistency between KCSM and firms with investment grade credit ratings. The amendment also included a “fall-away collateral” provision whereby KCSM’s facility would convert from secured to unsecured obligations if investment grade senior unsecured debt ratings were assigned by at least two of the three primary rating agencies. In the event that KCSM’s senior unsecured debt ratings were subsequently to fall below investment grade at all three primary rating agencies, collateral would be re-pledged and the facility would revert to a secured obligation. The amendment also incorporates a change in the pricing grid in the event that KCSM achieves a senior unsecured debt rating of BBB/Baa2 or higher by at least two of the three primary rating agencies. In that event, the floating interest rates paid by KCSM on the 2012 KCSM Credit Agreement would thereafter be determined by KCSM’s senior unsecured credit rating rather than by KCSM’s leverage ratio as is the case currently. Depending on KCSM’s credit rating during the life of the 2012 KCSM Credit Agreement, the margin KCSM would pay above the LIBOR at any point would be equal to or lower than the currently-applicable margin of 1.75%. In addition to the amendment, KCSM extended the maturity of the KCSM Revolving Facility to November 15, 2017.

The 2012 KCSM Credit Agreement is currently secured by the accounts receivable and certain locomotives of KCSM and certain of its subsidiaries. In addition, KCSM and certain of its subsidiaries agreed to subordinate payment of certain intercompany debt, certain KCSM subsidiaries guaranteed repayment of the amounts due under the 2012 KCSM Credit Agreement (up to the amount permitted by KCSM’s outstanding indentures) and certain equity interests as defined in the 2012 KCSM Credit Agreement were pledged to secure obligations under the 2012 KCSM Credit Agreement.

The 2012 KCSM Credit Agreement contains certain representations and warranties that are customary for credit agreements of this type. The 2012 KCSM Credit Agreement also contains affirmative and negative covenants that are customary for credit agreements of this type, including financial maintenance covenants related to a leverage ratio and an interest coverage ratio as defined in the 2012 KCSM Credit Agreement. Similarly, events of default under the 2012 KCSM Credit Agreement include, but are not limited to, certain payment defaults; breach of any representation or warranty; non-performance of covenants and obligations; default on other indebtedness; certain judgments rendered; restrictions or requirements limiting the availability or the transfer of foreign exchange; a change in control; bankruptcy or insolvency of KCSM and certain subsidiaries and obligors; an impairment of security; the failure of subordination; certain actions by a governmental authority; failure to obtain certain consents; and termination of the concession title. The occurrence of an event of default could result in the acceleration of the repayment of any outstanding principal balance of the KCSM Revolving Facility.

As of December 31, 2012 and 2011, KCSM had no outstanding amount under the KCSM Revolving Facility.

*12<sup>1</sup>/<sub>2</sub>% Senior Notes.* On March 30, 2009, KCSM issued \$200.0 million principal amount of 12<sup>1</sup>/<sub>2</sub>% senior unsecured notes due April 1, 2016 (the “12<sup>1</sup>/<sub>2</sub>% Senior Notes”), which bear interest semiannually at a fixed annual rate of 12<sup>1</sup>/<sub>2</sub>%. The 12<sup>1</sup>/<sub>2</sub>% Senior Notes were issued at a discount to par value, resulting in an \$11.0 million discount and a yield to maturity of 13<sup>3</sup>/<sub>4</sub>%. KCSM used a portion of the net proceeds from the offering to repay all amounts outstanding under a credit agreement KCSM entered into on June 14, 2007. The 12<sup>1</sup>/<sub>2</sub>% Senior Notes are redeemable at KCSM’s option in whole or in part on and after April 1, 2013, at the following redemption prices (expressed as percentages of principal amount) plus any accrued and unpaid interest: 2013 — 106.250%, 2014 — 103.125% and 2015 — 100.000%. In addition, the notes are redeemable, in whole but not in part, at KCSM’s option at their principal amount, plus any accrued and unpaid interest, in the event of certain changes in the Mexican withholding tax rate.

On June 4, 2010, the Company redeemed \$70.0 million principal amount of the 12<sup>1</sup>/<sub>2</sub>% Senior Notes pursuant to a provision which allowed KCSM to redeem up to 35% of the 12<sup>1</sup>/<sub>2</sub>% Senior Notes any time prior to April 1, 2012 at par value plus coupon from the proceeds of any sale of capital stock in KCSM or KCS. This followed KCS’s offering of 5.8 million shares of common stock for net proceeds of \$214.9 million in May 2010. On November 2, 2010, pursuant to an offer to purchase, KCSM commenced a cash tender offer for its 12<sup>1</sup>/<sub>2</sub>% Senior Notes. On December 20, 2010, KCSM purchased \$31.9 million principal amount of the tendered 12<sup>1</sup>/<sub>2</sub>% Senior Notes in accordance with the terms and conditions of the tender offer set forth in the offer to purchase using the proceeds received from the issuance of \$185.0 million principal amount of KCSM 6<sup>5</sup>/<sub>8</sub>% senior unsecured notes due December 15, 2020 (the “6<sup>5</sup>/<sub>8</sub>% Senior Notes”).

*KCSM 8.0% Senior Notes.* On January 22, 2010, KCSM issued \$300.0 million principal amount of 8.0% senior unsecured notes due February 1, 2018 (the “KCSM 8.0% Senior Notes”), which bear interest semiannually at a fixed annual rate of 8.0%. The KCSM 8.0% Senior Notes were issued at a discount to par value, resulting in a \$4.3 million discount and a yield to maturity of 8<sup>1</sup>/<sub>4</sub>%. KCSM used the net proceeds from the issuance of the KCSM 8.0% Senior Notes and available cash to purchase \$290.0 million principal amount of the 9<sup>3</sup>/<sub>8</sub>% senior unsecured notes due May 1, 2012 tendered under an offer to purchase and pay all fees and expenses incurred in connection with the KCSM 8.0% Senior Notes offering and the tender offer. The KCSM 8.0% Senior Notes are redeemable at KCSM’s option, in whole or in part, on and after February 1, 2014, at the following redemption prices (expressed as percentages of principal amount) plus any accrued and unpaid interest: 2014 — 104.000%, 2015 — 102.000%, 2016 and thereafter — 100.000%. In addition, KCSM may redeem up to 35% of the KCSM 8.0% Senior Notes any time prior to February 1, 2013 at par value plus coupon from the proceeds of the sale of capital stock in KCSM or KCS. In addition, the notes are redeemable, in whole but not in part, at KCSM’s option at their principal amount, plus any accrued and unpaid interest, in the event of certain changes in the Mexican withholding tax rate.

*6<sup>5</sup>/<sub>8</sub>% Senior Notes.* On December 20, 2010, KCSM issued the 6<sup>5</sup>/<sub>8</sub>% Senior Notes due December 15, 2020, which bear interest semiannually at a fixed annual rate of 6<sup>5</sup>/<sub>8</sub>%. KCSM used the net proceeds from the issuance of the 6<sup>5</sup>/<sub>8</sub>% Senior Notes and available cash to purchase \$142.6 million principal amount of the 7<sup>5</sup>/<sub>8</sub>% senior unsecured notes due December 1, 2013 (the “7<sup>5</sup>/<sub>8</sub>% Senior Notes”) and \$31.9 million principal amount of the 12<sup>1</sup>/<sub>2</sub>% Senior Notes tendered under an offer to purchase and pay all fees and expenses incurred in connection with the 6<sup>5</sup>/<sub>8</sub>% Senior Notes offering and the tender offers. The 6<sup>5</sup>/<sub>8</sub>% Senior Notes are redeemable at KCSM’s option, in whole or in part prior to December 15, 2015, by paying the greater of either 101% of the principal amount or the principal amount plus a “make whole” premium and in whole or in part on or after December 15, 2015, at the following redemption prices (expressed as percentages of principal amount) plus any accrued and unpaid interest: 2015 — 103.313%, 2016 — 102.208%, 2017 — 101.104%, 2018 and thereafter — 100.000%. In addition, KCSM may redeem up to 35% of the 6<sup>5</sup>/<sub>8</sub>% Senior Notes at a redemption price equal to 106.625% any time prior to December 15, 2013 at par value plus coupon from the proceeds of the sale of capital stock in KCSM or KCS. In addition, the notes are redeemable, in whole but not in part, at KCSM’s option at their principal amount, plus any accrued and unpaid interest, in the event of certain changes in the Mexican withholding tax rate.

*6<sup>1</sup>/<sub>8</sub>% Senior Notes.* On May 20, 2011, KCSM issued \$200.0 million principal amount of 6<sup>1</sup>/<sub>8</sub>% senior unsecured notes due June 15, 2021 (the “6<sup>1</sup>/<sub>8</sub>% Senior Notes”) at par, which bear interest semiannually at a fixed annual rate of 6<sup>1</sup>/<sub>8</sub>%. KCSM used the proceeds from the issuance of the 6<sup>1</sup>/<sub>8</sub>% Senior Notes and available cash to purchase and redeem the outstanding \$165.0 million principal amount of 7<sup>3</sup>/<sub>8</sub>% senior unsecured notes due June 1, 2014 and the remaining \$32.4 million principal amount of the 7<sup>5</sup>/<sub>8</sub>% Senior Notes, and pay all fees and expenses incurred in connection with the 6<sup>1</sup>/<sub>8</sub>% Senior Notes offering and the tender offers. The 6<sup>1</sup>/<sub>8</sub>% Senior Notes are redeemable at KCSM’s option, in whole or in part prior to June 15, 2016, by paying the greater of either 101% of the principal amount or the principal amount plus a “make whole” premium and in whole or in part on or after June 15, 2016, at the following redemption prices (expressed as percentages of principal amount) if

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

All of KCSM's senior notes described above are denominated in dollars, are unsecured, unsubordinated obligations, rank *pari passu* in right of payment with KCSM's existing and future unsecured, unsubordinated obligations, and are senior in right of payment to KCSM's future subordinated indebtedness. In addition, KCSM's senior notes include certain covenants which are customary for these types of debt instruments issued by borrowers with similar credit ratings and restrict or prohibit certain actions. Certain of these covenants no longer apply if KCSM's senior notes are assigned an investment grade rating by both Moody's Investors Service and Standard & Poor's Rating Services.

### ***KCSM Locomotive Financing***

***5.737% Financing Agreement.*** On February 26, 2008, KCSM entered into a financing agreement with Export Development Canada ("EDC") for an aggregate principal amount of \$72.8 million. KCSM used the proceeds to finance 85.0% of the purchase price of forty new SD70ACe locomotives purchased by KCSM in late 2007 and early 2008. KCSM granted EDC a security interest in the locomotives to secure the loan. The financing agreement requires KCSM to make thirty equal semi-annual principal payments of approximately \$2.4 million plus interest at an annual rate of 5.737%, with the final payment due and payable on February 28, 2023.

***6.195% Financing Agreement.*** On September 24, 2008, KCSM entered into a financing agreement with DVB Bank AG ("DVB") for an aggregate principal amount of \$52.2 million. KCSM used the proceeds to finance approximately 80% of the purchase price of twenty-nine ES44AC locomotives purchased by KCSM in June 2008. KCSM granted DVB a security interest in the locomotives to secure the loan. The financing agreement requires KCSM to make sixty equal quarterly principal payments plus interest at an annual rate of 6.195%, with the final payment due and payable on September 29, 2023.

***9.310% Loan Agreements.*** On September 1, 2011, KCSM, as borrower, entered into five Loan Agreements (each a "Loan Agreement", and collectively, the "Loan Agreements") with General Electric Capital Corporation, as lender ("GE"), each with a principal amount of approximately \$18.2 million. KCSM used the loan proceeds to finance approximately 88% of the purchase price of seventy-five GE AC4400 CW locomotives (the "Locomotives") purchased by KCSM from GE on September 1, 2011. The Locomotives were previously leased by KCSM from GE pursuant to a Lease Agreement dated April 30, 1998. The Lease Agreement, which had been accounted for as an operating lease, was terminated with the purchase of the Locomotives by KCSM. To secure the loans from GE, KCSM transferred legal ownership of the Locomotives to five irrevocable trusts established by KCSM to which GE is the primary beneficiary and KCSM has a right of reversion upon satisfaction of the obligations of the Loan Agreements.

Each Loan Agreement requires KCSM to make thirty-eight quarterly principal payments plus interest at an annual rate of 9.31%, which approximates the implicit interest rate in the Lease Agreement. KCSM generated certain tax benefits as a result of purchasing the locomotives. The first payments were due and payable on September 15, 2011, and the final payments are due and payable on December 15, 2020.

KCSM's locomotive financing agreements contain representations, warranties and covenants typical of such equipment loan agreements. Events of default in the financing agreements include, but are not limited to, certain payment defaults, certain bankruptcy and liquidation proceedings and the failure to perform any covenants or agreements contained in the financing agreements. Any event of default could trigger acceleration of KCSM's payment obligations under the terms of the financing agreements.

### ***Debt Covenants Compliance***

The Company was in compliance with all of its debt covenants as of December 31, 2012.

### ***Other Debt Provisions***

*Change in Control Provisions.* Certain loan agreements and debt instruments entered into or guaranteed by the Company and its subsidiaries provide for default in the event of a specified change in control of the Company or particular subsidiaries of the Company.

### ***Shelf Registration Statements and Public Securities Offerings***

KCS has one current shelf registration statement on file with the SEC (the “Universal Shelf” — Registration No. 333-178086). The Universal Shelf was filed on November 21, 2011 in accordance with the securities offering reform rules of the SEC that allow “well-known seasoned issuers” to register an unspecified amount of different types of securities on an immediately effective Form S-3 registration statement. The Universal Shelf will expire on November 21, 2014.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

KCS’s accounting and financial reporting policies are in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”). The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Management believes that the following accounting policies and estimates are critical to an understanding of KCS’s historical and future performance. Management has discussed the development and selection of the following critical accounting estimates with the Audit Committee of KCS’s Board of Directors and the Audit Committee has reviewed the selection, application and disclosure of the Company’s critical accounting policies and estimates.

### ***Capitalization, Depreciation and Amortization of Property and Equipment (including Concession Assets)***

Due to the highly capital intensive nature of the railroad industry, capitalization and depreciation of property and equipment are substantial components of the Company’s consolidated financial statements. Net property and equipment, including concession assets, comprised approximately 89% of the Company’s total assets as of December 31, 2012, and related depreciation and amortization comprised approximately 13% of total operating expenses for the year ended December 31, 2012.

The Company’s annual capital expenditures are primarily for capital replacement programs which are generally constructed by employees. KCS capitalizes costs for self-constructed additions and improvements to property including direct labor and material, indirect overhead costs, and interest during long-term construction projects. Direct costs are charged to capital projects based on the work performed and the material used. Indirect overhead costs are allocated to capital projects as a standard percentage, which is evaluated annually, and applied to direct labor and material costs. Asset removal activities are performed in conjunction with replacement activities; therefore, removal costs are estimated based on a standard percentage of direct labor and indirect overhead costs related to capital replacement projects. For purchased assets, all costs necessary to make the asset ready for its intended use are capitalized. Expenditures that significantly increase asset values, productive capacity, efficiency, safety or extend useful lives are capitalized. Repair and maintenance costs are expensed as incurred.

Property and equipment are carried at cost and are depreciated primarily on the group method of depreciation, which the Company believes closely approximates a straight line basis over the estimated useful lives of the assets measured in years. Technology assets and leasehold improvements are depreciated using the straight line method over the lesser of the estimated useful lives of the assets or the lease term. Costs incurred by the Company to acquire the concession rights and related assets, as well as subsequent improvements to the concession assets, are capitalized and amortized using the group method of depreciation over the lesser of the current expected Concession term, including probable renewal of an additional 50-year term, or the estimated useful lives of the assets and rights. The Company’s ongoing evaluation of the useful lives of concession assets and rights considers the aggregation of the following facts and circumstances:

- The Company’s executive management is dedicated to ensuring compliance with the various provisions of the Concession and to maintaining positive relationships with the SCT and other Mexican federal, state, and municipal governmental authorities;
- During the time since the Concession was granted, the relationships between KCSM and the various Mexican governmental authorities have matured and the guidelines for operating under the Concession have become more defined with experience;

- There are no known supportable sanctions or compliance issues that would cause the SCT to revoke the Concession or prevent KCSM from renewing the Concession; and
- KCSM operations are an integral part of the KCS operations strategy, and related investment analyses and operational decisions assume that the Company's cross border rail business operates into perpetuity, and do not assume that Mexico operations terminate at the end of the current Concession term.

Based on the above factors, as of December 31, 2012, the Company continues to believe that it is probable that the Concession will be renewed for an additional 50-year term beyond the current term.

The group method of depreciation applies a composite rate to classes of similar assets rather than to individual assets. Composite depreciation rates are based upon the Company's estimates of the expected average useful lives of assets as well as expected net salvage value at the end of their useful lives. In developing these estimates, the Company utilizes periodic depreciation studies performed by an independent engineering firm. Depreciation rate studies are performed at least every three years for equipment and at least every six years for road property (rail, ties, ballast, etc.). The depreciation studies take into account factors such as:

- Statistical analysis of historical patterns of use and retirements of each asset class;
- Evaluation of any expected changes in current operations and the outlook for the continued use of the assets;
- Evaluation of technological advances and changes to maintenance practices; and
- Historical and expected salvage to be received upon retirement.

The depreciation studies may also indicate that the recorded amount of accumulated depreciation is deficient or in excess of the amount indicated by the study. Any such deficiency or excess is amortized as a component of depreciation expense over the remaining useful lives of the affected asset class, as determined by the study. The Company also monitors these factors in non-study years to determine if adjustments should be made to depreciation rates. Any changes in depreciation rates are implemented prospectively. The Company completed a depreciation study on its U.S. based assets during 2012 and the depreciation impacts of the study results were immaterial to 2012 consolidated financial results.

During the year ended December 31, 2011, KCS engaged an independent engineering firm to assist management in performing a depreciation study on KCSM's road property and equipment. The depreciation impacts of the study results were immaterial to 2011 consolidated financial results.

Effective as of October 1, 2010, the Company changed depreciation rates on certain locomotive and road assets based on reassessment of the adequacy of the accumulated depreciation provisions, asset usage and replacement patterns. The full year net depreciation expense reduction in 2011 and 2012 resulting from these changes was \$4.2 million.

Also under the group method of depreciation, the cost of railroad property and equipment (net of salvage or sales proceeds) retired or replaced in the normal course of business is charged to accumulated depreciation with no gain or loss recognized. Actual historical costs are retired when available, such as with equipment costs. The use of estimates in recording the retirement of certain roadway assets is necessary as it is impractical to track individual, homogeneous network-type assets. For these types of assets, historical costs are estimated by (1) deflating current costs using inflation indices published by the U.S. Bureau of Labor Statistics and (2) the estimated useful life of the assets as determined by the depreciation studies. The indices applied to the replacement value are selected because they closely correlate with the major costs of the items comprising the roadway assets. Because of the number of estimates inherent in the depreciation and retirement processes and because it is impossible to precisely estimate each of these variables until a group of assets is completely retired, the Company continually monitors the estimated useful lives of its assets and the accumulated depreciation associated with each asset group to ensure the depreciation rates are appropriate. Gains or losses on dispositions of land or non-group property and abnormal retirements of railroad property are recognized through income. A retirement of railroad property would be considered abnormal if the cause of the retirement is unusual in nature and its actual life is significantly shorter than what would be expected for that group based on the depreciation studies. An abnormal retirement could cause the Company to re-evaluate the estimated useful life of the impacted asset class. There were no significant gains or losses from abnormal retirements of property or equipment for any of the three years ended December 31, 2012.

Estimation of the average useful lives of assets and net salvage values require significant management judgment. Estimated average useful lives may vary over time due to changes in physical use, technology, asset strategies and other factors that could have an impact on the retirement experience of the asset classes. Accordingly, changes in the assets' estimated useful

lives could significantly impact future periods' depreciation expense. Depreciation and amortization expense for the year ended December 31, 2012 was \$198.8 million. If the weighted average useful lives of assets were changed by one year, annual depreciation and amortization expense would change approximately \$6.9 million.

Long-lived assets are reviewed for impairment when events or circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment indicators are present and the estimated future undiscounted cash flows are less than the carrying value of the long-lived assets, the carrying value would be reduced to the estimated fair value. Future cash flow estimates for an impairment review would be based on the lowest level of identifiable cash flows, which are the Company's U.S. and Mexican operations. During the year ended December 31, 2012, management did not identify any indicators of impairment.

### ***Provision for Personal Injury Claims***

Due to the nature of railroad operations, personal injury claims related to work-related injuries and third party liabilities resulting from crossing collisions and derailments are a substantial expense to KCS. Claims are estimated and recorded for known reported occurrences as well as for incurred but not reported ("IBNR") occurrences. Consistent with general practices within the railroad industry, the estimated liability is actuarially determined on an undiscounted basis. The actuarial analysis is performed semi-annually by an independent third party actuarial firm and reviewed by management. In estimating the liability, the actuarial study calculates an estimate using historical experience and estimates of claim costs as well as numerous assumptions regarding factors relevant to the derivation of an estimate of future claim costs.

Personal injury claims are subject to a significant degree of uncertainty, especially estimates related to incurred but not reported personal injuries for which a party has yet to assert a claim. In deriving an estimate of the provision for personal injury claims, management must make assumptions related to substantially uncertain matters (injury severity, claimant age and legal jurisdiction). Changes in the assumptions used for actuarial studies could have a material effect on the estimate of the provision for personal injury claims. The most sensitive assumptions for personal injury accruals are the expected average cost per claim and the projected frequency rates for the number of claims that will ultimately result in payment. Management believes that the accounting estimate related to the liability for personal injuries claims is critical to KCS's results of operations. See also Note 14 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

### ***Income Taxes***

Deferred income taxes represent a substantial net liability of the Company. For financial reporting purposes, management determines the current tax liability, as well as deferred tax assets and liabilities, in accordance with the liability method of accounting for income taxes. The provision for income taxes is the sum of income taxes both currently payable and deferred into the future. Currently payable income taxes represent the liability related to the Company's U.S., state and foreign income tax returns for the current year and anticipated tax payments resulting from income tax audits, while the net deferred tax expense or benefit represents the change in the balance of net deferred tax assets or liabilities as reported on the balance sheet. The changes in deferred tax assets and liabilities are determined based upon the estimated timing of reversal of differences between the carrying amount of assets and liabilities for financial reporting purposes and the basis of assets and liabilities for tax purposes as measured using the currently enacted tax rates that will be in effect at the time these differences are expected to reverse. Additionally, management estimates whether taxable operating income in future periods will be sufficient to fully recognize any gross deferred tax assets.

The tax provision for Mexico has additional complexities such as the impacts of exchange rate variations and inflation, both of which can have a significant impact on the effective income tax rate. Finally, the Company pays the greater of Mexican income tax or the Entrepreneurial Tax of Unique Rate (referred to by its Spanish acronym, IETU or Flat Tax) annually. The general principles and complexities of income tax accounting related to Mexico apply to the calculation of the statutorily required Mexico employee profit sharing expense, and the related current and deferred liabilities. The employee profit sharing expense is recorded within compensation and benefits in the consolidated statements of income.

Management believes that the assumptions and estimates related to the provision for income taxes are critical to the Company's results of operations. For the year ended December 31, 2012, income tax expense totaled \$237.0 million. For every 1% change in the 2012 effective rate, income tax expense would have changed by approximately \$6.2 million. For income taxes paid in Mexico, which are paid in Mexican pesos, the revaluation of U.S. denominated amounts (primarily debt) into Mexican pesos is taxed currently under Mexican tax law. If the exchange rate used at the end of 2012 had decreased from

Ps.13.0 per U.S. dollar to Ps.12.0 per U.S. dollar, the effective income tax rate would have increased from 38.4% to 43.1% and income tax expense would have increased by approximately \$28.6 million. If the Mexican inflation rate used at the end of 2012 had increased from 4% to 5%, the effective income tax rate would have increased from 38.4% to 38.7%, and income tax expense would have increased by approximately \$1.6 million.

## **OTHER MATTERS**

*Litigation.* The Company is a party to various legal proceedings and administrative actions, all of which 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 that management believes are adequate to cover expected costs. Although it is not possible to predict the outcome of any legal proceeding, in the opinion of the Company's management, other than those proceedings described in Note 14 to the Consolidated Financial Statements in Item 8 of this Form 10-K, such proceedings and actions should not, individually, or in the aggregate, have a material adverse effect on the Company's consolidated financial statements.

*Inflation.* U.S. generally accepted accounting principles require the use of historical cost, which does not reflect the effects of inflation on the replacement cost of property. Due to the capital intensive nature of KCS's business, the replacement cost of these assets would be significantly higher than the amounts reported under the historical cost basis.

*Recent Accounting Pronouncements.* Refer to Note 2 to the Consolidated Financial Statements in Item 8 of this Form 10-K for information relative to recent accounting pronouncements.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

KCS utilizes various financial instruments that have certain inherent market risks. These instruments have not been entered into for trading purposes. The following information, together with information included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 15 to the Consolidated Financial Statements in Item 8 of this Form 10-K, describe the key aspects of certain financial instruments that have market risk to KCS.

*Interest Rate Sensitivity.* Floating-rate indebtedness totaled \$543.8 million and \$346.3 million at December 31, 2012 and 2011, respectively. The Company's revolving credit facilities and term loan facilities contain variable rate debt that accrues interest based on target interest indexes (London Interbank Offered Rate — "LIBOR" or an alternative base rate) plus an applicable spread. The Company has an aggregate notional amount of \$304.5 million of interest rate hedges at December 31, 2012, which effectively convert interest payments from variable rates to fixed rates. Considering the balance of \$239.3 million of variable rate debt at December 31, 2012, KCS is sensitive to fluctuations in interest rates. For example, a hypothetical 100 basis points increase in each of the respective target interest indexes would result in additional interest expense of \$2.4 million on an annualized basis for the floating-rate instruments issued by the Company as of December 31, 2012.

The Company determines fair values of its derivative financial instruments based upon pricing models using inputs from actively quoted markets. Pricing models take into consideration the contract terms as well as other inputs, including forward interest rate curves. Considering the outstanding derivative instruments fair value liability of \$0.9 million at December 31, 2012, the Company is sensitive to fluctuations in forward interest rate curves. For example, a hypothetical 100 basis points increase in the one-month LIBOR forward interest rate curve would result in a fair value asset of the derivative financial instruments of approximately \$2.0 million as of December 31, 2012.

Based upon the borrowing rates available to KCS and its subsidiaries for indebtedness with similar terms and average maturities, the fair value of debt was approximately \$1,719.9 million and \$1,741.3 million at December 31, 2012 and 2011, respectively, compared with a carrying value of \$1,607.8 million and \$1,639.1 million at December 31, 2012 and 2011, respectively.

*Commodity Price Sensitivity.* KCS periodically participates in diesel fuel purchase commitment and swap transactions. At December 31, 2012 and 2011, KCS did not have any outstanding fuel swap agreements. The Company also holds fuel inventories for use in operations. These inventories are not material to KCS's overall financial position. Fuel costs are expected to reflect market conditions in 2013; however, fuel costs are unpredictable and subject to a variety of factors outside the Company's control. Assuming annual consumption of 125 million gallons, a 10 cent change in the price per gallon of fuel

would cause a \$12.5 million change in operating expenses. KCS is able to mitigate the impact of increased fuel costs through fuel surcharge revenues from customers.

*Foreign Exchange Sensitivity.* While KCS's foreign subsidiaries use the U.S. dollar as their functional currency, however, a portion of the foreign subsidiaries' revenues and expenses are denominated in Mexican pesos. Based on the volume of revenue and expense transactions denominated in Mexican pesos, revenue and expense fluctuations generally offset, with insignificant net impacts to operating income.

The Company has exposure to fluctuations in the value of the Mexican peso against the U.S. dollar due to its net monetary assets that are denominated in Mexican pesos. If the exchange rate used at December 31, 2012, increased from Ps. 13.0 per U.S. dollar to Ps. 14.0 per U.S. dollar on net peso denominated monetary assets of Ps.933.0 million, it would have result in an additional foreign exchange loss of approximately \$5.1 million, and a decrease in the exchange rate from Ps. 13.0 per U.S. dollar to Ps. 12.0 per U.S. dollar would have result in an additional foreign exchange gain of approximately \$6.0 million.

For income taxes paid in Mexico, which are paid in Mexican pesos, the effect of the revaluation of U.S. denominated amounts (primarily debt) into Mexican pesos is taxed currently under Mexican tax law. If the exchange rate used at the end of 2012 increased from Ps. 13.0 per U.S. dollar to Ps. 14.0 per U.S. dollar, income tax expense for the year ended December 31, 2012 would have decreased by approximately \$24.3 million. If the exchange rate used at the end of 2012 decreased to Ps.12.0 per U.S. dollar, income tax expense for the year ended December 31, 2012, would have increased by approximately \$28.6 million.



**Item 8. *Financial Statements and Supplementary Data***

**Index to Consolidated Financial Statements**

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Financial Statement Schedules:	

All schedules are omitted because they are not applicable, are insignificant, or the required information is shown in the consolidated financial statements or notes thereto.

## **Management's Report on Internal Control over Financial Reporting**

The management of Kansas City Southern is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). KCS's internal control over financial reporting was designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2012, based on the framework established by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control — Integrated Framework* (commonly referred to as the COSO framework). Based on its evaluation, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2012, based on the criteria outlined in the COSO framework.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2012, has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their attestation report, which immediately follows this report.

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Kansas City Southern:

We have audited Kansas City Southern's (the Company) internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Kansas City Southern maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Kansas City Southern and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2012, and our report dated February 4, 2013 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Kansas City, Missouri  
February 4, 2013

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Kansas City Southern:

We have audited the accompanying consolidated balance sheets of Kansas City Southern and subsidiaries (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kansas City Southern and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

As discussed in note 2 to the consolidated financial statements, effective January 1, 2012, the Company elected to present comprehensive income and its components in two separate, consecutive statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Kansas City Southern's internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 4, 2013 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Kansas City, Missouri  
February 4, 2013

**Kansas City Southern and Subsidiaries**

**Consolidated Statements of Income  
Years Ended December 31,**

	2012	2011	2010
	(In millions, except share and per share amounts)		
Revenues	\$ 2,238.6	\$ 2,098.3	\$ 1,814.8
Operating expenses:			
Compensation and benefits	430.5	423.8	369.3
Purchased services	219.8	204.8	189.1
Fuel	359.6	346.5	263.6
Equipment costs	167.1	172.0	162.4
Depreciation and amortization	198.8	186.2	184.9
Materials and other	189.9	179.0	159.0
Elimination of deferred statutory profit sharing liability, net	(43.0)	—	—
Gain on insurance recoveries related to hurricane damage	—	(25.6)	—
Total operating expenses	1,522.7	1,486.7	1,328.3
Operating income	715.9	611.6	486.5
Equity in net earnings of unconsolidated affiliates	19.3	18.2	19.7
Interest expense	(100.4)	(129.1)	(158.1)
Debt retirement costs	(20.1)	(38.7)	(68.3)
Foreign exchange gain (loss)	2.7	(9.2)	4.7
Other income (expense), net	(1.0)	2.2	4.7
Income before income taxes	616.4	455.0	289.2
Income tax expense	237.0	123.1	109.2
Net income	379.4	331.9	180.0
Less: Net income (loss) attributable to noncontrolling interest	2.1	1.6	(0.2)
Net income attributable to Kansas City Southern and subsidiaries	377.3	330.3	180.2
Preferred stock dividends	0.2	1.6	11.0
Net income available to common stockholders	\$ 377.1	\$ 328.7	\$ 169.2
Earnings per share:			
Basic earnings per share	\$ 3.44	\$ 3.04	\$ 1.69
Diluted earnings per share	\$ 3.43	\$ 3.00	\$ 1.67
Average shares outstanding ( <i>in thousands</i> ):			
Basic	109,712	108,208	100,054
Potentially dilutive common shares	368	1,622	7,480
Diluted	110,080	109,830	107,534
Cash dividends declared per common share	\$ 0.780	\$ —	\$ —

See accompanying notes to consolidated financial statements.

**Kansas City Southern and Subsidiaries**  
**Consolidated Statements of Comprehensive Income**  
**Years Ended December 31,**

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	(In millions)		
Net income	\$ 379.4	\$ 331.9	\$ 180.0
Other comprehensive income (loss):			
Unrealized loss on cash flow hedges arising during the period, net of tax of \$(0.6) million and \$(0.3) million	(1.0)	—	(0.4)
Reclassification adjustment from cash flow hedges included in net income, net of tax of \$0.3 million, \$0.2 million and \$1.9 million	0.4	0.2	3.2
Amortization of prior service credit, net of tax of \$(0.1) million	(0.1)	(0.2)	(0.2)
Foreign currency translation adjustments, net of tax of \$0.4 million, \$(0.5) million, and \$0.2 million	0.5	(0.8)	0.4
Other comprehensive income (loss)	<u>(0.2)</u>	<u>(0.8)</u>	<u>3.0</u>
Comprehensive income	379.2	331.1	183.0
Less: comprehensive income (loss) attributable to noncontrolling interest	2.1	1.6	(0.2)
Comprehensive income attributable to Kansas City Southern and subsidiaries	<u>\$ 377.1</u>	<u>\$ 329.5</u>	<u>\$ 183.2</u>

See accompanying notes to consolidated financial statements.

**Kansas City Southern and Subsidiaries**

**Consolidated Balance Sheets**

**December 31,**

	2012	2011
	(In millions, except share and per share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 72.6	\$ 72.4
Accounts receivable, net	183.6	166.0
Materials and supplies	125.6	109.6
Deferred income taxes	92.1	225.0
Other current assets	48.4	69.5
Total current assets	522.3	642.5
Investments	51.5	50.4
Restricted funds	14.2	21.7
Property and equipment (including concession assets), net	5,684.8	5,321.6
Other assets	123.1	108.9
Total assets	\$ 6,395.9	\$ 6,145.1
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Debt due within one year	\$ 60.2	\$ 36.3
Accounts payable and accrued liabilities	364.6	401.1
Total current liabilities	424.8	437.4
Long-term debt	1,547.6	1,602.8
Deferred income taxes	894.2	861.4
Other noncurrent liabilities and deferred credits	128.6	184.8
Total liabilities	2,995.2	3,086.4
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; 110,131,353 and 109,910,857 shares outstanding at December 31, 2012 and 2011, respectively	1.1	1.1
Paid-in capital	925.3	884.2
Retained earnings	2,166.5	1,875.3
Accumulated other comprehensive loss	(2.4)	(2.2)
Total stockholders' equity	3,096.6	2,764.5
Noncontrolling interest	304.1	294.2
Total equity	3,400.7	3,058.7
Total liabilities and equity	\$ 6,395.9	\$ 6,145.1

See accompanying notes to consolidated financial statements.

**Kansas City Southern and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31,**

	2012	2011	2010
	(In millions)		
<b>Operating activities:</b>			
Net income	\$ 379.4	\$ 331.9	\$ 180.0
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	198.8	186.2	184.9
Deferred income taxes	197.3	120.7	106.2
Equity in net earnings of unconsolidated affiliates	(19.3)	(18.2)	(19.7)
Share-based compensation	10.7	8.5	8.8
Excess tax benefit from share-based compensation	(31.5)	(0.2)	(1.2)
Deferred compensation	7.3	19.5	1.6
Elimination of deferred statutory profit sharing liability	(47.8)	—	—
Distributions from unconsolidated affiliates	19.8	18.1	19.5
Gain on insurance recoveries related to hurricane damage	—	(25.6)	—
Cash payments related to hurricane damage	—	(3.3)	(27.8)
Insurance proceeds related to hurricane damage	—	40.2	8.2
Debt retirement costs	20.1	38.7	68.3
Changes in working capital items:			
Accounts receivable	(21.5)	(1.5)	(20.2)
Materials and supplies	(9.3)	(7.2)	6.3
Other current assets	(15.1)	(26.8)	(4.8)
Accounts payable and accrued liabilities	(3.0)	(7.5)	22.0
Other, net	(12.7)	(35.5)	(35.8)
Net cash provided by operating activities	<u>673.2</u>	<u>638.0</u>	<u>496.3</u>
<b>Investing activities:</b>			
Capital expenditures	(540.0)	(495.0)	(287.3)
Acquisition of an intermodal facility, net of cash acquired	—	—	(25.0)
Property investments in MSLLC	(35.2)	(33.3)	(25.2)
Contributions from noncontrolling interest	7.8	10.0	—
Insurance proceeds related to hurricane damage	—	12.4	1.8
Proceeds from disposal of property	14.7	10.0	8.3
Other, net	0.8	(14.5)	15.9
Net cash used for investing activities	<u>(551.9)</u>	<u>(510.4)</u>	<u>(311.5)</u>
<b>Financing activities:</b>			
Proceeds from issuance of long-term debt	329.6	550.0	480.7
Repayment of long-term debt	(375.9)	(653.3)	(839.7)
Proceeds from common stock issuance	—	—	214.9
Debt costs	(22.1)	(36.6)	(65.1)
Proceeds from employee stock plans	1.9	2.1	2.1
Excess tax benefit from share-based compensation	31.5	0.2	1.2
Dividends paid	(86.1)	(3.0)	(11.0)
Net cash used for financing activities	<u>(121.1)</u>	<u>(140.6)</u>	<u>(216.9)</u>
<b>Cash and cash equivalents:</b>			
Net increase (decrease) during each period	0.2	(13.0)	(32.1)
At beginning of year	72.4	85.4	117.5
At end of year	<u>\$ 72.6</u>	<u>\$ 72.4</u>	<u>\$ 85.4</u>
<b>Supplemental cash flow information</b>			
<b>Non-cash investing and financing activities:</b>			
Capital expenditures accrued but not yet paid at end of year	\$ 44.4	\$ 61.7	\$ 57.1
Capital lease obligations incurred	13.8	0.7	3.7
Non-cash asset acquisitions	13.2	116.1	7.3
<b>Cash payments:</b>			
Interest paid, net of amounts capitalized	\$ 97.9	\$ 125.0	\$ 153.0
Income tax payments, net of refunds	1.9	0.9	1.6

See accompanying notes to consolidated financial statements.



**Kansas City Southern and Subsidiaries**  
**Consolidated Statements of Changes in Equity**

	\$25 Par Preferred Stock	\$1 Par Cumulative Preferred Stock Series D 5.125%	\$.01 Par Common Stock	Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non- controlling Interest	Total
	(In millions)							
<b>Balance at December 31, 2009</b>	\$ 6.1	\$ 0.2	\$ 0.9	\$ 661.4	\$ 1,378.8	\$ (4.4)	\$ 282.8	\$ 2,325.8
Net income					180.2		(0.2)	180.0
Other comprehensive income						3.0		3.0
Common stock issued			0.1	214.8				214.9
Dividends on \$25 par preferred stock (\$1.00/share)					(0.2)			(0.2)
Dividends on series D cumulative preferred stock (\$51.24/share)					(10.8)			(10.8)
Options exercised and stock subscribed, net of shares withheld for employee taxes				(9.0)				(9.0)
Tax benefit from share-based compensation				1.2				1.2
Share-based compensation				8.8				8.8
<b>Balance at December 31, 2010</b>	<u>6.1</u>	<u>0.2</u>	<u>1.0</u>	<u>877.2</u>	<u>1,548.0</u>	<u>(1.4)</u>	<u>282.6</u>	<u>2,713.7</u>
Net income					330.3			331.9
Other comprehensive loss						(0.8)		(0.8)
Contributions from noncontrolling interest							10.0	10.0
Conversion of series D cumulative convertible preferred stock		(0.2)						(0.2)
Common stock issued for conversion of series D cumulative convertible preferred stock			0.1	0.1				0.2
Dividends on \$25 par preferred stock (\$1.00/share)					(0.3)			(0.3)
Dividends on series D cumulative preferred stock (\$12.81/share)					(2.7)			(2.7)
Options exercised and stock subscribed, net of shares withheld for employee taxes				(1.8)				(1.8)
Tax benefit from share-based compensation				0.2				0.2
Share-based compensation				8.5				8.5
<b>Balance at December 31, 2011</b>	<u>6.1</u>	<u>—</u>	<u>1.1</u>	<u>884.2</u>	<u>1,875.3</u>	<u>(2.2)</u>	<u>294.2</u>	<u>3,058.7</u>
Net income					377.3		2.1	379.4
Other comprehensive loss						(0.2)		(0.2)
Contribution from noncontrolling interest							7.8	7.8
Dividends on common stock (\$0.78/share)					(85.9)			(85.9)
Dividends on \$25 par preferred stock (\$1.00/share)					(0.2)			(0.2)
Options exercised and stock subscribed, net of shares withheld for employee taxes				(1.1)				(1.1)
Tax benefit from share-based compensation				31.5				31.5
Share-based compensation				10.7				10.7
<b>Balance at December 31, 2012</b>	<u>\$ 6.1</u>	<u>\$ —</u>	<u>\$ 1.1</u>	<u>\$ 925.3</u>	<u>\$ 2,166.5</u>	<u>\$ (2.4)</u>	<u>\$ 304.1</u>	<u>\$ 3,400.7</u>

See accompanying notes to consolidated financial statements.

**Kansas City Southern**  
**Notes to Consolidated Financial Statements**

**Note 1. Description of the Business**

Kansas City Southern (“KCS” or the “Company”), a Delaware corporation, is a holding company with principal operations in rail transportation.

The Company is engaged primarily in the freight rail transportation business operating through a single coordinated rail network under one reportable business segment. The Company generates revenues and cash flows by providing its customers with freight delivery services both within its regions, and throughout North America through connections with other Class I rail carriers. KCS’s customers conduct business in a number of different industries, including electric-generating utilities, chemical and petroleum products, paper and forest products, agriculture and mineral products, automotive products and intermodal transportation.

The primary subsidiaries of the Company consist of the following:

- The Kansas City Southern Railway Company (“KCSR”), a wholly-owned consolidated subsidiary;
- Kansas City Southern de México, S.A. de C.V. (“KCSM”), a wholly-owned consolidated subsidiary which operates under the rights granted by the Concession acquired from the Mexican government in 1997 (the “Concession”) as described below;
- Mexrail, Inc. (“Mexrail”), a wholly-owned consolidated subsidiary; which wholly owns The Texas Mexican Railway Company (“Tex-Mex”);
- Meridian Speedway, LLC (“MSLLC”), a seventy percent-owned consolidated affiliate. On December 1, 2005, KCS and KCSR entered into a transaction agreement with Norfolk Southern Corporation (“NS”) and its wholly-owned subsidiary, The Alabama Great Southern Railroad Company (“AGS”), providing for the formation of a limited liability company between the parties relating to the ownership and improvement of the KCSR rail line between Meridian, Mississippi and Shreveport, Louisiana, which is the portion of the KCSR rail line between Dallas, Texas and Meridian known as the “Meridian Speedway”;
- KCSM Servicios, S.A. de C.V. (“KCSM Servicios”), a wholly-owned consolidated subsidiary;

Including equity investments in:

- Panama Canal Railway Company (“PCRC”), a fifty percent-owned unconsolidated affiliate which includes Panarail Tourism Company (“Panarail”), a wholly-owned subsidiary of PCRC;
- Southern Capital Corporation, LLC (“Southern Capital”), a fifty percent-owned unconsolidated affiliate that owns and leases locomotives and other equipment;
- Ferrocarril y Terminal del Valle de México, S.A. de C.V. (“FTVM”), a twenty-five percent-owned unconsolidated affiliate that provides railroad services as well as ancillary services in the greater Mexico City area; and
- PTC-220, LLC (“PTC-220”), a fourteen percent-owned unconsolidated affiliate that holds the licenses to large blocks of radio spectrum and other assets for the deployment of positive train control.

*The KCSM Concession.* KCSM holds a concession from the Mexican government until June 2047 (exclusive through 2027, subject to certain trackage and haulage rights granted to other concessionaires), which is renewable under certain conditions for an additional period of up to 50 years (the “Concession”). The Concession is to provide freight transportation services over rail lines which are a primary commercial corridor of the Mexican railroad system. These lines include the shortest, most direct rail passageway between Mexico City and Laredo, Texas and serve most of Mexico’s principal industrial cities and three of its major shipping ports. KCSM has the right to use, but does not own, all track and buildings that are necessary for the rail lines’ operation. KCSM is obligated to maintain the right of way, track structure, buildings and related maintenance facilities to the operational standards specified in the Concession agreement and to return the assets in that condition at the end of the Concession period. KCSM was required to pay the Mexican government a concession duty equal to 0.5% of gross revenues during the first 15 years of the Concession period, and on June 24, 2012, KCSM began paying 1.25% of such revenues, which is effective for the remaining years of the Concession period.

Under the Concession and Mexican law, the Company may freely set rates unless the Mexican government determines that there is no effective competition in Mexico’s rail industry. KCSM is required to register its rates with the Mexican

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

government and to provide railroad services to all users on a fair and non-discriminatory basis and in accordance with efficiency and safety standards approved periodically by the Mexican government. In the event that rates charged are higher than the registered rates, KCSM must reimburse customers with interest, and risk the revocation of the Concession.

Mexican Railroad Services Law and regulations and the Concession establish several circumstances under which the Concession will terminate: revocation by the Mexican government, statutory appropriation, or KCSM's voluntary surrender of its rights or liquidation or bankruptcy. The Concession requires the undertaking of capital projects, including those described in a business plan filed every five years with the Mexican government. KCSM submitted its five-year plan with the Mexican government in the fourth quarter of 2012 in which KCSM committed to certain minimum investment and capital improvement goals, which may be waived by the Mexican government upon application for relief for good cause. The Mexican government could also revoke KCSM's exclusivity after 2027 if it determines that there is insufficient competition.

The Concession is subject to early termination or revocation under certain circumstances. In the event that the Concession is revoked by the Mexican government, KCSM will receive no compensation. Rail lines and all other fixtures covered by the Concession, as well as all improvements made by KCSM or third parties, will revert to the Mexican government. All other property not covered by the Concession, including all locomotives and railcars otherwise acquired, will remain KCSM's property. In the event of early termination, or total or partial revocation, the Mexican government would have the right to cause KCSM to lease all service-related assets to it for a term of at least one year, automatically renewable for additional one-year terms up to five years. The amount of the rent would be determined by experts appointed by KCSM and the Mexican government. The Mexican government must exercise this right within four months after early termination or revocation of the Concession. In addition, the Mexican government would have a right of first refusal with respect to certain transfers by KCSM of railroad equipment within 90 days after any revocation of the Concession. The Mexican government may also temporarily seize the rail lines and assets used in operating the rail lines in the event of a natural disaster, war, significant public disturbances, or imminent danger to the domestic peace or economy for the duration of any of the foregoing events; provided, however, that Mexican law requires that the Mexican government pay KCSM compensation equal to damages caused and losses suffered if it effects a statutory appropriation for reasons of the public interest. These payments may not be sufficient to compensate the Company for its losses and may not be made timely.

*Employees and Labor Relations.* 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 union employees are covered by one labor agreement, which was signed on June 23, 1997, between KCSM and the Sindicato de Trabajadores Ferrocarrileros de la República Mexicana ("Mexican Railroad Union"), for a term of fifty years, 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. As a result of the labor agreement signed on April 19, 2012, compensation terms for the period from July 1, 2012 through June 30, 2013, were finalized. Additionally, this labor agreement enabled KCS to complete an organizational restructuring whereby employees of KCSM became employees of KCSM Servicios. KCSM Servicios provides employee services to KCSM, and KCSM pays KCSM Servicios market-based rates for these services. The union labor negotiation with the Mexican Railroad Union has not historically resulted in any strike, boycott or other disruption in KCSM's business operations.

**Note 2. Significant Accounting Policies**

*Principles of Consolidation.* The accompanying consolidated financial statements are presented using the accrual basis of accounting and include the Company and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to the current year presentation.

The equity method of accounting is used for all entities in which the Company or its subsidiaries have significant influence, but not a controlling interest. The Company evaluates less-than-majority-owned investments for consolidation

## Kansas City Southern

### Notes to Consolidated Financial Statements-(Continued)

pursuant to consolidation and variable interest entity guidance. The Company does not have any less-than-majority-owned investments requiring consolidation.

*Use of Estimates.* The accounting and financial reporting policies of the Company conform to accounting principles generally accepted in the United States ("U.S. GAAP"). The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include those related to the recoverability and useful lives of assets, personal injury claims, litigation provisions and income taxes. Changes in facts and circumstances may result in revised estimates and actual results could differ from those estimates.

*Revenue Recognition.* The Company recognizes freight revenue based upon the percentage of completion of a commodity movement as a shipment moves from origin to destination, with the related expense recognized as incurred. Other revenues, in general, are recognized when the product is shipped, as services are performed or contractual obligations are fulfilled.

*Foreign Exchange Gain (Loss).* For financial reporting purposes, foreign subsidiaries maintain records in U.S. dollars, which is the functional currency. The dollar is the currency that reflects the economic substance of the underlying events and circumstances relevant to the entity. Monetary assets and liabilities denominated in pesos are remeasured into dollars using current exchange rates. The difference between the exchange rate on the date of the transaction and the exchange rate on the settlement date, or balance sheet date if not settled, is included in the income statement as foreign exchange gain or loss.

*Cash Equivalents.* Short-term liquid investments with an initial maturity of three months or less are classified as cash and cash equivalents.

*Accounts Receivable, net.* Accounts receivable are net of an allowance for uncollectible accounts as determined by historical experience and adjusted for economic uncertainties or known trends. Accounts are charged to the allowance when a customer enters bankruptcy, when an account has been transferred to a collection agent or submitted for legal action, or when a customer is significantly past due and all available means of collection have been exhausted. At December 31, 2012 and 2011, the allowance for doubtful accounts was \$3.2 million and \$4.6 million, respectively. For the years ended December 31, 2012 and 2010, accounts receivable allowance recovery was \$0.1 million and \$1.4 million, respectively. Bad debt expense was \$0.9 million for the year ended December 31, 2011.

*Materials and Supplies.* Materials and supplies consisting of diesel fuel, items to be used in the maintenance of rolling stock and items to be used in the maintenance or construction of road property are valued at average cost.

*Derivative Instruments.* Derivatives are measured at fair value and recorded on the balance sheet as either assets or liabilities. Changes in the fair value of derivatives are recorded either through current earnings or as other comprehensive income, depending on hedge designation. Gains and losses on derivative instruments classified as cash flow hedges are reported in other comprehensive income and are reclassified into earnings in the periods in which earnings are impacted by the variability of the cash flow of the hedged item. The ineffective portion of all hedge transactions is recognized in current period earnings.

*Restricted Funds.* Restricted funds represents cash held by MSLLC which is restricted for use by KCS. These funds are restricted until they are used by MSLLC for capacity additions on the Meridian Speedway.

*Property and Equipment (including Concession Assets).* KCS capitalizes costs for self-constructed additions and improvements to property including direct labor and material, indirect overhead costs, and interest during long-term construction projects. Direct costs are charged to capital projects based on the work performed and the material used. Indirect overhead costs are allocated to capital projects as a standard percentage, which is evaluated annually, and applied to direct labor and material costs. Asset removal activities are performed in conjunction with replacement activities; therefore, removal costs are estimated based on a standard percentage of direct labor and indirect overhead costs related to capital replacement projects. For purchased assets, all costs necessary to make the asset ready for its intended use are capitalized. Expenditures that

## Kansas City Southern

### Notes to Consolidated Financial Statements-(Continued)

significantly increase asset values, productive capacity, efficiency, safety or extend useful lives are capitalized. Repair and maintenance costs are expensed as incurred.

Property and equipment are carried at cost and are depreciated primarily on the group method of depreciation, which the Company believes closely approximates a straight line basis over the estimated useful lives of the assets measured in years. Technology assets and leasehold improvements are depreciated using the straight line method over the lesser of the estimated useful lives of the assets or the lease term. Costs incurred by the Company to acquire the concession rights and related assets, as well as subsequent improvements to the concession assets, are capitalized and amortized using the group method of depreciation over the lesser of the current expected Concession term, including probable renewal of an additional 50-year term, or the estimated useful lives of the assets and rights.

The group method of depreciation applies a composite rate to classes of similar assets rather than to individual assets. Composite depreciation rates are based upon the Company's estimates of the expected average useful lives of assets as well as expected net salvage value at the end of their useful lives. In developing these estimates, the Company utilizes periodic depreciation studies performed by an independent engineering firm. Depreciation rate studies are performed at least every three years for equipment and at least every six years for road property (rail, ties, ballast, etc.). The depreciation studies take into account factors such as:

- Statistical analysis of historical patterns of use and retirements of each asset class;
- Evaluation of any expected changes in current operations and the outlook for the continued use of the assets;
- Evaluation of technological advances and changes to maintenance practices; and
- Historical and expected salvage to be received upon retirement.

The depreciation studies may also indicate that the recorded amount of accumulated depreciation is deficient or in excess of the amount indicated by the study. Any such deficiency or excess is amortized as a component of depreciation expense over the remaining useful lives of the affected asset class, as determined by the study. The Company also monitors these factors in non-study years to determine if adjustments should be made to depreciation rates. Any changes in depreciation rates are implemented prospectively. The Company completed a depreciation study on its U.S. based assets during 2012 and the depreciation impacts of the study results were immaterial to 2012 consolidated financial results.

During the year ended December 31, 2011, KCS engaged an independent engineering firm to assist management in performing a depreciation study on KCSM's road property and equipment. The depreciation impacts of the study results were immaterial to 2011 consolidated financial results.

Effective as of October 1, 2010, the Company changed depreciation rates on certain locomotive and road assets based on reassessment of the adequacy of the accumulated depreciation provisions, asset usage and replacement patterns. The full year net depreciation expense reduction in 2011 and 2012 resulting from these changes was \$4.2 million.

Also under the group method of depreciation, the cost of railroad property and equipment (net of salvage or sales proceeds) retired or replaced in the normal course of business is charged to accumulated depreciation with no gain or loss recognized. Actual historical costs are retired when available, such as with equipment costs. The use of estimates in recording the retirement of certain roadway assets is necessary as it is impractical to track individual, homogeneous network-type assets. For these types of assets, historical costs are estimated by (1) deflating current costs using inflation indices published by the U.S. Bureau of Labor Statistics and (2) the estimated useful life of the assets as determined by the depreciation studies. The indices applied to the replacement value are selected because they closely correlate with the major costs of the items comprising the roadway assets. Because of the number of estimates inherent in the depreciation and retirement processes and because it is impossible to precisely estimate each of these variables until a group of assets is completely retired, the Company continually monitors the estimated useful lives of its assets and the accumulated depreciation associated with each asset group to ensure the depreciation rates are appropriate. Gains or losses on dispositions of land or non-group property and abnormal retirements of railroad property are recognized through income. A retirement of railroad property would be considered abnormal if the cause of the retirement is unusual in nature and its actual life is significantly shorter than what would be

## Kansas City Southern

### Notes to Consolidated Financial Statements-(Continued)

expected for that group based on the depreciation studies. An abnormal retirement could cause the Company to re-evaluate the estimated useful life of the impacted asset class.

Long-lived assets are reviewed for impairment when events or circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment indicators are present and the estimated future undiscounted cash flows are less than the carrying value of the long-lived assets, the carrying value would be reduced to the estimated fair value. Future cash flow estimates for an impairment review would be based on the lowest level of identifiable cash flows, which are the Company's U.S. and Mexican operations. During the years ended December 31, 2012 and 2011, management did not identify any indicators of impairment.

*Goodwill.* Goodwill represents the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. As of December 31, 2012 and 2011, the goodwill balance was \$13.2 million, which is included in other assets in the consolidated balance sheets. Goodwill is not amortized, but is reviewed at least annually, or more frequently as indicators warrant, for impairment. An impairment loss would be recognized to the extent that the carrying amount exceeds the assets' fair values. The Company performed its annual impairment review for goodwill as of November 30, 2012 and 2011, and concluded there was no impairment in 2012 or 2011.

*Fair Value of Financial Instruments.* Non-financial assets and liabilities are recognized at fair value on a nonrecurring basis. These assets and liabilities are measured at fair value on an ongoing basis but are subject to fair value only in certain circumstances. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company determines the fair values of its financial instruments based on the fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy is broken down into three levels based upon the observability of inputs. 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.

*Environmental Liabilities.* The Company records liabilities for remediation and restoration costs related to past activities when the Company's obligation is probable and the costs can be reasonably estimated. Costs of future expenditures for environmental remediation are not discounted to their present value. Recoveries of environmental remediation costs from other parties are recorded as assets when their receipt is deemed probable. Costs of ongoing compliance activities related to current operations are expensed as incurred.

*Personal Injury Claims.* 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 Company's personal injury liability is based on actuarial studies performed on an undiscounted basis by an independent third party actuarial firm and reviewed by management. The liability is based on claims filed and an estimate of claims incurred but not yet reported. Adjustments to the liability are reflected as operating expenses in the period in which the adjustments are known. Legal fees related to personal injury claims are recorded in operating expense in the period incurred.

*Health and Welfare and Postemployment Benefits.* The Company provides certain medical, life and other postemployment benefits to certain active employees and retirees. The Company uses actuaries to assist management in measuring the benefit obligation and cost based on the current plan provisions, employee demographics, and assumptions about financial and demographic factors affecting the probability, timing and amount of expected future benefit payments. Significant assumptions include the discount rate, rate of increase in compensation levels, and the health care cost trend rate. Actuarial gains and losses determined at the measurement date (typically December 31) are recognized immediately in the consolidated statements of income.

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

*Employees' Statutory Profit Sharing.* Mexican employees are statutorily entitled to receive Participacion a los Trabajadores de las Utilidades (referred to by its Spanish acronym, PTU or Statutory Profit Sharing). This payment is based on an employer's net profit based on accounting principles as prescribed in Mexican law, rather than net profit based on U.S. GAAP. Deferred employees' statutory profit sharing is accounted for using the liability method in a manner similar to income taxes and included as a component of compensation and benefits within the consolidated statements of income.

*Share-Based Compensation.* The Company accounts for all share-based compensation in accordance with fair value recognition provisions. Under this method, compensation expense is measured at grant date based on the then fair value of the award and is recognized over the requisite service period in which the award is earned. Forfeitures are estimated at the time of the grant and revised, as necessary, in subsequent periods should actual forfeitures differ from those estimates.

The Company issues treasury stock to settle share-based awards. The Company does not intend to repurchase any shares in 2013 to provide shares to issue as share-based awards; however, management frequently evaluates the appropriateness of the level of shares outstanding.

*Income Taxes.* Deferred income tax effects of transactions reported in different periods for financial reporting and income tax return purposes are recorded under the liability method of accounting for income taxes. This method gives consideration to the future tax consequences of the deferred income tax items and immediately recognizes changes in income tax laws in the year of enactment. In addition, the Company has not provided U.S. federal income taxes on the undistributed operating earnings of its foreign investments since the earnings will be reinvested indefinitely or the earnings will be remitted in a tax-free transaction.

The Company has recognized a deferred tax asset, net of a valuation allowance, for net operating loss carryovers. The Company projects sufficient future taxable income to realize the deferred tax asset recorded less the valuation allowance. These projections take into consideration assumptions about inflation rates, currency fluctuations, future income and future capital expenditures. If assumptions or actual conditions change, the deferred tax asset, net of the valuation allowance, will be adjusted to properly reflect the expected tax benefit.

***New Accounting Pronouncements***

Effective January 1, 2012, the Company adopted, on a retrospective basis, the new accounting guidance on the presentation of comprehensive income. As a result of the adoption, the Company reports net income and other comprehensive income in two separate consecutive statements.

**Note 3. Earnings Per Share**

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 Plan and shares issuable upon the conversion of preferred stock to common stock. During the first quarter of 2011, the Company converted all of the remaining outstanding Cumulative Convertible Perpetual Preferred Stock, Series D, into 6,999,887 shares of common stock.

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

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*):

	2012	2011	2010
Net income available to common stockholders for purposes of computing basic earnings per share	\$ 377.1	\$ 328.7	\$ 169.2
Effect of dividends on conversion of convertible preferred stock	—	1.3	10.8
Net income available to common stockholders for purposes of computing diluted earnings per share	<u>\$ 377.1</u>	<u>\$ 330.0</u>	<u>\$ 180.0</u>
Weighted-average number of shares outstanding ( <i>in thousands</i> ):			
Basic shares	109,712	108,208	100,054
Additional weighted average shares attributable to:			
Convertible preferred stock	—	1,245	7,000
Stock options and nonvested shares	368	377	480
Diluted shares	<u>110,080</u>	<u>109,830</u>	<u>107,534</u>
Basic earnings per share	<u>\$ 3.44</u>	<u>\$ 3.04</u>	<u>\$ 1.69</u>
Diluted earnings per share	<u>\$ 3.43</u>	<u>\$ 3.00</u>	<u>\$ 1.67</u>

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

	2012	2011	2010
Stock options excluded as their inclusion would be anti-dilutive	—	96	4

**Note 4. Elimination of Deferred Statutory Profit Sharing Liability, Net**

During the second quarter of 2012, the Company completed an organizational restructuring whereby employees of Kansas City Southern de México, S.A. de C.V. (“KCSM”) became employees of KCSM Servicios, S.A. de C.V. (“KCSM Servicios”), a wholly-owned subsidiary of the Company. KCSM Servicios provides employee services to KCSM, and KCSM pays KCSM Servicios market-based rates for these services. The effective date of this organizational restructuring was May 1, 2012.

Mexican employees are entitled to receive Mexican statutory profit sharing. The related cash payment to employees is based on an employer’s net profit determined under accounting principles prescribed in Mexican law, rather than its net profit determined under U.S. GAAP. U.S. GAAP requires the recording of deferred liabilities or assets for financial reporting purposes on the differences between the amounts determined under the two different accounting principles.

As a result of the organizational restructuring, KCSM’s obligation to pay Mexican statutory profit sharing terminated on the effective date. Accordingly, in the second quarter of 2012, KCSM recognized a \$43.0 million net reduction to operating expense. This reduction includes the elimination of \$47.8 million of the deferred Mexican statutory profit sharing liability, net of \$4.8 million of transaction costs. KCSM Servicios became obligated to pay Mexican statutory profit sharing to its employees beginning on the effective date of the organizational restructuring.



**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

**Note 5. Insurance Recoveries**

In the third quarter of 2011, the Company settled its insurance claim related to hurricane Alex, which struck in 2010 and resulted in extensive damage to KCSM's track and bridge infrastructures, caused multiple track-related incidents and significantly disrupted the Company's rail service. As a result of this settlement, the Company recognized a gain on insurance recoveries of \$25.6 million in the third quarter of 2011. This gain primarily represented the recovery of lost profits and the replacement value of property in excess of its carrying value, net of the self-insured retentions.

**Note 6. Property and Equipment (including Concession Assets)**

The following tables list the major categories of property and equipment, including concession assets, as well as the weighted-average composite depreciation rate for each category (*in millions, except percentages*):

<u>As of December 31, 2012</u>	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>	<u>Depreciation Rates for 2012</u>
Land	\$ 208.9	\$ —	\$ 208.9	N/A
Concession land rights	141.2	(19.5)	121.7	1.0%
Rail and other track material	1,509.9	(338.8)	1,171.1	1.8-2.8%
Ties	1,343.0	(290.9)	1,052.1	2.0-4.3%
Grading	827.8	(123.7)	704.1	1.1%
Bridges and tunnels	585.3	(110.7)	474.6	1.3%
Ballast	565.8	(137.6)	428.2	2.6-4.8%
Other (a)	832.6	(232.6)	600.0	3.1%
Total road property	5,664.4	(1,234.3)	4,430.1	2.8%
Locomotives	728.8	(155.6)	573.2	5.1%
Freight cars	196.4	(75.3)	121.1	4.5%
Other equipment	37.4	(10.7)	26.7	7.4%
Total equipment	962.6	(241.6)	721.0	5.1%
Technology and other	148.1	(101.2)	46.9	12.7%
Construction in progress	156.2	—	156.2	N/A
Total property and equipment (including concession assets)	\$ 7,281.4	\$ (1,596.6)	\$ 5,684.8	N/A

(a) Other includes signals, buildings and other road assets.

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

<u>As of December 31, 2011</u>	Cost	Accumulated Depreciation	Net Book Value	Depreciation Rates for 2011
Land	\$ 207.4	\$ —	\$ 207.4	N/A
Concession land rights	141.2	(18.0)	123.2	1.0%
Rail and other track material	1,415.7	(317.8)	1,097.9	1.8-2.9%
Ties	1,250.6	(259.0)	991.6	2.0-4.1%
Grading	830.5	(114.7)	715.8	1.0%
Bridges and tunnels	555.1	(103.3)	451.8	1.3%
Ballast	541.1	(122.8)	418.3	2.7-4.3%
Other (a)	717.7	(206.2)	511.5	2.9%
Total road property	5,310.7	(1,123.8)	4,186.9	2.6%
Locomotives	642.2	(127.0)	515.2	5.5%
Freight cars	142.0	(69.5)	72.5	4.1%
Other equipment	37.3	(9.2)	28.1	6.8%
Total equipment	821.5	(205.7)	615.8	5.3%
Technology and other	123.3	(87.7)	35.6	14.0%
Construction in progress	152.7	—	152.7	N/A
Total property and equipment (including concession assets)	<u>\$ 6,756.8</u>	<u>\$ (1,435.2)</u>	<u>\$ 5,321.6</u>	<u>N/A</u>

(a) Other includes signals, buildings and other road assets.

Concession assets, net of accumulated amortization of \$413.3 million and \$347.1 million, totaled \$1,916.5 million and \$1,855.1 million at December 31, 2012 and 2011, respectively.

The Company capitalized \$0.9 million, \$1.0 million, and \$1.3 million of interest for the years ended December 31, 2012, 2011, and 2010, respectively.

Depreciation and amortization of property and equipment (including concession assets) totaled \$198.8 million, \$186.2 million and \$184.9 million, for 2012, 2011, and 2010, respectively.

**Note 7. Other Balance Sheet Captions**

*Other Current Assets.* Other current assets included the following items at December 31 (*in millions*):

	2012	2011
Refundable taxes	\$ 31.4	\$ 31.8
Prepaid expenses	16.6	25.6
Deferred employees' statutory profit sharing asset	—	11.7
Other	0.4	0.4
Other current assets	<u>\$ 48.4</u>	<u>\$ 69.5</u>

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

*Accounts Payable and Accrued Liabilities.* Accounts payable and accrued liabilities included the following items at December 31 (in millions):

	2012	2011
Accounts payable	\$ 169.1	\$ 206.5
Accrued wages and vacation	71.2	63.7
Derailments, personal injury and other claim provisions	52.7	65.2
Income and other taxes	28.7	11.4
Interest payable	15.5	17.5
Rents and leases payable	12.3	14.3
Other	15.1	22.5
Accounts payable and accrued liabilities	\$ 364.6	\$ 401.1

**Note 8. Fair Value Measurements**

The Company's assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy as described in Note 2 — "Significant Accounting Policies". As of December 31, 2012, the Company's derivative financial instruments are measured at fair value on a recurring basis and consisted of interest rate liabilities of \$0.9 million, which are classified as Level 2. There were no derivative financial instruments outstanding as of December 31, 2011. The Company determines the fair value of its derivative financial instrument positions based upon pricing models using inputs observed from actively quoted markets. Pricing models take into consideration the contract terms as well as other inputs, including forward interest rate curves.

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

The fair value of the Company's debt is estimated using quoted market prices when available. When quoted market prices are not available, fair value is estimated based on current market interest rates for debt with similar maturities and credit quality. The fair value of the Company's debt was \$1,719.9 million and \$1,741.3 million at December 31, 2012 and 2011, respectively. The carrying value was \$1,607.8 million and \$1,639.1 million at December 31, 2012 and 2011, respectively. If the Company's debt was measured at fair value, 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)**

**Note 9. Long-Term Debt**

Long-term debt at December 31 (*in millions*):

	2012	2011
<b>KCSR</b>		
Revolving credit facility, variable interest rate, due 2017	\$ —	\$ 50.0
Term loans, variable interest rate, 1.599% at December 31, 2012, due 2018	543.8	296.3
RRIF loan, 2.96%, due serially to 2037	53.5	—
8.0% senior notes	—	275.0
Capital lease obligations, due serially to 2019	12.1	11.7
Other debt obligations	0.4	0.4
<b>Tex-Mex</b>		
RRIF loan, 4.29%, due serially to 2030	41.0	42.5
<b>KCSM</b>		
Revolving credit facility, variable interest rate, due 2017	—	—
12 1/2% senior notes, due 2016	95.0	94.3
8.0% senior notes, due 2018	296.9	296.5
6 5/8% senior notes, due 2020	185.0	185.0
6 1/8% senior notes, due 2021	200.0	200.0
5.737% financing agreement, due 2023	48.4	52.8
6.195% financing agreement, due 2023	37.4	40.9
9.310% loan agreements, due 2020	81.7	88.1
Capital lease obligations, due serially to 2017	9.8	1.5
Other debt obligations	2.6	3.9
<b>KCS</b>		
Other debt obligations	0.2	0.2
Total	1,607.8	1,639.1
Less: Debt due within one year	60.2	36.3
Long-term debt	\$ 1,547.6	\$ 1,602.8

**KCSR Debt**

*Revolving Credit Facility and Term Loans.* On July 12, 2011, KCS together with KCSR and certain subsidiaries named therein as guarantors (the “Subsidiary Guarantors”), entered into an amended and restated credit agreement (the “2011 KCSR Credit Agreement”) with various lenders. The 2011 KCSR Credit Agreement provided KCSR with (i) a five-and-one-half year \$300.0 million term loan credit facility (the “Term Loan Facility”) and (ii) a five-year \$200.0 million revolving credit facility consisting of a revolving facility up to \$200.0 million (the “Revolving Facility”), a letter of credit facility of \$25.0 million (the “Letter of Credit Facility”) and a swing line facility of up to \$15.0 million (the “Swing Line Facility”). The Letter of Credit Facility and the Swing Line Facility each constitute usage under the Revolving Facility.

On February 24, 2012, KCS, KCSR and certain other subsidiaries of the Company that guaranty the 2011 KCSR Credit Agreement entered into Amendment No. 1 and Additional Term Advance Agreement (“Amendment No. 1”), which provided for additional Term A advances to KCSR in an aggregate principal amount of \$275.0 million (the “Term Loan A-2”) on substantially the same terms as those applicable to the existing Term Loan Facility under the 2011 KCSR Credit Agreement. KCSR borrowed \$175.0 million of the Term Loan A-2 on February 24, 2012 and borrowed the remaining \$100.0 million of

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

Term Loan A-2 on June 1, 2012. The proceeds of the \$275.0 million of borrowings under the Term Loan A-2 and available cash were used to redeem all of KCSR's 8.0% senior unsecured notes due June 1, 2015 (the "8.0% Senior Notes").

On November 21, 2012, KCS, KCSR and certain other subsidiaries of the Company that guaranty the 2011 KCSR Credit Agreement entered into a second amended and restated credit agreement (the "2012 KCSR Credit Agreement"), which eliminated or modified a number of restrictive covenants in KCSR's facilities in order to achieve consistency between KCSR and firms with investment grade credit ratings. The amendment also included a "fall-away collateral" provision whereby KCSR's facilities would convert from secured to unsecured obligations if investment grade senior unsecured debt ratings were assigned by at least two of the three primary rating agencies. On November 21, 2012, subsequent to the closing of the 2012 KCSR Credit Agreement, KCSR's senior unsecured debt rating was upgraded to investment grade by Moody's Investor Service ("Moody's"). This action, combined with investment grade ratings previously assigned to KCSR by Fitch Ratings ("Fitch"), triggered the "fall-away collateral" provision and KCSR facilities became unsecured obligations. In the event that KCSR's senior unsecured debt ratings subsequently fall below investment grade at all three primary rating agencies, collateral would be re-pledged and the facilities would revert to secured obligations. The amendment also incorporates a change in the pricing grid for the Term Loan Facility and the Revolving Facility in the event that KCSR achieves a senior unsecured debt rating of BBB/Baa2 or higher by at least two of the three primary rating agencies. In that event, the floating interest rates paid by KCSR on the Term Loan Facility and the Revolving Facility would thereafter be determined by KCSR's senior unsecured credit rating rather than by KCSR's leverage ratio as is the case currently. Depending on KCSR's credit rating during the life of the 2012 KCSR Credit Agreement, the margin KCSR would pay above the London Interbank Offered Rate ("LIBOR") at any point would be equal to or lower than the currently applicable margin of 1.50%. This provision does not affect the interest rate on the Term Loan A-2, which remains fixed at the LIBOR plus a margin of 1.25% regardless of KCSR's leverage ratio or credit rating. In addition to the amendment, KCSR extended the maturities of its Revolving Facility from July 15, 2016, to November 15, 2017, and the Term Loan Facility and Term Loan A-2 from January 15, 2017 to May 15, 2018. KCSR is required to make quarterly principal payments on the term loan facilities.

KCS and KCSR gave certain representations and warranties that are customary for credit agreements of this type. The 2012 KCSR Credit Agreement also contains affirmative and negative covenants that are customary for credit agreements of this type, including financial maintenance covenants related to a leverage ratio and an interest coverage ratio as defined in the 2012 KCSR Credit Agreement. Similarly, events of default under the 2012 KCSR Credit Agreement are customary for transactions of this type and include, without limitation, non-payment of obligations; breach of any representation or warranty; non-performance of covenants and obligations; default on other indebtedness; certain judgments rendered; a change in control shall occur; bankruptcy or insolvency of KCS, KCSR, any restricted subsidiary or any Subsidiary Guarantor; and an impairment of security (if any). The occurrence of an event of default could result in the acceleration of the repayment of any outstanding principal balance of the term loan facilities and the Revolving Facility.

During the first quarter of 2012, the Company repaid the December 31, 2011 outstanding balance of \$50.0 million on KCSR's revolving credit facility. As of December 31, 2012, KCSR had \$194.7 million available under the Revolving Facility, with no outstanding borrowings and a \$5.3 million standby letter of credit issued and outstanding.

*8.0% Senior Notes.* On May 30, 2008, KCSR issued \$275.0 million principal amount of 8.0% Senior Notes due June 1, 2015, which bore interest semiannually at a fixed annual rate of 8.0%. The 8.0% Senior Notes were redeemable in whole or in part prior to June 1, 2012 by paying the greater of either 101% of the principal amount or the principal amount plus a "make whole" premium and in whole or in part on and after June 1, 2012, at the following redemption prices (expressed as a percentage of principal amount) plus any accrued and unpaid interest: 2012 — 104%, 2013 — 102% and 2014 — 100%.

On January 25, 2012, pursuant to an offer to purchase and related solicitation of consents, KCSR commenced a cash tender offer for all of its \$275.0 million outstanding aggregate principal amount of 8.0% Senior Notes, and a consent solicitation to amend the related indenture (the "Proposed Amendments") to eliminate substantially all of the restrictive covenants contained therein. In conjunction with receiving the requisite consents, on February 13, 2012, the Company entered into the First Supplemental Indenture to effect the Proposed Amendments, which became operative on February 24, 2012.

On February 24, 2012, KCSR purchased \$174.7 million principal amount of the tendered 8.0% Senior Notes in accordance with the terms and conditions of the tender offer set forth in the offer to purchase using the proceeds received under

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

Amendment No. 1 to the 2011 KCSR Credit Agreement, and available cash. On June 1, 2012, KCSR redeemed the remaining \$100.3 million principal amount of the 8.0% Senior Notes using additional proceeds received under Amendment No. 1 to the 2011 KCSR Credit Agreement and cash on hand, at a redemption price of 104% of the principal amount.

*13.0% Senior Notes.* On December 18, 2008, KCSR issued \$190.0 million principal amount of 13.0% senior unsecured notes due December 15, 2013, (the "13.0% Senior Notes") which bore interest semiannually at a fixed annual rate of 13.0%. The 13.0% Senior Notes were issued at a discount to par value, resulting in a \$22.0 million discount and a yield to maturity of 16.5%. On June 4, 2010, the Company redeemed \$66.5 million principal amount of the 13.0% Senior Notes pursuant to a provision which allowed KCSR to redeem up to 35% of the 13.0% Senior Notes at any time prior to December 15, 2010 at par value plus coupon from the proceeds of any sale of capital stock in KCSM or KCS. This followed KCS's offering of 5.8 million shares for net proceeds of \$214.9 million in May 2010. On December 15, 2011, the Company used available cash to redeem all of the outstanding \$123.5 million aggregate principal amount of the 13.0% Senior Notes at a redemption price of 113% of the principal amount.

*KCSR RRIF Loan Agreement.* On February 21, 2012, KCSR, as borrower, entered into a financing agreement with the United States of America represented by the Secretary of Transportation acting through the Administrator of the Federal Railroad Administration ("FRA").

The financing agreement provides KCSR with a 25-year, \$54.6 million loan under the Railroad Rehabilitation and Improvement Financing Program (the "KCSR RRIF Loan"). The proceeds of the KCSR RRIF Loan were used to reimburse KCSR for 80% of the purchase price of thirty new locomotives (the "Locomotives") acquired by KCSR in the fourth quarter of 2011. The outstanding principal balance bears interest at 2.96% per annum. KCSR is required to make quarterly principal and interest payments on the KCSR RRIF Loan commencing March 15, 2012, except for the first payment that was comprised solely of interest accrued from the date the funds were advanced to KCSR, which was February 24, 2012.

The obligations under the financing agreement are secured by a first priority security interest in the Locomotives and certain related rights. In addition, the Company has agreed to guarantee repayment of the amounts due under the financing agreement and certain related agreements.

The financing agreement contains representations, warranties, covenants and events of default that are similar to those contained in other KCSR debt agreements. The occurrence of an event of default could result in the acceleration of the repayment of any outstanding principal balance of the KCSR RRIF Loan.

***Tex-Mex Debt***

*RRIF Loan Agreement.* On June 28, 2005, Tex-Mex entered into an agreement with the FRA to borrow \$50.0 million to be used for infrastructure improvements in order to accommodate growing freight rail traffic related to the NAFTA corridor. The note bears interest at 4.29% annually and the principal balance amortizes quarterly with a final maturity of July 13, 2030. The loan was made under the Railroad Rehabilitation and Improvement Financing Program administered by the FRA. The loan is guaranteed by Mexrail, which has issued a Pledge Agreement in favor of the lender equal to the gross revenues earned by Mexrail on per-car fees on traffic crossing the International Rail Bridge in Laredo, Texas. In addition, the Company has agreed to guarantee the scheduled principal payment installments due to the FRA from Tex-Mex under the loan agreement on a rolling five-year basis.

***KCSM Debt***

*Revolving Credit Facility.* On August 30, 2010, KCSM entered into a secured credit agreement (the "2010 KCSM Credit Agreement") with various lenders and other institutions which provided KCSM with a three-year \$100.0 million revolving credit facility consisting of (i) a revolving facility in an amount up to \$100.0 million (the "2010 Revolving Facility") and, (ii) a letter of credit and a swing line facility in an amount up to \$10.0 million each.

On September 30, 2011, KCSM entered into an amended and restated credit agreement (the "2011 KCSM Credit Agreement") with various financial institutions. The 2011 KCSM Credit Agreement increased the revolving credit facility to

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

\$200.0 million and extended the maturity to September 30, 2016. The 2011 KCSM Credit Agreement included (i) a revolving credit facility up to \$200.0 million (the “KCSM Revolving Facility”), (ii) a letter of credit facility up to \$15.0 million (the “KCSM Letter of Credit Facility”), and (iii) a swing line facility up to \$15.0 million (the “KCSM Swing Line Facility”). The KCSM Letter of Credit Facility and the KCSM Swing Line Facility each constitute usage under the KCSM Revolving Facility.

On November 29, 2012, KCSM entered into an amended and restated credit agreement (the “2012 KCSM Credit Agreement”) with various financial institutions, which amended and restated the 2011 KCSM Credit Agreement and eliminated or modified a number of restrictive covenants in KCSM’s facility in order to achieve consistency between KCSM and firms with investment grade credit ratings. The amendment also included a “fall-away collateral” provision whereby KCSM’s facility would convert from secured to unsecured obligations if investment grade senior unsecured debt ratings were assigned by at least two of the three primary rating agencies. In the event that KCSM’s senior unsecured debt ratings were subsequently to fall below investment grade at all three primary rating agencies, collateral would be re-pledged and the facility would revert to a secured obligation. The amendment also incorporates a change in the pricing grid in the event that KCSM achieves a senior unsecured debt rating of BBB/Baa2 or higher by at least two of the three primary rating agencies. In that event, the floating interest rates paid by KCSM on the 2012 KCSM Credit Agreement would thereafter be determined by KCSM’s senior unsecured credit rating rather than by KCSM’s leverage ratio as is the case currently. Depending on KCSM’s credit rating during the life of the 2012 KCSM Credit Agreement, the margin KCSM would pay above the LIBOR at any point would be equal to or lower than the currently applicable margin of 1.75%. In addition to the amendment, KCSM extended the maturity of the KCSM Revolving Facility to November 15, 2017.

The 2012 KCSM Credit Agreement is currently secured by the accounts receivable and certain locomotives of KCSM and certain of its subsidiaries. In addition, KCSM and certain of its subsidiaries agreed to subordinate payment of certain intercompany debt, certain KCSM subsidiaries guaranteed repayment of the amounts due under the 2012 KCSM Credit Agreement (up to the amount permitted by KCSM’s outstanding indentures) and certain equity interests as defined in the 2012 KCSM Credit Agreement were pledged to secure obligations under the 2012 KCSM Credit Agreement.

The 2012 KCSM Credit Agreement contains certain representations and warranties that are customary for credit agreements of this type. The 2012 KCSM Credit Agreement also contains affirmative and negative covenants that are customary for credit agreements of this type, including financial maintenance covenants related to a leverage ratio and an interest coverage ratio as defined in the 2012 KCSM Credit Agreement. Similarly, events of default under the 2012 KCSM Credit Agreement include, but are not limited to, certain payment defaults; breach of any representation or warranty; non-performance of covenants and obligations; default on other indebtedness; certain judgments rendered; restrictions or requirements limiting the availability or the transfer of foreign exchange; a change in control; bankruptcy or insolvency of KCSM and certain subsidiaries and obligors; an impairment of security; the failure of subordination; certain actions by a governmental authority; failure to obtain certain consents; and termination of the concession title. The occurrence of an event of default could result in the acceleration of the repayment of any outstanding principal balance of the KCSM Revolving Facility.

As of December 31, 2012 and 2011, KCSM had no outstanding amount under the KCSM Revolving Facility.

*12<sup>1</sup>/<sub>2</sub>% Senior Notes.* On March 30, 2009, KCSM issued \$200.0 million principal amount of 12<sup>1</sup>/<sub>2</sub>% senior unsecured notes due April 1, 2016 (the “12<sup>1</sup>/<sub>2</sub>% Senior Notes”), which bear interest semiannually at a fixed annual rate of 12<sup>1</sup>/<sub>2</sub>%. The 12<sup>1</sup>/<sub>2</sub>% Senior Notes were issued at a discount to par value, resulting in an \$11.0 million discount and a yield to maturity of 13<sup>3</sup>/<sub>4</sub>%. KCSM used a portion of the net proceeds from the offering to repay all amounts outstanding under a credit agreement KCSM entered into on June 14, 2007. The 12<sup>1</sup>/<sub>2</sub>% Senior Notes are redeemable at KCSM’s option in whole or in part on and after April 1, 2013, at the following redemption prices (expressed as percentages of principal amount) plus any accrued and unpaid interest: 2013 — 106.250%, 2014 — 103.125% and 2015 — 100.000%. In addition, the notes are redeemable, in whole but not in part, at KCSM’s option at their principal amount, plus any accrued and unpaid interest, in the event of certain changes in the Mexican withholding tax rate.

On June 4, 2010, the Company redeemed \$70.0 million principal amount of the 12<sup>1</sup>/<sub>2</sub>% Senior Notes pursuant to a provision which allowed KCSM to redeem up to 35% of the 12<sup>1</sup>/<sub>2</sub>% Senior Notes any time prior to April 1, 2012 at par value plus coupon from the proceeds of any sale of capital stock in KCSM or KCS. This followed KCS’s offering of 5.8 million

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

shares of common stock for net proceeds of \$214.9 million in May 2010. On November 2, 2010, pursuant to an offer to purchase, KCSM commenced a cash tender offer for its 12<sup>1</sup>/<sub>2</sub>% Senior Notes. On December 20, 2010, KCSM purchased \$31.9 million principal amount of the tendered 12<sup>1</sup>/<sub>2</sub>% Senior Notes in accordance with the terms and conditions of the tender offer set forth in the offer to purchase using the proceeds received from the issuance of \$185.0 million principal amount of KCSM 6<sup>5</sup>/<sub>8</sub>% senior unsecured notes due December 15, 2020 (the “6<sup>5</sup>/<sub>8</sub>% Senior Notes”).

*KCSM 8.0% Senior Notes.* On January 22, 2010, KCSM issued \$300.0 million principal amount of 8.0% senior unsecured notes due February 1, 2018 (the “KCSM 8.0% Senior Notes”), which bear interest semiannually at a fixed annual rate of 8.0%. The KCSM 8.0% Senior Notes were issued at a discount to par value, resulting in a \$4.3 million discount and a yield to maturity of 8<sup>1</sup>/<sub>4</sub>%. KCSM used the net proceeds from the issuance of the KCSM 8.0% Senior Notes and available cash to purchase \$290.0 million principal amount of the 9<sup>3</sup>/<sub>8</sub>% senior unsecured notes due May 1, 2012 tendered under an offer to purchase and pay all fees and expenses incurred in connection with the KCSM 8.0% Senior Notes offering and the tender offer. The KCSM 8.0% Senior Notes are redeemable at KCSM’s option, in whole or in part, on and after February 1, 2014, at the following redemption prices (expressed as percentages of principal amount) plus any accrued and unpaid interest: 2014 — 104.000%, 2015 — 102.000%, 2016 and thereafter — 100.000%. In addition, KCSM may redeem up to 35% of the KCSM 8.0% Senior Notes any time prior to February 1, 2013 at par value plus coupon from the proceeds of the sale of capital stock in KCSM or KCS. In addition, the notes are redeemable, in whole but not in part, at KCSM’s option at their principal amount, plus any accrued and unpaid interest, in the event of certain changes in the Mexican withholding tax rate.

*6<sup>5</sup>/<sub>8</sub>% Senior Notes.* On December 20, 2010, KCSM issued the 6<sup>5</sup>/<sub>8</sub>% Senior Notes due December 15, 2020, which bear interest semiannually at a fixed annual rate of 6<sup>5</sup>/<sub>8</sub>%. KCSM used the net proceeds from the issuance of the 6<sup>5</sup>/<sub>8</sub>% Senior Notes and available cash to purchase \$142.6 million principal amount of the 7<sup>5</sup>/<sub>8</sub>% senior unsecured notes due December 1, 2013 (the “7<sup>5</sup>/<sub>8</sub>% Senior Notes”) and \$31.9 million principal amount of the 12<sup>1</sup>/<sub>2</sub>% Senior Notes tendered under an offer to purchase and pay all fees and expenses incurred in connection with the 6<sup>5</sup>/<sub>8</sub>% Senior Notes offering and the tender offers. The 6<sup>5</sup>/<sub>8</sub>% Senior Notes are redeemable at KCSM’s option, in whole or in part prior to December 15, 2015, by paying the greater of either 101% of the principal amount or the principal amount plus a “make whole” premium and in whole or in part on or after December 15, 2015, at the following redemption prices (expressed as percentages of principal amount) plus any accrued and unpaid interest: 2015 — 103.313%, 2016 — 102.208%, 2017 — 101.104%, 2018 and thereafter — 100.000%. In addition, KCSM may redeem up to 35% of the 6<sup>5</sup>/<sub>8</sub>% Senior Notes at a redemption price equal to 106.625% any time prior to December 15, 2013 at par value plus coupon from the proceeds of the sale of capital stock in KCSM or KCS. In addition, the notes are redeemable, in whole but not in part, at KCSM’s option at their principal amount, plus any accrued and unpaid interest, in the event of certain changes in the Mexican withholding tax rate.

*6<sup>1</sup>/<sub>8</sub>% Senior Notes.* On May 20, 2011, KCSM issued \$200.0 million principal amount of 6<sup>1</sup>/<sub>8</sub>% senior unsecured notes due June 15, 2021 (the “6<sup>1</sup>/<sub>8</sub>% Senior Notes”) at par, which bear interest semiannually at a fixed annual rate of 6<sup>1</sup>/<sub>8</sub>%. KCSM used the proceeds from the issuance of the 6<sup>1</sup>/<sub>8</sub>% Senior Notes and available cash to purchase and redeem the outstanding \$165.0 million principal amount of 7<sup>3</sup>/<sub>8</sub>% senior unsecured notes due June 1, 2014 and the remaining \$32.4 million principal amount of the 7<sup>5</sup>/<sub>8</sub>% Senior Notes, and pay all fees and expenses incurred in connection with the 6<sup>1</sup>/<sub>8</sub>% Senior Notes offering and the tender offers. The 6<sup>1</sup>/<sub>8</sub>% Senior Notes are redeemable at KCSM’s option, in whole or in part prior to June 15, 2016, by paying the greater of either 101% of the principal amount or the principal amount plus a “make whole” premium and in whole or in part on or after June 15, 2016, at the following redemption prices (expressed as percentages of principal amount) if redeemed during the 12-month period commencing on June 15 of the following years, plus any accrued and unpaid interest to the date of redemption: 2016 — 103.063%, 2017 — 102.042%, 2018 — 101.021%, 2019 and thereafter — 100.000%. In addition, KCSM may redeem up to 35% of the 6<sup>1</sup>/<sub>8</sub>% Senior Notes at a redemption price equal to 106.125% any time prior to June 15, 2014 from the proceeds of the sale of KCSM’s capital stock or the capital stock of KCS. In addition, the notes are redeemable, in whole but not in part, at KCSM’s option at their principal amount, plus any accrued and unpaid interest in the event of certain changes in the Mexican withholding tax rate.

All of KCSM’s senior notes described above are denominated in dollars, are unsecured, unsubordinated obligations, rank pari passu in right of payment with KCSM’s existing and future unsecured, unsubordinated obligations, and are senior in right of payment to KCSM’s future subordinated indebtedness. In addition, KCSM’s senior notes include certain covenants which are customary for these types of debt instruments issued by borrowers with similar credit ratings and restrict or prohibit certain



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### Notes to Consolidated Financial Statements-(Continued)

actions. Certain of these covenants no longer apply if KCSM's senior notes are assigned an investment grade rating by both Moody's Investors Service and Standard & Poor's Rating Services.

#### ***KCSM Locomotive Financing***

***5.737% Financing Agreement.*** On February 26, 2008, KCSM entered into a financing agreement with Export Development Canada ("EDC") for an aggregate principal amount of \$72.8 million. KCSM used the proceeds to finance 85.0% of the purchase price of forty new SD70ACe locomotives purchased by KCSM in late 2007 and early 2008. KCSM granted EDC a security interest in the locomotives to secure the loan. The financing agreement requires KCSM to make thirty equal semi-annual principal payments of approximately \$2.4 million plus interest at an annual rate of 5.737%, with the final payment due and payable on February 28, 2023.

***6.195% Financing Agreement.*** On September 24, 2008, KCSM entered into a financing agreement with DVB Bank AG ("DVB") for an aggregate principal amount of \$52.2 million. KCSM used the proceeds to finance approximately 80% of the purchase price of twenty-nine ES44AC locomotives purchased by KCSM in June 2008. KCSM granted DVB a security interest in the locomotives to secure the loan. The financing agreement requires KCSM to make sixty equal quarterly principal payments plus interest at an annual rate of 6.195%, with the final payment due and payable on September 29, 2023.

***9.310% Loan Agreements.*** On September 1, 2011, KCSM, as borrower, entered into five Loan Agreements (each a "Loan Agreement", and collectively, the "Loan Agreements") with General Electric Capital Corporation, as lender ("GE"), each with a principal amount of approximately \$18.2 million. KCSM used the loan proceeds to finance approximately 88% of the purchase price of seventy-five GE AC4400 CW locomotives (the "Locomotives") purchased by KCSM from GE on September 1, 2011. The Locomotives were previously leased by KCSM from GE pursuant to a Lease Agreement dated April 30, 1998. The Lease Agreement, which had been accounted for as an operating lease, was terminated with the purchase of the Locomotives by KCSM. To secure the loans from GE, KCSM transferred legal ownership of the Locomotives to five irrevocable trusts established by KCSM to which GE is the primary beneficiary and KCSM has a right of reversion upon satisfaction of the obligations of the Loan Agreements.

Each Loan Agreement requires KCSM to make thirty-eight quarterly principal payments plus interest at an annual rate of 9.31%, which approximates the implicit interest rate in the Lease Agreement. KCSM generated certain tax benefits as a result of purchasing the locomotives. The first payments were due and payable on September 15, 2011, and the final payments are due and payable on December 15, 2020.

KCSM's locomotive financing agreements contain representations, warranties and covenants typical of such equipment loan agreements. Events of default in the financing agreements include, but are not limited to, certain payment defaults, certain bankruptcy and liquidation proceedings and the failure to perform any covenants or agreements contained in the financing agreements. Any event of default could trigger acceleration of KCSM's payment obligations under the terms of the financing agreements.

#### ***Debt Covenants Compliance***

The Company was in compliance with all of its debt covenants as of December 31, 2012.

#### ***Other Debt Provisions***

***Change in Control Provisions.*** Certain loan agreements and debt instruments entered into or guaranteed by the Company and its subsidiaries provide for default in the event of a specified change in control of the Company or particular subsidiaries of the Company.

#### ***Leases and Debt Maturities***

The Company leases transportation equipment, as well as office and other operating facilities, under various capital and operating leases. Rental expenses under operating leases were \$108.8 million, \$120.6 million, and \$127.1 million for the years ended December 31, 2012, 2011, and 2010, respectively. Operating leases that contain scheduled rent adjustments are

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

recognized on a straight-line basis over the term of the lease. Contingent rentals and sublease rentals were not significant. Minimum annual payments and present value thereof under existing capital leases, other debt maturities and minimum annual rental commitments under non-cancelable operating leases are as follows (*in millions*):

Years	Capital Leases				Operating Leases			
	Long-Term Debt	Minimum Lease Payments	Less Interest	Net Present Value	Total Debt	Southern Capital	Third Party	Total
2013	\$ 55.6	\$ 5.7	\$ 1.1	\$ 4.6	\$ 60.2	\$ 14.5	\$ 103.8	\$ 118.3
2014	77.9	4.9	0.9	4.0	81.9	13.8	95.7	109.5
2015	84.7	5.1	0.8	4.3	89.0	13.5	75.3	88.8
2016	202.2	4.6	0.6	4.0	206.2	11.5	63.9	75.4
2017	108.2	2.3	0.3	2.0	110.2	8.3	56.2	64.5
Thereafter	1,057.3	3.2	0.2	3.0	1,060.3	38.7	220.5	259.2
Total	<u>\$ 1,585.9</u>	<u>\$ 25.8</u>	<u>\$ 3.9</u>	<u>\$ 21.9</u>	<u>\$ 1,607.8</u>	<u>\$ 100.3</u>	<u>\$ 615.4</u>	<u>\$ 715.7</u>

In the normal course of business, the Company enters into long-term contractual requirements for future goods and services needed for the operations of the business. Such commitments are not in excess of expected requirements and are not reasonably likely to result in performance penalties or payments that would have a material adverse effect on the Company's liquidity.

**Note 10. Income Taxes**

Current income tax expense represents the amounts expected to be reported on the Company's income tax returns, and deferred tax expense or benefit represents the change in net deferred tax assets and liabilities. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. Valuation allowances are recorded as appropriate to reduce deferred tax assets to the amount considered likely to be realized.

*Tax Expense.* Income tax expense consists of the following components (*in millions*):

	2012	2011	2010
<i>Current:</i>			
Federal	\$ 2.8	\$ —	\$ —
State and local	0.7	0.7	1.0
Foreign	36.2	1.7	2.0
Total current	<u>39.7</u>	<u>2.4</u>	<u>3.0</u>
<i>Deferred:</i>			
Federal	99.2	78.0	66.4
State and local	(7.4)	4.5	6.7
Foreign	105.5	38.2	33.1
Total deferred	<u>197.3</u>	<u>120.7</u>	<u>106.2</u>
Total income tax expense	<u>\$ 237.0</u>	<u>\$ 123.1</u>	<u>\$ 109.2</u>

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

Income before income taxes consists of the following (*in millions*):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
<i>Income before income taxes:</i>			
U.S.	\$ 282.8	\$ 231.0	\$ 193.2
Foreign	333.6	224.0	96.0
Total income before income taxes	<u>\$ 616.4</u>	<u>\$ 455.0</u>	<u>\$ 289.2</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities follow at December 31 (*in millions*):

	<u>2012</u>	<u>2011</u>
<i>Liabilities:</i>		
Depreciation and amortization	\$ 902.9	\$ 849.8
Investments	73.8	75.3
Other, net	6.0	7.5
Gross deferred tax liabilities	<u>982.7</u>	<u>932.6</u>
<i>Assets:</i>		
Loss carryovers	(54.3)	(189.7)
Book reserves not currently deductible for tax	(77.1)	(94.7)
Other, net	(53.5)	(27.3)
Gross deferred tax assets before valuation allowance	<u>(184.9)</u>	<u>(311.7)</u>
Valuation allowance	4.3	15.5
Net deferred tax assets	<u>(180.6)</u>	<u>(296.2)</u>
Net deferred tax liability	<u>\$ 802.1</u>	<u>\$ 636.4</u>

*Tax Rates.* Differences between the Company's effective income tax rate and the U.S. federal statutory income tax rate of 35% follow (*in millions*):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Income tax expense using the statutory rate in effect	\$ 215.7	\$ 159.3	\$ 101.2
Tax effect of:			
Difference between U.S. and foreign tax rate	(18.4)	(14.5)	(8.4)
Foreign exchange and inflation adjustments	42.3	(23.5)	22.6
State and local income tax provision, net	8.4	7.0	6.6
Change in valuation allowances	(11.2)	(1.6)	(9.9)
Tax credits	(3.1)	(2.3)	(2.3)
Uncertain tax positions	1.9	—	—
Other, net	1.4	(1.3)	(0.6)
Income tax expense	<u>\$ 237.0</u>	<u>\$ 123.1</u>	<u>\$ 109.2</u>
Effective tax rate	<u>38.4%</u>	<u>27.1%</u>	<u>37.8%</u>

## Kansas City Southern

### Notes to Consolidated Financial Statements-(Continued)

*Difference Attributable to Foreign Investments.* At December 31, 2012, the Company's book basis exceeded the tax basis of its foreign investments by \$1,187.3 million. The Company has not provided a deferred income tax liability for the income taxes, if any, which might become payable on the realization of this basis difference because the Company intends to indefinitely reinvest in foreign investments the operating earnings which gave rise to the basis differential or remit the earnings in tax-free transactions. Moreover, the Company has no other plans to realize this basis differential by a sale of its interests in foreign investments. If the earnings were to be remitted in a taxable transaction, as of December 31, 2012, the Company would incur gross federal income taxes of \$415.5 million which would be partially offset by foreign tax credits.

*Changes in Tax Law.* On December 17, 2012, changes to the Mexican Federal Income Tax Law were approved. The 30% income tax rate used in 2012 will remain applicable for 2013. The planned income tax rate reduction has been postponed one year with 29% starting in 2014 and 28% in 2015. The Company's deferred income tax assets and liabilities were revalued using the rates expected to be in effect when the underlying temporary differences are expected to reverse. This revaluation was immaterial to the 2012 tax provision.

*Tax Carryovers.* The Company has both U.S. federal and state net operating losses which are carried forward 20 years for federal tax purposes and from 5 to 20 years for state tax purposes. Both the federal and state loss carryovers are analyzed each year to determine the likelihood of realization. The U.S. federal loss carryover at December 31, 2012, was \$10.7 million and if not used, would begin to expire in 2023. Prior year federal loss carryovers of \$73.5 million not recognized in the consolidated financial statements as of December 31, 2011, due to a limitation on recognizing excess tax benefits related to share-based compensation have all been recognized in the consolidated financial statements as of December 31, 2012. The Company has \$29.4 million of tax credit carryovers consisting primarily of \$22.6 million of track maintenance credits which, if not used, will begin to expire in 2024, and \$1.5 million of alternative minimum tax credits which do not expire.

The state loss carryovers arise from both combined and separate tax filings from as early as 1997. The loss carryovers may expire as early as December 31, 2013 and as late as December 31, 2031. The state loss carryover at December 31, 2012, was \$391.4 million.

The valuation allowance for deferred tax assets as of December 31, 2012, was \$4.3 million, a decrease of \$11.2 million as compared to \$15.5 million as of December 31, 2011. The decrease primarily reflects a release of valuation allowance related to state net operating loss carryovers.

The Mexico federal loss carryovers at December 31, 2012, were \$117.5 million and will begin to expire in 2015. A deferred tax asset was recorded in prior periods for the expected future tax benefit of these losses which will be carried forward to reduce only ordinary Mexican income tax payable in future years. A deferred tax asset is also recorded for an asset tax credit carryover in the amount of \$6.8 million which will begin to expire in 2017.

The Company believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets, net of valuation allowances, related to loss carryovers and tax credits.

*Uncertain Tax Positions.* The accounting guidance for uncertainty in income taxes prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The guidance requires the Company to recognize in the consolidated financial statements the benefit of a tax position only if the impact is more likely than not of being sustained on audit based on the technical merits of the position. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (*in millions*):

	2012	2011
Balance at January 1,	\$ 1.7	\$ 1.7
Additions based on tax positions related to the current year	0.9	—
Additions for tax positions of prior years	1.0	—
Balance at December 31,	\$ 3.6	\$ 1.7

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

All of the unrecognized tax benefits would affect the effective income tax rate if recognized and is not expected to significantly change in the next twelve months.

Interest and penalties related to uncertain tax positions are included in income before taxes on the consolidated statements of income. Accrued interest and penalties on unrecognized tax benefits and interest and penalty expense was immaterial to the consolidated financial statements for all periods presented.

Tax years after 2008 remain open to examination by the IRS. State income tax returns generally remain open to examination for three to four years following the filing of the return.

During 2012, the 2004 KCSM tax return audit was completed without adjustment. Tax returns filed for periods after 2006 remain open to examination by the taxing authorities. The Company received audit assessments for KCSM for the year ended December 31, 2005, and NAFTA Rail, S.A. de C.V. for the year ended December 31, 2009, from the Servicio de Administracion Tributaria (the "SAT"), the Mexican equivalent of the IRS. The Company will initiate administrative proceedings with the SAT and if settlements are not reached, the matters will be litigated. The Company believes that it has strong legal arguments in its favor and more likely than not will prevail in any challenges of the assessments.

The Company believes that an adequate provision has been made for any adjustment (taxes and interest) that will be due for all open years. However, an unexpected adverse resolution could have a material effect on the consolidated financial statements in a particular quarter or fiscal year.

**Note 11. Stockholders' Equity**

Information regarding the Company's capital stock at December 31 follows:

	Shares Authorized		Shares Issued	
	2012	2011	2012	2011
\$25 par, 4% noncumulative, preferred stock	840,000	840,000	649,736	649,736
\$1 par, preferred stock	2,000,000	2,000,000	—	—
\$.01 par, common stock	400,000,000	400,000,000	123,352,185	123,352,185

Shares outstanding at December 31:

	2012	2011
\$25 par, 4% noncumulative, preferred stock	242,170	242,170
\$.01 par, common stock	110,131,353	109,910,857

*Treasury Stock.* Shares of common stock in Treasury and related activity follow:

	2012	2011	2010
Balance at beginning of year	13,441,328	13,703,453	14,369,722
Shares issued to fund stock option exercises	(141,728)	(158,440)	(480,514)
Employee stock purchase plan shares issued	(44,319)	(59,390)	(110,850)
Nonvested shares issued	(56,136)	(57,659)	(143,457)
Nonvested shares forfeited	21,687	13,364	68,552
Balance at end of year	<u>13,220,832</u>	<u>13,441,328</u>	<u>13,703,453</u>

## Kansas City Southern

### Notes to Consolidated Financial Statements-(Continued)

*Conversion of Cumulative Convertible Perpetual Preferred Stock, Series D.* On December 9, 2005, KCS completed the sale and issuance of 210,000 shares of its 5.125% Series D Convertible Preferred Stock, par value \$1.00 per share ("Series D Preferred Stock"). Each share of Series D Preferred Stock was convertible into 33.3333 shares of KCS common stock, subject to certain adjustments. Dividends on the Series D Preferred Stock were cumulative and payable quarterly in any combination of cash and KCS common stock, as declared by the KCS Board of Directors, at the rate of 5.125% per annum of the liquidation preference of \$1,000. During the first quarter of 2011, the Company converted all of the remaining outstanding 209,995 shares of the Series D Preferred Stock into 6,999,887 shares of KCS common stock. On May 5, 2011, the Company's Restated Certificate of Incorporation was amended to eliminate the Series D Preferred Stock and change the status to undesignated preferred stock of the Company.

*Common Stock Issuance.* On May 4, 2010, the Company completed a public offering of 5,769,230 shares of its common stock at a price of \$39.00 per share. The Company received net proceeds of approximately \$214.9 million after deducting offering expenses, underwriting discounts and commissions.

*Change in Control Provisions.* The Company and certain of its subsidiaries have entered into agreements with employees whereby, upon defined circumstances constituting a change in control of the Company or subsidiary, certain stock options become exercisable, certain benefit entitlements are automatically funded and such employees are entitled to specified cash payments upon termination of employment.

The Company and certain of its subsidiaries have established trusts to provide for the funding of corporate commitments and entitlements of officers, directors, employees and others in the event of a specified change in control of the Company or subsidiary. Assets held in such trusts on December 31, 2012 and 2011, were not material. Depending upon the circumstances at the time of any such change in control, the most significant factor of which would be the highest price paid for KCS common stock by a party seeking to control the Company, funding of the Company's trusts could be substantial.

*Accumulated Other Comprehensive Loss.* The following table summarizes the changes in the after-tax balances of each component of accumulated other comprehensive loss (in millions):

	Postemployment Benefits	Foreign Currency Translation Adjustment	Unrealized Loss on Cash Flow Hedges	Accumulated Other Comprehensive Loss
Balance at December 31, 2010	\$ 0.7	\$ (1.9)	\$ (0.2)	\$ (1.4)
Other comprehensive income (loss)	(0.2)	(0.8)	0.2	(0.8)
Balance at December 31, 2011	0.5	(2.7)	—	(2.2)
Other comprehensive income (loss)	(0.1)	0.5	(0.6)	(0.2)
Balance at December 31, 2012	<u>\$ 0.4</u>	<u>\$ (2.2)</u>	<u>\$ (0.6)</u>	<u>\$ (2.4)</u>

#### Note 12. Share-Based Compensation

On October 7, 2008, the Company's stockholders approved the Kansas City Southern 2008 Stock Option and Performance Award Plan (the "2008 Plan"). The 2008 plan became effective on October 14, 2008 and replaced the Kansas City Southern 1991 Amended and Restated Stock Option and Performance Award Plan (the "1991 Plan"). The 2008 Plan provides for the granting of up to 2.3 million shares of the Company's common stock to eligible persons as defined in the 2008 Plan. Outstanding equity awards granted under the 1991 Plan and the 2008 Plan (the "Plans") are to be governed by the terms and conditions of each individual plan and the related award agreements.

*Stock Options.* The exercise price for the options granted under the 2008 Plan is at 100% of the closing market price of the Company's stock on the date of grant. Under the 1991 Plan, options were granted at 100% of the average market price of the Company's stock on the date of grant. Options generally have either a 3 or 5 year cliff vesting period and are exercisable over the 10 year contractual term, except that options outstanding become immediately exercisable upon certain defined

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

circumstances constituting a change in control of the Company. The grant date fair value, less estimated forfeitures, is recorded to expense on a straight-line basis over the vesting period.

On March 1, 2010, the Company granted 190,300 stock option market-based awards under the 2008 Plan. The market-based award contained a market condition that accelerated the vesting in three tranches if the closing price of the Company's common stock was above \$38.95, \$42.85 or \$47.14 for a period of thirty consecutive trading days. The first two target prices of \$38.95 and \$42.85 were met in the fourth quarter of 2010 and the remaining target price of \$47.14 was met in January 2011.

The fair value of each option award subject only to service conditions granted in 2012 and 2011 is estimated on the date of grant using the Black-Scholes option pricing model. The fair value and service period of stock option market-based awards granted in 2010 was estimated on the date of grant using the Monte Carlo simulation model. The weighted-average assumptions used were as follows:

	2012	2011	2010
Expected dividend yield	0%	0%	0%
Expected volatility	46.59%	45.40%	43.43%
Risk-free interest rate	0.46%	1.29%	2.83%
Expected term ( <i>years</i> )	6.0	6.0	6.5
Weighted-average grant date fair value of stock options granted	\$ 29.45	\$ 23.39	\$ 15.96

The expected dividend yield for 2012 was 0% as all stock options were granted prior to the initial dividend declaration on March 30, 2012. The expected volatility is based on the historical volatility of the Company's stock price over a term equal to the estimated life of the options. The risk-free interest rate is determined based on U.S. Treasury rates for instruments with terms approximating the expected life of the options granted, which represents the period of time the awards are expected to be outstanding and is based on the historical experience of similar awards.

The following table summarizes the stock option activity under the Plans:

	Number of Shares	Weighted- Average Exercise Price Per Share	Weighted- Average Remaining Contractual Term  In years	Aggregate Intrinsic Value  In millions
Options outstanding at December 31, 2011	501,636	\$ 29.81		
Granted	69,552	66.99		
Exercised	(201,704)	17.12		
Forfeited or expired	(1,413)	59.87		
Options outstanding at December 31, 2012	368,071	\$ 43.67	6.97	\$ 14.7
Vested and expected to vest at December 31, 2012	363,782	\$ 43.55	6.96	\$ 14.5
Exercisable at December 31, 2012	222,486	\$ 34.43	6.09	\$ 10.9

Compensation cost of \$1.8 million, \$2.2 million, and \$2.7 million was recognized for stock option and market-based option awards for the years ended December 31, 2012, 2011, and 2010, respectively. The total income tax benefit recognized in the consolidated statements of income was \$0.7 million, \$0.8 million, and \$1.0 million for the years ended December 31, 2012, 2011 and 2010, respectively.

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

Additional information regarding stock option exercises appears in the table below (*in millions*):

	2012	2011	2010
Aggregate grant-date fair value of stock options vested	\$ 1.3	\$ 1.1	\$ 2.0
Intrinsic value of stock options exercised	12.1	9.5	21.7
Cash received from option exercises	1.9	2.1	2.1
Tax benefit realized from options exercised during the annual period	4.6	0.2	1.2

As of December 31, 2012, \$1.2 million of unrecognized compensation cost relating to nonvested stock options is expected to be recognized over a weighted-average period of 1.0 year. At December 31, 2012, there were 1,331,896 shares available for future grants under the 2008 Plan.

*Nonvested Stock.* The Plans provide for the granting of nonvested stock awards to officers and other designated employees. The grant date fair value is based on the average market price of the stock (under the 1991 Plan) or the closing market price (under the 2008 Plan) on the date of the grant. These awards are subject to forfeiture if employment terminates during the vesting period, which is generally 3 year or 5 year cliff vesting for employees and 1 year for directors. The grant date fair value of nonvested shares, less estimated forfeitures, is recorded to compensation expense on a straight-line basis over the vesting period.

A summary of nonvested stock activity is as follows:

	Number of Shares	Weighted- Average Grant Date Fair Value	Aggregate Intrinsic Value  In millions
Nonvested stock at December 31, 2011	318,412	\$ 41.08	
Granted	87,146	70.98	
Vested	(104,904)	42.53	
Forfeited	(21,687)	47.54	
Nonvested stock at December 31, 2012	<u>278,967</u>	<u>\$ 49.37</u>	<u>\$ 23.3</u>

The fair value (at vest date) of shares vested during the years ended December 31, 2012, 2011, and 2010 was \$7.8 million, \$9.9 million, and \$15.2 million, respectively.

The weighted-average grant date fair value of nonvested stock granted during 2012, 2011 and 2010 was \$70.98, \$54.74 and \$36.24, respectively. Compensation cost for nonvested stock was \$4.4 million, \$4.7 million, and \$5.6 million for the years ended December 31, 2012, 2011, and 2010, respectively. The total income tax benefit recognized in the consolidated statements of income was \$1.6 million, \$1.7 million, and \$2.1 million for the years ended December 31, 2012, 2011, and 2010, respectively.

As of December 31, 2012, \$6.6 million of unrecognized compensation costs related to nonvested stock is expected to be recognized over a weighted-average period of 1.5 years.

*Performance Based Awards.* The Company granted performance based nonvested stock awards during 2012 (the "2012 Awards") and 2011 ("the 2011 Awards"). The awards granted provide a target number of shares that generally vest at the end of a 3 year requisite service period following the grant date. In addition to the service condition, the number of nonvested shares to be received depends on the attainment of defined Company-wide performance goals based on operating ratio and return on invested capital over a three-year performance period for 2012 Awards and annual performance periods for the 2011 Awards. The number of nonvested shares ultimately earned will range between zero to 200% of the target award.



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

A summary of performance based nonvested stock activity at target is as follows:

	Target Number of Shares *	Weighted-Average Grant Date Fair Value
Nonvested stock, at December 31, 2011	25,160	\$ 52.66
Granted	86,302	62.81
Vested	(417)	52.62
Forfeited	(2,466)	61.26
Nonvested stock, at December 31, 2012	108,579	\$ 60.54

\* For the 2012 Awards, participants in the aggregate can earn up to a maximum of 119,342 shares. For the 2011 Awards, the performance shares earned in 2012 and 2011 were 48,898 and 47,995 which was approximately 200% and 193% of the annual target award granted for the 2012 and 2011 performance periods, respectively. For the 2013 performance period, participants in the aggregate can earn up to a maximum of 48,884 shares.

The weighted-average grant date fair value of performance based nonvested stock granted during 2012 and 2011 was \$62.81 and \$52.66, respectively. The Company expenses the grant date fair value of the awards which are probable of being earned over the performance periods. Compensation cost on performance based awards was \$4.0 million and \$1.2 million for the years ended December 31, 2012 and 2011, respectively. Total income tax benefit recognized in the consolidated statements of income for performance based awards was \$1.5 million and \$0.4 million for the years ended December 31, 2012 and 2011, respectively.

As of December 31, 2012, \$3.8 million of unrecognized compensation cost related to performance based awards is expected to be recognized over a weighted-average period of 0.9 year.

*Employee Stock Purchase Plan.* The employee stock purchase plan (“ESPP”) provides substantially all full-time employees of the Company, certain subsidiaries and certain other affiliated entities, with the right to subscribe to an aggregate of four million shares of common stock of the Company. Under the ESPP, eligible employees may contribute, through payroll deductions, up to 5% of their regular base compensation during six-month purchase periods. At the end of each purchase period, the accumulated deductions are applied toward the purchase of the Company’s common stock.

Pursuant to the terms of the ESPP, the purchase price for shares is equal to 90% of the closing market price on either the exercise date or the offering date, whichever is lower. Both the 10% discount in grant price and the 90% share option are valued to derive the award’s fair value. The awards vest and the expense is recognized ratably over the offering period.

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

The following table summarizes activity related to the various ESPP offerings:

	Exercise Date			Received from Employees(i)  In millions
	Date Issued	Purchase Price	Shares Issued	
July 2012 offering	January 14, 2013	\$ 61.73	23,099	\$ 1.4
January 2012 offering	July 13, 2012	61.84	21,559	1.3
July 2011 offering	January 13, 2012	54.55	22,760	1.2
January 2011 offering	July 14, 2011	43.76	27,170	1.2
July 2010 offering	January 14, 2011	32.49	32,220	1.0
January 2010 offering	July 14, 2010	29.63	30,670	0.9

(i) Represents amounts received from employees through payroll deductions for share purchases under applicable offering.

The fair value of the ESPP stock purchase rights is estimated on the date of grant using the Black-Scholes option pricing model. The weighted-average assumptions used for each of the respective periods were as follows:

	Year Ended December 31,		
	2012	2011	2010
Expected dividend yield	0.59%	0%	0%
Expected volatility	28.97%	22.72%	31.00%
Risk-free interest rate	0.14%	0.18%	0.21%
Expected term (years)	0.5	0.5	0.5
Weighted-average grant date fair value	\$ 12.40	\$ 8.87	\$ 6.46

Compensation expense of \$0.5 million, \$0.4 million, and \$0.4 million was recognized for ESPP option awards for the years ended December 31, 2012, 2011, and 2010, respectively. At December 31, 2012, there were 3.8 million remaining shares available for future ESPP offerings under the plan.

**Note 13. Postemployment Benefits**

*Health and Welfare.* Certain U.S. employees that have met age and service requirements are eligible for medical benefits and life insurance coverage during retirement. The retiree medical plan is contributory and provides benefits to retirees, their covered dependents and beneficiaries. The plan provides for annual adjustments to retiree contributions, and also contains, depending on the coverage selected, certain deductibles, co-payments, co-insurance, and coordination with Medicare. Certain management employees also maintain their status under a collective bargaining agreement, which permits them access to post-retirement medical under the multi-employer plan described below. The life insurance plan is non-contributory and covers union retirees only. The Company's policy, in most cases, is to fund benefits payable under these plans as the obligations become due.

*Postemployment Benefits.* Mexican law requires that the Company provide certain postemployment benefits to its Mexican union and non-union employees. These plans provide statutorily calculated benefits which are payable upon retirement, death, disability, voluntary or involuntary termination of employees based on length of service.

During September 2010, the Company completed negotiations with the Mexican labor union. Among other matters resolved in these negotiations, the Company is not required to provide an incremental benefit to its union employees upon retirement. Previous to the agreement reached with the Mexican labor union, the Company had recorded a liability for an

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

incremental retirement benefit which was based on various factors including retirement eligibility based on a combination of age and years of credited service and the employee's salary at the time of retirement. The Company has no legal obligation to fund any benefit previously calculated under these factors.

The Company uses December 31 as the measurement date for its postemployment benefit obligations.

**Net Periodic Benefit Cost, Plan Obligations and Funded Status**

Components of the net cost (benefit) for these plans were as follows for the years ended December 31 (*in millions*):

	Health and Welfare			Postemployment Benefits		
	2012	2011	2010	2012	2011	2010
Service cost	\$ 0.1	\$ 0.1	\$ 0.1	\$ 0.9	\$ 0.9	\$ 1.3
Interest cost	0.2	0.3	0.3	0.8	0.9	1.4
Actuarial (gain) loss (i)	0.1	1.6	0.8	3.1	0.8	(7.6)
Foreign currency (gain) loss	—	—	—	0.6	(1.4)	0.9
Prior service credit (ii)	(0.2)	(0.2)	(0.3)	—	—	—
Net periodic cost (benefit) recognized	<u>\$ 0.2</u>	<u>\$ 1.8</u>	<u>\$ 0.9</u>	<u>\$ 5.4</u>	<u>\$ 1.2</u>	<u>\$ (4.0)</u>

- (i) Net benefit costs above do not include a component for the amortization of actuarial gains or losses as the Company's policy is to recognize such gains and losses immediately.
- (ii) During 2005, the Company revised its medical plan to exclude prescription drug coverage available under Medicare part D. This negative plan amendment generated an unrecognized prior service benefit of \$2.3 million which is being amortized over the estimated remaining life of the affected participants of 9.5 years.

The following table reconciles the change in the benefit obligation, fair value of plan assets, change in the funded status, and the accrued benefit cost as of and for each of the years ended December 31 (*in millions*):

	Health and Welfare		Postemployment Benefits	
	2012	2011	2012	2011
Benefit obligation at beginning of year	\$ 6.4	\$ 5.2	\$ 10.0	\$ 10.4
Service cost	0.1	0.1	0.9	0.9
Interest cost	0.2	0.3	0.8	0.9
Actuarial (gain) loss	0.1	1.6	3.1	0.8
Foreign currency (gain) loss	—	—	0.6	(1.4)
Benefits paid, net of retiree contributions	(0.3)	(0.8)	(2.2)	(1.6)
Benefit obligation at end of year	<u>6.5</u>	<u>6.4</u>	<u>13.2</u>	<u>10.0</u>
Funded status	<u>\$ (6.5)</u>	<u>\$ (6.4)</u>	<u>\$ (13.2)</u>	<u>\$ (10.0)</u>

**Assumptions**

The assumptions used to determine benefit obligations and costs are selected based on current and expected market conditions. Discount rates are selected based on the rates on low risk government bonds with cash flows approximating the timing of expected benefit payments. The Mexico bond market is utilized for the postemployment obligation and the U.S. bond market is utilized for the U.S. health and welfare obligation.

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

Weighted average assumptions used to determine benefit obligations were as follows for the years ended December 31:

	Health and Welfare		Postemployment Benefits	
	2012	2011	2012	2011
Discount rate	3.50%	4.00%	6.75%	8.00%
Rate of compensation increase	n/a	n/a	4.50%	4.50%

Weighted average assumptions used to determine net benefit cost for the periods were as follows for the years ended December 31:

	Health and Welfare		Postemployment Benefits	
	2012	2011	2012	2011
Discount rate	4.00%	5.25%	8.00%	8.25%
Rate of compensation increase	n/a	n/a	4.50%	4.50%

The following table presents the assumed health care cost trends:

	2012	2011	2010
Health care trend rate for next year	8.00%	8.50%	9.00%
Ultimate trend rate	5.00%	5.00%	5.00%
Year that rate reaches ultimate rate	2029	2020	2020

**Cash Flows**

The following table presents benefit payments expected to be paid, which reflect expected future service, as appropriate, for each of the next five years and the aggregate five years thereafter (*in millions*):

Year	Health and Welfare	Postemployment Benefits
2013	\$ 0.5	\$ 0.8
2014	0.5	0.8
2015	0.5	0.9
2016	0.5	0.9
2017	0.4	1.0
2018-2022	1.9	6.7

**Multi-Employer Plan.** Under collective bargaining agreements, KCSR participates in a multi-employer benefit plan, which provides certain post-retirement health care and life insurance benefits to eligible union employees and certain retirees. Premiums under this plan are expensed as incurred and were \$4.3 million, \$4.6 million, and \$4.2 million for the years ended December 31, 2012, 2011, and 2010, respectively.

**401(k) and Profit Sharing Plan.** The Company sponsors the KCS 401(k) and Profit Sharing Plan (the "401(k) plan"), whereby participants can choose to make contributions in the form of salary deductions pursuant to Section 401(k) of the Internal Revenue Code. The Company matches 401(k) contributions up to a maximum of 5% of compensation. The Company recognized expense of \$2.3 million, \$2.2 million and \$1.8 million for the years ended December 31, 2012, 2011 and 2010, related to the KCS 401(k) and Profit Sharing Plan. The 401(k) plan includes the Company's common stock as an investment option. The common stock is acquired by the 401(k) plan trustee through open market transactions of previously registered shares.

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

**Note 14. Commitments and Contingencies**

*Concession Duty.* Under the Concession, KCSM paid concession duty expense of 0.5% of gross revenues for the first 15 years of the Concession period and, on June 24, 2012, KCSM began paying 1.25% of gross revenues, which is effective for the remaining years of the Concession. For the year ended December 31, 2012, the concession duty expense, which is recorded within materials and other in operating expenses, was \$9.4 million, compared to \$4.9 million and \$4.1 million for the same periods in 2011 and 2010, respectively.

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

*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 December 31, 2012 is based on an updated actuarial study of personal injury claims through November 30, 2012 and review of the last month's experience. For the years ended December 31, 2012 and 2011, the Company recorded a \$8.4 million and \$20.1 million reduction in personal injury liability, due to changes in estimates as a result of the Company's continuing favorable claims development and settlement experience.

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

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

	2012	2011
Balance at beginning of year	\$ 40.1	\$ 62.2
Accruals	10.0	10.7
Change in estimate	(8.4)	(20.1)
Payments	(7.3)	(12.7)
Balance at end of year	<u>\$ 34.4</u>	<u>\$ 40.1</u>

*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. KCSM is currently involved in discussions with Ferromex regarding the amounts payable to each other for the Services for this period. If KCSM cannot reach an agreement with Ferromex for rates applicable for Services provided prior to January 1, 2009, which are not subject to the Trackage Rights Agreement, the Mexican *Secretaria 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, when resolved, that these disputes will have a material effect on its consolidated financial statements.

On July 23, 2008, the SCT delivered notice to KCSM of proceedings against KCSM, claiming, among other things, that KCSM refused to grant Ferromex access to certain trackage over which Ferromex alleges it has trackage rights on six different occasions and thus denied Ferromex the ability to provide service to a Mexican subsidiary of a large U.S. auto manufacturer at this location. On July 15, 2010, the SCT resolved to consolidate these six sanction proceedings into a single proceeding, determining that the actions that motivated the underlying claims constitute a single occasion. On February 27, 2012, the SCT dismissed this proceeding on the basis that the extent of the Ferromex trackage rights had not been determined prior to the time KCSM refused Ferromex access.

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

*Credit Risk.* The Company continually monitors risks related to economic changes and certain customer receivables concentrations. Significant changes in customer concentration or payment terms, deterioration of customer creditworthiness or further weakening in economic trends could have a significant impact on the collectability of the Company’s receivables and operating results. If the financial condition of the Company’s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company has recorded provisions for uncollectability based on its best estimate at December 31, 2012.

*Panama Canal Railway Company (“PCRC”) Guarantees and Indemnities.* The Company has issued two irrevocable standby letters of credit totaling approximately \$0.4 million to fulfill the Company’s fifty percent guarantee of PCRC’s equipment loans. The Company agreed to fund fifty percent of any debt service reserve or liquidity reserve shortfall by PCRC,

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

reserves which were established by PCRC in connection with the issuance of the 7.0% Senior Secured Notes due November 1, 2026 (the "Notes"). At December 31, 2012, the Company had issued and outstanding \$5.3 million under a standby letter of credit to fulfill its obligation to fund fifty percent of these reserves. Additionally, KCS has pledged its shares of PCRC as security for the Notes.

**Note 15. Derivative Instruments**

In general, the Company enters into derivative transactions in limited situations based on management's assessment of current market conditions and perceived risks. However, management intends to respond to evolving business and market conditions and in doing so, may enter into such transactions more frequently 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 December 31, 2012, the Company did not expect any losses as a result of default of its counterparties.

*Interest Rate Swaps.* On March 5, 2012, KCSR entered into four amortizing interest rate swaps with an aggregate notional amount of \$320.0 million, which have been designated as cash flow hedges. The interest rate swaps effectively convert interest payments on a portion of outstanding term loans of KCSR from variable rates to fixed rates. The swaps are highly effective and as a result there will be minimal earnings impact associated with ineffectiveness of these hedges. As of December 31, 2012, the hedging instruments have an aggregate notional amount of \$304.5 million at a fixed rate of 0.4942%. Settlements are indexed to the one-month LIBOR and will occur monthly through March 31, 2014.

During 2008, the Company entered into five forward starting interest rate swaps with an aggregate notional amount of \$250.0 million, which were designated as cash flow hedges. The forward starting interest rate swaps effectively converted interest payments from variable rates to fixed rates. The swaps were highly effective and as a result there was minimal earnings impact associated with ineffectiveness of these hedges. Four of the five interest rate swaps with an aggregate notional amount of \$175.0 million expired during 2010. The remaining hedging instrument with an aggregate notional amount of \$75.0 million expired in March of 2011.

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

Balance Sheet Location	Liability Derivatives	
	December 31, 2012	December 31, 2011
Derivatives designated as hedging instruments:		
Interest rate swaps	\$ 0.9	\$ —
Total derivatives designated as hedging instruments	0.9	—
Total derivatives	<u>\$ 0.9</u>	<u>\$ —</u>

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

The following table presents the amounts affecting the consolidated statements of income for the years ended December 31 (*in millions*):

<b>Derivatives in Cash Flow Hedging Relationships</b>	<b>Amount of Gain/(Loss) Recognized in OCI on Derivative (Effective Portion)</b>			<b>Location of Gain/(Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</b>	<b>Amount of Gain/(Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>		<b>2012</b>	<b>2011</b>	<b>2010</b>
Interest rate swaps	\$ (1.6)	\$ —	\$ (0.7)	Interest expense	\$ (0.7)	\$ (0.4)	\$ (5.1)
Total	\$ (1.6)	\$ —	\$ (0.7)		\$ (0.7)	\$ (0.4)	\$ (5.1)

During the years ended December 31, 2012, 2011 and 2010, there was no ineffectiveness recognized related to cash flow hedges. As of December 31, 2012, the Company expects that approximately \$0.8 million of net losses will be reclassified from accumulated other comprehensive loss into interest expense over the next 12 months.

*Fuel Derivative Transactions.* During the years ended December 31, 2012, and 2011, the Company did not enter into any fuel swap agreements. In the first quarter of 2010, the Company entered into fuel swap agreements to hedge 22.6 million gallons of diesel fuel purchases through the end of 2010 at an average swap price per gallon of \$2.22, which were not designated as hedging instruments. For the year ended December 31, 2010, the Company recognized a loss of \$1.0 million for fuel swap contracts which were not designated as hedging instruments in fuel expense in the consolidated statements of income.



**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

**Note 16. Quarterly Financial Data (Unaudited)**

	Fourth	Third	Second	First
	(In millions, except per share amounts)			
<b>2012</b>				
Revenues	\$ 568.4	\$ 577.4	\$ 545.3	\$ 547.5
Operating income	173.6	180.7	203.8 (i)	157.8
Net income	92.5	90.7	120.9	75.3
Net income attributable to Kansas City Southern and subsidiaries	91.8	90.1	120.4	75.0
<i>Per share data:</i>				
Basic earnings per common share	\$ 0.84	\$ 0.82	\$ 1.10	\$ 0.68
Diluted earnings per common share	0.83	0.82	1.09	0.68
<b>2011</b>				
Revenues	\$ 530.3	\$ 544.5	\$ 534.9	\$ 488.6
Operating income	150.4	181.8 (ii)	151.6	127.8
Net income	96.0	100.1	71.7	64.1
Net income attributable to Kansas City Southern and subsidiaries	95.7	99.8	70.8	64.0
<i>Per share data:</i>				
Basic earnings per common share	\$ 0.87	\$ 0.91	\$ 0.65	\$ 0.60
Diluted earnings per common share	0.87	0.91	0.64	0.58

- (i) During the second quarter of 2012, the Company recognized a pre-tax gain of \$43.0 million within operating expenses for the elimination of deferred statutory profit sharing liability, net as a result of the organizational restructuring during the period.
- (ii) During the third quarter of 2011, the Company recognized a pre-tax gain of \$25.6 million within operating expenses for insurance recoveries related to hurricane damage.

**Note 17. 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. Corporate management is responsible for, among others, KCS's marketing strategy, the oversight of large cross-border customer accounts, overall planning and control of infrastructure and rolling stock, the allocation of capital resources based upon growth and capacity constraints over the coordinated network, and other functions such as financial planning, accounting, and treasury.

The role of each region is to manage the operational activities and monitor and control costs over the coordinated rail network. Such cost control is required to ensure that pre-established efficiency standards set at the corporate level are attained.

**Kansas City Southern**  
**Notes to Consolidated Financial Statements-(Continued)**

The activity centers are responsible for executing the overall corporate strategy and operating plan established by corporate management as a coordinated system.

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

	Years ended December 31,		
	2012	2011	2010
Revenues			
U.S.	\$ 1,216.7	\$ 1,159.9	\$ 1,020.1
Mexico	1,021.9	938.4	794.7
Total revenues	<u>\$ 2,238.6</u>	<u>\$ 2,098.3</u>	<u>\$ 1,814.8</u>

	Years ended December 31,	
	2012	2011
Property and equipment (including concession assets), net		
U.S.	\$ 3,126.2	\$ 2,875.0
Mexico	2,558.6	2,446.6
Total property and equipment (including concession assets), net	<u>\$ 5,684.8</u>	<u>\$ 5,321.6</u>

**Note 18. Subsequent Events**

***Common Stock Dividend***

On January 28, 2013, the Company's Board of Directors declared a cash dividend of \$0.215 per share payable on April 3, 2013, to common stockholders of record as of March 11, 2013. The aggregate amount of the dividend declared was approximately \$23.7 million.

***Foreign Currency Forward Contract***

On January 30, 2013, the Company entered into a forward contract with a notional amount of \$65.0 million to hedge its exposure to foreign currency risk. The contract obligates the Company to purchase a total of Ps. 853.0 million at an exchange rate of Ps. 13.12 to each U.S. dollar with a maturity date of December 31, 2013. The Company has not designated this forward contract as a hedging instrument for hedge accounting purposes. The Company will mark the contract to market at the end of each reporting period and recognize any foreign exchange gain or loss within the consolidated statements of income.

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

**Item 9A. *Controls and Procedures***

*(a) Disclosure Controls and Procedures*

The Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the fiscal year for which this annual report on Form 10-K is filed. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the current disclosure controls and procedures are effective to ensure that information required to be disclosed in reports filed or submitted 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 management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

*(b) Changes in Internal Control over Financial Reporting*

There have been no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter (the fourth quarter in the case of an annual report) that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

*(c) Internal Control over Financial Reporting*

The report of management on the Company's internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) is included as "Management's Report on Internal Control over Financial Reporting" in Item 8.

KPMG LLP, the independent registered public accounting firm that audited the Company's financial statements contained herein, has issued an attestation report on the Company's internal control over financial reporting as of December 31, 2012. The attestation report is included in Item 8 of this Form 10-K.

**Item 9B. *Other Information***

None.

### **Part III**

The Company has incorporated by reference certain responses to the Items of this Part III pursuant to Rule 12b-23 under the Exchange Act and General Instruction G(3) to Form 10-K. The Company's definitive proxy statement for the annual meeting of stockholders scheduled for May 2, 2013 ("Proxy Statement"), will be filed no later than 120 days after December 31, 2012.

#### **Item 10. *Directors, Executive Officers and Corporate Governance***

(a) Directors of the Company

The sections of the Proxy Statement entitled "Proposal 1 — Election of Three Directors" and "The Board of Directors" are incorporated by reference in partial response to this Item 10.

(b) Executive Officers of the Company

See "Executive Officers of KCS and Subsidiaries" in Part I, Item 1 of this annual report incorporated by reference herein for information about the executive officers of the Company.

(c) Changes to Shareholder Nominating Procedures

The Information set forth in the Proxy Statement is incorporated by reference in partial response to this Item 10.

(d) Audit Committee and Audit Committee Financial Experts

The section of the Proxy Statement entitled "Board Committees — The Audit Committee" is incorporated by reference in partial response to this Item 10.

(e) Compliance with Section 16(a) of the Exchange Act

The response to Item 405 of Regulation S-K under "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement is incorporated by reference in partial response to this Item 10.

(f) Code of Ethics

The Company has adopted a Code of Business Conduct and Ethics ("Code of Ethics") that applies to directors, officers (including, among others, the principal executive officer, principal financial officer and principal accounting officer) and employees. The Company has posted its Code of Ethics on its website ([www.kcsouthern.com](http://www.kcsouthern.com)) and will post on its website any amendments to, or waivers from, a provision of its Code of Ethics that applies to the Company's principal executive officer, principal financial officer or principal accounting officer as required by applicable rules and regulations. The Code of Ethics is available, in print, upon written request to the Corporate Secretary, P.O. Box 219335, Kansas City, Missouri 64121-9335.

(g) Annual Certification to the New York Stock Exchange

KCS's common stock is listed on the New York Stock Exchange ("NYSE") under the ticker symbol "KSU". As a result, the Chief Executive Officer is required to make annually, and he made on May 14, 2012, a CEO's Annual Certification to the New York Stock Exchange in accordance with Section 303A.12 of the NYSE Listed Company Manual stating that he was not aware of any violations by KCS of the NYSE corporate governance listing standards.

#### **Item 11. *Executive Compensation***

Information required by Item 11 of Part III is incorporated by reference from the Proxy Statement to be filed with the SEC within 120 days after the Company's fiscal year end of December 31, 2012 pursuant to Regulation 14A of the Exchange Act.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The section of the Proxy Statement entitled “Beneficial Ownership” is incorporated by reference in partial response to this Item 12.

**Equity Compensation Plan Information**

The following table provides information as of December 31, 2012, about the common stock that may be issued upon the exercise of options, warrants and rights, as well as shares remaining available for future issuance under the Company’s existing equity compensation plans.

Plan Category	Number of Securities to Be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans-Excluding Securities Reflected in the First Column (i)
Equity compensation plans:			
Approved by security holders	555,507	\$ 49.87	5,174,418
Not approved by security holders	—	—	—
Total	555,507	\$ 49.87	5,174,418

- (i) Includes 3,842,522 shares available for issuance under the 2009 Employee Stock Purchase Plan and 1,331,896 shares available for issuance under the 2008 Plan as awards in the form of Nonvested Shares, Bonus Shares, Performance Units or Performance Shares or issued upon the exercise of Options (including ISOs), stock appreciation rights or limited stock appreciation rights awarded under the 2008 Plan.

The Company has no knowledge of any arrangement the operation of which may at a subsequent date result in a change of control of the Company.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Information required by Item 13 of Part III is incorporated by reference from the Proxy Statement to be filed with the SEC within 120 days after the Company’s fiscal year end of December 31, 2012 pursuant to Regulation 14A of the Exchange Act.

**Item 14. Principal Accountant Fees and Services**

Information required by Item 14 of Part III is incorporated by reference from the Proxy Statement to be filed with the SEC within 120 days after the Company’s fiscal year end of December 31, 2012 pursuant to Regulation 14A of the Exchange Act.

## Part IV

### Item 15. Exhibits and Financial Statement Schedules

#### (a) List of Documents filed as part of this Report

##### (1) Financial Statements

The consolidated financial statements and related notes, together with the reports of KPMG LLP, Independent Registered Public Accounting Firm, appear in Part II Item 8, Financial Statements and Supplementary Data, of this Form 10-K.

##### (2) Financial Statement Schedules

None.

##### (3) List of Exhibits

###### (a) Exhibits

The Company has attached or incorporated by reference herein certain exhibits as specified below pursuant to Rule 12b-32 under the Exchange Act.

<u>Exhibit</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation of Kansas City Southern, filed as Exhibit 3.1 to the Company's Current Report on Form 8-K, filed on May 7, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 3.1.
3.2	Amended and Restated Bylaws of Kansas City Southern as amended and restated to August 7, 2012, filed as Exhibit 3.1 to the Company's Current Report on Form 8-K, filed on August 13, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 3.2.
4.1	As permitted by Item 601(b)(4)(iii)(A) of Regulation S-K, the Company has not filed with this Annual Report on Form 10-K certain instruments defining the rights of holders of long-term debt of the Company and its subsidiaries because the total amount of securities authorized under any of such instruments does not exceed 10% of the total assets of the Company and its subsidiaries on a consolidated basis. The Company agrees to furnish a copy of any such agreements to the Securities and Exchange Commission upon request.
4.2	Indenture, dated May 30, 2008, among The Kansas City Southern Railway Company ("KCSR"), the Company and certain subsidiaries of the Company, and U.S. Bank National Association, as trustee, covering up to \$275,000,000 of KCSR's 8% Senior Notes due 2015 (the "May 2008 Indenture"), filed as Exhibit 4.2 to the Company's Current Report on Form 8-K, filed on June 2, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 4.2.
4.2.1	First Supplemental Indenture dated as of February 13, 2012 among KCSR, the Company, Gateway Eastern Railway Company, Pabtex, Inc., Southern Development Company, Southern Industrial Services, Inc. and Trans-Serve, Inc. and U.S. Bank National Association, as trustee, filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on February 27, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 4.2.1.
4.3	Indenture, dated March 30, 2009, between KCSM and U.S. Bank National Association, as trustee and paying agent, covering up to \$200,000,000 of KCSM's 12 1/2% Senior Notes due 2016 (the "2009 KCSM Indenture"), filed as Exhibit 4.1 to the Company's Form 10-Q for the quarter ended March 31, 2009, filed on April 30, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 4.3.
4.3.1	First Supplemental Indenture to the 2009 KCSM Indenture, dated November 12, 2009, between KCSM, as issuer, and U.S. Bank National Association, as trustee and paying agent (the "2009 KCSM Supplemental Indenture"), filed as Exhibit 4.15.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2009, filed on February 12, 2010, is incorporated herein by reference as Exhibit 4.3.1.
4.3.2	Registration Rights Agreement, dated March 30, 2009, between KCSM and Banc of America Securities, LLC, as representative of the placement agents listed therein ("2009 KCSM Registration Rights Agreement"), filed as Exhibit 2.1 to the Company's Form 10-Q for the quarter ended March 31, 2009, filed on April 30, 2009 (File No. 1-4717), is incorporated by reference as Exhibit 4.3.2.
4.4	Indenture, dated January 22, 2010, between KCSM and U.S. Bank National Association, as trustee and paying agent, covering up to \$300,000,000 of KCSM's 8% Senior Notes due 2018 (the "2010 KCSM Indenture"), filed as Exhibit 4.1 to the Company's Current Report on Form 8-K, filed on January 28, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 4.4.

<u>Exhibit</u>	<u>Description</u>
4.4.1	Registration Rights Agreement, dated January 22, 2010, between KCSM and Banc of America Securities, LLC, as representative of the placement agents listed therein (the "2010 KCSM Registration Rights Agreement"), filed as Exhibit 4.2 to the Company's Current Report on Form 8-K, filed on January 28, 2010 (File No. 1-4717), is incorporated by reference as Exhibit 4.4.1.
4.5	Indenture, dated December 20, 2010, among KCSM and U.S. Bank National Association, as trustee and paying agent, covering up to \$185,000,000 of KCSM's 6.625% Senior Notes due 2020, filed as Exhibit 4.1 to the Company's Current Report on Form 8-K, filed on December 20, 2010, is incorporated herein by reference as Exhibit 4.5.
4.5.1	Registration Rights Agreement, dated December 20, 2010, among KCSM, Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC, Scotia Capital (USA) Inc., BBVA Securities Inc., Citigroup Global Markets Inc. and USB Securities LLC, filed as Exhibit 4.2 to the Company's Current Report on Form 8-K, filed on December 20, 2010, is incorporated herein by reference as Exhibit 4.5.1.
4.6	Indenture, dated May 20, 2011, between KCSM and U.S. Bank National Association, as trustee and paying agent, covering up to \$200,000,000 of KCSM's 6.125% Senior Notes due 2021, filed as Exhibit 4.1 to the Company's Current Report on Form 8-K, filed on May 25, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 4.6.
4.6.1	Registration Rights Agreement, dated May 20, 2011, among KCSM, and Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC, Scotia Capital (USA) Inc., Banco Bilbao Vizcaya Argentaria, S.A. and Morgan Stanley & Co. Incorporated, filed as Exhibit 4.2 to the Company's Current Report on Form 8-K, filed on May 25, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 4.6.1.
10.1	Form of Officer Indemnification Agreement, attached as Exhibit 10.1 to the Company's Form 10-K for the year ended December 31, 2001, filed on March 29, 2002 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.1.
10.2	Form of Director Indemnification Agreement, attached as Exhibit 10.2 to the Company's Form 10-K for the year ended December 31, 2001, filed on March 29, 2002 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.2.
10.3	Directors Deferred Fee Plan, adopted August 20, 1982, as amended and restated effective May 2, 2007, filed as Exhibit 10.3 to the Company's Form 10-K for the year ended December 31, 2010, filed on February 9, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.3.
10.4	Kansas City Southern 1991 Amended and Restated Stock Option and Performance Award Plan, as amended and restated effective as of August 7, 2007 (the "Amended 1991 Plan"), filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended September 30, 2007, filed on October 26, 2007 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.4.
10.4.1	First Amendment to the Kansas City Southern 1991 Amended and Restated Stock Option and Performance Award Plan, effective July 2, 2008, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on July 8, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.4.1.
10.4.2	Form of Non-Qualified Stock Option Award Agreement for employees under the Amended 1991 Plan, filed as Exhibit 10.8.2 to the Company's Form 10-K for the year ended December 31, 2004, filed on March 30, 2005 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.4.2.
10.4.3	Form of Non-Qualified Stock Option Award Agreement for Directors under the Amended 1991 Plan, filed as Exhibit 10.8.3 to the Company's Form 10-K for the year ended December 31, 2004, filed on March 30, 2005 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.4.3.
10.4.4	Form of Non-Qualified Stock Option Award agreement for employees under the Amended 1991 Plan (referencing threshold dates), filed as Exhibit 10.8.4 to the Company's Form 10-K for the year ended December 31, 2004, filed on March 30, 2005 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.4.4.
10.4.5	Form of Restricted Shares Award Agreement (cliff vesting) under the Amended 1991 Plan, filed as Exhibit 10.5.6 to the Company's Form 10-K for the year ended December 31, 2007, filed on February 15, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.4.5.
10.4.6	Form of Restricted Shares Award Agreement under the Amended 1991 Plan (applicable to restricted shares to be purchased), filed as Exhibit 10.8.7 to the Company's Form 10-K for the year ended December 31, 2004, filed on March 30, 2005 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.4.6.

<u>Exhibit</u>	<u>Description</u>
10.4.7	Form of Restricted Shares Award Agreement (consultants) under the Amended 1991 Plan, filed as Exhibit 10.5.9 to the Company's Form 10-K for the year ended December 31, 2007, filed on February 15, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.4.7.
10.4.8	Form of Restricted Shares Award Agreement (executive plan) under the Amended 1991 Plan, filed as Exhibit 10.5.10 to the Company's Form 10-K for the year ended December 31, 2007, filed on February 15, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.4.8.
10.5	Employment Agreement, as amended and restated January 1, 2001, among the Company, KCSR and Michael R. Haverty, filed as Exhibit 10.12 to the Company's Form 10-K for the year ended December 31, 2001, filed on March 29, 2002 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.5.
10.5.1	Addendum to Employment Agreement, dated August 18, 2004, between KCSR, the Company and Michael R. Haverty, filed as Exhibit 10.8.1 to the Company's Form 10-K for the year ended December 31, 2007, filed on February 15, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.5.1.
10.5.2	Amendment to Amended and Restated Employment Agreement, effective January 1, 2005, among KCSR, the Company and Michael R. Haverty, filed as Exhibit 10.8.2 to the Company's Form 10-K for the year ended December 31, 2007, filed on February 15, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.5.2.
10.5.3	Addendum to Employment Agreement, effective January 1, 2009, between the Company, KCSR and Michael R. Haverty, filed as Exhibit 10.7.3 to the Company's Form 10-K for the year ended December 31, 2008, filed on February 17, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.5.3.
10.5.4	Addendum to Employment Agreement, dated June 28, 2010, among the Company, KCSR and Michael Haverty, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on June 29, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.5.4.
10.5.5	Amendment to Employment Agreement dated December 17, 2012, between KCSR and Michael R. Haverty, filed as Exhibit 10.5.5 to this Annual Report on Form 10-K.
10.6	Employment Agreement, dated May 15, 2006, between KCSR and Patrick J. Ottensmeyer (the "Ottensmeyer Employment Agreement"), attached as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on June 12, 2006 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.6.
10.6.1	Amendment No. 1 to the Ottensmeyer Employment Agreement, dated May 7, 2007, filed as Exhibit 10.4 to the Company's Form 10-Q for the quarter ended June 30, 2007, filed on July 27, 2007 (File No. 1-4717), is incorporated by reference as Exhibit 10.6.1.
10.6.2	Addendum to Employment Agreement, effective January 1, 2009, between the Company, KCSR and Patrick J. Ottensmeyer, filed as Exhibit 10.8.2 to the Company's Form 10-K for the year ended December 31, 2008, filed on February 17, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.6.2.
10.6.3	Amendment to Employment Agreement dated December 17, 2012, between KCSR and Patrick J. Ottensmeyer, filed as Exhibit 10.6.3 to this Annual Report on Form 10-K.
10.7	Kansas City Southern Executive Plan, as amended and restated January 1, 2009, filed as Exhibit 10.10 to the Company's Form 10-K for the year ended December 31, 2008, filed on February 17, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.7.
10.8	Kansas City Southern Annual Incentive Plan, filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended March 31, 2011, filed on April 21, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.8.
10.9	English translation of concession title granted by the Secretaría de Comunicaciones y Transportes ("SCT") in favor of Ferrocarril del Noreste, S.A. de C.V. ("FNE"), dated December 2, 1996, filed as Exhibit 10.10 to the Company's Form 10-K for the year ended December 31, 2011, filed on February 8, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.9.
10.9.1	English translation of amendment, dated February 12, 2001, filed as Exhibit 10.10.1 to the Company's Form 10-K for the year ended December 31, 2011, filed on February 8, 2012 (File No. 1-4717), of concession title granted by SCT in favor of KCSM, formerly known as FNE, December 2, 1996, is incorporated herein by reference as Exhibit 10.9.1.



<u>Exhibit</u>	<u>Description</u>
10.9.2	English translation of amendment no. 2, dated November 22, 2006, filed as Exhibit 10.10.2 to the Company's Form 10-K for the year ended December 31, 2011, filed on February 8, 2012 (File No. 1-4717), of concession title granted by SCT in favor of KCSM, formerly known as FNE, December 2, 1996, amended February 12, 2001, is incorporated herein by reference as Exhibit 10.9.2.
10.10	Lease Agreement, originally dated June 26, 2001 and amended March 26, 2002, between KCSR and Broadway Square Partners LLP, filed as Exhibit 10.34 to the Company's Form 10-K for the year ended December 31, 2001, filed on March 29, 2002 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.10.
10.11	Agreement to Forego Compensation between A. Edward Allinson and the Company, fully executed on March 30, 2001; Loan Agreement between A. Edward Allinson and the Company, fully executed on September 18, 2001; and the Promissory Note executed by the Trustees of The A. Edward Allinson Irrevocable Trust Agreement, dated June 4, 2001, Courtney Ann Arnot, A. Edward Allinson III and Bradford J. Allinson, Trustees, as Maker, and the Company, as Holder, filed as Exhibit 10.36 to the Company's Form 10-K for the year ended December 31, 2002, filed on March 28, 2003 (File No. 1-4717), are incorporated herein by reference as Exhibit 10.11.
10.12	Agreement to Forego Compensation between Michael G. Fitt and the Company, fully executed on March 30, 2001; Loan Agreement between Michael G. Fitt and the Company, fully executed on September 7, 2001; and the Promissory Note executed by the Trustees of The Michael G. and Doreen E. Fitt Irrevocable Insurance Trust, Anne E. Skyes, Colin M-D. Fitt and Ian D.G. Fitt, Trustees, as Maker, and the Company, as Holder, filed as Exhibit 10.37 to the Company's Form 10-K for the year ended December 31, 2002, filed on March 28, 2003 (File No. 1-4717), are incorporated herein by reference as Exhibit 10.12.
10.13	Transaction Agreement, dated December 1, 2005, among the Company, KCSR, Norfolk Southern Corporation and The Alabama Great Southern Railroad Company (the "Transaction Agreement"), filed as Exhibit 10.46 to the Company's Form 10-K for the year ended December 31, 2005, filed on April 7, 2006 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.13.
10.13.1	Amendment No. 1 to the Transaction Agreement, dated January 17, 2006, filed as Exhibit 10.47 to the Company's Form 10-K for the year ended December 31, 2005, filed on April 7, 2006 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.13.1.
10.13.2	Amendment No. 2 to the Transaction Agreement, dated May 1, 2006, filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended March 31, 2006, filed on May 9, 2006 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.13.2.
10.13.3	Limited Liability Company Agreement of Meridian Speedway, LLC, dated May 1, 2006, between the Alabama Great Southern Railroad Company and the Company, filed as Exhibit 10.3 to the Company's Form 10-Q for the quarter ended March 31, 2006, filed on May 9, 2006 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.13.3.
10.13.4	Amendment No. 1 and Waiver to Limited Liability Company Agreement, dated August 12, 2011, among Meridian Speedway, LLC, the Company, KCS Holdings, Inc. and The Alabama Great Southern Railroad Company, filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended September 30, 2011, filed on October 21, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.13.4.
10.14	Participation Agreement, dated December 20, 2005, among KCSR, KCSR Trust 2005-1 (acting through Wilmington Trust Company, as owner trustee) ("2005 Trust"), GS Leasing (KCSR 2005-1) LLC, Wells Fargo Bank Northwest, National Association, Export Development Canada, and KFW, filed as Exhibit 10.48 to the Company's Form 10-K for the year ended December 31, 2005, filed on April 7, 2006 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.14.
10.14.1	Equipment Lease Agreement, dated December 20, 2005, between KCSR and the KCSR Trust 2005-1, filed as Exhibit 10.49 to the Company's Form 10-K for the year ended December 31, 2005, filed on April 7, 2006 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.14.1.
10.15	Participation Agreement, dated August 2, 2006, among KCSR, KCSR Trust 2006-1 (acting through Wilmington Trust Company, as owner trustee) ("2006 Trust"), HSH Nordbank AG, New York Branch, Wells Fargo Bank Northwest, National Association, and DVB Bank AG, filed as Exhibit 10.4 to the Company's Form 10-Q for the quarter ended September 30, 2006, filed on November 9, 2006 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.15.
10.15.1	Equipment Lease Agreement, dated August 2, 2006, between KCSR and the KCSR Trust 2006-1, filed as Exhibit 10.41 to the Company's Form 10-Q for the quarter ended September 30, 2006, filed on November 9, 2006 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.15.1.

<u>Exhibit</u>	<u>Description</u>
10.16	Lease Agreement, dated September 25, 2005, between KCSR and Louisiana Southern Railroad, Inc., filed as Exhibit 10.5 to the Company's Form 10-Q for the quarter ended June 30, 2005, filed on August 15, 2005 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.16.
10.17	Lease Agreement, dated September 25, 2005, between KCSR and Alabama Southern Railroad, Inc., filed as Exhibit 10.6 to the Company's Form 10-Q for the quarter ended June 30, 2005, filed on August 15, 2005 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.17.
10.18	Lease Agreement, dated September 25, 2005, between KCSR and Arkansas Southern Railroad, Inc., filed as Exhibit 10.7 to the Company's Form 10-Q for the quarter ended June 30, 2005, filed on August 15, 2005 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.18.
10.19	Lease Agreement, dated September 25, 2005, between KCSR and Arkansas Southern Railroad, Inc., filed as Exhibit 10.8 to the Company's Form 10-Q for the quarter ended June 30, 2005, filed on August 15, 2005 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.19.
10.20	Lease Agreement, dated September 25, 2005, between KCSR and Louisiana Southern Railroad, Inc., filed as Exhibit 10.9 to the Company's Form 10-Q for the quarter ended June 30, 2005, filed on August 15, 2005 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.20.
10.21	Equipment Lease Agreement, dated April 4, 2007, between KCSM and High Ridge Leasing, LLC, filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended March 31, 2007, filed on May 2, 2007 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.21.
10.22	Participation Agreement, dated September 27, 2007, among KCSR, KCSR 2007-1 Statutory Trust (acting through U.S. Bank Trust National Association, as owner trustee) ("2007 Trust"), U.S. Bank Trust National Association, GS Leasing (KCSR 2007-1) LLC, Wilmington Trust Company, and KfW, filed as Exhibit 10.51 to the Company's Form 10-K for the year ended December 31, 2007, filed on February 15, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.22.
10.22.1	Equipment Lease Agreement, dated September 27, 2007, between KCSR and the KCSR 2007-1 Statutory Trust, filed as Exhibit 10.52 to the Company's Form 10-K for the year ended December 31, 2007, filed on February 15, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.22.1.
10.23	Kansas City Southern 2008 Stock Option and Performance Award Plan (the "2008 Plan"), filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on October 7, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.
10.23.1	Form of Non-Qualified Stock Option Award Agreement under the 2008 Plan, filed as Exhibit 10.47.1 to the Company's Form 10-K for the year ended December 31, 2008, filed on February 17, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.1.
10.23.2	Form of Restricted Shares Award Agreement (cliff vesting) under the 2008 Plan, filed as Exhibit 10.47.2 to the Company's Form 10-K for the year ended December 31, 2008, filed on February 17, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.2.
10.23.3	Form of Restricted Shares Award Agreement (graded vesting) under the 2008 Plan, filed as Exhibit 10.47.3 to the Company's Form 10-K for the year ended December 31, 2008, filed on February 17, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.3.
10.23.4	Form of Restricted Shares Award Agreement under the 2008 Plan (applicable to restricted shares to be purchased), filed as Exhibit 10.47.4 to the Company's Form 10-K for the year ended December 31, 2008, filed on February 17, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.4.
10.23.5	Form of Restricted Shares Award and Performance Shares Award Agreement under the 2008 Plan, filed as Exhibit 10.47.5 to the Company's Form 10-K for the year ended December 31, 2008, filed on February 17, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.5.
10.23.6	Form of Restricted Shares Award Agreement (performance based vesting) under the 2008 Plan, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on September 17, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.6.

<u>Exhibit</u>	<u>Description</u>
10.23.7	Form of Non-Qualified Stock Option, Restricted Share and Performance Share Award Agreement (United States Employees) under the Kansas City Southern 2008 Stock Option and Performance Award Plan, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on March 1, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.7.
10.23.8	Form of Non-Qualified Stock Option, Restricted Share and Performance Share Award Agreement (Non-United States Employees) under the Kansas City Southern 2008 Stock Option and Performance Award Plan, filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on March 1, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.8.
10.23.9	Form of Non-Qualified Stock Option, Restricted Share and Performance Share Award Agreement (United States Employees) under the Kansas City Southern 2008 Stock Option and Performance Award Plan for the 2012 Long-Term Incentive Program, filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed on February 27, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.9.
10.23.10	Form of Non-Qualified Stock Option, Restricted Share and Performance Share Award Agreement (Non-United States Employees) under the Kansas City Southern 2008 Stock Option and Performance Award Plan for the 2012 Long-Term Incentive Program, filed as Exhibit 10.4 to the Company's Current Report on Form 8-K filed on February 27, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.23.10.
10.24	Participation Agreement (KCSR 2008-1), dated as of April 1, 2008, among KCSR, KCSR 2008-1 Statutory Trust (acting through U.S. Bank Trust National Association, not in its individual capacity, but solely as Owner Trustee) ("KCSR 2008-1 Statutory Trust"), U.S. Bank Trust National Association (only in its individual capacity as expressly provided therein), MetLife Capital, Limited Partnership (as Owners Participant), Wilmington Trust Company (as Indenture Trustee) and Export Development Canada (as Loan Participant), filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended March 31, 2008, filed on April 24, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.24.
10.24.1	Equipment Lease Agreement (KCSR 2008-1), dated as of April 1, 2008, between KCSR 2008-1 Statutory Trust (as Lessor) and KCSR (as Lessee), filed as Exhibit 10.3 to the Company's Form 10-Q for the quarter ended March 31, 2008, filed on April 24, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.24.1.
10.25	Loan and Security Agreement, dated February 26, 2008, between KCSM and Export Development Canada, filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended March 31, 2008, filed on April 24, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.25.
10.26	Loan Agreement, dated as of September 24, 2008, between KCSM and DVB Bank AG, filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended September 30, 2008, filed on October 28, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.26.
10.27	English translation of the Employment Agreement, dated April 20, 2006, between Kansas City Southern de México, S.A. de C.V. and José Guillermo Zozaya Delano, filed as Exhibit 10.4 to the Company's Form 10-Q for the quarter ended March 31, 2009, filed on April 30, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.27.
10.27.1	English translation of Amendment Agreement to the Individual Indefinite Employment Contract of April 20, 2006, dated May 27, 2009, between KCSM and José Guillermo Zozaya Delano, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on June 2, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.27.1.
10.28	Employment Agreement, dated August 15, 2008, between KCSR and Michael W. Upchurch, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on October 22, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.28.
10.28.1	Amendment to Employment Agreement dated December 17, 2012, between KCSR and Michael W. Upchurch, filed as Exhibit 10.28.1 to this Annual Report on Form 10-K.
10.29	Employment Agreement, dated September 10, 2008, between KCSR and David Starling, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on September 15, 2008 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.29.
10.29.1	Addendum to Employment Agreement, dated June 28, 2010, among the Company, KCSR and David L. Starling, filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on June 29, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.29.1.

<u>Exhibit</u>	<u>Description</u>
10.29.2	Amendment to Employment Agreement dated December 17, 2012, between KCSR and David L. Starling, filed as Exhibit 10.29.2 to this Annual Report on Form 10-K.
10.30	Employment Agreement, dated September 28, 2009, between KCSR and Mary K. Stadler, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on October 2, 2009 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.30.
10.30.1	Amendment to Employment Agreement dated December 17, 2012, between KCSR and Mary K. Stadler, filed as Exhibit 10.30.1 to this Annual Report on Form 10-K.
10.31	Settlement Agreement, dated February 9, 2010, between KCSM and Ferrocarril Mexicano S.A. de C.V. ("Ferromex"), Ferrosur S.A. de C.V., Minera Mexico, S.A. de C.V., Infraestructura y Transportes Ferroviarios, S.A. de C.V., Infraestructura y Transportes Mexico, S.A. de C.V., Lineas Ferroviarias de Mexico, S.A. de C.V., Grupo Ferroviario Mexicano, S.A. de C.V., and Grupo Mexico, S.A. B. de C.V., filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended March 31, 2010, filed on April 27, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.31.
10.32	Trackage Rights Agreement, dated February 9, 2010, between KCSM and Ferromex, filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended March 31, 2010, filed on April 27, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.32.
10.33	Amended and Restated Credit Agreement, dated as of July 12, 2011, by and among KCS, KCSR, as Borrower, certain of their subsidiaries named therein as guarantors, the various financial institutions and other persons from time to time parties thereto (the "Lenders"), The Bank of Nova Scotia, as administrative agent and collateral agent for the Lenders, Bank of America, N.A., as syndication agent, Compass Bank, JPMorgan Chase Bank, N.A. and Morgan Stanley Bank, N.A., as co-documentation agents and Merrill Lynch, Pierce, Fenner & Smith Incorporated and The Bank of Nova Scotia as joint lead arrangers and joint bookrunning managers, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on July 13, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.33.
10.33.1	Amendment No. 1 and Additional Term Advance Agreement dated as of February 24, 2012, to the Amended and Restated Credit Agreement dated as of July 12, 2011, by and among the Company, KCSR, as Borrower, certain of their subsidiaries named therein as guarantors, certain Lenders under the Credit Agreement, certain financial institutions and other persons parties thereto as providers of the additional Term A advances described therein, The Bank of Nova Scotia ("Scotia Capital"), as administrative agent and collateral agent for the Lenders, J.P. Morgan Securities LLC ("JPMorgan"), Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPFS"), Scotia Capital, Citibank Global Markets Inc. and Morgan Stanley Senior Funding, Inc. ("MSSF") as joint lead arrangers, JPMorgan, MLPFS and MSSF as joint bookrunners, JPMorgan as syndication agent and Scotia Capital, Citibank, N.A. and MSSF as co-documentation agents, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 27, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.33.1.
10.33.2	Restatement Agreement dated November 21, 2012, by and among KCS, KCSR, certain of their subsidiaries named therein as subsidiary guarantors, various financial institutions and other persons from time to time parties thereto (the "Lenders") and The Bank of Nova Scotia, as administrative agent and collateral agent for the Lenders, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on November 21, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.33.2.
10.33.3	Second Amended and Restated Credit Agreement dated as of November 21, 2012, by and among KCS, KCSR, as Borrower, certain of their subsidiaries named therein as guarantors, the various financial institutions and other persons from time to time parties thereto as lenders, The Bank of Nova Scotia, as administrative agent and collateral agent for the Lenders, Bank of America, N.A., as syndication agent and Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Securities LLC as joint lead arrangers and joint bookrunning managers, filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on November 21, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.33.3.
10.33.4	Amended and Restated Security Agreement, dated July 12, 2011, by and among KCS, KCSR, certain of their subsidiaries named therein as grantors and The Bank of Nova Scotia, as collateral agent, filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on July 13, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.33.4.

<u>Exhibit</u>	<u>Description</u>
10.34	Amended and Restated Credit Agreement, dated September 30, 2011, among KCSM, the lenders defined therein and JPMorgan Chase Bank, N.A., as administrative agent and collateral agent for the Lenders, J.P. Morgan Securities LLC and Merrill Lynch, Pierce, Fenner & Smith, Incorporated, as joint lead arrangers and joint bookrunners, BBVA Bancomer, S.A., Institución de Banca Múltiple Grupo Financiero BBVA Bancomer, as joint bookrunner and co-documentation agent, and Bank of America, N.A., as co-documentation agent, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on October 3, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.
10.34.1	Restatement Agreement dated as of November 29, 2012, by and among Kansas City Southern de México, S.A. de C.V., certain of its subsidiaries named therein as subsidiary guarantors, various financial institutions and other persons from time to time parties (the "Lenders"), and JPMorgan Chase Bank, N.A., as administrative agent (in such capacity, the "Administrative Agent") and as collateral agent (in such capacity, the "Collateral Agent"), filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on November 30, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.1.
10.34.2	Second Amended and Restated Credit Agreement, dated November 29, 2012, by and between Kansas City Southern de México, S.A. de C.V., the various financial institutions and other persons from time to time parties thereto (the "Lenders"), and JPMorgan Chase Bank, N.A., as administrative agent and collateral agent for the Lenders, J.P. Morgan Securities LLC and Merrill Lynch, Pierce, Fenner & Smith, Incorporated, as joint lead arrangers and joint bookrunners and certain other financial institutions party thereto, filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on November 30, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.2.
10.34.3	Amended and Restated Subsidiary Guaranty, dated as of September 30, 2011, by each subsidiary of KCSM from time to time party thereto, in favor of JPMorgan Chase Bank, N.A., in its capacity as administrative agent and collateral agent for each of the secured parties defined therein, filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on October 3, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.3.
10.34.4	Pledge Without Transfer of Possession Agreement, dated August 30, 2010, among KCSM, Arrendadora KCSM, S. de R.L. de C.V., Highstar Harbor Holdings Mexico, S. de R.L. de C.V., MTC Puerta Mexico, S. de R.L. de C.V., and Vamos a Mexico, S.A. de C.V., and Scotiabank Inverlat, S.A., Institucion de Banca Multiple, Grupo Financiero Scotiabank Inverlat, as collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as pledgee (English translation of document executed in Spanish), filed as Exhibit 10.3 to the Company's Current Report on Form 8-K, filed on September 3, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.4.
10.34.5	Stock Pledge Agreement, dated August 30, 2010, among MTC Puerta Mexico, S. de R.L. de C.V. and Highstar Harbor Holdings Mexico, S. de R.L. de C.V., as pledgors, Scotiabank Inverlat, S.A., Institucion de Banca Multiple, Grupo Financiero Scotiabank Inverlat, in its capacity as collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as pledgee, and Vamos a Mexico, S.A. de C.V. (English translation of document executed in Spanish), filed as Exhibit 10.4 to the Company's Current Report on Form 8-K, filed on September 3, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.5.
10.34.6	Partnership Interest Pledge Agreement, dated August 30, 2010, among KCSM, KCSM Holdings, LLC, as pledgors, Scotiabank Inverlat, S.A., Institucion de Banca Multiple, Grupo Financiero Scotiabank Inverlat, in its capacity as collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as pledgee and Arrendadora KCSM, S. de R.L. de C.V. (English translation of document executed in Spanish), filed as Exhibit 10.5 to the Company's Current Report on Form 8-K, filed on September 3, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.6.
10.34.7	Partnership Interest Pledge Agreement, dated August 30, 2010, among KCSM and Nafta Rail, S.A. de C.V., as pledgors, Scotiabank Inverlat, S.A., Institucion de Banca Multiple, Grupo Financiero Scotiabank Inverlat, in its capacity as collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as pledgee and Highstar Harbor Holdings Mexico, S. de R.L. de C.V. (English translation of document executed in Spanish), filed as Exhibit 10.6 to the Company's Current Report on Form 8-K, filed on September 3, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.7.
10.34.8	Partnership Interest Pledge Agreement, dated August 30, 2010, among Highstar Harbor Holdings Mexico, S. de R.L. de C.V. and Nafta Rail, S.A. de C.V., as pledgors, Scotiabank Inverlat, S.A., Institucion de Banca Multiple, Grupo Financiero Scotiabank Inverlat, in its capacity as collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as pledgee and MTC Puerta Mexico, S. de R.L. de C.V., (English translation of document executed in Spanish), filed as Exhibit 10.7 to the Company's Current Report on Form 8-K, filed on September 3, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.8.

<u>Exhibit</u>	<u>Description</u>
10.34.9	Intercompany Subordination Agreement, dated August 30, 2010, between KCSM and each of the persons defined therein, in favor of The Bank of Nova Scotia, as administrative agent for each of the secured parties defined therein, filed as Exhibit 10.8 to the Company's Current Report on Form 8-K, filed on September 3, 2010 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.9.
10.34.10	Assignment and Amendment Agreement, dated September 30, 2011, entered into by and among KCSM, Arrendadora KCSM, S. de R.L. de C.V., Highstar Harbor Holdings México, S. de R.L. de C.V., MTC Puerta Mexico, S. de R.L. de C.V., Vamos a México, S.A. de C.V., Scotiabank Inverlat, S.A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat, as original collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as original pledgee, and JPMorgan Chase Bank, N.A., a new collateral agent, acting on its own behalf and for the benefit of the secured parties and new pledgee. (English translation of document executed in Spanish), filed as Exhibit 10.3 to the Company's Current Report on Form 8-K, filed on October 3, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.10.
10.34.11	Assignment and Amendment Agreement, dated September 30, 2011, entered into by and among MTC Puerta México, S. de R.L. de C.V. and Highstar Harbor Holdings México, S. de R.L. de C.V., as pledgors, Vamos a México, S.A. de C.V., Scotiabank Inverlat, S.A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat, in its capacity as original collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as original pledgee, and JPMorgan Chase Bank, N.A., a new collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as new pledgee, filed as Exhibit 10.4 to the Company's Current Report on Form 8-K, filed on October 3, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.11.
10.34.12	Assignment and Amendment Agreement, dated September 30, 2011, entered into by and among KCSM and KSCM Holdings, LLC, as pledgors, Arrendadora KCSM S. de R.L. de C.V., Scotiabank Inverlat, S.A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat, in its capacity as original collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as original pledgee, and JPMorgan Chase Bank, N.A., as new collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties as new pledgee, filed as Exhibit 10.5 to the Company's Current Report on Form 8-K, filed on October 3, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.12.
10.34.13	Assignment and Amendment Agreement, dated September 30, 2011, entered into by and among KCSM and Nafta Rail, S.A. de C.V., as pledgors, Highstar Harbor Holdings México, S. de R.L. de C.V., Scotiabank Inverlat, S.A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat, in its capacity as original collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as original pledgee, and JPMorgan Chase Bank, N.A., as new collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties as new pledgee, filed as Exhibit 10.6 to the Company's Current Report on Form 8-K, filed on October 3, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.13.
10.34.14	Assignment and Amendment Agreement, dated September 30, 2011, entered into by and among Highstar Harbor Holdings México, S. de R.L. de C.V. and Nafta Rail, S.A. de C.V., as pledgors, MTC Puerta México, S. de R.L. de C.V., Scotiabank Inverlat, S.A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat, in its capacity as original collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties defined therein, as original pledgee, and JPMorgan Chase Bank, N.A., as new collateral agent, acting on its own behalf and on behalf and for the benefit of the secured parties as new pledgee, filed as Exhibit 10.7 to the Company's Current Report on Form 8-K, filed on October 3, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.14.
10.34.15	Amended and Restated Intercompany Subordination Agreement, dated as of September 30, 2011, by and between KCSM, and each of the subordinated debtors and subordinated creditors each as defined therein, in favor of JPMorgan Chase Bank, N.A., as administrative agent and collateral agent for each of the secured parties defined therein, filed as Exhibit 10.8 to the Company's Current Report on Form 8-K, filed on October 3, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.15.
10.34.16	Third Amendment to that certain Asset Pledge Agreement dated January 10, 2013 entered into by and among KCSM, Arrendadora KCSM, S. de R.L. de C.V., Highstar Harbor Holdings México, S. de R.L. de C.V., MTC Puerta Mexico, S. de R.L. de C.V., Vamos a México, S.A. de C.V. and, JPMorgan Chase Bank, N.A., as collateral agent, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on January 16, 2013 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.16.
10.34.17	Second Amendment Agreement to that certain Partnership Interest Pledge Agreement, dated January 10, 2013, entered into by and among KCSM, Nafta Rail, S.A. de C.V., Highstar Harbor Holdings México, S. de R.L. de C.V. and JPMorgan Chase Bank, N.A., as collateral agent, filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on January 16, 2013 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.17.

<u>Exhibit</u>	<u>Description</u>
10.34.18	Second Amendment Agreement to that certain Partnership Interest Pledge Agreement, dated January 10, 2013, entered into by and among KCSM, KCSM Holdings, LLC, Arrendadora KCSM, S. de R.L. de C.V. and JPMorgan Chase Bank, N.A., as collateral agent, filed as Exhibit 10.3 to the Company's Current Report on Form 8-K, filed on January 16, 2013 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.18.
10.34.19	Second Amendment Agreement to that certain Stock Interest Pledge Agreement, dated January 10, 2013, entered into by and among MTC Puerta México, S. de R.L. de C.V., Highstar Harbor Holdings México, S. de R.L. de C.V., Vamos a México, S.A. de C.V. and JPMorgan Chase Bank, N.A., as collateral agent, filed as Exhibit 10.4 to the Company's Current Report on Form 8-K, filed on January 16, 2013 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.19.
10.34.20	Second Amendment Agreement to that certain Partnership Interest Pledge Agreement, dated January 10, 2013, entered into by and among Highstar Harbor Holdings México, S. de R.L. de C.V., Nafta Rail, S.A. de C.V., MTC Puerta México, S. de R.L. de C.V. and JPMorgan Chase Bank, N.A., as collateral agent, filed as Exhibit 10.5 to the Company's Current Report on Form 8-K, filed on January 16, 2013 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.34.20.
10.35	Form of Loan Agreement between General Electric Capital Corporation and KCSM, dated September 1, 2011, filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended September 30, 2011, filed on October 21, 2011 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.35.
10.36	Financing Agreement dated as of February 21, 2012, between The Kansas City Southern Railway Company and the United States of America represented by the Secretary of Transportation acting through the Administrator of the Federal Railroad Administration, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 22, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.36.
10.37	Employment Agreement dated July 24, 2009, between The Kansas City Southern Railway Company and David R. Ebbrecht, filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on August 13, 2012 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.37.
10.37.1	Amendment to Employment Agreement dated December 17, 2012, between KCSR and David R. Ebbrecht, filed as Exhibit 10.37.1 to this Annual Report on Form 10-K.
12.1	Computation of Ratio of Earnings to Fixed Charges
21.1	Subsidiaries of the Company
23.1	Consent of KPMG LLP, Independent Registered Public Accounting Firm, is attached to this Form 10-K as Exhibit 23.1.
31.1	Certification of David L Starling, Chief Executive Officer of the Company, is attached to this Form 10-K as Exhibit 31.1.
31.2	Certification of Michael W. Upchurch, Chief Financial Officer of the Company, is attached to this Form 10-K as Exhibit 31.2.
32.1	Certification of David L. Starling, Chief Executive Officer of the Company, furnished pursuant to 18 U.S.C. Section 1350, is attached to this Form 10-K as Exhibit 32.1.
32.2	Certification of Michael W. Upchurch, Chief Financial Officer of the Company, furnished pursuant to 18 U.S.C. Section 1350, is attached to this Form 10-K as Exhibit 32.2.
101	The following financial information from Kansas City Southern's Annual Report on Form 10-K for the year ended December 31, 2012, formatted in XBRL (Extensible Business Reporting Language) includes: (i) Consolidated Statements of Income for the years ended December 31, 2012, 2011 and 2010, (ii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2012, 2011, and 2010, (iii) Consolidated Balance Sheets as of December 31, 2012 and December 31, 2011, (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011, and 2010, (v) Consolidated Statements of Changes in Equity for the Three Years ended December 31, 2012, 2011, and 2010, and (vi) the Notes to Consolidated Financial Statements.





Signature

Title

/s/ TERRENCE P. DUNN

Director.

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Terrence P. Dunn

/s/ ANTONIO O. GARZA, JR.

Director.

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Antonio O. Garza, Jr.

/s/ THOMAS A. McDONNELL

Director.

---

Thomas A. McDonnell

/s/ RODNEY E. SLATER

Director.

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Rodney E. Slater

**Kansas City Southern**  
**2012 Form 10-K Annual Report**  
**Index to Exhibits**

<u>Exhibit</u>	<u>Document</u>
10.5.5	Amendment to Employment Agreement dated December 17, 2012, between KCSR and Michael R. Haverty, filed as Exhibit 10.5.5 to this Annual Report on Form 10-K.
10.6.3	Amendment to Employment Agreement dated December 17, 2012, between KCSR and Patrick J. Ottensmeyer, filed as Exhibit 10.6.3 to this Annual Report on Form 10-K.
10.28.1	Amendment to Employment Agreement dated December 17, 2012, between KCSR and Michael W. Upchurch, filed as Exhibit 10.28.1 to this Annual Report on Form 10-K.
10.29.2	Amendment to Employment Agreement dated December 17, 2012, between KCSR and David L. Starling, filed as Exhibit 10.29.2 to this Annual Report on Form 10-K.
10.30.1	Amendment to Employment Agreement dated December 17, 2012, between KCSR and Mary K. Stadler, filed as Exhibit 10.30.1 to this Annual Report on Form 10-K.
10.37.1	Amendment to Employment Agreement dated December 17, 2012, between KCSR and David R. Ebbrecht, filed as Exhibit 10.37.1 to this Annual Report on Form 10-K.
12.1	Computation of Ratio of Earnings to Fixed Charges
21.1	Subsidiaries of the Company
23.1	Consent of KPMG LLP, Independent Registered Public Accounting Firm
31.1	Certification of David L. Starling pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Michael W. Upchurch pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of David L. Starling furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002
32.2	Certification of Michael W. Upchurch furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following financial information from Kansas City Southern's Annual Report on Form 10-K for the year ended December 31, 2012, formatted in XBRL (Extensible Business Reporting Language) includes: (i) Consolidated Statements of Income for the years ended December 31, 2012, 2011 and 2010, (ii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2012, 2011, and 2010, (iii) Consolidated Balance Sheets as of December 31, 2012 and December 31, 2011, (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011, and 2010, (v) Consolidated Statements of Changes in Equity for the Three Years ended December 31, 2012, 2011, and 2010, and (vi) the Notes to Consolidated Financial Statements

# Directors and Officers

## KANSAS CITY SOUTHERN DIRECTORS

### Lu M. Córdova (2, 4)

Chief Executive Officer  
Corlund Industries, LLC  
Boulder, Colorado

### Henry R. Davis (3, 4)

President, Promotora, DAC, S.A. de C.V.  
Mexico City, D.F.

### Robert J. Druten (2, 4, 5)

Retired Executive Vice President  
& Chief Financial Officer  
Hallmark Cards, Inc.  
Kansas City, Missouri

### Terrence P. Dunn (3, 4)

President & Chief Executive Officer  
J.E. Dunn Construction Group, Inc.  
Kansas City, Missouri

### Antonio O. Garza, Jr. (5)

Former U.S. Ambassador to Mexico  
Partner, ViaNovo  
Counsel, White & Case, LLP  
Mexico City, D.F.

### Michael R. Haverty (1)

Executive Chairman  
Kansas City Southern  
Kansas City, Missouri

### Thomas A. McDonnell (1, 2, 4, 5)

President & Chief Executive Officer  
Ewing Marion Kauffman Foundation  
Kansas City, Missouri

### Rodney E. Slater (1, 3, 4)

Partner  
Patton Boggs LLP  
Washington, DC

### David L. Starling

President &  
Chief Executive Officer  
Kansas City Southern  
Kansas City, Missouri

#### Committees of the Board:

- (1) Executive
- (2) Audit
- (3) Compensation and Organization
- (4) Nominating and Corporate Governance
- (5) Finance

## KANSAS CITY SOUTHERN OFFICERS

### Michael R. Haverty

Executive Chairman

### David L. Starling

President &  
Chief Executive Officer

### David R. Ebbrecht

Executive Vice President &  
Chief Operating Officer

### Warren K. Erdman

Executive Vice President  
Administration & Corporate  
Affairs

### Patrick J. Ottensmeyer

Executive Vice President  
Sales & Marketing

### Michael W. Upchurch

Executive Vice President  
& Chief Financial Officer

### John E. Derry

Senior Vice President  
Human Resources

### Michael J. Naatz

Senior Vice President &  
Chief Information Officer

### Mary K. Stadler

Senior Vice President  
& Chief Accounting Officer

### William J. Wochner

Senior Vice President &  
Chief Legal Officer

### James D. Byrd

Vice President  
International Taxes

### Michael W. Cline

Vice President Finance  
& Treasurer

### William H. Galligan

Vice President  
Investor Relations

### Adam J. Godderz

Associate General Counsel  
& Corporate Secretary


### Julie D. Powell

Assistant Secretary  
& Assistant Treasurer

### Rodrigo Flores León

Assistant Treasurer

*Kansas City Southern companies provide equal employment and advancement opportunities to qualified employees without regard to race, color, religion, gender, national origin, age, disability, or other category protected by law. Kansas City Southern's U.S. companies are also affirmative action employers.*

 This annual report is printed on recycled papers. The recycled paper industry is an important part of the market served by Kansas City Southern.

Find Kansas City Southern on the internet at:  
<http://www.kcsouthern.com>

#### Securities Listed

New York Stock Exchange  
Common Stock  
4% Preferred Stock  
Symbol KSU

#### Transfer Agent and Registrar

Computershare Trust Company, N.A.  
P.O. Box 43078  
Providence, RI 02940-3078

#### Independent Registered Public Accounting Firm

KPMG LLP  
1000 Walnut Street  
Suite 1000  
Kansas City, Missouri 64106

#### Annual meeting of stockholders

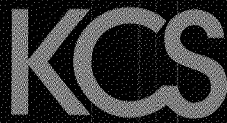
10:00 A.M., May 2, 2013  
Union Station Kansas City  
Arthur Stilwell Room  
30 West Pershing Road  
Kansas City, Missouri 64108

#### Corporate Offices

427 West 12th Street  
Kansas City, Missouri 64105  
(816) 983-1303

#### Mailing Address

P.O. Box 219335  
Kansas City, MO 64121-9335



**KANSAS CITY SOUTHERN**

427 West 12th Street  
Kansas City, Missouri 64105

Mailing address: PO Box 219335  
Kansas City, MO 64121-9335

[www.kcsouthern.com](http://www.kcsouthern.com)