KANSAS CITY SOUTHERN
Form 10-K
January 30, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

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

For the fiscal year ended December 31, 2014

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

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

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

Indicate by check mark 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. ý

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

| | | | |
|---|---|---|---|
| Large accelerated filer ý | Accelerated filer o | Non-accelerated filer o | Smaller reporting company o |

(Do not check if a smaller reporting company)

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

The aggregate market value of common stock held by non-affiliates of the registrant was $11.70 billion at June 30, 2014. There were 110,411,095 shares of $.01 par common stock outstanding at January 23, 2015.

DOCUMENTS INCORPORATED BY REFERENCE

Kansas City Southern’s Definitive Proxy Statement for the 2015 Annual Meeting of Stockholders which will be filed no later than 120 days after December 31, 2014, is incorporated by reference in Parts III.

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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 6,490 employees on December 31, 2014.

KCS controls and owns all of the stock of The Kansas City Southern Railway Company (“KCSR”), a U.S. Class I railroad founded in 1887. 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. KCSM 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 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 6,500 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 alternative to 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.

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 rail line between Dallas, Texas and Meridian known as the “Meridian Speedway.” Norfolk Southern Corporation, through its wholly-owned subsidiary, The Alabama Great Southern Railroad Company, owns the remaining thirty percent of MSLLC.
- KCSM Servicios, S.A. de C.V. (“KCSM Servicios”), a wholly-owned and consolidated affiliate that provides employee services to KCSM;
- Southern Capital Corporation, LLC (“Southern Capital”), a fifty percent-owned unconsolidated affiliate that owned and leased locomotives and other equipment;

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- 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 (“PTC”). See Government Regulation section for further information regarding PTC.

MARKETS SERVED

2014 Revenues
Business Mix

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, plates and pipe from U.S. based mini-mills in Mississippi and Alabama to several U.S. locations and Mexico for oil drilling, 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 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, food and industrial consumers in the U.S. and Mexico. United States export grain shipments and Mexico import grain shipments include primarily corn, wheat, and soybeans. 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 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 sector 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. Frac sand originating primarily in Wisconsin, Illinois or Iowa is delivered to transloads

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located in northeast Texas, northern Louisiana and south Texas for distribution to gas and oil wells in the region. 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. Crude oil originating in Canada, North Dakota, Colorado and west Texas is delivered to U.S. Gulf Coast refineries and tank farms in Texas, Louisiana and Alabama.

Intermodal. The intermodal freight sector 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 caused the KCS Mexico/U.S. cross border corridor to emerge as an increasingly important tool for the North American Free Trade Agreement ("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., European and Asian automakers have built or intend to build assembly plants in 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 ("FRA") 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, revised hours of service for train and certain other employees and mandated implementation of PTC at certain locations by the end of 2015. PTC 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. The U.S. rail industry, including KCS, has publicly stated it does not currently believe that PTC can be fully implemented by December 31, 2015, due to the many difficulties developing and deploying this interoperable technology across the U.S. rail system. KCS, along with other Class I railroads in the United States, is working with the FRA and Congress to seek an extension of the deadline for implementing PTC.

KCS's U.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.”

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The Company's 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 in North America is dominated by a few very large carriers. The larger U.S. 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 Mexico, KCSM's operations are subject to competition from other railroads, particularly Ferrocarril Mexicano, S.A. de C.V. ("Ferromex") and Ferrosur, S.A. de C.V. ("Ferrosur"), both controlled by Grupo Mexico S.A.B. de C.V. Ferromex and Ferrosur together are much larger and have significantly greater financial and other resources than KCSM, serving most of the major ports and cities in Mexico and together owning 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 continued to develop and implement multidisciplinary approaches to secure the Company's assets and personnel against criminal enterprises which prey on transportation networks. The Company has employed a variety of strategies to help mitigate the risk terrorist attacks could pose to the Company, its personnel and assets. 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.

KCSR and KCSM utilize a security plan based on an industry-wide security plan developed by the 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

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kept confidential, with access to the plan tightly limited to members of management with direct security and anti-terrorism implementation responsibilities. The Company participates with other AAR members in periodic drills under the industry plan to test and refine its various provisions.

To protect the confidentiality and sensitivity of both the AAR plans and the proprietary strategies the Company has developed to safeguard against criminal enterprises, terrorism, and other security and safety threats, the following paragraphs will provide only a general overview of some of these efforts.

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) 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;
- Development of smartphone applications to ensure immediate information and pictures from security supervisors and protection assets pertaining to potential operational risks;
- Developing a multi-layered security model using high-speed digital imaging, system velocity and 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;
- Performing constant due diligence by benchmarking security on a world-wide basis to monitor threat streams related to rail incidents;
- Implementation of a Tactical Intelligence Center by KCSM, training core members in new technology helping to prevent, detect, deter, deny and respond to potentially 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 geo-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.

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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 April 16, 2012, between KCSM Servicios and the Sindicato de Trabajadores Ferrocarrileros de la República Mexicana ("Mexican Railroad Union"), for an indefinite period of time, for the purpose of regulating the relationship between the parties. Approximately 80% of KCSM Servicios employees are covered by this labor agreement. The compensation terms under this labor agreement are subject to renegotiation on an annual basis and all other benefits are subject to negotiation every two years. The union labor negotiations with the Mexican Railroad Union have not historically resulted in any strike, boycott or other disruption in KCSM's business operations. On October 14, 2014, compensation terms covering the period from July 1, 2014 through June 30, 2015, were finalized between KCSM Servicios and the Mexican Railroad Union. The finalization of the compensation terms did not have a significant effect on the Company's consolidated financial statements.

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 that have been in their respective officer positions for a period longer than six months 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.

David L. Starling — President and Chief Executive Officer — 65 — 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 Chairman of the Board of Directors of KCSM since October 2013. He served as Vice Chairman of the Board of Directors of KCSM from September 2009 to October 2013. Mr. Starling has served as Co-Chairman of the Board of Directors of PCRC and Panarail since October 2013. He served as Vice Chairman of the Board of Directors of PCRC and Panarail from July 2008 to September 2013. Prior to joining KCS, Mr. Starling served as President and Director General of PCRC from 1999 through June 2008.

Warren K. Erdman — Executive Vice President — Administration and Corporate Affairs — 56 — Served in this capacity sinc 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 — 57 — 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 — 54 — Served in this capacity since October 16, 2008. Mr. Upchurch joined KCS in March 2008 as Senior Vice President Purchasing and Financial Management. 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 — 62 — 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.

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Lora S. Cheatum — Senior Vice President — Human Resources — 58 — Ms. Cheatum has served in this capacity since joinin KCS in October 2014. Ms. Cheatum previously served as Senior Vice President Global Human Resources of Layne Christensen since 2012. From 2010 to 2012, she served as Director — Field Operations at Fitness Together Holdings, Inc. Ms. Cheatum spent nine years with Kansas City Power & Light, from 2001 to 2010, where she was Vice President of Procurement and previously as Vice President Human Resources.

Michael J. Naatz — Senior Vice President Operations Support and Chief Information Officer — 49 — Served in this capacity since August 2014. Mr. Naatz served as Senior Vice President and Chief Information Officer of the Company from May 2012 to July 2014. 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.

Jeffrey M. Songer — Senior Vice President Engineering and Chief Transportation Officer — 45 — Mr. Songer has served in this capacity since August 2014. Mr. Songer previously was Vice President and Chief Engineer for KCSR from June 2012 to July 2014. Prior to serving as KCSR's Vice President and Chief Engineer, Mr. Songer served as Assistant Vice President — Engineering and Planning from March 2011 to June 2012, and as its General Director — Planning, Scheduling & Administration from January 2007 to March 2011.

Mary K. Stadler — Senior Vice President and Chief Accounting Officer — 55 — 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 — 67 — 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.

AVAILABLE INFORMATION

KCS's website (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, in lieu of press releases.

See Item 8, Financial Statements and Supplementary Data — Note 1 "Description of the Business" and Note 19 "Geographic Information" for more information on the description and general development of the Company's business and financial information about geographic areas.

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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;
- 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 continue 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. While KCS is currently paying dividends, there can be no assurance that it will continue to do so in the future.

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, 2014, there were 5,517,716 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 1,405,169 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, 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. 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

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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 key 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 until June 2047, 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, if the Comisión Federal de Competencia Económica (Mexican Antitrust Commission or "CFCE") determines that effective competition does not exist, then the SCT has authority to set rates. CFCE, however, has not published guidelines regarding the factors that constitute a lack of competition. It is, therefore, unclear under what particular circumstances CFCE would deem a lack of competition to exist. If the SCT intervenes and sets service rates, the rates it sets may negatively impact profitability.

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 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 a specified number of occasions for any of the following: unjustly interrupting the operation of its rail lines or for charging rates higher than those it has registered with the SCT; restricting the ability of other Mexican rail operators to use its rail lines; failing to make payments for damages caused during the performance of services; failing to comply with any term or condition of the Mexican Railroad Services Law and regulations or the Concession; failing to make the capital investments required under its five-year business plan filed with the SCT; or failing 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 its 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.

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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 regarding the amounts payable to Ferromex 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.

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, equipment, structures and technology and maintenance 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 a specified number of 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, short and long-term 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.

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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 energy, automotive, housing and agriculture industries. Any downturn or change in government policy 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.

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

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circumstances that are difficult to detect or foresee. Some of the Company’s risk management methods depend upon the evaluation of information regarding markets, customers 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 federal, state and local regulatory agencies, including environmental, health, safety and tax laws, and regulations that could require KCS to incur material costs or liabilities.

KCS is subject to legislation enacted by federal or state legislatures in the U.S. and Mexico, and is subject to regulation by 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. As an example, various proposals submitted to the STB for consideration could have a negative impact on KCS’s ability to negotiate prices for rail services and affect competition among rail carriers, which could result in a material adverse effect on KCS’s consolidated financial statements.

Additional or new economic regulation by the U.S. Congress or the Surface Transportation Board in the U.S. or by the Mexican Congress of the Union or the SCT (or other agencies) in Mexico 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.

In Mexico, proposed legislation was introduced in 2013 in the House of Deputies to amend certain provisions in the Mexican Regulatory Railroad Service Law. In February 2014, this proposed legislation was approved by the Mexican House of Deputies and was sent to the Mexican Senate. On December 14, 2014, the Mexican Senate passed a revised version of the House of Deputies’ bill, and on December 15, 2014, the House of Deputies passed the bill as amended by the Senate. On January 26, 2015, the bill was published in the Official Federal Gazette (Diario Oficial de la Federacion) and became law. It is too early to determine at this time how this legislation would be implemented and interpreted and thus what, if any, effect the rail legislation could have on the Mexican railroad industry and its customers.

In May 2014, new Mexican antitrust legislation was approved and became effective on July 7, 2014. This new law replaces antitrust law that had been effective since 1993. While the Company continues to evaluate the Mexican government’s implementation of this legislation, the Company does not believe it will have a material effect on its consolidated financial statements.

In response to several accidents involving the transportation of energy products by rail, U.S. rail and petroleum industry leaders met with the Secretary of the U.S. Department of Transportation in January 2014 to discuss voluntary actions to improve the transportation of energy products by rail. Additionally, in August 2013, the FRA issued Emergency Order 28 implementing new operating rules governing the transportation of energy products by rail. On August 1, 2014, the Pipeline and Hazardous Materials Safety Administration (PHMSA) of the U.S. Department of Transportation published for public comment new proposed rules on transportation of flammable liquids (including crude oil and ethanol) by rail. The proposed rules included new tank car standards, possible new speed restrictions and possible new braking requirements for trains carrying 20 or more carloads of Class 3 flammable liquids. Public comments have been received by PHMSA, and that agency is considering what final rules to propose. Any proposed new regulations or continued operating practice changes by U.S. railroads related to the transportation of energy products by rail, if ultimately adopted, could have a material adverse effect on the Company’s consolidated financial statements.

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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 PTC (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. PTC will add to operating costs, increase the number of employees the Company employs and require KCS to make significant investments in new safety technology. The U.S. rail industry, including KCS, has publicly stated it does not currently believe that PTC can be fully implemented by December 31, 2015 due to the many difficulties developing and deploying this inter-operable technology across the U.S. rail system. KCS, along with other Class I railroads in the United States, is working with the FRA and Congress to seek an extension of the deadline for implementing PTC. KCS's failure to meet the deadline, including any extension, could result in fines or penalties and could have a material adverse effect on the Company's consolidated financial statements.

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 obtain or 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 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.

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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 fluctuations in fuel costs and disruptions in fuel supplies.

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 through purchases at market prices from PEMEX Refinación (“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.

In addition, a significant and sustained decrease in crude oil prices could adversely affect the transport of crude oil by rail to the U.S. Gulf region as well as negatively impact railroad volumes related to equipment and other materials that support crude oil production. These factors could in turn adversely affect the Company’s consolidated financial statements.

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 availability of qualified personnel could adversely affect KCS’s operations.

Changes in demographics, training requirements and the availability of qualified personnel could negatively affect KCS’s ability to meet demand for rail service. Unpredictable increases in demand for rail services may exacerbate such risks, which could have a negative impact on KCS’s operational efficiency and otherwise have a material adverse effect on KCS’s consolidated financial statements.

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, 2014, 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

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workers to strike, there is no law in Mexico imposing similar restrictions on the right of railway workers in that country to strike.

Demand for North American rail services could exceed network capacity and could result in operational inefficiencies.

Over the last several years, the demand for rail services in both the United States and Mexico has increased substantially. If the demand for KCS's rail services were to exceed the capacity of KCS's network, KCS may experience network difficulties. Also, due to the interconnectivity between all railroads, especially in the U.S., congestion on other railroads caused by excess demand for rail services could also result in operational inefficiencies for KCS.

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. This system congestion and excess demand may also result in certain equipment shortages. 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 could also result in operational inefficiencies for KCS and adversely affect KCS's operations.

Any such operational difficulties could also be exacerbated by factors outside of KCS's control such as weather-related events. All of these issues could negatively affect the Company's ability to efficiently provide rail service to our customers. KCS's business is capital-intensive and significant expansions in the capacity of the Company's network can take a substantial amount of time, effort, and money to accomplish. Although KCS constantly monitors its network in an effort to optimize its rail services, there can be no assurance that any measures will be able to adequately accommodate such increases in demand for rail service.

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 and in compliance with the requirements of the Concession 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.

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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.
The social and political situation in Mexico could adversely affect the Mexican economy and changes in laws, public policies and government programs could be enacted, which could have an 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 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 weakening of the peso against the U.S. dollar 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.

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Fluctuations in the peso-dollar exchange rates also have an effect on KCS's consolidated financial statements. A weakening of the peso against the U.S. dollar 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 a strengthening of the peso against the U.S. dollar would cause an increase in the Company's cash tax obligation 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 4.1% in 2014, 4.0% in 2013 and 3.6% in 2012. 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 3,300 route miles in ten states extending from the midwest and southeast portions of the United States south to the Mexican border, which includes approximately 585 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 550 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."

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Kansas City Southern Rail Network

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Equipment Configuration

As of December 31, 2014 and 2013, KCS leased and owned the following units of equipment:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Leased | Owned | Total | Leased | Owned | Total |
| Freight Cars: | | | | | | |
| Box cars | 3,272 | 3,053 | 6,325 | 4,673 | 1,624 | 6,297 |
| Hoppers (covered and open top) | 2,559 | 3,012 | 5,571 | 3,704 | 2,013 | 5,717 |
| Gondolas | 2,681 | 1,647 | 4,328 | 3,148 | 1,064 | 4,212 |
| Automotive | 1,061 | 1,457 | 2,518 | 1,926 | 473 | 2,399 |
| Tank cars | 588 | 15 | 603 | 597 | 15 | 612 |
| Flat cars (intermodal and other) | 44 | 857 | 901 | 238 | 665 | 903 |
| Total | 10,205 | 10,041 | 20,246 | 14,286 | 5,854 | 20,140 |
| | | | | | | |
| Locomotives: | | | | | | |
| Freight | 121 | 687 | 808 | 169 | 604 | 773 |
| Switching | — | 187 | 187 | — | 148 | 148 |
| Total | 121 | 874 | 995 | 169 | 752 | 921 |

| Average Age (in Years) of Leased and Owned Locomotives: | 2014 | 2013 |
|---|---|---|
| Freight | 18.6 | 16.0 |
| Switching | 39.0 | 37.2 |
| All locomotives | 13.9 | 19.4 |

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, 2014, 2013, and 2012, and planned 2015 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 an Supplementary Data — Note 15 Commitments and Contingencies."

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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.

| | Fourth | Third | Second | First |
|---|---|---|---|---|
| 2014 | | | | |
| Dividends per share: | | | | |
| Common stock | $0.280 | $0.280 | $0.280 | $0.280 |
| $25 par preferred stock | 0.250 | 0.250 | 0.250 | 0.250 |
| | | | | |
| Stock price ranges: | | | | |
| $25 par preferred: | | | | |
| — High | $29.60 | $29.00 | $28.33 | $27.00 |
| — Low | 26.52 | 26.00 | 25.95 | 24.15 |
| Common: | | | | |
| — High | $126.49 | $123.95 | $108.87 | $123.83 |
| — Low | 109.57 | 106.67 | 95.41 | 88.56 |
| | | | | |
| 2013 | | | | |
| Dividends per share: | | | | |
| Common stock | $0.215 | $0.215 | $0.215 | $0.215 |
| $25 par preferred stock | 0.250 | 0.250 | 0.250 | 0.250 |
| | | | | |
| Stock price ranges: | | | | |
| $25 par preferred: | | | | |
| — High | $26.09 | $27.34 | $28.38 | $27.71 |
| — Low | 24.12 | 25.20 | 25.79 | 25.10 |
| Common: | | | | |
| — High | $125.96 | $118.68 | $118.88 | $112.25 |
| — Low | 107.84 | 104.02 | 100.35 | 84.52 |

Dividend Policy
Common Stock. Any declarations and payments 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.
Holders
There were 2,504 record holders of KCS common stock on January 23, 2015; 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.

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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.

Performance Graph

The following graph shows the changes in value over the five years ended December 31, 2014, 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; and (iii) the stocks that comprise the S&P 500 Index. 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

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|
| Kansas City Southern | $100.00 | $143.77 | $204.30 | $253.42 | $378.85 | $377.15 |
| S&P 500 (1) | 100.00 | 115.06 | 117.49 | 136.30 | 180.44 | 205.14 |
| Dow Jones U.S. Industrial Transportation (2) | 100.00 | 132.77 | 137.94 | 147.40 | 207.71 | 252.73 |

(1) 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.

(2) The Dow Jones U.S. Industrial Transportation Index is a registered trademark of Dow Jones & Co., Inc., an independent company.

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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.

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Earnings From Continuing Operations | | | | | |
| Revenues | $2,577.1 | $2,369.3 | $2,238.6 | $2,098.3 | $1,814.8 |
| Operating expenses (i) (ii) (iii) | 1,768.0 | 1,630.7 | 1,522.7 | 1,486.7 | 1,328.3 |
| Operating income | $809.1 | $738.6 | $715.9 | $611.6 | $486.5 |
| Net income (iv) | $504.3 | $353.3 | $379.4 | $331.9 | $180.0 |
| Earnings per common share: | | | | | |
| Basic | $4.56 | $3.19 | $3.44 | $3.04 | $1.69 |
| Diluted | 4.55 | 3.18 | 3.43 | 3.00 | 1.67 |
| Financial Position | | | | | |
| Total assets | $8,091.0 | $7,435.4 | $6,395.9 | $6,145.1 | $5,627.9 |
| Total long-term debt obligations, including current portion and short-term borrowings | 2,315.9 | 2,188.9 | 1,607.8 | 1,639.1 | 1,639.7 |
| Total stockholders' equity | 3,755.5 | 3,370.6 | 3,096.6 | 2,764.5 | 2,431.1 |
| Total equity | 4,064.1 | 3,676.6 | 3,400.7 | 3,058.7 | 2,713.7 |
| Other Data Per Common Share | | | | | |
| Cash dividends declared per common share | $1.12 | $0.86 | $0.78 | $— | $— |

(i) During 2014, the Company recognized pre-tax lease termination costs of $38.3 million within operating expenses due to the early termination of certain operating leases and the related purchase of equipment.

(ii) 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 as a result of the organizational restructuring during the period.

(iii) During 2011, the Company recognized a pre-tax gain of $25.6 million within operating expenses for insurance recoveries related to 2010 hurricane damage.

(iv) During 2014, 2013, 2012, 2011 and 2010, the Company recognized pre-tax debt retirement costs of $6.6 million, $119.2 million, $20.1 million, $38.7 million and $68.3 million, respectively, related to debt restructuring activities that occurred during the periods.

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## 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.

### 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 usually 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;
- the effect of demand for KCS's services exceeding network capacity or traffic congestion on operating efficiencies and service reliability;
- availability of qualified personnel;

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- 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 owned and leased 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

### 2014 Financial Overview

In 2014, the Company generated record-high revenues and volumes. Revenues of $2.6 billion were driven by strong growth in automotive, agriculture and minerals and intermodal business units. Revenues in 2014 increased 9% over 2013, as a result of carload/unit volumes and positive pricing impacts. Agriculture and minerals revenues increased $62.7 million for the year ended December 31, 2014, compared to the prior year, due to an increase of $57.4 million in grain revenues. During the first half of 2013, grain volumes and average length of haul were adversely affected as a result of the severe drought conditions experienced in the Midwest region of the U.S. during 2012.

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Operating expenses increased 8% compared to 2013, due to higher carload/unit volumes and $38.3 million of lease termination costs. The Company's continued focus on operating expense control resulted in operating expenses as a percentage of revenues of 68.6%.

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.

In 2014, the Company invested $702.7 million in capital expenditures. In addition, the Company purchased $300.7 million of equipment under existing operating leases and replacement equipment as certain operating leases expired, which was primarily funded with proceeds from the senior notes issued during the fourth quarter of 2013. The Company also recognized $38.3 million of lease termination costs during 2014, which are included in operating expenses, due to the early termination of certain operating leases and the related purchase of the equipment.

The Company reported 2014 earnings of $4.55 per diluted share on consolidated net income attributable to Kansas City Southern and subsidiaries of $502.6 million for the year ended December 31, 2014, compared to annual earnings of $3.18 per diluted share on consolidated net income attributable to Kansas City Southern and subsidiaries of $351.4 million for 2013. The increase is attributable to the $119.2 million of debt retirement costs recognized in 2013. In addition, consolidated net income increased due to higher operating income.

2015 Revenue Growth Considerations

The Company expects that its 2015 revenue growth rate will be in the mid-single digits, as revenue from volume growth, which is expected to grow at a rate similar to 2014, is expected to be partially offset by continued weakness in the value of the Mexican peso against the U.S. dollar and by lower fuel prices in the U.S. Based on the volume of KCSM's revenue contracts that are denominated in Mexican pesos and the current outlook for the Mexican peso, the Company expects an approximate 1% unfavorable impact to the 2015 revenue growth rate. Additionally, based on the volume of fuel surcharges calculated using U.S. fuel prices and current fuel future rates, the Company expects an approximate a 2%-3% unfavorable impact to the 2015 revenue growth rate.

Reduced revenue growth resulting from continued weakness in the Mexican peso against the U.S. dollar is expected to be substantially offset by reduced expense growth for expense transactions denominated in Mexican pesos. Additionally, the Company expects reduced revenue growth resulting from lower fuel surcharges will be largely offset by reduced U.S. fuel expense growth. 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, changes in fuel surcharge and fuel expense may differ.

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RESULTS OF OPERATIONS

Year Ended December 31, 2014, compared with the Year Ended December 31, 2013

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

| | 2014 | 2013 | Change |
|---|---|---|---|
| Revenues | $2,577.1 | $2,369.3 | $207.8 |
| Operating expenses | 1,768.0 | 1,630.7 | 137.3 |
| Operating income | 809.1 | 738.6 | 70.5 |
| Equity in net earnings of unconsolidated affiliates | 21.1 | 18.8 | 2.3 |
| Interest expense | (72.8) | (80.6) | 7.8 |
| Debt retirement costs | (6.6) | (119.2) | 112.6 |
| Foreign exchange loss | (35.5) | (5.2) | (30.3) |
| Other expense, net | (2.2) | (0.8) | (1.4) |
| Income before income taxes | 713.1 | 551.6 | 161.5 |
| Income tax expense | 208.8 | 198.3 | 10.5 |
| Net income | 504.3 | 353.3 | 151.0 |
| Less: Net income attributable to noncontrolling interest | 1.7 | 1.9 | (0.2) |
| Net income attributable to Kansas City Southern and subsidiaries | $502.6 | $351.4 | $151.2 |

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 | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2013 | % Change | 2014 | 2013 | % Change | 2014 | 2013 | % Change |
| Chemical and petroleum | $453.0 | $426.7 | 6% | 246.9 | 243.4 | 1% | $1,835 | $1,753 | 5% |
| Industrial and consumer products | 623.3 | 583.8 | 7% | 347.4 | 337.8 | 3% | 1,794 | 1,728 | 4% |
| Agriculture and minerals | 446.6 | 383.9 | 16% | 233.9 | 212.0 | 10% | 1,909 | 1,811 | 5% |
| Energy | 326.8 | 326.6 | — | 299.2 | 295.7 | 1% | 1,092 | 1,104 | (1%) |
| Intermodal | 395.8 | 356.6 | 11% | 1,019.6 | 965.6 | 6% | 388 | 369 | 5% |
| Automotive | 238.4 | 201.5 | 18% | 127.1 | 110.3 | 15% | 1,876 | 1,827 | 3% |
| Carload revenues, carloads and units | 2,483.9 | 2,279.1 | 9% | 2,274.1 | 2,164.8 | 5% | $1,092 | $1,053 | 4% |
| Other revenue | 93.2 | 90.2 | 3% | | | | | | |
| Total revenues (i) | $2,577.1 | $2,369.3 | 9% | | | | | | |

| | | |
|---|---|---|
| (i) Included in revenues: | | |
| Fuel surcharge | $334.7 | $320.2 |

Freight revenues include revenue for transportation services and fuel surcharges. For the year ended December 31, 2014, revenues and carload/unit volumes increased 9% and 5%, respectively, compared to the prior year. Agriculture and minerals revenues increased $62.7 million for the year ended December 31, 2014, compared to the prior year, due to an increase of $57.4 million in grain revenues. During the first half of 2013, grain volumes and average length of haul were adversely affected as a result of the severe drought conditions experienced in the Midwest region of the United States during 2012. Revenue per carload/unit increased by 4% for the year ended December 31, 2014, compared to the prior year, due to positive pricing impacts.

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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 2014

Chemical and petroleum. Revenues increased $26.3 million for the year ended December 31, 2014, compared to 2013, due to a 5% increase in revenue per carload/unit and a 1% increase in carload/unit volumes. Revenues increased due to positive pricing impacts in petroleum, plastics and chemicals.

Industrial and consumer products. Revenues increased $39.5 million for the year ended December 31, 2014, compared to 2013, due to a 4% increase in revenue per carload/unit and a 3% increase in carload/unit volumes. Metals and scrap revenues increased due to strong demand, positive pricing impacts and increased length of haul. Pulp and paper revenues increased due to positive pricing impacts.

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Revenues by commodity group for 2014

Agriculture and minerals. Revenues increased $62.7 million for the year ended December 31, 2014, compared to 2013, due to a 10% increase in carload/unit volumes and a 5% increase in revenue per carload/unit. Grain revenues increased $57.4 million, compared to 2013, as volumes and average length of haul were adversely affected in the first half of 2013 as a result of the severe drought conditions experienced in the Midwestern region of the United States during 2012. Record corn harvests in 2013 and 2014 also contributed to revenue growth.

Energy. Revenues increased $0.2 million for the year ended December 31, 2014, compared to 2013, due to a 1% increase in carload/unit volumes and a 1% decrease in revenue per carload/unit. The volume increase was due to strong frac sand demand driven by higher natural gas prices in the first half of the year and new drilling technologies. This increase was partially offset by volume decreases due to longer cycle times and connecting carrier fluidity in moving utility coal.

Intermodal. Revenues increased $39.2 million for the year ended December 31, 2014, compared to 2013, due to a 6% increase in carload/unit volumes and a 5% increase in revenue per carload/unit. Volume growth was driven by conversion of cross border and domestic general commodity truck traffic to rail, and trans-Pacific imports via the Port of Lazaro Cardenas. Revenue per carload/unit increased as a result of positive pricing impacts and increased average length of haul.

Automotive. Revenues increased $36.9 million for the year ended December 31, 2014, compared to 2013, due to a 15% increase in carload/unit volumes and a 3% increase in revenue per carload/unit. Growth was driven by the opening of three automotive plants in Mexico and an increase in import/export volumes through the Port of Lazaro Cardenas. The increase in revenues was partially offset by the weakening of the Mexican peso against the U.S. dollar.

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Operating Expenses

Operating expenses, as shown below (in millions), increased $137.3 million for the year ended December 31, 2014, when compared to 2013, due to higher carload/unit volumes and lease termination costs.

| | 2014 | 2013 | Change Dollars | Percent |
|---|---|---|---|---|
| Compensation and benefits | $474.5 | $441.6 | $32.9 | 7% |
| Purchased services | 245.2 | 217.6 | 27.6 | 13% |
| Fuel | 415.9 | 389.6 | 26.3 | 7% |
| Equipment costs | 119.2 | 160.5 | (41.3) | (26%) |
| Depreciation and amortization | 258.1 | 223.3 | 34.8 | 16% |
| Materials and other | 216.8 | 198.1 | 18.7 | 9% |
| Lease termination costs | 38.3 | — | 38.3 | 100% |
| Total operating expenses | $1,768.0 | $1,630.7 | $137.3 | 8% |

Compensation and benefits. Compensation and benefits increased $32.9 million for the year ended December 31, 2014, compared to 2013, due to carload/unit volumes, higher headcount and annual salary rate increases, partially offset by the weakening of the Mexican peso against the U.S. dollar.

Purchased services. Purchased services increased $27.6 million for the year ended December 31, 2014, compared to 2013, due to carload/unit volumes, increases in track and equipment maintenance and corporate expenses.

Fuel. Fuel expense increased $26.3 million for the year ended December 31, 2014, compared to 2013, due to higher consumption. The average price per gallon, including the effects of the weakening of the Mexican peso against the U.S. dollar, was $3.03 in 2014, compared to $3.05 in 2013.

Equipment costs. Equipment costs decreased $41.3 million for the year ended December 31, 2014, compared to 2013, due to lower lease expense as a result of the purchase of equipment under existing operating leases and replacement equipment as certain operating leases expired. In addition, equipment costs decreased due to lower net car hire expense as a result of the increase in owned equipment.

Depreciation and amortization. Depreciation and amortization increased $34.8 million for the year ended December 31, 2014, compared to 2013, due to a larger asset base, including the purchase of equipment under existing operating leases and replacement equipment as certain operating leases expired.

Materials and other. Materials and other increased $18.7 million for the year ended December 31, 2014, compared to 2013, due to increases in casualty expense, materials and supplies expense, and employee expenses. In addition, the Company recognized a recovery from a legal dispute in the first quarter of 2013.

Lease termination costs. Lease termination costs were $38.3 million for the year ended December 31, 2014, due to the early termination of certain operating leases and the related purchase of the equipment. The Company did not incur lease termination costs during 2013.

Non-Operating Expenses

Equity in net earnings of unconsolidated affiliates. Equity in net earnings from unconsolidated affiliates increased $2.3 million for the year ended December 31, 2014, compared to 2013. Equity in earnings from the operations of Panama Canal Railway Company (“PCRC”) increased as PCRC’s volumes were adversely affected during the first half of 2013 as the movement of containers was either trucked or rerouted to other destinations as a result of delays caused by a system implementation at the Port of Balboa.

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Interest expense. Interest expense decreased $7.8 million for the year ended December 31, 2014, compared to 2013, due to lower average interest rates as a result of the Company's refinancing activities during 2013 and the utilization of the commercial paper program during 2014. These decreases were partially offset by higher average debt balances driven by financing incurred during 2013. The average interest rate for the year ended December 31, 2014 was 3.3%, compared to 4.2% in 2013. For the year ended December 31, 2014, the average debt and short-term borrowing balances were $2,174.7 million, compared to $1,852.3 million in 2013.

Debt retirement costs. Debt retirement costs were $6.6 million and $119.2 million for the years ended December 31, 2014 and 2013, respectively. The debt retirement costs include tender and call premiums, original issue discounts and the write-off of unamortized debt issuance costs associated with the Company's various debt refinancing and redemption activities.

Foreign exchange gain (loss). For the years ended December 31, 2014 and 2013, foreign exchange loss was $35.5 million and $5.2 million, respectively. Foreign exchange gain (loss) includes the re-measurement and settlement of monetary assets and liabilities denominated in Mexican pesos and the gain (loss) on foreign currency forward contracts.

For the years ended December 31, 2014 and 2013, the re-measurement and settlement of monetary assets and liabilities denominated in Mexican pesos resulted in a foreign exchange loss of $7.6 million and $4.5 million, respectively.

The Company enters into foreign currency forward contracts to hedge its net exposure to fluctuations in the Mexican cash tax obligation due to changes in the value of the Mexican peso against the U.S. dollar. For the years ended December 31, 2014 and 2013, foreign exchange loss on foreign currency forward contracts was $27.9 million and $0.7 million, respectively.

Other expense, net. Other expense, net, increased $1.4 million for the year ended December 31, 2014 compared to 2013, due to higher miscellaneous fees.

Income tax expense. Income tax expense increased $10.5 million for the year ended December 31, 2014, compared to 2013, due to higher pre-tax income, offset by a lower effective tax rate. The effective tax rate was 29.3% and 35.9% for the years ended December 31, 2014 and 2013, respectively. The decrease in the effective tax rate was primarily due to the significant weakening of the Mexican peso against the U.S. dollar in 2014. The Company enters into foreign currency forward contracts to hedge its net exposure to fluctuations in the Mexican cash tax obligation due to changes in the value of the Mexican peso against the U.S. dollar, and gains (losses) on these foreign currency forward contracts are recorded in foreign exchange gain (loss). Further information on the components of the effective tax rates for the years ended December 31, 2014 and 2013, is presented in Note 11 to the Consolidated Financial Statements in Item 8.

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Year Ended December 31, 2013, compared with the Year Ended December 31, 2012

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

| | 2013 | 2012 | Change |
|---|---|---|---|
| Revenues | $2,369.3 | $2,238.6 | $130.7 |
| Operating expenses | 1,630.7 | 1,522.7 | 108.0 |
| Operating income | 738.6 | 715.9 | 22.7 |
| Equity in net earnings of unconsolidated affiliates | 18.8 | 19.3 | (0.5) |
| Interest expense | (80.6) | (100.4) | 19.8 |
| Debt retirement costs | (119.2) | (20.1) | (99.1) |
| Foreign exchange gain (loss) | (5.2) | 2.7 | (7.9) |
| Other expense, net | (0.8) | (1.0) | 0.2 |
| Income before income taxes | 551.6 | 616.4 | (64.8) |
| Income tax expense | 198.3 | 237.0 | (38.7) |
| Net income | 353.3 | 379.4 | (26.1) |
| Less: Net income attributable to noncontrolling interest | 1.9 | 2.1 | (0.2) |
| Net income attributable to Kansas City Southern and subsidiaries | $351.4 | $377.3 | $(25.9) |

Revenues

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

| | Revenues | | | Carloads and Units | | | Revenue per Carload/Unit | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2012 | % Change | 2013 | 2012 | % Change | 2013 | 2012 | % Change |
| Chemical and petroleum | $426.7 | $410.3 | 4% | 243.4 | 246.8 | (1%) | $1,753 | $1,662 | 5% |
| Industrial and consumer products | 583.8 | 551.1 | 6% | 337.8 | 336.1 | 1% | 1,728 | 1,640 | 5% |
| Agriculture and minerals | 383.9 | 400.5 | (4%) | 212.0 | 218.9 | (3%) | 1,811 | 1,830 | (1%) |
| Energy | 326.6 | 312.8 | 4% | 295.7 | 292.4 | 1% | 1,104 | 1,070 | 3% |
| Intermodal | 356.6 | 306.5 | 16% | 965.6 | 914.2 | 6% | 369 | 335 | 10% |
| Automotive | 201.5 | 174.4 | 16% | 110.3 | 103.7 | 6% | 1,827 | 1,682 | 9% |
| Carload revenues, carloads and units | 2,279.1 | 2,155.6 | 6% | 2,164.8 | 2,112.1 | 2% | $1,053 | $1,021 | 3% |
| Other revenue | 90.2 | 83.0 | 9% | | | | | | |
| Total revenues (i) | $2,369.3 | $2,238.6 | 6% | | | | | | |

| (i) Included in revenues: | | |
|---|---|---|
| Fuel surcharge | $320.2 | $282.1 |

Freight revenues include both revenue for transportation services and fuel surcharges. For the year ended December 31, 2013, revenues and carload/unit volumes increased 6% and 2%, respectively, compared to the prior year, driven by strong growth in intermodal, automotive and industrial and consumer products. Agriculture and minerals revenues decreased $16.6 million for the year ended December 31, 2013, due to a reduction of $12.3 million in grain revenues as the severe drought conditions experienced in the Midwestern region of the U.S. affected grain volumes in the second half of 2012 through the first half of 2013. Revenue per carload/unit increased by 3% for the year ended December 31, 2013, compared to the prior year, due

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to positive pricing impacts, fuel surcharge and the strengthening of the Mexican peso against the U.S. dollar, partially offset by 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 2013

Chemical and petroleum. Revenues increased $16.4 million for the year ended December 31, 2013, compared to 2012, due to a 5% increase in revenue per carload/unit, partially offset by a 1% decrease in carload/unit volumes. Revenues increased due to positive petroleum pricing impacts and higher demand for gases and chemicals used to manufacture glass and other industrial products. Petroleum volumes decreased in the second half of the year due to a customer's temporary route change and increased reliance on hydro power in Mexico.

Industrial and consumer products. Revenues increased $32.7 million for the year ended December 31, 2013, compared to 2012, due to a 5% increase in revenue per carload/unit and a 1% increase in carload/unit volumes. Metals and scrap revenues increased due to a high demand for slab and steel coil driven by strength in the automotive and oil and gas industries, partially offset by lower building material volumes due to increasing lumber prices and a decrease in other volumes as a result of lost business. Forest products revenues increased due to pulp and paper as a result of longer average length of haul attributable to cross border manufacturing demand in Mexico for the first half of 2013.

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Revenues by commodity group for 2013

Agriculture and minerals. Revenues decreased $16.6 million for the year ended December 31, 2013, compared to 2012, due to a 3% reduction in carload/unit volumes and a 1% decrease in revenue per carload/unit. Grain volumes and average length of haul decreased in the second half of 2012 through the first half of 2013 as a result of the severe drought conditions experienced in the Midwestern region of the U.S. during 2012. Food products volumes decreased as higher dried distillers grain prices drove a product substitution in Mexico.
Energy. Revenues increased $13.8 million for the year ended December 31, 2013, compared to 2012, due to a 3% increase in revenue per carload/unit and a 1% increase in carload/unit volumes. Volumes increased due to new crude oil business and strong frac sand demand driven by higher crude oil prices. In addition, pet coke volumes increased due to new business and increased highway project demand for cement. These increases were partially offset by the decline in utility coal volumes due to extended coal utility plant outages.
Intermodal. Revenues increased $50.1 million for the year ended December 31, 2013, compared to 2012, due to a 10% increase in revenue per carload/unit and a 6% increase in carload/unit volumes. Revenue per carload/unit increased as a result of cross border length of haul, and volume growth was driven by conversion of cross border general commodity truck traffic to rail.
Automotive. Revenues increased $27.1 million for the year ended December 31, 2013, compared to 2012, due to a 9% increase in revenue per carload/unit and a 6% increase in carload/unit volumes. Growth was driven by new business, strong year-over-year growth in North American automobile sales for Original Equipment Manufacturers and increased import/export volume through the Port of Lazaro Cardenas.

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Operating Expenses

Operating expenses, as shown below (in millions), increased $108.0 million for the year ended December 31, 2013, when compared to 2012, due to the elimination of $43.0 million of deferred Mexican statutory profit sharing liability as a result of the organizational restructuring in 2012, higher fuel prices and depreciation and amortization expense and the strengthening of the Mexican peso against the U.S. dollar.

| | 2013 | 2012 | Change Dollars | Percent |
|---|---|---|---|---|
| Compensation and benefits | $441.6 | $430.5 | $11.1 | 3 % |
| Purchased services | 217.6 | 219.8 | (2.2) | (1%) |
| Fuel | 389.6 | 359.6 | 30.0 | 8 % |
| Equipment costs | 160.5 | 167.1 | (6.6) | (4%) |
| Depreciation and amortization | 223.3 | 198.8 | 24.5 | 12 % |
| Materials and other | 198.1 | 189.9 | 8.2 | 4 % |
| Elimination of deferred statutory profit sharing liability, net | — | (43.0) | 43.0 | 100 % |
| Total operating expenses | $1,630.7 | $1,522.7 | $108.0 | 7 % |

Compensation and benefits. Compensation and benefits increased $11.1 million for the year ended December 31, 2013, compared to 2012, due to annual salary rate increases, benefit expenses and the strengthening of the Mexican peso against the U.S. dollar, partially offset by a $7.3 million reduction in Mexican deferred statutory profit sharing expense as a result of the organizational restructuring in 2012.

Purchased services. Purchased services decreased $2.2 million for the year ended December 31, 2013, compared to 2012, due to the termination of a maintenance contract as a result of in-sourcing of certain track maintenance activities and lower freight car repairs, partially offset by increases in security services, higher locomotive wireless monitoring service expense, corporate expenses and joint facilities expense.

Fuel. Fuel expense increased $30.0 million for the year ended December 31, 2013, compared to 2012, due to higher diesel fuel prices and consumption. The average price per gallon, including the effects of the strengthening of the Mexican peso against the U.S. dollar, was $3.05 in 2013, compared to $2.86 in 2012.

Equipment costs. Equipment costs decreased $6.6 million for the year ended December 31, 2013, compared to 2012, due to lower locomotive lease expense as a result of the purchase of 103 locomotives late in the second quarter of 2013, which were previously leased by the Company under operating lease agreements.

Depreciation and amortization. Depreciation and amortization increased $24.5 million for the year ended December 31, 2013, compared to 2012, due to a larger asset base, including the purchase of 103 locomotives late in the second quarter of 2013, which were previously leased by the Company under operating lease agreements.

Materials and other. Materials and other increased $8.2 million for the year ended December 31, 2013, compared to 2012, due to a $1.3 million increase in personal injury expense recognized in 2013, compared to an $8.4 million reduction in personal injury expense recognized in 2012, as a result of changes in estimates. In addition, materials and other expense increased due to a $4.9 million increase in concession duty expense. KCSM paid concession duty 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. These increases were partially offset by lower derailment expense, a recovery from a legal dispute in 2013 and the settlement of a legal dispute recognized in 2012.

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.

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Non-Operating Expenses

Equity in net earnings of unconsolidated affiliates. Equity in net earnings from unconsolidated affiliates decreased $0.5 million for the year ended December 31, 2013, compared to 2012, due to decreased net earnings from Southern Capital due to lower lease income.

Interest expense. Interest expense decreased $19.8 million for the year ended December 31, 2013, compared to 2012, due to lower average interest rates as a result of the Company's refinancing activities, partially offset by an increase in average debt balances. For the year ended December 31, 2013, the average debt balance and average interest rate were $1,852.3 million and 4.2%, compared to $1,620.9 million and 6.0%, respectively, in 2012.

Debt retirement costs. Debt retirement costs were $119.2 million and $20.1 million for the years ended December 31, 2013, and 2012, respectively, related to the tender and call premiums, original issue discounts and write-off of unamortized debt issuance costs associated with the various debt refinancing and redemption activities.

Foreign exchange gain (loss). For the year ended December 31, 2013, foreign exchange loss was $5.2 million, compared to a foreign exchange gain of $2.7 million in 2012. Foreign exchange gain (loss) includes the re-measurement and settlement of monetary assets and liabilities denominated in Mexican pesos and the gain (loss) on foreign currency forward contracts.

For the year ended December 31, 2013 and 2012, the re-measurement and settlement of monetary assets and liabilities denominated in Mexican pesos resulted in a foreign exchange loss of $4.5 million, compared to a foreign exchange gain of $2.7 million, respectively.

The Company enters into foreign currency forward contracts to hedge its net exposure to fluctuations in the Mexican cash tax obligation due to changes in the value of the Mexican peso against the U.S. dollar. For the year ended December 31, 2013, foreign exchange loss on foreign currency forward contracts was $0.7 million. The Company did not enter into foreign currency forward contracts in 2012.

Other expense, net. Other expense, net, decreased $0.2 million for the year ended December 31, 2013, compared to 2012, due to lower miscellaneous expense.

Income tax expense. Income tax expense decreased $38.7 million for the year ended December 31, 2013, compared to 2012, due to lower pre-tax income and a lower effective tax rate. The effective tax rate was 35.9% and 38.4% for the years ended December 31, 2013 and 2012, respectively. The decrease in the effective tax rate was due to a slight weakening of the Mexican peso against the U.S. dollar in 2013 compared to the strengthening of the Mexican peso against the U.S. dollar in 2012. These rates were also affected by the reversal in 2013 of a previously recognized benefit as a result of a court ruling, a reduction in 2012 of a deferred tax asset valuation allowance related to state net operating losses, and a higher rate of inflation in 2012. Further information on the components of the effective tax rates for the years ended December 31, 2013 and 2012, is presented in Note 11 to the Consolidated Financial Statements in Item 8.

## LIQUIDITY AND CAPITAL RESOURCES

### Overview

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

The Company believes, based on current expectations, that cash and other liquid assets, operating cash flows, access to debt and equity capital markets, and other available financing resources will be sufficient to fund anticipated operating expenses, capital expenditures, debt service costs, dividends and other commitments in the foreseeable future. The Company may, from time to time, incur debt to refinance existing indebtedness, purchase equipment under operating leases, fund equipment additions or new investments.

In 2014, the Company invested $702.7 million in capital expenditures and purchased $300.7 million of equipment under existing operating leases and replacement equipment as certain operating leases expired. These purchases were primarily funded with a portion of the proceeds from the senior notes issued during the fourth quarter of 2013. As a result, the Company has increased the percentage of owned equipment from 31% at December 31, 2013 to 51% at December 31, 2014.

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In January 2014, the Company amended its credit agreements to eliminate certain representations as a condition to borrowing under the KCSR and KCSM revolving facilities, provide for the prepayment of all outstanding term loans under the KCSR credit agreement on or before February 13, 2014, and increase the borrowing capacity under KCSR's revolving credit facility to $450.0 million. The Company also established a $450.0 million commercial paper program for KCSR and a $200.0 million commercial paper program for KCSM. The Company's revolving facilities will serve as a backstop for the commercial paper programs and these commercial paper programs generally serve as the Company's primary means of short-term funding.

In February 2014, KCSM redeemed all of the remaining $62.8 million aggregate principal amount of the KCSM 8.0% senior notes using a portion of the proceeds from the KCSM floating rate senior unsecured notes due October 28, 2016, (the "Floating Rate Senior Notes") issued in the fourth quarter of 2013. In addition, KCSR borrowed $175.0 million under the KCSR Revolving Facility and used the proceeds and cash on hand to repay the outstanding $245.3 million principal amount of the KCSR term loan. On February 14, 2014, KCSR repaid the outstanding $175.0 million principal amount of the KCSR Revolving Facility using proceeds received under the KCSR commercial paper program. As of December 31, 2014, $150.1 million was outstanding under the KCSR commercial paper program.

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

The Company's current financing instruments contain restrictive covenants which limit or preclude certain actions; however, the covenants are structured such that the Company has sufficient flexibility to conduct its operations. The Company was in compliance with all of its debt covenants as of December 31, 2014.

For discussion regarding the agreements representing the indebtedness of KCS, see "Note 9, Short-Term Borrowings" and "Note 10, Long-Term Debt" in the "Notes to the Consolidated Financial Statements" section of this annual report on Form 10-K.

During 2014, the Company's Board of Directors declared quarterly cash dividends of $0.28 per share or $30.9 million on its common stock. On January 29, 2015, the Company's Board of Directors declared a cash dividend of $0.33 per share payable on April 8, 2015, to common stockholders of record as of March 9, 2015. 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.

On December 31, 2014, total available liquidity (the cash balance plus revolving credit facility availability) was $847.9 million, compared to available liquidity at December 31, 2013 of $829.5 million. As of December 31, 2014, the total cash and cash equivalents held outside of the U.S. in foreign subsidiaries was $313.3 million. This cash is available to fund company operations without incurring additional income taxes.

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.

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Cash Flow Information and Contractual Obligations

Summary cash flow data follows (in millions):

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Cash flows provided by (used for): | | | |
| Operating activities | $906.0 | $798.3 | $673.2 |
| Investing activities | (982.9) | (833.3) | (551.9) |
| Financing activities | (4.6) | 391.9 | (121.1) |
| Net increase (decrease) in cash and cash equivalents | (81.5) | 356.9 | 0.2 |
| Cash and cash equivalents beginning of year | 429.5 | 72.6 | 72.4 |
| Cash and cash equivalents end of year | $348.0 | $429.5 | $72.6 |

During 2014, cash and cash equivalents decreased $81.5 million as a result of the purchase or replacement of certain equipment under existing leases and increased capital expenditures which were funded with borrowings incurred in 2013 and cash flows from operating activities. During 2013, cash and cash equivalents increased $356.9 million, due to an increase in borrowings that was used, in part, to fund the purchase or replacement of equipment under existing operating leases during 2013 and 2014.

Operating Cash Flows. Net operating cash flows for 2014 increased $107.7 million to $906.0 million due to increased net income and distributions from unconsolidated affiliates. Net operating cash flows for 2013 increased $125.1 million to $798.3 million due to increased net income and a decrease in cash used for working capital items, resulting mainly from the timing of certain payments and receipts.

Investing Cash Flows. Net investing cash outflows were $982.9 million and $833.3 million during 2014 and 2013, respectively. This $149.6 million increase was due to the purchase or replacement of equipment under operating leases and an increase in capital expenditures. Net investing cash outflows for 2013 increased $281.4 million as compared to 2012, primarily due to the purchase or replacement of equipment under operating leases and an increase in capital expenditures.

Financing Cash Flows. Financing cash inflows are generated from the issuance of long-term debt, commercial paper and proceeds from the issuance of common stock under employee stock plans. Financing cash outflows are used for the repayment of debt, short-term borrowings and the payment of dividends and debt costs. Financing cash flows for 2014, 2013, and 2012 are discussed in more detail below:

- Net financing cash outflows for 2014 were $4.6 million due to the net repayment of $333.0 million of long term debt and the payment of $116.6 million of dividends, offset by the net proceeds of $448.6 million from short-term borrowings.
- Net financing cash inflows for 2013 were $391.9 million due to the net proceeds of $575.2 million from long-term borrowings, offset by the payment of $117.8 million in debt costs and $71.2 million of dividends.
- Net financing cash outflows for 2012 were $121.1 million due to the payment of dividends of $86.1 million, the net repayment of long-term debt of $46.3 million and $22.1 million in debt costs.

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Contractual Obligations. The following table outlines the material obligations and commitments as of December 31, 2014 (in millions):

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | More than 5 years |
| Long-term debt and short-term borrowings (including interest and capital lease obligations) (i) | $3,211.8 | $543.7 | $426.9 | $167.4 | $2,073.8 |
| Operating leases | 365.7 | 74.5 | 124.9 | 67.8 | 98.5 |
| Obligations due to uncertainty in income taxes | 1.7 | — | 1.7 | — | — |
| Capital expenditure obligations (ii) | 504.4 | 156.3 | 316.0 | 32.1 | — |
| Other contractual obligations (iii) | 518.2 | 151.7 | 156.8 | 95.3 | 114.4 |
| Total | $4,601.8 | $926.2 | $1,026.3 | $362.6 | $2,286.7 |

(i) For variable rate obligations, interest payments were calculated using the December 31, 2014 rate. For fixed rate obligations, interest payments were calculated based on the applicable rates and payment dates.

(ii) Capital expenditure obligations include minimum capital expenditures under the KCSM Concession agreement and other regulatory requirements.

(iii) 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 ten utilization leases covering 1,811 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 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 and liquidity reserve (reserves which are required to be established by PCRC in connection with the issuance of the Notes). As of December 31, 2014, the Company's portion of these reserves was $5.4 million. The Company has issued a standby letter of credit in the amount of $5.4 million to fund its share of these reserves.

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Capital Expenditures

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

The following table summarizes capital expenditures by type for the years ended December 31, 2014, 2013, and 2012, respectively (in millions):

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Roadway capital program | $311.1 | $315.7 | $332.4 |
| Locomotives and freight cars | 245.1 | 194.7 | 101.5 |
| Capacity | 93.0 | 63.1 | 25.9 |
| Information technology | 31.9 | 15.6 | 11.6 |
| Other | 21.6 | 10.0 | 28.4 |
| Total capital expenditures (accrual basis) | 702.7 | 599.1 | 499.8 |
| Change in capital accruals | (34.5) | (4.3) | 17.3 |
| Total cash capital expenditures | $668.2 | $594.8 | $517.1 |
| | | | |
| Purchase or replacement of equipment under operating leases | | | |
| Locomotives | $76.3 | $155.3 | $— |
| Freight cars | 224.4 | 57.9 | 22.9 |
| Total purchase or replacement of equipment under operating leases (accrual basis) | 300.7 | 213.2 | 22.9 |
| Change in capital accruals | 1.4 | (1.4) | — |
| Total cash purchase or replacement of equipment under operating leases | $302.1 | $211.8 | $22.9 |

Generally, the Company’s capital program consists of capital replacement and equipment. For 2015, internally generated cash flows and short-term borrowings are expected to fund cash capital expenditures, which are currently estimated to be between $700.0 million and $720.0 million. In addition, the Company is continuously reviewing its equipment under operating leases. Any additional purchase or replacement of equipment under operating leases during 2015 is expected to be funded with internally generated cash flows, short and/or long-term debt.

Property Statistics

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

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Track miles of rail installed | 169 | 138 | 133 |
| Cross ties installed (thousands) | 880 | 929 | 997 |

Shelf Registration Statements and Public Securities Offerings

KCS has one current shelf registration statement on file with the SEC (the “Universal Shelf” — Registration No. 333-200411). The Universal Shelf was filed on November 20, 2014 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 20, 2017.

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 a substantial portion of the Company's consolidated financial statements. Net property and equipment, including concession assets, comprised approximately 88% of the Company's total assets as of December 31, 2014, and related depreciation and amortization comprised approximately 15% of total operating expenses for the year ended December 31, 2014.

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, 2014, 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.

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.

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. The Company completed depreciation studies for KCSM in 2014 and its U.S. based assets in 2012. The impacts of the studies were immaterial to the consolidated financial results for all periods.

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 roadway assets is necessary as it is impractical to track individual, homogeneous network-type assets. Certain types of roadway assets are retired using statistical curves derived from the depreciation studies that indicate the relative distribution of the age of the assets retired. For other roadway 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, 2014.

Estimation of the average useful lives of assets and net salvage values requires 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, 2014 was $258.1 million. If the weighted average useful lives of assets were changed by one year, annual depreciation and amortization expense would change approximately $9.2 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 years ended December 31, 2014 and 2013, management did not identify any indicators of impairment.

Provision for Personal Injury Claims

Personal injury claims represent work-related injuries and third party liabilities resulting from crossing collisions and derailments. 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

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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 15 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Income Taxes

Deferred income taxes represent a net asset or 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 deferred tax assets. Income tax expense related to Mexican operations has additional complexities such as the impact of exchange rate variations, which can have a significant impact on the effective income tax rate.

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, 2014, income tax expense totaled $208.8 million. For every 1% change in the 2014 effective rate, income tax expense would have changed by approximately $7.1 million. For further information on the impact of foreign exchange fluctuation on income taxes, refer to Foreign Exchange Sensitivity in Item 7A.

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 15 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.

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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 8 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 includes commercial paper borrowings, revolving credit facilities, term loan facilities and floating rate senior notes, which totaled $400.1 million and $495.3 million at December 31, 2014 and 2013, respectively. Considering the balance of $400.1 million of variable rate debt at December 31, 2014, KCS is sensitive to fluctuations in interest rates. For example, a hypothetical 100 basis points increase in interest rates would result in additional interest expense of $4.0 million on an annualized basis for the floating-rate instruments issued by the Company as of December 31, 2014.

Based upon the borrowing rates available to KCS and its subsidiaries for indebtedness with similar terms and average maturities, the fair value of long-term debt was approximately $1,884.1 million and $2,082.9 million at December 31, 2014 and 2013, respectively, compared with a carrying value of $1,865.8 million and $2,188.9 million at December 31, 2014 and 2013, respectively.

Commodity Price Sensitivity. KCS periodically participates in diesel fuel purchase commitment and swap transactions. At December 31, 2014 and 2013, 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 2015; however, fuel costs are unpredictable and subject to a variety of factors outside the Company's control. Assuming annual consumption of 137 million gallons, a 10 cent change in the price per gallon of fuel would cause a $13.7 million change in operating expenses. KCS mitigates the impact of increased fuel costs through fuel surcharge revenues from customers; however, in a period of volatile fuel prices or changing customer business mix, changes in fuel expense and fuel surcharge may differ.

Foreign Exchange Sensitivity. 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. The Company had Ps.850.7 million of net monetary assets at December 31, 2014.

The following table presents an estimate of the impact to the consolidated statements of income that would result from a hypothetical one Mexican peso change in the exchange rate at December 31, 2014:

| | Hypothetical Change in Exchange Rate | Amount of Gain (Loss) | Affected Line Item in the Consolidated Statements of Income |
|---|---|---|---|
| Net monetary assets denominated in Mexican pesos at December 31, 2014: | | | |
| Ps.850.7 million | From Ps.14.7 to Ps.15.7 | ($3.7 million) | Foreign exchange gain (loss) |
| Ps.850.7 million | From Ps.14.7 to Ps.13.7 | $4.2 million | Foreign exchange gain (loss) |

Mexican income taxes are paid in Mexican pesos, and as a result, the effective income tax rate reflects fluctuations in the value of the Mexican peso against the U.S. dollar. Most significantly, any gain or loss from the revaluation of net U.S. dollar-denominated monetary liabilities (primarily debt) into Mexican pesos is included in Mexican taxable income under Mexican tax law. As a result, a strengthening of the Mexican peso against the U.S. dollar for the reporting period will generally increase the Mexican cash tax obligation and the effective income tax rate, and a weakening of the Mexican peso against the U.S. dollar for the reporting period will generally decrease the Mexican cash tax obligation and the effective tax rate.

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The following table presents an estimate of the impact to the effective income tax rate and income tax expense that would result from a hypothetical one Mexican peso change in the exchange rate at December 31, 2014:

| Hypothetical Change in Exchange Rate | Increase (Decrease) in Effective Income Tax Rate | Amount of Expense (Benefit) | Affected Line Item in the Consolidated Statements of Income |
|---|---|---|---|
| From Ps.14.7 to Ps.15.7 | (2.1%) | ($14.8 million) | Income tax expense |
| From Ps.14.7 to Ps.13.7 | 2.4% | $17.0 million | Income tax expense |

The Company may enter into foreign currency derivative instruments to hedge its exposure to fluctuations in the Mexican cash tax obligation due to changes in the value of the Mexican peso against the U.S. dollar. In December 2014, the Company entered into foreign currency forward contracts with an aggregate notional amount of $300.0 million. These contracts matured on January 15, 2015, and obligated the Company to purchase a total of Ps.4,364.7 million at a weighted-average exchange rate of Ps.14.55 to each U.S. dollar. During January 2015, the Company entered into offsetting contracts with an aggregate notional amount of $298.8 million. These offsetting contracts matured on January 15, 2015, and obligated the Company to sell a total of Ps.4,364.7 million at a weighted-average exchange rate of Ps.14.61 to each U.S. dollar.

In addition, during January 2015, the Company entered into foreign currency forward contracts with an aggregate notional amount of $300.0 million. These contracts mature on January 15, 2016 and obligate the Company to purchase a total of Ps.4,480.4 million at a weighted average exchange rate of Ps.14.93 to each U.S. dollar.

The Company has not designated these foreign currency forward contracts as hedging instruments for accounting purposes. The foreign currency forward contracts will be measured at fair value each period and any change in fair value will be recognized in foreign exchange gain (loss) within the consolidated statements of income.

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Item 8. Financial Statements and Supplementary Data

Index to Consolidated Financial Statements



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.

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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, 2014, based on the framework established by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control — Integrated Framework (2013) (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, 2014, based on the criteria outlined in the COSO Framework.

The effectiveness of the Company’s internal control over financial reporting as of December 31, 2014, has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their attestation report, which immediately follows this report.

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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, 2014, based on criteria established in Internal Control - Integrated Framework (2013) 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, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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, 2014 and 2013, 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, 2014, and our report dated January 30, 2015 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP
Kansas City, Missouri
January 30, 2015

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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, 2014 and 2013, 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, 2014. 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, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

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, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated January 30, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP
Kansas City, Missouri
January 30, 2015

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

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | (In millions, except share and per share amounts) | | |
| Revenues | $2,577.1 | $2,369.3 | $2,238.6 |
| Operating expenses: | | | |
| Compensation and benefits | 474.5 | 441.6 | 430.5 |
| Purchased services | 245.2 | 217.6 | 219.8 |
| Fuel | 415.9 | 389.6 | 359.6 |
| Equipment costs | 119.2 | 160.5 | 167.1 |
| Depreciation and amortization | 258.1 | 223.3 | 198.8 |
| Materials and other | 216.8 | 198.1 | 189.9 |
| Lease termination costs | 38.3 | — | — |
| Elimination of deferred statutory profit sharing liability, net | — | — | (43.0) |
| Total operating expenses | 1,768.0 | 1,630.7 | 1,522.7 |
| Operating income | 809.1 | 738.6 | 715.9 |
| Equity in net earnings of unconsolidated affiliates | 21.1 | 18.8 | 19.3 |
| Interest expense | (72.8) | (80.6) | (100.4) |
| Debt retirement costs | (6.6) | (119.2) | (20.1) |
| Foreign exchange gain (loss) | (35.5) | (5.2) | 2.7 |
| Other expense, net | (2.2) | (0.8) | (1.0) |
| Income before income taxes | 713.1 | 551.6 | 616.4 |
| Income tax expense | 208.8 | 198.3 | 237.0 |
| Net income | 504.3 | 353.3 | 379.4 |
| Less: Net income attributable to noncontrolling interest | 1.7 | 1.9 | 2.1 |
| Net income attributable to Kansas City Southern and subsidiaries | 502.6 | 351.4 | 377.3 |
| Preferred stock dividends | 0.2 | 0.2 | 0.2 |
| Net income available to common stockholders | $502.4 | $351.2 | $377.1 |
| | | | |
| Earnings per share: | | | |
| Basic earnings per share | $4.56 | $3.19 | $3.44 |
| Diluted earnings per share | $4.55 | $3.18 | $3.43 |
| | | | |
| Average shares outstanding (in thousands): | | | |
| Basic | 110,163 | 109,973 | 109,712 |
| Potentially dilutive common shares | 270 | 367 | 368 |
| Diluted | 110,433 | 110,340 | 110,080 |

See accompanying notes to consolidated financial statements.

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

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | (In millions) | | |
| Net income | $504.3 | $353.3 | $379.4 |
| Other comprehensive income (loss): | | | |
| Unrealized loss on cash flow hedges arising during the period, net of tax of $(0.1) million and $(0.6) million | — | (0.2) | (1.0) |
| Reclassification adjustment from cash flow hedges included in net income, net of tax of less than $0.1 million, $0.3 million and $0.3 million | 0.1 | 0.7 | 0.4 |
| Amortization of prior service credit, net of tax of $(0.1) million for all periods presented | (0.2) | (0.1) | (0.1) |
| Foreign currency translation adjustments, net of tax of $(0.7) million and $0.4 million | (1.1) | — | 0.5 |
| Other comprehensive income (loss) | (1.2) | 0.4 | (0.2) |
| Comprehensive income | 503.1 | 353.7 | 379.2 |
| Less: comprehensive income attributable to noncontrolling interest | 1.7 | 1.9 | 2.1 |
| Comprehensive income attributable to Kansas City Southern and subsidiaries | $501.4 | $351.8 | $377.1 |

See accompanying notes to consolidated financial statements.

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Kansas City Southern and Subsidiaries
Consolidated Balance Sheets
December 31,

| | 2014 | 2013 |
|---|---|---|
| | (In millions, except share and per share amounts) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $348.0 | $429.5 |
| Accounts receivable, net | 181.6 | 198.3 |
| Materials and supplies | 111.0 | 121.3 |
| Deferred income taxes | 100.1 | 131.6 |
| Other current assets | 77.6 | 61.7 |
| Total current assets | 818.3 | 942.4 |
| Investments | 36.4 | 41.1 |
| Property and equipment (including concession assets), net | 7,154.7 | 6,356.3 |
| Other assets | 81.6 | 95.6 |
| Total assets | $8,091.0 | $7,435.4 |
| LIABILITIES AND EQUITY | | |
| Current liabilities: | | |
| Long-term debt due within one year | $24.8 | $332.0 |
| Short-term borrowings | 450.1 | — |
| Accounts payable and accrued liabilities | 423.9 | 398.6 |
| Total current liabilities | 898.8 | 730.6 |
| Long-term debt | 1,841.0 | 1,856.9 |
| Deferred income taxes | 1,156.3 | 1,044.6 |
| Other noncurrent liabilities and deferred credits | 130.8 | 126.7 |
| Total liabilities | 4,026.9 | 3,758.8 |
| 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; 110,392,330 and 110,229,229 shares outstanding at December 31, 2014 and 2013, respectively | 1.1 | 1.1 |
| Additional paid-in capital | 949.8 | 942.5 |
| Retained earnings | 2,801.7 | 2,422.9 |
| Accumulated other comprehensive loss | (3.2) | (2.0) |
| Total stockholders’ equity | 3,755.5 | 3,370.6 |
| Noncontrolling interest | 308.6 | 306.0 |
| Total equity | 4,064.1 | 3,676.6 |
| Total liabilities and equity | $8,091.0 | $7,435.4 |

See accompanying notes to consolidated financial statements.

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

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | (In millions) | | |
| Operating activities: | | | |
| Net income | $504.3 | $353.3 | $379.4 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 258.1 | 223.3 | 198.8 |
| Deferred income taxes | 140.1 | 111.2 | 197.3 |
| Equity in net earnings of unconsolidated affiliates | (21.1) | (18.8) | (19.3) |
| Share-based compensation | 10.0 | 13.6 | 10.7 |
| Excess tax benefit from share-based compensation | 0.7 | (4.2) | (31.5) |
| Elimination of deferred statutory profit sharing liability | — | — | (47.8) |
| Distributions from unconsolidated affiliates | 25.5 | 12.5 | 19.8 |
| Debt retirement costs | 6.6 | 119.2 | 20.1 |
| Changes in working capital items: | | | |
| Accounts receivable | 17.2 | (14.4) | (21.5) |
| Materials and supplies | 9.2 | 7.1 | (9.3) |
| Other current assets | (10.0) | (1.8) | (15.1) |
| Accounts payable and accrued liabilities | (21.8) | 0.3 | (3.0) |
| Other, net | (12.8) | (3.0) | (5.4) |
| Net cash provided by operating activities | 906.0 | 798.3 | 673.2 |
| Investing activities: | | | |
| Capital expenditures | (668.2) | (594.8) | (517.1) |
| Purchase or replacement of equipment under operating leases | (302.1) | (211.8) | (22.9) |
| Property investments in MSLLC | (26.7) | (31.6) | (35.2) |
| Proceeds from disposal of property | 9.9 | 8.2 | 14.7 |
| Other, net | 4.2 | (3.3) | 8.6 |
| Net cash used for investing activities | (982.9) | (833.3) | (551.9) |
| Financing activities: | | | |
| Proceeds from short-term borrowings | 15,368.8 | — | — |
| Repayment of short-term borrowings | (14,920.2) | — | — |
| Proceeds from issuance of long-term debt | 175.0 | 1,918.4 | 329.6 |
| Repayment of long-term debt | (508.0) | (1,343.2) | (375.9) |
| Dividends paid | (116.6) | (71.2) | (86.1) |
| Debt costs | (4.9) | (117.8) | (22.1) |
| Excess tax benefit from share-based compensation | (0.7) | 4.2 | 31.5 |
| Proceeds from employee stock plans | 2.0 | 1.5 | 1.9 |
| Net cash provided by (used for) financing activities | (4.6) | 391.9 | (121.1) |
| Cash and cash equivalents: | | | |
| Net increase (decrease) during each year | (81.5) | 356.9 | 0.2 |
| At beginning of year | 429.5 | 72.6 | 72.4 |
| At end of year | $348.0 | $429.5 | $72.6 |
| Supplemental cash flow information | | | |
| Non-cash investing and financing activities: | | | |
| Capital expenditures and purchase or replacement of equipment under operating lease accrued but not yet paid at end of year | $83.2 | $50.1 | $44.4 |

| | | | |
|---|---|---|---|
| Capital lease obligations incurred | 9.1 | — | 13.8 |
| Non-cash asset acquisitions | 5.9 | 56.7 | 13.2 |
| Dividends accrued but not yet paid at end of year | 31.0 | 23.8 | — |
| Cash payments: | | | |
| Interest paid, net of amounts capitalized | $72.5 | $84.1 | $97.9 |
| Income tax payments, net of refunds | 62.9 | 99.2 | 1.9 |

See accompanying notes to consolidated financial statements.

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Kansas City Southern and Subsidiaries
Consolidated Statements of Changes in Equity

| | $25 Par Preferred Stock | $.01 Par Common Stock | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Non-controlling Interest | Total |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2011 | $6.1 | $ 1.1 | $ 884.2 | $1,875.3 | $ (2.2) | $ 294.2 | $3,058.7 |
| Net income | | | | 377.3 | | 2.1 | 379.4 |
| Other comprehensive loss | | | | | (0.2) | | (0.2) |
| Contributions 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) |
| Excess tax benefit from share-based compensation | | | 31.5 | | | | 31.5 |
| Share-based compensation | | | 10.7 | | | | 10.7 |
| Balance at December 31, 2012 | 6.1 | 1.1 | 925.3 | 2,166.5 | (2.4) | 304.1 | 3,400.7 |
| Net income | | | | 351.4 | | 1.9 | 353.3 |
| Other comprehensive income | | | | | 0.4 | | 0.4 |
| Dividends on common stock ($0.86/share) | | | | (94.8) | | | (94.8) |
| 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 | | | (0.6) | | | | (0.6) |
| Excess tax benefit from share-based compensation | | | 4.2 | | | | 4.2 |
| Share-based compensation | | | 13.6 | | | | 13.6 |
| Balance at December 31, 2013 | 6.1 | 1.1 | 942.5 | 2,422.9 | (2.0) | 306.0 | 3,676.6 |
| Net income | | | | 502.6 | | 1.7 | 504.3 |
| Other comprehensive loss | | | | | (1.2) | | (1.2) |
| Contributions from noncontrolling interest | | | | | | 0.9 | 0.9 |
| Dividends on common stock ($1.12/share) | | | | (123.6) | | | (123.6) |
| 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 | | | (2.0) | | | | (2.0) |
| | | | (0.7) | | | | (0.7) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Excess tax benefit from share-based compensation | | | | | | | |
| Share-based compensation | | | 10.0 | | | | 10.0 |
| Balance at December 31, 2014 | $6.1 | $1.1 | $949.8 | $2,801.7 | $(3.2) | $308.6 | $4,064.1 |

See accompanying notes to consolidated financial statements.

Kansas City Southern and Subsidiaries
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. MSLLC owns the former KCSR rail line between Meridian, Mississippi and Shreveport, Louisiana, which is the portion of the 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;
- Southern Capital Corporation, LLC ("Southern Capital"), a fifty percent-owned unconsolidated affiliate that owned and leased 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. KCSM is required to register its rates with the Mexican 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.

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

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 to render railroad services 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 April 16, 2012, between KCSM Servicios and the Sindicato de Trabajadores Ferrocarrileros de la República Mexicana ("Mexican Railroad Union"), for an indefinite period of time, for the purpose of regulating the relationship between the parties. Approximately 80% of KCSM Servicios employees are covered by this labor agreement. The compensation terms under this labor agreement are subject to renegotiation on an annual basis and all other benefits are subject to negotiation every two years. The union labor negotiations with the Mexican Railroad Union have not historically resulted in any strike, boycott or other disruption in KCSM's business operations. On October 14, 2014, compensation terms covering the period from July 1, 2014 through June 30, 2015, were finalized between KCSM Servicios and the Mexican Railroad Union. The finalization of the compensation terms did not have a significant effect on the consolidated financial statements.

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

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

Use of Estimates. The accounting and financial reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“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, 2014 and 2013, the allowance for doubtful accounts was $8.7 million and $7.5 million, respectively. For the years ended December 31, 2014, 2013 and 2012, bad debt expense was $0.4 million, $0.6 million and $1.3 million, respectively.

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.

Property and Equipment (including Concession Assets). 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.

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

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

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.

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. The Company completed depreciation studies for KCSM in 2014 and its U.S. based assets in 2012. The impacts of the studies were immaterial to the consolidated financial results for all periods.

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 roadway assets is necessary as it is impractical to track individual, homogeneous network-type assets. Certain types of roadway assets are retired using statistical curves derived from the depreciation studies that indicate the relative distribution of the age of the assets retired. For other roadway 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.

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, 2014 and 2013, 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 business combinations. As of December 31, 2014 and 2013, 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, 2014 and 2013, and concluded there was no impairment.

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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 recognition in the financial statements 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 (December 31) are recognized immediately in 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 fair value net of estimated forfeitures, and is recognized over the requisite service period in which the award is earned.

The Company issues treasury stock to settle share-based awards. The Company does not intend to repurchase any shares in 2015 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.

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

The Company has recognized a deferred tax asset, net of a valuation allowance, for net operating loss and tax credit 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, 2014, the Company adopted, on a prospective basis, ASU No. 2013-11, Income Taxes, issued by the Financial Accounting Standards Board (FASB), related to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The guidance requires, unless certain conditions exists, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, similar tax loss, or a tax credit carryforward. If a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The adoption of this guidance did not have a material impact on the Company’s consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires companies to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration it expects to be entitled in exchange for those goods or services. The standard will be effective for the Company beginning in the first quarter of 2017 and early adoption is not permitted. The new standard permits the use of either the retrospective or cumulative effect transition method on adoption. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial 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.

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):

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Net income available to common stockholders for purposes of computing basic and diluted earnings per share | $502.4 | $351.2 | $377.1 |
| Weighted-average number of shares outstanding (in thousands): | | | |
| Basic shares | 110,163 | 109,973 | 109,712 |
| Effect of dilution | 270 | 367 | 368 |
| Diluted shares | 110,433 | 110,340 | 110,080 |
| Earnings per share: | | | |
| Basic earnings per share | $4.56 | $3.19 | $3.44 |
| Diluted earnings per share | $4.55 | $3.18 | $3.43 |

| Potentially dilutive shares excluded from the calculation (in thousands): | 2014 | 2013 | 2012 |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Stock options excluded as their inclusion would be anti-dilutive | 57 | 57 | — |

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Notes to Consolidated Financial Statements-(Continued)

Note 4. Lease Termination Costs
During 2014, the Company purchased $300.7 million of equipment under existing operating leases and replacement equipment as certain operating leases expired. During 2014, the Company recognized $38.3 million of lease termination costs (included in operating expenses) due to the early termination of certain operating leases and the related purchase of the equipment. The Company did not incur lease termination costs during 2013 or 2012.

Note 5. 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):

| As of December 31, 2014 | Cost | Accumulated Depreciation | | Net Book Value | Depreciation Rates for 2014 | |
|---|---|---|---|---|---|---|
| Land | $216.8 | $— | | $216.8 | N/A | |
| Concession land rights | 141.2 | (22.3 | ) | 118.9 | 1.0 | % |
| Rail and other track material | 1,707.6 | (361.1 | ) | 1,346.5 | 1.9-3.2% | |
| Ties | 1,484.7 | (312.6 | ) | 1,172.1 | 2.0-4.2% | |
| Grading | 839.6 | (137.9 | ) | 701.7 | 1.0 | % |
| Bridges and tunnels | 669.5 | (123.8 | ) | 545.7 | 1.2 | % |
| Ballast | 649.8 | (170.0 | ) | 479.8 | 2.7-4.8% | |
| Other (a) | 943.5 | (275.6 | ) | 667.9 | 3.1 | % |
| Total road property | 6,294.7 | (1,381.0 | ) | 4,913.7 | 2.8 | % |
| Locomotives | 1,310.3 | (238.3 | ) | 1,072.0 | 4.7 | % |
| Freight cars | 610.6 | (98.3 | ) | 512.3 | 5.3 | % |
| Other equipment | 59.0 | (18.5 | ) | 40.5 | 8.2 | % |
| Total equipment | 1,979.9 | (355.1 | ) | 1,624.8 | 5.0 | % |
| Technology and other | 160.9 | (121.9 | ) | 39.0 | 13.2 | % |
| Construction in progress | 241.5 | — | | 241.5 | N/A | |
| Total property and equipment (including concession assets) | $9,035.0 | $(1,880.3 | ) | $7,154.7 | N/A | |

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

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

| As of December 31, 2013 | Cost | Accumulated Depreciation | Net Book Value | Depreciation Rates for 2013 |
|---|---|---|---|---|
| Land | $216.4 | $— | $216.4 | N/A |
| Concession land rights | 141.2 | (20.9) | 120.3 | 1.0% |
| Rail and other track material | 1,617.8 | (341.1) | 1,276.7 | 1.8-3.1% |
| Ties | 1,425.1 | (303.7) | 1,121.4 | 2.0-4.3% |
| Grading | 829.6 | (129.7) | 699.9 | 1.1% |
| Bridges and tunnels | 606.4 | (116.5) | 489.9 | 1.2% |
| Ballast | 602.7 | (155.2) | 447.5 | 2.6-4.8% |
| Other (a) | 874.1 | (252.8) | 621.3 | 2.9% |
| Total road property | 5,955.7 | (1,299.0) | 4,656.7 | 2.7% |
| Locomotives | 1,017.4 | (193.2) | 824.2 | 5.0% |
| Freight cars | 362.2 | (78.9) | 283.3 | 3.9% |
| Other equipment | 56.6 | (14.1) | 42.5 | 7.4% |
| Total equipment | 1,436.2 | (286.2) | 1,150.0 | 4.8% |
| Technology and other | 152.8 | (111.3) | 41.5 | 11.6% |
| Construction in progress | 171.4 | — | 171.4 | N/A |
| Total property and equipment (including concession assets) | $8,073.7 | $(1,717.4) | $6,356.3 | N/A |

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

Concession assets, net of accumulated amortization of $483.1 million and $444.1 million, totaled $2,007.6 million and $1,951.0 million at December 31, 2014 and 2013, respectively.

The Company capitalized $0.9 million, $1.1 million, and $0.9 million of interest for the years ended December 31, 2014, 2013, and 2012, respectively.

Depreciation and amortization of property and equipment (including concession assets) totaled $258.1 million, $223.3 million and $198.8 million, for 2014, 2013, and 2012, respectively.

Note 6. Other Balance Sheet Captions

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

| | 2014 | 2013 |
|---|---|---|
| Accounts payable | $215.0 | $200.5 |
| Accrued wages and vacation | 75.1 | 72.7 |
| Derailments, personal injury and other claim provisions | 42.4 | 47.9 |
| Dividends payable | 31.0 | 23.8 |
| Income and other taxes | 24.8 | 18.5 |
| Other | 35.6 | 35.2 |
| Accounts payable and accrued liabilities | $423.9 | $398.6 |

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

Note 7. 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, 2014, the Company's derivative financial instruments are measured at fair value on a recurring basis and consist of foreign currency forward contract agreements, which are classified as Level 2 valuations. The Company determines the fair value of its derivative financial instrument positions based upon pricing models using inputs observed from actively quoted markets and also takes into consideration the contract terms as well as other inputs, including market currency exchange rates. The fair value of the foreign currency forward contract liabilities was $4.3 million as of December 31, 2014. There were no foreign currency forward contract agreements outstanding as of December 31, 2013.
The Company's short-term financial instruments include cash and cash equivalents, accounts receivable, accounts payable and short-term borrowings. The carrying value of the short-term financial instruments approximates their fair value.
The fair value of the Company's debt is estimated using quoted market prices when available. When quoted market prices are not available, fair value is estimated based on current market interest rates for debt with similar maturities and credit quality. The fair value of the Company's debt was $1,884.1 million and $2,082.9 million at December 31, 2014 and 2013, respectively. The carrying value was $1,865.8 million and $2,188.9 million at December 31, 2014 and 2013, respectively. If the Company's debt were measured at fair value, the fair value measurements of the individual debt instruments would have been classified as either Level 1 or Level 2 in the fair value hierarchy.

Note 8. Derivative Instruments
In general, the Company enters into derivative transactions in certain situations based on management's assessment of current market conditions and perceived risks. Management intends to respond to evolving business and market conditions and in doing so, may enter into such transactions as deemed appropriate.
Credit Risk. As a result of the use of derivative instruments, the Company is exposed to counterparty credit risk. The Company manages this risk by limiting its counterparties to large financial institutions which meet the Company's credit rating standards and have an established banking relationship with the Company. As of December 31, 2014, the Company did not expect any losses as a result of default of its counterparties.
Foreign Currency Forward Contracts. The Company's Mexican subsidiaries have net U.S. dollar-denominated liabilities (primarily debt) which, for Mexican income tax purposes, are subject to periodic revaluation based on changes in the value of the Mexican peso against the U.S. dollar. This revaluation creates fluctuations in the Company's Mexican cash tax obligation and the effective income tax rate. The Company has entered into foreign currency forward contracts to hedge its exposure to this risk.
In the first quarter of 2014, the Company entered into foreign currency forward contracts with an aggregate notional amount of $345.0 million. These contracts matured on December 31, 2014, and obligated the Company to purchase a total of Ps.4,642.5 million at a weighted-average exchange rate of Ps.13.46 to each U.S. dollar. During October and December 2014, the Company entered into offsetting contracts with an aggregate notional amount of $30.0 million and $291.4 million, respectively. These offsetting contracts matured on December 31, 2014, and obligated the Company sell a total of Ps.403.7 million and Ps.4,238.8 million at a weighted-average exchange rate of Ps.13.46 and Ps.14.57 to each U.S. dollar, respectively.
In December 2014, the Company entered into additional foreign currency forward contracts with an aggregate notional amount of $300.0 million. These contracts matured on January 15, 2015 and obligated the Company to purchase a total of Ps.4,364.7 million at a weighted-average rate of Ps.14.55 to each U.S. dollar. During January 2015, the Company entered into offsetting contracts with an aggregate notional amount of $298.8 million. These offsetting contracts matured on January 15, 2015, and obligated the Company to sell a total of Ps.4,364.7 million at a

weighted-average exchange rate of Ps.14.61 to each U.S. dollar.

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Kansas City Southern and Subsidiaries
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In the first half of 2013, the Company entered into foreign currency forward contracts with an aggregate notional amount of $325.0 million. These contracts matured on December 31, 2013, and obligated the Company to purchase a total of Ps.4,202.3 million at a weighted-average exchange rate of Ps.12.93 to each U.S. dollar. During December 2013, the Company entered into offsetting contracts with an aggregate notional amount of $324.3 million. These offsetting contracts matured on December 31, 2013, and obligated the Company sell a total of Ps.4,202.3 million at a weighted-average exchange rate of Ps.12.96 to each U.S. dollar.
In 2014 and 2013, the Company did not designate any of the foreign currency forward contracts as hedging instruments for accounting purposes, and the related net loss was recognized in foreign exchange gain (loss) within the consolidated statements of comprehensive income.
As of December 31, 2013, the Company had no outstanding foreign currency forward contracts.
The following table presents the fair value of derivative instruments included in the consolidated balance sheets (in millions):

| | Derivative Liabilities | | |
|---|---|---|---|
| | Balance Sheet Location | December 31, 2014 | December 31, 2013 |
| Derivatives not designated as hedging instruments: | | | |
| Foreign currency forward contracts | Accounts payable and accrued liabilities | $4.3 | $— |
| Total derivative liabilities | | $4.3 | $— |

The following table presents the effects of derivative instruments on the consolidated statements of income for the years ended December 31 (in millions):

| | Location of Gain/(Loss) Recognized in Income on Derivative | Amount of Gain/(Loss) Recognized in Income on Derivative | | |
|---|---|---|---|---|
| Derivatives not designated as hedging instruments: | | 2014 | 2013 | 2012 |
| Foreign currency forward contracts | Foreign exchange gain (loss) | $(27.9) | $(0.7) | $— |
| Total | | $(27.9) | $(0.7) | $— |

Note 9. Short-Term Borrowings
Short-term borrowings at December 31 (in millions):

| | 2014 | 2013 |
|---|---|---|
| Commercial paper | $150.1 | $— |
| Other short-term borrowings | 300.0 | — |
| Total short-term borrowings | $450.1 | $— |

Commercial Paper. KCSR and KCSM’s commercial paper programs generally serve as the primary means of short-term funding. As of December 31, 2014, KCSR had $150.1 million of commercial paper outstanding at a weighted-average interest rate of 0.716% and KCSM had no commercial paper outstanding.

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

Short-Term Borrowing. On October 22, 2014, Kansas City Southern International Investments, S.A. de C.V. ("KCSII"), a wholly-owned subsidiary of the Company, KCSR, and certain other subsidiaries of the Company that guaranty KCSR's Second Amended and Restated Credit Agreement dated as of November 21, 2012 (together with the Company and KCSR, the "Guarantors"), entered into a Credit Agreement dated as of October 22, 2014 (the "KCSII Credit Agreement") with The Bank of Tokyo-Mitsubishi UFJ, Ltd., as lender ("BTM"). Pursuant to the terms of the KCSII Credit Agreement, BTM agreed to extend credit in an aggregate principal amount of up to $300.0 million. KCSII borrowed $100.0 million on October 22, 2014, and borrowed an additional $200.0 million on December 15, 2014. The loans bear interest at weighted average rate of 1.49%. Repayment of each loan is due 90 days after each borrowing date of such loan, and each loan may be prepaid by KCSII with the prior written consent of the Lender. The proceeds of these loans were used to reduce commercial paper borrowings and for general corporate purposes. On January 22, 2015, KCSII repaid $100.0 million of this borrowing using available cash.

Note 10. Long-Term Debt
Long-term debt at December 31 (in millions):

| | 2014 | 2013 |
|---|---|---|
| KCSR | | |
| Revolving credit facility, variable interest rate, due 2017 | $— | $— |
| Term loan | — | 245.3 |
| 4.30% senior notes, due 2043 | 446.0 | 445.9 |
| 3.85% senior notes, due 2023 | 199.8 | 199.7 |
| RRIF loan, 2.96%, due serially to 2037 | 50.4 | 52.0 |
| Capital lease obligations, due serially to 2019 | 8.2 | 9.8 |
| Other debt obligations | 0.2 | 0.4 |
| Tex-Mex | | |
| RRIF loan, 4.29%, due serially to 2030 | 37.8 | 39.4 |
| KCSM | | |
| Revolving credit facility, variable interest rate, due 2017 | — | — |
| 8.0% senior notes, due 2018 | — | 62.3 |
| 2.35% senior notes, due 2020 | 274.7 | 274.7 |
| 3.0% senior notes, due 2023 | 448.4 | 448.2 |
| Floating rate senior notes, variable interest rate, 0.9331% at December 31, 2014, due 2016 | 250.0 | 250.0 |
| 5.737% financing agreement, due 2023 | 39.2 | 43.8 |
| 6.195% financing agreement, due 2023 | 30.4 | 33.9 |
| 9.310% loan agreements, due 2020 | 66.9 | 74.6 |
| Capital lease obligations, due serially to 2024 | 13.6 | 7.4 |
| Other debt obligations | — | 1.3 |
| KCS | | |
| Other debt obligations | 0.2 | 0.2 |
| Total | 1,865.8 | 2,188.9 |
| Less: Debt due within one year | 24.8 | 332.0 |
| Long-term debt | $1,841.0 | $1,856.9 |

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

KCSR Debt
Revolving Credit Facility and Term Loans. On January 30, 2014, the Company, KCSR and certain other subsidiaries of the Company that guaranty the KCSR credit agreement entered into an amendment to the KCSR credit agreement which eliminated certain representations as a condition to borrowing under the revolving credit facility (the "KCSR Revolving Facility"), provided for the prepayment of all outstanding term loans (the "Term Loan") under the KCSR credit agreement on or before February 13, 2014, and increased the borrowing capacity under the KCSR Revolving Facility to $450.0 million. In addition, on January 30, 2014, the Company and KCSR, entered into agreements to establish a $450.0 million commercial paper program for KCSR (the "KCSR Commercial Paper Program"). The KCSR Revolving Facility serves as a backstop for the KCSR Commercial Paper Program, which generally serves as KCSR's primary means of short-term funding.

KCSR's credit agreement also consists of 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.
In addition, KCSR's credit agreement consisted of a $300.0 million term loan credit facility ("Term Loan Facility") and a $275.0 million term loan A-2 credit facility ("Term Loan A-2"). On April 29, 2013, KCSR repaid the outstanding $277.5 million principal amount of the Term Loan Facility using a portion of the net proceeds from the issuance of $450.0 million principal amount of the 4.30% senior unsecured notes due May 15, 2043 (the "4.30% Senior Notes"). On February 7, 2014, KCSR borrowed $175.0 million under the KCSR Revolving Facility and used the proceeds and cash on hand to repay the outstanding $245.3 million principal amount of the KCSR Term Loan A-2. On February 14, 2014, KCSR repaid the outstanding $175.0 million principal amount of the KCSR Revolving Facility using proceeds received under the KCSR Commercial Paper Program.

The KCSR credit agreement is guaranteed by KCS, together with KCSR and certain subsidiaries named therein as guarantors (the "Subsidiary Guarantors") and matures on November 15, 2017. Under the KCSR credit agreement, in the event that KCSR's senior unsecured debt ratings would fall below investment grade at all three primary rating agencies, collateral would be re-pledged and the facilities would revert to secured obligations. In addition, 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, the floating interest rates paid on the KCSR Revolving Facility would thereafter be determined by KCSR's senior unsecured credit rating rather than by KCSR's leverage ratio. Depending on KCSR's credit rating during the life of the 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 1.50%.
The KCSR credit agreement also contains representations, warranties, covenants and events of default that are customary for credit agreements of this type. The occurrence of an event of default could result in the acceleration of the repayment of any outstanding principal balance of the Revolving Facility and KCSR Commercial Paper Program.
As of December 31, 2014 and 2013, KCSR had $299.9 million and $200.0 million available under the Revolving Facility, respectively, with no outstanding borrowings.
4.30% Senior Notes. On April 29, 2013, KCSR issued the 4.30% Senior Notes due May 15, 2043, which bear interest semiannually at a fixed annual rate of 4.30%. The 4.30% Senior Notes were issued at a discount to par value, resulting in a $4.1 million discount and a yield to maturity of 4.355%. The net proceeds from the offering were used to fund the prepayment of the Term Loan Facility, to finance the purchase of certain leased equipment and for other general corporate purposes. The 4.30% Senior Notes are redeemable at KCSR's option, in whole or in part, prior to November 15, 2042, by paying the greater of either (i) 100% of the principal amount of the 4.30% Senior Notes to be redeemed or (ii) the sum of the present values of the remaining scheduled payments of principal and interest

(exclusive of interest accrued to the date of redemption) discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the then-current U.S. Treasury rate plus 25 basis points, plus accrued interest to but excluding the redemption date. On or after November 15, 2042, the 4.30% Senior Notes may be redeemed at KCSR's option, in whole or in part, at any time at a redemption price equal to 100% of the principal amount, plus any accrued and unpaid interest.

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Kansas City Southern and Subsidiaries
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3.85% Senior Notes. On October 29, 2013, KCSR issued $200.0 million principal amount of 3.85% senior unsecured notes due November 15, 2023 (the "3.85% Senior Notes), which bear interest semiannually at a fixed annual rate of 3.85%. The 3.85% senior notes were issued at a discount to par value, resulting in a $0.3 million discount and a yield to maturity of 3.866%. The net proceeds from the offering were used to finance the purchase of equipment under existing operating leases and replacement equipment as certain operating leases expired, and pay all fees and expenses incurred in connection with the 3.85% Senior Notes offering. Any net proceeds not used for those purposes were used for general corporate purposes. The 3.85% Senior Notes are redeemable at KCSR's option, in whole or in part, prior to August 15, 2023, by paying the greater of either (i) 100% of the principal amount of the 3.85% Senior Notes to redeemed or (ii) the sum of the present values of the remaining scheduled payments of principal and interest (exclusive of interest accrued to the date of redemption) discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the then-current U.S. Treasury rate plus 20 basis points, plus accrued interest to but excluding the redemption date. On or after August 15, 2023, the 3.85% Senior Notes may be redeemed at KCSR's option, in whole or in part, at any time at a redemption price equal to 100% of the principal amount, plus any accrued and unpaid interest.

All of KCSR's senior notes described above are unconditionally guaranteed, jointly and severally, on an unsecured senior basis, by KCS and certain domestic subsidiaries of KCS that guarantee the KCSR credit agreement (the "Note Guarantors"). KCSR's senior notes and the note guarantees rank pari passu in right of payment with KCSR's, KCS's and the Note Guarantors' existing and future unsecured, unsubordinated obligations. In addition, KCSR's senior notes include certain covenants which are customary for these types of debt instruments issued by borrowers with similar credit ratings.

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.

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KCSM Debt

Revolving Credit Facility. KCSM's amended and restated credit agreement consists of an unsecured revolving credit facility up to $200.0 million (the "KCSM Revolving Facility"), a letter of credit facility up to $15.0 million (the "KCSM letter of Credit Facility"), and 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. The KCSM credit agreement matures on November 15, 2017.

On January 30, 2014, KCSM and certain subsidiaries of KCSM that guaranty the KCSM credit agreement entered into an amendment to the KCSM credit agreement which eliminated certain representations as a condition to borrowing under the KCSM Revolving Facility and provided for same-day availability of borrowed funds if desired by KCSM. Also on January 30, 2014, KCSM entered into agreements to establish a $200.0 million commercial paper program for KCSM (the "KCSM Commercial Paper Program"). The KCSM Revolving Facility serves as a backstop for the KCSM Commercial Paper Program, which generally serves as KCSM's primary means of short-term funding.

KCSM and certain of its subsidiaries have agreed to subordinate payment of certain intercompany debt, certain KCSM subsidiaries guaranteed repayment of the amounts due under the KCSM credit agreement (up to the amount permitted by KCSM's outstanding indentures) and certain equity interests as defined in the KCSM credit agreement were pledged to secure obligations under the KCSM credit agreement.

Under KCSM's credit agreement, 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. In addition, in the event that KCSM achieved a senior unsecured debt rating of BBB/Baa2 or higher by at least two of the three primary rating agencies, the floating interest rates paid on the KCSM credit agreement would thereafter be determined by KCSM's senior unsecured credit rating rather than by KCSM's leverage ratio. Depending on KCSM's credit rating during the life of the KCSM credit agreement, the margin KCSM would pay above the LIBOR at any point would be equal to or lower than 1.75%.

The KCSM credit agreement contains representations, warranties, covenants and events of default that are customary for credit agreements of this type. 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, 2014 and 2013, KCSM had no amount outstanding under the KCSM Revolving Facility.

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 bore interest semiannually at a fixed annual rate of 8.0%.

Through May 8, 2013, KCSM purchased $237.2 million principal amount of the tendered KCSM 8.0% Senior Notes, $181.0 million principal amount of the tendered $6^{5}/_{8}$% senior unsecured notes due December 15, 2020 and $149.7 million principal amount of the tendered $6^{1}/_{8}$% senior unsecured notes due June 15, 2021 (collectively, the "KCSM Senior Notes Tendered"), in accordance with the terms and conditions of the tender offer using a portion of the proceeds received from the issuance of $275.0 million principal amount of 2.35% senior unsecured notes due May 15, 2020 (the "2.35% Senior Notes") and $450.0 million principal amount of 3.0% senior unsecured notes due May 15, 2023 (the "3.0% Senior Notes").

On February 3, 2014, KCSM redeemed all of the remaining $62.8 million aggregate principal amount of the KCSM 8.0% Senior Notes, at a redemption price (expressed as a percentage of principal amount) of 104%, using a portion of the proceeds from the issuance of $250.0 million principal amount KCSM floating rate senior unsecured notes due October 28, 2016 (the "Floating Rate Senior Notes"), issued in the fourth quarter of 2013.

2.35% Senior Notes. On May 3, 2013, KCSM issued the 2.35% Senior Notes due May 15, 2020, which bear interest semiannually at a fixed annual rate of 2.35%. The 2.35% Senior Notes were issued at a discount to par value, resulting in a $0.3 million discount and a yield to maturity of 2.368%. KCSM used the net proceeds from the issuance of the 2.35% Senior Notes and the 3.0% Senior Notes to purchase the KCSM Senior Notes Tendered, pay all fees and expenses incurred in connection

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with the 2.35% Senior Notes and 3.0% Senior Notes offerings and the tender offers, to finance the purchase of certain leased equipment and for other general corporate purposes. The 2.35% Senior Notes are redeemable at KCSM's option, in whole or in part, prior to April 15, 2020, by paying the greater of either (i) 100% of the principal amount of the 2.35% Senior Notes to be redeemed or (ii) the sum of the present values of the remaining scheduled payments of principal and interest (exclusive of interest accrued to the date of redemption) discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the then-current U.S. Treasury rate plus 20 basis points, plus accrued interest and any additional amounts to but excluding the redemption date. On or after April 15, 2020, the 2.35% Senior Notes may be redeemed at KCSM's option, in whole or in part, at any time at a redemption price equal to 100% of the principal amount, plus any accrued and unpaid interest. In addition, the notes are redeemable, in whole but not in part, at KCSM's option at their principal amount, plus any accrued unpaid interest in the event of certain changes in the Mexican withholding tax rate.

3.0% Senior Notes. On May 3, 2013, KCSM issued the 3.0% Senior Notes due May 15, 2023, which bear interest semiannually at a fixed annual rate of 3.0%. The 3.0% Senior Notes were issued at a discount to par value, resulting in a $1.9 million discount and a yield to maturity of 3.048%. KCSM used the net proceeds from the issuance of the 3.0% Senior Notes and the 2.35% Senior Notes to purchase the KCSM Senior Notes Tendered, pay all fees and expenses incurred in connection with the 2.35% Senior Notes and 3.0% Senior Notes offerings and the tender offers, to finance the purchase of certain leased equipment and for other general corporate purposes. The 3.0% Senior Notes are redeemable at KCSM's option, in whole or in part, prior to February 15, 2023, by paying the greater of either (i) 100% of the principal amount of the 3.0% Senior Notes to be redeemed or (ii) the sum of the present values of the remaining scheduled payments of principal and interest (exclusive of interest accrued to the date of redemption) discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the then-current U.S. Treasury rate plus 20 basis points, plus accrued interest and any additional amounts to but excluding the redemption date. On or after February 15, 2023, the 3.0% Senior Notes may be redeemed at KCSM's option, in whole or in part, at any time at a redemption price equal to 100% of the principal amount, plus any accrued and unpaid interest. In addition, the notes are redeemable, in whole but not in part, at KCSM's option at their principal amount, plus any accrued unpaid interest in the event of certain changes in the Mexican withholding tax rate.

Floating Rate Senior Notes. On October 29, 2013, KCSM issued the Floating Rate Senior Notes due October 28, 2016, which bear interest quarterly at a rate equal to the three-month U.S. dollar LIBOR plus 70 basis points per annum. KCSM used the net proceeds from the issuance of the Floating Rate Senior Notes to pay fees and expenses related to the issuance of the Floating Rate Senior Notes and redeem the outstanding $29.4 million principal amount of the $6^1/_8$% Senior Notes. In addition, the Company used the remaining net proceeds to redeem the outstanding $62.8 million principal amount of the KCSM 8.0% Senior Notes during the first quarter of 2014 and to finance the purchase of equipment under existing operating leases and replacement equipment as certain operating leases expired. Any net proceeds not used for these purposes were used for general corporate purposes. The notes are redeemable, in whole but not in part, at KCSM's option at any time at a redemption price of 100% of their principal amount, plus any accrued 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 U.S. 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.

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.

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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. 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, 2014.

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.

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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 $76.4 million, $106.7 million, and $108.8 million for the years ended December 31, 2014, 2013 and 2012, respectively. Operating leases that contain scheduled rent adjustments are 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):

| | | Capital Leases | | | | | |
|---|---|---|---|---|---|---|---|
| Years | Long-Term Debt | Minimum Lease Payments | Less Interest | Net Present Value | Total Debt | Operating Leases | Total |
| 2015 | $20.0 | $6.8 | $2.0 | $4.8 | $24.8 | $74.5 | $99.3 |
| 2016 | 270.8 | 6.3 | 1.7 | 4.6 | 275.4 | 67.6 | 343.0 |
| 2017 | 22.0 | 4.0 | 1.3 | 2.7 | 24.7 | 57.3 | 82.0 |
| 2018 | 35.2 | 3.9 | 1.1 | 2.8 | 38.0 | 37.3 | 75.3 |
| 2019 | 15.5 | 2.7 | 0.8 | 1.9 | 17.4 | 30.5 | 47.9 |
| Thereafter | 1,480.5 | 6.7 | 1.7 | 5.0 | 1,485.5 | 98.5 | 1,584.0 |
| Total | $1,844.0 | $30.4 | $8.6 | $21.8 | $1,865.8 | $365.7 | $2,231.5 |

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.

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Note 11. 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):

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Current: | | | |
| Federal | $(2.5) | $6.0 | $2.8 |
| State and local | 1.2 | 1.9 | 0.7 |
| Foreign | 70.0 | 79.2 | 36.2 |
| Total current | 68.7 | 87.1 | 39.7 |
| Deferred: | | | |
| Federal | 112.6 | 99.0 | 99.2 |
| State and local | 16.9 | 11.9 | (7.4) |
| Foreign | 10.6 | 0.3 | 105.5 |
| Total deferred | 140.1 | 111.2 | 197.3 |
| Total income tax expense | $208.8 | $198.3 | $237.0 |

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

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Income before income taxes: | | | |
| U.S. | $341.8 | $319.2 | $282.8 |
| Foreign | 371.3 | 232.4 | 333.6 |
| Total income before income taxes | $713.1 | $551.6 | $616.4 |

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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):

| | 2014 | 2013 |
|---|---|---|
| Assets: | | |
| Loss carryovers | $52.2 | $52.6 |
| Reserves not currently deductible for tax | 94.5 | 91.2 |
| Other | 69.3 | 64.6 |
| Gross deferred tax assets before valuation allowance | 216.0 | 208.4 |
| Valuation allowance | (0.9) | (2.7) |
| Net deferred tax assets | 215.1 | 205.7 |
| Liabilities: | | |
| Property | (1,194.7) | (1,044.6) |
| Investments | (68.2) | (66.3) |
| Other | (8.4) | (7.8) |
| Gross deferred tax liabilities | (1,271.3) | (1,118.7) |
| Net deferred tax liability | $(1,056.2) | $(913.0) |

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):

| | 2014 Dollars | Percent | 2013 Dollars | Percent | 2012 Dollars | Percent |
|---|---|---|---|---|---|---|
| Income tax expense using the statutory rate in effect | $249.6 | 35.0 % | $193.1 | 35.0 % | $215.7 | 35.0 % |
| Tax effect of: | | | | | | |
| Difference between U.S. and foreign tax rate | (23.0) | (3.2 %) | (15.4) | (2.8 %) | (18.4) | (3.0 %) |
| Foreign exchange and inflation adjustments (i) | (25.6) | (3.6 %) | 4.7 | 0.8 % | 42.3 | 6.9 % |
| State and local income tax provision, net | 11.7 | 1.6 % | 8.9 | 1.6 % | 8.4 | 1.3 % |
| Change in valuation allowances | (1.8) | (0.3 %) | (0.9) | (0.2 %) | (11.2) | (1.8 %) |
| Other, net | (2.1) | (0.2 %) | 7.9 | 1.5 % | 0.2 | — |
| Income tax expense | $208.8 | | | | | |