

KANSAS CITY SOUTHERN
Form 10-Q
July 22, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2011

or

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

For the transition period from to

Commission File Number 1-4717

KANSAS CITY SOUTHERN

(Exact name of registrant as specified in its charter)

Delaware
*(State or other jurisdiction of
incorporation or organization)*

427 West 12th Street,

Kansas City, Missouri
(Address of principal executive offices)

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

64105
(Zip Code)

816.983.1303

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(Registrant's telephone number, including area code)

No Change

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

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

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

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June 30, 2011

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Kansas City Southern

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PART I FINANCIAL INFORMATION

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

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

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

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

See accompanying notes to consolidated financial statements.

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Kansas City Southern
Consolidated Balance Sheets

	June 30, 2011 (In millions, except share amounts) (Unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 156.0	\$ 85.4
Accounts receivable, net	195.8	160.0
Materials and supplies	115.4	101.4
Deferred income taxes	136.3	138.2
Other current assets	58.0	91.2
Total current assets	661.5	576.2
Investments	48.8	46.4
Restricted funds	14.7	22.0
Property and equipment (including concession assets), net	4,994.1	4,902.4
Other assets	106.6	93.9
Total assets	\$ 5,825.7	\$ 5,640.9
LIABILITIES AND EQUITY		
Current liabilities:		
Debt due within one year	\$ 18.2	\$ 18.1
Accounts payable and accrued liabilities	387.6	403.0
Total current liabilities	405.8	421.1
Long-term debt	1,614.6	1,621.6
Deferred income taxes	730.1	654.5
Other noncurrent liabilities and deferred credits	221.8	230.0
Total liabilities	2,972.3	2,927.2
Commitments and contingencies		
Stockholders' equity:		
\$25 par, 4% noncumulative, preferred stock, 840,000 shares authorized, 649,736 shares issued, 242,170 shares outstanding	6.1	6.1
Series D cumulative convertible perpetual preferred stock, \$1 par, 5.125%, 210,000 shares authorized and issued at December 31, 2010; 209,995 shares outstanding with a liquidation preference of \$1,000 per share at December 31, 2010		0.2
\$.01 par, common stock, 400,000,000 shares authorized; 123,352,185 and 116,352,298 shares issued at June 30, 2011 and December 31, 2010, respectively; 109,789,846 and 102,648,845 shares outstanding at June 30, 2011 and December 31, 2010, respectively	1.1	1.0
Paid-in capital	881.6	877.2
Retained earnings	1,679.9	1,548.0
Accumulated other comprehensive loss	(0.9)	(1.4)
Total stockholders' equity	2,567.8	2,431.1
Noncontrolling interest	285.6	282.6

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

See accompanying notes to consolidated financial statements.

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

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

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

See accompanying notes to consolidated financial statements.

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

In the opinion of the management of KCS, the accompanying unaudited consolidated financial statements contain all adjustments necessary for a fair presentation of the results for interim periods. All adjustments made were of a normal and recurring nature. Certain information and footnote disclosure normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. The results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the results to be expected for the full year ending December 31, 2011. Certain prior year amounts have been reclassified to conform to the current year presentation.

2. Recent Accounting Pronouncements

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

3. Earnings Per Share Data

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Nonvested stock awards granted to employees and officers are included in weighted average shares as they are earned for purposes of computing basic earnings per common share. Diluted earnings per share adjusts basic earnings per common share for the effects of potentially dilutive common shares, if the effect is not anti-dilutive. Potentially dilutive common shares include the dilutive effects of shares issuable upon the conversion of preferred stock to common stock and shares issuable under the Stock Option and Performance Award Plan. During the first quarter of 2011, the Company converted all of the remaining outstanding Cumulative Convertible Perpetual Preferred Stock, Series D, into 6,999,887 shares of common stock.

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

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

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

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

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

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

4. Hurricane Alex

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

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

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

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

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

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

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

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

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

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

6. Fair Value Measurements

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

The fair value of the Company's debt is estimated using quoted market prices when available. When quoted market prices are not available, fair value is estimated based on current market interest rates for debt with similar maturities and credit quality. The fair value of the Company's debt was \$1,721.9 million and \$1,739.8 million at June 30, 2011 and December 31, 2010, respectively. The carrying value was \$1,632.8 million and \$1,639.7 million at June 30, 2011 and December 31, 2010, respectively.

7. Long-Term Debt

On May 6, 2011, pursuant to an offer to purchase, Kansas City Southern de México, S.A. de C.V. (KCSM), a wholly-owned subsidiary of KCS, commenced a cash tender offer for all of its 7⁵/₈% Senior Notes due December 1, 2013 (the 7⁵/₈% Senior Notes) and, pursuant to a separate offer to purchase, KCSM commenced a cash tender offer for all of its 7³/₈% Senior Notes due June 1, 2014 (the 7³/₈% Senior Notes). Through June 7, 2011, KCSM purchased and redeemed the remaining \$32.4 million of the 7⁵/₈% Senior Notes and all of the outstanding \$165.0 million of the 7³/₈% Senior Notes using the proceeds received from the issuance of \$200.0 million principal amount of 6¹/₈% senior unsecured notes due June 15, 2021 (the 6¹/₈% Senior Notes) and cash on hand. The Company recorded debt retirement costs of \$10.3 million in the second quarter of 2011.

On May 20, 2011, KCSM issued \$200.0 million principal amount of 6¹/₈% Senior Notes, at par, bearing interest semiannually at a fixed annual rate of 6¹/₈%. KCSM used proceeds from the issuance of the 6¹/₈% Senior Notes and cash on hand to purchase and redeem the 7⁵/₈% Senior Notes and 7³/₈% Senior Notes as discussed above, and pay all fees and expenses incurred in connection with the 6¹/₈% Senior Notes offering and the tender offers. The 6¹/₈% Senior Notes are redeemable at KCSM's option, in whole or in part, on and after June 15, 2016, at the following

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redemption prices (expressed as percentages of principal amount) if redeemed during the 12-month period commencing on June 15 of the following years, plus any accrued and unpaid interest to the date of redemption: 2016 103.063%, 2017 102.042%, 2018 101.021% and 2019 100.000%. In addition, KCSM may redeem up to 35% of the 6¹/₈% Senior Notes at a redemption price equal to 106.125% any time prior to June 15, 2014 from the proceeds of the sale of KCSM's capital stock or the capital stock of KCS and the notes are redeemable, in whole but not in part, at KCSM's option at their principal amount, plus any accrued unpaid interest in the event of certain changes in the Mexican withholding tax rate.

The 6¹/₈% Senior Notes are denominated in dollars and are unsecured, unsubordinated obligations, rank *pari passu* in right of payment with KCSM's existing and future unsecured, unsubordinated obligations, and are senior in right of payment to KCSM's

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Kansas City Southern

Notes to Consolidated Financial Statements (Continued)

future subordinated indebtedness. In addition, the 6¹/₈% Senior Notes include certain covenants which are customary for these types of debt instruments and borrowers with similar credit ratings. The 6¹/₈% Senior Notes contain certain covenants that, among other things, prohibit or restrict KCSM from taking certain actions, including KCSM's ability to incur debt, pay dividends or make other distributions in respect of its stock, issue guarantees, enter into certain transactions with affiliates, make restricted payments, sell certain assets, create liens, engage in sale-leaseback transactions and engage in mergers, divestitures and consolidations. However, these limitations are subject to a number of important qualifications and exceptions.

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

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

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

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

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

	Noncontrolling Three Months Ended June 30, 2011			Noncontrolling Three Months Ended June 30, 2010		
	Kansas City Southern Stockholders Equity	Noncontrolling Interest	Total Equity	Kansas City Southern Stockholders Equity	Noncontrolling Interest	Total Equity
Beginning balance	\$ 2,495.9	\$ 282.7	\$ 2,778.6	\$ 2,082.0	\$ 281.7	\$ 2,363.7
Comprehensive income:						
Net income	70.8	0.9	71.7	37.4		37.4
Unrealized gain on cash flow hedges, net of tax of less than \$0.1 million				0.1		0.1
Reclassification adjustment from cash flow hedges included in net income, net of tax of \$0.7 million				0.9		0.9
Amortization of prior service credit, net of tax of less than \$(0.1) million	(0.1)		(0.1)			
Cumulative translation adjustment - FTVM, net of tax of less than \$0.1 million and less than \$(0.1) million	0.1		0.1	(0.2)		(0.2)
Comprehensive income	70.8	0.9	71.7	38.2		38.2
Contribution from noncontrolling interest		2.0	2.0			
Common stock issued				214.9		214.9
Dividends on \$25 par preferred stock	(0.1)		(0.1)			
Dividends on series D cumulative preferred stock						