

KANSAS CITY SOUTHERN
Form 10-Q
October 18, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended September 30, 2016

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 44-0663509

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

427 West 12th Street, 64105
Kansas City, Missouri

(Address of principal executive offices) (Zip Code)

816.983.1303

(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 October 11, 2016
Common Stock, \$0.01 per share par value 107,579,057 Shares

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Kansas City Southern and Subsidiaries
Consolidated Statements of Income

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(In millions, except share and per share amounts) (Unaudited)			
Revenues	\$604.5	\$631.9	\$1,735.7	\$1,820.8
Operating expenses:				
Compensation and benefits	127.9	112.7	347.0	338.3
Purchased services	54.5	57.0	159.1	172.1
Fuel	67.6	78.5	186.0	237.0
Mexican fuel excise tax credit	(15.6)	—	(49.6)	—
Equipment costs	32.0	31.2	85.9	90.2
Depreciation and amortization	76.9	71.4	226.9	210.7
Materials and other	61.4	61.2	172.8	178.0
Lease termination costs	—	—	—	9.6
Total operating expenses	404.7	412.0	1,128.1	1,235.9
Operating income	199.8	219.9	607.6	584.9
Equity in net earnings of affiliates	3.5	5.0	10.4	14.4
Interest expense	(25.2)	(21.9)	(73.2)	(58.2)
Foreign exchange loss	(19.8)	(30.0)	(47.3)	(52.1)
Other expense, net	—	(1.1)	(0.5)	(3.1)
Income before income taxes	158.3	171.9	497.0	485.9
Income tax expense	37.3	40.0	147.4	140.6
Net income	121.0	131.9	349.6	345.3
Less: Net income attributable to noncontrolling interest	0.4	0.3	1.1	1.1
Net income attributable to Kansas City Southern and subsidiaries	120.6	131.6	348.5	344.2
Preferred stock dividends	0.1	0.1	0.2	0.2
Net income available to common stockholders	\$120.5	\$131.5	\$348.3	\$344.0
Earnings per share:				
Basic earnings per share	\$1.12	\$1.20	\$3.23	\$3.12
Diluted earnings per share	\$1.12	\$1.20	\$3.23	\$3.12
Average shares outstanding (in thousands):				
Basic	107,621	109,692	107,800	110,109
Potentially dilutive common shares	191	209	199	203
Diluted	107,812	109,901	107,999	110,312
See accompanying notes to consolidated financial statements.				

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Consolidated Statements of Comprehensive Income

	Three Months Ended September 30, 2016 2015		Nine Months Ended September 30, 2016 2015	
	(In millions) (Unaudited)			
Net income	\$121.0	\$131.9	\$349.6	\$345.3
Other comprehensive loss:				
Amortization of prior service credit, net of tax of less than \$(0.1) million	—	—	—	(0.1)
Foreign currency translation adjustments, net of tax of \$(0.2) million, \$(0.5) million, \$(0.7) million and \$(0.8) million, respectively	(0.3)	(0.8)	(1.0)	(1.3)
Other comprehensive loss	(0.3)	(0.8)	(1.0)	(1.4)
Comprehensive income	120.7	131.1	348.6	343.9
Less: Comprehensive income attributable to noncontrolling interest	0.4	0.3	1.1	1.1
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$120.3	\$130.8	\$347.5	\$342.8
See accompanying notes to consolidated financial statements.				

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Consolidated Balance Sheets

	September 30, 2016	December 31, 2015
	(In millions, except share and per share amounts)	
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 293.1	\$ 136.6
Accounts receivable, net	193.7	171.9
Materials and supplies	146.0	137.9
Other current assets	136.2	90.6
Total current assets	769.0	537.0
Investments	37.9	34.7
Property and equipment (including concession assets), net	7,951.4	7,705.4
Other assets	71.2	63.9
Total assets	\$ 8,829.5	\$ 8,341.0
LIABILITIES AND EQUITY		
Current liabilities:		
Long-term debt due within one year	\$ 275.1	\$ 276.1
Short-term borrowings	—	80.0
Accounts payable and accrued liabilities	477.0	401.5
Total current liabilities	752.1	757.6
Long-term debt	2,275.7	2,045.0
Deferred income taxes	1,308.0	1,191.1
Other noncurrent liabilities and deferred credits	107.9	122.6
Total liabilities	4,443.7	4,116.3
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; 107,579,057 and 108,461,144 shares outstanding at September 30, 2016 and December 31, 2015, respectively	1.1	1.1
Additional paid-in capital	953.8	947.1
Retained earnings	3,116.6	2,964.7
Accumulated other comprehensive loss	(5.7) (4.7
Total stockholders' equity	4,071.9	3,914.3
Noncontrolling interest	313.9	310.4
Total equity	4,385.8	4,224.7
Total liabilities and equity	\$ 8,829.5	\$ 8,341.0

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

	Nine Months Ended September 30, 2016 2015 (In millions) (Unaudited)	
Operating activities:		
Net income	\$349.6	\$345.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	226.9	210.7
Deferred income taxes	117.4	87.9
Equity in net earnings of affiliates	(10.4)	(14.4)
Share-based compensation	15.2	11.8
Excess tax benefit from share-based compensation	0.2	(5.3)
Distributions from unconsolidated affiliates	5.0	7.8
Unrealized loss on foreign currency derivative instruments	23.4	43.1
Mexican fuel excise tax credit	(49.6)	—
Changes in working capital items:		
Accounts receivable	(21.5)	(12.5)
Materials and supplies	(6.0)	(15.3)
Other current assets	(4.2)	15.8
Accounts payable and accrued liabilities	40.3	5.0
Other, net	(2.5)	(8.7)
Net cash provided by operating activities	683.8	671.2
Investing activities:		
Capital expenditures	(405.1)	(522.8)
Purchase or replacement of equipment under operating leases	(26.6)	(143.0)
Property investments in MSLLC	(31.2)	(7.2)
Other, net	(3.1)	(21.0)
Net cash used for investing activities	(466.0)	(694.0)
Financing activities:		
Proceeds from short-term borrowings	6,499.0	9,605.5
Repayment of short-term borrowings	(6,579.3)	(10,056.6)
Proceeds from issuance of long-term debt	248.7	538.7
Repayment of long-term debt	(20.8)	(59.6)
Dividends paid	(107.2)	(104.0)
Shares repurchased	(99.8)	(136.3)
Debt costs	(2.6)	(5.8)
Excess tax benefit from share-based compensation	(0.2)	5.3
Proceeds from employee stock plans	0.9	4.2
Net cash used for financing activities	(61.3)	(208.6)
Cash and cash equivalents:		
Net increase (decrease) during each period	156.5	(231.4)

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At beginning of year	136.6	348.0
At end of period	\$293.1	\$ 116.6
See accompanying notes to consolidated financial statements.		

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Kansas City Southern and Subsidiaries

Notes to Consolidated Financial Statements

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

1. Basis of Presentation

In the opinion of the management of KCS, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal and recurring adjustments) necessary to fairly present the results for interim periods in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”). Pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”), certain information and note disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015. The results of operations for the three and nine months ended September 30, 2016, are not necessarily indicative of the results to be expected for the full year ending December 31, 2016. Certain prior year amounts have been reclassified to conform to the current year presentation.

2. New Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers, which requires companies to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration it expects to be entitled in exchange for those goods or services. The new standard will become effective for the Company beginning with the first quarter 2018 and can be adopted either retrospectively to each prior reporting period presented or as a cumulative effect adjustment as of the date of adoption. While the Company is currently reviewing its contracts with customers, the adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which requires lessees to recognize a right-to-use asset and a lease obligation for all leases. Lessees are permitted to make an accounting policy election to not recognize an asset and liability for leases with a term of twelve months or less. Lessor accounting under the new standard is substantially unchanged. Additional qualitative and quantitative disclosures, including significant judgments made by management, will be required. The new standard will become effective for the Company beginning with the first quarter 2019 and requires a modified retrospective transition approach. Early adoption of the standard is permitted. The Company is currently evaluating the impacts the adoption of this accounting guidance will have on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification of related amounts within the statement of cash flows. The new standard will become effective for the Company beginning with the first quarter of 2017. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows, which reduces diversity in practice in how certain transactions are classified in the statement of cash flows. The new standard will become effective for the Company beginning with the first quarter of 2018, with early adoption permitted. The adoption of this guidance will not have a material impact on the Company’s consolidated financial statements.

3. Mexican Fuel Excise Tax Credit

Fuel purchases made in Mexico are subject to an excise tax that is included in fuel expense. During the second quarter of 2016, the Company determined that it could utilize a credit available under changes in Mexican law for the excise tax included in the price of fuel that is purchased and consumed in locomotives and certain work equipment in

Mexico. As a result, the Company recognized a \$15.6 million and \$49.6 million benefit during the three and nine months ended September 30, 2016. The Mexican fuel excise tax credit is realized through the offset of the total 2016 Mexico income tax liability and income tax withholding payment obligations of Kansas City Southern de Mexico, S.A. de C.V. ("KCSM"), with no carryforward to future periods.

4. Flooding in the Southeastern United States

In March 2016, flooding in the southeastern United States caused damage to the Company's track infrastructure and interruptions to the Company's rail service. During the three months ended June 30, 2016, the Company determined that it would file a claim under its insurance program for property damage, incremental expenses and lost profits caused by this flooding

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Notes to Consolidated Financial Statements—(Continued)

event. Accordingly, during the three months ended June 30, 2016, the Company recognized a receivable for probable insurance recovery of \$7.0 million, which offsets the impact of incremental expenses recognized in the first half of 2016. The incremental expenses and probable insurance recovery have been recognized in Materials and other in the Consolidated Statements of Income. The recognition of remaining probable insurance recoveries represents a contingent gain, which will be recognized when all contingencies have been resolved, which generally occurs at the time of final settlement or when nonrefundable cash payments are received.

5. Earnings Per Share Data

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

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

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Net income available to common stockholders for purposes of computing basic and diluted earnings per share	\$ 120.5	\$ 131.5	\$ 348.3	\$ 344.0
Weighted-average number of shares outstanding (in thousands):				
Basic shares	107,621	109,692	107,800	110,109
Effect of dilution	191	209	199	203
Diluted shares	107,812	109,901	107,999	110,312
Earnings per share:				
Basic earnings per share	\$ 1.12	\$ 1.20	\$ 3.23	\$ 3.12
Diluted earnings per share	\$ 1.12	\$ 1.20	\$ 3.23	\$ 3.12

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

Stock options excluded as their inclusion would be anti-dilutive 34 95 220 60

6. Property and Equipment (including Concession Assets)

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

	September 30, 2016	December 31, 2015
Land	\$ 219.6	\$ 218.1
Concession land rights	141.2	141.2
Road property	7,084.5	6,784.3
Equipment	2,402.2	2,326.1
Technology and other	171.2	159.3
Construction in progress	245.4	184.7
Total property	10,264.1	9,813.7
Accumulated depreciation and amortization	2,312.7	2,108.3
Property and equipment (including concession assets), net	\$ 7,951.4	\$ 7,705.4

Concession assets, net of accumulated amortization of \$591.5 million and \$538.0 million, totaled \$2,127.8 million and \$2,070.5 million at September 30, 2016 and December 31, 2015, respectively.

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

7. Fair Value Measurements

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

The Company's derivative financial instruments are measured at fair value on a recurring basis and consist of foreign currency forward and option contracts, which are classified as Level 2 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 and in the case of option contracts, volatility, the risk-free interest rate and the time to expiration. The fair value of the foreign currency derivative instruments was a liability of \$23.4 million and \$46.0 million at September 30, 2016 and December 31, 2015, respectively.

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

The fair value of the Company's debt is estimated using quoted market prices when available. When quoted market prices are not available, fair value is estimated based on current market interest rates for debt with similar maturities and credit quality. The fair value of the Company's debt was \$2,704.7 million and \$2,287.5 million at September 30, 2016 and December 31, 2015, respectively. The carrying value was \$2,550.8 million and \$2,321.1 million at September 30, 2016 and December 31, 2015, 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.

8. Derivative Instruments

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

Credit Risk. As a result of the use of derivative instruments, the Company is exposed to counterparty credit risk. The Company manages this risk by limiting its counterparties to large financial institutions which meet the Company's credit rating standards and have an established banking relationship with the Company. As of September 30, 2016, the Company did not expect any losses as a result of default of its counterparties.

Foreign Currency Derivative Instruments. The Company's Mexican subsidiaries have net U.S. dollar-denominated monetary liabilities which, for Mexican income tax purposes, are subject to periodic revaluation based on changes in the value of the Mexican peso against the U.S. dollar. This revaluation creates fluctuations in the Company's Mexican income tax expense and the amount of income taxes paid in Mexico. The Company hedges its exposure to this cash tax risk by entering into foreign currency forward contracts and foreign currency option contracts known as zero-cost collars. The foreign currency forward contracts involve the Company's purchase of pesos at an agreed-upon weighted-average exchange rate to each U.S. dollar.

The zero-cost collars involve the Company's purchase of a Mexican peso call option and a simultaneous sale of a Mexican peso put option, with equivalent U.S. dollar notional amounts for each option and no net cash premium paid

by the Company. As of September 30, 2016, there were no outstanding zero-cost collar contracts.

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Notes to Consolidated Financial Statements—(Continued)

Below is a summary of the Company's 2016 and 2015 foreign currency derivative contracts (amounts in millions, except Ps./USD):

Foreign currency forward contracts

	Contracts to purchase Ps./pay USD				Offsetting contracts to sell Ps./receive USD				Cash received/(paid) on settlement
	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Maturity date	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Maturity date	
2016 contracts outstanding at September 30, 2016	\$340.0	Ps. 6,207.7	Ps. 18.3	1/17/2017	—	—	—	—	—
2016 contracts and 2016 offsetting contracts settled	\$60.0	Ps. 1,057.3	Ps. 17.6	4/29/2016	\$60.7	Ps. 1,057.3	Ps. 17.4	4/29/2016	\$ 0.7
2015 contracts and 2016 offsetting contracts settled	\$300.0	Ps. 4,480.4	Ps. 14.9	1/15/2016	\$251.0	Ps. 4,480.4	Ps. 17.9	1/15/2016	\$ (49.0)

Foreign currency zero-cost collar contracts

	Notional amount	Maturity date	Cash received/(paid) on settlement
2015 contracts settled in 2015	\$50.0	9/28/2015	\$ (4.3)
2015 contracts settled in 2016	\$80.0	1/15/2016	\$ (10.1)

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

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

	Derivative Liabilities		
	Balance Sheet Location	September 30, 2016	December 31, 2015
Derivatives not designated as hedging instruments:			
Foreign currency forward contracts	Accounts payable and accrued liabilities	\$ 23.4	\$ 39.8
Foreign currency zero-cost collar contracts	Accounts payable and accrued liabilities	—	6.2

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Total derivative liabilities \$ 23.4 \$ 46.0

The following table presents the effects of derivative instruments on the consolidated statements of income (in millions):

	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative			
		Three Months Ended September 30, 2016 2015		Nine Months Ended September 30, 2016 2015	
Derivatives not designated as hedging instruments:					
Foreign currency forward contracts	Foreign exchange loss	\$(16.1)	\$(17.9)	\$(31.9)	\$(34.2)
Foreign currency zero-cost collar contracts	Foreign exchange loss	—	(7.0)	(3.9)	(10.1)
Total		\$(16.1)	\$(24.9)	\$(35.8)	\$(44.3)

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Notes to Consolidated Financial Statements—(Continued)

9. Short-Term Borrowings

Commercial Paper. The Company's commercial paper program generally serves as the primary means of short-term funding. As of September 30, 2016, KCS had no commercial paper outstanding. As of December 31, 2015, KCS had \$80.0 million of commercial paper outstanding at a weighted-average interest rate of 1.072%.

10. Long-Term Debt

Senior Notes

On May 16, 2016, KCS issued \$250.0 million principal amount of senior unsecured notes due June 1, 2026 (the "3.125% Senior Notes"), which bear interest semiannually at a fixed annual rate of 3.125%. The 3.125% Senior Notes were issued at a discount to par value, resulting in a \$1.3 million discount and a yield to maturity of 3.185%. The net proceeds were used to repay the outstanding commercial paper issued by KCS and for other general corporate purposes. The 3.125% Senior Notes are redeemable at the issuer's option, in whole or in part, at any time, by paying the greater of 100% of the principal amount to be redeemed and a formula price based on interest rates prevailing at the time of redemption and time remaining to maturity.

The 3.125% Senior Notes include certain covenants which are customary for this type of debt instrument issued by borrowers with similar credit ratings. The 3.125% Senior Notes are unsecured and unsubordinated obligations of the Company and are unconditionally guaranteed, jointly and severally, by The Kansas City Southern Railway Company ("KCSR") and each current and future domestic subsidiary of KCS that guarantees the KCS revolving credit facility or certain other debt of KCS or a note guarantor.

Debt Exchange

During the first quarter of 2016, KCS entered into agreements with certain holders of KCSR and KCSM senior notes (collectively, the "Existing Notes") to exchange Existing Notes for new securities issued by KCS. Each KCS note issued in exchange for an Existing Note has the same interest rate, interest payment dates and maturity date and substantially identical redemption provisions as the corresponding Existing Note. The KCS notes have the same terms (other than the issue date) as the corresponding notes issued by KCS in the exchange offers that closed on December 9, 2015. The following table summarizes the outstanding notes that were exchanged on March 29, 2016 (in millions):

Issuer of Existing Notes	Series of Existing Notes	Principal Amount Outstanding Prior to Exchange	Principal Amount of Notes Exchanged	Principal Amount Outstanding Following Exchange
KCSR	3.85% Senior Notes due 2023	\$ 5.0	\$ 4.2	\$ 0.8
KCSR	4.30% Senior Notes due 2043	12.4	11.1	1.3
KCSR	4.95% Senior Notes due 2045	23.3	22.5	0.8
KCSM	2.35% Senior Notes due 2020	35.4	17.8	17.6

The Company has accounted for this transaction as a debt exchange as the exchanged debt instruments are not considered to be substantially different. The balance of the unamortized discount and issue costs from the Existing Notes is being amortized as an adjustment of interest expense over the term of the KCS notes. There was no gain or loss recognized as a result of the exchange.

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Kansas City Southern and Subsidiaries

Notes to Consolidated Financial Statements—(Continued)

11. Equity

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

	Three Months Ended September 30, 2016			Three Months Ended September 30, 2015		
	City Southern Stockholders Equity	Noncontrolling Interest	Total Equity	City Southern Stockholders Equity	Noncontrolling Interest	Total Equity
Beginning balance	\$4,020.6	\$ 311.1	\$4,331.7	\$3,888.1	\$ 309.4	\$4,197.5
Net income	120.6	0.4	121.0	131.6	0.3	131.9
Other comprehensive loss	(0.3)	—	(0.3)	(0.8)	—	(0.8)
Contribution from noncontrolling interest	—	2.4	2.4	—	—	—
Dividends on common stock	(35.5)	—	(35.5)	(36.0)	—	(36.0)
Dividends on \$25 par preferred stock	(0.1)	—	(0.1)	(0.1)	—	(0.1)
Share repurchases	(40.6)	—	(40.6)	(115.7)	—	(115.7)
Options exercised and stock subscribed, net of shares withheld for employee taxes	2.9	—	2.9	2.9	—	2.9
Excess tax benefit from share-based compensation	0.2	—	0.2	0.9	—	0.9
Share-based compensation	4.1	—	4.1	3.7	—	3.7
Ending balance	\$4,071.9	\$ 313.9	\$4,385.8	\$3,874.6	\$ 309.7	\$4,184.3
	Nine Months Ended September 30, 2016			Nine Months Ended September 30, 2015		
	City Southern Stockholders Equity	Noncontrolling Interest	Total Equity	City Southern Stockholders Equity	Noncontrolling Interest	Total Equity
Beginning balance	\$3,914.3	\$ 310.4	\$4,224.7	\$3,755.5	\$ 308.6	\$4,064.1
Net income	348.5	1.1	349.6	344.2	1.1	345.3
Other comprehensive loss	(1.0)	—	(1.0)	(1.4)	—	(1.4)
Contribution from noncontrolling interest	—	2.4	2.4	—	—	—
Dividends on common stock	(106.7)	—	(106.7)	(108.9)	—	(108.9)
Dividends on \$25 par preferred stock	(0.2)	—	(0.2)	(0.2)	—	(0.2)
Share repurchases	(99.8)	—	(99.8)	(136.3)	—	(136.3)
Options exercised and stock subscribed, net of shares withheld for employee taxes	1.8	—	1.8	4.6	—	4.6
Excess tax benefit from share-based compensation	(0.2)	—	(0.2)	5.3	—	5.3
Share-based compensation	15.2	—	15.2	11.8	—	11.8
Ending balance	\$4,071.9	\$ 313.9	\$4,385.8	\$3,874.6	\$ 309.7	\$4,184.3

Share Repurchase Program

In May 2015, the Company announced a share repurchase program of up to \$500.0 million, which expires on June 30, 2017. Management's assessment of market conditions, available liquidity and other factors will determine the timing and volume of repurchases. During the three months ended September 30, 2016, KCS repurchased 416,000 shares of

common stock for \$40.6 million at an average price of \$97.71 per share. During the nine months ended September 30, 2016, KCS repurchased 1,146,612 shares of common stock for \$99.8 million at an average price of \$87.11 per share. Since inception of this program, KCS has repurchased 3,280,596 shares of common stock for \$294.0 million at an average price of \$89.63 per share. The excess of repurchase price over par value is allocated between additional paid-in capital and retained earnings.

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Cash Dividends on Common Stock

On August 15, 2016, the Company's Board of Directors declared a cash dividend of \$0.330 per share payable on October 5, 2016, to common stockholders of record as of September 12, 2016. The aggregate amount of the dividends declared for the three and nine months ended September 30, 2016 was \$35.5 million and \$106.7 million, respectively. The following table presents the amount of cash dividends declared per common share by the Company's Board of Directors:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Cash dividends declared per common share	\$0.330	\$0.330	\$0.990	\$0.990

12. Commitments and Contingencies

Concession Duty. Under KCSM's 50-year railroad concession from the Mexican government (the "Concession"), which would expire in 2047 unless extended, KCSM pays concession duty expense of 1.25% of gross revenues. For the three and nine months ended September 30, 2016, the concession duty expense, which is recorded within Materials and other in operating expenses, was \$3.9 million and \$11.2 million, respectively, compared to \$4.1 million and \$11.8 million for the same periods in 2015.

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

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

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

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

The Company performs ongoing reviews and evaluations of the various environmental programs and issues within the Company's operations, and, as necessary, takes actions intended to limit the Company's exposure to potential liability.

Although these costs cannot be predicted with certainty, management believes that the ultimate outcome of identified matters will not have a material adverse effect on the Company's consolidated financial statements.

Personal Injury. The Company's personal injury liability is based on semi-annual actuarial studies performed on an undiscounted basis by an independent third party actuarial firm and reviewed by management. This liability is based on personal injury claims filed and an estimate of claims incurred but not yet reported. Actual results may vary from estimates due to the number, type and severity of the injury, costs of medical treatments and uncertainties in litigation. Adjustments to the liability are reflected

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Notes to Consolidated Financial Statements—(Continued)

within operating expenses in the period in which changes to estimates are known. Personal injury claims in excess of self-insurance levels are insured up to certain coverage amounts, depending on the type of claim and year of occurrence. The personal injury liability as of September 30, 2016, was based on an updated actuarial study of personal injury claims through May 31, 2016, and review of the last four months' experience.

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

	Nine Months Ended September 30,	
	2016	2015
Balance at beginning of year	\$23.9	\$29.3
Accruals	3.6	5.6
Change in estimate	(0.6)	(3.5)
Payments	(2.3)	(4.0)
Balance at end of period	\$24.6	\$27.4

Certain Disputes with Ferromex. KCSM and Ferrocarril Mexicano, S.A. de C.V. ("Ferromex") use certain trackage rights, switching services and interline services provided by each other. KCSM and Ferromex had not agreed on the rates to be charged for trackage rights and switching services for periods beginning in 1998 through December 31, 2008, or for interline services for periods beginning in 1998 through February 8, 2010. Both KCSM and Ferromex had initiated administrative proceedings seeking a determination by the Mexican Secretaría de Comunicaciones y Transportes ("Secretary of Communications and Transportation" or "SCT") of the rates that KCSM and Ferromex should pay each other. The SCT issued rulings in 2002 and 2008 setting the rates for the services and both KCSM and Ferromex had challenged these rulings based on different grounds. Additionally, KCSM and Ferromex had not settled amounts payable to each other for trackage rights and switching services for the year ended December 31, 2009.

In the first quarter of 2016, KCSM and Ferromex executed a settlement agreement resolving amounts payable to each other for trackage rights and switching services for periods beginning in 1998 through December 31, 2009, and for interline services for periods beginning in 1998 through February 8, 2010. Under this settlement agreement, KCSM and Ferromex also agreed to terminate all related administrative proceedings. This settlement agreement did not have a significant effect on the consolidated financial statements.

Tax Contingencies. A tax benefit of \$1.7 million was recognized in the third quarter relating to a previous uncertain tax position as a result of a lapse of the statute of limitations. The Company has no other remaining uncertain tax positions as of September 30, 2016. Tax returns filed in the U.S. for periods after 2012 and in Mexico for periods after 2008 for KCSM and after 2010 for Mexico subsidiaries other than KCSM remain open to examination by the taxing authorities. The Servicio de Administración Tributaria (the "SAT"), the Mexican equivalent of the IRS, is currently examining the KCSM 2009, 2010 and 2011 Mexico tax returns and the 2013 Mexico tax return of KCSM Servicios, S.A. de C.V. ("KCSM Servicios"), a wholly-owned subsidiary of KCS. An SAT examination was completed during the second quarter without adjustment for the 2012 Mexico tax return of KCSM Servicios. The Company is litigating a Value Added Tax ("VAT") audit assessment from the SAT for KCSM for the year ended December 31, 2005. While the outcome of this matter cannot be predicted with certainty, the Company does not believe, when resolved, that this dispute will have a material effect on its consolidated financial statements. However, an unexpected adverse resolution could have a material effect on the consolidated financial statements in a particular quarter or fiscal year.

KCSM has not historically assessed VAT on international import transportation services provided to its customers based on a written ruling that KCSM obtained from the SAT in 2008 stating that such services were exempt from VAT (the "2008 Ruling"). Notwithstanding the 2008 Ruling, in December 2013, the SAT unofficially informed KCSM of an intended implementation of new criteria effective as of January 1, 2014, pursuant to which VAT would be assessed on all international import transportation services on the portion of the services provided within Mexico. Additionally, in November 2013, the SAT filed an action to nullify the 2008 Ruling, potentially exposing the

application of the new criteria to open tax years. In February 2014, KCSM filed an action opposing the SAT's nullification action. While the SAT's unofficial communication to KCSM is not enforceable and the 2008 Ruling continues to be in effect, KCSM notified its customers in December 2013 of the potential assessment of VAT on international import transportation services; however, implementation of any VAT assessment will depend on future developments and any guidance published by the SAT. Due to the pass-through nature of VAT assessed on services provided to customers, the Company does not believe any ultimate requirement to assess VAT on international import transportation services will have a significant effect on its consolidated financial statements. However, unexpected adverse implementation criteria imposed by the SAT for open tax years could have a material effect on the consolidated financial statements of the Company in a particular quarter or fiscal year.

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Notes to Consolidated Financial Statements—(Continued)

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

Credit Risk. The Company continually monitors risks related to economic changes and certain customer receivables concentrations. Significant changes in customer concentration or payment terms, deterioration of customer creditworthiness or further weakening in economic trends could have a significant impact on the collectability of the Company's receivables and its operating results. If the financial condition of the Company's customers were to deteriorate and result in an impairment of their ability to make payments, additional allowances may be required. The Company has recorded provisions for uncollectability based on its best estimate at September 30, 2016.

Panama Canal Railway Company ("PCRC") Guarantees and Indemnities. At September 30, 2016, the Company had issued and outstanding \$5.3 million under a standby letter of credit to fulfill its obligation to fund fifty percent of the debt service reserve and liquidity reserve established by PCRC in connection with the issuance of the 7.0% Senior Secured Notes due November 1, 2026 (the "PCRC Notes"). Additionally, KCS has pledged its shares of PCRC as security for the PCRC Notes.

Mexican Antitrust Review. Pursuant to the Mexican Regulatory Railroad Service Law as recently amended and the new Mexican Antitrust Law, on September 12, 2016, the Mexican government's antitrust commission (Comisión Federal de Competencia Económica or "COFECE"), announced that it would review competitive conditions in the Mexican railroad industry, with respect to the existence of effective competition in the provision of interconnection services, trackage rights and switching rights used to render public freight transport in Mexico. The COFECE review includes the entire freight rail transportation market in Mexico and is not targeted to any single rail carrier. It is too early to determine what, if any, impact this review may have on Mexican rail operations in the future.

Surface Transportation Board. On July 27, 2016, the Surface Transportation Board issued a Notice of Proposed Rulemaking in Ex Parte 711 (Sub-No.1) Reciprocal Switching proposing rules related to reciprocal switching. Initial comments on the proposed rule are due by October 26, 2016, and replies to the initial comments are due by January 13, 2017. Until the rule has been finalized, KCS cannot determine what effect, if any, the rule will have on its business.

13. Geographic Information

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

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

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Revenues	\$317.4	\$336.4	\$896.4	\$ 935.7
U.S.	287.1	295.5	839.3	885.1
Mexico	\$604.5	\$631.9	\$1,735.7	\$ 1,820.8
Total revenues				

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	September 30, 2016	December 31, 2015
Property and equipment (including concession assets), net		
U.S.	\$4,865.2	\$ 4,642.6
Mexico	3,086.2	3,062.8
Total property and equipment (including concession assets), net	\$7,951.4	\$ 7,705.4

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Notes to Consolidated Financial Statements—(Continued)

14. Condensed Consolidating Financial Information

Pursuant to Securities and Exchange Commission (“SEC”) Regulation S-X Rule 3-10 “Financial statements of guarantors and issuers of guaranteed securities registered or being registered”, the Company is required to provide condensed consolidating financial information for issuers of certain of its senior notes that are guaranteed. During 2015 and the first quarter of 2016, the Company completed a debt exchange whereby current holders of KCSR notes exchanged their notes for new KCS notes. As such, condensed consolidating financial information is presented with KCS as issuer of the new KCS notes and the 3.125% Senior Notes and with KCSR as issuer of the remaining Existing Notes that were not exchanged.

As of September 30, 2016, KCS had outstanding \$244.8 million principal amount of Floating Rate Senior Notes due October 28, 2016, \$257.3 million principal amount of 2.35% Senior Notes due May 15, 2020, \$439.1 million principal amount of 3.00% Senior Notes due May 15, 2023, \$199.2 million principal amount of 3.85% Senior Notes due November 15, 2023, \$250.0 million principal amount of 3.125% Senior Notes due June 1, 2026, \$448.7 million principal amount of 4.30% Senior Notes due May 15, 2043 and \$499.2 million principal amount of 4.95% Senior Notes due August 15, 2045, which are unsecured obligations of KCS, and are also jointly and severally and fully and unconditionally guaranteed on an unsecured senior basis by KCSR and certain wholly-owned domestic subsidiaries of KCS.

The 3.125% Senior Notes were registered under KCS’s shelf registration statement filed and automatically effective as of November 20, 2014. The Company filed a registration statement on Form S-4 with the SEC in connection with an exchange offer with respect to the remaining KCS notes, which was declared effective on June 27, 2016. As a result, the Company is providing the following condensed consolidating financial information (in millions).

Condensed Consolidating Statements of Comprehensive Income - KCS Notes

	Three Months Ended September 30, 2016				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$ 289.9	\$ 319.0	\$ (4.4)	\$ 604.5
Operating expenses	0.9	214.7	193.5	(4.4)	404.7
Operating income (loss)	(0.9)	75.2	125.5	—	199.8
Equity in net earnings of affiliates	119.1	1.7	3.0	(120.3)	3.5
Interest expense	(21.7)	(20.6)	(16.7)	33.8	(25.2)
Foreign exchange loss	—	—	(19.8)	—	(19.8)
Other income (expense), net	26.3	(0.1)	7.1	(33.3)	—
Income before income taxes	122.8	56.2	99.1	(119.8)	158.3
Income tax expense	2.2	19.9	15.2	—	37.3
Net income	120.6	36.3	83.9	(119.8)	121.0
Less: Net income attributable to noncontrolling interest	—	0.4	—	—	0.4
Net income attributable to Kansas City Southern and subsidiaries	120.6	35.9	83.9	(119.8)	120.6
Other comprehensive loss	(0.3)	—	(0.4)	0.4	(0.3)
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$ 120.3	\$ 35.9	\$ 83.5	\$ (119.4)	\$ 120.3

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Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Statements of Comprehensive Income - KCS Notes—(Continued)

Three Months Ended September 30, 2015

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$ 307.4	\$ 329.2	\$ (4.7)	\$ 631.9
Operating expenses	0.8	204.2	211.7	(4.7)	412.0
Operating income (loss)	(0.8)	103.2	117.5	—	219.9
Equity in net earnings of affiliates	121.1	1.5	4.5	(122.1)	5.0
Interest expense	—	(22.6)	(9.6)	10.3	(21.9)
Foreign exchange loss	—	—	(30.0)	—	(30.0)
Other income (expense), net	10.2	(1.0)	—	(10.3)	(1.1)
Income before income taxes	130.5	81.1	82.4	(122.1)	171.9
Income tax expense (benefit)	(1.1)	30.9	10.2	—	40.0
Net income	131.6	50.2	72.2	(122.1)	131.9
Less: Net income attributable to noncontrolling interest	—	0.3	—	—	0.3
Net income attributable to Kansas City Southern and subsidiaries	131.6	49.9	72.2	(122.1)	131.6
Other comprehensive loss	(0.8)	—	(1.3)	1.3	(0.8)
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$ 130.8	\$ 49.9	\$ 70.9	\$ (120.8)	\$ 130.8

Nine Months Ended September 30, 2016

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$ 817.5	\$ 931.6	\$ (13.4)	\$ 1,735.7
Operating expenses	3.7	585.1	552.7	(13.4)	1,128.1
Operating income (loss)	(3.7)	232.4	378.9	—	607.6
Equity in net earnings of affiliates	336.3	4.7	9.0	(339.6)	10.4
Interest expense	(61.1)	(63.2)	(46.6)	97.7	(73.2)
Foreign exchange loss	—	—	(47.3)	—	(47.3)
Other income, net	79.1	—	16.9	(96.5)	(0.5)
Income before income taxes	350.6	173.9	310.9	(338.4)	497.0
Income tax expense	2.1	65.9	79.4	—	147.4
Net income	348.5	108.0	231.5	(338.4)	349.6
Less: Net income attributable to noncontrolling interest	—	1.1	—	—	1.1
Net income attributable to Kansas City Southern and subsidiaries	348.5	106.9	231.5	(338.4)	348.5
Other comprehensive loss	(1.0)	—	(1.7)	1.7	(1.0)
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$ 347.5	\$ 106.9	\$ 229.8	\$ (336.7)	\$ 347.5

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Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Statements of Comprehensive Income - KCS Notes—(Continued)

	Nine Months Ended September 30, 2015				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$ 852.1	\$ 982.7	\$ (14.0)	\$ 1,820.8
Operating expenses	3.8	595.8	650.3	(14.0)	1,235.9
Operating income (loss)	(3.8)	256.3	332.4	—	584.9
Equity in net earnings of affiliates	320.3	4.7	13.0	(323.6)	14.4
Interest expense	(0.1)	(62.3)	(29.6)	33.8	(58.2)
Foreign exchange loss	—	—	(52.1)	—	(52.1)
Other income (expense), net	33.6	(2.8)	(0.1)	(33.8)	(3.1)
Income before income taxes	350.0	195.9	263.6	(323.6)	485.9
Income tax expense	5.8	74.7	60.1	—	140.6
Net income	344.2	121.2	203.5	(323.6)	345.3
Less: Net income attributable to noncontrolling interest	—	1.1	—	—	1.1
Net income attributable to Kansas City Southern and subsidiaries	344.2	120.1	203.5	(323.6)	344.2
Other comprehensive loss	(1.4)	—	(2.1)	2.1	(1.4)
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$342.8	\$ 120.1	\$ 201.4	\$ (321.5)	\$ 342.8

Condensed Consolidating Balance Sheets - KCS Notes

	September 30, 2016				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Assets:					
Current assets	\$279.7	\$ 369.3	\$ 366.0	\$ (246.0)	\$ 769.0
Investments	—	3.9	34.0	—	37.9
Investments in consolidated subsidiaries	3,384.3	491.8	—	(3,876.1)	—
Property and equipment (including concession assets), net	—	4,107.0	3,845.2	(0.8)	7,951.4
Other assets	2,015.5	45.4	254.5	(2,244.2)	71.2
Total assets	\$5,679.5	\$ 5,017.4	\$ 4,499.7	\$ (6,367.1)	\$ 8,829.5
Liabilities and equity:					
Current liabilities	\$(493.3)	\$ 1,283.6	\$ 209.0	\$(247.2)	\$ 752.1
Long-term debt	2,063.6	1,177.4	1,278.9	(2,244.2)	2,275.7
Deferred income taxes	23.0	1,061.1	223.9	—	1,308.0
Other liabilities	3.9	84.2	19.8	—	107.9
Stockholders' equity	4,082.3	1,097.2	2,768.1	(3,875.7)	4,071.9
Noncontrolling interest	—	313.9	—	—	313.9
Total liabilities and equity	\$5,679.5	\$ 5,017.4	\$ 4,499.7	\$ (6,367.1)	\$ 8,829.5

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Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Balance Sheets - KCS Notes—(Continued)

	December 31, 2015				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Assets:					
Current assets	\$242.8	\$ 189.5	\$ 359.5	\$ (254.8)	\$ 537.0
Investments	—	3.9	30.8	—	34.7
Investments in consolidated subsidiaries	3,108.4	479.6	—	(3,588.0)	—
Property and equipment (including concession assets), net	—	3,903.2	3,803.0	(0.8)	7,705.4
Other assets	1,791.1	40.6	19.3	(1,787.1)	63.9
Total assets	\$5,142.3	\$ 4,616.8	\$ 4,212.6	\$ (5,630.7)	\$ 8,341.0
Liabilities and equity:					
Current liabilities	\$(566.9)	\$ 1,066.6	\$ 512.8	\$ (254.9)	\$ 757.6
Long-term debt	1,759.8	1,260.0	812.3	(1,787.1)	2,045.0
Deferred income taxes	20.9	998.4	171.8	—	1,191.1
Other liabilities	3.8	94.4	24.4	—	122.6
Stockholders' equity	3,924.7	887.0	2,691.3	(3,588.7)	3,914.3
Noncontrolling interest	—	310.4	—	—	310.4
Total liabilities and equity	\$5,142.3	\$ 4,616.8	\$ 4,212.6	\$ (5,630.7)	\$ 8,341.0

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Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Statements of Cash Flows - KCS Notes

Nine Months Ended September 30, 2016

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Operating activities:					
Net cash provided	\$ 178.4	\$ 380.8	\$ 288.5	\$ (163.9)	\$ 683.8
Investing activities:					
Capital expenditures	—	(269.5)	(135.6)	—	(405.1)
Purchase or replacement of equipment under operating leases	—	(26.6)	—	—	(26.6)
Property investments in MSLLC	—	—	(31.2)	—	(31.2)
Proceeds from repayment of loans to affiliates	6,743.5	—	—	(6,743.5)	—
Loans to affiliates	(6,742.5)	—	—	6,742.5	—
Contribution to consolidated affiliates	(103.4)	(6.5)	—	109.9	—
Other investing activities	—	(9.0)	5.9	—	(3.1)
Net cash used	(102.4)	(311.6)	(160.9)	108.9	(466.0)
Financing activities:					
Proceeds from short-term borrowings	6,499.0	243.5	—	(243.5)	6,499.0
Repayment of short-term borrowings	(6,579.3)	—	—	—	(6,579.3)
Proceeds from issuance of long-term debt	248.7	—	—	—	248.7
Repayment of long-term debt	—	(2.6)	(18.2)	—	(20.8)
Dividends paid	(107.2)	—	(162.2)	162.2	(107.2)
Shares repurchased	(99.8)	—	—	—	(99.8)
Proceeds from loans from affiliates	—	6,499.0	—	(6,499.0)	—
Repayment of loans from affiliates	—	(6,743.5)	—	6,743.5	—
Contribution from affiliates	—	103.1	6.8	(109.9)	—
Other financing activities	(1.7)	(0.1)	(1.8)	1.7	(1.9)
Net cash provided (used)	(40.3)	99.4	(175.4)	55.0	(61.3)
Cash and cash equivalents:					
Net increase (decrease)	35.7	168.6	(47.8)	—	156.5
At beginning of year	0.2	10.2	126.2	—	136.6
At end of period	\$ 35.9	\$ 178.8	\$ 78.4	\$ —	\$ 293.1

Table of ContentsKansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Statements of Cash Flows - KCS Notes—(Continued)

Nine Months Ended September 30, 2015

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Operating activities:					
Net cash provided	\$25.7	\$ 249.2	\$ 406.1	\$ (9.8)	\$ 671.2
Investing activities:					
Capital expenditures	—	(267.3)	(255.5)	—	(522.8)
Purchase or replacement of equipment under operating leases	—	(81.6)	(61.4)	—	(143.0)
Property investments in MSLLC	—	—	(7.2)	—	(7.2)
Proceeds from repayment of loans to affiliates	205.7	—	—	(205.7)	—
Other investing activities	(0.5)	(6.6)	(14.9)	1.0)	(21.0)
Net cash provided (used)	205.2	(355.5)	(339.0)	(204.7)	(694.0)
Financing activities:					
Proceeds from short-term borrowings	—	9,605.5	—	—	9,605.5
Repayment of short-term borrowings	—	(9,756.6)	(300.0)	—	(10,056.6)
Proceeds from issuance of long-term debt	—	498.7	40.0	—	538.7
Repayment of long-term debt	—	(2.5)	(57.1)	—	(59.6)
Dividends paid	(104.0)	—	(9.8)	9.8)	(104.0)
Shares repurchased	(136.3)	—	—	—	(136.3)
Repayment of loans from affiliates	—	(205.7)	—	205.7	—
Other financing activities	9.5	(5.3)	0.5	(1.0)	3.7
Net cash provided (used)	(230.8)	134.1	(326.4)	214.5	(208.6)
Cash and cash equivalents:					
Net increase (decrease)	0.1	27.8	(259.3)	—	(231.4)
At beginning of year	0.2	29.5	318.3	—	348.0
At end of period	\$0.3	\$ 57.3	\$ 59.0	\$ —	\$ 116.6

Table of ContentsKansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

As of September 30, 2016, KCSR had outstanding \$0.8 million principal amount of 3.85% Senior Notes due November 15, 2023, \$1.3 million principal amount of 4.30% Senior Notes due May 15, 2043 and \$0.8 million principal amount of 4.95% Senior Notes due August 15, 2045 (collectively, the “KCSR Notes”) which are unsecured obligations of KCSR, and are also jointly and severally and fully and unconditionally guaranteed on an unsecured senior basis by KCS and certain wholly-owned domestic subsidiaries. The 4.95% Senior Notes were registered under KCS’s shelf registration filed and automatically effective as of November 20, 2014. KCSR filed a registration statement on Form S-4 with the SEC in connection with an exchange offer with respect to the 3.85% Senior Notes and 4.30% Senior Notes, which was declared effective on May 28, 2014. As a result, the Company is providing the following condensed consolidating financial information (in millions).

Condensed Consolidating Statements of Comprehensive Income - KCSR Notes

	Three Months Ended September 30, 2016					
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$283.5	\$ 11.8	\$ 319.0	\$ (9.8)	\$ 604.5
Operating expenses	0.9	210.1	10.0	193.5	(9.8)	404.7
Operating income (loss)	(0.9)	73.4	1.8	125.5	—	199.8
Equity in net earnings (losses) of affiliates	119.1	(0.3)	1.2	3.0	(119.5)	3.5
Interest expense	(21.7)	(20.6)	—	(16.7)	33.8	(25.2)
Foreign exchange loss	—	—	—	(19.8)	—	(19.8)
Other income (expense), net	26.3	(0.1)	—	7.1	(33.3)	—
Income before income taxes	122.8	52.4	3.0	99.1	(119.0)	158.3
Income tax expense	2.2	18.8	1.1	15.2	—	37.3
Net income	120.6	33.6	1.9	83.9	(119.0)	121.0
Less: Net income attributable to noncontrolling interest	—	—	0.4	—	—	0.4
Net income attributable to Kansas City Southern and subsidiaries	120.6	33.6	1.5	83.9	(119.0)	120.6
Other comprehensive loss	(0.3)	—	—	(0.4)	0.4	(0.3)
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$120.3	\$33.6	\$ 1.5	\$ 83.5	\$ (118.6)	\$ 120.3

Table of ContentsKansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Statements of Comprehensive Income - KCSR Notes—(Continued)

Three Months Ended September 30, 2015

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$302.7	\$ 9.5	\$ 329.2	\$ (9.5)	\$ 631.9
Operating expenses	0.8	199.4	9.6	211.7	(9.5)	412.0
Operating income (loss)	(0.8)	103.3	(0.1)	117.5	—	219.9
Equity in net earnings (losses) of affiliates	121.1	(1.2)	1.0	4.5	(120.4)	5.0
Interest expense	—	(22.6)	—	(9.6)	10.3	(21.9)
Foreign exchange loss	—	—	—	(30.0)	—	(30.0)
Other income (expense), net	10.2	(1.0)	—	—	(10.3)	(1.1)
Income before income taxes	130.5	78.5	0.9	82.4	(120.4)	171.9
Income tax expense (benefit)	(1.1)	30.6	0.3	10.2	—	40.0
Net income	131.6	47.9	0.6	72.2	(120.4)	131.9
Less: Net income attributable to noncontrolling interest	—	—	0.3	—	—	0.3
Net income attributable to Kansas City Southern and subsidiaries	131.6	47.9	0.3	72.2	(120.4)	131.6
Other comprehensive loss	(0.8)	—	—	(1.3)	1.3	(0.8)
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$ 130.8	\$ 47.9	\$ 0.3	\$ 70.9	\$ (119.1)	\$ 130.8

Nine Months Ended September 30, 2016

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$798.8	\$ 33.9	\$ 931.6	\$ (28.6)	\$ 1,735.7
Operating expenses	3.7	571.6	28.7	552.7	(28.6)	1,128.1
Operating income (loss)	(3.7)	227.2	5.2	378.9	—	607.6
Equity in net earnings of affiliates	336.3	—	3.3	9.0	(338.2)	10.4
Interest expense	(61.1)	(63.2)	—	(46.6)	97.7	(73.2)
Foreign exchange loss	—	—	—	(47.3)	—	(47.3)
Other income, net	79.1	—	—	16.9	(96.5)	(0.5)
Income before income taxes	350.6	164.0	8.5	310.9	(337.0)	497.0
Income tax expense	2.1	62.4	3.5	79.4	—	147.4
Net income	348.5	101.6	5.0	231.5	(337.0)	349.6
Less: Net income attributable to noncontrolling interest	—	—	1.1	—	—	1.1
Net income attributable to Kansas City Southern and subsidiaries	348.5	101.6	3.9	231.5	(337.0)	348.5
Other comprehensive loss	(1.0)	—	—	(1.7)	1.7	(1.0)
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$ 347.5	\$ 101.6	\$ 3.9	\$ 229.8	\$ (335.3)	\$ 347.5

Table of ContentsKansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Statements of Comprehensive Income - KCSR Notes—(Continued)

Nine Months Ended September 30, 2015

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Revenues	\$—	\$835.5	\$ 30.4	\$ 982.7	\$ (27.8)	\$ 1,820.8
Operating expenses	3.8	581.9	27.7	650.3	(27.8)	1,235.9
Operating income (loss)	(3.8)	253.6	2.7	332.4	—	584.9
Equity in net earnings (losses) of affiliates	320.3	(0.9)	3.3	13.0	(321.3)	14.4
Interest expense	(0.1)	(62.3)	—	(29.6)	33.8	(58.2)
Foreign exchange loss	—	—	—	(52.1)	—	(52.1)
Other income (expense), net	33.6	(2.8)	—	(0.1)	(33.8)	(3.1)
Income before income taxes	350.0	187.6	6.0	263.6	(321.3)	485.9
Income tax expense	5.8	72.4	2.3	60.1	—	140.6
Net income	344.2	115.2	3.7	203.5	(321.3)	345.3
Less: Net income attributable to noncontrolling interest	—	—	1.1	—	—	1.1
Net income attributable to Kansas City Southern and subsidiaries	344.2	115.2	2.6	203.5	(321.3)	344.2
Other comprehensive loss	(1.4)	—	—	(2.1)	2.1	(1.4)
Comprehensive income attributable to Kansas City Southern and subsidiaries	\$342.8	\$115.2	\$ 2.6	\$ 201.4	\$ (319.2)	\$ 342.8

Condensed Consolidating Balance Sheets - KCSR Notes

September 30, 2016

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Assets:						
Current assets	\$279.7	\$364.7	\$ 5.6	\$ 366.0	\$ (247.0)	\$ 769.0
Investments	—	3.9	—	34.0	—	37.9
Investments in consolidated subsidiaries	3,384.3	(9.0)	489.7	—	(3,865.0)	—
Property and equipment (including concession assets), net	—	3,926.0	181.0	3,845.2	(0.8)	7,951.4
Other assets	2,015.5	45.3	—	254.5	(2,244.1)	71.2
Total assets	\$5,679.5	\$4,330.9	\$ 676.3	\$ 4,499.7	\$ (6,356.9)	\$ 8,829.5
Liabilities and equity:						
Current liabilities	\$(493.3)	\$1,189.6	\$ 94.9	\$ 209.0	\$ (248.1)	\$ 752.1
Long-term debt	2,063.6	1,177.3	0.1	1,278.9	(2,244.2)	2,275.7
Deferred income taxes	23.0	923.0	138.1	223.9	—	1,308.0
Other liabilities	3.9	84.1	0.1	19.8	—	107.9
Stockholders' equity	4,082.3	956.9	129.2	2,768.1	(3,864.6)	4,071.9
Noncontrolling interest	—	—	313.9	—	—	313.9
Total liabilities and equity	\$5,679.5	\$4,330.9	\$ 676.3	\$ 4,499.7	\$ (6,356.9)	\$ 8,829.5

Table of ContentsKansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Balance Sheets - KCSR Notes—(Continued)

December 31, 2015

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Assets:						
Current assets	\$242.8	\$182.7	\$ 7.7	\$ 359.5	\$ (255.7)	\$ 537.0
Investments	—	3.9	—	30.8	—	34.7
Investments in consolidated subsidiaries	3,108.4	(7.6)	477.6	—	(3,578.4)	—
Property and equipment (including concession assets), net	—	3,716.4	186.8	3,803.0	(0.8)	7,705.4
Other assets	1,791.1	40.5	—	19.3	(1,787.0)	63.9
Total assets	\$5,142.3	\$3,935.9	\$ 672.1	\$ 4,212.6	\$ (5,621.9)	\$ 8,341.0
Liabilities and equity:						
Current liabilities	\$(566.9)	\$959.6	\$ 107.8	\$ 512.8	\$ (255.7)	\$ 757.6
Long-term debt	1,759.8	1,259.9	0.1	812.3	(1,787.1)	2,045.0
Deferred income taxes	20.9	863.7	134.7	171.8	—	1,191.1
Other liabilities	3.8	94.2	0.2	24.4	—	122.6
Stockholders' equity	3,924.7	758.5	118.9	2,691.3	(3,579.1)	3,914.3
Noncontrolling interest	—	—	310.4	—	—	310.4
Total liabilities and equity	\$5,142.3	\$3,935.9	\$ 672.1	\$ 4,212.6	\$ (5,621.9)	\$ 8,341.0

Table of ContentsKansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Statements of Cash Flows - KCSR Notes

Nine Months Ended September 30, 2016

	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated KCS
Operating activities:						
Net cash provided	\$178.4	\$380.2	\$ 0.6	\$ 288.5	\$ (163.9)	\$ 683.8
Investing activities:						
Capital expenditures	—	(269.0)	(0.5)	(135.6)	—	(405.1)
Purchase or replacement of equipment under operating leases	—	(26.6)	—	—	—	(26.6)
Property investments in MSLLC	—	—	—	(31.2)	—	(31.2)
Proceeds from repayment of loans to affiliates	6,743.5	—	—	—	(6,743.5)	—
Loans to affiliates	(6,742.5)	—	—	—	6,742.5	—
Contribution to consolidated affiliates	(103.4)	—	(6.5)	—	109.9	—
Other investing activities	—	(9.0)	—	5.9	—	(3.1)
Net cash used	(102.4)	(304.6)	(7.0)	(160.9)	108.9	(466.0)
Financing activities:						
Proceeds from short-term borrowings	6,499.0	243.5	—	—	(243.5)	6,499.0
Repayment of short-term borrowings	(6,579.3)	—	—	—	—	(6,579.3)
Proceeds from issuance of long-term debt	248.7	—	—	—	—	248.7
Repayment of long-term debt	—	(2.5)	(0.1)	(18.2)	—	(20.8)
Dividends paid	(107.2)	—	—	(162.2)	162.2	(107.2)
Shares repurchased	(99.8)	—	—	—	—	(99.8)
Proceeds from loans from affiliates	—	6,499.0	—	—	(6,499.0)	—
Repayment of loans from affiliates	—	(6,743.5)	—	—	6,743.5	—
Contribution from affiliates	—	96.6	6.5	6.8	(109.9)	—
Other financing activities	(1.7)	(0.1)	—	(1.8)	1.7	(1.9)
Net cash provided (used)	(40.3)	93.0	6.4	(175.4)	55.0	(61.3)
Cash and cash equivalents:						
Net increase (decrease)	35.7	168.6	—	(47.8)	—	156.5
At beginning of year	0.2	10.1	0.1	126.2	—	136.6
At end of period	\$35.9	\$178.7	\$ 0.1	\$ 78.4	\$ —	\$ 293.1

Table of ContentsKansas City Southern and Subsidiaries
Notes to Consolidated Financial Statements—(Continued)

Condensed Consolidating Statements of Cash Flows - KCSR Notes—(Continued)

	Nine Months Ended September 30, 2015					Consolidated Adjustments	Consolidated KCS
	Parent	KCSR	Guarantor Subsidiaries	Non-Guarantor Subsidiaries			
Operating activities:							
Net cash provided	\$25.7	\$248.0	\$ 1.2	\$ 406.1	\$ (9.8)		\$ 671.2
Investing activities:							
Capital expenditures	—	(266.1)	(1.2)	(255.5)	—		(522.8)
Purchase or replacement of equipment under operating leases	—	(81.6)	—	(61.4)	—		(143.0)
Property investments in MSLLC	—	—	—	(7.2)	—		(7.2)
Proceeds from repayment of loans to affiliates	205.7	—	—	—	(205.7)		—
Other investing activities	(0.5)	(6.1)	(0.5)	(14.9)	1.0		(21.0)
Net cash provided (used)	205.2	(353.8)	(1.7)	(339.0)	(204.7)		(694.0)
Financing activities:							
Proceeds from short-term borrowings	—	9,605.5	—	—	—		9,605.5
Repayment of short-term borrowings	—	(9,756.6)	—	(300.0)	—		(10,056.6)
Proceeds from issuance of long-term debt	—	498.7	—	40.0	—		538.7
Repayment of long-term debt	—	(2.4)	(0.1)	(57.1)	—		(59.6)
Dividends paid	(104.0)	—	—	(9.8)	9.8		(104.0)
Shares repurchased	(136.3)	—	—	—	—		(136.3)
Repayment of loans from affiliates	—	(205.7)	—	—	205.7		—
Other financing activities	9.5	(5.8)	0.5	0.5	(1.0)		3.7
Net cash provided (used)	(230.8)	133.7	0.4	(326.4)	214.5		(208.6)
Cash and cash equivalents:							
Net increase (decrease)	0.1	27.9	(0.1)	(259.3)	—		(231.4)
At beginning of year	0.2	29.0	0.5	318.3	—		348.0
At end of period	\$0.3	\$56.9	\$ 0.4	\$ 59.0	\$ —		\$ 116.6

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

The discussion below, as well as other portions of this Form 10-Q, contain forward-looking statements that are not based upon historical information. Readers can identify these forward-looking statements by the use of such verbs as “expects,” “anticipates,” “believes” or similar verbs or conjugations of such verbs. Such forward-looking statements are based upon information currently available to management and management’s perception thereof as of the date of this Form 10-Q. However, such statements are dependent on and, therefore, can be influenced by, a number of external variables over which management has little or no control, including: competition and consolidation within the transportation industry; the business environment in industries that produce and use items shipped by rail; loss of the rail concession of Kansas City Southern’s subsidiary, Kansas City Southern de México, S.A. de C.V.; the termination of, or failure to renew, agreements with customers, other railroads and third parties; access to capital; disruptions to the Company’s technology infrastructure, including its computer systems; natural events such as severe weather, hurricanes and floods; market and regulatory responses to climate change; legislative and regulatory developments and disputes; rail accidents or other incidents or accidents on KCS’s rail network or at KCS’s facilities or customer facilities involving the release of hazardous materials, including toxic inhalation hazards; fluctuation in prices or availability of key materials, in particular diesel fuel; dependency on certain key suppliers of core rail equipment; changes in securities and capital markets; availability of qualified personnel; labor difficulties, including strikes and work stoppages; insufficiency of insurance to cover lost revenue, profits or other damages; acts of terrorism or risk of terrorist activities; war or risk of war; domestic and international economic, political and social conditions; the level of trade between the United States and Asia or Mexico; fluctuations in the peso-dollar exchange rate; increased demand and traffic congestion; the outcome of claims and litigation involving the Company or its subsidiaries; and other factors affecting the operation of the business. For more discussion about each risk factor, see Part II Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, which is on file with the U.S. Securities and Exchange Commission (File No. 1-4717) and Part I Item 1A — “Risk Factors” in the Form 10-K and any updates contained herein. Readers are strongly encouraged to consider these factors when evaluating forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results and will not necessarily be accurate indications of the timing when, or by which, such performance or results will be achieved. As a result, actual outcomes or results could materially differ from those indicated in forward-looking statements. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements. This discussion is intended to clarify and focus on Kansas City Southern’s (“KCS” or the “Company”) results of operations, certain changes in its financial position, liquidity, capital structure and business developments for the periods covered by the consolidated financial statements included under Item 1 of this Form 10-Q. This discussion should be read in conjunction with those consolidated financial statements and the related notes and is qualified by reference to them.

Critical Accounting Policies and Estimates

The Company’s discussion and analysis of its financial position and results of operations is based upon its consolidated financial statements. The preparation of these consolidated financial statements requires estimation and judgment that affect the reported amounts of revenue, expenses, assets and liabilities. The Company bases its estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the accounting for assets and liabilities that are not readily apparent from other sources. If the estimates differ materially from actual results, the impact on the consolidated financial statements may be material. The Company’s critical accounting policies are disclosed in the 2015 Annual Report on Form 10-K.

Overview

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

and cash flows by providing customers with freight delivery services within its regions, and throughout North America through connections with other Class I rail carriers. Customers conduct business in a number of different industries, including chemical and petroleum products, industrial and consumer products, agriculture and mineral products, energy products, automotive products and intermodal transportation. Appropriate eliminations and reclassifications have been recorded in preparing the consolidated financial statements.

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Third Quarter Analysis

Revenues decreased 4% for the three months ended September 30, 2016, as compared to the same period in 2015, due to a 4% decrease in carload/unit volumes and a 1% decrease in revenue per carload/unit as a result of the weakening of the Mexican peso against the U.S. dollar and lower fuel surcharge, partially offset by positive pricing impacts. Operating expenses decreased 2% during the three months ended September 30, 2016, as compared to the same period in 2015, due to the Mexican fuel excise tax credit and the weakening of the Mexican peso against the U.S. dollar, partially offset by higher incentive compensation. Expense reductions resulting from the weakening Mexican peso and lower fuel prices generally offset the revenue reductions driven by these same macroeconomic factors. Operating expenses as a percentage of revenues was 66.9% for the three months ended September 30, 2016, compared to 65.2% for the same period in 2015.

The Company reported quarterly earnings of \$1.12 per diluted share on consolidated net income of \$120.6 million for the three months ended September 30, 2016, compared to earnings of \$1.20 per diluted share on consolidated net income of \$131.6 million for the same period in 2015.

Results of Operations

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

	Three Months		
	Ended		Change
	September 30, 2016	2015	
Revenues	\$604.5	\$631.9	\$(27.4)
Operating expenses	404.7	412.0	(7.3)
Operating income	199.8	219.9	(20.1)
Equity in net earnings of affiliates	3.5	5.0	(1.5)
Interest expense	(25.2)	(21.9)	(3.3)
Foreign exchange loss	(19.8)	(30.0)	10.2
Other expense, net	—	(1.1)	1.1
Income before income taxes	158.3	171.9	(13.6)
Income tax expense	37.3	40.0	(2.7)
Net income	121.0	131.9	(10.9)
Less: Net income attributable to noncontrolling interest	0.4	0.3	0.1
Net income attributable to Kansas City Southern and subsidiaries	\$120.6	\$131.6	\$(11.0)
	Nine Months Ended		
	September 30,		Change
	2016	2015	
Revenues	\$1,735.7	\$1,820.8	\$(85.1)
Operating expenses	1,128.1	1,235.9	(107.8)
Operating income	607.6	584.9	22.7
Equity in net earnings of affiliates	10.4	14.4	(4.0)
Interest expense	(73.2)	(58.2)	(15.0)
Foreign exchange loss	(47.3)	(52.1)	4.8
Other expense, net	(0.5)	(3.1)	2.6
Income before income taxes	497.0	485.9	11.1
Income tax expense	147.4	140.6	6.8
Net income	349.6	345.3	4.3
Less: Net income attributable to noncontrolling interest	1.1	1.1	—
Net income attributable to Kansas City Southern and subsidiaries	\$348.5	\$344.2	\$4.3

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Revenues

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

	Revenues			Carloads and Units			Revenue per Carload/Unit		
	Three Months Ended			Three Months Ended			Three Months Ended		
	September 30, 2016	2015	% Change	September 30, 2016	2015	% Change	September 30, 2016	2015	% Change
Chemical and petroleum	\$124.3	\$123.0	1 %	65.8	68.2	(4 %)	\$1,889	\$1,804	5 %
Industrial and consumer products	140.5	150.2	(6 %)	79.2	84.2	(6 %)	1,774	1,784	(1 %)
Agriculture and minerals	113.4	110.6	3 %	61.7	62.6	(1 %)	1,838	1,767	4 %
Energy	62.8	73.7	(15 %)	77.9	83.8	(7 %)	806	879	(8 %)
Intermodal	88.6	95.2	(7 %)	240.6	252.7	(5 %)	368	377	(2 %)
Automotive	51.4	54.6	(6 %)	36.5	31.9	14 %	1,408	1,712	(18 %)
Carload revenues, carloads and units	581.0	607.3	(4 %)	561.7	583.4	(4 %)	\$1,034	\$1,041	(1 %)
Other revenue	23.5	24.6	(4 %)						
Total revenues (i)	\$604.5	\$631.9	(4 %)						

(i) Included in revenues:

Fuel surcharge \$25.9 \$58.3

	Revenues			Carloads and Units			Revenue per Carload/Unit		
	Nine Months Ended			Nine Months Ended			Nine Months Ended		
	September 30, 2016	2015	% Change	September 30, 2016	2015	% Change	September 30, 2016	2015	% Change
Chemical and petroleum	\$364.0	\$353.8	3 %	197.8	193.2	2 %	\$1,840	\$1,831	—
Industrial and consumer products	418.0	440.8	(5 %)	240.4	248.1	(3 %)	1,739	1,777	(2 %)
Agriculture and minerals	338.5	320.7	6 %	184.6	178.3	4 %	1,834	1,799	2 %
Energy	142.0	184.5	(23 %)	182.5	201.5	(9 %)	778	916	(15 %)
Intermodal	265.1	288.1	(8 %)	712.0	746.0	(5 %)	372	386	(4 %)
Automotive	137.0	164.0	(16 %)	94.4	93.7	1 %	1,451	1,750	(17 %)
Carload revenues, carloads and units	1,664.6	1,751.9	(5 %)	1,611.7	1,660.8	(3 %)	\$1,033	\$1,055	(2 %)
Other revenue	71.1	68.9	3 %						
Total revenues (i)	\$1,735.7	\$1,820.8	(5 %)						

(i) Included in revenues:

Fuel surcharge \$76.8 \$181.6

Freight revenues include revenue for transportation services and fuel surcharges. For the three months ended September 30, 2016, revenues and carload/unit volumes decreased 4%, compared to the same period in 2015. For the nine months ended September 30, 2016, revenues and carload/unit volumes decreased 5% and 3%, respectively, compared to the same period in 2015. For the three and nine months ended September 30, 2016, revenues decreased by approximately \$12.0 million and \$49.0 million, respectively, compared to the same periods in 2015, due to the weakening of the Mexican peso against the U.S. dollar for revenue transactions denominated in Mexican pesos. The average exchange rate of Mexican pesos per U.S. dollar was Ps.18.7 and Ps.18.3 for the three and nine months ended September 30, 2016, respectively, compared to Ps.16.4 and Ps.15.5 for the same periods in 2015.

Revenue per carload/unit decreased 1% and 2% for the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015, due to the weakening of the Mexican peso against the U.S. dollar and lower fuel surcharge, partially offset by positive pricing impacts.

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KCS's fuel surcharges are a mechanism to adjust revenue based upon changes in fuel prices above fuel price thresholds set in KCS's tariffs or contracts. Fuel surcharge revenue 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 revenue may differ.

For the three and nine months ended September 30, 2016, fuel surcharge revenue decreased \$32.4 million and \$104.8 million, respectively, compared to the same periods in 2015, due in part to the adjustment of certain line haul rates while reducing or eliminating fuel surcharges on those rates. In addition, fuel surcharge revenue decreased due to lower U.S. fuel prices and the impact of fuel prices falling below fuel price thresholds for certain of KCS's tariffs and contracts in the nine months ended September 30, 2016.

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

Revenues by
commodity
group
for the three
months ended
September 30,
2016

Chemical and petroleum. Revenues increased \$1.3 million for the three months ended September 30, 2016, compared to the same period in 2015, due to a 5% increase in revenue per carload/unit, partially offset by a 4% decrease in carload/unit volumes. Revenue per carload unit increased due to positive pricing impacts and longer average length of haul, partially offset by lower fuel surcharge and the weakening of the Mexican peso against the U.S. dollar. Chemical volumes decreased as a result of a customer's lost business, partially offset by an increase in plastics volumes due to strong market demand and low commodity pricing environment.

Revenues increased \$10.2 million for the nine months ended September 30, 2016, compared to the same period in 2015, due to a 2% increase in carload/unit volumes. Petroleum volumes increased as a result of several customers' business expansion and plastics volumes increased due to strong market demand and low commodity pricing environment.

Industrial and consumer products. Revenues decreased \$9.7 million for the three months ended September 30, 2016, compared to the same period in 2015, due to a 6% decrease in carload/unit volumes and a 1% decrease in revenue per carload/unit. Revenues decreased \$22.8 million for the nine months ended September 30, 2016, compared to the same period in 2015, due to a 3% decrease in carload/unit volumes and a 2% decrease in revenue per carload/unit. Paper volumes decreased due to competitive trucking market, global softness in the market, and high inventory levels. Metals and scrap volumes decreased due to a customer's plant shutdown due to reduced demand. Revenue per carload/unit decreased due to the weakening of the Mexican peso against the U.S. dollar and lower fuel surcharge, partially offset by positive pricing impacts.

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Revenues by
commodity
group
for the three
months
ended
September
30, 2016

Agriculture and minerals. Revenues increased \$2.8 million for the three months ended September 30, 2016, compared to the same period in 2015, due to a 4% increase in revenue per carload/unit, partially offset by a 1% decrease in carload/unit volumes. Revenues increased \$17.8 million for the nine months ended September 30, 2016, compared to the same period in 2015, due to a 4% increase in carload/unit volumes and a 2% increase in revenue per carload/unit. Revenue per carload/unit increased due to longer average length of haul and mix, partially offset by lower fuel surcharge and the weakening of the Mexican peso against the U.S. dollar. For the three months ended September 30, 2016, ores and minerals volumes decreased due to weather related issues in the southeast region of the United States. For the nine months ended September 30, 2016, grain and food products volumes increased due to improved cycle times. In addition, grain volumes increased due to additional equipment capacity, partially offset by a decrease in ores and minerals volumes due to weather related issues in the southeast region of the United States.

Energy. Revenues decreased \$10.9 million for the three months ended September 30, 2016, compared to the same period in 2015, due to an 8% decrease in revenue per carload/unit and a 7% decrease in carload/unit volumes. Revenues decreased \$42.5 million for the nine months ended September 30, 2016, compared to the same period in 2015, due to a 15% decrease in revenue per carload/unit and a 9% decrease in carload/unit volumes. Revenue per carload/unit decreased due to shorter average length of haul and lower fuel surcharge. Crude oil volumes decreased as a result of low crude oil spreads and increased pipeline capacity. Volumes also decreased as the decline in new crude drilling operations in the U.S. has reduced the demand for frac sand. In addition, low natural gas prices and high coal inventory levels reduced the demand for utility coal in 2016.

Intermodal. Revenues decreased \$6.6 million for the three months ended September 30, 2016, compared to the same period in 2015, due to a 5% decrease in carload/unit volumes and a 2% decrease in revenue per carload/unit. Revenues decreased \$23.0 million for the nine months ended September 30, 2016, compared to the same period in 2015, due to a 5% decrease in carload/unit volumes and a 4% decrease in revenue per carload/unit. Volumes decreased due to service disruptions related to the flooding in the southeastern United States earlier in the year and protests in Mexico during July of 2016, increased truck conversion, and high retail inventory levels. Revenue per carload/unit decreased as a result of pricing impacts and shorter average length of haul.

Automotive. Revenues decreased \$3.2 million for the three months ended September 30, 2016, compared to the same period in 2015, due to an 18% decrease in revenue per carload/unit, partially offset by a 14% increase in carloads/unit volumes. Revenues decreased \$27.0 million for the nine months ended September 30, 2016, compared to the same period in 2015, due to a 17% decrease in revenue per carload/unit, partially offset by a 1% increase in carload/unit volumes. Revenue per carload/unit decreased due to the weakening of the Mexican peso against the U.S. dollar and lower fuel surcharge. For the three and nine months ended September 30, 2016, volumes increased due to 2015 service-related issues and a new customer in 2016. In addition, for the nine months ended September 30, 2016, volume increases were partially offset by customers' temporary plant shutdowns in the first half of 2016.

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Operating Expenses

Operating expenses, as shown below (in millions), decreased \$7.3 million and \$107.8 million for the three and nine months ended September 30, 2016, compared to the same periods in 2015, due to the Mexican fuel excise tax credit and the weakening of the Mexican peso against the U.S. dollar, partially offset by higher incentive compensation. The weakening of the Mexican peso against the U.S. dollar resulted in expense reductions of approximately \$12.0 million and \$47.0 million for the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015 for expense transactions denominated in Mexican pesos. The average exchange rate of Mexican pesos per U.S. dollar was Ps.18.7 and Ps.18.3 for the three and nine months ended September 30, 2016, respectively, compared to Ps.16.4 and Ps.15.5 for the same periods in 2015. In addition, operating expenses decreased for the nine months ended September 30, 2016 due to lower U.S. fuel prices and lease termination costs recognized in the first quarter of 2015.

	Three Months Ended			
	September 30,		Change	
	2016	2015	Dollars	Percent
Compensation and benefits	\$127.9	\$112.7	\$15.2	13 %
Purchased services	54.5	57.0	(2.5)	(4 %)
Fuel	67.6	78.5	(10.9)	(14 %)
Mexican fuel excise tax credit	(15.6)	—	(15.6)	100 %
Equipment costs	32.0	31.2	0.8	3 %
Depreciation and amortization	76.9	71.4	5.5	8 %
Materials and other	61.4	61.2	0.2	—
Total operating expenses	\$404.7	\$412.0	\$(7.3)	(2 %)
	Nine Months Ended			
	September 30,		Change	
	2016	2015	Dollar	Percent
Compensation and benefits	\$347.0	\$338.3	\$8.7	3 %
Purchased services	159.1	172.1	(13.0)	(8 %)
Fuel	186.0	237.0	(51.0)	(22 %)
Mexican fuel excise tax credit	(49.6)	—	(49.6)	100 %
Equipment costs	85.9	90.2	(4.3)	(5 %)
Depreciation and amortization	226.9	210.7	16.2	8 %
Materials and other	172.8	178.0	(5.2)	(3 %)
Lease termination costs	—	9.6	(9.6)	(100%)
Total operating expenses	\$1,128.1	\$1,235.9	\$	