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THE DATE OF THIS PROSPECTUS IS NOVEMBER 12, 2003

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission, or SEC, utilizing a "shelf" registration process or continuous offering process. Under this shelf registration process, the selling securityholders may, from time to time, sell the securities described in this prospectus in one or more offerings. This prospectus provides you with a general description of the securities which may be offered by the selling securityholders. Each time a selling securityholder sells securities, the selling securityholder is required to provide you with this prospectus and, in certain cases, a prospectus supplement containing specific information about the selling securityholder and the terms of the securities being offered. That prospectus supplement may include additional risk factors or other special considerations applicable to those securities. Any prospectus supplement may also add, update, or change information in this prospectus. If there is any inconsistency between the information in this prospectus and any prospectus supplement, you should rely on the information in that prospectus supplement. You should read both this prospectus and any prospectus supplement together with

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additional information described under "Where You Can Find More Information."

UNLESS WE HAVE INDICATED OTHERWISE, REFERENCES IN THIS PROSPECTUS TO "KCS" MEAN KANSAS CITY SOUTHERN (FORMERLY KANSAS CITY SOUTHERN INDUSTRIES, INC.) AND REFERENCES TO THE "COMPANY," "WE," "US," "OUR," AND SIMILAR TERMS REFER TO KCS AND OUR CONSOLIDATED SUBSIDIARIES, EXCLUDING THE DISCONTINUED OPERATIONS OF ITS FORMER FINANCIAL SERVICES BUSINESS STILWELL FINANCIAL, INC. (NOW KNOWN AS JANUS CAPITAL GROUP INC. ("JANUS")). UNLESS THE CONTEXT OTHERWISE REQUIRES, REFERENCES IN THIS PROSPECTUS TO "KCSR" MEAN THE KANSAS CITY SOUTHERN RAILWAY COMPANY, THE PRINCIPAL SUBSIDIARY OF KCS, AND INCLUDES FOR ALL PERIODS PRESENTED THE GATEWAY WESTERN RAILWAY COMPANY, WHICH WAS MERGED INTO KCSR EFFECTIVE OCTOBER 1, 2001. REFERENCES TO "TFM" AND "TEX-MEX" MEAN TFM, S.A. de C.V. AND THE TEXAS-MEXICAN RAILWAY COMPANY, RESPECTIVELY, AFFILIATES OF KCS. REFERENCES TO "GRUPO TFM" AND "MEXRAIL" MEAN GRUPO TRANSPORTACION FERROVIARIA MEXICANA, S.A. DE C.V. AND MEXRAIL, INC., RESPECTIVELY, THE PARENT COMPANIES OF TFM AND TEX-MEX, RESPECTIVELY. REFERENCES TO "GRUPO TMM" MEAN GRUPO TMM, S.A. (THE SURVIVING ENTITY IN A MERGER OF TRANSPORTACION MARITIMA MEXICANA, S.A. DE C.V. AND THE FORMER GRUPO SERVIA, S.A. DE C.V. AND WHICH, AFTER A REORGANIZATION THAT ELIMINATED THE VARIABLE PORTION OF GRUPO TMM, S.A. DE C.V. CAPITAL STOCK, BECAME A FIXED CAPITAL CORPORATION WITH THE NAME GRUPO TMM, S.A.), CURRENTLY A JOINT VENTURE PARTNER AND THE LARGEST SHAREHOLDER OF GRUPO TFM. REFERENCES TO "TMM HOLDINGS" AND "MULTIMODAL" MEAN TMM HOLDINGS, S.A. DE C.V. AND TMM MULTIMODAL, S.A. DE C.V., RESPECTIVELY, SUBSIDIARIES OF GRUPO TMM. REFERENCES TO "KARA SUB" MEAN KARA SUB, INC., A WHOLLY-OWNED SUBSIDIARY OF KCS. REFERENCES TO "NAFTA" MEAN THE NORTH AMERICAN FREE TRADE AGREEMENT.

### PROSPECTUS SUMMARY

This summary may not contain all the information that may be important to you. You should read this entire prospectus and the documents to which we have referred you before making an investment decision. You should carefully consider the information set forth under "Risk Factors." In addition, certain statements include forward-looking information which involves risks and uncertainties. See "Forward-Looking Statements."

### OUR COMPANY

We, along with our subsidiaries and affiliates, own and operate a uniquely positioned North American rail network strategically focused on the growing north/south freight corridor that connects key commercial and industrial markets in the central United States with major industrial cities in Mexico. KCS's principal subsidiary, KCSR, which was founded in 1887, is one of seven Class I railroads in the United States (railroads with annual revenues of at least \$250 million, as indexed for inflation). Our rail network (KCSR, TFM and Tex-Mex) is comprised of approximately 6,000 miles of main and branch lines. We have further expanded our rail network through marketing alliances and strategic alliances.

Our expanded network includes:

- o KCSR, which operates approximately 3,100 miles of main and branch lines running on a north/south axis from Kansas City, Missouri to the Gulf of Mexico and on an east/west axis from Meridian, Mississippi to Dallas, Texas (our "Meridian Speedway") and from Kansas City to East St. Louis, Illinois and Springfield, Illinois;
- o our affiliates, TFM, which operates approximately 2,650 miles of main and branch lines running from the U.S./Mexico border at Laredo, Texas to Mexico City and serves most of Mexico's principal industrial cities

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and three of its major shipping ports, and Tex-Mex, which operates a 160-mile rail line extending from Laredo to Corpus Christi, Texas;

- o a marketing agreement with Norfolk Southern Railway Company ("Norfolk Southern") that allows us to gain incremental traffic volume between the southeast and the southwest United States and a marketing agreement with I&M Rail Link, now known as IC&E, that provides us with access to Minneapolis and Chicago and to originations of corn and other grain in Iowa, Minnesota and Illinois;
- o a strategic alliance with Canadian National Railway Company ("CN") and Illinois Central Corporation ("IC," and together with CN, "CN/IC"), through which we have created a contiguous rail network of approximately 25,000 miles of main and branch lines connecting Canada, the United States and Mexico;
- o a joint marketing alliance, entered into in April 2002 with The Burlington Northern and Santa Fe Railway Company ("BNSF") aimed at promoting cooperation, revenue growth and extending market reach, principally to enhance chemical, grain and forest product traffic for both railroads in the United States and Canada. The marketing alliance is also expected to improve operating efficiencies for both carriers in key market areas, as well as provide customers with expanded service options; and
- o our affiliate, the Panama Canal Railway Company ("PCRC"), which holds the concession to operate the Panama Canal Railway, a 47-mile railroad located adjacent to the Panama Canal. This railroad has been reconstructed for the purpose of performing freight and passenger

operations. Its wholly-owned subsidiary, Panarail Tourism Company ("PTC"), operates a commuter and tourist railway service over the lines of the Panama Canal Railway.

### COMPANY INFORMATION

KCS is incorporated in Delaware. Our principal executive offices are located at 427 West 12th Street, Kansas City, Missouri 64105. Our telephone number is 816-983-1303.

### PROPOSED ACQUISITION

#### GENERAL

Since 1997, pursuant to a joint venture agreement, and other agreements, entered into by KCS and Grupo TMM, subsidiaries of KCS and Grupo TMM have owned, along with Mexican governmental agencies, interests in Grupo TFM, which is the owner of 80% of the voting stock of TFM. TFM holds the concession to operate, and operates, a major rail system in Mexico, formerly known as the "Northeast Rail Lines". In 1995, KCS acquired from Grupo TMM 49% of the stock of Mexrail, owner of 100% of the voting stock of Tex-Mex. Mexrail also owns the northern half of the international railway bridge at Laredo, Texas. Tex-Mex operates a 160 mile rail line from Laredo to Corpus Christi, Texas, which connects with the KCSR through trackage rights over the Union Pacific Railroad between Robbstown, Texas and Beaumont, Texas. In March, 2002, KCS and Grupo TMM sold their interests in Mexrail to TFM, with KCS receiving approximately \$31.4 million for its 49% interest in Mexrail. The structure of this ownership prior to the execution of the Acquisition Agreement (defined below) (with intermediate subsidiaries, other than KCSR, eliminated), including imputed ownership from

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TFM's ownership of 24.6% of Grupo TFM, appears in the following diagram:

[Organizational chart type diagram appears here showing ownership of Grupo TFM by KCS (46.6%, indirectly through its 100% ownership of KCSR) and Grupo TMM (48.5%) (including in both cases imputed ownership from TFM's ownership of 24.6% of Grupo TFM), Grupo TFM's ownership of 80% of TFM (with the other 20% held by the Mexican Government), TFM's ownership of 100% of Mexrail and Mexrail's ownership of 100% of Tex-Mex]

On April 20, 2003, KCS and Grupo TMM entered into separate agreements for the acquisition by KCS of control of TFM and Mexrail. On May 9, 2003, pursuant to the terms of a stock purchase agreement for KCS to acquire control of Mexrail (the "Stock Purchase Agreement"), KCS acquired from Grupo TMM (through its subsidiary, TFM) 51% of the shares of Mexrail for approximately \$32.7 million. KCS deposited the Mexrail shares into a voting trust pending resolution of KCS's

application to the Surface Transportation Board ("STB") seeking authority to exercise common control over Tex-Mex and KCS's other rail companies, KCSR and the Gateway Eastern Railway Company ("Gateway Eastern"). See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements" and "Description of the Acquisition--Regulatory Matters." On September 30, 2003, in accordance with the terms of the Stock Purchase Agreement, TFM reacquired the 51% interest in Mexrail from KCS at the purchase price paid to TFM by KCS in May 2003. Upon the repurchase of these Mexrail shares by TFM, the Stock Purchase Agreement automatically terminated. See "--Recent Developments," "Description of the Acquisition--Recent Developments," and "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--The Stock Purchase Agreement."

Pursuant to the agreement for the acquisition of control of TFM (the "Acquisition") entered into on April 20, 2003 by KCS with Grupo TMM and other parties (the "Acquisition Agreement"), KCS will acquire all of the interest of Grupo TMM (held by its subsidiary, Multimodal) in Grupo TFM for \$200 million in cash and 18,000,000 shares of a new class of common securities of KCS, to be designated "Class A Convertible Common Stock." Grupo TFM owns an 80% economic interest in TFM and all of the shares of stock with full voting rights of TFM (the "TFM Voting Stock"). KCS has the right to elect to pay up to \$80 million of the cash portion of the purchase price by delivering up to 6,400,000 shares of KCS Class A Convertible Common Stock or KCS common stock. KCS and Grupo TMM are in dispute over Grupo TMM's attempt to terminate the Acquisition Agreement. See "--Recent Developments," "Description of the Acquisition--Recent Developments."

The following diagram illustrates the ownership structure resulting if the acquisition of TFM is completed (eliminating intermediate subsidiaries)

[Organizational chart type diagram appears here showing ownership by KCS (to be renamed "NAFTA Rail") of 100% of Grupo TFM, as well as KCS's 100% ownership of KCSR; Grupo TFM's ownership of 80% of TFM (with the other 20% held by the Mexican Government and footnoted with the information in (1) below), TFM's ownership of 100% of Mexrail and Mexrail's ownership of 100% of Tex-Mex]

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(1) Limited Voting. Mexican government has certain "put" rights discussed under "Risk Factors--KCS Risk Factors--Risks Related to Our Business--We may be required to make additional investments in TFM" and "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--Agreement of Assignment and Assumption of Rights, Duties and Obligations."

In addition, provided the Acquisition has occurred and neither KCS nor any of its subsidiaries has purchased TFM shares held by the Mexican government upon exercise of the Mexican government's right to compel purchase of those shares (referred to as the "Put"), KCS will be obligated to pay to Grupo TMM an additional amount (referred to as the "VAT Contingency Payment") of up to \$180 million in cash in the event that a pending Value Added Tax claim (referred to as the "VAT Claim") against the Mexican government by TFM is successfully resolved and the amount received is greater than the purchase price of the Put. See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--The Acquisition Agreement--VAT Contingency Payment." Upon completion of the Acquisition, KCS will assume Grupo TMM's obligations to make any payment upon the exercise by the Mexican government of the Put and will indemnify Grupo TMM and its affiliates, and their respective officers, directors, employees and shareholders, against obligations or liabilities relating thereto. See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--Agreement of Assignment and Assumption of Rights, Duties and Obligations."

In connection with the Acquisition, KCS will enter into a consulting agreement with a consulting company organized by Jose Serrano Segovia pursuant to which it will provide consulting services to KCS in connection with the portion of the business of KCS in Mexico for a period of three years. As consideration for the services, the consulting company will receive an annual fee of \$600,000 per year and a grant of 2,100,000 shares of restricted stock of KCS. The restricted stock will vest over a period of time subject to certain conditions. The consulting agreement may be extended for an additional year at the option of KCS, upon delivery of an additional 525,000 shares of restricted stock. See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--Consulting Agreement."

The obligations of KCS and Grupo TMM to complete the Acquisition are subject to a number of conditions. See "Description of the Acquisition--Summary of the Acquisition Agreement and Related Agreements--The Acquisition Agreement--Conditions to Obligations to Complete the Acquisition."

### RECENT DEVELOPMENTS

#### DISPUTE OVER ACQUISITION AGREEMENT

On August 18, 2003, Grupo TMM shareholders purportedly voted not to approve the sale of Grupo TMM's interests in Grupo TFM to KCS. On August 23, 2003, Grupo TMM sent a notice to KCS claiming to terminate the Acquisition Agreement, because the Grupo TMM shareholders had failed to approve the Acquisition Agreement.

On August 27, 2003, KCS announced that it had received notice from the Mexican Foreign Investment Commission of its decision to close the proceeding with respect to KCS's application to acquire control of Grupo TFM and, thus, TFM, without prejudice to refile in the event the dispute is resolved between KCS and Grupo TMM over whether the Acquisition Agreement remains in effect.

On August 29, 2003, KCS delivered to Grupo TMM a formal notice of dispute, referred to as the Notice of Dispute, pursuant to the Acquisition Agreement. This initiated a 60-day negotiation period between the parties. If the parties

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are unable to resolve the disputes within that period of time, KCS intends to initiate a binding arbitration in accordance with the terms of the Acquisition Agreement. In addition, on August 29, 2003, KCS filed a complaint in the

Delaware Chancery Court alleging that Grupo TMM had breached the Acquisition Agreement and seeking a final order requiring Grupo TMM not to sell Grupo TFM or take other actions outside of the ordinary course of business, so as to preserve the assets and business of TFM while the parties follow the dispute resolution procedures provided for in the Acquisition Agreement. The Notice of Dispute and complaint point out that the Acquisition Agreement does not provide that a negative shareholder vote by Grupo TMM shareholders is a basis for termination, and KCS maintains that the Acquisition Agreement is still valid and remains in effect until December 31, 2004.

On September 2, 2003, KCS filed in the Delaware Court of Chancery a motion for a preliminary injunction to preserve the parties' positions while KCS seeks to resolve its dispute over Grupo TMM's attempt to terminate the Acquisition Agreement. KCS asked for an expedited hearing on its motion for a preliminary injunction.

On September 15, 2003, KCS confirmed that negotiations with Grupo TMM have begun under the dispute resolution process contained in the Acquisition Agreement for Grupo TMM's interest in Grupo TFM. One meeting was held to discuss negotiations, but no further meetings have been held.

On October 22, 2003, KCS announced that Chancellor William B. Chandler III of the Delaware Court of Chancery has, in a ruling from the bench, stated his intention to grant KCS' motion seeking a preliminary injunction to preserve the parties' positions pending resolution of KCS' dispute with Grupo TMM.

### REPURCHASE OF MEXRAIL SHARES BY TFM

On August 29, 2003, KCS received a demand for TFM to repurchase from KCS shares of Mexrail sold to KCS in May 2003. On September 23, 2003, the STB issued a decision finding no need to rule on the transfer back to TFM of the 51% interest in Mexrail that KCS acquired on May 9, 2003. The effect of the decision was to allow TFM to reacquire the shares in accordance with the Stock Purchase Agreement and KCS has abided by that agreement. The repurchase of Mexrail by TFM on September 30, 2003 returned 100% ownership of Mexrail to TFM and the Stock Purchase Agreement automatically terminated. The repurchase price was the price KCS paid TFM in May.

### NOTICE OF TERMINATION OF JOINT VENTURE AGREEMENT

In addition, KCS acknowledged receipt from Grupo TMM of a notice to terminate a joint venture agreement between the parties entered into in 1995. Pursuant to such notice, the joint venture agreement will terminate on December 1, 2003. The joint venture agreement provides that upon its termination, the joint venture shall be liquidated and any assets held in the name of the joint venture shall be distributed proportionally to KCS and Grupo TMM. There are no significant assets held by the joint venture and KCS does not expect the termination of the joint venture agreement to have a material adverse effect on KCS.

### STB REVIEW STATUS

On September 23, 2003, the STB entered an order asking all interested parties to file comments by September 30, 2003 addressing whether "in light of recent developments" the STB should continue with the procedural schedule, which called for a decision on the merits to be issued by October 17, 2003. On

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September 30, 2003, KCS filed comments with the STB suggesting that STB precedent establishes that the STB has sufficient jurisdiction to rule on control applications even where closing on the underlying transaction has been put in doubt. In the alternative, KCS argued that the matter should be held in abeyance, rather than dismissed, until the arbitration is completed. On October 8, 2003, the STB issued an order suspending the procedural schedule pending a resolution of the uncertainties that now surround KCS's efforts to acquire control of Tex-Mex, and requiring KCS to file status reports regarding developments in its efforts to acquire control of TFM and Tex-Mex.

### THE OFFERING

On May 5, 2003, we completed a private offering of the Series C Preferred Stock. We entered into a registration rights agreement with the initial purchasers in the private offering in which we agreed, for the benefit of the holders of the Series C Preferred Stock, to file a registration statement with the SEC by August 3, 2003 with respect to resales of the Series C Preferred Stock and common stock issued upon the conversion of the Series C Preferred Stock. We also agreed to use our best efforts to cause the shelf registration statement to be declared effective under the Securities Act of 1933 by November 1, 2003 and to keep the shelf registration statement effective until the earlier of (i) the sale to the public pursuant to Rule 144 (or any similar provision then in force, but not Rule 144A) under the Securities Act or the registration statement of which this prospectus forms a part of all the securities registered thereunder, and (ii) the expiration of the holding period applicable to such securities held by persons that are not our affiliates under Rule 144(k) under the Securities Act or any successor provision, subject to permitted exceptions.

Securities offered..... 400,000 shares of Series C Preferred Stock.

Liquidation preference..... \$500 per share of Series C Preferred Stock.

Dividends..... Holders of Series C Preferred Stock are entitled to receive, when, as and if, declared by our board of directors, out of funds legally available therefor, cash dividends at the rate of 4.25% per annum payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year, commencing August 15, 2003. Dividends on the Series C Preferred Stock will be cumulative from the date of initial issuance. Accumulated but unpaid dividends cumulate dividends at the annual rate of 4.25%.

We will also pay "special dividends" if we fail to comply with certain obligations under the registration rights agreement discussed above.

For so long as the Series C Preferred Stock remains outstanding, (1) we will not declare, pay or set apart funds for the payment of any dividend or other distribution with respect to any junior stock or parity stock and (2) neither we, nor any of our subsidiaries will, subject to certain exceptions, redeem, purchase or otherwise acquire for consideration junior stock or parity stock through a sinking fund or otherwise, in each case unless we have paid or



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set apart funds for the payment of all accumulated and unpaid dividends, including special dividends, if any, with respect to the shares of Series C Preferred Stock and any parity stock for all preceding dividend periods. See "Description of the Series Preferred Stock--Dividends."

Conversion..... A holder may convert its Series C Preferred Stock into a number of shares of our common stock equal to the conversion rate only under the following circumstances:

- o in any fiscal quarter commencing after June 30, 2003 if the closing sale price of our common stock for at least 20 trading days in

a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is more than 110% of the initial conversion price (initially 110% of \$14.9375, or \$16.4313);

- o after the earlier of (1) the date the Series C Preferred Stock is assigned a credit rating by both Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. and its successors ("S&P") and Moody's Investor Services and its successors ("Moody's") and (2) May 31, 2003, during any period in which the credit rating assigned to the Series C Preferred Stock by S&P is below CCC, or the credit rating assigned to the Series C Preferred Stock by Moody's is below Caa3, or no rating is assigned to the Series C Preferred Stock by either S&P or Moody's or any rating is suspended or withdrawn by either S&P or Moody's;
- o during the five business day period after any five consecutive trading day period in which the trading price per share of Series C Preferred Stock for each day of that period was less than 98% of the product of the closing sale price of our common stock and the conversion rate on each such day;
- o if the Series C Preferred Stock has been called for redemption; or
- o upon the occurrence of certain corporate transactions described under "Description of the Series C Preferred Stock--Conversion Rights--Conversion Upon Occurrence of Certain Corporate Transactions."

For each share of Series C Preferred Stock surrendered for conversion, a holder will

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receive 33.4728 shares of our common stock. This represents an initial conversion price of \$14.9375 per share of common stock. The conversion rate may be adjusted for certain reasons, but will not be adjusted for accumulated and unpaid dividends or special dividends, if any. Upon conversion, holders will not receive any cash payment representing accumulated dividends, if any. Instead, accumulated dividends, if any, will be deemed paid by the common stock received by holders on conversion.

Optional redemption.....We may not redeem any shares of Series C Preferred Stock at any time before May 20, 2008. On or after May 20, 2008, we may redeem some or all of the Series C Preferred Stock at a redemption price equal to 100% of the liquidation preference, plus accumulated but unpaid dividends, including special dividends, if any, to the redemption date, but only if the closing sale price of our common stock for 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date we give the redemption notice exceeds 135% of the conversion price of the Series C Preferred Stock, subject to adjustment in a number of circumstances as described under "Description of the Series C Preferred Stock-- Adjustments to the Conversion Rate." We may choose to pay the redemption price in cash, common stock, or a combination of cash and common stock. If we elect to pay all or a portion of the redemption price in shares of common stock, the common stock will be valued at a discount of 2.5% below the average of the closing sale prices for the five trading days ending on the third trading day prior to the redemption date. The terms of our debt instruments and/or bank facilities currently restrict our ability to redeem shares of Series C Preferred Stock for cash.

If full cumulative dividends on the Series C Preferred Stock have not been paid, the Series C Preferred Stock may not be redeemed and we may not purchase or acquire any shares of Series C Preferred Stock otherwise than pursuant to a purchase or exchange offer made on the same terms to all holders of Series C Preferred Stock.

The Series C Preferred Stock is not subject to any mandatory redemption or sinking fund provision.

Fundamental change..... If we become subject to a fundamental change, each holder of shares of Series C Preferred Stock will have the right to require us to purchase any or all of its shares at a purchase price equal to 100% of the liquidation preference, plus accumulated and unpaid

dividends, including special dividends, if any, to the date of purchase. We may choose to pay the purchase price in cash, common stock, or a combination of cash and common stock. If we elect to pay all or a portion of the purchase price in shares of common stock, the common stock will be valued at a discount of 2.5% below the average of the closing sale prices for the five trading days ending on the third trading day prior to the purchase date. Our ability to purchase all or a portion of Series C Preferred Stock for cash is subject to our obligation to repay or repurchase any outstanding debt required to be repaid or repurchased in connection with a fundamental change and to any contractual restrictions then contained in our debt. If, following a fundamental change, we are prohibited from paying the purchase price of the Series C Preferred Stock in cash under the terms of our debt instruments, but are not prohibited under applicable law from paying such purchase price in shares of our common stock, we will pay the purchase price of the Series C Preferred Stock in shares of our common stock.

Voting rights..... Holders of Series C Preferred Stock do not have any voting rights except as set forth below, as specifically provided for in our restated certificate of incorporation or as otherwise from time to time required by law. Whenever (1) dividends on the Series C Preferred Stock or any other class or series of stock ranking on a parity with the Series C Preferred Stock with respect to the payment of dividends are in arrears for dividend periods, whether or not consecutive, containing in the aggregate a number of days equivalent to six calendar quarters, or (2) we fail to pay the redemption price on the date shares of Series C Preferred Stock are called for redemption or the purchase price on the purchase date for shares of Series C Preferred Stock following a fundamental change, then, in each case, the holders of Series C Preferred Stock (voting separately as a class with all other series of Series C Preferred Stock upon which like voting rights have been conferred and are exercisable) will be entitled to vote for the election of two of the authorized number of our directors at the next annual meeting of stockholders and at each subsequent meeting until all dividends accumulated on the Series C Preferred Stock have been fully paid or set apart for payment. The term of office of all directors elected by the holders of Series C Preferred Stock will terminate immediately upon the termination of the rights of the holder of Series C Preferred Stock to vote for directors. Holders of shares of Series C Preferred Stock will have one vote for each share of Series C Preferred Stock held.

Ranking..... The Series C Preferred Stock are, with respect

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to dividend rights and rights upon liquidation, winding up or dissolution:

- o junior to all our existing and future debt obligations;
- o junior to our \$25 par value preferred stock and each other class or series of our capital stock other than (a) our common stock and any other class or series of our capital stock the terms of which provide that such class or series will rank junior to the Series C Preferred Stock and (b) any other class or series of our capital stock the terms of which provide that such class or series will rank on a parity with the Series C Preferred Stock;
- o on a parity with any other class or series of our capital stock the terms of which provide that such class or series will rank on a parity with the Series C Preferred Stock;
- o senior to our common stock and any other class or series of our capital stock the terms of which provide that such class or series will rank junior to the Series C Preferred Stock; and
- o effectively junior to all of our subsidiaries' (i) existing and future liabilities and (ii) capital stock held by others.

Trading..... We do not intend to list the Series C Preferred Stock on any national securities exchange.

NYSE symbol for our common stock..... Our common stock is traded on the New York Stock Exchange under the symbol "KSU."

On September 24, 2003, KCS announced that its Board of Directors declared a cash dividend of \$5.3125 per share on its outstanding Series C Preferred Stock. The dividend will be payable on November 17, 2003, to stockholders of record at the close of business on November 3, 2003.

### RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS

For purposes of determining the ratio of earnings to combined fixed charges and preferred dividends, earnings are defined as (i) the sum of (a) pretax income from continuing operations before adjustment for minority interests in consolidated subsidiaries or income or loss from equity investees, (b) fixed charges, (c) amortization of capitalized interest, (d) distributed income of equity investees, and (e) our share of pretax losses of equity investees for which charges arising from guarantees are included in fixed charges, less (ii) the sum of (x) interest capitalized, (y) preference security dividend

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requirements of consolidated subsidiaries, and (z) the minority interest in pretax income of subsidiaries that have not incurred fixed charges. Fixed charges consist of interest (whether expensed or capitalized), amortized premiums, discounts and capitalized expenses related to indebtedness, and estimate of the interest within rental expense, and preference security dividend requirements of consolidated subsidiaries. Preference security dividend consists of the amount of pretax earnings that is required to pay the dividends on outstanding preference securities.

	SIX MONTHS ENDED JUNE 30,	YEAR ENDED DECEMBER		
	----- 2003 ----	----- 2002 ----	----- 2001 ----	----- 2000 ----
Ratio of earnings to combined fixed charges and preferred dividends	0.95	1.28	1.07	1.03

The ratio of earnings to fixed charges for June 30, 2003 would have been 1:1 if a deficiency of \$1.7 million was eliminated.

### RISK FACTORS

An investment in the Series C Preferred Stock or the underlying common stock involves certain risks that a potential investor should carefully evaluate prior to making an investment in the Series C Preferred Stock. See "Risk Factors."

### RISK FACTORS

#### KCS RISK FACTORS

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#### RISKS RELATED TO THE SERIES C PREFERRED STOCK

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THE SERIES C PREFERRED STOCK RANKS JUNIOR TO ALL OF OUR LIABILITIES AND TO OUR \$25 PAR VALUE PREFERRED STOCK.

The Series C Preferred Stock ranks junior to all of our liabilities. The Series C Preferred Stock also ranks junior to our \$25 par value preferred stock ("Preferred Stock"). In the event of our bankruptcy, liquidation or winding-up, our assets will be available to pay obligations on the Series C Preferred Stock, including the purchase of your shares of the Series C Preferred Stock for cash upon a change in control, only after all our indebtedness and other liabilities and our Preferred Stock have been paid. In addition, the Series C Preferred Stock will effectively rank junior to all existing and future liabilities of our

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subsidiaries and any capital stock of our subsidiaries held by others. The rights of holders of the Series C Preferred Stock to participate in the distribution of assets of our subsidiaries will rank junior to the prior claims of that subsidiary's creditors and any other equity holders. As of March 31, 2003, we had total consolidated liabilities of approximately \$1.3 billion. Consequently, if we are forced to liquidate our assets to pay our creditors, we may not have sufficient assets remaining to pay amounts due on any or all of the Series C Preferred Stock then outstanding. We and our subsidiaries may incur substantial amounts of additional debt and other obligations that will rank senior to the Series C Preferred Stock.

WE MAY NOT BE ABLE TO PAY THE PURCHASE PRICE OF THE SERIES C PREFERRED STOCK IN CASH UPON A FUNDAMENTAL CHANGE. WE ALSO COULD BE PREVENTED FROM PAYING DIVIDENDS ON SHARES OF THE SERIES C PREFERRED STOCK.

In the event of a fundamental change you will have the right to require us to purchase all your shares of Series C Preferred Stock. We may pay the purchase price in cash, shares of our common stock, or a combination thereof. However, we may not have sufficient cash to purchase your shares of Series C Preferred Stock upon a fundamental change or may in certain circumstances either be forced to pay the purchase price in shares of our common stock or may be unable to pay the purchase price in cash or may be legally prohibited from paying the purchase price in shares of our common stock.

Under the terms of our current debt instruments we are prohibited from paying the purchase price of the Series C Preferred Stock in cash. Even if the terms of the instruments governing our indebtedness allow us to pay cash dividends and to redeem and purchase the Series C Preferred Stock in cash, we can only make such payments from legally available funds, as determined by our board of directors, and such funds may not be available to pay cash dividends to you or to redeem or purchase your shares of Series C Preferred Stock.

In addition, because we are a holding company, our ability to purchase the Series C Preferred Stock for cash or to pay dividends on the Series C Preferred Stock may be limited by restrictions on our ability to obtain funds for such repurchase through dividends from our subsidiaries.

YOU MAY BE UNABLE TO CONVERT THE SERIES C PREFERRED STOCK INTO OUR COMMON STOCK AND, IF YOU ARE ABLE AND DO CONVERT, YOU WILL EXPERIENCE IMMEDIATE DILUTION.

You may convert your shares of Series C Preferred Stock into common stock only if (1) the closing sale price of our common stock reaches, or the trading price of the Series C Preferred Stock falls below, specified thresholds, (2) the Series C Preferred Stock is called for redemption, (3) specified corporate transactions have occurred or (4) upon certain credit downgrade events. Your inability to convert the Series C Preferred Stock may adversely affect its value.

If you convert your shares of Series C Preferred Stock into shares of common stock, you will experience immediate dilution because the per share

conversion price of the Series C Preferred Stock immediately after this offering will be higher than the net tangible book value per share of the outstanding common stock. In addition, you will also experience dilution when and if we issue additional shares of common stock, which we may be required to issue pursuant to the Acquisition or related ancillary agreements or otherwise issue pursuant to options, warrants, our stock option plan or other employee or director compensation plans.

THE PRICE OF OUR COMMON STOCK, AND THEREFORE OF THE SERIES C PREFERRED STOCK,

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MAY FLUCTUATE SIGNIFICANTLY, WHICH MAY MAKE IT DIFFICULT FOR YOU TO RESELL THE SERIES C PREFERRED STOCK, OR COMMON STOCK ISSUABLE UPON CONVERSION OF THE SERIES C PREFERRED STOCK, WHEN YOU WANT OR AT PRICES YOU FIND ATTRACTIVE.

The price of our common stock on the New York Stock Exchange constantly changes. We expect that the market price of our common stock will continue to fluctuate. Because the Series C Preferred Stock is convertible into our common stock, volatility or depressed prices for our common stock could have a similar effect on the trading price of the Series C Preferred Stock. Holders who have received common stock upon conversion will also be subject to the risk of volatility and depressed prices.

Our stock price can fluctuate as a result of a variety of factors, many of which are beyond our control. These factors include:

- o quarterly variations in our operating results;
- o operating results that vary from the expectations of management, securities analysts and investors;
- o changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- o developments generally affecting our industry;
- o announcements by us or our competitors of significant contracts, acquisitions, joint marketing relationships, joint ventures or capital commitments;
- o announcements by third parties of significant claims or proceedings against us;
- o our dividend policy;
- o future sales of our equity or equity-linked securities;
- o our dispute with Grupo TMM over Grupo TMM's attempt to terminate the Acquisition Agreement; and
- o general domestic and international economic conditions.

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

THE TRADING PRICE FOR THE SERIES C PREFERRED STOCK WILL BE DIRECTLY AFFECTED BY THE TRADING PRICES FOR OUR COMMON STOCK, WHICH IS IMPOSSIBLE TO PREDICT.

The price of our common stock could be affected by possible sales of our common stock by investors who view the Series C Preferred Stock as a more attractive means of equity participation in KCS and by hedging or arbitrage activity that may develop involving the common stock. The arbitrage could, in turn, affect the trading prices of the Series C Preferred Stock.

OUR RIGHTS AGREEMENT AND AMENDED CHARTER DOCUMENTS MAY MAKE IT HARDER FOR OTHERS TO OBTAIN CONTROL OF US EVEN IF SOME STOCKHOLDERS MIGHT CONSIDER SUCH A

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DEVELOPMENT FAVORABLE, WHICH MAY ADVERSELY AFFECT OUR STOCK PRICE.

Our rights agreement and provisions of our amended and restated certificate of incorporation and our by-laws may delay, inhibit or prevent someone from gaining control of us through a tender offer, business combination, proxy contest or some other method even if some of our stockholders might believe a change in control is desirable.

ISSUANCE OF CLASS A CONVERTIBLE COMMON STOCK AND COMMON STOCK IN CONNECTION WITH THE ACQUISITION COULD CAUSE THE PRICE OF OUR COMMON STOCK TO FALL.

Under the terms of the Acquisition Agreement, KCS, at its option, may elect to pay up to \$80 million of the \$200 million cash consideration for the Grupo TFM shares by delivering a number of shares of common stock or Class A Convertible Common Stock determined by dividing the amount that KCS elects to pay other than in cash by \$12.50. Assuming KCS elects to pay \$80 million in this manner, KCS would deliver 6,400,000 shares. In addition, shares of KARA Sub purchased by Multimodal during the course of the Acquisition shall be automatically converted into 18,000,000 shares of our Class A Convertible Common Stock upon the successful completion of the Acquisition. The Class A Convertible Common Stock will be convertible into an equal number of shares of common stock at any time, upon the option of holders, and mandatorily, upon the occurrence of certain conditions.

In connection with the Acquisition, KCS will enter into a consulting agreement pursuant to which 2,100,000 shares of restricted common stock will be granted to the consulting firm. The restricted common stock, subject to certain performance conditions under the consulting agreement, will vest over the course of three years following the date the Acquisition is consummated. If KCS, in its sole discretion, chooses to extend the consulting agreement at the end of its three-year term, an additional 525,000 shares of restricted common stock will be granted and will immediately vest.

KCS will, pursuant to a registration rights agreement, be obligated to register the shares of common stock issued upon conversion of the Class A Convertible Common Stock, pursuant to the Acquisition Agreement to the extent that KCS elects to pay a portion of the cash consideration through the issuance of shares of common stock, pursuant to the consulting agreement, or otherwise acquired by Grupo TMM, TMM Holdings, Multimodal, certain Grupo TMM stockholders or any of their respective affiliates upon the exercise of pre-emptive rights in compliance with the Stockholders' Agreement.

We cannot predict whether any actual or potential increase in availability of our common stock for sale as a result of these transactions will adversely affect the market price of our common stock.

OUR ABILITY TO PAY DIVIDENDS MAY BE LIMITED, AND WE DO NOT ANTICIPATE PAYING CASH DIVIDENDS ON OUR COMMON STOCK IN THE FORESEEABLE FUTURE.

We are restricted in our ability to pay dividends to the holders of our common stock by the terms of our outstanding Series C Preferred Stock and our credit facilities and senior notes. In the future, we may agree to further restrictions on our ability to pay dividends. In addition, to maintain our credit ratings, we may be limited in our ability to pay dividends so that we can maintain an appropriate level of debt. During the first quarter of 2000, our board of directors suspended our common stock dividends. We do not anticipate making any cash dividend payments to our common stockholders for the foreseeable future.



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SUBSTANTIAL SALES OF OUR COMMON STOCK COULD ADVERSELY AFFECT OUR STOCK PRICE. SALES OF SUBSTANTIAL AMOUNTS OF OUR COMMON STOCK IN THE PUBLIC MARKET COULD ADVERSELY AFFECT THE PREVAILING MARKET PRICE OF OUR COMMON STOCK.

Commencing July 29, 2003, an additional 5,384,883 shares beneficially owned by our executive officers and directors became freely tradeable upon the expiration of agreements not to sell such shares, subject to compliance with Rule 144 under the Securities Act of 1933. In addition, as of June 30, 2003, we had 1,188,020 remaining shares of common stock reserved for issuance under our stock option plan. Sales of common stock by stockholders upon expiration of the lock-up agreements, exercise of their options, or the perception that such sales could occur, may adversely affect the market price of our common stock.

WE HAVE PROVISIONS IN OUR CHARTER, BYLAWS AND RIGHTS AGREEMENT THAT COULD DETER, DELAY OR PREVENT A THIRD PARTY FROM ACQUIRING US AND THAT COULD DEPRIVE YOU OF AN OPPORTUNITY TO OBTAIN A TAKEOVER PREMIUM FOR SHARES OF OUR COMMON STOCK.

We have provisions in our charter and bylaws that may delay or prevent unsolicited takeover bids from third parties. These provisions may deprive our stockholders of an opportunity to sell their shares at a premium over prevailing market prices. For example, our restated certificate of incorporation provides for a classified board of directors. It further provides that the vote of 70% of the shares entitled to vote in the election of directors is required to amend our restated certificate of incorporation to increase the number of directors to more than eighteen, abolish cumulative voting for directors and abolish the classification of the board. The same vote requirement is imposed by our restated certificate of incorporation on certain transactions involving mergers, consolidations, sales or leases of assets with or to certain owners of more than 5% of our outstanding stock entitled to vote in the election of directors. Our bylaws provide that a stockholder must provide us with advance written notice of its intent to nominate a director or raise a matter at an annual meeting. In addition, we have adopted a rights agreement which under certain circumstances would significantly impair the ability of third parties to acquire control of us without prior approval of our board of directors.

### RISKS RELATED TO OUR BUSINESS

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WE MAY BE REQUIRED TO MAKE ADDITIONAL INVESTMENTS IN TFM.

The Mexican government has the right to sell its 20% interest in TFM through a public offering on October 31, 2003 (or prior to October 31, 2003, with the consent of Grupo TFM). If, on October 31, 2003, the Mexican government has not sold all of its capital stock in TFM, Grupo TFM is obligated to purchase the capital stock at the initial share price paid by Grupo TFM plus interest computed at the Mexican Base Rate, published by Banco de Mexico. In the event that Grupo TFM does not purchase the Mexican government's 20% interest in TFM, Grupo TMM, and we, or either of us alone, will be obligated to purchase the Mexican government's remaining interest in TFM. If the Acquisition is completed, we will be solely responsible for purchasing the Mexican government's 20% interest in TFM. If we had been required to purchase this interest as of June 30, 2003, the total purchase price would have been approximately \$490.9 million and as of that date, based on publicly available financial information about Grupo TMM, Grupo TMM did not appear to have the financial resources to complete its share of the purchase. Grupo TMM disclosed in its Form 20-F for the year ended December 31, 2002, that it did not at the time of the filing have sufficient resources to acquire the Mexican government's interest if required to do so.

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WE ARE VULNERABLE TO INCREASES IN FUEL COSTS AND DECREASES IN FUEL SUPPLIES. ANY SIGNIFICANT INCREASE IN THE COST OF FUEL, OR SEVERE DISRUPTION OF FUEL SUPPLIES, WOULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OEPRATIONS AND FINANCIAL CONDITION.

We incur substantial fuel costs in our railroad operations. During the three-year period ended December 31, 2002, locomotive fuel expenses represented an average of 8.7% of KCSR's total operating costs. Fuel costs are affected by traffic levels, efficiency of operations and equipment, and petroleum market conditions. The supply and cost of fuel is subject to market conditions and is influenced by numerous factors beyond our control, including general economic conditions, world markets, government programs and regulations and competition. Fuel represented 7.7% of total KCSR operating costs in 2002. We attempt to minimize the effects of fuel price fluctuations through forward purchase contracts and hedging agreements, but cannot guarantee that those arrangements will be beneficial to us. Any significant increase in the cost of fuel could have a material adverse effect on our business, results of operations and financial condition. During the first quarter of 2003, average fuel prices were 43% higher than in the first quarter of 2002. Our operations, as well as those of our competitors, could also be affected by any limitation in the fuel supply or by any imposition of mandatory allocation or rationing regulations. In the event of a severe disruption of fuel supplies resulting from supply shortages, political unrest, war or otherwise, the operations of rail and truck carriers, including us, could be adversely affected.

ONE OF OUR COAL CUSTOMERS ACCOUNTS FOR APPROXIMATELY 11% OF KCS'S TOTAL REVENUES.

Our largest coal customer, Southwestern Electric Power Company ("SWEPCO"), a subsidiary of American Electric Power Company, Inc., accounted for approximately 64% of our coal revenues and approximately 11% of KCS's total revenues for the year ended December 31, 2002. The loss of all or a significant part of SWEPCO's business, or a service outage at one or both of SWEPCO's facilities that we serve, could materially adversely affect our financial condition and results of operations.

WE ARE SUBJECT TO EXTENSIVE RAILROAD INDUSTRY REGULATION AND RELY UPON UNIONIZED LABOR.

Labor relations in the U.S. railroad industry are subject to extensive governmental regulation under the Railway Labor Act. Railroad industry personnel are covered by the Railroad Retirement Act instead of the Social Security Act and by the Federal Employers' Liability Act rather than state workers' compensation systems. These federal labor regulations are often more burdensome and expensive than regulations governing other industries and may place us at a competitive disadvantage relative to other industries that are not subject to these regulations.

Approximately 84% of KCSR employees are covered under various collective bargaining agreements. Periodically, the collective bargaining agreements with the various unions become eligible for re-negotiation. In 1996, national labor contracts governing KCSR were negotiated with all major railroad unions, including the United Transportation Union ("UTU"), the Brotherhood of Locomotive Engineers, the Transportation Communications International Union ("TCU"), the Brotherhood of Maintenance of Way Employees ("BMWE"), and the International Association of Machinists and Aerospace Workers. In August 2002, a new labor

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contract was reached with the UTU. The provisions of this agreement include the use of remote control locomotives in and around terminals and retroactive application of wage increases back to July 1, 2002. Also, a new labor contract has been reached with the TCU which was signed on January 23, 2003. A new labor contract was reached with the BMW effective May 31, 2001. Formal negotiations to enter into new agreements are in progress with the other unions and the 1996 labor contracts will remain in effect until new agreements are reached. The wage increase elements of these new agreements may have retroactive application. Management has reached new agreements with all but one of the unions relating to the former Gateway Western. Gateway Western was merged into KCSR on October 1, 2001. Similarly, management has reached new agreements with all but one of the unions relating to the former MidSouth Railroad ("MidSouth") employees (MidSouth was merged into KCSR on January 1, 1994). Discussions with these unions are ongoing. The provisions of the various labor agreements generally include periodic general wage increases, lump-sum payments to workers and greater work

rule flexibility, among other provisions. Management does not expect that the negotiations or the resulting labor agreements will have a material impact on our consolidated results of operations, financial condition or cash flows.

We may be subject to work stoppages in the future as a result of labor disputes and may be subject to terms and conditions in amended or future labor agreements that could have a material adverse affect on our results of operations, financial position and cash flows. Railroads continue to be restricted by certain remaining restrictive work rules, and are thus prevented from achieving optimum productivity with existing technology and systems.

UTILITY INDUSTRY DEREGULATION MAY REDUCE OUR COAL FREIGHT REVENUES OR MARGINS.

Historically, coal has been an important commodity handled by us. In 2002, coal revenues comprised approximately 18.1% of KCSR's total carload revenues, all of which result from deliveries to utility customers. The utility industry is undergoing a process of deregulation which will likely cause utilities to become more competitive and thus more aggressive in negotiating with coal transportation companies to reduce costs. This could create downward pressure on utility coal transportation rates and increase service requirements. Additionally, there can be no assurance that negotiated coal transportation rates will remain at current levels in the future. Continuing competitive pressures, lower coal transportation rates and declining margins could have a material adverse effect on our business, financial condition and results of operations.

Utilities will also have greater flexibility in selling electricity to, and buying electricity from, other regional markets. This could have a material adverse effect on our utility customers if such customers are not able to compete effectively with new utility companies that enter their respective markets. As a result, the pattern of coal shipments in a particular market may shift to an alternative utility company that does not use us to deliver its coal requirements. While we are working to help our utility customers remain competitive in this evolving environment, changes in the pattern of coal movements could have a material adverse impact on our business, financial condition and results of operations.

IF THE PROPOSED MERGER OF TWO MEXICAN TRUNK LINE RAILROADS IS CONSUMMATED, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON THE VALUE OF OUR INVESTMENT IN GRUPO TFM.

Grupo Carso, S.A. de C.V. and Grupo Mexico, S.A. de C.V. announced their intention to merge the Mexican main line railroads, Ferrosur, S.A. de C.V. ("Ferrosur") and Ferrocarril Mexicano, S.A. de C.V. ("Ferromex"). Ferrosur and

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Ferromex are two of the three main line railroads created out of the privatization of the Mexican National Railway System. Our affiliate, TFM, is the third. Approval of the proposed merger was denied by the Mexican Federal Competition Commission, as was Ferrosur-Ferromex's motion to reconsider. Ferromex has filed an appeal (amparo) from the decision of the Mexican Federal Competition Commission's decision that is still pending before the courts. Should the decision of the Mexican Federal Competition Commission be reversed on grounds that allow the proposed merger to go forward, and should the proposed merger be consummated, it could have a material adverse effect on the value of our investment in Grupo TFM.

WE MAY BE ADVERSELY AFFECTED BY CHANGES IN GENERAL ECONOMIC, WEATHER OR OTHER CONDITIONS.

Our operations may be adversely affected by changes in the economic conditions of the industries and geographic areas that produce and consume the freight that we transport. The relative strength or weakness of the United States economy as well as various international and regional economies also affects the businesses served by us. Grupo TFM, Panama Canal Railway Company and Panarail Tourism Company are more directly affected by their respective local economy. Historically, a stronger economy has resulted in improved results for our rail transportation operations. Conversely, when the economy has slowed, results have been less favorable. Our revenues may be affected by prevailing economic conditions and, if an economic slowdown or recession occurs in our key markets, the volume of rail shipments is likely to be reduced. Additionally, our operations may be affected by adverse weather conditions. A weak harvest in the Midwest, for example, may substantially reduce the volume of business we

traditionally handle for our agricultural products customers. Additionally, many of the goods and commodities we carry experience cyclical demand. Our results of operations can be expected to reflect this cyclical demand because of the significant fixed costs inherent in railroad operations. Our operations may also be affected by natural disasters or terrorist acts. Significant reductions in our volume of rail shipments due to economic, weather or other conditions could have a material adverse effect on our business, financial condition and results of operations.

OUR OPERATING RESULTS AND FINANCIAL CONDITION WILL DEPEND ON EXECUTION OF OUR BUSINESS STRATEGY. IF WE FAIL TO EXECUTE OUR BUSINESS STRATEGY, IT MAY NEGATIVELY IMPACT OUR FINANCIAL CONDITION.

Our operating results and financial condition will depend in large measure on our ability to successfully execute our business strategy. Our business strategy includes capitalizing on NAFTA trade to generate traffic and increase revenues, exploiting our domestic opportunities, establishing new and expanding existing strategic alliances and marketing agreements, and providing superior customer service. Successful implementation of this strategy depends on many factors, including factors beyond our control. There can be no assurance that we will be able to implement our strategy on a timely basis or at all or that, if implemented, such strategy will achieve the desired results.

WE COMPETE AGAINST OTHER RAILROADS, TRUCK CARRIERS AND OTHER MODES OF TRANSPORTATION.

If we are unable to compete successfully, it could have a material adverse effect on our business, financial condition and results of operations.

Our rail operations compete against other railroads, many of which are much larger and have significantly greater financial and other resources than us. Since 1994, there has been significant consolidation among major North American

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rail carriers. As a result of this consolidation, the railroad industry is now dominated by a few "mega-carriers." We believe that our revenues were negatively affected by the merger of Burlington Northern, Inc. and Santa Fe Pacific Corporation in 1995 (forming BNSF), the merger of the Union Pacific Railroad Company ("UP") with the Chicago and North Western Transportation Company in 1995 and the merger of the UP and the Southern Pacific Rail Corporation in 1996, which led to diversions of rail traffic away from our lines. We also regard the larger western railroads (BNSF and UP), in particular, as significant competitors to our operations and prospects because of their substantial resources.

Truck carriers have eroded the railroad industry's share of total transportation revenues. Changing regulations, subsidized highway improvement programs and favorable labor regulations have improved the competitive position of trucks in the United States as an alternative mode of surface transportation for many commodities. In the United States, the trucking industry generally is more cost and transit-time competitive than railroads for short-haul distances. We are also subject to competition from barge lines and other maritime shipping. Mississippi and Missouri River barge traffic, among others, compete with us in the transportation of bulk commodities such as grains, steel and petroleum products.

Increased competition has resulted in downward pressure on freight rates. Competition with other railroads and other modes of transportation is generally based on the rates charged, the quality and reliability of the service provided and the quality of the carrier's equipment for certain commodities. Continuing competitive pressures and declining margins could have a material adverse effect on our business, financial condition and results of operations.

OUR BUSINESS STRATEGY, OPERATIONS AND GROWTH RELY SIGNIFICANTLY ON JOINT VENTURES AND OTHER STRATEGIC ALLIANCES.

Operation of our integrated rail network and our plans for growth and expansion rely significantly on joint ventures and other strategic alliances. Unless the Acquisition is consummated, we will continue to hold an indirect interest in two strategically significant railroad companies, Tex-Mex through TFM and TFM through our minority interest in Grupo TFM. As a minority

shareholder, we are not in a position to control operations, strategies or financial decisions without the concurrence of Grupo TMM, the largest shareholder in Grupo TFM. In addition, conflicts have arisen in the past and may arise in the future between our business objectives and those of Grupo TMM. We are currently in a dispute with Grupo TMM over Grupo TMM's attempt to terminate the Acquisition Agreement. We cannot assure that this dispute will be resolved in our favor. If the Acquisition is not consummated, resolution of any future conflicts in our favor may be difficult or impossible given our minority ownership position. We do maintain supermajority rights, which provide us with the ability to block certain actions proposed by Grupo TMM at Grupo TFM. Our ownership interests in these companies are subject to restrictions on disposition. KCS received notice from Grupo TMM to terminate a joint venture agreement between the parties entered into in 1995. Pursuant to such notice, that joint venture agreement will terminate on December 1, 2003. This joint venture agreement provides that upon its termination, the joint venture shall be liquidated and any assets held in the name of the joint venture shall be distributed proportionally to KCS and Grupo TMM. There are no significant assets held by the joint venture and KCS does not expect the termination of the joint venture agreement to have a material adverse effect on KCS.

Our operations are dependent on interchange, trackage rights, haulage rights and marketing agreements with other railroads and third parties that

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enable us to exchange traffic and utilize trackage we do not own. These agreements extend our network and provide strategically important rail links to Mexico, the northern Midwest United States and Canada. Our ability to provide comprehensive rail service to our customers depends in large part upon our ability to maintain these agreements with other railroads and third parties. The termination of these agreements could adversely affect our business, financial condition and results of operations. There can be no assurance that these agreements will be renewed after their expiration and the failure to renew any of them could adversely affect our business, financial condition and results of operations. In addition, we are dependent in part upon the financial health and efficient performance of other railroads. For example, much of Tex-Mex's traffic moves over the UP's lines via trackage rights, and a significant portion of our grain shipments originate with Iowa, Chicago & Eastern Railroad Corporation ("IC&E" - formerly I&M Rail Link, LLC) pursuant to our marketing agreement with it. BNSF is our largest partner in the interchange of rail traffic. There can be no assurance that we will not be materially affected adversely by operational or financial difficulties of other railroads.

OUR SUCCESS WILL DEPEND UPON OUR ABILITY TO RETAIN AND ATTRACT QUALIFIED MANAGEMENT PERSONNEL.

Our operations and the continued execution of our business strategy are dependent upon the continued employment of our senior management team. Recruiting, motivating and retaining qualified management personnel, particularly those with expertise in the railroad industry, are vital to our operations and ultimate success. There is substantial competition for qualified management personnel and there can be no assurance that we will be able to attract or retain qualified personnel. The loss of key personnel or the failure to hire qualified personnel could materially adversely affect our business and financial results.

OUR MEXICAN INVESTMENT SUBJECTS US TO POLITICAL AND ECONOMIC RISKS.

As of December 31, 2002, we had invested approximately \$300 million in Grupo TFM. If the Acquisition is consummated, our investment in Mexico will be materially increased. Our investment in Mexico involves a number of risks. The Mexican government exercises significant influence over the Mexican economy and its actions could have a significant impact on TFM. Our Mexican investment may also be adversely affected by currency fluctuations, price instability, inflation, interest rates, regulations, taxation, cultural differences, social instability, labor disputes and other political, social and economic developments in or affecting Mexico. Moreover, TFM's commercial success is heavily dependent on expected increases in U.S.-Mexico trade and will be strongly influenced by the effect of NAFTA on such trade. Downturns in either of the U.S. or Mexican economies or in trade between the United States and Mexico would be likely to adversely impact TFM's business, financial condition and results of operations. There can be no assurances that the various risks

associated with operating in Mexico can be effectively and economically mitigated by TFM. Additionally, no assurances can be given that the value of these investments will not become impaired.

TFM holds the concession to operate Mexico's Northeast Rail Lines (the "Concession") for 50 years, beginning in 1997, and, subject to certain conditions, has a 50-year extension option. The Concession is subject to certain mandatory trackage rights and is only exclusive for 30 years. Additionally, the Mexican government may revoke exclusivity after 20 years if it determines that there is insufficient competition and may terminate the Concession as a result of certain conditions or events, including (1) TFM's failure to meet its operating and financial obligations with regard to the Concession under

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applicable Mexican law, (2) a statutory appropriation by the Mexican government for reasons of public interest and (3) liquidation or bankruptcy of TFM. TFM's assets and its rights under the Concession may also be seized temporarily by the Mexican government. Revocation or termination of the Concession would materially adversely affect TFM's operations and its ability to make payments on its debt. Further, even though TFM would be entitled to compensation for a statutory appropriation or temporary seizure, any such compensation might be insufficient to cover TFM's losses. The loss of the Concession would materially adversely impact TFM's business, financial condition and results of operations which, in turn, would materially adversely impact the value of and return on our investment in Grupo TFM and our ability to market our U.S. operations on the basis of our access to Mexican locations. Currently, Grupo TFM is limited in the amount of dividends it may pay because of debt covenants. An absence of dividends from Grupo TFM will, or limited dividends may, negatively impact our ability to obtain a current cash return on our investment in Grupo TFM.

Under the Concession, TFM is obligated to grant and is entitled to receive certain trackage rights. The compensation for use of the trackage rights has been under discussion since the granting of the Concession. As TFM and Ferromex were unable to reach an agreement concerning compensation, the Ministry of Communications and Transports, or "Ministry of Transportation," issued its ruling on March 13, 2002 setting the compensation to be paid by each of TFM and Ferromex for use of the mandatory trackage rights. On April 15, 2002, the Ministry of Transportation rejected TFM's petition seeking reconsideration of its trackage rights decision. TFM has appealed to an administrative court both the Ministry of Transportation's rejection of its petition seeking reconsideration and the Ministry of Transportation's underlying decision on trackage rights compensation. TFM also requested and obtained a suspension of the effectiveness of the Ministry of Transportation's ruling pending resolution of its appeal. An adverse trackage rights compensation decision could negatively impact our investment in Grupo TFM.

### OUR PANAMANIAN INVESTMENT SUBJECTS US TO POLITICAL AND ECONOMIC RISKS.

We have entered into a joint venture with Mi-Jack Products, Inc. ("Mi-Jack"--a private U.S. company located in Illinois), through which we own 50% of the common stock of the Panama Canal Railway Company ("PCRC"), which owns all of the common stock of Panarail Tourism Company ("PTC"). As of December 31, 2002, we had invested approximately \$19.9 million in the PCRC, comprised of \$12.9 million in equity and \$7.0 million in subordinated loans. PCRC operates a railroad between Panama City and Colon, Panama, while PTC operates a tourist and commuter railway service in conjunction with and over the lines of the PCRC. Our investment in PCRC has risks associated with operating in Panama, including, among others, cultural differences, varying labor and operating practices, political risk and differences between the U.S. and Panamanian economies. There can be no assurances that the risks associated with operating in Panama can be effectively and economically mitigated by PCRC. Additionally, no assurances can be given that the value of our investment in PCRC will not become impaired. Further, KCS is a guarantor to the International Finance Corporation ("IFC") for up to \$5.6 million of deferred principal payments on behalf of PCRC and, if PCRC terminates the concession contract without the consent of the IFC, a guarantor for up to 50% of the outstanding senior loans of PCRC. The senior loans had an outstanding balance of approximately \$45 million at December 31, 2002. KCSR is also a guarantor for up to \$2.1 million of equipment loans from Transamerica Corporation.

WE ARE SUBJECT TO REGULATION BY FEDERAL, STATE AND LOCAL REGULATORY AGENCIES. OUR FAILURE TO COMPLY WITH VARIOUS FEDERAL, STATE AND LOCAL REGULATIONS COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

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In addition to safety, health and other regulations, generally our U.S. rail subsidiaries, like other rail common carriers, are subject to regulation by the Surface Transportation Board, the Federal Railroad Administration, the Occupational Safety and Health Administration, state departments of transportation and other state and local regulatory agencies. Government regulation of the railroad industry is a significant determinant of the competitiveness and profitability of railroads. While deregulation of rates and services in the United States has substantially increased the flexibility of railroads to respond to market forces, the deregulated environment has also resulted in highly competitive rates. Material noncompliance by us with these various regulatory requirements or changes in regulation of the industry through legislative, administrative, judicial or other action could have a material adverse effect on our business, financial condition and results of operations, including limitations on our operating activities until compliance with applicable requirements is completed.

ENVIRONMENTAL LIABILITIES COULD REQUIRE US TO INCUR MATERIAL COSTS AND TEMPORARILY SUSPEND ANY OPERATIONS THAT ARE FOUND TO VIOLATE ENVIRONMENTAL LAWS.

Our operations are subject to extensive federal, state and local environmental laws and regulations concerning, among other things, emissions to the air, discharges to waters, waste management, hazardous substance transportation, handling and storage, decommissioning of underground storage tanks and soil and groundwater contamination. Those laws and regulations can (1) impose substantial fines and criminal sanctions for violations, (2) require us to upgrade equipment or make operational changes to limit pollution emissions or decrease the likelihood of accidental hazardous substance releases or (3) temporarily prohibit us from conducting operations if those operations violate applicable requirements. We incur, and expect to continue to incur, significant environmental compliance costs, including, in particular, costs necessary to maintain compliance with requirements governing our chemical and hazardous material shipping operations, our refueling operations and our repair facilities.

Many of our current and former properties are or have been used for industrial purposes, including, for example, hazardous material storage, waste disposal and treatment, foundry operations, drum reconditioning services and chemical treatment of wood products. Accordingly, we also are subject to potentially material liabilities relating to the investigation and cleanup of contaminated properties, and to claims alleging personal injury or property damage as the result of exposures to, or releases of, hazardous substances. Such liabilities could relate to properties that we owned or operated in the past, as well as any of our currently owned or operated properties. Such liabilities also could relate to third-party sites to which we or our predecessors sent waste for treatment or disposal, or which otherwise were affected by our operations. For example, we are conducting investigation and cleanup activities at several properties which we own or which we or our predecessors owned or operated in the past. We also are investigating and remediating several third-party sites that were affected by spills from our rail car operations and have been identified as a potentially responsible party at several third-party disposal sites to which we sent waste and other materials in the past. In addition, we are a defendant in a class action lawsuit alleging personal injuries and property damage from a chemical rail car explosion in 1995.

Although we have recorded liabilities for estimated environmental remediation and other environmental costs, actual expenditures or liabilities could exceed estimated amounts and could have a material adverse effect on our consolidated results of operations or financial position. New laws and regulations, stricter enforcement of existing requirements, new spills, releases or violations or the discovery of previously unknown contamination could require us to incur costs or become the basis for new or increased liabilities that



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could have a material adverse effect on our business, results of operations or financial condition.

WE MAY SUFFER A CATASTROPHE, COLLISION, PROPERTY LOSS, SERVICE INTERRUPTION OR TERRORIST ACT.

The operation of any railroad carries with it an inherent risk of catastrophe, collision and property loss. In the course of train operations, service interruptions, derailments, spills, explosions, leaks, other environmental events, cargo loss or damage and business interruption resulting from adverse weather conditions or natural phenomena could result in loss of revenues, increased liabilities or increased costs. Significant environmental mishaps can cause serious bodily injury, death and extensive property damage, particularly when such accidents occur in heavily populated areas. We maintain insurance (including self-insurance) consistent with industry practice against accident-related risks involved in the operation of our business. However, there can be no assurance that such insurance would be sufficient to cover the cost of damages suffered by us or damages to others or that such insurance will continue to be available at commercially reasonable rates. Moreover, our insurance coverage for events occurring prior to 1996 did not extend to punitive damage awards, which are increasingly being levied in civil cases related to environmental accidents.

While we maintain terrorism coverage under certain of our liability insurance policies, we do not maintain such coverage under our property damage insurance policies and do not otherwise maintain insurance coverage for terrorist acts. Recently, the U.S. Department of Transportation issued a warning about possible terrorist attacks on rail and transit systems in the U.S. There can be no assurance that any accident, natural disaster or terrorist act would not cause a significant interruption in our operations or materially adversely affect our business, financial condition and results of operations.

WE MAY BE UNABLE TO COMPLETE THE ACQUISITION.

On August 18, 2003, Grupo TMM shareholders purportedly voted not to approve the sale of Grupo TMM's interests in Grupo TFM to KCS. On August 23, 2003, Grupo TMM sent a notice to KCS claiming to terminate the Acquisition Agreement, because the Grupo TMM shareholders had failed to approve the Acquisition Agreement. On August 29, 2003, KCS delivered to Grupo TMM a Notice of Dispute, which initiated a 60-day negotiation period between the parties. If the parties are unable to resolve the disputes within that period of time, KCS intends to initiate binding arbitration in accordance with the terms of the Acquisition Agreement. In addition on August 29, 2003, KCS filed a complaint in the Delaware Chancery Court alleging that Grupo TMM had breached the Acquisition Agreement. The Notice of Dispute and complaint point out that the Acquisition Agreement does not provide that a negative shareholder vote by Grupo TMM shareholders is a basis for termination, and KCS maintains that the Acquisition Agreement is still valid and remains in effect until December 31, 2004. On September 2, 2003, KCS filed in the Delaware Court of Chancery a motion for preliminary injunction to preserve the parties' positions while KCS seeks to resolve its dispute over Grupo TMM's attempt to terminate the Acquisition Agreement. KCS has asked for an expedited hearing on its motion for a preliminary injunction. However, there can be no assurance that the parties will resolve their disputes relating to the Acquisition Agreement, or that the arbitrators or the courts will resolve the disputes, in favor of KCS.

Even if disputes relating to the Acquisition Agreement are resolved in

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favor of KCS, the consummation of the Acquisition is subject to a number of conditions, including among others, that Grupo TMM obtain consent of the holders of its outstanding 2003 notes and 2006 notes. Grupo TMM has disclosed in its Form 20-F for the fiscal year ended December 31, 2002 that it sought consents in connection with its recent exchange offers but was not successful in obtaining such consents. There can be no assurance that Grupo TMM will be able to obtain such consents or that the other conditions to the Acquisition will be satisfied. If the Acquisition is not consummated, the value of our investment in Grupo TFM may become impaired.

As of June 30, 2003, KCS has recorded deferred costs of approximately \$4.6 million related to the transaction, which have been reflected in our consolidated balance sheet pending completion of the Acquisition. We expect that we will incur and defer additional costs related to the Acquisition. If we are unable to complete the Acquisition, these deferred costs would be reflected as a charge to earnings in our consolidated income statement in the period in which such determination is made.

### TFM RISK FACTORS

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TFM'S SUBSTANTIAL INDEBTEDNESS COULD ADVERSELY AFFECT ITS FINANCIAL POSITION AND ITS ABILITY TO MEET ITS OBLIGATIONS UNDER ITS DEBT SECURITIES AND TO OPERATE ITS BUSINESS.

TFM has a significant amount of debt and significant debt service obligations. As of December 31, 2002, TFM had total outstanding indebtedness of \$1,023.1 million, consisting of senior unsecured indebtedness under its outstanding notes and debentures, obligations under capital leases and its new bank facilities (its commercial paper program and its term loan facility). TFM has no secured indebtedness. Under U.S. GAAP, TFM's shareholders' equity was \$1,133.9 million as of December 31, 2002, resulting in a debt to equity ratio of 92.2%. In addition, TFM may incur more debt, subject to the restrictions contained in the indentures governing the existing notes and the outstanding notes and the credit agreements governing its new commercial paper program and term loan facility.

TFM's substantial indebtedness could interfere with its ability to pay interest and principal on its debt and may have important consequences for its operations and capital expenditure requirements, including the following:

- o TFM will have to dedicate a substantial portion of its cash flow from operations to the payment of principal, premium, if any, or interest on its debt, which will reduce funds available for other purposes;
- o TFM may not be able to fund capital expenditures, working capital and other corporate requirements;
- o TFM may not be able to obtain additional financing, or to obtain it at acceptable rates;
- o TFM's ability to adjust to changing market conditions and to withstand competitive pressures could be limited, and it may be vulnerable to additional risk if there is a downturn in general economic conditions or its business;
- o TFM may be exposed to risks in exchange rate fluctuations, because any devaluation of the peso would cause the cost of TFM's dollar-denominated debt to increase; and

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- o TFM may be at a competitive disadvantage compared to its competitors that have less debt and greater operating and financing flexibility than it does.

In addition, the notes issued under TFM's new commercial paper program generally have maturities of less than 180 days, so it must either repay them or refinance them by issuing and selling new commercial paper notes on an ongoing basis. TFM's commercial paper program terminates on September 17, 2004 (unless extended), so it must either repay, replace, refinance or extend the program at that time. TFM may be unable to refinance its commercial paper program or it may not have sufficient cash to repay this debt when it becomes due. These events could result in a default under the respective indentures governing the existing notes and the outstanding notes as well as the agreements governing TFM's commercial paper program.

FAILURE TO COMPLY WITH RESTRICTIVE COVENANTS IN TFM'S EXISTING CONTRACTUAL ARRANGEMENTS COULD ACCELERATE ITS REPAYMENT OBLIGATIONS UNDER ITS DEBT.

The indentures relating to TFM's outstanding notes, and the credit agreements relating to TFM's bank facilities, contain a number of restrictive covenants, and any additional financing arrangements it enters into may contain additional restrictive covenants. The credit agreements relating to TFM's bank facilities contain covenants that are more restrictive than those contained in the indentures relating to the existing notes and the outstanding notes, including certain financial covenants which require TFM to maintain specified

financial ratios. Any breach of these covenants could result in a default under the indentures and the credit agreements. These covenants restrict or prohibit many actions, including TFM's ability to:

- o incur debt;
- o create or suffer to exist liens;
- o make prepayments of particular debt;
- o pay dividends;
- o make investments;
- o engage in transactions with stockholders and affiliates;
- o sell assets; and
- o engage in mergers and consolidations or in sale-leaseback transactions.

If TFM fails to comply with these restrictive covenants, its obligation to repay the existing notes and the exchange notes or its other debt may be accelerated. In addition, a default under these covenants could affect TFM's ability to refinance its commercial paper program.

TFM MAY BE UNABLE TO GENERATE SUFFICIENT CASH TO SERVICE OR REFINANCE ITS DEBT.

TFM's ability to satisfy its obligations under its debt in the future will depend upon its future performance, including its ability to increase revenues significantly and control expenses. TFM's future operating performance depends upon prevailing economic, financial, business and competitive conditions and other factors, many of which are beyond TFM's control.

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We cannot assure you that TFM's business will generate sufficient cash flow from operations, that currently anticipated revenues and operating performance will be realized or that future borrowings will be available to TFM in amounts sufficient to pay its debt or to fund its other liquidity needs.

If TFM's cash flow from operations is insufficient to satisfy its obligations, it may take specific actions, including delaying or reducing capital expenditures, attempting to refinance its debt at or prior to its maturity or, in the absence of such refinancing, attempting to sell assets quickly in order to make up for any shortfall in payments under circumstances that might not be favorable to getting the best price for the assets, or seeking additional equity capital. TFM's ability to refinance its debt and take other actions will depend on, among other things, its financial condition at the time, the restrictions in the instruments governing its debt and other factors, including market conditions, beyond TFM's control. TFM may be unable to take any of these actions on satisfactory terms or in a timely manner. Further, any of these actions may not be sufficient to allow TFM to meet its debt obligations. In addition, TFM's debt agreements and, upon consummation of the Acquisition, our debt agreements, will limit TFM's ability to take certain of these actions. TFM's failure to successfully undertake any of these actions or to earn enough revenues to pay its debts, or significant increases in the peso cost to service its dollar-denominated debt, could materially and adversely affect TFM's business or operations.

TFM'S BUSINESS IS CAPITAL INTENSIVE AND IT MUST MAKE SIGNIFICANT ADDITIONAL CAPITAL EXPENDITURES; FAILURE TO MAKE SUCH ADDITIONAL CAPITAL EXPENDITURES COULD RESULT IN THE REVOCATION OF TFM'S CONCESSION.

TFM's business is capital intensive and requires substantial ongoing expenditures for, among other things, improvements to roadway, structures and technology, acquisitions, leases and repair of equipment and maintenance of its rail system. TFM's failure to make necessary capital expenditures could impair

its ability to accommodate increases in traffic volumes or service its existing customers. In addition, TFM's railroad Concession from the Mexican government requires it to make investments and undertake capital projects, including capital projects described in a business plan filed every five years with the Mexican government. TFM may defer capital expenditures with respect to its five-year business plan with the permission of the Secretaria de Comunicaciones y Transportes (Ministry of Communications and Transports or "Ministry of Transportation"). However, the Ministry of Transportation might not grant this permission, and TFM's failure to comply with its commitments in its business plan could result in the Mexican government revoking the Concession.

In 2000, 2001 and 2002, TFM made capital expenditures of \$66.9 million, \$85.2 million and \$89.4 million, which represented 9.6%, 11.8% and 12.5% of its transportation revenues for each of those years, respectively. These capital expenditures include the expenses TFM expects to incur for the rehabilitation and improvement of its secondary rail lines and the construction of new intermodal terminals near the manufacturing plants of its automotive customers. TFM has funded, and expects to continue to fund, capital expenditures with funds from operating cash flows and vendor financing. TFM may not be able to generate sufficient cash flows from its operations or obtain sufficient funds from external sources to fund its capital expenditure requirements. Also, additional financing may not be available to TFM. If financing is available, it may not be obtainable on terms acceptable to TFM and within the limitations contained in the indentures and other agreements relating to TFM's debt. If TFM is unable to complete its planned capital improvements projects, TFM's ability to accommodate increases in its traffic volumes or service its existing customers may be

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limited or impaired, and the Mexican government could revoke TFM's Concession.

SIGNIFICANT COMPETITION FROM TRUCKS AND OTHER RAILROADS, AS WELL AS LIMITED COMPETITION FROM THE SHIPPING INDUSTRY, COULD ADVERSELY AFFECT TFM'S FUTURE FINANCIAL PERFORMANCE.

TFM faces significant competition from trucks and other rail carriers as well as limited competition from the shipping industry in its freight operations. The trucking industry is TFM's primary competition. In the past, the trucking industry has significantly eroded the railroad's market share of Mexico's total overland freight transportation. In some circumstances, the trucking industry can provide effective rate and service competition because trucking requires substantially smaller capital investments and maintenance expenditures, and allows for more frequent and flexible scheduling.

NAFTA called for Mexican trucks to have unrestricted access to highways in the U.S. border states by 1995 and full access to all U.S. highways by January 2000. In February 2001, a NAFTA tribunal ruled in an arbitration between the United States and Mexico that the United States must allow Mexican trucks to cross the border and operate on U.S. highways. However, the United States has not followed the timetable because of concerns over Mexico's trucking safety standards. On March 14, 2002, as part of its agreement under NAFTA, the U.S. Department of Transportation issued safety rules that allow Mexican truckers to apply for operating authority to transport goods beyond the 20-mile commercial zones along the U.S.-Mexico border. These safety rules require Mexican carriers seeking to operate in the United States to pass, among other things, safety inspections, obtain valid insurance with a U.S. registered insurance company, conduct alcohol and drug testing for drivers and obtain a U.S. Department of Transportation identification number. Mexican commercial vehicles with authority to operate beyond the commercial zones will be permitted to enter the United States only at commercial border crossings and only when a certified motor carrier safety inspector is on duty. Given these recent developments, we cannot assure you that truck transport between Mexico and the United States will not increase substantially in the future. Such an increase could affect TFM's ability to continue converting traffic to rail from truck transport because it may result in an expansion of the availability, or an improvement of the quality, of the trucking services offered in Mexico. Since a key element of TFM's business strategy is to recapture market share lost to the trucking industry, its inability to successfully convert traffic to rail from truck transport would materially impair its ability to achieve its strategic objectives. There can be no assurance that TFM will have the ability to continue to convert traffic from truck to rail transport or that TFM will retain the customers that it has already converted. For example, in 2000 TFM lost a significant amount of the business it derived from a major customer, as this customer increased the use of trucks in its product distribution network.

In addition to trucks, TFM faces significant competition in some industry segments from other railroads, in particular Ferromex, which operates the Pacific-North Rail Lines. In particular, TFM has experienced, and continues to experience, competition from Ferromex with respect to the transport of grain, minerals and steel products. The rail lines operated by Ferromex run from Guadalajara and Mexico City to four U.S. border crossings west of Laredo, Texas, providing a potential alternative to TFM's routes for the transport of freight from those cities to the U.S. border. Ferromex directly competes with TFM in some areas of its service territory, including Tampico, Saltillo, Monterrey and Mexico City. Also in direct competition for traffic to and from southeastern Mexico is Ferrosur, which operates the Southeast Rail Lines. Ferrosur, like TFM, serves Mexico City, Puebla and Veracruz.

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Ferromex and Ferrosur are privately owned companies that may have greater financial resources than TFM. Among other things, this advantage may give them greater ability to reduce freight prices. Price reductions by competitors would make TFM's freight services less competitive, and we cannot assure you that TFM would be able to match these rate reductions. For example, TFM has experienced, and continues to experience, aggressive price competition from Ferromex in freight rates for agricultural products which has adversely affected its results of operations. TFM's ability to respond to competitive measures by decreasing its prices without adversely affecting its gross margins and operating results will depend on, among other things, TFM's ability to reduce its operating costs. TFM's failure to respond to competitive pressures, and particularly price competition, in a timely manner would have a material adverse effect on its results of operations.

Under TFM's Concession, TFM must grant to Ferromex the right to operate over a north-south portion of our rail lines between Ramos Arizpe near Monterrey and the city of Queretaro that constitutes over 600 kilometers of its main track. Using these trackage rights, Ferromex may be able to compete with TFM over its rail lines for traffic between Mexico City and the United States. TFM's Concession also requires it to grant rights to use certain portions of its tracks to Ferrosur and the "belt railroad" operated in the greater Mexico City area by the Ferrocarril y Terminal del Valle de Mexico, S.A. de C.V. ("Mexico City Railroad and Terminal"), thereby providing Ferrosur with more efficient access to certain Mexico City industries. As a result of having to grant trackage rights to other railroads, TFM must incur additional maintenance costs and also lose the flexibility of using its tracks at all times.

Ferromex and Ferrosur announced that they agreed to the acquisition of Ferrosur by Ferromex. TFM filed a notice with the Mexican Federal Competition Commission objecting to the proposed acquisition on the grounds that it limits competition. Approval of the proposed merger was denied by the Mexican Federal Competition Commission, as was Ferrosur-Ferromex's motion to reconsider. Ferromex has filed an appeal (amparo) from the decision of the Mexican Federal Competition Commission's decision that is still pending before the courts. Should the decision of the Mexican Federal Competition Commission be reversed on grounds that allow the proposed merger to go forward, and should the proposed merger be consummated, the resulting railroad would operate the largest rail system in Mexico, and we cannot assure you that this would not have a material adverse effect on TFM's operations, particularly on the revenues generated by its route between Mexico City and the port of Veracruz.

In addition, in recent years, there has been significant consolidation among major North American rail carriers. The resulting merged railroads could attempt to use their size and pricing power to block other railroads' access to efficient gateways and routing options that are currently and have been historically available. We cannot assure you that further consolidation will not have an adverse effect on TFM.

TFM also faces limited competition from the shipping industry with respect to some products, including chemicals transported by barges and vessels from Gulf of Mexico ports in Texas and Louisiana.

THE RATES FOR TRACKAGE RIGHTS SET BY THE MINISTRY OF TRANSPORTATION MAY NOT ADEQUATELY COMPENSATE TFM.

Pursuant to TFM's Concession, it is required to grant rights to use portions of its tracks to Ferromex, Ferrosur and the Mexico City Railroad and

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Terminal. Applicable law stipulates that Ferromex, Ferrosur and the Mexico City Railroad and Terminal are required to grant to TFM rights to use portions of their tracks.

TFM's Concession classifies trackage rights as short trackage rights and long-distance trackage rights. Although all of these trackage rights have been granted under TFM's Concession, no railroad has actually operated under the long-distance trackage rights because the means of setting rates for usage and other related terms of usage have not been agreed upon. Under the Ley Reglamentaria del Servicio Ferroviario (Law Regulating Railroad Services or "Mexican railroad services law and regulations"), the rates that TFM may charge for rights to use its tracks must be agreed upon in writing between TFM and the party to which those rights are granted. However, if TFM cannot reach an agreement on rates with rail carriers entitled to trackage rights on its rail lines, the Ministry of Transportation is entitled to set the rates using criteria including:

- o the costs of infrastructure maintenance and traffic control relating to the portion of TFM's lines to be used by the other rail operator;
- o the increment in costs due to interference with TFM's operations;
- o the amortized capital investments, including the value of the Concession, directly related to the affected lines; and
- o a reasonable profit calculated with reference to international railroad standards and reflecting investment conditions in Mexico.

TFM and Ferromex have not been able to agree upon the rates each of them is required to pay the other for interline services and haulage and trackage rights. Therefore, in accordance with its rights under the Mexican railroad services law and regulations, in February 2001, TFM initiated an administrative proceeding requesting a determination of such rates by the Ministry of Transportation.

In September 2001, Ferromex filed a legal claim against TFM relating to the payments that TFM and Ferromex are required to make to each other for interline services and trackage and haulage rights. TFM has indicated it believes that this legal claim is without merit, and that the payments for interline services and trackage and haulage rights owed to TFM by Ferromex exceed the amount of payments that Ferromex claims TFM owes to Ferromex for such services and rights. Accordingly, TFM has indicated it believes that the outcome of this legal claim will not have a material adverse effect on the financial condition of TFM. On September 25, 2002, the third civil court of Mexico City rendered its judgment in TFM's favor. Ferromex has appealed the judgment, and we cannot predict whether TFM will ultimately prevail.

In connection with the Ferromex claim, Ferromex temporarily prevented TFM from using certain short trackage rights which TFM has over a portion of its route running from Celaya to Silao, which is the site of a General Motors plant from where TFM transports finished vehicles to the border crossing at Nuevo Laredo. Ferromex was subsequently ordered by the court to resume giving TFM access, and in October 2001, TFM filed a counterclaim against Ferromex relating to these actions.

In March 2002, the Ministry of Transportation issued its ruling in response to TFM's request, establishing a rate to be charged for trackage rights using the criteria set forth in the Mexican railroad services law and regulations. TFM is appealing the ruling on the grounds that it fails to establish rates for interline service and because TFM disagrees with the methodology applied to the criteria in calculating the trackage rights rates. TFM also requested and obtained a suspension of the effectiveness of the ruling pending resolution of

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its appeal.

We cannot predict whether TFM will ultimately prevail in this proceeding and whether the rates TFM is ultimately allowed to charge will be adequate to compensate TFM. TFM has indicated it believes that, even if the rates established in the ruling go into effect and TFM and Ferromex begin using the long-distance trackage rights over each other's rail line, this will not have a material adverse effect on TFM's results of operations. However, we cannot guarantee that TFM's competitors' usage of its rail lines will not result in TFM losing business or that its losses will be offset by revenues generated from the payments for the rights to use its tracks. The occurrence of any of these events could have a material adverse effect on TFM's results of operations. A separate ruling was issued confirming TFM's right to the Celaya-Silao stretch of Ferromex track.

RECENT TERRORIST ACTIVITIES AND GEOPOLITICAL EVENTS AND THEIR CONSEQUENCES COULD ADVERSELY AFFECT TFM'S OPERATIONS.

As a result of the terrorist attacks in the United States on September 11, 2001, and the recent war involving, among others, the United States and Iraq, there has been increased short-term market volatility, and there may be long-term effects on U.S. and world economies and markets.

Terrorist attacks may negatively affect TFM's operations. The continued threat of terrorism within the United States and abroad and the potential for military action and heightened security measures in response to such threat may cause significant disruption to commerce throughout the world, including restrictions on cross-border transport and trade. In addition, related political events may cause a lengthy period of uncertainty that may adversely affect TFM's business. There can be no assurance that there will not be further large-scale terrorist attacks. Political and economic instability in other regions of the world, including the United States and Canada, may also result and could negatively impact TFM's operations. The consequences of terrorism and the responses thereto are unpredictable, and could have an adverse effect on TFM's operations.

DOWNTURNS IN GLOBAL ECONOMIC CONDITIONS, IN THE U.S. ECONOMY, IN U.S.-MEXICO TRADE OR IN CERTAIN CYCLICAL INDUSTRIES IN WHICH TFM'S CUSTOMERS OPERATE COULD ADVERSELY AFFECT ITS BUSINESS AND RESULTS OF OPERATIONS.

TFM believes that traffic that crosses the U.S. border on its rail lines generates the majority of its freight revenue. As a result, the level and timing of TFM's business activity is, and will continue to be, strongly influenced by the level of U.S.-Mexican trade and the effects of NAFTA or other international trade agreements on such trade. Downturns in global economic conditions, in the U.S. or Mexican economy or in trade between the United States and Mexico will likely have adverse effects on TFM's business and results of operations. Mexican exports to the United States of manufactured goods, beer, metals and minerals, automobiles, chemical and petrochemical products and other products, many of which TFM transports, are an important element of U.S.-Mexico trade. In addition, a significant portion of TFM's business consists of imports into Mexico from the United States. The level of TFM's business activity depends heavily on the U.S. and Mexican economies and markets, the relative competitiveness of Mexican and U.S. products at any given time and existing and new tariffs or other barriers to trade. For example, the recent downturn in the U.S. economy has had an adverse effect on TFM's revenues in all product categories, particularly in the automotive and industrial segments. This downturn may continue and could worsen, thereby having a material adverse effect on TFM's results of operations and its ability to meet its debt service obligations as described above.



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Some of TFM's customers operate in industries that experience cyclicity, including the oil and gas, automotive and agricultural sectors. Any downturn in these sectors due to the effects of cyclicity, or otherwise, could have a material adverse effect on TFM's operating results. Also, some of the products TFM transports have had a historical pattern of price cyclicity which has typically been influenced by the general economic environment and by industry capacity and demand. For example, global steel and petrochemical prices have decreased in the past. We cannot assure you that prices and demand for these products will not decline in the future, adversely affecting those industries and, in turn, TFM's financial results.

Fluctuations in the peso-dollar exchange rate could lead to shifts in the types and volumes of Mexican imports and exports. Although a decrease in the level of exports of some of the commodities that TFM transports to the United

States may be offset by a subsequent increase in imports of other commodities TFM hauls into Mexico and vice versa, any offsetting increase might not occur on a timely basis, if at all. Future developments in U.S.-Mexico trade beyond TFM's control may result in a reduction of freight volumes or in an unfavorable shift in the mix of products and commodities it transports.

POTENTIAL LABOR DISRUPTIONS COULD ADVERSELY AFFECT TFM'S FINANCIAL CONDITION AND ITS ABILITY TO MEET ITS OBLIGATIONS UNDER ITS DEBT.

Approximately 73% of TFM's employees are covered by a labor agreement. The compensation terms of the labor agreement are subject to renegotiation on an annual basis and all other terms are renegotiated every two years. TFM may not be able to negotiate these provisions favorably under its labor agreement, and strikes, boycotts or other disruptions could occur. These potential disruptions could have a material adverse effect on TFM's financial condition and results of operations and on its ability to meet its payment obligations under its debt.

THE MEXICAN GOVERNMENT MAY REVOKE OR RESTRICT TFM'S ABILITY TO EXPLOIT ITS CONCESSION UNDER A NUMBER OF CIRCUMSTANCES.

Under the Concession and Mexican law, TFM may freely set its rates for rail freight services unless the Mexican Antitrust Commission determines that there is no effective competition, taking into account alternative rail routes and modes of transportation. If the Mexican Antitrust Commission determines that there is a lack of competition in the railroad system, the Ministry of Transportation will establish the basis for TFM's rates. TFM's rates must be registered and applied in accordance with the Mexican railroad services law and regulations. In applying its rates, TFM must not make cross-subsidies, engage in tied sales or engage in other discriminatory pricing tactics. TFM is required to provide railroad services to all users on a fair and non-discriminatory basis and in accordance with the efficiency and safety standards approved periodically by the Ministry of Transportation. In the event that TFM collects from customers rates higher than the registered rates, it must reimburse those customers with interest. Since the Mexican government only recently privatized Mexico's rail system and opened the rail industry to competition, the Mexican Antitrust Commission has not considered the issue of, or published guidelines concerning, what constitutes a lack of competition. It is therefore unclear under what circumstances the Mexican Antitrust Commission would deem a lack of competition to exist. If the Ministry of Transportation does intervene and sets tariffs, the rates it sets may be too low to allow TFM to operate profitably.

The Mexican government may terminate the Concession as a result of TFM's surrender of its rights under the Concession, or for reasons of public interest, by revocation or upon TFM's liquidation or bankruptcy. The Mexican government

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may also temporarily seize TFM's assets and its rights under the Concession. The Mexican railroad services law and regulations provide that the Ministry of Transportation may revoke the Concession upon the occurrence of specified events, some of which will trigger automatic revocation.

Revocation or termination of the Concession would prevent TFM from operating its railroad and would materially adversely affect TFM's operations and its ability to make payments on its debt. In the event that the Concession is revoked by the Ministry of Transportation, TFM will receive no compensation, and its rail lines and all other fixtures covered by the Concession, as well as all improvements made by it, will revert to the Mexican government. All other property not covered by the Concession, including movable railroad property TFM purchased from the Mexican government, as well as all locomotives and railcars it otherwise acquired, will remain TFM's property. However, TFM's ability to sell this property will be restricted, and the Mexican government will have certain rights to purchase or lease such property from TFM.

The Ministry of Transportation has agreed that, except with respect to those events which constitute grounds for automatic revocation of the Concession, it will notify those creditors which provided financing for Grupo TFM's acquisition of its equity interest in TFM in 1997 and are identified by TFM and Grupo TFM to the Ministry of Transportation of all events which constitute grounds for revocation of the Concession and will allow such

creditors, with the Ministry of Transportation's prior written consent, the opportunity to nominate a party to assume the Concession. The Concession would be automatically revoked in the case of: TFM's unjustified interruption of the operation of its rail lines; TFM's assignment of or creation of liens on the Concession without the Ministry of Transportation's approval; and TFM's failure to maintain insurance coverage required under the Mexican railroad services law and regulations. In addition, if the Concession is terminated by revocation, permanent seizure of its rail lines, or upon the liquidation or bankruptcy of TFM, then profits received by the Mexican government or by a third party concessionaire from the operation and exploitation of our rail lines shall continue to be committed to repay creditors that provided financing to TFM for work projects directly related to the rendering of railroad services and performed on the rail lines.

If the Mexican government terminates the Concession for reasons of public interest, public domain assets used in the operation of TFM's rail lines would be owned, controlled and managed by the Mexican government. The Mexican government may also temporarily seize TFM's rail lines and TFM's assets used in connection with its operations of its rail lines in the case of a natural disaster, war, significant public disturbances, or imminent danger to the domestic peace or economy. In such events, the Ministry of Transportation may restrict TFM's ability to exploit the Concession fully for such time and in such manner as the Ministry of Transportation deems necessary under the circumstances.

Mexican law requires that the Mexican government pay TFM compensation if it effects a statutory appropriation for reasons of the public interest. With respect to a temporary seizure due to any cause other than international war, the Mexican railroad services law and regulations provide that the Mexican government will indemnify an affected concessionaire for an amount equal to damages caused and losses suffered. These payments may not be sufficient to compensate TFM for our losses and may not be timely made.

TRAFFIC CONGESTION OR SIMILAR PROBLEMS EXPERIENCED IN THE U.S. OR MEXICAN RAILROAD SYSTEM MAY ADVERSELY AFFECT TFM'S OPERATIONS.

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

### CONFLICTS MAY ARISE INVOLVING TFM'S STRATEGIC PARTNERS.

TFM is a subsidiary of Grupo TFM, which holds 80.0% of its equity, representing 100.0% of its shares with unrestricted voting rights. If the Acquisition is not consummated, Grupo TMM and KCS are expected to remain the principal shareholders of Grupo TFM. As a result of their indirect ownership of TFM's capital stock, Grupo TMM and KCS are able to direct TFM's policies and operations and elect all but one of TFM's directors. Although Grupo TMM holds a majority voting interest in Grupo TFM, the bylaws of Grupo TFM and TFM require that decisions on certain material matters require the approval of the representatives of both of Grupo TMM and KCS.

Differences of views between TFM's strategic partners have arisen in the past and may arise in the future. Such differences may result in delayed decisions or in failures to agree upon major matters which could adversely affect TFM's operations and business. Grupo TMM and KCS are currently in dispute over Grupo TMM's attempt to terminate the Acquisition Agreement. In addition, KCS received from Grupo TMM a notice to terminate the joint venture agreement between the parties entered into in 1995. Pursuant to such notice, the joint venture agreement will terminate on December 1, 2003.

In addition, although the trucking and specialized shipping operations of Grupo TMM are generally complementary to, and not competitive with TFM's operations, it is possible that they will compete with TFM's operations. Also,

KCS or Grupo TMM may at times be required to negotiate with TFM with respect to the allocation of revenues generated by shipments both over TFM's rail lines and by KCSR. Conflicts of interest with or between these strategic partners could have a material adverse effect on TFM's ability to operate successfully.

Both Grupo TMM and KCS periodically re-evaluate their businesses and make changes, including acquisitions or divestitures, which they believe to be consistent with their corporate objectives. In 2000, KCS spun off its financial asset management and related operations through a distribution of the common stock of its former subsidiary, Stilwell Financial Inc. (now known as Janus Capital Group Inc.). As a result, KCS currently engages only in rail transportation activities. Grupo TMM sold its container shipping business in December 1999 and certain other operations in 2000. Based on information included in Grupo TMM's Form 20-F for the fiscal year ended December 31, 2002, on May 13, 2003, Grupo TMM completed the sale of its 51% interest in TMM Ports and Terminals to an affiliate of its former partner in the division, Stevedoring Services of America. Included in the sale were the operations at the ports of Manzanillo, Cozumel, Veracruz and Progreso. We cannot assure you that, if the Acquisition is not consummated, Grupo TMM will continue to retain any of its joint venture interests or continue to own or control any of its subsidiaries, including its interest in Grupo TFM, or that KCS will continue to own KCSR, its other subsidiaries or its interest in Grupo TFM. A change in the corporate structure of TFM's strategic partners may also adversely affect its operations.

TFM'S BUSINESS STRATEGY, OPERATIONS AND GROWTH RELY SIGNIFICANTLY ON THIRD

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PARTIES.

TFM's operations are dependent on interchange agreements that it has negotiated with major U.S. railroads in the north, Ferromex in the west and Ferrosur in the south of Mexico. TFM also has trackage rights agreements with Ferrosur and a terminal operations agreement with the Mexico City Railroad and Terminal and it is negotiating and expects to have a trackage rights agreement with Ferromex. In addition, TFM and each of the concessionaires of Ferromex and Ferrosur has a 25.0% interest in the Mexico City Railroad and Terminal. These agreements enable TFM to exchange traffic and utilize trackage which is not part of its rail system, extending our network and providing it with strategically important rail links to the United States and to areas of Mexico that it does not directly serve. TFM's ability to provide comprehensive service to its customers will depend in part on its ability to maintain these agreements with other railroads and third parties. TFM's failure to enter into these agreements, or the termination of these agreements, could adversely affect its business, financial condition and results of operations. The other parties to these agreements may not faithfully execute their obligations under their agreements or arrangements with TFM, and may become TFM's competitors. The failure of any of these parties to fulfill its obligations to TFM could adversely affect TFM's financial condition and results of operations. In addition, TFM may not be able to coordinate its interchange and switching activities with these other concessionaires and railroads in an efficient manner. Inefficient coordination of our interchange and switching activities would negatively impact TFM's operating results.

IF TFM'S PRIMARY FUEL SUPPLY CONTRACT IS TERMINATED, OR IF FUEL PRICES SUBSTANTIALLY INCREASE, TFM'S OPERATIONS COULD BE ADVERSELY AFFECTED.

Nearly all of the locomotives TFM operates are diesel-powered, and its fuel expenses are significant. TFM currently meets, and expects to continue to meet, its fuel requirements almost exclusively through purchases at market prices from Petroleos Mexicanos (Mexican Petroleum or "PEMEX"), a government-owned entity exclusively responsible for the distribution and sale of diesel fuel in Mexico. TFM is party to a fuel supply contract with PEMEX of indefinite duration. Either party may terminate the contract upon 30 days' written notice to the other at any time. If the fuel contract terminates and TFM is unable to acquire diesel fuel from alternative sources on acceptable terms, TFM's operations could be materially adversely affected. In addition, instability in the Middle East may result in an increase in fuel prices. Since TFM's fuel expense represents a significant portion of its operating expenses, significant increases in the price of diesel fuel could have a material adverse effect on its results of operations. TFM experienced increases of 61.3%, 21.6% and 17.9% in its average price of fuel per gallon in 2000, 1999 and 1998, respectively, which resulted in increases in its fuel expense for each of these periods. In 2001, TFM's fuel

costs decreased by 8.7% from 2000. In 2002, TFM's fuel costs decreased by 15.5% from 2001. The price of diesel fuel has increased significantly recently which could have an adverse effect on TFM's future results of operations.

TFM FACES POSSIBLE CATASTROPHIC LOSS AND LIABILITY.

The operation of any railroad carries with it an inherent risk of catastrophe, mechanical failure, collision and property loss. In the course of TFM's operation, spills or other environmental mishaps, cargo loss or damage, business interruption due to political developments, as well as labor disputes, strikes and adverse weather conditions, could result in a loss of revenues, liabilities or increased costs. Collisions, environmental mishaps or other accidents can cause serious bodily injury, death and extensive property damage, particularly when such accidents occur in heavily populated areas. Additionally,

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TFM's operations may be affected from time to time by natural disasters such as earthquakes, volcanoes, hurricanes or other storms. The occurrence of a major natural disaster, especially in the Mexico City area, which is the site of the Mexico City Railroad and Terminal and significant portions of TFM's customer base, could have a material adverse effect on TFM's operations. TFM has acquired insurance that is consistent with industry practice against the accident-related risks involved in the conduct of its business and business interruption due to natural disaster. However, this insurance is subject to a number of limitations on coverage, depending on the nature of the risk insured against. This insurance may not be sufficient to cover TFM's damages or damages to others, and this insurance may not continue to be available at commercially reasonable rates. Even with insurance, if any catastrophic interruption of service occurs, TFM may not be able to restore service without a significant interruption to operations.

### TFM FACES POTENTIAL ENVIRONMENTAL LIABILITY.

TFM's operations are subject to general Mexican federal and state laws and regulations relating to the protection of the environment. The Procuraduria Federal de Proteccion al Ambiente (Attorney General for Environmental Protection) is empowered to bring administrative proceedings and impose corrective actions and economic sanctions against companies that violate environmental laws, and temporarily or permanently close non-complying facilities. The Secretaria del Medio Ambiente y Recursos Naturales (Ministry of the Environment and Natural Resources) and other ministries have promulgated compliance standards for, among other things, water discharge, water supply, air emissions, noise pollution, hazardous substances transportation and handling, and hazardous and solid waste generation.

TFM is responsible for the costs of environmental compliance associated with its ongoing operations. Pursuant to TFM's Concession, Ferrocarriles Nacionales de Mexico, S.A. de C.V. ("FNM") is responsible for any environmental damage caused before the commencement of TFM's operations, and both the Mexican government and FNM will indemnify TFM for any environmental liability relating to soil, subsoil or groundwater contamination arising from acts or omissions attributable to FNM that occurred before Grupo TFM's acquisition of TFM's shares. However, the Mexican government is not obligated to compensate TFM for any expenses that it incurs in complying with any amended environmental laws or regulations relating to our ongoing operations or activities that impose higher regulatory standards than those in effect on the date the Concession was granted. TFM cannot predict the effect, if any, that the adoption of additional or more stringent environmental laws and regulations would have on our results of operations, cash flows or financial condition. TFM may also incur other environmental liabilities with respect to U.S. environmental laws in connection with its ownership of Mexrail. The U.S. Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA" or "Superfund") and similar state laws (known as Superfund laws) impose liability for the cost of remedial or removal actions, natural resources damages and related costs at certain sites identified as posing a threat to the environment or public health. CERCLA imposes strict liability on the owners and operators of facilities in which hazardous waste and other hazardous substances are deposited or from which they are released or are likely to be released into the environment. Liability may be imposed, without regard to fault or the legality of the activity, on certain classes of persons, including the current and certain prior owners or operators of a site and persons that arranged for the disposal or treatment of hazardous substances.

Liability is imposed on a joint and several basis. In addition, other potentially responsible parties, adjacent landowners or other third parties may initiate cost recovery actions or toxic tort litigation against sites subject to CERCLA or similar state laws.

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TFM COULD BE SUBJECT TO THIRD PARTY CLAIMS OR LEGAL ACTIONS AS A CONSEQUENCE OF THE NEW RULING ISSUED BY THE MEXICAN FISCAL COURT IN CONNECTION WITH THE VAT REFUND.

On July 9, 2003, TFM was formally notified by the Mexican appellate court of its June 11, 2003 judgment which granted TFM constitutional protection against the ruling of the Mexican Fiscal Court issued on December 6, 2002, which had denied TFM the right to receive the Value Added Tax ("VAT") refund. The Mexican appellate court's judgment ordered the Mexican Fiscal Court to vacate its December 6, 2002 resolution, and to issue a new resolution following the guidelines of the Mexican appellate court's judgment. The Mexican appellate court found that the VAT refund certificate had not been delivered to TFM, and confirmed the Mexican Fiscal Court's determination that TFM has the right to receive the VAT refund certificate. The Mexican appellate court's ruling states that the Mexican Treasury's decision denying delivery of the VAT refund certificate to TFM violated the law, and it instructs that the VAT reimbursement certificate be issued to TFM on the terms established by Article 22 of the Mexican Federal Fiscal Code in effect at that time. As a result of this ruling, the case was remanded to the Mexican Fiscal Court. On August 14, 2003, Grupo TMM announced that in a public session held August 13, the Mexican Fiscal Court issued a resolution regarding TFM's VAT Claim (defined below) vacating its previous resolution of December 6, 2002, and, in strict compliance with the ruling issued on June 11, 2003 by the Mexican appellate court, resolved that TFM had proved its case, and that a "ficta denial" occurred, declaring such denial null and void as ordered by the Mexican appellate court. On October 3, 2003, Grupo TMM announced that the Tax Attorney of the Mexican Government has filed for a review of the ruling. We cannot at this point in time be certain as to the amount or timing of any VAT refund recovery. In addition, a third party claim or legal action could be brought against TFM as a consequence of this new ruling issued by the Mexican Fiscal Court. Although TFM has indicated that it believes it would have sufficient legal defenses should such an action or claim be brought against TFM, there can be no assurance that TFM would prevail in such action or claim. If TFM does not prevail in any such action or claim, this could adversely affect TFM's financial condition and results of operations.

### FACTORS RELATED TO MEXICO

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MEXICAN REGULATORY, POLITICAL AND ECONOMIC RISKS ASSOCIATED WITH EMERGING MARKET ECONOMIES COULD ADVERSELY AFFECT TFM'S FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The Mexican government has exercised, and continues to exercise, significant influence over the Mexican economy. Accordingly, Mexican governmental actions concerning the economy and state-owned enterprises could have a significant impact on Mexican private sector entities in general and TFM in particular, as well as on market conditions, prices and returns on Mexican securities, including TFM's outstanding notes and debentures. TFM's financial condition, results of operations and prospects and, consequently, the price for its outstanding notes and debentures, may also be affected by currency fluctuations, inflation, interest rates, regulation, taxation, social instability and other political, social and economic developments in or affecting Mexico.

The national elections held on July 2, 2000 ended 71 years of rule by the Institutional Revolutionary Party ("PRI") with the election of President Vicente Fox Quesada, a member of the National Action Party ("PAN") and resulted in the increased representation of opposition parties in the Mexican Congress and in mayoral and gubernatorial positions. Although there have not yet been any material adverse repercussions resulting from this political change, multiparty rule is still relatively new in Mexico and could result in economic or political conditions that could materially and adversely affect TFM's operations. We

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cannot predict the impact that this political landscape will have on the Mexican economy.

Securities of companies in emerging market countries tend to be influenced by economic and market conditions in other emerging market countries. Emerging market countries have recently been experiencing significant economic downturns

and market volatility. These events have had an adverse effect on the economic conditions and securities markets of other emerging market countries, including Mexico.

The Mexican economy in the past has suffered balance of payment deficits and shortages in foreign exchange reserves. There are currently no exchange controls in Mexico; however, Mexico has imposed foreign exchange controls in the past. Pursuant to the provisions of NAFTA, if Mexico experiences serious balance of payment difficulties or the threat thereof in the future, Mexico would have the right to impose foreign exchange controls on investments made in Mexico, including those made by U.S. and Canadian investors. Any restrictive exchange control policy could adversely affect TFM's ability to obtain dollars or to convert pesos into dollars for purposes of making payments of principal, premium, if any, and interests due on its indebtedness, to the extent that it may have to effect those conversions. This could have a material adverse effect on TFM's business and financial condition.

In addition, the value of the peso relative to the dollar has been volatile in the past. Greater than 50% of TFM's revenues for the year ended December 31, 2002 were denominated in U.S. Dollars. After a five-year period of controlled devaluation of the peso, on December 19, 1994 the value of the peso dropped sharply as a result of pressure against the currency. This decline, among other factors, precipitated an economic crisis in Mexico that continued for several years. In 2002, the peso depreciated 12.8% against the dollar. Any future devaluations in the peso and currency instability could make it difficult for TFM to purchase dollars and to service its dollar-denominated obligations. Further, any additional devaluation of the peso would cause the peso cost of TFM's dollar-denominated debt to increase. Furthermore, currency instability may affect the balance of trade between the United States and Mexico.

Mexico also has a history of high levels of inflation, and may experience inflation in the future. During most of the 1980s and during the mid- and late 1990s, Mexico experienced periods of high levels of inflation. The annual rates of inflation, as measured by changes in the Mexican National Consumer Price Index, for the years from 1997 through 2002 as provided by Banco de Mexico, Mexico's central bank, were:

1997 .....	15.7%
1998 .....	18.6%
1999 .....	12.3%
2000 .....	9.0%
2001 .....	4.4%
2002 .....	5.7%

A substantial increase in the Mexican inflation rate would have the effect of increasing TFM's costs including salaries, some purchased services and other costs denominated in pesos, which could adversely affect TFM's results of operations and financial condition. High levels of inflation may also affect the

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balance of trade between the United States and Mexico, which could also adversely affect TFM's results of operations.

Mexican political events may also affect significantly TFM's operations and the performance of Mexican securities, including its outstanding notes and debentures. In addition, a change in economic policy could have a material adverse effect on TFM's business, financial condition, prospects and results of operation.

We are unable to predict whether any future political or economic events in Mexico could impact the Mexican transportation regulatory environment.

### USE OF PROCEEDS

We will not receive any of the proceeds from the sale of the Series C Preferred Stock or the common stock contemplated by this prospectus. Please read "Selling Securityholders" for a list of the persons receiving proceeds from the sale of the Series C Preferred Stock or the underlying common stock.

### BUSINESS

We, along with our subsidiaries and affiliates, own and operate a uniquely positioned North American rail network strategically focused on the growing north/south freight corridor that connects key commercial and industrial markets in the central United States with major industrial cities in Mexico. Our principal subsidiary, KCSR, which was founded in 1887, is one of seven Class I railroads in the United States. Our rail network (KCSR, TFM and Tex-Mex) is comprised of approximately 6,000 miles of main and branch lines. Through a strategic alliance with Canadian National Railway Company ("CN") and Illinois Central Corporation ("IC") (together "CN/IC"), we have access to a contiguous rail network of approximately 25,000 miles of main and branch lines connecting Canada, the United States and Mexico. Management believes that, as a result of the strategic position of our rail network, we are poised to continue to benefit from the growing north/south trade between the United States, Mexico and Canada promoted by NAFTA.

Our rail network interconnects with all other Class I railroads and provides shippers with an effective alternative to other railroad routes, giving direct access to Mexico and the southeastern and southwestern United States through less congested interchange hubs.

Our rail network links directly to major trading centers in Mexico through Tex-Mex and TFM. TFM operates a railroad that runs from the U.S./Mexico border at Laredo, Texas to Mexico City and serves most of Mexico's principal industrial cities and three of its major shipping ports. On May 9, 2003, KCS acquired from TFM for cash 51% of the shares of Mexrail, which owns 100% of Tex-Mex, and deposited the Mexrail shares into an irrevocable voting trust pending resolution of KCS's application to the STB seeking authority to exercise common control over Tex-Mex and KCS's other rail companies, KCSR and Gateway Eastern. However, on September 30, 2003, KCS returned its 51% interest in Mexrail to TFM. TFM now owns 100% of Mexrail. Tex-Mex operates between Laredo and the port city of Corpus Christi, Texas and with trackage rights connects to KCSR at Beaumont, Texas. TFM, through its Concession with the Mexican government, has the right to control and operate the southern half of the rail-bridge at Laredo and, TFM indirectly through its ownership of Mexrail, owns the northern half of the rail-bridge at Laredo, which spans the Rio Grande River between the United



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States and Mexico. Our principal international gateway is at Laredo, where more than 50% of all rail and truck traffic between the United States and Mexico crosses the border.

Our rail network is further expanded through our strategic alliance with CN/IC and marketing agreements with Norfolk Southern Railway Company ("Norfolk Southern"), The Burlington Northern and Santa Fe Railway Company ("BNSF") and the Iowa, Chicago & Eastern Railroad Corporation ("IC&E" - formerly I&M Rail Link, LLC). The CN/IC alliance connects Canadian markets with major midwestern and southern markets in the United States as well as with major markets in Mexico through KCSR's connections with Tex-Mex and TFM. Marketing agreements with Norfolk Southern allow us to capitalize on our east/west route from Meridian, Mississippi to Dallas, Texas ("Meridian Speedway") to gain incremental traffic volume between the southeast and the southwest. The marketing alliance with BNSF was developed to promote cooperation, revenue growth and extend market reach for both railroads in the United States and Canada. It is also designed to improve operating efficiencies for both KCSR and BNSF in key market areas, as well as provide customers with expanded service options. KCSR's marketing agreement with IC&E provides access to Minneapolis, Minnesota and Chicago and to originations of corn and other grain in Iowa, Minnesota and Illinois.

We also owns 50% of the common stock (or a 42% equity interest) of PCRC, which holds the concession to operate a 47-mile coast-to-coast railroad located adjacent to the Panama Canal. The railroad handles containers in freight service across the isthmus. Panarail, a wholly owned subsidiary of PCRC, operates a commuter and tourist railway service over the lines of the Panama Canal Railway. Passenger service commenced during the third quarter of 2001 and freight service started during the fourth quarter of 2001.

Additional information concerning us is included in our reports and other documents incorporated by reference in this prospectus. Please read "Where You Can Find More Information."

### DESCRIPTION OF THE ACQUISITION

#### OVERVIEW

On April 20, 2003, KCS entered into the Acquisition Agreement with Grupo TMM under which KCS ultimately would acquire control of TFM through the purchase of shares of common stock of Grupo TFM. Grupo TFM holds an 80% economic interest in TFM and all of the TFM Voting Stock. The remaining 20% economic interest in TFM is owned by the Mexican government in the form of shares with limited voting rights. KCS currently owns a 46.6% economic interest in Grupo TFM and 49.0% of the shares of common stock of Grupo TFM entitled to full voting rights. On February 27, 2002, KCS, Grupo TMM, and certain of Grupo TMM's affiliates entered into a stock purchase agreement with TFM to sell to TFM all of the common stock of Mexrail. The sale closed on March 27, 2002 and KCS received approximately \$31.4 million for its 49% interest in Mexrail. On May 9, 2003, KCS acquired from TFM for \$32.7 million in cash 51% of the shares of Mexrail, which owns 100% of Tex-Mex. KCS deposited the Mexrail shares into a voting trust pending resolution of KCS's application to the STB seeking authority to exercise common control over Tex-Mex and KCS's other rail companies, KCSR and Gateway Eastern. However, on September 30, 2003, in accordance with the terms of the Stock Purchase Agreement, TFM repurchased from KCS the 51% interest in Mexrail acquired by KCS in May 2003. Upon this repurchase by TFM, the Stock Purchase Agreement

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automatically terminated. The repurchase price was the price paid by KCS for these shares in May 2003. According to the terms of the Acquisition Agreement and certain related agreements (described in detail below), KCS will issue:

- o 18,000,000 shares of Class A Convertible Common Stock to Multimodal upon the closing of the Acquisition;
- o at KCS's option, up to 6,400,000 shares of Class A Convertible Common Stock or Common Stock in lieu of a portion of the \$200 million consideration to be paid in cash at the closing of the Acquisition Agreement; and
- o up to 2,625,000 shares of restricted Common Stock pursuant to the Consulting Agreement.

The securities to be issued in connection with the Acquisition represent in the aggregate more than 20% of the issued and outstanding shares of KCS Common Stock.

### SUMMARY OF THE ACQUISITION AGREEMENT AND RELATED AGREEMENTS

The following summary of the terms and provisions of the Acquisition Agreement, First Amendment to Rights Agreement, Stockholders' Agreement, Registration Rights Agreement, Consulting Agreement, Marketing and Services Agreement, Agreement of Assignment and Assumption of Rights, Duties and Obligations and Stock Purchase Agreement is qualified in its entirety by reference to each of those documents, each of which are exhibits to the registration statement of which this prospectus forms a part. You should read these agreements carefully for more details regarding the provisions described below and for other provisions that may be important to you.

### THE ACQUISITION AGREEMENT

Upon the terms and subject to the conditions of the Acquisition Agreement, dated April 20, 2003, by and among KCS, KARA Sub, Grupo TMM, TMM Holdings and Multimodal, KCS would acquire all of the interest of Multimodal in Grupo TFM for consideration to Multimodal of \$200 million and 18 million shares of KCS Class A Convertible Common Stock. The Acquisition will be accomplished in three steps, the Stock Purchase, the Subsidiary Investment and the Merger described below (and together comprising the Acquisition), all occurring sequentially and virtually simultaneously as follows:

(1) THE STOCK PURCHASE. KARA Sub will purchase from Multimodal all Grupo TFM shares held by Multimodal, consisting of 25,500 shares of Series "A" fixed capital stock of Grupo TFM and 3,842,901 shares of Series "A" variable capital stock of Grupo TFM. The purchase price to be paid by KARA Sub to Multimodal at the closing for the purchase of the Grupo TFM shares is: (i) \$200 million (up to \$80 million of which may be paid, at KCS's option, in shares of KCS Common Stock or KCS Class A Convertible Common Stock); and (ii) a subordinated promissory note of KARA Sub in the principal amount of \$25 million. KCS will provide KARA Sub with the funds and securities to make these payments.

(2) THE SUBSIDIARY INVESTMENT. Immediately following the Stock Purchase, Multimodal will purchase 10% of the issued and outstanding shares of KARA Sub common stock, in consideration for delivery by Multimodal to KARA Sub of the KARA Sub subordinated promissory note.

(3) THE MERGER. KARA Sub will then be merged into KCS in accordance with the Delaware Corporation Law. The Merger will be consummated by filing a

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certificate of merger with the Delaware Secretary of State in accordance with the Delaware Corporation Law. At such time, the shares of KARA Sub held by Multimodal will be converted into and exchanged for 18 million shares of KCS Class A Convertible Common Stock. As a result of the Merger, the separate corporate existence of KARA Sub will cease and KCS will continue as the surviving corporation. Subject to approval by KCS stockholders, upon the date and time of the filing of the Certificate of Merger, KCS will change its name to "NAFTA Rail" and the capital stock of KCS (including the KCS common stock, the \$25 par value preferred stock and the Series C Preferred Stock) will continue to be issued and outstanding as the capital stock of NAFTA Rail without further action by any holder thereof. Subject to listing approval by the New York Stock Exchange ("NYSE"), the NAFTA Rail Common Stock and \$25 par value preferred stock will trade on the NYSE.

The closing of the Acquisition is dependent upon the closing of each of the Stock Purchase, the Subsidiary Investment and the Merger. If the Acquisition is consummated, two new directors, Jose Serrano Segovia, Chairman of Grupo TMM and Javier Segovia Serrano, President of Grupo TMM, will be appointed to the NAFTA Rail Board of Directors to serve until the first Annual Meeting of Stockholders of NAFTA Rail following consummation of the Acquisition. At that meeting, Jose Serrano Segovia will be nominated for election to the class of directors serving until the annual meeting of stockholders in 2006 and Javier Segovia Serrano will be nominated for election to the class of directors serving until the annual meeting of stockholders in 2005.

KCS and Grupo TMM are currently in a dispute over Grupo TMM's attempt to terminate the Acquisition Agreement. For a discussion of recent developments in connection with the Acquisition, see "--Recent Developments" below.

### CONDITIONS TO OBLIGATIONS TO COMPLETE THE ACQUISITION

The obligations of KCS and Grupo TMM to complete the Acquisition are subject to a number of conditions, including, among others:

- o KCS must have obtained approval of KCS stockholders of the amendments to KCS's restated certificate of incorporation and the issuance of Class A Convertible Common Stock and common stock;
- o All consents, waivers, authorizations and approvals required from all governmental authorities to consummate the Acquisition must have been obtained and remain effective as of the closing date of the Acquisition Agreement;
- o The common stock to be issued must have been approved for listing by the NYSE;
- o Each of the Ancillary Agreements must have been duly executed and delivered by or on behalf of KCS and each of Grupo TMM, TMM Holdings and Multimodal, as the case may be;
- o Grupo TMM must have received consents from the holders of its outstanding Notes due 2003 and Notes due 2006; and
- o There must not be any insolvency or bankruptcy proceeding pending against Multimodal, TMM Holdings or TFM that has been pending for more than 60 days, and certain material adverse effects shall not have occurred.

### TERMINATION

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The Acquisition Agreement may be terminated prior to the closing of the Acquisition as follows:

- o By written consent of KCS and Grupo TMM;
- o By KCS or Grupo TMM if any order of any governmental authority permanently prohibiting the consummation of the Acquisition has become final and non-appealable or if any of the approvals of any governmental authority to perform the transactions contemplated by the Acquisition Agreement imposes any condition or requirement, the satisfaction of which is reasonably likely to have a material adverse effect on either KCS or Grupo TMM;
- o By KCS if any conditions to the obligations of KCS under the Acquisition Agreement becomes incapable of fulfillment through no fault of KCS and is not waived by KCS;
- o By Grupo TMM if any condition to the obligations of Grupo TMM, Multimodal and TMM Holdings (collectively, the "Sellers") under the Acquisition Agreement becomes incapable of fulfillment through no fault of Sellers and is not waived by Grupo TMM;
- o By KCS if Grupo TMM has experienced a change of control, or by Grupo TMM if KCS has experienced a change of control; and
- o By KCS or Grupo TMM if the closing of the Acquisition does not occur on or prior to December 31, 2004 (the "Termination Date"); provided, however, that the Termination Date may be extended by KCS and Grupo TMM by written agreement.

A termination fee of \$18 million is payable in the event of termination of the Acquisition Agreement due to (i) a change of control of either KCS or Grupo TMM, in which case the party experiencing the change of control shall pay the termination fee to the other party, or (ii) the failure of the stockholders of KCS or of Grupo TMM to approve the Acquisition if at or prior to the meeting of such stockholders to approve the Acquisition, the Board of Directors of KCS, in the case of the KCS stockholders' meeting, or the Board of Directors of Grupo TMM, in the case of the Grupo TMM stockholders' meeting, has failed to recommend or has withdrawn and not reinstated its recommendation of the Acquisition, then the party whose stockholders shall not have approved the Acquisition shall pay the termination fee to the other party.

### REQUIRED REGULATORY AND OTHER CONSENTS, APPROVALS AND FILINGS

Certain regulatory approvals and filings and other consents are required in connection with the closing of the Acquisition. These include, among others:

- o Prior approval of the Mexican Foreign Investments Commission of control of Grupo TFM by a non-Mexican entity;
- o Clearance by the Mexican Antitrust Commission of anti-competitive concerns;
- o Notice to the Mexican Ministry of Communications and Transportation;
- o Filing with NYSE for listing of common stock issuable upon conversion of Class A Convertible Common Stock;
- o Grupo TMM noteholder consents;

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- o Notice filing under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR") filing and clearance of investment by Multimodal in KCS; and
- o KCS stockholder approval of amendments to its restated certificate of incorporation and issuance of KCS equity.

KCS has obtained an amendment to its Amended and Restated Credit Agreement allowing:

- o KCS (NAFTA Rail) investment in further equity interests of Grupo TFM;
- o KCS (NAFTA Rail) investment in equity interests representing 51% of Mexrail's issued and outstanding capital stock;
- o Use of KCS cash to acquire Mexrail.

For a discussion of the filings made and the status of such filings, see "--Regulatory Matters" below.

### VAT CONTINGENCY PAYMENT

The VAT Claim, which has been pending in the Mexican courts since 1997, arose out of the Mexican Treasury's delivery of a VAT credit certificate to a Mexican governmental agency rather than to TFM. On September 25, 2002, the Mexican appellate court issued a judgment in favor of TFM on the VAT Claim, vacating a prior judgment of the Mexican Fiscal Court and remanding the case to the Fiscal Court with specific instructions to enter a new decision consistent with the guidance provided by the Mexican appellate court's ruling. The Mexican appellate court's ruling required the fiscal authorities to issue the VAT credit certificate only in the name of TFM. On December 6, 2002, the upper chamber of the Fiscal Court issued a ruling denying TFM's right to receive a VAT refund from the Mexican Federal Government. On January 8, 2003, TFM was officially notified of the new judgment of the Fiscal Court and on January 29, 2003, filed the appropriate appeal. On June 11, 2003, the Mexican appellate court issued a judgment in favor of TFM against the ruling of the Fiscal Court. The judgment granted TFM constitutional protection against the ruling of the Fiscal Court issued on December 6, 2002 denying TFM's right to receive the VAT refund. The judgment ordered the Fiscal Court to vacate its December 6, 2002 resolution and to issue a new resolution following the guidelines of the Mexican appellate court's judgment. The Mexican appellate court found that the VAT refund certificate had not been delivered to TFM, and confirmed the Fiscal Court's determination that TFM has the right to receive the VAT refund certificate. The Mexican appellate court's ruling states that the Treasury's decision denying delivery of the VAT refund certificate to TFM violated the law, and it instructs that the VAT reimbursement certificate be issued to TFM on the terms established by Article 22 of the Federal Fiscal Code in effect at that time. As a result of the Mexican appellate court's ruling, the case was remanded to the Mexican Fiscal Court. On August 14, 2003, Grupo TMM announced that in a public session held August 13, the Mexican Fiscal Court issued a resolution regarding TFM's VAT Claim vacating its previous resolution of December 6, 2002, and, in strict compliance with the ruling issued on June 11, 2003 by the Mexican appellate court, resolved that TFM has proved its case, and that a "ficta denial" occurred, declaring such denial null and void as ordered by the Mexican appellate court. On October 3, 2003, Grupo TMM announced that the Tax Attorney

of the Mexican Government has filed for a review of the ruling. We cannot at this point in time be certain as to the amount or timing of any VAT refund recovery.

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Provided the Acquisition has occurred and neither KCS nor any of its subsidiaries has purchased the TFM "Class III" shares (representing 20% of the capital stock of TFM) currently held by the Mexican government upon exercise by the Mexican government of its Put to compel purchase of the shares of TFM held by it, as compensation for Grupo TMM's services in obtaining the final settlement or resolution of TFM's VAT Claim against the Mexican Treasury for the refund of a VAT payment in the original principal amount of 2,111,111,790 pesos, KCS will make or cause TFM to make the VAT Contingency Payment to Grupo TMM as set forth below, following the date of final resolution of the VAT Claim, and the receipt by TFM or its designee of shares or cash compensation received by TFM or its designee from the Mexican government on the VAT Claim (the "VAT Payment"). The VAT Payment must consist of at least (i) all of the TFM "Class III" shares currently held by the Mexican government or (ii) a cash payment or other property acceptable to the parties which has a fair value equal to or greater than the Put Purchase Price (as defined in the Acquisition Agreement) as calculated on the date the VAT Payment is received. In such event, KCS will, at its option, pay or cause TFM to pay to Grupo TMM (iii) \$100 million within 90 days thereafter or (iv) \$50 million within 90 days thereafter and an additional \$55 million within 365 days thereafter. If the VAT Payment exceeds the Put Purchase Price as calculated on the date the VAT Payment is received, KCS will pay or cause TFM to pay to Grupo TMM within 90 days after the VAT Payment and final resolution of the VAT Claim the first \$25 million received above the Put Purchase Price, and 15% of any additional amount received above the Put Purchase Price beyond the first \$25 million, not to exceed \$50 million. The VAT Contingency Payment shall be made after reducing the value of the VAT Payment by the amount of all expenses incurred by or on behalf of TFM in effecting final resolution of the VAT Claim and receipt of the VAT Payment.

### THIRD PARTY MATTERS

Until the filing of the Certificate of Merger for the Merger, neither KCS nor Sellers can seek or entertain other offers with respect to acquisitions, mergers or business combinations of KCS or KCSR, and TMM Holdings, Multimodal, Grupo TFM or any of their respective subsidiaries, respectively. In addition, Grupo TMM will not enter into any agreement concerning any acquisition or purchase of a controlling equity interest in Grupo TMM by any competitor. These limitations are subject to the fiduciary duties of the respective Board of Directors of KCS and Grupo TMM.

### INDEMNIFICATION

The representations and warranties of the Sellers and KCS survive for three to five years. The Sellers have jointly and severally agreed to indemnify KCS, the surviving corporation and each of their subsidiaries, and their respective officers, directors, employees, members, stockholders, agents and representatives harmless from and against all losses, damages, liabilities, claims, demands, obligations, deficiencies, payments, judgments, settlements, costs and expenses of any nature whatsoever ("Losses") resulting from or arising out of any inaccuracy or misrepresentation in, or breach of, any representation or warranty of Sellers in connection with the Acquisition Agreement, or any breach or nonfulfillment of any covenant or agreement of any of the Sellers in connection with the Acquisition Agreement, or any claims, causes of actions, rights asserted or demands made by any third parties arising from or relating to any of the foregoing. The Sellers' indemnification obligations for any inaccuracy or misrepresentation in, or breach of, any representation or warranty regarding Grupo TFM or its subsidiaries is limited to 51% of Losses aggregating \$5 million or more. This limitation is not applicable to any Losses arising out of or resulting from any action or omission on the part of any Seller or its affiliate that involved a crime, fraud, willful misconduct or gross negligence.

KCS has agreed to indemnify the Sellers, each of their subsidiaries and

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each of their respective officers, directors, employees, members, stockholders, agents and representatives from and against all Losses resulting from or arising out of any inaccuracy or misrepresentation in, or breach of, any representation or warranty of KCS in connection with the Acquisition Agreement, or any breach

or nonfulfillment of any covenant of KCS in connection with the Acquisition Agreement, or any claims, causes of actions, rights asserted or demands made by any third parties arising from or relating to any of the foregoing. KCS's indemnification obligations are limited to Losses aggregating \$10 million or more. This limitation is not applicable to any Losses arising out of or resulting from any action or omission on the part of KCS or its affiliate that involved a crime, fraud, willful misconduct or gross negligence.

Additionally, KCS's Restated Certificate of Incorporation and Bylaws would be amended to reflect the agreements contained in the Acquisition Agreement and certain Ancillary Agreements. A number of Ancillary Agreements have been, or will be prior to the closing of the Acquisition, entered into to carry out certain objectives of the Acquisition Agreement and the Acquisition. Each of these Ancillary Agreements is described below.

### FIRST AMENDMENT TO RIGHTS AGREEMENT

In connection with the Acquisition, KCS and Harris Trust & Savings Bank, as Rights Agent will enter into a First Amendment to Rights Agreement (the "Rights Agreement") dated as of September 19, 1995. The Rights Agreement will be amended to prevent any TMM Holder from becoming an Acquiring Person (as defined in the Rights Agreement), which would otherwise cause a Triggering Event (as defined in the Rights Agreement) as a result of the Acquisition. Accordingly, the First Amendment to Rights Agreement will amend Section 1(a), the definition of Acquiring Person, to provide that no person or affiliate of such person shall become an "Acquiring Person" as a result of the acquisition of beneficial ownership of (i) shares of Class A Convertible Common Stock, (ii) shares of Common Stock issued or issuable upon conversion of the Class A Convertible Common Stock, (iii) any shares of Common Stock or Class A Convertible Common Stock acquired pursuant to Section 1.2 of the Acquisition Agreement, (iv) any shares of Common Stock or Class A Convertible Common Stock acquired pursuant to the Consulting Agreement, and (v) shares of Common Stock or Class A Convertible Common Stock acquired in compliance with the Stockholders' Agreement, including upon exercise of pre-emptive rights as provided therein.

The definition of "Substantial Block" found at Section 1(z) of the Rights Agreement will also be amended to lower the threshold beneficial ownership that constitutes a "Triggering Event" from 20% to 15% (and from 15% to 13% in the event the Acquiring Person is declared by the Board of Directors to be an Adverse Person (as defined in the Rights Agreement)).

In order to conform to the foregoing amendments, subsection (iii) of Section 3(e) regarding Restrictions on transfer of Rights to Acquiring Persons shall be deleted and amended to provide that no Right (as defined in the Rights Agreement) shall be transferable or transferred other than as permitted under Section 1(a) of the Rights Agreement, as amended, to any person who, as a result of such transfer, would beneficially own 15% or more of the Rights.

Finally, Section 7(e) of the Rights Agreement will be amended to correct a clerical error.

### STOCKHOLDERS' AGREEMENT

KCS, Grupo TMM, TMM Holdings, Multimodal and the Principal Stockholders plan to enter into a Stockholders' Agreement, which shall set forth the rights

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and duties of the parties thereto arising out or and in connection with the Acquisition Agreement and the transactions contemplated thereby.

### STANDSTILL PROVISIONS

For a period of seven years from the date of the Stockholders' Agreement, Grupo TMM, TMM Holdings, Multimodal and each of the Principal Stockholders agrees that, unless specifically invited in writing to do so by the Board of

Directors, such Person (as defined in the Stockholders' Agreement) will not, and will cause each of its affiliates not to, among other things:

- o acquire or agree to acquire aggregate beneficial ownership of more than 20% of the Total Voting Power of KCS (as defined in the Stockholders' Agreement);
- o initiate or propose any matter for submission to a vote of stockholders of KCS or participate in the making of, or solicit stockholders for the approval of, any stockholder proposal;
- o grant any proxy with respect to any Voting Securities to any Person not approved in writing by KCS;
- o except through its representatives on the Board of Directors (or any committee thereof) of KCS, otherwise act, alone or in concert with others, to seek to control or influence the management, Board of Directors or policies of KCS.

The standstill provisions terminate upon the earliest to occur of (i) a Change of Control of KCS (as defined in the Stockholders' Agreement), or (ii) the first date the TMM Holders beneficially own in the aggregate less than 15% of the outstanding Voting Securities of KCS for at least 30 consecutive days.

### TRANSFER RESTRICTIONS

The TMM Holders may not sell, assign, transfer, pledge, hypothecate, otherwise subject to any lien, grant an option with respect to or otherwise dispose of any interest in (or enter into an agreement or understanding with respect to the foregoing) any Voting Securities beneficially owned by them (a "Disposition") except in accordance with the terms of the Stockholders' Agreement. For a period of five years from the date of the Stockholders' Agreement, the TMM Holders may not effect a Disposition:

- o to a Competitor (as defined in the Stockholders' Agreement);
- o to an Affiliate unless such Affiliate agrees in writing to be bound by the terms of the Stockholders' Agreement and provided that the TMM Holders shall remain responsible, jointly and severally, for any breaches of the Stockholders' Agreement by such Affiliate;
- o that in the aggregate represents 5% or more of the outstanding Voting Securities to any Person other than an 13G Filer (as defined in the Stockholders' Agreement), and no disposition shall be made to any 13G Filer unless such 13G Filer would continue to be eligible to file reports pursuant to Section 13G under the Exchange Act with respect to the Voting Securities after giving effect to the proposed acquisition and KCS has been provided the right (but not the obligation) to purchase such Voting Securities;
- o to any Person that would, together with such person's Affiliates or



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Associates (as defined in the Stockholders' Agreement) and after giving effect to the acquisition of such Voting Securities, beneficially own or have the right to acquire 15% of the Total Voting Power; and

- o of any capital stock or Voting Securities or control of any Person that, directly or indirectly, beneficially owns any Voting Securities of KCS to a Competitor.

Subject to the provisions contained in the Stockholders' Agreement, a TMM Holder may pledge or hypothecate as security for any indebtedness or other obligations any or all Voting Securities beneficially owned by such Person provided that KCS shall have a right to purchase the pledged Voting Securities upon the occurrence of a Foreclosure Event (as defined in the Stockholders' Agreement).

The TMM Holders may participate in a tender or exchange offer made by an unaffiliated third party, provided the TMM Holders did not solicit the tender or exchange offer and (i) the same consideration is offered to all holders of the

securities tendered in the tender offer; (ii) the transaction is approved by a majority of other KCS stockholders; (iii) the tender or exchange offer is not conditioned on financing; and (iv) the TMM Holders do not tender, or publicly disclose their intention to tender, prior to the last day before expiration of the offer.

The transfer restrictions contained in the Stockholders' Agreement terminate upon the earliest to occur of (i) a Change of Control of KCS, or (ii) the first date the TMM Holders beneficially own in the aggregate less than 15% of the outstanding Voting Securities of KCS for at least 30 consecutive days.

### PRE-EMPTIVE RIGHTS

TMM Holders have the right to purchase additional shares of Class A Convertible Common Stock to maintain their percentage ownership in the event KCS authorizes the issuance or sale of any shares of Common Stock or any securities containing options or rights to acquire shares of Common Stock, except for issuances of Common Stock (including for this purpose, options, warrants and other securities convertible into or exercisable for Common Stock) issued:

- o to KCS's employees, directors, consultants, agents, independent contractors or other service providers in connection with a Plan (as defined in the Stockholders' Agreement) existing as of the date of the Stockholders' Agreement or a Plan approved by the Board of Directors and adopted by KCS after the date of the Stockholders' Agreement;
- o upon the conversion of Class A Convertible Common Stock;
- o upon the exercise of any options, warrants, convertible or exchangeable securities which are outstanding as of the date hereof;
- o in connection with the acquisition (by merger, consolidation, acquisition of assets or equity interests or otherwise) of the equity interests or assets of another Person; or
- o in the event KCS issues additional equity in lieu of up to \$80 million in cash at Closing.

### CORPORATE GOVERNANCE

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The Stockholders' Agreement provides for the Board of Directors to be comprised of eleven directors, to be selected as follows: (i) the chief executive officer of KCS and another person selected by him; (ii) two persons elected by the holders of the Class A Convertible Common Stock (reduced to one in the event the TMM Holders' ownership falls below 75% of the Voting Securities initially acquired pursuant to the Merger and reduced to zero in the event the TMM Holders' ownership falls below 40% of the Voting Securities initially acquired pursuant to the Merger); and (iii) seven independent directors designated by the chief executive officer of KCS. The Nominating Committee of the Board of Directors will consist of three Independent Directors designated by the chief executive officer of KCS. The Compensation Committee will consist of three Independent Directors designated by the chief executive officer of KCS and one Independent Director designated by the chief executive officer of Grupo TMM. The Executive Committee will consist of three Directors designated by the chief executive officer of KCS and one Director designated by the chief executive officer of Grupo TMM.

Each TMM Holder shall vote all of the Voting Securities beneficially owned by such Person and entitled to vote in the election of directors: (i) in favor of all nominees of the Nominating Committee; and (ii) against any proposal to remove any director nominated by the Nominating Committee and elected to the Board of Directors.

The TMM Holders' rights and duties under the corporate governance provisions of the Stockholders' Agreement terminate upon the earliest to occur of (i) the first date the TMM Holders beneficially own in the aggregate at least 40% of the outstanding Voting Securities initially acquired pursuant to the Merger, or (ii) a Change of Control of Grupo TMM or any of the TMM Holders.

### TERMINATION

Subject to specific termination provisions contained in the Stockholders' Agreement, the entire Agreement (with a few exceptions) terminates when the TMM Holders ownership falls below 40% of the Voting Securities initially acquired pursuant to the Merger, or in the event the Class A nominees are not elected to the KCS Board of Directors (except for good cause).

### REGISTRATION RIGHTS AGREEMENT

The Registration Rights Agreement to be entered into by KCS, Grupo TMM, TMM Holdings, Multimodal and certain principal stockholders of Grupo TMM, will provide Grupo TMM, TMM Holdings, Multimodal, such principal stockholders of Grupo TMM, and any Permitted Transferee (as defined in the Registration Rights Agreement) who acquires shares of Class A Convertible Common Stock or shares of Registrable Stock (as defined in the Registration Rights Agreement) and agrees to be bound by the terms and conditions of the Registration Rights Agreement (collectively, the "Holders") with certain registration rights with respect to the shares of KCS Common Stock (i) issuable upon conversion of the KCS Class A Convertible Common Stock, (ii) issued in lieu of cash at closing, (iii) issued pursuant to the Consulting Agreement and (iv) acquired on pre-emptive exercises.

### REQUIRED AND INCIDENTAL REGISTRATIONS

Beginning on the 180th day following the consummation of the Acquisition, the Holders shall have the right to request, and KCS shall use commercially reasonable efforts to effect, six demand registrations. In the event KCS issues additional equity in lieu of up to \$80 million in cash at Closing, the Holders shall be entitled to one additional shelf registration. Holders shall also be entitled to unlimited incidental, or "piggy-back," registrations. KCS can delay filing registrations upon the occurrence of certain events, including situations

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in which KCS is not eligible to use Form S-3 to effect such registration or in the event that KCS furnishes to the Holders a resolution adopted by the Board of Directors to the effect that in the good faith judgment of KCS it would be seriously detrimental for a registration statement to be filed at that time.

In the event the managing underwriters of a public offering furnish a written opinion that the amount of securities to be included in an offering exceed the maximum amount which can be marketed without materially and adversely affecting such offering, then the Holders, KCS and all other holders of KCS securities having the right to include such securities in the registration shall be subject to certain underwriting cut-backs. Holders are also subject to certain market standoff provisions during the ten days prior to and up to, but not exceeding, 90 days following the effective date of a registration statement to the same extent that KCS or its officers or directors are subject to such market standoff provisions.

### REGISTRATION EXPENSES

With respect to the first four demand registrations and any incidental registrations, KCS shall pay all registration expenses, including all registration, qualification and filing fees, printing expenses, escrow fees, fees and disbursements or counsel for KCS and blue sky fees and expenses. With respect to demand registrations effected beyond the first four, the Holders whose shares are included in the applicable registration shall pay all registration expenses.

### CONSULTING AGREEMENT

KCS and the consulting firm controlled by Jose Serrano Segovia ("Consulting Firm") plan to enter into a Consulting Agreement, which calls for Consulting Firm to provide certain consulting services to the KCS Board of Directors and Chief Executive Officer relating to the Mexican portion of KCS's rail network operations, including its customers and suppliers, regulatory matters and

regarding the Mexican railroad industry in general. Jose Serrano Segovia is required under the terms of the Consulting Agreement to be personally involved in the provision of services by the Consulting Firm. Jose Serrano Segovia is the current Chairman of the Board of Directors of Grupo TMM and certain of its subsidiaries, including TFM and Grupo TFM and will become a director and Vice-Chairman of KCS.

### TERM

The Consulting Agreement has an initial term of three years beginning on the closing date of the Acquisition Agreement. KCS has the option of extending the term of the Consulting Agreement for an additional year. In the event of a Change of Control (as defined in the Consulting Agreement), Consulting Firm agrees to continue its engagement with KCS for a period equal to the longer of (i) one year from the date of such Change of Control; or (ii) the remainder of the term and KCS agrees to continue to engage Consulting Firm during the remainder of the term.

Notwithstanding the initial three-year term, the Consulting Agreement and Consulting Firm's engagement shall terminate automatically upon the death or disability of Jose Serrano Segovia or dissolution or bankruptcy of Consulting Firm. Consulting Firm may terminate the Consulting Agreement at any time by giving at least 30 days' advance written notice to KCS or in the event of a material breach, and failure to cure the same, by KCS. Additionally, KCS may terminate the Consulting Agreement and Consulting Firm's engagement for cause, or other than for cause, subject to certain conditions specified in the

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Consulting Agreement.

### COMPENSATION

Under the Consulting Agreement, KCS will pay to Consulting Firm an annual fee of \$600,000. In addition, KCS will grant to Consulting Firm 2,100,000 shares of KCS restricted Common Stock (the "Consulting Firm Stock"), subject to the following vesting provisions:

- o 525,000 shares shall become vested with ten days after TFM enters into a renegotiated or extended labor agreement with the El Sindicato de Trabajadores Ferrocarrileros de la Republica Mexicana;
- o 250,000 shares shall become vested on each of the first, second and third anniversary dates of the Consulting Agreement;
- o 125,000 shares shall become vested in the event KCS or any subsidiary receives the Certificate of Devolution of Taxes (Certificado de Devolucion de Impuestos) issued by the Treasury of the Mexican Federation (Tesoreria de la Federacion) in the term of Article 22 of the Tax Code of the Mexican Federation (Codigo Fiscal de la Federacion); and
- o 700,000 shares shall become vested in the event KCS or any subsidiary receives the shares or cash compensation from the Mexican government as a result of TFM's claim against the Mexican Treasury for the refund of a value added tax payment. See Section 6(i) of the Consulting Agreement attached to this proxy statement as Appendix F and Section 7.13 of the Acquisition Agreement attached to this proxy statement as Appendix B.

As a condition to the vesting of Consulting Firm Stock on the first, second and third anniversary dates, KCS's Board of Directors shall review the compliance, good faith performance and existence of triggering events that would terminate the Agreement. If the Board determines that the Consulting Firm has not satisfied the requisite standard during any one-year period, the Consulting Firm Stock subject to vesting at such one-year period shall be forfeited.

If KCS extends the initial term of the Consulting Agreement, KCS will grant to Consulting Firm on the first day of the extended term an additional 525,000 shares of KCS restricted Common Stock which will vest immediately upon issuance.

### TRANSFER RESTRICTIONS

Consulting Firm may not sell, transfer, assign, pledge or otherwise dispose of (whether with or without consideration and whether voluntary or involuntary or by operation of law) any interest in any shares of Consulting Firm Stock, except in accordance with the terms of the Stockholders' Agreement (described above).

### MARKETING AND SERVICES AGREEMENT

The Marketing and Services Agreement to be entered into by Grupo TMM (together with its subsidiaries and affiliates), TFM and KCS (together with its subsidiaries and affiliates), provides for the parties to enter into various most favored nations provisions, requiring, among other things, (i) KCS to provide certain services to Grupo TMM on terms which are no less favorable than the terms provided to third or fourth party logistics companies; (ii) that Grupo TMM shall have the right to be the exclusive provider of Road-Railer freight services over TFM's rail system within Mexico; (iii) Grupo TMM shall have the

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right, but not the obligation, to operate KCS's intermodal terminals to the extent that KCS determines to utilize a third party to operate such within Mexico, the terms of such operations subject to mutual agreement of Grupo TMM and KCS; and (iv) that Grupo TMM shall have the right to make a bid for the provision of certain specified transportation related services normally provided by Grupo TMM or its affiliates, if TFM determines to have such services provided by any unaffiliated third party in Mexico or the United States. The relationships among KCS and Grupo TMM shall be those of independent contractors and neither KCS nor Grupo TMM shall be or represent itself to be an agent, employee or joint venturer of the other. Neither KCS nor Grupo TMM shall have or represent itself to have any power or authority to act for, bind or commit the other party.

The initial term of the Marketing and Services Agreement is five years from the Effective Date (as defined in the Acquisition Agreement), subject to automatic renewal for periods of one year unless terminated by Grupo TMM or KCS. Notwithstanding the foregoing, the Marketing and Services Agreement shall terminate automatically in the event that (i) TMM Logistics, a subsidiary of Grupo TMM, files any voluntary proceeding under any bankruptcy laws, or if TMM Logistics has filed against it any involuntary proceeding under any bankruptcy law which is not dismissed or stayed within 30 days or (ii) a change of control of Grupo TMM occurs and the party effecting such change of control is a Competitor (as defined in the Marketing and Services Agreement).

### AGREEMENT OF ASSIGNMENT AND ASSUMPTION OF RIGHTS, DUTIES AND OBLIGATIONS.

This agreement is to be entered into by and among Grupo TMM, KCS, and Grupo TFM (a form of which is attached as Exhibit C to the Acquisition Agreement), by which Grupo TMM will assign and transfer to KCS, and KCS will accept and assume, all of Grupo TMM's rights, duties and obligations with respect to the purchase of the Put Shares (defined below) under the Put Agreement described below. KCS shall have the right to designate another party to be the purchaser of the Put Shares, however, no such designation shall relieve KCS of its obligation to pay the purchase price for such Put Shares or to indemnify Grupo TMM or its Affiliates.

According to the terms of the original share purchase agreement for the Northeast Rail lines and an Agreement, dated June 9, 1997, by and among the Federal Government of the Mexican States, Grupo TFM, Grupo TMM and KCS (the "Put Agreement"), the Mexican government has the right to sell its 20% interest in TFM through a public offering on October 31, 2003 (or prior to October 31, 2003, with the consent of Grupo TFM). If, on October 31, 2003, the Mexican government has not sold all of its capital stock in TFM, Grupo TFM is obligated under the Put Agreement following receipt of notice from the Mexican government to purchase the Mexican government's 20% interest in TFM (the "Put Shares"). In the event that Grupo TFM does not purchase the Put Shares within the sixty-day

period following notification by the Mexican government, and the Acquisition has not been consummated, then Grupo TMM and KCS, are jointly and severally obligated to purchase the Mexican government's remaining interest in TFM. Should the Mexican government cause Grupo TMM to purchase any of the Put Shares, KCS would be obligated to purchase such shares from Grupo TMM.

### THE STOCK PURCHASE AGREEMENT

Pursuant to the terms and conditions of the Stock Purchase Agreement, dated as of April 20, 2003, by and among KCS, Grupo TMM and TFM, on May 9, 2003, KCS purchased from TFM 51% of the outstanding shares of Mexrail, a wholly-owned subsidiary of TFM, for \$32,680,000. TFM had the right to repurchase all of the shares of Mexrail capital stock acquired by KCS at any time for the purchase

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price paid by KCS, subject to any STB orders or directions. TFM made a demand in August 2003 to repurchase from KCS the shares of Mexrail sold to KCS in May 2003. On September 23, 2003, the STB issued a decision finding no need to rule on the transfer back to TFM of the 51% interest in Mexrail that KCS acquired on May 9, 2003. The effect of the STB decision was to allow TFM to reacquire the shares in accordance with the Stock Purchase Agreement. On September 30, 2003, TFM repurchased the Mexrail shares from KCS at the price KCS paid TFM in May 2003, and TFM now owns 100% of Mexrail. Under the terms of the Stock Purchase Agreement, upon this repurchase, the Stock Purchase Agreement automatically terminated. However, the Stock Purchase Agreement provided that in the event TFM reacquired the Mexrail shares from KCS, the parties to the Stock Purchase Agreement intended the terms and conditions of a February 27, 2002 stock purchase agreement under which TFM acquired the Mexrail shares, the Grupo TFM bylaws and the shareholders agreement dated May 1997 to become again valid and fully enforceable against the parties to such agreements.

On February 27, 2002, KCS, Grupo TMM, and certain of Grupo TMM's affiliates entered into a stock purchase agreement with TFM to sell to TFM all of the common stock of Mexrail. Under this stock purchase agreement, KCS retained rights to prevent further sale or transfer of the stock or significant assets of Mexrail and Tex-Mex and the right to continue to participate in the corporate governance of Mexrail and Tex-Mex, which will remain U.S. corporations and subject to KCS's super majority rights contained in Grupo TFM's bylaws.

The shareholders agreement dated May 1997 between KCS and Grupo TMM and certain affiliates, which governed KCS's investment in Grupo TFM (1) restricted each of the parties to the shareholders agreement from directly or indirectly transferring any interest in Grupo TFM or TFM to a competitor of Grupo TFM or TFM without the prior written consent of each of the parties, and (2) provided that KCS and Grupo TMM may not transfer control of any subsidiary holding all or any portion of shares of Grupo TFM to a third party, other than an affiliate of the transferring party or another party to the shareholders agreement, without the consent of the other parties to the shareholders agreement. The shareholders agreement required that the boards of directors of Grupo TFM and TFM be constituted to reflect the parties' relative ownership of the ordinary voting common stock of Grupo TFM.

### REGULATORY MATTERS

As discussed in "--Summary of the Acquisition Agreement and Related Agreements--The Acquisition Agreement" and "--Summary of the Acquisition Agreement and Related Agreements--The Stock Purchase Agreement" above, certain regulatory approvals and filings are required in connection with the closing of the Acquisition. The following actions have occurred to date:

- o KCS's solicitation for permission as a foreign investor to control TFM, through Grupo TFM, was filed with the Mexican National Foreign Investments Commission on April 25, 2003. On August 27, 2003, KCS announced that it received notice from the Mexican National Foreign Investments Commission of that Commission's decision to close the proceeding with respect to KCS's application to acquire control of Grupo TFM and, through Grupo TFM, of TFM, without prejudice to refile

in the event the dispute is resolved between KCS and Grupo TMM over whether the Acquisition Agreement remains in effect. See "--Recent Developments";

- o KCS's Notification with respect to the acquisition of the Grupo TFM shares from Multimodal was filed with the Mexican Competition Commission on April 21, 2003. KCS has received formal written notice

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that the Mexican Competition Commission has approved the proposed consolidation, without conditions. On September 26, 2003, KCS announced this approval was extended for an additional 180 days;

- o TFM formerly notified the Secretary of Communications and Transportation of the proposed transactions on May 2, 2003;
- o On December 26, 2002, Grupo TMM announced the commencement of public offers for the exchange of its 9 1/2% Notes due 2003 (the "2003 Notes") and its 10 1/4% Notes due 2006 (the "2006 Notes") for new bonds and solicitations of consents from the holders of these notes to eliminate substantially all of the restrictive covenants of the indentures governing the 2003 Notes and the 2006 Notes. When it failed to receive a sufficiently high positive response, Grupo TMM announced amendments of the exchange offers and consent solicitations on February 18, 2003 and again on April 24, 2003. On May 16, 2003, Grupo TMM announced the expiration of the exchange offers and consent solicitations and that the conditions to the exchange offers were not satisfied at the expiration date. In its Form 20-F filed on June 30, 2003, referred to as its Form 20-F, Grupo TMM disclosed that it did not make payment of the principal amount of the 2003 Notes, which matured on May 15, 2003, or accrued interest on the due date. Grupo TMM further stated that, as a result, it is in default under the terms of the 2003 Notes, and such default resulted in a cross-default under its 2006 Notes and under certain other obligations of Grupo TMM and its subsidiaries. On May 29, 2003, Grupo TMM announced that it had initiated discussions with holders of the 2003 Notes and 2006 Notes and their representatives to encourage the formation of an informal committee to engage Grupo TMM in negotiations over the terms of a consensual restructuring of the 2003 Notes and the 2006 Notes. On June 16, 2003, Grupo TMM announced the formation of an informal committee of holders of the 2003 Notes and the 2006 Notes. In an Information Statement filed on Form 6-K on August 6, 2003, Grupo TMM disclosed that in order to restructure its debt, the management of Grupo TMM has initiated negotiations with the informal committee. Grupo TMM has not made any further public statements concerning the progress of its negotiations with this informal committee;
- o KCS filed with the STB on May 13, 2003 a Railroad Control Application, seeking permission to exercise common control over KCSR, Gateway Eastern and Tex-Mex. On June 9, 2003, the STB issued its decision, effective June 13, 2003, finding that the transaction proposed in KCS's application is a "minor transaction" under 49 CFR 1180.2(c), although KCS was required to supplement its application as discussed in the decision, to address some of the implication of KCS's acquisition of control of TFM. KCS filed the supplement on June 23, 2003, as required by the decision. The STB also outlined a procedural schedule for consideration of KCS's application to exercise common control over KCSR, Gateway Eastern and Tex-Mex. The STB decision set October 17, 2003 as the date by which it will issue its final decision on the merits of the application. On September 23, 2003, the STB entered an order asking all interested parties to file comments by September 30, 2003 addressing whether "in light of recent developments" the STB should continue with the procedural schedule, which calls for a decision on the merits to be issued by October 17, 2003. On September 30, 2003, KCS filed comments with the STB suggesting that STB precedent establishes that the STB has sufficient jurisdiction to rule on control applications even where closing on the underlying transaction has been put in doubt. In the alternative, KCS argued that the matter should be held in abeyance, rather than dismissed, until the arbitration is completed. On October 8, 2003, the STB issued an order suspending the procedural schedule pending a

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resolution of the uncertainties that now surround KCS's efforts to acquire control of Tex-Mex, and requiring KCS to file status reports regarding developments in its efforts to acquire control of TFM and Tex-Mex;

- o KCS filed its Hart-Scott-Rodino notification on May 19, 2003. Grupo TMM filed its HSR notification on July 1, 2003. Under the HSR process, the United States Department of Justice ("DOJ") has 30 days after notice is filed to issue a second request asking for various documents and information from the HSR parties. The waiting period under the HSR officially expired on July 31, 2003, with no request for additional information from the DOJ.

### RECENT DEVELOPMENTS

#### DISPUTE OVER ACQUISITION AGREEMENT

On August 18, 2003, Grupo TMM announced that at its General Ordinary Shareholders meeting that day, the shareholders did not approve the sale of Grupo TMM's interest in Grupo TFM to KCS. Grupo TMM further announced that as a result of the stockholder vote, Grupo TMM's Board of Directors intended to meet to review Grupo TMM's options and that Grupo TMM was proceeding to inform the authorities at the Ministry of Communications and Transportation, the Ministry of Finance, other relevant authorities and stakeholders at Grupo TMM and subsidiaries of the Grupo TMM shareholders' decision. On August 23, 2003, Grupo TMM sent a notice to KCS claiming to terminate the Acquisition Agreement, because the Grupo TMM shareholders had failed to approve the Acquisition Agreement.

On August 29, 2003, KCS delivered to Grupo TMM the Notice of Dispute pursuant to the Acquisition Agreement. This initiated a 60-day negotiation period between the parties. If the parties are unable to resolve the disputes within that period of time, KCS intends to initiate a binding arbitration in accordance with the terms of the Acquisition Agreement. In addition, on August 29, 2003, KCS filed a complaint in the Delaware Chancery Court alleging that Grupo TMM had breached the Acquisition Agreement and seeking a final order requiring Grupo TMM not to sell Grupo TFM or take other actions outside of the ordinary course of business, so as to preserve the assets and business of TFM while the parties follow the dispute resolution procedures provided for in the Acquisition Agreement. The Notice of Dispute and complaint point out that the Acquisition Agreement does not provide that a negative shareholder vote by Grupo TMM shareholders is a basis for termination, and KCS maintains that the Acquisition Agreement is still valid and remains in effect until December 31, 2004.

On September 2, 2003, KCS filed in the Delaware Court of Chancery a motion for a preliminary injunction to preserve the parties' positions while KCS seeks to resolve its dispute over Grupo TMM's attempt to terminate the Acquisition Agreement. KCS asked for an expedited hearing on its motion for a preliminary injunction.

On September 15, 2003, KCS confirmed that negotiations with Grupo TMM have begun under the dispute resolution process contained in the Acquisition Agreement for Grupo TMM's interest in Grupo TFM. One meeting was held to discuss negotiations, but no further meetings have been held.

On October 22, 2003, KCS announced that Chancellor William B. Chandler III of the Delaware Court of Chancery has, in a ruling from the bench, stated his intention to grant KCS' motion seeking a preliminary injunction to preserve the parties' positions pending resolution of KCS' dispute with Grupo TMM.



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### REPURCHASE OF MEXRAIL SHARES BY TFM

On August 29, 2003, KCS received a demand for TFM to repurchase from KCS shares of Mexrail sold to KCS in May 2003. On September 23, 2003, the STB issued a decision finding no need to rule on the transfer back to TFM of the 51% interest in Mexrail that KCS acquired on May 9, 2003. The effect of the decision was to allow TFM to reacquire the shares in accordance with the Stock Purchase Agreement and KCS has abided by that agreement. The repurchase of Mexrail by TFM on September 30, 2003 returned 100% ownership of Mexrail to TFM and the Stock Purchase Agreement automatically terminated. The repurchase price was the price KCS paid TFM in May.

### NOTICE OF TERMINATION OF JOINT VENTURE AGREEMENT

In addition, KCS acknowledged receipt from Grupo TMM of a notice to terminate a joint venture agreement between the parties entered into in 1995. Pursuant to such notice, the joint venture agreement will terminate on December 1, 2003.

### DESCRIPTION OF THE SERIES C PREFERRED STOCK

The following is a summary of certain provisions of the certificate of designations for our 4.25% Redeemable Cumulative Convertible Perpetual Preferred Stock, Series C, which we refer to as the "Series C Preferred Stock." A copy of the certificate of designations and the form of Series C Preferred Stock share certificate are available upon request from us at the address set forth under "Where You Can Find More Information." The following summary of the terms of the Series C Preferred Stock does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the certificate of designations, including the definitions of terms used in the certificate of designations. Wherever particular provisions or defined terms of the certificate of designations or form of Series C Preferred Stock are referred to, these provisions or defined terms are incorporated by reference in this prospectus by reference. We urge you to read the certificate of designations because it, and not this description, defines your rights as a holder of shares of Series C Preferred Stock. As used in this section, the terms the "KCS," "us," "we" or "our" refer to Kansas City Southern and not any of its subsidiaries.

### GENERAL

Under our restated certificate of incorporation, our board of directors is authorized, without further stockholder action, to issue up to 2,000,000 shares of New Series Preferred Stock, par value \$1.00 per share, in one or more series, with such voting powers or without voting powers, and with such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions, as shall be set forth in the resolutions providing therefor. We have 450,000 shares of authorized New Series Preferred Stock which are undesignated. Of the 2,000,000 shares of New Series Preferred Stock, (1) 150,000 shares are designated as New Series Preferred Stock Series A, of which no shares are currently outstanding, (2) 1,000,000 shares are designated as Series B Convertible Preferred Stock, of which no shares are

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currently outstanding and (3) 400,000 shares of are designated as 4.25% Redeemable Cumulative Convertible Perpetual Preferred Stock, Series C, of which 400,000 shares are currently outstanding. We also have outstanding 242,170 shares of Preferred Stock out of 840,000 authorized shares.

The holders of the shares of Series C Preferred Stock will have no preemptive rights or preferential rights to purchase or subscribe for stock, obligations, warrants or any other of our securities.

### RANKING

The Series C Preferred Stock, with respect to dividend rights and upon liquidation, winding up and dissolution, ranks:

- o junior to all our existing and future debt obligations;
- o junior to "senior stock," which is our Preferred Stock, and each class or series of our capital stock other than (a) our common stock and any other class or series of our capital stock the terms of which provide that such class or series will rank junior to the Series C Preferred Stock and (b) any other class or series of our capital stock the terms of which provide that such class or series will rank on a parity with the Series C Preferred Stock;
- o on a parity with "parity stock," which is (a) our New Series Preferred Stock, Series A, (b) our Series B Convertible Preferred Stock and (c) any other class or series of our capital stock that has terms which provide that such class or series will rank on a parity with the Series C Preferred Stock;
- o senior to "junior stock," which is our common stock and each class or series of our capital stock that has terms which provide that such class or series will rank junior to the Series C Preferred Stock; and
- o effectively junior to all of our subsidiaries' (i) existing and future liabilities and (ii) capital stock held by others.

The term "senior stock" includes warrants, rights, calls or options exercisable for or convertible into that type of stock.

### DIVIDENDS

Holders of the shares of Series C Preferred Stock are entitled to receive, when, as and if declared by our board of directors, out of funds legally available for payment, cumulative cash dividends on each outstanding share of Series C Preferred Stock at the annual rate of 4.25% of the liquidation preference per share. The dividend rate is initially equivalent to \$21.25 per share annually. The right of holders of the shares of Series C Preferred Stock to receive dividend payments is subject to the rights of any holders of shares of senior stock and parity stock.

Dividends are payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year, beginning on August 15, 2003. If any of those dates is not a business day, then dividends will be payable on the next succeeding business day. Dividends will accumulate from the most recent date as to which dividends will have been paid or, if no dividends have been paid, from the date of original issuance of the Series C Preferred Stock. Dividends are payable to holders of record as they appear in our stock records at the close of business on February 1, May 1, August 1 and November 1 of each year or on a record date that may be fixed by our board of directors and that will be not

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more than 60 days nor fewer than 10 days before the applicable quarterly dividend payment date. Dividends will be cumulative from each quarterly dividend payment date, whether or not we have funds legally available for the payment of those dividends.

Dividends payable on the shares of Series C Preferred Stock for any period shorter than a full quarterly period will be computed on the basis of a 360-day year consisting of twelve 30-day months. Dividends on the shares of Series C Preferred Stock, including special dividends, if any, will be payable in cash. Accumulated unpaid dividends cumulate dividends at the annual rate of 4.25% and are payable in the manner provided above.

For so long as the Series C Preferred Stock is outstanding, (1) we will not declare, pay or set apart funds for the payment of any dividend or other distribution with respect to any junior stock or parity stock and (2) neither we, nor any of our subsidiaries, will redeem, purchase or otherwise acquire for consideration junior stock or parity stock through a sinking fund or otherwise, unless we have paid or set apart funds for the payment of all accumulated and unpaid dividends, including special dividends, if any, with respect to the shares of the Series C Preferred Stock and any parity stock for all preceding dividend periods. As an exception to clause (2), we will be able to redeem, purchase or otherwise acquire for consideration parity stock pursuant to a purchase or exchange offer made on the same terms to all holders of Series C Preferred Stock and such parity stock.

Holders of the Series C Preferred Stock will not have any right to receive dividends that we may declare on our common stock. The right to receive dividends declared on our common stock will be realized only after conversion of such holder's shares of Series C Preferred Stock into shares of our common stock.

### CONVERSION RIGHTS

#### GENERAL

Each share of Series C Preferred Stock will be convertible at any time and from time to time, on or after the occurrence of the conversion triggering events described below at the option of the holder, into fully paid and nonassessable shares of our common stock at a conversion rate of 33.4728 shares, subject to adjustments as described under "--Adjustments to the Conversion Rate."

A holder of shares of the Series C Preferred Stock may convert any or all of those shares by surrendering to us at our principal office or at the office of the transfer agent, as may be designated by our board of directors, the certificate or certificates for those shares of the Series C Preferred Stock accompanied by a written notice stating that the holder elects to convert all or

a specified whole number of those shares in accordance with the provisions described in this prospectus and specifying the name or names in which the holder wishes the certificate or certificates for shares of common stock to be issued. In case the notice specifies a name or names other than that of the holder, the notice will be accompanied by payment of all transfer taxes payable upon the issuance of shares of common stock in that name or names. Other than those taxes, we will pay any documentary, stamp or similar issue or transfer taxes that may be payable in respect of any issuance or delivery of shares of common stock upon conversion of shares of the Series C Preferred Stock. As promptly as practicable after the surrender of that certificate or certificates and the receipt of the notice relating to the conversion and payment of all required transfer taxes, if any, or the demonstration to our satisfaction that

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those taxes have been paid, we will deliver or cause to be delivered (a) certificates representing the number of validly issued, fully paid and nonassessable full shares of our common stock to which the holder, or the holder's transferee, of shares of the Series C Preferred Stock being converted will be entitled and (b) if less than the full number of shares of Series C Preferred Stock evidenced by the surrendered certificate or certificates is being converted, a new certificate or certificates, of like tenor, for the number of shares evidenced by the surrendered certificate or certificates less the number of shares being converted. This conversion will be deemed to have been made at the close of business on the date of giving the notice and of surrendering the certificate or certificates representing the shares of Series C Preferred Stock to be converted so that the rights of the holder thereof as to the shares being converted will cease except for the right to receive shares of common stock, and the person entitled to receive the shares of common stock will be treated for all purposes as having become the record holder of those shares of common stock at that time.

In lieu of the foregoing procedures, if the Series C Preferred Stock is held in global form, you must comply with The Depository Trust Company ("DTC") procedures to convert your beneficial interest in respect of Series C Preferred Stock evidenced by a global share of Series C Preferred Stock.

If a holder of shares of Series C Preferred Stock exercises conversion rights, upon delivery of the shares for conversion, those shares will cease to cumulate dividends as of the end of the day immediately preceding the date of conversion. Holders of shares of Series C Preferred Stock who convert their shares into our common stock will not be entitled to, nor will the conversion rate be adjusted for, any accumulated and unpaid dividends. Accordingly, shares of Series C Preferred Stock surrendered for conversion after the close of business on any record date for the payment of dividends declared and before the opening of business on the dividend payment date relating to that record date must be accompanied by a payment in cash of an amount equal to the dividend payable in respect of those shares for the dividend period in which the shares are converted. A holder of shares of Series C Preferred Stock on a dividend payment record date who converts such shares into shares of our common stock on the corresponding dividend payment date will be entitled to receive the dividend payable on such shares of Series C Preferred Stock on such dividend payment date, and the converting holder need not include payment of the amount of such dividend upon surrender of shares of Series C Preferred Stock for conversion.

Notwithstanding the foregoing, if shares of Series C Preferred Stock are converted during the period between the close of business on any dividend payment record date and the opening of business on the corresponding dividend payment date, and we have called such shares of Series C Preferred Stock for redemption during such period or we have specified a fundamental change purchase date during such period, the holder who tenders such shares for conversion will receive the dividend payable on such dividend payment date and need not include payment of the amount of such dividend upon surrender of shares of Series C Preferred Stock for conversion.

In case any shares of Series C Preferred Stock are to be redeemed, the right to convert those shares of the Series C Preferred Stock will terminate at 5:00 p.m., New York City time, on the business day immediately preceding the date fixed for redemption unless we default in the payment of the redemption price of those shares.

In connection with the conversion of any shares of Series C Preferred Stock, no fractional shares of common stock will be issued, but we will pay a cash adjustment in respect of any fractional interest in an amount equal to the fractional interest multiplied by the closing sale price of our common stock (as defined below under "--Conversion Rights--Events Triggering Conversion Rights--Conversion Rights Based on Trading Price of Our Common Stock") on the

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date the shares of Series C Preferred Stock are surrendered for conversion. If more than one share of Series C Preferred Stock will be surrendered for conversion by the same holder at the same time, the number of full shares of common stock issuable on conversion of those shares will be computed on the basis of the total number of shares of Series C Preferred Stock so surrendered.

We will at all times reserve and keep available, free from preemptive rights, for issuance upon the conversion of shares of Series C Preferred Stock a number of our authorized but unissued shares of common stock that will from time to time be sufficient to permit the conversion of all outstanding shares of Series C Preferred Stock.

Before the delivery of any securities that we will be obligated to deliver upon conversion of the Series C Preferred Stock, we will comply with all applicable federal and state laws and regulations that require action to be taken by us. All shares of common stock delivered upon conversion of the Series C Preferred Stock will upon delivery be duly and validly issued, fully paid and nonassessable, free of all liens and charges and not subject to any preemptive rights.

### EVENTS TRIGGERING CONVERSION RIGHTS

A holder's right to convert its shares of Series C Preferred Stock will arise only upon the occurrence of the events specified in this section.

CONVERSION RIGHTS BASED ON TRADING PRICE OF OUR COMMON STOCK. Commencing after June 30, 2003, a holder may surrender shares of Series C Preferred Stock for conversion into shares of our common stock in any fiscal quarter (and only during such fiscal quarter), if, as of the last day of the preceding fiscal quarter, the closing sale price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of such preceding fiscal quarter is more than 110% of the "conversion price" as of the last day of such preceding fiscal quarter. The "conversion price" as of any day will equal the liquidation preference divided by the conversion rate in effect on such date.

"Trading day" means a day during which trading in securities generally occurs on the New York Stock Exchange or, if our common stock is not listed on the New York Stock Exchange, on the principal other national or regional securities exchange on which our common stock is then listed or, if our common stock is not listed on a national or regional securities exchange, on the National Association of Securities Dealers Automated Quotation System ("Nasdaq") or, if our common stock is not quoted on Nasdaq, on the principal other market on which our common stock is then traded.

The "closing sale price" of our common stock on any date means the closing sale price per share (or if no closing sale price is reported, the average of the closing bid and ask prices or, if more than one in either case, the average of the average closing bid and the average closing ask prices) on such date as reported on the principal United States securities exchange on which our common stock is traded or, if our common stock is not listed on a United States national or regional securities exchange, as reported by Nasdaq or by the National Quotation Bureau Incorporated. In the absence of such a quotation, we will determine the closing sale price on the basis we consider appropriate.

CONVERSION RIGHTS UPON CREDIT RATING DOWNGRADE. After the earlier of (a) the date the Series C Preferred Stock is assigned a credit rating by both S&P and Moody's and (b) May 31, 2003, during a period in which (1) the credit rating assigned to the Series C Preferred Stock by S&P is below CCC, (2) the credit

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rating assigned to the Series C Preferred Stock by Moody's is below Caa3 (3) either S&P or Moody's does not assign a credit rating to the Series C Preferred Stock, or (4) any rating is suspended or withdrawn by either S&P or Moody's, holders may also surrender Series C Preferred Stock for conversion into shares of our common stock.

CONVERSION UPON SATISFACTION OF TRADING PRICE CONDITION. Holders may surrender their shares of Series C Preferred Stock for conversion into shares of our common stock during the five business day period after any five consecutive

trading-day period in which the trading price of the Series C Preferred Stock for each day of that five trading-day period was less than 98% of the product of the closing sale price of our common stock and the conversion rate in effect on each such day.

The "trading price" of the Series C Preferred Stock on any date of determination means the average of the secondary market bid quotations obtained by us or a calculation agent for 50,000 shares of Series C Preferred Stock at approximately 3:30 p.m., New York City time, on such determination date from three independent nationally recognized securities dealers that we or a calculation agent selects; provided that if three such bids cannot reasonably be obtained by us or a calculation agent, but two such bids are obtained, then the average of the two bids shall be used, and if only one such bid can reasonably be obtained by us or the calculation agent, that one bid shall be used. If we or a calculation agent cannot reasonably obtain at least one bid for 50,000 shares of Series C Preferred Stock from a nationally recognized securities dealer, or in our reasonable judgment, the bid quotations are not indicative of the secondary market value of the Series C Preferred Stock, then the trading price per share of Series C Preferred Stock will be deemed to be less than 98% of the product of the closing sale price of our common stock and the conversion rate.

CONVERSION RIGHTS UPON NOTICE OF REDEMPTION. A holder may surrender for conversion any or all shares of Series C Preferred Stock that have been called for redemption at any time prior to 5:00 p.m., New York City time, on the business day immediately preceding the date of redemption, even if the Series C Preferred Stock is not otherwise convertible at that time.

CONVERSION RIGHTS UPON OCCURRENCE OF CERTAIN CORPORATE TRANSACTIONS. If we are party to a consolidation, merger or binding share exchange pursuant to which shares of our common stock would be converted into cash, securities or other property, a holder may surrender shares of Series C Preferred Stock for conversion into shares of our common stock at any time from and after the date that is 15 days prior to the anticipated effective date of the transaction until 15 days after the actual date of such transaction and, at the effective time, the right to convert shares of Series C Preferred Stock into shares of our common stock will be changed into a right to convert such Series C Preferred Stock into the kind and amount of cash, securities or other property of us or another person that the holder would have received if the holder had converted the holder's Series C Preferred Stock immediately prior to the transaction. If such transaction also constitutes a fundamental change, the holder will be able to require us to purchase all or a portion of such holder's Series C Preferred Stock as described under "--Fundamental Change Requires Us to Purchase Shares of Series C Preferred Stock at the Option of the Holder."

If we elect to:

- o distribute to all holders of our common stock rights or warrants entitling them to purchase, for a period expiring within 45 days of the record date for such distribution, our common stock at less than the average closing sale price for the 10 trading days preceding the

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declaration date for such distribution; or

- o distribute to all holders of our common stock, cash, assets, debt securities or rights to purchase our securities, which distribution has a per share value exceeding 5% of the closing sale price of our common stock on the day immediately preceding the declaration date for such distribution;

we must notify you at least 20 days prior to the ex-dividend date for such distribution. Once we have given such notice, you may surrender your shares of Series C Preferred Stock for conversion at any time until the earlier of the close of business on the business day immediately preceding the ex-dividend date or any announcement by us that such distribution will not take place. No adjustment to the conversion rate or your ability to convert will be made if you will otherwise participate in the distribution without conversion.

Upon determination that Series C Preferred Stock holders are or will be entitled to convert their Series C Preferred Stock into shares of our common stock in accordance with any of the foregoing provisions, we will issue a press release and publish such information on our website on the World Wide Web.

### ADJUSTMENTS TO THE CONVERSION RATE

The conversion rate is subject to adjustment from time to time if any of the following events occur:

- o dividends or distributions on shares of our common stock payable in shares of our common stock;
- o subdivisions, combinations or certain reclassifications of shares of our common stock;
- o distributions to all holders of shares of our common stock of rights or warrants entitling them to purchase, for a period expiring within 45 days of the record date for such distribution, our common stock at less than the average closing sale price for the 10 trading days preceding the declaration date for such distribution;
- o distributions to all holders of shares of our common stock of shares of our capital stock, evidences of indebtedness or assets, including securities but excluding:
  - o rights or warrants specified above;
  - o dividends or distributions specified above; and
  - o cash distributions.

In the event that we make a distribution to all holders of our common stock consisting of capital stock of, or similar equity interest in, a subsidiary or other business unit of ours, the conversion rate will be adjusted based on the market value of the securities so distributed relative to the market value of our common stock, in each case based on the average closing sale prices of those securities for the 10 trading days commencing on and including the fifth trading day after the date on which "ex-dividend trading" commences for such dividend or distribution on the New York Stock Exchange or such other national or regional exchange or market on which the securities are then listed or quoted.

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- o distributions to all holders of shares of our common stock of cash, excluding any dividend or distribution in connection with our liquidation, dissolution or winding up, to the extent that the aggregate cash dividends per share of common stock in any twelve month period exceeds the greater of:
  - o the annualized amount per share of common stock of the next preceding quarterly cash dividend on the common stock to the extent that the preceding quarterly dividend did not require an adjustment of the conversion rate pursuant to this clause, as adjusted to reflect subdivisions or combinations of the common stock; and
  - o 5% of the average of the closing sale price of the common stock during the ten trading days immediately prior to the declaration date of the dividend.

If an adjustment is required to be made under this clause as a result of a distribution that is a quarterly dividend, the adjustment would be based upon the amount by which the distribution exceeds the amount of the quarterly cash dividend permitted to be excluded pursuant to this clause. If an adjustment is required to be made under this clause as a result of a distribution that is not a quarterly dividend, the adjustment would be based upon the full amount of the distribution;

- o we or one of our subsidiaries makes a payment in respect of a tender offer or exchange offer for our common stock to the extent that the cash and value of any other consideration included in the payment per share of common stock exceeds the closing sale price per share of common stock on the trading day next succeeding the last date on which

tenders or exchanges may be made pursuant to such tender or exchange offer; and

- o someone other than us or one of our subsidiaries makes a payment in respect of a tender offer or exchange offer in which, as of the closing date of the offer, our board of directors is not recommending rejection of the offer. The adjustment referred to in this clause will only be made if:
  - o the tender offer or exchange offer is for an amount that increases the offeror's ownership of common stock to more than 25% of the total shares of common stock outstanding; and
  - o the cash and value of any other consideration included in the payment per share of common stock exceeds the closing sale price per share of common stock on the business day next succeeding the last date on which tenders or exchanges may be made pursuant to the tender or exchange offer.

However, the adjustment referred to in this clause will generally not be made if as of the closing of the offer, the offering documents disclose a plan or an intention to cause us to engage in a consolidation or merger or a sale of all or substantially all of our assets.

We have adopted a Rights Agreement dated September 19, 1995, pursuant to which certain rights were issued with respect to our shares of common stock. You will receive, upon conversion of your Series C Preferred Stock, in addition to the common stock, the rights under the rights agreement or any other rights plan



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then in effect unless, prior to conversion, the rights have expired, terminated or been redeemed or unless the rights have separated from the common stock at the time of conversion, in which case the conversion rate will be adjusted at the time of separation as if we had distributed to all holders of our common stock, shares of our capital stock, evidences of indebtedness or assets as described under the fourth bullet point above, subject to readjustment in the event of the expiration, termination or redemption of such rights.

In the event of:

- o any reclassification of our common stock;
- o a consolidation, merger or combination involving us; or
- o a sale or conveyance to another person or entity of all or substantially all of our property and assets;

in which holders of our common stock would be entitled to receive stock, other securities, other property, assets or cash for their common stock, upon conversion of your Series C Preferred Stock you will be entitled to receive the same type of consideration that you would have been entitled to receive if you had converted the Series C Preferred Stock into our common stock immediately prior to any of these events.

The proposed Acquisition and transactions described under "Description of the Acquisitions" including the Merger, and the renaming of KCS to NAFTA Rail are not, as proposed, expected to trigger any adjustments to the conversion rate.

You may in certain situations be deemed to have received a distribution subject to United States federal income tax as a dividend in the event of any taxable distribution to holders of common stock or in certain other situations requiring a conversion rate adjustment. See "Certain United States Federal Tax Considerations."

We may, from time to time, increase the conversion rate if our board of directors has made a determination that this increase would be in our best interests. Any such determination by our board will be conclusive. In addition, we may increase the conversion rate if our board of directors deems it advisable to avoid or diminish any income tax to holders of common stock resulting from any stock or rights distribution. See "Certain United States Federal Tax Considerations."

We will not be required to make an adjustment in the conversion rate unless the adjustment would require a change of at least 1% in the conversion rate. However, we will carry forward any adjustments that are less than 1% of the conversion rate. Except as described above in this section, we will not adjust the conversion rate for any issuance of our common stock or convertible or exchangeable securities or rights to purchase our common stock or convertible or exchangeable securities.

### OPTIONAL REDEMPTION

We may not redeem any shares of Series C Preferred Stock before May 20, 2008. On or after May 20, 2008, we will have the option to redeem some or all the shares of Series C Preferred Stock at a redemption price of 100% of the liquidation preference, plus accumulated and unpaid dividends, including special dividends, if any, to the redemption date, but only if the closing sale price of our common stock for 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date we give the redemption notice

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exceeds 135% of the conversion price in effect on each such day. If full cumulative dividends on the Series C Preferred Stock have not been paid, the Series C Preferred Stock may not be redeemed and we may not purchase or acquire any shares of Series C Preferred Stock otherwise than pursuant to a purchase or exchange offer made on the same terms to all holders of Series C Preferred Stock and any parity stock.

We may elect to pay the redemption price in cash, common stock, or a combination of cash and common stock. The number of shares of common stock a holder will receive will equal the relevant amount of the redemption price divided by 97.5% of the average of the closing sale prices of our common stock for the five trading days ending on the third trading day prior to the redemption date. However, we may not pay the purchase price in common stock or a combination of common stock and cash unless we satisfy certain conditions prior to the redemption date as provided in the certificate of designations, including:

- o registration of the shares of our common stock to be issued upon redemption under the Securities Act and the Exchange Act, if required;
- o qualification of the shares of our common stock to be issued upon redemption under applicable state securities laws, if necessary, or the availability of an exemption therefrom; and
- o listing of our common stock on a United States national securities exchange or quotation thereof in an inter-dealer quotation system of any registered United States national securities association.

In the event of an optional redemption, we will send a written notice by first class mail to each holder of record of the Series C Preferred Stock at such holder's registered address, not fewer than 30 nor more than 90 days prior to the redemption date, stating, among other things, whether the redemption price will be paid in cash or common stock, or a combination and, if a combination, specifying the portions payable in cash and common stock. In addition, we will (i) publish such information once in a daily newspaper printed in the English language and of general circulation in the Borough of Manhattan, City of New York, (ii) issue a press release containing such information, and (iii) publish such information on our website on the World Wide Web.

Because the average closing sale price of our common stock will be determined prior to the redemption date, holders of Series C Preferred Stock bear the market risk that our common stock will decline in value between the date the average closing sale price is calculated and the redemption date. In addition, because the number of shares of our common stock that you will receive upon any redemption for shares is based on the average closing sale price for a 5 trading day period, the market value of those shares on the date of receipt may be less than the value of those shares based on the average closing sale price.

If we give notice of redemption, then, by 12:00 p.m., New York City time, on the redemption date, to the extent funds are legally available, we shall, with respect to:

- o shares of Series C Preferred Stock held by DTC or its nominees, deposit or cause to be deposited, irrevocably with DTC cash or common stock sufficient to pay the redemption price and will give DTC irrevocable instructions and authority to pay the redemption price to holders of such shares of Series C Preferred Stock; and
- o shares of Series C Preferred Stock held in certificated form, deposit

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or cause to be deposited, irrevocably with the transfer agent cash or common stock sufficient to pay the redemption price and will give the transfer agent irrevocable instructions and authority to pay the redemption price to holders of such shares of Series C Preferred Stock upon surrender of their certificates evidencing their shares of Series C Preferred Stock.

If on the redemption date DTC and the transfer agent hold cash or common stock sufficient to pay the redemption price for the shares of Series C Preferred Stock delivered for redemption in accordance with the terms of the certificate of designations, dividends will cease to accumulate on those shares of Series C Preferred Stock called for redemption and all rights of holders of such shares will terminate except for the right to receive the redemption price.

Payment of the redemption price for the shares of Series C Preferred Stock is conditioned upon book-entry transfer of or physical delivery of certificates representing the Series C Preferred Stock, together with necessary endorsements, to the transfer agent, or to the transfer agent's account at DTC, at any time after delivery of the redemption notice. Payment of the redemption price for the Series C Preferred Stock will be made (i) if book-entry transfer of or physical delivery of the Series C Preferred Stock has been made by or on the redemption date, on the redemption date, or (ii) if book-entry transfer of or physical delivery of the Series C Preferred Stock has not been made by or on such date, at the time of book-entry transfer of or physical delivery of the Series C Preferred Stock.

If the redemption date falls after a dividend payment record date and before the related dividend payment date, holders of the shares of Series C Preferred Stock at the close of business on that dividend payment record date will be entitled to receive the dividend payable on those shares on the corresponding dividend payment date. The redemption price payable on such redemption date will include only the liquidation preference, but will not include any amount in respect of dividends declared and payable on such corresponding dividend payment date.

In the case of any partial redemption, we will select the shares of Series C Preferred Stock to be redeemed on a pro rata basis, by lot or any other method that we, in our discretion, deem fair and appropriate.

Our restated certificate of incorporation provides that we may not redeem the Series C Preferred Stock if, (i) as of the date of the mailing of the redemption notice, such redemption would, if such date were the date fixed for redemption, reduce our net assets remaining after such redemption below twice the aggregate amount payable upon voluntary or involuntary liquidation, dissolution or winding up or (ii) we have not paid or set apart for payment all accumulated dividends for the current and prior dividend periods in respect of shares which have a right to cumulative dividends.

### FUNDAMENTAL CHANGE REQUIRES US TO PURCHASE SHARES OF SERIES C PREFERRED STOCK AT THE OPTION OF THE HOLDER

In the event of a fundamental change, you will have the right, at your option, subject to the terms and conditions of the certificate of designations, to require us to purchase any or all of your shares of Series C Preferred Stock. We will purchase the Series C Preferred Stock at a price equal to 100% of the liquidation preference of the Series C Preferred Stock to be purchased plus any accumulated and unpaid dividends, including special dividends, if any, to, but excluding, the fundamental change purchase date, unless such fundamental change purchase date falls after a record date and on or prior to the corresponding dividend payment date, in which case (i) we will pay the full amount of accumulated and unpaid dividends payable on such dividend payment date only to the holder of record at the close of business on the corresponding record date

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and (ii) the purchase price payable on the fundamental change purchase date will

include only the liquidation preference, but will not include any amount in respect of dividends declared and payable on such corresponding payment date. We will be required to purchase the Series C Preferred Stock as of the date that is not less than 20 nor more than 35 business days after the occurrence of such fundamental change, which we refer to as a fundamental change purchase date.

We will pay the purchase price of the Series C Preferred Stock, at our option, in cash, in shares of our common stock or any combination thereof. The number of shares of common stock a holder will receive will equal the purchase price divided by 97.5% of the average closing sale prices for the five trading days ending on the third trading day prior to the fundamental change purchase date. However, we may not pay the purchase price in common stock, unless we satisfy certain conditions prior to the fundamental change purchase date as provided in the certificate of designations including:

- o registration of the shares of the applicable common stock or securities to be issued upon repurchase under the Securities Act and the Exchange Act, if required;
- o qualification of the shares of common stock to be issued upon repurchase under applicable state securities laws, if necessary, or the availability of an exemption therefrom; and
- o listing of the shares of common stock on a United States national securities exchange or quotation thereof in an inter-dealer quotation system of any registered United States national securities association.

If we pay the purchase price in shares of common stock, we will notify you of such payment in our notice regarding the fundamental change. Because the average closing sale price of our common stock will be determined prior to the fundamental change purchase date, holders of Series C Preferred Stock bear the market risk that our common stock will decline in value between the date the average closing sale price is calculated and the purchase date. In addition, because the number of shares of our common stock that you will receive is based on the average closing sale price for a five trading day period, the market value of those shares on the date of receipt may be less than the value of those shares based on the average closing sale price.

A "fundamental change" is any transaction or event (whether by means of an exchange offer, liquidation, tender offer, consolidation, merger, combination, reclassification, recapitalization or otherwise) in connection with which all or substantially all of our common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive consideration which is not all or substantially all common stock that:

- o is listed on, or immediately after the transaction or event will be listed on, a United States national securities exchange, or
- o is approved, or immediately after the transaction or event will be approved, for quotation on the Nasdaq National Market or any similar United States system of automated dissemination of quotations of securities prices.

Within 15 business days after the occurrence of a fundamental change, we are obligated to mail to all holders of Series C Preferred Stock at their addresses shown in the register of the registrar and to beneficial owners as required by applicable law (and issue a press release and publish on our website

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on the World Wide Web) a notice regarding the fundamental change, stating, among other things:

- o the events causing a fundamental change;
- o the date of such fundamental change;
- o the last date on which the purchase right may be exercised;
- o the fundamental change purchase price and whether that price will be paid in cash or shares of our common stock or any specified combination thereof;
  
- o the fundamental change purchase date;
- o the na