KANSAS CITY SOUTHERN
Form 424B4
December 05, 2006

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File number 333-138831

PROSPECTUS

1,494,469 Shares

Kansas City Southern

COMMON STOCK

The selling stockholder identified in this prospectus is selling 1,494,469 shares of our common stock. We will not receive any proceeds from the sale of shares by the selling stockholder.

Our common stock is listed on the New York Stock Exchange under the trading symbol KSU. The last reported sale price of our common stock on December 4, 2006, was $26.77 per share.

Investing in our common stock involves risks. See Risk Factors on beginning on page 4 of this prospectus.

PRICE $26.65 A SHARE

	Price to Public	***Underwriting Discounts and Commissions***	***Proceeds to Selling Stockholder***
Per Share	$26.6500	$0.8661	$25.7839
Total	$39,827,598.85	$1,294,359.60	$38,533,239.25

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Morgan Stanley & Co. Incorporated expects to deliver the shares to purchasers on December 7, 2006.

MORGAN STANLEY

December 4, 2006

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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 cover of this prospectus or the date of such information as specified in this prospectus, if different.

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FORWARD-LOOKING STATEMENTS

This prospectus and the documents incorporated in this prospectus by reference may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). In addition, management may make forward-looking statements orally or in other writings, including, but not limited to, in press releases, in the annual report to shareholders and in our other filings with the Securities and Exchange Commission (SEC). Readers can identify these forward-looking statements by the use of such verbs as expects, anticipates, believes or similar verbs or conjugations of such verbs. These statements involve a number of risks and uncertainties. Actual results could materially differ from those anticipated by such forward-looking statements. Such differences could be caused by a number of factors or combination of factors including, but not limited to, the factors identified below and the factors discussed under the heading Risk Factors. Readers are strongly encouraged to consider these factors and the following factors when evaluating any forward-looking statements concerning us:

- fluctuations in the market price for our common stock;
- our dividend policy and restrictions on our ability to pay dividends on our common stock;
- our high degree of leverage;
- our potential need for and ability to obtain additional financing;
- our ability to successfully implement our business strategy, including the strategy to convert customers from using trucking services to rail transportation services;
- the impact of competition, including competition from other rail carriers and trucking companies in the United States and Mexico;
- United States, Mexican and global economic, political and social conditions;
- the effects of the North American Free Trade Agreement, or NAFTA, on the level of trade between the United States, Mexico and Canada;
- uncertainties regarding the litigation we face;
- the effects of our employee training, technological improvements and capital expenditures on labor productivity, operating efficiencies and service reliability;
- changes in legal or regulatory requirements in the United States, Mexico or Canada;
- our ability to generate sufficient cash to pay principal and interest on our debt, meet our obligations and fund our other liquidity needs;
- the effects of adverse general economic conditions affecting customer demand and the industries and geographic areas that produce and consume the commodities we carry;

material adverse changes in economic and industry conditions, both within the United States and Mexico and globally;

natural events such as severe weather, fire, floods, hurricanes, earthquakes or other disruptions of our operating systems, structures and equipment;

changes in fuel prices;

our ability to attract and retain qualified management personnel;

changes in labor costs and labor difficulties, including work stoppages affecting either our operations or our customers abilities to deliver goods to us for shipment;

the outcome of claims and litigation, including those related to environmental contamination, personal injuries, and occupational illnesses arising from hearing loss, repetitive motion and exposure to asbestos and diesel fumes;

acts of terrorism or risk of terrorist activities;

war or risk of war;

legislative, regulatory, or legal developments involving taxation, including enactment of new foreign, federal or state income or other tax rates, revisions of controlling authority, and the outcome of tax claims and litigation.

Forward-looking statements speak only as of the date on which they are made. We will not update any forward-looking statements to reflect future events, developments, or other information. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect thereto or with respect to other forward-looking statements.

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PROSPECTUS SUMMARY

This summary highlights selected information from this prospectus and may not contain all of the information that may be important to you. To understand the terms of the securities being offered by this prospectus, you should read this entire prospectus and the documents identified in this prospectus under the caption Where You Can Find More Information, including our consolidated financial statements and the notes to those financial statements, before making an investment decision. You should also 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.

Unless we have indicated otherwise, references in this prospectus to KCS mean Kansas City Southern and references to the Company, we, us, our, and similar terms refer to KCS and our consolidated subsidiaries.

KANSAS CITY SOUTHERN

We are a holding company that owns and operates uniquely positioned domestic and international rail operations in North America that are strategically focused on the growing north/south freight corridor connecting key commercial and industrial markets in the Central and Southeastern United States with major industrial cities in Mexico. The Kansas City Southern Railway Company (KCSR), which was founded in 1887, is one of seven Class I railroads. KCSR serves a ten-state region in the Midwest and Southeast regions of the United States and has the shortest north/south rail route between Kansas City, Missouri and several key ports along the Gulf of Mexico in Alabama, Louisiana, Mississippi and Texas.

We control and own all of the stock of Kansas City Southern de México, S.A. de C.V. (KCSM), through our wholly owned subsidiary, Grupo KCSM, S.A. de C.V., formerly known as Grupo Transportación Ferroviaria Mexicana, S.A. de C.V., or Grupo TFM (Grupo KCSM). Through its 50-year concession from the Mexican government (the Concession), KCSM operates a primary commercial corridor of the Mexican railroad system and has as its core route a key portion of the shortest, most direct rail passageway between Mexico City and Laredo, Texas. KCSM serves most of Mexico s principal industrial cities and three of its major shipping ports. KCSM s rail lines are the only ones which serve Nuevo Laredo, Mexico, the largest rail freight interchange point between the United States and Mexico. Under the Concession, KCSM has the right to control and operate the southern half of the rail-bridge at Laredo, Texas, which spans the Rio Grande River between the United States and Mexico.

We own, directly and indirectly, through our wholly-owned subsidiaries, 100% of Mexrail, Inc. (Mexrail). Mexrail owns 100% of The Texas Mexican Railway Company (Tex-Mex). Tex-Mex operates a 157-mile rail line extending from Laredo, Texas to the port city of Corpus Christi, Texas, which connects the operations of KCSR with KCSM. Tex-Mex connects with KCSM at the United States/Mexico border at Laredo, Texas, and connects to KCSR through trackage rights at Beaumont, Texas. Through our ownership in Mexrail, we own the northern half of the rail-bridge at Laredo, Texas. Laredo is a principal international gateway through which more than 50% of all rail and truck traffic between the United States and Mexico crosses the border.

Our rail network (KCSR, KCSM and Tex-Mex) comprises approximately 6,000 miles of main and branch lines extending from the Midwest and Southeastern portions of the United States south into Mexico and connects with most other Class I railroads, providing shippers with an effective alternative to other railroad routes and giving direct access to Mexico and the Southeastern and Southwestern United States through less congested interchange hubs.

We also own 50% of the stock of Panama Canal Railway Company (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 of Panama. Panarail Tourism Company (Panarail), a wholly owned subsidiary of PCRC, operates commuter and tourist railway services over the lines of PCRC.

Other subsidiaries and affiliates of KCS include the following:

Southern Capital Corporation, LLC (Southern Capital), a 50% owned unconsolidated affiliate that leases locomotives and rail equipment to KCSR;

Transfin Insurance, Ltd., a wholly-owned and consolidated captive insurance company, providing property, general liability and certain other insurance coverage to KCS and its subsidiaries and affiliates;

Trans-Serve, Inc. (doing business as Superior Tie and Timber ST&T), a wholly-owned and consolidated operator of a railroad wood tie treatment facility;

PABTEX GP, LLC (Pabtex), a wholly-owned and consolidated owner of a bulk materials handling facility with deep-water access to the Gulf of Mexico at Port Arthur, Texas that stores and transfers petroleum coke and soda ash from trucks and rail cars to ships, primarily for export; and

Meridian Speedway, LLC (MSLLC), a 90% owned consolidated affiliate that owns the former KCSR rail line between Meridian, Mississippi and Shreveport, Louisiana, which is a portion of the KCSR rail line between Dallas, Texas and Meridian known as the Meridian Speedway. Norfolk Southern Corporation (NS) through its wholly-owned subsidiary, The Alabama Great Southern Railroad Company, owns the remaining 10% of MSLLC. KCS will ultimately own a 70% interest and NS will ultimately own a 30% interest in MSLLC upon the contribution of additional capital by NS to MSLLC.

KCS was organized in 1962 as Kansas City Southern Industries, Inc. and in 2002 changed its name to Kansas City Southern. KCS, as the holding company, supplies its various subsidiaries with managerial, legal, tax, financial and accounting services, in addition to managing other minor non-operating investments.

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.

RECENT DEVELOPMENTS

Sale of KCSM Senior Notes

On November 21, 2006, KCSM sold $175.0 million in aggregate principal amount of new 7.625% Senior Notes due 2013. Proceeds from the sale were used to refinance $146.0 million of the $150.0 million aggregate principal amount outstanding of KCSM s 10.25% Senior Notes due 2007 and to pay down $29.0 million of KCSM s term loan facility.

Acquisition of New Locomotives

On August 23, 2006, KCSR entered into an agreement with Electro-Motive Diesel, Inc. to acquire 30 locomotives to be delivered to KCSR from June 2007 through September 2007 at an aggregate cost of approximately $61.4 million. On August 14, 2006, KCSM entered into an agreement with General Electric Company to acquire 30 locomotives to be delivered to KCSM in December 2006 and January 2007 at an aggregate cost of approximately $63.7 million. We intend to finance these locomotives through equipment lease financing consistent with past practice.

On September 28, 2006, KCSR and KCSM entered into a letter of intent with General Electric Company to purchase an aggregate of 80 locomotives to be delivered in late 2007 through August 2008 at an aggregate cost of approximately $160.8 million. The letter of intent also provided KCSR and KCSM with an option to acquire an additional aggregate of 40 locomotives. If such option is exercised, the additional 40 locomotives would be delivered in 2008. Each of KCSR and KCSM anticipates entering into definitive agreements with General Electric Company in the fourth quarter of 2007 with respect to these locomotives.

On November 29, 2006, KCSR entered into a letter of intent with Electro-Motive Diesel, Inc. to acquire 70 locomotives to be delivered to KCSR from October 2007 through April 2008 at an aggregate cost of approximately $140.9 million.

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THE OFFERING

Selling stockholder	Grupo TMM, S.A. (TMM or the selling stockholder).
Common stock offered by the selling stockholder	1,494,469 shares
Common stock to be outstanding after this offering	75,834,470 shares(1)
Use of proceeds	We will not receive any proceeds from the sale of shares by the selling stockholder.
Risk factors	Please read Risk Factors and other information included in this prospectus for a discussion of factors you should carefully consider before deciding to invest in shares of our common stock.
New York Stock Exchange symbol	KSU
Rights	Each share of the common stock offered hereby is accompanied by one Series A Preferred Stock Purchase Right, as described in Description of KCS Common Stock Anti-Takeover Provisions Rights Agreement.

(1) The number of shares outstanding above excludes:

shares of common stock issuable upon the exercise of options outstanding as of October 31, 2006 under our employee benefit plans;

shares of common stock issuable upon the conversion of convertible preferred stock outstanding as of October 31, 2006; and

shares of common stock reserved for issuance under our employee stock option plans or stock ownership plans in effect as of the date of this prospectus.

RISK FACTORS

Risks Related to an Investment in Our Common Stock

The price of our common stock may fluctuate significantly, which may make it difficult for you to resell common stock when you want to or at prices you find attractive.

The price of our common stock on the New York Stock Exchange (NYSE) constantly changes. We expect that the market price of our common stock will continue to fluctuate.

Our stock price can fluctuate as a result of a variety of factors, many of which are beyond our control. These factors include, but are not limited to:

- quarterly variations in our operating results;
- operating results that vary from the expectations of management, securities analysts, ratings agencies and investors;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts, ratings agencies and investors;
- developments generally affecting our industry;
- announcements by us or our competitors of significant contracts, acquisitions, joint marketing relationships, joint ventures or capital commitments;
- the assertion or resolution of significant claims or proceedings against us;
- our dividend policy and restrictions on the payment of dividends;
- future sales of our equity or equity-linked securities;
- the issuance of common stock in payment of dividends on preferred stock or upon conversion of preferred stock; and
- 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.

Our ability to pay dividends is currently restricted, and we do not anticipate paying cash dividends on our common stock in the foreseeable future.

We have agreed, and may agree again, to restrictions on our ability to pay dividends on our common stock. In addition, to maintain our credit ratings, we may be limited in our ability to pay dividends on our common stock 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.

We have not paid dividends on our Series C Preferred Stock or Series D Preferred Stock since February 15, 2006.

Because of certain restrictions in the indentures governing notes issued by KCSR, we have not paid dividends on our Series C Preferred Stock or Series D Preferred Stock since February 15, 2006 for the fourth quarter of 2005. If dividends on the Series C Preferred Stock or Series D Preferred Stock are in arrears for six consecutive quarters (or an equivalent number of days in the aggregate, whether or not consecutive) holders of the Series C Preferred Stock or Series D Preferred Stock, as applicable, will be entitled to vote for the election of two of the authorized directors at the next annual stockholders meeting at which directors are elected and at each subsequent stockholders meeting until such time as all accumulated dividends are paid on the Series C Preferred Stock or Series D Preferred Stock, as applicable, or set aside for payment. In addition, we will not be eligible to register future offerings of securities on Form S-3 or to avail ourselves of the other benefits available to companies that qualify as well-known seasoned issuers under SEC rules until we resume paying such dividends and thereafter file our annual financial statements. This could adversely affect our ability to access capital markets, and increase the cost of accessing capital markets, until we qualify as a well-known seasoned issuer.

We convened a special meeting of the holders of record of our Series C Preferred Stock on March 30, 2006 to vote on a proposed amendment to the terms of the Series C Preferred Stock that would allow dividends on the Series C Preferred Stock to be paid, at our option, in cash, in shares of KCS common stock, or in any combination of cash and common stock. While the special meeting was adjourned indefinitely due to the absence of a quorum, there can be no assurance we will not attempt to reconvene the meeting or take some other action to amend the terms of the Series C Preferred Stock to, among other things, allow us to pay dividends in shares of KCS common stock or to induce conversion of our Series C Preferred Stock. Any of these actions could result in immediate dilution of the voting power and equity interests of holders of our common stock, including purchasers in this offering.

Sales of substantial amounts of our common stock in the public market could adversely affect the prevailing market price of our common stock.

As of September 30, 2006, we had 10,720,859 shares of common stock issued or reserved for issuance under our 1991 Amended and Restated Stock Option and Performance Award Plan and our Employee Stock Purchase Plan, 2,023,113 shares of common stock held by executive officers and directors outside those plans, and 20,389,050 shares of common stock reserved for issuance upon conversion of our outstanding shares of convertible preferred stock. Sales of common stock by employees upon exercise of their options, sales by our executive officers and directors subject to compliance with Rule 144 under the Securities Act, and sales of common stock that may be issued upon conversion of our outstanding preferred stock, 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 give us 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

We compete against other railroads and other transportation providers.

Our domestic and international operations are subject to competition from other railroads, in particular the Union Pacific Railroad Company (UP) and BNSF Railway Company (BNSF) in the United States and Ferrocarril Mexicano, S.A. de C.V. (Ferromex) in Mexico. Many of our rail competitors are much larger and have significantly greater financial and other resources than we do. In addition, we are subject to competition from truck carriers and from barge lines and other maritime shipping. Increased competition could result 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. While we must build or acquire and maintain our infrastructure, truck carriers, maritime shippers and barges are able to use public rights-of-way. The trucking industry has in the past provided effective rate and service competition to the railroad industry. Trucking requires substantially smaller capital investment and maintenance expenditures than railroads and allows for more frequent and flexible scheduling. Continuing competitive pressures, any reduction in margins due to competitive pressures, future improvements that increase the quality of alternative modes of transportation in the locations in which we operate, or legislation or regulations that provide motor carriers with additional advantages, such as increased size of vehicles and reduced weight restrictions, could have a material adverse effect on our results of operations, financial condition and liquidity.

A material part of our growth strategy is based upon the conversion of truck traffic to rail. There can be no assurance we will have the ability to convert traffic from truck to rail transport or that we will retain the customers we have already converted. If the railroad industry in general, and our Mexican operations in particular, are unable to preserve their competitive advantages vis-à-vis the trucking industry, our projected revenue growth from our Mexican operations could be adversely affected. Additionally, the revenue growth attributable to our Mexican operations could be affected by, among other factors, our inability to grow our existing customer base, negative macroeconomic developments impacting the United States or Mexican economies, and failure to capture additional cargo transport market share from the shipping industry and other railroads.

NAFTA called for Mexican trucks to have unrestricted access to highways in U.S. border states by 1995 and full access to all U.S. highways by January 2000. However, the U.S. did not follow that timetable because of concerns over Mexico s trucking safety standards. 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. 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 motor carriers seeking to operate in the United States to, among other things, pass 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. Under the rules issued by the U.S. Department of Transportation, it was expected that the border would have been opened to Mexican motor carriers in 2002. However, in January 2003, in response to a lawsuit filed in May 2002 by a coalition of environmental, consumer and labor groups, the U.S. Court of Appeals for the Ninth Circuit issued a ruling which held that the rules issued by the U.S. Department of Transportation violated federal environmental laws because the Department of Transportation failed to adequately review the impact on U.S. air quality of rules allowing Mexican carriers to transport beyond the 20-mile commercial zones along the U.S.-Mexico border. The Court of Appeals ruling required the Department of Transportation to provide an Environmental Impact Statement on the Mexican truck plan and to certify compliance with the U.S. Clean Air Act. The Department of Transportation requested the U.S. Supreme Court to review the Court of Appeals ruling and, on December 15, 2003, the Supreme Court granted the Department of Transportation s request. On June 7, 2004, the Supreme Court unanimously overturned the Court of Appeals ruling. Although the Department of Transportation is no longer required to provide an Environmental Impact Statement under the Supreme Court s ruling, the United States and Mexico must still complete negotiations on safety inspections before the border is opened. We cannot predict when these negotiations will be completed. There can be no assurance that truck transport between Mexico and the United States will not increase substantially in the future if the United States and Mexico complete the negotiations and the border is opened. Any such increase in truck traffic could affect our ability to continue converting traffic to rail from truck transport because it may result in an expansion in the availability, or an improvement in the quality, of the trucking services offered by Mexican carriers.

Through KCSM s Concession from the Mexican government, we have the right to control and operate the southern half of the rail-bridge at Laredo, Texas. Under the Concession, KCSM must grant to Ferromex the right to operate over a north-south portion of KCSM s rail lines between Ramos Arizpe near Monterrey and the city of Queretaro that constitutes over 600 kilometers of KCSM s main track. Using these trackage rights, Ferromex may be able to compete with KCSM over KCSM s rail lines for traffic between Mexico City and the United States. The Concession also requires KCSM to grant rights to use certain portions of its tracks to Ferrocarril del Sureste, S.A. de C.V. (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. (Ferrovalle), thereby providing Ferrosur with more efficient access to certain

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Mexico City industries. As a result of having to grant trackage rights to other railroads, we incur additional maintenance costs and lose the flexibility of using a portion of our tracks at all times.

Ferromex, the operator of the largest railway system in Mexico, is in close proximity to KCSM s rail lines. In particular, KCSM has experienced and continues to experience competition from Ferromex with respect to the transport of a variety of products. The rail lines operated by Ferromex run from Guadalajara and Mexico City to four U.S. border crossings west of the Nuevo Laredo-Laredo crossing, providing an alternative to KCSM s routes for the transport of freight from those cities to the U.S. border. In addition, Ferromex directly competes with KCSM in some areas of its service territory, including Tampico, Saltillo, Monterrey and Mexico City. Ferrosur competes directly with KCSM for traffic to and from southeastern Mexico. Ferrosur, like KCSM, also services Mexico City, Puebla and Veracruz.

In November 2005, Grupo México, the controlling shareholder of Ferromex, acquired all of the shares of Ferrosur. The common control of Ferromex and Ferrosur would give Grupo México control over a nationwide railway system in Mexico and ownership of 50% of the shares of Ferrovalle. The merger between Ferromex and Ferrosur has been declared illegal by the Mexican Antitrust Commission. Both Ferromex and Ferrosur have challenged this ruling. There can be no assurance as to whether Grupo México will be successful in challenging this ruling. If Grupo México is successful in its appeal, KCSM s competitive position may be harmed.

On August 3, 2006, the Mexican Antitrust Commission announced an investigation into possible antitrust practices in the provision of rail cargo services. The targets of that investigation have not been identified, and while KCSM may be required to provide information in connection with the investigation, we do not believe KCSM s operations are the subject of the inquiry, although there can be no assurance KCSM is not or would not become a subject of the inquiry.

Rate reductions by competitors could make our freight services less competitive, and we cannot assure you we would always be able to match these rate reductions. In recent years, we have experienced aggressive price competition from Ferromex in freight rates for agricultural products, which has adversely affected our results of operations. Our ability to respond to competitive pressures by decreasing our rates without adversely affecting our gross margins and operating results will depend on, among other things, our ability to reduce our operating costs. Our failure to respond to competitive pressures, and particularly rate competition, in a timely manner could have a material adverse effect on our financial condition.

In recent years, there has also 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. There can be no assurance that further consolidation in the railroad industry, whether in the United States or Mexico, will not have an adverse effect on our 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. Our operations are dependent on interchange, trackage rights, haulage rights and marketing agreements with other railroads and third parties that enable us to exchange traffic and utilize trackage we do not own. 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, or the failure to renew, these agreements could adversely affect our business, financial condition and results of operations. We are also 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, a significant portion of our grain shipments originate with another rail carrier pursuant to our marketing agreement with that carrier, and BNSF is our largest partner in the interchange of rail traffic. There can be no assurance that we will not be materially adversely affected by operational or financial difficulties of other railroads.

Pursuant to the Concession, KCSM is required to grant rights to use portions of its tracks to Ferromex, Ferrosur and Ferrovalle. Applicable law stipulates that Ferromex, Ferrosur and Ferrovalle are required to grant to KCSM rights to use portions of their tracks. KCSM s Concession classifies trackage rights as short trackage rights and long-distance trackage rights. Although all of these trackage rights have been granted under the Concession, no railroad has actually operated under the long-distance trackage rights because the means of setting rates for usage and often related terms of usage have not been agreed upon. Under the Mexican railroad services law and regulations, the rates KCSM may charge for the right to use its tracks must be agreed upon in writing between KCSM and the party to which those rights are granted. However, if KCSM cannot reach an agreement on rates with rail carriers entitled to trackage rights on KCSM s rail lines, the Mexican Ministry of Communications and Transportation (SCT) is entitled to set the rates in accordance with Mexican law and regulation, which rates may not adequately compensate KCSM. KCSM 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. KCSM and Ferromex are involved in civil, commercial and administrative proceedings in connection with amounts payable to each other for interline services, haulage and trackage rights. On March 13, 2002, the SCT issued a ruling setting the rates for trackage and haulage rights. On August 5, 2002, the SCT issued a ruling setting the rates for interline and terminal services. KCSM and Ferromex appealed both rulings to the Mexican Supreme Court. KCSM and Ferromex also requested and obtained a suspension of the effectiveness of the SCT rulings pending resolution of the litigation. In February 2006, the Mexican Supreme Court sustained KCSM s appeal of the SCT s trackage and haulage rights ruling, vacated the SCT ruling and ordered the SCT to issue a new ruling consistent with the Court s opinion. We have not yet received the written opinion of the Mexican Supreme Court on the February 2006 ruling, nor has the Court decided the interline and terminal services appeal. On October 2, 2006, KCSM was served with a claim by Ferromex asking for information concerning the interline traffic between KCSM and Ferromex from January 1, 2002 to December 31, 2004. KCSM has filed an answer to this claim. We cannot predict the ultimate outcome of these matters, or whether the rates KCSM is ultimately permitted to charge will be sufficient to compensate it.

We are highly leveraged and have significant debt service obligations. Our leverage could adversely affect our ability to fulfill obligations under various debt instruments and operate our business.

Our level of debt could make it more difficult for us to borrow money in the future, reduces the amount of money available to finance our operations and other business activities, exposes us to the risk of increased interest rates, makes us more vulnerable to general economic downturns and adverse industry conditions, and could reduce our flexibility in planning for, or responding to, changing business and economic conditions. Our failure to comply with the financial and other restrictive covenants in our debt instruments, which, among other things, require us to maintain specified financial ratios and limit our ability to incur debt and sell assets, could result in an event of default that, if not cured or waived, could have a material adverse effect on our business or prospects. If we do not have enough cash to service our debt, meet other obligations and fund other liquidity needs, we may be required to take actions such as reducing or delaying capital expenditures, selling assets, restructuring or refinancing all or part of our existing debt, or seeking additional equity capital. We cannot assure you that any of these remedies, including obtaining appropriate waivers from our lenders, can be effected on commercially reasonable terms or at all. In addition, the terms of existing or future debt agreements may restrict us from adopting any of these alternatives.

The indebtedness of KCSM exposes us to risks of exchange rate fluctuations, because any devaluation of the peso would cause the cost of KCSM s dollar-denominated debt to increase, and could place us at a competitive disadvantage in Mexico compared to our Mexican competitors that have less debt and greater operating and financing flexibility than KCSM does.

Our business is capital intensive.

Our business is capital intensive and requires substantial ongoing expenditures for, among other things, additions and improvements to roadway, structures and technology, acquisitions, and maintenance and repair of our equipment and rail system. Our failure to make necessary capital expenditures to maintain our operations could impair our ability to serve our existing customers or accommodate increases in traffic volumes.

We have funded, and expect to continue to fund, capital expenditures with funds from operating cash flows, debt, leases and, to a lesser extent, vendor financing. We may not be able to generate sufficient cash flows from our operations or obtain sufficient funds from external sources to fund our capital expenditure requirements. If financing is available, it may not be obtainable on terms acceptable to us and within the limitations contained in the indentures and other agreements relating to our debt.

KCSM s Concession from the Mexican government requires KCSM to make investments and undertake capital projects, including capital projects described in a business plan filed every five years with the SCT. If KCSM is unable to make such capital investments, KCSM s business plan commitments with the Mexican government may be at risk, requiring KCSM to seek waivers of its business plan, if possible. KCSM may defer capital expenditures under its business plan with the permission of the SCT. However, the SCT might not grant this permission, and any failure by KCSM to comply with the capital investment commitments in its business plan could result in sanctions imposed by the SCT. We cannot assure you that the Mexican government would grant any such permission or waiver. If such permission or waiver is not obtained in any instance and KCSM is sanctioned, its Concession might be at risk of revocation, which would adversely affect our financial condition and results of operations. See KCSM s Mexican Concession is subject to revocation or termination in certain circumstances below.

Our business 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 and Mexican economies affect the businesses served by us. PCRC and Panarail are directly affected by the Panamanian local economy. Our investments in Mexico and Panama expose us to risks associated with operating in Mexico and Panama, including, among others, cultural differences, varying labor and operating practices, political risk and differences between the United States, Mexican and Panamanian economies. 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.

Our operations may also be affected by natural disasters or adverse weather conditions. We operate in and along the Gulf Coast of the United States, and our facilities may be adversely affected by hurricanes and other extreme weather conditions. For example, hurricanes have adversely affected some of our shippers located along the Gulf Coast and caused interruptions in the flow of traffic within the southern United States and between the United States and Mexico. As another example, a weak harvest in the Midwest may substantially reduce the volume of business handled for agricultural products customers. Many of the goods and commodities we transport 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. 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, results of operations and cash flows.

The transportation industry is highly cyclical, generally tracking the cycles of the world economy. Although transportation markets are affected by general economic conditions, there are numerous specific factors within each particular market segment that may influence operating results. Some of our customers do business in industries that are highly cyclical, including the oil and gas, automotive, housing and agricultural industries. Any downturn in these industries could have a material adverse effect on our operating results. Also, some of the products we transport have had a historical pattern of price cyclicality 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, our financial condition or results.

Our business is subject to regulation by international, federal, state and local regulatory agencies. Our failure to comply with these regulations could have a material adverse effect on our operations.

We are subject to governmental regulation by international, federal, state and local regulatory agencies with respect to our railroad operations, as well as a variety of health, safety, labor, environmental, and other matters. Government regulation of the railroad industry is a significant determinant of the competitiveness and profitability of railroads. Our failure to comply with applicable laws and regulations could have a material adverse effect on our operations, including limitations on our operating activities until compliance with applicable requirements is achieved. These government agencies may change the legislative or regulatory framework within which we operate without providing any recourse for any adverse effects on our business that occur as a result of such change. Additionally, some of the regulations require us to obtain and maintain various licenses, permits and other authorizations, and we cannot assure you that we will continue to be able to do so.

Our business is subject to environmental, health and safety laws and regulations that could require us to incur material costs or liabilities relating to environmental, health or safety compliance or remediation.

Our operations are subject to extensive international, federal, state and local environmental, health and safety laws and regulations concerning, among other things, emissions to the air, discharges to waters, the handling, storage, transportation and disposal of waste and other materials, the cleanup of hazardous material or petroleum releases, decommissioning of underground storage tanks and noise pollution. Violations of these laws and regulations can result in substantial penalties, permit revocations, facility shutdowns and other civil and criminal sanctions. From time to time, certain of our facilities have not been in compliance with environmental, health and safety laws and regulations and there can be no assurances that we will always be in compliance with such laws and regulations in the future. We incur, and expect to continue to incur, environmental compliance costs, including, in particular, costs necessary to maintain compliance with requirements governing chemical and hazardous material shipping operations, refueling operations and repair facilities. 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 could have a material adverse effect on our business, results of operations, financial condition and cash flows.

In the operation of a railroad, it is possible that derailments, explosions or other accidents may occur that could cause harm to the environment or to human life or health. As a result, we may incur costs in the future, which may be material, to address any such harm, including costs relating to the performance of clean-ups, natural resources damages and compensatory or punitive damages relating to harm to property or individuals.

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 joint, strict and several 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 where hazardous substances have been released and persons that arranged for the disposal or treatment of hazardous substances. 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. Given the nature of our business, we presently have environmental investigation and remediation obligations at certain sites, including a former foundry site in Alexandria, Louisiana, and will likely incur such obligations at additional sites in the future. Liabilities accrued for environmental costs represent our best estimate of our probable future obligation for the remediation and settlement of these sites. Although the recorded liability includes our best estimate of all probable costs, clean-up costs can not be predicted with any certainty due to various factors such as evolving environmental laws and regulations, changes in technology, the extent of other parties participation, developments in environmental surveys and studies, and the extent of corrective action that may ultimately be required.

Our Mexican operations are subject to Mexican federal and state laws and regulations relating to the protection of the environment. The primary environmental law in Mexico is the General Law of Ecological Balance and Environmental Protection (the Ecological Law). The Mexican federal agency in charge of overseeing compliance with and enforcement of the Ecological Law is the Ministry of Environmental Protection and Natural Resources (Semarnat). The regulations issued under the Ecological Law and technical environmental requirements issued by Semarnat have promulgated standards for, among other things, water discharge, water supply, emissions, noise pollution, hazardous substances and transportation and handling of hazardous and solid waste. As part of its enforcement powers, Semarnat is empowered to bring administrative and criminal proceedings and impose economic sanctions against companies that violate environmental laws, and temporarily or even permanently close non-complying facilities. We are also subject to the laws of various jurisdictions and international conferences with respect to the discharge of materials into the environment. KCSM is also subject to environmental laws and regulations issued by the governments of each of the Mexican states in which KCSM s facilities are located. The terms of KCSM s Concession from the Mexican government also impose environmental compliance obligations on KCSM. We cannot predict the effect, if any, that the adoption of additional or more stringent environmental laws and regulations would have on KCSM s results of operations, cash flows or financial condition.

Our business is vulnerable to rising fuel costs and disruptions 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 operations and financial condition.

We incur substantial fuel costs in our railroad operations and these costs represent a significant portion of our transportation expenses. Significant price increases for fuel may have a material adverse effect on our operating results. Fuel expense increased from approximately 15% of our consolidated operating costs during the first nine months of 2005 to approximately 19% of our consolidated operating costs during the first nine months of 2006. We have been able to pass approximately 75% of these fuel cost increases on to customers in the form of fuel surcharges applied to our customer billings. If we are unable to continue the existing fuel surcharge program for KCSR and expand the fuel surcharge program for KCSM, our operating results could be materially adversely affected.

The U.S. Surface Transportation Board (STB) is currently evaluating potential changes in its standards for regulating fuel surcharge programs in our industry. We cannot predict the impact that any such changes may have on our business.

Fuel costs are affected by traffic levels, efficiency of operations and equipment, and petroleum market conditions. The supply and cost of fuel are subject to market conditions and are influenced by numerous factors beyond our control, including general economic conditions, world markets, government programs and regulations and competition. In addition, instability in the Middle East and interruptions in domestic production and refining due to hurricane damage may result in an increase in fuel prices. Fuel prices and supplies 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, a disruption of oil imports, weather events, war or otherwise, the resulting impact on fuel prices could materially adversely affect our operating results, financial condition and cash flows.

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

The loss of key personnel could negatively affect our business.

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

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A majority of our employees belong to labor unions. Strikes or work stoppages could adversely affect our operations.

We are a party to collective bargaining agreements with various labor unions in the United States and Mexico. As of September 30, 2006, approximately 81% of KCSR employees and approximately 74% of KCSM employees were covered by collective labor contracts. We may be subject to, among other things, strikes, work stoppages or work slowdowns as a result of disputes under these collective bargaining agreements and labor contracts or our potential inability to negotiate acceptable contracts with these unions. In the United States, because such agreements are generally negotiated on an industry-wide basis, determination of the terms and conditions of labor agreements have been and could continue to be beyond our control. We may, therefore, be subject to terms and conditions in industry-wide labor agreements that could have a material adverse affect on our results of operations, financial position and cash flows. If the unionized workers in the United States or Mexico were to engage in a strike, work stoppage or other slowdown, if other employees were to become unionized, or if the terms and conditions in future labor agreements were renegotiated, we could experience a significant disruption of our operations and higher ongoing labor costs. Although the U.S. Railway Labor Act imposes restrictions on the right of U.S. railway workers to strike, there is no law in Mexico imposing similar restrictions on the right of railway workers in that country to strike.

We face possible catastrophic loss and liability, and our insurance may not be sufficient to cover our damages or damages to others.

The operation of any railroad carries with it an inherent risk of catastrophe, mechanical failure, collision and property loss. In the course of our operations, spills or other environmental mishaps, cargo loss or damage, business interruption due to political developments, as well as labor disputes, strikes and adverse weather conditions, could result in a loss of revenues or increased liabilities and costs. Collisions, environmental mishaps or other accidents can cause serious bodily injury, death and extensive property damage, particularly when such accidents occur in heavily populated areas. Additionally, our 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 could have a material adverse effect on our operations and our financial condition. We have acquired insurance that is consistent with industry practice against the accident-related risks involved in the conduct of our 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 our 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, we may not be able to restore service without a significant interruption to operations and an adverse effect on our financial condition.

Our business may be affected by future acts of terrorism or war.

Terrorist attacks, such as those that occurred on September 11, 2001, any government response thereto and war or risk of war may adversely affect our results of operations, financial condition, and cash flows. These acts may also impact our ability to raise capital or our future business opportunities. Our rail lines and facilities could be direct targets or indirect casualties of acts of terror, which could cause significant business interruption and result in increased costs and liabilities and decreased revenues. These acts could have a material adverse effect on our results of operations, financial condition, and cash flows. In addition, insurance premiums charged for some or all of the terrorism coverage currently maintained by us could increase dramatically or certain coverage may not be available in the future.

KCSM s Mexican Concession is subject to revocation or termination in certain circumstances.

KCSM operates under a 50-year Concession granted by the Mexican government. The Concession gives KCSM exclusive rights to provide freight transportation services over its rail lines for 30 years of the 50-year Concession, subject to certain trackage rights. The SCT is principally responsible for regulating railroad services in Mexico. The SCT has broad powers to monitor KCSM s compliance with the Concession and it can require KCSM to supply it with any technical, administrative and financial information it requests. KCSM must comply with the investment commitments established in its business plan, which forms an integral part of the Concession, and must

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update the plan every five years. SCT treats KCSM s business plans confidentially, The SCT monitors KCSM s compliance with efficiency and safety standards established in the Concession. The SCT reviews, and may amend, these standards every five years.

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

The Concession is renewable for additional periods of up to 50 years, subject to certain conditions. The SCT may terminate the Concession if, among other things, there is an unjustified interruption in the operation of KCSM s rail lines, KCSM charges tariffs higher than the tariffs it has registered with the SCT, KCSM restricts the ability of other Mexican rail operators to use its rail lines, KCSM fails to make payments for damages caused during the performance of services, KCSM fails to comply with any term or condition of the Mexican railroad services law and regulations, KCSM fails to make the capital investments required under its five-year business plan filed with the SCT, or KCSM fails to maintain an obligations compliance bond and insurance overage as specified in the Mexican railroad services law and regulations. In addition, the Concession would revoke automatically if KCSM changes its nationality or assigns or creates any lien on the Concession without the SCT s approval. The SCT may also terminate the Concession as a result of KCSM s surrender of its rights under the Concession, or for reasons of public interest, by revocation or upon KCSM s liquidation or bankruptcy. Revocation or termination of the Concession would prevent KCSM from operating its railroad and would materially adversely affect our Mexican operations and ability to make payments on KCSM s debt. If the Concession is revoked by the SCT, KCSM would receive no revenue, and its interest in its rail lines and all other fixtures covered by the Concession, as well as all improvements made by it, would revert to the Mexican government.

In April 2006, the SCT initiated sanction proceedings against KCSM, claiming that KCSM had failed to make the minimum capital investments projected for 2004 and 2005 under its five-year business plan filed with the SCT. Although we believe KCSM made capital expenditures exceeding the amounts projected in its business plan for 2004 and 2005, the SCT has objected to the nature of the investments made by KCSM. KCSM has responded to the SCT by providing evidence in support of its investments and explaining why it believes sanctions are not appropriate. The SCT has not yet responded to KCSM s arguments. KCSM has further filed a request to amend its capital expenditure plan for 2006. KCSM will have the right to challenge a negative ruling by the SCT before the Administrative Federal Court, and, if necessary, the right to challenge any negative ruling by the Administrative Federal Court before a Federal Magistrate s Tribunal. However, if these proceedings are determined adversely to KCSM and sanctions are imposed, KCSM could be subject to fin