

KANSAS CITY SOUTHERN  
Form PRER14A  
February 07, 2005

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**SCHEDULE 14A**

**Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. 2)**

Filed by the registrant   
Filed by a party other than the registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to § 240.14a-12.

**Kansas City Southern**

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(Name of Registrant as Specified in its Charter)

**Not Applicable**

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(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of filing fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

- (1) Title of each class of securities to which transaction applies:
- (2) Aggregate number of securities to which transaction applies:
- (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:
- (4) Proposed maximum aggregate value of transaction:
- (5) Total fee paid:

Fee paid previously with preliminary materials.

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- Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed:

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**Table of Contents**

**KANSAS CITY SOUTHERN**

427 West 12th Street  
Kansas City, Missouri 64105

**NOTICE AND PROXY STATEMENT**

**for  
a Special Meeting of Stockholders  
to be held  
[March 29], 2005  
YOUR VOTE IS IMPORTANT!**

Please mark, date and sign the enclosed proxy card and promptly return it in the enclosed envelope, or vote by telephone or through the Internet as described on the proxy card.

**Mailing of this Notice and Proxy Statement and the accompanying enclosed**

**Proxy commenced on or about \_\_\_\_\_, 2005**

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Table of Contents

**KANSAS CITY SOUTHERN**

**427 West 12th Street  
Kansas City, Missouri 64105  
, 2005**

To Our Stockholders:

On April 20, 2003, Kansas City Southern ( KCS ) entered into an acquisition agreement with Grupo TMM, S.A. ( Grupo TMM ) under which KCS would acquire control of TFM, S.A. de C.V. ( TFM ) which operates one of the three major rail systems in Mexico. This acquisition agreement was not consummated due to disputes arising between the parties which led to litigation and arbitration. As a result of negotiations between KCS and Grupo TMM to resolve their dispute over the acquisition agreement, on December 15, 2004, KCS entered into an amended and restated acquisition agreement with Grupo TMM (the Acquisition Agreement ), amending certain terms of the original acquisition agreement.

In connection with this acquisition, KCS proposes to issue 18 million shares of common stock, plus an additional number of shares of common stock (the Additional Shares ) under certain circumstances and substantial cash payments. The Additional Shares will not exceed that number which, under an agreed upon formula, shall have a market value of \$171 million (which represents \$166 million in consideration and up to \$5 million in interest). Based on the closing price of \$17.64 for KCS common stock on the New York Stock Exchange on February 1, 2005, the market value of the 18 million shares would have been \$317,520,000.

Important information about this acquisition and related transactions is contained in the accompanying proxy materials.

A Special Meeting of Stockholders will be held at 10:00 a.m. on [Tuesday, March 29], 2005 at [the offices of KCS, 427 West 12th Street,] Kansas City, Missouri, to consider and approve the proposal described in the attached proxy statement.

Your vote is important. KCS's Board of Directors has recommended that you vote FOR the proposal contained in the proxy statement.

The proxy statement contains detailed information about the Special Meeting and the formal business to be acted upon by the stockholders. We urge you to read these proxy materials and to participate in the Special Meeting either in person or by proxy. ***Whether or not you plan to attend the meeting in person, please sign and return promptly the accompanying proxy card, in the envelope provided, to assure that your shares will be represented. Alternatively, you may cast your votes by telephone or through the Internet as described on the accompanying proxy card.***

Sincerely,

MICHAEL R. HAVERTY  
*Chairman of the Board, President  
and Chief Executive Officer*

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**Table of Contents**

**KANSAS CITY SOUTHERN**

**427 West 12th Street  
Kansas City, Missouri 64105**

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**NOTICE OF SPECIAL MEETING OF STOCKHOLDERS**

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A Special Meeting of the Stockholders of Kansas City Southern, a Delaware corporation ( KCS ), will be held at [the offices of KCS, 427 West 12th Street], Kansas City, Missouri, at 10:00 a.m. on [Tuesday, March 29], 2005, to consider and vote upon approval of the proposed issuance of 18 million shares of common stock, par value \$0.01 per share ( Common Stock ), plus an additional number of shares of Common Stock issuable under certain circumstances with a market value of up to \$171 million (which represents \$166 million in consideration and up to \$5 million in interest), pursuant to an amended and restated acquisition agreement with Grupo TMM, S.A. and others and related agreements, and upon such other business as may properly come before the Special Meeting and any adjournments thereof. Based on the closing price of \$17.64 for KCS Common Stock on the New York Stock Exchange on February 1, 2005, the market value of the 18 million shares would have been \$317,520,000. (At present, our Board of Directors is not aware of any other business that will be presented for consideration at the Special Meeting.)

The 18 million shares, together with \$200 million in cash, constitute a part of the purchase price for the shares of Grupo TFM to be acquired by KCS. The up to \$171 million of additional shares that may be issued consists of: (i) up to \$110 million (of which \$35 million may be paid in KCS Common Stock or cash) payable in the event of the resolution of certain disputes with the Mexican government; (ii) up to \$47 million in principal of, and up to \$5 million in interest on, KCS promissory notes placed in an escrow account to cover certain indemnity claims (all of which is payable in either KCS Common Stock or cash); and (iii) \$9 million payable to a consulting firm in the event of the resolution of certain disputes with the Mexican government (all of which is payable in either KCS Common Stock or cash).

Only holders of KCS Common Stock and holders of KCS Preferred Stock, \$25 par value per share, of record at the close of business on [February 7], 2005, are entitled to notice of and to vote at this meeting or any adjournment thereof. Holders of KCS Series C Preferred Stock do not have voting rights with respect to the proposal to be presented at this meeting. The list of stockholders entitled to vote at this meeting will be available for inspection during normal business hours in the office of KCS's Corporate Secretary at least 10 days prior to the date of the meeting.

By Order of the Board of Directors,

MICHAEL R. HAVERTY  
*Chairman of the Board, President  
and Chief Executive Officer*

The date of this notice is \_\_\_\_\_, 2005.

**Please date, sign and promptly return the enclosed proxy card, regardless of the number of shares you may own and whether or not you plan to attend the meeting in person. Alternatively, you may cast your votes by telephone or through the Internet as described on the accompanying proxy card. You may revoke your proxy and vote your shares in person if revoked in accordance with the procedures described in this notice and proxy statement. Please also indicate on your proxy card whether you plan to attend the Special Meeting.**

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Table of Contents

**KANSAS CITY SOUTHERN**

427 West 12th Street  
Kansas City, Missouri 64105

**PROXY STATEMENT**

**TABLE OF CONTENTS**

	<u>Page</u>
<u>INTRODUCTION</u>	1
<u>SUMMARY TERM SHEET FOR THE PROPOSAL</u>	1
<u>INFORMATION ABOUT THE SPECIAL MEETING</u>	8
<u>VOTING</u>	9
<u>BUSINESS OF KCS, TFM, AND TEX-MEX</u>	12
<u>KCS</u>	12
<u>TFM</u>	12
<u>Tex-Mex</u>	13
<u>BACKGROUND AND RECOMMENDATION</u>	15
<u>Background</u>	19
<u>Reasons for the Proposal</u>	19
<u>Opinion of Financial Advisor</u>	21
<u>Recommendation</u>	26
<u>PROPOSAL – PROPOSED ISSUANCE OF COMMON STOCK</u>	27
<u>Overview</u>	27
<u>Purpose and Effect of Proposed Issuance of Stock</u>	27
<u>Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements</u>	27
<u>The Acquisition Agreement</u>	28
<u>Ancillary Agreements</u>	34
<u>Stockholders Agreement</u>	34
<u>Registration Rights Agreement</u>	37
<u>Marketing and Services Agreement</u>	38
<u>Releases</u>	39
<u>Closing Escrow Agreement</u>	39
<u>Indemnity Escrow Agreement</u>	40
<u>VAT Escrow Agreement</u>	40
<u>Authority Litigation Agreement</u>	41
<u>Agreement of Assignment and Assumption of Rights, and Agency Agreement with Undisclosed Principal, Duties and Obligations</u>	41
<u>Other Agreements</u>	42
<u>First Amendment to Rights Agreement</u>	42
<u>Consulting Agreement</u>	42
<u>Consulting Compensation Escrow Agreement</u>	43
<u>Agreement regarding Sellers' indemnification of KCS Indemnitees</u>	44
<u>Regulatory Matters</u>	44
<u>Requirement for Stockholder Approval</u>	45
<u>Required Vote and Board of Directors' Recommendation</u>	45
<u>SELECTED FINANCIAL DATA</u>	46

**Table of Contents**

	<b><u>Page</u></b>
<u>Selected Historical Consolidated Financial Data of KCS</u>	46
<u>Selected Historical Combined and Consolidated Financial Data of Grupo TFM</u>	48
<u>UNAUDITED PRO FORMA SELECTED CONSOLIDATED FINANCIAL DATA</u>	49
<u>FINANCIAL STATEMENTS OF GRUPO TFM PRO FORMA FINANCIAL INFORMATION</u>	52
<u>PRINCIPAL STOCKHOLDERS AND STOCK OWNED BENEFICIALLY BY DIRECTORS AND CERTAIN EXECUTIVE OFFICERS</u>	69
<u>STOCKHOLDER PROPOSALS</u>	73
<u>SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE</u>	74
<u>HOUSEHOLDING OF SPECIAL MEETING MATERIALS</u>	74
<u>OTHER MATTERS</u>	74
<u>FORWARD-LOOKING STATEMENTS</u>	74
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	75
<u>DOCUMENTS INCORPORATED BY REFERENCE</u>	75
Exhibit 1 Grupo TFM Combined and Consolidated Financial Statements, December 31, 2001, 2002 and 2003	77
Exhibit 2 Grupo TFM Consolidated Financial Statements, September 30, 2004	110
APPENDICES:	
Appendix A Amended and Restated Acquisition Agreement, dated as of December 15, 2004, by among Kansas City Southern, KARA Sub, Inc., KCS Investment I, Ltd., KCS Acquisition Subsidiary, Inc., Caymex Transportation, Inc., Grupo TMM, S.A., TMM Holdings, S.A. de C.V., TMM Multimodal, S.A. de C.V. and Grupo Transportación Ferroviaria Mexicana, S.A. de C.V.	A-1
Appendix B Stockholders Agreement by and among Kansas City Southern, Grupo TMM, S.A., TMM Holdings, S.A. de C.V., TMM Multimodal, S.A. de C.V. and certain stockholders of Grupo TMM, S.A.	B-1
Appendix C Consulting Agreement by and between Kansas City Southern and José F. Serrano International Business, S.A. de C.V.	C-1
Appendix D Fairness Opinion of Morgan Stanley	D-1



**Table of Contents**

**INTRODUCTION**

The accompanying proxy is solicited by the Board of Directors of Kansas City Southern ( KCS ) from holders of KCS Common Stock, par value \$0.01 per share (the Common Stock ), and holders of KCS Preferred Stock, par value \$25.00 per share (the Preferred Stock ), as of the record date for use at the Special Meeting of Stockholders to be held at the time and place and for the purposes set forth in the accompanying notice. This proxy statement is first being mailed to stockholders on or about [ ], 2005.

**SUMMARY TERM SHEET FOR THE PROPOSAL**

*This summary term sheet for the proposal highlights selected information from this proxy statement regarding the proposal and may not contain all of the information that is important to you as a KCS stockholder. Accordingly, we encourage you to carefully read this entire document, including the appendices, and the documents to which we have referred you. You may obtain a copy of the documents to which we have referred you without charge by following the instructions in the section entitled Where You Can Find More Information.*

**Background and Reasons for the Proposal (Pages 15 through 20)**

Since 1997, pursuant to a joint venture agreement (which terminated on December 1, 2003), and other agreements, entered into by KCS and Grupo TMM, S.A. ( Grupo TMM ), subsidiaries of KCS and Grupo TMM have owned, along with Mexican governmental agencies, interests in Grupo Transportación Ferroviaria Mexicana, S.A. de C.V. ( Grupo TFM ).

Grupo TFM is the owner of 80% of the voting stock of TFM, S.A. de C.V. ( TFM ).

TFM holds the concession to operate, and operates, a major rail system in Mexico.

KCS currently owns 51% of the stock of Mexrail, Inc. ( Mexrail ), owner of 100% of the voting stock of The Texas-Mexican Railway Company ( Tex-Mex ). KCS has an exclusive option to purchase from TFM on or before October 31, 2005 the remaining 49% of the shares of Mexrail. If KCS does not exercise this option by October 31, 2005, KCS becomes obligated to purchase such remaining shares on October 31, 2005 at a purchase price of approximately \$31.4 million. See Proposal Proposed Issuance of Common Stock Regulatory Matters.

Tex-Mex operates a 157 mile rail line from Laredo to Corpus Christi, Texas, and connects the operations of The Kansas City Southern Railway Company ( KCSR ) with TFM.

Mexrail also owns the northern half of the international railway bridge at Laredo, Texas. TFM, through its concession with the Mexican government, has the right to control and operate the southern half of the rail-bridge at Nuevo Laredo.

The structure of this ownership prior to the execution of the Acquisition Agreement (with intermediate subsidiaries, except for KCSR and TMM Multimodal, S.A. de C.V. ( Multimodal ), eliminated), including KCSR s and Multimodal s imputed ownership from TFM s ownership of 24.6% of Grupo TFM, appears in the following diagram:

**Table of Contents**

On April 20, 2003, KCS and Grupo TMM entered into an agreement for the acquisition by KCS of control of TFM, referred to as the Original Acquisition Agreement. The Original Acquisition Agreement was not consummated due to disputes arising between the parties which led to litigation and arbitration. See Background and Recommendation Background. On December 15, 2004, KCS and Grupo TMM entered into an amended and restated acquisition agreement, referred to as the Acquisition Agreement, amending and restating the Original Acquisition Agreement.

The following diagram illustrates the ownership structure resulting if the acquisition of TFM (through the acquisition of all the interest of Grupo TMM (held by its subsidiary, Multimodal) in Grupo TFM) (the Acquisition ) is completed (eliminating intermediate subsidiaries).

- (1) Limited Voting. Mexican government has certain put rights discussed under Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements Ancillary Agreements Agreement of Assignment and Assumption of Rights, and Agency Agreement with Undisclosed Principal, Duties and Obligations.

## **Table of Contents**

### **Questions and Answers About the Proposal**

This question-and-answer section highlights important information in this proxy statement but does not contain all of the information that is important to you. You should read carefully this entire proxy statement, including the appendices, and the other documents we refer you to for a more complete understanding of the matters being considered at the Special Meeting. In addition, we incorporate by reference into this proxy statement important business and financial information about KCS. You may obtain the information incorporated by reference into this proxy statement without charge by following the instructions in the section entitled *Where You Can Find More Information*.

***Q: On what am I being asked to vote?***

A: You are being asked to approve the issuance of 18 million shares of Common Stock, and up to that additional number of shares of Common Stock, valued as described in this proxy statement, equal to \$171 million (which represents \$166 million in consideration and up to \$5 million in interest), in connection with our acquisition of control of TFM. See *Proposal Proposed Issuance of Common Stock*.

***Q: Why does KCS want to acquire additional interests in Grupo TFM?***

A: Grupo TFM owns 80 percent of the economic interest in TFM and all the shares of TFM entitled to full voting rights. KCS currently owns a 46.6% economic interest in Grupo TFM and 49.0% of the shares of Grupo TFM entitled to full voting rights. If KCS purchases the additional shares of Grupo TFM, it will have a controlling interest in Grupo TFM and, by virtue of Grupo TFM's ownership interest in TFM, KCS will have a controlling interest in TFM.

***Q: What is TFM?***

A: TFM holds the concession to operate a strategically significant corridor between Mexico and the United States, and has as its core route a key portion of the shortest, most direct rail passageways between Mexico City and the border crossing to Laredo, Texas. TFM's rail lines connect the most populated and industrialized regions of Mexico with Mexico's principal U.S. border railway gateway at Nuevo Laredo. In addition, TFM serves three of Mexico's primary seaports and 15 Mexican states and Mexico City, which together represent a majority of the country's population and account for a majority of its estimated gross domestic product.

***Q: What is the purpose of this Acquisition?***

A: The purpose of the Acquisition is to place TFM under the control of KCS which will also control KCSR, Gateway Eastern and Tex-Mex. KCS management believes that common control of these railroads, which are already physically linked in an end-to-end configuration, will enhance competition and give shippers in the North American Free Trade Agreement (NAFTA) trade corridor a strong transportation alternative as they make their decisions to move goods between the United States, Mexico and Canada. In addition, KCS management believes that this common control offers stockholders greater value through the operating efficiencies expected to come from common ownership and control.

***Q: Why is KCS stockholder approval necessary?***

A: The rules of the New York Stock Exchange require listed companies, such as KCS, to obtain stockholder approval before the issuance of common stock in any transaction or series of related transactions which amount to 20% or more of the listed company's issued and outstanding common stock. The proposed issuance of shares of Common Stock is expected to exceed 20% of KCS's issued and outstanding common stock.

***Q: Do I have appraisal rights if I oppose the Proposal?***

A: No. Under Delaware law, stockholders do not have the right to an appraisal of the value of their shares in connection with the Proposal.

***Q: What is the Board of Directors' recommendation on how to vote?***

A: The KCS Board of Directors has recommended that you vote FOR the Proposal.



**Table of Contents**

***Q: What will happen if the Proposal is not approved?***

A: KCS will not be able to take the actions proposed, and KCS will be required to dismiss with prejudice certain legal actions pending against Grupo TMM. If the Proposal is not approved, KCS may not be able to complete the Acquisition.

***Q: What effects will the proposed issuances of Common Stock have on KCS stockholders?***

A: The proposed issuance of Common Stock will result in dilution in the percentage ownership interest of KCS's existing stockholders. The amount of such dilution cannot be determined until the time of issuance; however, if KCS had issued, as of September 30, 2004, the maximum number of shares of Common Stock contemplated by the Acquisition Agreement and by the Consulting Agreement, assuming a price of \$16.91 per share (based on the average trading price per share for KCS Common Stock on the New York Stock Exchange, as reported on Bloomberg (VAP function), for the 20 consecutive trading days immediately preceding December 21, 2004), which would aggregate approximately 28.1 million shares, then based upon approximately 62.7 million shares of Common Stock outstanding as of September 30, 2004 and a book value per share then of \$12.54, the shares of Common Stock outstanding would have increased by approximately 44.8%, and the book value per share of Common Stock would have decreased, from \$12.54 to \$12.01. These results may be different at the time the Acquisition is completed.

***Q: Who can help answer other questions I may have?***

A: If you have any questions concerning the Proposals or the Special Meeting, or if you would like additional copies of the proxy statement, please contact the Senior Vice President and General Counsel of KCS at 816-983-1370.

**The Proposal**

You are being asked to consider and vote upon approval of the proposal to authorize our issuance of shares of KCS Common Stock in connection with the Acquisition, as described in more detail below.

***Proposed Issuance of Common Stock (Pages 27 through 45)***

We propose to issue shares of Common Stock, along with the payment of cash, to acquire control of TFM, in accordance with the terms of the Acquisition Agreement. Pursuant to the Acquisition Agreement and related agreements, we propose to issue 18 million shares of KCS Common Stock, and an additional number of shares of KCS Common Stock (the *Additional Shares*) with a market value of up to \$171 million (which represents \$166 million in consideration and up to \$5 million in interest payable on certain promissory notes). Based on the closing price of \$17.64 for KCS Common Stock on the New York Stock Exchange, or NYSE, on February 1, 2005, the market value of the 18 million shares would have been \$317,520,000. The terms and conditions of these stock issuances and related transactions are set forth in the Acquisition Agreement, related ancillary agreements (the *Ancillary Agreements*) and other agreements described below. See *Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements*.

***Acquisition Agreement (Pages 28 to 34 and Appendix A)***

Pursuant to the Acquisition Agreement, KCS will acquire all of the interest of Grupo TMM (held by its subsidiary, Multimodal) in Grupo TFM for the following consideration at the closing of the Acquisition (the *Closing*):

\$200 million in cash;

18 million shares of KCS Common Stock, the market value of which would have been \$317,520,000 based on the closing price of \$17.64 for KCS Common Stock on the NYSE on February 1, 2005; and

KCS promissory notes in the aggregate principal amount of \$47 million (the *Indemnity Escrow Notes*) which will be deposited in an escrow account and held, reduced and released in accordance

**Table of Contents**

with the terms of an indemnity escrow agreement (the Indemnity Escrow Agreement ). KCS may convert the remaining balance due under the Indemnity Escrow Notes, including accrued and unpaid interest of up to \$5 million, into shares of KCS Common Stock on the terms set forth in the Indemnity Escrow Notes. See Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements Ancillary Agreements Indemnity Escrow Agreement.

In addition, upon a positive resolution of certain proceedings related to TFM s value added tax ( VAT ) claim ( VAT Claim ) and the Mexican government s right under certain circumstances to compel the purchase of its 20% interest in TFM (the Put ), KCS will pay to Multimodal up to \$110 million in cash and KCS Common Stock (referred to as the VAT Contingency Payment ). See Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements The Acquisition Agreement . 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 ).

Upon completion of the Acquisition, KCS will assume Grupo TMM s rights and obligations to make any payment upon the exercise by the Mexican government of its right to compel the purchase of its 20% interest in TFM in accordance with the applicable agreements (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 Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements Ancillary Agreements Agreement of Assignment and Assumption of Rights, and Agency Agreement with Undisclosed Principal, Duties and Obligations.

The obligations of KCS and Grupo TMM to complete the Acquisition are subject, in addition to standard conditions, to the following conditions:

Approval by KCS s stockholders of issuance of KCS Common Stock (described in Proposal);

Obtaining required consents, waivers, authorizations and approvals from governmental authorities;

Approval for listing on the New York Stock Exchange of the KCS Common Stock to be issued in connection with the Acquisition;

Absence of any legal or judicial restraints or prohibitions preventing consummation of the Acquisition;

Absence of any insolvency or bankruptcy proceeding against Grupo TMM, Multimodal, TMM Holdings, S.A. de C.V. ( TMM Holdings ), Grupo TFM or TFM; and

Eligibility for release of certain of the documents from an escrow account (the Closing Escrow ), subject only to the occurrence of the Closing.

See Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements The Acquisition Agreement.

The Acquisition Agreement also contains indemnification provisions pursuant to which the parties will indemnify each other and certain of their affiliates against certain losses and tax liabilities. KCS and Grupo TMM have also agreed that upon Closing of the Acquisition substantially all litigation between them will be dismissed.

The Acquisition Agreement is subject to termination prior to the Closing under certain circumstances. A termination fee of \$18 million may be payable in the event of termination of the Acquisition Agreement due to certain circumstances. See Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements The Acquisition Agreement Termination.

**Table of Contents**

***Ancillary Agreements (Pages 34 to 42 and Appendix B)***

Certain Ancillary Agreements have also been entered into by certain of the parties, including the following which will become effective as of the date of the Closing (the Closing Date):

*Stockholders Agreement.* Under this agreement, Grupo TMM and certain of its subsidiaries and principal stockholders (the Principal Stockholders), and their respective affiliates who are then holders of KCS Common Stock (collectively, the TMM Holders) are subject to provisions which restrict transfer and certain acquisitions of, and provide pre-emptive rights with respect to, shares of KCS Common Stock, and which restrict certain activities aimed at influencing the control and management of KCS by Grupo TMM. The Stockholders Agreement also requires the TMM Holders to vote their shares of KCS in favor of the KCS Board of Directors slate of director nominees and against any proposal to remove any director nominated by the KCS Nominating and Corporate Governance Committee (the Nominating Committee) and elected to the KCS Board of Directors by KCS stockholders. Subject to specific termination provisions contained in the Stockholders Agreement, the agreement (with a few exceptions) terminates when the TMM Holders' ownership, for 30 consecutive days, falls below 40% of the voting securities of KCS initially acquired pursuant to the Merger. A copy of this agreement is attached as Appendix B.

*Registration Rights Agreement.* This agreement provides Grupo TMM, Multimodal, certain of the Principal Stockholders and Permitted Transferees (as defined in the Registration Rights Agreement) (collectively, the Holders) with registration rights with respect to the shares of KCS Common Stock to be issued pursuant to the Acquisition Agreement and the Consulting Agreement and shares otherwise acquired upon the exercise of pre-emptive rights in compliance with the Stockholders Agreement. Pursuant to the terms and conditions of the Registration Rights Agreement, the Holders will have the right to request up to six demand registrations upon the request of Holders of 10% or more of the shares of Registrable Stock. However, KCS will not be required to file more than one shelf registration. The Holders will also be entitled to unlimited incidental, or piggy-back, registrations. The registration rights under this agreement terminate as to any Holder on the earliest to occur of (i) five years after the Closing and (ii) such time as the Holder is free to sell its shares of Registrable Stock without registration under the Securities Act of 1933 and without restriction as to the manner of sale. This agreement also contains certain indemnification provisions under which KCS will be obligated to indemnify certain persons against certain losses and KCS will be entitled to indemnification against certain losses from the Holders. See Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements Ancillary Agreements Registration Rights Agreement.

***Other Agreements (Pages 42 to 44 and Appendix C)***

KCS has entered into other agreements with Grupo TMM and certain of its affiliates, including the consulting agreement summarized below, entered into on the same date as the Acquisition Agreement to become effective as of the Closing Date.

*Consulting Agreement.* This agreement provides for José F. Serrano International Business, S.A. de C.V. (the Consulting Firm) to provide certain consulting services to the KCS Board of Directors. José Serrano Segovia, the Chairman and Chief Executive Officer of Grupo TMM and the current Chairman of TFM and Grupo TFM, is required under the terms of the Consulting Agreement to be personally involved in the provision of services by the consulting firm. The Consulting Agreement has a term of three years commencing on the first business day following the Closing Date. Subject to the limitations set forth in the Consulting Agreement, KCS will pay to the Consulting Firm an annual fee of \$3,000,000 in cash. In addition, upon the resolution of certain disputes with the Mexican government, KCS will pay to the Consulting Firm \$9,000,000 (the VAT Claim and Put Advisory Fee). Such amount may be paid, at KCS's election, in cash or KCS Common Stock. The Consulting Agreement contains certain restrictions on transfer of shares of KCS Common Stock. A copy of this agreement is attached as Appendix C. See Proposal Proposed Issuance of Common Stock

**Table of Contents**

Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements    Other Agreements    Consulting Agreement.

**Fairness Opinion (Pages 21 to 26 and Appendix D)**

Morgan Stanley & Co. Incorporated, ( Morgan Stanley ) acted as financial advisor to KCS in connection with the Acquisition. At a December 14, 2004 meeting of the KCS Board of Directors, Morgan Stanley delivered an oral opinion, subsequently confirmed in writing, that, as of that date and based upon and subject to the assumptions made, matters considered and limits of the review undertaken by Morgan Stanley, the consideration to be paid by KCS in the Acquisition was fair, from a financial point of view, to KCS. For purposes of its opinion, the consideration to be paid by KCS included the stock consideration, the cash consideration, any amounts that could become payable pursuant to the VAT Contingency Payment to Multimodal, the cash consideration for the consulting services and any amount that could become payable as a fee for advisory services in connection with the Final Resolution of the VAT Claim and Put to Consulting Firm pursuant to the Consulting Agreement, subject to certain assumptions and conditions. The full text of the written opinion of Morgan Stanley is attached hereto as Appendix D. KCS encourages you to read the opinion carefully, as well as the description of the analyses on which it was based.

**Vote Required to Approve the Proposal (Pages 9 and 45)**

Approval of the Proposal will require the affirmative vote of the holders of a majority of the outstanding shares of KCS Common Stock and of Preferred Stock present in person or represented by proxy and entitled to vote on these matters, voting together as a single class, provided a quorum is present. The Series C Preferred Stock is not entitled to vote on the Proposal.



**Table of Contents**

**INFORMATION ABOUT THE SPECIAL MEETING**

**Why Were KCS's Stockholders Sent this Proxy Statement?**

KCS is mailing this proxy statement on or about \_\_\_\_\_, 2005 to its stockholders of record on [February 7], 2005 in connection with KCS's Board of Directors' solicitation of proxies for use at a Special Meeting of Stockholders and any adjournment thereof (the "Special Meeting"). The Special Meeting will be held at [the offices of KCS, 427 West 12th Street], Kansas City, Missouri, on [Tuesday, March 29], 2005 at 10:00 a.m. The Notice of Special Meeting of Stockholders and a proxy card accompany this proxy statement.

KCS will pay for the Special Meeting, including the cost of mailing the proxy materials and any supplemental materials. Directors, officers and employees of KCS may, either in person, by telephone or otherwise, also solicit proxy cards. They have not been specifically engaged for that purpose, nor will they be compensated for their efforts. [Strategic Stock Surveillance, LLC] has been retained and will be paid by KCS to assist in the solicitation of proxies at a cost not expected to exceed [\$7,000], plus expenses. In addition, KCS may reimburse brokerage firms and other persons representing beneficial owners of KCS shares for their expenses in forwarding this proxy statement and other soliciting materials to the beneficial owners.

Brokers, dealers, banks, voting trustees, other custodians and their nominees are asked to forward this notice and proxy statement and the proxy card to the beneficial owners of KCS's stock held of record by them. Upon request, KCS will reimburse them for their reasonable expenses in completing the mailing of the materials to beneficial owners of our stock.

**Who May Attend the Special Meeting?**

Only KCS stockholders or their proxies and guests of KCS may attend the Special Meeting. Any stockholder or stockholder's representative who, because of a disability, may need special assistance or accommodation to allow him or her to participate in the Special Meeting may request reasonable assistance or accommodation from KCS by contacting the office of the Corporate Secretary at KCS's principal executive offices, (816) 983-1538. If written requests are made to the Corporate Secretary of KCS, they should be mailed to P.O. Box 219335, Kansas City, Missouri 64121-9335 (or if by United Parcel Service or other form of express delivery to 427 West 12th Street, Kansas City, Missouri 64105). To provide KCS sufficient time to arrange for reasonable assistance, please submit all requests by \_\_\_\_\_, 2005.

**What Matters Will Be Considered at the Special Meeting?**

At the Special Meeting, stockholders will consider and vote upon a proposal to issue 18,000,000 shares of Common Stock and up to that additional number of shares of Common Stock equal to \$171 million (which represents \$166 million in consideration and up to \$5 million in interest payable on the Indemnity Escrow Notes), calculated at the price set forth in the applicable agreement. Based on the closing price of \$17.64 for KCS Common Stock on the NYSE on February 1, 2005, the market value of the 18 million shares would have been \$317,520,000. These matters have been proposed by the Board of Directors. The Board of Directors knows of no other matters that will be presented or voted on at the Special Meeting.

**Table of Contents**

**VOTING**

**Which Stockholders May Vote at the Special Meeting?**

Only the holders of record at the close of business on [February 7], 2005 (the Record Date ), of the Common Stock and the holders of the Preferred Stock, are entitled to notice of and to vote at the Special Meeting. On the Record Date, KCS had outstanding [ ] shares of Common Stock and 242,170 shares of Preferred Stock for a total of [ ] shares eligible to be voted at the Special Meeting. The holders of Series C Preferred Stock will not have any right to vote on the matter known to be presented at the Special Meeting. Holders of the Series C Preferred Stock only have contingent voting rights, as in the case of a dividend or redemption payment default, as set forth in KCS's Restated Certificate of Incorporation and as otherwise required by law.

The Common Stock and the Preferred Stock (collectively, the Voting Stock ) constitute KCS's only voting securities which are entitled to vote at the Special Meeting and will vote together as a single class on all matters to be considered at the Special Meeting. Each holder of Voting Stock is entitled to cast one vote for each share of Voting Stock held on the Record Date on all matters. Internet and telephone voting are also available, and the accompanying form of proxy contains the Internet address and toll-free telephone number.

**How Does KCS Decide Whether Its Stockholders Have Approved the Proposal?**

Stockholders owning at least a majority of the shares of Voting Stock entitled to vote must be present in person or represented by proxy to constitute a quorum for the transaction of business at the Special Meeting. The shares of a stockholder who is present and entitled to vote at the Special Meeting, either in person or through a proxy, are counted for purposes of determining whether there is a quorum, regardless of whether the stockholder votes the shares. Abstentions and broker non-votes (defined below) are counted as present and entitled to vote for purposes of determining a quorum.

For the Proposal to be voted on at the Special Meeting, the affirmative vote of the holders of a majority of the outstanding shares of KCS Common Stock and of Preferred Stock present in person or represented by proxy and entitled to vote on the Proposal to approve the issuance of Common Stock, voting together as a single class, assuming a quorum is present, is required for the adoption of the Proposal.

Voting ceases when the chairman of the Special Meeting closes the polls. The votes are counted and certified by inspectors appointed by the Board of Directors of KCS in advance of the Special Meeting. In determining whether a majority of shares have been affirmatively voted for the Proposal, the affirmative votes for the Proposal are measured against the votes for and against the Proposal plus the abstentions from voting on the Proposal. In other words, abstentions will have the effect of votes against the Proposal.

**What if a Stockholder Holds Shares in a Brokerage Account?**

The Voting Stock is traded on the New York Stock Exchange, Inc. (the NYSE ). Under the rules of the NYSE, member stockbrokers who hold shares of Voting Stock in the broker's name for customers are required to get directions from the customers on how to vote their shares. NYSE rules also permit brokers to vote shares on certain proposals when they have not received any directions. The Staff of the NYSE, prior to the Special Meeting, informs the brokers whether or not the brokers are entitled to vote the undirected shares on the Proposal. KCS does not believe that brokers will be permitted to vote on the Proposal if they have not received directions from their customers.

A broker non-vote occurs when a broker holding shares of Voting Stock for a beneficial owner does not vote on a particular proposal because the broker does not have discretionary voting power for that particular item and has not received instructions from the beneficial owner (customer directed abstentions are not broker non-votes). Broker non-votes generally do not affect the determination of whether a quorum is present at the Special Meeting because, in most cases, some of the shares held in the broker's name have been voted, and, therefore, all of those shares are considered present at the Special Meeting. Under applicable law, a broker

**Table of Contents**

non-vote will not be considered present and entitled to vote on non-discretionary items and will have no effect on the vote.

**How may a Stockholder Vote by Proxy?**

Stockholders may vote by proxy in three ways, each of which is valid under Delaware law.

*By Internet:* Access our Internet voting site at <http://www.eproxyvote.com/ksu> and follow the instructions on the screen, prior to 5:00 p.m., central time, \_\_\_\_\_, 2005.

*By Telephone:* Using a touch-tone telephone, call toll-free 1-800-758-6573 and follow the voice instructions, prior to 5:00 p.m., central time, \_\_\_\_\_, 2005.

*By Mail:* Mark, sign, date and return the enclosed proxy or instruction card. Only proxy cards received prior to 5:00 p.m., central time, on \_\_\_\_\_, 2005, will be counted.

**How are a Stockholder's Shares Voted if the Stockholder Submits a Proxy?**

Stockholders who return a properly executed proxy card or properly vote via the Internet or telephone are appointing the Proxy Committee to vote their shares of Voting Stock covered by the Proxy. That Committee consists of the three directors of KCS whose names are listed on the related proxy card. A stockholder wishing to name as his, her or its proxy someone other than the Proxy Committee designated on the proxy card may do so by crossing out the names of the designated proxies and inserting the name of another person. In that case, it will be necessary for the stockholder to sign the proxy card and deliver it to the person so named and for that person to be present and vote at the Special Meeting. Proxy cards so marked should *not* be mailed directly to KCS.

The Proxy Committee will vote the shares of Voting Stock covered by a proxy in accordance with the instructions given by the stockholders executing the proxy(1) or authorizing the proxy and voting by Internet or telephone. If a properly executed, or authorized, and unrevoked proxy solicited hereunder does not specify how the shares represented thereby are to be voted, the Proxy Committee intends to vote the shares **FOR** the Proposal to issue shares of Common Stock, and in accordance with their discretion upon such other matters as may properly come before the Special Meeting.

**May a Stockholder Revoke His or Her Proxy or Voting Instruction Card?**

Yes. At any time before the polls for the Special Meeting are closed, a stockholder who holds stock in his or her name may revoke a properly executed or authorized proxy by (a) an Internet or telephone vote subsequent to the date shown on a previously executed and delivered proxy or to the date of a prior electronic vote or telephone vote, or (b) with a later-dated, properly executed and delivered proxy, or (c) a written revocation delivered to the Corporate Secretary of KCS. A stockholder who holds stock in a brokerage account must contact the broker and comply with the broker's procedures if he or she wants to revoke or change the instructions that the stockholder returned to the broker. Attendance at the Special Meeting will not have the effect of revoking a properly executed or authorized proxy unless the stockholder delivers a written revocation to the Corporate Secretary before the proxy is voted.

**How do Participants in KCS's or DST Systems, Inc.'s Employee Stock Ownership Plans, in KCS's 401(k) and Profit Sharing Plan, in the Janus 401(k), Profit Sharing and Employee Stock Ownership Plan, or in KCS's union 401(k) plans Vote?**

Participants in KCS's and DST Systems, Inc.'s employee stock ownership plans ( ESOPs ), in KCS's 401(k) and Profit Sharing Plans ( 401(k) Plan ), in the Janus 401(k), Profit Sharing and Employee Stock Ownership Plan ( Janus Plan, formerly the Stilwell Financial Inc. 401(k) and Profit Sharing Plan) and in

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(1) Internet and telephone voting are also available, and the accompanying form of proxy contains the Internet address and toll-free telephone number.

**Table of Contents**

KCS's union 401(k) plans ( Union Plans ) are each provided a separate voting instruction card (accompanying this proxy statement) to instruct the respective trustees of these ESOPs, 401(k) Plan, Janus Plan and Union Plans how to vote the shares of Common Stock held on behalf of the participant.<sup>2</sup> The trustee is required under the trust agreements to vote the shares in accordance with the instructions indicated on the voting instruction card.<sup>2</sup> If voting instructions are not given by the participant, the trustee must vote those shares, as well as any unallocated shares, in the same proportions as the shares for which voting instructions were received from the plan participants. Unless giving voting instructions by Internet or telephone, the voting instruction card should be returned in the envelope provided to UMB Bank, N.A., Securities Transfer Division, P.O. Box 410064, Kansas City, Missouri 64179-0013. *The voting instruction card should not be returned to KCS, Janus Capital Group Inc. ( Janus ) or DST Systems, Inc. ( DST ).* ESOP participants, 401(k) Plan participants, Janus Plan participants and Union Plan participants who wish to revoke their voting instructions must contact the trustee and follow its procedures.

**Are the Votes of Participants in the ESOPs, the 401(k) Plan, the Janus Plan and the Union Plans Confidential?**

Under the terms of the ESOPs, the 401(k) Plan, the Janus Plan and the Union Plans, the trustee is required to establish procedures to ensure that the instructions received from participants are held in confidence and not divulged, released or otherwise utilized in a manner that might influence the participants' free exercise of their voting rights.

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(2) Voting instructions may also be given by Internet or telephone by participants in the KCS and DST ESOPs and the KCS 401(k) and Profit Sharing Plan, and the accompanying voting instruction card relating to such plans contains the Internet address and toll-free number.

**Table of Contents**

**BUSINESS OF KCS, TFM AND TEX-MEX**

**KCS**

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 \$272 million, as indexed for inflation). Our rail network (KCSR, TFM and Tex-Mex) comprises approximately 6,000 miles of main and branch lines extending from the midwest portions of the United States south into Mexico. We have further expanded our rail network through marketing alliances and a strategic alliance.

Our expanded network includes:

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, and 1,250 miles of other tracks in a ten state region that includes Missouri, Kansas, Arkansas, Oklahoma, Mississippi, Alabama, Tennessee, Louisiana, Texas and Illinois;

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 and three of its major shipping ports, and Tex-Mex, which operates a 157-mile rail line extending from Laredo to the port city of Corpus Christi, Texas and connects the operations of KCSR with TFM;

marketing agreements 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 the Iowa, Chicago & Eastern Railroad Corporation ( IC&E ), that provides us with access to Minneapolis, Minnesota and Chicago, Illinois and to the origination of corn and other grain in Iowa, Minnesota and Illinois;

a strategic alliance with Canadian National Railway Company ( CN ) and Illinois Central Corporation ( IC, and together with CN, CN/ IC ), through which 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;

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; and

our affiliate, the Panama Canal Railway Company ( PCRC ), which holds the concession to operate the Panama Canal Railway, a 47-mile coast-to-coast 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 ( Panarail ), operates a commuter and tourist railway service over the lines of the Panama Canal Railway.

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.

**TFM**

TFM is 80% owned by Grupo TFM, which holds all of the TFM Voting Stock. The remaining 20% economic interest in TFM is held by the Mexican government. Grupo TFM is a non-operating holding company with no material assets or operations other than its investment in TFM. The stockholders of Grupo TFM are Multimodal, an indirect subsidiary of Grupo TMM, NAFTA Rail, S. A. de C. V., an indirect wholly

## **Table of Contents**

owned subsidiary of KCS, and TFM. TFM is the owner of the limited voting shares previously held by the Mexican National Railway, representing 24.6% of the equity of Grupo TFM. TFM holds the concession, which was awarded by the Mexican Government in 1996, to operate one of three principal rail systems in Mexico, with tracks and facilities located in the north and central regions of Mexico, for the 50 years ending in June 2047 and, subject to certain conditions, has an option to extend the Concession for an additional 50 years. The Concession is subject to certain mandatory trackage rights and is exclusive until 2027. However, the Mexican government may revoke TFM's exclusivity after 2017 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 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, under certain circumstances such as natural disaster, war or other similar situations, also be seized temporarily by the Mexican government. Under Mexican law, the Mexican government would be obligated to compensate Grupo TFM for damages arising out of the permanent or temporary condemnation of or seizure of the Concession.

Under the Concession, TFM operates a strategically significant corridor between Mexico and the United States, and has as its core route a key portion of the shortest, most direct rail passageways between Mexico City and the border crossing to Laredo, Texas. TFM's rail lines are the only ones which serve Nuevo Laredo, the largest rail freight exchange point between the United States and Mexico. TFM's rail lines connect the most populated and industrialized regions of Mexico with Mexico's principal U.S. border railway gateway at Nuevo Laredo. In addition, TFM serves three of Mexico's primary seaports at Veracruz and Tampico on the Gulf of Mexico and Lazaro Cardenas on the Pacific Ocean. TFM serves 15 Mexican states and Mexico City, which together represent a majority of the country's population and account for a majority of its estimated gross domestic product. KCS management believes the Nuevo Laredo gateway is the most important interchange point for rail freight between the United States and Mexico. As a result, TFM's routes are an integral part of Mexico's foreign trade distribution system.

TFM operates approximately 2,650 miles of main and branch lines and certain additional sidings, spur tracks and main line tracks under trackage rights. TFM has the right to operate the rail lines, but does not own the land, roadway or associated structures, which remain owned by the Mexican Government.

The principal executive offices of TFM are located in Mexico City at Av. Periferico Sur 4829, Piso 4°, Col. Parques Del. Pedregal, Mexico, D.F. 14010.

We are proposing to acquire control of TFM. See Proposal Proposed Issuance of Common Stock.

## **TEX-MEX**

Tex-Mex is a wholly-owned subsidiary of Mexrail. Mexrail is a holding company which owns 100% of the stock of Tex-Mex, the northern half of the International Bridge at Laredo, Texas and real property (approximately 70 acres of land) in and around Laredo, Texas.

Tex-Mex operates a 157-mile rail line extending from Laredo to Corpus Christi. Tex-Mex connects to KCSR through trackage rights over the Union Pacific Railroad Company between Robbstown and Beaumont, Texas. These trackage rights were granted pursuant to a 1996 STB decision and have an initial term of 99 years. Tex-Mex provides a vital link between KCS's U.S. operations through KCSR and its Mexican operations through TFM.

The principal executive offices of Tex-Mex are located at 5810 San Bernardo, Laredo, Texas 78041.

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 we received approximately \$31.4 million for our 49% interest in Mexrail. On August 16, 2004, in accordance with the terms of the Stock Purchase Agreement, KCS acquired from TFM 51% of the shares of Mexrail for approximately \$32.7 million. KCS has received the required approval from the STB and on January 1, 2005, the Mexrail shares were released from a voting trust to KCS. KCS has an exclusive

**Table of Contents**

option until October 31, 2005 to purchase from TFM the remaining 49% of the shares of Mexrail, and if not purchased pursuant to this option, becomes obligated to purchase such remaining shares on October 31, 2005, at a purchase price of approximately \$31.4 million.

**Table of Contents**

**BACKGROUND AND RECOMMENDATION**

**Background**

In December 1995, KCS and Grupo TMM entered into a joint venture to participate in the privatization of the Mexican railroad. To facilitate the joint venture, they formed the entity which subsequently became Grupo TFM.

On January 31, 1997, Grupo TFM paid approximately \$565 million to the Mexican government, using funds provided by KCS and Grupo TMM, for a portion of the purchase price of the shares representing 80% of the economic interest in the Northeast Rail Lines. The Northeast Rail Lines, subsequently renamed TFM, holds the concession to operate the lines of the former Mexican National Railway Company running through the north and central portions of Mexico. Grupo TFM paid the remainder of the purchase price, approximately \$835 million, to the Mexican government on June 23, 1997. Grupo TFM funded this second payment from a combination of TFM credit facilities, TFM debt securities sales, proceeds from the sale of 24.6% of Grupo TFM to the Mexican government and additional capital contributions from KCS and Grupo TMM.

Following Grupo TFM's purchase of TFM, executive officers of KCS and Grupo TMM have from time to time discussed the possibility of combining their respective U.S. and Mexican rail operations under a single transportation holding company. Shortly after joining KCS in 1995, Michael Haverty the Chairman, President and Chief Executive of KCS, proposed bringing KCSR, Tex-Mex and TFM under the control of a single holding company in order to capitalize on NAFTA trade developments.

At a meeting on January 23, 2002, Mr. Haverty and Jose Serrano Segovia, Chairman and Chief Executive Officer of Grupo TMM, agreed it was time to direct their respective financial advisors to begin preliminary consideration of a possible transaction combining the rail operations of KCS and Grupo TMM under a single holding company. Larry Lawrence, Special Advisor to Mr. Haverty, subsequently met with KCS's then financial advisor to assess valuation issues associated with such a transaction.

The following month, KCS's financial advisor and Grupo TMM's financial advisor held discussions regarding possible terms for a transaction, and KCS's financial advisor made a presentation to KCS regarding those terms. On February 6, 2002, Messrs. Haverty and Lawrence presented to the KCS Board of Directors a general outline of a possible transaction in which the U.S. rail operations of KCSR and Tex-Mex and the Mexican rail operations of TFM would be put under common control.

Over the next seven months, business representatives and the financial and legal advisors for KCS and Grupo TMM held numerous discussions among themselves and with other representatives of KCS and Grupo TMM, in person, by telephone and electronically, to discuss various proposals for a U.S.-Mexican rail combination and issues associated with those proposals, and to try to agree on a term sheet for such a transaction. Key issues addressed in those discussions included the amount of the purchase price and the proportions of the price to be paid in cash and securities; the terms, and restrictions on transfer, of securities to be issued in the transaction; governance of the surviving entity; providing liquidity to the recipients of KCS securities in the transaction, U.S. and Mexican tax consequences; regulatory, stockholder and noteholder approval matters and post-closing operations.

On May 1, 2002, at a regular meeting of the KCS Board of Directors, the Board received from management a presentation concerning the status of the negotiations between KCS and Grupo TMM and discussed the proposed transaction.

In July 2002, KCS and Grupo TMM caused TFM to purchase the Mexican government's 24.6% interest in Grupo TFM for approximately \$256 million, using a combination of proceeds from an offering of TFM debt securities, a credit from the Mexican government for a reversion of certain redundant rail facilities, cash on hand and other financial resources. The Mexican government retained a 20% economic interest in TFM, which the Government had the right to sell in a public offering or to compel Grupo TFM to purchase following notification by the Government in accordance with the terms of the applicable agreements. In the event that Grupo TFM failed to purchase the Mexican government's 20% economic interest in TFM, the Mexican government had the right to compel KCS and Grupo TMM to purchase the Government's interest.



**Table of Contents**

Grupo TFM and the Government are currently in litigation concerning Grupo TFM's assertion that the Government does not currently have the right to compel the purchase of the Government's interest by Grupo TFM, Grupo TMM or KCS and a Mexican court has enjoined the Government from seeking to compel the purchase pending resolution of the litigation.

On September 24, 2002, at a regular meeting of the KCS Board of Directors, Mr. Lawrence and KCS's legal and financial advisors made a presentation regarding a possible transaction with Grupo TMM to acquire control of TFM by acquiring additional shares of Grupo TFM.

In October 2002, when the parties could not reach agreement on the proposed term sheet for a transaction, negotiations between the parties were suspended.

During November 2002, KCS's financial advisor and Grupo TMM's financial advisor held intermittent discussions regarding proposed terms for the transaction and the term sheet. A revised term sheet was prepared. During that month, there were numerous telephonic and electronic communications between the respective legal advisors to KCS and Grupo TMM regarding the draft term sheet. On November 9, 2002, KCS and Grupo TMM executed confidentiality and standstill agreements.

In December 2002, KCS officers and advisors met several times by telephone to discuss financial models and alternative structures for a proposed transaction and exchanged numerous electronic messages relating to the transaction.

During January 2003, further discussions were held between representatives of KCS and Grupo TMM regarding a term sheet and the standstill provisions of the confidentiality agreement between KCS and Grupo TMM were extended. On January 16, 2003, at a regular meeting, the KCS Board of Directors discussed the status of the negotiations.

In February 2003, KCS and Grupo TMM, and their respective legal advisors, worked on drafts of the transaction documents, including an Acquisition Agreement, a Stock Purchase Agreement, and the other Ancillary Agreements.

During March 2003, representatives of KCS and Grupo TMM, including their respective financial and legal advisors met to negotiate the terms of the transaction documents and to conduct due diligence reviews of their businesses.

At a special meeting held on April 15, 2003, the KCS Board received an extensive presentation on the possible transaction, which included a review of the proposed terms and draft transaction documents, consideration of financing alternatives and the results of due diligence inquiries. KCS's financial advisor made a presentation to the Board regarding the transaction and delivered its oral fairness opinion. The Board requested that further due diligence be conducted and continued the meeting to April 20, 2003.

On April 20, 2003, the KCS Board held a telephonic meeting, reviewed the results of the further due diligence review and after discussion of the proposed transaction, approved the proposals set forth in KCS's preliminary proxy statement filed on June 26, 2003. KCS and Grupo TMM then executed and delivered the Original Acquisition Agreement dated April 20, 2003, and the original stock purchase agreement dated as of April 20, 2003 and a press release announcing their actions was released the next morning.

On June 26, 2003, KCS filed a preliminary proxy statement for a special meeting of stockholders in connection with the Acquisition.

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 SCT), the Ministry of Finance, other relevant authorities and stakeholders of the Grupo TMM shareholder's decision.

**Table of Contents**

On August 21, 2003, KCS's legal advisor wrote Grupo TMM's legal advisor expressing KCS's strong concerns over the Grupo TMM shareholders' vote and KCS's intention to pursue the consummation of the transaction.

On August 23, 2003, Grupo TMM sent a notice to KCS purporting to terminate the Original Acquisition Agreement because the Grupo TMM shareholders had failed to approve that agreement.

Grupo TMM representatives called a TFM Board Meeting for August 25, 2003. At the meeting, which the KCS appointed Board members did not attend, the Board purported to grant Mr. Serrano sole authority to negotiate the VAT and Put issue with the Mexican government, purported to grant Mario Mohar and Jose Serrano unlimited authority to approve TFM transactions and purported to approve a large commercial contract. KCS objected to the meeting based on improper notice and objected to the actions taken at the meeting as violating KCS's rights under TFM's governing documents and the Original Acquisition Agreement.

On August 29, 2003, KCS delivered to Grupo TMM a Notice of Dispute pursuant to the Original Acquisition Agreement contesting Grupo TMM's claimed termination. This initiated a 60-day negotiation period between the parties. In addition, on August 29, 2003, KCS filed a complaint in the Delaware Chancery Court alleging that Grupo TMM had breached the Original 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 followed the dispute resolution procedures. The Notice of Dispute and complaint pointed out that the Original Acquisition Agreement did not provide that a negative vote by Grupo TMM shareholders was a basis for termination.

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 sought to resolve its dispute over Grupo TMM's attempt to terminate the Original Acquisition Agreement.

On September 11, 2003, Mr. Lawrence and Ronald Russ, Executive Vice President and Chief Financial Officer of KCS, met with Javier Segovia, President of Grupo TMM and two other TMM representatives. No progress was made toward resolving the dispute.

On September 23, 2003, the KCS Board of Directors was provided an update on the many recent developments between KCS and Grupo TFM and affirmed KCS's efforts to pursue all legal means to enforce the Original Acquisition Agreement.

On October 29, 2003, the Delaware Court of Chancery granted KCS's motion and issued a preliminary injunction to preserve the parties' positions pending resolution of the dispute between KCS and Grupo TMM.

On October 31, 2003, KCS initiated binding arbitration in accordance with the terms of the Original Acquisition Agreement. In its Arbitration Demand, KCS sought a determination that the Original Acquisition Agreement was in full force and effect, specific performance and damages for Grupo TMM's breach of the terms of the Original Acquisition Agreement and failure to negotiate in good faith during the 60-day negotiation period. By the agreement of the parties, the arbitration was bifurcated. The first stage of the arbitration addressed only the question of whether Grupo TMM's purported negative shareholder vote gave Grupo TMM the right to terminate the Original Acquisition Agreement.

On December 10, 2003, Mr. Haverty of KCS met with Mr. Serrano of Grupo TMM in Monterrey, Mexico. They agreed to appoint negotiators to determine if a resolution of the dispute could be reached. On December 16, 2003, Mr. Russ for KCS and Rafael Moreno Valle for TMM met in Mexico City. Mr. Moreno Valle expressed that TMM would consider a new deal based solely on equity without cash. The meeting ended with no meaningful progress.

By order dated January 6, 2004, the Delaware Court of Chancery held Grupo TMM in contempt of court for taking action inconsistent with the court's October 29, 2003 order discussed above. The court held that by Grupo TMM causing its subsidiary Grupo TFM to revoke powers of attorney requiring the signature of a KCS representative for transactions in excess of \$2.5 million and in granting new powers of attorney to Grupo TMM directors, Mr. Serrano and Mario Mohar, to act on behalf of the company, Grupo TMM violated provisions of the Original Acquisition Agreement. The previous order of the court required Grupo TMM to cause Grupo

**Table of Contents**

TFM to conduct its business in accordance with the past practices and not to directly or indirectly amend its organizational documents. The court ordered Grupo TMM to take the actions necessary to revoke the new powers of attorney, to re-enact the original power of attorney, and to pay KCS its costs and attorneys fees for bringing the motion for contempt.

On March 19, 2004, the arbitration panel issued an interim award finding that the Original Acquisition Agreement remained in force and was binding on KCS and Grupo TMM in accordance with its terms. The arbitration panel concluded that the rejection of the Original Acquisition 2003 Agreement by Grupo TMM shareholders did not authorize Grupo TMM's purported termination of the Original Acquisition Agreement. The second phase of the arbitration was to decide the remaining issues, including remedies and damages.

On April 4, 2004, KCS and Grupo TMM agreed to and signed, and the arbitration panel approved, a stipulation agreement in which KCS and Grupo TMM agreed to discharge in good faith all of the obligations of the Original Acquisition Agreement.

In the absence of TMM shareholder approval, and as an alternative to proceeding immediately to the second phase of arbitration on remedies and damages, TMM and KCS representatives began negotiating toward a comprehensive Amended and Restated Acquisition Agreement, each reserving the right to resume arbitration proceedings at any time.

In negotiations, in person, by telephone, and electronically, Mr. Lawrence and Mr. Moreno Valle agreed in principle by the end of April to maintain many elements of the Original Acquisition Agreement (such as the base consideration to be paid by KCS to TMM and the standstill and shareholder restrictions on TMM) and to make a few specific changes (such as the lessening of TMM involvement in the governance of KCS or TFM going forward).

For the next five months, from May through September, the TMM and KCS teams remained far apart on several issues, including, among other issues, the structure of the contingent consideration, the scope of TMM's indemnification obligations, the proportion of consideration that would be placed in escrow to secure TMM's obligations, the method for resolving pending lawsuits between the parties, the scope of the consulting agreement with a consulting company to be formed by José F. Serrano Segovia, and the resolution of various commercial agreements between TMM and TFM. During this time, TMM restructured its bonds, eliminating bondholder approval as a condition to close.

To facilitate the negotiation of the Amended and Restated Acquisition Agreement, Grupo TMM and KCS asked the arbitration panel to extend the termination date of the Original Acquisition Agreement for 45 (forty five) days, until February 15, 2005. The arbitration panel entered the order on September 9, 2004. On September 16, 2004, Grupo TMM and KCS announced that they had agreed to further extend the termination date of the Original Acquisition Agreement until June 15, 2005.

On September 28, 2004, the KCS Board of Directors reviewed the status of negotiations with Grupo TMM.

On October 15, 2004, KCS tendered a comprehensive offer, including a complete set of the key transaction documents to Grupo TMM. KCS provided that the offer would be open until October 29, 2004 and would be withdrawn on that date if not accepted. KCS informed TMM that in the absence of an agreement, it expected the KCS Board to take decisive action at its meeting scheduled for November 4, 2004.

TMM representatives scheduled a meeting in Kansas City on October 18, 2004 to discuss the proposal. TMM then cancelled the meeting and its representatives requested a meeting in Mexico City the week of October 25, 2004. Mr. Lawrence and KCS's legal and financial advisors met with Mr. Segovia and TMM's advisors from October 25 through October 28, 2004 in Mexico City. TMM and KCS each made several limited concessions, but a number of key issues remained unresolved.

On October 29, 2004 KCS withdrew its offer pending further directions from the KCS Board. Upon learning of the withdrawal of the offer, TMM offered several compromise proposals. In addition, Mr. Segovia sent a letter stating that the TMM Board endorsed the transaction, subject to final resolution of certain critical issues.

## **Table of Contents**

On November 4, 2004, the KCS Board of Directors reviewed the status of negotiations with Grupo TMM. The Board directed management to make a final effort to conclude a transaction and established a December 3, 2004 deadline for the completion of all negotiations with Grupo TMM.

Business representatives and legal and financial advisors for both parties met in New York on November 8 to discuss KCS position. KCS stated that its Board was willing to continue discussions, but had established a deadline of December 3rd to conclude negotiations. The parties continued to meet in New York and negotiated various issues through November 10.

For the next week, legal representatives from both parties worked on preparing documents for the transaction while substantive negotiations on the remaining open issues continued telephonically. Mr. Segovia and TMM's legal and financial advisors met with Mr. Lawrence and KCS legal and financial advisors in Kansas City on November 17 and 18 to continue discussions intended to resolve the remaining open issues.

The final major business issues were agreed to in principle over the next two weeks. TMM, with approval from its Board, submitted a signed Amended and Restated Acquisition Agreement to KCS management on December 3, 2004. The parties worked to finalize all of the documents concerning the Acquisition over the next 12 days.

The KCS Board met on December 14, 2004 to consider the transaction. KCS management presented a detailed description and analysis of the proposed transaction. Morgan Stanley provided its opinion concerning the fairness of the consideration for the transaction and presented its analysis to the Board.

Following discussion, the KCS Board approved the transaction and recommended that the shareholders approve the proposal described in this proxy statement.

The parties executed the Acquisition Agreement on December 15, 2004.

## **Reasons for the Proposal**

KCS proposes to issue the Common Stock pursuant to the Acquisition Agreement to obtain a controlling interest in TFM through the purchase of shares of Grupo TFM, which holds an 80% economic interest in TFM and all of the TFM Voting Stock. KCS may issue additional Common Stock in order to consummate the Acquisition and pursuant to the Consulting Agreement.

KCS believes that the acquisition of a controlling interest in TFM will benefit KCS and its stockholders. Upon consummation of the acquisition, KCSR, TFM and Tex-Mex will be under the common control of a single transportation holding company, KCS. KCS management believes that common control of these three railroads, which are already physically linked in an end-to-end configuration, will enhance competition and give shippers in the NAFTA trade corridor a strong transportation alternative as they make their decisions to move goods between the United States, Mexico and Canada. In addition, KCS management believes that this common control offers stockholders greater value through the operating efficiencies expected to come from common ownership and control.

In arriving at its decision to approve the Acquisition and the transactions contemplated by the Acquisition Agreement and the Ancillary Agreements and in making its recommendation discussed below under Recommendation, the KCS Board of Directors considered the following material factors which it believed supported its decision:

The opinion of Morgan Stanley, KCS's financial advisor, based upon the factors set forth in their written opinion letter, to the effect that, the consideration was fair, from a financial point of view, to KCS. See Opinion of Financial Advisor;

The importance of the Acquisition to KCS's strategic objective of owning and operating under common control a cross-border rail system linking the commercial and industrial centers of the United States and Mexico;

**Table of Contents**

The importance of TFM to the results of operations of KCS, including the expected increase in earnings per share contribution from the faster-growing rail operations of TFM, and the current lack of control over TFM;

The terms of the Acquisition Agreement, including among other things, the conditions to closing, the consideration to be paid and received, the rights of termination and termination fee provisions set forth in that agreement, and the terms of the Ancillary Agreements and other related agreements;

The operation of KCSR, TFM and Tex-Mex under integrated management, and the belief of KCS management that common control of these three railroads will enhance competition, give shippers in the NAFTA trade corridor a strong transportation alternative for moving goods between the United States, Mexico and Canada, and generate longer hauls;

The operating efficiencies expected to come from common ownership and control of KCSR, TFM and Tex-Mex;

The expected positive impact of the Acquisition on the customers of KCSR, Tex-Mex and TFM, including enabling the provision of common customer access and integrated customer service, and which as a result of combined resources is expected to lead to enhanced product offerings;

The financial resources of KCS, Grupo TMM, Grupo TFM, TFM and Tex-Mex, including the potential for KCS to repay existing debt and refinance at a more favorable rate;

The inclusion of more extensive interim governance arrangements in the Acquisition Agreement that require Grupo TMM to conduct the business of Grupo TFM in the ordinary course during the period between signing of the Acquisition Agreement and Closing, and the right of KCS to create a transition management team to facilitate the transition to KCS of ownership of Grupo TFM and certain subsidiaries of Grupo TFM;

The resolution of the dispute over Grupo TMM's purported termination of the Original Acquisition Agreement, and other litigation and arbitration proceedings that have arisen in connection with the dispute; and

The expense and uncertain outcome of continuing to litigate with Grupo TMM regarding the Original Acquisition Agreement and the dismissal upon the Closing of all litigation (with a few exceptions).

The Board of Directors also considered the following potentially negative factors concerning the Acquisition:

The dilution in the percentage ownership interest of KCS's existing stockholders upon issuance of the shares of KCS Common Stock in connection with the Acquisition;

If the Acquisition is not consummated under the Acquisition Agreement, KCS would continue its efforts to consummate the Original Acquisition Agreement, which would delay its ability to have common control over KCSR, TFM and Tex-Mex and to achieve the anticipated efficiencies of operations, and would continue with certain legal actions;

If KCS stockholder approval is not obtained, KCS will not be able to take the actions proposed, but will be required to dismiss with prejudice certain legal actions pending against Grupo TMM.

The foregoing discussion addresses certain material information and factors considered by the Board of Directors in its consideration of the Acquisition, including factors that support the Acquisition as well as those that may weigh against it. In reaching its determination to approve the Acquisition, the Ancillary Agreements and the transactions contemplated by these agreements and in making its recommendations to KCS stockholders, the Board of Directors did not assign any relative or specific weight to the foregoing factors, and individual directors may have given different weights to different factors. The Board of Directors' determination was made after consideration of all of the factors in the aggregate.

**Table of Contents**

**Opinion of Financial Advisor**

Morgan Stanley acted as financial advisor to KCS in connection with the Acquisition. KCS's Board of Directors selected Morgan Stanley to act as its financial advisor based on Morgan Stanley's qualifications, expertise, reputation and its knowledge of the business and affairs of KCS. At a December 14, 2004 meeting of the KCS Board of Directors, Morgan Stanley delivered an oral opinion, subsequently confirmed in writing, that, as of that date and based upon and subject to the assumptions made, matters considered and limits of the review undertaken by Morgan Stanley, the consideration to be paid pursuant to the Acquisition was fair, from a financial point of view, to KCS. For purposes of its opinion, the consideration to be paid by KCS included the stock consideration, the cash consideration, any amounts that could become payable pursuant to the VAT Contingency Payment to Multimodal, the consideration for consulting services and any amount that could become payable pursuant to the Final Resolution of the VAT Claim and Put to Consulting Firm pursuant to the Consulting Agreement, based on certain assumptions and considerations as described below. See Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements The Acquisition Agreement VAT Contingency Payment and Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements Other Agreements Consulting Agreement.

*The full text of Morgan Stanley's written opinion, dated December 14, 2004, which sets forth, among other things, the assumptions made, procedures followed, matters considered and limits on the scope of the review undertaken by Morgan Stanley in rendering its opinion, is attached as Appendix D to this proxy statement and is incorporated herein by reference. KCS stockholders are urged to read Morgan Stanley's opinion in its entirety. Morgan Stanley's opinion is directed to the KCS Board of Directors and addresses only the fairness from a financial point of view of the consideration to be paid by KCS in the Acquisition, and does not address any other aspect of the Acquisition and does not constitute a recommendation to any stockholder of KCS as to how to vote with respect to the Acquisition. The summary of Morgan Stanley's opinion set forth in this proxy statement is qualified in its entirety by reference to the full text of Morgan Stanley's opinion.*

In connection with rendering its opinion, Morgan Stanley, among other things:

reviewed certain publicly available financial statements and other information of Grupo TFM, Grupo TMM and KCS;

reviewed certain internal financial statements and other financial and operating data concerning Grupo TFM prepared by the management of Grupo TFM;

reviewed certain financial projections prepared by the management of Grupo TFM;

discussed the past and current operations and financial condition and the prospects of Grupo TFM with senior executives of Grupo TFM and Grupo TMM;

reviewed certain internal financial statements and other financial operating data concerning KCS prepared by the management of KCS;

reviewed certain financial projections regarding Grupo TFM and KCS prepared by the management of KCS;

discussed the past and current operations and financial condition and the prospects of KCS, including information relating to certain strategic, financial and operational benefits anticipated from the Acquisition, with senior executives of KCS;

reviewed the pro forma impact of the Acquisition on KCS's earnings per share, consolidated and standalone capitalization and financial ratios;

compared the financial performance of Grupo TFM with that of certain other comparable publicly-traded companies and their securities;

reviewed the financial terms, to the extent publicly available, of certain comparable acquisition transactions;

**Table of Contents**

discussed the strategic rationale for the Acquisition with the management of KCS;

participated in discussions and negotiations among representatives of Grupo TMM and KCS and their financial and legal advisors;

reviewed the Acquisition Agreement and the Consulting Agreement and certain related documents; and

performed such other analyses and considered such other factors as Morgan Stanley deemed appropriate.

In rendering its opinion, Morgan Stanley assumed and relied upon, without independent verification, the accuracy and completeness of the information reviewed by it for the purposes of its opinion. With respect to the financial projections, including information relating to certain financial and operational benefits anticipated from the Acquisition, Morgan Stanley assumed that they were reasonably prepared on bases reflecting the best then-currently available estimates and judgments of the future financial performance of Grupo TFM and KCS, and expressed no opinion with respect to such forecasts or assumptions on which they were based. Morgan Stanley relied upon the assessments by the management of KCS of the strategic rationale for the Acquisition.

Morgan Stanley did not make, and did not assume any responsibility for making, any independent valuation or appraisal of the assets or liabilities of Grupo TFM or KCS, nor was it furnished with any such appraisals. Morgan Stanley assumed that the Acquisition will be consummated in accordance with the terms set forth in the Acquisition Agreement and the Consulting Agreement. Morgan Stanley relied upon the assessments by the management of KCS of the strategic rationale for the Acquisition. Morgan Stanley is not a legal, tax or regulatory expert and for the purposes of its analysis, Morgan Stanley assumed the accuracy and veracity of the assessments provided by such advisors to KCS with respect to such issues.

Morgan Stanley's opinion did not address the fairness or the relative fairness of the consideration to be paid to the recipients thereof or the terms and conditions of the receipt of such consideration. Morgan Stanley's opinion did not address the relative merits of the Acquisition or its structure compared to any other alternative business transaction or transaction structure that might be or might have been available to KCS, including the transaction contemplated as part of the Original Acquisition Agreement. Morgan Stanley's opinion was necessarily based on financial, economic, market and other conditions as in effect on, and the information made available to it, as of December 14, 2004.

The following is a summary of certain analyses performed by Morgan Stanley in connection with the preparation of its written opinion letter dated December 14, 2004. Some of these summaries of financial analyses include information presented in tabular format. In order to fully understand the financial analyses used by Morgan Stanley, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses.

For purposes of the following analyses, Morgan Stanley assumed two cases: (1) one in which no VAT payment refund and no exercise of the Put occurred, resulting in 38.8% as the effective economic ownership interest that KCS would be purchasing in TFM, for consideration of \$553 million (which includes the \$47 million of Indemnity Escrow Notes and the \$9 million total fees paid over a three-year period under the Consulting Agreement) (the No VAT/ Put Case ); and (2) one in which the VAT payment refund equaled the purchase price of the TFM shares subject to the Put, resulting in 51.0% as the effective economic ownership interest that KCS would be purchasing in TFM, for consideration of \$672 million (which assumes the payment of the \$110 million VAT Contingency Payment and includes the \$47 million of Indemnity Escrow Notes, and the \$9 million total fees paid over a three-year period and the \$9 million VAT Claim and Put Advisory Fee under the Consulting Agreement) (the VAT Equals Put Case ).

For purposes of valuing the consideration, Morgan Stanley valued the KCS Common Stock at \$16.50 per share, which was the last reported sale price of KCS Common Stock on December 7, 2004. Morgan Stanley also performed separate analyses to assess the trading value of KCS shares. The assumptions used in determining the value of consideration were made for convenience only. The publicly traded price of KCS

**Table of Contents**

stock to be provided as part of the consideration may change considerably between the date of the opinion and the date of the Closing of the Acquisition or the date upon which KCS would issue KCS stock as consideration.

Neither Morgan Stanley nor KCS was able to assign relative probabilities to any of the scenarios described above because whether the Mexican government will validly exercise the Put and whether TFM will receive any payment from the VAT Claim (or, if any such payment is received, the magnitude of such payment) are beyond the control of Morgan Stanley, KCS, TFM or Grupo TMM. The VAT Claim and the Put are more fully discussed below in Proposal Proposed Issuance of Common Stock Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements The Acquisition Agreement VAT Contingency Payment.

*Comparable Public Company Analysis*

As part of its analysis, Morgan Stanley compared forecasted financial information for TFM with publicly-available information for the following railroad companies. Morgan Stanley selected companies for the peer group that operate in and are exposed to the railroad industry and that have similar lines of business as TFM. The peer group contained Burlington Northern Santa Fe Corporation ( BNSF ), CSX Corporation ( CSX ), Norfolk Southern Corporation ( Norfolk Southern ), Union Pacific Corporation ( Union Pacific ), Canadian Pacific Railway Limited and Canadian National Railway Company ( Canadian National ), KCS and two other publicly traded railroad companies, Genesee & Wyoming, Inc. ( Genesee ) and RailAmerica, Inc. ( RailAmerica ). The table below presents, as of December 7, 2004, the low, high and mean of the ratios of aggregate value, defined as market capitalization plus total debt less cash and cash equivalents, to forecasted 2004 and 2005 earnings before interest, taxes, depreciation and amortization (or EBITDA) for the comparable companies and KCS. For the comparable companies, the forecasted EBITDA for 2004 and 2005 was based on a compilation of projections by securities research analysts.

	Aggregate Value to Forecasted 2004 EBITDA	Aggregate Value to Forecasted 2005 EBITDA
Low	7.6x	6.9x
High	12.3x	11.2x
Mean, including KCS, RailAmerica and Genesee	9.4x	8.5x
Mean, excluding KCS, RailAmerica and Genesee	8.6	7.6

Morgan Stanley noted that based on estimated 2004 EBITDA, using TFM financial projections developed by KCS management, a comparable trading multiple range for the comparable companies of 8.0x to 10.0x 2004 EBITDA would imply a range of consideration for the Acquisition of \$400 million to \$775 million, assuming no VAT payment refund and no exercise of the Put, and a range of consideration of \$525 million to \$1 billion, assuming the VAT payment refund equals the purchase price of the TFM shares subject to the Put. Morgan Stanley noted that the consideration in the No VAT/ Put Case was \$553 million and that the consideration in the VAT Equals Put Case was \$672 million. Morgan Stanley also noted that based on estimated 2005 EBITDA, using TFM financial projections developed by KCS management, a comparable trading multiple range of 7.0x to 9.0x 2005 EBITDA would imply a range of consideration of \$450 million to \$875 million, assuming no VAT payment refund and no exercise of the Put, and a range of consideration of \$600 million to \$1.15 billion, assuming the VAT payment refund equals the purchase price of the TFM shares subject to the Put. Based on estimated 2005 EBITDA, using TFM financial projections developed by TFM management, Morgan Stanley noted that a comparable trading multiple range of 7.0x to 9.0x 2005 EBITDA would imply a range of consideration of \$375 million to \$775 million, assuming no VAT payment refund and no exercise of the Put, and a range of consideration of \$500 million to \$1 billion, assuming the VAT payment refund equals the purchase price of the TFM shares subject to the Put. In each of these cases, the high point of the range assumes a 30% control premium based on past public company change of control transactions.



**Table of Contents**

No company utilized in the comparable public company analysis as a comparison is identical to TFM. In evaluating the companies, Morgan Stanley made judgments and assumptions with regard to industry performance, general business, economic, market and financial conditions and other matters, many of which are beyond KCS's or TFM's control such as the impact of competition on KCS's or TFM's business and the industry generally, industry growth and the absence of any material adverse change in KCS's or TFM's financial condition and prospects or the industry or in the financial markets in general. Mathematical analysis, such as determining an average or a median, is not in itself a meaningful method of using comparable public company data.

*Analysis of Selected Precedent Transactions*

Using publicly available information, Morgan Stanley considered 10 announced or completed precedent transactions in the rail transportation industry comparable in certain respects to the Acquisition. These precedent transactions included:

Burlington Northern's acquisition of Santa Fe Pacific (announced June 1994);

Illinois Central's proposed acquisition of KCS (announced July 1994, but not completed);

Union Pacific's acquisition of Chicago North Western Corporation (announced March 1995);

Union Pacific's acquisition of Southern Pacific Rail (announced August 1995);

Norfolk Southern's and CSX's acquisition of Conrail (announced October 1996);

Grupo TMM's and KCS's acquisition of TFM (announced January 1997);

Canadian National's acquisition of Illinois Central (announced February 1998);

BNSF's proposed acquisition of Canadian National (announced December 1999, but not completed);

Canadian National's acquisition of Wisconsin Central (announced January 2001); and

KCS's acquisition of Grupo TMM's ownership in TFM pursuant to the Original Acquisition Agreement (announced April 2003, but not completed).

Morgan Stanley compared publicly available financial and market statistics of the precedent transactions. For each of the transactions above, Morgan Stanley reviewed the price paid (or proposed to be paid) and calculated the multiple of aggregate value implied by the consideration to the acquired or target company's (i) last twelve month EBITDA (or LTM EBITDA), (ii) last twelve month earnings before interest and taxes (or LTM EBIT), and (iii) last twelve month revenues (or LTM Revenues). This analysis indicated the following multiples:

	<b>Aggregate Value as a Multiple of</b>		
	<b>LTM EBITDA</b>	<b>LTM EBIT</b>	<b>LTM Revenues</b>
Low	7.2x	9.7x	1.7x
High	16.6x	45.0x	4.4x
Mean	10.4x	16.5x	3.0x
Median	9.7x	13.2x	3.2x

Based on estimated 2004 EBITDA, using TFM financial projections developed by KCS management, Morgan Stanley observed that a transaction multiple range of 8.0x to 11.0x 2004 EBITDA would imply a range of consideration for the Acquisition of \$400 million to \$675 million, assuming no VAT payment refund and no exercise of the Put, and a range of consideration of \$525 million to \$900 million, assuming the VAT payment refund equals the purchase price of the TFM shares subject to the Put. Morgan Stanley noted that the consideration in the No VAT/ Put Case was \$553 million and that the consideration in the VAT Equals Put Case was \$672 million.

No transaction utilized as a comparison in the analysis of selected precedent transactions is identical to the Acquisition, accordingly, an analysis of the results of the foregoing necessarily involves complex

**Table of Contents**

considerations and judgments concerning differences in our financial and operating characteristics and other factors that would affect the acquisition value of the companies to which it is being compared. In evaluating the precedent transactions, Morgan Stanley made judgments and assumptions with regard to conditions and other matters, many of which are beyond our control, such as the impact of competition on us and the industry generally, industry growth and the absence of any adverse material change in our financial conditions and prospects or the industry or in the financial markets in general. Mathematical analysis, such as determining the mean or median, is not, in itself, a meaningful method of using precedent transactions data.

*Discounted Cash Flow Analysis*

Morgan Stanley performed a discounted cash flow analysis, which is an analysis of the present value of projected unlevered free cash flows using terminal year multiples of EBITDA as of the end of the period for which TFM financial projections were provided by KCS management and by TFM management, in each case ranging from 7.0x to 9.0x, and discount rates, in each case ranging from 10% to 12%.

Based on this analysis, and using TFM financial projections developed by KCS management, Morgan Stanley calculated a range of consideration of \$725 million to \$1.05 billion, assuming no VAT payment refund and no exercise of the Put, and a range of consideration of \$950 million to \$1.375 billion, assuming the VAT payment refund equals the purchase price of the TFM shares subject to the Put. Using TFM financial projections developed by TFM management, based on this analysis, Morgan Stanley calculated a range of consideration of \$550 million to \$800 million, assuming no VAT payment refund and no exercise of the Put, and a range of consideration of \$700 million to \$1.05 billion, assuming the VAT payment refund equals the purchase price of the TFM shares subject to the Put. Morgan Stanley noted that the consideration in the No VAT/ Put Case was \$553 million and that the consideration in the VAT Equals Put Case was \$672 million.

In connection with the review of the Acquisition by the KCS Board of Directors, Morgan Stanley performed a variety of financial and comparative analyses for purposes of rendering its opinion. The preparation of a fairness opinion is a complex process and does not lend itself to a partial analysis or summary description. In arriving at its opinion, Morgan Stanley considered the results of all of its analyses as a whole and did not attribute a specific weight to any single method of analysis or factor it considered. Morgan Stanley believes that relying solely on a portion of its analyses, without considering all of its analyses as a whole, would create an incomplete view of the process underlying its analyses and opinion. While Morgan Stanley did not rely solely on any single method of analysis or factor, Morgan Stanley may have given various analyses and factors more or less weight than other analyses and factors, and may have deemed various assumptions more or less probable than other assumptions. None of these valuations, however, should be taken to be Morgan Stanley's view of TFM's actual value. In performing its analyses, Morgan Stanley made numerous assumptions with respect to industry performance, general business and economic conditions and other matters. Many of these assumptions are beyond KCS's control. Any estimates contained in Morgan Stanley's analyses are not necessarily indicative of future results or actual values, which may be significantly more or less favorable than those suggested by such estimates.

Morgan Stanley conducted the analyses described above solely as part of its analysis of the fairness of the consideration to be paid pursuant to the Acquisition from a financial point of view to KCS and in connection with the delivery of its opinion to the KCS Board of Directors. Morgan Stanley's analyses do not purport to be appraisals.

In addition, as described above, Morgan Stanley's opinion and its presentation to the KCS Board of Directors was one of many factors taken into consideration by the KCS Board of Directors in deciding to approve the Acquisition. Consequently, the Morgan Stanley analyses described above should not be viewed as determinative of the opinion of the KCS Board of Directors or the view of the management of KCS with respect to the Acquisition consideration or of whether the KCS Board of Directors would have been willing to agree to different consideration.

Morgan Stanley is an internationally recognized investment banking and advisory firm. Morgan Stanley, as part of its investment banking and financial advisory business, is continuously engaged in the valuation of businesses and securities in connection with mergers and acquisitions, negotiated underwritings, competitive

**Table of Contents**

biddings, secondary distributions of listed and unlisted securities, private placements and valuations for corporate, estate and other purposes. In the past, Morgan Stanley has provided financial advisory and financing services for KCS and has received fees for the rendering of these services. In addition, Morgan Stanley or one or more of its affiliates intends to participate in the financing of the Acquisition. In the ordinary course of its securities trading, investment management or brokerage activities, Morgan Stanley or its affiliates may actively trade the securities or loans of KCS or Grupo TMM for its own account, for the accounts of investment funds or other accounts under the management of Morgan Stanley or its affiliates and for the accounts of customers, and accordingly, may at any time hold a long or short position in these securities or loans. During the last two years, KCS has paid to Morgan Stanley fees of approximately \$6.7 million (not including fees under the engagement letter discussed below).

Pursuant to the engagement letter, Morgan Stanley provided financial advisory and investment banking services in connection with the Acquisition and a financial fairness opinion to the KCS Board of Directors in connection with the Acquisition, and KCS agreed to pay Morgan Stanley a fee in connection therewith. KCS agreed to pay Morgan Stanley a fee of up to \$7.5 million for providing its financial advisory services in connection with the Acquisition, payable in installments. A portion of the fee was a fixed amount attributable to Morgan Stanley's contribution to the parties' reaching an agreement. Another portion of the fee was a fixed amount attributable to Morgan Stanley's services with respect to the preparation and delivery of its opinion. The final portion of the fee is contingent upon the consummation of the Acquisition. KCS has also agreed to reimburse Morgan Stanley for its expenses incurred in performing its services. In addition, KCS has agreed to indemnify Morgan Stanley and its affiliates, their respective directors, officers, agents and employees and each person, if any, controlling Morgan Stanley or any of its affiliates against certain liabilities and expenses, including certain liabilities under the federal securities laws, related to or arising out of Morgan Stanley's engagement.

Morgan Stanley did not recommend any of the specific financial terms of the Acquisition. The Board of Directors of KCS relied, among other things, on Morgan Stanley's opinion in arriving at the Board's conclusions regarding the Acquisition, but did not specifically adopt the conclusions of Morgan Stanley. KCS does not intend to request an update to Morgan Stanley's opinion.

**Recommendation**

KCS's Board of Directors has determined that the proposed issuance of Common Stock in connection with the Acquisition is in the best interests of KCS. KCS's Board of Directors recommends a vote FOR the issuance of Common Stock as set forth in the Proposal.

**Table of Contents**

**PROPOSAL PROPOSED ISSUANCE OF COMMON STOCK**

**Overview**

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. Pursuant to the Acquisition Agreement, we seek to acquire the shares of Grupo TFM entitled to full voting rights that we do not own, by issuing:

18,000,000 shares of KCS Common Stock to Multimodal (which shares, based on the closing price for KCS Common Stock on the NYSE on February 1, 2005 of \$17.64, would have had a market value of \$317,520,000);

up to that additional number of shares of KCS Common Stock, as valued at the Volume Weighted Price pursuant to the Acquisition Agreement, equal to \$47 million plus accrued interest of up to \$5 million; and

in the event of the Final Resolution of the VAT Claim and Put, up to that additional number of shares of KCS Common Stock, as valued at the Volume Weighted Price pursuant to the Acquisition Agreement, equal to \$110 million and up to that additional number of shares of KCS Common Stock, as valued at the Volume Weighted Price pursuant to the Consulting Agreement, equal to \$9 million.

The Volume Weighted Price to be used to determine the number of shares of KCS Common Stock issuable pursuant to the Acquisition Agreement (i.e., the up to \$47 million principal and up to \$5 million in interest on the Indemnity Escrow Notes and the up to \$110 million for the VAT Contingency Payment) is the average trading price per share for KCS Common Stock on the NYSE, as reported on the Bloomberg (VAP function) for the 20 consecutive trading days immediately preceding the later of (i) the Closing Date, or (ii) the date of the public announcement by KCS of the Final Resolution of the VAT Claim and Put. The Volume Weighted Price to be used to determine the number of shares issuable pursuant to the Consulting Agreement (i.e., the \$9 million payment referred to above) is the average trading price per share for KCS Common Stock on the NYSE for the 20 consecutive trading days immediately preceding announcement of the Final Resolution of the VAT Claim and Put, as reported on Bloomberg (VAP Function).

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.

**Purpose and Effect of Proposed Issuance of Stock**

We are seeking your approval to issue the shares of KCS Common Stock in order to allow us to consummate the Acquisition and thereby acquire control of TFM, upon receipt of all regulatory approvals and satisfaction of the conditions to closing.

The proposed issuance of KCS Common Stock will result in dilution in the percentage ownership interest of KCS's existing stockholders. The amount of such dilution cannot be determined until the time of issuance; however, if KCS had issued, as of September 30, 2004 the maximum number of shares of KCS Common Stock contemplated by the Acquisition Agreement and by the Consulting Agreement, which would aggregate approximately 28.1 million shares (assuming a price of \$16.91 per share), then based upon approximately 62.7 million shares of KCS Common Stock outstanding as of that date and a book value per share then of \$12.54, the outstanding shares of KCS Common Stock outstanding would have increased by approximately 44.8%, and the book value per share of KCS Common Stock would have decreased, from \$12.54 to \$12.01.

**Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements**

The following summary of the terms and provisions of the Acquisition Agreement, the Stockholders' Agreement and the Consulting Agreement is qualified in its entirety by reference to each of those documents, a copy of which has been attached hereto as an appendix. You should read these agreements carefully for more details regarding the provisions described below and for other provisions that may be important to you.

**Table of Contents*****The Acquisition Agreement***

Upon the terms and subject to the conditions of the Acquisition Agreement, dated December 15, 2004, by and among KCS, KARA Sub, Inc. ( KARA Sub ), KCS Investment I, Ltd. ( KCS Investment ), Caymex Transportation, Inc. ( Caymex ), KCS Acquisition Subsidiary, Inc. ( KCS Sub ), Grupo TMM, TMM Holdings and Multimodal and Grupo TFM, KCS would acquire all of the interest of Multimodal in Grupo TFM for consideration to Multimodal of \$200 million, 18 million shares of KCS Common Stock, and the remaining amount due on the Indemnity Escrow Notes. In addition, if there is a Final Resolution of the VAT Claim and Put, KCS will pay to Multimodal any VAT Contingency Payment due pursuant to the terms of the Acquisition Agreement. 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, KCS Investment and Caymex (the KCS Purchasers ) will purchase from Multimodal, in the proportions set forth below, 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.

	Share of Grupo TFM Series A Fixed Capital Stock	Shares of Grupo TFM Series A Variable Capital Stock
KARA Sub	12,750	1,696,201
KCS Investment	12,750	1,696,201
Caymex	0	450,499
	<hr/>	<hr/>
Total	25,500	3,842,901
	<hr/>	<hr/>

The purchase price to be paid by the KCS Purchasers to Multimodal for the purchase of the Grupo TFM shares shall be paid by the delivery at the Closing of: (i) \$200 million in cash; (ii) 18 million shares of KCS Common Stock; and (iii) Indemnity Escrow Notes to be deposited into the Indemnity Escrow at Closing to be held in accordance with the terms and conditions of the Indemnity Escrow Agreement. Upon satisfaction of the terms and conditions of the Indemnity Escrow Agreement, the remaining amount due under the Indemnity Escrow Notes will be paid to Multimodal. Additionally, in the event of the Final Resolution of the VAT Claim and Put, KCS will pay to Multimodal on the date that is determined as provided in the Acquisition Agreement, the amount of any VAT Contingency Payment then due under the terms and conditions of the Acquisition Agreement. This step is referred to as the Stock Purchase.

At the Closing, the intercompany receivables between Grupo TFM and its subsidiaries, on the one hand, and Grupo TMM and its affiliates, on the other hand, will be settled as a net receivable amount and will be paid to the party with the greater amount of open accounts receivables within three business days after the amount is finally determined as set forth in the Acquisition Agreement.

(2) *The Subsidiary Investment.* Grupo TFM will, effective at the Closing Date, adopt resolutions to effect a capital reduction (the Capital Reduction ). The Capital Reduction will result in Grupo TFM s issuance to Multimodal of a subordinated promissory note of Grupo TFM in the amount of MXP \$2,440,228,860 (the Grupo TFM Sub Note ).

At the Closing, the following transactions, referred to as the Subsidiary Investment will take place: (i) Multimodal will exchange the Grupo TFM Sub Note for a subordinated promissory note of KCS Sub (the KCS Sub Note ) in the same principal amount as the Grupo TFM Sub Note; and (ii) Multimodal will purchase 10% of the authorized KCS Sub common stock (the KCS Sub Shares ), in consideration for delivery by Multimodal to KCS Sub of the KCS Sub Note. This step is referred to as the Subsidiary Investment. Multimodal and KCS Sub have entered into the Subscription Agreement for the purchase by Multimodal of these shares. The Grupo TFM Sub Note will following the Closing be delivered to Grupo TFM by KCS or subsidiaries of KCS in exchange for additional equity of Grupo TFM.

**Table of Contents**

(3) *The Merger.* KCS Sub will then be merged into KCS in accordance with the General Corporation Law of the State of Delaware (the Delaware Corporation Law ). The Merger will be consummated by filing a certificate of merger with the Delaware Secretary of State in accordance with the Delaware Corporation Law. This step is referred to as the Merger. At such time, the shares of KCS Sub held by Multimodal will be converted into and exchanged for 18 million shares of KCS Common Stock. As a result of the Merger, the separate corporate existence of KCS Sub will cease and KCS will continue as the surviving corporation. The shares of KCS Common Stock and KCS Preferred Stock issued and outstanding immediately prior to the filing of the certificate of merger will remain issued and outstanding as shares of KCS Common Stock and KCS Preferred Stock.

The closing of the Acquisition is dependent upon the closing of each of the Stock Purchase, the Subsidiary Investment and the Merger.

*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:

KCS must have obtained approval of KCS stockholders of the issuance of KCS Common Stock specified in the Proposal;

All consents, waivers, authorizations and approvals required from all governmental authorities must have been obtained;

The KCS Common Stock to be issued must have been approved for listing by the NYSE;

There must not be any insolvency or bankruptcy proceeding pending against Grupo TMM, Multimodal, TMM Holdings, Grupo TFM or TFM; and

Certain of the documents placed in the Closing Escrow must be eligible for release from the Closing Escrow, subject only to the occurrence of the Closing.

*Termination*

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

By written consent of KCS and Grupo TMM;

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 TFM;

By KCS if any condition to the obligations of KCS under the Acquisition Agreement becomes incapable of fulfillment through no fault of KCS and is not waived by KCS;

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;

By KCS if Grupo TMM has experienced a change of control or publicly announced any agreement or intention to complete a transaction which would result in a change of control, or by Grupo TMM if KCS has experienced a change of control or publicly announced any agreement or intention to complete a transaction which would result in a change of control;

**Table of Contents**

By KCS or Grupo TMM if the Closing has not occurred on or prior to December 31, 2005 (the Termination Date ); provided, however, that the Termination Date may be extended by KCS and Grupo TMM by written agreement; and

By KCS or Grupo TMM if KCS does not obtain stockholder approval of the Proposal.

A termination fee of \$18 million is payable in the event of termination of the Acquisition Agreement due to (i) a change of control, or the public announcement of any agreement or intention to complete a transaction which would result in a change of control, of either KCS or Grupo TMM, in which case the party experiencing the change of control or making such public announcement must 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 have not approved the Acquisition shall pay to the other party, if that other party elects to terminate, the termination fee.

*Required Regulatory and Other Consents, Approvals and Filings*

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

Prior approval of the Mexican Foreign Investments Commission of control of Grupo TFM by a non-Mexican entity;

Clearance by the Mexican Antitrust Commission of anti-competitive concerns;

Notice to the Mexican Ministry of Communications and Transportation;

Approval by the NYSE for listing of Common Stock to be issued by KCS pursuant to the Acquisition Agreement;

Notice filing under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ( HSR ) and clearance of investment by Multimodal in KCS; and

KCS stockholder approval of issuance of KCS Common Stock.

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

*VAT Contingency Payment*

The VAT Claim by TFM against the Mexican Treasury for the refund of a VAT payment in the original principal amount of 2,111,111,790 pesos, plus indexation and interest, 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.

After a number of rulings and appeals, on January 19, 2004, TFM received a Special Certificate from the Mexican Federal Treasury. The Special Certificate represents the refund of the value added tax paid and may be used by TFM to satisfy any tax liabilities due. The Special Certificate has the same face amount as the VAT refund claimed by TFM in 1997 (2,111,111,790 pesos). The Special Certificate delivered to TFM had not been adjusted to reflect interest and inflation.

TFM was served on January 20, 2004 with an official letter notifying TFM of the Mexican Government's findings and conclusions arising from its tax audit of TFM's 1997 tax returns ( Tax Audit Summary ). In the Tax Audit Summary, the Mexican government notified TFM of its preliminary conclusion that the documentation provided by TFM in support of the VAT refund and TFM's basis in the concession title, locomotives and rail equipment, and capital leases purchased by TFM's predecessor in interest, Ferrocarril del Noreste, S.A. de C.V., prior to Grupo TFM's purchase of 80% of the shares of TFM, do not comply with the formalities required by the applicable tax legislation. If sustained, the conclusions of the Tax Audit Summary



**Table of Contents**

would prevent TFM from depreciating the concession title, locomotives and rail equipment, and capital leases that represent the majority of the value of the assets owned by TFM. The Tax Audit Summary also seized the Special Certificate received by TFM on January 19, 2004 from the Mexican Federal Treasury, pending resolution of the audit, as a potential asset to be used to satisfy any tax obligations owed by TFM as a result of the audit. TFM has advised that it has, within the time allowed by the Tax Audit Summary, contested the conclusions of the Mexican tax authorities, and it has filed a constitutional appeal against the Tax Audit Summary, alleging that the process followed by the Mexican government violated TFM's constitutional rights.

TFM also filed a complaint seeking an order that would require the Mexican government to issue a new Special Certificate in the amount of the original VAT refunded, adjusted to reflect interest and penalties from 1997 in accordance with applicable Mexican law and regulations. The Mexican Fiscal Court denied TFM's complaint, and TFM appealed that decision. TFM was served on January 5, 2005 with the favorable decision of the Federal Appellate Court. The decision upholds TFM's claim that it is entitled to inflation and interest from 1997 on VAT refund it received from the Mexican government. The Federal Appellate Court remanded the case to the Fiscal Court with instructions to enter a new order consistent with this decision. On January 26, 2005, the Mexican Fiscal Court issued from the bench a favorable decision upholding TFM's claim for inflation and interest from 1997 on the VAT refund it received from the Mexican government. TFM has not yet been formally notified of the Court's written decision.

Grupo TMM and KCS also announced on January 6, 2005 that Grupo TMM, Grupo TFM, and TFM have been served with a commercial lawsuit brought before a Mexican Federal Court by the Mexican Federal Government. KCS is also named as a defendant, but it has not yet been served. The Court refused to accept several claims asserted by the Mexican government in the lawsuit. The Mexican government has appealed that decision. The Court accepted for consideration the Mexican government's request to determine whether the defendants have complied with all of the legal obligations they assumed during the process of the privatization of Ferrocarril del Noreste, S.A. de C.V. (today, TFM). Grupo TMM, Grupo TFM and TFM have answered the lawsuit, denying the Mexican government's claims and asserting several affirmative defenses.

On the later to occur of (i) the Closing Date, or (ii) the Final Resolution of the VAT Claim and Put (defined below), KCS will pay the VAT Contingency Payment. Final Resolution of the VAT Claim and Put means any combination of settlements, resolutions, agreements or other legal actions which collectively result in KCS, any affiliate, Grupo TFM or any GTFM Subsidiary receiving the shares of TFM owned by the Mexican government, without any appeal or other claim having been brought within 180 days thereafter by any governmental agency or other person, and the favorable cancellation of the 1997 tax audit carried out by the Mexican Tax Administration Service as a result of which no additional tax liability is imposed in connection with the amortization and or deduction of the value of the Concession and Concession related assets with respect to that tax period and the termination or dismissal with prejudice of all litigation relating to the VAT Claim and the Put, or which is otherwise agreed to in writing by KCS, provided KCS receives the consideration provided for in such written agreement. The VAT Contingency Payment is equal to the sum of \$110 million, reduced (but not below zero) by the following:

any cash payments required to be made by KCS, TFM or any of their respective affiliates to any Mexican government agency to obtain the Final Resolution of the VAT Claim and Put, net of any cash payments received by KCS, TFM or such affiliates from any Mexican government agency related to the Final Resolution of the VAT Claim and Put;

23% of the amount of any net operating losses available to TFM and its subsidiaries under applicable UMS tax laws which are relinquished to the Mexican government by TFM and its affiliates without any other value received therefor (the NOL Value);

67% of the face amount of any other tax credits under Mexican law which TFM or any of its affiliates is required to apply, use or relinquish to the Mexican government without any other value received in exchange therefor, to obtain the Final Resolution of the VAT Claim and Put;

## **Table of Contents**

any taxes incurred with respect to the Final Resolution of the VAT Claim and Put which are not offset by the NOL Value or the other tax credits referred to above; and

the contingency fees, in an amount of \$1,500,000 each (but not any portion of ongoing legal fees and expenses) to the extent required to be paid by Grupo TFM or any GTFM Subsidiary to either of two law firms in connection with the successful resolution of the Put and another law firm in connection with the successful resolution of the VAT Claim.

The VAT Contingency Payment will be paid as follows: (i) \$35 million will be paid in cash; (ii) \$35 million will be paid by delivery of that number of shares of KCS Common Stock, valued at the Volume Weighted Price (defined below), equal to \$35 million, and (iii) \$40 million will be paid by deposit into escrow (the VAT Escrow ), to be held and be subject to reduction in accordance with the terms of the VAT Escrow Agreement, of a promissory note in the principal amount of \$40 million (the VAT Escrow Note ), which will be converted at the fifth anniversary of the Closing Date, or at such earlier date following the date that is two years after the Final Resolution of the VAT Claim and Put as KCS may, in its sole discretion, deem appropriate after consultation with a tax consultant knowledgeable about Mexican tax laws, into that number of shares of KCS Common Stock, valued at the Volume Weighted Price, equal to the remaining principal amount of the VAT Escrow as of such date. Any reduction in the VAT Contingency Payment will be made in equal proportions in the amounts set forth in (i) through (iii) above. KCS may, at its election, deliver shares of KCS Common Stock valued at the Volume Weighted Price, in lieu of any portion of the cash payment. Under the Acquisition Agreement, the Volume Weighted Price means the average trading price per share for KCS Common Stock on the NYSE, as reported on the Bloomberg (VAP function), for the 20 consecutive trading days immediately preceding the later of (i) the Closing Date, or (ii) the date of the public announcement by KCS of the Final Resolution of the VAT Claim and Put.

KCS has the exclusive right to manage the negotiation, prosecution and settlement of the VAT Claim and any extensions or other modifications of the obligations under the Put on behalf of Grupo TFM and TFM.

### *Voting Trust and Amendment to Trust Agreement*

Holders of more than a majority of the outstanding Series A shares of Grupo TMM have entered into an irrevocable voting trust agreement and an amendment to a trust agreement pursuant to which the trustee has been irrevocably instructed to vote such shares in favor of the Acquisition Agreement and the transactions contemplated by that agreement and the Ancillary Agreements. The affirmative vote of the shares subject to the voting trust and the amended trust agreement are sufficient to constitute the necessary approval of Grupo TMM stockholders of the Acquisition Agreement and such contemplated transactions.

As part of the Grupo TMM stockholder approval, Grupo TMM (as the holder owning all but one share of TMM Holdings capital stock) will be irrevocably instructed to irrevocably vote all such shares of TMM Holdings capital stock in favor of the Acquisition Agreement and the transactions contemplated by that agreement and the Ancillary Agreements. As part of the TMM Holdings stockholder approval, TMM Holdings (holder of more than 91% of the shares of Multimodal entitled to vote), will be irrevocably instructed to irrevocably vote such shares of Multimodal capital stock in favor of the Acquisition Agreement and the transactions contemplated by that agreement and the Ancillary Agreements.

### *Third Party Matters*

Until the filing of the Certificate of Merger for the Merger, neither KCS nor Sellers may seek or entertain other offers, or enter into any agreements, with respect to certain 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.

**Table of Contents**

*Indemnification*

The representations and warranties of the Sellers and KCS generally survive until April 1, 2007, or in some cases for the applicable statute of limitations. The Sellers have jointly and severally agreed to indemnify KCS, and its subsidiaries (including, following the Acquisition, Grupo TFM and the GTFM Subsidiaries), and their respective officers, directors, alternative directors, employees, members, stockholders, agents and representatives ( KCS Indemnitees ) 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, arising out of or due to:

(i) any inaccuracy or misrepresentation in, or breach of, any representation or warranty of Sellers (except as discussed below with respect to tax indemnification) 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;

(ii) certain actions by certain persons that constituted a fraud or a felonious criminal act, or occurred during the period from April 20, 2003 to the date of the Acquisition Agreement and required the approval of KCS under the terms of the Original Acquisition Agreement, which approval was not obtained and resulted in Losses to Grupo TFM or any Grupo TFM Subsidiary in excess of \$1 million;

(iii) penalties and other termination payments aggregating more than \$1 million required to be paid by Grupo TFM and the GTFM Subsidiaries to terminate certain contracts;

(iv) claims against Grupo TMM or any of its affiliates for any breach in performance during the two-year period following the Closing Date of any obligation of Grupo TMM or any of its affiliates under certain agreements with Grupo TFM or any GTFM Subsidiary continuing after the Closing Date; or

(v) any litigation, arbitration, mediation or other adversary proceeding brought against any KCS Indemnitee by José Joaquín de Teresa y Polignac or any of its affiliates, other than for certain fees or expenses incurred in certain ongoing litigation.

The Sellers' indemnification obligations for any inaccuracy or misrepresentation in, or breach of, any representation or warranty regarding Grupo TFM or its subsidiaries, with certain exceptions, is limited to 51% of Losses aggregating \$5 million or more. Any claim against the Sellers for indemnification for Losses with certain exceptions, will be satisfied exclusively out of, and the maximum aggregate liability of all of the Sellers for such Losses is limited to, the assets held in the Indemnity Escrow. 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 or willful misconduct. The computation of Losses excludes all Losses with respect to any single matter that are less than \$50,000.

The Sellers have jointly and severally agreed to indemnify each of the KCS Indemnitees against 51% of certain taxes and associated penalties, interest and similar charges of Grupo TFM and the GTFM Subsidiaries. The Sellers' indemnification obligations with respect to these taxes is not limited to the assets held in the Indemnity Escrow or the VAT Escrow; provided that at KCS's election, to the extent assets remain in the Indemnity Escrow or the VAT Escrow, Sellers' indemnification obligations may be satisfied from such assets.

KCS has agreed to indemnify the Sellers, each of their subsidiaries and each of their respective officers, directors, alternate directors, employees, members, stockholders, agents and representatives ( Seller Indemnitees ) from and against all Losses resulting from, arising out of or due to 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

**Table of Contents**

part of KCS or its affiliate that involved a crime, fraud or willful misconduct. The computation of Losses excludes all Losses with respect to any single matter that are less than \$50,000.

KCS has agreed to indemnify the Sellers against certain post-Closing taxes of Grupo TFM and the GTFM Subsidiaries.

Any claim for indemnification by KCS against the assets held in the Indemnity Escrow, unless the claim is not contested by Grupo TMM, must be made by KCS by instituting arbitration proceedings in accordance with the dispute resolution procedures set forth in the Acquisition Agreement. No more than two indemnification arbitration proceedings may be instituted and no claim or proceeding may be instituted later than April 1, 2007.

*Suspension and Dismissal of Actions and Releases*

From the date of the Acquisition Agreement to the Closing Date or the date of termination of the Acquisition Agreement in accordance with its termination provisions, none of KCS, Grupo TMM or any of their respective controlled affiliates will commence, publicly threaten to commence or continue to pursue any previously filed proceedings, except to preserve their rights under the Acquisition Agreement, which are based upon or arise out of the Original Acquisition Agreement or any claim or allegation with respect to certain actions prior to the date of the Acquisition Agreement by management, employees, shareholders or agents of Grupo TMM or any of its subsidiaries. These claims will be dismissed or may be reinstated as set forth in the Acquisition Agreement.

Within 10 days after the date of the Acquisition Agreement, the parties will cause their respective litigation counsel to inform the American Arbitration Association of the suspension of the arbitration proceedings between KCS and Grupo TMM. The arbitration will be held in abeyance, but not dismissed or terminated until the Closing Date.

On the date of the Acquisition Agreement, KCS and Grupo TMM entered into mutual release agreements (the Releases ), which have been deposited in the Closing Escrow. The Releases will become effective on the Closing Date and will be released from the Closing Escrow to the parties entitled to receive them at the Closing, or at such earlier time as set forth in the Acquisition Agreement. See Ancillary Agreements Releases below.

With respect to the Authority Litigation (defined below), KCS will grant releases to persons identified in the Authority Litigation Agreement described below. See Ancillary Agreements Authority Litigation Agreement below.

Except where otherwise noted, the Ancillary Agreements have been entered into as of the date of the Acquisition Agreement, to become effective upon the Closing, to carry out certain objectives of the Acquisition Agreement and the Acquisition. These Ancillary Agreements are described below.

*Ancillary Agreements*

Stockholders Agreement

KCS, Grupo TMM, TMM Holdings, Multimodal and the Principal Stockholders have entered into a Stockholders Agreement, to become effective as of the Closing Date, which sets forth the rights and duties of the parties thereto arising out of and in connection with the Acquisition Agreement and the transactions contemplated thereby.

*Standstill Provisions*

For a period of seven years from the effective date of the Stockholders Agreement, Grupo TMM, TMM Holdings, Multimodal and each of the Principal Stockholders agree that, unless specifically invited in writing

**Table of Contents**

to do so by the Board of Directors, such person will not, and will cause each of its affiliates not to, among other things:

acquire or agree to acquire (other than pursuant to the Acquisition Agreement, the Consulting Agreement or the Stockholders Agreement) aggregate beneficial ownership of more than 20% of the Total Voting Power of KCS (as defined in the Stockholders Agreement);

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;

except as otherwise set forth in the Stockholders Agreement, grant any proxy with respect to any voting securities of KCS to any person not approved in writing by KCS;

otherwise act, alone or in concert with others, to seek to control or influence materially 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 of KCS beneficially owned by them (a Disposition), except in accordance with the terms of the Stockholders Agreement. For a period of seven years from the effective date of the Stockholders Agreement, the TMM Holders may not effect a Disposition:

to a Competitor (as defined in the Stockholders Agreement), except as otherwise permitted by the Stockholders Agreement;

to any affiliate of Grupo TMM, TMM Holdings, Multimodal or the Principal Stockholders unless such affiliate agrees in writing to be bound by the terms of the Stockholders Agreement and provided that the TMM Holders will generally remain jointly and severally responsible for any breaches of the Stockholders Agreement by such affiliate;

that in the aggregate represents 5% or more of the outstanding voting securities of KCS to any Person other than a 13G Filer (as defined in the Stockholders Agreement), and no such disposition shall be made to any 13G Filer unless such 13G Filer would continue to be eligible to file reports pursuant to Section 13(g) 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 at the same per share purchase price in the proposed acquisition;

to any person or group that would, together with such person's affiliates and 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 more than 15% of the Total Voting Power of KCS; and

of any capital stock or voting securities of KCS or control of any person that, directly or indirectly, beneficially owns any voting securities of KCS to a Competitor, except as otherwise permitted by the Stockholders Agreement.

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 of KCS beneficially owned by such person provided that KCS shall have a right to purchase the pledged voting securities upon the occurrence of an event which gives the pledgee the right to foreclose on the pledged voting securities.

The TMM Holders may participate in a tender or exchange offer made by an unaffiliated third party to acquire KCS Common Stock, provided: (i) the TMM Holders are in compliance with the standstill provisions

## **Table of Contents**

of the Stockholders Agreement with respect to such offer; (ii) the offer is for all of the outstanding voting securities of KCS; (iii) the offeror has made a commitment to effect a merger after completion of the offer to provide the same consideration being provided to the holders of the securities tendered in the tender offer; (iv) the holders of a majority of the voting securities of KCS, other than the voting securities beneficially owned by the TMM Holders, have tendered and not withdrawn their voting securities pursuant to the offer; (v) the tender or exchange offer is not conditioned on financing; and (vi) the TMM Holders do not tender, or publicly disclose their intention to tender, prior to the last business day before expiration of the offer.

Except as otherwise provided, 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 KCS Common Stock (or, as applicable, options, warrants or other securities convertible into or exercisable for KCS Common Stock) to maintain their percentage ownership in the event KCS authorizes the issuance or sale of any shares of KCS Common Stock or any securities containing options or rights to acquire shares of KCS Common Stock, other than as a dividend on the outstanding KCS Common Stock, and except for issuances of KCS Common Stock (including for this purpose, options, warrants and other securities convertible into or exercisable for KCS Common Stock) issued:

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;

upon the exercise of any options, warrants, convertible or exchangeable securities which are outstanding as of the date of the Stockholders Agreement;

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

issued pursuant to the Acquisition Agreement, the Ancillary Agreements or the Consulting Agreement.

The TMM Holders pre-emptive rights under the Stockholders Agreement terminate on the earlier to occur of (i) the date that the TMM Holders beneficially own in the aggregate less than 40% of the voting securities of KCS initially acquired by Multimodal pursuant to the Acquisition Agreement; or (ii) three years following the date of the Stockholders Agreement.

### *Voting Agreement*

Each TMM Holder will vote all of the voting securities of KCS beneficially owned by such person and entitled to vote in the election of directors: (i) in favor of all nominees of the KCS Nominating Committee; and (ii) against any proposal to remove any director nominated by the KCS Nominating Committee and elected to the KCS Board of Directors by the KCS stockholders.

### *Termination*

Subject to specific termination provisions contained in the Stockholders Agreement, the Agreement (with a few exceptions) terminates on the earliest to occur of (i) the first date the TMM Holders and their affiliates have, for at least 30 consecutive days, beneficially owned in the aggregate less than 40% of the voting securities of KCS initially acquired by Multimodal pursuant to the Merger; and (ii) the termination of the Stockholders Agreement by the parties in writing and approved by the KCS Board of Directors.

**Table of Contents**

*Registration Rights Agreement*

KCS, Grupo TMM, Multimodal and certain principal stockholders of Grupo TMM have entered into the Registration Rights Agreement, which provides Grupo TMM, Multimodal, such principal stockholders of Grupo TMM, and any Permitted Transferee (as defined in the Registration Rights Agreement) who acquires shares of Registrable Stock (as defined in the Registration Rights Agreement) from Grupo TMM, Multimodal or any such principal stockholder 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) issued pursuant to the Acquisition Agreement, (ii) issued pursuant to the Consulting Agreement, or (iii) otherwise acquired by a Holder upon exercise of pre-emptive rights in compliance with the Stockholders Agreement.

*Required and Incidental Registrations*

The Holders shall have the right to request at any time prior to the five year anniversary of the effective date of the Registration Rights Agreement up to six demand registrations upon the request of Holders of 10% or more of the shares of Registrable Stock. However, KCS will not be required to file more than one shelf registration. KCS will use commercially reasonable efforts to file the registration statement within 30 business days after receipt of the request, provided that KCS will not be required to file a registration statement prior to 180 days after the Closing. Holders will also be entitled to unlimited incidental, or piggy-back, registrations. KCS can delay filing registrations upon the occurrence of certain events, including situations in which (i) KCS is not eligible to use Form S-3 to effect such registration, (ii) KCS gives notice to the Holders of its bona fide intention to file a registration statement with the SEC within 30 days of receipt of the Holders request for registration (other than a Form S-8 registration statement), or (iii) 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 will 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. The registration expenses to be paid by KCS do not include any underwriting discounts, selling commissions or stock transfer taxes applicable to the sale of the Registrable Stock, or expenses of marketing and promotional efforts of the underwriters in connection with an underwritten offering of Registrable Stock in a demand registration. 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.

*Indemnification*

In the event of a registration of Registrable Stock pursuant to the Registration Rights Agreement, KCS will indemnify the Sellers, underwriters, their respective control persons, and their respective officers, directors, employees and advisors, against certain expenses, losses, claims, damages or liabilities which arise out of or are based upon any untrue or alleged untrue statement or any omission or alleged omission of a required material fact contained in the registration statement, any related prospectus, amendment or supplement. The Holders will jointly and severally indemnify KCS, each of its control persons, officers of KCS who sign the registration statement, directors of KCS and underwriters and their control persons against such

## **Table of Contents**

expenses, losses, claims, damages or liabilities if such statement or omission was made in reliance upon and in conformity with information furnished to KCS by a Holder of Registrable Stock specifically for use in connection with the preparation of the registration statement, related prospectus, amendment or supplement.

### *Termination*

Except with respect to the indemnification provisions, the rights under the Registration Rights Agreement terminate as to any Holder on the earliest to occur of (i) five years after the Closing and (ii) such time as the Holder is free to sell all of such Holder's shares of Registrable Stock without registration under the Securities Act of 1933 and without restriction as to the manner of sale.

### *Marketing and Services Agreement*

#### *Most Favored Nation Arrangement and Provision of Services*

TMM Logistics, S.A. de C.V. ( TMM Logistics ) and together with its subsidiaries, affiliates and joint venture companies, the Parent Group ), TFM and KCSR (together with its subsidiaries and affiliates, the KCS Group ) have entered into the Marketing and Services Agreement. The Marketing and Services Agreement provides, among other things, that (i) except as otherwise provided, upon the request of any member of the Parent Group, TFM will provide certain intermodal services to any member of the Parent Group on terms which are no less favorable than the terms for like volumes and services provided to third or fourth party logistics companies (i.e., companies that are not rail carriers or shippers, and which as a majority of their business, arrange for transportation of goods and manage the supply chain of goods for others); (ii) the Parent Group will have the right to be the exclusive provider of Road-Railer freight services over TFM's rail system within Mexico, and that the KCS Group will not sell, market or otherwise provide such services through any other person over TFM's rail system within Mexico; (iii) to the extent that TFM determines to utilize a third party to operate its intermodal terminals within Mexico or to provide other services of the type which are the subject of the Marketing and Services Agreement, the Parent Group will be preferred to operate such intermodal terminals or to provide such services over any unrelated third party, subject to certain conditions; and (iv) the Parent Group will have the right to make a bid for the provision of certain transportation logistics services, if TFM and its subsidiaries and affiliates determine to have such services provided by any unaffiliated third party in Mexico.

### *Term and Termination*

The initial term of the Marketing and Services Agreement is five years from the Closing Date, and will be automatically renewed for periods of one year unless terminated by the Parent Group or the KCS Group. Notwithstanding the foregoing, the Marketing and Services Agreement will terminate automatically in the event that (i) TMM Logistics 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 the Parent Group occurs and the party effecting such change of control is a Competitor (as defined in the Acquisition Agreement). The Marketing and Services Agreement may also be terminated by TFM or the KCS Group in the event the Parent Group or TMM Logistics or any of their officers, directors or controlling shareholders has engaged in any act which has resulted in harm to the assets or business of TFM or the KCS Group or which involved the receipt of a material improper benefit by any person. Certain provisions of the Marketing and Services Agreement survive the termination of that agreement.

### *Indemnification*

Every party to the Marketing and Services Agreement will indemnify the other party or parties, as the case may be, and their respective shareholders, directors, officers, employees, representatives, agents, servants, successors and assigns and reimburse indemnified parties for any losses, damages, deficiencies, claims, causes of action or expenses incurred by indemnified parties arising out of or resulting from any breach of any warranty, representation, covenant or obligation of the indemnifying party under the Marketing and Services Agreement.



**Table of Contents**

Acquisition Agreement Claims and Management Claims Releases

KCS and Grupo TMM, each on behalf of itself and its controlled affiliates, have entered into Releases releasing and discharging certain of the other's officers and directors from all losses, damages, liabilities, claims, demands, obligations, deficiencies, payments, judgments, settlements, costs and expenses based upon or arising out of the Original Acquisition Agreement or the transactions referred to in that agreement ( Acquisition Agreement Claims ) or any claim or allegation with respect to actions taken or meetings held prior to the date of the Acquisition Agreement by, or in their capacity as, directors, officers, employees, shareholders or agents of Grupo TMM or any of its subsidiaries ( Management Claims ). The Acquisition Agreement Claims Releases and the Management Claims Releases will become effective only upon and subject to the Closing and the proper release of the Releases by the escrow agent (the Closing Escrow Agent ) in accordance with the terms of the Acquisition Agreement and the Closing Escrow Agreement described below. The Releases provide that nothing in the Releases will be deemed to release any of Grupo TMM, TMM Holdings, or Multimodal from their respective indemnification obligations under the Acquisition Agreement. The Releases become null and void if the Acquisition Agreement is terminated prior to the Closing for any reason other than as set forth in the Releases.

Closing Escrow Agreement

KCS, KARA Sub, KCS Investment, KCS Sub, Caymex, Grupo TMM, TMM Holdings, Multimodal (collectively referred to in this description of this agreement as the Parties ) and the Closing Escrow Agent have entered into the Closing Escrow Agreement dated and effective as of December 15, 2004, which provides for certain funds, securities, documents and other property deposited into the Closing Escrow to be held by the Closing Escrow Agent and released pursuant to the terms and conditions set forth in the agreement. Pursuant to the Closing Escrow Agreement, the Parties have deposited the following into the Closing Escrow:

the \$200 million in cash constituting a portion of the purchase price for the Grupo TFM shares;

the KCS Sub Note;

the stock certificate for the KCS Sub Shares;

two executed copies of the Subscription Agreement;

the form of the certificate of merger of KCS Sub with and into KCS;

the stock certificate for the 18 million shares of KCS Common Stock to be received by Multimodal in the Merger, which shares are not deemed issued or delivered by KCS until the issuance has been approved by the KCS stockholders and the shares have been listed for trading on the NYSE;

Releases relating to the Acquisition Agreement Claims;

Releases relating to the Management Claims;

Release resolutions;

documents to effect dismissals of the Acquisition Agreement Claims, the Management Claims and the Authority Litigation (defined below);

Releases relating to the Authority Litigation;

stock certificates for the Grupo TFM shares to be purchased pursuant to the Acquisition Agreement;

the Grupo TFM Sub Note;

resolutions adopted by the Grupo TFM Board of Directors effecting the Capital Reduction;

Upon receipt of written advice from both KCS and Grupo TMM that the Closing has occurred, the Closing Escrow Agent will date all undated documents in the Closing Escrow as of the Closing Date.

The Closing Escrow Agreement sets forth the rights and obligations of the Closing Escrow Agent, including the fees to be paid the Closing Escrow Agent under the agreement. Under the terms of the Closing

**Table of Contents**

Escrow Agreement, KCS and Grupo TMM will each pay one-half of the fees and expenses of the Closing Escrow Agent. This agreement terminates upon distribution in full of the Closing Escrow.

**Indemnity Escrow Agreement**

The Indemnity Escrow Agreement among KCS, Grupo TMM and the escrow agent (the Indemnity Escrow Agent ), dated and effective as of December 15, 2004, provides, among other things, that the KCS Purchasers will deposit with the Indemnity Escrow Agent the Indemnity Escrow Notes, or in the event KCS exercises its option to convert any portion of the Indemnity Escrow Notes to shares of KCS Common Stock, certificate(s) representing such shares. The Indemnity Escrow Agent will hold, reduce the principal amount of the Indemnity Escrow Notes or the number of shares, and deliver those notes or shares pursuant to the terms of the Indemnity Escrow Agreement. Under this agreement, the Indemnity Escrow Agent will reduce the Indemnity Escrow if the Indemnity Escrow Agent (i) receives joint written instructions from KCS and Grupo TMM, (ii) receives written instructions from KCS, simultaneously sent to Grupo TMM, and Grupo TMM does not object to those instructions within the time set forth in the Indemnity Escrow Agreement, or (iii) receives a final order, decree or judgment of a court of competent jurisdiction or arbitration tribunal. On June 1, 2007, the Indemnity Escrow Agent will deliver to Multimodal the Indemnity Escrow Notes, as reduced by all claims subject to payment from the Indemnity Escrow, and any shares of KCS Common Stock in the Indemnity Escrow. In the event there is an unresolved objection from Grupo TMM with respect to any claim for reduction of the principal amount of the Indemnity Escrow Notes (or shares of KCS Common Stock) on that date, the Indemnity Escrow Agent will deliver that portion of the Indemnity Escrow Notes or shares to Multimodal not subject to the unresolved objection, and will deliver the balance as directed by joint instructions from KCS and Grupo TMM, or a final order, decree or judgment of a court of competent jurisdiction or arbitration tribunal. The Indemnity Escrow Agreement sets forth the rights and obligations of the Indemnity Escrow Agent, including the fees to be paid the Indemnity Escrow Agent under the agreement. Under the terms of the Indemnity Escrow Agreement, KCS and Grupo TMM will each pay one-half of the fees and expenses of the Indemnity Escrow Agent. This agreement terminates upon the reduction of the Indemnity Escrow Notes in full principal amount or the delivery of the Indemnity Escrow Notes or shares to Multimodal.

**VAT Escrow Agreement**

The VAT Escrow Agreement among KCS, KARA Sub, KCS Investment, KCS Sub, Caymex, Grupo TMM, TMM Holdings, Multimodal and the escrow agent (the VAT Escrow Agent ), dated and effective as of December 15, 2004, sets forth the terms and conditions for the deposit, holding and release of the \$40 million VAT Escrow Note. This agreement provides, among other things, that on the later of the Closing Date or the Final Resolution of the VAT Claim and Put, KCS will deliver the VAT Escrow Note to the VAT Escrow Agent, to be held by the VAT Escrow Agent, and reduced and released only pursuant to the terms and conditions of the VAT Escrow Agreement. Under this agreement, the VAT Escrow Agent will reduce the VAT Escrow Note if the VAT Escrow Agent (i) receives joint written instructions from KCS and Grupo TMM, (ii) receives written instructions from KCS, simultaneously sent to Grupo TMM, and Grupo TMM does not object to those instructions within the time set forth in the VAT Escrow Agreement, or (iii) receives a final order, decree or judgment of a court of competent jurisdiction or arbitration tribunal (a final resolution ). On the earliest to occur of (a) the fifth anniversary of the deposit of the VAT Escrow Note into the VAT Escrow, (b) the receipt by the VAT Escrow Agent of written instructions from KCS, or (c) a final resolution of the dispute, the VAT Escrow Note, as reduced by all claims subject to payment from the VAT Escrow and in accordance with the procedures set forth in the VAT Escrow Agreement, will automatically be converted into the right to receive that number of shares of KCS Common Stock as provided for in the VAT Escrow Note. KCS will issue those shares of KCS Common Stock to Multimodal and the VAT Escrow Agent will return the VAT Escrow Note to KCS. In the event there is an unresolved objection with respect to any claim for reduction of the principal amount of the VAT Escrow Note on that date (i) KCS will deliver to MM that number of shares of KCS Common Stock as equal the portion of the VAT Escrow Note not subject to the dispute, and will deliver the balance upon agreement of the parties or a final resolution of the dispute, and (ii) the VAT Escrow Agent will deliver the VAT Escrow Note to KCS upon receipt of joint instructions of

**Table of Contents**

KCS and TMM, or a final resolution of the dispute. The VAT Escrow Agreement sets forth the rights and obligations of the VAT Escrow Agent, including the fees to be paid the VAT Escrow Agent under the agreement. Under the terms of the Indemnity Escrow Agreement, KCS and Grupo TMM will each pay one-half of the fees and expenses of the Indemnity Escrow Agent. This agreement terminates upon the earlier to occur of the reduction of the VAT Escrow Note in full principal amount or the delivery of the VAT Escrow Note to KCS.

*Authority Litigation Agreement and Authority Litigation Releases*

KCS, KARA Sub, KCS Investment, KCS Sub, Caymex, Nafta Rail, S.A. de C.V. (a subsidiary of KCS) (collectively, the KCS Parties ), Grupo TMM, TMM Holdings, Multimodal and Grupo TFM have entered into this agreement which provides for the KCS Parties and their employees who have initiated suits to grant releases (the Authority Litigation Releases ) to certain persons from all claims in connection with (i) certain powers of attorney purportedly granted by the TFM Board of Directors, (ii) the purported approval by the Grupo TFM Board of Directors of the purported execution of certain agreements by TFM, and (iii) the purported ratification of the TFM Board of Directors of the purported execution of certain agreements by TFM (the lawsuits relating thereto referred to as the Authority Litigation ). The Authority Litigation Releases will become effective and be released from the Closing Escrow to the parties entitled to receive them at the Closing in accordance with the terms of the Closing Escrow Agreement. The Authority Litigation Agreement further provides that within 10 days after the Closing, the KCS Parties will request that actions in the Authority Litigation against certain individuals be dismissed.

*Agreement of Assignment and Assumption of Rights, and Agency Agreement with Undisclosed Principal, Duties and Obligations*

This agreement, dated as of December 15, 2004, by and among Grupo TMM, KCS, and Grupo TFM, provides that Grupo TMM assigns and transfers to KCS, and KCS accepts and assumes, all of Grupo TMM's rights, duties and obligations with respect to the purchase of the TFM shares subject to the Put (the Put Shares ) under the Put Agreement described below, effective upon the Closing of the Acquisition. KCS will have the right to designate another party to be the purchaser of the Put Shares. However, no such designation will relieve KCS of its obligation to pay the purchase price for such Put Shares or to indemnify Grupo TMM, its affiliates, and their respective officers, directors, employees and shareholders against all Losses (as defined in this agreement) from KCS's failure to fully discharge the obligations of Grupo TMM and KCS under the Put Agreement.

According to the terms of the original share purchase agreement for the company currently known as TFM, as amended by 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 option under certain circumstances to compel the purchase of its 20% interest in TFM by Grupo TFM following notification to Grupo TFM by the Mexican government in accordance with the terms of the Put Agreement. Upon proper exercise of the Put, Grupo TFM would be obligated to purchase the TFM capital stock at the initial share price paid by Grupo TFM adjusted for interest and inflation. Prior to October 30, 2003, Grupo TFM filed suit in the Federal District Court of Mexico City seeking, among other things, a declaratory judgment interpreting whether Grupo TFM was obligated to honor its obligation under the Put Agreement, as the Mexican government had not made any effort to sell the TFM shares subject to the Put prior to October 31, 2003. In its suit, Grupo TFM named Grupo TMM and KCS as additional interested parties. The Mexican government has provided Grupo TFM with notice of its intention to sell its interest in TFM. Grupo TFM has responded to the Mexican government's notice reaffirming its right and interest in purchasing the Mexican government's remaining interest in TFM, but also advising the Mexican government that it would not take any action until its lawsuit seeking a declaratory judgment was resolved. Grupo TFM has obtained an injunction, which blocks the Mexican government from exercising the Put until the litigation is resolved. Following the final judicial determination that the Mexican government has properly exercised the Put or the lifting of this injunction, in the event that Grupo TFM does not purchase the Mexican government's 20% interest in TFM, Grupo TMM and KCS, or either of Grupo TMM or KCS alone, would, following notification by the Mexican government in accordance with the terms of the Put Agreement, be obligated to

## **Table of Contents**

purchase the Mexican government's remaining interest in TFM. If the Acquisition is completed prior to the valid exercise of the Put, KCS will be solely responsible for purchasing the Mexican government's 20% interest in TFM. If KCS had been required to purchase this interest as of September 30, 2004, the total purchase price would have been approximately \$476.5 million.

### ***Other Agreements***

#### **First Amendment to Rights Agreement**

In connection with the Acquisition, KCS and Harris Trust & Savings Bank, as Rights Agent will amend the Rights Agreement, dated as of September 19, 1995 (the "Rights Agreement"). The amendment will prevent the parties acquiring shares of KCS Common Stock as a result of the Acquisition and their affiliates from becoming an Acquiring Person (as defined in the Rights Agreement), which would otherwise cause a Triggering Event (as defined in the Rights Agreement). 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 KCS Common Stock issued or issuable upon the conversion and exchange of the KCS Sub common stock pursuant to the Acquisition Agreement, (ii) shares of KCS Common Stock acquired pursuant to Section 7.13(a) of the Acquisition Agreement, (iii) shares of KCS Common Stock issued pursuant to Section 6 of the Consulting Agreement, or (iv) shares of KCS Common Stock acquired in compliance with the Stockholders' Agreement, including upon exercise of pre-emptive rights as provided in that agreement.

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 will 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.

#### **Consulting Agreement**

KCS and the Consulting Firm have entered into a Consulting Agreement, dated as of December 15, 2004 but to become effective on the Closing Date, which calls for Consulting Firm to provide certain consulting services to the KCS Board of Directors related to the maintenance, fostering and promotion of a positive relationship between KCS and/or its affiliates and high-ranking officials of those branches of the Mexican government that have an impact on the Mexican railroad industry or KCS's rail network operations. José Serrano Segovia is required under the terms of the Consulting Agreement to be personally involved in the provision of services by the Consulting Firm. José Serrano Segovia is the current Chairman of the Board of Directors of Grupo TMM and certain of its subsidiaries, including TFM and Grupo TFM.

#### ***Term***

The Consulting Agreement has a term of three years beginning on the first business day following the Closing Date. Notwithstanding the three-year term, the Consulting Agreement and Consulting Firm's engagement shall terminate automatically upon the death or disability of José 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 Consulting Agreement.

**Table of Contents**

*Compensation*

Subject to the terms and conditions of the Consulting Agreement, KCS will pay to Consulting Firm an annual fee of \$3,000,000. The Consulting Agreement requires KCS to deposit the total amount of annual fee payable under the Consulting Agreement (\$9,000,000) in an escrow account (the Consulting Compensation Escrow ) to be held and released in accordance with the terms and conditions of the Consulting Agreement and the applicable escrow agreement (the Consulting Compensation Escrow Agreement ). The annual fee payable for each successive one-year period in the term will not be paid if a majority of the members of KCS's Board of Directors who are independent directors under the applicable rules of the NYSE (the Non-Management Directors ) reasonably determine in good faith that during the applicable one-year period, Consulting Firm or José Serrano Segovia has failed to comply in any material respect with the terms of the Consulting Agreement, which failure was not remedied after written notice from the Non-Management Directors.

As of the date of execution of the Consulting Compensation Escrow Agreement, Consulting Firm will control all investment decisions regarding the Consulting Compensation Escrow. Subject to the Stockholders' Agreement and applicable U.S. laws and regulations, if so instructed by Consulting Firm, the Consulting Compensation Escrow agent may acquire shares of capital stock of KCS (the Consulting Firm Stock ).

*VAT Claim and Put Advisory Fee*

On the later of the Closing Date and the Final Resolution of the VAT Claim and Put, KCS will pay to Consulting Firm \$9,000,000, which at KCS's election may be paid in cash or KCS Common Stock, valued at the Volume Weighted Price as defined in the Consulting Agreement, as consideration for Consulting Firm's services to KCS in connection with the resolution of the VAT Claim and Put. Volume Weighted Price is defined in the Consulting Agreement as the average trading price per share of KCS Common Stock on the NYSE for the 20 consecutive trading days immediately preceding the announcement of the Final Resolution of the VAT Claim and Put, as reported on Bloomberg (VAP function).

*Transfer Restrictions*

Consulting Firm may not sell, transfer, assign, pledge or otherwise dispose of (whether with or without consideration and whether voluntarily or involuntarily 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).

*Indemnification*

Consulting Firm will indemnify KCS, its affiliates and their respective officers, directors, employees, members, stockholders, agents and representatives against all losses resulting from, arising out of, or due to the filing of a lawsuit by one or more of Consulting Firm or any director, officer or employee of Consulting Firm against KCS and/or one or more of its affiliates claiming that a relationship, other than an independent contractor relationship, exists between any director, officer or employee of Consulting Firm and KCS and/or one or more of its affiliates. Jose Serrano Segovia has personally guaranteed these indemnification obligations of Consulting Firm.

*Consulting Compensation Escrow Agreement*

KCS, the Consulting Firm and the Consulting Compensation Escrow Agent have entered into the Consulting Compensation Escrow Agreement, dated and effective as of December 15, 2004, which sets forth the terms and conditions for the Consulting Compensation Escrow Agent to hold, invest and distribute the Consulting Compensation Escrow. At the Closing, KCS will deposit with the Consulting Compensation Escrow Agent the \$9,000,000 total amount of annual fee payable under the Consulting Agreement. All interest, gains, income and other distributions with respect to the Consulting Compensation Escrow will be for the benefit of the Consulting Firm.

## **Table of Contents**

No later than the last day of the month (or if not a business day, the next business day) following each of the first, second and third anniversary of the Consulting Compensation Escrow Agreement, the Consulting Compensation Escrow Agent will transfer to Consulting Firm the applicable amount of annual fee unless the Consulting Compensation Escrow Agent receives a written notice from KCS that the Consulting Firm is not entitled to such payment. Upon the timely receipt of such a notice, the Consulting Compensation Escrow Agent will transfer such amount to KCS (unless Consulting Firm disputes such notice, in which case no amounts will be transferred to KCS until the dispute is finally resolved), and will transfer to Consulting Firm the interest received on the Consulting Compensation Escrow during the applicable one-year period. If the Consulting Agreement is terminated prior to the expiration of its three-year term, the Consulting Compensation Escrow Agent will release the following amounts, upon written notice from KCS and Consulting Firm that the Consulting Agreement was terminated: (i) due to the death or disability of José Serrano Segovia, by the Consulting Firm due to a material breach thereof by KCS, or by KCS other than for cause, any remaining amounts held in the Consulting Compensation Escrow as of the date of termination to the Consulting Firm, (ii) due to the dissolution, bankruptcy or certain other events set forth in the Consulting Agreement with respect to the Consulting Firm, the annual fee or portion thereof accrued as of the date of the termination, together with interest received and not paid, to the Consulting Firm, and any remaining amounts in the Consulting Compensation Escrow after such payment, to KCS, and (iii) by the Consulting Firm without reason or by KCS for cause, the principal amount remaining in the Consulting Compensation Escrow as of the date of termination to KCS and any interest received and not paid as of the date of termination to the Consulting Firm.

The Consulting Compensation Escrow Agreement also includes provisions regarding the rights and obligations of the Consulting Compensation Escrow Agent, including the fees to be paid the Consulting Compensation Escrow Agent under the agreement. Under the terms of the Consulting Compensation Escrow Agreement, KCS and Grupo TMM will each pay one-half of the fees and expenses of the Consulting Compensation Escrow Agent. The agreement terminates upon distribution in full of the Consulting Compensation Escrow and all interest earned thereon.

### Agreement regarding Sellers' indemnification of KCS Indemnitees

The parties to the Acquisition Agreement have entered into an agreement, dated the same date as the Acquisition Agreement, which provides for the Sellers to indemnify the KCS Indemnitees against all Losses from any adversary proceeding brought against any KCS Indemnitee (i) by any Grupo TMM security holder relating to the Consulting Agreement, or (ii) with respect to the Capital Reduction. Any claim against Sellers for indemnification pursuant to this agreement may be satisfied from, but is not limited to, assets remaining in the Indemnity Escrow.

## **Regulatory Matters**

As discussed in Summary of the Acquisition Agreement, Ancillary Agreements and Other Agreements The Acquisition Agreement and Summary of the Acquisition Agreement, Ancillary Agreements and Other 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:

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. KCS filed a renewed application seeking authorization from that Commission on June 23, 2004. In a decision dated September 13, 2004, the Mexican National Foreign Investments Commission denied KCS's application, but invited KCS to reapply for authorization at anytime. KCS filed an amended application seeking authorization from that Commission on September 17, 2004. On

**Table of Contents**

October 6, 2004, KCS announced that it had received notice from that Commission approving its application. KCS must complete the transactions described in the Acquisition Agreement and the related agreements on or before October 5, 2005, or seek renewed authority from the Mexican National Foreign Investments Commission.

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 received formal written notice 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. On April 5, 2004, KCS announced that on April 2, 2004, the Mexican Competition Commission granted an extension of 180 days from the April 2, 2004 date of notice for its ruling issued on May 19, 2003 granting authority for the sale of Grupo TMM's interest in Grupo TFM to KCS. On October 7, 2004, KCS was notified by the Mexican Competition Commission that it had extended KCS's authority to purchase Grupo TMM's interest in Grupo TFM for an additional 180 days. This new ruling extends the authorization to April 5, 2005.

TFM formerly notified the Secretary of Communications and Transportation of the proposed transactions on May 2, 2003.

KCS filed its HSR 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. As more than one year has passed since the expiration of the waiting period, Grupo TMM and KCS will need to refile with the DOJ and restart the HSR process prior to consummating the transactions contemplated by the Acquisition Agreement. KCS and Grupo TMM filed new HSR notifications on December 22, 2004. The 30-day waiting period has expired without a formal request from the DOJ for additional information or documentary material.

**Requirement for Stockholder Approval**

KCS's listing application with the NYSE requires stockholder approval for the issuance of KCS Common Stock that represents in the aggregate more than 20% of the issued and outstanding shares of KCS Common Stock. In addition, the listing application requires stockholder approval for the issuance of securities to a substantial stockholder of KCS.

As of September 30, 2004, 62,702,450 shares of Common Stock were issued and outstanding. At the Closing of the Acquisition Agreement, Multimodal will acquire 18,000,000 shares of KCS Common Stock, which represents more than 20% of the issued and outstanding shares of Common Stock on a fully diluted basis, and Multimodal will become a substantial stockholder of KCS. In addition, KCS may issue up to that number of shares as equals \$157 million, valued at the Volume Weighted Price, as defined in the Acquisition Agreement. KCS may also issue up to that number of shares as equals \$9 million, valued at the Volume Weighted Price, as defined in the Consulting Agreement, entered into in connection with the transactions contemplated by the Acquisition Agreement.

**Required Vote and Board of Directors Recommendation**

In accordance with the Delaware Corporation Law and KCS's Restated Certificate of Incorporation, approval of this proposal requires the affirmative vote of the holders of a majority of the outstanding shares of Voting Stock present in person or represented by proxy at the Special Meeting and that are entitled to vote on the proposal, assuming a quorum is present.

YOUR BOARD RECOMMENDS THAT YOU VOTE

**FOR**  
PROPOSAL PROPOSED ISSUANCE OF COMMON STOCK



**Table of Contents****SELECTED FINANCIAL DATA****Selected Historical Consolidated Financial Data of KCS***(dollars in millions, except per share and ratio data)*

The following table sets forth selected consolidated financial data for KCS and certain subsidiaries and affiliates. The statement of income data for the years ended December 31, 2001, 2002 and 2003 and the balance sheet data as of December 31, 2002 and 2003 have been derived from KCS's audited financial statements which are incorporated by reference in this proxy statement. The statement of income data for the years ended December 31, 1999 and 2000 and the balance sheet data as of December 31, 1999, 2000 and 2001 have been derived from KCS's audited financial statements, none of which are included in this proxy statement. The statement of income data for the nine-month periods ended September 30, 2003 and 2004 and the balance sheet data as of September 30, 2004 have been derived from KCS's unaudited financial statements, which have been incorporated by reference in this proxy statement. The balance sheet data as of September 30, 2003 has been derived from KCS's unaudited financial statements not included in this proxy statement. The unaudited balance sheet data and statement of income data as of and for the nine-month periods ended September 30, 2003 and 2004 include all adjustments, consisting only of normal, recurring adjustments, which management considers necessary for a fair presentation of the financial position and results of operations of KCS as of such date and for such periods. Operating results for the nine months ended September 30, 2004 are not necessarily indicative of results that may be expected for the entire year or for any future period. All periods presented reflect the 1-for-2 reverse Common Stock split to stockholders of record on June 28, 2000 paid July 12, 2000. All of the summary data presented below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements of KCS and other financial information included elsewhere or incorporated by reference in this proxy statement.

	Nine Months September 30,		Year Ended December 31,				
	2004	2003	2003	2002	2001	2000	1999
	(Unaudited)						
Revenues	\$ 464.9	\$ 432.8	\$ 581.3	\$ 566.2	\$ 583.2	\$ 578.7	\$ 609.0
Equity in net earnings of unconsolidated affiliates							
continuing operations	\$ 5.7	\$ 5.2	\$ 11.0	\$ 43.4	\$ 27.1	\$ 22.1	\$ 5.2
Income from continuing operations(i)	\$ 23.7	\$ 8.5(ii)	\$ 3.3(ii)	\$ 57.2	\$ 31.1(iii)	\$ 16.7	\$ 10.2
Income from continuing operations per common share:							
Basic	\$ 0.27	\$ 0.06	\$ (0.04)	\$ 0.94	\$ 0.53	\$ 0.29	\$ 0.18
Diluted	\$ 0.27	\$ 0.06	\$ (0.04)	\$ 0.91	\$ 0.51	\$ 0.28	\$ 0.17
Total Assets (iv)	\$2,307.8	\$2,218.0	\$2,152.9	\$2,008.8	\$2,010.9	\$1,944.5	\$2,672.0
Total Debt	\$ 571.4	\$ 578.7	\$ 523.4	\$ 582.6	\$ 658.4	\$ 674.6	\$ 760.9
Cash dividends per common share	\$	\$	\$	\$	\$	\$	\$ 0.32
Ratio of earnings to fixed charges(v)	1.5x	(vi)	(vi)	1.3x	1.1x	1.0x	1.2x

- (i) Income from continuing operations for the years ended December 31, 2003, 2002, and 2001 include certain unusual operating expenses and other income as further described in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operation Results of Operations, in KCS's Annual Report on Form 10-K for the year ended December 31, 2003, which is incorporated by reference in this proxy statement. These costs include casualty claims, costs related to the implementation of MCS, benefits received from the settlement of certain legal and insurance claims, severance costs and expenses associated with legal verdicts against KCS, gains recorded on the sale of operating property, among others. Other non-operating income includes gains recorded on sale of non-operating properties and investments. For the year ended December 31, 1999, income from continuing operations



**Table of Contents**

includes unusual costs and expenses related to facility and project closures, employee separations and related costs, labor and personal injury related issues.

- (ii) Income from continuing operations for the nine months ended September 30, 2003 and for the year ended December 31, 2003 does not include a favorable after-tax benefit of \$8.9 million relating to the cumulative effect of an accounting change arising from a required change in the method of accounting for removal costs of certain track structure assets.
- (iii) Income from continuing operations for the year ended December 31, 2001 excludes a charge for the cumulative effect of an accounting change of \$0.4 million (net of income taxes of \$0.2 million). This charge reflects KCS's adoption of Statement of Financial Accounting Standard No. 133, Accounting for Derivative Instruments and Hedging Activities effective January 1, 2001.
- (iv) The total assets presented herein as of December 31, 1999 include the net assets of Stilwell Financial Inc. of \$814.6 million. Due to the spin-off of Stilwell Financial Inc. on July 12, 2000, the total assets as of December 31, 2003, 2002, 2001 and 2000 do not include the net assets of Stilwell Financial Inc.
- (v) The ratio of earnings to fixed charges is computed by dividing earnings by fixed charges. For this purpose earnings represent the sum of (i) pretax income from continuing operations adjusted for income (loss) from unconsolidated affiliates, (ii) fixed charges, (iii) distributed income from unconsolidated affiliates and (iv) amortization of capitalized interest, less capitalized interest. Fixed charges represent the sum of (i) interest expensed, (ii) capitalized interest, (iii) amortization of deferred debt issuance costs and (iv) one-third of our annual rental expense, which management believes is representative of the interest component of rental expense.
- (vi) For the year ended December 31, 2003, the ratio of earnings to fixed charges was less than 1:1. The ratio of earnings to fixed charges would have been 1:1 if a deficiency of \$18.2 million was eliminated. For the nine months ended September 30, 2003, the ratio of earnings to fixed charges was less than 1:1. The ratio of earnings to fixed charges would have been 1:1 if a deficiency of \$1.7 million was eliminated.

**Table of Contents****Selected Historical Combined and Consolidated Financial Data of Grupo TFM**

(amounts in millions of dollars, except per share amounts)

The following table sets forth selected combined and consolidated financial data for Grupo TFM and subsidiaries. The statement of income data for the years ended December 31, 2001, 2002 and 2003 and the balance sheet data as of December 31, 2002 and 2003 have been derived from Grupo TFM's audited financial statements included in this proxy statement. The statement of income data for the nine-month periods ended September 30, 2003 and 2004 and the balance sheet data as of September 30, 2003 and 2004 have been derived from Grupo TFM's unaudited financial statements as provided to KCS and included in this proxy statement. The statement of income data for the years ended December 31, 1999 and 2000 and the balance sheet data as of December 31, 1999, 2000 and 2001 have been derived from Grupo TFM's audited financial statements, none of which are included in this proxy statement. Operating results for the nine months ended September 30, 2004 are not necessarily indicative of results that may be expected for the entire year or for any future period. Financial information in the table below for Grupo TFM is reported under U.S. GAAP.

	Nine Months September 30,		Year Ended December 31,				
	2004	2003	2003	2002	2001	2000	1999
	(Unaudited)						
Revenues	\$ 526.9	\$ 523.3	\$ 698.5	\$ 712.1	\$ 720.6	\$ 695.4	\$ 574.6
Net income from continuing operations	\$ 9.3	\$ 13.5	\$ 27.3	\$ 110.2	\$ 73.6	\$ 44.9	\$ 1.6
Net income per share(i)	\$ 1.22	\$ 1.78	\$ 3.60	\$ 12.23	\$ 7.31	\$ 4.32	\$ 0.25
Total assets	\$2,308.5	\$2,299.9	\$2,337.5	\$2,326.5	\$2,272.2	\$2,130.4	\$2,109.5
Long-term debt	\$ 879.5	\$ 846.0	\$ 771.4	\$1,002.7	\$ 570.9	\$ 811.3	\$ 664.4
Long-term portion of capital lease obligations	\$ 1.3	\$ 1.6	\$ 1.6	\$ 1.9	\$ 2.1	\$	\$ 4.2
Cash dividends per common share							

- (i) Grupo TFM computes its provision for income taxes under the guidance of Statement of Financial Accounting Standards No. 109 as required by U.S. GAAP. The computation of deferred income taxes for Grupo TFM has a significant impact on its operating results. Deferred taxes for Grupo TFM are impacted by a number of factors, including the amount of pre-tax income or loss, inflationary gains or losses recognized for Mexican tax purposes especially those related to tax loss carryforwards, which represents a significant difference between U.S. and Mexican tax law. Other factors include differences between book and tax depreciation and amortization, changes in Mexican corporate tax rates, foreign exchange gains and losses and foreign exchange rate effects on deferred tax balances. Grupo TFM reported deferred tax benefits (expense) of (\$11.5) million, \$13.2 million, (\$9.3) million, \$91.5 million, \$62.3 million, \$29.5 million and \$20.9 million for the years ended December 31, 1999, 2000, 2001, 2002, 2003 and the nine-month periods ended September 30, 2003 and 2004, respectively. Additionally, deferred tax benefits (expense) impacted Grupo TFM earnings per share by (\$0.92), \$1.05, (\$0.87), \$8.12, \$8.21, \$5.07 and (\$3.08) for the years ended December 31, 1999, 2000, 2001, 2002, 2003 and the nine-month periods ended September 30, 2003 and 2004, respectively.

**Table of Contents****UNAUDITED PRO FORMA SELECTED CONSOLIDATED FINANCIAL DATA****For the Nine Months Ended September 30, 2004 (dollars in millions, except per share data)**

The following summarizes pro forma selected consolidated financial data of KCS assuming the transaction acquiring a controlling interest in Grupo TFM had been completed as of January 1, 2004 for income statement purposes and as of September 30, 2004 for balance sheet purposes.

	KCS Historical	Grupo TFM Historical	Mexrail Historical(iv)	Pro Forma Adjustments		Pro Forma
				Debit	Credit	
Revenues	\$ 464.9	\$ 526.9	\$ 9.7			\$ 1001.5
Equity in net earnings (losses) from unconsolidated affiliates continuing operations	\$ 5.7	\$ (0.8)		\$ 4.5(i)		\$ .4
Income from continuing operations	\$ 23.7	\$ 9.3	\$ (1.6)	\$ 10.5		\$ 20.9
Income from continuing operations per common share:						
Basic(ii)	\$ 0.27					\$ 0.18
Diluted(ii)	\$ 0.27					\$ 0.17
Basic Weighted Average Common shares outstanding ( <i>in thousands</i> )	62,605			18,000		80,605
Diluted Weighted Average Common shares outstanding ( <i>in thousands</i> )	63,856			18,000		81,856
Total Assets	\$2,307.8	\$2,308.5	\$85.8	\$ 403.4	\$752.5	\$4,353.0
Total Debt	\$ 571.4	\$ 906.7	\$31.3	\$ 51.0	\$115.9	\$1,574.3
Cash dividends per common share	\$	\$				\$
Book value per common share(iii)	\$ 12.55					\$ 13.52

- (i) Assuming the contemplated transaction would have been consummated on January 1, 2004, KCS would have consolidated earnings of Grupo TFM and accordingly, the equity in earnings of Grupo TFM would be eliminated.
- (ii) Pro forma per share amounts assume 18,000,000 shares of KCS Common Stock to be issued under the Acquisition Agreement.
- (iii) Historical book value per share is calculated as Total Stockholder's equity less \$199.1 million preferred equity divided by Common shares outstanding at September 30, 2004 of 62,702,460. Pro forma book value per share is calculated as Total Stockholder's equity less \$199.1 million preferred equity divided by 80,702,460, which includes the 18,000,000 shares of KCS Common stock to be issued under the Acquisition Agreement.
- (iv) Represents Mexrail's Historical Income Statement for the period August 1, 2004 through September 30, 2004 (See Note 21 of Notes to Condensed Consolidated Pro Forma Financial Statements).

**Table of Contents****UNAUDITED PRO FORMA SELECTED CONSOLIDATED FINANCIAL DATA**

**For the Year Ended December 31, 2003 (dollars in millions, except per share data)**

The following summarizes pro forma selected consolidated financial data of KCS assuming the transaction acquiring a controlling interest in Grupo TFM had been completed as of January 1, 2003.

	KCS Historical	Consolidated Grupo TFM	Pro Forma Adjustments		Pro Forma
			Debit	Credit	
Revenues	\$ 581.3	\$698.5			\$1,279.8
Equity in net earnings (losses) from unconsolidated affiliates continuing operations	\$ 11.0		\$12.3(i)		\$ (1.3)
Income from continuing operations	\$ 3.3	\$ 27.3	\$24.8		\$ 5.8
Income from continuing operations per common share before cumulative effect of accounting change:					
Basic (ii)	\$ (0.04)				\$ (0.04)
Diluted (ii)	\$ (0.04)				\$ (0.04)
Basic Weighted Average Common shares outstanding ( <i>in thousands</i> )	62,605			18,000	80,605
Diluted Weighted Average Common shares outstanding ( <i>in thousands</i> )	63,856			18,000	81,856
Cash dividends per common share	\$	\$	\$	\$	\$

(i) Assuming the contemplated transaction would have been consummated on January 1, 2003, KCS would have consolidated earnings of Grupo TFM and accordingly, the equity in earnings of Grupo TFM would be eliminated.

(ii) Pro forma per share amounts assume 18,000,000 shares of KCS Common Stock to be issued under the Acquisition Agreement.

**Table of Contents**

**FINANCIAL STATEMENTS OF GRUPO TFM**

The combined and consolidated financial statements for Grupo TFM (including the notes thereto and the Report of Independent Accountants thereon) as of December 31, 2003 and 2002 and for each of the three years in the period ended December 31, 2003 are included in this proxy statement as Exhibit 1.

The unaudited combined and consolidated financial statements for Grupo TFM (including the notes thereto) as of September 30, 2004 and December 31, 2003 and for each of the nine months ended September 30, 2004 and 2003 are included herein in Exhibit 2.

**Table of Contents****PRO FORMA FINANCIAL INFORMATION**

On December 15, 2004, KCS and Grupo TMM announced a series of transactions that were approved by both respective boards of directors that would, following KCS shareholder approval and satisfaction of other conditions, place KCSR, Mexrail and TFM under the common control of KCS. Grupo TFM holds an 80% interest in TFM, which holds a 49% interest in Mexrail. Mexrail wholly-owns Tex-Mex.

Under the terms of the agreement, Grupo TMM will receive as consideration for the transaction 18 million shares of KCS Common Stock and \$200 million in cash. Additional contingent consideration includes up to \$47 million represented by notes payable (the Indemnity Escrow Notes) and a potential payment of up to \$110 million based upon the resolution of the VAT/ Put Contingency. The following table illustrates the range of consideration to be paid based on the aforementioned contingencies:

<b>Purchase Price:</b>	<b>Minimum</b>	<b>Maximum</b>
Value of 18 million shares of KCS Common Stock (at \$16.91 per share) issued at Closing	\$ 304.4	\$ 304.4
Cash	200.0	200.0
VAT/Put Contingency (cash or shares)	0.0	110.0
Indemnity Escrow Notes	0.0	47.0
<b>Total Purchase Price</b>	<b>\$ 504.4</b>	<b>\$ 661.4</b>

See Note 5 and Note 19 to the Pro Forma Condensed Consolidated Financial Statements for further information.

The following pro forma condensed consolidated financial statements are presented to illustrate the impact of the Acquisition on KCS's historical financial statements and reflect the effect of the various transactions necessary to consummate the agreements as if the transaction had occurred on January 1, 2003 for income statement purposes for the year ended December 31, 2003 and the nine months ended September 30, 2004, respectively, and as of September 30, 2004 for balance sheet purposes. The historical financial statements of Grupo TFM are prepared under the principles of International Financial Reporting Standards ( IFRS ) and include a reconciliation between U.S. Generally Accepted Accounting Principles ( US GAAP ) and IFRS. The Grupo TFM historical financial information included in these pro forma financial statements is reflected under US GAAP and therefore no reconciliation of financial information between US GAAP and IFRS is required for these purposes.

The Company has not completed a fair value appraisal of tangible or intangible assets as of this date. At the time those processes are completed, the allocation of the purchase price could change and may include certain identifiable intangible assets, such as customer contracts, customer relationships or similar items. For purposes of these pro forma financial statements, the Company has assumed the excess of the purchase price over book value is attributable to concession assets.



**Table of Contents**

The following summarizes selected pro forma financial information of the Registrant assuming the transaction acquiring a controlling interest in Grupo TFM had been completed as of September 30, 2004.

**KANSAS CITY SOUTHERN****PRO FORMA CONDENSED CONSOLIDATED BALANCE SHEET  
AS OF SEPTEMBER 30, 2004**

	Registrant Historical	Grupo TFM Historical	Mexrail Historical	Pro Forma Adjustments		Pro Forma
				Debit	Credit	
(Dollars in millions, except per share data) (Unaudited)						
<b>ASSETS:</b>						
Current Assets:						
Cash and cash equivalents	\$ 170.0	\$ 11.8	\$ 2.4	\$ 37.5(3,15)	\$207.5(3)	\$ 14.2
Accounts receivable, net	127.2	194.4	12.0		7.1(11)	326.5
Inventories	42.1	23.9	0.6			66.6
Other current assets	27.9	23.7	2.4			54.0
<b>Total current assets</b>	<b>367.2</b>	<b>253.8</b>	<b>17.4</b>	<b>37.5</b>	<b>214.6</b>	<b>461.3</b>
Investments	481.5	39.0		9.4(21)	481.8(1,21)	48.1
Concession rights and related assets		1,142.2		308.6(2,8,10)		1,450.8
Properties, net	1,414.8	561.9	68.4	16.5(21)		2,061.6
Goodwill	10.6					10.6
Deferred income taxes and employee s statutory profit sharing		280.1				280.1
Other assets	33.7	31.5		31.4(21)	56.1(11,15)	40.5
<b>Total assets</b>	<b>\$2,307.8</b>	<b>\$2,308.5</b>	<b>\$85.8</b>	<b>\$ 403.4</b>	<b>\$752.5</b>	<b>\$4,353.0</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY:</b>						
Current Liabilities:						
Debt due within one year	\$ 7.9	\$ 66.6	\$31.3	\$ 51.0(11)	\$ 31.4(21)	\$ 86.2
Accounts and wages payable and accrued liabilities	220.0	195.6	0.6	7.1(11)		409.1
<b>Total current liabilities</b>	<b>227.9</b>	<b>262.2</b>	<b>31.9</b>	<b>58.1</b>	<b>31.4</b>	<b>495.3</b>
<b>Other Liabilities:</b>						
Long-term debt	563.5	840.1			84.5(3,5,15)	1,488.1
Deferred income taxes	419.1				124.3(10,21)	543.4
Other deferred credits	111.3	26.3				137.6
<b>Total other liabilities</b>	<b>1,093.9</b>	<b>866.4</b>			<b>208.8</b>	<b>2,169.1</b>
<b>Minority interest</b>		<b>357.5</b>			<b>40.7(16)</b>	<b>398.2</b>
<b>Stockholders Equity</b>						
Preferred stock	6.1					6.1
Redeemable cumulative convertible perpetual preferred	0.4					0.4

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stock						
Common/capital stock	0.6	807.0		807.0(7)		0.6
New issue common, \$. 01 par					0.2(4)	0.2
Treasury shares and effect on purchase of subsidiary shares		(222.0)			222.0(7)	
Retained earnings	861.2	237.4	(9.4)	237.4(7)	9.4(7)	861.2
Capital Surplus	116.2		63.3	63.3(7)	304.2(4)	420.4
Accumulated other comprehensive income (loss)	1.5					1.5
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Total stockholders equity</b>	<u>986.0</u>	<u>822.4</u>	<u>53.9</u>	<u>1,107.7</u>	<u>535.8</u>	<u>1,290.4</u>
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Total liabilities and stockholders equity</b>	<u>\$2,307.8</u>	<u>\$2,308.5</u>	<u>\$85.8</u>	<u>\$1,165.8</u>	<u>\$816.7</u>	<u>\$4,353.0</u>
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

See notes to pro forma condensed financial statements.

**Table of Contents**

The following summarizes selected pro forma financial information of the Registrant assuming the transaction acquiring a controlling interest in Grupo TFM had been completed as of January 1, 2004.

**KANSAS CITY SOUTHERN****PRO FORMA CONDENSED CONSOLIDATED INCOME STATEMENT  
For the Nine Months Ended September 30, 2004**

	<b>Registrant Historical</b>	<b>Grupo TFM Historical</b>	<b>Mexrail Historical(21)</b>	<b>Pro Forma Adjustments</b>	<b>Pro Forma</b>
(Dollars in Millions, except per share data) (Unaudited)					
<b>Revenues</b>	\$ 464.9	\$526.9	\$ 9.7	\$	\$1,001.5
Costs and expenses	369.5	360.6	11.4	2.3(14,11)	743.8
Depreciation and amortization	39.3	66.3	0.5	7.6(15,21)	113.7
<b>Operating income</b>	<u>56.1</u>	<u>100.0</u>	<u>(2.2)</u>	<u>(9.9)</u>	<u>144.0</u>
Equity in net earnings of unconsolidated affiliates:					
Grupo Transportacion Ferroviaria Mexicana, S.A. de C.V.	6.1			(6.1)(9,21)	
Other	(0.4)	(0.8)		1.6 (9)	0.4
Interest expense	(33.0)	(85.7)	(0.1)	(4.7)(5,6)	(123.5)
Debt retirement costs	(4.2)				(4.2)
Other income (expense)	11.8	(20.6)	(0.1)	11.1 (6,21)	2.2
Income (loss) before income taxes	<u>36.4</u>	<u>(7.1)</u>	<u>(2.4)</u>	<u>(8.0)</u>	<u>18.9</u>
Income tax provision (benefit)	12.7	(18.9)	(0.8)	1.0(10,21)	(6.0)
<b>Income (loss) before minority interest</b>	<u>23.7</u>	<u>11.8</u>	<u>(1.6)</u>	<u>(9.0)</u>	<u>24.9</u>
<b>Minority interest</b>		(2.5)		(1.5)(16,21)	(4.0)
<b>Net income (loss)</b>	<u>23.7</u>	<u>9.3</u>	<u>(1.6)</u>	<u>(10.5)</u>	<u>20.9</u>
<b>Preferred stock dividends</b>	6.6				6.6
<b>Net income available to Common shareholders</b>	<u>\$ 17.1</u>	<u>\$ 9.3</u>	<u>\$ (1.6)</u>	<u>\$ (10.5)</u>	<u>\$ 14.3</u>
<b>Basic Earnings per Common Share:</b>					
Net income available to Common shareholders	<u>\$ 0.27</u>				<u>\$ 0.18(12)</u>
Basic Weighted Average Common shares outstanding ( <i>in thousands</i> )	<u>62,605</u>			<u>18,000</u>	<u>80,605(13)</u>
<b>Diluted Earnings per Common share:</b>					
Net income available to Common shareholders	<u>\$ 0.27</u>				<u>\$ 0.17(12)</u>
Diluted Weighted Average Common shares outstanding ( <i>in thousands</i> )	<u>63,856</u>			<u>18,000</u>	<u>81,856(13)</u>

See notes to pro forma condensed financial statements.





**Table of Contents****KANSAS CITY SOUTHERN****NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Note 1: Removal of the Equity Investment in Grupo TFM**

Pursuant to the Amended and Restated Acquisition Agreement dated December 15, 2004 (the Amended Acquisition Agreement), Kansas City Southern (the Company or KCS) would acquire a controlling interest in Grupo Transportacion Ferroviaria Mexicana, S.A. de C.V. (Grupo TFM), resulting in the full consolidation of Grupo TFM's balance sheet into KCS. Accordingly, the equity investment as of September 30, 2004 reflected on the Company's pro forma condensed consolidated balance sheet would be eliminated.

**Note 2: Creation of Identifiable Intangible Assets**

Additional identifiable intangibles or goodwill may be recorded as a result of the Grupo TFM acquisition. At September 30, 2004, the current value of the consideration to obtain a controlling interest in Grupo TFM exceeds the current book value of the underlying net assets by approximately \$308.6 million, which is reflected on the pro forma condensed consolidated balance sheet as an addition to concession assets. The determination of the increase in concession assets is as follows (in millions):

Purchase price:	
Value of 18 million shares of KCS Common (at \$16.91 per share)	\$ 304.4
Cash	200.0
VAT/Put Contingency (See Note 19)	0.0
Indemnity Escrow Note	47.0
	<hr/>
Total Purchase Price	\$ 551.4
	<hr/>
Grupo TFM book value of net assets acquired	\$ 398.8(i)
	<hr/>
Increase in Concession Assets:	
Excess of Purchase Price over Grupo TFM Book Value of net assets acquired	\$ 152.6
KCS Deferred Costs (basis difference and acquisition costs)	38.0
Deferred Tax liability adjustment (see Note 10)	118.0
	<hr/>
Increase in Concession Assets	\$ 308.6
	<hr/>

(i) Amount represents 48.5% of Grupo TFM net book value of \$822.4 million as of September 30, 2004.

For purposes of these pro forma financial statements the Company has assumed the excess of the purchase price over book value is attributable to the concession and related assets. The Company has not completed a fair value appraisal of tangible or intangible assets as of this date, and expects to do so during the second quarter of 2005. At the time that valuation process is completed, the allocation of the purchase price is likely to change, and may include certain identifiable intangible assets such as customer relationships or similar items.

TFM has contracts with approximately 120 large customers that account for almost 80% of revenue. Most of those have non-exclusive contracts with TFM with terms of less than three years. The short-term nature of these contracts makes it unlikely that any significant value will be attributed to the contracts. However, some value may be attributed to non-contractual relationships with those customers. Given the nature of customer relationships in the rail industry in general and for TFM in particular, the Company expects that any value that may be assigned to such intangible assets would have a long useful life.

Management's best estimate of the amount of amortization is included in the pro forma financial statements, and is based on information currently available. Increases or decreases may result from the fair





**Table of Contents****KANSAS CITY SOUTHERN****NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

value appraisal valuation. For example, values could be reallocated to assets with shorter lives than the concession assets, and the lives of some asset classes could be extended or shortened. A one-year change in the lives assumed for these pro forma financial statements for all TFM assets would change depreciation and amortization by approximately \$2.0 million. The average remaining useful life used for depreciation of the concession assets is 32 years. A reallocation of purchase price amounts to other assets such as customer relationships, which may have shorter periods of amortization, could result in increases in annual amortization as set out in the table below, assuming that there were no offsetting changes in useful lives of other assets.

**Annual impact of a potential reallocation of amounts from concession assets to other identifiable intangibles**

other identifiable intangibles amounts	Amortization rates, reflecting potentially shorter periods of amortization					
	3.1%	4.0%	5.0%	6.0%	7.0%	8.0%
	<i>in \$ millions</i>					
\$0.0	0	0	0	0	0	0
\$10.0	0	0.09	0.19	0.29	0.39	0.49
\$20.0	0	0.18	0.38	0.58	0.78	0.98
\$30.0	0	0.27	0.57	0.87	1.17	1.47
\$40.0	0	0.36	0.76	1.16	1.56	1.96
\$50.0	0	0.45	0.95	1.45	1.95	2.45

**Note 3: Cash at Closing Source of Funds**

Consideration for the transaction includes a cash payment of \$200 million. For purposes of these pro forma financial statements, the payment of \$200 million has been funded from the net proceeds of the sale of 4.25% Redeemable Cumulative Convertible Perpetual Preferred Stock, Series C ( Convertible Preferred Stock ). The Convertible Preferred Stock offering generated approximately \$193.0 million, when it was completed in April 2003. Net of amounts used for operations and expansion, KCS has approximately \$170 million available for the acquisition. The remaining \$30 million in cash consideration, plus amounts to be paid to Morgan Stanley of up to \$7.5 million will be funded from borrowings under the Company's credit facility.

The Company's historical consolidated financial statements as of and for the nine months ended September 30, 2004 fully reflect the impacts of the issuance of the Convertible Preferred Stock. The Company's historical consolidated income statement for the year ended December 31, 2003 reflects only \$5.7 million of dividends related to the Convertible Preferred Stock issued in April 2003. Accordingly, a pro forma adjustment of \$2.8 million for preferred dividends was recorded in order to annualize preferred dividends and give effect to the transaction as if completed at January 1, 2003.

Holders of the Convertible Preferred Stock are entitled to receive any dividends declared by the Company's board of directors 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. The dividends are cumulative from the date of initial issuance and accumulated but unpaid dividends cumulate dividends at the annual rate of 4.25%. In addition, the Company will also pay special dividends if it fails to comply with certain obligations under a registration rights agreement. Additional information regarding the Convertible Preferred Stock issuance can be found in the Company's 2003 Annual Report on Form 10-K, including the circumstances under which KCS would be required to redeem the Convertible Preferred Stock.

**Table of Contents**

**KANSAS CITY SOUTHERN**

**NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 4: Shares of KCS Common Stock**

Grupo TMM, S.A. ( Grupo TMM ) will receive as consideration for the transaction 18 million shares of KCS Common Stock. This pro forma adjustment reflects the addition to stockholders' equity of a total of \$304.4 million of equity based upon 18 million common shares as part of the initial agreement and assuming a stock price of \$16.91 per share. The assumed stock price was derived by averaging the closing price of the Company's common stock five days before and five days after the announcement of the transaction on December 15, 2004. The total allocation of the new capital as reflected in the pro forma condensed consolidated balance sheet at September 30, 2004 is \$0.2 million, which is comprised of 18 million shares of new common stock with a par value of \$.01 per share and \$304.2 million, which is reflected as capital surplus representing the value of the stock issued in excess of par.

**Note 5: Indemnity Escrow**

KCS promissory notes in the aggregate principal amount of \$47.0 million will be deposited in an escrow account (the Indemnity Escrow ) and held, reduced and released in accordance with the terms of an indemnity escrow agreement (the Indemnity Escrow Agreement ) entered into and effective as of December 15, 2004 by certain parties to the Amended Acquisition Agreement. For purposes of the pro forma condensed consolidated balance sheet at September 30, 2004, the full amount of the Indemnity Escrow has been shown as a note payable and an increase in consideration. At the time of the acquisition, the Company will assess the amount to be recorded based upon the terms of the Indemnity Escrow Agreement and the amount likely to be paid under those terms. The Indemnity Escrow may be reduced, pursuant to the

**Table of Contents****KANSAS CITY SOUTHERN****NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

indemnification provisions of the Amended Acquisition Agreement, by the amount of certain losses relating to breaches of certain representations and warranties, or any covenant or agreement of Grupo TMM, TMM Holdings, S.A. de C.V. or TMM Multimodal, S.A. de C.V. in that agreement, or any claims relating thereto, or for certain actions by certain persons that constituted a fraud or felonious criminal act or that required KCS approval under the Original Acquisition Agreement that was not obtained. Therefore, the principal amount of the Indemnity Escrow could potentially be reduced to \$0.

The note bears interest at a rate of 5%. Accordingly, the pro forma condensed consolidated income statements include increased interest expense of \$2.4 million and \$1.8 million for the periods ended December 31, 2003 and September 30, 2004, respectively.

At KCS option, prior to their release, KCS may convert the net amount of the promissory notes into shares of KCS Common Stock. Conversion of the net amount will occur at the Volume Weighted Price ( VWP ) or the average trading price per share for KCS Common Stock on the NYSE, as reported on Bloomberg (VAP function), for the twenty (20) consecutive trading days immediately prior to a measurement date. For purposes of settling the Indemnity Escrow Note, the VWP will be based on the 20 days prior to April 1, 2007. See additional discussion of share price sensitivity in Note 20.

**Note 6: Adjustments to Interest Income and Interest Expense**

In addition to the increase in interest expense related to the Indemnity Escrow Agreement described in Note 5, the pro forma condensed consolidated income statements include the following adjustments to interest income and expense.

The pro forma condensed consolidated income statements for the year ended December 31, 2003 and the nine months ended September 30, 2004 reflect a \$1.2 million and \$0.8 million reduction to interest income (included in other income and expense), respectively. These adjustments reflect the fact that, assuming the Acquisition had been consummated as of the beginning of the period of each pro forma condensed consolidated income statement presented, the Company's cash balance relating to the issuance of the Convertible Preferred Stock would have been used to fund the \$200 million payment described above, and thus, interest income relating to that cash balance would not have been realized.

Had the Acquisition been consummated as of January 1, 2003, cash would not have been available to pay down \$49.3 million of debt during December 2003 and \$38.5 million during March 2004. Therefore, an adjustment has been made to the pro forma condensed consolidated income statements to increase interest expense by \$0.1 million for the year ended December 31, 2003 and \$2.2 million for the nine months ended September 30, 2004.

As described in Note 3, the Company will also incur additional borrowing to fund the acquisition and certain acquisition related costs of \$37.5 million. Therefore, an adjustment has been made to the pro forma condensed consolidated income statements to increase interest expense by \$1.3 million for the year ended December 31, 2003 and \$1.0 million for the nine months ended September 30, 2004.

The pro forma condensed consolidated income statements for the year ended December 31, 2003 and the nine months ended September 30, 2004 reflect a \$0.1 million and \$0.3 million reduction to interest expense and interest income (included in other income and expense), respectively. These adjustments reflect the fact that, assuming the Acquisition had been consummated as of the beginning of the period of each pro forma condensed consolidated income statement presented, interest charged by KCS to Tex-Mex (wholly-owned subsidiary of Mexrail) would have been eliminated in consolidation.

**Note 7: Elimination of Grupo TFM and Mexrail Stockholders' Equity**

As a result of KCS obtaining a controlling interest in Grupo TFM, Grupo TFM's assets and liabilities would be consolidated with KCS. Accordingly, Grupo TFM's stockholders' equity amounts would be eliminated in the consolidation process.



**Table of Contents****KANSAS CITY SOUTHERN****NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As a result of KCS obtaining a controlling interest in Mexrail, Mexrail's assets and liabilities would be consolidated with KCS. Accordingly, Mexrail's stockholders' equity amounts would be eliminated in the consolidation process (see also Note 21).

**Note 8: Elimination of Equity Basis Difference in Grupo TFM**

The calculation of the Company's net equity in Grupo TFM's underlying net assets utilizing the Company's current ownership percentage of approximately 46.6%, as compared to the amount recorded as an investment as of September 30, 2004, results in a basis difference of approximately \$15.0 million. This difference in basis results from a number of factors, the most significant of which is the changing ownership interest in Grupo TFM, which produced a difference in investment basis that occurred when TFM, S.A. de C.V. (TFM) acquired the Mexican government's 24.6% interest in Grupo TFM during 2002. This basis difference would have been amortized over time; however, because the Company will obtain a controlling interest in Grupo TFM, the remaining basis difference will be recognized at the date of the Acquisition. The pro forma financial statements as stated herein recognize the elimination of this basis difference as an addition to concession assets on the pro forma condensed consolidated balance sheet.

**Note 9: Elimination of Equity Earnings from Grupo TFM and Mexrail**

Assuming the contemplated transaction would have been consummated on January 1, 2003, the Company would have consolidated Grupo TFM and accordingly, the equity in earnings of Grupo TFM would be eliminated.

For the year ended December 31, 2003 and for the seven months ended July 31, 2004, the historical financial statement of Grupo TFM reflect the operations of Mexrail on a consolidated basis. Accordingly, elimination of equity in earnings of Grupo TFM includes elimination of equity in earnings of Mexrail. Because Mexrail was not consolidated by either KCS or TFM for the historical two month period ending September 30, 2004, the pro forma adjustments reflect the elimination of equity in earnings of Mexrail. (See also Note 21)

**Note 10: Provision for Income Taxes/Deferred Income Taxes**

The pro forma condensed consolidated income statement reflects the income tax impacts of the pro forma adjustments utilizing an income tax rate of 38.25%, but excluding any consideration of the equity earnings of Grupo TFM and Mexrail, since the Company has not previously provided a tax provision on these amounts. See note (i) to the Selected Historical Combined and Consolidated Financial Data of Grupo TFM for a discussion of the impact of taxes on Grupo TFM's results.

For the periods presented, the pro forma tax calculation is as follows:

	September 30, 2004	December 31, 2003
	_____	_____
Pretax Proforma Adjustments (income) expense	\$ 8.0	\$ 30.3
Add back TFM Equity in Earnings Adjustment	(6.1)	(12.3)
Add back Mexrail Equity in Earnings Adjustment	1.6	
Add TFM loss on sale of interest in Mexrail Adjustment	12.2	
	_____	_____
Net Proforma Adjustments (income) expense subject to tax at 38.25%	\$ 15.7	\$ 18.0
	_____	_____
Tax (benefit) of net adjustments	\$ (6.0)	\$ (6.9)
Adjust TFM benefit derived from Mexrail transaction	7.0	
	_____	_____
Net pro forma tax expense (benefit)	\$ 1.0	\$ (6.9)

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**Table of Contents**

**KANSAS CITY SOUTHERN**

**NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In addition, the recognition of additional identifiable intangible assets in the form of concession assets creates an additional deferred tax liability associated with those assets. The pro forma condensed consolidated balance sheet recognizes the deferred tax liability of approximately \$118.0 million related to the Grupo TFM transaction and \$6.3 million related to the Mexrail acquisition, as of September 30, 2004.

**Note 11: Consolidation Eliminations**

These pro forma adjustments reflect the elimination of intercompany amounts between the Company, Grupo TFM and Mexrail, assuming the three entities were consolidated for financial reporting purposes.

In addition, there are certain transactions between KCSR, Mexrail and TFM which arise in the normal course of operations. These transactions eliminate within the same line item; therefore, the impact shown in the proforma adjustments is zero and no additional elimination entry is required.

**Note 12: Computation of Earnings Per Share**

Basic earnings per share for purposes of the pro forma condensed consolidated income statement reflect pro forma consolidated net income, less dividends on the Company's \$25 par preferred stock of approximately \$242,000 annually, less dividends on the Company's \$1.00 par Convertible Preferred Stock of approximately \$8.5 million annually, divided by the weighted average outstanding shares as described in Note 13 below.

Diluted earnings per share for purposes of the pro forma condensed consolidated income statements reflect pro forma consolidated net income, less dividends on the Company's \$25 par preferred stock of approximately \$242,000 annually, divided by the weighted average diluted outstanding shares as described in Note 13 below.

The assumed conversion of the Company's \$1.00 par Convertible Preferred Stock (convertible into 13,389,121 common shares) would have been anti-dilutive to the pro forma diluted earnings per share computations in each of the periods presented. Accordingly, conversion of preferred shares into common shares was not assumed and these shares were not included in the pro forma diluted earnings per share computations. Total preferred dividends, however, were subtracted from net income in the computation of the pro forma diluted earnings per share.

Because the transaction contains a number of payments that will be made only on the resolution of significant contingencies, additional disclosure regarding the contingent payments and their impact on both the weighted average shares outstanding and earnings per share is provided in Note 19.

**Note 13: Weighted Average Shares Outstanding**

The weighted average basic shares outstanding are calculated beginning with Company historical average basic shares (61,725,000 for the year ended December 31, 2003 and 62,605,000 for the nine months ended September 30, 2004) plus 18 million shares assumed to be issued as described in Note 4 above.

For the nine months ended September 30, 2004, the weighted average diluted shares outstanding are calculated beginning with Company historical average diluted shares of 63,856,000 plus 18 million shares assumed to be issued as described in Note 4 above.

For the year ended December 31, 2003, the weighted average diluted shares outstanding are calculated beginning with Company historical average diluted shares of 61,725,000 plus 18 million shares assumed to be issued as described in Note 4 above.

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As stated in Note 12 above, the inclusion of the 13,389,121 shares assuming full conversion of the Convertible Preferred Stock into common utilizing a conversion rate of 33.4728 for each share of preferred to



**Table of Contents**

**KANSAS CITY SOUTHERN**

**NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

common shares would have had an anti-dilutive effect on the computations of pro forma dilutive earnings per share for all periods presented.

**Note 14: Consulting Agreement**

In connection with the transaction, the Company has entered into a consulting agreement, effective upon the closing of the Acquisition, with Jose F. Serrano International Business, S.A. de C.V. (the Consulting Firm) with an initial term of three years. In consideration of services provided, the Consulting Firm will receive an annual fee of \$3 million in cash. The pro forma condensed consolidated income statements reflect the effect of these transactions as consulting expense.

In addition, upon the resolution of certain disputes with the Mexican government, KCS will pay to the Consulting Firm \$9 million. The contingent payment can be settled in either shares of the Company's stock or cash at the Company's discretion. No provision has been made in the pro forma condensed consolidated financial statements for the payment of the contingency due to the uncertainty surrounding settlement of the disputes. See also Note 19.

**Note 15: Amortization of Identifiable Intangibles Concession Assets**

The transactions as described above result in a net addition to concession assets of approximately \$308.6 million as of September 30, 2004. For purposes of the pro forma condensed consolidated income statements presented herein, this balance is amortized over the remaining amortizable life of the concession assets of 32 years. The original concession was acquired in 1997 and Grupo TFM assigned the concession value to the various asset classes including land, way and structures, equipment, and other tangible assets, typical of a railroad enterprise. This allocation resulted in a weighted average life of the concession assets of 38 years in 1997; therefore, under the straight line method of depreciation, the remaining life of the concession assets at January 1, 2003 would be 32 years. Adjustments have been made to the pro forma condensed consolidated financials for additional amortization expense, calculated on a straight-line basis, of approximately \$9.6 million for the year ended December 31, 2003 and \$7.2 million for the nine months ended September 30, 2004. Following completion of a fair value appraisal of all tangible and intangible assets during the second quarter of 2005 there may be a further change in amortization costs, as described in Note 2.

Approximately \$15.5 million related to acquisition costs have been recorded by KCS as other non-current assets. This amount has been reclassified to concession assets as consideration paid in the pro forma condensed consolidated balance sheet as of September 30, 2004. In addition, estimated fees payable to Morgan Stanley of \$7.5 million for work currently being performed relating to the acquisition have been included as an increase in consideration paid with a corresponding increase in concession assets and long-term debt at September 30, 2004. Because the transaction is not yet completed, the Company will likely incur additional fees or charges that are directly related to the acquisition. Except as described above, no provision has been made for additional acquisition costs in these pro forma condensed consolidated financial statements.

**Note 16: Minority Interest**

As previously reported, TFM repurchased the Mexican government's 24.6% interest in Grupo TFM in June 2002. Since the purchase of the Mexican government's 24.6% interest was completed by Grupo TFM's subsidiary, TFM, and the fact that the Mexican government also continues to maintain a 20% minority interest in TFM, the Mexican government retained an indirect 4.9448% minority interest in Grupo TFM through its ownership of TFM. The pro forma adjusting entries to minority interest reflect the continuing indirect minority ownership in Grupo TFM by the Mexican government for the periods indicated. For the pro forma condensed consolidated balance sheet as of September 30, 2004, an additional \$40.7 million of minority interest was added to the pro forma balances representing 4.9448% of Grupo TFM's net assets. For the pro forma condensed consolidated income statements, the amount of minority interest in Grupo TFM's US

**Table of Contents**

**KANSAS CITY SOUTHERN**

**NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

GAAP net income was computed for the periods presented resulting in approximately \$1.4 million for the year ended December 31, 2003 and \$0.5 million for the nine months ended September 30, 2004.

**Note 17: VAT Related Matters**

The impact of any settlement of the VAT dispute between TFM and the Mexican government on the Company's consolidated financial statements will be dependent upon the timing and amount of any such settlement. It is expected that the value of any consideration received from the Mexican government from the settlement of the VAT dispute will be recorded as income by TFM and Grupo TFM, net of related income taxes. If a binding agreement is reached before the consummation of the Acquisition, the Company would record its proportionate share of any such gain through its equity in earnings of Grupo TFM, based upon its existing ownership of 46.6%. If the Acquisition is subsequently consummated, the proceeds from any settlement received and retained by TFM, including the impacts of any additional consideration as may become payable as discussed below, would impact the Company's allocation of the purchase price to assets acquired and liabilities assumed, likely impacting amounts otherwise allocable to long-lived assets, including intangibles, as presented herein.

If the VAT dispute is settled following the consummation of the Acquisition, the Company would record in income its proportionate share of any such gain through its consolidation of the operating results of Grupo TFM, based upon its pre-acquisition ownership interest of 46.6%. The portion of any gain attributable to the acquired interest of Grupo TMM would likely constitute a pre-acquisition contingency and not impact the Company's operating results, but rather would be considered in the allocation of the purchase price to assets acquired and liabilities assumed, likely reducing amounts otherwise allocable to long-lived assets, including intangibles, as presented herein. Any payments to or by the Company related to the settlement of the VAT dispute will be made only on the resolution of significant contingencies; no amounts related to the gain contingency have been included in the pro forma condensed consolidated financial statements.

**Note 18: Consideration of the Mexican Government's Put Rights Regarding Its 20% Minority Interest in TFM**

The provisions of the Put Agreement obligate Grupo TFM under certain circumstances to purchase the Put shares and, if Grupo TFM fails to purchase, then KCS and/or Grupo TMM would be obligated to purchase the Mexican government's 20% minority interest in TFM. As disclosed in the Company's Form 10-Q for the nine months ended September 30, 2004, the total estimated purchase price of the Mexican government's minority interest was approximately \$476.5 million. The calculation of the purchase price is dependent upon inflationary factors of the Mexican economy and foreign exchange rate factors, which the Company can not predict. While the Company, along with Grupo TFM, is currently exploring financing alternatives, the source and cost any such financing for this obligation is not reasonably determinable at this time.

The purchase of the Mexican government's shares of TFM is the subject of an ongoing judicial proceeding. On November 3, 2003, the Ministry of Transportation stated in a communication to Grupo TFM that it had complied with the requirements for the exercise of its put rights as set out in the Put Agreements and that all procedures required to execute the sale of the Mexican government's TFM shares would be made through the Mexican Treasury. Grupo TFM requested that a federal court review the Ministry of Transportation's communications with respect to the Mexican government's put rights. On December 16, 2003, the Fourth Administrative District Court issued an injunction ordering Grupo TFM, the Ministry of Transportation and the Treasury to maintain the status quo pending judicial resolution of the dispute. Additionally, Grupo TFM requested and received from a federal judge an injunction, which blocked the Mexican government from exercising its put option. The ability of the Mexican government to exercise its put option has been suspended until the put lawsuit is resolved. Grupo TFM will vigorously defend its view that the

**Table of Contents**

**KANSAS CITY SOUTHERN**

**NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Mexican government has not fulfilled the prescribed steps required to exercise its put rights. Although Grupo TFM believes that it will prevail in legal proceedings related to these matters, there can be no assurance that it will prevail. Further, the acquisition of the Mexican government's interest and funding of this obligation could be affected by the outcome and settlement of TFM's VAT dispute with the Mexican government.

Due to the uncertainties noted above, the accompanying pro forma financial statements do not reflect the impact of the acquisition of additional shares of TFM which could arise under the Put Agreement. If, following the consummation of the acquisition of Grupo TFM shares from Grupo TMM, the Company acquires the remaining shares of TFM held by the Mexican government pursuant to the Put Agreement, the accompanying pro forma financial statements would be generally impacted as follows. The excess of the purchase price over the carrying value of minority interest would be allocated to the assets and liabilities of Grupo TFM, based upon their fair values, with the likely impact being an increase to recorded amounts for long-lived assets, including intangibles, as presented herein. Additionally, the minority interest in earnings of Grupo TFM would be eliminated from the pro forma condensed consolidated income statement, offset by the costs of any debt financing incurred to finance the purchase and any increases in depreciation or amortization expense relating to the application of purchase accounting.

**Note 19: VAT/PUT Contingency**

Pursuant to the terms of the Amended Acquisition Agreement, if the value of the consideration received by TFM in connection with the settlement of the VAT dispute (Note 17) equals or exceeds the amount payable pursuant to the Put Agreement (Note 18) KCS shall pay the sum of \$110 million, reduced (but not below zero) by net cash paid or received relating to obtaining the settlement and adjusted for the impact of certain Mexican tax implications related to the settlement. If the VAT Contingency Payment is made in the full amount of \$110 million, it shall be paid as follows: (i) \$35 million shall be paid in cash; (ii) \$35 million shall be paid by delivery of that number of shares of KCS Common Stock as, valued at the VWP, shall be equal to \$35 million, and (iii) \$40 million shall be paid by deposit into escrow (the VAT Escrow) of a \$40 million note, the residual of which shall be converted at the fifth anniversary of the closing date of the Acquisition or such earlier date as deemed appropriate by KCS in accordance with the terms of the Amended Acquisition Agreement into that number of shares of KCS Common Stock as, valued at the VWP, shall be equal to the remaining principal amount of the VAT Escrow as of such date. Per the Amended Acquisition Agreement, KCS may at its election deliver shares of KCS Common Stock valued at the VWP, in lieu of any portion of the cash payment. Any such payment would constitute additional consideration for the purchase of the interests of Grupo TMM and the Mexican government in Grupo TFM and as such, would impact amounts allocable to long-lived assets, including intangibles, as presented herein. Conversion of the cash amounts stated above will occur at the VWP 20 days prior to a measurement date.

In addition, KCS will pay to the Consulting Firm an additional \$9 million as consideration for the Consulting Firm's services to the Company in connection with the resolution of the VAT dispute and Put advisory services to the Company. The contingent payment can be settled in either shares of the Company's stock or cash at the Company's discretion. No provision has been made in the pro forma condensed consolidated financial statements for the payment of the contingency due to the uncertainty surrounding settlement of the disputes.

While it is uncertain if KCS will exercise its option to pay the full amount of the \$119 million liability in shares, the number of shares that would have been issued at the December 21, 2004 VWP of \$16.91 is 7,037,256.

Accounting for the settlement of the VAT dispute or the Put will be driven by the facts and circumstances of the settlement agreements and would likely impact the financial statements as described in Notes 17 and 18, respectively. Because these amounts are uncertain, no provision has been made for such a settlement in the accompanying pro forma condensed consolidated financial statements. The following table

**Table of Contents****KANSAS CITY SOUTHERN****NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

provides additional proforma information as if the VAT/ Put contingency were resolved at January 1, 2003 in order to illustrate potential impacts on net income and earnings per share for the full year and nine month periods presented. Because the share price will be determined using the VWP developed on a future date, a range of share prices and the related shares to be issued, if the Company chose to settle the amounts in shares, are presented.

**Adjustment of Pro Forma Results for Impact of Settlement of the VAT/ Put Contingency**

	Nine Months Ended September 30, 2004		Year Ended December 31, 2003	
	Pro Forma	Adjusted	Pro Forma	Adjusted
	(Amount in millions)(1)			
Consolidated pro forma net income available to Common Shareholders	\$ 14.3	\$ 14.3	\$ (2.9)	\$ (2.9)
Add: Income allocated to Minority Interest		4.0		8.3
Pro forma net income available to Common Shareholders	\$ 9.6	\$ 18.3	\$ (2.9)	\$ 5.4
Shares Outstanding	81,856	88,893	79,725	86,762
Pro forma EPS available to Common Shareholders	\$ 0.17	\$ 0.21	\$ (0.04)	\$ 0.06

**Impact of Share Price on Number of Shares to Be Issued in Settlement of****the \$119 Million Contingency and Diluted EPS as Adjusted**

VWP Price Range (Dollars)	Additional Shares(2)	Diluted Earnings Per Share(3)	
		Nine Months Ended September 30, 2004	Year Ended December 31, 2003
\$11.91	9,991,604	\$0.20	\$0.06
12.91	9,217,661	0.20	0.06
13.91	8,554,996	0.20	0.06
14.91	7,981,221	0.20	0.06
15.91	7,479,573	0.20	0.06
16.91	7,037,256	0.21	0.06
17.91	6,644,333	0.21	0.06
18.91	6,292,967	0.21	0.06
19.91	5,976,896	0.21	0.06
20.91	5,691,057	0.21	0.06
21.91	5,431,310	0.21	0.06

- (1) Pro Forma column includes all aspects of the acquisition except the VAT contingency payment and the issue of shares for the Indemnity Escrow. Adjusted Column includes the VAT/ Put contingency payment of \$119 million converted to shares of 7,037,256 at the December 21, 2004 VWP of \$16.91 per share and elimination of Minority Interest.

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- (2) Derived by dividing the amount of the VAT/ Put settlement payable in stock of \$119.0 million by the applicable VWP .
- (3) Based on adjusted net income available to Common Shareholders divided by Pro Forma shares outstanding plus Additional Shares .

65

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**Table of Contents****KANSAS CITY SOUTHERN****NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 20: Indemnity Escrow/ Share Price Sensitivity**

As described in Note 5 above, the Indemnity Escrow Notes can be settled in cash or KCS shares at the discretion of KCS. Conversion of the net amount will occur at the VWP 20 days prior to April 1, 2007. Further, the Amended Acquisition Agreement provides for interest at an annual rate of 5% from the date of closing through the settlement date (approximately 2 years). Assuming no offsetting amounts and assuming two years of interest, the settlement amount would be \$51.7 million. While it is uncertain if KCS will exercise its option to settle the notes in shares, the following table presents the number of shares at various price levels and impact on EPS as presented in the pro forma condensed consolidated financial statements.

**Adjustment of Pro Forma Results for Impact of Settlement of the Indemnity Escrow Notes**

	Nine Months Ended September 30, 2004		Year Ended December 31, 2003	
	Pro Forma	Adjusted	Pro Forma	Adjusted
	(Amount in millions)(1)			
Consolidated pro forma net income available to Common Shareholders	\$ 14.3	\$ 14.3	\$ (2.9)	\$ (2.9)
Add: Interest Expense on Escrow Note, net of tax		1.1		1.5
Pro forma net income available to Common Shareholders	\$ 14.3	\$ 15.4	\$ (2.9)	\$ (1.4)
Shares Outstanding	81,856	84,913	79,725	82,782
Pro forma EPS available to Common Shareholders	\$ 0.17	\$ 0.18	\$ (0.04)	\$ (0.02)

**Impact of Share Price on Number of Shares to Be Issued in Settlement of  
the \$51.7 Million Indemnity Escrow Notes and Diluted EPS as Adjusted**

VWP Price Range (Dollars)	Additional Shares(2)	Diluted Earnings Per Share(3)	
		Nine Months Ended September 30, 2004	Year Ended December 31, 2003
\$11.91	4,340,890	\$ 0.18	\$ (0.02)
12.91	4,004,648	0.18	(0.02)
13.91	3,716,751	0.18	(0.02)
14.91	3,467,471	0.18	(0.02)
15.91	3,249,529	0.18	(0.02)
16.91	3,057,363	0.18	(0.02)
17.91	2,886,655	0.18	(0.02)
18.91	2,734,003	0.18	(0.02)
19.91	2,596,685	0.18	(0.02)
20.91	2,472,501	0.18	(0.02)
21.91	2,359,653	0.18	(0.02)

- (1) Pro Forma column includes all aspects of the acquisition except the VAT contingency payment and the issue of shares for the Indemnity Escrow. Adjusted Column includes the issue of shares for the settlement of the Indemnity Escrow Notes of \$51.7 million converted to shares of 3,057,363 at the December 21, 2004 VWP of \$16.91 per share and elimination of Minority Interest.

**Table of Contents**

**KANSAS CITY SOUTHERN**

**NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

- (2) Derived by dividing the amount of the VAT/ Put settlement payable in stock of \$51.7 million by the applicable VWP .
- (3) Based on adjusted net income available to Common Shareholders divided by Pro Forma shares outstanding plus Additional Shares .

**Note 21: Repurchase of Mexrail Shares by KCS**

On August 16, 2004, the Company, Grupo TMM and TFM entered into a new Stock Purchase Agreement for the purchase by KCS of a 51% investment in Mexrail, Inc. for a total of approximately \$32.7 million. The Mexrail shares were placed in a voting trust pending the approval of the Surface Transportation Board of KCS application for authority to exercise common control over The Texas-Mexican Railway Company, The Kansas City Southern Railway Company and the Gateway Eastern Railway Company. On November 29, 2004, the STB approved KCS application for authority to exercise common control over The Texas-Mexican Railway Company. The Kansas City Southern Railway Company and the Gateway Eastern Railway Company. The decision became effective December 29, 2004 and control of the shares was transferred from the voting trust to KCS on January 1, 2005. In addition, the proforma financial statements include adjustments for the following items related to the Mexrail acquisition.

Pending the STB's approval of common control, and for the period ended September 30, 2004 both the Company and Grupo TFM have recorded their respective ownership percentages in Mexrail as an equity investment in their historical balance sheet. For the period from August 1, 2004 through September 30, 2004, the Company and Grupo TFM have recorded their respective percentage of Mexrail's earnings as equity earnings in their historical income statements. Mexrail's historical earnings for the period from August 1, 2004 through September 30, 2004 have been presented in the condensed consolidated income statement to give effect to consolidation of Mexrail for the full nine month period presented. Accordingly, the condensed consolidated income statement for the nine months ended September 30, 2004 reflects adjustments necessary to eliminate the equity in earnings derived from Mexrail. No equity adjustment is necessary for the 12 months ended December 31, 2003 since the results of Mexrail are presented on a consolidated basis with TFM for that period.

As a result of the Mexrail transaction, TFM recognized a loss, net of tax and minority interest, of \$4.2 million on the sale of 51% of its interest in Mexrail to KCS. Accordingly, the accompanying pro forma condensed consolidated income statement for September 30, 2004 includes the following adjustments to eliminate the loss on the Mexrail transaction: decrease in other expense of \$12.2 million, decrease in tax benefit of \$7.0 million and an increase in the minority interest of 1.0 million.

As a result of the STB approval, KCS recorded a proforma adjustment of \$31.4 million representing the purchase price of the remaining 49% of Mexrail. Because this transaction is between KCS and Grupo TFM, the pro forma condensed consolidated balance sheet reflects elimination of the intercompany receivable and payable as described in Note 11.

Approval by the STB combined with acquisition of Grupo TFM would result in the full consolidation of Mexrail's balance sheet into KCS. Accordingly, the equity investment as of September 30, 2004 reflected on the Company's pro forma condensed consolidated balance sheet would be eliminated.



**Table of Contents****KANSAS CITY SOUTHERN****NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The pro forma condensed consolidating balance sheet includes adjustments necessary to reflect the acquisition of Mexrail as of September 30, 2004, resulting in an increase in property and equipment of \$16.5 million calculated as follows:

Purchase price	\$64.1
Mexrail book value of net assets acquired	53.9
	<hr/>
Excess of purchase price over Mexrail book value of net assets acquired	10.2
Deferred Tax liability assumed	6.3
	<hr/>
Increase in Property and Equipment	\$16.5

The Company has not completed a fair value appraisal of tangible or intangible assets as of this date. At the time those processes are completed, the allocation of the purchase price could change which could result in a change in the amortization period. For purposes of the pro forma condensed consolidated income statement, the amortization period is assumed to be equal to the remaining useful life of the underlying assets of Mexrail of 30 years and results in an increase in amortization expense of \$0.6 million for the year ended December 31, 2003 and \$0.4 million for the nine months ended September 30, 2004.

A change in the allocation of the purchase price to shorter lived assets would effect the amortization expense for the consolidated entity. A reduction in the useful life of the underlying assets from an average of 30 to 20 years would increase the amortization expense \$300 thousand per year.

**Table of Contents**

**PRINCIPAL STOCKHOLDERS AND STOCK OWNED BENEFICIALLY**  
**BY DIRECTORS AND CERTAIN EXECUTIVE OFFICERS**

The following table sets forth information as of the Record Date concerning the beneficial ownership of KCS's Common Stock by: (i) beneficial owners of more than five percent of any class of such stock that have publicly disclosed their ownership; (ii) the members of the Board of Directors, the Chief Executive Officer and the four other executive officers expected to be the most highly compensated executive officers in 2004; and (iii) all executive officers and directors as a group. KCS is not aware of any beneficial owner of more than five percent of the Preferred Stock. None of the directors or executive officers own any shares of Preferred Stock. No officer or director of KCS owns any equity securities of any subsidiary of KCS. Holders of 4.25% Redeemable Cumulative Convertible Perpetual Preferred Stock, Series C ( Series C Preferred Stock ) do not have any voting rights except under certain limited circumstances or as otherwise from time to time required by law, and do not currently have rights to vote at the Special Meeting. No officer or director of KCS owns any shares of Series C Preferred Stock. Beneficial ownership is generally either the sole or shared power to vote or dispose of the shares. Except as otherwise noted, the beneficial owners have sole power to vote and dispose of the shares. KCS is not aware of any arrangement which would at a subsequent date result in a change of control of KCS.

[INFORMATION AS OF 12/24/04; TABLE TO BE UPDATED AS OF RECORD DATE]

Name and Address	Common Stock(1)	Percent of Class(1)
Capital Group International, Inc.	3,217,500(2)	5.14%
Dimensional Fund Advisors Inc.	3,700,415(3)	5.91%
Mac-Per-Wolf Company, PWMCO, LLC, Perkins, Wolf, McDonnell and Company, LLC	5,070,414(4)	8.10%
Waddell & Reed Financial, Inc., Waddell & Reed Ivy Investment Company, Waddell & Reed Investment Management Company, Waddell & Reed, Inc., Waddell & Reed Financial Services, Inc.	3,910,712(5)	6.24%
Merrill Lynch & Co. Inc. (on behalf of Merrill Lynch Investment Managers), FAM D/ B/ A Mercury Advisors, Federated Investment Management Co., Fund Asset Management, L.P., Merrill Lynch Investment Managers, L.P., Merrill Lynch Investment Managers, LLC,	3,522,200(6)	5.62%
A. Edward Allinson Director	106,033(7)	*
Gerald K. Davies Executive Vice President and Chief Operating Officer	158,094(8)	*
Robert J. Druten Director	5,412	
Michael G. Fitt Director	116,800(9)	*
Michael R. Haverty Chairman of the Board, President and Chief Executive Officer	2,643,499(10)	4.09%

**Table of Contents**

Name and Address	Common Stock(1)	Percent of Class(1)
Jerry W. Heavin Senior Vice President Operations of KCSR	73,721(11)	*
James R. Jones Director	86,480(12)	*
Thomas A. McDonnell Director	623,321(13)	*
Karen L. Pletz Director	0	*
Ronald G. Russ Executive Vice President and Chief Financial Officer	90,021(14)	*
Rodney E. Slater Director	40,000(15)	*
Robert B. Terry Senior Vice President and General Counsel	2,500	*
All Directors and Executive Officers as a Group (16 Persons)	4,174,993(16)	6.39%

\* Less than one percent of the outstanding shares.

- (1) Under applicable law, shares that may be acquired upon the exercise of options or other convertible securities that are exercisable on the Record Date, or will become exercisable within 60 days of that date, are considered beneficially owned. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares subject to options held by that person that are exercisable on the Record Date, or exercisable within 60 days of the Record Date, are deemed outstanding. These shares are not, however, deemed outstanding for the purpose of computing the percentage ownership of any other person. In addition, under applicable law, shares that are held indirectly are considered beneficially owned. Directors and executive officers may also be deemed to own, beneficially, shares included in the amounts shown above which are held in other capacities. The holders may disclaim beneficial ownership of shares included under certain circumstances. Except as noted, the holders have sole voting and dispositive power over the shares. The list of executive officers of KCS is included in KCS's Annual Report on Form 10-K. See the last page of this proxy statement for instructions on how to obtain a copy of the Form 10-K.
- (2) The address of Capital Group International, Inc. ( CGII ) is 11100 Santa Monica Blvd., Los Angeles, California 90025. CGII is the parent holding company of a group of investment management companies that hold investment power and, in some cases, voting power over the securities. The investment management companies provide investment advisory and management services for their respective clients which include registered investment companies and institutional accounts. These investment management companies, which are wholly-owned subsidiaries of CGII include: Capital Guardian Trust Company, a bank as defined in Section 3(a)(6) of the Securities Exchange Act of 1934 and a registered investment adviser; and Capital International Research and Management, Inc. dba Capital International, Inc., a registered investment adviser. Capital International S.A., a wholly-owned subsidiary of CGII, does not fall within any of the categories described in Rule 13d-1(b)(ii)(A-F) but its holdings of any reported securities come within the five percent limitation as set forth in a December 15, 1986 no-action letter from the Staff of the Securities and Exchange Commission to The Capital Group Companies, Inc. CGII does not have investment power or voting power over any of the securities. Shares reported by CGII include 488,710 shares resulting from the assumed conversion of 14,600 shares of the Series C Preferred Stock. CGII disclaims beneficial ownership of the securities. This information is based on Schedule 13G filed February 13, 2004.
- (3) The address of Dimensional Fund Advisors Inc. ( Dimensional ) is 1299 Ocean Avenue, 11th Floor, Santa Monica, California 90401. Dimensional is a registered investment advisor that furnishes investment advice to four registered investment companies and serves as investment manager to certain

**Table of Contents**

other commingled group trusts and separate accounts (collectively, the Funds ). These securities are owned by advisory clients of Dimensional, no one of which, to the knowledge of Dimensional, owns more than 5% of the class. Dimensional disclaims beneficial ownership of all such securities. This information is based on Dimensional's Schedule 13G filed February 6, 2004.

- (4) The address of Mac-Per-Wolf Company and its two subsidiaries, PWMCO, LLC and Perkins, Wolf, McDonnell and Company, LLC, is 310 S. Michigan Ave., Suite 2600, Chicago, IL 60604. Perkins, Wolf, McDonnell and Company, LLC, a registered investment adviser, furnishes investment advice to various registered investment companies and to individual and institutional clients (collectively referred to herein as Managed Portfolios ). The Managed Portfolios have the right to receive all dividends from, and the proceeds from the sale of, the securities held in their respective accounts. The interest of any one such person does not exceed 5% of the class of securities. PWMCO, LLC is a wholly-owned subsidiary of Mac-Per-Wolf Company and is both a registered broker dealer and a registered investment adviser. This information is based on Schedule 13G filed February 2, 2004.
- (5) The address for each of Waddell & Reed Ivy Investment Company, Waddell & Reed Investment Management Company, Waddell & Reed, Inc., Waddell & Reed Financial Services, Inc., and Waddell & Reed Financial, Inc., is 6300 Lamar Avenue, Overland Park, KS 66202. The securities are beneficially owned by one or more open-end investment companies or other managed accounts which are advised or sub-advised by Waddell & Reed Ivy Investment Company ( WRIICO ), an investment advisory subsidiary of Waddell & Reed Financial, Inc. ( WDR ) or Waddell & Reed Investment Management Company ( WRIMCO ), an investment advisory subsidiary of Waddell & Reed, Inc. ( WRI ). WRI is a broker-dealer and underwriting subsidiary of Waddell & Reed Financial Services, Inc., a parent holding company ( WRFSI ). In turn, WRFSI is a subsidiary of WDR, a publicly traded company. The investment advisory contracts grant WRIICO and WRIMCO all investment and/or voting power over securities owned by such advisory clients. The investment sub-advisory contracts grant WRIICO and WRIMCO investment power over securities owned by such sub-advisory clients and, in most cases, voting power. Any investment restriction of a sub-advisory contract does not restrict investment discretion or power in a material manner. Therefore, WRIICO and/or WRIMCO may be deemed the beneficial owner of the securities covered by this statement under Rule 13d-3 of the Securities Exchange Act of 1934 (the 1934 Act ). These entities have sole voting and dispositive power over the following number of shares of KCS common stock: WDR 3,910,712 (indirect), WRFSI 3,170,012 (indirect), WRI 3,170,012 (indirect), WRIMCO 3,170,012 (direct), and WRIICO 740,700 (direct). WRIICO, WRIMCO, WRI, WRFSI and WDR are of the view that they are not acting as a group for purposes of Section 13(d) under the 1934 Act. Indirect beneficial ownership is attributed to the respective parent companies solely because of the parent companies' control relationship to WRIMCO. This information is based on Schedule 13G filed January 30, 2004.
- (6) Merrill Lynch & Co., Inc. ( ML&Co. ) is a parent holding company. Merrill Lynch Investment Managers ( MLIM ) is an operating division of ML&Co. consisting of ML&Co.'s indirectly-owned asset management subsidiaries. The following asset management subsidiaries hold certain shares of the common stock, FAM d/b/a Mercury Advisors (Sub), Federated Investment Management Co., Fund Asset Management, L.P., Merrill Lynch Investment Managers, L.P., and Merrill Lynch Investment Managers, LLC. The address for these entities is World Financial Center, North Tower 250 Vesey Street, New York, NY 10381. MLIM of ML&Co. is comprised of the following legal entities: Merrill Lynch Investment Managers, L.P., ( MLIMLP ) doing business as Merrill Lynch Investment Managers; Fund Asset Management, L.P. ( FAM ) doing business as Fund Asset Management; Merrill Lynch Investment Managers, LLC ( MLIMLLC ); Merrill Lynch Asset Management U.K. Limited ( MLAM UK ); Merrill Lynch (Suisse) Investment Management S.A. (MLS); Merrill Lynch Investment Managers International Limited ( MLIMI ); Merrill Lynch Investment Managers Limited; Merrill Lynch Investment Managers (Asia Pacific) Limited; Merrill Lynch Investment Managers (Asia) Limited; Merrill Lynch Investment Managers Limited (Australia); Merrill Lynch Investment Managers (Isle of Man) Limited; Munich London Investment Management Limited; Munich London Investment Management (Jersey) Limited; Merrill Lynch Investment Managers Co. Ltd; DSP Merrill Lynch Fund Managers Ltd; Merrill Lynch Global Asset Management Limited;

**Table of Contents**

Merrill Lynch Fund Managers Limited; Merrill Lynch Fund Managers (Channel Islands) Limited; Merrill Lynch Investment Managers (Channel Islands) Limited; and Merrill Lynch Pensions Limited. Each of MLIMLP, FAM, MLAM UK, MLS and MLIMI is a registered investment adviser which acts as investment adviser to various registered investment companies. Each other firm constituting part of MLIM is an investment adviser operating under the laws of a jurisdiction other than the United States. The investment advisers that comprise MLIM exercise voting and investment powers over portfolio securities independently from other direct and indirect subsidiaries of ML&Co. The information is based on Schedule 13G filed January 27, 2004.

- (7) Mr. Allinson's beneficial ownership includes 84,000&nbs