KANSAS CITY SOUTHERN
Form 10-Q
July 20, 2018
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 1-4717

KANSAS CITY SOUTHERN
(Exact name of registrant as specified in its charter)

Delaware	44-0663509
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
427 West 12th Street, Kansas City, Missouri	64105
(Address of principal executive offices)	(Zip Code)

816.983.1303
(Registrant’s telephone number, including area code)
No Change
(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
Emerging growth company ¨
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Class	July 13, 2018
Common Stock, $0.01 per share par value	102,159,153 Shares

Kansas City Southern and Subsidiaries
Form 10-Q
June 30, 2018
Index

Table of Contents

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

Kansas City Southern and Subsidiaries
Consolidated Statements of Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(In millions, except share and per share amounts) (Unaudited)			
Revenues	$682.4	$656.4	$1,321.0	$1,265.9
Operating expenses:				
Compensation and benefits	122.3	125.2	243.9	242.6
Purchased services	49.5	51.4	96.6	100.2
Fuel	85.5	78.9	166.8	154.3
Mexican fuel excise tax credit	(8.0)	(12.8)	(17.2)	(24.5)
Equipment costs	30.7	31.2	62.9	62.4
Depreciation and amortization	86.3	80.4	169.6	159.7
Materials and other	70.3	62.8	133.9	121.2
Total operating expenses	436.6	417.1	856.5	815.9
Operating income	245.8	239.3	464.5	450.0
Equity in net earnings of affiliates	1.0	2.9	2.0	6.9
Interest expense	(28.0)	(25.0)	(53.5)	(49.7)
Debt retirement costs	(2.2)	—	(2.2)	—
Foreign exchange gain (loss)	(21.0)	14.2	6.8	61.0
Other income (expense), net	0.5	(0.1)	0.2	1.0
Income before income taxes	196.1	231.3	417.8	469.2
Income tax expense	47.4	96.6	124.2	187.6
Net income	148.7	134.7	293.6	281.6
Less: Net income attributable to noncontrolling interest	0.5	0.3	0.9	0.6
Net income attributable to Kansas City Southern and subsidiaries	148.2	134.4	292.7	281.0
Preferred stock dividends	—	—	0.1	0.1
Net income available to common stockholders	$148.2	$134.4	$292.6	$280.9
Earnings per share:				
Basic earnings per share	$1.45	$1.27	$2.86	$2.66
Diluted earnings per share	$1.45	$1.27	$2.85	$2.65
Average shares outstanding (in thousands):				
Basic	102,092	105,473	102,332	105,792
Potentially dilutive common shares	400	285	401	250
Diluted	102,492	105,758	102,733	106,042

See accompanying notes to the unaudited consolidated financial statements.

2

Table of Contents

Kansas City Southern and Subsidiaries
Consolidated Statements of Comprehensive Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(In millions) (Unaudited)			
Net income	$148.7	$134.7	$293.6	$281.6
Other comprehensive income (loss):				
Unrealized gain (loss) on interest rate derivative instruments during the period, net of tax of $0.5 million, $(1.5) million, $2.1 million and $(1.5) million, respectively	1.5	(2.3)	6.0	(2.3)
Foreign currency translation adjustments, net of tax of $0.3 million and $0.8 million, respectively, for 2017	(1.2)	0.5	—	1.3
Other comprehensive income (loss)	0.3	(1.8)	6.0	(1.0)
Comprehensive income	149.0	132.9	299.6	280.6
Less: Comprehensive income attributable to noncontrolling interest	0.5	0.3	0.9	0.6
Comprehensive income attributable to Kansas City Southern and subsidiaries	$148.5	$132.6	$298.7	$280.0

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

Kansas City Southern and Subsidiaries
Consolidated Balance Sheets

	June 30, 2018	December 31, 2017
	(In millions, except share and per share amounts)	
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 61.1	$ 134.1
Accounts receivable, net	250.0	237.8
Materials and supplies	154.0	150.8
Other current assets	62.7	157.4
Total current assets	527.8	680.1
Investments	45.6	44.6
Property and equipment (including concession assets), net	8,595.7	8,403.8
Other assets	94.0	70.2
Total assets	$ 9,263.1	$ 9,198.7
LIABILITIES AND EQUITY		
Current liabilities:		
Long-term debt due within one year	$ 10.8	$ 38.8
Short-term borrowings	—	345.1
Accounts payable and accrued liabilities	430.1	587.8
Total current liabilities	440.9	971.7
Long-term debt	2,682.3	2,235.5
Deferred income taxes	1,020.8	987.2
Other noncurrent liabilities and deferred credits	122.9	138.9
Total liabilities	4,266.9	4,333.3
Stockholders' equity:		
$25 par, 4% noncumulative, preferred stock, 840,000 shares authorized, 649,736 shares issued, 242,170 shares outstanding	6.1	6.1
$.01 par, common stock, 400,000,000 shares authorized; 123,352,185 shares issued; 102,126,882 and 103,036,805 shares outstanding at June 30, 2018 and December 31, 2017, respectively	1.0	1.0
Additional paid-in capital	946.4	943.3
Retained earnings	3,731.7	3,611.4
Accumulated other comprehensive loss	(7.6)	(12.9)
Total stockholders' equity	4,677.6	4,548.9
Noncontrolling interest	318.6	316.5
Total equity	4,996.2	4,865.4
Total liabilities and equity	$ 9,263.1	$ 9,198.7

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

Kansas City Southern and Subsidiaries
Consolidated Statements of Cash Flows

	Six Months Ended June 30, 2018	2017
	(In millions) (Unaudited)	
Operating activities:		
Net income	$293.6	$281.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	169.6	159.7
Deferred income taxes	31.5	99.2
Equity in net earnings of affiliates	(2.0)	(6.9)
Share-based compensation	11.6	10.5
Distributions from affiliates	2.5	5.0
Settlement of foreign currency derivative instruments	12.0	(23.7)
Gain on foreign currency derivative instruments	(4.1)	(42.2)
Mexican fuel excise tax credit	(17.2)	(24.5)
Deemed mandatory repatriation tax	(4.0)	—
Changes in working capital items:		
Accounts receivable	(17.2)	(42.2)
Materials and supplies	1.8	(3.3)
Other current assets	(4.1)	(20.7)
Accounts payable and accrued liabilities	(41.0)	34.0
Other, net	(7.2)	(9.6)
Net cash provided by operating activities	425.8	416.9
Investing activities:		
Capital expenditures	(267.3)	(285.4)
Purchase or replacement of equipment under operating leases	(98.9)	(21.9)
Property investments in MSLLC	(20.4)	(19.7)
Investments in and advances to affiliates	(6.3)	(6.6)
Proceeds from disposal of property	5.7	5.5
Other, net	3.0	(9.3)
Net cash used for investing activities	(384.2)	(337.4)
Financing activities:		
Proceeds from short-term borrowings	3,955.0	5,901.5
Repayment of short-term borrowings	(4,303.1)	(5,781.9)
Proceeds from issuance of long-term debt	499.4	—
Repayment of long-term debt	(76.0)	(12.7)
Dividends paid	(74.1)	(70.3)
Shares repurchased	(108.5)	(120.4)
Debt issuance and retirement costs paid	(8.0)	—
Proceeds from employee stock plans	0.7	—
Net cash used for financing activities	(114.6)	(83.8)

Cash and cash equivalents:		
Net decrease during each period	(73.0)	(4.3)
At beginning of year	134.1	170.6
At end of period	$61.1	$166.3

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements
For purposes of this report, “KCS” or the “Company” may refer to Kansas City Southern or, as the context requires, to one or more subsidiaries of Kansas City Southern.

1. Basis of Presentation
In the opinion of the management of KCS, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal and recurring adjustments) necessary to reflect a fair statement of the results for interim periods in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”). Pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”), certain information and note disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. The results of operations for the three and six months ended June 30, 2018, are not necessarily indicative of the results to be expected for the full year ending December 31, 2018. Certain prior year amounts have been reclassified to conform to the current year presentation.
During the first quarter of 2018, the Company adopted Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, which is also known as Accounting Standard Codification ("ASC") Topic 606, for all contracts, using the modified retrospective method. Results from reporting periods beginning after January 1, 2018, are presented under ASC Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historical accounting under ASC Topic 605, Revenue Recognition. The adoption of this guidance did not have a significant impact on the Company's consolidated financial statements; thus no adjustment was made to the opening balance of equity at January 1, 2018. See Note 3 - Revenue for additional information.
During the first quarter of 2018, the Company adopted ASU No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows for a reclassification from accumulated other comprehensive loss to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The Company applied the guidance as of the beginning of the period of adoption and reclassified $0.7 million, due to the change in federal corporate tax rate, from accumulated other comprehensive loss to retained earnings. It is the Company’s policy to release income tax effects from accumulated other comprehensive loss using the portfolio approach.

2. New Accounting Pronouncements
In February 2016, the FASB issued ASU No. 2016-02, Leases, which requires lessees to recognize for all leases a right-to-use asset and a lease obligation in the consolidated balance sheet. Expenses are recognized in the consolidated statement of income in a manner similar to current accounting guidance. Lessees are permitted to make an accounting policy election to not recognize an asset and liability for leases with a term of twelve months or less. Lessor accounting under the new standard is substantially unchanged. Additional qualitative and quantitative disclosures, including significant judgments made by management, will be required. The new standard will become effective for the Company beginning with the first quarter 2019. The Company plans to adopt the accounting standard using a prospective transition approach tentatively approved by the FASB in March 2018, which applies the provisions of the new guidance at the effective date without adjusting the comparative periods presented. The Company continues to assess the contractual arrangements that may qualify as a lease under the new standard and is implementing a lease accounting system. At December 31, 2017, KCS disclosed approximately $282 million of undiscounted operating leases in the leases and debt maturities table within Note 11, Long-Term Debt in the Company’s most recent Form 10-K and will evaluate those contracts as well as other existing arrangements to determine if they qualify for lease accounting under the new standard. The Company is continuing to evaluate the impacts the adoption of this accounting guidance will have on the consolidated financial statements.

3. Revenue

Significant Accounting Policy

The primary performance obligation for the Company is to move customers’ freight from an origin to a destination. A performance obligation is created when a customer under a transportation contract or public tariff submits a bill of lading for the transport of goods. The Company recognizes revenue proportionally as a shipment moves from origin to destination, using the distance shipped to measure progress, as the customer simultaneously receives and consumes the benefit over time. Related expenses are recognized as incurred. Revenue associated with in-transit shipments at period end is recognized based on the distance shipped as of the balance sheet date. Payment is received at or shortly after the performance obligation is satisfied.

The transaction price is generally in the form of a fixed fee determined at the inception of the transportation contract or the inception of the bill of lading. Certain customer agreements have variable consideration that are based on milestone achievements in

Table of Contents

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

the form of rebates, discounts or incentives. The Company makes judgments to determine whether the variable consideration is probable of occurring and should be included in the estimated transaction price at the beginning of the period to apply a more consistent rate throughout the year based on an analysis of historical experience with the customer, forecasted shipments and other economic indicators. The Company adjusts the estimate on a quarterly basis. Other revenues, including switching, storage, and demurrage are distinct services and are recognized as services are performed or as contractual obligations are fulfilled. The consideration for other revenue is allocated between the separate services based upon the stand-alone transaction price.

Disaggregation of Revenue

The following table presents revenues disaggregated by the major commodity groups as well as the product types included within the major commodity groups (in millions). The Company believes disaggregation by product type best depicts how cash flows are affected by economic factors. See Note 14 for revenues by geographical area.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018 (ASC 606)	2017 (ASC 605)	2018 (ASC 606)	2017 (ASC 605)
Chemical & Petroleum				
Chemicals	$60.4	$56.0	$118.1	$110.6
Petroleum	57.8	50.8	106.8	89.6
Plastics	39.6	32.0	72.6	65.1
Total	157.8	138.8	297.5	265.3
Industrial & Consumer Products				
Forest Products	69.2	62.2	134.5	125.7
Metals & Scrap	54.0	57.3	107.8	111.6
Other	29.5	29.1	56.7	51.4
Total	152.7	148.6	299.0	288.7
Agriculture & Minerals				
Grain	75.4	73.1	140.6	139.3
Food Products	36.3	38.1	72.5	76.4
Ores & Minerals	5.8	4.8	10.7	9.1
Stone, Clay & Glass	7.6	7.4	14.7	14.9
Total	125.1	123.4	238.5	239.7
Energy				
Utility Coal	23.9	39.0	53.2	81.8
Coal & Petroleum Coke	11.2	10.3	21.4	21.3
Frac Sand	10.5	14.0	21.6	24.7
Crude Oil	10.9	7.2	21.6	11.7
Total	56.5	70.5	117.8	139.5
Intermodal	93.7	90.6	184.6	174.1
Automotive	67.3	57.5	127.1	108.8

Total Freight Revenues	653.1	629.4	1,264.5	1,216.1
Other Revenue	29.3	27.0	56.5	49.8
Total Revenues	$682.4	$656.4	$1,321.0	$1,265.9

Major customers

No individual customer makes up greater than 10% of total consolidated revenues.

Table of Contents

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

Contract Balances

The amount of revenue recognized in the second quarter of 2018 from performance obligations partially satisfied in previous periods was $23.1 million. The performance obligations that were unsatisfied or partially satisfied as of June 30, 2018, were $25.8 million, which represents in-transit shipments that are fully satisfied the following month.

A receivable is any unconditional right to consideration, and is recognized as shipments have been completed and the relating performance obligation has been fully satisfied. At June 30, 2018, and December 31, 2017, the accounts receivable, net balance was $250.0 million and $237.8 million, respectively. Contract assets represent a conditional right to consideration in exchange for goods or services. The Company did not have any contract assets at June 30, 2018, and December 31, 2017.

Contract liabilities represent advance consideration received from customers, and are recognized as revenue over time as the relating performance obligation is satisfied. The amount of revenue recognized in the second quarter of 2018 that was included in the opening contract liability balance was $9.1 million. The Company has recognized contract liabilities within the accounts payable and accrued liabilities financial statement caption on the balance sheet. These are considered current liabilities as they will be settled in less than 12 months.

The following tables summarize the changes in contract liabilities (in millions):

Contract liabilities	Three Months Ended June 30,		Six Months Ended June 30,	
	2018 (ASC 606)	2017 (ASC 605)	2018 (ASC 606)	2017 (ASC 605)
Beginning balance	$20.0	$8.0	$26.8	$13.7
Revenue recognized that was included in the contract liability balance at the beginning of the period	(9.1)	(7.1)	(18.5)	(13.6)
Increases due to cash received, excluding amounts recognized as revenue during the period	5.7	5.0	8.3	5.8
Ending balance	$16.6	$5.9	$16.6	$5.9

4. Hurricane Harvey

In late August 2017, Hurricane Harvey made landfall on the Texas coast and caused flood damage to the Company’s track infrastructure and significantly disrupted the Company’s rail service. The Company filed a claim in the fourth quarter of 2017 under its insurance program for property damage, incremental expenses, and lost profits caused by Hurricane Harvey. In the third quarter of 2017, the Company recognized a receivable for probable insurance recovery offsetting the impact of incremental expenses recognized in the quarter. The recognition of remaining probable insurance recoveries in excess of incremental expenses and self-insured retention represents a contingent gain that will be recognized when all contingencies have been resolved, which generally occurs at the time of final settlement or when nonrefundable cash payments are received.

5. Income Taxes

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act (the “Tax Reform Act”). The legislation significantly changed U.S. tax law by, among other things, lowering corporate income tax rates, implementing a territorial tax system and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. The Tax Reform Act permanently reduced the U.S. corporate income tax rate from a maximum of 35% to a 21% rate, effective January 1, 2018.

While the Tax Reform Act provides for a territorial tax system, beginning in 2018, it includes the global intangible low-taxed income ("GILTI") provision. The Company elected to account for GILTI tax in the period in which it is incurred. The GILTI provisions require the Company to include in its U.S. income tax return foreign subsidiary earnings in excess of an allowable return on the foreign subsidiary's tangible assets. The GILTI tax expense is caused by two aspects of U.S. foreign tax credit limitation provisions. First, required allocations of interest expense to the GILTI income effectively renders the expense non-deductible. Secondly, U.S. income tax return income inclusion of the foreign taxes paid on the GILTI income is subject to U.S. tax without any associated foreign tax credit, resulting in incremental U.S. income tax. As a result of the GILTI provisions, the Company's effective tax rate increased by 0.9% and 2.0% for the three and six months ended June 30, 2018, respectively.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 ("SAB 118") to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Reform Act. The Company recognized provisional tax impacts related to the deemed repatriated earnings and the revaluation of deferred tax assets and liabilities

Table of Contents

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

in its consolidated financial statements for the year ended December 31, 2017. The ultimate impact may differ from those provisional amounts, possibly materially, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, additional regulatory guidance that may be issued, and actions the Company may take as a result of the Tax Reform Act. Any adjustments made to the provisional amounts under SAB 118 should be recorded as discrete adjustments in the period identified (not to extend beyond the one-year measurement provided in SAB 118).
On April 2, 2018, the Internal Revenue Service ("IRS") issued guidance on how to determine, report and pay the repatriation tax on deemed repatriated earnings of foreign subsidiaries provided in the Tax Reform Act and included in the consolidated financial statements for the year ended December 31, 2017. During the three months ended June 30, 2018, the Company recognized a $4.3 million discrete tax benefit resulting from the additional guidance. The deemed repatriated earnings and the revaluation of deferred tax assets and liabilities are provisional as of June 30, 2018. The accounting is expected to be completed when the 2017 U.S. corporate income tax return is filed in 2018.

6. Earnings Per Share Data

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share adjusts basic earnings per common share for the effects of potentially dilutive common shares, if the effect is not anti-dilutive. Potentially dilutive common shares include the dilutive effects of shares issuable under the stock option and performance award plans.
The following table reconciles the basic earnings per share computation to the diluted earnings per share computation (in millions, except share and per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income available to common stockholders for purposes of computing basic and diluted earnings per share	$148.2	$134.4	$292.6	$280.9
Weighted-average number of shares outstanding (in thousands):				
Basic shares	102,092	105,473	102,332	105,792
Effect of dilution	400	285	401	250
Diluted shares	102,492	105,758	102,733	106,042
Earnings per share:				
Basic earnings per share	$1.45	$1.27	$2.86	$2.66
Diluted earnings per share	$1.45	$1.27	$2.85	$2.65

Potentially dilutive shares excluded from the calculation (in thousands):				
Stock options excluded as their inclusion would be anti-dilutive	93	111	100	210

Table of Contents

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

7. Property and Equipment (including Concession Assets)
Property and equipment, including concession assets, and related accumulated depreciation and amortization are summarized below (in millions):

	June 30, 2018	December 31, 2017
Land	$218.7	$ 218.6
Concession land rights	141.2	141.2
Road property	7,489.4	7,557.1
Equipment	2,695.7	2,534.9
Technology and other	260.4	229.1
Construction in progress	223.4	223.7
Total property	11,028.8	10,904.6
Accumulated depreciation and amortization	2,433.1	2,500.8
Property and equipment (including concession assets), net	$8,595.7	$ 8,403.8

Concession assets, net of accumulated amortization of $602.3 million and $638.2 million, totaled $2,233.1 million and $2,208.1 million at June 30, 2018 and December 31, 2017, respectively.

8. Fair Value Measurements
The Company's derivative financial instruments are measured at fair value on a recurring basis and consist of foreign currency forward and option contracts and treasury lock agreements, which are classified as Level 2 valuations. The Company determines the fair value of its derivative financial instrument positions based upon pricing models using inputs observed from actively quoted markets and also takes into consideration the contract terms as well as other inputs, including market currency exchange rates and in the case of option contracts, volatility, the risk-free interest rate and the time to expiration.
The Company's short-term financial instruments include cash and cash equivalents, accounts receivable, accounts payable and short-term borrowings. The carrying value of the short-term financial instruments approximates their fair value.
The fair value of the Company's debt is estimated using quoted market prices when available. When quoted market prices are not available, fair value is estimated based on current market interest rates for debt with similar maturities and credit quality. The carrying value of the Company's debt was $2,693.1 million and $2,274.3 million at June 30, 2018 and December 31, 2017, respectively. If the Company's debt were measured at fair value, the fair value measurements of the individual debt instruments would have been classified as Level 2 in the fair value hierarchy.

The fair value of the Company's financial instruments is presented in the following table (in millions):

	June 30, 2018 Level 2	December 31, 2017 Level 2
Assets		
Foreign currency derivative instruments	$ —	$ 7.9
Treasury lock agreements	2.5	—
Liabilities		
Debt instruments	2,656.8	2,377.8
Treasury lock agreements	—	5.6

9. Derivative Instruments

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

Table of Contents

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

Credit Risk. As a result of the use of derivative instruments, the Company is exposed to counterparty credit risk. The Company manages this risk by limiting its counterparties to large financial institutions which meet the Company’s credit rating standards and have an established banking relationship with the Company. As of June 30, 2018, the Company did not expect any losses as a result of default of its counterparties.

Interest Rate Derivative Instruments. In May 2017, the Company executed four treasury lock agreements with an aggregate notional value of $275.0 million and a weighted average interest rate of 2.85%. The purpose of the treasury locks is to hedge the U.S. Treasury benchmark interest rate associated with future interest payments related to the anticipated refinancing of the $275.0 million, 2.35% senior notes due May 15, 2020. The Company has designated the treasury locks as cash flow hedges and recorded unrealized gains and losses in accumulated other comprehensive loss. Upon settlement, the unrealized gain or loss in accumulated other comprehensive income will be amortized to interest expense over the life of the future underlying debt issuance.

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

The foreign currency forward contracts involve the Company’s purchase of pesos at an agreed-upon weighted-average exchange rate to each U.S dollar. The zero-cost collars involve the Company’s purchase of a Mexican peso call option and a simultaneous sale of a Mexican peso put option, with equivalent U.S. dollar notional amounts for each option and no net cash premium paid by the Company. The Company’s foreign currency forward and zero-cost collar contracts are executed with counterparties in the U.S. and are governed by an International Swaps and Derivatives Association agreement that includes standard netting arrangements. Asset and liability positions from contracts with the same counterparty are net settled upon maturity/expiration and presented on a net basis in the consolidated balance sheets prior to settlement.

Below is a summary of the Company’s 2018 and 2017 foreign currency derivative contracts (amounts in millions, except Ps./USD):

Foreign currency forward contracts

	Contracts to purchase Ps./pay USD				Offsetting contracts to sell Ps./receive USD				
	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Maturity date	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Maturity date	Cash received/(paid) on settlement
Contracts executed in 2016 and settled in 2017	$340.0	Ps. 6,207.7	Ps. 18.3	1/17/2017	$287.0	Ps. 6,207.7	Ps. 21.6	1/17/2017	$ (53.0)

Foreign currency zero-cost collar contracts

	Notional amount	Weighted-average call rate outstanding options (in Ps./USD)	Weighted-average put rate outstanding options (in Ps./USD)	Cash received/(paid) on settlement

Contracts executed in 2018 and outstanding	$215.0	Ps.	19.3	Ps.	22.2	—
Contracts executed in 2018 and settled in 2018	$125.0					$2.0
Contracts executed in 2017 and settled in 2018	$80.0					$10.0