CHS INC
Form 10-K/A
February 13, 2004

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K/A-2

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

For the Fiscal Year Ended August 31, 2003

or

o	**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: 0-50150

CHS Inc.

(Exact name of registrant as specified in its charter)

Minnesota *(State or other jurisdiction of incorporation or organization)*	**41-0251095** *(I.R.S. Employer Identification Number)*
5500 Cenex Drive **Inver Grove Heights, Minnesota 55077** *(Address of principal executive office, including zip code)*	**(651) 355-6000** *(Registrant s Telephone number, including area code)*

Securities Registered Pursuant to Section 12(b) of the Act:
None
Securities Registered Pursuant to Section 12(g) of the Act:
8% Cumulative Redeemable Preferred Stock
(Title of Class)

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K: o

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter:

The registrant s voting and non-voting common equity has no market value (the registrant is a member cooperative).

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date: The registrant has no common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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This Form 10-K/A-2 amends Items 1, 9A and 15(a)(3) to the Registrant s Annual Report on Form 10-K for the fiscal year ended August 31, 2003, as previously amended by the Registrant s Form 10-K/A-1. In addition, in connection with the filing of this Form 10-K/A-2 and pursuant to the rules of the Securities and Exchange Commission, the Registrant is including with this Form 10-K/A-2 certain currently dated certifications. No other changes have been made to the Annual Report and this Form 10-K/A-2 does not modify or update the disclosure contained in the Form 10-K as amended by the Form 10-K/A-1 in any way other than as required to reflect the amendments discussed above and reflected below.

PART I.

Item 1. ***Business***

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

The information in this Annual Report on Form 10-K for the year ended August 31, 2003, includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the Company. In addition, the Company and its representatives and agents may from time to time make other written or oral forward-looking statements, including statements contained in the Company s filings with the Securities and Exchange Commission and its reports to its members and securityholders. Words and phrases such as will likely result, are expected to, is anticipated, estimate, project and similar expressions identify forward-looking statements. The Company wishes to caution readers not to place undue reliance on any forward-looking statements, which speak only as of the date made.

The Company s forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those discussed in the forward-looking statements. This Cautionary Statement is for the purpose of qualifying for the safe harbor provisions of the Act and is intended to be a readily available written document that contains factors which could cause results to differ materially from those projected in the forward-looking statements. The following matters, among others, may have a material adverse effect on the business, financial condition, liquidity, results of operations or prospects, financial or otherwise, of the Company. Reference to this Cautionary Statement in the context of a forward-looking statement shall be deemed to be a statement that any one or more of the following factors may cause actual results to differ materially from those which might be projected, forecasted, estimated or budgeted by the Company in the forward-looking statement or statements.

The following factors are in addition to any other cautionary statements, written or oral, which may be made or referred to in connection with any particular forward-looking statement. The following review should not be construed as exhaustive.

The Company undertakes no obligation to revise any forward-looking statements to reflect future events or circumstances.

OUR REVENUES AND OPERATING RESULTS COULD BE ADVERSELY AFFECTED BY CHANGES IN COMMODITY PRICES. Our revenues and earnings are affected by market prices for commodities such as crude oil, natural gas, grain, oilseeds, and flour. Commodity prices generally are affected by a wide range of factors beyond our control, including the weather, disease, insect damage, drought, the availability and adequacy of supply, government regulation and policies, and general political and economic conditions. We are also exposed to fluctuating commodity prices as the result of our inventories of commodities, typically grain and petroleum products, and purchase and sale contracts at fixed or partially fixed prices. At any time, our inventory levels and unfulfilled fixed or partially fixed price contract obligations may be substantial. Increases in market prices for commodities that we purchase without a corresponding increase in the prices of our products or our sales volume or a decrease in our other operating expenses could reduce our revenues and net income.

In our energy operations, profitability depends largely on the margin between the cost of crude oil that we refine and the selling prices that we obtain for our refined products. Prices for both crude oil and for gasoline, diesel fuel, and other refined petroleum products fluctuate widely. Factors influencing these prices, many of which are beyond our control, include:

- levels of worldwide and domestic supplies;
- capacities of domestic and foreign refineries;
- the ability of the members of OPEC to agree to and maintain oil price and production controls, and the price and level of foreign imports generally;
- political instability or armed conflict in oil-producing regions;
- the level of consumer demand;
- the price and availability of alternative fuels;
- the availability of pipeline capacity; and
- domestic and foreign governmental regulations and taxes.

The long-term effects of these and other conditions on the prices of crude oil and refined petroleum products are uncertain and ever-changing. Accordingly, we expect our margins on and the profitability of our energy business to fluctuate, possibly significantly, over time.

OUR OPERATING RESULTS COULD BE ADVERSELY AFFECTED IF OUR MEMBERS WERE TO DO BUSINESS WITH OTHERS RATHER THAN WITH US. We do not have an exclusive relationship with our members and our members are not obligated to supply us with their products or purchase products from us. Our members often have a variety of distribution outlets and product sources available to them. If our members were to sell their products to other purchasers or purchase products from other sellers, our revenues would decline and our results of operations could be adversely affected.

WE PARTICIPATE IN HIGHLY COMPETITIVE BUSINESS MARKETS IN WHICH WE MAY NOT BE ABLE TO CONTINUE TO COMPETE SUCCESSFULLY. We operate in several highly competitive business segments and our competitors may succeed in developing new or enhanced products that are better than ours, and may be more successful in marketing and selling their products than we are with ours. Competitive factors include price, service level, proximity to markets, product quality and marketing. In some of our business segments, such as Energy, we compete with companies that are larger, better known and have greater marketing, financial, personnel and other resources. As a result, we may not be able to continue to compete successfully with our competitors.

CHANGES IN FEDERAL INCOME TAX LAWS OR IN OUR TAX STATUS COULD INCREASE OUR TAX LIABILITY AND REDUCE OUR NET INCOME. Current federal income tax laws, regulations and interpretations regarding the taxation of cooperatives, which allow us to exclude income generated through business with or for a member (patronage income) from our taxable income, could be changed. If this occurred, or if in the future we were not eligible to be taxed as a cooperative, our tax liability would significantly increase and our net income significantly decrease.

WE INCUR SIGNIFICANT COSTS IN COMPLYING WITH APPLICABLE LAWS AND REGULATIONS. ANY FAILURE TO MAKE THE CAPITAL INVESTMENTS NECESSARY TO COMPLY WITH THESE LAWS AND REGULATIONS COULD EXPOSE US TO FINANCIAL LIABILITY. We are subject to numerous federal, state and local provisions regulating our business and operations and we incur and expect to incur significant capital and operating expenses to comply with these laws and regulations. We may be unable to pass on those expenses to customers without experiencing volume and margin losses. For example, capital expenditures for upgrading our refineries, largely to comply with regulations requiring the reduction of sulfur levels in refined petroleum products, are expected to be approximately $87.0 million for our Laurel, Montana refinery and $324.0 million for National Cooperative Refinery Association s McPherson, Kansas refinery, of which $8.7 million had been spent at the Laurel refinery and $36.5 million had been spent by NCRA at the McPherson refinery as of August 31, 2003. We expect all of these compliance capital expenditures at the refineries to be complete by December 31, 2005, and anticipate funding these projects with a combination of cash flows from operations and debt proceeds.

We establish reserves for the future cost of meeting known compliance obligations, such as remediation of identified environmental issues. However, these reserves may prove inadequate to meet our actual liability. Moreover, amended, new or more stringent requirements, stricter interpretations of existing requirements or the future discovery of currently unknown compliance issues may require us to make material expenditures or subject us to liabilities that we currently do not anticipate. Furthermore, our failure to comply with applicable laws and regulations could subject us to administrative penalties and injunctive relief, civil remedies including fines and injunctions, and recalls of our products.

ENVIRONMENTAL LIABILITIES COULD ADVERSELY AFFECT OUR RESULTS AND FINANCIAL CONDITION. Many of our current and former facilities have been in operation for many years and, over that time, we and other operators of those facilities have generated, used, stored and disposed of substances or wastes that are or might be considered hazardous under applicable environmental laws, including chemicals and fuels stored in underground and above-ground tanks. Any past or future actions in violation of applicable environmental laws could subject us to administrative penalties, fines and injunctions. Moreover, future or unknown past releases of hazardous substances could subject us to private lawsuits claiming damages and to adverse publicity.

ACTUAL OR PERCEIVED QUALITY, SAFETY OR HEALTH RISKS ASSOCIATED WITH OUR PRODUCTS COULD SUBJECT US TO LIABILITY AND DAMAGE OUR BUSINESS AND REPUTATION. If any of our food or feed products became adulterated or misbranded, we would need to recall those items and could experience product liability claims if consumers were injured as a result. A widespread product recall or a significant product liability judgment could cause our products to be unavailable for a period of time or a loss of consumer confidence in our products. Even if a product liability claim is unsuccessful or is not fully pursued, the negative publicity surrounding any assertion that our products caused illness or injury could adversely affect our reputation with existing and potential customers and our corporate and brand image. Moreover, claims or liabilities of this sort might not be covered by our insurance or by any rights of indemnity or contribution that we may have against others. In addition, general public perceptions regarding the quality, safety or health risks associated with particular food or feed products, such as the concern in some quarters regarding genetically modified crops, could reduce demand and prices for some of the products associated with our businesses. To the extent that consumer preferences evolve away from products that our members or we produce for health or other reasons, such as the growing demand for organic food products, and we are unable to develop products that satisfy new consumer preferences, there will be a decreased demand for our products.

OUR OPERATIONS ARE SUBJECT TO BUSINESS INTERRUPTIONS AND CASUALTY LOSSES; WE DO NOT INSURE AGAINST ALL POTENTIAL LOSSES AND COULD BE SERIOUSLY HARMED BY UNEXPECTED LIABILITIES. Our operations are subject to business interruptions due to unanticipated events such as explosions, fires, pipeline interruptions, transportation delays, equipment failures, crude oil or refined product spills, inclement weather and labor disputes. For example:

- our oil refineries and other facilities are potential targets for terrorist attacks that could halt or discontinue production;
- our inability to negotiate acceptable contracts with unionized workers in our operations could result in strikes or work stoppages; and
- the significant inventories that we carry could be damaged or destroyed by catastrophic events, extreme weather conditions or contamination.

We maintain insurance against many, but not all, potential losses or liabilities arising from these operating hazards, but uninsured losses or losses above our coverage limits are possible. Uninsured losses

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and liabilities arising from operating hazards could have a material adverse effect on our financial position or results of operations.

OUR COOPERATIVE STRUCTURE LIMITS OUR ABILITY TO ACCESS EQUITY CAPITAL. As a cooperative, we may not sell common equity in our company. In addition, existing laws and our articles of incorporation and bylaws contain limitations on dividends of 8% of any preferred stock that we may issue. These limitations restrict our ability to raise equity capital and may adversely affect our ability to compete with enterprises that do not face similar restrictions.

CONSOLIDATION AMONG THE PRODUCERS OF PRODUCTS WE PURCHASE AND CUSTOMERS FOR PRODUCTS WE SELL COULD ADVERSELY AFFECT OUR REVENUES AND OPERATING RESULTS. Consolidation has occurred among the producers of products we purchase, including crude oil and grain, and it is likely to continue in the future. Consolidation could increase the price of these products and allow suppliers to negotiate pricing and other contract terms that are less favorable to us. Consolidation also may increase the competition among consumers of these products to enter into supply relationships with a smaller number of producers resulting in potentially higher prices for the products we purchase.

Consolidation among purchasers of our products and in wholesale and retail distribution channels has resulted in a smaller customer base for our products and intensified the competition for these customers. For example, ongoing consolidation among distributors and brokers of food products and food retailers has altered the buying patterns of these businesses, as they have increasingly elected to work with product suppliers who can meet their needs nationwide rather than just regionally or locally. If these distributors, brokers, and retailers elect not to purchase our products, our sales volumes, revenues, and profitability could be significantly reduced.

IF OUR CUSTOMERS CHOSE ALTERNATIVES TO OUR REFINED PETROLEUM PRODUCTS OUR REVENUES AND PROFITS MAY DECLINE. Numerous alternative energy sources currently under development could serve as alternatives to our gasoline, diesel fuel and other refined petroleum products. If any of these alternative products become more economically viable or preferable to our products for environmental or other reasons, demand for our energy products would decline. Demand for our gasoline, diesel fuel and other refined petroleum products also could be adversely affected by increased fuel efficiencies.

OUR AGRONOMY BUSINESS IS DEPRESSED AND COULD CONTINUE TO UNDERPERFORM IN THE FUTURE. Demand for agronomy products in general has been adversely affected in recent years by drought and poor weather conditions, idle acreage and development of insect and disease-resistant crops. These factors could cause Agriliance, LLC, an agronomy marketing and distribution venture in which we own a minority interest, to be unable to operate at profitable margins. In addition, these and other factors, including fluctuations in the price of natural gas and other raw materials, an increase in recent years in domestic and foreign production of fertilizer, and intense competition within the industry, in particular from lower-cost foreign producers, have created particular pressure on producers of fertilizers. As a result, CF Industries, Inc., a fertilizer manufacturer in which we hold a minority cooperative interest, has suffered significant losses in recent years as it has incurred increased prices for raw materials but has been unable to pass those increased costs on to its customers.

TECHNOLOGICAL IMPROVEMENTS IN AGRICULTURE COULD DECREASE THE DEMAND FOR OUR AGRONOMY PRODUCTS. Technological advances in agriculture could decrease the demand for crop nutrients, and other crop input products and services that we provide. Genetically engineered seeds that resist disease and insects or meet certain nutritional requirements could affect the demand for our crop nutrients and crop protection products, as well as the demand for fuel that we sell and which is used to operate application equipment relating to these products.

WE OPERATE SOME OF OUR BUSINESS THROUGH JOINT VENTURES IN WHICH OUR RIGHTS TO CONTROL BUSINESS DECISIONS ARE LIMITED. Several parts of our business, including in particular our agronomy business segment and portions of our grain marketing, wheat milling and foods businesses, are operated through joint ventures with unaffiliated third parties. By operating a business through a joint venture, we have less control over business decisions than we have in our wholly owned businesses. In particular, we generally cannot act on major business initiatives in our joint ventures without the consent of the other party or parties in that venture.

THE COMPANY

CHS Inc. (CHS or the Company) is one of the nation s leading integrated agricultural companies. As a cooperative, the Company is owned by farmers and ranchers and their local cooperatives from the Great Lakes to the Pacific Northwest and from the Canadian border to Texas. CHS buys commodities from and provides products and services to its members and other customers. The Company provides a wide variety of products and services, from initial agricultural inputs such as fuels, farm supplies, crop nutrients and crop protection products, to agricultural outputs that include grains and oilseeds, grain and oilseed processing and food products. A portion of the Company s operations are conducted through equity investments and joint ventures whose operating results are not fully consolidated with the Company s results; rather, a proportionate share of the income or loss from those entities is included as a component in the Company s net income under the equity method of accounting. For the fiscal year ended August 31, 2003, the Company s total revenues were $9.4 billion.

The Company s operations are organized into five business segments: Agronomy, Energy, Country Operations and Services, Grain Marketing and Processed Grains and Foods. Together these business segments create vertical integration to link producers with consumers. The first two segments, Agronomy and Energy, produce and provide for the wholesale distribution of inputs that are essential for crop production. The third segment, Country Operations and Services, serves as the Company-owned retailer of a portion of these crop inputs and also serves as the first handler of a significant portion of the crops marketed and processed by the Company. The fourth segment, Grain Marketing, purchases and resells grains and oilseeds originated by the Country Operations and Services segment, by member cooperatives and also by third parties. The fifth business segment, Processed Grains and Foods, converts grains and oilseeds into value-added products.

Only producers of agricultural products and associations of producers of agricultural products may be members of CHS. The Company s earnings derived from business conducted with these members are allocated to members based on the volume of business they do with the Company. Members receive earnings in the form of patronage refunds (which are also called patronage dividends) in cash and patron s equities, which may be redeemed over time. Earnings derived from non-members are taxed at regular corporate rates and are retained by the Company as unallocated equity. The Company also receives patronage refunds from the cooperatives in which it is a member if those cooperatives have earnings to distribute and the Company qualifies for patronage refunds from them.

The origins of CHS date back to the early 1930s with the founding of the predecessor companies of Cenex, Inc. and Harvest States Cooperatives. CHS emerged as the result of the merger of the two entities in 1998, and is headquartered in Inver Grove Heights, Minnesota. In August 2003, the Company changed its name from Cenex Harvest States Cooperatives to CHS Inc.

The international sales information and segment information in Notes 2 and 11 to the consolidated financial statements are incorporated by reference into the following business segment descriptions.

The business segment financial information presented below does not represent the results that would have been obtained had the relevant business segment been operated as an independent business.

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AGRONOMY

Overview

Through the Agronomy business segment, the Company is engaged in the manufacture of crop nutrients and the wholesale distribution of crop nutrients and crop protection products. The Company conducts its agronomy operations primarily through two investments a 20% cooperative ownership interest in CF Industries, Inc. (CF Industries) and, effective January 2000, a 25% ownership interest in Agriliance, LLC (Agriliance). CF Industries manufactures crop nutrient products, particularly nitrogen and phosphate fertilizers, and is one of the largest suppliers to Agriliance. Agriliance is one of North America s largest wholesale distributors of crop nutrients, crop protection products and other agronomy products based on sales.

There is significant seasonality in the sale of crop nutrients and crop protection products and services, with peak activity coinciding with the planting and input seasons.

The Company s minority ownership interests in CF Industries and Agriliance are treated as investments, and therefore, those entities revenues and expenses are not reflected in the Company s operating results. CF Industries is treated as a cost method investment and Agriliance is treated as an equity method investment. CF Industries and Agriliance each have their own line of financing, without recourse to the Company.

Operations

CF Industries. CF Industries is an interregional agricultural cooperative involved in the manufacturing of crop nutrient products. It is one of North America s largest producers of nitrogen and phosphate fertilizers based on plant capacity. Through its members, CF Industries nitrogen and phosphate fertilizer products reach farmers and ranchers in 48 states and two Canadian provinces. CF Industries conducts its operations primarily from the following facilities:

a nitrogen manufacturing and processing facility at Donaldsonville, Louisiana;

a phosphate mine and phosphate fertilizer plant in central Florida; and

a 66% ownership interest in a nitrogen fertilizer manufacturing and processing facility in Alberta, Canada.

Agriliance. Agriliance is the one of the nation s largest wholesale distributors of crop nutrients (fertilizers) and crop protection products (insecticides, fungicides and pesticides) based on sales, accounting for an estimated 19% of the U.S. market for crop nutrients and approximately 26% of the U.S. market for crop protection products. As a wholesale distributor, Agriliance has warehouse, distribution and service facilities located throughout the country. Agriliance also owns and operates retail agricultural units in the southern United States. Agriliance purchased approximately 36% of its fertilizer from CF Industries during fiscal year 2003, and purchases most of its crop protection products from Monsanto and Sygenta.

Agriliance was formed in 2000 when CHS, Farmland Industries Inc. (Farmland) and Land O Lakes, Inc. (Land O Lakes) contributed their respective agronomy businesses to the new company in consideration for ownership interests (25% each for CHS and Farmland and 50% for Land O Lakes) in the venture. CHS and Farmland hold their interests in Agriliance through United Country Brands, LLC, a 50/50 jointly-owned holding company.

In April, 2003, CHS acquired a 13.1% additional economic interest in the crop protection products business of Agriliance (the CPP Business) for a cash payment of $34.3 million. After the transaction, the economic interests in Agriliance are owned 50% by Land O Lakes, 25% plus an additional 13.1% of the CPP Business by CHS and 25% less 13.1% of the CPP Business by Farmland. The ownership or governance interests in Agriliance did not change with the purchase of this additional economic interest. Agriliance s earnings are split among the members based upon the respective economic interests of each member.

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Products and Services

CF Industries manufactures crop nutrient products, primarily nitrogen and phosphate fertilizers and potash. Agriliance wholesales crop nutrient products and crop protection products that include insecticides, fungicides, and pesticides. Agriliance also provides field and technical services, including soil testing, adjuvant and herbicide formulation, application and related services.

Sales and Marketing; Customers

CF Industries sells its crop nutrient products to large agricultural cooperatives and distributors. Its largest customers are Land O Lakes, CHS and seven other regional cooperatives that wholesale the products to their members. Agriliance distributes agronomy products through approximately 2,200 local cooperatives from Ohio to the West Coast and from the Canadian border south to Kansas. Agriliance also provides sales and services through 48 Agriliance Service Centers and other retail outlets. Agriliance s largest customer is the Company s Country Operations and Services business segment. In 2003, Agriliance sold approximately $1.3 billion of crop nutrient products and approximately $1.2 billion of crop protection and other products.

Industry; Competition

Regulation. The Agronomy business segment s operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar state agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; the transportation, handling and disposition of wastes; and the labelling of pesticides and similar substances. Failure to comply with these laws, regulations and rules could subject CHS to administrative penalties, injunctive relief and civil remedies. CHS believes that it is in compliance with these laws, regulations and rules in all material respects and does not expect continued compliance to have a material effect on its capital expenditures, earnings or competitive position.

CF Industries. North American fertilizer producers operate in a highly competitive, global industry. Commercial fertilizers are world-traded commodities and producers compete principally on the basis of price and service. Many of the raw materials that are used in fertilizer production, such as natural gas, are often more expensive in the U.S. than other parts of the world. Crop nutrient margins and earnings have historically been cyclical; large profits generated throughout the mid-1990 s attracted additional capital and expansion and the industry now suffers from excess capacity. These factors have produced depressed margins for North American fertilizer manufacturers over the past several years, although recently fertilizer margins have stabilized.

CF Industries competes with numerous domestic and international crop nutrient manufacturers.

Agriliance. The wholesale distribution of agronomy products is highly competitive and dependent upon relationships with agricultural producers and local cooperatives, proximity to producers and local cooperatives and competitive pricing. Moreover, the crop protection products industry is mature with slow growth predicted for the future, which has led distributors and suppliers to turn to consolidation and strategic partnerships to benefit from economies of scale and increased market share. Agriliance competes with other large agronomy distributors, as well as other regional or local distributors and retailers. Agriliance competes on the strength of its relationships with the members of the Company, Farmland and Land O Lakes, its purchasing power and competitive pricing, and its attention to service in the field.

Major competitors of Agriliance in crop nutrient distribution include Agrium, Growmark, Cargill, United Suppliers and West Central. Major competitors of Agriliance in crop protection products distribution include Helena, ConAgra (UAP), Tenkoz and numerous smaller distribution companies.

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Summary Operating Results

The Company accounts for its Agronomy business segment as follows:

CF Industries. The Company s investment in CF Industries of $153 million on August 31, 2003 is carried on the balance sheet at cost, including allocated patronage. Since CF Industries is a cooperative, the Company recognizes income from the investment only if it receives patronage refunds. Over the past five years CF Industries has realized operating losses and, as a result, it has not issued any patronage refunds to its members. Historically, crop nutrients manufacturing earnings have been cyclical in nature. CHS management has performed the appropriate impairment tests of this investment, and based upon those tests, believes that fair market value exceeds its carrying value. The Company will continue to perform impairment tests annually, including reviewing operating results, or as circumstances dictate, which could result in an impairment to its CF Industries investment.

Agriliance. At August 31, 2003 the Company s equity investment in Agriliance was $129.3 million. The Company recognizes earnings from Agriliance using the equity method of accounting, which results in the Company including its economic interest percentage of Agriliance s net earnings as equity income from investments. The Company applies related internal expenses against those earnings.

Summary operating results and identifiable assets for the Agronomy business segment for the fiscal years ended August 31, 2003, 2002 and 2001 are shown below:

	2003	2002	2001
		(dollars in thousands)	
Revenues:			
Net sales			
Patronage dividends	$ (84)	$ (89)	$ 196
Other revenues			
	(84)	(89)	196
Cost of goods sold			
Marketing, general and administrative	8,138	8,957	8,503
Operating losses	(8,222)	(9,046)	(8,307)
Interest	(974)	(1,403)	(4,529)
Equity income from investments	(20,773)	(13,425)	(7,360)
Income before income taxes	$ 13,525	$ 5,782	$ 3,582
Total identifiable assets August 31	$285,906	$242,015	$230,051

ENERGY

Overview

CHS is the nation s largest cooperative energy company based on sales, with operations that include petroleum refining and pipelines; the supply, marketing and distribution of refined fuels (gasoline, diesel, and other energy products); the blending, sale and distribution of lubricants; and the wholesale supply of propane. The Energy business segment processes crude oil into refined petroleum products at refineries in Laurel, Montana (wholly-owned) and McPherson, Kansas (an entity in which CHS has an approximately 74.5% ownership interest) and sells those products under the Cenex brand to CHS s member cooperatives and others, through a network of approximately 1,500 independent retailers, including approximately 800 that operate Cenex/ Ampride convenience stores.

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Operations

Laurel Refinery. The Company s Laurel, Montana refinery processes medium and high sulfur crude oil into refined petroleum products that primarily include gasoline, diesel, and asphalt. The Laurel refinery sources approximately 90% of its crude oil supply from Canada, with the balance obtained from domestic sources. Laurel has access to Canadian and northwest Montana crude through the Company s wholly-owned Front Range Pipeline, LLC and other common carrier pipelines. The Laurel refinery also has access to Wyoming crude via common carrier pipelines from the south.

The Laurel facility processes approximately 55,000 barrels of crude oil per day to produce refined products that consist of approximately 42% gasoline, 30% diesel and other distillates and 28% asphalt and other residual products. Refined fuels produced at Laurel, Montana are available via the Yellowstone Pipeline to western Montana terminals and to Spokane and Moses Lake, Washington, south via common carrier pipelines to Wyoming terminals and Denver, Colorado, and east via the Company s wholly-owned Cenex Pipeline, LLC to Glendive, Montana, and Minot and Fargo, North Dakota.

McPherson Refinery. The McPherson, Kansas refinery is owned and operated by the National Cooperative Refinery Association (NCRA), of which the Company owns approximately 74.5%. The McPherson refinery processes low and medium sulfur crude oil into gasoline, diesel and other distillates, propane, and other products. McPherson sources approximately 95% of its crude oil from Kansas, Oklahoma, and Texas through NCRA-owned and common carrier pipelines.

The McPherson refinery processes approximately 80,000 barrels of crude oil per day to produce refined products that consist of approximately 57% gasoline, 34% diesel and other distillates, and 9% propane and other products. Approximately 90% of the refined fuels are shipped via NCRA s proprietary products pipeline to its terminal in Council Bluffs, Iowa and to other markets via common carrier pipelines. The balance of the fuels are loaded into trucks at the refinery.

Other Energy Operations. The Company owns and operates three propane terminals, four asphalt terminals and three lubricants blending and packaging facilities. The Company also owns and leases a fleet of liquid and pressure trailers and tractors which are used to transport refined fuels, propane and anhydrous ammonia.

Products and Services

The Energy business segment produces and sells (primarily wholesale) gasoline, diesel, propane, asphalt, lubricants and other related products and provides transportation services. It obtains the petroleum products that it sells both from the Laurel and McPherson refineries and from third parties.

Sales and Marketing; Customers

The Company makes approximately 75% of its refined fuel sales to members, with the balance sold to non-members. Sales are made wholesale to member cooperatives and through a network of independent retailers that operate convenience stores under the Cenex/ Ampride tradename. The Company sold approximately 1.5 billion gallons of gasoline and approximately 1.3 billion gallons of diesel fuel in fiscal year 2003. The Company also wholesales auto and farm machinery lubricants to both members and non-members. In fiscal year 2003, energy operations sold approximately 23 million gallons of lube oil. The Company is one of the nation s largest propane wholesalers based on gallons sold. In fiscal year 2003, energy operations sold approximately 844 million gallons of propane. Most of the propane sold in rural areas is for heating and agricultural consumption. Annual sales volumes of propane vary greatly depending on weather patterns and crop conditions.

Industry; Competition

Regulation. Governmental regulations and policies, particularly in the areas of taxation, energy and the environment, have a significant impact on the Company s Energy business segment. The Energy business segment s operations are subject to laws and related regulations and rules designed to protect the

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environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar state agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; the transportation, handling and disposition of wastes; and the labelling of pesticides and similar substances. Failure to comply with these laws, regulations and rules could subject CHS to administrative penalties, injunctive relief and civil remedies. CHS believes that it is in compliance with these laws, regulations and rules in all material respects and does not expect continued compliance to have a material effect on its capital expenditures, earnings or competitive position.

Like many other refineries, the Energy business segment s refineries are currently focusing their capital spending on reducing pollution. In particular, these refineries are currently working to comply with the Environmental Protection Agency low sulfur fuel regulations required by 2006, which are intended to lower the sulfur content of gasoline and diesel. The Company currently expects that the cost of compliance will be approximately $87.0 million for the Company s Laurel, Montana refinery and $324.0 million for NCRA s McPherson, Kansas refinery, of which $8.7 million had been spent at the Laurel refinery and $36.5 million had been spent by NCRA at the McPherson refinery as of August 31, 2003. The Company expects all of these compliance capital expenditures at the refineries to be complete by December 31, 2005, and anticipates funding these projects with a combination of cash flows from operations and debt proceeds.

The energy business is highly cyclical. Demand for crude oil and its products are driven by the condition of local and worldwide economies, local and regional weather patterns and taxation relative to other energy sources. Most of the Company s energy product market is located in rural areas, so sales activity tends to follow the planting and harvesting cycles. More fuel efficient equipment, reduced crop tillage, depressed prices for crops, warm winter weather, and government programs which encourage idle acres may all reduce demand for the Company s energy products.

The refining and wholesale fuels business is very competitive. Among the Company s competitors are some of the world s largest integrated petroleum companies, which have their own crude oil supplies, distribution and marketing systems. The Company also competes with smaller domestic refiners and marketers in the midwestern and northwestern United States, with foreign refiners who import products into the United States and with producers and marketers in other industries supplying other forms of energy and fuels to consumers. Given the commodity nature of the end products, profitability in the refining and marketing industry depends largely on margins, as well as operating efficiency, product mix, and costs of product distribution and transportation. The retail gasoline market is highly competitive, with much larger competitors that have greater brand recognition and distribution outlets throughout the country and the world. CHS owned and non-owned retail outlets are located primarily in the southern, midwestern and northwestern United States.

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Summary Operating Results

Summary operating results and identifiable assets for the Energy business segment for the fiscal years ended August 31, 2003, 2002 and 2001 are shown below:

	2003	2002	2001
	(dollars in thousands)		
Revenues:			
Net sales	$3,648,093	$2,657,689	$2,781,243
Patronage dividends	415	458	712
Other revenues	10,461	6,392	4,036
	3,658,969	2,664,539	2,785,991
Cost of goods sold	3,475,947	2,489,352	2,549,099
Marketing, general and administrative	63,740	66,731	48,432
Operating earnings	119,282	108,456	188,460
Interest	16,401	16,875	25,097
Equity (income) loss from investments	(1,353)	1,166	4,081
Minority interests	20,782	14,604	34,713
Income before income taxes	$ 83,452	$ 75,811	$ 124,569
Total identifiable assets August 31	$1,449,652	$1,305,828	$1,154,036

COUNTRY OPERATIONS AND SERVICES

Overview

The Country Operations and Services business segment purchases a variety of grains from the Company s producer members and provides cooperative members and producers with access to a full range of products and services including farm supplies, programs for crop and livestock production, hedging and insurance services, and agricultural operations financing. Country Operations and Services operates at 282 locations dispersed throughout Minnesota, North Dakota, South Dakota, Nebraska, Montana, Idaho, Washington and Oregon. Most of these locations purchase grain from farmers and sell agronomy products, energy products and feed to those same producers and others, although not all locations provide every product and service.

Products and Services

Grain Purchasing. The Company is one of the largest country elevator operators in North America based on the number of country elevators. Through a majority of its elevator locations, the Country Operations and Services business segment purchases grain from member and non-member producers and other elevators and grain dealers. Most of the grain purchased is either sold through the Company s Grain Marketing business segment or used for local feed and processing operations. For the year ended August 31, 2003, the Country Operations and Services business segment purchased approximately 298 million bushels of grain, primarily wheat (136 million bushels), corn (79 million bushels) and soybeans (46 million bushels). Of these bushels, 274 million were purchased from members and 204 million were sold through the Grain Marketing business segment.

Other Products. Country Operations and Services manufactures and sells other products, both directly and through ownership interests in other entities. These include seed; plant food; energy products; animal feed ingredients, supplements and products; animal health products; crop protection products; and processed sunflowers. The Company sells agronomy products at 155 locations, feed products at 128 locations and energy products at 93 locations. Farm supplies are purchased through cooperatives whenever possible.

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Financial Services. The Company has provided open account financing to more than 150 CHS members that are cooperatives (cooperative association members) in the past year. These arrangements involve the discretionary extension of credit in the form of term and seasonal loans and can also be used as a clearing account for settlement of grain purchases and as a cash management tool. A substantial part of the term and seasonal loans are sold to the National Bank for Cooperatives (CoBank), with CoBank purchasing up to 90% of any loan. The Company s guarantee exposure on these loans at August 31, 2003 was approximately $6.7 million. Through its wholly-owned subsidiary Fin-Ag, Inc. the Company provides seasonal cattle feeding and swine financing loans, facility financing loans and crop production loans. It also provides consulting services to member cooperatives. Most loans are sold to CoBank under a separate program from that described above, under which the Company has guaranteed a portion of the loans. The Company s exposure at August 31, 2003 was approximately $43.0 million. The Company s borrowing arrangements allow for the Company to retain up to $110.0 million of loans in aggregate for both finance programs, or to sell the loans and extend guarantees up to $150.0 million in aggregate.

The Company s wholly-owned subsidiary Country Hedging, Inc., which is a registered futures commission merchant and a clearing member of both the Minneapolis Grain Exchange and the Kansas City Board of Trade, is a full service commodity futures and options broker.

Ag States Agency, LLC is an independent insurance agency in which the Company holds a majority ownership interest. It sells insurance, including group benefits, property and casualty, and bonding programs. Its approximately 1,600 customers are primarily agricultural businesses, including local cooperatives and independent elevators, oil stations, agronomy and feed/seed plants, implement dealers, fruit and vegetable packers/warehouses, and food processors.

Industry; Competition

Regulation. The Country Operations and Services business segment s operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar state agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; the transportation, handling and disposition of wastes; and the labelling of pesticides and similar substances. The Country Operations and Services business segment s operations are also subject to laws and related regulations and rules administered by the United States Department of Agriculture, the Federal Food and Drug Administration, and other federal state, local and foreign governmental agencies that govern the processing, packaging, storage, distribution, advertising, labeling, quality and safety of feed and grain products. Failure to comply with these laws, regulations and rules could subject CHS to administrative penalties, injunctive relief, civil remedies and possible recalls of products. CHS believes that it is in compliance with these laws, regulations and rules in all material respects and does not expect continued compliance to have a material effect on its capital expenditures, earnings or competitive position.

Competition. Competitors for the purchase of grain include other elevators and large grain marketing companies. Competitors for farm supply include a variety of cooperatives, privately held and large national companies. The Company competes primarily on the basis of price, services and patronage.

Competitors to the Company s financing operations are primarily other financial institutions. The Company competes primarily on the basis of price, services and patronage. Country Hedging s competitors include international brokerage firms, national brokerage firms, regional brokerage firms (both cooperatives and non-cooperatives) as well as local introducing brokers, with competition driven by price and level of service. Ag States Agency, LLC competes with other insurance agencies, primarily on the basis of price and services.

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Summary Operating Results

Summary operating results and identifiable assets for the Country Operations and Services business segment for the fiscal years ended August 31, 2003, 2002 and 2001 are shown below:

	2003	2002	2001
		(dollars in thousands)	
Revenues:			
Net sales	$1,885,825	$1,474,553	$1,577,268
Patronage dividends	2,467	2,572	3,683
Other revenues	81,739	80,789	80,479
	1,970,031	1,557,914	1,661,430
Cost of goods sold	1,876,811	1,474,392	1,569,884
Marketing, general and administrative	55,887	47,995	53,417
Operating earnings	37,333	35,527	38,129
Gain on legal settlements	(10,867)	(2,970)	
Interest	14,975	13,851	15,695
Equity income from investments	(788)	(283)	(246)
Minority interests	1,168	786	385
Income before income taxes	$ 32,845	$ 24,143	$ 22,295
Total identifiable assets August 31	$ 857,523	$ 799,711	$ 679,053

GRAIN MARKETING

Overview

CHS is the nation s largest cooperative marketer of grain and oilseed based on grain storage capacity and grain sales, handling about 1.1 billion bushels annually. During fiscal year 2003, the Company purchased approximately 67% of total grain volumes from individual and member cooperatives and the Country Operations and Services business segment, with the balance purchased from third parties. CHS arranges for the transportation of the grains either directly to customers or to Company owned or leased grain terminals and elevators awaiting delivery to domestic and foreign purchasers. The Company primarily conducts its Grain Marketing operations directly, but does conduct some of its business through two 50% owned joint ventures.

Operations

The Grain Marketing segment purchases grain directly and indirectly from agricultural producers primarily in the midwestern and western United States. The purchased grain is typically contracted for sale for future delivery at a specified location, with the Company responsible for handling the grain and arranging for its transportation to that location. The sale of grain is recorded after title to the commodity has transferred and final weights, grades and settlement price have been agreed upon. Amounts billed to the customer as part of a sales transaction include the costs for shipping and handling. The Company s ability to arrange efficient transportation, including loading capabilities onto unit trains, ocean-going vessels, and barges, is a significant part of the service it offers to its customers. Rail, vessel, barge and truck transportation is carried out by third parties, often under long-term freight agreements with the Company. Grain intended for export is usually shipped by rail or barge to an export terminal, where it is loaded onto ocean-going vessels. Grain intended for domestic use is usually shipped by rail or truck to various locations throughout the country.

CHS owns export terminals, river terminals, and elevators involved in the handling and transport of grain. River terminals at St. Paul, Savage, and Winona, Minnesota, and Davenport, Iowa are used to load

grains onto barges for shipment to both domestic and export customers via the Mississippi River System. The Company s export terminal at Superior, Wisconsin provides access to the Great Lakes and St. Lawrence Seaway, and an export terminal at Myrtle Grove, Louisiana serves the Gulf market. In the Pacific Northwest, the Company conducts its grain marketing operations through United Harvest, LLC (a 50% joint venture with United Grain Corporation) and TEMCO, LLC (a 50% joint venture with Cargill, Incorporated). United Harvest, LLC operates grain terminals in Vancouver and Kalama, Washington. TEMCO, LLC operates a large export terminal in Tacoma, Washington. These facilities serve the Pacific market, as well as domestic grain customers in the western United States. Grain Suppliers, LLC, a wholly-owned subsidiary (previously a 50% joint venture), operates elevator facilities in Friona, Texas and Collins, Mississippi. In 2003, the Company opened an office in Sao Paulo, Brazil for the procurement of soybeans for the Grain Marketing segment s international customers.

Grain Marketing purchases most of its grain during the summer and fall harvest period. Because of the Company s geographic location and the fact that it is further from its export facilities, grain tends to be sold later than in other parts of the country. However, as many producers have significant on-farm storage capacity and in light of the Company s own storage capacity, the Grain Marketing business segment buys and ships grain throughout the year. Due to the amount of grain purchased and held in inventory, the Grain Marketing business segment has significant working capital needs at various times of the year. The amount of borrowings for this purpose, and the interest rate charged on those borrowings, directly affect the profitability of the Grain Marketing segment.

Products and Services

The primary grains purchased by the Grain Marketing business segment for the year ended August 31, 2003 were corn (412 million bushels), wheat (329 million bushels) and soybeans (245 million bushels). Of the total grains purchased by the Grain Marketing business segment during the year ended August 31, 2003, 508 million bushels were purchased from the Company s individual and cooperative association members, 204 million bushels were purchased from the Country Operations and Services business segment and the remainder were purchased from third parties.

Sales and Marketing; Customers

Purchasers include domestic and foreign millers, maltsters, feeders, crushers, and other processors. To a much lesser extent purchasers include intermediaries and distributors. Grain Marketing operations are not dependent on any one customer. The G