

CHS INC  
Form S-1/A  
February 12, 2007

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As filed with the Securities and Exchange Commission on February 12, 2007

Registration No. 333-139300

**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Amendment No. 2  
to  
Form S-1  
REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933**

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 No.)*

**5500 Cenex Drive  
Inver Grove Heights, Minnesota 55077  
(651) 355-6000**

*(Address, including zip code, and telephone number,  
including area code, of registrant's principal executive offices)*

**David Kastelic  
Senior Vice President and General Counsel  
CHS Inc.**

**5500 Cenex Drive  
Inver Grove Heights, Minnesota 55077  
(651) 355-3712**

**Fax (651) 355-4554**

*(Name, address, including zip code, and telephone number,  
including area code, of agent for service)*

**Copy to:**

**Michael W. Clausman  
Dorsey & Whitney LLP  
50 South Sixth Street  
Minneapolis, Minnesota 55402  
(612) 340-2600  
Fax (612) 340-8738**

**Approximate date of commencement of proposed sale to the public:** As soon as practicable after this registration statement becomes effective.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

If the registrant elects to deliver its latest annual report to security holders, or a complete and legible facsimile thereof, pursuant to Item 11(a)(1) of this form, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

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The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any jurisdiction where the offer or sale is not permitted.

**SUBJECT TO COMPLETION DATED FEBRUARY 12, 2007**

**PROSPECTUS**

**1,374,619 Shares**

**CHS Inc.**

**8% Cumulative Redeemable Preferred Stock**

We are issuing 1,374,619 shares of our 8% Cumulative Redeemable Preferred Stock to redeem \$35,863,809.71 of our patrons' equities. The shares will be issued to redeem our outstanding patrons' equities on a pro rata basis based on the face value of patronage certificates eligible for redemption. Subject to the exceptions described below in Plan of Distribution, shares of preferred stock issued in redemption of the patrons' equities will be issued only to active members that are not individuals and who have conducted business with us during the past five years and whose pro rata share of the redemption amount is equal to or greater than \$500. For each member eligible to receive such preferred stock, shares will be issued only in a number that does not exceed 14,660 shares of preferred stock (which equals one-quarter of one percent (0.25%) of our total shares of preferred stock outstanding as of the end of the 2006 calendar year). See Membership in CHS and Authorized Capital Patrons' Equities for a description of patrons' equities and our annual pro rata redemptions of patrons' equities. The amount of patrons' equities that will be redeemed with each share of preferred stock issued will be \$26.09, which is the greater of \$25.26 (equal to the \$25.00 liquidation preference per share of preferred stock plus \$0.26 of accumulated dividends from January 1, 2007 through February 15, 2007) or the closing price for one share of the preferred stock on February 8, 2007. There will not be any cash proceeds from the issuance of the preferred stock. However, by issuing shares of preferred stock in redemption of patrons' equities, we will make the cash that we would otherwise have used to redeem those patrons' equities available for working capital purposes.

Holders of the preferred stock are entitled to receive cash dividends at the rate of \$2.00 per share per year. Dividends are payable quarterly in arrears when, as and if declared on March 31, June 30, September 30 and December 31 of each year (each, a payment date), except that if a payment date is a Saturday, Sunday or legal holiday, the dividend is paid without interest on the next day that is not a Saturday, Sunday or legal holiday. Dividends payable on the preferred stock are cumulative. The preferred stock is subject to redemption and has the preferences described in this prospectus. The preferred stock is not convertible into any of our other securities and is non-voting except in certain limited circumstances.

The preferred stock is traded on The NASDAQ Global Select Market under the trading symbol CHSCP. On February 8, 2007, the closing price of the preferred stock was \$26.09 per share.

**Ownership of our preferred stock involves risks. See Risk Factors beginning on page 6.**

We expect to issue the preferred stock on or about February 15, 2007.

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

**CHS Inc.**

5500 Cenex Drive  
Inver Grove Heights, Minnesota 55077  
(651) 355-6000

The date of this prospectus is February , 2007.

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### IMPORTANT INFORMATION ABOUT THIS PROSPECTUS

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized any other person to provide you with different or additional information. This prospectus does not constitute an offer to sell or the solicitation of an offer to buy any securities other than the securities to which it relates. We are not making an offer of these securities in any state where the offer is not permitted. The information in this prospectus is current as of the date on the front of this prospectus.

References in this prospectus, and the documents incorporated by reference in this prospectus, to CHS, the Company, we, our and us refer to CHS Inc., a Minnesota cooperative corporation, and its subsidiaries. We maintain a web site at <http://www.chsinc.com>. Information contained in our website does not constitute part of this prospectus.

All references to preferred stock in this prospectus are to our 8% Cumulative Redeemable Preferred Stock unless the context requires otherwise.

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**PROSPECTUS SUMMARY**

*The following summary highlights information we present in greater detail elsewhere in this prospectus and in the information incorporated by reference in it. This summary may not contain all of the information that is important to you and you should carefully consider all of the information contained or incorporated by reference in this prospectus. This prospectus contains forward-looking statements that are subject to risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements. These factors include those listed under Risk Factors and elsewhere in this prospectus.*

**CHS Inc.**

CHS Inc. (referred to herein as CHS, we or us) is one of the nation's leading integrated agricultural companies. As a cooperative, we are owned by farmers and ranchers and their local cooperatives (referred to herein as members) from the Great Lakes to the Pacific Northwest and from the Canadian border to Texas. We also have preferred stockholders that own shares of our 8% Cumulative Redeemable Preferred Stock, which is listed on the NASDAQ Global Select Market under the symbol CHSCP. We buy commodities from and provide products and services to patrons (including our members and other non-member customers), both domestic and international. We provide 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 our operations are conducted through equity investments and joint ventures whose operating results are not fully consolidated with our results; rather, a proportionate share of the income or loss from those entities is included as a component in our net income under the equity method of accounting. For the fiscal year ended August 31, 2006, our total revenues were \$14.4 billion and our net income was \$490.3 million. On November 30, 2006, we had 5,864,238 shares of preferred stock outstanding.

We have aligned our business segments based on an assessment of how our businesses operate and the products and services they sell. Our three business segments Energy, Ag Business and Processing create vertical integration to link producers with consumers. Our Energy segment refines, wholesales and retails petroleum products. Our Ag Business segment originates and markets grain, including service activities conducted at export terminals, has retail sales of petroleum and agronomy products, processed sunflowers, feed and farm supplies, and also derives equity income from agronomy joint ventures, grain export joint ventures and other investments. Our Processing segment sells soybean meal and soybean refined oil, and also derives equity income from wheat milling joint ventures, a vegetable oil-based food manufacturing and distribution joint venture, and an ethanol manufacturing company. We include other business operations in Corporate and Other because of the nature of their products and services, as well as the relative revenue size of those businesses. These businesses primarily include our insurance, hedging and other service activities related to crop production.

Membership in CHS is restricted to certain producers of agricultural products and to associations of producers of agricultural products that are organized and operating so as to adhere to the provisions of the Agricultural Marketing Act and the Capper-Volstead Act, as amended. Our Board of Directors may establish other qualifications for membership, as it may from time to time deem advisable.

Our earnings from cooperative business are allocated to members (and to a limited extent to non-members with which we have agreed to do business on a patronage basis) based on the volume of business they do with us. We allocate these earnings to our patrons 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, which are not allocated patronage, are taxed at federal and state statutory corporate rates and are retained by us as unallocated capital reserve.



We also receive patronage refunds from the cooperatives in which we are a member, if those cooperatives have earnings to distribute and we qualify for patronage refunds from them.

Our origins date back to the early 1930s with the founding of the predecessor companies of Cenex, Inc. and Harvest States Cooperatives. CHS Inc., resulting from the merger of the two entities in 1998, is headquartered in Inver Grove Heights, Minnesota.

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### ***Energy***

We are the nation's largest cooperative energy company based on revenues and identifiable assets, with operations that include petroleum refining and pipelines; the supply, marketing (including ethanol and biodiesel) and distribution of refined fuels (gasoline, diesel and other energy products); the blending, sale and distribution of lubricants; and the wholesale supply of propane. Our Energy segment processes crude oil into refined petroleum products at refineries in Laurel, Montana (wholly-owned) and McPherson, Kansas (an entity in which we have an approximate 74.5% ownership interest) and sells those products under the Cenex brand to member cooperatives and others through a network of approximately 1,600 independent retail sites, including approximately 850 that operate Cenex/Ampride convenience stores.

### ***Ag Business***

Our Ag Business segment includes agronomy, country operations and grain marketing. We conduct our wholesale and some of our retail agronomy operations through our 50% ownership interest in Agriliance LLC (Agriliance). Land O Lakes, Inc. (Land O Lakes) holds the other 50% ownership interest. Agriliance is one of North America's largest wholesale distributors of crop nutrients, crop protection products and other agronomy products based upon annual sales. At November 30, 2006, our equity investment in Agriliance was \$159.6 million. We also hold an ownership interest in CF Industries Holding, Inc. (CFIH) of approximately 2.9%. Prior to CFIH's initial public offering, Agriliance entered into a multi-year supply contract with CFIH, and as a result, given our small ownership interest in the company, we now consider the relationship to be as a supplier rather than a strategic joint venture.

Our country operations business purchases a variety of grains from our producer members and other third parties, and provides cooperative members and producers with access to a full range of products and services including farm supplies and programs for crop and livestock production. Country operations operates at 325 locations, which includes 3 sunflower plants, dispersed throughout Minnesota, North Dakota, South Dakota, Montana, Nebraska, Kansas, Oklahoma, Colorado, 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.

We are the nation's largest cooperative marketer of grain and oilseed based on grain storage capacity and grain sales, handling about 1.4 billion bushels annually. During fiscal year 2006, we purchased approximately 64% of our total grain volumes from individual and cooperative association members and our country operations business, with the balance purchased from third parties. We arrange for the transportation of the grains either directly to customers or to our owned or leased grain terminals and elevators awaiting delivery to domestic and foreign purchasers. We primarily conduct our grain marketing operations directly, but do conduct some of our business through joint ventures.

### ***Processing***

Our Processing segment converts raw agricultural commodities into ingredients for finished food products or into finished consumer food products and also for renewable fuels. We have focused on areas that allow us to utilize the products supplied by our member producers. These areas are oilseed processing, wheat milling, foods and renewable fuels.

### ***The Issuance***

We are issuing 1,374,619 shares of our 8% Cumulative Redeemable Preferred Stock to redeem \$35,863,809.71 of our patrons' equities. The shares will be issued to redeem our outstanding patrons' equities on a pro rata basis based on the face value of patronage certificates eligible for redemption. Subject to the exceptions described below in Plan of

Distribution, shares of preferred stock issued in redemption of the patrons' equities will be issued only to active members that are not individuals who have conducted business with us during the past five years and whose pro rata share of the redemption amount is equal to or greater than \$500. For each member eligible to receive such preferred stock, shares will be issued only in a number that does not exceed 14,660 shares of preferred stock (which equals one-quarter of one percent (0.25%) of our

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total shares of preferred stock outstanding as of the end of the 2006 calendar year). See Membership in CHS and Authorized Capital Patrons Equities for a description of patrons equities and our annual pro rata redemptions of patrons equities. The amount of patrons equities that will be redeemed with each share of preferred stock issued will be \$26.09, which is the greater of \$25.26 (equal to the \$25.00 liquidation preference per share of preferred stock plus \$0.26 of accumulated dividends from January 1, 2007 through February 15, 2007) or the closing price for one share of the preferred stock on The NASDAQ Global Select Market on February 8, 2007. There will not be any cash proceeds from the issuance of the preferred stock. However, by issuing shares of preferred stock in redemption of patrons equities, we will make the cash that we would otherwise have used to redeem those patrons equities available for working capital purposes.

## **Terms of the Preferred Stock**

### **Dividends**

Holders of the preferred stock (which include both members and non-member third parties) are entitled to receive cash dividends at the rate of \$2.00 per share per year when, as and if declared by our board of directors. Dividends are cumulative and are payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each year (each, a payment date ), except that if a payment date is a Saturday, Sunday or legal holiday, the dividend is paid without interest on the next day that is not a Saturday, Sunday or legal holiday.

### **Liquidation Rights**

In the event of our liquidation, holders of the preferred stock will be entitled to receive \$25.00 per share plus all dividends accumulated and unpaid on the shares to and including the date of liquidation, subject, however, to the rights of any of our securities that rank senior or on parity with the preferred stock.

### **Rank**

As to payment of dividends and as to distributions of assets upon the liquidation, dissolution or winding up of CHS, whether voluntary or involuntary, the preferred stock ranks prior to:

any patronage refund;

any other class or series of our capital stock designated by our board of directors as junior to the preferred stock; and

our common stock, if any.

Shares of any class or series of our capital stock that are not junior to the preferred stock, rank equally with the preferred stock as to the payment of dividends and the distribution of assets.

### **Redemption at our Option**

We may not redeem the preferred stock prior to February 1, 2008. On or after that date we may, at our option, redeem the preferred stock, in whole or from time to time in part, for cash at a price of \$25.00 per share plus all dividends accumulated and unpaid on that share to and including the date of redemption.

### **Redemption at the Holder's Option**

In the event of a change in control initiated by our board of directors, holders of the preferred stock will have the right, for a period of 90 days from the date of the change in control, to require us to repurchase their shares of preferred stock at a price of \$25.00 per share plus all dividends accumulated and unpaid on that share to and including the date of redemption. Change in control is defined in Description of the Preferred Stock-Redemption at the Holder's Option.

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<b>No Exchange or Conversion Rights, No Sinking Fund</b>	The preferred stock is not exchangeable for or convertible into shares of any other shares of our capital stock or any other securities or property. The preferred stock is not subject to the operation of any purchase, retirement or sinking fund.
<b>Voting Rights</b>	Holder s of the preferred stock do not have voting rights, except as required by applicable law; provided, that the affirmative vote of two-thirds of the outstanding preferred stock will be required to approve:  any amendment to our articles of incorporation or the resolutions establishing the terms of the preferred stock if the amendment adversely affects the rights or preferences of the preferred stock; or  the creation of any class or series of equity securities having rights senior to the preferred stock as to the payment of dividends or distribution of assets upon the liquidation, dissolution or winding up of CHS.
<b>No Preemptive Rights</b>	Holder s of the preferred stock have no preemptive right to acquire shares of any class or series of our capital stock.
<b>Trading</b>	The preferred stock is listed on The NASDAQ Global Select Market under the symbol CHSCP .
<b>Comparison of Rights</b>	Holder s of the preferred stock have different rights from those of holder s of patron s equities. See Comparison of Rights of Holder s of Patron s Equities and Rights of Holder s of Preferred Stock.
<b>Risk Factors</b>	Ownership of our preferred stock involves risks. See Risk Factors beginning on page 6.

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The selected consolidated financial data below has been derived from our consolidated financial statements for the periods indicated below. The selected consolidated financial information for August 31, 2006, 2005 and 2004 and for the three months ended November 30, 2006 and 2005 should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this filing. In the opinion of our management, the unaudited historical financial data were prepared on the same basis as the audited historical financial data and include all adjustments, consisting of only normal recurring adjustments, necessary for a fair statement of this information. Results of operations for the three-month periods are not necessarily indicative of results of operations that may be expected for the full fiscal year.

**Summary Selected Consolidated Financial Data**

	<b>Three Months Ended</b>		<b>Years Ended August 31,</b>				
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>(Unaudited)</b>	<b>(Unaudited)</b>					
	<b>(Dollars in thousands)</b>						
Income Statement							
Revenues	\$ 3,751,070	\$ 3,453,513	\$ 14,383,835	\$ 11,926,962	\$ 10,969,081	\$ 9,314,116	\$ 7,187,578
Cost of goods sold	3,528,794	3,199,068	13,570,507	11,449,858	10,527,715	8,989,050	6,877,951
Gross profit	222,276	254,445	813,328	477,104	441,366	325,066	309,627
Marketing, general and administrative	52,102	49,626	231,238	199,354	202,455	175,662	170,458
Operating earnings	170,174	204,819	582,090	277,750	238,911	149,404	139,169
Gain on sale of investments	(5,348)			(13,013)	(14,666)		
Gain on legal settlements					(692)	(10,867)	(2,970)
Interest, net	7,688	7,331	41,305	41,509	42,758	40,516	37,009
Equity income from investments	(4,531)	(9,177)	(84,188)	(95,742)	(79,022)	(47,299)	(58,133)
Minority interests	18,912	32,161	85,974	47,736	33,830	21,950	15,390
Income from continuing operations before income taxes	153,453	174,504	538,999	297,260	256,703	145,104	147,873
Income taxes	17,171	20,478	49,327	30,434	29,462	16,031	19,881
Income from continuing operations	136,282	154,026	489,672	266,826	227,241	129,073	127,992
		(208)	(625)	16,810	5,909	5,232	1,854

(income) loss on  
 discontinued  
 operations, net of  
 taxes

Net income	\$ 136,282	\$ 154,234	\$ 490,297	\$ 250,016	\$ 221,332	\$ 123,841	\$ 126,138
Balance Sheet Data:							
Working capital	\$ 828,191	\$ 784,241	\$ 828,954	\$ 758,703	\$ 493,440	\$ 458,738	\$ 249,115
Net property, plant and equipment	1,525,028	1,395,180	1,476,239	1,359,535	1,249,655	1,122,982	1,057,421
Total assets	5,511,494	4,669,397	4,942,583	4,726,937	4,031,292	3,807,968	3,481,727
Long-term debt, including current maturities	727,199	766,298	744,745	773,074	683,818	663,173	572,124
Total equities	2,126,076	1,836,450	2,017,391	1,757,897	1,628,086	1,481,711	1,289,638
Ratio of earnings to fixed charges and preferred dividends(1)	9.8x	10.8x	7.9x	4.6x	4.5x	3.2x	3.6x

(1) For purposes of computing the ratio of earnings to fixed charges and preferred dividends, earnings consist of income from continuing operations before income taxes on consolidated operations, distributed income from equity investees and fixed charges. Fixed charges consist of interest expense and one-third of rental expense, considered representative of that portion of rental expense estimated to be attributable to interest.



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**RISK FACTORS**

*You should be aware that ownership of our preferred stock involves risks. In consultation with your own financial and legal advisers, you should carefully consider the following discussion of risks that we believe to be significant, together with the other information contained or incorporated by reference in this prospectus, including the section entitled *Special Note Regarding Forward-Looking Statements* on page 81, and our consolidated financial statements and the notes to them. The value of any preferred stock that you own may decline and you could lose the entire value of your preferred stock.*

**Risks Related to our Operations**

*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, flour, and crude and refined vegetable oil. Commodity prices generally are affected by a wide range of factors beyond our control, including 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. Although the prices for crude oil reached historical highs during 2006, the 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;

disruption in supply;

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. Increases in crude oil prices without a corresponding increase in the prices of our refined petroleum products could reduce our net income. 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.

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*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, were completed in fiscal year 2006. We incurred capital expenditures from fiscal year 2003 through 2006 related to these upgrades of \$88.1 million for our Laurel, Montana refinery and \$328.7 million for the National Cooperative Refinery Association's (NCRA) McPherson, Kansas refinery.

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. Liabilities, including legal costs, related to remediation of contaminated properties are not recognized until the related costs are considered probable and can be reasonably estimated.

*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,

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safety or health risks associated with particular food or feed products, such as concerns 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;

the significant inventories that we carry or the facilities we own could be damaged or destroyed by catastrophic events, extreme weather conditions or contamination; and

an occurrence of a pandemic flu or other disease affecting a substantial part of our workforce or our customers could cause an interruption in our business operations, the affects of which could be significant.

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 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.

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*OPERATING RESULTS FROM OUR AGRONOMY BUSINESS COULD BE VOLATILE AND ARE DEPENDENT UPON CERTAIN FACTORS OUTSIDE OF OUR CONTROL.* Planted acreage, and consequently the volume of fertilizer and crop protection products applied, is partially dependent upon government programs and the perception held by the producer of demand for production. Weather conditions during the spring planting season and early summer spraying season also affect agronomy product volumes and profitability.

*TECHNOLOGICAL IMPROVEMENTS IN AGRICULTURE COULD DECREASE THE DEMAND FOR OUR AGRONOMY AND ENERGY PRODUCTS.* Technological advances in agriculture could decrease the demand for crop nutrients, energy and other crop input products and services that we provide. Genetically engineered seeds that resist disease and insects, or that meet certain nutritional requirements, could affect the demand for our crop nutrients and crop protection products. Demand for fuel that we sell could decline as technology allows for more efficient usage of equipment.

*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 operations and portions of our grain marketing, wheat milling, foods and renewable fuels operations, are operated through joint ventures with third parties. By operating a business through a joint venture, we have less control over business decisions than we have in our wholly-owned or majority-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 those ventures.

### **Risks Related to the Preferred Stock**

*THE PREFERRED STOCK MAY NOT CONTINUE TO QUALIFY FOR LISTING ON THE NASDAQ GLOBAL SELECT MARKET.* Although the preferred stock is listed on The NASDAQ Global Select Market, it may not continue to qualify for listing. For example, we may be unable to satisfy the requirements regarding independent directors as now or subsequently in effect. If our preferred stock were delisted, the liquidity of the market for the preferred stock could be reduced, possibly significantly.

*THE TRADING MARKET FOR THE PREFERRED STOCK MAY NOT BE MAINTAINED, WHICH MAY LIMIT YOUR ABILITY TO RESELL YOUR SHARES.* The trading market for the preferred stock may not be maintained or provide any significant liquidity. If you decide to sell your preferred stock there may be either no or only a limited number of potential buyers. This, in turn, may affect the price you receive for your preferred stock or your ability to sell your preferred stock at all.

*IF YOU ARE ABLE TO RESELL YOUR PREFERRED STOCK, MANY FACTORS MAY AFFECT THE PRICE YOU RECEIVE, WHICH MAY BE LOWER THAN YOU BELIEVE TO BE APPROPRIATE.* As with other publicly traded securities, many factors could affect the market price of our preferred stock. In addition to those factors relating to CHS and the preferred stock described elsewhere in this Risk Factors section and elsewhere in this prospectus, the market price of our preferred stock could be affected by conditions in and perceptions of agricultural and energy markets and companies and also by broader, general market, political and economic conditions.

Furthermore, U.S. stock markets have experienced price and volume volatility that has affected many companies' stock prices, often for reasons unrelated to the operating performance of those companies. Fluctuations such as these also may affect the market price of our preferred stock. As a result of these factors, you may only be able to sell your preferred stock at prices below those you believe to be appropriate. The trading price for the preferred stock may at any time be less than its issue price pursuant to this prospectus or its liquidation value.

*ISSUANCES OF SUBSTANTIAL AMOUNTS OF PREFERRED STOCK COULD ADVERSELY AFFECT THE MARKET PRICE OF OUR PREFERRED STOCK.* From time to time in the future, we expect to again issue shares of preferred stock to our members in redemption of a portion of their patrons' equities or other equity securities and may do so as frequently as annually. We expect these shares to be freely tradeable upon issuance to our members, and some or all members who receive preferred stock may seek to sell their shares



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in the public market. Furthermore, from time to time we may sell additional shares of preferred stock to the public. Future issuances or sales of our preferred stock or the availability of our preferred stock for sale may adversely affect the market price for our preferred stock or our ability to raise capital by offering equity securities.

*THE TERMS OF THE PREFERRED STOCK ARE FIXED AND CHANGES IN MARKET CONDITIONS, INCLUDING MARKET INTEREST RATES, MAY DECREASE THE MARKET PRICE FOR THE PREFERRED STOCK.* The terms of the preferred stock, such as the 8% dividend rate, the amount of the liquidation preference and the redemption terms, are fixed and will not change, even if market conditions with respect to these terms fluctuate. This may mean that you could obtain a higher return from an investment in other securities. It also means that an increase in market interest rates is likely to decrease the market price for the preferred stock.

*YOU WILL HAVE LIMITED VOTING RIGHTS.* As a holder of the preferred stock, you will be entitled to vote only on actions that would amend, alter or repeal our articles of incorporation or the resolutions establishing the preferred stock if the amendment, alteration or repeal would adversely affect the rights or preferences of the preferred stock or that would create a series of senior equity securities. You will not have the right to vote on actions customarily subject to shareholder vote or approval, including the election of directors, the approval of significant transactions, and other amendments to our articles of incorporation that would not adversely affect the rights and preferences of the preferred stock.

*PAYMENT OF DIVIDENDS ON THE PREFERRED STOCK IS NOT GUARANTEED.* Although dividends on the preferred stock accumulate, our board of directors must approve the actual payment of those dividends. Our board of directors can elect at any time or from time to time, and for an indefinite duration, not to pay the accumulated dividends. Our board of directors could do so for any reason, including the following:

unanticipated cash requirements;

the need to make payments on our indebtedness;

concluding that the payment of dividends would cause us to breach the terms of any agreement, such as financial ratio covenants; or

determining that the payment of dividends would violate applicable law regarding unlawful distributions to shareholders.

*WE CAN REDEEM THE PREFERRED STOCK AT OUR DISCRETION, WHICH REDEMPTION MAY BE AT A PRICE LESS THAN ITS MARKET PRICE AND MAY LIMIT THE TRADING PRICE FOR THE PREFERRED STOCK.* We have the option of redeeming your shares at any time on or after February 1, 2008 for \$25.00 per share plus any accumulated and unpaid dividends. If we redeem your shares, the redemption price may be less than the price you might receive if you were to sell your shares in the open market. In addition, the fact that the shares are redeemable may limit the price at which they trade.

*THE AMOUNT OF YOUR LIQUIDATION PREFERENCE OR REDEMPTION PAYMENT IS FIXED AND YOU WILL HAVE NO RIGHT TO RECEIVE ANY GREATER PAYMENT REGARDLESS OF THE CIRCUMSTANCES.* The payment due upon a liquidation or redemption is fixed at \$25.00 per share plus accumulated and unpaid dividends. If we have value remaining after payment of this amount, you will have no right to participate in that value. If the market price for our preferred stock is greater than the redemption price, you will have no right to receive the market price from us upon liquidation or redemption.

*YOUR LIQUIDATION RIGHTS WILL BE SUBORDINATE TO THOSE OF HOLDERS OF OUR INDEBTEDNESS AND OF ANY SENIOR EQUITY SECURITIES WE HAVE ISSUED OR MAY ISSUE IN THE FUTURE AND MAY BE SUBJECT TO THE EQUAL RIGHTS OF OTHER EQUITY SECURITIES.* There are no restrictions in the terms of the preferred stock on our ability to incur indebtedness. We can also, with the consent of two-thirds of the outstanding preferred stock, issue preferred equity securities that are senior with respect to liquidation payments to the preferred stock. If we were to liquidate our business, we would be required to repay all of our outstanding indebtedness and to satisfy the liquidation preferences of any senior

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equity securities that we may issue in the future before we could make any distributions to holders of our preferred stock. We could have insufficient cash available to do so, in which case you would not receive any payment on the amounts due you. Moreover, there are no restrictions on our ability to issue preferred equity securities that rank on a parity with the preferred stock as to liquidation preferences and any amounts remaining after the payment of senior securities would be split equally among all holders of those securities, which might result in your receiving less than the full amount due you.

**USE OF PROCEEDS**

The shares of preferred stock that are being issued pursuant to this prospectus and the registration statement of which it is a part are being issued to redeem \$35,863,809.71 of our patrons equities. The shares will be issued to redeem our outstanding patrons equities on a pro rata basis based on the face value of patronage certificates eligible for redemption. Subject to the exceptions described below in Plan of Distribution, shares of preferred stock issued in redemption of the patrons equities will be issued only to active members that are not individuals and who have conducted business with us during the past five years and whose pro rata share of the redemption amount is equal to or greater than \$500. For each member eligible to receive such preferred stock, shares will be issued only in a number that does not exceed 14,660 shares of preferred stock (which equals one-quarter of one percent (0.25%) of our total shares of preferred stock outstanding as of the end of the 2006 calendar year). See Membership and Authorized Capital Patrons Equities for a discussion of patrons equities and our redemption of them. There will not be any cash proceeds from the issuance of preferred stock. However, by issuing shares of preferred stock in redemption of patrons equities we will make the cash that we would otherwise have used to redeem those patrons equities available for working capital purposes.

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**BUSINESS**

We are one of the nation's leading integrated agricultural companies. As a cooperative, we are owned by farmers and ranchers and their local cooperatives from the Great Lakes to the Pacific Northwest and from the Canadian border to Texas. We also have preferred stockholders (both members and non-member third parties) that own shares of our 8% Cumulative Redeemable Preferred Stock, which is listed on the NASDAQ Global Select Market under the symbol CHSCP. On November 30, 2006, we had 5,864,238 shares of preferred stock outstanding. We buy commodities from and provide products and services to our members and other customers, both domestic and international. We provide 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 our operations are conducted through equity investments and joint ventures whose operating results are not fully consolidated with our results; rather, a proportionate share of the income or loss from those entities is included as a component in our net income under the equity method of accounting. For the fiscal year ended August 31, 2006, our total revenues were \$14.4 billion and net income was \$490.3 million.

We have aligned our business segments based on an assessment of how our businesses operate and the products and services they sell. Our three business segments; Energy, Ag Business and Processing, create vertical integration to link producers with consumers. Our Energy segment derives its revenues through refining, wholesaling and retailing of petroleum products. Our Ag Business segment derives its revenues through the origination and marketing of grain, including service activities conducted at export terminals, through the retail sales of petroleum and agronomy products, processed sunflowers, feed and farm supplies, and records equity income from investments in our agronomy joint ventures, grain export joint ventures and other investments. Our Processing segment derives its revenues from the sales of soybean meal and soybean refined oil, and records equity income from wheat milling joint ventures, a vegetable oil-based food manufacturing and distribution joint venture, and an ethanol manufacturing company. We include other business operations in Corporate and Other because of the nature of their products and services, as well as the relative revenue size of those businesses. These businesses primarily include our insurance, hedging and other service activities related to crop production.

In May 2005, we sold the majority of our Mexican foods business for proceeds of \$38.3 million resulting in a loss on disposition of \$6.2 million. During the year ended August 31, 2006, we sold all of the remaining assets for proceeds of \$4.2 million and a gain of \$1.6 million. The operating results of the Mexican foods business are reported as discontinued operations for all periods presented.

Only producers of agricultural products and associations of producers of agricultural products may be our members. Our earnings derived from cooperative business are allocated to patrons based on the volume of business they do with us. We allocate these earnings to our members (and to a limited extent to non-members with which we have agreed to do business on a patronage basis) 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, which are not allocated patronage, are taxed at federal and state statutory corporate rates and are retained by us as unallocated capital reserve. We also receive patronage refunds from the cooperatives in which we are a member, if those cooperatives have earnings to distribute and we qualify for patronage refunds from them.

Our origins date back to the early 1930s with the founding of the predecessor companies of Cenex, Inc. and Harvest States Cooperatives. CHS Inc. emerged as the result of the merger of the two entities in 1998, and is headquartered in Inver Grove Heights, Minnesota.



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The following table presents a summary of our primary subsidiary holdings and equity investments for each of our business segments.

**Primary Subsidiaries and Equity Investments**

<b>Business Segment</b>	<b>Entity Name</b>	<b>Business Activity</b>	<b>CHS Ownership %</b>	<b>Income Recognition</b>
Energy	National Cooperative Refinery Association	Petroleum refining	74.50%	Consolidated Subsidiary
	Provista Renewable Fuels Marketing, LLC	Ethanol marketing	50.00%	Consolidated Subsidiary
	Front Range Pipeline, LLC	Crude oil transportation	100.00%	Consolidated Subsidiary
	Cenex Pipeline, LLC	Finished product transportation	100.00%	Consolidated Subsidiary
Ag Business	Agriliance LLC	Wholesale and retail distribution of agronomy products.	50.00%	Equity Method
	CHS do Brasil Ltda.	Soybean procurement in Brazil	100.00%	Consolidated Subsidiary
	United Harvest, LLC	Grain Exporter	50.00%	Equity Method
	TEMCO, LLC	Grain Exporter	50.00%	Equity Method
Processing	Multigrain S.A.	Soybean procurement in Brazil	50.00%	Equity Method
	Horizon Milling, LLC	Wheat milling in US	24.00%	Equity Method
	Horizon Milling General Partnership	Wheat milling in Canada	24.00%	Equity Method
	Ventura Foods, LLC	Food manufacturing	50.00%	Equity Method
	U.S. BioEnergy Corporation	Ethanol manufacturing	aprx 22 - 25%	Equity Method
Corporate and Other	Country Hedging, Inc.	Risk management products broker	100.00%	Consolidated Subsidiary
	Ag States Agency, LLC	Insurance agency	100.00%	Consolidated Subsidiary
	Cofina Financial, LLC	Finance company	49.00%	Equity Method

Our international sales information and segment information in Notes 2 and 12 to the consolidated financial statements are incorporated by reference into the following business segment descriptions.

The business segment financial information presented below may not represent the results that would have been obtained had the relevant business segment been operated as an independent business due to efficiencies in scale, corporate cost allocations and intersegment activity.

## ENERGY

### Overview

We are the nation's largest cooperative energy company based on revenues and identifiable assets, with operations that include petroleum refining and pipelines; the supply, marketing (including ethanol and biodiesel) and distribution of refined fuels (gasoline, diesel and other energy products); the blending, sale and distribution of lubricants; and the wholesale supply of propane. Our Energy segment processes crude oil into refined petroleum products at refineries in Laurel, Montana (wholly-owned) and McPherson, Kansas (an entity in which we have an approximate 74.5% ownership interest) and sells those products under the Cenex brand to member cooperatives and others through a network of approximately 1,600 independent retail sites, including approximately 850 that operate Cenex/Ampride convenience stores.

### Operations

*Laurel Refinery.* Our Laurel, Montana refinery processes medium and high sulfur crude oil into refined petroleum products that primarily include gasoline, diesel and asphalt. Our Laurel refinery sources approximately 90% of its crude oil supply from Canada, with the balance obtained from domestic sources, and we have access to Canadian and northwest Montana crude through our wholly-owned Front Range Pipeline, LLC

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and other common carrier pipelines. Our Laurel refinery also has access to Wyoming crude via common carrier pipelines from the south.

Our Laurel facility processes approximately 55,000 barrels of crude oil per day to produce refined products that consist of approximately 39% gasoline, 31% diesel and other distillates, and 30% asphalt and other residual products. During fiscal 2005, the Board of Directors approved the installation of a coker unit at Laurel, along with other refinery improvements, which will allow us to extract a greater volume of high value gasoline and diesel fuel from a barrel of crude oil and less relatively low value asphalt. Total cost for this project is expected to be approximately \$325.0 million, of which approximately \$238.0 million is expected to be spent during fiscal 2007, with completion planned during fiscal 2008. 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 our wholly-owned Cenex Pipeline, LLC to Glendive, Montana, and Minot and Fargo, North Dakota. Our Board of Directors has approved a \$30 million capital expenditure to construct three product terminals tied into the Yellowstone Pipeline that include rail capability. This investment is being undertaken to preserve our long-term ability to participate in western markets.

*McPherson Refinery.* The McPherson, Kansas refinery is owned and operated by National Cooperative Refinery Association (NCRA), of which we own 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 90% of its crude oil from Kansas, Oklahoma and Texas through NCRA-owned and common carrier pipelines.

The McPherson refinery processes approximately 85,000 barrels of crude oil per day to produce refined products that consist of approximately 55% gasoline, 41% diesel and other distillates, and 4% propane and other products. Approximately 32% of the refined fuels are loaded into trucks at the McPherson refinery and shipped via NCRA's proprietary products pipeline to its terminal in Council Bluffs, Iowa. The remaining refined fuel products are shipped to other markets via common carrier pipelines.

*Provista Renewable Fuels Marketing, LLC.* We acquired a 50% ownership in an ethanol and biodiesel marketing and distribution company, Provista Renewable Fuels Marketing, LLC, (Provista) formally known as United BioEnergy Fuels, LLC. U.S. BioEnergy Corporation (US BioEnergy), of which we own approximately 22%, is the other 50% owner of Provista. Provista contracts with ethanol and biodiesel production plants, including US BioEnergy, to market and distribute their finished products. From the April 1, 2006, acquisition date through August 31, 2006, volume totaled 109.5 million gallons of ethanol. Provista is consolidated within our financial statements, and we guarantee Provista's \$20.0 million revolving credit facility. We are the operating manager of Provista.

*Other Energy Operations.* We own and operate a propane terminal, four asphalt terminals, five refined product terminals and three lubricants blending and packaging facilities. We also own and lease a fleet of liquid and pressure trailers and tractors, which are used to transport refined fuels, propane, anhydrous ammonia and other products.

## **Products and Services**

Our Energy segment produces and sells (primarily wholesale) gasoline, diesel, propane, asphalt, lubricants and other related products and provides transportation services. Over the past two years, we have obtained approximately 55% of the petroleum products we sell from our Laurel and McPherson refineries, and approximately 45% from third parties.

## **Sales and Marketing; Customers**



We make approximately 70% of our 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. We sold approximately 1.3 billion gallons of gasoline and approximately 1.4 billion gallons of diesel fuel in fiscal year 2006. We also blend,

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package and wholesale auto and farm machinery lubricants to both members and non-members. In our fiscal year 2006, our lubricants operations sold approximately 20.2 million gallons of lube oil. We are one of the nation's largest propane wholesalers based on revenues. In our fiscal year 2006, our propane operations sold approximately 716 million gallons of propane. Most of the propane sold in rural areas is for heating and agricultural usage. 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 our Energy segment. Our Energy 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 government 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 labeling of pesticides and similar substances. Failure to comply with these laws, regulations and rules could subject us (and, in the case of the McPherson refinery, NCRA) to administrative penalties, injunctive relief, civil remedies and possible recalls of products. We believe that we and NCRA are in compliance with these laws, regulations and rules in all material respects and do not expect continued compliance to have a material effect on capital expenditures, earnings or competitive position of either us or NCRA.

Like many other refineries, our Energy segment's refineries recently focused their capital spending on reducing pollution and at the same time increasing production to pay for those expenditures. In particular, our refineries have completed work 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. We incurred capital expenditures from fiscal year 2003 through 2006 related to this compliance of \$88.1 million for our Laurel, Montana refinery and \$328.7 million for NCRA's McPherson, Kansas refinery.

The petroleum business is highly cyclical. Demand for crude oil and energy products is driven by the condition of local and worldwide economies, local and regional weather patterns and taxation relative to other energy sources which can significantly affect the price of refined fuels products. Most of our 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, weather conditions and government programs which encourage idle acres may all reduce demand for our energy products.

The petroleum refining and wholesale fuels business is very competitive. Among our competitors are some of the world's largest integrated petroleum companies, which have their own crude oil supplies, distribution and marketing systems. We also compete 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. Our owned and non-owned retail outlets are located primarily in the northwestern, midwestern and southern United States.

We market refined fuels, motor gasoline and distillate products in five principal geographic areas. The first area includes the Midwest and northern plains. Competition at the wholesale level in this area includes the major oil companies ConocoPhillips, Valero and Citgo, independent refiners including Flint Hills Resources and Growmark, Inc., and wholesale brokers/suppliers including Western Petroleum Company. This area has a robust spot market and is influenced by the large refinery center along the Gulf coast.

Another unique marketing area to the east is centered around Chicago and includes eastern Wisconsin, Illinois and Indiana. We principally compete with the major oil companies Marathon, BP Amoco and ExxonMobil, independent refineries including Flint Hills Resources and Growmark, Inc., and wholesale brokers/suppliers including U.S. Oil.

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Another market area is located south of Chicago. Arkansas, Missouri, and the northern part of Texas make up much of this area. Competition in this area includes the major oil companies Valero and ExxonMobil, and independent refiners including Lion. This area is principally supplied from the Gulf Coast refinery center and is also driven by a strong spot market that reacts quickly to changes in the international and national supply balance.

Another geographic area includes Montana, western North Dakota, Wyoming, Utah, Idaho, Colorado and western South Dakota. Competition at the wholesale level in this area includes the major oil companies ExxonMobil and ConocoPhillips, and independent refiners including Frontier Refining and Sinclair. This area is also noted for being fairly well balanced in demand and supply, but is typically influenced by Canadian refined fuels moving into the US through terminals in Canada and by rail from independent Canadian refiners.

The last area includes much of Washington and Oregon. We compete with the major oil companies Tesoro, BP Amoco and Chevron in this area. This area is also known for volatile prices and an active spot market.

**Summary Operating Results**

Summary operating results and identifiable assets for our Energy segment for the three months ended November 30, 2006 and 2005 and the fiscal years ended August 31, 2006, 2005 and 2004 are shown below:

	<b>Three Months Ended November 30</b>		<b>Years Ended August 31,</b>		
	<b>2006 (unaudited)</b>	<b>2005 (unaudited)</b>	<b>Energy 2006</b>	<b>2005</b>	<b>2004</b>
	<b>(Dollars in thousands)</b>				
Revenues	\$ 1,853,409	\$ 1,861,256	\$ 7,414,361	\$ 5,794,266	\$ 4,038,561
Cost of goods sold	1,702,786	1,665,456	6,834,676	5,487,813	3,780,726
Gross profit	150,623	195,800	579,685	306,453	257,835
Marketing, general and administrative	20,987	17,441	82,867	69,951	72,876
Operating earnings	129,636	178,359	496,818	236,502	184,959
Gain on sale of investments				(862)	(14,666)
Interest, net	385	1,119	6,534	8,918	12,090
Equity income from investments	(1,056)	(838)	(3,840)	(3,478)	(1,399)
Minority interests	18,961	32,127	86,483	46,741	32,507
Income from continuing operations before income taxes	\$ 111,346	\$ 145,951	\$ 407,641	\$ 185,183	\$ 156,427
Intersegment sales	\$ (67,820)	\$ (55,563)	\$ (242,430)	\$ (170,642)	\$ (121,199)
Total identifiable assets at end of period	\$ 2,130,876	\$ 2,105,351	\$ 2,164,217	\$ 2,238,614	\$ 1,591,254



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**AG BUSINESS**

Our Ag Business segment includes agronomy, country operations and grain marketing.

**Agronomy**

***Overview***

We conduct our wholesale and some of our retail agronomy operations through our 50% ownership interest in Agriliance LLC (Agriliance). Land O Lakes, Inc. (Land O Lakes) holds the other 50% ownership interest. Agriliance is one of North America's largest wholesale distributors of crop nutrients, crop protection products and other agronomy products based upon annual sales. Our 50% ownership interest in Agriliance is treated as an equity method investment, and therefore, Agriliance's revenues and expenses are not reflected in our operating results. At November 30, 2006, our equity investment in Agriliance was \$159.6 million. Agriliance has its own line of financing, without recourse to us.

In August 2005, we sold 81% of our 20% ownership interest in CF Industries, Inc. (CF), a crop nutrients manufacturer and distributor, in an initial public offering. After the initial public offering, our ownership interest in the company was reduced to approximately 3.9%. Subsequent to our fiscal year ended August 31, 2006, we sold 540,000 shares of our CF stock for proceeds of \$10.9 million, and recorded a gain of \$5.3 million, with a remaining ownership interest in CF of approximately 2.9%. Prior to the initial public offering, Agriliance entered into a multi-year supply contract with CF, and as a result, given our small ownership interest in the company, we now consider the relationship to be as a supplier rather than a strategic joint venture.

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.

***Operations***

Agriliance is 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 15% of the US market for crop nutrients and approximately 23% of the US 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 primarily in the southern United States. In addition, Agriliance blends and packages crop protection products under the Agri Solutions brand. Agriliance purchased approximately 28% of its fertilizer from CF during fiscal year 2006, and its other suppliers include Mosaic, PCS, PIC and Koch. Most of Agriliance's crop protection products are purchased from Monsanto, Syngenta, Dow, Bayer, Dupont and BASF.

***Products and Services***

Agriliance sells nitrogen and potassium based crop nutrients products as well as crop protection products that include insecticides, fungicides and pesticides. In addition, Agriliance blends and packages 9% of the products it sells under the Agri Solutions brand. Agriliance also provides field and technical services, including soil testing, adjuvant and herbicide formulation, application and related services.

***Sales and Marketing; Customers***

Agrilience distributes agronomy products through approximately 2,200 local cooperatives from Ohio to the West Coast and from the Canadian border south to Kansas. Agrilience also provides sales and services through more than 50 strategically located Agrilience Service Centers as well as nearly 150 company-owned retail locations. Agrilience's largest customer is our country operations business, also included in our Ag Business segment. In 2006, Agrilience had total revenues of \$3.7 billion, of which approximately \$1.8 billion was crop nutrient products and approximately \$1.9 billion was crop protection and other products.

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### ***Industry; Competition***

*Regulation.* The agronomy 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 government 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 labeling of pesticides and similar substances. Failure to comply with these laws, regulations and rules could subject Agriliance or us to administrative penalties, injunctive relief, civil remedies and possible recalls of products. We believe that Agriliance is in compliance with these laws, regulations and rules in all material respects and do not expect continued compliance to have a material effect on our capital expenditures, earnings or competitive position.

The wholesale and retail distribution of agronomy products is highly competitive and dependent upon relationships with agricultural producers, local cooperatives and growers, 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 CHS and Land O Lakes members, its purchasing power and competitive pricing, and its attention to service in the field.

Major competitors of Agriliance in crop nutrient distribution include Agrium, Mosaic, Koch, UAP and United Suppliers. Major competitors of Agriliance in crop protection products distribution include Helena, UAP, Tenkoz and numerous smaller distribution companies.

### **Country Operations**

#### ***Overview***

Our country operations business purchases a variety of grains from our producer members and other third parties, and provides cooperative members and producers with access to a full range of products and services including farm supplies and programs for crop and livestock production. Country operations operates at 325 locations, which includes 3 sunflower plants, dispersed throughout Minnesota, North Dakota, South Dakota, Montana, Nebraska, Kansas, Oklahoma, Colorado, 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.* We are one of the largest country elevator operators in North America based on revenues. Through a majority of our elevator locations, the country operations business purchases grain from member and non-member producers and other elevators and grain dealers. Most of the grain purchased is either sold through our grain marketing operations or used for local feed and processing operations. For the year ended August 31, 2006, country operations purchased approximately 367 million bushels of grain, primarily wheat (184 million bushels), corn (98 million bushels) and soybeans (43 million bushels). Of these bushels, 338 million were purchased from members and 294 million were sold through our grain marketing operations.

*Other Products.* Our country operations business manufactures and sells other products, both directly and through ownership interests in other entities. These include seed, crop nutrients, crop protection products, energy products, animal feed, animal health products and processed sunflowers. We sell agronomy products at 178 locations, feed products at 130 locations and energy products at 120 locations.



*Fin-Ag, Inc.* In the past, through our wholly-owned subsidiary Fin-Ag, Inc., we provided seasonal cattle feeding and swine financing loans, facility financing loans and crop production loans to our members. Most of these loans were sold to ProPartners (an affiliate of CoBank) under a financing program in which we guarantee a portion of the loans. Financing activity through Fin-Ag, Inc. has decreased substantially as most of the

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production loans were contributed to Cofina Financial, LLC (Cofina), a 49% owned joint venture that was formed during the fourth quarter of fiscal year 2005 (see Corporate and Other section below). The only activity of Fin-Ag, Inc. is seasonal cattle feeding financing and a small amount of crop loans not transferred to Cofina.

### ***Industry; Competition***

*Regulation.* Our country operations business is 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 government 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 labeling of pesticides and similar substances. Our country operations business is 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 us to administrative penalties, injunctive relief, civil remedies and possible recalls of products. We believe that we are in compliance with these laws, regulations and rules in all material respects and do not expect continued compliance to have a material effect on our capital expenditures, earnings or competitive position.

*Competition.* We compete primarily on the basis of price, services and patronage. Competitors for the purchase of grain include Archer Daniels Midland (ADM), Cargill, Incorporated (Cargill), local cooperatives and smaller private grain companies and processors at the majority of our locations in our trade territory, as previously defined in the Overview of our country operations business. In addition, Columbia Grain is also our competitor in Montana.

Competitors for our farm supply businesses include Cargill, United Agri-Products (UAP), local cooperatives and smaller private companies at the majority of locations throughout our trade territory. In addition, Land O Lakes Purina Feed LLC and Hubbard Feed are our competitors for the sale of feed products at our feed locations.

## **Grain Marketing**

### ***Overview***

We are the nation's largest cooperative marketer of grain and oilseed based on grain storage capacity and grain sales, handling about 1.4 billion bushels annually. During fiscal year 2006, we purchased approximately 64% of our total grain volumes from individual and cooperative association members and our country operations business, with the balance purchased from third parties. We arrange for the transportation of the grains either directly to customers or to our owned or leased grain terminals and elevators awaiting delivery to domestic and foreign purchasers. We primarily conduct our grain marketing operations directly, but do conduct some of our business through joint ventures.

### ***Operations***

Our grain marketing operations 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, and we are 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. Our ability to arrange efficient transportation, including loading capabilities onto unit trains, ocean-going vessels and barges, is a significant part of the services we offer to our customers. Rail, vessel, barge and truck transportation is carried out by third parties, often under long-term freight agreements with us. Grain intended for

export is usually shipped by rail or barge

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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.

We own and operate export terminals, river terminals and elevators involved in the handling and transport of grain. Our river terminals at 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. Our export terminal at Superior, Wisconsin provides access to the Great Lakes and St. Lawrence Seaway, and our export terminal at Myrtle Grove, Louisiana serves the Gulf market. In the Pacific Northwest, we conduct our 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, and primarily exports wheat. TEMCO, LLC operates an export terminal in Tacoma, Washington, and primarily exports corn and soybeans. These facilities serve the Pacific market, as well as domestic grain customers in the western United States. We also own two 110-car shuttle-receiving elevator facilities in Friona, Texas and Collins, Mississippi that serve large-scale feeder cattle, dairy and poultry producers in those regions. In 2003, we opened an office in Sao Paulo, Brazil for the procurement of soybeans for our grain marketing operations international customers.

In October of 2006, we invested approximately \$30.0 million in a Brazil-based grain handling and merchandising company named Multigrain S.A., that is owned jointly (50/50) with Multigrain Comercio, an agricultural commodities business headquartered in Sao Paulo, Brazil. This venture which includes grain storage and export facilities, builds on our South American soybean origination and helps meet customer needs year-round. Our grain marketing operations continue to explore other opportunities to establish a presence in other emerging grain origination and export markets.

Our grain marketing operations purchases most of its grain during the summer and fall harvest period. Because of our geographic location and the fact that we are further from our export facilities, the grain that we handle tends to be sold later after the harvest period than in other parts of the country. However, as many producers have significant on-farm storage capacity and in light of our own storage capacity, our grain marketing operations buys and ships grain throughout the year. Due to the amount of grain purchased and held in inventory, our grain marketing operations 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 affects the profitability of our grain marketing operations.

### ***Products and Services***

The primary grains purchased by our grain marketing operations for the year ended August 31, 2006 were corn (491 million bushels), wheat (442 million bushels) and soybeans (350 million bushels). Of the total grains purchased by our grain marketing operations during the year ended August 31, 2006, 561 million bushels were purchased from our individual and cooperative association members, 294 million bushels were purchased from our country operations business, and the remainder was purchased from third parties.

### ***Sales and Marketing; Customers***

Purchasers of our grain and oilseed include domestic and foreign millers, maltsters, feeders, crushers and other processors. To a much lesser extent purchasers include intermediaries and distributors. Our grain marketing operations are not dependent on any one customer, and its supply relationships call for delivery of grain at prevailing market prices.

### ***Industry; Competition***

*Regulation.* Our grain marketing 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 government agencies. These laws, regulations and rules govern the discharge of materials to environment, air and water; reporting storage of hazardous wastes; and the transportation, handling and disposition of wastes. Our grain marketing operations are also subject to laws and related regulations and rules administered by the United States Department of Agriculture, the Federal Food

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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 food and grain products. Failure to comply with these laws, regulations and rules could subject us to administrative penalties, injunctive relief, civil remedies and possible recalls of products. We believe that we are in compliance with these laws, regulations and rules in all material respects and do not expect continued compliance to have a material effect on our capital expenditures, earnings or competitive position.

*Competition.* Our grain marketing operations compete for both the purchase and the sale of grain. Competition is intense and margins are low. Some competitors are integrated food producers, which may also be customers. A few major competitors have substantially greater financial resources than we have.

In the purchase of grain from producers, location of the delivery facility is a prime consideration, but producers are increasingly willing to transport grain longer distances for sale. Price is affected by the capabilities of the facility; for example, if it is cheaper to deliver to a customer by unit train than by truck, a facility with unit train capabilities provides a price advantage. We believe that our relationships with individual members serviced by our local country operations locations and with our cooperative members give us a broad origination capability.

Our grain marketing operations competes for grain sales based on price, services and ability to provide the desired quantity and quality of grains. Location of facilities is a major factor in the ability to compete. Our grain marketing operations competes with numerous grain merchandisers, including major grain merchandising companies such as Archer Daniels Midland (ADM), Cargill, Incorporated (Cargill), ConAgra, Bunge and Louis Dreyfus, each of which handle grain volumes of more than one billion bushels annually.

The results of our grain marketing operations may be adversely affected by relative levels of supply and demand, both domestic and international, commodity price levels (including grain prices reported on national markets) and transportation costs and conditions. Supply is affected by weather conditions, disease, insect damage, acreage planted and government regulations and policies. Demand may be affected by foreign governments and their programs, relationships of foreign countries with the United States, the affluence of foreign countries, acts of war, currency exchange fluctuations and substitution of commodities. Demand may also be affected by changes in eating habits, by population growth, and by increased or decreased per capita consumption of some products.

**Table of Contents****Summary Operating Results**

Summary operating results and identifiable assets for our Ag Business segment for the three months ended November 30, 2006 and 2005 and the fiscal years ended August 31, 2006, 2005 and 2004 are shown below:

	<b>Three Months Ended November 30,</b>		<b>Years Ended August 31,</b>		
	<b>2006 (unaudited)</b>	<b>2005 (unaudited)</b>	<b>Ag Business 2006</b>	<b>2005</b>	<b>2004</b>
	<b>(Dollars in thousands)</b>				
Revenues	\$ 1,804,616	\$ 1,490,543	\$ 6,575,165	\$ 5,670,644	\$ 6,306,530
Cost of goods sold	1,746,843	1,446,890	6,401,527	5,541,282	6,187,082
Gross profit	57,773	43,653	173,638	129,362	119,448
Marketing, general and administrative	19,285	21,162	99,777	83,600	85,479
Operating earnings	38,488	22,491	73,861	45,762	33,969
Gain on sale of investments	(5,348)			(11,358)	
Gain on legal settlements					(692)
Interest, net	5,170	3,504	23,559	20,535	18,932
Equity loss (income) from investments	10,589	2,261	(40,902)	(55,473)	(47,488)
Minority interests	(49)	34	(509)	(41)	(24)
Income from continuing operations before income taxes	\$ 28,126	\$ 16,692	\$ 91,713	\$ 92,099	\$ 63,241
Intersegment sales	\$ (1,381)	\$ (2,327)	\$ (8,779)	\$ (9,640)	\$ (18,372)
Total identifiable assets at end of period	\$ 2,240,442	\$ 1,736,940	\$ 1,806,243	\$ 1,604,571	\$ 1,590,337

**PROCESSING****Overview**

Our Processing segment converts raw agricultural commodities into ingredients for finished food products or into finished consumer food products. We have focused on areas that allow us to utilize the products supplied by our member producers. These areas are oilseed processing, wheat milling, foods and renewable fuels.

*Regulation.* Our Processing 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 government agencies. These laws, regulations and rules govern the discharge of materials to environment, air and water; reporting storage of hazardous wastes; and the transportation, handling and disposition

of wastes. Our Processing 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 food and grain products. Failure to comply with these laws, regulations and rules could subject us, or our foods partners, or our renewable fuels partners to administrative penalties, injunctive relief, civil remedies and possible recalls of products. We believe that we are in compliance with these laws, regulations and rules in all material



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respects and do not expect continued compliance to have a material effect on our capital expenditures, earnings or competitive position.

## **Oilseed Processing**

Our oilseed processing operations convert soybeans into soybean meal, soyflour, crude soyoil, refined soybean oil and associated by-products. These operations are conducted at a facility in Mankato, Minnesota that can crush approximately 39 million bushels of soybeans on an annual basis, producing approximately 940,000 short tons of soybean meal and 460 million pounds of crude soybean oil. The same facility is able to process approximately 1 billion pounds of refined soybean oil annually. Another crushing facility in Fairmont, Minnesota has a crushing capacity of over 45 million bushels of soybeans on an annual basis and became operational in the first quarter of our fiscal year 2004.

Our oilseed processing operations produce three primary products: refined oils, soybean meal and soyflour. Refined oils are used in processed foods, such as margarine, shortening, salad dressings and baked goods, as well as methyl ester/biodiesel production, and to a lesser extent, for certain industrial uses such as plastics, inks and paints. Soybean meal has high protein content and is used for feeding livestock. Soyflour is used in the baking industry, as a milk replacement in animal feed and in industrial applications.

Our soy processing facilities are located in areas with a strong production base of soybeans and end-user market for the meal and soyflour. We purchase virtually all of our soybeans from members. Our oilseed crushing operations currently produce approximately 90% of the crude oil that we refine, and purchase the balance from outside suppliers.

Our customers for refined oil are principally large food product companies located throughout the United States. However, over 50% of our customers are located in the Midwest due to relatively lower freight costs and slightly higher profitability potential. Our largest customer for refined oil products is Ventura Foods, LLC (Ventura Foods), in which we hold a 50% ownership interest and with which we have a long-term supply agreement to supply minimum quantities of edible soybean oils as long as we maintain a minimum 25.5% ownership interest and our price is competitive with other suppliers of the product. Our sales to Ventura Foods were \$64.7 million in fiscal year 2006. We also sell soymeal to about 400 customers, primarily feed lots and feed mills in southern Minnesota. In fiscal 2006, Commodity Specialists Company accounted for 22% of soymeal sold and Land O Lakes/Purina Feed, LLC accounted for 15% of soymeal sold. We sell soyflour to customers in the baking industry both domestically and for export.

The refined soybean products industry is highly competitive. Major industry competitors include ADM, Cargill, Ag Processing Inc., and Bunge. These and other competitors have acquired other processors and have expanded existing plants, or have constructed new plants, both domestically and internationally. Price, transportation costs, services and product quality drive competition. We estimate that we have a market share of approximately 4% to 5% of the domestic refined soybean oil market and approximately 4% of the domestic soybean crushing capacity.

Soybeans are a commodity and their price can fluctuate significantly depending on production levels, demand for the products, and other supply factors.

## **Wheat Milling**

In January 2002, we formed a joint venture with Cargill named Horizon Milling, LLC (Horizon Milling), in which we hold an ownership interest of 24%, with Cargill owning the remaining 76%. Horizon Milling is the largest US wheat miller based on output volume. We own five mills that we lease to Horizon Milling. Sales and purchases of wheat and durum by us to Horizon Milling during our fiscal year 2006 were \$251.5 million and \$5.6 million, respectively. Horizon Milling's advance payments on grain to us were \$7.6 million on August 31, 2006, and are included in

Customer Advance Payments on our Consolidated Balance Sheet. We account for Horizon Milling using the equity method of accounting. At August 31, 2006, our value of assets leased to Horizon Milling was \$82.0 million.

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In September of 2006, we invested \$15.6 million in a new Horizon Milling venture (24% CHS ownership) that acquired the Canadian grain-based foodservice and industrial businesses of Smucker Foods of Canada, a wholly owned subsidiary of J.M. Smucker Company, which includes three flour milling operations and two dry baking mixing facilities in Canada.

## **Foods**

Our primary focus in the foods area is Ventura Foods, which produces and distributes vegetable oil-based products such as margarine, salad dressing and other food products. Ventura Foods was created in 1996, and is owned 50% by us and 50% by Wilsey Foods, Inc., a majority owned subsidiary of Mitsui & Co., Ltd. We account for our Ventura Foods investment under the equity method of accounting, and at August 31, 2006, our investment was \$132.2 million.

Ventura Foods manufactures, packages, distributes and markets bulk margarine, salad dressings, mayonnaise, salad oils, syrups, soup bases and sauces, many of which utilize soybean oil as a primary ingredient. Approximately 45% of Ventura Foods' volume, based on sales, comes from products for which Ventura Foods owns the brand, and the remainder comes from products that it produces for third parties. A variety of Ventura Foods' product formulations and processes are proprietary to it or its customers. Ventura Foods is the largest manufacturer of margarine for the foodservice sector in the US and is a major producer of many other products.

Ventura Foods has 13 manufacturing and distribution locations across the United States. It sources its raw materials, which consist primarily of soybean oil, canola oil, cottonseed oil, peanut oil and various other ingredients and supplies, from various national suppliers, including our oilseed processing operations. It sells the products it manufactures to third parties as a contract manufacturer, as well as directly to retailers, food distribution companies and large institutional food service companies. Ventura Foods sales are approximately 60% in foodservice and the remainder split between retail and industrial customers who use edible oil products as ingredients in foods they manufacture for resale. During Ventura Foods' 2006 fiscal year, Sysco accounted for 22% of its net sales. During our fourth quarter of fiscal year 2005, Ventura Foods purchased two Dean Foods businesses: Marie's dressings and Dean's dips. The transaction included a license agreement for Ventura Foods to use the Dean's trademark on dips.

Ventura Foods competes with a variety of large companies in the food manufacturing industry. Some of its major competitors are ADM, Cargill, Bunge, Unilever, ConAgra, ACH Food Companies, Smuckers, Kraft and CF Sauer, Ken's, Marzetti and Nestle.

## **Renewable Fuels**

In fiscal 2006, we invested \$70.0 million in US BioEnergy Corporation (US BioEnergy), an ethanol manufacturing company, representing an approximate 24% ownership on August 31, 2006. On September 1, 2006, we acquired additional shares of Class A Common Stock for an aggregate purchase price of \$35.0 million.

In August 2006, US BioEnergy filed a registration statement with the Securities and Exchange Commission to register shares of common stock for sale in an initial public offering, and in December 2006, US BioEnergy went public, bringing our current ownership in the company to approximately 22%. Based upon the per share price of \$14.00 at the initial public offering in December 2006, our investment had a market value of approximately \$201 million. We are recognizing earnings of US BioEnergy to the extent of our ownership interest using the equity method of accounting.

US BioEnergy currently has two ethanol plants in operation, one in Woodbury, Michigan and the other in Central City, Nebraska. In addition, there are three ethanol plants under construction in Albert City, Iowa, Ord, Nebraska and Hankinson, North Dakota and an expansion project in progress at the plant in Central City, Nebraska. US BioEnergy has also announced plans to build additional ethanol plants in the Midwest.



**Table of Contents*****Summary Operating Results***

Summary operating results and identifiable assets for our Processing segment for the three months ended November 30, 2006 and 2005 and the fiscal years ended August 31, 2006, 2005 and 2004 are shown below:

	<b>Three Months Ended November 30,</b>		<b>Years Ended August 31,</b>		
	<b>2006 (unaudited)</b>	<b>2005 (unaudited)</b>	<b>Processing 2006</b>	<b>2005</b>	<b>2004</b>
	<b>(Dollars in thousands)</b>				
Revenues	\$ 155,024	\$ 152,978	\$ 614,471	\$ 613,766	\$ 734,944
Cost of goods sold	148,463	145,310	588,732	604,198	703,129
Gross profit	6,561	7,668	25,739	9,568	31,815
Marketing, general and administrative	5,956	4,958	21,645	20,750	20,323
Operating earnings (losses)	605	2,710	4,094	(11,182)	11,492
Gain on sale of investments				(457)	
Interest, net	2,887	2,423	11,096	12,287	12,392
Equity income from investments	(12,850)	(9,591)	(35,504)	(36,202)	(29,966)
Income from continuing operations before income taxes	\$ 10,568	\$ 9,878	\$ 28,502	\$ 13,190	\$ 29,066
Intersegment sales	\$ (84)	\$ (109)	\$ (368)	\$ (502)	\$ (1,363)
Total identifiable assets at end of period	\$ 600,463	\$ 456,272	\$ 518,186	\$ 420,373	\$ 415,761

**CORPORATE AND OTHER****Services**

*Financial Services.* We have provided open account financing to more than 130 of our members that are cooperatives (cooperative association members) in the past year. These arrangements involve the discretionary extension of credit in the form of a clearing account for settlement of grain purchases and as a cash management tool.

In the past, we have made seasonal and term loans to member cooperatives. Some of these loans were sold to CoBank, and we guarantee a portion of the loans sold. Currently, these loans are made by Cofina, a joint venture finance company in which we hold a 49% ownership interest.

During the fourth quarter of our fiscal year 2005, we contributed certain assets related to our financial services business and related to Fin-Ag Inc., along with cash, to form Cofina. Cenex Finance Association, which prior to the formation of Cofina operated as an independent finance company, owns the other 51% of Cofina, however, the governance of this joint venture is 50/50. We participated in the formation of Cofina for the purpose of expanding the size of our financing platform, to improve the scope of services offered to customers, to gain efficiencies in sourcing

funds, and to achieve some synergistic savings through participation in larger customer-financing programs. We account for our Cofina investment using the equity method of accounting.

We may, at our own discretion, choose to guarantee certain loans made by Cofina. On August 31, 2006, we had guarantees related to Cofina loans totaling \$31.3 million. Guarantees for other loans that were not transferred to Cofina were \$91 thousand on August 31, 2006.

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*Country Hedging, Inc.* Our 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.* Ag States Agency, LLC, is an independent insurance agency, and after the purchase of the minority owner's interest during our fiscal year 2005, is now a wholly-owned subsidiary. It sells insurance, including group benefits, property and casualty, and bonding programs. Its approximately 1,800 customers are primarily agricultural businesses, including local cooperatives and independent elevators, petroleum outlets, agronomy, feed and seed plants, implement dealers, fruit and vegetable packers/warehouses, and food processors.

## **PRICE RISK AND HEDGING**

When we enter into a commodity purchase commitment, we incur risks of carrying inventory, including risks related to price changes and performance (including delivery, quality, quantity and shipment period). We are exposed to risk of loss in the market value of positions held, consisting of inventory and purchase contracts at a fixed or partially fixed price in the event market prices decrease. We are also exposed to risk of loss on our fixed price or partially fixed price sales contracts in the event market prices increase.

To reduce the price change risks associated with holding fixed price commitments, we generally take opposite and offsetting positions by entering into commodity futures contracts (either a straight futures contract or an options futures contract) on regulated commodity futures exchanges for grain, and regulated mercantile exchanges for refined products and crude oil. The crude oil and most of the grain and oilseed volume we handle can be hedged. Some grains cannot be hedged because there are no futures for certain commodities. For those commodities, risk is managed through the use of forward sales and various pricing arrangements and to some extent cross-commodity futures hedging. While hedging activities reduce the risk of loss from changing market values of inventory, such activities also limit the gain potential which otherwise could result from changes in market prices of inventory. Our policy is to generally maintain hedged positions in grain. Our profitability from operations is primarily derived from margins on products sold and grain merchandised, not from hedging transactions. Hedging arrangements do not protect against nonperformance by counterparties to contracts, and therefore, contract values are reviewed and adjusted to reflect potential non-performance.

When a futures contract is entered into, an initial margin deposit must be sent to the applicable exchange or broker. The amount of the deposit is set by the exchange and varies by commodity. If the market price of a short futures contract increases, then an additional maintenance margin deposit would be required. Similarly, if the price of a long futures contract decreases, a maintenance margin deposit would be required and sent to the applicable exchange. Subsequent price changes could require additional maintenance margins or could result in the return of maintenance margins.

At any one time, inventory and purchase contracts for delivery to us may be substantial. We have risk management policies and procedures that include net position limits. These limits are defined for each commodity and include both trader and management limits. This policy, and computerized procedures in our grain marketing operations, requires a review by operations management when any trader is outside of position limits and also a review by our senior management if operating areas are outside of position limits. A similar process is used in our energy operations. The position limits are reviewed at least annually with our management. We monitor current market conditions and may expand or reduce our risk management policies or procedures in response to changes in those conditions. In addition, all purchase and sales contracts are subject to credit approvals and appropriate terms and conditions.

## **EMPLOYEES**

At August 31, 2006, we had approximately 6,540 full, part-time, temporary and seasonal employees, which included approximately 590 employees of NCRA. Of that total, approximately 1,930 were employed in our Energy segment, 3,560 in our country operations business (including approximately 1,115 seasonal and temporary employees), 420 in our grain marketing operations, 260 in our Processing segment and 370 in



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Corporate and Other. In addition to those employed directly by us, many employees work for joint ventures in which we have a 50% or less ownership interest, and are not included in these totals. A portion of all of our business segments are employed in this manner.

Employees in certain areas are represented by collective bargaining agreements. Refinery and pipeline workers in Laurel, Montana are represented by agreements with two unions: United Steel Workers of America (USWA) (169 employees) and Oil Basin Pipeliners Union (OBP) (17 employees), for which agreements are in place through 2008 and 2007, respectively, in regards to wages and benefits. The contracts covering the NCRA McPherson, Kansas refinery (274 employees in the USWA union) are also in place through 2009. There are approximately 160 employees in transportation and lubricant plant operations that are covered by other collective bargaining agreements that expire at various times. Certain production workers in our oilseed processing operations are subject to collective bargaining agreements with the Bakery, Confectionary, Tobacco Worker and Grain Millers (BTWGM) (108 employees) and the Pipefitters Union (2 employees) for which agreements are in place through 2009. The BTWGM also represents 52 employees at our Superior, WI grain export terminal with a contract expiring in 2010. The USWA represents 48 employees at our Myrtle Grove, LA grain export terminal with a contract expiring in 2009, the Teamsters represent 8 employees at our Winona, MN export terminal with a contract expiring in 2008, and the International Longshoremen and Warehousemen's Union (ILWU) represents 19 employees at our Kalama, WA export terminal with an expired contract since September 2006 that is currently being negotiated with expectations of a positive outcome. Finally, certain employees in our country operations business are represented by collective bargaining agreements with two unions; the BTWGM (26 employees), with contracts expiring in December 2008 and June 2010, and the United Food and Commercial Workers (10 employees), with a contract expiring in July 2008.

## **LEGAL PROCEEDINGS**

We are involved as a defendant in various lawsuits, claims and disputes, which are in the normal course of our business. The resolution of any such matters may affect consolidated net income for any fiscal period; however, our management believes any resulting liabilities, individually or in the aggregate, will not have a material effect on our consolidated financial position, results of operations or cash flows during any fiscal year.

In October 2003, we and NCRA reached agreements with the Environmental Protection Agency (EPA) and the State of Montana's Department of Environmental Quality and the State of Kansas Department of Health and Environment, regarding the terms of settlements with respect to reducing air emissions at our Laurel, Montana and NCRA's McPherson, Kansas refineries. These settlements are part of a series of similar settlements that the EPA has negotiated with major refiners under the EPA's Petroleum Refinery Initiative. The settlements, which resulted from nearly three years of discussions, take the form of consent decrees filed with the U.S. District Court for the District of Montana (Billings Division) and the U.S. District Court for the District of Kansas. Each consent decree details potential capital improvements, supplemental environmental projects and operational changes that we and NCRA have agreed to implement at the relevant refinery over the next several years. The consent decrees also require us and NCRA to pay approximately \$0.5 million in aggregate civil cash penalties. As of November 30, 2006, the aggregate capital expenditures for us and NCRA related to these settlements was approximately \$15 million, and we anticipate spending an additional \$8 million over the next five years. We do not believe that the settlements will have a material adverse affect on us or NCRA.

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**PROPERTIES**

We own or lease energy, grain handling and processing, and agronomy related facilities throughout the United States. Below is a summary of these locations.

**Energy**

Facilities in our Energy business segment include the following, all of which are owned except where indicated as leased:

Refinery	Laurel, Montana
Propane terminal	Glenwood, Minnesota
Transportation terminals/ repair facilities	12 locations in Iowa, Kansas, Minnesota, Montana, North Dakota, South Dakota, Texas, Washington and Wisconsin, 3 of which are leased
Petroleum & asphalt terminals/ storage facilities	9 locations in Montana, North Dakota and Wisconsin
Pump stations	11 locations in Montana and North Dakota
Pipelines:	
Cenex Pipeline, LLC	Laurel, Montana to Fargo, North Dakota
Front Range Pipeline, LLC	Canadian border to Laurel, Montana
Convenience stores/ gas stations	42 locations in Iowa, Minnesota, Montana, North Dakota, South Dakota and Wyoming, 12 of which are leased
Lubricant plants/ warehouses	3 locations in Minnesota, Ohio and Texas, 1 of which is leased

We have a 74.5% interest in NCRA, which owns and operates the following facilities:

Refinery	McPherson, Kansas
Petroleum terminals/ storage	2 locations in Iowa and Kansas
Pipeline	McPherson, Kansas to Council Bluffs, Iowa
Jayhawk Pipeline, LLC	Throughout Kansas, with branches in Oklahoma, Texas and Nebraska
Jayhawk stations	32 locations located in Kansas, Oklahoma and Nebraska
Osage Pipeline (50% owned by NCRA)	Oklahoma to Kansas
Kaw Pipeline (66.7% owned by NCRA)	Throughout Kansas

**Ag Business**

Within our Ag Business business segment, we own or lease the following facilities:

***Country Operations***

In our country operations business, we own 315 agri-operations locations (of which some of the facilities are on leased land), 7 feed manufacturing facilities and 3 sunflower plants located in Minnesota, North Dakota, South Dakota,

Montana, Nebraska, Kansas, Oklahoma, Colorado, Idaho, Washington and Oregon.

***Grain Marketing***

We use grain terminals in our grain marketing operations at the following locations:

Collins, Mississippi (owned)  
Davenport, Iowa (2 owned)  
Friona, Texas (owned)  
Kalama, Washington (leased)

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Minneapolis, Minnesota (owned, idle)  
Myrtle Grove, Louisiana (owned)  
Savage, Minnesota (owned)  
Spokane, Washington (owned)  
Superior, Wisconsin (owned)  
Winona, Minnesota (1 owned, 1 leased)

## **Processing**

Within our Processing business segment, we own and lease the following facilities:

### ***Oilseed Processing***

We own a campus in Mankato, Minnesota, comprised of a soybean crushing plant, an oilseed refinery, a soyflour plant, a quality control laboratory and an administration office. We also own a crushing plant in Fairmont, Minnesota.

### ***Wheat Milling***

We own five flour milling facilities at the following locations, all of which are leased to Horizon Milling:

Rush City, Minnesota  
Kenosha, Wisconsin  
Houston, Texas  
Mount Pocono, Pennsylvania  
Fairmount, North Dakota

## **Corporate Headquarters**

We are headquartered in Inver Grove Heights, Minnesota. We own a 33-acre campus consisting of one main building with approximately 320,000 square feet of office space and two smaller buildings with approximately 13,400 and 9,000 square feet of space.

Our internet address is [www.chsinc.com](http://www.chsinc.com).

## **MEMBERSHIP IN CHS AND AUTHORIZED CAPITAL**

### **Introduction**

We are an agricultural membership cooperative organized under Minnesota cooperative law to do business with member and non-member patrons. Our patrons, not us, are subject to income taxes on income from patronage sources, which is distributed to them. We are subject to income taxes on non-patronage-sourced income. See Tax Treatment below.

### **Distribution of Net Income; Patronage Dividends**

We are required by our organizational documents annually to distribute net earnings derived from patronage business with members, after payment of dividends on equity capital, to members on the basis of patronage, except that our Board of Directors may elect to retain and add to our unallocated capital reserve an amount not to exceed 10% of the distributable net income from patronage business. We also may distribute net income derived from patronage business

with a non-member if we have agreed to conduct business with the non-member on a patronage basis. Net income from non-patronage business may be distributed to members or added to the unallocated capital reserve, in whatever proportions our Board of Directors deems appropriate.

These distributions, referred to as patronage dividends, may be made in cash, patrons equities, revolving fund certificates, our securities, securities of others, or any combination designated by the Board of Directors. Since 1998, the Board of Directors has distributed patronage dividends in the form of 30% cash and

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70% patrons equities (see Patrons Equities below). For fiscal year 2006, the Board of Directors has approved the upcoming distribution of patronage dividends in the form of 35% cash and 65% patrons equities. Our Board of Directors may change the mix in the form of the patronage dividends in the future. In making distributions, the Board of Directors may use any method of allocation that, in its judgment, is reasonable and equitable.

Patronage dividends distributed during the years ended August 31, 2006, 2005 and 2004 were \$207.8 million (\$62.5 million in cash), \$171.3 million (\$51.6 million in cash) and \$95.2 million (\$28.7 million in cash), respectively.

## **Patrons Equities**

Patrons equities are in the form of a book entry and represent a right to receive cash or other property when we redeem them. Patrons equities form part of our capital, do not bear interest, and are not subject to redemption upon request of a member. Patrons equities are redeemable only at the discretion of our Board of Directors and in accordance with the terms of the redemption policy adopted by our Board of Directors, which may be modified at any time without member consent. A policy was adopted effective September 1, 2004, whereby redemptions of capital equity certificates approved by the Board of Directors are divided into two pools, one for non-individuals (primarily member cooperatives) who may participate in an annual pro-rata program for equities older than 10 years held by them, and another for individuals who are eligible for equity redemptions at age 72 or upon death. Effective September 1, 2006, the 10-year aging factor on the retirement of equity on a pro-rata basis was eliminated for equity redemptions to be paid in fiscal year 2007. The amount that each non-individual receives under the pro-rata program in any year will be determined by multiplying the dollars available for pro-rata redemptions, if any that year, as determined by the Board of Directors, by a fraction, the numerator of which is the face value of patronage certificates eligible for redemption held by them, and the denominator, of which is the sum of the patronage certificates eligible for redemption held by all eligible holders of patronage certificates that are not individuals. In addition to the annual pro-rata program, the Board of Directors has approved an additional \$50.0 million of cash redemptions to be paid in fiscal year 2007, targeting older capital equity certificates. In accordance with authorization from our Board of Directors, we expect total redemptions related to year ended August 31, 2006, that will be distributed in fiscal year 2007, to be approximately \$112.4 million, of which 47.1 million was redeemed in cash during the three months ended November 30, 2006, compared to \$6.3 million during the three months ended November 30, 2005. Included in our redemptions during the second quarter of fiscal 2007 is the planned redemption of by issuing shares of our 8% Cumulative Redeemable Preferred Stock (Preferred Stock) pursuant to this registration statement.

Cash redemptions of patrons and other equities during the years ended August 31, 2006, 2005 and 2004 were \$55.9 million, \$23.7 million and \$10.3 million, respectively. An additional \$23.8 million, \$20.0 and \$13.0 million of equities were redeemed by issuance of shares of our 8% Cumulative Redeemable Preferred Stock during the years ended August 31, 2006, 2005 and 2004, respectively.

## **Governance**

We are managed by a Board of Directors of not less than 17 persons elected by the members at our annual meeting. Terms of directors are staggered so that no more than seven directors are elected in any year, and after our 2006 elections, the maximum number of directors elected in any year will be six. The Board of Directors is currently comprised of 17 directors. Our articles of incorporation and bylaws may be amended only upon approval of a majority of the votes cast at an annual or special meeting of our members, except for the higher vote described under Certain Antitakeover Measures below.

## **Membership**

Membership in CHS is restricted to certain producers of agricultural products and to associations of producers of agricultural products that are organized and operating so as to adhere to the provisions of the

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Agricultural Marketing Act and the Capper-Volstead Act, as amended. Our Board of Directors may establish other qualifications for membership, as it may from time to time deem advisable.

As a membership cooperative, we do not have common stock. We may issue equity or debt instruments, on a patronage basis or otherwise, to our members. We have two classes of outstanding membership. Individual members are individuals actually engaged in the production of agricultural products. Cooperative associations are associations of agricultural producers and may be either cooperatives or other associations organized and operated under the provisions of the Agricultural Marketing Act and the Capper-Volstead Act.

## **Voting Rights**

Voting rights arise by virtue of membership in CHS, not because of ownership of any equity or debt instruments. Members that are cooperative associations are entitled to vote based upon a formula that takes into account the equity held by the cooperative in CHS and the average amount of business done with us over the previous three years.

Members who are individuals are entitled to one vote each. Individual members may exercise their voting power directly or through a patrons' association affiliated with a grain elevator, feed mill, seed plant or any other of our facilities (with certain historical exceptions) recognized by our Board of Directors. The number of votes of patrons' associations is determined under the same formula as cooperative association members.

Most matters submitted to a vote of the members require the approval of a majority of the votes cast at a meeting of the members, although certain actions require a greater vote. See [Certain Antitakeover Measures](#) below.

## **Debt and Equity Instruments**

We may issue debt and equity instruments to our current members and patrons, on a patronage basis or otherwise, and to persons who are neither members nor patrons. Capital Equity Certificates issued by us are subject to a first lien in favor of us for all indebtedness of the holder to us. On November 30, 2006, our outstanding capital included patrons' equities (consisting of capital equity certificates and non-patronage earnings certificates), 8% Cumulative Redeemable Preferred Stock and certain capital reserves.

## **Distribution of Assets upon Dissolution; Merger and Consolidation**

In the event of our dissolution, liquidation or winding up, whether voluntary or involuntary, all of our debts and liabilities would be paid first according to their respective priorities. After such payment, the holders of each share of our preferred stock would then be entitled to receive out of available assets up to \$25.00 per share plus all dividends accumulated and unpaid on that share, whether or not declared, to and including the date of distribution. This distribution to the holders of our preferred stock would be made before any payment is made or assets distributed to the holders of any security that ranks junior to the preferred stock but after the payment of the liquidation preference of any of our securities that rank senior to the preferred stock. After such distribution to the holders of equity capital, any excess would be paid to patrons on the basis of their past patronage. Our bylaws provide for the allocation among our members and nonmember patrons of the consideration received in any merger or consolidation to which we are a party.

## **Certain Antitakeover Measures**

Our governing documents may be amended upon the approval of a majority of the votes cast at an annual or special meeting. However, if our Board of Directors, in its sole discretion, declares that a proposed amendment to our governing documents involves or is related to a hostile takeover, the amendment must be adopted by 80% of the total



voting power of our members.

The approval of not less than two-thirds of the votes cast at a meeting is required to approve a change of control transaction which would include a merger, consolidation, liquidation, dissolution, or sale of all or substantially all of our assets. If our Board of Directors determines that a proposed change of control

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transaction involves a hostile takeover, the 80% approval requirement applies. The term "hostile takeover" is not further defined in the Minnesota cooperative law or our governing documents.

**Tax Treatment**

Subchapter T of the Internal Revenue Code sets forth rules for the tax treatment of cooperatives and applies to both cooperatives exempt from taxation under Section 521 of the Internal Revenue Code and to nonexempt corporations operating on a cooperative basis. We are a nonexempt cooperative.

As a cooperative, we are not taxed on qualified patronage (minimum cash requirement of 20%) allocated to our members either in the form of equities or cash. Consequently, those amounts are taxed only at the patron level. However, the amounts of any allocated but undistributed patronage earnings (called non-qualified unit retains) are taxable to us when allocated. Upon redemption of any non-qualified unit retains, the amount is deductible to us and taxable to the member.

Income derived by us from non-patronage sources is not entitled to the "single tax" benefit of Subchapter T and is taxed to us at corporate income tax rates.

NCRA is not consolidated for tax purposes.

**Table of Contents****SELECTED CONSOLIDATED FINANCIAL DATA**

The selected consolidated financial data below has been derived from our consolidated financial statements for the periods indicated below. The selected consolidated financial information for August 31, 2006, 2005 and 2004 and for the three months ended November 30, 2006 and 2005 should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this filing. In the opinion of our management, the unaudited historical financial data were prepared on the same basis as the audited historical financial data and include all adjustments, consisting of only normal recurring adjustments, necessary for a fair statement of this information. Results of operations for the three-month periods are not necessarily indicative of results of operations that may be expected for the full fiscal year.

**Summary Selected Consolidated Financial Data**

	<b>Three Months Ended</b>		<b>Years Ended August 31,</b>				
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>(Unaudited)</b>	<b>(Unaudited)</b>					
	<b>(Dollars in thousands)</b>						
<b>Income Statement Data:</b>							
Revenues	\$ 3,751,070	\$ 3,453,513	\$ 14,383,835	\$ 11,926,962	\$ 10,969,081	\$ 9,314,116	\$ 7,187,578
Cost of goods sold	3,528,794	3,199,068	13,570,507	11,449,858	10,527,715	8,989,050	6,877,951
Gross profit	222,276	254,445	813,328	477,104	441,366	325,066	309,627
Marketing, general and administrative	52,102	49,626	231,238	199,354	202,455	175,662	170,458
Operating earnings	170,174	204,819	582,090	277,750	238,911	149,404	139,169
Gain on sale of investments	(5,348)			(13,013)	(14,666)		
Gain on legal settlements					(692)	(10,867)	(2,970)
Interest, net	7,688	7,331	41,305	41,509	42,758	40,516	37,009
Equity income from investments	(4,531)	(9,177)	(84,188)	(95,742)	(79,022)	(47,299)	(58,133)
Minority interests	18,912	32,161	85,974	47,736	33,830	21,950	15,390
Income from continuing operations before income taxes	153,453	174,504	538,999	297,260	256,703	145,104	147,873
Income taxes	17,171	20,478	49,327	30,434	29,462	16,031	19,881
Income from continuing operations	136,282	154,026	489,672	266,826	227,241	129,073	127,992
		(208)	(625)	16,810	5,909	5,232	1,854

(Income) loss on  
discontinued  
operations, net of  
taxes

Net income	\$ 136,282	\$ 154,234	\$ 490,297	\$ 250,016	\$ 221,332	\$ 123,841	\$ 126,138
Balance Sheet Data:							
Working capital	\$ 828,191	\$ 784,241	\$ 828,954	\$ 758,703	\$ 493,440	\$ 458,738	\$ 249,115
Net property, plant and equipment	1,525,028	1,395,180	1,476,239	1,359,535	1,249,655	1,122,982	1,057,421
Total assets	5,511,494	4,669,397	4,942,583	4,726,937	4,031,292	3,807,968	3,481,727
Long-term debt, including current maturities	727,199	766,298	744,745	773,074	683,818	663,173	572,124
Total equities	2,126,076	1,836,450	2,017,391	1,757,897	1,628,086	1,481,711	1,289,638
Ratio of earnings to fixed charges and preferred dividends(1)	9.8x	10.8x	7.9x	4.6x	4.5x	3.2x	3.6x

(1) For purposes of computing the ratio of earnings to fixed charges and preferred dividends, earnings consist of income from continuing operations before income taxes on consolidated operations, distributed income from equity investees and fixed charges. Fixed charges consist of interest expense and one-third of rental expense, considered representative of that portion of rental expense estimated to be attributable to interest.

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The selected financial information below has been derived from our three business segments, and Corporate and Other, for the fiscal years ended August 31, 2006, 2005 and 2004 and for the three months ended November 30, 2006 and 2005. The intercompany sales between segments were \$253.3 million, \$182.4 million and \$142.4 million for the fiscal years ended August 31, 2006, 2005 and 2004, respectively. The intercompany sales between segments were \$69.3 and \$58.0 million for the three months ended November 30, 2006 and 2005, respectively.

**Summary Financial Data By Business Segment**

	<b>Three Months Ended November 30</b>		<b>Years Ended August 31,</b>		
	<b>2006 (unaudited)</b>	<b>2005 (unaudited)</b>	<b>Energy 2006</b>	<b>2005</b>	<b>2004</b>
	<b>(Dollars in thousands)</b>				
Revenues	\$ 1,853,409	\$ 1,861,256	\$ 7,414,361	\$ 5,794,266	\$ 4,038,561
Cost of goods sold	1,702,786	1,665,456	6,834,676	5,487,813	3,780,726
Gross profit	150,623	195,800	579,685	306,453	257,835
Marketing, general and administrative	20,987	17,441	82,867	69,951	72,876
Operating earnings	129,636	178,359	496,818	236,502	184,959
Gain on sale of investments				(862)	(14,666)
Interest, net	385	1,119	6,534	8,918	12,090
Equity income from investments	(1,056)	(838)	(3,840)	(3,478)	(1,399)
Minority interests	18,961	32,127	86,483	46,741	32,507
Income from continuing operations before income taxes	\$ 111,346	\$ 145,951	\$ 407,641	\$ 185,183	\$ 156,427
Intersegment sales	\$ (67,820)	\$ (55,563)	\$ (242,430)	\$ (170,642)	\$ (121,199)
Total identifiable assets at end of period	\$ 2,130,876	\$ 2,105,351	\$ 2,164,217	\$ 2,238,614	\$ 1,591,254

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	<b>Three Months Ended November 30,</b>		<b>Years Ended August 31,</b>		
	<b>2006 (unaudited)</b>	<b>2005 (unaudited)</b>	<b>Ag Business 2006</b>	<b>2005</b>	<b>2004</b>
	<b>(Dollars in thousands)</b>				
Revenues	\$ 1,804,616	\$ 1,490,543	\$ 6,575,165	\$ 5,670,644	\$ 6,306,530
Cost of goods sold	1,746,843	1,446,890	6,401,527	5,541,282	6,187,082
Gross profit	57,773	43,653	173,638	129,362	119,448
Marketing, general and administrative	19,285	21,162	99,777	83,600	85,479
Operating earnings	38,488	22,491	73,861	45,762	33,969
Gain on sale of investments	(5,348)			(11,358)	
Gain on legal settlements					(692)
Interest, net	5,170	3,504	23,559	20,535	18,932
Equity loss (income) from investments	10,589	2,261	(40,902)	(55,473)	(47,488)
Minority interests	(49)	34	(509)	(41)	(24)
Income from continuing operations before income taxes	\$ 28,126	\$ 16,692	\$ 91,713	\$ 92,099	\$ 63,241
Intersegment sales	\$ (1,381)	\$ (2,327)	\$ (8,779)	\$ (9,640)	\$ (18,372)
Total identifiable assets at end of period	\$ 2,240,442	\$ 1,736,940	\$ 1,806,243	\$ 1,604,571	\$ 1,590,337

	<b>Three Months Ended November 30,</b>		<b>Years Ended August 31,</b>		
	<b>2006 (unaudited)</b>	<b>2005 (unaudited)</b>	<b>Processing 2006</b>	<b>2005</b>	<b>2004</b>
	<b>(Dollars in thousands)</b>				
Revenues	\$ 155,024	\$ 152,978	\$ 614,471	\$ 613,766	\$ 734,944
Cost of goods sold	148,463	145,310	588,732	604,198	703,129
Gross profit	6,561	7,668	25,739	9,568	31,815
Marketing, general and administrative	5,956	4,958	21,645	20,750	20,323
Operating earnings (losses)	605	2,710	4,094	(11,182)	11,492
Gain on sale of investments				(457)	

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Interest, net	2,887	2,423	11,096	12,287	12,392
Equity income from investments	(12,850)	(9,591)	(35,504)	(36,202)	(29,966)
Income from continuing operations before income taxes	\$ 10,568	\$ 9,878	\$ 28,502	\$ 13,190	\$ 29,066
Intersegment sales	\$ (84)	\$ (109)	\$ (368)	\$ (502)	\$ (1,363)
Total identifiable assets at end of period	\$ 600,463	\$ 456,272	\$ 518,186	\$ 420,373	\$ 415,761

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	<b>Three Months Ended</b>		<b>Years Ended August 31,</b>		
	<b>November 30</b>		<b>Corporate and Other</b>		
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>	<b>(Dollars in thousands)</b>		
Revenues	\$ 7,306	\$ 7,324	\$ 33,175	\$ 30,672	\$ 31,466
Cost of goods sold	(13)		(1,091)	(1,049)	(802)
Gross profit	7,319	7,324	34,266	31,721	32,268
Marketing, general and administrative	5,874	6,065	26,949	25,053	23,777
Operating earnings	1,445	1,259	7,317	6,668	8,491
Gain on sale of investments				(336)	
Interest, net	(754)	285	116	(231)	(656)
Equity income from investments	(1,214)	(1,009)	(3,942)	(589)	(169)
Minority interests				1,036	1,347
Income from continuing operations before income taxes	\$ 3,413	\$ 1,983	\$ 11,143	\$ 6,788	\$ 7,969
Intersegment sales		\$ (589)	\$ (1,760)	\$ (1,602)	\$ (1,486)
Total identifiable assets at end of period	\$ 539,713	\$ 370,834	\$ 453,937	\$ 463,379	\$ 433,940

During the year ended August 31, 2004, we received cash proceeds and recorded gains of \$0.7 million, related to legal settlements from several vitamin product suppliers against whom we alleged certain price-fixing claims.



**Table of Contents****Supplementary Financial Information**

Supplementary financial information required by Item 302 of Regulation S-K for the three-month period ended November 30, 2006 and each quarter during the years ended August 31, 2006 and 2005 is presented below.

	<b>(Unaudited)</b> <b>(Dollars in thousands)</b>			
	<b>November 30,</b>			
	<b>2006</b>			
	<b>November 30,</b>		<b>2006</b>	
	<b>2005</b>	<b>February 28</b>	<b>May 31</b>	<b>August 31</b>
Revenues	\$ 3,413,018			
Gross profit	257,508			
Income from continuing operations	154,026			
Net income	154,234			
	<b>November 30,</b>		<b>2006</b>	
	<b>2005</b>	<b>February 28</b>	<b>May 31</b>	<b>August 31</b>
Revenues	\$ 3,453,549	\$ 3,156,834	\$ 3,743,021	\$ 4,030,431
Gross profit	254,481	114,668	218,528	225,651
Income from continuing operations	154,026	40,247	136,563	158,836
Net income	154,234	40,148	136,593	159,322
	<b>November 30,</b>		<b>2005</b>	
	<b>2004</b>	<b>February 28</b>	<b>May 31</b>	<b>August 31</b>
Revenues	\$ 2,962,923	\$ 2,425,199	\$ 3,133,597	\$ 3,405,243
Gross profit	108,450	88,108	151,348	129,198
Income from continuing operations	20,341	19,718	109,861	116,906
Net income	17,996	8,723	106,946	116,351

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

CHS Inc. (CHS, we or us) is a diversified company, which provides grain, foods and energy resources to businesses and consumers. As a cooperative, we are owned by farmers, ranchers and their local cooperatives from the Great Lakes to the Pacific Northwest and from the Canadian border to Texas. We also have preferred stockholders that own shares of our 8% Cumulative Redeemable Preferred Stock.

We provide a full range of production agricultural inputs such as refined fuels, propane, farm supplies, animal nutrition and agronomy products, as well as services, which include hedging, financing and insurance services. We own and operate petroleum refineries and pipelines and market and distribute refined fuels and other energy products under the Cenex<sup>®</sup> brand through a network of member cooperatives and independent retailers. We purchase grains and oilseeds directly and indirectly from agricultural producers primarily in the Midwestern and Western United States. These grains and oilseeds are either sold to domestic and international customers, or further processed into a variety of food products.

We have aligned our business segments based on an assessment of how our businesses operate and the products and services they sell. Our three business segments: Energy, Ag Business and Processing, create vertical integration to link producers with consumers. Our Energy segment produces and provides for the wholesale distribution of petroleum products and transports those products. Our Ag Business segment purchases and resells grains and oilseeds originated by our country operations business, by our member cooperatives and by third parties, and also serves as wholesaler and retailer of crop inputs. Our Processing segment converts grains and oilseeds into value-added products.

Summary data for each of our business segments for the fiscal years ended August 31, 2006, 2005 and 2004 and for the three-month periods ending November 30, 2005 and 2006 is shown on prior pages. Except as otherwise specified, references to years indicate our fiscal year ended August 31, 2006 or ended August 31 of the year referenced.

Corporate administrative expenses are allocated to all three business segments, and Corporate and Other, based on either direct usage for services that can be tracked, such as information technology and legal, and other factors or considerations relevant to the costs incurred.

Many of our business activities are highly seasonal and operating results will vary throughout the year. Overall, our income is generally lowest during the second fiscal quarter and highest during the third fiscal quarter. Our business segments are subject to varying seasonal fluctuations. For example in our Ag Business segment, agronomy and country operations businesses experience higher volumes and income during the spring planting season and in the fall, which corresponds to harvest. Also in our Ag Business segment, our grain marketing operations is subject to fluctuations in volume and earnings based on producer harvests, world grain prices and demand. Our Energy segment generally experiences higher volumes and profitability in certain operating areas, such as refined products, in the summer and early fall when gasoline and diesel fuel usage is highest and is subject to global supply and demand forces. Other energy products, such as propane, may experience higher volumes and profitability during the winter heating and crop drying seasons.

Our revenue can be significantly affected by global market prices for commodities such as petroleum products, natural gas, grains, oilseeds and flour. Changes in market prices for commodities that we purchase without a corresponding change in the selling prices of those products can affect revenues and operating earnings. Commodity prices are

affected by a wide range of factors beyond our control, including the weather, crop damage due to disease or insects, drought, the availability and adequacy of supply, government regulations and policies, world events, and general political and economic conditions.

While our revenues and operating results are derived from businesses and operations which are wholly-owned and majority-owned, a portion of our business operations are conducted through companies in which we hold ownership interests of 50% or less and do not control the operations. We account for these investments primarily using the equity method of accounting, wherein we record our proportionate share of

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income or loss reported by the entity as equity income from investments, without consolidating the revenues and expenses of the entity in our Consolidated Statements of Operations. These investments principally include our 50% ownership in each of the following companies: Agriliance LLC (Agriliance), TEMCO, LLC (TEMCO) and United Harvest, LLC (United Harvest) included in our Ag Business segment; Ventura Foods, LLC (Ventura Foods), our 24% ownership in Horizon Milling, LLC (Horizon Milling), and an approximate 24% ownership in US BioEnergy Corporation (US BioEnergy) included in our Processing segment; and our 49% ownership in Cofina Financial, LLC (Cofina) included in Corporate and Other.

Agriliance is owned and governed by United Country Brands, LLC (50%) and Land O Lakes, Inc. (50%). United Country Brands, LLC, was initially owned and governed 50% by us and 50% by Farmland Industries, Inc. (Farmland), and was formed solely to hold a 50% interest in Agriliance. On April 30, 2004, we purchased all of Farmland's remaining interest in Agriliance for \$27.5 million in cash. We now own 50% of the economic and governance interests in Agriliance, held through our 100% ownership interest in United Country Brands, LLC, and continue to account for this investment using the equity method of accounting.

In May 2005, we sold the majority of our Mexican foods business for proceeds of \$38.3 million resulting in a loss on disposition of \$6.2 million, with minor activity continuing in 2006. During the year ended August 31, 2006, we sold all of the remaining assets for proceeds of \$4.2 million and a gain of \$1.6 million. The operating results of the Mexican Foods business have been reclassified and reported as discontinued operations for all periods presented.

The consolidated financial statements include the accounts of CHS and all of our wholly-owned and majority-owned subsidiaries, including the National Cooperative Refinery Association (NCRA), which is in our Energy segment. All significant intercompany accounts and transactions have been eliminated.

Certain reclassifications have been made to prior year's amounts to conform to current year classifications. These reclassifications had no effect on previously reported net income, equities and comprehensive income, or total cash flows.

The Consolidated Statements of Cash Flows for the period ended November 30, 2005 and for the years ended August 31, 2005 and 2004 were restated to correct an error in the classification of our cash flows received from our interest in joint ventures and distributions made to minority owners. We determined that a portion of the cash flows from our joint ventures should have been considered a return on our investment and classified as an operating activity as distributions from equity investments, instead of as an investing activity. Additionally, we had previously reported distributions to minority owners as investing activities when they should have been classified as financing activities. The restatement did not have any impact on our Consolidated Statements of Operations, Consolidated Statements of Shareholders' Equities and Comprehensive Income, or total change in cash and cash equivalents on our Consolidated Statements of Cash Flows for the period ended November 30, 2005 and for the years ended August 31, 2005 and 2004. In addition, it did not have any impact on our Consolidated Balance Sheets as of November 30, 2005, August 31, 2005, or 2004.

## **Recent Events**

Subsequent to our fiscal year ended August 31, 2006, we made an additional investment of \$35.0 million in US BioEnergy, bringing our current ownership of the company to approximately 22% after the completion of the initial public offering of US BioEnergy, and also made investments in two new ventures. We invested approximately \$30.0 million in a Brazil-based grain handling and merchandising company named Multigrain S.A., that is owned jointly (50/50) with Multigrain Comercio, an agricultural commodities business headquartered in Sao Paulo, Brazil and will be included in our Ag Business segment. This venture, which includes grain storage and export facilities, builds on our South American soybean origination and helps meet customer needs year-round. Our grain marketing

operations continue to explore other opportunities to establish a presence in other emerging grain origination and export markets. We have also invested \$15.6 million in a new Horizon Milling venture (24% CHS ownership) that acquired the Canadian grain-based foodservice and industrial businesses of Smucker Foods of Canada, which includes three flour milling operations and two dry baking mixing facilities in Canada.

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Also subsequent to our fiscal year ended August 31, 2006, we sold 540,000 shares of our CF Industries Holding, Inc. (CFIH) stock for proceeds of \$10.9 million, and recorded a gain of \$5.3 million, reducing our ownership interest in CFIH to approximately 2.9%

**Results of Operations****Comparison of the three months ended November 30, 2006 and 2005**

*General.* We recorded income from continuing operations before income taxes of \$153.5 million during the three months ended November 30, 2006 compared to \$174.5 million during the three months ended November 30, 2005, a decrease of \$21.0 million (12%). These results reflected decreased pretax earnings in our Energy segment, partially offset by improved earnings in our Ag Business and Processing segments, and Corporate and Other.

Our Energy segment generated income from continuing operations before income taxes of \$111.3 million for the three months ended November 30, 2006 compared to \$146.0 million in the three months ended November 30, 2005. This decrease in earnings of \$34.7 million (24%) is primarily attributable to lower margins on refined fuels, which resulted mainly from changes in the refining capacity and global demand. With hurricane damage to gulf-coast refineries at the start of fiscal year 2006, the energy industry faced supply restrictions and distribution disruptions. This situation created wide margins for inland refineries not affected by the hurricanes during the fall of 2005. Earnings in our propane, renewable fuels marketing, transportation, and lubricants operations improved during the three months ended November 30, 2006 when compared to the same three-month period of the previous year. These improvements were partially offset by decreased earnings in our petroleum equipment businesses.

Our Ag Business segment generated income from continuing operations before income taxes of \$28.1 million for the three months ended November 30, 2006 compared to \$16.7 million in the three months ended November 30, 2005, an increase in earnings of \$11.4 million (68%). Strong domestic grain movement, much of it driven by increased US ethanol production, contributed to improved performance by both grain marketing and country operations businesses. Our country operations earnings increased \$9.1 million, primarily as a result of overall improved product margins, including historically high margins on energy, sunflower, agronomy and grain transactions. Market expansion into Oklahoma and Kansas also increased country operations volumes. Our grain marketing operations improved earnings by \$4.3 million during the three months ended November 30, 2006 compared with the same period in 2005, primarily from increased grain volumes and improved margins on those grains. Volatility in the grain markets creates opportunities for increased grain margins, and additionally during the current year, increased interest in renewable fuels, and changes in transportation costs shifted marketing patterns and dynamics for our grain marketing business. Additionally, during the three months ended November 30, 2006, we sold approximately 25% of our investment in CF Industries Holdings, Inc. (CF), a domestic fertilizer manufacturer in which we hold a minority interest, and we received cash of \$10.9 million and recorded a gain of \$5.3 million. These improvements in earnings in our country operations, grain marketing, partial sale of CF, and some of our agronomy businesses, were partially offset by reduced earnings generated by Agriliance, an agronomy joint venture in which we hold a 50% interest. Those results, net of allocated internal expenses, decreased \$7.3 million, primarily because of reduced wholesale crop nutrient margins, partially offset by improved retail and wholesale crop protection margins. Weather-interrupted supply patterns and resulting price fluctuations dramatically reduced crop nutrient use and sales during the year. High natural gas prices, increasing international demand for nitrogen, and hurricane damage to warehouse facilities and the resulting transportation grid, led to price increases early in fiscal 2006. Coupled with high energy costs and lower grain prices in early plant planning of 2006 many crop producers elected to scale back nutrient applications for the 2006 growing year. As a result, larger remaining inventories later in the year drove significant decline in realizable value of inventories and reduced revenues.

Our Processing segment generated income from continuing operations before income taxes of \$10.6 million for the three months ended November 30, 2006 compared to \$9.9 million in the three months ended November 30, 2005, an increase in earnings of \$0.7 million (7%). Our share of earnings from Ventura Foods,

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our packaged foods joint venture, increased \$2.7 million during the three months ended November 30, 2006, compared to the same period in the prior year, primarily from improved product margins. Our share of earnings from our wheat milling joint ventures reported similar earnings for the three months ended November 30, 2006, compared to the same period in the prior year. We recorded our share of pretax losses, net of internal expenses, related to US BioEnergy Corporation (US BioEnergy), an ethanol manufacturing company in which we hold a minority ownership interest, of \$0.9 million and \$0.1 million, respectively, for the three months ended November 30, 2006 and 2005. Oilseed processing earnings decreased \$1.3 million during the three months ended November 30, 2006 as compared to the same period in the prior year. This was primarily the result of reduced oilseed refining margins partially offset by improved crushing margins. While volumes stayed fairly consistent at our two crushing facilities, oilseed crushing margins showed significant improvement when comparing the three months ended November 30, 2006 with the same three-month period in the prior year.

Corporate and Other generated income from continuing operations before income taxes of \$3.4 million for the three months ended November 30, 2006 compared to \$2.0 million in the three months ended November 30, 2005, an increase in earnings of \$1.4 million (72%). All of this improvement is attributable to our business solutions operations where financing and hedging services both recorded increases in business volume compared to the same period of a year ago.

*Net Income.* Consolidated net income for the three months ended November 30, 2006 was \$136.3 million compared to \$154.2 million for the three months ended November 30, 2005, which represents a \$17.9 million (12%) decrease.

*Revenues.* Consolidated revenues of \$3.8 billion for the three months ended November 30, 2006 compared to \$3.5 billion for the three months ended November 30, 2005, which represents a \$297.6 million (9%) increase.

Total revenues include other revenues generated primarily within our Ag Business segment and Corporate and Other. Our Ag Business segment's country operations elevators and agri-service centers derives other revenues from activities related to production agriculture, which include grain storage, grain cleaning, fertilizer spreading, crop protection spraying and other services of this nature, and our grain marketing operations receives other revenues at our export terminals from activities related to loading vessels. Corporate and Other derives revenues primarily from our hedging and insurance operations.

Our Energy segment revenues, after elimination of intersegment revenues, of \$1.8 billion decreased \$20.1 million (1%) during the three months ended November 30, 2006 compared to the three months ended November 30, 2005. During the three months ended November 30, 2006 and 2005, our Energy segment recorded revenues from our Ag Business segment of \$67.8 million and \$55.6 million, respectively. The revenues net decrease of \$20.1 million is comprised of a net decrease of \$127.1 million related to price depreciation on refined fuels and propane products, partially offset by a \$107.0 million net increase in sales volume. The net change in revenues includes \$139.5 million from our ethanol marketing venture, which we acquired in April of fiscal 2006. Refined fuels revenues decreased \$92.2 million (7%), of which \$113.4 million was related to a net average selling price decrease, partially offset by \$21.2 million attributable to increased volumes, compared to the same period in the previous year. The sales price of refined fuels decreased \$0.17 per gallon (8%) and volumes increased 2% when comparing the three months ended November 30, 2006 with the same period a year ago. Lower crude oil prices during the first quarter of this fiscal year compared to the same three-month period last fiscal year were primarily attributable to the effects of the hurricanes in the United States during the fall of 2005. Primarily as a result of the hurricanes, we saw the affects of strong global demand and limited refining capacity, which contributed to the increases in refined fuels selling prices during fiscal 2006. Propane revenues decreased by \$57.0 million (27%), of which \$56.6 million was related to decreased volumes and \$0.4 million was related to a net average selling price decrease when compared to the same period in the previous year. Propane sales volume decreased 27% in comparison to the same period of the prior year, while the average selling price of propane was relatively unchanged. Propane prices tend to follow the prices of crude oil and natural



gas, both of which decreased during the three months ended November 30, 2006 compared to the same period in 2005. The decrease in propane volumes reflects a loss of

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exclusive propane marketing rights at our former supplier's proprietary terminals, and also milder temperatures in our trade area which affected the demand for home heating.

Our Ag Business segment revenues, after elimination of intersegment revenues, of \$1.8 billion increased \$315.0 million (21%) during the three months ended November 30, 2006 compared to the three months ended November 30, 2005. Grain revenues in our Ag Business segment totaled \$1,504.5 million and \$1,232.4 million during the three months ended November 30, 2006 and 2005, respectively. Of the grain revenues increase of \$272.1 million (22%), \$177.8 million is attributable to increased volumes and \$94.3 million is due to increased average grain selling prices during the three months ended November 30, 2006 compared to the same period last fiscal year. The average sales price of all grain and oilseed commodities sold reflected an increase of \$0.32 per bushel (8%). The 2006 fall harvest produced good yields throughout most of the United States, with the quality of most grains rated as excellent or good. Despite the good harvest, prices for nearly all grain commodity prices increased because of strong demand, particularly for corn which is used as the feedstock for most ethanol plants as well as for livestock feed. The higher average month-end market price per bushel of corn, spring wheat and soybeans were approximately \$1.24, \$1.15 and \$0.56, respectively, as compared to the prices of those same grains for the three months ended November 30, 2005. Volumes increased 13% during the three months ended November 30, 2006 compared with the same period of a year ago. Corn and soybeans reflect the largest volume increases compared to the three months ended November 30, 2005. Our Ag Business segment non-grain product revenues of \$265.8 million increased by \$39.8 million (18%) during the three months ended November 30, 2006 compared to the three months ended November 30, 2005, primarily the result of increased revenues of energy, crop nutrient, processed sunflower, crop protection, and feed products. Other revenues within our Ag Business segment of \$32.9 million during the three months ended November 30, 2006 increased \$3.1 million (10%).

Our Processing segment revenues, after elimination of intersegment revenues, of \$154.9 million increased \$2.1 million (1%) during the three months ended November 30, 2006 compared to the three months ended November 30, 2005. Because our wheat milling, renewable fuels and packaged foods operations are operated through non-consolidated joint ventures, revenues reported in our Processing segment are entirely from our oilseed processing operations. Processed soybean volumes increased 1%, accounting for an increase in revenues of \$0.9 million, and were partially offset by a lower average sales price of processed oilseed and other revenues which reduced total revenues for this segment by \$0.6 million. Oilseed refining revenues increased \$1.3 million (2%), of which \$1.1 million was due to higher average sales price and \$0.2 million was due to a slight net increase in sales volume. The average selling price of processed oilseed decreased \$1 per ton and the average selling price of refined oilseed products increased slightly compared to the same period of the previous year. These changes in the average selling price of products are primarily driven by the higher price of soybeans.

*Cost of Goods Sold.* Cost of goods sold of \$3.5 billion increased \$329.7 million (10%) during the three months ended November 30, 2006 compared to the three months ended November 30, 2005.

Our Energy segment cost of goods sold, after elimination of intersegment costs, of \$1.6 billion increased by \$25.1 million (2%) during the three months ended November 30, 2006 compared to the same period of the prior year. The net change in cost includes \$137.4 million from our ethanol marketing venture, which we acquired in April of fiscal 2006. The remaining change in cost of goods sold is primarily due to decreased average costs of refined fuels and propane products. On a more product-specific basis, the average cost of refined fuels decreased by \$0.19 (10%) per gallon, and was partially offset by a 2% increase in volumes compared to the three months ended November 30, 2005. We process approximately 55,000 barrels of crude oil per day at our Laurel, Montana refinery and 80,000 barrels of crude oil per day at NCRA's McPherson, Kansas refinery. The average cost decrease on refined fuels is reflective of lower input costs at our two crude oil refineries and lower average prices on the refined products that we purchased for resale compared to the three months ended November 30, 2005. The average per unit cost of crude oil purchased for the two refineries decreased 4% compared to the three months ended November 30, 2005. The propane

volumes decreased 27%, and the average cost of propane decreased \$0.01 (1%) compared to the three months ended November 30, 2005.

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Our Ag Business segment cost of goods sold, after elimination of intersegment costs, of \$1.7 billion increased \$300.9 million (21%) during the three months ended November 30, 2006 compared to the same period of the prior year. Grain cost of goods sold in our Ag Business segment totaled \$1,471.8 million and \$1,204.7 million during the three months ended November 30, 2006 and 2005, respectively. The cost of grains and oilseed procured through our Ag Business segment increased \$267.1 million (22%) compared to the three months ended November 30, 2005. This is primarily the result of a 13% increase in bushels sold along with an increase of \$0.32 (8%) average cost per bushel as compared to the prior year. Corn and soybeans reflected the largest volume increases compared to the three months ended November 30, 2005. Commodity prices on corn, spring wheat and soybeans have increased compared to the prices that were prevalent during the same three-month period in 2005. Our Ag Business segment cost of goods sold, excluding the cost of grains procured through this segment, increased during the three months ended November 30, 2006 compared to the three months ended November 30, 2005, primarily due to higher volumes in energy, crop nutrient, processed sunflower, crop protection and feed products.

Our Processing segment cost of goods sold, after elimination of intersegment costs of \$148.4 million, increased \$3.2 million (2%) compared to the three months ended November 30, 2005, which was primarily due to increased basis costs of soybeans.

*Marketing, General and Administrative.* Marketing, general and administrative expenses of \$52.1 million for the three months ended November 30, 2006 increased by \$2.5 million (5%) compared to the three months ended November 30, 2005. The net increase of \$2.5 million is primarily due to increased performance-based incentive plan expense, in addition to other employee benefits and general inflation.

*Gain on Sale of Investment.* During the three months ended November 30, 2006, we sold approximately 25% of our investment in CF. We received cash proceeds of \$10.9 million and recorded a gain of \$5.3 million, which is reflected within the results reported for our Ag Business segment.

*Interest, net.* Interest, net of \$7.7 million for the three months ended November 30, 2006 increased \$0.4 million (5%) compared to the three months ended November 30, 2005. Interest expense for the three months ended November 30, 2006 and 2005 was \$11.3 million and \$11.7 million, respectively. Interest income, generated primarily from marketable securities, was \$3.6 million and \$4.3 million, for the three months ended November 30, 2006 and 2005, respectively. The interest expense decrease of \$0.4 million (3%) includes an increase in capitalized interest of \$0.2 million, partially offset by an increase in short-term borrowings primarily created by higher working capital needs and an increase in the average short-term interest rate. For the three months ended November 30, 2006 and 2005, we capitalized interest of \$1.8 million and \$1.6 million, respectively, related to capitalized construction projects. The increase in capitalized interest relates to the financing interest on our coker project partially offset by the final stages of the ultra-low sulfur upgrades at our energy refineries during fiscal 2006. The average level of short-term borrowings increased \$24.3 million during the three months ended November 30, 2006 compared to the three months ended November 30, 2005, and the average short-term interest rate increased 1.42%. The interest income decrease of \$0.7 million (17%) was primarily in our Energy segment related to a decrease in interest income from short term investments, primarily at NCRA.

*Equity Income from Investments.* Equity income from investments of \$4.5 million for the three months ended November 30, 2006 decreased \$4.6 million (51%) compared to the three months ended November 30, 2005. We record equity income or loss from the investments in which we have an ownership interest of 50% or less and have significant influence, but not control, for our proportionate share of income or loss reported by the entity, without consolidating the revenues and expenses of the entity in our Consolidated Statements of Operations. The net decrease in equity income from investments was attributable to reduced earnings from investments within our Ag Business segment of \$8.3 million, and was partially offset by improved earnings within our Processing and Energy segments, and Corporate and Other of \$3.3 million, \$0.2 million and \$0.2 million, respectively.

Our Ag Business segment generated reduced earnings of \$8.3 million from equity investments. Our investment in a Canadian agronomy joint venture contributed improved earnings of \$0.3 million. Our share of equity investment earnings in Agriliance decreased \$7.8 million and primarily relates to reduced crop nutrient

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margins. Weather-interrupted supply patterns and resulting wide price fluctuations dramatically reduced crop nutrient use and sales during fiscal 2006. High natural gas prices, increasing international demand for nitrogen, and hurricane damage to warehouse facilities and the related transportation grid led to price increases during fiscal 2006. Coupled with high energy costs and low grain prices, many crop producers elected to scale back nutrient applications for the 2006 growing year. As a result, larger remaining inventories later in the year drove significant declines in realizable value of inventories and reduced revenues. The Agriliance retail operations and crop protection margins showed slight improvements over the three months ended November 30, 2005. Our wheat exporting investment in United Harvest contributed slightly reduced earnings of \$0.2 million, and our equity income from our investment in TEMCO, a joint venture which exports primarily corn and soybeans, also recorded slightly reduced earnings of \$0.1 million. Our country operations reported decreases in equity investment earnings of \$0.5 million.

Our Processing segment generated improved earnings of \$3.3 million from equity investments. Ventura Foods, our vegetable oil-based products and packaged foods joint venture, recorded improved earnings of \$2.7 million, and Horizon Milling, our domestic and Canadian wheat milling joint ventures, recorded slightly reduced earnings of \$0.1 million compared to the same period in the previous year. During fiscal years 2006 and 2007, we invested \$105.0 million in US BioEnergy, an ethanol manufacturing company, and recorded earnings of \$0.6 million during the three months ended November 30, 2006. A shifting demand balance for soybeans for both food and renewable fuels meant addressing supply and price challenges for both CHS and our joint venture with Ventura Foods. Horizon Milling's results are primarily affected by US dietary habits. Although the preference for a low carbohydrate diet appears to have reached the bottom of its cycle, milling capacity, which had been idled over the past few years because of lack of demand for flour products, can easily be put back in production as consumption of flour products increases, which will continue to depress gross margins in the milling industry.

Our Energy segment generated increased equity investment earnings of \$0.2 million related to improved margins in an NCRA equity investment, and Corporate and Other generated improved earnings of \$0.2 million from equity investment earnings, primarily from Cofina, our financial services equity investment, and from an insurance equity investment as compared to the three months ended November 30, 2005.

*Minority Interests.* Minority interests of \$18.9 million for the three months ended November 30, 2006 decreased by \$13.2 million (41%) compared to the three months ended November 30, 2005. This net decrease was a result of less profitable operations within our majority-owned subsidiaries compared to the same three-month period in the prior year. Substantially all minority interests relate to NCRA, an approximately 74.5% owned subsidiary, which we consolidate in our Energy segment.

*Income Taxes.* Income tax expense, excluding discontinued operations, of \$17.2 million for the three months ended November 30, 2006 compares with \$20.5 million for the three months ended November 30, 2005, resulting in effective tax rates of 11.2% and 11.7%, respectively. The federal and state statutory rate applied to nonpatronage business activity was 38.9% for the three-month periods ended November 30, 2006 and 2005. The income taxes and effective tax rate vary each year based upon profitability and nonpatronage business activity during each of the comparable years.

*Discontinued Operations.* During fiscal 2005, we reclassified our Mexican foods operations, previously reported in Corporate and Other, along with gains and losses recognized on sales of assets, and impairments on assets for sale, as discontinued operations that were sold or have met required criteria for such classification. In our Consolidated Statements of Operations, all of our Mexican foods operations have been accounted for as discontinued operations. The income recorded for the three months ended November 30, 2005 was \$0.3 million (\$0.2 million in income, net of taxes), primarily the result of the sale of our remaining assets.



**Table of Contents****Comparison of the years ended August 31, 2006 and 2005**

*General.* We recorded income from continuing operations before income taxes of \$539.0 million in fiscal 2006 compared to \$297.3 million in fiscal 2005, an increase of \$241.7 million (81%). These results reflected increased pretax earnings in our Energy and Processing segments, and Corporate and Other, partially offset by slightly decreased earnings in our Ag Business segment.

Our Energy segment generated income from continuing operations before income taxes of \$407.6 million for the year ended August 31, 2006 compared to \$185.2 million in the prior year. This increase in earnings of \$222.4 million (120%) is primarily attributable to higher margins on refined fuels, which resulted mainly from limited refining capacity and increased global demand. With hurricane damage at the start of the fiscal year, the energy industry faced supply restrictions and distribution disruptions. Pipelines owned and operated by a third party were shut down to repair areas of corrosion and leaks. This factor also limited crude oil volumes. Earnings in our propane and transportation operations also improved compared to the previous year. These improvements were partially offset by decreased earnings in our lubricants and petroleum equipment businesses.

Our Ag Business segment generated income from continuing operations before income taxes of \$91.7 million for the year ended August 31, 2006 compared to \$92.1 million in the prior year, a decrease in earnings of \$0.4 million (less than 1%). Strong domestic grain movement, much of it driven by increased US ethanol production, contributed to record performance by both country operations and grain marketing businesses. Our country operations earnings increased \$14.3 million, primarily as a result of increased grain volumes and overall improved product margins, including historically high margins on grain and energy transactions. Market expansion into Oklahoma and Kansas also increased country operations volumes. Our grain marketing operations improved earnings by \$11.0 million in fiscal 2006 compared with 2005, primarily from increased grain volumes and improved margins on those grains. Volatility in the grain markets creates opportunities for increased grain margins, and additionally during the current year, increased interest in renewable fuels, and higher transportation costs shifted marketing patterns and dynamics for our grain marketing business. These improvements in earnings in our country operations and grain marketing businesses were partially offset by reduced earnings generated through our wholesale and retail agronomy ownership interests, primarily Agrilience, net of allocated internal expenses, which decreased \$16.1 million, primarily in reduced crop nutrient and crop protection margins. Weather-interrupted supply patterns and resulting price fluctuations dramatically reduced crop nutrient use and sales during the year. High natural gas prices, increasing international demand for nitrogen, and hurricane damage to warehouse facilities and the resulting transportation grid led to price increases early in the year. Coupled with high energy costs and low grain prices, many crop producers elected to scale back nutrient applications for the 2006 growing year. As a result, larger remaining inventories later in the year drove significant devaluation and reduced revenues.

Also affecting the agronomy business of our Ag Business segment, during the first quarter of fiscal 2005 we evaluated the carrying value of our investment in CF Industries, Inc. (CF), a domestic fertilizer manufacturer in which we held a minority interest. Our carrying value at that time of \$153.0 million consisted primarily of non-cash patronage refunds received from CF over the years. Based upon indicative values from potential strategic buyers for the business and through other analyses, we determined at that time that the carrying value of our CF investment should be reduced by \$35.0 million, resulting in an impairment charge to our first quarter in fiscal 2005. The net effect to first fiscal quarter in 2005 income after taxes was approximately \$32.1 million.

In February 2005, after reviewing indicative values from strategic buyers, the board of directors of CF determined that a greater value could be derived for the business through an initial public offering of stock in the company. The initial public offering was completed in August 2005. Prior to the initial public offering, we held an ownership interest of approximately 20% in CF. Through the initial public offering, we sold approximately 81% of our ownership interest for cash proceeds of approximately \$140.4 million. Our book basis in the portion of our ownership interest sold



through the initial public offering, after the \$35.0 million impairment charge recognized in our first fiscal quarter results, was \$95.8 million. As a result, we recognized a pretax gain of \$44.6 million on the sale of that ownership interest during the fourth quarter of fiscal 2005.

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This gain, net of the impairment loss of \$35.0 million recognized during the first quarter of fiscal 2005, resulted in a \$9.6 million pretax gain recognized during fiscal 2005. The net effect to fiscal 2005 income, after taxes, was approximately \$8.8 million.

Our Processing segment generated income from continuing operations before income taxes of \$28.5 million for the year ended August 31, 2006 compared to \$13.2 million in the prior year, an increase in earnings of \$15.3 million (116%). Oilseed processing earnings increased \$13.8 million, which was primarily the result of improved crushing margins, partially offset by slightly decreased oilseed refining margins. Contrasting the two years, the soybean harvest in the geographical area near our two crushing facilities was greatly improved in the fall of 2005 (fiscal 2006) compared with the fall of 2004 (fiscal 2005) harvest. During fiscal 2005, basis levels we paid for soybeans were higher than in most of the other soybean producing areas of the country. The improved 2005 fall harvest (fiscal 2006) normalized soybean prices in our geographical area. These lower soybean prices translated into lower raw material costs and higher volumes of soybeans crushed at our two crushing facilities. Our share of earnings from Horizon Milling, our wheat milling joint venture, increased \$1.9 million for the year ended August 31, 2006 compared to the prior year. In addition, we recorded a loss of \$2.4 million in fiscal 2005 on the disposition of wheat milling equipment at a closed facility. Our share of earnings from Ventura Foods, our packaged foods joint venture, decreased \$2.0 million compared to the prior year. During fiscal 2006, we invested \$70.0 million in US BioEnergy, an ethanol manufacturing company, in which we recorded a loss of \$0.7 million, including allocated interest and internal expenses the pretax loss was \$3.2 million.

Corporate and Other generated income from continuing operations before income taxes of \$11.1 million for the year ended August 31, 2006 compared to \$6.8 million in the prior year, an increase in earnings of \$4.3 million (64%). The primary increase in earnings resulted from our business solutions operations which reflected improved earnings of \$4.2 million, primarily as a result of improved hedging and financial services income and reduced internal expenses.

*Net Income.* Consolidated net income for the year ended August 31, 2006 was \$490.3 million compared to \$250.0 million for the year ended August 31, 2005, which represents a \$240.3 million (96%) increase.

*Revenues.* Consolidated revenues of \$14.4 billion for the year ended August 31, 2006 compared to \$11.9 billion for the year ended August 31, 2005, which represents a \$2,456.9 million (21%) increase.

Total revenues include other revenues generated primarily within our Ag Business segment and Corporate and Other. Our Ag Business segment's country operations elevator and agri-service centers derives other revenues from activities related to production agriculture, which include grain storage, grain cleaning, fertilizer spreading, crop protection spraying and other services of this nature, and our grain marketing operations receives other revenues at our export terminals from activities related to loading vessels.

Our Energy segment revenues, after elimination of intersegment revenues, of \$7.2 billion increased \$1,548.3 million (28%) during the year ended August 31, 2006 compared to the year ended August 31, 2005. During the years ended August 31, 2006 and 2005, our Energy segment recorded revenues to our Ag Business segment of \$242.4 million and \$170.6 million, respectively. The revenues increase of \$1,548.3 million is comprised of a net increase of \$1,490.1 million related to price appreciation on refined fuels and propane products and \$58.2 million related to a net increase in sales volume. Refined fuels revenues increased \$1,186.1 million (28%), of which \$1,452.4 million was related to a net average selling price increase, partially offset by \$266.3 million, which was related to decreased volumes, compared to the same period in the previous year. The increased revenues also included \$220.6 million from ethanol marketing, which was partially offset by decreased volumes of other refined fuels and propane products. The sales price of refined fuels increased \$0.53 per gallon (35%) and volumes decreased 5% when comparing the year ended August 31, 2006 with the same period a year ago. Higher crude oil prices, strong global demand and limited refining capacity contributed to the increase in refined fuels selling prices. The decrease in refined fuels volumes

reflects intentional reduction of lower margin unbranded volumes. Propane revenues increased by \$57.8 million (9%), of which \$125.8 million was related to a net average selling price increase, partially offset by \$68.0 million which was related to decreased volumes compared to the same period in the previous year. Propane prices increased \$0.17 per gallon (19%) and sales volume decreased 9% in comparison to the same

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period of the prior year. Propane prices tend to follow the prices of crude oil and natural gas, both of which increased during the year ended August 31, 2006 compared to the same period in 2005. The decrease in propane volumes reflects a loss of exclusive propane marketing rights at our former supplier's proprietary terminals.

Our Ag Business segment revenues, after elimination of intersegment revenues, of \$6.6 billion increased \$905.4 million (16%) during the year ended August 31, 2006 compared to the year ended August 31, 2005. Grain revenues in our Ag Business segment totaled \$5,337.2 million and \$4,613.6 million during the years ended August 31, 2006 and 2005, respectively. Of the grain revenues increase of \$723.6 million (16%), \$647.0 million is attributable to increased volumes and \$76.6 million due to increased average selling grain prices during the year ended August 31, 2006 compared to the same period last fiscal year. The average sales price of all grain and oilseed commodities sold reflected an increase of \$0.07 per bushel (2%). Commodity prices in general increased following a strong fall 2005 harvest that produced good yields throughout most of the United States, with the quality of most grains rated as excellent or good. The higher average market price per bushel of spring wheat and corn were approximately \$0.74 and \$0.15, respectively, partially offset by lower average market price per bushel of soybeans of approximately \$0.15, as compared to the prices of those same grains for the year ended August 31, 2005. Volumes increased 14% during the year ended August 31, 2006 compared with the same period of a year ago. Corn, winter wheat and soybeans reflect the largest volume increases compared to the year ended August 31, 2005. While some areas of the US experienced drought conditions it appears there will be a large harvest in 2006, which is well underway in most of the geographical areas covered by our country elevator system. Our Ag Business segment non-grain revenues of \$1.2 billion increased by \$181.8 million (17%) during the year ended August 31, 2006 compared to the year ended August 31, 2005, primarily the result of increased revenues of energy, crop nutrient, feed and crop protection products, in addition to seed and processed sunflower revenues. The average selling price of energy products increased due to overall market conditions while volumes were fairly consistent to the year ended August 31, 2005.

Our Processing segment revenues, after elimination of intersegment revenues, of \$614.1 million increased \$0.8 million (less than 1%) during the year ended August 31, 2006 compared to the year ended August 31, 2005. Because our wheat milling and packaged foods operations are operated through non-consolidated joint ventures, revenues reported in our Processing segment are entirely from our oilseed processing operations. Processed soybean volumes increased 10%, accounting for an increase in revenues of \$22.6 million, and were partially offset by lower average sales price of processed oilseed and other revenues which reduced revenues by \$21.8 million. Oilseed refining revenues decreased \$14.3 million (5%), of which \$9.3 million was due to lower average sales price and \$5.0 million was due to a 2% net decrease in sales volume. The average selling price of processed oilseed decreased \$7 per ton and the average selling price of refined oilseed products decreased \$0.01 per pound compared to the same period of the previous year. These changes in the selling price of products are primarily driven by the average price of soybeans.

*Cost of Goods Sold.* Cost of goods sold of \$13.6 billion increased \$2.1 billion (19%) during the year ended August 31, 2006 compared to the year ended August 31, 2005.

Our Energy segment cost of goods sold, after elimination of intersegment costs, of \$6.6 billion increased by \$1,275.1 million (24%) during the year ended August 31, 2006 compared to the same period of the prior year, primarily due to increased average costs of refined fuels and propane products. On a more product-specific basis, the average cost of refined fuels increased by \$0.49 (33%) per gallon, which included an increased cost of \$220.8 million from ethanol marketing, and was partially offset by a 5% decrease in volumes compared to the year ended August 31, 2005. We process approximately 55,000 barrels of crude oil per day at our Laurel, Montana refinery and 80,000 barrels of crude oil per day at NCRA's McPherson, Kansas refinery. The average cost increase on refined fuels is reflective of higher input costs at our two crude oil refineries and higher average prices on the refined products that we purchased for resale compared to the year ended August 31, 2005. The average per unit cost of crude oil purchased for the two refineries increased 16% compared to the year ended August 31, 2005. The average cost of propane increased \$0.16 (19%) per gallon, partially offset by a 9% decrease in volumes compared to the year ended August 31,

2005. The average price of propane increased due to higher procurement costs.

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Our Ag Business segment cost of goods sold, after elimination of intersegment costs, of \$6.4 billion increased \$861.1 million (16%) during the year ended August 31, 2006 compared to the same period of the prior year. Grain cost of goods sold in our Ag Business segment totaled \$5,265.3 million and \$4,550.2 million during the years ended August 31, 2006 and 2005, respectively. The cost of grains and oilseed procured through our Ag Business segment increased \$715.1 million (16%) compared to the year ended August 31, 2005. This is primarily the result of a 14% increase in bushels along with an increase of \$0.07 (2%) average cost per bushel as compared to the prior year. Corn, winter wheat and soybeans reflected the largest volume increases compared to the year ended August 31, 2005. Commodity prices on spring wheat and corn have increased, while soybeans commodity prices showed an average decrease, compared to the prices that were prevalent during the majority of fiscal 2005. Our Ag Business segment cost of goods sold, excluding the cost of grains procured through this segment, increased during the year ended August 31, 2006 compared to the year ended August 31, 2005, primarily due to energy, crop nutrient, feed and crop protection products, in addition to seed and processed sunflower products. The average cost of energy products increased due to overall market conditions while volumes stayed fairly consistent to the year ended August 31, 2005.

Our Processing segment cost of goods sold, after elimination of intersegment costs, of \$588.4 million decreased \$15.3 million (3%) compared to the year ended August 31, 2005, which was primarily due to decreased input costs of soybeans processed at our two crushing plants, partially offset by higher volumes of soybeans processed at those plants.

*Marketing, General and Administrative.* Marketing, general and administrative expenses of \$231.2 million for the year ended August 31, 2006 increased by \$31.9 million (16%) compared to the year ended August 31, 2005. The net increase of \$31.9 million is primarily due to increased performance-based incentive plan expense, in addition to other compensation benefits, pension and general inflation.

*Gain on Sale of Investments.* During the fourth quarter of fiscal 2005, we sold approximately 81% of our investment in CF Industries, Inc. through an initial public offering of our equity in that company. We received cash proceeds of \$140.4 million and recorded a gain of \$9.6 million, net of an impairment charge of \$35.0 million recognized during the first quarter of fiscal 2005. This gain is reflected within the results reported for our Ag Business segment.

During the second quarter of fiscal 2005, we sold stock representing a portion of our investment in a publicly-traded company for cash proceeds of \$7.4 million and recorded a gain of \$3.4 million.

*Interest, net.* Interest, net of \$41.3 million for the year ended August 31, 2006 decreased \$0.2 million (less than 1%) compared to the year ended August 31, 2005. Interest expense for the years ended August 31, 2006 and 2005 was \$50.6 million and \$51.5 million, respectively. Interest income, primarily from marketable securities, for the years ended August 31, 2006 and 2005 was \$9.3 million and \$10.0 million, respectively. The interest expense decrease of \$0.9 million (2%), includes a decrease of short-term borrowings primarily related to reduced working capital, partially offset by an increase in the average short-term interest rate and a reduction in capitalized interest. For the fiscal years ended August 31, 2006 and 2005, we capitalized interest of \$4.7 million and \$6.8 million, respectively, related to capitalized construction projects. The reduction in capitalized interest relates to the interest on financing the final stages of the ultra-low sulfur upgrades at our energy refineries. The average level of short-term borrowings decreased \$143.4 million during fiscal 2006 compared to the year ended August 31, 2005, while the average short-term interest rate increased 1.50%. The interest income decrease of \$0.7 million (8%) was primarily in our Energy segment related to a decrease in interest income from short term investments, primarily at NCRA.

*Equity Income from Investments.* Equity income from investments of \$84.2 million for the year ended August 31, 2006 decreased \$11.6 million (12%) compared to the year ended August 31, 2005. We record equity income or loss from the investments in which we have an ownership interest of 50% or less and have significant influence, but not control, for our proportionate share of income or loss reported by the entity, without consolidating the revenues and

expenses of the entity in our Consolidated Statements of Operations. The net decrease in equity income from investments was attributable to reduced earnings from investments within our Ag Business and Processing segments of \$14.6 million and \$0.7 million, respectively and was

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partially offset by improved earnings within our Energy segment and Corporate and Other of \$0.4 million and \$3.3 million, respectively.

Our Ag Business segment generated reduced earnings of \$14.6 million from equity investments. Our investments in a Canadian joint venture contributed reduced earnings of \$1.5 million. Our share of equity investment earnings in Agrilience decreased \$12.4 million and primarily relates to reduced crop nutrient and crop protection margins. Weather-interrupted supply patterns and resulting wide price fluctuations dramatically reduced crop nutrient use and sales during the year. High natural gas prices, increasing international demand for nitrogen, and hurricane damage to warehouse facilities and the related transportation grid led to price increases early in the year. Coupled with high energy costs and low grain prices, many crop producers elected to scale back nutrient applications for the 2006 growing year. As a result, larger remaining inventories later in the year drove significant devaluation and reduced revenues. Our equity income from our investment in TEMCO, a joint venture, which exports primarily corn and soybeans, recorded reduced earnings primarily on logistics of \$4.2 million, while our wheat exporting investment in United Harvest contributed improved earnings of \$2.4 million. Our country operations reported increases in equity investments of \$1.1 million.

Our Processing segment generated reduced earnings of \$0.7 million from equity investments. Ventura Foods, our vegetable oil-based products and packaged foods joint venture, recorded reduced earnings of \$2.0 million, partially offset by Horizon Milling, our wheat milling joint venture, which recorded improved earnings of \$1.9 million compared to the same period in the previous year. During 2006, we invested \$70.0 million in US BioEnergy Corporation (US BioEnergy), an ethanol manufacturing company, representing an approximate 24% ownership and recorded losses of \$0.7 million. A shifting demand balance for soybeans for both food and renewable fuels meant addressing supply and price challenges for both CHS and our joint venture with Ventura Foods. Ventura Foods also completed integration of its dressing and dips acquisition, and exited a large part of its nutritional products business, all of which resulted in increased general expenses. Horizon Milling's results are primarily affected by US dietary habits. Although the preference for a low carbohydrate diet appears to have reached the bottom of its cycle, milling capacity, which had been idled over the past few years because of lack of demand for flour products, can easily be put back in production as consumption of flour products increases, which will continue to depress gross margins in the milling industry.

Our Energy segment generated improved earnings of \$0.4 million related to improved margins in an NCRA equity investment, and Corporate and Other generated improved earnings of \$3.3 million from equity investments, primarily from Cofina, our financial services equity investment, as compared to the year ended August 31, 2005.

*Minority Interests.* Minority interests of \$86.0 million for the year ended August 31, 2006 increased by \$38.2 million (80%) compared to the year ended August 31, 2005. This net increase was a result of more profitable operations within our majority-owned subsidiaries compared to the prior year. Substantially all minority interests relate to NCRA, an approximately 74.5% owned subsidiary, which we consolidate in our Energy segment.

*Income Taxes.* Income tax expense, excluding discontinued operations, of \$49.3 million for the year ended August 31, 2006 compares with \$30.4 million for the year ended August 31, 2005, resulting in effective tax rates of 9.2% and 10.2%, respectively. The federal and state statutory rate applied to nonpatronage business activity was 38.9% for the years ended August 31, 2006 and 2005. The income taxes and effective tax rate vary each year based upon profitability and nonpatronage business activity during each of the comparable years.

*Discontinued Operations.* During the year ended August 31, 2005, we reclassified our Mexican foods operations, previously reported in Corporate and Other, along with gains and losses recognized on sales of assets, and impairments on assets for sale, as discontinued operations that were sold or have met required criteria for such classification. In our Consolidated Statements of Operations, all of our Mexican foods operations have been accounted



for as discontinued operations. The amounts recorded for the years ended August 31, 2006 and 2005 were \$1.0 million income (\$0.6 million in income, net of taxes), primarily the result of the sale of remaining assets, and \$27.5 million loss (\$16.8 million loss, net of taxes), respectively.

**Table of Contents****Comparison of the years ended August 31, 2005 and 2004**

*General.* We recorded income from continuing operations before income taxes of \$297.3 million in fiscal 2005 compared to \$256.7 million in fiscal 2004, an increase of \$40.6 million (16%). These results reflected increased pretax earnings in our Ag Business and Energy segments, partially offset by decreased earnings in our Processing segment, and Corporate and Other.

Our Energy segment generated income from continuing operations before income taxes of \$185.2 million for the year ended August 31, 2005 compared to \$156.4 million in the prior year. This increase in earnings of \$28.8 million (18%) was primarily attributable to higher margins on refined fuels, which resulted mainly from limited refining capacity and increased global demand. Earnings in our lubricants operations also improved compared to the previous year. These improvements were partially offset by decreased earnings in our propane and transportation businesses.

Our Ag Business segment generated income from continuing operations before income taxes of \$92.1 million for the year ended August 31, 2005 compared to \$63.2 million in the prior year, an increase in earnings of \$28.9 million (46%). All three operations that comprise this business segment generated improved earnings in fiscal 2005 compared to fiscal 2004 results. Our grain marketing operations improved earnings by \$5.8 million in fiscal 2005 compared with fiscal 2004, of which \$11.3 million of the increase is attributable to a situation in fiscal 2004 involving export contracts to China. During fiscal 2004, we, along with several other international grain marketing companies, experienced contract issues with Chinese customers for soybeans. Because the market value of soybeans had declined between the date of the contracts and the delivery date, certain Chinese customers indicated their intent of nonperformance on these contracts. At that time, based upon our assessment of the impact of default, we valued those contracts at \$18.5 million less than current market value, which was recorded as an addition to cost of goods sold in 2004. Our country operations earnings increased \$2.1 million, primarily as a result of improved margins. Strong export demand to Asia favored shuttle train movement to the west coast, and many of our country elevators were positioned to take advantage of that market. Our share of agronomy earnings generated through our ownership interests, primarily Agrilience, net of certain allocated internal expenses, increased \$11.3 million. Strong grain prices during 2004 encouraged producers to increase planted acres and to purchase agronomy products to optimize yields in 2005.

Also affecting the agronomy business of our Ag Business segment, during the first quarter of fiscal 2005, we evaluated the carrying value of our investment in CF Industries, Inc. (CF), a domestic fertilizer manufacturer in which we held a minority interest. Our carrying value at that time of \$153.0 million consisted primarily of non-cash patronage refunds received from CF over the years. Based upon indicative values from potential strategic buyers for the business and through other analyses, we determined at that time that the carrying value of our CF investment should be reduced by \$35.0 million, resulting in an impairment charge to our first quarter in fiscal 2005. The net effect to first fiscal quarter in 2005 income after taxes was approximately \$32.1 million.

In February 2005, after reviewing indicative values from strategic buyers, the board of directors of CF determined that a greater value could be derived for the business through an initial public offering of stock in the company. The initial public offering was completed in August 2005. Prior to the initial public offering, we held an ownership interest of approximately 20% in CF. Through the initial public offering, we sold approximately 81% of our ownership interest for cash proceeds of approximately \$140.4 million. Our book basis in the portion of our ownership interest sold through the initial public offering, after the \$35.0 million impairment charge recognized in our first fiscal quarter results, was \$95.8 million. As a result, we recognized a pretax gain of \$44.6 million on the sale of that ownership interest during the fourth quarter of fiscal 2005. This gain, net of the impairment loss of \$35.0 million recognized during the first quarter of fiscal 2005, resulted in a \$9.6 million pretax gain recognized during fiscal 2005. The net effect to fiscal 2005 income, after taxes, was approximately \$8.8 million.

Our Processing segment generated income from continuing operations before income taxes of \$13.2 million for the year ended August 31, 2005 compared to \$29.1 million in the prior year, a decrease in earnings of \$15.9 million (55%). Oilseed processing earnings decreased \$21.7 million, which was primarily the result of lower crushing margins, partially offset by improved oilseed refining margins. The lower crushing margins

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were due to higher raw material costs and crushing over-capacity in the geographical area around our plants. Higher demand for soybeans in foreign markets had increased the cost of soybeans used in our crushing operations, and lower-cost soybeans from areas less affected by export demand allowed soybean meal to be shipped into our trade area at costs competitive with our own. This basis difference in the price of soybeans in our geographical area compared to other areas of the country also impaired our ability to ship soybean meal to more distant markets with less local crushing capacity, which resulted in poor margins on soybean meal. Refined soybean oil, which has more of a national market, enjoyed improved margins over those generated in the prior fiscal year. Our share of earnings from Horizon Milling, our wheat milling joint venture, decreased \$2.4 million for the year ended August 31, 2005 compared to the prior year. In addition, we recorded a loss of \$2.4 million in fiscal 2005 on the disposition of wheat milling equipment at a closed facility. Partially offsetting these decreases in earnings was our share of earnings from Ventura Foods, our packaged foods joint venture, which increased \$8.5 million compared to the prior year. Ventura Foods experienced rapidly increasing soybean oil costs in fiscal 2004 which could not be passed on to customers as quickly as the additional costs were incurred. During fiscal 2005, soybean oil costs were less volatile which allowed Ventura Foods to adjust sales prices and even increase market share for several categories of products.

Corporate and Other generated income from continuing operations before income taxes of \$6.8 million for the year ended August 31, 2005 compared to \$8.0 million in the prior year, a decrease in earnings of \$1.2 million (15%). The primary decrease in earnings was in our business solutions operations which reflected decreased earnings of \$1.1 million, primarily as a result of reduced hedging and insurance income. Less volatility in grain prices affected hedging commissions and lower insurance premiums, upon which we are paid a commission, reduced insurance income.

*Net Income.* Consolidated net income for the year ended August 31, 2005 was \$250.0 million compared to \$221.3 million for the year ended August 31, 2004, which represents a \$28.7 million (13%) increase.

*Revenues.* Consolidated revenues of \$11.9 billion for the year ended August 31, 2005 compared to \$11.0 billion for the year ended August 31, 2004, which represents a \$957.9 million (9%) increase.

Total revenues include other revenues generated primarily within our Ag Business segment and Corporate and Other. Our Ag Business segment's country operations elevator and agri-service centers derives other revenues from activities related to production agriculture, which include grain storage, grain cleaning, fertilizer spreading, crop protection spraying and other services of this nature, and our grain marketing operations receives other revenues at our export terminals from activities related to loading vessels.

Our Energy segment revenues, after elimination of intersegment revenues, of \$5.6 billion increased \$1,706.3 million (44%) during the year ended August 31, 2005 compared to the year ended August 31, 2004. During the years ended August 31, 2005 and 2004, our Energy segment recorded revenues to our Ag Business segment of \$170.6 million and \$121.2 million, respectively. The revenues increase of \$1,706.3 million was comprised of a net increase of \$1,549.8 million related to price appreciation on refined fuels and propane products and \$156.5 million related to a net increase in sales volume. Refined fuels revenues increased \$1,360.6 million (48%), of which \$1,112.5 million was related to a net average selling price increase and \$248.1 million was related to in