

CHS INC
Form 424B1
March 05, 2004

DATED MARCH 4, 2004

PROSPECTUS

479,315 Shares

CHS Inc.

8% Cumulative Redeemable Preferred Stock

We are issuing 479,315 shares of our 8% Cumulative Redeemable Preferred Stock to redeem \$12,989,436.50 of our patrons equities that have been outstanding for at least 10 years and that are held by active members. For those members whose redemption amount is less than \$500, that amount will be paid in cash. For those members whose redemption amount is equal to or greater than \$500, that amount will be paid by the issuance of preferred stock, subject to the exceptions described below in Plan of Distribution. 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 \$27.10, which is the greater of \$25.36 (equal to the \$25.00 liquidation preference per share of preferred stock plus \$0.36 of accumulated dividends from and including January 1, 2004 to and including March 4, 2004) and the \$27.10 closing price for one share of the preferred stock on The NASDAQ National Market on March 2, 2004. We will not issue any fractional shares of preferred stock. The amount of patrons equities that would otherwise be issued as a fractional share to any member will instead be retained as part of that member's patrons equities. 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 National Market under the trading symbol CHSCP. On March 2, 2004 the closing price of the preferred stock was \$27.10 per share.

Ownership of our preferred stock involves risks. See Risk Factors beginning on page 7.

We expect to issue the preferred stock on or about March 8, 2004.

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 March 4, 2004.

TABLE OF CONTENTS

| | Page |
|--|------|
| IMPORTANT INFORMATION ABOUT THIS PROSPECTUS | 1 |
| PROSPECTUS SUMMARY | 2 |
| RISK FACTORS | 7 |
| USE OF PROCEEDS | 12 |
| BUSINESS | 12 |
| MEMBERSHIP IN CHS AND AUTHORIZED CAPITAL | 24 |
| SELECTED CONSOLIDATED FINANCIAL DATA | 27 |
| MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS | 30 |
| QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK | 50 |
| DESCRIPTION OF THE PREFERRED STOCK | 51 |
| COMPARISON OF RIGHTS OF HOLDERS OF PATRONS' EQUITIES AND RIGHTS OF HOLDERS OF PREFERRED STOCK | 55 |
| MATERIAL FEDERAL INCOME TAX CONSEQUENCES | 56 |
| PLAN OF DISTRIBUTION | 59 |
| LEGAL MATTERS | 60 |
| EXPERTS | 60 |
| WHERE YOU CAN FIND MORE INFORMATION | 60 |
| SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS | 61 |
| INDEX TO CONSOLIDATED FINANCIAL STATEMENTS | F-i |

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, CHS Cooperatives, Cenex Harvest States Cooperatives, the Company, we, our and us refer to CHS Inc., a Minnesota cooperative, 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.

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 that is important to you and you should 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. is 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 buy commodities from and provide products and services to our members and other customers. 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, 2003, our total revenues were \$9.4 billion.

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

Only producers of agricultural products and associations of producers of agricultural products may be members of CHS. Our earnings or losses derived from business conducted with these members are allocated to members based on the volume of business they do with us. Members receive earnings in the form of patronage refunds in cash and patron's equities, which may be redeemed over time. Earnings derived from non-members are taxed at regular corporate rates and are retained by CHS as unallocated equity.

The origins of CHS Inc. date back to the early 1930s with the founding of the predecessor companies of Cenex, Inc. and Harvest States Cooperatives. Cenex Harvest States Cooperatives emerged as the result of the merger of the two entities in 1998. In August 2003 we changed our name to CHS Inc. We are headquartered in Inver Grove Heights, Minnesota. Our address is 5500 Cenex Drive, Inver Grove Heights, Minnesota 55077. Our telephone number is (651) 355-6000.

Agronomy

Through our Agronomy business segment, we are engaged in the manufacture of crop nutrients and the wholesale distribution of crop nutrients and crop protection products. We conduct our agronomy operations primarily through two investments—a 20% cooperative ownership interest in CF Industries, Inc. (CF Industries) and a 25% ownership interest in Agriliance, LLC (Agriliance). CF Industries manufactures crop nutrient products, particularly nitrogen and phosphate fertilizers, and is one of the largest suppliers to Agriliance. Agriliance is one of North America's largest wholesale distributors of crop nutrients, crop protection products and other agronomy products based on sales. Our minority ownership

interests in CF Industries and Agriliance are treated as investments and, therefore, those entities' revenues and expenses are not reflected in our operating results.

Energy

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

Country Operations and Services

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

Grain Marketing

We are the nation's largest cooperative marketer of grain and oilseed based on grain storage capacity and grain sales, handling about 1.1 billion bushels annually. During fiscal year 2003, we purchased approximately 67% of our total grain volumes from individual and member cooperatives and the Country Operations and Services business segment, 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 conduct most of our Grain Marketing operations directly, although we do conduct some of our business through two joint ventures in which we have a 50% ownership.

Processed Grain and Foods

Our Processed Grains and Foods business segment converts raw agricultural commodities into ingredients for finished food products or into finished consumer food products. We have focused on areas that utilize the products supplied by our member producers. These areas are oilseed processing and refining, wheat milling and foods, including oilseed-based products (such as margarine and salad dressing) and Mexican foods.

The Issuance

We are issuing 479,315 shares of our 8% Cumulative Redeemable Preferred Stock in connection with our redemption of \$12,989,436.50 of our patrons' equities that have been outstanding for at least 10 years and that are held by active members. For those members whose redemption amount is less than \$500, that amount will be paid in cash. For those members whose redemption amount is equal to or greater than \$500, that amount will be paid by the issuance of shares of preferred stock, subject to the exceptions described below in Plan of Distribution. 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 \$27.10, which is the greater of \$25.36 (equal to the \$25.00 liquidation preference per share of preferred stock plus \$0.36 of accumulated dividends from and including January 1, 2004 to and including March 4, 2004) and the \$27.10 closing price for one share of the preferred stock on The NASDAQ National Market on March 2, 2004. We will not issue any fractional shares of preferred stock. The amount of patrons' equities that would otherwise be issued as a fractional share to any member will instead be retained as part of that member's patrons' equities. 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 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 are 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.

No Exchange or Conversion Rights, No Sinking Fund

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.

Voting Rights

Holders 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; and
- 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.

No Preemptive Rights

Holders of the preferred stock have no preemptive right to acquire shares of any class or series of our capital stock.

Trading

The preferred stock is listed on The NASDAQ National Market under the symbol CHSCP.

Comparison of Rights

Holders of the preferred stock have different rights from those of holders of patrons' equities. See Comparison of Rights of Holders of Patrons' Equities and Rights of Holders of Preferred Stock.

Risk Factors

Ownership of our preferred stock involves risks. See Risk Factors beginning on page 7.

Summary 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, 2003, 2002 and 2001 should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this filing. The selected consolidated financial data for the three months ended November 30, 2003 and 2002 are unaudited and have been derived from, and should be read together with, our unaudited consolidated financial statements and notes thereto contained in the quarterly report on Form 10-Q for the quarterly period ended November 30, 2003, incorporated by reference in this prospectus. 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 Consolidated Financial Data

| | Three Months Ended November 30, | | Years Ended August 31, | | | | |
|---|------------------------------------|------------------|------------------------|-------------------|-------------------|------------------|------------------|
| | 2003 | 2002 | 2003 | 2002 | 2001 | 2000 | 1999 |
| | (Unaudited) | (Unaudited) | (dollars in thousands) | | | | |
| Income statement data: | | | | | | | |
| Revenues: | | | | | | | |
| Net sales | \$ 2,489,344 | \$ 2,400,596 | \$ 9,270,734 | \$ 7,156,454 | \$ 7,464,242 | \$ 8,248,413 | \$ 6,198,843 |
| Patronage dividends | 320 | 166 | 3,257 | 3,885 | 5,977 | 5,494 | 5,876 |
| Other revenues | 32,713 | 35,089 | 124,542 | 109,459 | 116,254 | 97,471 | 81,180 |
| | <u>2,522,377</u> | <u>2,435,851</u> | <u>9,398,533</u> | <u>7,269,798</u> | <u>7,586,473</u> | <u>8,351,378</u> | <u>6,285,899</u> |
| Cost of goods sold | 2,414,530 | 2,338,559 | 9,058,951 | 6,940,926 | 7,181,433 | 8,051,057 | 6,010,796 |
| Marketing, general and administrative | 47,732 | 43,148 | 190,582 | 187,292 | 184,046 | 155,266 | 152,031 |
| | <u>60,115</u> | <u>54,144</u> | <u>149,000</u> | <u>141,580</u> | <u>220,994</u> | <u>145,055</u> | <u>123,072</u> |
| Operating earnings | 60,115 | 54,144 | 149,000 | 141,580 | 220,994 | 145,055 | 123,072 |
| Gain on legal settlements | | (1,797) | (10,867) | (2,970) | | | |
| Interest | 11,540 | 12,813 | 48,675 | 42,455 | 61,436 | 57,566 | 42,438 |
| Equity income from investments | (13,707) | (8,165) | (47,299) | (58,133) | (28,494) | (28,325) | (22,363) |
| Minority interests | 3,922 | 5,431 | 21,950 | 15,390 | 35,098 | 24,546 | 10,017 |
| | <u>58,360</u> | <u>45,862</u> | <u>136,541</u> | <u>144,838</u> | <u>152,954</u> | <u>91,268</u> | <u>92,980</u> |
| Income before income taxes | 58,360 | 45,862 | 136,541 | 144,838 | 152,954 | 91,268 | 92,980 |
| Income taxes | 7,621 | 5,506 | 12,700 | 18,700 | (25,600) | 3,880 | 6,980 |
| | <u>\$ 50,739</u> | <u>\$ 40,356</u> | <u>\$ 123,841</u> | <u>\$ 126,138</u> | <u>\$ 178,554</u> | <u>\$ 87,388</u> | <u>\$ 86,000</u> |
| Balance sheet data (at end of period): | | | | | | | |
| Working capital | \$ 489,333 | \$ 431,751 | \$ 458,738 | \$ 249,115 | \$ 305,280 | \$ 214,223 | \$ 219,045 |
| Net property, plant and equipment | 1,135,351 | 1,068,786 | 1,122,982 | 1,057,421 | 1,023,872 | 1,034,768 | 968,333 |
| Total assets | 4,156,283 | 3,835,688 | 3,807,968 | 3,481,727 | 3,057,319 | 3,172,680 | 2,787,664 |
| Long-term debt, including current maturities | 659,624 | 743,222 | 663,173 | 572,124 | 559,997 | 510,500 | 482,666 |
| Total equities | 1,516,134 | 1,305,677 | 1,481,711 | 1,289,638 | 1,261,153 | 1,164,426 | 1,117,636 |
| Ratio of earnings to fixed charges and preferred dividends(1) | 5.2x | 4.5x | 3.0x | 3.4x | 3.4x | 2.6x | 2.5x |

- (1) For purposes of computing the ratio of earnings to fixed charges and preferred dividends, earnings consist of earnings 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.

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" 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, and flour. Commodity prices generally are affected by a wide range of factors beyond our control, including the weather, disease, insect damage, drought, the availability and adequacy of supply, government regulation and policies, and general political and economic conditions. We are also exposed to fluctuating commodity prices as the result of our inventories of commodities, typically grain and petroleum products, and purchase and sale contracts at fixed or partially fixed prices. At any time, our inventory levels and unfulfilled fixed or partially fixed price contract obligations may be substantial. Increases in market prices for commodities that we purchase without a corresponding increase in the prices of our products or our sales volume or a decrease in our other operating expenses could reduce our revenues and net income.

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

levels of worldwide and domestic supplies;

capacities of domestic and foreign refineries;

the ability of the members of OPEC to agree to and maintain oil price and production controls, and the price and level of foreign imports generally;

political instability or armed conflict in oil-producing regions;

the level of consumer demand;

the price and availability of alternative fuels;

the availability of pipeline capacity; and

domestic and foreign governmental regulations and taxes.

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

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

WE PARTICIPATE IN HIGHLY COMPETITIVE BUSINESS MARKETS IN WHICH WE MAY NOT BE ABLE TO CONTINUE TO COMPETE SUCCESSFULLY. We operate in several highly competitive business segments and our competitors may succeed in developing new or enhanced products that are better than ours, and may be more successful in marketing and selling their products than we are

with ours. Competitive factors include price, service level, proximity to markets, product quality and marketing. In some of our business segments, such as Energy, we compete with companies that are larger, better known and have greater marketing, financial, personnel and other resources. As a result, we may not be able to continue to compete successfully with our competitors.

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

WE INCUR SIGNIFICANT COSTS IN COMPLYING WITH APPLICABLE LAWS AND REGULATIONS. ANY FAILURE TO MAKE THE CAPITAL INVESTMENTS NECESSARY TO COMPLY WITH THESE LAWS AND REGULATIONS COULD EXPOSE US TO FINANCIAL LIABILITY. We are subject to numerous federal, state and local provisions regulating our business and operations and we incur and expect to incur significant capital and operating expenses to comply with these laws and regulations. We may be unable to pass on those expenses to customers without experiencing volume and margin losses. For example, capital expenditures for upgrading our refineries, largely to comply with regulations requiring the reduction of sulfur levels in refined petroleum products, are expected to be approximately \$87.0 million for our Laurel, Montana refinery and \$324.0 million for National Cooperative Refinery Association's McPherson, Kansas refinery, of which \$13.4 million had been spent at the Laurel refinery and \$53.7 million had been spent by NCRA at the McPherson refinery as of November 30, 2003. We expect all of these compliance capital expenditures at the refineries to be complete by December 31, 2005, and anticipate funding these projects with a combination of cash flows from operations and debt proceeds.

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

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

ACTUAL OR PERCEIVED QUALITY, SAFETY OR HEALTH RISKS ASSOCIATED WITH OUR PRODUCTS COULD SUBJECT US TO LIABILITY AND DAMAGE OUR BUSINESS AND REPUTATION. If any of our food or feed products became adulterated or misbranded, we would need to recall those items and could experience product liability claims if consumers were injured as a result. A widespread product recall or a significant product liability judgment could cause our products to be unavailable for a period of time or a loss of consumer confidence in our products. Even if a product liability claim is unsuccessful or is not fully pursued, the negative publicity surrounding any assertion that our products caused illness or injury could adversely affect our reputation with existing and potential customers and our corporate and brand image. Moreover, claims or liabilities of this sort might not be covered by our insurance or by any rights of indemnity or contribution that we may have against others. In addition, general public perceptions regarding the quality, safety or health risks associated with particular

food or feed products, such as the concern in some quarters regarding genetically modified crops, could reduce demand and prices for some of the products associated with our businesses. To the extent that consumer preferences evolve away from products that our members or we produce for health or other reasons, such as the growing demand for organic food products, and we are unable to develop products that satisfy new consumer preferences, there will be a decreased demand for our products.

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

our oil refineries and other facilities are potential targets for terrorist attacks that could halt or discontinue production;

our inability to negotiate acceptable contracts with unionized workers in our operations could result in strikes or work stoppages; and

the significant inventories that we carry could be damaged or destroyed by catastrophic events, extreme weather conditions or contamination.

We maintain insurance against many, but not all, potential losses or liabilities arising from these operating hazards, but uninsured losses or losses above our coverage limits are possible. Uninsured losses and liabilities arising from operating hazards could have a material adverse effect on our financial position or results of operations.

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

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

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

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

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

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

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

Risks Related to the Preferred Stock

THE PREFERRED STOCK MAY NOT CONTINUE TO QUALIFY FOR LISTING ON THE NASDAQ NATIONAL MARKET. Although the preferred stock is listed on The NASDAQ National 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 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 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 479,315 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 \$12,989,436.50 of our patrons' equities that have been outstanding for at least 10 years and that are held by active members whose pro rata portion of the total amount of patrons' equities to be redeemed is equal to or greater than \$500, subject to the exceptions described below in Plan of Distribution. 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.

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 buy commodities from and provide products and services to our members and other customers. 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, 2003, our total revenues were \$9.4 billion.

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

parties. The fifth business segment, Processed Grains and Foods, converts grains and oilseeds into value-added products.

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

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

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

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

AGRONOMY

Overview

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

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

Our minority ownership interests in CF Industries and Agrilience are treated as investments, and therefore, those entities' revenues and expenses are not reflected in our operating results. CF Industries is treated as a cost method investment and Agrilience is treated as an equity method investment. CF Industries and Agrilience each have their own line of financing, without recourse to CHS.

Operations

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

a nitrogen manufacturing and processing facility at Donaldsonville, Louisiana;

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

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

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

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

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

Products and Services

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

Sales and Marketing; Customers

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

Industry; Competition

Regulation. The Agronomy business segment's operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar state agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; the transportation, handling and disposition of wastes; and the labelling of pesticides and similar substances. Failure to comply with these laws, regulations and rules could subject us to administrative penalties, injunctive relief and civil remedies. 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.

CF Industries. North American fertilizer producers operate in a highly competitive, global industry. Commercial fertilizers are world-traded commodities and producers compete principally on the basis of price and service. Many of the raw materials that are used in fertilizer production, such as natural gas, are often more expensive in the U.S. than other parts of the world. Crop nutrient margins and earnings have

historically been cyclical; large profits generated throughout the mid-1990 s attracted additional capital and expansion and the industry now suffers from excess capacity. These factors have produced depressed margins for North American fertilizer manufacturers over the past several years, although recently fertilizer margins have stabilized.

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

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

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

Summary Operating Results

We account for our Agronomy business segment as follows:

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

Agrilience. At August 31, 2003 our equity investment in Agrilience was \$129.3 million. We recognize earnings from Agrilience using the equity method of accounting, which results in us including our economic interest percentage of Agrilience s net earnings as equity income from investments. We apply related internal expenses against those earnings.

ENERGY

Overview

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

approximately 90% of its crude oil supply from Canada, with the balance obtained from domestic sources. Laurel has access to Canadian and northwest Montana crude through our wholly owned Front Range Pipeline, LLC and other common carrier pipelines. The Laurel refinery also has access to Wyoming crude via common carrier pipelines from the south.

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

McPherson Refinery. The McPherson, Kansas refinery is owned and operated by the National Cooperative Refinery Association (NCRA), of which 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 95% of its crude oil from Kansas, Oklahoma, and Texas through NCRA-owned and common carrier pipelines.

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

Other Energy Operations. We own and operate three propane terminals, four asphalt 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 and anhydrous ammonia.

Products and Services

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

Sales and Marketing; Customers

We make approximately 75% 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 1.5 billion gallons of gasoline and approximately 1.3 billion gallons of diesel fuel in fiscal year 2003. We also wholesale auto and farm machinery lubricants to both members and non-members. In fiscal year 2003, energy operations sold approximately 23 million gallons of lube oil. We are one of the nation's largest propane wholesalers based on gallons sold. In fiscal year 2003, energy operations sold approximately 844 million gallons of propane. Most of the propane sold in rural areas is for heating and agricultural consumption. Annual sales volumes of propane vary greatly depending on weather patterns and crop conditions.

Industry; Competition

Regulation. Governmental regulations and policies, particularly in the areas of taxation, energy and the environment, have a significant impact on our Energy business segment. The Energy business segment's operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar state agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; the transportation, handling and disposition of wastes; and the labelling of pesticides and similar substances. Failure to comply

with these laws, regulations and rules could subject us to administrative penalties, injunctive relief and civil remedies. 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.

Like many other refineries, the Energy business segment's refineries are currently focusing their capital spending on reducing pollution. In particular, these refineries are currently working to comply with the Environmental Protection Agency low sulfur fuel regulations required by 2006, which are intended to lower the sulfur content of gasoline and diesel. We currently expect that the cost of compliance will be approximately \$87.0 million for our Laurel, Montana refinery and \$324.0 million for NCRA's McPherson, Kansas refinery, of which \$13.4 million had been spent at the Laurel refinery and \$53.7 million had been spent by NCRA at the McPherson refinery as of November 30, 2003. We expect all of these compliance capital expenditures at the refineries to be complete by December 31, 2005, and anticipate funding these projects with a combination of cash flows from operations and debt proceeds.

The energy business is highly cyclical. Demand for crude oil and its products are driven by the condition of local and worldwide economies, local and regional weather patterns and taxation relative to other energy sources. Most of 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, warm winter weather, and government programs that encourage idle acres may all reduce demand for our energy products.

The 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. CHS owned and non-owned retail outlets are located primarily in the southern, midwestern and northwestern United States.

COUNTRY OPERATIONS AND SERVICES

Overview

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

Products and Services

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

bushels, 274 million were purchased from members and 204 million were sold through the Grain Marketing business segment.

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

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

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

Industry; Competition

Regulation. The Country Operations and Services business segment's operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar state agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; the transportation, handling and disposition of wastes; and the labelling of pesticides and similar substances. The Country Operations and Services business segment's operations are also subject to laws and related regulations and rules administered by the United States Department of Agriculture, the Federal Food and Drug Administration, and other federal state, local and foreign governmental agencies that govern the processing, packaging, storage, distribution, advertising, labeling, quality and safety of feed and grain products. Failure to comply with these laws, regulations and rules could subject 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. Competitors for the purchase of grain include other elevators and large grain marketing companies. Competitors for farm supply include a variety of cooperatives, privately held and large national companies. We compete primarily on the basis of price, services and patronage.

Competitors to our financing operations are primarily other financial institutions. We compete primarily on the basis of price, services and patronage. Country Hedging's competitors include international

brokerage firms, national brokerage firms, regional brokerage firms (both cooperatives and non-cooperatives) as well as local introducing brokers, with competition driven by price and level of service. Ag States Agency, LLC competes with other insurance agencies, primarily on the basis of price and services.

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 1.1 billion bushels annually. During fiscal year 2003, we purchased approximately 67% of total grain volumes from individual and member cooperatives and the Country Operations and Services business segment, with the balance purchased from third parties. We arrange for the transportation of the grains either directly to customers or to CHS 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 two 50% owned joint ventures.

Operations

The Grain Marketing segment purchases grain directly and indirectly from agricultural producers primarily in the midwestern and western United States. The purchased grain is typically contracted for sale for future delivery at a specified location, with CHS 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 service we offer to our customers. Rail, vessel, barge and truck transportation is carried out by third parties, often under long-term freight agreements with CHS. Grain intended for export is usually shipped by rail or barge to an export terminal, where it is loaded onto ocean-going vessels. Grain intended for domestic use is usually shipped by rail or truck to various locations throughout the country.

We own export terminals, river terminals, and elevators involved in the handling and transport of grain. River terminals at St. Paul, Savage, and Winona, Minnesota, and Davenport, Iowa are used to load grains onto barges for shipment to both domestic and export customers via the Mississippi River System. Our export terminal at Superior, Wisconsin provides access to the Great Lakes and St. Lawrence Seaway, and an export terminal at Myrtle Grove, Louisiana serves the Gulf market. In the Pacific Northwest, 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. TEMCO, LLC operates a large export terminal in Tacoma, Washington. These facilities serve the Pacific market, as well as domestic grain customers in the western United States. Grain Suppliers, LLC, a wholly owned subsidiary (previously a 50% joint venture), operates elevator facilities in Friona, Texas and Collins, Mississippi. In 2003, we opened an office in Sao Paulo, Brazil for the procurement of soybeans for the Grain Marketing segment's international customers.

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

Products and Services

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

Sales and Marketing; Customers

Purchasers include domestic and foreign millers, maltsters, feeders, crushers, and other processors. To a much lesser extent purchasers include intermediaries and distributors. Grain Marketing operations are not dependent on any one customer. The Grain Marketing segment has supply relationships calling for delivery of grain at prevailing market prices.

Industry; Competition

Regulation. The Grain Marketing business segment's operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar state agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; and the transportation, handling and disposition of wastes. The Grain Marketing business segment's operations are also subject to laws and related regulations and rules administered by the United States Department of Agriculture, the Federal Food and Drug Administration, and other federal, state, local and foreign governmental agencies that govern the processing, packaging, storage, distribution, advertising, labeling, quality and safety of 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. The Grain Marketing business segment competes for both the purchase and 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 us.

In the purchase of grain from producers, location of the delivery facility is a prime consideration, but producers are increasingly willing to truck 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 capability provides a price advantage. We believe that our relationships with individual members serviced by local Country Operations and Services locations and with cooperative members gives us a broad origination capability.

The Grain Marketing business segment 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. Grain marketing operations compete 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 the grain marketing business 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.

PROCESSED GRAINS AND FOODS

Overview

The Processed Grains and Foods business 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 member producers. These areas are oilseed processing, wheat milling and foods.

The Processed Grains and Foods business segment's operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar state agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; and the transportation, handling and disposition of wastes. The Processed Grains and Foods business segment's operations are also subject to laws and related regulations and rules administered by the United States Department of Agriculture, the Federal Food and Drug Administration, and other federal state, local and foreign governmental agencies that govern the processing, packaging, storage, distribution, advertising, labeling, quality and safety of 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.

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 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 produce approximately 1 billion pounds of refined soybean oil annually. Another crushing facility in Fairmont, Minnesota has a crushing capacity and crude soyoil output similar to the Mankato facility. The facility in Fairmont was essentially complete and became operational in the first fiscal quarter of 2004. Total costs for this new facility are estimated to be approximately \$85.0 million, of which \$76.6 million has been spent through November 30, 2003.

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 and, to a lesser extent for certain industrial uses for plastics, inks and paints. Soybean meal has a 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. The oilseed crushing operations currently produce approximately 45% of the crude oil that we refine; it purchases the balance from outside suppliers. Once the Fairmount, Minnesota crushing facility is fully operational, the oilseed crushing operations will produce approximately 85% of the crude oil we refine.

Our customers for refined oil are principally large food product companies located throughout the United States. However, over 50% of the customers are located in the midwest due to lower freight costs and slightly higher profitability. The 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 comparative with other suppliers of the product. Our sales to Ventura Foods were \$78.5 million in fiscal year 2003. We also sell soymeal to almost 400 customers, primarily feed lots and feed mills in southern Minnesota. Five of these customers accounted for approximately 58% of the soymeal sold. One customer accounted for 25% of soymeal sold and another customer accounted for 12% 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 are proposing to construct 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 less than 3% of the domestic soybean crushing capacity.

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

Wheat Milling

In January 2002, we formed Horizon Milling, LLC (Horizon Milling) with Cargill, in which we own a 24% interest and Cargill owns the remaining 76%. Horizon Milling is the largest U.S. wheat miller based on milling capacity. Sales and purchases of wheat and durum by us to Horizon Milling during fiscal year 2003 were \$191.3 million and \$8.8 million, respectively. Horizon Milling's advance payments on grain to us were \$7.5 million on August 31, 2003, and are included in Customer advance payments on our Consolidated Balance Sheets.

We ceased operations at our Huron, Ohio mill prior to the formation of Horizon Milling and our facility lease expired on September 30, 2002. We have dismantled the milling equipment and are currently negotiating for the sale of the equipment that has not yet been sold. The Processed Grains and Foods business segment established an impairment of approximately \$6.5 million on the equipment during the fourth quarter of fiscal year 2002.

Foods

We have two primary areas of focus in the foods area: Ventura Foods, which produces oilseed based products such as margarine and salad dressing and which is 50% owned by us, and the production of Mexican foods such as tortillas, tortilla chips and entrees.

Ventura Foods. 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 30% of Ventura Food's volume, based on sales revenues, 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 Food's product formulations and processes are proprietary to it or its customers. Ventura Foods is one of the largest manufacturers of margarine in the U.S. based on sales 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. One customer accounted for 23% of net sales during Ventura Foods' 2003 fiscal year.

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, Smuckers, Kraft, and CF Sauer.

Ventura Foods was created in 1996 and at the time was owned 40% by us and 60% by Wilsey Foods, Inc., a majority owned subsidiary of Mitsui & Co., Ltd. In March 2000, we purchased an additional 10% interest from Wilsey Foods, Inc. bringing our total equity investment in Ventura Foods to 50%. We account for the Ventura Foods investment under the equity method of accounting.

Mexican Foods. Since June 2000, we have acquired three regional producers of Mexican foods. Through our Mexican foods operations, we manufacture, package, and distribute tortillas, tortilla chips and prepared frozen Mexican food products such as burritos and tamales. We sell these products under a variety of local and regional brand names and also produce private label products and co-packs for customers. The current operational focus is on integrating these disparate operations into a single business entity with consistent standards, systems and sales practices.

The tortilla and tortilla chip industry in the United States is comprised of a large number of small regional manufacturers and a few dominant manufacturers. We estimate that our Mexican foods operation has approximately a 1.5% share of the national tortilla market and less than a 1% share of the national tortilla chip market. On a national basis, the primary competitors are large chip and snack companies such as Frito Lay. During our fiscal year ended August 31, 2003 one customer accounted for 13% of Mexican foods net sales and another customer accounted for 12% of net sales.

PRICE RISK AND HEDGING

Whenever 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 handled by us 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 of a contract.

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 margin deposit (maintenance margin) 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 grain marketing operations, requires a review by operations management when any trader is outside of position limits and also a review by senior management of CHS if operating areas are outside of position limits. A similar process is used in energy operations. The position limits are reviewed at least annually with the management of CHS. 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 sale contracts are subject to credit approvals and appropriate terms and conditions.

EMPLOYEES

At August 31, 2003, we had approximately 6,820 full and part-time employees, which included approximately 560 employees of NCRA. Of that total, approximately 1,890 were employed in the Energy segment, 2,440 in the Country Operations and Services segment (not including an estimated 1,010 seasonal and temporary employees), 440 in the Grain Marketing segment, 850 in the Processed Grains and Foods segment and 190 in corporate and administrative functions. In addition to those employed directly by us, many employees work for the joint ventures in which we have an ownership interest. All of the employees in the Agronomy segment and a portion of the Grain Marketing and Processed Grains and Foods segments are employed in this manner.

Employees in certain areas are represented by collective bargaining agreements. Refinery workers in Laurel, Montana (185 employees), are represented by agreements with two unions (Paper, Allied-Industrial, Chemical and Energy Workers International Union (PACE) and Oil Basin Pipeliners Union (OBP)), for which agreements are in place through 2006 for PACE, and through 2006 for OBP in regard to wages and benefits. The contracts covering the NCRA McPherson, Kansas refinery (254 employees in the PACE union) are also in place through 2006. There are approximately 170 employees in transportation and lubricant plant operations that are covered by collective bargaining agreements that expire at various times. Production workers in grain marketing operations (144 employees) are represented by agreements with four unions that expire at various times from 2003 through 2005. In particular, grain marketing employees in the Bakers, Confectionary, Tobacco Workers and Grain Millers International Union in Superior, Wisconsin (49 employees) have contracts that have expired. We have negotiated a new contract with these employees that expires in 2005 that has been ratified by the union membership but not yet signed. Finally, certain production workers in oilseed processing operations are subject to collective bargaining agreements with the American Federation of Grain Millers (127 employees) and the Pipefitters Union (2 employees) for which agreements are in place through 2006.

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. Patrons, and not CHS, are subject to income taxes on income from patronage. We are subject to income taxes on non-patronage-sourced income. See Tax Treatment below.

Distribution of Net Income; Patronage Refunds

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. Net income from non-patronage business may be distributed to members or added to the unallocated capital reserve, in whatever proportions the Board of Directors deems appropriate.

These distributions, referred to as patronage refunds or patronage dividends, may be distributed in cash, patrons equities, revolving fund certificates, securities of CHS or others or any combination designated by our Board of Directors. Since 1998, our Board of Directors has distributed patronage refunds in the form of 30% cash and 70% patrons equities (see Patrons Equities below). Our Board of Directors may change the mix in the form of the patronage refunds in the future. In making distributions, our Board of Directors may use any method of allocation that, in its judgment, is reasonable and equitable.

Patronage refunds distributed during the years ended August 31, 2003, 2002 and 2001 were \$88.3 million (\$26.5 million in cash), \$132.6 million (\$40.1 million in cash) and \$86.4 million (\$26.1 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, including securities, when redeemed by us. 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. Our bylaws grant our Board of Directors the discretion to redeem patrons' equities upon such terms as the Board of Directors may, from time to time, determine. Our current policy is to redeem the equities of those members who were age 61 and older on June 1, 1998 when they reach the age of 72 and upon death. The current policy also provides for an annual pro-rata redemption of equities older than 10 years held by active members in an amount determined by our Board of Directors.

Redemptions of patrons' and other equities, including equity participation units (discussed in Note 9 to the Consolidated Financial Statements), during the years ended August 31, 2003, 2002 and 2001 were \$31.1 million, \$31.1 million and \$33.0 million, respectively.

Governance

We are managed by a Board of Directors of at least 17 persons elected by our members at our annual meeting. Terms of directors are staggered so that no more than seven directors are elected in any year. Our 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 the members, except for the higher vote described under "Certain Antitakeover Measures" below.

Membership

Our membership 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.

As a membership cooperative, we do not have common stock. We may issue equity or debt securities, 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, 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 security. 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. Individual members may exercise their voting power directly or through a patrons' association associated with a grain elevator, feed mill, seed plant or any other CHS facility (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 our members require the approval of a majority of the votes cast at a meeting of the members, although the approval of not less than two-thirds of the votes cast at a meeting is required to approve Change of Control transactions, which include a merger, consolidation, liquidation, dissolution, or the sale of all or substantially all of our assets and, in certain circumstances, a greater vote may be required. 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. Under our articles of incorporation, all equity issued by CHS is subject to a first lien in favor of us for all indebtedness of the holder to us. As of August 31, 2003, our outstanding capital included patrons' equities (consisting of capital equity certificates and non-patronage earnings certificates), 8% Cumulative Redeemable Preferred Stock (dividends paid quarterly) and certain capital reserves.

Distribution of Assets Upon Dissolution; Merger and Consolidation

In the event of any dissolution, liquidation or winding up of CHS, whether voluntary or involuntary, all debts and liabilities would be paid first according to their respective priorities. As more particularly provided in our bylaws, the remaining assets would be paid to the holders of equity capital to the extent of their interests and 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. Further, if our Board of Directors determines that a proposed change of control 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 patronage paid to our members either in the form of equities or cash. Consequently, 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 we derive 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.

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, 2003, 2002 and 2001 should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this filing. The selected consolidated financial data for the three months ended November 30, 2003 and 2002 are unaudited and have been derived from, and should be read together with, our unaudited consolidated financial statements and notes thereto contained in the quarterly report on Form 10-Q for the quarterly period ended November 30, 2003, incorporated by reference in this prospectus. 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 Consolidated Financial Data

| | Three Months Ended November 30, | | Years Ended August 31, | | | | |
|--|------------------------------------|------------------|------------------------|-------------------|-------------------|------------------|------------------|
| | 2003 | 2002 | 2003 | 2002 | 2001 | 2000 | 1999 |
| | (Unaudited) | (Unaudited) | (dollars in thousands) | | | | |
| Income statement data: | | | | | | | |
| Revenues: | | | | | | | |
| Net sales | \$2,489,344 | \$2,400,596 | \$9,270,734 | \$7,156,454 | \$7,464,242 | \$8,248,413 | \$6,198,843 |
| Patronage dividends | 320 | 166 | 3,257 | 3,885 | 5,977 | 5,494 | 5,876 |
| Other revenues | 32,713 | 35,089 | 124,542 | 109,459 | 116,254 | 97,471 | 81,180 |
| | <u>2,522,377</u> | <u>2,435,851</u> | <u>9,398,533</u> | <u>7,269,798</u> | <u>7,586,473</u> | <u>8,351,378</u> | <u>6,285,899</u> |
| Cost of goods sold | 2,414,530 | 2,338,559 | 9,058,951 | 6,940,926 | 7,181,433 | 8,051,057 | 6,010,796 |
| Marketing, general and administrative | 47,732 | 43,148 | 190,582 | 187,292 | 184,046 | 155,266 | 152,031 |
| | <u>60,115</u> | <u>54,144</u> | <u>149,000</u> | <u>141,580</u> | <u>220,994</u> | <u>145,055</u> | <u>123,072</u> |
| Operating earnings | 60,115 | 54,144 | 149,000 | 141,580 | 220,994 | 145,055 | 123,072 |
| Gain on legal settlements | | (1,797) | (10,867) | (2,970) | | | |
| Interest | 11,540 | 12,813 | 48,675 | 42,455 | 61,436 | 57,566 | 42,438 |
| Equity income from investments | (13,707) | (8,165) | (47,299) | (58,133) | (28,494) | (28,325) | (22,363) |
| Minority interests | 3,922 | 5,431 | 21,950 | 15,390 | 35,098 | 24,546 | 10,017 |
| | <u>58,360</u> | <u>45,862</u> | <u>136,541</u> | <u>144,838</u> | <u>152,954</u> | <u>91,268</u> | <u>92,980</u> |
| Income before income taxes | 58,360 | 45,862 | 136,541 | 144,838 | 152,954 | 91,268 | 92,980 |
| Income taxes | 7,621 | 5,506 | 12,700 | 18,700 | (25,600) | 3,880 | 6,980 |
| | <u>\$ 50,739</u> | <u>\$ 40,356</u> | <u>\$ 123,841</u> | <u>\$ 126,138</u> | <u>\$ 178,554</u> | <u>\$ 87,388</u> | <u>\$ 86,000</u> |
| | <u>50,739</u> | <u>40,356</u> | <u>123,841</u> | <u>126,138</u> | <u>178,554</u> | <u>87,388</u> | <u>86,000</u> |
| Balance sheet data (at end of period): | | | | | | | |
| Working capital | \$ 489,333 | \$ 431,751 | \$ 458,738 | \$ 249,115 | \$ 305,280 | \$ 214,223 | \$ 219,045 |
| Net property, plant and equipment | 1,135,351 | 1,068,786 | 1,122,982 | 1,057,421 | 1,023,872 | 1,034,768 | 968,333 |
| Total assets | 4,156,283 | 3,835,688 | 3,807,968 | 3,481,727 | 3,057,319 | 3,172,680 | 2,787,664 |
| Long-term debt, including current maturities | 659,624 | 743,222 | 663,173 | 572,124 | 559,997 | 510,500 | 482,666 |
| Total equities | 1,516,134 | 1,305,677 | 1,481,711 | 1,289,638 | 1,261,153 | 1,164,426 | 1,117,636 |

Edgar Filing: CHS INC - Form 424B1

The selected financial statement information below has been derived from our five business segments, and Corporate and Other, for the fiscal years ended August 31, 2003, 2002 and 2001 and for the three months ended November 30, 2003 and 2002. The intercompany sales between segments were \$894.3 million, \$753.3 million and \$973.2 million for the fiscal years ended August 31, 2003, 2002 and 2001, respectively. The intercompany sales between segments were \$285.5 million and \$275.4 million for the three months ended November 30, 2003 and 2002, respectively.

Summary Financial Data By Business Segment

| | Three Months Ended November 30, | | Years Ended August 31, | | | Three Months Ended November 30, | | Years Ended August 31, | | |
|---|------------------------------------|-------------|-------------------------|-----------|-----------|------------------------------------|-------------|------------------------|-------------|-------------|
| | Agronomy | | | | | Energy | | | | |
| | 2003 | 2002 | 2003 | 2002 | 2001 | 2003 | 2002 | 2003 | 2002 | 2001 |
| | (Unaudited) | (Unaudited) | (Unaudited) (Unaudited) | | | | | | | |
| | (dollars in thousands) | | | | | | | | | |
| Revenues: | | | | | | | | | | |
| Net sales | | | | | | \$ 916,040 | \$ 911,589 | \$3,648,093 | \$2,657,689 | \$2,781,243 |
| Patronage dividends | | | \$ (84) | \$ (89) | \$ 196 | 15 | 13 | 415 | 458 | 712 |
| Other revenues | | | | | | 2,854 | 2,736 | 10,461 | 6,392 | 4,036 |
| | | | | | | | | | | |
| | | | (84) | (89) | 196 | 918,909 | 914,338 | 3,658,969 | 2,664,539 | 2,785,991 |
| Cost of goods sold | | | | | | 859,948 | 860,329 | 3,475,947 | 2,489,352 | 2,549,099 |
| Marketing, general and administrative | \$ 1,314 | \$ 1,140 | 8,138 | 8,957 | 8,503 | 14,566 | 14,185 | 63,740 | 66,731 | 48,432 |
| Operating (losses) earnings | (1,314) | (1,140) | (8,222) | (9,046) | (8,307) | 44,395 | 39,824 | 119,282 | 108,456 | 188,460 |
| Interest | (83) | (298) | (974) | (1,403) | (4,529) | 3,799 | 4,010 | 16,401 | 16,875 | 25,097 |
| Equity loss (income) from investments | 3,131 | 4,018 | (20,773) | (13,425) | (7,360) | (296) | (320) | (1,353) | 1,166 | 4,081 |
| Minority interests | | | | | | 3,689 | 5,135 | 20,782 | 14,604 | 34,713 |
| (Loss) Income before income taxes | \$ (4,362) | \$ (4,860) | \$ 13,525 | \$ 5,782 | \$ 3,582 | \$ 37,203 | \$ 30,999 | \$ 83,452 | \$ 75,811 | \$ 124,569 |
| Total identifiable assets End of Period | \$269,320 | \$232,942 | \$285,906 | \$242,015 | \$230,051 | \$1,386,239 | \$1,311,583 | \$1,449,652 | \$1,305,828 | \$1,154,036 |

| | Three Months Ended November 30, | | Years Ended August 31, | | | Three Months Ended November 30, | | Years Ended August 31, | | |
|--|------------------------------------|-------------|-------------------------|------|------|------------------------------------|------|------------------------|------|------|
| | Country Operations and Services | | | | | Grain Marketing | | | | |
| | 2003 | 2002 | 2003 | 2002 | 2001 | 2003 | 2002 | 2003 | 2002 | 2001 |
| | (Unaudited) | (Unaudited) | (Unaudited) (Unaudited) | | | | | | | |
| | (dollars in thousands) | | | | | | | | | |

Edgar Filing: CHS INC - Form 424B1

| | | | | | | | | | | |
|---|----------------|----------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Revenues: | | | | | | | | | | |
| Net sales | \$ 502,944 | \$ 489,066 | \$ 1,885,825 | \$ 1,474,553 | \$ 1,577,268 | \$ 1,205,217 | \$ 1,161,554 | \$ 4,139,226 | \$ 3,281,469 | \$ 3,416,239 |
| Patronage dividends | 20 | 51 | 2,467 | 2,572 | 3,683 | 261 | 78 | 218 | 497 | 840 |
| Other revenues | 21,078 | 24,537 | 81,739 | 80,789 | 80,479 | 6,920 | 6,604 | 25,458 | 21,902 | 22,964 |
| | <u>524,042</u> | <u>513,654</u> | <u>1,970,031</u> | <u>1,557,914</u> | <u>1,661,430</u> | <u>1,212,398</u> | <u>1,168,236</u> | <u>4,164,902</u> | <u>3,303,868</u> | <u>3,440,043</u> |
| Cost of goods sold | 496,202 | 487,910 | 1,876,811 | 1,474,392 | 1,569,884 | 1,203,596 | 1,159,447 | 4,133,677 | 3,272,985 | 3,416,500 |
| Marketing, general and administrative | 15,151 | 12,603 | 55,887 | 47,995 | 53,417 | 6,189 | 6,071 | 21,072 | 22,213 | 22,396 |
| | <u>12,689</u> | <u>13,141</u> | <u>37,333</u> | <u>35,527</u> | <u>38,129</u> | <u>2,613</u> | <u>2,718</u> | <u>10,153</u> | <u>8,670</u> | <u>1,147</u> |
| Operating earnings | | | | | | | | | | |
| Gain on legal settlements | | (1,797) | (10,867) | (2,970) | | | | | | |
| Interest | 3,245 | 5,388 | 14,975 | 13,851 | 15,695 | 1,154 | 1,858 | 4,738 | 4,807 | 8,144 |
| Equity (income) loss from investments | (25) | (215) | (788) | (283) | (246) | (1,975) | (814) | 1,673 | (4,257) | (4,519) |
| Minority interests | 233 | 296 | 1,168 | 786 | 385 | | | | | |
| | <u>9,236</u> | <u>9,469</u> | <u>32,845</u> | <u>24,143</u> | <u>22,295</u> | <u>3,434</u> | <u>1,674</u> | <u>3,742</u> | <u>8,120</u> | <u>(2,478)</u> |
| Income (loss) before income taxes | | | | | | | | | | |
| Total identifiable assets End of Period | \$ 1,113,530 | \$ 1,035,287 | \$ 857,523 | \$ 799,711 | \$ 679,053 | \$ 597,638 | \$ 594,278 | \$ 450,415 | \$ 481,232 | \$ 345,696 |

Edgar Filing: CHS INC - Form 424B1

| | (dollars in thousands) | | | |
|----------------|------------------------|--------------|--------------|--------------|
| Net sales | \$ 1,729,453 | \$ 1,704,249 | \$ 1,763,266 | \$ 1,959,486 |
| Total revenues | 1,762,250 | 1,729,085 | 1,792,696 | 1,985,767 |
| Gross profit | 100,385 | 62,245 | 90,983 | 75,259 |
| Net income | 41,355 | 2,371 | 46,641 | 35,771 |

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

We are one of the nation's leading integrated agricultural companies. 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 buy commodities from, and provide products and services to members and other customers. We provide a wide variety of products and services, from initial agricultural inputs such as fuels, farm supplies and crop nutrients, to agricultural outputs that include grains and oilseeds, grain and oilseed processing, and food products.

We have five distinct business segments: Agronomy, Energy, Country Operations and Services, Grain Marketing and Processed Grains and Foods. Summary data for each of these segments for the fiscal years ended August 31, 2003, 2002 and 2001 and for the three months ended November 30, 2003 and 2002 is shown on prior pages.

Many of our business activities are highly seasonal, and as a result, 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. Certain business segments are subject to varying seasonal fluctuations. For example, the Agronomy and Country Operations and Services segments experience higher volumes and income during the spring planting season and in the fall, which corresponds to harvest. The Grain Marketing segment 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 when gasoline and diesel usage is highest. Other energy products, such as propane, 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, grain, 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 regulation and policies, world events, and general political and economic conditions.

While our sales and operating results are derived from businesses and operations which are wholly owned and majority-owned, a portion of 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 as equity income from investments 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. These investments principally include our 25% ownership in Agriliance, LLC (Agriliance), our 50% ownership in TEMCO, LLC, our 50% ownership in United Harvest, LLC, our 24% ownership in Horizon Milling, LLC (Horizon) and our 50% ownership in Ventura Foods, LLC (Ventura).

Agriliance is owned and governed by Land O' Lakes, Inc. (50%) and United Country Brands, LLC (50%). United Country Brands, LLC is owned and governed 50% by CHS and 50% by Farmland Industries, Inc. (Farmland), and was formed solely to hold a 50% interest in Agriliance. Prior to the transaction described below, our indirect share of earnings (economic interest) in Agriliance was 25%, which was the same as our ownership or governance interest. Subsequent to the transaction, our indirect economic interest in Agriliance is no longer the same as our ownership or governance interest.

In April 2003, we acquired an additional economic interest in the Agriliance wholesale crop protection business (the CPP Business), which constitutes only a part of the Agriliance business operations. We acquired 13.1% of the CPP Business for a cash payment of \$34.3 million. The economic interests in Agriliance are owned 50% by Land O' Lakes, 25% plus an additional 13.1% of the CPP Business by CHS and 25% less 13.1% of the CPP Business by Farmland. The ownership or governance

interests in Agriliance did not change with the purchase of this additional economic interest. Agriliance's earnings are split among the members based upon the respective economic interests of each member.

Results of Operations

Comparison of the Three Months Ended November 30, 2003 and 2002

Net Income. Consolidated net income for the three months ended November 30, 2003 was \$50.7 million compared to \$40.4 million for the three months ended November 30, 2002, which represents a \$10.3 million (26%) increase. The most significant increases in earnings, when comparing the three months ended November 30, 2003 with the same period of a year ago, were generated with our Energy and Processed Grains and Foods segments. The Energy segment generated increased earnings of \$6.2 million, primarily as the result of strong refining margins. The Processed Grains and Foods segment earnings increased \$4.3 million, primarily the result of improved margins within the soybean crushing and oil packaging complex. Stronger soymeal margins resulted in the geographical area of our plants primarily because a competitor's facility was inoperative during much of the period. Refined soybean oil-based products generated improved margins primarily due to increased volumes.

Net Sales. Consolidated net sales of \$2.5 billion for the three months ended November 30, 2003 increased \$88.7 million (4%) compared to the three months ended November 30, 2002.

Company-wide grain and oilseed net sales of \$1.3 billion increased \$31.9 million (3%) during the three months ended November 30, 2003 compared with that sales activity during the three months ended November 30, 2002. Sales consummated by the Grain Marketing segment totaled \$1,205.1 million and \$1,161.6 million during the periods ended November 30, 2003 and 2002, respectively. Grain sales for the Country Operations and Services segment to outside customers during these same periods were \$71.4 million and \$83.0 million, respectively. Sales of grain between the Country Operations and Services segment and the Grain Marketing segment during those periods were \$258.3 million and \$251.4 million, respectively. These intersegment sales are included for segment reporting purposes, but we eliminate all intersegment sales on a consolidated basis. The net sales increase of \$31.9 million is attributable to higher grain prices during the three month period ended November 30, 2003 compared to those prevailing during the same period a year earlier. In an analysis of this increase in net sales, the weighted average sale price of all grain and oilseed commodities sold reflected an increase of \$0.22 per bushel (5%) which contributed \$63.0 million to the increase. Volume decreased about 2% during the three month period ended November 30, 2003 compared with the same three month period of a year ago, and had the affect of reducing sales by \$31.1 million. Soybeans reflected the largest price increase, and corn reflected the largest volume decrease.

Energy net sales of \$888.9 million increased \$1.3 million (less than 1%) during the three months ended November 30, 2003 compared with that sales activity during the three months ended November 30, 2002. During the three months ended November 30, 2003 and 2002, respectively, the Energy segment had sales to the Country Operations and Services segment of \$27.1 million and \$24.0 million, respectively. Those intersegment sales are eliminated in deriving consolidated sales but are included for segment reporting purposes. The net sales increase of \$1.3 million is comprised of an increase of \$72.5 million related to price appreciation and a decrease in sales of \$71.2 million because of lower sales volume. On a more product-specific basis, refined fuels prices increased \$0.05 per gallon and volumes decreased 2% comparing the three months ended November 30, 2003 with the same period a year ago. Propane prices increased \$0.15 per gallon and sales volume decreased 19% in comparison of the same two periods. Refined fuel prices are generally reflective of crude oil prices. The higher propane prices reflect lower industry stocks in 2003 as the result of a cold winter earlier in the calendar year. The lower sales volume for propane during the three months ended November 30, 2003 is primarily reflective of a dry autumn which offered minimal opportunity for corn drying (propane is used as the fuel for corn dryers at grain elevators) and a relatively warm fall season which reduces its demand for home heating.

Country operations non-grain net sales of \$173.3 million increased by \$18.8 million (12%) during the three months ended November 30, 2003 compared to the three months ended November 30, 2002,

primarily in agronomy and energy products compared to November 30, 2002. Fertilizer volume and the net average sales price increased compared to the previous year. Energy product sales increased primarily as the result of an increase in the average selling price of propane compared to the previous year.

Processed Grains and Foods segment net sales of \$150.6 million increased \$36.8 million (32%) during the three months ended November 30, 2003 compared to the three months ended November 30, 2002. Oilseed processing net sales increased \$37.6 million primarily due to additional volumes at a new crushing plant in Fairmont, Minnesota that began operations during the first quarter of fiscal year 2004 and an average selling price increase of \$0.04 per pound in refined oilseed products.

Patronage Dividends. Patronage dividends received of \$0.3 million increased \$0.2 million during the three months ended November 30, 2003 compared to the three months ended November 30, 2002.

Other Revenues. Other revenues of \$32.7 million decreased \$2.4 million (7%) during the three months ended November 30, 2003 compared to the three months ended November 30, 2002. The most significant decrease was in the Country Operations and Services segment compared to the prior year.

Cost of Goods Sold. Cost of goods sold of \$2.4 billion increased \$76.0 million (3%) during the three months ended November 30, 2003 compared to the three months ended November 30, 2002. The cost of all grains and oilseed procured by CHS through its Grain Marketing and Country Operations and Services segments increased 2% compared to the three months ended November 30, 2002 primarily due to a \$0.21 (5%) average cost per bushel increase, which was partially offset by a 2% decrease in volumes compared to the prior year. This increase in cost of goods sold was primarily the result of higher commodity prices. The Energy segment cost of goods sold decreased by \$0.4 million during the three months ended November 30, 2003 compared to the same period of the prior year, primarily due to reduced volumes, which was partially offset by increased average costs. On a more product-specific basis, refined fuels volumes decreased by 2%, which was partially offset by an average cost increase of \$0.05 per gallon compared to the three months ended November 30, 2002. The average cost increase on refined fuels is reflective of crude oil prices. Propane volumes decreased 19%, which was partially offset by an increased average cost of \$0.15 per gallon compared to the three months ended November 30, 2002. Volumes of propane products were reduced due to a dry autumn, which was partially offset by an average cost increase due to higher input costs compared to the three months ended November 30, 2002. Country operations non-grain cost of goods sold increased by 12% during the three months ended November 30, 2003 compared to the three months ended November 30, 2002 due to an increased average cost per unit on fertilizer and propane products. The Processed Grains and Foods segment cost of goods sold increased by \$33.9 million (32%) compared to the three months ended November 30, 2002, which was primarily due to increased volumes at the new crushing plant in Fairmont, Minnesota and increased cost of raw materials in oilseed processing.

Marketing, General and Administrative. Marketing, general and administrative expenses of \$47.7 million for the three months ended November 30, 2003 increased by \$4.6 million (11%) compared to the three months ended November 30, 2002. The net increase is primarily due to additional expenses within the Country Operations and Services segment related to acquisitions during 2003.

Gain on Legal Settlements. The Country Operations and Services segment received cash of \$1.8 million during the three months ended November 30, 2002 from a class action lawsuit alleging illegal price fixing against various feed vitamin product suppliers.

Interest. Interest expense of \$11.5 million for the three months ended November 30, 2003 decreased by \$1.3 million (10%) compared to the three months ended November 30, 2002. The average level of short-term borrowings decreased \$76.5 million primarily due to financing lower average working capital needs and an average short-term interest rate decrease of 0.7% during the three months ended November 30, 2003 compared to the three months ended November 30, 2002.

Equity Income from Investments. Equity income from investments of \$13.7 million for the three months ended November 30, 2003 increased \$5.5 million (68%) compared to the three months ended November 30, 2002. This increase is primarily attributable to improved earnings within the Grain

Marketing segment's two exporting joint ventures, improved earnings by Horizon Milling and improved earnings by Ventura.

A weaker U.S. dollar and poor weather conditions in certain competing grain exporting countries contributed to a \$0.8 million increase in equity income from our investment in TEMCO, LLC, a joint venture which exports corn and soybeans. These same conditions contributed to a \$0.4 million improvement in equity income from our investment in United Harvest, LLC, a joint venture which exports wheat. Improved margins resulting primarily from a reduction in industry supply contributed to a \$2.3 million improvement in equity income derived from our investment in Horizon Milling. Our equity income from its investment in Ventura improved \$1.4 million in comparison to the prior year, primarily due to increased volumes.

Minority Interests. Minority interests of \$3.9 million for the three months ended November 30, 2003 decreased by \$1.5 million (28%) compared to the three months ended November 30, 2002. The net change in minority interests during the three months ended November 30, 2003 compared to the prior year was primarily a result of more profitable operations within our majority-owned subsidiaries. Substantially all minority interests relate to National Cooperative Refinery Association (NCRA) an approximately 74.5% owned subsidiary.

Income Taxes. Income tax expense of \$7.6 million for the three months ended November 30, 2003 compares to \$5.5 million for the three months ended November 30, 2002, resulting in effective tax rates of 13.1% and 12.0%, respectively. The federal and state statutory rate applied to nonpatronage business activity was 38.9% for the periods ended November 30, 2003 and 2002. The income taxes and effective tax rate vary each period based upon profitability and nonpatronage business activity during each of the comparable periods.

Comparison of the years ended August 31, 2003 and 2002

General. We recorded pretax earnings of \$136.5 million in fiscal 2003 compared to pretax earnings of \$144.8 million in fiscal 2002, with fiscal 2003 net income of \$123.8 million, slightly below fiscal 2002 net income of \$126.1 million. These results reflected increased pretax earnings in our Agronomy, Energy and Country Operations and Services segments, offset, however, by decreased pretax earnings in our Grain Marketing and Processed Grains and Foods segments.

The Agronomy segment generated pretax earnings of \$13.5 million for the year ended August 31, 2003 compared to \$5.8 million in the prior year. This increase in earnings is primarily attributable to the acquisition of an additional economic interest in the Agrilience crop protection business, as discussed earlier.

The Energy segment generated pretax earnings of \$83.5 million during the year ended August 31, 2003 compared with \$75.8 million during the prior year. This increase in earnings is primarily attributable to strong refining margins. Because agricultural use of fuels is gradually declining, we have introduced initiatives to market greater volumes of refined fuels, propane and lubricants to customers outside our traditional base in the agricultural market. We established a record number of new Cenex-branded retail sites during fiscal 2003, with nearly 160 dealerships added or converted to the Cenex brand, and have introduced new lines of lubricant products for use in snowmobiles, all terrain vehicles and marine equipment.

The Grain Marketing segment generated pretax earnings of \$3.7 million for the year ended August 31, 2003 compared to \$8.1 million in the prior year. A major contributing factor was a decrease in exports of grains and oilseeds as the result of increased prices for U.S. grains and oilseeds resulting from drought in parts of the U.S. crop production area which, along with large crops in certain other grain-exporting countries, put U.S. grains and oilseeds in a non-competitive position in the world export market for most of fiscal 2003. During fiscal 2003 we constructed 110-car shuttle train receiving stations in Friona, Texas and Collins, Mississippi, which are located near large-scale cattle and poultry producers, with a goal of increasing the volume of domestic grain sales, in part to reduce our exposure to volatile export markets.

The Country Operations and Services segment generated pretax earnings of \$32.8 million for the year ended August 31, 2003 compared to \$24.1 million for the prior year. This increase resulted primarily from \$10.9 million that we received in cash from a class action lawsuit alleging illegal price fixing against various feed vitamin product suppliers, partially offset by impairments related to facilities where the undiscounted projected income and related cash flows were less than the carrying value of the facilities.

The Processed Grains and Foods segment generated pretax earnings of \$4.2 million for the year ended August 31, 2003 compared to \$32.2 million for the prior year. This decrease was the result of several factors, most significantly the decrease in CHS's equity income from its investment in Ventura Foods discussed below under Equity Income from Investments, depressed soybean meal prices and margins through much of the year, the effects of the recent shifting of U.S. dietary preferences from carbohydrates to high protein and the impact of restructuring efforts in our Mexican foods operations. These factors were partially offset by the effect of higher prices for refined soybean oil and improved results from our wheat milling operations, in part because of impairment charges recognized in fiscal 2002. In late fiscal 2003, margins at both Ventura Foods and Horizon Milling began to improve.

Net Income. Consolidated net income for the year ended August 31, 2003 was \$123.8 million compared to \$126.1 million for the year ended August 31, 2002, which represents a \$2.3 million (2%) decrease. This decrease in profitability is primarily attributable to decreased earnings in our Processed Grains and Foods and Grain Marketing segments, which was partially offset by increased earnings within the Energy, Country Operations and Services and Agronomy segments compared to the year ended August 31, 2002.

Net Sales. Consolidated net sales of \$9.3 billion for the year ended August 31, 2003 increased \$2.1 billion (30%) compared to the year ended August 31, 2002.

Company-wide grain and oilseed net sales of \$4.5 billion increased \$1.0 billion (30%) during the year ended August 31, 2003 compared to the year ended August 31, 2002. Sales for the year ended August 31, 2003 were \$4,139.2 million and \$1,140.0 million from Grain Marketing and Country Operations and Services segments, respectively. Sales for the year ended August 31, 2002 were \$3,281.5 million and \$862.0 million from Grain Marketing and Country Operations and Services segments, respectively. We eliminated all intersegment sales between Country Operations and Services and Grain Marketing, of \$799.4 million and \$685.4 million, for the years ended August 31, 2003 and 2002, respectively. The net increase in sales was primarily due to an increase of \$0.93 (30%) per bushel in the average sales price of all grain and oilseed marketed by CHS while volumes remained essentially unchanged from the prior year. The net increase in company-wide grain and oilseed of \$1.0 billion was primarily related to the price change due to stronger commodity prices and increased international soybean exports.

Energy net sales of \$3.6 billion increased \$963.6 million (37%) during the year ended August 31, 2003 compared to the year ended August 31, 2002. Sales for the year ended August 31, 2003 and 2002 were \$3,648.1 million and \$2,657.7 million, respectively. We eliminated all intersegment sales from Energy to Country Operations and Services of \$94.2 million and \$67.4 million for the years ended August 31, 2003 and 2002, respectively. Refined fuels net sales increased by \$783.2 million, of which \$418.0 million was related to a net average price change and \$365.2 million was related to a net volume change. The sales price of refined fuels increased \$0.18 per gallon and volume increased 17% compared to the year ended August 31, 2002. Refined fuels commodity prices increased due to global uncertainty in the energy markets brought on by the ensuing war and the Venezuela disruption. Propane net sales increased by \$137.0 million, of which \$75.9 million was related to a net volume change and \$61.1 million was related to a net average price change. The average sales price of propane increased by \$0.09 per gallon and volume increased by 19% compared to the year ended August 31, 2002. Domestic propane inventories were at extremely low levels coming out of the heating season, which supported a higher selling price. Refined fuels and propane volume increases were primarily a result of acquisitions, with the largest acquisition taking place in November 2001, when we purchased for \$32.6 million, the wholesale energy business of

Farmland Industries, Inc. (Farmland), as well as all interest in Country Energy, LLC a joint venture formerly with Farmland.

Country operations non-grain net sales of \$745.8 million increased by \$133.3 million (22%) during the year ended August 31, 2003 compared to the year ended August 31, 2002. The net average price and net volume increased on the majority of farm supply products, which consists of seed; plant food; energy products; animal health ingredients, supplements and products; animal health products; and crop nutrient and crop protection products, compared to the prior year. In addition, net sales increased \$46.4 million compared to the prior year due to the acquisition of a sunflower processing plant.

Processed Grains and Foods segment net sales of \$491.2 million decreased \$4.3 million (1%) during the year ended August 31, 2003 compared to the year ended August 31, 2002. Intersegment sales of \$0.7 million and \$0.6 million for the years ended August 31, 2003 and 2002, respectively, have been eliminated. Oilseed processing and refining net sales increased \$81.4 million primarily due to an average selling price increase of \$0.07 per pound in refined oilseed. In addition, Mexican Foods sales increased \$4.1 million compared to the prior year. These sales increases were partially offset by an \$89.6 million decrease in sales due to the formation of Horizon Milling, a wheat flour milling and processing joint venture that was formed in January 2002. After that date, we accounted for operating results of Horizon Milling under the equity method of accounting.

Patronage Dividends. Patronage dividends received from other cooperatives of \$3.3 million decreased \$0.6 million (16%) during the year ended August 31, 2003 compared to the year ended August 31, 2002 from cooperatives of which CHS is a member and with which it does business. The amount of patronage dividends received by CHS in each year depends on the volume of business CHS conducted with the other cooperative (which, in turn, depends on how the terms offered by that cooperative compare to the terms offered by other entities), the profitability generated by the other cooperative on the product purchased by or from CHS, and the patronage distribution resolution adopted by that other cooperative for that year. All of these factors vary from year to year.

Other Revenues. Other revenues of \$124.5 million increased \$15.1 million (14%) during the year ended August 31, 2003 compared to the year ended August 31, 2002. The majority of other revenue was generated within the Country Operations and Services and the Grain Marketing segments and derived primarily from services performed through the Country Operations and Services segment's elevator and agri-service centers, including grain storage, grain cleaning, fertilizer spreading, crop protection product spraying and other services of this nature; the Country Operations and Services segment's financial services; and the Grain Marketing segment's service activities at its export terminals for loading vessels.

Cost of Goods Sold. Cost of goods sold of \$9.1 billion increased \$2.1 billion (31%) during the year ended August 31, 2003 compared to the year ended August 31, 2002. The cost of all grains and oilseed procured by the Company through its Grain Marketing and Country Operations and Services segments increased 30% compared to the year ended August 31, 2002 primarily due to a \$0.92 (30%) average cost per bushel increase while volumes remained essentially unchanged from the prior year. This increase in cost of goods sold was primarily the result of higher commodity prices and increased international exports. The Energy segment cost of goods sold increased by \$986.6 million (40%) during the year ended August 31, 2003 compared to the prior year, primarily due to refined fuels average cost increase of \$778.1 million (46%), which consists of increased average cost of \$0.18 per gallon and volume increases of 17% compared to the year ended August 31, 2002. In addition, the average cost of propane increased by \$138.1 million (43%), of which the average cost increased by \$0.10 per gallon and volumes increased by 19% compared to the prior year. Energy cost increases were primarily related to the global effects of higher input costs and increased volumes primarily as a result of acquisitions. Country operations non-grain cost of goods sold increased by 12% during the year ended August 31, 2003 compared to the prior year primarily due to a sunflower processing plant acquisition and increased average cost per unit on most farm supply products. Processed Grains and Foods segment cost of goods sold increased by \$9.3 million (2%) compared to the year ended August 31, 2002. Oilseed processing and refining cost of goods sold increased \$94.6 million, primarily due to the increased cost of raw materials related to oilseed refining of \$0.07 per

bushel. This increase was partially offset by decreased cost of goods sold of \$89.7 million related to the formation of Horizon Milling, as previously discussed.

Marketing, General and Administrative. Marketing, general and administrative expenses of \$190.6 million for the year ended August 31, 2003 increased by \$3.3 million (2%) compared to the year ended August 31, 2002. The net increase is primarily due to additional expenses within the Country Operations and Services segment primarily due to a sunflower plant acquisition.

Gain on Legal Settlements. The Country Operations and Services segment received cash of \$10.9 million and \$3.0 million during the years ended August 31, 2003 and 2002, respectively, from a class action lawsuit alleging illegal price fixing against various feed vitamin product suppliers.

Interest. Interest expense of \$48.7 million for the year ended August 31, 2003 increased by \$6.2 million (15%) compared to the year ended August 31, 2002. The average level of short-term borrowings increased \$88.1 million primarily due to financing working capital needs, which was partially offset by an average short-term interest rate decrease of 0.4% during the year ended August 31, 2003 compared to August 31, 2002. Long-term debt borrowings increased due to an additional \$175.0 million of private placement debt that was issued in October 2002.

Equity Income from Investments. Equity income from investments of \$47.3 million for the year ended August 31, 2003 decreased by \$10.8 million (19%) compared to the year ended August 31, 2002. We record equity income or loss from the investments we own 50% or less of 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 decrease in equity income from investments was primarily attributable to decreased earnings in Ventura Foods, which was partially offset by increased earnings in Agriliance compared to the prior year. Equity earnings in Ventura Foods decreased \$16.2 million during fiscal 2003 when compared with earnings of the previous year. This decrease was mostly attributable to higher priced refined soybean oil, which is a primary ingredient in many of Ventura Foods products, and also to the fact that the depressed U.S. economy reduced business for many of Ventura Foods restaurant customers, in turn decreasing demand for and margins on certain of Ventura's products. Equity earnings in Agriliance increased \$6.8 million during fiscal 2003 when compared with the previous year. This increase is primarily attributable to the Company's acquisition of an additional 13.1% of economic interest in the Wholesale CPP business of Agriliance, as previously discussed.

Minority Interests. Minority interests of \$22.0 million for the year ended August 31, 2003 increased by \$6.6 million (43%) compared to the year ended August 31, 2002. The net change in minority interests during the year ended August 31, 2003 compared to the prior year was primarily a result of more profitable operations within the Company's majority-owned subsidiaries. Substantially all minority interests relate to National Cooperative Refinery Association (NCRA) an approximately 74.5% owned subsidiary.

Income Taxes. Income tax expense of \$12.7 million for the year ended August 31, 2003 compares to \$18.7 million for the year ended August 31, 2002, resulting in effective tax rates of 9.3% and 12.9%, respectively. The federal and state statutory rate applied to nonpatronage business activity was 38.9% for the years ended August 31, 2003 and 2002. The income taxes and effective tax rate vary each year based upon profitability and nonpatronage business activity during each of the comparable years.

Comparison of the years ended August 31, 2002 and 2001

Net Income. Consolidated net income for the year ended August 31, 2002 was \$126.1 million compared to \$178.6 million for the year ended August 31, 2001, which represents a \$52.5 million (29%) decrease. This decrease in profitability is primarily attributable to a tax benefit of \$34.2 million in the prior year and decreased earnings in the Company's Energy segment compared to the year ended August 31, 2001.

Net Sales. Consolidated net sales of \$7.2 billion for the year ended August 31, 2002 decreased \$307.8 million (4%) compared to the year ended August 31, 2001.

Company-wide grain and oilseed net sales of \$3.5 billion increased \$29.0 million (1%) during the year ended August 31, 2002 compared to the year ended August 31, 2001. Sales for the year ended August 31, 2002 were \$3,281.4 million and \$862.0 million from Grain Marketing and Country Operations and Services segments, respectively. Sales for the year ended August 31, 2001 were \$3,416.2 million and \$913.4 million from Grain Marketing and Country Operations and Services segments, respectively. We eliminated all intersegment sales from Country Operations and Services to Grain Marketing, of \$685.4 million and \$900.6 million, for the years ended August 31, 2002 and 2001, respectively. The net change in sales was primarily due to an increase of \$0.28 per bushel (10%) in the average sales price of all grain and oilseed marketed by us, which was partially offset by a decrease in grain volume of 8% compared to the prior year. The net increase in company-wide grain and oilseed of \$29.0 million was primarily related to an average price increase of \$335.8 million, which was partially offset by a \$306.8 million decrease related to volume.

Energy net sales of \$2.6 billion decreased \$119.1 million (4%) during the year ended August 31, 2002 compared to the year ended August 31, 2001. Sales for the year ended August 31, 2002 and 2001 were \$2,657.7 million and \$2,781.2 million, respectively. We eliminated all intersegment sales from the Energy segment to Country Operations and Services segment of \$67.4 million and \$71.8 million for the years ended August 31, 2002 and 2001, respectively. Prior to December 31, 2000 we consolidated the business activity of Cooperative Refining LLC (CRLLC), a refining joint venture into the Energy segment. We held a 58% interest in CRLLC, which was dissolved effective December 31, 2000. Energy sales decreased by \$371.6 million primarily due to this dissolution. Refined fuels net sales that were not part of CRLLC increased by \$259.5 million due to a net volume increase of \$575.6 million, which was partially offset by a \$316.1 million decrease due to the price change compared to the previous year. These refined fuels sales volumes increased by 49%, which was partially offset by a decrease of \$0.21 in the average selling price compared to August 31, 2001. Propane net sales decreased by \$35.0 million; \$109.7 million due to the decrease in net price, which was partially offset by a \$74.8 million increase due to net volume change. The average sales price of propane decreased by \$0.21 per gallon, which was partially offset by volume increases of 28% compared to the year ended August 31, 2001. Refined fuels and propane volume increases were primarily a result of acquisitions, with the most substantial acquisition taking place in November 2001, when we purchased for \$32.6 million, the wholesale energy business of Farmland Industries, Inc. (Farmland), as well as all interest in Country Energy, LLC a joint venture formerly with Farmland.

Country operations non-grain sales of \$612.5 million decreased by \$51.3 million (8%) during the year ended August 31, 2002 compared to the year ended August 31, 2001. The decrease is primarily due to a reduction of \$46.3 million (24%) in the average retail sales price of energy products compared to the prior year. Non-grain sales consist of seed; plant food; energy products; animal health ingredients, supplements and products; animal health products; and crop nutrient and crop protection products.

Processed Grains and Foods segment net sales of \$495.5 million decreased \$166.4 million (25%) during the year ended August 31, 2002 compared to the year ended August 31, 2001. Intersegment sales of \$0.6 million and \$0.8 million, for the years ended August 31, 2002 and 2001, respectively, have been eliminated. Sales decreased \$167.4 million primarily due to the formation of Horizon Milling as previously discussed.

Patronage Dividends. Patronage dividends received of \$3.9 million decreased \$2.1 million (35%) during the year ended August 31, 2002 compared to the year ended August 31, 2001, due to reduced patronage dividends from cooperatives.

Other Revenues. Other revenues of \$109.5 million decreased \$6.8 million (6%) during the year ended August 31, 2002 compared to the year ended August 31, 2001. The majority of other revenue was generated within the Country Operations and Services and the Grain Marketing segments and derived primarily from services performed through the Country Operations and Services segment's elevator and agri-service centers, including grain storage, grain cleaning, fertilizer spreading, crop protection product

spraying and other services of this nature; the Country Operations and Services segment's financial services; and the Grain Marketing segment's service activities at its export terminals for loading vessels.

Cost of Goods Sold. Cost of goods sold of \$6.9 billion decreased \$240.5 million (3%) during the year ended August 31, 2002 compared to the year ended August 31, 2001. The cost of all grains and oilseed procured by CHS through its Grain Marketing and Country Operations and Services segments increased \$28.0 million compared to the year ended August 31, 2001 primarily due to a \$0.27 (10%) average cost per bushel increase, which was partially offset by an 8% decrease in volume. This increase was partially offset by decreases in cost of goods sold in the Processed Grains and Foods, Country Operations and Services and Energy segments. Processed Grains and Foods segment cost of goods sold decreased by 26% compared to the year ended August 31, 2001, primarily due to the formation of Horizon Milling, as previously described. Country operations non-grain cost of goods sold decreased by 9% during the year ended August 31, 2002 compared to the prior year primarily due to the reduced cost of energy products. The Energy segment cost of goods sold decreased by 2% during the year ended August 31, 2002 compared to the prior year, primarily due to the dissolution of CRLLC, as previously discussed. However, the volumes of refined fuels that were not associated with the dissolution of CRLLC increased by 49%, which was partially offset by an average cost decrease of \$0.18 per gallon compared to the year ended August 31, 2001. The average cost of propane decreased by \$0.19 per gallon, which was partially offset by a 28% volume increase compared to the prior year. These volume increases were primarily the result of acquisitions.

Marketing, General and Administrative. Marketing, general and administrative expenses of \$187.3 million for the year ended August 31, 2002 increased by \$3.2 million (2%) compared to the year ended August 31, 2001. The net increase is primarily due to additional expenses resulting from Energy segment acquisitions, which was partially offset by reduced expenses within the Processed Grains and Foods segment due to the formation of Horizon Milling described earlier.

Gain on Legal Settlements. During the fiscal year ended August 31, 2002, the Country Operations and Services segment received \$3.0 million in cash from a class action lawsuit alleging illegal price fixing against various feed vitamin product suppliers.

Interest. Interest expense of \$42.5 million for the year ended August 31, 2002 decreased by \$19.0 million (31%) compared to the year ended August 31, 2001. The average level of short-term borrowings decreased \$68.3 million (24%) and the average short-term interest rate decreased 3.6% during the year ended August 31, 2002 compared to the prior year. The net decrease in interest expense from short-term borrowings was partially offset by an increase due to an additional \$80.0 million of long-term debt from a private placement, of which \$25.0 million and \$55.0 million were issued in January and March 2001, respectively.

Equity Income from Investments. Equity income from investments of \$58.1 million for the year ended August 31, 2002 increased by \$29.6 million (104%) compared to the year ended August 31, 2001. The increase was primarily attributable to decreased losses from technology investments of \$15.1 million by the Corporate and Other segment, which was dissolved. In addition, earnings from Agronomy, and Processed Grains and Foods segments investments increased in fiscal year 2002 by \$6.1 million and \$5.8 million, respectively compared to the prior year.

Minority Interests. Minority interests of \$15.4 million for the year ended August 31, 2002 decreased by \$19.7 million (56%) compared to the year ended August 31, 2001. The change in minority interests during the year ended August 31, 2002 compared to the prior year was primarily a result of less profitable operations within our majority-owned subsidiaries and the dissolution of CRLLC. Substantially all minority interests relate to National Cooperative Refinery Association (NCRA) an approximately 74.5% owned subsidiary.

Income Taxes. Income tax expense of \$18.7 million for the year ended August 31, 2002 compares to a tax benefit of \$25.6 million for the year ended August 31, 2001, resulting in effective tax rates of a 12.9% expense and a 16.7% benefit, respectively. The federal and state statutory rate applied to

nonpatronage business activity was 38.9% for the years ended August 31, 2002 and 2001. An income tax benefit of \$34.2 million for the year ended August 31, 2001 resulted from a change in the tax rate applied to our cumulative temporary differences between income for financial statement purposes and income used for tax reporting purposes. Our calculation of our patronage distribution using earnings for financial statement purposes rather than tax basis earnings prompted the rate change. We recorded income tax expense of \$18.7 million for the year ended August 31, 2002, which compares to \$8.6 million for the year ended August 31, 2001, exclusive of the \$34.2 million benefit related to the change in patronage determination described above. The income taxes and effective tax rate vary each year based upon profitability and nonpatronage business activity during each of the comparable years.

Liquidity and Capital Resources

On November 30, 2003 we had working capital, defined as current assets less current liabilities, of \$489.3 million and a current ratio, defined as current assets divided by current liabilities, of 1.3 to 1.0 compared to working capital of \$458.7 million and a current ratio of 1.3 to 1.0 on August 31, 2003. On November 30, 2002 we had working capital of \$431.8 million and a current ratio of 1.3 to 1.0, compared to working capital of \$249.1 million and a current ratio of 1.2 to 1.0 on August 31, 2002. On August 31, 2001, we had working capital of \$305.3 million and a current ratio of 1.3 to 1.0. During fiscal 2003, we borrowed \$175.0 million from a group of insurance companies on a long-term basis and also received net proceeds of \$82.5 million from the sale of preferred stock to the general public. These sources contributed significantly to the increase in the amount of our working capital during fiscal 2003. We raised this additional capital in part to fund capital expenditures that we made in fiscal 2003 and expect to make in fiscal years 2004 and 2005 to meet the new low sulfur fuel regulations discussed below in Cash Flows from Investing Activities. We have committed lines of revolving credit totaling \$730.0 million, of which \$250 million was drawn on August 31, 2003, and \$376.0 million was drawn on November 30, 2003, primarily for the purpose of financing receivables and inventories. We believe that our liquidity is adequate to cover any increase in net operating assets and liabilities.

Cash Flows from Operations

Cash flows from operations are generally affected by commodity prices. These commodity prices are affected by a wide range of factors beyond our control, including weather, crop conditions, drought, the availability and adequacy of supply and transportation, government regulations and policies, world events, and general political and economic conditions. These factors are described in the Risk Factors on page 7 and may affect net operating assets and liabilities and liquidity.

Cash flows provided by (used in) operating activities were \$(160.5) million and \$15.1 million for the three months ended November 30, 2003 and 2002, respectively. Volatility in cash flows from operations for these periods is primarily the result of changing grain prices. On November 30, 2003, the market price per bushel of spring wheat, soybeans and corn, were \$0.30 (8%), \$1.85 (31%), and \$.01 (0%) greater than their respective values on August 31, 2003. These increases in grain prices, in combination with larger inventory quantities due to fall harvest, had the effect of contributing significantly to an increase in net operating assets and liabilities values compared with those on August 31, 2003, thus using cash resources. In contrast, on November 30, 2002, the market price per bushel of spring wheat, soybeans and corn were \$1.35 (26%), \$0.35 (6%) and \$0.28 (11%) lower than their respective values on August 31, 2002. While inventory quantities increased somewhat due to fall harvest, these declining commodity prices partially mitigated that factor and net operating assets and liabilities increased only moderately when compared with those on August 31, 2002.

Operating activities of CHS used net cash of \$160.5 million during the three months ended November 30, 2003. Net income of \$50.7 million and net non-cash expenses of \$16.9 million were offset by an increase in net operating assets and liabilities of \$228.1 million. The primary components of net noncash expenses included depreciation and amortization of \$26.8 million and a partial offset of net income from equity investments of \$13.7 million. The increase in net operating assets and liabilities was caused primarily by increases in the prices of the three primary grain commodities handled by CHS, as

explained in the preceding paragraph. Factors contributing to this price appreciation included a shortage of transportation and a perceived future shortage of soybeans due to poor late season growing conditions for that crop. These and other less significant factors increased net operating assets and liabilities \$228.1 million and was the largest use of cash from operations. A major part of this increase in net operating assets and liabilities was financed with short-term notes payable. Because the change in short-term notes payable is shown in cash flows from financing activities, this source of cash does not offset the corresponding use of cash as part of the cash flows from operating activities in the Consolidated Statements of Cash Flows.

Operating activities of CHS provided net cash of \$15.1 million during the three months ended November 30, 2002. Net income of \$40.4 million and net non-cash expenses of \$23.8 million were partially offset by an increase in net operating assets and liabilities \$49.1 million. The primary components of net non-cash expenses included depreciation and amortization of \$25.9 million and a partial offset of net income from equity investments of \$8.2 million. The increase in net operating assets and liabilities was primarily due to the seasonality of grain harvest, with the affect of greater volume partially offset by lower grain prices. This increase in net operating assets and liabilities of \$49.1 million represented the largest use of cash generated through operations.

We expect that railcars will continue to be in short supply during the next quarter to transport grain from our country elevator locations to sale destinations. Inventories at most of our country operations elevators are already at near maximum capacity; consequently this situation is likely not to contribute to an increase in net operating assets and liabilities, but rather these inventories will not be reduced at the pace normally experienced. We also expect to increase crop nutrient and crop protection product inventories and prepayments to suppliers of these products at its country operations locations during the next fiscal quarter. At the same time we expect this increase in net operating assets and liabilities to be partially offset by the collection of prepayments from our own customers for these products. Prepayments are used frequently for agronomy products to assure supply, and at times to guarantee price. We believe that we have adequate capacity through our committed credit facility to meet any likely increase in net operating assets and liabilities.

Cash flows provided by (used in) operating activities were \$216.5 million, (\$35.9) million, and \$253.9 million for the years ended August 31, 2003, 2002 and 2001, respectively. Volatility in cash flows from operations for the years ended August 31, 2003, 2002 and 2001 was caused primarily by fluctuations in the year-end price of spring wheat, soybeans and corn, our highest volume commodities. Although crude oil prices have experienced volatility during the three-year period, values on August 31, 2003, 2002, and 2001 were comparable, thus not contributing significantly to changes in net operating assets and liabilities on those dates.

Operating activities of CHS provided net cash of \$216.5 million during the year ended August 31, 2003. Net income of \$123.8 million and net non-cash expenses of \$98.0 million were partially offset by a small increase in net operating assets and liabilities requirements of \$5.3 million. The primary components of net non-cash expenses included depreciation and amortization of \$111.3 million which was partially offset by net income from equity investments of \$47.3 million. Grain and oilseed prices on August 31, 2003 remained at the approximate level prevailing at the end of the previous fiscal year, as market conditions were similar to those at the end of the previous fiscal year. Consequently, net operating assets and liabilities at August 31, 2003 changed only slightly compared with those at the prior year-end.

Operating activities of CHS used net cash of \$35.9 million during the year ended August 31, 2002. Net income of \$126.1 million and net non-cash expenses of \$62.4 million were offset by an increase in net operating assets and liabilities of \$224.4 million. The primary components of net non-cash expenses included depreciation and amortization of \$104.0 million which was partially offset by net income from equity investments of \$58.1 million. The increase in net operating assets and liabilities was primarily due to increased grain prices. Grain and oilseed prices increased considerably at the end of fiscal 2002 in response to drought conditions in parts of the grain production area, which reduced overall market supply and resulted in an increase in grain and oilseed inventory values of \$155.6 million compared to that same

inventory category of the year before. The market price of spring wheat, soybeans and corn was higher on August 31, 2002 by \$2.15 per bushel (a 70% increase), \$1.15 per bushel (a 24% increase) and \$0.45 per bushel (a 21% increase), respectively, than at the end of the prior fiscal year. These increases in grain prices also had the affect of increasing hedging margin deposits, which are carried in other current assets, and receivables. These factors in combination with related current liabilities caused net operating assets and liabilities to increase, when comparing August 31, 2002 with August 31, 2001, by \$224.4 million. A major part of our operating assets and liabilities are financed through short-term notes payable. Since the changes in short-term notes payable are shown in cash flows from financing activities, they do not offset an increase in operating assets and liabilities in cash flows from operations. This increase in net operating assets and liabilities requirements at the end of fiscal 2002 was the primary factor in the significant change in cash flows generated by operations when comparing fiscal 2002 with fiscal 2001.

Operating activities of CHS provided net cash of \$253.9 million during the year ended August 31, 2001. Net income of \$178.6 million, net non-cash expenses of \$50.5 million and decreased net operating assets and liabilities of \$24.8 million provided this net cash from operating activities. The primary components of net non-cash expenses included depreciation and amortization of \$109.2 million which was partially offset by net income from equity investments of \$28.5 million and deferred tax credits of \$46.6 million. Stable prices for grain and oilseeds as well as crude oil allowed us to reduce net operating assets and liabilities slightly on August 31, 2001 when compared to net operating assets and liabilities at the close of the prior fiscal year.

Cash Flows from Investing Activities

For the three months ended November 30, 2003 and 2002, the net cash flows used in our investing activities totaled \$4.6 million and \$44.9 million, respectively.

The acquisition of property, plant and equipment comprised the primary use of cash totaling \$52.2 million and \$40.6 million for the three months ended November 30, 2003 and 2002, respectively. For the three months ended November 30, 2002, the acquisitions of property, plant and equipment included \$8.5 million acquired as part of a business. Capital expenditures during the three months ended November 30, 2003 included \$7.7 million for the construction of an oilseed processing facility in Fairmont, Minnesota, with total expenditures for the project at \$76.6 million through November 30, 2003. The Fairmont facility was essentially complete and operational during the three months ended November 30, 2003, and during the same quarter, we entered into a sale leaseback transaction for the facility equipment and received cash proceeds of \$19.8 million from the sale. Total costs are estimated to be approximately \$85 million. For the year ended August 31, 2004 we expect to spend approximately \$252.7 million for the acquisition of property, plant and equipment. Capital expenditures started in Fiscal 2002, primarily related to the U.S. Environmental Protection Agency (EPA) low sulfur fuel regulations required by 2006, are expected to be approximately \$87.0 million for our Laurel, Montana refinery and \$324.0 million for NCRA's McPherson, Kansas refinery, of which \$13.4 million has been spent at the Laurel refinery and \$53.7 million has been spent by NCRA at the McPherson refinery as of November 30, 2003. We expect all of these compliance capital expenditures at the refineries to be completed by December 31, 2005, and anticipate funding these projects with a combination of cash flows from operations and debt proceeds.

Investments made during the three months ended November 30, 2003 and 2002 totaled \$10 thousand and \$1.4 million, respectively.

Acquisitions of intangibles were \$0.4 million for the three months ended November 30, 2002, and net working capital acquired in business acquisitions was \$13.0 million during the same period.

During the three months ended November 30, 2003 and 2002 the changes in notes receivable resulted in decreases in cash flows of \$6.1 million and \$11.2 million, respectively, primarily from related party notes receivables at NCRA with its minority owners, Growmark, Inc. and MFA Oil Company.

Distributions to minority owners for the three months ended November 30, 2003 and 2002 were \$1.3 million and \$0.5 million, respectively, and were primarily related to NCRA. Cash distributions

NCRA has made to its members decreased in 2003 and 2002, due to the funding requirements for environmental capital expenditures previously discussed. Partially offsetting cash outlays in investing activities were proceeds from the disposition of property, plant and equipment of \$21.7 million and \$4.7 million for the three months ended November 30, 2003 and 2002, respectively. During the three months ended November 30, 2003, proceeds of \$19.8 million were from a sale leaseback transaction previously discussed. Also partially offsetting cash usages were distributions received from joint ventures and investments totaling \$31.0 million and \$17.0 million for the three months ended November 30, 2003 and 2002, respectively.

For the years ended August 31, 2003, 2002 and 2001, the net cash flows used in our investing activities totaled \$173.3 million, \$147.6 million and \$70.2 million, respectively.

The acquisition of property, plant and equipment comprised the primary use of cash totaling \$175.7 million, \$140.2 million and \$97.6 million for the years ended August 31, 2003, 2002 and 2001, respectively. These acquisitions of property, plant and equipment included \$8.5 million, \$6.6 million and \$5.3 million acquired as part of business acquisitions during the respective fiscal years. Capital expenditures during the year ended August 31, 2003 included \$46.0 million for the construction of an oilseed processing facility in Fairmont, Minnesota, with total expenditures for the project at \$68.9 million through August 31, 2003.

In October 2003, CHS and NCRA reached agreement with the EPA and the State of Montana's Department of Environmental Quality and the State of Kansas Department of Health and Environment, respectively, 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, respectively. Each consent decree details specific capital improvements, supplemental environmental projects and operational changes that CHS and NCRA have agreed to implement at the relevant refinery over the next several years. The consent decrees also require CHS and NCRA to pay approximately \$0.5 million in aggregate civil cash penalties. CHS and NCRA anticipate that their aggregate capital expenditures related to these settlements will total approximately \$25.0 million to \$30.0 million over the next eight years. Approximately 50 percent of the expenditures will be made over the first three years. We do not believe that the settlements will have a material adverse affect on us.

Investments made during the years ended August 31, 2003, 2002 and 2001 totaled \$43.5 million, \$6.2 million and \$14.2 million, respectively. Investments during the year ended August 31, 2003 included the purchase of an additional economic interest in the wholesale crop protection business of Agrilience, as previously explained.

Acquisitions of intangibles were \$0.8 million, \$29.5 million and \$7.3 million for the years ended August 31, 2003, 2002 and 2001, respectively. During the year ended August 31, 2002, \$26.4 million of the acquisitions of intangibles were related to the purchase of Farmland's interest in its wholesale energy business, as previously discussed, and represented trademarks, tradenames and non-compete agreements. During the year ended August 31, 2001, the intangibles resulted primarily from the purchase of a Mexican foods business.

Net working capital acquired in business acquisitions was \$13.0 million, \$5.8 million and \$1.1 million, respectively, during the years ended August 31, 2003, 2002 and 2001.

During the years ended August 31, 2003 and 2002 the changes in notes receivable resulted in decreases in cash flows of \$6.6 million and \$22.0 million, respectively, primarily from related party notes receivables at NCRA from its minority owners, Growmark, Inc. and MFA Oil Company. During the year ended August 31, 2001 the changes in notes receivable resulted in an increase in cash flows of \$0.5 million.

Distributions to minority owners for the years ended August 31, 2003, 2002 and 2001 were \$4.4 million, \$7.4 million and \$19.3 million, respectively, and were primarily related to NCRA. For the year ended August 31, 2001 NCRA's distributions also included the distributions made by CRLLC. Cash distributions NCRA has made to its members has decreased in 2003 and 2002, due to the funding requirements for environmental capital expenditures previously discussed.

Partially offsetting cash outlays in investing activities were proceeds from the disposition of property, plant and equipment of \$26.9 million, \$20.2 million and \$35.3 million for the years ended August 31, 2003, 2002 and 2001, respectively. During the year ended August 31, 2003, the proceeds were primarily from disposals of propane plants and non-strategic locations in the Energy segment, sales of equipment and non-strategic agri-operations locations in the Country Operations and Services segment, and sales of wheat milling equipment. During the year ended August 31, 2002, the proceeds were primarily from the disposal of propane plants in the Energy segment and of non-strategic agri-operations locations in the Country Operations and Services segment. Also partially offsetting cash usages were distributions received from joint ventures and investments totaling \$44.4 million, \$44.0 million and \$31.8 million for the years ended August 31, 2003, 2002 and 2001, respectively.

Cash Flows from Financing Activities

We finance our working capital needs through short-term lines of credit with a syndication of banks. In May 2003, we entered into a 364-day credit facility of \$600.0 million committed. In addition to these lines of credit, we have a 364-day credit facility dedicated to NCRA, with a syndication of banks in the amount of \$30.0 million committed. On November 30, 2003, August 31, 2003 and November 30, 2002, we had total short-term indebtedness outstanding on these various facilities and other short-term notes payable totaling \$376.8 million, \$251.1 million and \$246.1 million, respectively. The increase in short-term notes payable on November 30, 2003 was primarily due to increased grain prices on November 30, 2003 as compared to August 31, 2003. The increase in grain prices is related to a decrease in supply related to poor late summer growing conditions, as well as increased inventories at country elevator facilities due to harvest and a shortage of railcars available to transport the grain to sale destinations. In October 2002, \$175.0 million received from private placement proceeds was used to pay down our 364-day credit facility. In January 2003, \$83.0 million of proceeds received from the issuance of the Company's preferred stock (net of broker's commissions of \$3.2 million) was also used to pay down the 364-day credit facility.

In June 1998, we established a five-year revolving credit facility with a syndication of banks, with \$200.0 million committed, which expired in May 2003. We had a previous outstanding balance on this facility of \$75.0 million on August 31, 2002 and November 30, 2002, of which repayments of \$75.0 million were made during the year ended August 31, 2003.

In May 2003, we established a three-year revolving credit facility with a syndication of banks, with \$100.0 million committed. The interest rate on any borrowings under this facility will be set on the date of borrowing pursuant to a formula; at November 30, 2003 this rate would have been LIBOR plus 100 basis points. There was no outstanding balance on this new credit facility on August 31, 2003 or November 30, 2003.

We finance our long-term capital needs, primarily for the acquisition of property, plant and equipment, with long-term agreements with various insurance companies and banks. In June 1998, we established a long-term credit agreement through the cooperative banks. This facility committed \$200.0 million of long-term borrowing capacity to CHS, with repayments through fiscal year 2009. The amount outstanding on this credit facility was \$136.1 million and \$142.7 million on November 30, 2003 and November 30, 2002, respectively. Interest rates on November 30, 2003 ranged from 2.04% to 7.13%. Repayments of approximately \$1.6 million were made on this facility during each of the three months ended November 30, 2003 and 2002. The amount outstanding on this credit facility was \$137.8 million and \$144.3 million on August 31, 2003 and 2002, respectively. Interest Rates on August 31, 2003 ranged from

2.14% to 7.13%. Repayments of \$6.6 million were made on this facility during each of the three years ended August 31, 2003, 2002 and 2001.

Also in June 1998, we completed a private placement offering with several insurance companies for long-term debt in the amount of \$225.0 million with an interest rate of 6.81%. Repayments will be made in equal annual installments of \$37.5 million each in the years 2008 through 2013.

In January 2001, we entered into a note purchase and private shelf agreement with Prudential Insurance Company. The long-term note in the amount of \$25.0 million has an interest rate of 7.9% and will be repaid in equal annual installments of approximately \$3.6 million, in the years 2005 through 2011. A subsequent note for \$55.0 million was issued in March 2001, related to the private shelf facility. The \$55.0 million note has an interest rate of 7.43% and will be repaid in equal annual installments of approximately \$7.9 million, in the years 2005 through 2011.

In October 2002, we completed a private placement with several insurance companies for long-term debt in the amount of \$175.0 million which was layered into two series. The first series of \$115.0 million has an interest rate of 4.96% and will be repaid in equal semi-annual installments of approximately \$8.8 million during the years 2007 through 2013. The second series of \$60.0 million has an interest rate of 5.60% and will be repaid in equal semi-annual installments of approximately \$4.6 million during fiscal years 2012 through 2018.

Through NCRA, we had revolving term loans outstanding of \$14.3 million, \$15.0 million, \$17.3 million and \$18 million on November 30, 2003, August 31, 2003, November 30, 2002, and August 31, 2002, respectively. Interest rates on November 30, 2003 and August 31, 2003 ranged from 6.48% to 6.99%. Repayments of approximately \$0.8 million were made during each of the three months ended November 30, 2003 and 2002. Repayments of \$3.0 million were made during each of the three years ended August 31, 2003, 2002 and 2001.

On November 30, 2003, we had total long-term debt outstanding of \$659.6 million, of which \$164.3 million was bank financing, \$480.0 million was private placement proceeds and \$15.3 million was industrial development revenue bonds and other notes and contracts payable. Our long-term debt is unsecured except for industrial revenue bonds in the amount of \$1.6 million and other notes and contracts in the amount of \$5.4 million, however, restrictive covenants under various agreements have requirements for maintenance of minimum working capital levels and other financial ratios. We are in compliance with all debt covenants and restrictions as of November 30, 2003. During the three months ended November 30, 2003 and 2002, we borrowed on a long-term basis no dollars and \$175.0 million, respectively, and during the same periods repaid long-term debt of \$3.8 million and \$3.9 million, respectively.

On August 31, 2003, we had total long-term debt outstanding of \$663.2 million, of which \$168.0 million was bank financing, \$480.0 million was private placement proceeds and \$15.2 million was industrial development revenue bonds and other notes and contracts payable. On August 31, 2002, we had long-term debt outstanding of \$572.1 million. We are in compliance with all debt covenants and restrictions as of August 31, 2003. The aggregate amount of long-term debt payable as of August 31, 2003 was as follows (dollars in thousands):

| | |
|------------|-------------------|
| 2004 | \$ 14,951 |
| 2005 | 34,716 |
| 2006 | 35,176 |
| 2007 | 59,671 |
| 2008 | 98,190 |
| Thereafter | 420,469 |
| | <u> </u> |
| | \$ 663,173 |
| | <u> </u> |

The aggregate amount of long-term debt payable did not materially change during the three months ended November 3, 2003.

During the years ended August 31, 2003, 2002 and 2001, we borrowed on a long-term basis \$175.0 million, \$30.0 million and \$116.9 million, respectively, and during the same periods repaid long-term debt of \$89.5 million, \$18.0 million and \$67.4 million, respectively.

In accordance with our bylaws and by action of our Board of Directors, annual net earnings from patronage sources are distributed to consenting patrons following the close of each fiscal year. Patronage refunds are calculated based on amounts using financial statement earnings. The cash portion of the patronage distribution is determined annually by our Board of Directors, with the balance issued in the form of capital equity certificates. The patronage earnings from the fiscal year ended August 31, 2002 were primarily distributed during the second quarter of the year ended August 31, 2003. The cash portion of this distribution, deemed by our Board of Directors to be 30% was \$26.5 million. During the years ended August 31, 2002 and 2001, we distributed cash patronage of \$40.1 million and \$26.1 million, respectively.

Cash patronage for the year ended August 31, 2003, deemed by our Board of Directors to be 30% and to be distributed in fiscal year 2004, is expected to be approximately \$27.0 million and is classified as a current liability on the August 31, 2003 and November 30, 2003 consolidated balance sheets.

The current equity redemption policy, as authorized by our Board of Directors, allows for the redemption of capital equity certificates held by inactive direct members and patrons and active direct members and patrons at age 72 or death that were of age 61 or older on June 1, 1998. Such redemptions are at the discretion of our Board of Directors. For active direct members and patrons who were of age 60 or younger on June 1, 1998, and member cooperatives, equities older than 10 years may be redeemed annually based on a pro rata formula where the numerator is dollars available for such purpose as determined by the Board of Directors, and the denominator is the sum of the patronage certificates older than 10 years held by such eligible members and patrons. For the years ended August 31, 2003, 2002 and 2001, we redeemed patronage related equities in accordance with authorization from the Board of Directors in the amounts of \$31.1 million, \$31.1 million and \$18.7 million, respectively. Total cash redemptions related to the year ended August 31, 2003, to be distributed in fiscal year 2004, are expected to be approximately \$10.8 million and are classified as a current liability on the August 31, 2003 consolidated balance sheet. Of this amount \$1.3 million was redeemed during the three months ended November 30, 2003 compared to \$2.4 million during the three months ended November 30, 2002. An additional \$13 million of capital equity certificates are expected to be redeemed in fiscal year 2004 in exchange for shares of the Company's 8% Cumulative Redeemable Preferred Stock pursuant to the offering described in this prospectus.

During the year ended May 31, 1997, we offered securities in the form of Equity Participation Units (EPUs) in our Wheat Milling and Oilseed Processing and Refining Defined Business Units. These EPUs gave the holder the right and obligation to deliver to us a stated number of bushels in return for a pro rata share of the undiluted grain based patronage earnings of these respective Defined Business Units. The offering resulted in the issuance of such equity with a stated value of \$13,870,000 and generated additional capital and cash of \$10,837,000, after issuance cost and conversion privileges. Conversion privileges allowed a member to elect to use outstanding patrons' equities for the payment of up to one-sixth the purchase price of the EPUs. During 2001, our Board of Directors adopted a resolution to issue, at no charge, to each Defined Member of the Oilseed Processing and Refining Defined Business Unit an additional 1/4 Equity Participation Unit (EPU) for each EPU held, due to increased crush volume.

In August 2001, our Board of Directors approved and consummated a plan to end the Defined Investment Program. We redeemed all of the EPUs and allocated the assets of the Oilseed Processing and Refining and Wheat Milling Defined Business Units to us as provided in the plan. Due to loss carry-forwards incurred by the Wheat Milling Defined Business Unit the plan also provided for the cancellation of all outstanding Preferred Capital Certificates issued to the EPU holders, totaling \$0.2 million. The plan further provided to the Oilseed Processing Defined Member EPU holders for the redemption of all outstanding Preferred Capital Certificates issued and a 100% cash distribution during 2002 for the patronage refunds earned for the fiscal year ended August 31, 2001.

In 2001 and 2002 we issued approximately \$9.5 million (9,454,874 shares) of 8% Preferred Stock (Old Preferred). In late 2002, we suspended sales of the Old Preferred, and on February 25, 2003 we filed a post-effective amendment to terminate the offering of the Old Preferred shares. In January 2003, our Board of Directors authorized the sale and issuance of up to 3,500,000 shares of 8% Cumulative Redeemable Preferred Stock (New Preferred) at a price of \$25.00 per share. We filed a registration statement on Form S-2 with the Securities and Exchange Commission registering 3,000,000 shares of the New Preferred (with an additional over-allotment option of 450,000 shares granted to the underwriters), which was declared effective on January 27, 2003. The shares were subsequently sold for proceeds of \$86.3 million (3,450,000 shares), and are listed on the NASDAQ National Market. The Board of Directors' intent is to pay quarterly dividends. Expenses related to the issuance of the New Preferred were \$3.8 million.

On March 5, 2003, our Board of Directors authorized the redemption and conversion of the Old Preferred shares. A redemption notification and a conversion election form were sent to holders of the Old Preferred shares on March 21, 2003 explaining that on April 25, 2003 all shares of the Old Preferred would be redeemed by us for \$1.00 per share unless they were converted into shares of our New Preferred. The conversion did not change the base liquidation amount or dividend amount of the Old Preferred, since 25 shares of the Old Preferred converted to 1 share of the New Preferred. The total Old Preferred converted to the New Preferred was \$7.5 million (7,452,439 shares), and the balance of the Old Preferred (2,002,435 shares) was redeemed in cash at \$1.00 per share. As of August 31, 2003 we had \$93.7 million (3,748,099 shares) of the New Preferred outstanding.

Off Balance Sheet Financing Arrangements

Lease Commitments:

We have commitments under operating leases for various refinery, manufacturing and transportation equipment, rail cars, vehicles and office space. Some leases include purchase options at not less than fair market value at the end of the leases.

Total rental expense for all operating leases, net of rail car mileage credits received from the railroad and sublease income for the years ended August 31, 2003, 2002 and 2001 was \$31.7 million, \$30.7 million and \$35.5 million, respectively.

Minimum future lease payments, required under noncancellable operating leases as of August 31, 2003, were as follows:

| | Total |
|--|------------------------------|
| | (dollars in millions) |
| 2004 | \$ 33.4 |
| 2005 | 24.4 |
| 2006 | 19.2 |
| 2007 | 12.6 |
| 2008 | 7.2 |
| Thereafter | 10.6 |
| Total minimum future lease payments | \$ 107.4 |

Guarantees:

We are a guarantor for lines of credit for related companies of which \$56.7 million was outstanding on November 30, 2003. Our bank covenants allow maximum guarantees of \$150.0 million. In addition, our bank covenants allow for guarantees dedicated solely for NCRA in the amount of \$125.0 million. All outstanding loans with respective creditors were current as of November 30, 2003.

Debt:

There is no material off balance sheet debt.

Critical Accounting Policies

Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires the use of estimates as well as management's judgments and assumptions regarding matters that are subjective, uncertain or involve a high degree of complexity, all of which affect the results of operations and financial condition for the periods presented. We believe that of our significant accounting policies, the following may involve a higher degree of estimates, judgments, and complexity.

Allowances for Doubtful Accounts

The allowances for doubtful accounts are maintained at a level considered appropriate by management based on analyses of credit quality for specific accounts, historical trends of charge-offs and recoveries, and current and projected economic and market conditions. Different assumptions, changes in economic circumstances or the deterioration of the financial condition of our customers could result in additional provisions to the allowances for doubtful accounts and increased bad debt expense.

Inventory Valuation and Reserves

Grain, processed grains, oilseed and processed oilseeds are stated at net realizable values, which approximates market values. All other inventories are stated at the lower of cost or market. The cost of certain energy inventories (wholesale refined products, crude oil and asphalt) are determined on the last-in, first-out (LIFO) method; all other energy inventories are valued on the first-in, first-out (FIFO) and average cost methods. Estimates are used in determining the net realizable value of grain and oilseed and processed grains and oilseeds inventories. These estimates include the measurement of grain in bins and other storage facilities, which use formulas in addition to actual measurements taken to arrive at appropriate quantity. Other determinations made by management include quality of the inventory and estimates for freight. Grain shrink reserves and other reserves that account for spoilage also affect inventory valuations. If estimates regarding the valuation of inventories or the adequacy of reserves are less favorable than management's assumptions, then additional reserves or write-downs of inventories may be required.

Derivative Financial Instruments

We enter into exchange-traded commodity futures and options contracts to hedge our exposure to price fluctuations on energy, grain and oilseed transactions to the extent considered practicable for minimizing risk. We do not use derivatives for speculative purposes. Futures and options contracts used for hedging are purchased and sold through regulated commodity exchanges. Fluctuations in inventory valuations, however, may not be completely hedged, due in part to the absence of satisfactory hedging facilities for certain commodities and geographical areas and in part to our assessment of our exposure from expected price fluctuations. We also manage our risks by entering into fixed price purchase contracts with pre-approved producers and establishing appropriate limits for individual suppliers. Fixed price sales contracts are entered into with customers of acceptable creditworthiness, as internally evaluated. We are exposed to loss in the event of nonperformance by the counterparties to the contracts; however, we do not anticipate nonperformance by counterparties. The fair value of futures and options contracts are determined primarily from quotes listed on regulated commodity exchanges. Fixed price purchase and sales contracts are with various counterparties, and the fair values of such contracts are determined from the market price of the underlying product.

Pension and Other Postretirement Benefits

Pension and other postretirement benefits costs and obligations are dependent on assumptions used in calculating such amounts. These assumptions include discount rates, health care cost trend rates, benefits earned, interest costs, expected return on plan assets, mortality rates, and other factors. In accordance with accounting principles generally accepted in the United States of America, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect recognized expenses and the recorded obligations in future periods. While management believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect our pension and other postretirement obligations and future expenses.

Deferred Tax Assets

We assess whether a valuation allowance is necessary to reduce our deferred tax assets to the amount that we believe is more likely than not to be realized. While we have considered future taxable income as well as other factors in assessing the need for the valuation allowance, in the event that we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to income in the period such determination was made.

Long-Lived Assets

Depreciation and amortization of our property, plant and equipment is provided on the straight-line method by charges to operations at rates based upon the expected useful lives of individual or groups of assets. Economic circumstances or other factors may cause management's estimates of expected useful lives to differ from actual.

All long-lived assets, including property plant and equipment, goodwill, investments in unconsolidated affiliates and other identifiable intangibles, are evaluated for impairment on the basis of undiscounted cash flows at least annually for goodwill, and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impaired asset is written down to its estimated fair market value based on the best information available. Estimated fair market value is generally measured by discounting estimated future cash flows. Considerable management judgment is necessary to estimate discounted future cash flows and may differ from actual.

Environmental Liabilities

Liabilities, including legal costs, related to remediation of contaminated properties are recognized when the related costs are considered probable and can be reasonably estimated. Estimates of these costs are based on current available facts, existing technology, undiscounted site-specific costs and currently enacted laws and regulations. Recoveries, if any, are recorded in the period in which recovery is considered probable. It is often difficult to estimate the cost of environmental compliance, remediation and potential claims given the uncertainties regarding the interpretation and enforcement of applicable environmental laws and regulations, the extent of environmental contamination and the existence of alternate cleanup methods. All liabilities are monitored and adjusted as new facts or changes in law or technology occur and management believes adequate provisions have been made for environmental liabilities. Changes in facts or circumstances may have an adverse impact on our financial results.

Revenue Recognition

The Company provides a wide variety of products and services, from agricultural inputs such as fuels, farm supplies and crop nutrients, to agricultural outputs that include grain and oilseed, processed grains and oilseeds and food products. Grain and oilseed sales are recorded after the commodity has been delivered to its destination and final weights, grades and settlement price have been agreed upon. All other sales are recognized upon transfer of title, which could occur upon either shipment or receipt by the customer, depending upon the contract. Amounts billed to a customer as part of a sales transaction related

to shipping and handling are included in net sales. Service revenues are recorded only after such services have been rendered, and are included in other revenues.

Effect of Inflation and Foreign Currency Transactions

We believe that inflation and foreign currency fluctuations have not had a significant effect on our operations. During fiscal year 2003, we opened a grain marketing office in Brazil that will impact our exposure to foreign currency fluctuations, but to date, there has been no material effect.

Recent Accounting Pronouncements

During 2003, we adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*, issued by the Financial Accounting Standards Board (FASB) which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. Our Energy segment operates oil refineries and related pipelines for which we would be subject to Asset Retirement Obligations (ARO) if such assets were to be dismantled. We expect, however, to operate our refineries and related pipelines indefinitely. Since the time period to dismantle these assets is indeterminate, a corresponding ARO is not estimable and therefore has not been recorded.

On April 30, 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. The new guidance amends SFAS No. 133 for decisions made as part of the Derivatives Implementation Group process that effectively required amendments to SFAS No. 133, and decisions made in connection with other FASB projects dealing with financial instruments and in connection with implementation issues raised in relation to the application of the definition of a derivative and characteristics of a derivative that contains financing components. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statements of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. We believe that the effects of adopting this standard do not have a material effect on us.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in certain circumstances). Many of those instruments were previously classified as equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Statement is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. Adoption of this standard did not have a material effect on us.

In December 2003, the FASB revised FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*. The interpretation addresses consolidation of certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. It also requires consolidation by the primary beneficiary. For public entities the interpretation applies to interests in variable interest entities for periods ending after December 15, 2003. We have not yet determined what the effects of adopting this standard will have on us.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Commodity Price Risk

We utilize futures and options contracts offered through regulated commodity exchanges to reduce price risk. We are exposed to risk of loss in the market value of inventories and fixed or partially fixed purchase and sales contracts. In order to reduce that risk, we generally take opposite and offsetting positions using futures contracts or options.

Certain commodities cannot be hedged with futures or options contracts because such contracts are not offered for these commodities by regulated commodity exchanges. Inventories and purchase contracts for those commodities are hedged with forward sales contracts, to the extent practical, in order to arrive at a net commodity position within the formal position limits set by us and deemed prudent for each of those commodities. Commodities for which futures contracts and options are available are also typically hedged first with forward contracts, with futures and options used to hedge within position limits the remaining portion. These futures and options contracts and forward purchase and sales cash contracts used to hedge against commodity price changes are effective economic hedges of price risk, but they are not designated as, or accounted for as, hedging instruments for accounting purposes. Hedging arrangements do not protect against non-performance of a contract.

Unrealized gains and losses on futures contracts and options used as economic hedges of grain and oilseed inventories and fixed price contracts are recognized in cost of goods sold for financial reporting on a monthly basis using market based prices. Inventories and fixed price contracts are marked to fair value using market based prices so that gains or losses on the derivative contracts are offset by gains or losses on inventories and fixed priced contracts during the same accounting period.

Unrealized gains and losses on futures contracts and options used as economic hedges of energy inventories and fixed price contracts are recognized in cost of goods sold for financial reporting on a monthly basis using market based prices. The inventories hedged with these derivatives are valued at the lower of cost or fair value, and the fixed price contracts are marked to fair value using market based prices. Certain fixed price contracts related to propane in the Energy segment meet the normal purchase and sales exemption, and thus are not required to be marked to fair value.

A 10% adverse change in market prices would not materially affect our results of operations, financial position or liquidity, since our operations have effective economic hedging requirements as a general business practice.

Interest Rate Risk

We manage interest expense using a mix of fixed and floating rate debt. These debt instruments are carried at amounts approximating estimated fair value. Short-term debt used to finance inventories and receivables is represented by notes payable within thirty days or less so that the blended interest rate to us for all such notes approximates current market rates. Long-term debt used to finance non-current assets carries various fixed interest rates and is payable at various dates as to minimize the effect of market interest rate changes. The effective interest rate to CHS on fixed rate debt outstanding on August 31, 2003, was approximately 6.5%; a 10% adverse change in market rates would not materially affect our results of operations, financial position or liquidity.

In August 2002, we entered into interest rate treasury lock instruments to secure the interest rate related to a portion of our private placement debt issued on October 18, 2002. These instruments were designated and effective as cash flow hedges for accounting purposes, and accordingly, the loss on settlement was recorded as a component of other comprehensive income. Interest expense for the year ended August 31, 2003, includes \$0.7 million related to the interest rate derivatives. The additional interest expense is an offset to the lower actual interest paid on the outstanding debt instruments.

Foreign Currency Risk

We conduct essentially all of our business in U.S. dollars except for grain marketing operations in Brazil and some purchases of products from Canada, and had minimal risk regarding foreign currency fluctuations during 2003. Foreign currency fluctuations do, however, impact the ability of foreign buyers to purchase U.S. agricultural products and the competitiveness of U.S. agricultural products compared to the same products offered by alternative sources of world supply.

DESCRIPTION OF THE PREFERRED STOCK

The following section summarizes the material terms and provisions of our preferred stock. This summary is not a complete legal description of our preferred stock, and is qualified in its entirety by reference to our restated articles of incorporation, as amended, and the resolution of our board of directors establishing the preferred stock.

General

The shares of preferred stock are shares of a series of preferred equity securities created by our board of directors. Subject to the restrictions noted below under Limitations and Restrictions on Future Issuances, there is no limit on the number of shares in the series and shares may be issued from time to time. Our board of directors has expressly authorized the initial sale and subsequent transfer of the shares of preferred stock in accordance with our articles of incorporation.

The shares of preferred stock to be issued as described in this prospectus will be fully paid and nonassessable when issued.

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 (as that term is used in our bylaws), whether or not represented by a certificate, and any redemption thereof;

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.

Dividends

Holders of the preferred stock are entitled to receive quarterly dividends when, as and if declared by our board of directors out of funds legally available for that purpose at the rate of \$2.00 per share per year. Dividends are payable 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 payable without interest on the next day that is not a Saturday, Sunday or legal holiday. Dividends on the preferred stock are fully cumulative and accumulate without interest from and including the day immediately following the most recent date as to which dividends have been paid. The most recent date as to which dividends have been paid is December 31, 2003.

Dividends are computed on the basis of a 360-day year of twelve 30-day months. Each payment of dividends includes dividends to and including the date on which paid.

Dividends are paid to holders of record as they appear on our books ten business days prior to the relevant payment date. We may, in our sole discretion, pay dividends by any one or more of the following means:

- check mailed to the address of the record holder as it appears on our books;
- electronic transfer in accordance with instructions provided by the record holder; or
- any other means mutually agreed between us and the record holder.

We may not make any distribution to the holders of any security that ranks junior to the preferred stock unless and until all accumulated and unpaid dividends on the preferred stock and on any other class or series of our capital stock that ranks equally with the preferred stock, including the full dividend for the then-current dividend period, have been paid or declared and set apart for payment. For these purposes, a distribution does not include any distribution made in connection with a liquidation, dissolution or winding up, which will be governed by the provisions summarized under **Liquidation Preference** below.

Liquidation Preference

In a liquidation, dissolution or winding up of CHS, whether voluntary or involuntary, the holders of the preferred stock are entitled to receive out of our available assets \$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 the preferred stock will 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. Any distribution to the holders of the preferred stock will be made ratably among the holders of the preferred stock and any other of our capital stock which ranks on a parity as to liquidation rights with the preferred stock in proportion to the respective preferential amounts to which each is entitled. After payment in full of the liquidation preference of the shares of preferred stock, the holders of the preferred stock will not participate further in the distribution of our assets.

Neither a consolidation or merger with another entity nor a sale or transfer of all or part of our assets for cash, securities or other property will constitute a liquidation, dissolution or winding up if, following the transaction, the preferred stock remains outstanding as duly authorized stock of us or any successor entity.

Redemption

At Our Option

From and after February 1, 2008 we may, at our option, redeem at any time all, or from time to time any portion, of the preferred stock. An optional redemption will be at a price of \$25.00 per share plus all dividends accumulated and unpaid on that share, whether or not declared, to and including the date fixed for redemption. If we redeem less than all of the then outstanding shares of preferred stock, we will designate the shares to be redeemed either by lot or in any other manner that our board of directors may determine or may effect the redemption pro rata. However, we may not redeem less than all of the then outstanding shares of preferred stock until all dividends accumulated and unpaid on all then outstanding shares of preferred stock have been paid for all past dividend periods.

At the Holder's Option

If at any time there has been a change in control (as defined below), each record holder of shares 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 redeem all or any portion of the shares of preferred stock owned by that record holder. Not later than 130 days after the date of the change in control (or, if that date is a Saturday, Sunday or legal holiday, the next day that is not a Saturday, Sunday or legal holiday) we will redeem all shares the record holder has elected to have redeemed in a written notice delivered to us on or prior to the 90th day after

the change in control. The redemption price is \$25.00 per share plus all dividends accumulated and unpaid on that share, whether or not declared, to and including the date fixed for redemption.

A change in control will have occurred if, in connection with a merger or consolidation that has been approved by our board of directors (prior to submitting the merger or consolidation to our members for approval), whether or not we are the surviving entity, those persons who were members of our board of directors on January 1, 2003, together with those persons who became members of our board of directors after that date at our annual meeting, have ceased to constitute a majority of our board of directors. Under the Minnesota cooperative statute, our members could initiate a merger or consolidation without the approval of our board of directors; a member-initiated merger or consolidation would not meet this definition and thus would not trigger a redemption right.

Mechanics of Redemption

Not less than 30 days prior to any redemption date pursuant to the exercise of our optional redemption right, we will give written notice to the holders of record of the shares of preferred stock to be redeemed. This notice will specify:

- the redemption date;
- the redemption price;
- the number of shares of preferred stock held by the record holder that are subject to redemption;
- the time, place and manner in which the holder should surrender the certificate or certificates, if any, representing the shares of preferred stock to be redeemed, including the steps that a holder should take with respect to any certificates which have been lost, stolen or destroyed or to any uncertificated shares; and
- that from and after the redemption date, dividends will cease to accumulate on the shares and the shares will no longer be deemed outstanding.

On or after the redemption date, once a holder surrenders the certificate or certificates representing the shares of preferred stock called for redemption in the manner provided in the redemption notice or takes the appropriate steps with respect to lost, stolen or destroyed certificates or uncertificated shares, the holder will be entitled to receive payment of the redemption price. If fewer than all of the shares of preferred stock represented by a surrendered certificate or certificates are redeemed, we will issue a new certificate representing the unredeemed shares.

Effect of Redemption

From and after the redemption date, if funds necessary for the redemption are and have been irrevocably deposited or set aside, then:

- dividends will cease to accumulate with respect to the shares of preferred stock called for redemption;
- the shares will no longer be deemed outstanding;
- the holders of the shares will cease to be shareholders; and
- all rights with respect to the shares of preferred stock will terminate except the right of the holders to receive the redemption price, without interest.

Purchases

We may at any time and from time to time in compliance with applicable law purchase shares of preferred stock on the open market, pursuant to a tender offer or otherwise, at whatever price or prices and other terms we determine. We may not make any purchases at a time when there are accumulated but unpaid dividends for past dividend periods.

Voting

Except as described below, the holders of the preferred stock have only those voting rights that are required by applicable law. As a result, the holders of the preferred stock have very limited voting rights and, among other things, do not have any right to vote for the election of directors.

Unless the preferred stock is redeemed pursuant to its terms, the affirmative vote of the holders of at least two-thirds of the outstanding shares of the preferred stock, voting separately as a class, is required:

for any amendment, alteration or repeal, whether by merger or consolidation or otherwise, of our articles of incorporation or the resolutions establishing the terms of the preferred stock, if the amendment, alteration or repeal adversely affects the rights or preferences of the preferred stock; and

to establish, by board resolution or otherwise, any class or series of our 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, whether voluntary or involuntary.

The creation and issuance of any other class of our securities ranking on a parity with or junior to the preferred stock, including an increase in the authorized number of shares of any such securities, will not be deemed to adversely affect the rights or preferences of the preferred stock.

Our board of director's ability to authorize, without preferred shareholder approval, the issuance of additional classes or series of preferred stock with conversion and other rights may adversely affect you as a holder of preferred stock or the rights of holders of any series of preferred stock that may be outstanding.

Limitations and Restrictions on Future Issuances

We may not offer to issue additional shares of preferred stock in exchange for or in redemption of outstanding patrons' equities or other equity securities held by our members more than one time per calendar year. If, in connection with an offer of this type, any member would receive more than 0.25% of the number of shares of preferred stock outstanding at the end of the prior calendar year, that member will instead be entitled to receive the shares in quarterly installments as nearly equal as possible. In any calendar year, we may not issue additional shares of preferred stock in exchange for or in redemption of outstanding patrons' equities or other equity securities held by our members in excess of:

for issuances during the years 2004, 2005 and 2006, 20% of the number of shares of preferred stock outstanding at the end of the prior calendar year or 400,000 shares, whichever is greater; and

for issuances during any calendar year after the year 2006, 25% of the number of shares of preferred stock outstanding at the end of the prior calendar year or 400,000 shares, whichever is greater.

We may not issue additional shares of preferred stock in exchange for or in redemption of outstanding patrons' equities owned by an estate of one of our former individual members or in redemption of outstanding patrons' equities owned by individual members who have reached age 72, pursuant to our current policy.

No Exchange or Conversion Rights; No Sinking Fund

Shares of the preferred stock are not exchangeable or convertible into other class or series of our capital stock or other securities or property. The preferred stock is not subject to the operation of a purchase, retirement or sinking fund.

Certain Charter Provisions

For a description of some of the provisions of our articles of incorporation that might have an effect of delaying, deferring or preventing a change in control of us, see Business Membership in CHS and Authorized Capital Certain Antitakeover Measures.

As noted above under Business Membership in CHS and Authorized Capital Debt and Equity Instruments, under our articles of incorporation all equity we issue (including the preferred stock) is subject to a first lien in favor of us for all indebtedness of the holder to us. However, we have not to date taken, and do not intend to take, any steps to perfect this lien against shares of the preferred stock.

No Preemptive Rights

Holders of the preferred stock have no preemptive right to acquire shares of any class or series of our capital stock.

Market for the Preferred Stock

The preferred stock is currently listed on The NASDAQ National Market under the symbol CHSCP .

The following is a listing of the high and low sales prices as listed on The NASDAQ National Market for our preferred stock during our fiscal quarters ended February 29, 2004, November 30, 2003, August 31, 2003, May 31, 2003 and February 28, 2003.

| | February 29, 2004 | November 30, 2003 | August 31, 2003 | May 31, 2003 | February 28, 2003* |
|------------|----------------------|----------------------|--------------------|-----------------|-----------------------|
| High Price | 29.04 | 28.10 | 28.10 | 27.00 | 26.20 |
| Low Price | 26.99 | 27.00 | 26.68 | 25.80 | 25.00 |

* The range of calculation for the quarter ended February 28, 2003 started on January 29, 2003, which was the first day that the preferred stock traded on The NASDAQ National Market.

Transfer Agent and Registrar

Wells Fargo Bank, National Association serves as transfer agent and registrar with respect to the preferred stock.

**COMPARISON OF RIGHTS OF HOLDERS OF PATRONS' EQUITIES
AND RIGHTS OF HOLDERS OF PREFERRED STOCK**

The following describes the material differences between the rights that the patrons' equities being redeemed provided to the members of CHS holding them and the rights that the preferred stock provides to the holders. While CHS believes that the description covers the material differences between the two, this summary may not contain all of the information that is important to you. You should carefully read this entire prospectus, including the sections entitled Membership in CHS and Authorized Capital and Description of the Preferred Stock, and refer to the documents discussed in those sections for a more complete understanding of the differences.

Priority on Liquidation

In a liquidation, dissolution or winding up of CHS, the rights of a holder of preferred stock rank senior to those of a holder of patrons' equities.

Dividends

A holder of patrons' equities is not entitled to any interest or dividends on those patrons' equities. A holder of preferred stock is entitled to dividends as described under "Description of the Preferred Stock - Dividends."

Redemption

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, as in effect from time to time. Shares of preferred stock are subject to redemption both at the option of CHS and at the holder's option under certain circumstances, both as described under "Description of the Preferred Stock - Redemption."

Voting Rights

Ownership of patrons' equities does not, by itself, entail any voting rights, although the amount of patrons' equities held by a member that is a cooperative association or a member that is part of a patron's association is considered in the formula used to determine the level of the member's voting rights of that cooperative association or patron's association. See "Membership in CHS and Authorized Capital - Voting Rights." Ownership of preferred stock entails the limited voting rights described under "Description of the Preferred Stock - Voting Rights."

Transfers

Patrons' equities may not be transferred without the approval of our board of directors. Shares of preferred stock are not subject to any similar restrictions on transfer.

Market

There is no public market for patrons' equities. The preferred stock is listed on The NASDAQ National Market.

MATERIAL FEDERAL INCOME TAX CONSEQUENCES

The following summarizes the material federal income tax consequences of the issuance of Shares of our preferred stock in redemption of patrons' equities (the "Exchange") and the consequences of the ownership, redemption and disposition of the preferred stock. This summary is based upon the provisions of the Internal Revenue Code ("Code"), the final, temporary and proposed regulations promulgated thereunder and administrative rulings and judicial decisions now in effect, all of which are subject to change (possibly with retroactive effect). This summary addresses only the tax consequences to a person who is a U.S. holder of patrons' equities or the preferred stock. You are a U.S. holder if you are:

- an individual who is a citizen or resident of the U.S.;
- a corporation (or any entity treated as a corporation for U.S. federal income tax purposes, such as a cooperative) organized under the laws of the U.S. or any political subdivision of the U.S.;
- an estate if its income is subject to U.S. federal income tax regardless of its source; or
- a trust if a U.S. court can exercise primary supervision over the trust's administration and one or more U.S. persons are authorized to control all substantial decisions of the trust.

This summary assumes that you will hold your shares of preferred stock as capital assets within the meaning of Section 1221 of the Code. The summary also assumes that all dividends will be paid as they accrue and that, if the preferred stock is redeemed, there will be no dividend arrearages at the time of redemption. The summary does not purport to deal with all aspects of federal income taxation that may be relevant to your receipt of preferred stock pursuant to the Exchange or your ownership, redemption or disposition of the preferred stock, such as estate and gift tax consequences or tax consequences arising under the laws of any state, local or other taxing jurisdiction. This summary also does not apply to you if

you belong to a category of investors subject to special tax rules, such as dealers in securities, financial institutions, insurance companies, tax-exempt organizations, foreign persons, qualified retirement plans, individual retirement accounts, regulated investment companies, U.S. expatriates, investors in pass-through entities or persons subject to the alternative minimum tax.

We can give no assurance that the Internal Revenue Service (the IRS) will take a similar view with respect to the tax consequences described below. We have not requested, nor do we plan to request, a ruling from the IRS on any tax matters relating to the Exchange or the preferred stock. We strongly encourage you to consult your own tax advisor regarding the federal, state, local, and foreign tax consequences of the Exchange and of the ownership, redemption, and disposition of the preferred stock in light of your particular tax circumstances.

The Exchange

We have received an opinion of Dorsey & Whitney LLP that the following federal income tax consequences will result from the Exchange:

1. The Exchange will constitute a reorganization within the meaning of Section 368(a)(1)(E) of the Code. We will be a party to a reorganization within the meaning of Section 368(b) of the Code.
2. We will recognize no gain or loss upon the receipt of the patrons' equities in exchange for the preferred stock.
3. No gain or loss will be recognized by the participants upon the exchange of patrons' equities for the preferred stock.
4. The basis of the preferred stock received by the participants in the transaction will be the same as the basis of the patrons' equities surrendered in exchange therefor.
5. The holding period of the preferred stock received by each participant will include the period during which the participant held the patrons' equities surrendered in exchange therefor, provided that the patrons' equities surrendered were held as capital assets on the date of the exchange.
6. The preferred stock received by the participants in the Exchange will not constitute section 306 stock within the meaning of Section 306(c) of the Code. Accordingly, a disposition of the Preferred Stock will not be subject to Section 306(a) of the Code, which provides generally that the gross proceeds from the sale or redemption of section 306 stock shall be treated either as ordinary income or as a distribution of property to which section 301 of the Code (concerning amounts taxable as dividends) applies.

You should be aware that the opinion of Dorsey & Whitney LLP is subject to the following qualifications and assumptions: it relies on certifications of relevant facts by us, is based upon provisions of the Code, regulations, and administrative and judicial decisions now in effect, all of which are subject to change (possibly with retroactive effect), is subject to the assumption that the Exchange will be effected in the manner described in this prospectus, and is limited to the federal income tax matters expressly addressed in the six numbered paragraphs set forth above. The opinion represents counsel's legal judgment and is not binding on the Internal Revenue Service or the courts.

Dividends and Other Distributions

Distributions on the preferred stock are treated as dividends and taxable as ordinary income to the extent of our current or accumulated earnings and profits, as determined for federal income tax purposes. Any distribution in excess of our current or accumulated earnings and profits is treated first as a nontaxable return of capital reducing your tax basis in the preferred stock. Any amount in excess of your tax basis is treated as a capital gain.

Dividends received by corporate holders of the preferred stock are eligible for a dividends received deduction equal to 70% of the amount of the distribution, subject to applicable limitations, including limitations related to debt financed portfolio stock under Section 246A of the Code and to the holding period requirements of Section 246 of the Code. In addition, any amount received by a corporate holder that is treated as a dividend may constitute an extraordinary dividend subject to the provisions of Section 1059 of the Code (except as may otherwise be provided in Treasury Regulations yet to be promulgated). Under Section 1059, a corporate holder generally must reduce the tax basis of all of the holder's shares (but not below zero) by the nontaxed portion of any extraordinary dividend and, if the nontaxed portion exceeds the holder's tax basis for the shares, must treat any excess as gain from the sale or exchange of the shares in the year the payment is received. If you are a corporate holder, we strongly encourage you to consult your own tax advisor regarding the extent, if any, to which these provisions may apply to you in light of your particular facts and circumstances.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (the Act), signed into law by the President on May 28, 2003, reduced the maximum rates of taxation for individual taxpayers on both long-term capital gains and certain dividends to 15%. Dividends distributed to individuals on the preferred stock will generally be eligible for the current 15% tax rate. These rate reductions will cease to be effective for taxable years beginning after December 31, 2008, at which time the dividend and long-term capital gains rates in effect prior to enactment of the Act will be restored.

Sale or Exchange of Preferred Stock

On the sale or exchange of the preferred stock to a party other than us, you generally will realize capital gain or loss in an amount equal to the difference between (a) the amount of cash and the fair market value of any property you receive on the sale and (b) your adjusted tax basis in the preferred stock. We strongly encourage you to consult your own tax advisor regarding applicable rates, holding periods and netting rules for capital gains and losses in light of your particular facts and circumstances. Certain limitations exist on the deduction of capital losses by both corporate and noncorporate taxpayers.

Redemption of Preferred Stock

If we exercise our right to redeem the preferred stock, your surrender of the preferred stock for the redemption proceeds will be treated either as a payment received upon sale or exchange of the preferred stock or as a distribution with respect to all of your equity interests in us. Resolution of this issue will turn on the application of Section 302 of the Code to your individual facts and circumstances.

The redemption will be treated as gain or loss from the sale or exchange of the preferred stock (as discussed above under **Sale or Exchange of Preferred Stock**) if:

- the redemption is substantially disproportionate with respect to you within the meaning of Section 302(b)(2) of the Code; or
- your interest in the preferred stock and any other equity interest in us is completely terminated (within the meaning of Section 302(b)(3) of the Code) as a result of such redemption; or
- the redemption is not essentially equivalent to a dividend (within the meaning of Section 302(b)(1) of the Code). In general, redemption proceeds are not essentially equivalent to a dividend if the redemption results in a meaningful reduction of your interest in the issuer.

In determining whether any of these tests has been met, you must take into account not only shares of preferred stock and other equity interests in us (including patrons' equities and other equity interests) that you actually own, but also shares and other equity interests that you constructively own within the meaning of Section 318 of the Code.

If none of the above tests giving rise to sale treatment is satisfied, then a payment made in redemption of the preferred stock will be treated as a distribution that is subject to the tax treatment described above under **Dividends and other Distributions**. The amount of the distribution will be measured by the amount of cash and the fair market value of property you receive without any offset for

your basis in the preferred stock. Your adjusted tax basis in the redeemed shares of preferred stock will be transferred to any of your remaining stock holdings in us. If, however, you have no remaining stock holdings in us, your basis could be lost.

We strongly encourage you to consult your own tax advisor regarding:

whether the redemption payment will qualify for sale or exchange treatment under Section 302 of the Code or, alternatively, will be characterized as a distribution; and
the resulting tax consequences to you in light of your individual facts and circumstances.

Backup Withholding

We may be required to withhold federal income tax at a rate of 28% from dividends and redemption proceeds paid to you if (i) you fail to furnish us with your correct taxpayer identification number in the manner required (ii) the IRS notifies us that your taxpayer identification number is incorrect (iii) the IRS notifies us that you have failed to report properly certain interest and dividend income to the IRS and to respond to notices to that effect or (iv) when required to do so, you fail to certify that you are not subject to backup withholding. Any amounts withheld may be credited against your federal income tax liability.

PLAN OF DISTRIBUTION

On October 8, 2003, our board of directors authorized us to redeem, on a pro rata basis, up to \$13,000,000 of patrons' equities that have been outstanding for at least 10 years and that are held by active members. See Membership in CHS and Authorized Capital Patrons' Equities for a description of patrons' equities and our annual pro rata redemptions of patrons' equities. For those members whose redemption amount is less than \$500, that amount will be paid in cash. For those members whose redemption amount is equal to or greater than \$500, that amount will be paid by the issuance of shares of preferred stock pursuant to this prospectus and the registration statement of which it is a part. However, we reserve the right not to issue preferred stock to any member whose member account with us is delinquent. Instead, we may elect to pay a delinquent member cash to redeem equities in an amount equal to approximately one half of that member's pro rata preferred stock redemption amount less any delinquent amounts owing to us, which we will retain in satisfaction of that member's delinquent amounts. The amount of patrons' equities that will be redeemed with each share of preferred stock issued will be \$27.10, which is the greater of \$25.36 (equal to the \$25.00 liquidation preference per share of preferred stock plus \$0.36 of accumulated dividends from and including January 1, 2004 to and including March 4, 2004) and the \$27.10 closing price for one share of the preferred stock on The NASDAQ National Market on March 2, 2004. We will not issue any fractional shares of preferred stock. The amount of patrons' equities that would otherwise be issued as a fractional share to any member will instead be retained as part of that member's patrons' equities.

We will issue the shares of preferred stock directly to the relevant members. We have not engaged and will not engage any underwriter, broker-dealer, placement agent or similar agent or representative in connection with the issuance of the preferred stock described in this prospectus.

We will not pay any commissions or other compensation related to the issuance of the shares of preferred stock. We estimate that the total expenses of the issuance will be approximately \$83,000, all of which we will bear.

Except in the circumstances described below, we will not prepare or distribute stock certificates to represent the shares of preferred stock so issued. Instead, we will issue the shares of preferred stock in book-entry form on the records of our transfer agent for the preferred stock (Wells Fargo Bank,

Edgar Filing: CHS INC - Form 424B1

National Association). Members who require a stock certificate should contact Wells Fargo Shareowner Services in writing or by telephoning at the following address:

Wells Fargo Shareowner Services

161 North Concord Exchange
South St. Paul, MN 55075
(800) 468-9716

Some of our members have pledged their patrons' equities and made those pledged patrons' equities the subject of control agreements between us and various financial institutions. For these members, we will in fact prepare stock certificates representing the shares issued in redemption of their patrons' equities. We will retain those stock certificates subject to our control agreements with the relevant financial institutions until otherwise instructed by the relevant financial institution. We will also instruct the transfer agent to place a stop transfer order with respect to those shares. Members whose shares are issued as described in this paragraph may obtain more information by contacting David Kastelic in writing or by telephone at the following address or telephone number:

David Kastelic

Senior Vice President and General Counsel
CHS Inc.
5500 Cenex Drive
Inver Grove Heights, Minnesota 55077
(651) 355-3712

LEGAL MATTERS

Dorsey & Whitney LLP, Minneapolis, Minnesota, will provide us with an opinion that the shares of preferred stock issued pursuant to this prospectus have been duly authorized and validly issued and will be fully paid and nonassessable.

EXPERTS

The consolidated financial statements of CHS Inc. and Subsidiaries as of August 31, 2003 and 2002 and for each of the three years in the period ended August 31, 2003 included in and incorporated by reference in this prospectus have been so included in and incorporated by reference in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

The consolidated financial statements of Ventura Foods, LLC and Subsidiary incorporated in this prospectus by reference from our Annual Report on Form 10-K/A-3 for the year ended August 31, 2003 have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report, which is incorporated herein by reference, and have been so incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the information requirements of the Securities Exchange Act of 1934 and file reports and other information with the Securities and Exchange Commission. Our SEC filings are available to the public over the Internet at the SEC's website at <http://www.sec.gov>. You may also read and copy any document we file with the SEC at its Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. You can also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of its Public Reference Room.

The SEC allows us to incorporate by reference into this prospectus information we have filed with it. The information incorporated by reference is an important part of this prospectus. The information incorporated by reference is considered to be part of this prospectus. We incorporate by reference the documents listed below:

our Annual Report on Form 10-K for the fiscal year ended August 31, 2003, as amended by our Form 10-K/A-1, Form 10-K/A-2, and our Form 10-K/A-3 and
our Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2003, as amended by our Form 10-Q/A-1 and our Form 10-Q/A-2.

You may request a copy of these filings, at no cost, by writing or telephoning us at the following address:

CHS Inc.

Attention: Jodell M. Heller, Controller
5500 Cenex Drive
Inver Grove Heights, Minnesota 55077
(651) 355-5270

You should rely only on the information provided in or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus and the information incorporated by reference in it include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words and phrases such as will likely result, are expected to, is anticipated, estimate, project and similar expressions identify forward-looking statements. We wish to caution you not to place undue reliance on any forward-looking statements, which speak only as of the date made. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those discussed in the forward-looking statements. These risks and uncertainties include, but are not limited to, risks related to the level of commodity prices, loss of member business, competition, changes in the taxation of cooperatives, compliance with laws and regulations, environmental liabilities, perceptions of food quality and safety, business interruptions and casualty losses, access to equity capital, consolidation of producers and customers, fluctuations in prices for crude oil and refined petroleum products, alternative energy sources, the performance of our agronomy business, technological improvements and joint ventures. These risks and uncertainties are further described under Risk Factors and elsewhere in this prospectus.

We do not guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements, which speak only as of the date on which they were made.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

CHS INC.

| | |
|---|------|
| Consolidated Balance Sheets as of August 31, 2003 and 2002 | F-1 |
| Consolidated Statements of Operations for the years ended August 31, 2003, 2002 and 2001 | F-2 |
| Consolidated Statements of Equities and Comprehensive Income for the years ended August 31, 2003, 2002 and 2001 | F-3 |
| Consolidated Statements of Cash Flows for the years ended August 31, 2003, 2002 and 2001 | F-4 |
| Notes to Consolidated Financial Statements | F-5 |
| Report of Independent Accountants | F-30 |

CHS INC.

CONSOLIDATED BALANCE SHEETS

| | August 31 | |
|------------------------------------|------------------|------------------|
| | 2003 | 2002 |
| (dollars in thousands) | | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 168,249 | \$ 108,192 |
| Receivables | 763,780 | 741,578 |
| Inventories | 801,883 | 759,663 |
| Other current assets | 178,661 | 140,944 |
| | <u>1,912,573</u> | <u>1,750,377</u> |
| Total current assets | 1,912,573 | 1,750,377 |
| Investments | 532,893 | 496,607 |
| Property, plant and equipment | 1,122,982 | 1,057,421 |
| Other assets | 239,520 | 177,322 |
| | <u>3,807,968</u> | <u>3,481,727</u> |
| Total assets | \$3,807,968 | \$3,481,727 |
| LIABILITIES AND EQUITIES | | |
| Current liabilities: | | |
| Notes payable | \$ 251,131 | \$ 332,514 |
| Current portion of long-term debt | 14,951 | 89,032 |
| Customer credit balances | 58,417 | 26,461 |
| Customer advance payments | 123,383 | 169,123 |
| Checks and drafts outstanding | 85,239 | 84,251 |
| Accounts payable | 627,250 | 517,667 |
| Accrued expenses | 254,415 | 225,704 |
| Dividends and equities payable | 39,049 | 56,510 |
| | <u>1,453,835</u> | <u>1,501,262</u> |
| Total current liabilities | 1,453,835 | 1,501,262 |
| Long-term debt | 648,222 | 483,092 |
| Other liabilities | 111,555 | 118,280 |
| Minority interests in subsidiaries | 112,645 | 89,455 |
| Commitments and contingencies | | |
| Equities | 1,481,711 | 1,289,638 |
| | <u>3,807,968</u> | <u>3,481,727</u> |
| Total liabilities and equities | \$3,807,968 | \$3,481,727 |

The accompanying notes are an integral part of the consolidated financial statements.

CHS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

| | For the years ended August 31 | | |
|---------------------------------------|-------------------------------|-------------------|-------------------|
| | 2003 | 2002 | 2001 |
| | (dollars in thousands) | | |
| Revenues: | | | |
| Net sales | \$9,270,734 | \$7,156,454 | \$7,464,242 |
| Patronage dividends | 3,257 | 3,885 | 5,977 |
| Other revenues | 124,542 | 109,459 | 116,254 |
| | <u>9,398,533</u> | <u>7,269,798</u> | <u>7,586,473</u> |
| Cost of goods sold | 9,058,951 | 6,940,926 | 7,181,433 |
| Marketing, general and administrative | 190,582 | 187,292 | 184,046 |
| | <u>149,000</u> | <u>141,580</u> | <u>220,994</u> |
| Operating earnings | 149,000 | 141,580 | 220,994 |
| Gain on legal settlements | (10,867) | (2,970) | |
| Interest | 48,675 | 42,455 | 61,436 |
| Equity income from investments | (47,299) | (58,133) | (28,494) |
| Minority interests | 21,950 | 15,390 | 35,098 |
| | <u>136,541</u> | <u>144,838</u> | <u>152,954</u> |
| Income before income taxes | 136,541 | 144,838 | 152,954 |
| Income taxes | 12,700 | 18,700 | (25,600) |
| | <u>\$ 123,841</u> | <u>\$ 126,138</u> | <u>\$ 178,554</u> |
| Net income | \$ 123,841 | \$ 126,138 | \$ 178,554 |
| Distribution of net income: | | | |
| Patronage refunds | \$ 90,000 | \$ 92,900 | \$ 128,900 |
| Unallocated capital reserve | 33,841 | 33,238 | 49,654 |
| | <u>\$ 123,841</u> | <u>\$ 126,138</u> | <u>\$ 178,554</u> |
| Net income | \$ 123,841 | \$ 126,138 | \$ 178,554 |

The accompanying notes are an integral part of the consolidated financial statements.

CHS INC.

CONSOLIDATED STATEMENTS OF EQUITIES

AND COMPREHENSIVE INCOME

| | Capital Equity Certificates | Nonpatronage Equity Certificates | Preferred Stock | Wheat Milling EPU's | Oilseed Processing & Refining EPU's | Patronage Refunds | Unallocated Capital Reserve | Accumulated Other Comprehensive Income (Loss) | Allocated Capital Reserve | Total Equities |
|---|-----------------------------------|--|--------------------|---------------------------|---|----------------------|-----------------------------------|---|---------------------------------|-------------------|
| (dollars in thousands) | | | | | | | | | | |
| For the years ended August 31, 2003, 2002 and 2001 | | | | | | | | | | |
| Balances, September 1, 2000 | \$ 940,880 | \$ 28,509 | | \$ 9,246 | \$ 4,182 | \$ 61,180 | \$ 114,736 | \$ (2,427) | \$ 8,120 | \$ 1,164,426 |
| Patronage and equity retirement determination | 17,474 | | | | | 26,220 | | | | 43,694 |
| Patronage distribution | 60,304 | | | | | (87,400) | 967 | | | (26,129) |
| Equities retired | (18,662) | (74) | | | | | | | | (18,736) |
| Equities issued | 5,481 | | | | | | | | | 5,481 |
| Equity Participation Units issued | | | | | 1,045 | | (1,045) | | | |
| Equity Participation Units redeemed | | | | (9,066) | (5,227) | | | | | (14,293) |
| Other, net | (120) | (277) | | (180) | | | 445 | | (70) | (202) |
| Comprehensive income: | | | | | | | | | | |
| Net income | | | | | | 128,900 | 49,654 | | | 178,554 |
| Other comprehensive income | | | | | | | | 512 | | 512 |
| Total comprehensive income | | | | | | | | | | 179,066 |
| Dividends and equities payable | (33,484) | | | | | (38,670) | | | | (72,154) |
| Balances, August 31, 2001 | 971,873 | 28,158 | | | | 90,230 | 164,757 | (1,915) | 8,050 | 1,261,153 |
| Patronage and equity retirement determination | 33,484 | | | | | 38,670 | | | | 72,154 |
| Patronage distribution | 92,484 | | | | | (128,900) | (3,666) | | | (40,082) |
| Equities retired | (31,099) | (46) | | | | | | | | (31,145) |
| Equities issued | 2,600 | | | | | | | | | 2,600 |
| Preferred stock issued, net | | | \$ 9,325 | | | | (3,428) | | | 5,897 |
| Preferred stock dividends | | | | | | | (240) | | | (240) |
| Other, net | (106) | (339) | | | | | 100 | | | (345) |
| Comprehensive income: | | | | | | | | | | |

Edgar Filing: CHS INC - Form 424B1

| | | | | | | | | | | |
|---|--------------|-----------|-----------|----|----|-----------|------------|-------------|----------|--------------|
| Net income | | | | | | 92,900 | 33,238 | | | 126,138 |
| Other comprehensive loss | | | | | | | | (49,982) | | (49,982) |
| Total comprehensive income | | | | | | | | | | 76,156 |
| Dividends and equities payable | (28,640) | | | | | (27,870) | | | | (56,510) |
| Balances, August 31, 2002 | 1,040,596 | 27,773 | 9,325 | | | 65,030 | 190,761 | (51,897) | 8,050 | 1,289,638 |
| Patronage and equity retirement determination | 28,639 | | | | | 27,870 | | | | 56,509 |
| Patronage distribution | 61,784 | | | | | (92,900) | 4,638 | | | (26,478) |
| Equities retired | (31,092) | (52) | | | | | | | | (31,144) |
| Equities issued | 350 | | | | | | | | | 350 |
| Preferred stock issued, net | | | 86,379 | | | | (3,895) | | | 82,484 |
| Preferred stock redeemed | | | (2,002) | | | | | | | (2,002) |
| Preferred stock dividends | | | | | | | (3,575) | | | (3,575) |
| Other, net | (2,440) | (3) | | | | | (4) | | | (2,447) |
| Comprehensive income: | | | | | | | | | | |
| Net income | | | | | | 90,000 | 33,841 | | | 123,841 |
| Other comprehensive income | | | | | | | | 33,584 | | 33,584 |
| Total comprehensive income | | | | | | | | | | 157,425 |
| Dividends and equities payable | (10,800) | | | | | (27,000) | (1,249) | | | (39,049) |
| Balances, August 31, 2003 | \$ 1,087,037 | \$ 27,718 | \$ 93,702 | \$ | \$ | \$ 63,000 | \$ 220,517 | \$ (18,313) | \$ 8,050 | \$ 1,481,711 |

The accompanying notes are an integral part of the consolidated financial statements.

CHS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended August 31

| | 2003 | 2002 | 2001 |
|--|------------|------------|------------|
| (dollars in thousands) | | | |
| Cash flows from operating activities: | | | |
| Net income | \$ 123,841 | \$ 126,138 | \$ 178,554 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 111,347 | 103,986 | 109,180 |
| Noncash net income from equity investments | (47,299) | (58,133) | (28,494) |
| Minority interests | 21,950 | 15,390 | 35,098 |
| Noncash portion of patronage dividends received | (1,795) | (2,327) | (3,896) |
| Loss (gain) on sale of property, plant and equipment | 741 | (6,418) | (13,941) |
| Deferred tax expense (benefit) | 9,000 | 4,400 | (46,625) |
| Other, net | 4,052 | 5,467 | (801) |
| Changes in operating assets and liabilities: | | | |
| Receivables | (18,669) | (32,517) | 147,922 |
| Inventories | (25,692) | (255,107) | 39,248 |
| Other current assets and other assets | (83,347) | (86,636) | (24,128) |
| Customer credit balances | 30,238 | (12,025) | 1,707 |
| Customer advance payments | (45,740) | 59,988 | (22,800) |
| Accounts payable and accrued expenses | 135,310 | 92,781 | (130,142) |
| Other liabilities | 2,569 | 9,079 | 13,050 |
| Net cash provided by (used in) operating activities | 216,506 | (35,934) | 253,932 |
| Cash flows from investing activities: | | | |
| Acquisition of property, plant and equipment | (175,689) | (140,169) | (97,610) |
| Proceeds from disposition of property, plant and equipment | 26,886 | 20,205 | 35,263 |
| Investments | (43,478) | (6,211) | (14,247) |
| Equity investments redeemed | 35,939 | 37,689 | 30,104 |
| Investments redeemed | 8,467 | 6,310 | 1,672 |
| Changes in notes receivable | (6,630) | (22,031) | 533 |
| Acquisitions of intangibles | (767) | (29,501) | (7,328) |
| Acquisitions of working capital, net | (13,030) | (5,750) | (1,103) |
| Distribution to minority owners | (4,444) | (7,413) | (19,256) |
| Other investing activities, net | (507) | (685) | 1,775 |
| Net cash used in investing activities | (173,253) | (147,556) | (70,197) |
| Cash flows from financing activities: | | | |
| Changes in notes payable | (81,383) | 235,319 | (120,731) |
| Long-term debt borrowings | 175,000 | 30,000 | 116,861 |
| Principal payments on long-term debt | (89,512) | (17,968) | (67,364) |
| Payments on derivative instruments | (7,574) | | |
| Changes in checks and drafts outstanding | 988 | (3,557) | 3,722 |
| Proceeds from sale of preferred stock, net of expenses | 82,484 | 5,897 | |
| Redemptions of preferred stock | (2,002) | | |
| Preferred stock dividends paid | (3,575) | (240) | |
| Retirements of equity | (31,144) | (31,145) | (18,736) |
| Equity Participation Units redeemed | | | (14,293) |
| Cash patronage dividends paid | (26,478) | (40,082) | (26,129) |

Edgar Filing: CHS INC - Form 424B1

| | | | |
|--|------------|------------|------------|
| Net cash provided by (used in) financing activities | 16,804 | 178,224 | (126,670) |
| Net increase (decrease) in cash and cash equivalents | 60,057 | (5,266) | 57,065 |
| Cash and cash equivalents at beginning of period | 108,192 | 113,458 | 56,393 |
| Cash and cash equivalents at end of period | \$ 168,249 | \$ 108,192 | \$ 113,458 |

The accompanying notes are an integral part of the consolidated financial statements.

F-4

CHS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

Organization:

Effective August 5, 2003, Cenex Harvest States Cooperatives changed its name to CHS Inc. (CHS or the Company). CHS is an agricultural cooperative organized for the mutual benefit of its members. Members of the cooperative are located throughout the United States. In addition to grain marketing, oilseed processing and refining, foods and wheat milling, the Company provides its patrons with energy and agronomy products as well as other farm supplies. Sales are both domestic and international.

Effective September 1, 2000, the Company's Board of Directors approved a resolution providing for the computation of patronage distributions based on earnings for financial statement purposes rather than federal income tax basis earnings. On December 1, 2000, this resolution was ratified by the Company's members, the by-laws were amended and beginning with fiscal year 2001 patronage distributions have been calculated based on financial statement earnings. The by-laws further provide that an amount of up to 10% of the distributable annual net savings from patronage sources be added to the unallocated capital reserve as determined by the Board of Directors.

Consolidation:

The consolidated financial statements include the accounts of CHS and all of its wholly-owned and majority-owned subsidiaries, including National Cooperative Refinery Association (NCRA). The effects of all significant intercompany transactions have been eliminated.

On September 1, 1999, NCRA and Farmland Industries, Inc. (Farmland) formed Cooperative Refining, LLC (CRLLC), which was established to operate and manage the refineries and related pipelines and terminals of NCRA and Farmland. On December 31, 2000, NCRA and Farmland signed an Agreement of Dissolution and dissolved CRLLC.

During 2000, the Company entered into a series of transactions, the result of which was the exchange of its agronomy operations, consisting primarily of its interests in and ownership of the Cenex/ Land O Lakes Agronomy Company and Agro Distribution, LLC and related entities for a 25% equity ownership interest in Agriliance, LLC (Agriliance). Agriliance is a distributor of crop nutrients, crop protection products and other agronomy inputs and services formerly owned by the Company, Land O Lakes, Inc. (Land O Lakes) and Farmland. The company accounts for the Agriliance investment under the equity method.

During 2003 and 2002, the Company had various other acquisitions, which have been accounted for using the purchase method of accounting. Operating results of the acquisitions are included in the consolidated financial statements since the respective acquisition dates. The respective purchase prices were allocated to the assets and liabilities acquired based upon the estimated fair values. The excess purchase price over the estimated fair values of the net assets acquired has been reported as identifiable intangible assets and goodwill.

Cash Equivalents:

Cash equivalents include short-term highly liquid investments with original maturities of three months or less at date of acquisition.

Inventories:

Grain, processed grain, oilseed and processed oilseed are stated at net realizable values which approximates market values. All other inventories are stated at the lower of cost or market. Costs for inventories produced or modified by the Company through a manufacturing process include fixed and

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

variable production costs and raw material costs, and in-bound freight costs for raw materials over the amount charged to cost of goods sold. Costs for inventories purchased for resale include the cost of products and any freight incurred to place the products at the Company's point of sales. The cost of certain energy inventories (wholesale refined products, crude oil and asphalt) is determined on the last-in, first-out (LIFO) method; all other inventories of non-grain products purchased for resale are valued on the first-in, first-out (FIFO) and average cost methods.

Derivative Financial Instruments:

The Company enters into exchange-traded commodity futures and options contracts to hedge its exposure to price fluctuations on energy, grain and oilseed transactions to the extent considered practicable for minimizing risk. Futures and options contracts used for hedging are purchased and sold through regulated commodity exchanges. Fluctuations in inventory valuations, however, may not be completely hedged, due in part to the absence of satisfactory hedging facilities for certain commodities and geographical areas and in part to the Company's assessment of its exposure from expected price fluctuations. The Company also manages its risks by entering into fixed price purchase contracts with pre-approved producers and establishing appropriate limits for individual suppliers. Fixed price sales contracts are entered into with customers of acceptable creditworthiness, as internally evaluated. The Company is exposed to loss in the event of nonperformance by the counterparties to the contracts; however, the Company does not anticipate nonperformance by counterparties.

Commodity trading in futures and options contracts is a natural extension of cash market trading. The commodity futures and options markets have underlying principles of increased liquidity and longer trading periods than the cash market, and hedging is one method of reducing exposure to price fluctuations. The Company's use of the derivative instruments described above reduces the effects of price volatility, thereby protecting against adverse short-term price movements while somewhat limiting the benefits of short-term price movements. Changes in market value of derivative instruments described above are recognized in the consolidated statements of operations in the period such changes occur. The fair value of futures and options contracts are determined primarily from quotes listed on regulated commodity exchanges. Fixed price purchase and sales contracts are with various counterparties, and the fair values of such contracts are determined from the market price of the underlying product. At August 31, 2003, the Company's derivative assets and liabilities were \$54.5 million and \$46.5 million, respectively. At August 31, 2002, the Company's derivative assets and liabilities were \$53.8 million and \$67.9 million, respectively.

Commodity Price Risk

The Company utilizes futures and options contracts offered through regulated commodity exchanges to reduce price risk. The Company is exposed to risk of loss in the market value of inventories and fixed or partially fixed purchase and sale contracts. In order to reduce that risk, the Company generally takes opposite and offsetting positions using futures contracts or options. Certain commodities cannot be hedged with futures or options contracts because such contracts are not offered for these commodities by regulated commodity exchanges. Inventories and purchase contracts for those commodities are hedged with forward sales contracts, to the extent practical, in order to arrive at a net commodity position within the formal position limits set by the Company and deemed prudent for each of those commodities. Commodities for which future contracts and options are available are also typically hedged with forward contracts, with futures and options used to hedge within position limits the remaining portion. These futures and options contracts and forward purchase and sales contracts used to hedge against commodity price changes are effective economic hedges of price risk, but they are not designated as, and accounted for as, hedging instruments for accounting purposes.

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Unrealized gains and losses on futures contracts and options used as economic hedges of grain and oilseed inventories and fixed price contracts are recognized in cost of goods sold for financial reporting on a monthly basis using market based prices. Inventories and fixed price contracts are marked to fair value using market based prices so that gains or losses on the derivative contracts are offset by gains or losses on inventories and fixed price contracts during the same accounting period.

Unrealized gains and losses on futures contracts and options used as economic hedges of energy inventories and fixed price contracts are recognized in cost of goods sold for financial reporting on a monthly basis using market based prices. The inventories hedged with these derivatives are valued at the lower of cost or market, and fixed price contracts are marked to fair value using market based prices. Certain fixed price contracts related to propane in the Energy segment meet the normal purchase and sales exemption, and thus are not required to be marked to fair value.

Interest Rate Risk

The Company manages interest expense using fixed and floating rate debt. These debt instruments are carried at amounts approximating estimated fair value. Short-term debt used to finance inventories and receivables is represented by notes payable within thirty days or less so that the blended interest rate to the Company for all such notes approximates current market rates. Long-term debt used to finance non-current assets has various fixed interest rates and is payable at various dates as to minimize the effect of market interest rate changes. The effective interest rate to the Company on fixed rate debt outstanding on August 31, 2003, was approximately 6.5%.

In August 2002, the Company entered into interest rate treasury lock instruments to secure the interest rate related to a portion of its private placement debt issued on October 18, 2002. These instruments were designated and are effective as cash flow hedges for accounting purposes, and accordingly, the loss on settlement was recorded as a component of other comprehensive income. Interest expense for the year ended August 31, 2003, includes \$0.7 million related to the interest rate derivatives. The additional interest expense is an offset to the lower actual interest paid on the outstanding debt instruments.

Foreign Currency Risk

The Company conducts essentially all of its business in U.S. dollars except for grain marketing operations in Brazil, and had minimal risk regarding foreign currency fluctuations during 2003. Foreign currency fluctuations do, however, impact the ability of foreign buyers to purchase U.S. agricultural products and the competitiveness of U.S. agricultural products compared to the same products offered by alternative sources of world supply.

Investments:

Investments in other cooperatives are stated at cost, plus patronage dividends received in the form of capital stock and other equities. Patronage dividends are recorded at the time qualified written notices of allocation are received. Joint ventures and other investments, in which the Company has significant ownership and influence, but not control, are accounted for in the consolidated financial statements under the equity method of accounting. Investments in other debt and equity securities are considered available for sale financial instruments and are stated at market value, with unrealized amounts included as a component of accumulated other comprehensive income (loss).

Property, Plant and Equipment:

Property, plant and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided on the straight-line method by charges to operations at rates

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

based upon the expected useful lives of individual or groups of assets (primarily 15 to 40 years for land improvements and buildings and 3 to 20 years for machinery, equipment, office and other). The cost and related accumulated depreciation and amortization of assets sold or otherwise disposed of are removed from the related accounts and resulting gains or losses are reflected in operations. Expenditures for maintenance and repairs and minor renewals are expensed, while costs of major renewals and betterments are capitalized.

The Company periodically reviews property, plant and equipment and other long-lived assets in order to assess recoverability based on projected income and related cash flows on an undiscounted basis. Should the sum of the expected future net cash flows be less than the carrying value, an impairment loss would be recognized. An impairment loss would be measured by the amount by which the carrying value of the asset exceeds the fair value of the asset.

Goodwill and Other Intangible Assets:

Effective September 1, 2001, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. This statement discontinued the amortization of goodwill and indefinite-lived intangible assets, subject to periodic impairment testing. At August 31, 2001, goodwill (net of accumulated amortization) prior to the adoption of SFAS No. 142, was \$29.2 million and was included as a component of other assets. The effect of adopting the new standard will reduce goodwill amortization expense by approximately \$2.0 million annually. No changes to the carrying value of goodwill and other intangible assets were required as a result of the adoption of SFAS No. 142. Subsequent impairment testing is performed annually as well as when a triggering event indicating impairment may have occurred. During 2003, as a result of the impairment testing, the Company believes that no impairments are required.

In 2001, the Company recorded goodwill amortization expense of \$2.6 million. Had SFAS No. 142 been in effect during the year ended August 31, 2001, net income would have been \$181.1 million.

Revenue Recognition:

The Company provides a wide variety of products and services, from agricultural inputs such as fuels, farm supplies and crop nutrients, to agricultural outputs that include grain and oilseed, processed grains and oilseeds and food products. Grain and oilseed sales are recorded after the commodity has been delivered to its destination and final weights, grades and settlement price have been agreed upon. All other sales are recognized upon transfer of title, which could occur upon either shipment or receipt by the customer, depending upon the contract. Amounts billed to a customer as part of a sales transaction related to shipping and handling are included in net sales. Service revenues are recorded only after such services have been rendered, and are included in other revenues.

Environmental Expenditures:

Liabilities, related to remediation of contaminated properties are recognized when the related costs are considered probable and can be reasonably estimated. Estimates of environmental costs are based on current available facts, existing technology, undiscounted site-specific costs and currently enacted laws and regulations. Recoveries, if any, are recorded in the period in which recovery is considered probable. Liabilities are monitored and adjusted as new facts or changes in law or technology occur. Environmental expenditures are capitalized when such costs provide future economic benefits. The Company accrues legal costs expected to be incurred in connection with loss contingencies when those legal costs are probable and can be reasonably estimated.

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Taxes:

The Company is a nonexempt agricultural cooperative and files a consolidated federal income tax return with its 80% or more owned subsidiaries. The Company is subject to tax on income from nonpatronage sources and undistributed patronage-sourced income. Deferred income taxes reflect the impact of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and such amounts recognized for federal and state income tax purposes, at each year end, based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

Comprehensive Income:

Comprehensive income (defined as the change in equity of a business enterprise during a period from sources other than those resulting from investments by owners and distribution to owners), primarily includes net income and the effects of minimum pension liability adjustments. Total comprehensive income is reflected in the consolidated statements of equities and comprehensive income.

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recent Accounting Pronouncements:

During 2003, the Company adopted SFAS No. 143, Accounting for Asset Retirement Obligations, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company's Energy segment operates oil refineries and related pipelines for which the Company would be subject to Asset Retirement Obligations (ARO) if such assets were to be dismantled. The Company, however, expects to operate its refineries and related pipelines indefinitely. Since the time period to dismantle these assets is indeterminate, a corresponding ARO is not estimable and therefore has not been recorded.

In January 2003, the FASB issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities. The interpretation addresses consolidation of certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. It also requires consolidation by primary beneficiary. The interpretation applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after December 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Company believes that the effects of adopting this standard will not have a material effect on the Company.

On April 30, 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. The new guidance amends SFAS No. 133 for decisions made as part of the Derivatives Implementation Group process that effectively required amendments to SFAS No. 133,

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and decisions made in connection with other FASB projects dealing with financial instruments and in connection with implementation issues raised in relation to the application of the definition of a derivative and characteristics of a derivative that contains financing components. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statements of cash flows. SFAS No. 149 is effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003. The Company believes that the effects of adopting this standard do not have a material effect on the Company.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in certain circumstances). Many of those instruments were previously classified as equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities which are subject to the provisions for the first fiscal period beginning after December 15, 2003. The Statement is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. The Company believes that the effects of adopting this standard will not have a material effect on the Company.

Reclassifications:

Certain reclassifications have been made to prior year's amounts to conform to current year classifications. In addition, the Company has made changes to net sales and cost of goods sold for years ended August 31, 2002 and 2001, to eliminate certain intercompany sales identified subsequent to the issuance of the 2002 Annual Report. These reclassifications and changes had no effect on previously reported net income, equities and comprehensive income, or cash flows.

2. Receivables:

Receivables as of August 31, 2003 and 2002 are as follows:

| | 2003 | 2002 |
|---------------------------------------|------------------------|-----------|
| | (dollars in thousands) | |
| Trade | \$748,398 | \$717,888 |
| Other | 47,000 | 49,846 |
| | 795,398 | 767,734 |
| Less allowances for doubtful accounts | 31,618 | 26,156 |
| | \$763,780 | \$741,578 |

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

All international sales are denominated in U.S. dollars. International sales for the years ended August 31, 2003, 2002 and 2001 are as follows:

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|-------------------------------|-----------------------|----------------|----------------|
| | (dollars in millions) | | |
| Africa | \$ 99 | \$ 135 | \$ 138 |
| Asia | 815 | 407 | 403 |
| Europe | 156 | 282 | 255 |
| North America, excluding U.S. | 367 | 298 | 317 |
| South America | 166 | 100 | 101 |
| | <u>\$1,603</u> | <u>\$1,222</u> | <u>\$1,214</u> |

3. Inventories:

Inventories as of August 31, 2003 and 2002 are as follows:

| | <u>2003</u> | <u>2002</u> |
|-----------------------------|------------------------|------------------|
| | (dollars in thousands) | |
| Grain and oilseed | \$370,381 | \$393,095 |
| Energy | 292,095 | 229,981 |
| Feed and farm supplies | 95,589 | 91,138 |
| Processed grain and oilseed | 42,688 | 36,264 |
| Other | 1,130 | 9,185 |
| | <u>\$801,883</u> | <u>\$759,663</u> |

As of August 31, 2003, the Company valued approximately 24% of inventories, primarily related to energy, using the lower of cost, determined on the LIFO method, or market (26% as of August 31, 2002). If the FIFO method of accounting for these inventories had been used, inventories would have been higher than the reported amount by \$86.3 million and \$40.5 million at August 31, 2003 and 2002, respectively.

4. Investments:

Investments as of August 31, 2003 and 2002 are as follows:

| | <u>2003</u> | <u>2002</u> |
|---------------------|------------------------|-------------|
| | (dollars in thousands) | |
| Cooperatives: | | |
| CF Industries, Inc. | \$152,996 | \$152,996 |
| CoBank ACB (CoBank) | 22,505 | 30,069 |
| Ag Processing, Inc. | 24,481 | 25,797 |
| Land O Lakes, Inc. | 27,105 | 26,232 |
| Joint ventures: | | |
| Ventura Foods, LLC | 107,464 | 108,981 |

Edgar Filing: CHS INC - Form 424B1

| | | |
|----------------------------|----------------|----------------|
| United Country Brands, LLC | 129,286 | 86,175 |
| TEMCO, LLC | 9,087 | 8,414 |
| Other | 59,969 | 57,943 |
| | <u>532,893</u> | <u>496,607</u> |

F-11

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CHS's investment in CF Industries, Inc. (CF) is carried at cost, including allocated patronage refunds. Since CF is a cooperative, CHS recognizes income from this investment only when patronage refunds are received. Over the past five years CF has generated operating losses, none of which were allocated to its owners. CHS management has performed the appropriate impairment tests of this investment, and based upon those tests, believes that fair market value exceeds its carrying value. CHS will continue to perform impairment tests annually, including reviewing operating results, or as circumstances dictate, which could result in an impairment to its CF investment.

In March 2000, the Company purchased an additional 10% interest in Ventura Foods, LLC, its consumer products and packaging joint venture, for \$25.6 million, of which \$13.8 million was goodwill. The Company has a 50% interest in this joint venture. The following provides summarized unaudited financial information for Ventura Foods, LLC balance sheets as of August 31, 2003 and 2002, and statements of operations for the twelve months ended August 31, 2003, 2002 and 2001:

| | 2003 | 2002 |
|-------------------------|------------------------|------------|
| | (dollars in thousands) | |
| Current assets | \$ 193,632 | \$ 171,084 |
| Non-current assets | 231,649 | 231,045 |
| Current liabilities | 227,400 | 133,230 |
| Non-current liabilities | 21,738 | 90,819 |

| | 2003 | 2002 | 2001 |
|--------------|------------------------|--------------|------------|
| | (dollars in thousands) | | |
| Net sales | \$ 1,165,823 | \$ 1,013,475 | \$ 925,962 |
| Gross profit | 155,274 | 181,217 | 161,405 |
| Net income | 42,837 | 75,368 | 71,148 |

Effective January 1, 2000, CHS, Farmland and Land O Lakes created Agrilience, a distributor of crop nutrients, crop protection products and other agronomy inputs and services. At formation, Agrilience managed the agronomy marketing and distribution operations of CHS (which included principally its wholesale agronomy, Cenex/Land O Lakes Agronomy Company and Agro Distribution, LLC business operations), Farmland and Land O Lakes, with the Company exchanging the right to use its agronomy operations for 26.455% of the results of the jointly managed operations.

In March 2000, the Company sold 1.455% of its economic interest in the operations collectively managed by Agrilience to Land O Lakes, resulting in a gain of \$7.4 million. This left the Company with a 25% economic interest in such operations. In July 2000, Agrilience secured its own financing, which is without recourse to the Company. Agrilience also purchased the net working capital related to agronomy operations from each of its member owners, consisting primarily of trade accounts receivable and inventories, net of accounts payable. On July 31, 2000, the Company contributed outright its ownership interest in the Cenex/ Land O Lakes Agronomy Company and in Agro Distribution, LLC, with a total investment of \$64.7 million, along with the rest of its wholesale agronomy business, to Agrilience. The Company retained a 25% interest in Agrilience after the outright contribution of its ownership interests in those two ventures and its wholesale agronomy business. Agrilience ownership also includes Farmland (25%) and Land O Lakes (50%). The interests of the Company and Farmland are held through equal ownership in United Country Brands, LLC, a joint venture holding company whose sole operations consist of the ownership of a 50% interest in Agrilience. The Company's equity in the joint venture was recorded at the historical carrying value of its ownership in Cenex/ Land O Lakes Agronomy Company and Agro Distribution, LLC and no gain or loss was recorded on the exchange.

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In April 2003, the Company acquired an additional economic interest in the Agrilience wholesale crop protection business (the CPP Business), which constitutes only a part of the Agrilience business operations. The Company acquired 13.1% of the CPP Business for a cash payment of \$34.3 million. The economic interests in Agrilience are owned 50% by Land O Lakes, 25% plus an additional 13.1% of the CPP Business by the Company and 25% less 13.1% of the CPP Business by Farmland. The ownership or governance interests in Agrilience did not change. Agrilience's earnings or losses are split among the members based upon the respective economic interest of each member.

The following provides summarized financial information for Agrilience balance sheets as of August 31, 2003 and 2002, and statements of operations for the years ended August 31, 2003, 2002 and 2001:

| | 2003 | 2002 |
|-------------------------|------------------------|------------|
| | (dollars in thousands) | |
| Current assets | \$ 1,249,941 | \$ 922,958 |
| Non-current assets | 119,615 | 134,247 |
| Current liabilities | 1,083,743 | 700,903 |
| Non-current liabilities | 27,061 | 107,960 |

| | 2003 | 2002 | 2001 |
|--------------------------|------------------------|--------------|--------------|
| | (dollars in thousands) | | |
| Net sales | \$ 3,485,623 | \$ 3,625,849 | \$ 4,072,248 |
| Earnings from operations | 67,239 | 57,604 | 50,423 |
| Net income | 60,741 | 47,044 | 25,053 |

Disclosure of the fair value of financial instruments to which the Company is a party includes estimates and assumptions which may be subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Financial instruments are carried at amounts that approximate estimated fair values. Investments in cooperatives and joint ventures have no quoted market prices.

Various agreements with other owners of investee companies and a majority-owned subsidiary set out parameters whereby CHS may buy and sell additional interests in those companies, upon the occurrence of certain events, at fair values determinable as set forth in the specific agreements.

5. Property, Plant and Equipment:

A summary of property, plant and equipment as of August 31, 2003 and 2002 is as follows:

| | 2003 | 2002 |
|--|------------------------|--------------|
| | (dollars in thousands) | |
| Land and land improvements | \$ 60,453 | \$ 63,045 |
| Buildings | 380,940 | 371,107 |
| Machinery and equipment | 1,508,963 | 1,470,475 |
| Office and other | 68,369 | 62,144 |
| Construction in progress | 159,555 | 71,540 |
| | 2,178,280 | 2,038,311 |
| Less accumulated depreciation and amortization | 1,055,298 | 980,890 |
| | \$ 1,122,982 | \$ 1,057,421 |



F-13



CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In January 2002, the Company formed a limited liability company with Cargill, Incorporated to engage in wheat flour milling and processing. The Company holds a 24% interest in the entity, which is known as Horizon Milling, LLC. The Company is leasing certain of its wheat milling facilities and related equipment to Horizon Milling under an operating lease agreement. The book value of the leased milling assets at August 31, 2003, was \$99.4 million, net of accumulated depreciation of \$31.3 million.

For the years ended August 31, 2003, 2002 and 2001, the Company capitalized interest of \$3.9 million, \$2.1 million and \$1.2 million, respectively, related to capitalized construction projects.

6. Other Assets:

Other assets as of August 31, 2003 and 2002 are as follows:

| | <u>2003</u> | <u>2002</u> |
|---|------------------------|------------------|
| | (dollars in thousands) | |
| Goodwill | \$ 27,052 | \$ 27,926 |
| Customer lists, less accumulated amortization of \$5,112 and \$3,511, respectively | 9,414 | 8,447 |
| Non-compete covenants, less accumulated amortization of \$11,774 and \$2,896, respectively | 1,766 | 11,204 |
| Other intangible assets, less accumulated amortization of \$1,986 and \$2,462, respectively | 14,607 | 15,795 |
| Prepaid pension and other benefit assets | 151,389 | 54,230 |
| Deferred tax asset | 28,689 | 50,544 |
| Notes receivable | 1,991 | 4,822 |
| Other | 4,612 | 4,354 |
| | <u>\$239,520</u> | <u>\$177,322</u> |

Intangible assets subject to amortization are provided on a straight-line basis over the number of years that approximate their respective useful lives (ranging from 2 to 15 years). The straight-line method of amortization reflects an appropriate allocation of the cost of intangible assets to earnings in proportion to the amount of economic benefit obtained by the Company in each reporting period. Amortization expenses for the years ended August 31, 2003 and 2002, were \$12.2 million and \$4.2 million, respectively. The estimated amortization expense related to intangible assets subject to amortization for the next five years will approximate \$2.7 million annually.

Through Country Energy, LLC, formerly a joint venture with Farmland, the Company marketed refined petroleum products including gasoline, diesel fuel, propane and lubricants under the Cenex brand. On November 30, 2001, the Company purchased the wholesale energy business of Farmland, as well as all interest in Country Energy, LLC. Based on estimated fair values, \$26.4 million of the purchase price was allocated to intangible assets, primarily trademarks, tradenames and non-compete agreements. The intangible assets had a weighted-average life of approximately 12 years. During the year ended August 31, 2003, the Company accelerated the amortization of the non-compete agreement due to Farmland's July 31, 2003 notification that it intends to liquidate its assets in bankruptcy. The Company had additional amortization expense of \$7.5 million during 2003 related to the acceleration, and the asset has a zero book value as of August 31, 2003. The Company also entered into an exclusive two-year supply agreement to purchase, at prevailing market prices, all of the refined fuels production from Farmland's Coffeyville, Kansas facility. On May 22, 2003, the Company gave notice to Farmland that it will not renew the supply agreement, and the non-renewal is effective November 30, 2003. The Company's management is confident that alternative sources of supply will be available and that the non-renewal will not have a material affect on the Company.

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Notes Payable and Long-Term Debt:

Notes payable and long-term debt as of August 31, 2003 and 2002 consisted of the following:

| | Interest rates at August 31, | | |
|--|------------------------------|------------|------------|
| | 2003 | 2003 | 2002 |
| | (dollars in thousands) | | |
| Notes payable (a)(i) | 1.63% to 1.96% | \$ 251,131 | \$ 332,514 |
| Long-term debt: | | | |
| Revolving term loans from cooperative and other banks, payable in installments through 2009, when the balance is due (b)(c)(i) | 2.14% to 13.00% | \$ 168,032 | \$ 254,962 |
| Private placement, payable in equal installments beginning in 2008 through 2013 (d)(i) | 6.81% | 225,000 | 225,000 |
| Private placement, payable in installments beginning in 2007 through 2018 (e)(i) | 4.96% to 5.60% | 175,000 | |
| Private placement, payable in equal installments beginning in 2005 through 2011 (f)(i) | 7.43% to 7.90% | 80,000 | 80,000 |
| Industrial Revenue Bonds, payable in installments through 2011 (g) | 5.23% to 12.97% | 5,831 | 7,444 |
| Other notes and contracts (h) | 5.70% to 12.17% | 9,310 | 4,718 |
| Total long-term debt | | 663,173 | 572,124 |
| Less current portion | | 14,951 | 89,032 |
| Long-term portion | | \$ 648,222 | \$ 483,092 |

| | 2003 | 2002 |
|---|-------|-------|
| Weighted average interest rates at August 31: | | |
| Short-term debt | 1.83% | 2.58% |
| Long-term debt | 6.52% | 6.38% |

- (a) The Company finances its working capital needs through short-term lines of credit with a syndication of banks. The Company has a 364-day credit facility of \$600.0 million, all of which is committed, and of which \$250.0 million was outstanding on August 31, 2003. In addition to this short-term line of credit, the Company has a 364-day credit facility dedicated to NCRA with a syndication of banks in the amount of \$30.0 million, all of which is committed, with no amounts outstanding on August 31, 2003. Other miscellaneous notes payable totaled \$1.1 million at August 31, 2003.
- (b) The Company established a \$100.0 million three-year revolving credit facility with a syndication of banks. On August 31, 2003, the Company had no outstanding balance on this facility.
- (c) The Company established a long-term credit agreement which committed \$200.0 million of long-term borrowing capacity to the Company through May 31, 1999, of which \$164.0 million was drawn before the expiration date of that commitment. On August 31, 2003,

Edgar Filing: CHS INC - Form 424B1

\$137.8 million was outstanding. NCRA term loans of \$15.0 million are collateralized by NCRA's investment in CoBank.

- (d) The Company entered into a private placement with several insurance companies for long-term debt in the amount of \$225.0 million.
- (e) In October 2002, the Company entered into a private placement with several insurance companies for long-term debt in the amount of \$175.0 million.

F-15

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- (f) In January 2001, the Company entered into a note purchase and private shelf agreement with Prudential Insurance Company. A long-term note was issued for \$25.0 million and a subsequent note for \$55.0 million was issued in March 2001.
- (g) Industrial Revenue Bonds in the amount of \$1.6 million are collateralized by property, plant and equipment, primarily energy refinery equipment, with a cost of approximately \$152.0 million, less accumulated depreciation of approximately \$120.4 million as of August 31, 2003.
- (h) Grain Suppliers, LLC, a wholly-owned subsidiary of the Company, has other notes payable of \$5.4 million collateralized by property, plant and equipment, with a cost of approximately \$8.3 million, less accumulated depreciation of approximately \$0.2 million on August 31, 2003.
- (i) The debt is unsecured, however restrictive covenants under various agreements have requirements for maintenance of minimum working capital levels and other financial ratios.

The fair value of long-term debt approximates book value as of August 31, 2003 and 2002.

The aggregate amount of long-term debt payable as of August 31, 2003 is as follows:

| | (dollars in thousands) |
|------------|------------------------|
| 2004 | \$ 14,951 |
| 2005 | 34,716 |
| 2006 | 35,176 |
| 2007 | 59,671 |
| 2008 | 98,190 |
| Thereafter | 420,469 |
| | \$ 663,173 |

The Company is in compliance with all debt covenants and restrictions as of August 31, 2003.

8. Income Taxes:

As a result of the Company's by-law changes during 2001, and the by-law changes of its majority-owned subsidiary (NCRA) in 2002, to distribute patronage based on financial statement earnings, the statutory rate applied to the cumulative differences between financial statement earnings and tax basis earnings, has been changed. In connection with this change the Company recorded a deferred tax benefit of \$10.9 million as of August 31, 2002, and \$34.2 million as of August 31, 2001. The \$10.9 million deferred tax benefit recorded as a result of the change in patronage distribution by NCRA as of August 31, 2002, has been offset by a \$10.9 million NCRA valuation allowance. Additional valuation allowances of \$1.7 million, \$6.2 million and \$2.4 million were provided to offset deferred tax benefits generated by NCRA as of August 31, 2003, 2002 and 2001, respectively.

The provision for income taxes for the years ended August 31, 2003, 2002 and 2001 is as follows:

| | 2003 | 2002 | 2001 |
|---------------------|------------------------|-----------|-------------|
| | (dollars in thousands) | | |
| Current | \$ 3,700 | \$ 14,300 | \$ 21,025 |
| Deferred | 7,300 | (12,700) | (49,025) |
| Valuation allowance | 1,700 | 17,100 | 2,400 |
| | \$ 12,700 | \$ 18,700 | \$ (25,600) |

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The tax effect of temporary differences of deferred tax assets and liabilities as of August 31, 2003 and 2002 is as follows:

| | 2003 | 2002 |
|--|------------------------|-----------|
| | (dollars in thousands) | |
| Deferred tax assets: | | |
| Accrued expenses and valuation reserves | \$ 53,521 | \$ 49,236 |
| Postretirement health care and deferred compensation | 29,153 | 32,671 |
| Property, plant and equipment | 9,369 | 11,532 |
| Alternative minimum tax credit and patronage loss carryforward | 8,948 | 6,993 |
| Other | 19,316 | 12,439 |
| | 120,307 | 112,871 |
| Deferred tax liabilities: | | |
| Pension, including minimum liability | 34,531 | 2,635 |
| Equity method investments | 23,310 | 20,482 |
| Other | | 730 |
| | 57,841 | 23,847 |
| Deferred tax assets valuation reserve | (11,765) | (19,466) |
| Net deferred tax assets | \$ 50,701 | \$ 69,558 |

As of August 31, 2003, net deferred tax assets of \$22.0 million and \$28.7 million are included in current assets and other assets, respectively (\$19.0 million and \$50.6 million, respectively, as of August 31, 2002). At August 31, 2003, NCRA recognized a valuation allowance for the entire tax benefit associated with its net deferred tax asset, as it is considered more likely than not, based on the weight of available information, that the future tax benefits related to these items will not be realized. At August 31, 2003, NCRA's net deferred tax assets of \$11.8 million were comprised of deferred tax assets of \$21.4 million and deferred tax liabilities of \$9.6 million. Deferred tax assets are comprised of basis differences related to inventories, investments, lease obligations, accrued liabilities and certain federal and state tax credits. NCRA files a separate tax return and, as such, these items must be assessed independently of the Company's deferred tax assets when determining recoverability.

The reconciliation of the statutory federal income tax rates to the effective tax rates for the years ended August 31, 2003, 2002 and 2001 is as follows:

| | 2003 | 2002 | 2001 |
|---|--------|--------|---------|
| Statutory federal income tax rate | 35.0% | 35.0% | 35.0% |
| State and local income taxes, net of federal income tax benefit | 3.9 | 3.9 | 3.9 |
| Patronage earnings | (25.7) | (25.0) | (32.8) |
| Change in patronage determination | | (7.5) | (22.4) |
| Export activities at rates other than the U.S. statutory rate | (3.2) | (1.9) | |
| Deferred tax asset valuation allowance | 1.3 | 11.8 | 1.6 |
| Other | (2.0) | (3.4) | (2.0) |
| | 9.3% | 12.9% | (16.7)% |
| Effective tax rate | 9.3% | 12.9% | (16.7)% |



CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The principal differences between financial statement income and taxable (loss) income for the years ended August 31, 2003, 2002 and 2001 are as follows:

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--------------------------------------|------------------------|------------------|------------------|
| | (dollars in thousands) | | |
| Income before income taxes | \$ 136,541 | \$ 144,838 | \$ 152,954 |
| Financial reporting/tax differences: | | | |
| Environmental reserves | 2,208 | 1,939 | 4,453 |
| Oil and gas activities, net | (21,989) | 1,540 | (22,230) |
| Energy inventory market reserves | 1,210 | (933) | (2,441) |
| Pension and compensation | (21,966) | (21,491) | 8,981 |
| Investments in other entities | 117 | 1,898 | 26,495 |
| Export activities | (11,253) | (7,141) | |
| Other, net | 1,716 | (2,291) | 10,038 |
| Patronage refund provisions | (90,000) | (92,900) | (128,900) |
| Taxable (loss) income | <u>\$ (3,416)</u> | <u>\$ 25,459</u> | <u>\$ 49,350</u> |

No tax benefit has been recognized for NCRA's \$13.1 million operating loss that was included in the Company's August 31, 2003 taxable loss as shown above.

9. Equities:

In accordance with the by-laws and by action of the Board of Directors, annual net savings from patronage sources are distributed to consenting patrons following the close of each year, and are based on amounts using financial statement earnings. The cash portion of the patronage distribution is determined annually by the Board of Directors, with the balance issued in the form of capital equity certificates.

Annual net savings from sources other than patronage may be added to the unallocated capital reserve or, upon action by the Board of Directors, allocated to members in the form of nonpatronage equity certificates. Redemptions are at the discretion of the Board of Directors.

Inactive direct members and patrons and active direct members and patrons age 61 and older on June 1, 1998, are eligible for redemption of their capital equity certificates at age 72 or death. For other active direct members and patrons and member cooperatives, equities will be redeemed annually as determined by the Board of Directors.

On May 31, 1997, the Company completed an offering for the sale of Equity Participation Units (EPU) in its Wheat Milling Defined Business Unit and its Oilseed Processing and Refining Defined Business Unit to qualified subscribers. Qualified subscribers were identified as Defined Members or representatives of Defined Members who were persons or associations of producers actually engaged in the production of agricultural products. Subscribers were allowed to purchase a portion of their EPU by exchanging existing patronage certificates. The purchasers of EPU had the right and obligation to deliver annually the number of bushels of wheat or soybeans equal to the number of units held. Unit holders participated in the net patronage-sourced income from operations of the applicable Defined Business Unit as patronage refunds. Retirements of patrons' equities attributable to EPU, were at the discretion of the Board of Directors, and it was the Board's goal to retire such equity on a revolving basis seven years after declaration.

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During 2001, the Company's Board of Directors adopted a resolution to issue, at no charge, to each Defined Member of the Oilseed Processing and Refining Defined Business Unit an additional 1/4 EPU, for each EPU held, due to increased crush volume.

In August 2001, the CHS Board of Directors approved and consummated a plan to end the Defined Investment Program. The Company redeemed all of the EPUs and allocated the assets of the Oilseed Processing and Refining and Wheat Milling Defined Business Units to the Company as provided in the plan. The amounts redeemed to the Oilseed Processing and Refining and Wheat Milling Defined Member EPU holders were \$5.2 million and \$9.1 million, respectively. Due to loss carry-forwards incurred by the Wheat Milling Defined Business Unit, the plan also provided for the cancellation of all outstanding Preferred Capital Certificates issued to the Wheat Milling EPU holders, totaling \$0.2 million. The plan further provided to the Oilseed Processing and Refining Defined Member EPU holders for the redemption of all outstanding Preferred Capital Certificates issued of \$0.2 million and a 100% cash distribution during 2002 for the patronage refunds earned for the fiscal year ended August 31, 2001.

In January 2003, the Board of Directors authorized the sale and issuance of up to 3,500,000 shares of 8% Cumulative Redeemable Preferred Stock (New Preferred) at a price of \$25.00 per share. The Company filed a registration statement on Form S-2 with the Securities and Exchange Commission registering 3,000,000 shares of the New Preferred (with an additional over-allotment option of 450,000 shares granted to the underwriters), which was declared effective on January 27, 2003. The shares were subsequently sold for proceeds of \$86.3 million (3,450,000 shares), and are listed on the NASDAQ National Market. Expenses related to the issuance of the New Preferred were \$3.8 million.

The Company had previously suspended sales of its 8% Preferred Stock (Old Preferred) after raising \$9.5 million (9,454,874 shares), and on February 25, 2003, the Company filed a post-effective amendment to terminate the offering of the Old Preferred shares. On March 5, 2003, the Company's Board of Directors authorized the redemption and conversion of the Old Preferred shares. A redemption notification and a conversion election form were sent to holders of the Old Preferred shares on March 21, 2003 explaining that on April 25, 2003 all shares of the Old Preferred would be redeemed by the Company for \$1.00 per share unless they were converted into shares of the Company's New Preferred. The conversion did not change the base liquidation amount or dividend amount of the Old Preferred, since 25 shares of the Old Preferred converted to 1 share of the New Preferred. The total Old Preferred converted to the New Preferred was \$7.5 million (7,452,439 shares) and the balance of the Old Preferred (2,002,435 shares) was redeemed in cash at \$1.00 per share. As of August 31, 2003, the Company had \$93.7 million (3,748,099 shares) of the New Preferred outstanding.

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Employee Benefit Plans:

The Company has various pension and other defined benefit and defined contribution plans, in which substantially all employees may participate.

Financial information on changes in benefit obligation and plan assets funded and balance sheet status as of August 31, 2003 and 2002 is as follows:

| | Qualified Pension Benefits | | Non-Qualified Pension Benefits | | Other Benefits | |
|--|-------------------------------|-------------------|-----------------------------------|--------------------|--------------------|--------------------|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| (dollars in thousands) | | | | | | |
| Change in benefit obligation: | | | | | | |
| Benefit obligation at beginning of period | \$ 253,868 | \$ 241,728 | \$ 14,543 | \$ 11,836 | \$ 24,915 | \$ 22,667 |
| Service cost | 10,840 | 9,275 | 800 | 1,168 | 648 | 557 |
| Interest cost | 17,503 | 17,673 | 1,033 | 886 | 1,722 | 1,586 |
| Plan participants contributions | 1,771 | | | | 215 | 189 |
| Plan amendments | | 2,383 | | | 88 | |
| Transfers | | 3,677 | | | | |
| Actuarial loss (gain) | 22,049 | 1,157 | (766) | 1,607 | 2,527 | 1,716 |
| Assumption change | 4,659 | | | | 1,469 | 638 |
| Benefits paid | (20,784) | (22,025) | (1,776) | (954) | (2,329) | (2,438) |
| Benefit obligation at end of period | <u>\$ 289,906</u> | <u>\$ 253,868</u> | <u>\$ 13,834</u> | <u>\$ 14,543</u> | <u>\$ 29,255</u> | <u>\$ 24,915</u> |
| Change in plan assets: | | | | | | |
| Fair value of plan assets at beginning of period | \$ 201,563 | \$ 230,121 | | | | |
| Actual income (loss) on plan assets | 14,915 | (14,810) | | | | |
| Company contributions | 84,523 | 4,600 | \$ 1,776 | \$ 954 | \$ 2,114 | \$ 2,249 |
| Participants contributions | | | | | 215 | 189 |
| Net transfers | | 3,677 | | | | |
| Benefits paid | (20,784) | (22,025) | (1,776) | (954) | (2,329) | (2,438) |
| Fair value of plan assets at end of period | <u>\$ 280,217</u> | <u>\$ 201,563</u> | <u>\$</u> | <u>\$</u> | <u>\$</u> | <u>\$</u> |
| Funded status | \$ (9,689) | \$ (52,305) | \$ (13,834) | \$ (14,543) | \$ (29,255) | \$ (24,915) |
| Employer contributions after measurement date | | 31,362 | 84 | 32 | 247 | 269 |
| Unrecognized actuarial loss (gain) | 118,025 | 85,066 | (899) | 16 | 707 | (3,505) |
| Unrecognized transition obligation | | | | | 9,261 | 10,197 |
| Unrecognized prior service cost | 7,467 | 6,502 | 3,503 | 4,067 | (1,076) | (1,336) |
| Prepaid benefit cost (accrued) | <u>\$ 115,803</u> | <u>\$ 70,625</u> | <u>\$ (11,146)</u> | <u>\$ (10,428)</u> | <u>\$ (20,116)</u> | <u>\$ (19,290)</u> |

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

| | Qualified Pension Benefits | | Non-Qualified Pension Benefits | | Other Benefits | |
|--|-------------------------------|------------------|-----------------------------------|-------------------|-------------------|-------------------|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| (dollars in thousands) | | | | | | |
| Amounts recognized on balance sheets consist of: | | | | | | |
| Accrued benefit liability | \$ 95,917 | \$(11,028) | \$(12,125) | \$(12,809) | \$(20,116) | \$(19,290) |
| Intangible asset | 2,425 | 6,510 | 253 | 1,485 | | |
| Minority interests | | 6,195 | | | | |
| Accumulated other comprehensive loss | 17,461 | 68,948 | 726 | 896 | | |
| Net amounts recognized | <u>\$ 115,803</u> | <u>\$ 70,625</u> | <u>\$(11,146)</u> | <u>\$(10,428)</u> | <u>\$(20,116)</u> | <u>\$(19,290)</u> |

For measurement purposes, a 9% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year ended August 31, 2003. The rate was assumed to decrease gradually to 6.0% for 2006 and remain at that level thereafter. Components of net periodic benefit costs for the years ended August 31, 2003, 2002 and 2001 are as follows:

| | Qualified Pension Benefits | | | Non-Qualified Pension Benefits | | | Other Benefits | | |
|--|-------------------------------|-----------------|-----------------|-----------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 2003 | 2002 | 2001 | 2003 | 2002 | 2001 | 2003 | 2002 | 2001 |
| (dollars in thousands) | | | | | | | | | |
| Components of net periodic benefit cost: | | | | | | | | | |
| Service cost | \$ 10,840 | \$ 9,275 | \$ 7,875 | \$ 800 | \$ 1,168 | \$ 631 | \$ 648 | \$ 557 | \$ 566 |
| Interest cost | 17,503 | 17,673 | 17,580 | 1,033 | 886 | 907 | 1,722 | 1,586 | 1,569 |
| Expected return on assets | (23,788) | (21,386) | (22,855) | | | | | | |
| Prior service cost amortization | 806 | 740 | 619 | 564 | 574 | 574 | (172) | (197) | (131) |
| Actuarial loss (gain) amortization | 2,623 | 1,369 | 231 | 159 | 18 | 144 | (215) | (505) | (538) |
| Transition amount amortization | | (708) | (874) | | | 13 | 936 | 936 | 936 |
| Other | | | | | | | | | (22) |
| Net periodic benefit cost | <u>\$ 7,984</u> | <u>\$ 6,963</u> | <u>\$ 2,576</u> | <u>\$ 2,556</u> | <u>\$ 2,646</u> | <u>\$ 2,269</u> | <u>\$ 2,919</u> | <u>\$ 2,377</u> | <u>\$ 2,380</u> |

Weighted-average assumptions:

| | | | | | | | | | |
|--------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Discount rate | 6.30% | 7.10% | 7.30% | 6.00% | 7.25% | 7.50% | 6.30% | 7.10% | 7.30% |
| Expected return on plan assets | 9.00% | 9.00% | 9.00% | N/A | N/A | N/A | N/A | N/A | N/A |
| Rate of compensation increase | 5.00% | 5.00% | 5.00% | 5.00% | 5.00% | 5.00% | 5.00% | 5.00% | 5.00% |

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The aggregate projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets were as follows as of August 31, 2003 and 2002:

| | Qualified Pension Benefits | | Non-Qualified Pension Benefits | |
|--------------------------------|-------------------------------|------------|-----------------------------------|-----------|
| | 2003 | 2002 | 2003 | 2002 |
| | (dollars in thousands) | | | |
| Projected benefit obligation | \$ 120,068 | \$ 253,868 | \$ 13,834 | \$ 14,543 |
| Accumulated benefit obligation | 107,760 | 243,953 | 12,209 | 12,842 |
| Fair value of plan assets | 104,560 | 201,563 | | |

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage point change in the assumed health care cost trend rates would have the following effects:

| | 1% Increase | 1% Decrease |
|---|-------------|------------------------|
| | | (dollars in thousands) |
| Effect on total of service and interest cost components | \$ 275 | \$ (250) |
| Effect on postretirement benefit obligation | 2,618 | (2,399) |

The Company provides defined life insurance and health care benefits for certain retired employees. The plan is contributory based on years of service and family status, with retiree contributions adjusted annually.

The Company has other contributory defined contribution plans covering substantially all employees. Total contributions by the Company to these plans were \$8.5 million, \$11.0 million and \$6.1 million, for the years ended August 31, 2003, 2002 and 2001, respectively.

11. Segment Reporting:

The Company manages five business segments, which are based on products and services, and are Agronomy, Energy, Country Operations and Services, Grain Marketing, and Processed Grains and Foods. The Agronomy segment consists of joint ventures and other investments, from which the Company derives investment income based upon the profitability of these investments. The Energy segment derives its revenues through refining, wholesaling and retailing of petroleum products. The Country Operations and Services segment derives its revenues through the origination and marketing of grain, through the retail sales of petroleum and agronomy products, and processed sunflowers, feed and farm supplies. The Country Operations segment also derives revenues from service activities related to crop production. The Grain Marketing segment derives its revenues from the sale of grains and oilseeds and from service activities conducted at its export terminals. Processed Grains and Foods segment derives its revenues from the sales of soybean meal and soybean refined oil, from equity income in two wheat milling joint ventures, from equity income in an oilseed food manufacturing joint venture, and from the sale of Mexican food products.

Reconciling Amounts represent the elimination of sales between segments. Such transactions are conducted at market prices to more accurately evaluate the profitability of the individual business segments.

The Company assigns certain corporate general and administrative expenses to its business segments based on use of such services and allocates other services based on factors or considerations relevant to the costs incurred.

Expenses that are incurred at the corporate level for the purpose of the general operation of the Company are allocated to the segments based upon factors which management considers to be non-

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

asymmetrical. Nevertheless, due to efficiencies in scale, cost allocations, and intersegment activity, management does not represent that these segments, if operated independently, would report the income before income taxes and other financial information as presented.

Segment information for the years ended August 31, 2003, 2002 and 2001 is as follows:

| | Agronomy | Energy | Country Operations and Services | Grain Marketing | Processed Grains and Foods | Corporate and Other | Reconciling Amounts | Total |
|--|------------|--------------|--|--------------------|----------------------------------|------------------------|------------------------|--------------|
| (dollars in thousands) | | | | | | | | |
| For the year ended August 31, 2003: | | | | | | | | |
| Net sales | | \$ 3,648,093 | \$ 1,885,825 | \$ 4,139,226 | \$ 491,931 | | \$ (894,341) | \$ 9,270,734 |
| Patronage dividends | \$ (84) | 415 | 2,467 | 218 | 111 | \$ 130 | | 3,257 |
| Other revenues | | 10,461 | 81,739 | 25,458 | 2,300 | 4,584 | | 124,542 |
| | (84) | 3,658,969 | 1,970,031 | 4,164,902 | 494,342 | 4,714 | (894,341) | 9,398,533 |
| Cost of goods sold | | 3,475,947 | 1,876,811 | 4,133,677 | 466,857 | | (894,341) | 9,058,951 |
| Marketing, general and administrative | 8,138 | 63,740 | 55,887 | 21,072 | 36,540 | 5,205 | | 190,582 |
| Gain on legal settlements | | | (10,867) | | | | | (10,867) |
| Interest | (974) | 16,401 | 14,975 | 4,738 | 12,845 | 690 | | 48,675 |
| Equity (income) loss from investments | (20,773) | (1,353) | (788) | 1,673 | (26,056) | (2) | | (47,299) |
| Minority interests | | 20,782 | 1,168 | | | | | 21,950 |
| Income (loss) before income taxes | \$ 13,525 | \$ 83,452 | \$ 32,845 | \$ 3,742 | \$ 4,156 | \$ (1,179) | \$ | \$ 136,541 |
| Intersegment sales | | \$ (94,209) | \$ (796,999) | \$ (2,435) | \$ (698) | | \$ 894,341 | \$ |
| Goodwill | | \$ 3,185 | \$ 262 | | \$ 23,605 | | | \$ 27,052 |
| Capital expenditures | | \$ 80,837 | \$ 26,738 | \$ 5,298 | \$ 60,576 | \$ 2,240 | | \$ 175,689 |
| Depreciation and amortization | \$ 1,247 | \$ 65,868 | \$ 21,039 | \$ 6,718 | \$ 13,321 | \$ 3,154 | | \$ 111,347 |
| Total identifiable assets at August 31, 2003 | \$ 285,906 | \$ 1,449,652 | \$ 857,523 | \$ 450,415 | \$ 498,872 | \$ 265,600 | | \$ 3,807,968 |

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

| | Agronomy | Energy | Country Operations and Services | Grain Marketing | Processed Grains and Foods | Corporate and Other | Reconciling Amounts | Total |
|--|------------|--------------|--|--------------------|----------------------------------|------------------------|------------------------|--------------|
| (dollars in thousands) | | | | | | | | |
| For the year ended August 31, 2002: | | | | | | | | |
| Net sales | | \$ 2,657,689 | \$ 1,474,553 | \$ 3,281,469 | \$ 496,084 | | \$ (753,341) | \$ 7,156,454 |
| Patronage dividends | \$ (89) | 458 | 2,572 | 497 | 260 | \$ 187 | | 3,885 |
| Other revenues | | 6,392 | 80,789 | 21,902 | (1,469) | 1,845 | | 109,459 |
| | (89) | 2,664,539 | 1,557,914 | 3,303,868 | 494,875 | 2,032 | (753,341) | 7,269,798 |
| Cost of goods sold | | 2,489,352 | 1,474,392 | 3,272,985 | 457,538 | | (753,341) | 6,940,926 |
| Marketing, general and administrative | 8,957 | 66,731 | 47,995 | 22,213 | 36,930 | 4,466 | | 187,292 |
| Gain on legal settlements | | | (2,970) | | | | | (2,970) |
| Interest | (1,403) | 16,875 | 13,851 | 4,807 | 9,514 | (1,189) | | 42,455 |
| Equity (income) loss from investments | (13,425) | 1,166 | (283) | (4,257) | (41,331) | (3) | | (58,133) |
| Minority interests | | 14,604 | 786 | | | | | 15,390 |
| | 5,782 | 75,811 | 24,143 | 8,120 | 32,224 | (1,242) | \$ | \$ 144,838 |
| Income (loss) before income taxes | \$ 5,782 | \$ 75,811 | \$ 24,143 | \$ 8,120 | \$ 32,224 | \$ (1,242) | \$ | \$ 144,838 |
| Intersegment sales | | \$ (67,367) | \$ (615,853) | \$ (69,561) | \$ (560) | | \$ 753,341 | \$ |
| Goodwill | | \$ 4,059 | \$ 262 | | \$ 23,605 | | | \$ 27,926 |
| Capital expenditures | | \$ 54,576 | \$ 34,305 | \$ 14,851 | \$ 35,144 | \$ 1,293 | | \$ 140,169 |
| Depreciation and amortization | \$ 1,247 | \$ 58,701 | \$ 21,214 | \$ 6,235 | \$ 13,436 | \$ 3,153 | | \$ 103,986 |
| Total identifiable assets at August 31, 2002 | \$ 242,015 | \$ 1,305,828 | \$ 799,711 | \$ 481,232 | \$ 439,942 | \$ 212,999 | \$ | \$ 3,481,727 |
| For the year ended August 31, 2001: | | | | | | | | |
| Net sales | | \$ 2,781,243 | \$ 1,577,268 | \$ 3,416,239 | \$ 662,726 | | \$ (973,234) | \$ 7,464,242 |
| Patronage dividends | \$ 196 | 712 | 3,683 | 840 | 339 | \$ 207 | | 5,977 |
| Other revenues | | 4,036 | 80,479 | 22,964 | (238) | 9,013 | | 116,254 |
| | 196 | 2,785,991 | 1,661,430 | 3,440,043 | 662,827 | 9,220 | (973,234) | 7,586,473 |
| Cost of goods sold | | 2,549,099 | 1,569,884 | 3,416,500 | 619,184 | | (973,234) | 7,181,433 |
| Marketing, general and administrative | 8,503 | 48,432 | 53,417 | 22,396 | 44,870 | 6,428 | | 184,046 |
| Interest | (4,529) | 25,097 | 15,695 | 8,144 | 13,026 | 4,003 | | 61,436 |
| Equity (income) loss from investments | (7,360) | 4,081 | (246) | (4,519) | (35,505) | 15,055 | | (28,494) |
| Minority interests | | 34,713 | 385 | | | | | 35,098 |
| | 3,582 | 124,569 | 22,295 | (2,478) | 21,252 | (16,266) | \$ | \$ 152,954 |
| Income (loss) before income taxes | \$ 3,582 | \$ 124,569 | \$ 22,295 | \$ (2,478) | \$ 21,252 | \$ (16,266) | \$ | \$ 152,954 |
| Intersegment sales | | \$ (71,846) | \$ (709,910) | \$ (190,695) | \$ (783) | | \$ 973,234 | \$ |
| Capital expenditures | | \$ 38,984 | \$ 32,448 | \$ 3,715 | \$ 20,485 | \$ 1,978 | | \$ 97,610 |

Edgar Filing: CHS INC - Form 424B1

| | | | | | | | |
|----------------------------------|----------|-----------|-----------|----------|-----------|----------|------------|
| Depreciation and amortization | \$ 1,250 | \$ 55,343 | \$ 21,738 | \$ 4,917 | \$ 22,304 | \$ 3,628 | \$ 109,180 |
|----------------------------------|----------|-----------|-----------|----------|-----------|----------|------------|

F-24

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Commitments and Contingencies:

Environmental:

The Company is required to comply with various environmental laws and regulations incidental to its normal business operations. In order to meet its compliance requirements, the Company establishes reserves for the probable future costs of remediation of identified issues, which are included in cost of goods sold or in marketing, general and administrative expenses in the consolidated statements of operations. Remediation costs with respect to an asset are reported in costs of goods sold if the asset is owned and operated by the Company and the Company reports sales related to it. Remediation costs are reported in marketing, general and administrative expenses if the Company does not own or operate the asset and the Company does not report sales related to it. Management does not believe that the resolution of any such matters, individually or in the aggregate, are reasonably likely to have a material effect on the consolidated financial position of the Company or the results of operations or cash flows during any reporting period.

In connection with certain refinery upgrades and enhancements that are necessary in order to comply with existing environmental regulations, the Company expects to incur additional capital expenditures of approximately \$87.0 million for the Company's Laurel, Montana refinery and \$324.0 million for NCRA's McPherson, Kansas refinery, of which \$8.7 million has been spent at the Laurel refinery and \$36.5 million has been spent by NCRA at the McPherson refinery as of August 31, 2003. The Company expects all of these compliance capital expenditures at the refineries to be complete by December 31, 2005, and anticipates funding these projects with a combination of cash flows from operations and debt proceeds.

Other Litigation and Claims:

The Company is involved as a defendant in various lawsuits, claims and disputes which are in the normal course of the Company's business. Management does not believe that the resolution of any such matters, individually or in the aggregate, are reasonably likely to have a material effect on the consolidated financial position of the Company or the results of operations or cash flows during any reporting period.

Grain Storage:

As of August 31, 2003 and 2002, the Company stored grain and processed grain products for third parties totaling \$155.2 million and \$148.0 million, respectively. Such stored commodities and products are not the property of the Company and therefore are not included in the Company's inventories.

Guarantees:

The Company is a guarantor for lines of credit for related companies of which \$52.3 million was outstanding as of August 31, 2003. The Company's bank covenants allow maximum guarantees of \$150.0 million. In addition, the Company's bank covenants allow for guarantees dedicated solely for NCRA in the amount of \$125.0 million. All outstanding loans with respective creditors are current as of August 31, 2003.

In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The interpretation addresses the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. The interpretation also clarifies the

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

requirements related to the recognition of a liability by a guarantor at the inception of the guarantee for obligations the guarantor has undertaken in issuing the guarantee.

The Company makes seasonal and term loans to member cooperatives, and its wholly-owned subsidiary, Fin-Ag, Inc., makes loans for agricultural purposes to individual producers. Some of these loans are sold to CoBank, and the Company guarantees a portion of the loans sold. In addition, the Company also guarantees certain debt and obligations under contracts for its subsidiaries and members.

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company's obligations pursuant to its guarantees as of August 31, 2003 are as follows:

| Entities | Guarantee/ Maximum Exposure | Exposure on August 31, 2003 | Nature of Guarantee | Expiration Date | Triggering Event | Recourse Provisions | Assets Held as Collateral |
|--|-----------------------------------|-----------------------------------|---|--|--------------------------|---|---|
| (dollars in thousands) | | | | | | | |
| The Company's Financial Services cooperative loans sold to CoBank | * | \$ 6,667 | 10% of the obligations of borrowers (agricultural cooperatives) under credit agreements for loans sold | None stated, but may be terminated by either party upon 60 days prior notice in regard to future obligations | Credit agreement default | Subrogation against borrower | Some or all assets of borrower are held as collateral and should be sufficient to cover guarantee exposure |
| Fin-Ag, Inc. agricultural loans sold to CoBank | * | 43,016 | 15% of the obligations of borrowers under credit agreements for some of the loans sold, and 100% of the obligations of borrowers for the remaining loans sold | None stated, but may be terminated by either party upon 90 days prior notice in regard to future obligations | Credit agreement default | Subrogation against borrower | Some or all assets of borrower are held as collateral and should be sufficient to cover guarantee exposure |
| TEMCO, LLC | \$ 7,500 | | Obligations by TEMCO, LLC under credit agreement | None stated | Credit agreement default | Subrogation against TEMCO, LLC | None |
| North Valley Petroleum, LLC | \$ 194 | 179 | Obligations by North Valley Petroleum, LLC under credit agreement | None stated | Credit agreement default | Subrogation against North Valley Petroleum, LLC | None |
| Third parties | * | 2,413 | Surety for, or indemnification of surety for sales contracts between affiliates and sellers of grain under deferred payment contracts | Annual renewal on December 1st in regard to surety for one third party, otherwise none stated and may be terminated by the Company at any time in regard to future obligations | Nonpayment | Subrogation against affiliates | Some or all assets of borrower are held as collateral but might not be sufficient to cover guarantee exposure |
| | | \$52,275 | | | | | |

* The Company's bank covenants allow for guarantees of up to \$150.0 million, but the Company is under no obligation to extend these guarantees. The maximum exposure on any given date is equal to the actual guarantees extended as of that date.

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Lease Commitments:

The Company leases approximately 1,900 rail cars with remaining lease terms of one to ten years. In addition, the Company has commitments under other operating leases for various refinery, manufacturing and transportation equipment, vehicles and office space. Some leases include purchase options at not less than fair market value at the end of the leases.

Total rental expense for all operating leases, net of rail car mileage credits received from the railroad and sublease income was \$31.7 million, \$30.7 million and \$35.5 million for the years ended August 31, 2003, 2002 and 2001, respectively. Mileage credits and sublease income were \$7.1 million, \$9.5 million and \$11.0 million for the years ended August 31, 2003, 2002 and 2001, respectively.

Minimum future lease payments, required under noncancellable operating leases as of August 31, 2003 are as follows:

| | Rail Cars | Vehicles | Equipment and Other | Total |
|-------------------------------------|--------------|-----------|------------------------|------------|
| (dollars in thousands) | | | | |
| 2004 | \$ 9,407 | \$ 12,141 | \$ 11,856 | \$ 33,404 |
| 2005 | 7,447 | 10,158 | 6,842 | 24,447 |
| 2006 | 5,027 | 9,273 | 4,881 | 19,181 |
| 2007 | 4,073 | 4,825 | 3,668 | 12,566 |
| 2008 | 2,914 | 2,240 | 2,061 | 7,215 |
| Thereafter | 4,246 | 1,643 | 4,693 | 10,582 |
| Total minimum future lease payments | \$33,114 | \$40,280 | \$34,001 | \$ 107,395 |

13. Supplemental Cash Flow and Other Information:

Additional information concerning supplemental disclosures of cash flow activities for the years ended August 31, 2003, 2002 and 2001 is as follows:

| | 2003 | 2002 | 2001 |
|--|-----------|-----------|-----------|
| (dollars in thousands) | | | |
| Net cash paid during the period for: | | | |
| Interest | \$ 45,239 | \$ 44,231 | \$ 63,034 |
| Income taxes | 956 | 27,965 | 11,709 |
| Other significant noncash transactions: | | | |
| Distributions of inventories of minority interests | | | (54,399) |
| Capital equity certificates issued in exchange for elevator properties | 350 | 1,842 | 5,481 |
| Equity Participation Units issued | | | 1,045 |
| Exchange of preferred stock | 7,452 | | |
| Accrual of dividends and equities payable | (39,049) | (56,510) | (72,154) |
| Other comprehensive income (loss) | 33,583 | (49,982) | 512 |

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Related Party Transactions:

Related party transactions with equity investees as of August 31, 2003 and 2002 are as follows:

| | 2003 | 2002 |
|------------------------|------------|------------|
| (dollars in thousands) | | |
| Sales | \$ 779,857 | \$ 549,978 |
| Purchases | 637,357 | 502,450 |
| Receivables | 13,393 | 21,232 |
| Payables | 29,113 | 18,296 |

These related party transactions were primarily with Agrilience, CF Industries, Inc., Horizon Milling, TEMCO, LLC and Ventura Foods, LLC.

15. Comprehensive Income:

The components of comprehensive income, net of taxes, for the years ended August 31, 2003, 2002 and 2001 are as follows:

| | 2003 | 2002 | 2001 |
|---|------------|------------|------------|
| (dollars in thousands) | | | |
| Net income | \$ 123,841 | \$ 126,138 | \$ 178,554 |
| Additional minimum pension liability | 36,105 | (48,797) | (15) |
| Financial instruments | 1,045 | (548) | 527 |
| Cash flow hedges | (3,548) | (637) | |
| Foreign currency translation adjustment | (18) | | |
| | \$ 157,425 | \$ 76,156 | \$ 179,066 |

The components of accumulated other comprehensive loss, net of taxes, as of August 31, 2003 and 2002 are as follows:

| | 2003 | 2002 |
|---|-----------|-----------|
| (dollars in thousands) | | |
| Additional minimum pension liability | \$ 13,946 | \$ 50,051 |
| Financial instruments | 164 | 1,209 |
| Cash flow hedges | 4,185 | 637 |
| Foreign currency translation adjustment | 18 | |
| | \$ 18,313 | \$ 51,897 |

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Members and Patrons of

CHS Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of equities and comprehensive income and of cash flows present fairly, in all material respects, the financial position of CHS Inc. and subsidiaries as of August 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended August 31, 2003, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

November 5, 2003

Minneapolis, Minnesota

F-30

479,315 Shares

CHS Inc.

8% Cumulative Redeemable Preferred Stock

PROSPECTUS

March 4, 2004
