CHS INC
Form 10-K
November 22, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the fiscal year ended August 31, 2006
	or
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from to .

Commission file number: 0-50150

CHS Inc.
(Exact name of registrant as specified in its charter)

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: NONE
SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

8% Cumulative Redeemable Preferred Stock
(Title of Class)

Indicate by check mark whether the Registrant is a well-known seasoned issuer (as defined in Rule 405 of the Exchange Act).

YES o NO þ

Indicate by check mark whether the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

YES o NO þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES þ NO o

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO þ

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

None.

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PART I.

ITEM 1. *BUSINESS*

THE COMPANY

CHS Inc. (referred to herein as CHS , we or us) is one of the nation s leading integrated agricultural companies. As a cooperative, we are owned by farmers and ranchers and their local cooperatives from the Great Lakes to the Pacific Northwest and from the Canadian border to Texas. We also have preferred stockholders that own shares of our 8% Cumulative Redeemable Preferred Stock, which is listed on the NASDAQ National Market under the symbol CHSCP. On August 31, 2006, we had 5,864,238 shares of preferred stock outstanding. We buy commodities from and provide products and services to our members and other customers, both domestic and international. We provide a wide variety of products and services, from initial agricultural inputs such as fuels, farm supplies, crop nutrients and crop protection products, to agricultural outputs that include grains and oilseeds, grain and oilseed processing and food products. A portion of our operations are conducted through equity investments and joint ventures whose operating results are not fully consolidated with our results; rather, a proportionate share of the income or loss from those entities is included as a component in our net income under the equity method of accounting. For the fiscal year ended August 31, 2006, our total revenues were $14.4 billion and net income was $490.3 million.

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

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

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

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

Inver Grove Heights, Minnesota.

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

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

ENERGY

Overview

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

Operations

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

Our Laurel facility processes approximately 55,000 barrels of crude oil per day to produce refined products that consist of approximately 39% gasoline, 31% diesel and other distillates, and 30% asphalt and other residual products. During fiscal 2005, the Board of Directors approved the installation of a coker unit at Laurel, along with other refinery improvements, which will allow us to extract a greater volume of high value gasoline and diesel fuel from a barrel of crude oil and less relatively low value asphalt. Total cost for this project is expected to be approximately $325.0 million, of which $62.8 million has been spent through August 31, 2006, with completion planned during fiscal 2008. Refined fuels produced at Laurel, Montana are available via the Yellowstone Pipeline to western Montana terminals and to Spokane and Moses Lake, Washington, south via common carrier pipelines to Wyoming terminals and Denver, Colorado, and east via our wholly-owned Cenex Pipeline, LLC to Glendive, Montana, and Minot and Fargo, North Dakota. Our Board of Directors has approved a $30 million capital expenditure to construct three product terminals tied into the Yellowstone Pipeline that include rail capability. This investment is being undertaken to preserve our long-term ability to participate in western markets.

McPherson Refinery. The McPherson, Kansas refinery is owned and operated by National Cooperative Refinery Association (NCRA), of which we own approximately 74.5%. The McPherson refinery processes low and medium sulfur crude oil into gasoline, diesel and other distillates, propane and other products. McPherson sources approximately 90% of its crude oil from Kansas, Oklahoma and Texas through NCRA-owned and common carrier pipelines.

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

Provista Renewable Fuels Marketing, LLC. We acquired a 50% ownership in an ethanol and biodiesel marketing and distribution company, Provista Renewable Fuels Marketing, LLC, (Provista) formally known as United Bio Energy Fuels, LLC. U.S. BioEnegy Corporation (US BioEnergy), of which we own approximately

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25.6%, is the other 50% owner of Provista. Provista contracts with ethanol and biodiesel production plants, including US BioEnergy, to market and distribute their finished products. From the April 1, 2006, acquisition date through August 31, 2006, volume totaled 109.5 million gallons of ethanol. Provista is consolidated within our financial statements, and we guarantee Provista s $20.0 million revolving credit facility. We are the operating manager of Provista.

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

Products and Services

Our Energy segment produces and sells (primarily wholesale) gasoline, diesel, propane, asphalt, lubricants and other related products and provides transportation services. We obtain the petroleum products that we sell from our Laurel and McPherson refineries, and from third parties.

Sales and Marketing; Customers

We make approximately 70% of our refined fuel sales to members, with the balance sold to non-members. Sales are made wholesale to member cooperatives and through a network of independent retailers that operate convenience stores under the Cenex/Ampride tradename. We sold approximately 1.3 billion gallons of gasoline and approximately 1.4 billion gallons of diesel fuel in fiscal year 2006. We also blend, package and wholesale auto and farm machinery lubricants to both members and non-members. In our fiscal year 2006, our lubricants operations sold approximately 20.2 million gallons of lube oil. We are one of the nation s largest propane wholesalers based on revenues. In our fiscal year 2006, our propane operations sold approximately 716 million gallons of propane. Most of the propane sold in rural areas is for heating and agricultural usage. Annual sales volumes of propane vary greatly depending on weather patterns and crop conditions.

Industry; Competition

Regulation. Governmental regulations and policies, particularly in the areas of taxation, energy and the environment, have a significant impact on our Energy segment. Our Energy segment s operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar government agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; the transportation, handling and disposition of wastes; and the labeling of pesticides and similar substances. Failure to comply with these laws, regulations and rules could subject us (and, in the case of the McPherson refinery, NCRA) to administrative penalties, injunctive relief, civil remedies and possible recalls of products. We believe that we and NCRA are in compliance with these laws, regulations and rules in all material respects and do not expect continued compliance to have a material effect on capital expenditures, earnings or competitive position of either us or NCRA.

Like many other refineries, our Energy segment s refineries recently focused their capital spending on reducing pollution and at the same time increasing production to pay for those expenditures. In particular, our refineries have completed work to comply with the Environmental Protection Agency low sulfur fuel regulations required by 2006, which are intended to lower the sulfur content of gasoline and diesel. We incurred capital expenditures from fiscal year 2003 through 2006 related to this compliance of $88.1 million for our Laurel, Montana refinery and $328.7 million for NCRA s McPherson, Kansas refinery.

The petroleum business is highly cyclical. Demand for crude oil and energy products is driven by the condition of local and worldwide economies, local and regional weather patterns and taxation relative to other energy sources which can significantly affect the price of refined fuels products. Most of our energy product market is located in rural areas, so sales activity tends to follow the planting and harvesting cycles. More fuel-

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efficient equipment, reduced crop tillage, depressed prices for crops, weather conditions and government programs which encourage idle acres may all reduce demand for our energy products.

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

Summary Operating Results

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

	2006	2005	2004
		(Dollars in thousands)	
Revenues	$ 7,414,361	$ 5,794,266	$ 4,038,561
Cost of goods sold	6,834,676	5,487,813	3,780,726
Gross profit	579,685	306,453	257,835
Marketing, general and administrative	82,867	69,951	72,876
Operating earnings	496,818	236,502	184,959
Gain on sale of investments		(862)	(14,666)
Interest, net	6,534	8,918	12,090
Equity income from investments	(3,840)	(3,478)	(1,399)
Minority interests	86,483	46,741	32,507
Income before income taxes	$ 407,641	$ 185,183	$ 156,427
Intersegment sales	$ (242,430)	$ (170,642)	$ (121,199)
Total identifiable assets August 31	$ 2,164,217	$ 2,238,614	$ 1,591,254

AG BUSINESS

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

Agronomy

Overview

We conduct our wholesale and some of our retail agronomy operations through our 50% ownership interest in Agriliance LLC (Agriliance). Land O Lakes, Inc. (Land O Lakes) holds the other 50% ownership interest. Agriliance is one of North America s largest wholesale distributors of crop nutrients, crop protection products and other agronomy products based upon annual sales. Our 50% ownership interest in Agriliance is treated as an equity method investment, and therefore, Agriliance s revenues and expenses are not reflected in our operating results. At August 31, 2006, our equity investment in Agriliance was $175.3 million. Agriliance has its own line of financing, without recourse to us.

In August 2005, we sold 81% of our 20% ownership interest in CF Industries, Inc. (CF), a crop nutrients manufacturer and distributor, in an initial public offering. After the initial public offering, our ownership

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

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

Operations

Agriliance is one of the nation s largest wholesale distributors of crop nutrients (fertilizers) and crop protection products (insecticides, fungicides and pesticides) based on sales, accounting for an estimated 15% of the US market for crop nutrients and approximately 23% of the US market for crop protection products. As a wholesale distributor, Agriliance has warehouse, distribution and service facilities located throughout the country. Agriliance also owns and operates retail agricultural units primarily in the southern United States. In addition, Agriliance blends and packages crop protection products under the Agri Solutions brand. Agriliance purchased approximately 28% of its fertilizer from CF during fiscal year 2006, and its other suppliers include Mosaic, PCS, PIC and Koch. Most of Agriliance s crop protection products are purchased from Monsanto, Syngenta, Dow, Bayer, Dupont and BASF.

Products and Services

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

Sales and Marketing; Customers

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 more than 50 strategically located Agriliance Service Centers as well as nearly 150 company-owned retail locations. Agriliance s largest customer is our country operations business, also included in our Ag Business segment. In 2006, Agriliance had total revenues of $3.7 billion, of which approximately $1.8 billion was crop nutrient products and approximately $1.9 billion was crop protection and other products.

Industry; Competition

Regulation. The agronomy operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar government agencies. These laws, regulations and rules govern the discharge of materials to the environment, air and water; reporting storage of hazardous wastes; the transportation, handling and disposition of wastes; and the labeling of pesticides and similar substances. Failure to comply with these laws, regulations and rules could subject Agriliance or us to administrative penalties, injunctive relief, civil remedies and possible recalls of products. We believe that Agriliance is in compliance with these laws, regulations and rules in all material respects and do not expect continued compliance to have a material effect on our capital expenditures, earnings or competitive position.

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

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

Country Operations

Overview

Our country operations business purchases a variety of grains from our producer members and other third parties, and provides cooperative members and producers with access to a full range of products and services including farm supplies and programs for crop and livestock production. Country operations operates at 325 locations, which includes 3 sunflower plants, dispersed throughout Minnesota, North Dakota, South Dakota, Montana, Nebraska, Kansas, Oklahoma, Colorado, Idaho, Washington and Oregon. Most of these locations purchase grain from farmers and sell agronomy products, energy products and feed to those same producers and others, although not all locations provide every product and service.

Products and Services

Grain Purchasing. We are one of the largest country elevator operators in North America based on revenues. Through a majority of our elevator locations, the country operations business purchases grain from member and non-member producers and other elevators and grain dealers. Most of the grain purchased is either sold through our grain marketing operations or used for local feed and processing operations. For the year ended August 31, 2006, country operations purchased approximately 367 million bushels of grain, primarily wheat (184 million bushels), corn (98 million bushels) and soybeans (43 million bushels). Of these bushels, 338 million were purchased from members and 294 million were sold through our grain marketing operations.

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

Fin-Ag, Inc. In the past, through our wholly-owned subsidiary Fin-Ag, Inc., we provided seasonal cattle feeding and swine financing loans, facility financing loans and crop production loans to our members. Most of these loans were sold to ProPartners (an affiliate of CoBank) under a financing program in which we guarantee a portion of the loans. Financing activity through Fin-Ag, Inc. has decreased substantially as most of the production loans were contributed to Cofina Financial, LLC (Cofina), a 49% owned joint venture that was formed during the fourth quarter of fiscal year 2005 (see Corporate and Other section below). The only activity of Fin-Ag, Inc. is seasonal cattle feeding financing and a small amount of crop loans not transferred to Cofina.

Industry; Competition

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

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

Grain Marketing

Overview

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

Operations

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

We own and operate export terminals, river terminals and elevators involved in the handling and transport of grain. Our river terminals at Savage and Winona, Minnesota, and Davenport, Iowa are used to load grains onto barges for shipment to both domestic and export customers via the Mississippi River system. Our export terminal at Superior, Wisconsin provides access to the Great Lakes and St. Lawrence Seaway, and our export terminal at Myrtle Grove, Louisiana serves the Gulf market. In the Pacific Northwest, we conduct our grain marketing operations through United Harvest, LLC (a 50% joint venture with United Grain Corporation), and TEMCO, LLC (a 50% joint venture with Cargill, Incorporated). United Harvest, LLC, operates grain terminals in Vancouver and Kalama, Washington, and primarily exports wheat. TEMCO, LLC operates an export terminal in Tacoma, Washington, and primarily exports corn and soybeans. These facilities serve the Pacific market, as well as domestic grain customers in the western United States. We also own two 110-car shuttle-receiving elevator facilities in Friona, Texas and Collins, Mississippi that serve large-scale feeder cattle, dairy and poultry producers in those regions. In 2003, we opened an office in Sao Paulo, Brazil for the procurement of soybeans for our grain marketing operations international customers.

Subsequent to the fiscal year ended August 31, 2006, we invested approximately $30.0 million in a Brazil-based grain handling and merchandising company named Multigrain S.A., that will be owned jointly (50/50) with Multigrain Comercio, an agricultural commodities business headquartered in Sao Paulo, Brazil. This venture which includes grain storage and export facilities, builds on our South American soybean origination and helps meet customer needs year-round. Our grain marketing operations continue to explore other opportunities to establish a presence in other emerging grain origination and export markets.

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

Products and Services

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

Sales and Marketing; Customers

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

Industry; Competition

Regulation. Our grain marketing operations are subject to laws and related regulations and rules designed to protect the environment that are administered by the Environmental Protection Agency, the Department of Transportation and similar government agencies. These laws, regulations and rules govern the discharge of materials to environment, air and water; reporting storage of hazardous wastes; and the transportation, handling and disposition of wastes. Our grain marketing operations are also subject to laws and related regulations and rules administered by the United States Department of Agriculture, the Federal Food and Drug Administration, and other federal, state, local and foreign governmental agencies that govern the processing, packaging, storage, distribution, advertising, labeling, quality and safety of food and grain products. Failure to comply with these laws, regulations and rules could subject us to administrative penalties, injunctive relief, civil remedies and possible recalls of products. We believe that we are in compliance with these laws, regulations and rules in all material respects and do not expect continued compliance to have a material effect on our capital expenditures, earnings or competitive position.

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

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

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

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

Summary Operating Results

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

	2006	2005	2004
		(Dollars in thousands)	
Revenues	$ 6,575,165	$ 5,670,644	$ 6,306,530
Cost of goods sold	6,401,527	5,541,282	6,187,082
Gross profit	173,638	129,362	119,448
Marketing, general and administrative	99,777	83,600	85,479
Operating earnings	73,861	45,762	33,969
Gain on sale of investments		(11,358)	
Gain on legal settlements			(692)
Interest, net	23,559	20,535	18,932
Equity income from investments	(40,902)	(55,473)	(47,488)
Minority interests	(509)	(41)	(24)
Income before income taxes	$ 91,713	$ 92,099	$ 63,241
Intersegment sales	$ (8,779)	$ (9,640)	$ (18,372)
Total identifiable assets August 31	$ 1,806,243	$ 1,604,571	$ 1,590,337

PROCESSING

Overview

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

Regulation. Our Processing segment s operations are subject to laws and related regulations and rules de