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

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q/A-1

(Mark One)

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

for the quarterly period ended November 30, 2003.

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 333-17865

Exchange Act Filing Number 0-50150

CHS Inc.

(Exact name of registrant as specified in its charter)

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

Include 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 whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES o NO þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Number of Shares Outstanding at November 30, 2003
NONE	NONE

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This Form 10-Q/ A-1 amends Items 2 and 6(a) to the Registrant s Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2003. In addition, in connection with the filing of this Form 10-Q/ A-1 and pursuant to the rules of the Securities and Exchange Commission, the Registrant is including with this Form 10-Q/ A-1 certain currently dated certifications. Item 2 has been amended solely to incorporate the text of prior Exhibit 99.1 (with certain changes to that text) in Item 2. No other changes have been made to the Form 10-Q for the fiscal quarter ended November 30, 2003 and this Form 10-Q/ A-1 does not modify or update the disclosure contained in the Form 10-Q in any way other than as required to reflect the amendments discussed above and reflected below.

PART I. FINANCIAL INFORMATION

Item 2. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

Cautionary Statement Regarding Forward-Looking Statements

The information in this Quarterly Report on Form 10-Q/ A-1 for the quarterly period ended November 30, 2003, includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the Company. In addition, the Company and its representatives and agents may from time to time make other written or oral forward-looking statements, including statements contained in the Company s filings with the Securities and Exchange Commission and its reports to its members and securityholders. Words and phrases such as will likely result, are expected to, is anticipated, estimate, project and similar expressions identify forward-looking statements. The Company wishes to caution readers not to place undue reliance on any forward-looking statements, which speak only as of the date made.

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

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

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

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 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. 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.

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.

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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 that 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.

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General

CHS Inc. (CHS or the Company) is one of the nation s leading integrated agricultural companies. As a cooperative, the Company is owned by farmers, ranchers and their local cooperatives from the Great Lakes to the Pacific Northwest and from the Canadian border to Texas. CHS buys commodities from, and provides products and services to members and other customers. The Company provides 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.

The Company has 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 three months ended November 30, 2003 and 2002 is shown in Note 8 to the Consolidated Financial Statements.

Many of the Company s business activities are highly seasonal, and as a result, operating results will vary throughout the year. Overall, the Company s 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. The Company s 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.

The Company s 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 the Company purchases 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 the Company s 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 the Company s 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 the Company holds ownership interests of 50% or less and does not control the operations. The Company accounts for these investments primarily using the equity method of accounting, wherein CHS records as equity income from investments its proportionate share of income or loss reported by the entity, without consolidating the revenues and expenses of the entity in the Company s consolidated statements of operations. These investments principally include the Company s 25% ownership in Agriliance, LLC (Agriliance), the 50% ownership in TEMCO, LLC, the 50% ownership in United Harvest, LLC, the 24% ownership in Horizon Milling, LLC (Horizon) and the 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 the Company and 50% by Farmland Industries, Inc. (Farmland), and was formed solely to hold a 50% interest in Agriliance. Prior to the transaction described below, the Company s indirect share of earnings (economic interest) in Agriliance was 25%, which was the same as the Company s ownership or governance interest. Subsequent to the transaction, the Company s indirect economic interest in Agriliance is no longer the same as the Company s ownership or governance interest.

In April 2003, the Company 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. The Company 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 the Company 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 the Company s 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 the Company s 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 the Company eliminates 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,

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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 bushel 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 the Company 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

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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 the Company s 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 the Company s 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 the Company s investment in Horizon Milling. The Company s 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 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 $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.

Liquidity and Capital Resources

On November 30, 2003 the Company 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, the Company 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. In October 2002, the Company borrowed $175.0 million from a group of insurance companies on a long-term basis and in January 2003 received net proceeds of $82.5 million from the sale of preferred stock to the general public. This financing was initiated in part to fund capital expenditures related to the low sulfur fuel regulations discussed below in Cash Flows from Investing Activities. The Company has committed lines of revolving credit totaling $730.0 million, of which $376.0 million was drawn on November 30, 2003, primarily for the purpose of financing receivables and inventories. These receivables and inventories are highly liquid. The Company believes that its 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 the adequacy of supply and transportation, government regulations and policies, world events, and general political and economic conditions. These factors are described in Exhibit 99.1 Cautionary Statement 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 affect of contributing significantly to an increase in net

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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 the Company 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 non-cash 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 the Company, 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 the Company 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.

The Company expects that railcars will continue to be in short supply during the next quarter to transport grain from its country elevator locations to sale destinations. Inventories at most of the Company s 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. The Company also expects 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 the Company expects this increase in net operating assets and liabilities to be partially offset by the collection of prepayments from its own customers for these products. Prepayments are used frequently for agronomy products to assure supply, and at times to guarantee price. The Company believes that it has adequate capacity through its committed credit facility to meet any likely increase in net operating assets and liabilities.

Cash Flows from Investing Activities

For the three months ended November 30, 2003 and 2002, the net cash flows used in the Company s 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, the Company entered into a sale leaseback transaction for the facility equipment and received cash proceeds of $19.8 million from the sale. For the year ended August 31, 2004 the Company expects 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 the Company s 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. The Company expects all of these compliance capital expenditures at the refineries to be completed by December 31, 2005, and anticipates 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.

Cash Flows from Financing Activities

The Company finances its working capital needs through short-term lines of credit with a syndication of banks. In May 2003, the Company entered into a 364-day credit facility of $600.0 million committed. In addition to these lines 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 committed. On November 30, 2003, August 31, 2003 and November 30, 2002, the Company 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 the Company s 364-day credit facility.

In June 1998, the Company established a five-year revolving credit facility with a syndication of banks, with $200.0 million committed, which expired in May 2003. The Company had a previous outstanding balance on this facility of $75.0 million on November 30, 2002.

In May 2003, the Company established a three-year revolving credit facility with a syndication of banks, with $100.0 million committed. There was no outstanding balance on this new credit facility on November 30, 2003 or August 31, 2003.

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The Company finances its 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, the Company established a long-term credit agreement through the cooperative banks. This facility committed $200.0 million of long-term borrowing capacity to the Company, with repayments through fiscal year 2009. The amount outstanding on this credit facility was $136.1 million, $137.8 million and $142.7 million on November 30, 2003, August 31, 2003 and November 30, 2002, respectively. Interest rates on November 30, 2003 ranged from 2.04% to 13.0%. Repayments of approximately $1.6 million were made on this facility during each of the three months ended November 30, 2003 and 2002.

Also in June 1998, the Company 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, the Company 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, the Company 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.

The Company, through NCRA, had revolving term loans outstanding of $14.3 million, $15.0 million and $17.3 million on November 30, 2003, August 31, 2003 and November 30, 2002, respectively. Interest rates on November 30, 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.

On November 30, 2003, the Company 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. The aggregate amount of long-term debt payable presented in the Management s Discussion and Analysis in the Company s Annual Report on Form 10-K for the year ended August 31, 2003 has not materially changed during the three months ended November 30, 2003. The Company s long-term debt is unsecured except for industrial revenue bonds and other notes and contracts in the amount of $7.0 million, however restrictive covenants under various agreements have requirements for maintenance of minimum working capital levels and other financial ratios. The Company is in compliance with all debt covenants and restrictions as of November 30, 2003.

During the three months ended November 30, 2003 and 2002, the Company 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.

In accordance with the bylaws and by action of the 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 the Board of Directors, with the balance issued in the form of capital equity certificates. The patronage earnings from the fiscal year ended August 31, 2003 are expected to be distributed during the second quarter of the fiscal year 2004. The cash portion of this distribution, deemed by the Board of Directors to be 30% is expected to be approximately $27.0 million, and is classified as a current liability on the November 30, 2003 and the August 31, 2003 consolidated balance sheets.

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The current equity redemption policy, as authorized by the 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 the 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 prorata 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. 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, of which $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.

In 2001 and 2002 the Company issued approximately $9.5 million (9,454,874 shares) of 8% Preferred Stock (Old Preferred). In late 2002, the Company suspended sales of the Old Preferred, and on February 25, 2003 the Company filed a post-effective amendment to terminate the offering of the Old Preferred shares. 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. 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, 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 November 30, 2003 the Company had $93.7 million (3,748,099 shares) of the New Preferred outstanding.

The Company s Board of Directors authorized the issuance of up to $13.0 million of the New Preferred in exchange for capital equity certificates. On November 26, 2003 the Company filed a registration statement on Form S-2 with the Securities and Exchange Commission registering the additional New Preferred, however, the registration statement is pending review and approval by the Securities and Exchange Commission and is not yet effective.

Off Balance Sheet Financing Arrangements

Lease Commitments

The Company s lease commitments presented in Management s Discussion and Analysis in the Companies Annual Report on Form 10-K for the year ended August 31, 2003 have not materially changed during the three months ended November 30, 2003.

Guarantees

The Company is a guarantor for lines of credit for related companies of which $56.7 million was outstanding on November 30, 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

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NCRA in the amount of $125.0 million. All outstanding loans with respective creditors are current as of November 30, 2003.

Debt

There is no material off balance sheet debt.

Critical Accounting Policies

The Company s Critical Accounting Policies are presented in the Company s Annual Report on Form 10-K for the year ended August 31, 2003. There have been no changes to these policies during the three months ended November 30, 2003.

Effect of Inflation and Foreign Currency Transactions

The Company believes that inflation and foreign currency fluctuations have not had a significant effect on its operations. During fiscal 2003, the Company opened a grain marketing office in Brazil that will impact its exposure to foreign currency fluctuations, but to date, there has been no material effect.

Recent Accounting Pronouncements

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. The Company has not yet determined what the effects of adopting this standard will have 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. 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 any effect on the Company.

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PART II. OTHER INFORMATION

Item 6. ***Exhibits and Reports on Form 8-K***

(a) *Exhibits*

Exhibit	Description
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) *Reports on Form 8-K*

None.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHS INC.
(Registrant)

/s/ JOHN SCHMITZ

John Schmitz
Executive Vice President and
Chief Financial Officer

February 13, 2004
(Date)

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