

CHS INC  
Form 10-Q  
January 11, 2007

**Table of Contents**

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

**Form 10-Q**

(Mark One)

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

**for the quarterly period ended November 30, 2006.**

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

**for the transition period from \_\_\_\_\_ to \_\_\_\_\_ .**

**Commission File Number 0-50150**

**CHS Inc.**

*(Exact name of registrant as specified in its charter)*

**Minnesota**

*(State or other jurisdiction of incorporation or organization)*

**41-0251095**

*(I.R.S. Employer Identification Number)*

**5500 Cenex Drive**

**Inver Grove Heights, 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  NO

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

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

**Number of Shares Outstanding**

**Class**

**at November 30, 2006**

NONE

NONE

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INDEX

	<b>Page No.</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<u>Item 1.</u>	3
<u>Financial Statements (unaudited)</u>	
<u>Consolidated Balance Sheets as of November 30, 2006, August 31, 2006 and November 30, 2005</u>	3
<u>Consolidated Statements of Operations for the three months ended November 30, 2006 and 2005</u>	4
<u>Consolidated Statements of Cash Flows for the three months ended November 30, 2006 and 2005</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
<u>Item 2.</u>	17
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
<u>Item 3.</u>	34
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	
<u>Item 4.</u>	34
<u>Controls and Procedures</u>	
<b><u>PART II. OTHER INFORMATION</u></b>	
<u>Item 5.</u>	35
<u>Other Information</u>	
<u>Item 6.</u>	35
<u>Exhibits</u>	
<b><u>SIGNATURE PAGE</u></b>	36
<u>Articles of Incorporation</u>	
<u>Commercial Paper Dealer Agreement</u>	
<u>Commercial Paper Dealer Agreement</u>	
<u>Section 302 Certification</u>	
<u>Section 302 Certification</u>	
<u>Section 906 Certification</u>	
<u>Section 906 Certification</u>	

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

**SAFE HARBOR STATEMENT UNDER THE PRIVATE  
SECURITIES LITIGATION REFORM ACT OF 1995**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties that may cause the Company's actual results to differ materially from the results discussed in the forward-looking statements. These factors include those set forth in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, under the caption Cautionary Statement Regarding Forward-Looking Statements to this Quarterly Report on Form 10-Q for the quarterly period ended November 30, 2006.

**Table of Contents****Item 1. Financial Statements**

**CHS INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**

	<b>November 30, 2006</b>	<b>August 31, 2006</b>	<b>November 30, 2005</b>
<b>(dollars in thousands)</b>			
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 112,232	\$ 112,525	\$ 244,756
Receivables	1,141,811	1,076,602	938,148
Inventories	1,180,498	1,130,824	1,006,853
Other current assets	600,990	298,666	297,846
<b>Total current assets</b>	<b>3,035,531</b>	<b>2,618,617</b>	<b>2,487,603</b>
Investments	713,382	624,253	561,869
Property, plant and equipment	1,525,028	1,476,239	1,395,180
Other assets	237,553	223,474	224,745
<b>Total assets</b>	<b>\$ 5,511,494</b>	<b>\$ 4,942,583</b>	<b>\$ 4,669,397</b>
<b>LIABILITIES AND EQUITIES</b>			
Current liabilities:			
Notes payable	\$ 291,422	\$ 22,007	\$ 21,147
Current portion of long-term debt	61,443	60,748	36,942
Customer credit balances	75,907	66,468	70,964
Customer advance payments	118,319	82,362	103,087
Checks and drafts outstanding	77,558	57,083	61,004
Accounts payable	917,719	904,143	902,808
Accrued expenses	410,433	347,078	303,889
Dividends and equities payable	254,539	249,774	203,521
<b>Total current liabilities</b>	<b>2,207,340</b>	<b>1,789,663</b>	<b>1,703,362</b>
Long-term debt	665,756	683,997	729,356
Other liabilities	355,452	310,157	239,416
Minority interests in subsidiaries	156,870	141,375	160,813
Commitments and contingencies			
Equities	2,126,076	2,017,391	1,836,450
<b>Total liabilities and equities</b>	<b>\$ 5,511,494</b>	<b>\$ 4,942,583</b>	<b>\$ 4,669,397</b>

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

**Table of Contents**

**CHS INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	<b>For the Three Months Ended November 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(dollars in thousands)</b>	
Revenues	\$ 3,751,070	\$ 3,453,513
Cost of goods sold	3,528,794	3,199,068
Gross profit	222,276	254,445
Marketing, general and administrative	52,102	49,626
Operating earnings	170,174	204,819
Gain on sale of investment	(5,348)	
Interest, net	7,688	7,331
Equity income from investments	(4,531)	(9,177)
Minority interests	18,912	32,161
Income from continuing operations before income taxes	153,453	174,504
Income taxes	17,171	20,478
Income from continuing operations	136,282	154,026
Income on discontinued operations, net of taxes		(208)
Net income	\$ 136,282	\$ 154,234

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



**Table of Contents****CHS INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)**

	<b>For the Three Months Ended November 30,</b>	
	<b>2006</b>	<b>2005 (as restated)</b>
	<b>(dollars in thousands)</b>	
Cash flows from operating activities:		
Net income	\$ 136,282	\$ 154,234
Depreciation and amortization	34,201	27,984
Income from equity investments	(4,531)	(9,177)
Distributions from equity investments	15,272	3,532
Minority interests	18,912	32,161
Noncash patronage dividends received	(321)	(251)
(Gain) loss on sale of property, plant and equipment	(302)	294
Gain on sale of investment	(5,348)	
Deferred taxes	17,171	37,512
Other, net	375	228
Changes in operating assets and liabilities:		
Receivables	(39,841)	151,493
Inventories	(45,118)	(90,281)
Other current assets and other assets	(300,523)	57,168
Customer credit balances	9,439	(20,938)
Customer advance payments	35,932	(23,813)
Accounts payable and accrued expenses	82,329	(141,678)
Other liabilities	11,458	(14,782)
Net cash (used in) provided by operating activities	(34,613)	163,686
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(80,192)	(64,524)
Proceeds from disposition of property, plant and equipment	1,415	5,431
Investments	(77,420)	(37,015)
Investments redeemed	1,376	1,175
Proceeds from sale of investment	10,918	
Changes in notes receivable	(32,546)	8,826
Other investing activities, net	(3,097)	(45)
Net cash used in investing activities	(179,546)	(86,152)
Cash flows from financing activities:		
Changes in notes payable	269,415	(40,000)
Principal payments on long-term debt	(17,641)	(6,776)
Changes in checks and drafts outstanding	20,475	(6,582)

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Distribution to minority owners	(8,313)	(11,677)
Costs incurred capital equity certificates redeemed	(4)	
Preferred stock dividends paid	(2,932)	(2,476)
Retirements of equities	(47,134)	(6,285)
Net cash provided by (used in) financing activities	213,866	(73,796)
Net (decrease) increase in cash and cash equivalents	(293)	3,738
Cash and cash equivalents at beginning of period	112,525	241,018
Cash and cash equivalents at end of period	\$ 112,232	\$ 244,756

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

**Table of Contents**

**CHS INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)  
(dollars in thousands)**

**Note 1. Accounting Policies**

The unaudited consolidated balance sheets as of November 30, 2006 and 2005, and the statements of operations and cash flows for the three months ended November 30, 2006 and 2005 reflect, in the opinion of our management, all normal recurring adjustments necessary for a fair statement of the financial position and results of operations and cash flows for the interim periods presented. The results of operations and cash flows for interim periods are not necessarily indicative of results for a full fiscal year because of, among other things, the seasonal nature of our businesses. The consolidated balance sheet data as of August 31, 2006 has been derived from our audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The consolidated financial statements include our accounts and the accounts of all of our wholly-owned and majority-owned subsidiaries and limited liability companies. The effects of all significant intercompany accounts and transactions have been eliminated.

These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended August 31, 2006, included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission.

***Goodwill and Other Intangible Assets***

Goodwill was \$3.9 million, \$3.9 million and \$3.3 million on November 30, 2006, August 31, 2006 and November 30, 2005, respectively, and is included in other assets in the consolidated balance sheets. The increase in goodwill during fiscal 2006 was due to the consolidation of Provista Renewable Fuels Marketing, LLC, included in our Energy segment, which had \$0.6 million of goodwill on its balance sheet.

Intangible assets subject to amortization primarily include trademarks, customer lists and agreements not to compete, and are amortized over the number of years that approximate their respective useful lives (ranging from 3 to 15 years). The gross carrying amount of these intangible assets was \$29.2 million with total accumulated amortization of \$9.4 million as of November 30, 2006. Intangible assets of \$2.7 million were acquired during the three months ended November 30, 2006. Total amortization expense for intangible assets during the three-month periods ended November 30, 2006 and 2005, was \$0.7 million and \$0.6 million, respectively. The estimated annual amortization expense related to intangible assets subject to amortization for the next five years will approximate \$2.4 million annually for the first three years, \$2.2 million for the fourth year and \$1.8 million for the following year.

***Recent Accounting Pronouncements***

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. FIN 48 is effective for fiscal years beginning after December 15, 2006, with early adoption permitted. We are currently evaluating the impact that this standard will have

on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158). SFAS No. 158 requires that employers recognize on a prospective basis the funded status of their defined benefit pension and other postretirement plans on their consolidated balance sheet and recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits

**Table of Contents****CHS INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

that arise during the period but are not recognized as components of net periodic benefit cost. SFAS No. 158 also requires additional disclosures in the notes to financial statements. SFAS No. 158 is effective as of the end of fiscal years ending after December 15, 2006. We are currently assessing the impact of SFAS No. 158 on our consolidated financial statements.

Based on the funded status of our defined benefit pension and postretirement medical plans as of the most recent measurement dates, we would be required to increase our net liabilities for pension and postretirement medical benefits upon adoption of SFAS No. 158, which would result in a decrease to owners equity in our Consolidated Balance Sheet. The ultimate amounts recorded are highly dependent on a number of assumptions, including the discount rates in effect in 2007, the actual rate of return on pension assets for 2007 and the tax effects of the adjustment. Changes in these assumptions since our last measurement date could increase or decrease the expected impact of implementing SFAS No. 158 in our consolidated financial statements at August 31, 2007.

In September 2006, the FASB issued FASB Staff Position (FSP) AUG AIR-1, Accounting for Planned Major Maintenance Activities, addressing the accounting for planned major maintenance activities which includes refinery turnarounds. This FSP prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods but allows the alternative deferral method. The FSP shall be applied to the first fiscal year beginning after December 15, 2006. We are currently using the accrue-in-advance method of accounting, and are in the process of assessing the impact this FSP will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157) to increase consistency and comparability in fair value measurements by defining fair value, establishing a framework for measuring fair value in generally accepted accounting principles, and expanding disclosures about fair value measurements. SFAS No. 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are in the process of evaluating the effect that the adoption of SFAS No. 157 will have on our consolidated results of operations and financial condition.

**Reclassifications**

Certain reclassifications have been made to prior periods amounts to conform to current period classifications. These reclassifications had no effect on previously reported net income, equities or total cash flows.

**Note 2. Receivables**

	November 30, 2006	August 31, 2006	November 30, 2005
Trade	\$ 1,101,845	\$ 1,056,514	\$ 923,090
Other	95,215	73,986	77,117
	1,197,060	1,130,500	1,000,207

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Less allowances for doubtful accounts	55,249	53,898	62,059
	\$ 1,141,811	\$ 1,076,602	\$ 938,148

Table of Contents**CHS INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)****Note 3. Inventories**

	<b>November 30, 2006</b>	<b>August 31, 2006</b>	<b>November 30, 2005</b>
Grain and oilseed	\$ 619,913	\$ 511,413	\$ 460,182
Energy	378,260	447,664	372,050
Feed and farm supplies	146,516	137,978	146,347
Processed grain and oilseed	34,128	32,198	26,754
Other	1,681	1,571	1,520
	<b>\$ 1,180,498</b>	<b>\$ 1,130,824</b>	<b>\$ 1,006,853</b>

**Note 4. Derivative Assets and Liabilities**