CIGNA CORP
Form 425
August 13, 2018
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report (Date of earliest event reported) August 13, 2018

Cigna Corporation
(Exact name of registrant as specified in its charter)

Delaware	1-08323	06-1059331
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

900 Cottage Grove Road
Bloomfield, Connecticut 06002
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code:

(860) 226-6000

Not Applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

[X] Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
[ ] Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
[ ] Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
[ ] Pre-commencement communication pursuant to Rule 13e-49(c) under the Exchange Act (17 CFR 240.13e-4(c))
Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (17 CFR §230.405) or Rule 12b-2 of the Securities Exchange Act of 1934 (17 CFR §240.12b-2).
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Item 8.01 Other Events.

On August 13, 2018, Cigna Corporation ("Cigna") issued a press release announcing Glass Lewis' recommendation that shareholders vote in favor of the proposal to approve the merger agreement between Cigna and Express Scripts Holding Company, as further described in the definitive proxy statement filed with the Securities and Exchange Commission on July 16, 2018. A copy of Cigna's press release is attached as Exhibit 99.1 to this report and is incorporated herein by reference.

FORWARD LOOKING STATEMENTS

Information included or incorporated by reference in this communication, and information which may be contained in other filings with the Securities and Exchange Commission (the "SEC") and press releases or other public statements, contains or may contain forward-looking statements. These forward-looking statements include, among other things, statements of plans, objectives, expectations (financial or otherwise) or intentions, including statements concerning the potential future performance of Cigna, Express Scripts, or the combined company, the potential for new laws or regulations, or any impact of any such new laws or regulations, including on the business of Cigna, Express Scripts or the combined company, the ability to achieve the anticipated benefits of the proposed merger, on the expected timeline or at all, the timeline for deleveraging the combined company, and the ability to consummate the proposed merger, on the anticipated timeline or at all, and other statements regarding the parties' future beliefs, expectations, plans, intentions, financial condition or performance. You may identify forward-looking statements by the use of words such as "believe," "expect," "plan," "intend," "anticipate," "estimate," "predict," "potential," "may," "should," "will" or other words or expressions of similar meaning, although not all forward-looking statements contain such terms.

Forward-looking statements, including as they relate to Express Scripts or Cigna, the management of either such company, the transaction or any expected benefits of the transaction, involve risks and uncertainties. Actual results may differ significantly from those projected or suggested in any forward-looking statements. Express Scripts and Cigna do not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect events or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events. Any number of factors could cause actual results to differ materially from those contemplated by any forward-looking statements, including, but not limited to, the risks associated with the following:

the inability of Express Scripts and Cigna to obtain stockholder or regulatory approvals required for the merger or the requirement to accept conditions that could reduce the anticipated benefits of the merger as a condition to obtaining regulatory approvals;

the possibility that the anticipated benefits from the merger (including anticipated synergies) cannot be realized in full, or at all or may take longer to realize than expected;

a longer time than anticipated to consummate the proposed merger;

problems regarding the successful integration of the businesses of Express Scripts and Cigna;

unexpected costs regarding the proposed merger;

diversion of management's attention from ongoing business operations and opportunities;

potential litigation associated with the proposed merger;

the ability to retain key personnel;

the availability of financing;

effects on the businesses as a result of uncertainty surrounding the proposed merger;

the ability of the combined company to achieve financial, strategic and operational plans and initiatives;

the ability of the combined company to predict and manage medical costs and price effectively and develop and maintain good relationships with physicians, hospitals and other health care providers;

the impact of modifications to the combined company's operations and processes;
the ability of the combined company to identify potential strategic acquisitions or transactions and realize the expected benefits of such transactions;
the substantial level of government regulation over the combined company's business and the potential effects of new laws or regulations or changes in existing laws or regulations;
the outcome of litigation relating to the businesses of Express Scripts and Cigna, regulatory audits, investigations, actions and/or guaranty fund assessments;
uncertainties surrounding participation in government-sponsored programs such as Medicare;
the effectiveness and security of the combined company's information technology and other business systems;
unfavorable industry, economic or political conditions, including foreign currency movements;
acts of war, terrorism, natural disasters or pandemics; and
the industry may be subject to future risks that are described in SEC reports filed by Express Scripts and Cigna.

You should carefully consider these and other relevant factors, including those risk factors in this communication and other risks and uncertainties that affect the businesses of Express Scripts and Cigna described in their respective filings with the SEC, when reviewing any forward-looking statement. These factors are noted for investors as permitted under the Private Securities Litigation Reform Act of 1995. Investors should understand it is impossible to predict or identify all such factors or risks. As such, you should not consider either foregoing lists, or the risks identified in SEC filings, to be a complete discussion of all potential risks or uncertainties, and should not place undue reliance on forward-looking statements.

IMPORTANT INFORMATION ABOUT THE TRANSACTION AND WHERE TO FIND IT

This communication does not constitute an offer to sell or solicitation of an offer to buy any securities. In connection with the proposed transaction, the newly formed company which will become the holding company following the transaction ("Holdco") filed with the SEC a registration statement on Form S-4. The registration statement on Form S-4 includes a joint proxy statement of Cigna and Express Scripts that also constitutes a prospectus of Holdco. The registration statement was declared effective by the SEC on July 16, 2018, and Cigna and Express Scripts commenced mailing the definitive joint proxy statement/prospectus to the respective stockholders of Cigna and Express Scripts on or about July 17, 2018. Cigna and Express Scripts also plan to file other relevant documents with the SEC regarding the proposed transaction. This document is not a substitute for the registration statement or the joint proxy statement/prospectus or any other document which Cigna, Express Scripts or Holdco may file with the SEC. INVESTORS AND SECURITY HOLDERS ARE URGED TO READ THE REGISTRATION STATEMENT, JOINT PROXY STATEMENT/PROSPECTUS AND ANY OTHER RELEVANT DOCUMENTS THAT ARE FILED OR MAY BE FILED WITH THE SEC, AS WELL AS ANY AMENDMENTS OR SUPPLEMENTS TO THESE DOCUMENTS, CAREFULLY AND IN THEIR ENTIRETY BECAUSE THEY CONTAIN OR WILL CONTAIN IMPORTANT INFORMATION. You may obtain a free copy of the registration statement on Form S-4 and the definitive joint proxy statement/prospectus and other relevant documents filed by Holdco, Cigna and Express Scripts with the SEC at the SEC's website at www.sec.gov. Copies of documents filed with the SEC by Cigna will be available free of charge on Cigna's website at www.Cigna.com or by contacting Cigna's Investor Relations Department at (215) 761-4198. Copies of documents filed with the SEC by Express Scripts will be available free of charge on Express Scripts' website at www.express-scripts.com or by contacting Express Scripts' Investor Relations Department at (314) 810-3115.

PARTICIPANTS IN THE SOLICITATION

Cigna (and, in some instances, Holdco) and Express Scripts and their respective directors and executive officers may be deemed to be participants in the solicitation of proxies in respect of the proposed transaction under the rules of the SEC. Investors may obtain information regarding the names, affiliations and interests of directors and executive officers of Cigna (and, in some instances, Holdco) in Cigna's Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the SEC on February 28, 2018, and its definitive proxy statement for its 2018 Annual Meeting, which was filed with the SEC on March 16, 2018. Investors may obtain information regarding the names, affiliations and interests of Express Scripts' directors and executive officers in Express Scripts' Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the SEC on February 27, 2018, and its proxy statement for its 2018 Annual Meeting, which was filed with the SEC on March 29, 2018. You may obtain free copies of these documents at the SEC's website at www.sec.gov, at Cigna's website at www.Cigna.com or by contacting Cigna's Investor Relations Department at (215) 761-4198. Copies of documents filed with the SEC by Express Scripts will be available free of charge on Express Scripts' website at www.express-scripts.com or by contacting Express Scripts' Investor Relations Department at (314) 810-3115. Other information regarding the participants in the proxy solicitation and a description of their direct and indirect interests, by security holdings or otherwise, is contained in the joint proxy statement/prospectus and other relevant materials filed or to be filed with the SEC regarding the proposed transaction. Investors should read the joint proxy statement/prospectus carefully and in its entirety before making any voting or investment decisions.

NO OFFER OR SOLICITATION

This communication is for informational purposes only and not intended to and does not constitute an offer to subscribe for, buy or sell, the solicitation of an offer to subscribe for, buy or sell or an invitation to subscribe for, buy or sell any securities or the solicitation of any vote or approval in any jurisdiction pursuant to or in connection with the proposed transaction or otherwise, nor shall there be any sale, issuance or transfer of securities in any jurisdiction in contravention of applicable law. No offer of securities shall be made except by means of a prospectus meeting the requirements of Section 10 of the Securities Act of 1933, as amended, and otherwise in accordance with applicable law.

Item 9.01 Financial Statements and Exhibits.

(d) Exhibits.

Exhibit No.	Description
99.1	Press release dated August 13, 2018.

SIGNATURE

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 hereunto duly authorized.

Cigna Corporation

Date: August 13, 2018	By:	/s/ Eric P. Palmer
		Eric P. Palmer
		Executive Vice President and
		Chief Financial Officer
		(Principal Financial Officer)

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John Schmitz *Executive Vice President and Chief Financial Officer*

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CHS INC.

CONSOLIDATED BALANCE SHEETS

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

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

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CHS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

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

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

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CHS INC.

CONSOLIDATED STATEMENTS OF EQUITIES

AND COMPREHENSIVE INCOME

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

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

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

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CHS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

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

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

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CHS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

Organization:

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

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

Consolidation:

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

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

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

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

Cash Equivalents:

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

Inventories:

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

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Derivative Financial Instruments:

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

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

Commodity Price Risk

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

Unrealized gains and losses on futures contracts and options used as economic hedges of grain and oilseed inventories and fixed price contracts are recognized in cost of goods sold for financial reporting on a

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

monthly basis using market based prices. Inventories and fixed price contracts are marked to fair value using market based prices so that gains or losses on the derivative contracts are offset by gains or losses on inventories and fixed price contracts during the same accounting period.

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

Interest Rate Risk

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

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

Foreign Currency Risk

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

Investments:

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

Property, Plant and Equipment:

Property, plant and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided on the straight-line method by charges to operations at rates based upon the expected useful lives of individual or groups of assets (primarily 15 to 40 years for land improvements and buildings and 3 to 20 years for machinery, equipment, office and other). The cost and

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

related accumulated depreciation and amortization of assets sold or otherwise disposed of are removed from the related accounts and resulting gains or losses are reflected in operations. Expenditures for maintenance and repairs and minor renewals are expensed, while costs of major renewals and betterments are capitalized.

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

Goodwill and Other Intangible Assets:

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

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

Revenue Recognition:

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

Environmental Expenditures:

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

Income Taxes:

The Company is a nonexempt agricultural cooperative and files a consolidated federal income tax return with its 80% or more owned subsidiaries. The Company is subject to tax on income from nonpatronage sources and undistributed patronage-sourced income. Deferred income taxes reflect the

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

impact of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and such amounts recognized for federal and state income tax purposes, at each year end, based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

Comprehensive Income:

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

Use of Estimates:

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

Recent Accounting Pronouncements:

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

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

On April 30, 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. The new guidance amends SFAS No. 133 for decisions made as part of the Derivatives Implementation Group process that effectively required amendments to SFAS No. 133, and decisions made in connection with other FASB projects dealing with financial instruments and in connection with implementation issues raised in relation to the application of the definition of a derivative and characteristics of a derivative that contains financing components. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statements of cash flows.

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SFAS No. 149 is effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003. The Company believes that the effects of adopting this standard do not have a material effect on the Company.

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

Reclassifications:

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

2. Receivables:

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

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Inventories:

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

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

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

4. Investments:

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

	2003	2002
	(dollars in thousands)	
Cooperatives:		
CF Industries, Inc.	$152,996	$152,996
CoBank ACB (CoBank)	22,505	30,069
Ag Processing, Inc.	24,481	25,797
Land O Lakes, Inc.	27,105	26,232
Joint ventures:		
Ventura Foods, LLC	107,464	108,981
United Country Brands, LLC	129,286	86,175
TEMCO, LLC	9,087	8,414
Other	59,969	57,943
	$532,893	$496,607

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

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. Agriliance s earnings or losses are split among the members based upon the respective economic interest of each member.

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

5. Property, Plant and Equipment:

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

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Other Assets:

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

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Notes Payable and Long-Term Debt:

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

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

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

(a) The Company finances its working capital needs through short-term lines of credit with a syndication of banks. The Company has a 364-day credit facility of $600.0 million, all of which is committed, and of which $250.0 million was outstanding on August 31, 2003. In addition to this short-term line of credit, the Company has a 364-day credit facility dedicated to NCRA with a syndication of banks in the amount of $30.0 million, all of which is committed, with no amounts outstanding on August 31, 2003. Other miscellaneous notes payable totaled $1.1 million at August 31, 2003.

(b) The Company established a $100.0 million three-year revolving credit facility with a syndication of banks. On August 31, 2003, the Company had no outstanding balance on this facility.

(c) The Company established a long-term credit agreement which committed $200.0 million of long-term borrowing capacity to the Company through May 31, 1999, of which $164.0 million was drawn before the expiration date of that commitment. On August 31, 2003,

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

(d) The Company entered into a private placement with several insurance companies for long-term debt in the amount of $225.0 million.

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(f) In January 2001, the Company entered into a note purchase and private shelf agreement with Prudential Insurance Company. A long-term note was issued for $25.0 million and a subsequent note for $55.0 million was issued in March 2001.

(g) Industrial Revenue Bonds in the amount of $1.6 million are collateralized by property, plant and equipment, primarily energy refinery equipment, with a cost of approximately $152.0 million, less accumulated depreciation of approximately $120.4 million as of August 31, 2003.

(h) Grain Suppliers, LLC, a wholly-owned subsidiary of the Company, has other notes payable of $5.4 million collateralized by property, plant and equipment, with a cost of approximately $8.3 million, less accumulated depreciation of approximately $0.2 million on August 31, 2003.

(i) The debt is unsecured, however restrictive covenants under various agreements have requirements for maintenance of minimum working capital levels and other financial ratios.

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

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

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

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

8. Income Taxes:

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

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

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

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

9. Equities:

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

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

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Employee Benefit Plans:

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

	Qualified Pension Benefits			Non-Qualified Pension Benefits			Other Benefits		
	2003	2002	2001	2003	2002	2001	2003	2002	2001
				(dollars in thousands)					
Components of net periodic benefit cost:									
Service cost	$ 10,840	$ 9,275	$ 7,875	$ 800	$1,168	$ 631	$ 648	$ 557	$ 566
Interest cost	17,503	17,673	17,580	1,033	886	907	1,722	1,586	1,569
Expected return on assets	(23,788)	(21,386)	(22,855)						
Prior service cost amortization	806	740	619	564	574	574	(172)	(197)	(131)
Actuarial loss (gain) amortization	2,623	1,369	231	159	18	144	(215)	(505)	(538)
Transition amount amortization		(708)	(874)			13	936	936	936
Other									(22)
Net periodic benefit cost	$ 7,984	$ 6,963	$ 2,576	$2,556	$2,646	$2,269	$2,919	$2,377	$2,380
Weighted-average assumptions:									
Discount rate	6.30%	7.10%	7.30%	6.00%	7.25%	7.50%	6.30%	7.10%	7.30%
Expected return on plan assets	9.00%	9.00%	9.00%	N/A	N/A	N/A	N/A	N/A	N/A
Rate of compensation increase	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%

CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

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

11. Segment Reporting:

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

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Commitments and Contingencies:

Environmental:

The Company is required to comply with various environmental laws and regulations incidental to its normal business operations. In order to meet its compliance requirements, the Company establishes reserves for the probable future costs of remediation of identified issues, which are included in cost of goods sold and marketing, general and administrative expenses in the consolidated statements of operations. The resolution of any such matters may affect consolidated net income for any fiscal period; however, management believes any resulting liabilities, individually or in the aggregate, will not have a material effect on the consolidated financial position, results of operations or cash flows of the Company during any fiscal year.

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

Other Litigation and Claims:

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

Grain Storage:

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

Guarantees:

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Lease Commitments:

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

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

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

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

13. Supplemental Cash Flow and Other Information:

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

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

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CHS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Related Party Transactions:

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

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

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

15. Comprehensive Income:

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

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

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

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Members and Patrons of

CHS Inc.:

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

November 5, 2003

Minneapolis, Minnesota

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INDEPENDENT AUDITORS REPORT

Members Committee
Ventura Foods, LLC

We have audited the accompanying balance sheets of Ventura Foods, LLC (the Company) as of March 31, 2004 and 2003, and the related statements of income, members capital and cash flows for the years ended March 31, 2004, 2003 and 2002. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Ventura Foods, LLC as of March 31, 2004 and 2003, and the results of their operations and their cash flows for the years ended March 31, 2004, 2003 and 2002 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, effective April 1, 2002.

Deloitte & Touche LLP

Costa Mesa, California
June 18, 2004

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VENTURA FOODS, LLC

BALANCE SHEETS
MARCH 31, 2004 AND 2003

ASSETS (Note 3)	**2004**	**2003**
CURRENT ASSETS:		
Cash and cash equivalents (Note 2)	$117,783,000	$ 2,800,000
Trade receivables, net of allowance for doubtful accounts of $1,929,000 and $1,909,000 at 2004 and 2003, respectively (Notes 2, 3 and 4)	79,877,000	64,313,000
Inventories (Notes 2, 3 and 4)	108,605,000	92,366,000
Prepaid expenses and other current assets	4,609,000	5,922,000
Due from Wilsey Foods, Inc. (Note 4)		309,000
Derivative contract asset (Notes 2 and 4)	31,073,000	18,703,000
Total current assets	341,947,000	184,413,000
PROPERTY (Notes 2 and 3):		
Land, buildings and improvements	103,903,000	102,768,000
Machinery and equipment	145,001,000	139,264,000
Construction-in-progress	13,692,000	6,905,000
Other property	13,856,000	10,798,000
Total	276,452,000	259,735,000
Less accumulated depreciation and amortization	118,074,000	106,914,000
Property net	158,378,000	152,821,000
GOODWILL, Net of amortization of $18,087,000 at 2004 and 2003 (Notes 2 and 7)	43,156,000	43,156,000
TRADEMARKS, Net of amortization of $8,526,000 at 2004 and 2003 (Notes 2 and 7)	19,318,000	19,318,000
DEFERRED COMPENSATION PLAN TRUST (Note 5)	15,626,000	13,574,000
OTHER ASSETS, Net of amortization of $3,670,000 and $3,520,000 at 2004 and 2003 (Notes 2, 3 and 7)	4,319,000	4,673,000
TOTAL	$582,744,000	$417,955,000

LIABILITIES AND MEMBERS CAPITAL	**2004**	**2003**
CURRENT LIABILITIES:		
Accounts payable (Note 4)	$ 81,199,000	$ 58,395,000

Accrued liabilities (Note 4)	53,325,000	36,984,000
Dividends payable	16,091,000	5,748,000
Bank lines of credit (Note 3)		20,500,000
Current portion of long-term debt (Note 3)	2,804,000	74,228,000
Derivative contract liability (Notes 2 and 4)	21,900,000	12,162,000
Total current liabilities	175,319,000	208,017,000
LONG-TERM DEBT (Note 3)	195,152,000	22,950,000
DEFERRED COMPENSATION OBLIGATIONS (Note 5)	26,513,000	20,496,000
Total liabilities	396,984,000	251,463,000
COMMITMENTS AND CONTINGENCIES (Notes 5 and 6)		
MEMBERS CAPITAL	185,760,000	166,492,000
TOTAL	$582,744,000	$417,955,000

See notes to financial statements.

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VENTURA FOODS, LLC

STATEMENTS OF INCOME
YEARS ENDED MARCH 31, 2004, 2003 AND 2002

	2004	2003	2002
NET SALES (Notes 2 and 5)	$1,312,356,000	$1,096,425,000	$965,521,000
COST OF GOODS SOLD (Notes 2 and 5)	1,124,482,000	912,702,000	791,061,000
GROSS PROFIT	187,874,000	183,723,000	174,460,000
OPERATING EXPENSES:			
Selling, general and administrative (Notes 2 and 5)	111,375,000	105,424,000	91,827,000
Amortization of intangibles (Notes 2 and 7)	83,000	223,000	6,227,000
Total operating expenses	111,458,000	105,647,000	98,054,000
OPERATING INCOME	76,416,000	78,076,000	76,406,000
INTEREST EXPENSE Net (Note 4)	8,932,000	6,785,000	7,474,000
OTHER EXPENSE (INCOME)	(1,758,000)	733,000	(1,554,000)
NET INCOME	$ 69,242,000	$ 70,558,000	$ 70,486,000

See notes to financial statements.

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STATEMENTS OF MEMBERS CAPITAL
YEARS ENDED MARCH 31, 2004, 2003 AND 2002

	Wilsey Foods, Inc.	CHS, Inc.	Total
BALANCE March 31, 2001	$ 65,872,000	$ 65,872,000	$131,744,000
Net income	35,243,000	35,243,000	70,486,000
Dividends	(25,757,000)	(25,757,000)	(51,514,000)
BALANCE March 31, 2002	75,358,000	75,358,000	150,716,000
Net income	35,279,000	35,279,000	70,558,000
Dividends	(27,391,000)	(27,391,000)	(54,782,000)
BALANCE March 31, 2003	83,246,000	83,246,000	166,492,000
Net income	34,621,000	34,621,000	69,242,000
Dividends	(24,987,000)	(24,987,000)	(49,974,000)
BALANCE March 31, 2004	$ 92,880,000	$ 92,880,000	$185,760,000

See notes to financial statements.

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VENTURA FOODS, LLC

STATEMENTS OF CASH FLOWS
YEARS ENDED MARCH 31, 2004, 2003 AND 2002

	2004	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 69,242,000	$ 70,558,000	$ 70,486,000
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	13,437,000	12,416,000	12,186,000
Amortization of intangibles	83,000	223,000	6,227,000
Impairment of other assets	984,000		
Deferred rent	1,095,000	515,000	
Loss on disposal of assets	646,000	872,000	324,000
Derivative contract asset	(2,632,000)	2,637,000	(1,803,000)
Changes in operating assets and liabilities:			
Trade receivables	(15,564,000)	(7,174,000)	(771,000)
Inventories	(16,239,000)	(29,567,000)	3,881,000
Prepaid expenses and other current assets	1,169,000	(3,639,000)	(793,000)
Accounts payable	22,804,000	6,350,000	(4,491,000)
Accrued liabilities	15,246,000	10,685,000	2,893,000
Deferred compensation obligations	3,965,000	4,815,000	4,866,000
Due from (to) affiliates	309,000	(309,000)	47,000
Net cash provided by operating activities	94,545,000	68,382,000	93,052,000
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisition of property	(19,698,000)	(16,062,000)	(13,268,000)
Proceeds from sale of assets	58,000	1,845,000	69,000
Investment in rabbi trust			(13,976,000)
Other assets	(569,000)	(1,332,000)	(48,000)
Net cash used in investing activities	(20,209,000)	(15,549,000)	(27,223,000)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Borrowing of long-term debt	175,000,000		
Repayment of long-term debt	(74,223,000)	(12,758,000)	(12,603,000)
Net (payments on) borrowings from line of credit	(20,500,000)	12,500,000	3,000,000
Payment to Wilsey Foods, Inc. (Note 1)		(491,000)	(487,000)

Dividends paid	(39,630,000)	(58,584,000)	(60,589,000)
Net cash provided by (used in) financing activities	40,647,000	(59,333,000)	(70,679,000)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	114,983,000	(6,500,000)	(4,850,000)
CASH AND CASH EQUIVALENTS Beginning of period	2,800,000	9,300,000	14,150,000
CASH AND CASH EQUIVALENTS End of period	$117,783,000	$ 2,800,000	$ 9,300,000
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION Cash paid during the period for interest	$ 6,250,000	$ 7,183,000	$ 8,129,000

See notes to financial statements.

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VENTURA FOODS, LLC

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2004, 2003 AND 2002

1. GENERAL MATTERS

Ventura Foods, LLC (the Company) is a processor and distributor of edible oils used in food preparation and a packager of food products. The Company sells its products to national and regional restaurant chains, food wholesalers and retail chains. In April 2002, the Company dissolved its wholly-owned subsidiary, Ventura Jets, Inc., and consequently no longer consolidates the financial statements.

The Company was formed pursuant to a Joint Venture Agreement (the Agreement) dated August 30, 1996 between Wilsey Foods, Inc. (Wilsey) and CHS Inc. (CHS) whereby substantially all the assets and liabilities of Wilsey and Holsum Foods (a division of CHS) were transferred and assigned, with certain exclusions, to the Company. Wilsey is a majority owned subsidiary of Mitsui & Co., Ltd. From the period of inception through March 31, 2000, Wilsey and CHS owned 60% and 40%, respectively, of the Company. On March 31, 2000, Wilsey sold a 10% interest in the Company to CHS. Accordingly, Wilsey and CHS each own 50% of the Company.

At the formation date, a liability equal to the net deferred income tax liability of Wilsey at August 30, 1996 was assumed by the Company. The amount was payable in five equal annual installments of $487,000 plus a final installment of $491,000. The final installment of $491,000 was paid during fiscal 2003.

2. ACCOUNTING POLICIES

Cash and Cash Equivalents The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents. Included in accounts payable are bank overdrafts of $1,102,000 and $15,231,000 at March 31, 2004 and 2003, respectively.

Inventories Inventories consist of the following at March 31:

	2004	**2003**
Bulk oil	$ 46,682,000	$38,751,000
Finished goods	40,948,000	34,119,000
Ingredients and supplies	20,975,000	19,496,000
Total	$108,605,000	$92,366,000

Inventories are accounted for at the lower of cost or market, using the first-in, first-out method. Cost for inventories produced or modified by the Company through a manufacturing process includes fixed and variable production costs and raw materials costs, and inbound freight costs. Cost for inventories purchased for resale includes the cost of the product and freight and handling costs incurred to place the product at the Company s point of sale.

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Derivative Financial Instruments The Company s use of derivative financial instruments is limited to forwards, futures and certain other delivery contracts as discussed below. The Company enters into these contracts to limit its exposure to price volatility of various food oils that are critical to its processing and distribution activities. It is the Company s policy to remain substantially hedged with respect to edible oil product price risk; derivative contracts are used to maintain this hedged position. Forward purchase and sales contracts with established market participants as well as exchange-traded futures contracts are entered into in amounts necessary to protect against price changes on raw materials needed for the Company s food oil processing and distribution activities. The Company also enters into purchase and sales commitments with major suppliers and customers at a specified premium or discount from a future market price (Basis Contracts). Additionally, the Company s policies do not permit speculative trading of such contracts. All of these qualify as derivatives under Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and are stated at market value. Changes in market value are recognized in the statements of income, through cost of sales, in the periods such changes occur. The market value of futures contracts, Basis Contracts, and forward purchase and sales contracts is recorded separately on the balance sheets as derivative contract assets or liabilities. These contracts have maturities of less than one year.

The following summarizes the Company s various derivative contracts outstanding at March 31, 2004 and 2003 (pounds and dollars in thousands)

Forward Contracts and Commitments	**Pounds**	**Net Unrealized Gain (Loss)**
March 31, 2004		
Forward purchases	412,000	$ 12,164
Forward sales	630,000	(19,493)
Basis purchase	810,600	6,462
Basis sales	65,100	(185)
Futures contracts	421,400	10,225
	2,339,100	$ 9,173
March 31, 2003		
Forward purchases	334,100	$ 11,060
Forward sales	433,300	(6,208)
Basis purchase	259,800	857
Basis sales	17,500	(126)
Futures contracts	146,000	958
	1,190,700	$ 6,541

The fair value of futures contracts is determined from quotes listed on the Chicago Board of Trade or other market makers. Forward purchase and sales contracts are with various counterparties and the fair values of such contracts are determined from the market price of the underlying product.

The Company is exposed to loss in the event of nonperformance by the other parties to the contracts. However, the Company does not anticipate nonperformance by counterparties.

Property and Depreciation Property is stated at cost. Depreciation and amortization are provided for using the straight-line method over the estimated useful lives of the assets, as follows:

Buildings	40 years
Leasehold improvements	3 19 years
Machinery and equipment	10 25 years
Other property	3 20 years

Fair Value of Financial Instruments The Company estimates the fair value of financial instruments using the following methods and assumptions:

Accounts Receivable and Accounts Payable The carrying amounts approximate fair value due to the short maturities of these instruments.

Lines of Credit The carrying amounts approximate fair value, as the interest rates are based upon variable reference rates.

Long-Term Debt The fair value of long-term fixed rate debt is estimated based upon prevailing market interest rates available to the Company. The Company estimates the fair value on the $22,950,000 6.55% fixed rate debt as of March 31, 2004 to be $24,118,000. The Company estimates the fair value on the $175,000,000 senior notes fixed rate debt as of March 31, 2004 to approximate carrying value.

Futures Contracts The fair value of futures contracts (used for hedging purposes) is determined from quotes listed principally on the Chicago Board of Trade.

Concentration of Credit Risk During the years ended March 31, 2004, 2003 and 2002, net sales to one customer were 23%, 23% and 22% of total net sales, respectively. This customer represents approximately 19% and 23% of trade receivables at March 31, 2004 and 2003, respectively. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses.

The Company maintains cash deposits with various financial institutions. The Company periodically evaluates the credit standing of these financial institutions and has not sustained any credit losses relating to such balances.

Marketable Securities The Company s marketable securities comprise equity securities that have been classified as trading securities. The equity securities are carried at fair market value based upon quoted market prices. Unrealized (gains) and losses on equity securities are recognized in net income and totaled $(2,052,000) and $666,000 for the years ended March 31, 2004 and 2003, respectively (see Note 5). The Company investments included an enterprise with which it conducted business; an impairment loss of $984,000 was recorded in the year ended March 31, 2004.

Goodwill and Trademarks The Company adopted SFAS No. 142, Go*odwill and Other Intangible Assets*, effective April 1, 2002, the first day of its 2003 fiscal year. As a result, goodwill and indefinite life intangible assets (trademarks) are no longer amortized, but reviewed for impairment annually, or more frequently if certain impairment indicators arise. See Note 7 for the effect of adopting SFAS No. 142.

Other identifiable intangible assets consist of patents, deferred financing costs and other assets, which are amortized using the straight-line method over 5 to 15 years.

Impairment of Long-Lived Assets Long-lived assets, including identifiable intangibles, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing the review for recoverability, future cash flows expected to result from the use of the asset and its eventual disposition are estimated. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recorded under the discounted future cash flow method.

Advertising Costs The Company expenses advertising costs in the period incurred. For the years ended March 31, 2004, 2003 and 2002, the Company incurred advertising expenses of approximately $8,366,000, $9,039,000 and $7,100,000, respectively.

Income Taxes The Company is a limited liability company and has no liability for federal and state income taxes. Income is taxed to the members based on their allocated share of taxable income or loss. However, certain states tax the income of limited liability companies. The Company s liability for such state income taxes is not significant.

Revenue Recognition The Company is a processor and distributor of edible oils used in food preparation and a packager of food products. Revenue is recognized upon transfer of title to the customer, which occurs generally upon shipment. In certain instances, title is transferred upon receipt by the customer, at which time the Company records revenue. Amounts billed to the customer as part of a sales transaction related to shipping and handling are included in sales. Revenue is recorded net of discounts, rebates and certain sales incentives.

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

Recent Accounting Pronouncements In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The adoption of SFAS No. 143 did not have a material impact on the Company s financial statements.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-03, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in Restructuring)*. This statement requires that the fair value of an initial liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred as opposed to when the entity commits to an exit plan, thereby eliminating the definition and requirements for recognition of exit costs. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The adoption of SFAS No. 146 did not have a material impact on the Company s financial statements.

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

and in connection with implementation issues raised in relation to the application of the definition of a derivative and characteristics of a derivative that contains financing components. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on the Company s financial statements.

3. LINE OF CREDIT AND LONG-TERM DEBT

Line of Credit At March 31, 2004, the Company had a revolving line-of-credit agreement with a banking group to provide for borrowings of up to an aggregate of $75,000,000. Outstanding borrowings at March 31, 2004 and 2003 were $0 and $20,500,000, respectively. The applicable interest rates are based, at the option of the Company, at a London InterBank Offered Rate (LIBOR) or a term federal funds rate (TFFR) option. The weighted-average interest rate at March 31, 2003 was 1.72%. The line of credit matures on December 21, 2004.

Long-Term Debt At March 31, 2003, the Company had term loans with a banking group with a balance outstanding of $71,605,000. The interest rate applicable to these term loans is based, at the option of the Company, at a TFFR-based, LIBOR-based or a fixed rate option. The weighted-average interest rate on such borrowings at March 31, 2003 was 6.53%. The term loans with the banking group matured on December 23, 2003.

In December 2003, the Company issued, in a private placement, a series of senior unsecured notes in the aggregate amount of $175,000,000. The Company issued Series A, B and C notes in the amounts of $40,000,000, $70,000,000 and $65,000,000, respectively. The Series A and C notes have maturity dates of December 31, 2013 and December 23, 2018, respectively. The notes bear interest at an annualized rate of 5.65% and 5.95%. Interest is paid semiannually on June 23 and December 23 and principal is due on the maturity date. The Series B notes mature on December 23, 2015 and bear interest at an annualized rate of 5.65%. Interest is paid semiannually on June 23 and December 23. Beginning on December 23, 2011, the Company is required to make semi-annual payments of $7,777,778 on December 23 and June 23 through December 23, 2015 for principal and interest. Accrued interest at March 31, 2004 was $2,771,000. Proceeds from the borrowing in the amount of $71,600,000 were used to retire the long-term debt described above. The Company incurred $632,000 of debt issuance costs, included in other assets, which have been deferred and are being amortized as a component of interest expense over the term of the notes.

The Company has a standby letter of credit available of $10,000,000 as of March 31, 2004.

At March 31, 2004 and 2003, balances outstanding on a term loan with a bank were $22,950,000 and $25,573,000, respectively. The agreement requires quarterly principal and interest payments of $1,058,000. The interest rate on this term loan is fixed at 6.55%. The term loan with the bank matures in November 2010.

The line of credit, term loan agreement and senior notes contain various covenants, including compliance with debt limitations, members capital minimums, interest coverage ratio and other financial ratios, restrictions on mergers, consolidations, sale of assets, transactions with affiliates and limitations on liens.

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Annual maturities of long-term debt are as follows at March 31, 2004:

2005	$ 2,804,000
2006	2,987,000
2007	3,187,000
2008	3,401,000
2009	3,629,000
Thereafter	181,948,000
Total	197,956,000
Less current portion	2,804,000
Long-term debt	$ 195,152,000

4. TRANSACTIONS WITH AFFILIATES

Purchases from CHS for the years ended March 31, 2004, 2003 and 2002 were $83,592,000, $66,682,000 and $47,745,000, respectively. Sales to CHS for the years ended March 31, 2004, 2003 and 2002 totaled $2,294,000, $1,056,000 and $883,000, respectively. Included in accounts payable at March 31, 2004 and 2003 were $10,000,000 and $8,035,000, respectively, payable to CHS for purchases of oil.

During the years ended March 31, 2004, 2003, and 2002, the Company recorded expenses of $10,006,000, $9,402,000 and $8,487,000, respectively, to Mitsui USA for the Company s participation in Mitsui USA s insurance plans. Included in accounts payable at March 31, 2004 and 2003 were $1,001,000 and $790,000, respectively, due to Mitsui USA in connection with the Company s participation in such plans.

Sales to Mitsui USA for the years ended March 31, 2004, 2003 and 2002 totaled $1,231,000, $1,423,000 and $1,406,000, respectively. Included in trade receivables at March 31, 2004 and 2003 were $133,000 and $123,000, respectively, of receivables from Mitsui USA for product sales.

Forward purchase contracts as of March 31, 2004 included commitments for purchases of 162,080,000 pounds of oil from CHS. The Company recognized gains of $763,000, $1,081,000 and $934,000 on such related party commitments for the years ended March 31, 2004, 2003 and 2002, respectively.

5. EMPLOYEE BENEFIT PLANS

The Company has long-term incentive arrangements for certain key executives. Benefits under the initial plan were based on earnings over a three-to-five year period (as defined) from January 1, 1997 through December 31, 2001. An amount equal to the obligation incurred under the plan was contributed to a rabbi trust that would be available to general creditors in the event of bankruptcy. The trust holds investments primarily in marketable securities that are recorded at market value (classified as trading securities). The assets in the trust are to be distributed to the employees upon retirement. The liability under the arrangements was $15,626,000 and $13,574,000 as of March 31, 2004 and 2003, respectively, and is included in deferred compensation obligation in the accompanying balance sheets.

On January 1, 2002, the Company established new long-term incentive arrangements with certain key executives. Under these arrangements, the amount of additional compensation is based on the attainment of cumulative income-based or equity-based targets over a two- to three-year period. At the end of the defined periods, assets equaling amounts earned by individual executives will be contributed to a rabbi trust, unless representatives of Wilsey and CHS elect to pay such amounts directly to the respective key executives. At March 31, 2004 and 2003, a liability for the plan of $8,017,000 and $4,702,000, respectively, is included in long-term deferred compensation obligation in the accompanying balance sheets.

For the years ended March 31, 2004, 2003 and 2002, the Company recognized compensation expense under the long-term incentive arrangements of $2,148,000, $4,264,000 and $5,658,000, respectively.

The Company has a combined 401(k) and defined contribution profit-sharing plan (the Plan) covering substantially all employees not covered by collective bargaining agreements. Under the Plan, employees can make annual voluntary contributions not to exceed the lesser of an amount equal to 15% of their compensation or limits established by the Internal Revenue Code. The Company is required, by the Plan, to make certain matching contributions of up to 4% of each participant s salary and may make discretionary profit-sharing contributions. Expenses under this plan for the years ended March 31, 2004, 2003 and 2002 were $4,576,000, $6,484,000 and $5,855,000, respectively. The Company also established a 401(k) defined contribution plan covering employees under certain collective bargaining agreements. Under this plan, employees can make annual voluntary contributions of up to 15% of their compensation. Certain of the Company s union employees are participants in multiemployer plans. Payments to multiemployer pension plans are negotiated in various collective bargaining agreements and aggregated $2,660,000, $2,367,000 and $1,162,000 for the years ended March 31, 2004, 2003 and 2002, respectively. The actuarial present value of accumulated plan benefits and net assets available for benefits to union employees under these multiemployer pension plans is not available, as the Company does not administer these plans.

Effective January 1, 1999, the Company established a Supplemental Executive Retirement Plan for certain of its employees. The projected benefit obligation as of March 31, 2004 and 2003 was $3,922,000 and $2,955,000, respectively. A liability of $2,862,000 and $2,220,000 as of March 31, 2004 and 2003, respectively, is included in long-term deferred compensation obligation in the accompanying balance sheets. The plan is unfunded. During the years ended March 31, 2004, 2003 and 2002, the Company recorded an expense related to the plan of $642,000, $552,000 and $111,000, respectively.

The assumptions used in the measurement of the Company s benefit obligation are as follows:

	March 31		
	2004	**2003**	**2002**
Discount rate	6.0%	6.0%	7.0%
Rate of compensation increase	3.0%	3.0%	3.0%

The Company accrues the actuarially determined amount necessary to fund the participants benefits in accordance with the requirements of the Employee Retirement Income Security Act of 1974.

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6. COMMITMENTS AND CONTINGENCIES

Future minimum annual payments under noncancelable operating leases with lease terms in excess of one year at March 31, 2004 are as follows:

	Gross Rent	Sublease Income	Net Lease Commitment
2005	$ 8,186,000	$ 942,000	$ 7,244,000
2006	6,551,000	942,000	5,609,000
2007	4,848,000	942,000	3,906,000
2008	3,914,000	707,000	3,207,000
2009	3,351,000		3,351,000
Thereafter	12,948,000		12,948,000
Total	$39,798,000	$3,533,000	$36,265,000

Under the lease agreements, the Company is obligated to pay certain property taxes, insurance and maintenance costs. Certain leases contain renewal and purchase options. Rental expense for the years ended March 31, 2004, 2003 and 2002 under operating leases totaled $8,336,000, $7,138,000 and $5,671,000, respectively.

The Company is involved from time to time in routine legal matters incidental to its business. The Company believes that the resolution of such matters will not have a material adverse effect on the Company s business, financial condition or results of operations.

7. GOODWILL

In June 2001, the FASB issued SFAS No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets*. These statements, among other things, eliminate the pooling-of-interests method of accounting for business combinations as of June 30, 2001, eliminate the amortization of goodwill and indefinite life intangible assets for all fiscal years beginning after December 15, 2001, and require that goodwill and indefinite life intangible assets be reviewed annually for impairment, or more frequently if impairment indicators arise. The Company adopted SFAS Nos. 141 and 142 with respect to new goodwill as of July 1, 2001 and adopted SFAS No. 142 with respect to existing goodwill and indefinite life intangible assets as of April 1, 2002, the first day of its 2003 fiscal year. The adoption of SFAS No. 141 did not impact the Company s financial condition or results of operations. Upon the adoption of SFAS No. 142, the Company ceased amortizing existing goodwill and trademarks.

The Company completed the transitional test of goodwill and trademarks during 2003. Based on the result of the test, the Company determined that there was no impairment of goodwill and trademarks as of April 1, 2002. Pursuant to SFAS No. 142, goodwill and trademarks will be tested for impairment at least annually and more frequently if an event occurs which indicates that goodwill or trademarks may be impaired. Based on the result of the test, the Company determined that there was no impairment of goodwill and trademarks as of March 31, 2004 and March 31, 2003. During 2003, the Company abandoned the use of certain trademarks with a net book value of $100,000.

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A reconciliation of net income to the amount adjusted for the exclusion of goodwill and trademarks amortization follows for the years ended March 31:

	2004	2003	2002
Reported net income	$69,242,000	$70,558,000	$70,486,000
Add:			
Goodwill amortization			3,972,000
Trademark amortization			1,853,000
Adjusted net income	$69,242,000	$70,558,000	$76,311,000

Amortization expense for other intangible assets subject to amortization was $83,000, $223,000 and $402,000 for the years ended March 31, 2004, 2003 and 2002, respectively. Estimated annual amortization for each of the years in the five-year period ending March 31, 2008 is $180,000.

8. SUBSEQUENT EVENTS

On April 2, 2004, the Company purchased the assets of portion packing company for $7,437,000 before certain closing adjustments.

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