CHS INC
Form 10-Q
April 03, 2014
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended February 28, 2014.

or

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to .

Commission file number: 0-50150

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES þ NO o

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).
YES þ NO o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ (Do not check if a smaller reporting company)	Smaller reporting company o

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

YES o NO þ

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

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PART I. FINANCIAL INFORMATION
SAFE HARBOR STATEMENT UNDER THE PRIVATE
SECURITIES LITIGATION REFORM ACT OF 1995

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties that may cause the Company’s actual results to differ materially from the results discussed in the forward-looking statements. These factors include those set forth in Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations, under the caption “Cautionary Statement Regarding Forward-Looking Statements” to this Quarterly Report on Form 10-Q for the quarterly period ended February 28, 2014.

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ITEM 1. FINANCIAL STATEMENTS

CHS INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	February 28, 2014	August 31, 2013	February 28, 2013
	(Dollars in thousands)		
ASSETS			
Current assets:			
Cash and cash equivalents	$909,169	$1,808,532	$478,341
Receivables	2,658,922	2,935,478	2,751,952
Inventories	3,381,737	2,664,735	3,626,673
Derivative assets	621,523	499,890	501,178
Margin deposits	373,432	340,905	367,113
Supplier advance payments	1,036,037	398,441	1,071,960
Other current assets	283,011	262,779	242,985
Total current assets	9,263,831	8,910,760	9,040,202
Investments	806,816	765,946	693,640
Property, plant and equipment	3,468,473	3,171,404	2,967,181
Other assets	765,137	656,160	464,883
Total assets	$14,304,257	$13,504,270	$13,165,906
LIABILITIES AND EQUITIES			
Current liabilities:			
Notes payable	$1,074,280	$889,312	$858,496
Current portion of long-term debt	156,507	156,612	93,363
Current portion of mandatorily redeemable noncontrolling interest	65,188	65,981	65,227
Customer margin deposits and credit balances	250,932	299,364	279,052
Customer advance payments	1,310,232	432,097	1,292,887
Checks and drafts outstanding	201,913	185,660	208,807
Accounts payable	1,865,423	2,416,038	2,049,731
Derivative liabilities	553,693	465,066	429,975
Accrued expenses	471,156	485,070	527,364
Dividends and equities payable	224,463	390,153	266,180
Total current liabilities	6,173,787	5,785,353	6,071,082
Long-term debt	1,315,653	1,450,420	1,296,207
Mandatorily redeemable noncontrolling interest	146,852	209,419	206,788
Other liabilities	971,381	906,331	736,981
Commitments and contingencies			
Equities:			
Preferred stock	602,346	319,368	319,368
Equity certificates	3,532,770	3,588,346	3,048,499
Accumulated other comprehensive loss	(165,432)	(156,867)	(230,334)
Capital reserves	1,708,641	1,380,361	1,696,380
Total CHS Inc. equities	5,678,325	5,131,208	4,833,913
Noncontrolling interests	18,259	21,539	20,935
Total equities	5,696,584	5,152,747	4,854,848
Total liabilities and equities	$14,304,257	$13,504,270	$13,165,906

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

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

	For the Three Months Ended February 28,		For the Six Months Ended February 28,	
	2014	2013	2014	2013
	(Dollars in thousands)			
Revenues	$9,680,274	$9,882,378	$20,706,395	$21,592,316
Cost of goods sold	9,238,840	9,411,731	19,864,045	20,576,151
Gross profit	441,434	470,647	842,350	1,016,165
Marketing, general and administrative	155,771	134,680	288,912	259,162
Operating earnings	285,663	335,967	553,438	757,003
(Gain) loss on investments	(2,609)	(45)	(2,609)	(45)
Interest, net	28,989	53,385	59,774	120,595
Equity (income) loss from investments	(31,049)	(16,760)	(63,727)	(44,832)
Income before income taxes	290,332	299,387	560,000	681,285
Income taxes	29,711	23,869	56,351	59,886
Net income	260,621	275,518	503,649	621,399
Net income attributable to noncontrolling interests	552	432	1,394	2,606
Net income attributable to CHS Inc.	$260,069	$275,086	$502,255	$618,793

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

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CHS INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	For the Three Months Ended February 28,		For the Six Months Ended February 28,	
	2014	2013	2014	2013
	(Dollars in thousands)			
Net income	$ 260,621	$ 275,518	$ 503,649	$ 621,399
Other comprehensive income, net of tax:				
Postretirement benefit plan activity, net of tax expense of $4,123, $71, $4,375 and $91, respectively	6,687	28	7,096	61
Unrealized net gain (loss) on available for sale investments, net of tax (benefit) expense of $(265), $331, $917 and $338, respectively	(430)	536	1,488	548
Cash flow hedges, net of tax (benefit) expense of $(7,110), $261, $(9,042) and $352, respectively	(11,531)	424	(14,665)	571
Foreign currency translation adjustment, net of tax (benefit) expense of $(1,760), $629, $(1,531) and $663, respectively	(2,856)	1,021	(2,484)	1,074
Other comprehensive income (loss), net of tax	(8,130)	2,009	(8,565)	2,254
Comprehensive income	252,491	277,527	495,084	623,653
Less: comprehensive income attributable to noncontrolling interests	552	432	1,394	2,606
Comprehensive income attributable to CHS Inc.	$ 251,939	$ 277,095	$ 493,690	$ 621,047

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

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CHS INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended February 28,	
	2014	2013
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income including noncontrolling interests	$503,649	$621,399
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	127,199	116,912
Amortization of deferred major repair costs	25,033	14,779
(Income) loss from equity investments	(63,727)	(44,832)
Distributions from equity investments	48,357	39,492
Noncash patronage dividends received	(4,779)	(4,277)
(Gain) loss on sale of property, plant and equipment	(1,520)	(2,725)
(Gain) loss on investments	(2,609)	(45)
Unrealized (gain) loss on crack spread contingent liability	6,497	13,471
Deferred taxes	2,372	(315)
Other, net	11,520	293
Changes in operating assets and liabilities, net of acquisitions:		
Receivables	460,197	256,510
Inventories	(693,903)	(404,607)
Derivative assets	(145,339)	584,600
Margin deposits	(32,527)	786,409
Supplier advance payments	(637,003)	(387,140)
Other current assets and other assets	(40,070)	(5,035)
Customer margin deposits and credit balances	(48,675)	(529,860)
Customer advance payments	871,878	600,341
Accounts payable and accrued expenses	(558,254)	(280,425)
Derivative liabilities	88,628	(311,564)
Other liabilities	51,862	(33,321)
Net cash provided by (used in) operating activities	(31,214)	1,030,060
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(389,537)	(264,332)
Proceeds from disposition of property, plant and equipment	3,081	3,900
Expenditures for major repairs		(9,248)
Investments in joint ventures and other	(19,849)	(9,718)
Investments redeemed	4,164	3,132
Proceeds from sale of investments	2,725	
Changes in notes receivable, net	(243,247)	46,963
Business acquisitions, net of cash acquired	(97,858)	(8,074)
Other investing activities, net	(3,577)	(397)
Net cash provided by (used in) investing activities	(744,098)	(237,774)
Cash flows from financing activities:		
Changes in notes payable	184,948	55,994
Long-term debt borrowings	1,426	

Principal payments on long-term debt	(136,389)	(50,871)
Mandatorily redeemable noncontrolling interest payments	(65,981)	(65,981)
Payments on crack spread contingent liability	(8,670)	
Changes in checks and drafts outstanding	16,253	2,755
Preferred stock issued	282,979	
Preferred stock issuance costs	(9,655)	
Preferred stock dividends paid	(18,153)	(12,272)
Distributions to noncontrolling interests	(575)	(740)
Retirements of equities	(79,656)	(179,369)
Cash patronage dividends paid	(287,736)	(380,892)
Other financing activities, net	1,172	1,112
Net cash provided by (used in) financing activities	(120,037)	(630,264)
Effect of exchange rate changes on cash and cash equivalents	(4,014)	2,290
Net increase (decrease) in cash and cash equivalents	(899,363)	164,312
Cash and cash equivalents at beginning of period	1,808,532	314,029
Cash and cash equivalents at end of period	$909,169	$478,341

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

CHS INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(dollars in thousands)

Note 1 Accounting Policies

Basis of Presentation and Revisions

The unaudited Consolidated Balance Sheets as of February 28, 2014 and 2013, the Consolidated Statements of Operations for the the three and six months ended February 28, 2014 and 2013, the Consolidated Statements of Comprehensive Income for the three and six months ended February 28, 2014 and 2013, and the Consolidated Statements of Cash Flows for the six months ended February 28, 2014 and 2013, reflect in the opinion of our management, all normal recurring adjustments necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods presented. The results of operations and cash flows for interim periods are not necessarily indicative of results for a full fiscal year because of, among other things, the seasonal nature of our businesses. Our Consolidated Balance Sheet data as of August 31, 2013, has been derived from our audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP).

The consolidated financial statements include our accounts and the accounts of our wholly-owned and majority-owned subsidiaries and limited liability companies, which is primarily National Cooperative Refinery Association (NCRA), included in our Energy segment. The effects of all significant intercompany accounts and transactions have been eliminated.

These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended August 31, 2013, included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission.

We previously reported certain derivative assets and liabilities on a net basis on our Consolidated Balance Sheets. In connection with the issuance of our August 31, 2013 financial statements, we determined that such derivatives should have been reported on a gross basis and have therefore revised our February 28, 2013 Consolidated Balance Sheet, which resulted in an increase in both derivative assets and derivative liabilities of $212.7 million. The Consolidated Statement of Cash Flows for the six months ended February 28, 2013, has also been revised for this change with no impact to net operating, investing or financing cash flows. We do not believe these revisions are material.

In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-11, “Disclosures about Offsetting Assets and Liabilities.” ASU No. 2011-11, and the subsequent amendments issued in ASU No. 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities," create new disclosure requirements about the nature of an entity’s rights of setoff and related arrangements associated with certain financial instruments and recognized derivative instruments. The disclosure requirements in this update are effective for annual reporting periods, and interim periods within those years, beginning on or after January 1, 2013. The required disclosures have been included in Note 9, Derivative Financial Instruments and Hedging Activities.

In February 2013, the FASB issued ASU No. 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." ASU No. 2013-02 requires an entity to provide information about the effects of significant reclassifications out of accumulated other comprehensive income, by component, either on the face of the financial statements or in the notes to the financial statements and is intended to help improve the transparency of changes in other comprehensive income. ASU No. 2013-02 does not amend any existing requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 became effective for our annual and interim reporting periods beginning in fiscal 2014. The required disclosures have been included in Note 6, Equities.

Goodwill and Other Intangible Assets

Goodwill was $104.6 million, $85.1 million and $88.1 million on February 28, 2014, August 31, 2013 and February 28, 2013, respectively, and is included in other assets on our Consolidated Balance Sheets. We acquired goodwill of $19.4 million during the six months ended February 28, 2014, which related primarily to acquisitions in our Ag segment for which we paid $97.9 million in cash consideration. These acquisitions were not material, individually or in aggregate, to our consolidated financial statements.

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Intangible assets subject to amortization primarily include customer lists, trademarks and agreements not to compete, and are amortized over their respective useful lives (ranging from 2 to 30 years). Excluding goodwill, the gross carrying amount of our intangible assets was $113.5 million, $81.5 million and $81.8 million on February 28, 2014, August 31, 2013 and February 28, 2013, respectively. Accumulated amortization was $46.7 million, $46.0 million and $40.5 million as of February 28, 2014, August 31, 2013 and February 28, 2013, respectively. Intangible assets acquired were $36.2 million and $1.4 million during the six months ended February 28, 2014 and 2013, respectively. Intangible assets acquired during the six months ended February 28, 2014, primarily relate to various acquisitions in our Ag segment. Total amortization expense for intangible assets during the six months ended February 28, 2014 and 2013, was $4.9 million and $5.0 million, respectively. The estimated annual amortization expense related to intangible assets subject to amortization for the next five years is as follows:

	(Dollars in thousands)
Year 1	$8,141
Year 2	8,654
Year 3	7,902
Year 4	6,334
Year 5	3,543
Thereafter	31,407
Total	$65,981

In our Energy segment, major maintenance activities (turnarounds) at our two refineries are accounted for under the deferral method. Turnarounds are the scheduled and required shutdowns of refinery processing units. The costs related to the significant overhaul and refurbishment activities include materials and direct labor costs. The costs of turnarounds are deferred when incurred and amortized on a straight-line basis over the period of time estimated to lapse until the next turnaround occurs, which is generally 2 to 4 years. The amortization expense related to turnaround costs is included in cost of goods sold in our Consolidated Statements of Operations. The selection of the deferral method, as opposed to expensing the turnaround costs when incurred, results in deferring recognition of the turnaround expenditures. The deferral method also results in the classification of the related cash outflows as investing activities in our Consolidated Statements of Cash Flows, whereas expensing these costs as incurred, would result in classifying the cash outflows as operating activities.

Supplier Advance Payments

Beginning November 30, 2013, supplier advance payments are reported as a separate line item on our Consolidated Balance Sheets. Prior period amounts have been reclassified accordingly. Supplier advance payments primarily include amounts paid for in-transit grain purchases from suppliers and amounts paid to crop nutrient suppliers to lock in future supply and pricing.

Customer Advance Payments

Customer advance payments primarily consist of amounts received from customers for in-transit grain shipments and amounts received from crop nutrients customers for future shipments.

Recent Accounting Pronouncements

In February 2013, the FASB issued ASU No. 2013-04, "Liabilities." ASU No. 2013-04 requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this ASU also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. We are currently evaluating the impact that the adoption will have on our consolidated financial statements in fiscal 2015.

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Note 2 Receivables

	February 28, 2014	August 31, 2013	February 28, 2013
	(Dollars in thousands)		
Trade accounts receivable	$1,804,831	$2,338,336	$1,991,909
CHS Capital notes receivable	561,323	437,141	530,267
Other	390,925	254,590	346,695
	2,757,079	3,030,067	2,868,871
Less allowances and reserves	98,157	94,589	116,919
Total receivables	$2,658,922	$2,935,478	$2,751,952

Trade accounts receivable are initially recorded at a selling price, which approximates fair value, upon the sale of goods or services to customers. Subsequently, trade accounts receivable are carried at net realizable value, which includes an allowance for estimated uncollectible amounts. We calculate this allowance based on our history of write-offs, level of past due accounts, and our relationships with, and the economics status of, our customers.

CHS Capital, LLC (CHS Capital), our wholly-owned subsidiary, has notes receivable from commercial borrowers and producer borrowings. The short-term notes receivable generally have terms of 12-14 months and are reported at their outstanding principle balances as CHS Capital has the ability and intent to hold these notes to maturity. The carrying value of CHS Capital notes receivable approximates fair value, given their short duration and the use of market pricing adjusted for risk.The notes receivable from commercial borrowers are collateralized by various combinations of mortgages, personal property, accounts and notes receivable, inventories and assignments of certain regional cooperative’s capital stock. These loans are primarily originated in the states of Minnesota, Wisconsin and North Dakota. CHS Capital also has loans receivable from producer borrowers which are collateralized by various combinations of growing crops, livestock, inventories, accounts receivable, personal property and supplemental mortgages. In addition to the short-term amounts included in the table above, CHS Capital had long-term notes receivable with durations of not more than 10 years of $160.2 million, $127.7 million and $120.2 million at February 28, 2014, August 31, 2013 and February 28, 2013, respectively. The long-term notes receivable are included in other assets on our Consolidated Balance Sheets. As of February 28, 2014, August 31, 2013 and February 28, 2013 the commercial notes represented 76%, 59% and 79%, respectively, and the producer notes represented 24%, 41% and 21%, respectively, of the total CHS Capital notes receivable.

CHS Capital evaluates the collectability of both commercial and producer notes on a specific identification basis, based on the amount and quality of the collateral obtained, and records specific loan loss reserves when appropriate. A general reserve is also maintained based on historical loss experience and various qualitative factors. In total, our specific and general loan loss reserves related to CHS Capital are not material to our consolidated financial statements, nor are the historical write-offs. The accrual of interest income is discontinued at the time the loan is 90 days past due unless the credit is well-collateralized and in process of collection. The amount of CHS Capital notes that were past due was not material at any reporting date presented.

CHS Capital has commitments to extend credit to a customer as long as there is no violation of any condition established in the contract. As of February 28, 2014, CHS Capital's customers have additional available credit of $943.7 million.

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Note 3 Inventories

	February 28, 2014	August 31, 2013	February 28, 2013
	(Dollars in thousands)		
Grain and oilseed	$1,405,236	$1,133,555	$1,607,972
Energy	752,247	742,194	705,160
Crop nutrients	417,843	293,370	471,487
Feed and farm supplies	698,816	407,023	725,974
Processed grain and oilseed	85,622	79,706	94,667
Other	21,973	8,887	21,413
Total inventories	$3,381,737	$2,664,735	$3,626,673

As of February 28, 2014, we valued approximately 14% of inventories, primarily related to Energy, using the lower of cost, determined on the LIFO method, or market (16% and 14% as of August 31, 2013 and February 28, 2013, respectively). If the FIFO method of accounting had been used, inventories would have been higher than the reported amount by $579.4 million, $652.6 million and $535.1 million at February 28, 2014, August 31, 2013 and February 28, 2013, respectively. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Interim LIFO calculations are based on management's estimates of expected year-end inventory levels and costs, and are subject to the final year-end LIFO inventory valuation.

Note 4 Investments

As of August 31, 2013, we owned 79.2% of NCRA. In fiscal 2012, we entered into an agreement to purchase the remaining shares of NCRA from Growmark Inc. and MFA Oil Company in separate closings to be held annually through fiscal 2016. Pursuant to this agreement, we made payments during the six months ended February 28, 2014 and 2013 of $66.0 million and $66.0 million respectively; increasing our ownership to 84.0%. The present value of the remaining payments is included as mandatorily redeemable noncontrolling interest on our consolidated balances sheets. In addition to these payments, we paid $16.5 million during the six months ended February 28, 2014 related to the associated crack spread contingent liability. The fair value of the remaining contingent liability was $140.6 million as of February 28, 2014.

We have a 24% ownership in Horizon Milling, LLC and Horizon Milling G.P., flour milling joint ventures with Cargill Incorporated (Cargill), which are included in Corporate and Other. On March 4, 2013, we entered into a definitive agreement with Cargill and ConAgra Foods, Inc. to form Ardent Mills, a joint venture combining the North American flour milling operations of the three parent companies, including the Horizon Milling, LLC and Horizon Milling G.P. assets, with CHS holding a 12% interest. Upon closing, Ardent Mills is expected to be financed with funds from third-party borrowings, which would not require credit support from the owners. The borrowings are anticipated to be no less than $600 million with proceeds distributed to each owner in proportion to the ownership interests, adjusted for any deviations in specified working capital target amounts. The transaction is expected to close in fiscal 2014, subject to financing and certain other customary closing conditions. In connection with the closing, the parties will also enter into various ancillary and non-compete agreements including, among other things, an agreement for CHS to supply Ardent Mills with certain wheat and durum products.

We have a 50% interest in Ventura Foods, LLC (Ventura Foods), a joint venture which produces and distributes primarily vegetable oil-based products, and is included in Corporate and Other. We account for Ventura Foods as an equity method investment, and as of February 28, 2014, our carrying value of Ventura Foods exceeded our share of their equity by $12.9 million, which represents equity method goodwill.

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Note 5 Notes Payable and Long-Term Debt

	February 28, 2014	August 31, 2013	February 28, 2013
	(Dollars in thousands)		
Notes payable	$648,102	$521,864	$419,536
CHS Capital notes payable	426,178	367,448	438,960
Total notes payable	$1,074,280	$889,312	