

CHS INC  
Form 10-Q  
January 12, 2017  
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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Form 10-Q

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Quarterly  
Report  
pursuant to  
Section 13  
or 15(d) of  
the  
Securities  
Exchange  
p Act of  
1934 for  
the  
quarterly  
period  
ended  
November  
30, 2016.

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

Commission file number: 001-36079

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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)

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5500 Cenex Drive Inver Grove Heights, Minnesota 55077 (651) 355-6000  
(Address of principal executive offices, (Registrant's telephone number,  
including zip code) including area code)

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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  NO

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  NO

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  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

YES  NO

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

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Unless the context otherwise requires, for purposes of this Quarterly Report on Form 10-Q, the words “we,” “us,” “our,” the “Company” and “CHS” refer to CHS Inc., a Minnesota cooperative corporation, and its subsidiaries as of November 30, 2016.

#### FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains and our other publicly available documents may contain, and our officers, directors and other representatives may from time to time make, "forward-looking statements" within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as "anticipate," "intend," "plan," "goal," "seek," "believe," "project," "estimate," "expect," "strategy," "future," "likely," "may," "should," "will" and similar references to future periods. Forward-looking statements are neither historical facts nor assurances of future performance. Instead, they are based only on our current beliefs, expectations and assumptions regarding the future of our businesses, financial condition and results of operations, future plans and strategies, projections, anticipated events and trends, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and many of which are outside of our control. Our actual results and financial condition may differ materially from those indicated in the forward-looking statements. Therefore, you should not place undue reliance on any of these forward-looking statements. Important factors that could cause our actual results and financial condition to differ materially from those indicated in the forward-looking statements are discussed or identified in our public filings made with the U.S. Securities and Exchange Commission ("SEC"), including in the "Risk Factors" discussion in Item 1A of our Annual Report on Form 10-K for the fiscal year ended August 31, 2016. Any forward-looking statements made by us in this Quarterly Report on Form 10-Q are based only on information currently available to us and speak only as of the date on which the statement is made. We undertake no obligation to publicly update any forward-looking statement, whether written or oral, that may be made from time to time, whether as a result of new information, future developments or otherwise, except as required by applicable law.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

CHS INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)November 30, August 31,  
2016 2016  
(Dollars in thousands)

## ASSETS

## Current assets:

Cash and cash equivalents	\$515,484	\$279,313
Receivables	3,052,989	2,880,763
Inventories	3,117,935	2,370,699
Derivative assets	419,103	543,821
Margin deposits	312,899	310,276
Supplier advance payments	480,709	347,600
Other current assets	189,896	202,708
Total current assets	8,089,015	6,935,180
Investments	3,828,899	3,795,976
Property, plant and equipment	5,443,079	5,488,323
Other assets	1,069,468	1,092,656
Total assets	\$18,430,461	\$17,312,135

## LIABILITIES AND EQUITIES

## Current liabilities:

Notes payable	\$3,227,564	\$2,731,479
Current portion of long-term debt	206,894	214,329
Customer margin deposits and credit balances	180,850	208,991
Customer advance payments	544,266	412,823
Accounts payable	2,568,533	1,819,049
Derivative liabilities	317,505	513,599
Accrued expenses	389,321	422,494
Dividends and equities payable	275,448	198,031
Total current liabilities	7,710,381	6,520,795
Long-term debt	1,958,907	2,082,876
Long-term deferred tax liabilities	497,283	487,762
Other liabilities	332,610	354,452
Commitments and contingencies		
Equities:		
Preferred stock	2,244,132	2,244,132
Equity certificates	4,208,336	4,237,174
Accumulated other comprehensive loss	(226,220 )	(211,726 )
Capital reserves	1,691,603	1,582,380
Total CHS Inc. equities	7,917,851	7,851,960
Noncontrolling interests	13,429	14,290
Total equities	7,931,280	7,866,250
Total liabilities and equities	\$18,430,461	\$17,312,135

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 November 30	
	2016	2015
	(Dollars in thousands)	
Revenues	\$8,048,250	\$7,728,792
Cost of goods sold	7,695,553	7,316,974
Gross profit	352,697	411,818
Marketing, general and administrative	166,206	152,004
Operating earnings (loss)	186,491	259,814
(Gain) loss on investments	7,401	(5,672 )
Interest expense	38,265	9,051
Other income	(44,401 )	(2,058 )
Equity (income) loss from investments	(40,328 )	(31,362 )
Income (loss) before income taxes	225,554	289,855
Income tax expense (benefit)	16,612	23,681
Net income (loss)	208,942	266,174
Net income (loss) attributable to noncontrolling interests	(208 )	(301 )
Net income (loss) attributable to CHS Inc.	\$209,150	\$266,475

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 November 30	
	2016	2015
	(Dollars in thousands)	
Net income (loss)	\$208,942	\$266,174
Other comprehensive income (loss), net of tax:		
Postretirement benefit plan activity, net of tax expense (benefit) of \$2,011 and \$1,760, respectively	3,239	3,201
Unrealized net gain (loss) on available for sale investments, net of tax expense (benefit) of \$482 and \$363, respectively	777	560
Cash flow hedges, net of tax expense (benefit) of \$406 and \$(2,697), respectively	654	(4,334 )
Foreign currency translation adjustment, net of tax expense (benefit) of \$(209) and \$0, respectively	(19,164 )	(2,980 )
Other comprehensive income (loss), net of tax	(14,494 )	(3,553 )
Comprehensive income (loss)	194,448	262,621
Less: comprehensive income (loss) attributable to noncontrolling interests	(208 )	(301 )
Comprehensive income (loss) attributable to CHS Inc.	\$194,656	\$262,922

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 Three Months Ended	
	November 30 2016	2015
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income	\$208,942	\$266,174
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	121,372	100,350
Amortization of deferred major repair costs	18,302	18,518
(Income) loss from equity investments	(40,328 )	(31,362 )
Provision for doubtful accounts	27,812	2,945
Distributions from equity investments	16,393	22,991
(Gain) loss on disposition of property, plant and equipment	(5,244 )	(1,611 )
(Gain) loss on investments	7,401	(5,672 )
Unrealized (gain) loss on crack spread contingent liability	(6,770 )	(32,289 )
Deferred taxes	6,199	7,409
Other, net	10,706	10,927
Changes in operating assets and liabilities, net of acquisitions:		
Receivables	(16,555 )	(24,110 )
Inventories	(754,253 )	(466,554 )
Derivative assets	110,306	72,117
Margin deposits	(2,623 )	59,942
Supplier advance payments	(133,109 )	(358,194 )
Other current assets and other assets	12,082	50,348
Customer margin deposits and credit balances	(28,141 )	(22,038 )
Customer advance payments	131,444	261,931
Accounts payable and accrued expenses	743,427	596,881
Derivative liabilities	(195,545 )	(107,373 )
Other liabilities	6,599	(5,231 )
Net cash provided by (used in) operating activities	238,417	416,099
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(116,986 )	(251,678 )
Proceeds from disposition of property, plant and equipment	2,574	2,931
Expenditures for major repairs	(239 )	(18,897 )
Investments in joint ventures and other	—	(12,709 )
Proceeds from sale of investments	—	17,990
Changes in notes receivable, net	(211,126 )	(137,599 )
Other investing activities, net	(1,245 )	(518 )
Net cash provided by (used in) investing activities	(327,022 )	(400,480 )
Cash flows from financing activities:		
Proceeds from lines of credit and long-term borrowings	10,300,476	2,524,577
Payments on lines of credit, long term-debt and capital lease obligations	(9,936,369 )	(2,034,405 )
Mandatorily redeemable noncontrolling interest payments	—	(153,022 )
Payments on crack spread contingent liability	—	(2,625 )

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Changes in checks and drafts outstanding	14,334	(4,811	)
Preferred stock dividends paid	(41,825	)	(40,500 )
Retirements of equities	(9,528	)	(3,314 )
Other financing activities, net	384	—	
Net cash provided by (used in) financing activities	327,472	285,900	
Effect of exchange rate changes on cash and cash equivalents	(2,696	)	1,928
Net increase (decrease) in cash and cash equivalents	236,171	303,447	
Cash and cash equivalents at beginning of period	279,313	953,813	
Cash and cash equivalents at end of period	\$515,484	\$1,257,260	

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

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CHS INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1 Organization, Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The unaudited Consolidated Balance Sheet as of November 30, 2016, the Consolidated Statements of Operations for the three months ended November 30, 2016, and 2015, the Consolidated Statements of Comprehensive Income for the three months ended November 30, 2016, and 2015, and the Consolidated Statements of Cash Flows for the three months ended November 30, 2016, and 2015, 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, 2016, 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 notes to our consolidated financial statements make reference to our Energy, Ag, Nitrogen Production and Foods reportable segments, as well as our Corporate and Other category, which represents an aggregation of individually immaterial operating segments. The Nitrogen Production reportable segment resulted from our investment in CF Industries Nitrogen, LLC ("CF Nitrogen") in February 2016. The Foods segment resulted from our investment in Ventura Foods, LLC ("Ventura Foods") becoming a significant operating segment in fiscal 2016. See Note 9, Segment Reporting for more information.

Our consolidated financial statements include the accounts of CHS and all of our wholly owned and majority owned subsidiaries. The effects of all significant intercompany transactions have been eliminated.

These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended August 31, 2016, included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission (the "SEC").

Derivative Financial Instruments and Hedging Activities

Our derivative instruments primarily consist of commodity and freight futures and forward contracts and, to a lesser degree, may include foreign currency and interest rate swap contracts. These contracts are economic hedges of price risk, but are not designated or accounted for as hedging instruments for accounting purposes, with the exception of certain interest rate swap contracts which are accounted for as cash flow hedges or fair value hedges. Derivative instruments are recorded on our Consolidated Balance Sheets at fair value. See Note 10, Derivative Financial Instruments and Hedging Activities and Note 11, Fair Value Measurements for additional information.

Although we have certain netting arrangements for our exchange-traded futures and options contracts and certain over-the-counter ("OTC") contracts, we have elected to report our derivative instruments on a gross basis on our Consolidated Balance Sheets under Accounting Standards Codification ("ASC") Topic 210-20, Balance Sheet - Offsetting.

Major Maintenance Activities

Within our Energy segment, major maintenance activities (“turnarounds”) are performed at our Laurel, Montana and McPherson, Kansas refineries regularly. Turnarounds are the planned and required shutdowns of refinery processing units, which include the replacement or overhaul of equipment that have experienced decreased efficiency in resource conversion. Because turnarounds are performed to extend the life, increase the capacity, and/or improve the safety or efficiency of refinery processing assets, we follow the deferral method of accounting for turnarounds. Expenditures for turnarounds are capitalized (deferred) when incurred and amortized on a straight-line basis over a period of 2 to 4 years, which is the estimated time lapse between turnarounds. Should the estimated period between turnarounds change, we may be required to amortize the remaining cost of the turnaround over a shorter period, which would result in higher depreciation and amortization costs. Capitalized turnaround costs are included in other assets (long-term) on our Consolidated Balance Sheets and amortization expense related to the capitalized turnaround costs is included in cost of goods sold in our Consolidated Statements of Operations.

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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. Repair, maintenance and related labor costs are expensed as incurred and are included in operating cash flows.

For the three months ended November 30, 2016 and 2015, turnaround expenditures were \$0.3 million and \$18.9 million, respectively.

### Recent Accounting Pronouncements

#### Adopted

In April 2015, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which simplifies the presentation of debt issuance costs. This ASU requires the presentation of debt issuance costs on the balance sheet as a deduction from the carrying amount of the related debt liability instead of a deferred financing cost. This ASU was effective for us beginning September 1, 2016, for our fiscal year 2017 and for interim periods within the fiscal year. As a result, \$5.6 million of deferred issuance costs related to private placement debt and bank financing have been reclassified from other assets to long-term debt as of August 31, 2016.

In August 2015, the FASB issued ASU No. 2015-15, Interest-Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, which codifies an SEC staff announcement that entities are permitted to defer and present debt issuance costs related to line of credit arrangements as assets. ASU 2015-15 was effective immediately. At August 31, 2016, we had unamortized deferred financing costs related to our line of credit arrangements, and we will continue to present debt issuance costs related to line of credit arrangements as an asset in our Consolidated Balance Sheets.

#### Not Yet Adopted

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. This ASU is intended to reduce diversity in practice by adding or clarifying guidance on classification and presentation of changes in restricted cash on the statement of cash flows. This ASU is effective for us beginning September 1, 2018, for our fiscal year 2019 and for interim periods within that fiscal year. Early adoption is permitted, including in an interim period. The amendments in this ASU should be applied retrospectively to all periods presented. We are currently evaluating the impact the adoption will have on our consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes - Intra-Entity Transfers of Assets Other Than Inventory (Topic 740). This ASU is intended to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory by requiring an entity to recognize the income tax consequences when a transfer occurs, instead of when an asset is sold to an outside party. The amendments in this ASU should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. This ASU is effective for us beginning September 1, 2018, for our fiscal year 2019 and for interim periods within that fiscal year. Early adoption is permitted as of the beginning of an annual reporting period for which interim or annual financial statements have not been issued. We are currently evaluating the impact the adoption will have on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU is intended to reduce existing diversity in practice in how certain cash receipts and payments are presented and classified in the statement of cash flows. This ASU is effective for us beginning September 1, 2018, for our fiscal year 2019 and for interim periods within that fiscal year. Early adoption is permitted, including in an interim period. We are currently evaluating the impact the adoption will have on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments in this ASU introduce a new approach, based on expected losses, to estimate credit losses on certain types of financial instruments. This ASU is intended to provide financial statement users with more decision-useful information about the expected credit losses associated with most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held-to-maturity debt securities, net investments in leases, and off-balance-sheet credit exposures. Entities are required to apply the standard's provisions as a cumulative-effect

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adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. This ASU is effective for us beginning September 1, 2020, for our fiscal year 2021 and for interim periods within that fiscal year. We are currently evaluating the impact the adoption will have on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which replaces the existing guidance in ASC 840 - Leases. The amendments within this ASU introduce a lessee model requiring entities to recognize assets and liabilities for most leases, but continue recognizing the associated expenses in a manner similar to existing accounting guidance. This ASU does not make fundamental changes to existing lessor accounting; however, it does modify what constitutes a sales-type or direct financing lease and the related accounting, and aligns a number of the underlying principles with those of the new revenue standard, ASU No. 2014-09. The guidance also eliminates existing real estate-specific provisions and requires expanded qualitative and quantitative disclosures. Entities are required to apply the standard's provisions using a modified retrospective approach at the beginning of the earliest comparative period presented in the year of adoption. This ASU is effective for us beginning September 1, 2019, for our fiscal year 2020 and for interim periods within that fiscal year. We are currently evaluating the impact the adoption will have on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. The amendments within this ASU provide a single comprehensive model to be used in the accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This ASU includes a five step model for the recognition of revenue, including (1) identifying the contract with a customer, (2) identifying the performance obligations in the contract, (3) determining the transaction price, (4) allocating the transaction price to the performance obligations, and (5) recognizing revenue when (or as) an entity satisfies a performance obligation. This ASU also specifies the accounting for certain costs to obtain or fulfill a contract with a customer and requires expanded disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued ASU No. 2015-14 delaying the effective date of adoption for CHS to September 1, 2018. The FASB issued four subsequent ASUs in 2016 containing implementation guidance related to ASU No. 2014-09, including: ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations; ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which is intended to clarify two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance; ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which contains certain provision and practical expedients in response to identified implementation issues; and ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers, which contains certain corrections and clarifications to increase stakeholders' awareness of the proposals and to expedite improvements. ASU No. 2014-09 permits the use of either a full or modified retrospective method upon adoption. Although early application as of the original date is permitted, we expect to adopt ASU No. 2014-09 and the related ASUs on September 1, 2018, in the first quarter of fiscal 2019. We are continuing to evaluate the effect this guidance will have on our consolidated financial statements, including potential impacts on the timing of revenue recognition and additional information that may be necessary for expanded disclosures regarding revenue. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

## Note 2      Receivables

November 30, August 31,  
2016          2016  
(Dollars in thousands)

Trade accounts receivable      \$1,663,377    \$1,804,646

CHS Capital notes receivable	1,064,702	858,805
Other	516,366	380,956
	3,244,445	3,044,407
Less allowances and reserves	191,456	163,644
Total receivables	\$3,052,989	\$2,880,763

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 economic status of, our customers. The carrying value of CHS Capital, LLC ("CHS Capital") short-term notes receivable approximates fair value, given the notes' short duration and the use of market

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pricing adjusted for risk. Other receivables is comprised of certain other amounts recorded in the normal course of business, including receivables related to valued added taxes and production cost financing.

CHS Capital has notes receivable from commercial and producer borrowers. The short-term notes receivable generally have terms of 12-14 months and are reported at their outstanding principal balances as CHS Capital has the ability and intent to hold these notes to maturity. 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 cooperatives' capital stock. These loans are primarily originated in the states of Minnesota, Wisconsin, North Dakota and Michigan. 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 balances included in the table above, CHS Capital had long-term notes receivable with durations of generally not more than 10 years of \$318.8 million and \$322.4 million at November 30, 2016, and August 31, 2016, respectively. The long-term notes receivable are included in other assets on our Consolidated Balance Sheets. As of November 30, 2016, and August 31, 2016, the commercial notes represented 39% and 26%, respectively, and the producer notes represented 61% and 74%, respectively, of the total CHS Capital notes receivable. As of November 30, 2016, a single producer borrower accounted for 19% of the total outstanding CHS Capital short-term and long-term notes receivable. These notes were originated in the midwestern region of the United States and are collateralized by inventories (typically crops), personal property and mortgages which we have access to inspect. No other third party borrower accounted for more than 10% of the total outstanding 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. 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. We do not consider the amount of CHS Capital notes past due to be material at any reporting date presented. Past due amounts were approximately 3.0% and 2.5% of the total CHS Capital notes outstanding as of November 30, 2016 and August 31, 2016, respectively.

Specific and general loan loss reserves related to CHS Capital totaled \$71.9 million and \$45.8 million at November 30, 2016, and August 31, 2016, respectively. Nearly all of the reserve increase was due to an increased reserve associated with the single producer borrower discussed above. In determining the amount of reserve necessary for this producer borrower, we used a probability-weighted model incorporating various assumptions primarily related to the valuation of inventory, personal property and mortgages used as collateral. The reserve represents our best estimate based upon current facts and circumstances. Future market conditions for commodity prices, real estate, and agricultural yields are uncertain and future developments in those market conditions or changes to the assumptions used in the reserve analysis may cause us to record adjustments to the amount of the reserve for this borrower, which adjustments may be material.

CHS Capital has commitments to extend credit to customers as long as there are no violations of any contractually established conditions. As of November 30, 2016, customers of CHS Capital had additional available credit of approximately \$818.0 million.

Note 3 Inventories

November 30, August 31,  
2016 2016  
(Dollars in thousands)

Grain and oilseed	\$1,597,261	\$937,258
Energy	699,278	729,695
Crop nutrients	235,320	217,521
Feed and farm supplies	506,514	417,431
Processed grain and oilseed	57,769	48,930
Other	21,793	19,864
Total inventories	\$3,117,935	\$2,370,699

As of November 30, 2016, we valued approximately 15% of inventories, primarily related to our Energy segment, using the lower of cost, determined on the LIFO method, or market (19% as of August 31, 2016). If the FIFO method of accounting had been used, inventories would have been higher than the reported amount by \$99.0 million and \$93.9 million at

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November 30, 2016, and August 31, 2016, 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

	2016	2016
	(Dollars in thousands)	
Equity method investments:		
CF Industries Nitrogen, LLC	\$2,811,020	\$2,796,323
Ventura Foods, LLC	372,049	369,487
Ardent Mills, LLC	200,980	194,986
TEMCO, LLC	42,686	44,578
Other equity method investments	273,115	263,025
Cost method investments	129,049	127,577
Total investments	\$3,828,899	\$3,795,976

## Equity Method Investments

Joint ventures and other investments, in which we have significant ownership and influence, but not control, are accounted for in our consolidated financial statements using the equity method of accounting. Our primary equity method investments are described below. None of these investments are individually significant such that disclosure of summarized income statement information would be required under Article 10 of Regulation S-X.

On February 1, 2016, we invested \$2.8 billion in CF Nitrogen, commencing our strategic venture with CF Industries Holdings, Inc. ("CF Industries"). The investment consists of an 11.4% membership interest (based on product tons) in CF Nitrogen. We also entered into an 80-year supply agreement that entitles us to purchase up to 1.1 million tons of granular urea and 580,000 tons of urea ammonium nitrate ("UAN") annually from CF Nitrogen for ratable delivery. Our purchases under the supply agreement are based on prevailing market prices and we receive semi-annual cash distributions (in January and July of each year) from CF Nitrogen via our membership interest. These distributions are based on actual volumes purchased from CF Nitrogen under the strategic venture and will have the effect of reducing our investment to zero over 80 years on a straight-line basis. We account for this investment using the hypothetical liquidation at book value method, recognizing our share of the earnings and losses of CF Nitrogen based upon our contractual claims on the entity's net assets pursuant to the liquidation provisions of CF Nitrogen's Limited Liability Company Agreement, adjusted for the semi-annual cash distributions. For the three months ended November 30, 2016, this amount was \$14.7 million, and is included as equity income from investments in our Nitrogen Production segment. No earnings were recognized for the three months ended November 30, 2015, as this period was prior to our investment.

We have a 50% interest in Ventura Foods, a joint venture which produces and distributes primarily vegetable oil-based products, and which constitutes our Foods segment. We account for Ventura Foods as an equity method investment, and as of November 30, 2016, our carrying value of Ventura Foods exceeded our share of its equity by \$12.9 million, which represents equity method goodwill. The earnings are reported as equity income from investments in our Foods segment.

We have a 12% interest in Ardent Mills, LLC ("Ardent Mills"), a joint venture with Cargill Incorporated ("Cargill") and ConAgra Foods, Inc., which combines the North American flour milling operations of the three parent companies. We account for Ardent Mills as an equity method investment included in Corporate and Other.

TEMCO, LLC ("TEMCO") is owned and governed by Cargill (50%) and CHS (50%). Both owners have committed to sell all of their feedgrains, wheat, oilseeds and by-product origination that are tributary to the Pacific Northwest, United States ("Pacific Northwest") to TEMCO and to use TEMCO as their exclusive export-marketing vehicle for such grains exported through the Pacific Northwest through January 2037. We account for TEMCO as an equity method investment included in our Ag segment.

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## Note 5 Goodwill and Other Intangible Assets

Goodwill of \$158.8 million and \$160.4 million on November 30, 2016, and August 31, 2016, respectively, is included in other assets on our Consolidated Balance Sheets. Changes in the net carrying amount of goodwill for the three months ended November 30, 2016, by segment, are as follows:

	EnergyAg	Corporate and Other	Total
	(Dollars in thousands)		
Balances, August 31, 2016	\$552 \$148,916	\$10,946	\$160,414
Effect of foreign currency translation adjustments	— (1,291 )	—	(1,291 )
Other	— —	(372 )	(372 )
Balances, November 30, 2016	\$552 \$147,625	\$10,574	\$158,751

No goodwill has been allocated to our Nitrogen Production or Foods segments, which consist of investments accounted for under the equity method.

Intangible assets subject to amortization primarily include customer lists, trademarks and non-compete agreements, and are amortized over their respective useful lives (ranging from 2 to 30 years). Information regarding intangible assets that are included in other assets on our Consolidated Balance Sheets is as follows:

	November 30, 2016			August 31, 2016		
	Carrying Amount	Accumulated Amortization	Net	Carrying Amount	Accumulated Amortization	Net
	(Dollars in thousands)					
Customer lists	\$48,818	\$ (13,039 )	\$35,779	\$51,554	\$ (15,550 )	\$36,004
Trademarks and other intangible assets	31,567	(23,869 )	7,698	35,015	(26,253 )	8,762
Total intangible assets	\$80,385	\$ (36,908 )	\$43,477	\$86,569	\$ (41,803 )	\$44,766

Total amortization expense for intangible assets during the three months ended November 30, 2016 and 2015 was \$1.3 million and \$1.7 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	\$ 3,906
Year 2	3,885
Year 3	3,862
Year 4	3,516
Year 5	3,455

## Note 6 Notes Payable and Long-Term Debt

Our notes payable and long-term debt are subject to various restrictive requirements for maintenance of minimum consolidated net worth and other financial ratios. We were in compliance with our debt covenants as of November 30, 2016.

	November 30, 2016	August 31, 2016
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	(Dollars in thousands)	
Notes payable	\$2,315,412	\$1,803,174
CHS Capital notes payable	912,152	928,305
Total notes payable	\$3,227,564	\$2,731,479

On November 30, 2016, our primary line of credit was a five-year, unsecured revolving credit facility with a committed amount of \$3.0 billion which expires in September 2020.

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Interest expense for the three months ended November 30, 2016, and 2015 was \$38.3 million and \$9.1 million respectively, net of capitalized interest of \$1.6 million and \$13.7 million, respectively.

## Note 7 Equities

## Preferred Stock

In June 2014, we filed a shelf registration statement on Form S-3 with the SEC. Under the shelf registration, which has been declared effective by the SEC, we may offer and sell, from time to time, up to \$2.0 billion of our Class B Cumulative Redeemable Preferred Stock over a three-year period from the time of effectiveness. As of November 30, 2016, \$990.0 million of our Class B Cumulative Redeemable Preferred Stock remained available for issuance under the shelf registration statement.

## Changes in Equities

Changes in equities for the three months ended November 30, 2016, are as follows:

	Equity Certificates Capital Equity Certificates (Dollars in thousands)	Nonpatronage Equity Certificates	Nonqualified Equity Certificates	Preferred Stock	Accumulated Other Comprehensive Loss	Capital Reserves	Noncontrolling Interests	Total Equities
Balance, August 31, 2016	\$3,932,513	\$22,894	\$281,767	\$2,244,132	\$(211,726)	\$1,582,380	\$14,290	\$7,866,250
Reversal of prior year redemption estimate	9,528	—	—	—	—	—	—	9,528
Redemptions of equities	(8,946)	(60)	(522)	—	—	—	—	(9,528)
Preferred stock dividends	—	—	—	—	—	(41,825)	—	(41,825)
Other, net	(47)	(59)	(24)	—	—	136	(653)	(647)
Net income	—	—	—	—	—	209,150	(208)	208,942
Other comprehensive income (loss), net of tax	—	—	—	—	(14,494)	—	—	(14,494)
Estimated 2017 cash patronage refunds	—	—	—	—	—	(58,238)	—	(58,238)
Estimated 2017 equity redemptions	(28,708)	—	—	—	—	—	—	(28,708)
Balance, November 30, 2016	\$3,904,340	\$22,775	\$281,221	\$2,244,132	\$(226,220)	\$1,691,603	\$13,429	\$7,931,280

## Accumulated Other Comprehensive Loss

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Changes in accumulated other comprehensive income (loss) by component, net of tax, are as follows for the three months ended November 30, 2016, and 2015:

	Pension and Other Postretirement Benefits	Unrealized Net Gain on Available for Sale Investments	Cash Flow Hedges	Foreign Currency Translation Adjustment	Total
	(Dollars in thousands)				
Balance as of August 31, 2016	\$ (165,146)	\$ 5,656	\$ (9,196)	\$ (43,040 )	\$ (211,726)
Current period other comprehensive income (loss), net of tax	—	777	383	(19,149 )	(17,989 )
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	3,239	—	271	(15 )	3,495
Net other comprehensive income (loss), net of tax	3,239	777	654	(19,164 )	(14,494 )
Balance as of November 30, 2016	\$ (161,907)	\$ 6,433	\$ (8,542)	\$ (62,204 )	\$ (226,220)

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	Pension and Other Postretirement Benefits	Unrealized Net Gain on Available for Sale Investments	Cash Flow Hedges	Foreign Currency Translation Adjustment	Total
	(Dollars in thousands)				
Balance as of August 31, 2015	\$(171,729)	\$ 4,156	\$(5,324)	\$(41,310 )	\$(214,207)
Current period other comprehensive income (loss), net of tax	6,419	560	(4,216 )	(2,980 )	(217 )
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	(3,218 )	—	(118 )	—	(3,336 )
Net other comprehensive income (loss), net of tax	3,201	560	(4,334 )	(2,980 )	(3,553 )
Balance as of November 30, 2015	\$(168,528)	\$ 4,716	\$(9,658)	\$(44,290 )	\$(217,760)

Amounts reclassified from accumulated other comprehensive income (loss) were primarily related to pension and other postretirement benefits. Pension and other postretirement reclassifications include amortization of net actuarial loss, prior service credit and transition amounts and are recorded as marketing, general and administrative expenses (see Note 8, Benefit Plans for further information).

## Note 8 Benefit Plans

We have various pension and other defined benefit and defined contribution plans, in which substantially all employees may participate. We also have non-qualified supplemental executive and Board retirement plans.

Components of net periodic benefit costs for the three months ended November 30, 2016, and 2015 are as follows:

	Qualified Pension Benefits		Non-Qualified Pension Benefits		Other Benefits	
	2016	2015	2016	2015	2016	2015
(Dollars in thousands)						
Components of net periodic benefit costs for the three months ended November 30 are as follows:						
Service cost	\$9,383	\$9,383	\$ 259	\$ 259	\$353	\$353
Interest cost	7,692	7,693	352	352	427	427
Expected return on assets	(12,014 )	(12,014 )	—	—	—	—
Prior service cost (credit) amortization	402	402	57	57	(30 )	(30 )
Actuarial (gain) loss amortization	4,765	4,754	173	173	(116 )	(116 )
Net periodic benefit cost	\$10,228	\$10,218	\$ 841	\$ 841	\$634	\$634

## Employer Contributions

Total contributions to be made during fiscal 2017, will depend primarily on market returns on the pension plan assets and minimum funding level requirements. During the three months ended November 30, 2016, we made no contributions to the pension plans. At this time, we do not anticipate having to make a required contribution for our benefit plans in fiscal 2017, but we may make a voluntary contribution during the fourth quarter of fiscal 2017.

## Note 9 Segment Reporting

We define our operating segments in accordance with ASC Topic 280, Segment Reporting, to reflect the manner in which our chief operating decision maker, our Chief Executive Officer, evaluates performance and allocates resources in managing the business. We have aggregated those operating segments into four reportable segments: Energy, Ag, Nitrogen Production and Foods.

Our Energy segment produces and provides primarily for the wholesale distribution of petroleum products and transportation of those products. Our Ag segment purchases and further processes or resells grains and oilseeds originated by our country operations business, by our member cooperatives and by third parties; serves as a wholesaler and retailer of crop inputs; and produces and markets ethanol. Our Nitrogen Production segment consists solely of our equity method investment in CF Nitrogen, which was completed in February 2016 and which entitles us, pursuant to a supply agreement that we entered into

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with CF Nitrogen, to purchase granular urea and UAN annually from CF Nitrogen to a specified annual quantity. The addition of our Nitrogen Production segment had no impact on historically reported segment results and balances as this segment came into existence in fiscal 2016. Our Foods segment consists solely of our equity method investment in Ventura Foods. In prior periods, Ventura Foods was reported as a component of Corporate and Other because it was an insignificant operating segment. Historically reported segment results and balances have been revised to reflect the addition of our Foods segment. There were no changes to the composition of our Energy or Ag segments as a result of the addition of our Nitrogen Production and Foods segments. Corporate and Other primarily represents our non-consolidated wheat milling operations, as well as our business solutions operations, which primarily consists of commodities hedging, insurance and financial services related to crop production.

Corporate administrative expenses and interest are allocated to each business segment, and Corporate and Other, based on direct usage for services that can be tracked, such as information technology and legal, and other factors or considerations relevant to the costs incurred.

Many of our business activities are highly seasonal and operating results vary throughout the year. For example, in our Ag segment, our crop nutrients and country operations businesses generally experience higher volumes and income during the spring planting season and in the fall, which corresponds to harvest. Our grain marketing operations are also subject to fluctuations in volume and earnings based on producer harvests, world grain prices and demand. Our Energy segment generally experiences higher volumes and profitability in certain operating areas, such as refined products, in the summer and early fall when gasoline and diesel fuel usage is highest and is subject to global supply and demand forces. Other energy products, such as propane, may experience higher volumes and profitability during the winter heating and crop drying seasons.

Our revenues, assets and cash flows can be significantly affected by global market prices for commodities such as petroleum products, natural gas, ethanol, grains, oilseeds, crop nutrients and flour. Changes in market prices for commodities that we purchase without a corresponding change in the selling prices of those products can affect revenues and operating earnings. Commodity prices are affected by a wide range of factors beyond our control, including the weather, crop damage due to disease or insects, drought, the availability and adequacy of supply, government regulations and policies, world events, and general political and economic conditions.

While our revenues and operating results are derived from businesses and operations which are wholly owned and majority owned, a portion of our business operations are conducted through companies in which we hold ownership interests of 50% or less and do not control the operations. See Note 4, Investments for more information on these entities.

Reconciling Amounts represent the elimination of revenues and interest between segments. Such transactions are executed at market prices to more accurately evaluate the profitability of the individual business segments.

Segment information for the three months ended November 30, 2016, and 2015 is presented in the tables below.

	Energy	Ag	Nitrogen Production	Foods	Corporate and Other	Reconciling Amounts	Total
For the Three Months Ended November 30, 2016:	(Dollars in thousands)						
Revenues	\$1,700,180	\$6,435,994	\$—	\$—	\$27,441	\$(115,365 )	\$8,048,250
Operating earnings (loss) (Gain) loss on investments	72,780	109,597	(4,029 )	(2,797 )	10,940	—	186,491
	—	7,385	—	—	16	—	7,401

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Interest expense	4,268	16,339	12,736	—	7,974	(3,052	) 38,265
Other income	(309	) (17,923	) (29,106	) —	(115	) 3,052	(44,401 )
Equity (income) loss from investments	(1,162	) (5,417	) (14,696	) (13,369	) (5,684	) —	(40,328 )
Income (loss) before income taxes	\$69,983	\$109,213	\$27,037	\$10,572	\$8,749	\$—	\$225,554
Intersegment revenues	\$(110,087	) \$(3,765	) \$—	\$—	\$(1,513	) \$115,365	\$—
Capital expenditures	\$80,754	\$29,226	\$—	\$—	\$7,006	\$—	\$116,986
Depreciation and amortization	\$54,954	\$59,406	\$—	\$—	\$7,012	\$—	\$121,372
Total assets at November 30, 2016	\$4,243,151	\$7,748,375	\$2,835,125	\$372,049	\$3,231,761	\$—	\$18,430,461

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	Energy	Ag	Nitrogen Production	Foods	Corporate and Other	Reconciling Amounts	Total
For the Three Months Ended November 30, 2015:	(Dollars in thousands)						
Revenues	\$ 1,705,913	\$ 6,114,256	\$ —	\$ —	\$ 19,895	\$(111,272)	\$ 7,728,792
Operating earnings (loss)	180,513	74,990	—	(1,951)	6,262	—	259,814
(Gain) loss on investments	—	(5,672)	—	—	—	—	(5,672)
Interest expense	(11,599)	16,782	—	822	3,655	(609)	9,051
Other income	(2)	(1,812)	—	—	(853)	609	(2,058)
Equity (income) loss from investments	(823)	(3,576)	—	(21,077)	(5,886)	—	(31,362)
Income (loss) before income taxes	\$ 192,937	\$ 69,268	\$ —	\$ 18,304	\$ 9,346	\$ —	\$ 289,855
Intersegment revenues	\$(107,103)	\$(3,053)	\$ —	\$ —	\$(1,116)	\$ 111,272	\$ —
Capital expenditures	\$ 132,367	\$ 98,138	\$ —	\$ —	\$ 21,173	\$ —	\$ 251,678
Depreciation and amortization	\$ 41,063	\$ 55,173	\$ —	\$ —	\$ 4,114	\$ —	\$ 100,350

## Note 10 Derivative Financial Instruments and Hedging Activities

Our derivative instruments primarily consist of commodity and freight futures and forward contracts and, to a minor degree, may include foreign currency and interest rate swap contracts. These contracts are economic hedges of price risk, but we do not apply hedge accounting under ASC Topic 815, Derivatives and Hedging, except with respect to certain interest rate swap contracts which are accounted for as cash flow or fair value hedges. Derivative instruments are recorded on our Consolidated Balance Sheets at fair value as described in Note 11, Fair Value Measurements.

The following tables present the gross fair values of derivative assets, derivative liabilities, and margin deposits (cash collateral) recorded on our Consolidated Balance Sheets along with the related amounts permitted to be offset in accordance with GAAP. We have elected not to offset derivative assets and liabilities when we have the right of offset under ASC Topic 210-20, Balance Sheet - Offsetting; or when the instruments are subject to master netting arrangements under ASC Topic 815-10-45, Derivatives and Hedging - Overall.

	November 30, 2016			
	Amounts Not Offset on the Consolidated Balance Sheet but Eligible for Offsetting			
	Gross Amounts Recognized	Cash Collateral	Derivative Instruments	Net Amounts
	(Dollars in thousands)			
Derivative Assets:				
Commodity and freight derivatives	\$ 364,218	\$ —	\$ 24,504	\$ 339,714
Foreign exchange derivatives	20,335	—	5,270	15,065
Interest rate derivatives - hedge	10,444	—	—	10,444
Embedded derivative asset	24,106	—	—	24,106
Total	\$ 419,103	\$ —	\$ 29,774	\$ 389,329
Derivative Liabilities:				

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Commodity and freight derivatives	\$300,167	\$237	\$ 24,504	\$275,426
Foreign exchange derivatives	15,690	—	5,270	10,420
Interest rate derivatives - hedge	1,642	—	—	1,642
Interest rate derivatives - non-hedge	6	—	—	6
Total	\$317,505	\$237	\$ 29,774	\$287,494

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	August 31, 2016			
	Amounts Not Offset on the Consolidated Balance Sheet but Eligible for Offsetting			
	Gross Amounts Recognized (Dollars in thousands)	Cash Collateral	Derivative Instruments	Net Amounts
Derivative Assets:				
Commodity and freight derivatives	\$500,192	\$—	\$ 23,689	\$476,503
Foreign exchange derivatives	21,551	—	9,187	12,364
Interest rate derivatives - hedge	22,078	—	—	22,078
Total	\$543,821	\$—	\$ 32,876	\$510,945
Derivative Liabilities:				
Commodity and freight derivatives	\$491,302	\$811	\$ 23,689	\$466,802
Foreign exchange derivatives	22,289	—	9,187	13,102
Interest rate derivatives - non-hedge	8	—	—	8
Total	\$513,599	\$811	\$ 32,876	\$479,912

## Derivatives Not Designated as Hedging Instruments

The majority of our derivative instruments have not been designated as hedging instruments for accounting purposes. The following table sets forth the pretax gains (losses) on derivatives not accounted for as hedging instruments that have been included in our Consolidated Statements of Operations for the three months ended November 30, 2016, and 2015.

		For the Three Months Ended November 30	
	Location of Gain (Loss)	2016	2015
(Dollars in thousands)			
Commodity and freight derivatives	Cost of goods sold	\$18,410	\$35,046
Foreign exchange derivatives	Cost of goods sold	6,024	683
Foreign exchange derivatives	Marketing, general and administrative	145	7,523
Interest rate derivatives	Interest expense	2	(704)
Embedded derivative	Other Income	29,106	—
Total		\$53,687	\$42,548

## Commodity and Freight Contracts:

As of November 30, 2016, and August 31, 2016, we had outstanding commodity futures, options and freight contracts that were used as economic hedges, as well as fixed-price forward contracts related to physical purchases and sales of commodities. The table below presents the notional volumes for all outstanding commodity and freight contracts

accounted for as derivative instruments.

	November 30, 2016		August 31, 2016	
	Long	Short	Long	Short
	(Units in thousands)			
Grain and oilseed - bushels	698,853	992,878	774,279	995,396
Energy products - barrels	12,666	5,767	14,740	6,470
Processed grain and oilseed - tons	502	1,958	541	2,060
Crop nutrients - tons	65	209	108	135
Ocean and barge freight - metric tons	6,571	1,422	4,406	877
Rail freight - rail cars	195	77	205	79
Natural gas - MMBtu	3,706	50	3,550	300

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### Foreign Exchange Contracts:

We are exposed to risk regarding foreign currency fluctuations even though a substantial amount of international sales are denominated in U.S. dollars. In addition to specific transactional exposure, foreign currency fluctuations can 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. From time to time, we enter into foreign currency hedge contracts to minimize the impact of currency fluctuations on our transactional exposures. The notional amounts of our foreign exchange derivative contracts were \$789.1 million and \$802.2 million as of November 30, 2016, and August 31, 2016, respectively.

### Embedded Derivative Asset:

Under the terms of our strategic investment in CF Nitrogen, if CF Industries' credit rating is reduced below certain levels by two of three specified credit ratings agencies, we are entitled to receive a non-refundable annual payment of \$5.0 million from CF Industries. The payment would continue on an annual basis until the date that CF Industries' credit rating is upgraded to or above certain levels by two of the three specified credit ratings agencies or February 1, 2026, whichever is earlier.

During the three months ended November 30, 2016, CF Industries' credit rating was reduced below the specified levels and we received a \$5.0 million payment from CF Industries, which was recorded as a gain in our Consolidated Statement of Operations. Additionally, we recorded a \$24.1 million embedded derivative asset on our Consolidated Balance Sheet and a corresponding gain in our Consolidated Statement of Operations for the fair value of the embedded derivative. See Note 11, Fair Value Measurements for more information on the valuation of the embedded derivative.

### Derivatives Designated as Cash Flow or Fair Value Hedging Strategies

As of November 30, 2016, and August 31, 2016, we had certain derivatives designated as cash flow and fair value hedges.

### Interest Rate Contracts:

We have outstanding interest rate swaps with an aggregate notional amount of \$495.0 million designated as fair value hedges of portions of our fixed-rate debt. Our objective in entering into these transactions is to offset changes in the fair value of the debt associated with the risk of variability in the 3-month U.S. dollar LIBOR interest rate, in essence converting the fixed-rate debt to variable-rate debt. Offsetting changes in the fair values of both the swap instruments and the hedged debt are recorded contemporaneously each period and only create an impact to earnings to the extent that the hedge is ineffective. During the three months ended November 30, 2016, and 2015, we recorded offsetting fair value adjustments of \$13.3 million and \$2.3 million, respectively, with no ineffectiveness recorded in earnings.

In fiscal 2015, we entered into forward-starting interest rate swaps with an aggregate notional amount of \$300.0 million designated as cash flow hedges of the expected variability of future interest payments on our anticipated issuance of fixed-rate debt. During the first quarter of fiscal 2016, we determined that certain of the anticipated debt issuances would be delayed; and we consequently recorded an immaterial amount of losses on the ineffective portion of the related swaps in earnings. Additionally, we paid \$6.4 million in cash to settle two of the interest rate swaps upon their scheduled termination dates. During the second quarter of fiscal 2016, we settled an additional two interest rate swaps, paying \$5.3 million in cash upon their scheduled termination. In January 2016, we issued the fixed-rate debt associated with these swaps and will amortize the amounts which were previously deferred to other comprehensive income into earnings over the life of the debt. The amounts to be included in earnings are not expected

to be material during any 12-month period. During the third quarter of fiscal 2016, we settled the remaining two interest rate swaps, paying \$5.1 million in cash upon their scheduled termination. We did not issue additional fixed-rate debt as previously planned, and we reclassified all amounts previously recorded to other comprehensive income into earnings. As of November 30, 2016, we had no outstanding cash flow hedges.

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The following table presents the pretax gains (losses) recorded in other comprehensive income relating to cash flow hedges for the three months ended November 30, 2016, and 2015.

For the  
Three  
Months  
Ended  
November  
30