



# *Garden City Co-op, Inc.*

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## **Annual Report 2006**

This has been an exciting year for your Co-op. The Garden City Co-op has a proud tradition of 87 years of serving Western Kansas farmers. Amazingly that is a profitability win-loss record of 85-2. The only years your Co-op have ever posted a loss was 2002 and 2003. The midst of the depression and dust bowl era was a difficult time for your Co-op, but even then general manager W. G. Hopkins and his crew squeezed through with a \$236 profit in 1934.

The most profitable year for your Co-op was 1999 when record grain volume and the sale of the railroad contributed to post a \$3.2 million profit. In 1999 the Farmers Cooperative Elevator and Mercantile Association in Dighton had a \$557,000 profit for a combined total profit of \$3.7 million. That combined record is a full \$1 million above the performance of the second place year so it was a significant accomplishment.

This year, your Co-op is proud to report a \$3.7 million profit tying the record for combined operations. This outstanding result was accomplished without record grain production or significant capital asset sales. This profitable result is a tribute to the effort and efficiency your Co-op employees demonstrated while providing products and services to your farming operations. It is also a tribute to your commitment to support and patronize your member-owned business.

The story of the Garden City Co-op's success in 2006 is not just about the income statement though. This was a year of innovation in an attempt to be better positioned to serve your needs in the future. This was a year that your Co-op's staff executed decisively to capture profitability where it was offered. This was a year when given the choice between maximizing profitability and being a dependable supplier, we made the right choice and had reliable supplies of fertilizer there to meet your needs. 2006 was a year of unknowns and the creation of a new definition of volatility and unpredictability in agricultural and energy markets.

## **Outside Investments**

This report's focus on outside investments is usually included in the divisional

reports. For instance, we might discuss WindRiver in the Grain Division's report. I would like to address these investments more comprehensively this year with a discussion of our strategy for them as a group.

The Garden City Co-op has a long record of innovation. Much of this innovation has been held outside the Co-op's balance sheet in outside investments for two reasons. The first and most important strategy is to partner with other Co-ops and other companies in ventures that success is largely determined by committed volume. WindRiver is an example of that strategy. By sharing the ownership of WindRiver, we have developed committed partners that openly share information and grain volume. Many competing High Plains unit train loaders/unloaders are held by single entities and have lacked the volume and commitment to be successful.

The second strategy for our outside investments is to protect the patronage income flow of our membership. We attempt to invest in a way that will provide the efficiencies and income streams to strengthen your Co-op's financial statements. We also know how important maintaining a strong and dependable patronage and equity retirement flow is to you. Investing in outside ventures allows us to provide needed products and services while managing the risks inherent in agribusiness.

We are extremely proud of the performance of our outside investments and regional cooperative membership. LLC investments returned 45.5% on our equity of which a large portion of the earnings were returned in cash. The return on equity for regional co-ops was 35.4%. The rate that our regional co-op, CHS, is revolving equity has recently dramatically increased providing more liquidity. These impressive numbers demonstrate that our investment philosophy and our commitment to the federated co-op system is sound and performing well. Some of this outside income is returned to you through the patronage stream with the balance going into your Co-op's retained earnings. It all contributes to the financial strength of the Co-op and our ability to return needed dollars to you on a timely basis.

These outside investments will continue to play a larger role in future Co-op operations and income streams. Some regional patronage rates in the coming year are expected to reach record levels, maybe even multiples of record levels. We continue to be strongly committed to our LLCs. This year, we started some new ventures with neighboring Co-ops to address needs all farmers in Southwest Kansas share. We anticipate they will continue in the long tradition of growth and prosperity that we have enjoyed by cooperating with neighbors and by being committed to the Co-op system in the past.

## **Grain**

The Grain Division experienced another year of growth in geography and capacity. The addition of four Sullivan Grain elevators and the elevator at Arnold increased the

number of elevators to 20 and almost 24 million bushels of licensed capacity. The distance between the perimeter elevators, Milepost and Arnold is 165 miles. These additions plus last years Dighton merger have roughly doubled the grain division in two years.

Our objectives for grain division expansion are:  
Improve our service by being more flexible in harvest. The addition of elevators increases our ability to quick ship grain from full elevators in a timely and profitable method. This helps keep you in the field.  
Provide geographical diversity of cropping and weather patterns to spread exposure to either risk.  
Provide adequate grain storage in diverse dryland and irrigated areas so our company owned grain income could be maximized.  
Provide adequate geographical diversity that would cover several rail lines and end user customers to maximize our marketing alternatives.  
Provide increased scale and scope of operations to reduce administration and other overhead costs on a per unit basis.

We believe that we have been successful in accomplishing these objectives. The Grain Division was very profitable this year. We are even more optimistic for the future. The growth has been a big change and we learn new ways to leverage our geography and capacity every marketing season. It is our commitment to use the growth to improve your marketing alternatives and profitability. It is also our commitment to never forget the pressure you are under during harvest and to keep your needs at the front and center of our planning.

### **Crop Production**

2006 in crop production was a year that saw a new level of sharing with neighbors to make each other successful. We started two new businesses, a seed and a cash and carry chemical business by partnering with 5 neighboring Co-ops. This model will allow us the scale to attract quality suppliers, afford qualified agronomists and the sharing of risk and start-up costs. It lets us enter two difficult markets to offer you the expertise and products you need at the most competitive price.

Surprisingly, the seed business has been profitable the first year. We had anticipated that it may take three years to become profitable. It not only contributed greatly to our Crop Production Department income stream but will increase the profitability of neighboring Co-ops.

The cash and carry chemical business, Western Ag Chemical, had some start-up costs that will be overcome next year. More importantly, it provided a source for the most competitive chemical pricing for you. We have been students in that market and will be even more competitive next year.

The Crop Production Department was not profitable this year, so patronage will not be paid on its volume. The major reason was declining margins on fertilizer. Last fall during the height of energy markets volatility, many manufacturers were considering the shut down of domestic nitrogen production. Had this happened, fertilizer shortages and related price increases would have been devastating last spring. Your Co-op worked with a group of Nebraska and Iowa Co-ops through our membership in NIK to guarantee manufacturers the necessary volume to continue operations. After the markets began to decline, that commitment left us with a position that was impossible to risk manage.

It was a difficult year for margins and profitability in crop production. I am proud to let you know that we served the co-operative principle by taking the position that made sure your needs were covered. It wasn't profitable this year but we were there for you with the product you needed when you needed it.

### **Petroleum**

Agricultural use of refined fuels and lubricants has dropped dramatically. Reduced tillage practices and larger more efficient equipment have required much less petroleum products to cover the same acres. While you use less, you certainly need a reliable quality supplier for your remaining volume. It has been our challenge to be profitable in a business that our customers require less volume at a better price in a volatile market.

We have answered that need by looking outside of traditional agricultural users for the volume to be profitable. We now sell gas through our partnerships in Eastern Kansas, North Central Colorado and Wyoming, and Central Oklahoma. We supply trucking companies in five states and provide product for truck stops and commercial users. For the second year in a row, we have been the top seller of CHS refined fuels and lubricants in their entire system. This comes at a time when refining margins has been at their peak maximizing our patronage stream from CHS. Petroleum has been a great provider of outside income to support our Co-op and help drought-proof it by bringing in a non-agricultural income source.

### **Our Commitment To You**

Our job is to bring you the best products and highest level of expertise at the most competitive prices. It is to provide markets for your grain in this volatile time that helps your farm to be successful. We have to build for the future so your Co-op can continue to be a strong provider and leader. We have to return your equity in this company and continue to be profitable so there is future income to share.

We hope you review this information and determine that your patronage and your confidence in your Co-op was well placed. We have much yet to do. I speak for the

entire employee team when I say, "Thanks for helping us keep Moving Forward Together"!!!