

Sarkis Sherbetchyan

So in the press release, I see that you guys have kind of outlined the fact that you want to become a more efficient and successful production platform, marketing and sales organization, right. So just kind of thinking about that statement and given the fact that you maintained your annual revenue guidance, how do we reconcile the existing operating expense base of this business compared to this revenue trajectory? In other words, are you potentially looking at some cost rationalization? And if not, what degree of confidence do you have that you are going to grow revenues materially higher from this trajectory?

Matthew Szot

Yes. Sarkis, I think at this stage, we feel comfortable where our operating expense spend is. We are going to see a bit of, probably a \$400,000 increase year-over-year in our research and development line item. But overall, we are most focused on growing revenues and expanding gross margins and we think our operating expenses. Of course, we are always looking for ways to drive efficiencies there and reduce costs, but we don't see significant opportunities nor is that really in our plan over the next 12 months to be dramatically changing the operating expense line item.

Sarkis Sherbetchyan

Understood. If we think about the maintenance of the annual guidance, can you just maybe remind us the confidence at this stage in the year or the cycle?

Matthew Szot

Well, certainly one of our largest course for revenue is in Q4. So we don't have a complete order book to substantiate the full \$75 million to \$80 million. But with that being said, based on our detailed rollup by our projections from our sales guys and communications from our customers, at this time, we believe \$75 million to \$80 million is a reasonable range of expectations for our revenue for this year. We will also be driving, we will be driving, we expect to be driving gross margin improvements year-over-year and that should be translating into an EBITDA of around \$4 million to \$5.5 million. And if the Saudi market continues to soften, we will probably be in the lower part of that range. And if the Saudi market remains stable or starts to improve, we will be at the high end of that range.

Sarkis Sherbetchyan

Got it. That's helpful. I appreciate the commentary around the progress in sorghum and sunflower, those programs you have. Can you maybe outline what your near-term, mid-term and long-term revenue and gross margin targets are for those programs?

Mark Wong

Sarkis, this is Mark. The development of new species like this starts off with a breeding program that can take up to eight years to generate its first varieties and that's why most seed companies enter new markets as we have done through an acquisition of a breeding program or an existing company. I think in the last call, we said that after that, it's a two or three year process to kind of ramp up breeder seed in the form of...these are all hybrids in sorghum and sunflower that we are developing. We are not doing any OPs of currently. So you have a three line system for hybrids, A, B lines and restores. And so we are developing all those and increasing all those lines and then putting them in the field to produce the seed that we will sell to our farmer customers. So we expect this year some number around \$2 million, \$2.5 million in sales and from my experience we can ramp that number up looking at historical growth sort of growth rates for companies that do a good job in new crop like these, which I am sure we will do. But

we still think we can hit sort of \$30 million number in five years that we have mentioned before. How we get the \$30 million from \$2 million, \$2.5 million is going to be a little bumpy. It always is. But we think we have a good chance based on our germplasm and our distribution and production assets to still get to that number within a five year period. Hope that answers your question.

Sarkis Sherbetchyan

That's helpful. One more and I will hop back in the queue. I know you have talked about creating a customer centric organization as a key piece of the go-forward strategy working with key distributors, et cetera. Can you maybe give us a flavor or sense of how those discussions are going at this stage and/or maybe some specific plans that you have been communicating with your customers?

Mark Wong

Sure. So we, like many seed companies, have concentrated on the handoff, right. So the next company along the line that gets our product is usually a distributor of some kind or a dealer who then sells directly to a farmer or a dairy farmer or someone like that in the alfalfa business, which is obviously our concentration. We are selling to dairy farmers around the world who then produce the alfalfa and either feed it to their cows or we are selling to beef producers in general who grow the alfalfa and feed it to their cattle. But there is also a big alfalfa trading market. So we sell to a lot of farmers who grow alfalfa hay and put that on the water to different countries and that's why hay prices are pretty good right now and that's what's happening in that, we think, some of the Middle Eastern demand that we are not seeing. In Saudi as an example, it's translating to improved shipments of alfalfa forage from both East Coast and West Coast markets to Saudi Arabia. So we are trying to focus on, especially with these new traits that we are looking and evaluating and putting into our products.

I will just give you an example, since you asked for one. So what's really the benefit to the dairy farmer, right? So maybe the dairy farmer is buying through a distributor something and that relationship is absolutely important to us and the distributor understands the technical aspect of our products and why they are superior to our competitors' products is important to us. We have to prove to dairy farmer that he gets more milk from our alfalfa. I mean that's bottom line there. And that's what I mean by a customer focused effort. We have got to work more with the final user, right. He is the one or she is the one that translates a bale of alfalfa or a bale of forage that is in a silage pit to milk. And we have got to do more to understand what that metric looks like, how to both produce seed that gets the farmer more value but also to teach the farmer what kind of processes he needs or she needs to plant, harvest and then feed that alfalfa to his or her animals to get more value.

So it's both a process of putting more and better genetics in the plants and the seeds. But it's also a teaching process of making sure that our customers are informed how to use our seeds to get more value at the farm, at the animal level. The dairy farmer wants to know, how does he get more milk? How does he get more milk for every pound of S&W alfalfa that he buys that he then grows and translates into silage or hay and that then he feeds to his dairy cows or beef cows? That's what we are trying to develop, that whole chain of information and value for ourselves and for our customers. They have got to know how to use our products. Hope that answers your question.

Sarkis Sherbetchyan

That's great. I will hop back in the queue. Thank you.



**Operator**

Our next question comes from Gerry Sweeney from Roth. Please go ahead with your question.

Gerry Sweeney

Hi, good afternoon, Mark and Matt.

Mark Wong

Good afternoon.

Matthew Szot

Hi, Gerry.

Gerry Sweeney

Mark, this is probably a little more for you. So in the prepared remarks, you went through a lot of different things, the Calyxt opportunity, the alfalfa traits, sorghum, and sunflower. But obviously you have been in this business a long time. As you are looking at a wide variety of opportunities in front of you, as you look out, this year is this year, but as you look out the next couple of years, what gets you most excited? What do you think maybe on like a risk based analysis, what has the biggest opportunity to hit the market and could be the most successful?

Mark Wong

Yes. I am going to talk about that in a little bit general terms, because if I name the exact traits, probably our competitors are listening to this call and that probably wouldn't be a good thing. But so bear with me please. But I will break it down to a couple of categories, right.

I think traits really break down into two main categories, traits that help the farmer in some way, right. They either reduce his cost or they improve his yield. But the bottom line for him is that he can make more money at the same original price of his commodity. But the other set of traits which are just as important are traits for the end consumer. So if you had a more nutritious kind of milk with better makeup of protein and fats and vitamins and things like that, that would be something that would be valuable. So we are trying to look at both of those two categories, the customer sort of focus traits and the farmer sort of focus traits.

The customer traits, in the history of the industry have been a bit harder to develop. But we think they are really important and we think that, from a public acceptance standpoint, they are very, very important because the public has to see something in this technology development that really helps them, right. They have got to see a better product. Yes, they care about the price of the products and they care if the farmer is making money in sort of an opaque sort of way. But they really like to see something that helps them and we are focused on those kind of opportunities as well as more traditional ones that either increase yield or reduce farmer cost. So that would be my general answer to your question.

Gerry Sweeney

Alright. And then on the gross margin side, Matt, has this been the result of the optimization program sort of growing S&W, the California seed in Australia that we have always sort of talked about the last couple of years driving the margin?

Matthew Szot

Well, I would say, in Q1, the margin improvement was more just pronounced by the fact that, which was primarily a non-dormant quarter for us, Gerry, the cost of that production, we did a better job of securing contract production at lower cost this year than our historical costs and doing that while maintaining a firm pricing was the main driver to margin improvement in Q1. And as we look to Q2 and Q3 in particular, both of those quarters have had higher concentration of sales of our dormant varieties are merely being sold to DuPont Pioneer. Those also carry higher margin profiles. So as we look at our business in 2018 to 2017, we feel confident that we are going to be demonstrating margin improvement and more importantly, getting back to your original question about Australian varieties and being optimized, that's certainly part of our go forward margin expansion opportunity and I think that that's going to be a fundamental tool that we are going to use to continue to drive margins for the next three to five years.

Gerry Sweeney

Got it.

Matthew Szot

This year, we don't have as many Australian seeds to incorporate into that optimization program.

Gerry Sweeney

That's right. Because you were sold out at one point, if I remember correctly.

Mark Wong

Well, the Australian harvest, the yields were really low back in May 2017.

Gerry Sweeney

Yes. Got it.

Mark Wong

It's absolutely a part of our go forward strategy.

Gerry Sweeney

Okay. Got it. And then Saudi Arabia, obviously it's a headwind and there was talk before about some of that land moving to Sudan and other places that you eventually could make up some of that lost revenue. Is that still the case? Are you pursuing that? Or you just going to maybe just take this as an opportunity to pivot more towards the trait work and move in a different direction?

Mark Wong

Yes. A great question. So Saudi Arabia is a difficult market right now. That's pretty clear from all the press we are all reading about the political situations there too. So in line with our trying to get closer to our customers, we have had meetings in Saudi with some of the dairies. And the dairies have gone through their strategies with us in the terms how much production and what kind of production are they going to try to keep in Saudi Arabia? Where are they going in terms of neighboring countries to plant some of the alfalfa that they can't grow in Saudi Arabia? Where are they going to buy land in other places all around the world from California to Argentina to wherever to grow alfalfa that they are then going to ship to their cows in Saudi? What kind of short-term philosophy are they trying to take towards importing forages in the forage market?



And lastly, if push comes to shove, will they cut cow numbers and just import milk for the Saudi market, which has 35 million people and a certain amount of demand for liquid milk and milk products. So we are trying to work through all of those options. See where we can help them. See where there is an opportunity for us as a seed company. But that goes back to Sarkis' question. We are trying to really try to understand what the customer really wants and how we can help them get to a better solution than the solution that they may have before we showed up. So we are working on that pretty hard.

Gerry Sweeney

Got it. And then a final question. The term loan, I think Matt, you talked about with KeyBanc for the Pioneer note, that has not been finalized, correct?

Matthew Szot

Yes. Gerry, to clarify, so our working capital facility is with KeyBanc. We are working with another ag lender on our 15-year term loan. And we are just in the process of finalizing our appraisals on that. And once the appraisals are done, we can finalize the exact loan amount and close. Looking to do that here in the next 30 days or ideally this month.

Gerry Sweeney

And this appraisal, is that the appraisals on the Pioneer assets that I know you are going to get...

Matthew Szot

Well, yes. Sorry, to clarify, this term loan is going to be collateralized by the mill in California and the mill that we bought from Pioneer that's located in Idaho in our R&D facilities. It will be a mortgage-backed facility.

Gerry Sweeney

Okay.

Matthew Szot

And that's what the appraisals are for.

Gerry Sweeney

Got it. And you got those assets pretty cheap. That was a little bit before my time, but it sounds like there is an opportunity to sort of extract some value with this. Is that a fair assumption?

Matthew Szot

Can you repeat the question? I want to make I address it properly.

Gerry Sweeney

Yes. I think you got those assets pretty cheap. So there is an opportunity to take that loan out, borrow against it and put yourself in a little bit better situation, maybe bring out some of the asset value to investors is what I am really trying to get at, show them what the value is, yes.



Matthew Szot

Well, yes. We were very comfortable with the valuation we paid and we acquired a tremendous set of assets and that's our job to leverage off of those assets as much as possible.

Gerry Sweeney

Okay. Got it. I appreciate it. Thanks.

Operator

Once again if you would like to ask a question please press "*" and then "1", to withdraw yourself from the question queue, you may press "*" and "2." Our next question comes from Ben Klieve from Noble Capital Markets. Please go ahead with your question.

Ben Klieve

Alright. Thank you. A few questions from me here. One, curious about kind of your take on GMO space after the Pioneer transaction. Do you see more opportunity there? Or do you think the germplasm targets beyond the Pioneer transaction will largely be conventional?

Mark Wong

I am not sure we understood your question, Ben. I mean we think the assets that we acquired that are non-GMO are very important. I mean there are the majority of the sales in the deal. Obviously, we believe in traits. We said that about, I should have said at least 20 times in 30 different ways. So we think those are valuable assets. We are still in the process of negotiating that deal. We have till the end of the year. As you can imagine, the other parties to the deal being Pioneer and Forage Genetics are in some ways our allies and in other ways our competitors. So it's a three-way negotiation. So it's not an easy negotiation. I will just put it that way and say no more about that.

Ben Klieve

Yes. I understood. Okay. Fair enough. And a couple of other questions here. One question relative to your customer centric approach, I know like you said that those kinds of changes don't happen overnight. But I am curious, when you look at the timeline here, do you see this more as a multi-quarter process or a multi-year process? And given you have a distribution...you know that there is a distribution network in place, I would guess it would be the former. But I am curious what your thoughts are there?

Mark Wong

Well, you know, it's like anything else in life. You start on a quarterly basis and you do it for years. So yes, to your question, right, good question. And that's how she works. It depends on what markets, the dairy market are easier to show, I think are going to be easier to show value of alfalfa versus maybe the beef markets which alfalfa is only one of many feeds. So I think it's a market-by-market analysis. And for sure, it's not easy. That's why everyone doesn't do it. But I think it's important for us to understand the value of our products to our customers. I think that's the shorthand for what the question or our customer centric sort of approach. And we believe in that. It might be difficult to do, but we don't see how that can be wrong. If we learn from our customers what they want to see in our seed in terms of traits, whether they be GM or non-GM or from breeding and we are out to make a better product for them so that hopefully there is added value that we can get a little higher price so that we can up our returns for our shareholders.

Ben Klieve

Okay. Thank you. And then one last one from me here, Mark, I know some of your initial comments this summer talked about the investments that you thought were needed in working capital and I guess besides seasonal build ups [technical difficulty], are you happy with the current level of investment in working capital? Or do you think you are going to need to build this up a bit more here?

Mark Wong

I am happy with our level of working capital. I am happy with the commitments our shareholders have made to the rights offering and to the equity that they put in the company. I will give you the best thermometer, if you asked my wife, she would go, man for the last five months you have been a very, very happy guy sort of, just seemingly in a good mood all the time, you don't kick the dog anymore and man, what the hell happened with you, it must be your new job, that's the only thing that changed, boy, well, you should have taken that job a long time ago. So, all I can say is, yes, I think we are doing fine on the financial side. Our banks and our equity investors seem to have confidence in our team and we couldn't ask for more than that. So thanks for the question.

Ben Klieve

Well, I am glad that things are going well at work and the home now. I will jump back in queue, guys. Thank you.

Mark Wong

You are welcome, Ben.

Operator

And ladies and gentlemen, at this time we have reached the end of the allotted time for today's question and answer session. I would like to turn the conference call back over to Mark Wong for any closing remarks.

CONCLUSION**Mark Wong**

Well, I would just like to thank everyone for participating in the call today and listening so intently to our explanation of the company's progress. We will have another call in mid-February and we look forward to having the opportunity to communicate to all of you again. Thanks so very much.

Operator

Ladies and gentlemen, that does conclude today's conference call. We do thank you for attending. You may now disconnect your lines.

