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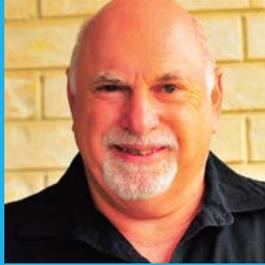
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# THE EXECUTIVE INTERVIEW SERIES



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Lytham Partners talks to S&W Seed Company (Nasdaq: SANW) regarding the recent acquisition of SV Genetics Pty Ltd (“SVG”), based in Queensland, Australia. SVG is a provider of proprietary hybrid sorghum and sunflower seed germplasm. The acquisition expands S&W’s product portfolio by adding two complementary crops that are expected to provide diversification into higher margin opportunities while leveraging the Company’s existing infrastructure. S&W is the global leader in alfalfa seed, with unrivaled research and development, production and distribution capabilities. S&W’s capabilities span the world’s alfalfa seed production regions, with operations in the United States, Australia, and Canada, and S&W sells its seed products in more than 30 countries.

## Talk about the acquisition and what it means for S&W?

[MG] We believe this acquisition has the potential to generate meaningful revenue through the introduction of these two new product lines, sorghum and sunflower, and additional income streams from royalties. We believe these new product lines are a solid complementary fit in the key markets where S&W has current alfalfa seed business including North and South America, Africa, the Middle East, Australia and Europe. We also believe there is solid potential for these products to be sold through our existing channels to markets as well as cross-selling synergies whereby S&W alfalfa seed can be sold through SVG’s existing channels. In addition, we believe the SVG sunflower genetics have market potential in regions, including Central and Eastern Europe, China, where S&W currently has little or no presence but has dormant alfalfa seed products—acquired in the Pioneer acquisition—that we plan to sell into these respective markets in future years.

## Can you provide a background on SVG and their history, ownership profile?

[AS] SVG was formed in 2011 and, at that time, acquired a sunflower product development program from SeedVision. SeedVision had commenced a sunflower program in 2005 and had put together some nice hybrid combinations testing them throughout the world. These assets were then rolled into SVG back in 2011. The program at that time was focused on both temperate and subtropical sunflower markets. Then in 2015 the program was re-located to Hungary to better focus the program on the European sunflower market. The new company commenced sorghum breeding in 2011 and focused on both grain and forage market segments.

## What has the breeding and R&D process been to develop these newly acquired varieties?

[AS] SVG developed an innovative breeding program that seemed more cost effective and faster to commercialization compared to other institutional and corporate breeding programs. They accessed germplasm from a very wide range of global sources mainly unencumbered but some with in-licensing arrangements with royalty flow back to the IP owners. This germplasm has been used as a breeding base to produce a range of unique hybrids that have demonstrated some very good potential compared to existing standards in some of the key markets. Innovative use of molecular markers has enabled a highly-effective selection mechanism for heterosis prediction based on genetic distance. This has enabled the program to fast-track and sharpen the focus of the breeding process with some excellent outcomes.

## Why do you believe this is the right time to expand into complementary crops?

[MG] We believe SVG’s products are complementary to our core focus in alfalfa, with very near term sales synergies that we hope to take advantage of. With our established infrastructure, we see this as a unique opportunity to diversify our product offering; and leverage our distribution channels with a relatively modest investment. We view this as a low cost / low risk entry into some potentially large addressable markets. We feel very fortunate to have been able to come together with some tremendous human capital assets like Dave and Alan. They are highly respected in the industry and we feel they add quite a bit of strength to our agricultural executive experience and expertise. I thank them very much for joining us.

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## Sorghum requires less water to grow than many other crops and is generally used as a replacement for corn and other grains in areas where water is scarce.

[Why did you choose sorghum and sunflower as your first foray outside alfalfa?](#)

[MG] Sorghum is an extremely complementary crop to alfalfa.

Similar to alfalfa, sorghum grows well in poor soil and drought conditions, thanks to its hardiness, market versatility and high-quality seed. Sorghum requires less water to grow than many other crops, and is generally used as a replacement for corn and other grains in areas where water is scarce. In Africa, sorghum is a food staple for human consumption. With water availability becoming a significant issue in many countries, the importance of sorghum as a more drought tolerant crop is increasing. The utilization of forage sorghum and sweet sorghums for alternative ethanol production options also remains relevant for the future.

Sunflower remains an important crop in Eastern Europe and Russia. It is well suited to the climate and soil types, and sunflower oil is well accepted in that marketplace and throughout Europe. Sunflower also offers traits such as mono-unsaturated and poly-unsaturated fatty acid profiles, which address market demands for healthy vegetable oils.

We feel it's a very good fit with the infrastructure we have in place with our specialty crop division and we're also looking at potential synergies for our stevia products. So we thought it was a tremendous fit, and we were very happy we were able to get this completed.

[What advantages do the SVG genetics have over those in the market place?](#)

[AS] SV Genetic products have performed very well in its target markets. In Australia, SV Genetics sorghum hybrids are performing up to 25% better in yield than some of the main commercial varieties under both research and farm grown conditions. The forage sorghums we developed have also been well-accepted in that market. In Pakistan, SV Genetics sunflowers performed extremely well in the Government registration trials, but more importantly in farmers' fields. In Brazil and Bolivia, SV Genetics products are proving to be well-adapted under a wide-range of climatic regimes and soil types. One aspect that SV Genetics research has focused

on is its seed yield of the parental parents. And a large emphasis has been placed in developing female parents that have a higher seed yield. We believe this is the best way to lower production costs and improve margins.

[Talk a bit about the SVG business model and what the opportunities are to grow the business into the future?](#)

[DH] We provide regional and multi-national seed companies with proprietary germplasm in the form of either complete hybrids or specific parent products. We then license the proprietary seed genetics to these regional seed companies and we sell parent seed to allow local production and distribution into the countries of choice. The licensees then produce their own hybrid seed using our genetics and pay us a royalty on the seed produced and sold. As of today we have licensing agreements with different partners to provide grain sorghum, forage sorghum and sunflower genetics in numerous locations throughout the world, including Australia, Argentina, Brazil, Bolivia, China, Europe, Pakistan, South Africa, Ukraine, and the USA. We're also testing additional products through material testing agreements in about 20 countries, with more than 50 potential commercialization partners.

[Talk about the market size and competitive landscape for sorghum and sunflower?](#)

[DH] We estimate that the forage sorghum markets are around the \$50 million mark globally, and grain sorghum more like \$245-\$250 million. A little larger for sunflower. Sunflowers in Central & Eastern Europe and Russia around \$900 million—very significant crops in those regions—and with production in other regions the worldwide market would probably be around \$1 billion to \$1.2 billion.

In addition, we believe there are other opportunities to potentially develop non-GM forage and grain corn products for sale into the existing S&W channels and also SVG channels.

[You just recently signed a new licensing agreement in Eastern Europe and Russia, can you talk a bit about it?](#)

[DH] Sure. Eastern Europe, in particular Ukraine, and Russia as a group are the largest sunflower production areas in the world. Entering this market area is a significant opportunity for us with a very dynamic and well positioned seed company with significant distribution. The sunflower varieties are expected to be introduced into the marketplace for the 2017 production, providing us with a good presence in a very large market.

[What trends are taking place within sorghum and sunflower that will expand those markets in the future?](#)

[DH] In sunflowers, in the Eastern Europe, Ukraine, and Russia area, there's a trend toward herbicide tolerance and genetic resistance to overcome a very serious threat from a parasitic plant called Orobanche. SV Genetics has developed sunflower hybrids that contain natural resistance to the Imidazilone herbicide, which can be used to control that parasite. We also have some genetic resistance to Orobanche in our breeding programs. Additionally,

there's a trend to producing sunflower hybrids that have a higher level of oleic acid than traditional varieties. SV Genetics has developed hybrids with this high oleic trait. And these products are lower in polyunsaturated fats, which makes them less likely to become rancid, makes them more stable in higher cooking temperatures and low in the omega-6 fat.

In sorghum, water use efficiency is becoming a very significant issue in agricultural markets around the world. Fortunately, sorghum has a high level of heat and drought tolerance and this makes it well-suited to expand into these areas where water is becoming limited. For example, in the Texas Panhandle there's a significant move away from corn production to sorghum production as water supplies for irrigation become limited in that area.

#### What does the patent profile for the new acquisition look like?

[AS] SV Genetics is not focusing on patentable traits. We believe it could patent its genetics in the US system but not in the rest of the world. We feel that our excellent producibility of its parents in the hybrid production process will continue to differentiate SVG in many ways. This focus alone should offer collaborators a significant market advantage by developing products that perform well in the farmers field and in the seed production phase. Hybrid seed that can be produced at less cost than its competitors is essential in improving net margins and profitability.

#### What is your long-term growth strategy within sorghum and sunflower?

[MG] We're focusing our considerable efforts to pursue additional new opportunities in the North and South America, and Middle East / North Africa markets in grain sorghum, as well as increased emphasis on Sunflower in Europe. We'll look to extend our growth into these regions with significant crop rotation capabilities and more of a one-stop shop distribution unit operation. We feel it's a very positive move.

#### What are the main challenges to entering a new market opportunity?

[MG] There are several. First, Phytosanitary restrictions are becoming increasingly difficult, as some countries appear to use these restrictions as non-tariff barriers. There have been recent efforts at the International Seed Trade level to work towards harmonization of some of these protocols, but these will not solve the problem. SV Genetics has established breeding and seed production activity in Europe and South America to offset, in part, some of these constraints.

The time that it takes from initial product testing to royalty flow is also a challenge. This typically takes up to five years – two years of testing, two years to commercial scale production, and royalty streams commencing after sales in year five. However, SV Genetics has several Licensing Agreements that are now at the Commercial scale production level, and an ongoing supply of products in the product pipeline for Licensees which should somewhat mitigate this impact moving forward.

Finding suitable Licensees who wish to embrace a partnership philosophy can also be a challenge. As SV Genetics has no control over the sales performance of its Licensees, it has been important to identify Licensees who have integrity, enthusiasm and a willingness to aggressively promote the sale of SV Genetics hybrids. This process takes time, but several of SV Genetics Licensees are considered to be true partners with strategic value to SV Genetics.

#### Talk about how you are able to leverage your existing infrastructure to expand the newly acquired operations?

[DJ] These operations will fold into the existing infrastructure at SGI.

#### Where are the current operations located?

[DJ] The administration, marketing and production functions of SVG are based in Queensland, Australia.

The research activities for sorghum and sub-tropical sunflower are also based in Queensland, Australia while the temperate sunflower program is located in Hungary in Central Europe.

#### What does hybrid mean in reference to the sorghum and sunflower varieties?

[AS] A hybrid is a product that is produced by crossing two or more genetically distinct parental lines. In both sorghum and sunflower, a cytoplasmic sterile female line is crossed with a fertile restorer or male parent to produce the vigorous F1 hybrid.

#### What is the difference between grain and forage sorghum?

[DH] A grain sorghum is a variety that is grown for the purpose of harvesting the grain. That grain can be used for livestock feed, human consumption and even alcohol production. The color of that grain can either be red or white in color. And the red can vary in color from dark red to browns to light tan. A forage sorghum is generally cut before the grain matures, and is used for feeding animals. It can be either grazed, cut for green feed or used in various silage style applications. Forage sorghum is bred for high green matter production. It can also be used for methane production in the biogas industry.

**“Because this is a royalty based model, the gross margins are comparatively high.”**

Over the last few months, there has been a tremendous amount of M&A activity, from FGI's acquisition of two alfalfa seed traits from Monsanto, to the much larger potential consolidations. Can you discuss what you see taking place and where the opportunity is for S&W to benefit going forward?

[MG] It's not new for seed companies to purchase traits or to consolidate and leverage experts to focus in specific crop markets. Outsourcing is done when one can do it better and/or for less cost, saving each party the time and money involved in the process by reducing the costs of companies working on the same trait.

The ability to work with the experts to outsource R&D for specific trait development for specific crops also reduces costs for everyone involved and accelerates development of product lines which result in improved yield, quality and protein that will feed the increased population. S&W with its large grower and distribution networks is expected to benefit from these continued consolidations, collaborations, joint ventures, and various relationships. Improved R&D strategies will result from these types of combinations. By increasing our global footprint and expanding the agronomic crop benefits of our strategic traits that our developed by our breeders, we expect this will also provide the ability to grow crops around the world in poor environmental conditions whether due to a weather event or from soil and water issues. And this should also enhance and improve these conditions by growing these crops through reclamation with proper variety selection and enhanced agronomic management and technologies. The bottom line is that long-term soils and water table improvements that should allow future generations the ability to feed the world.

In addition to that, just recently FGI purchased two traits from Monsanto. I think this provides some validation in the market on how alfalfa is looked at and the long-term potential that alfalfa can bring and the macro-trends there are in the protein play in the global market today. These M&A activities with the large Ag consolidators should result in a lot of exciting opportunities for a lot of people including S&W when we look at the potential of maybe spinning things off or adding additional core product lines. It's a pretty exciting time for us.

How many employees will S&W take on from the acquisition and what sort of additional staffing requirements might you need?

[MG] To start with S&W is not taking on any employees. Dave and Alan, two of the three SV Genetic Directors are expected to remain on contract. They're going to be involved in the business as well as helping us with our current businesses as consultants and they're going to ensure that the proper transition of the business as we go forward into future years.

It is planned to appoint a Plant Breeder and Technician in 2016 and Alan is already working into that area. Additional staff will follow on an as needs basis. And being a royalty-based business, it is envisaged that the headcount will be extremely low, but will eventually require a Seed Production Coordinator and a Commercial Manager.

One of the really attractive opportunities that we're going to be able to put into place is that some of the really high level foundation breeder seed-type cleaning will be done at our new Keith facility and some of the things that Dave and Alan had to do in Queensland will be transferred over to our South Australian operation. This should bode well for our specialty crop division and the new facility.

Why hasn't S&W pursued developing a hybrid alfalfa?

[DG] The short answer is the amount of hybrid vigor exhibited by alfalfa make the pursuit of hybrid alfalfa unattractive from a business perspective.

What are the challenges with developing and producing hybrid alfalfa?

[DG] The genetics of alfalfa is more complicated than sunflower or Sorghum. Its genes reside in a state known as polyploidy, which makes it impossible to create inbred lines. Without these distinct inbred lines, pure hybrid cultivars cannot be obtained and the amount of hybrid vigor is less than other crop species.

Additionally, pollination in alfalfa is difficult compared to other species. Pollination in hybrid crops requires movement of the pollen from the male to the female parents in a hybrid seed production field. In alfalfa pollination is not efficient in a conventional variety and a hybrid alfalfa becomes exceedingly difficult to achieve efficient pollination.

Finally, a breeding program must exhibit continuous genetic gain to remain competitive. S&W has developed a breeding system we feel is the most effective in the industry and will allow us continued growth in market share.

Do you anticipate that this will be accretive during fiscal 2017, beyond?

[MS] We're estimating that this acquisition will be neutral to EPS for Fiscal Year 17 but we certainly expect it be accretive thereafter.

There is an earn-out associated with the acquisition, can you go into more details?

[MS] There is an earn-out that is based on the performance of the acquired business in fiscal years ended June 30, 2018 and 2019. The earn-out is based on a calculation where, if the net income target is 100% achieved then the sellers will receive additional consideration of \$2.2 million which is payable in cash or stock at S&W's sole discretion. Should the business do less than 60% of the net income target no earn-out is payable. If it's between 60% and 150% of the target, the earn-out is proportionately payable up to \$3.3 million which is the upper limit.

Now please note that the net income target for '18 and '19 combined is \$4.2 million. So, any additional earn-out compensation would be in essence self-funded by the actual earnings of the business at the time of payment.

I want to point out that we believe that the purchase price of this deal is attractively priced. If future performance triggers earn-out

payments, it brings the purchase price multiple down to less than 2x 2018/2019 EBITDA. For a point of reference, our historical deals with Imperial Valley Seeds, Seed Genetics International and our most recent acquisition in December of '14 with Pioneer, those deals were priced in the mid-single digits from an EBITDA perspective so we believe this deal is priced fairly based on 2017 numbers and becomes a bargain deal if the business comes close to the income thresholds required for an earn-out payment.

#### What does the margin profile look like for the business?

[MS] This is new for us. Because this is a royalty based model, the gross margins are comparatively high. In future years, we are expecting gross margins from the acquired business to be in the 85% to 90% range. And probably more importantly, our EBITDA or Operating Margins are expected to be in the 55% to 60% range within the next 2 years. Which we're really excited about.

#### How does the licensing model work and how does that differ from your existing business?

[MS] With the acquisition of SV Genetics, this is our first entrance into the high margin royalty model. Royalties are collected after harvest from seed production or sale, and this ultimately should create a stronger revenue stream for us.

#### Why did the owners of SVG decide to sell at this time?

[MG] I do think Dave and Alan saw an opportunity and advantage with our young public company and its movements into these types of crops and the fit with S&W. I think that they saw an opportunity to leverage off that with the resources. I think they also saw the potential to grow this business in a lot of different core areas. I think it was a win-win for everybody.

I'll ask Dave and Alan if they have any comments on why they wanted to join us.

[DH] I think from where both of us sit we do see a tremendous fit with S&W in terms of both complimentary products and complimentary distribution. And we can just say that we are extremely excited about this moving forward and looking forward to working with the team.



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