



S&W Seed Company
(NASDAQ: SANW)



Second Quarter Fiscal Year 2019
Financial Results Conference Call

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CORPORATE PARTICIPANTS

Mark Wong – President and Chief Executive Officer, S&W Seed Company
Matthew Szot – Chief Financial Officer, S&W Seed Company
Robert Blum – Managing Partner, Lytham Partners, LLC

PRESENTATION

Operator

Good morning and welcome to the S&W Seed Company Reports Second Quarter Fiscal Year 2019 Financial Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*), then one (1) on your telephone keypad. To withdraw your question, please press star (*), then two (2). Please note this event is being recorded.

I would now like to turn the conference over to Robert Blum with Lytham Partners. Please go ahead.

Robert Blum

Thank you so much and thank all of you for joining us today to discuss the financial results for S&W Seed Company for the second quarter of fiscal year end 2019 ended December 31, 2018. With us on the call representing the company today are Mark Wong, President and Chief Executive Officer; and Matthew Szot, Chief Financial Officer. At the conclusion of today's prepared remarks, we will open the call for a question-and-answer session.

Before we begin with prepared remarks, we submit for the record the following statement. Statements made by the Management team of S&W Seed Company during the course of this conference call may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 as amended and Section 21E of the Securities and Exchange Act of 1934 as amended and such forward-looking statements are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements describe future expectations, plans, results, or strategies and are generally preceded by words such as "may", "future", "plan" or "planned", "will" or "should", "expected", "anticipates", "draft", "eventually", or "projected." Listeners are cautioned that such statements are subject to a multitude of risks and uncertainties that could cause future

circumstances, events, or results to differ materially from those projected in the forward-looking statements, including the risk that actual results may differ materially from those projected in the forward looking statements as a result of various factors and other risks identified in the company's 10-K for the fiscal year ended June 30, 2018, and other filings made by the company with the Securities and Exchange Commission.

With that said, let me turn the call over to Mark Wang, Chief Executive Officer for S&W Seed Company. Mark?

Mark Wang

Thank you, Robert, and good morning to everyone on the call today. I'd like to cover four points. First, talk a little bit about the Chromatin integration, since it's been 100 days exactly almost, since we closed the transaction on October 25th. And then discuss the sort of sales picture as I see it right now for this year, although Matt's going to give most of the details on the numbers. I'd like to talk a little bit about the major traits that we're pursuing in alfalfa and sorghum, and then finish with a short discussion on and an update on our stevia progress.

So, we closed the Chromatin acquisition on October 25th, which was the Thursday. We had our new organization ready to go that Sunday night. It's always a difficult task to buy a company that is in trouble out of a bankruptcy, which is what we did when we purchased Chromatin. The situation was not a healthy one for Chromatin, unfortunately. They had lost roughly \$30 million, \$33 million in the previous, each of the two previous financial years, so about \$60 million, \$65 million in total. So, when we went into evaluate the acquisition, we had to do the normal things that a company does when they're looking at acquiring assets, but we also realized that these were assets that were under some pressure. The performance of the company had not been good and there had been huge losses.

So, we had to do the normal sort of evaluation of Chromatin's assets. How valuable were they? How would they perform under our management? What kind of price could we bid to have sort of mid-teens returns, which is our—always our target and we feel are achievable in the middle-market seed industry.

But, then we had a second issue, which was these huge losses. Like I said, almost \$60 million, \$65 million over the last couple of years, and we had to make sure that we were not in a situation where there was really a huge deduction from our potential returns based on hidden losses that we would have to fund, once the company was integrated into S&W. So, just to give you a little color on that, Chromatin at its peak had about 140 employees, I believe. When we looked at the company, they've had—they had a couple of layoffs and they had maybe 80-to-85 people. We acquired with the company about 60 of those 80 to 85 people and importantly, we were able obviously, because we were adding the company to an existing seed biotech company, we were able to cut a lot of the most expensive employees, because we had management in place that we could integrate the Chromatin assets into S&W and effectively move forward as one company.

So, the strategy from day one was to run the company as one company. So, as I said, on October 25th we made the acquisition. On that Sunday night, I think, which was the 28th, we announced our new organization. We reorganized, focused on markets, which we thought was a much more efficient way to develop the assets of the now S&W Chromatin merger. We appointed two new Executive Vice Presidents to run the operations. We organized along the lines of Americas being North America, South



America, Central America, put that business under the care of a new guy to the company, Don Panter, long history in the seed industry. I've actually worked with Don in the past and have all the confidence that he can deliver the kind of results that we require and that he is very good at these kind of integration issues. And, then we had another gentleman, David Callachor, who had come to us at that point in time, maybe five months before, from Limagrain and we promoted him also to Executive Vice President and put him in charge of all of our international operations all around the world that were outside of the Americas.

With that change, we saw some real efficiencies in the company. We now, as I said, 100 days kind of after the acquisition on October 25th, feel confident that the estimates that we had made when we closed the company in terms of expenses and rough sales numbers of sorghum worldwide from the acquisition of around \$14 million to \$15 million for the 2019 fiscal year for S&W are still our best estimates of what our performance is going to be for 2019. We were very efficient in that all of the Chromatin employees on that Monday were transferred over to, for instance, S&W e-mail addresses. And, you know, we went forward as one company from that point on. So, the roughly 60 people that were part of the Chromatin acquisition plus roughly the 75 people that we had at the time at S&W equal about 135 or 140 people that we have at the company today.

I'd like to just remind all of the people on the call, you know, what we thought were the biggest assets of the acquisition. So, I've talked about now for all--for the year, for the six quarters that I've been CEO and President of S&W that we needed to be closer to the customer, the farmer customer. So, we were very pleased when we started to look at Chromatin that it, as a company, came with a farmer-dealer network, which had been part of the old Syngenta acquisition that Chromatin made of Sorghum Partners. And, so we've been working hard at evaluating that farmer-dealer network in the 100 days that we've owned it now and looking at how to strengthen it, reorganize it, make it more efficient. And, we've done some obvious things, the low-hanging fruit. For instance, we're coming up in the North American market to the spring 2019 planting, and so we have added alfalfa to the traditional sorghum product line that's been offered to our farmer-dealers. And, so now for the spring selling season, our sales reps will be selling to the farmer-dealers alfalfa plus sorghum. Our sales reps are in the process of educating our farmer-dealers as to what kind of alfalfa varieties we have and the performance of those in the field, and hopefully we'll have some orders from those same farmer-dealers that have been traditionally sorghum farmer-dealers for Chromatin.

In addition, the International distribution customers, distributors that we acquired with the Chromatin acquisition, we have a lot of hope for in the future. The sales number is, for 2019 and going forward is pretty much split almost equally between the Americas and the rest of the world, the International market areas for now S&W, because we only call ourselves by one name. We don't sell the Chromatin--any Chromatin brands except for Sorghum Partners. And we're very excited about the opportunities in Asia. We have an Asia sort of sales director that was previously the Chromatin Asia sales director. We are looking for a person as the sales director for Europe, who will also have some responsibility for our sunflower business in Eastern Europe, where we have a reasonably large breeding program in sunflower. That's of course where most of the worldwide acres are, so it's a good place to do breeding in the sort of home market of your customers.

We have our traditional S&W director of sales for the MENA area and we're starting to concentrate heavily on our second home market, which is Australia. We think Australia offers some production



advantages but also logistical advantages in selling to the growing markets in Asia. And so we are now currently looking at putting a bigger footprint down in Australia. We're looking at a couple of acquisitions, and that's all part and parcel of moving the company forward. But, we're very excited about the International distribution channels that were part of the acquisition when we acquired Chromatin.

On the production side, we had got a couple of production plants and of course some very experienced production employees and a grower network that have been growing both the grain sorghum and the forage sorghums for Chromatin and now will be going those same crops for S&W. We were very pleased with the crop release that Chromatin had put in the ground. So, remember that they were the ones who decided what to plant in the spring of 2018, which we have just now finished the harvest of in the fall of 2018, are in the process of cleaning all that seed. So, we were very pleased with the variety and hybrid selection that the Chromatin management had made. It was a smaller crop than they had grown in the past for lots of reasons, one of which was they didn't have a lot of money to pay growers. And, we think that inventory, which is now being cleaned and is in our, the ex-Chromatin plants, which are now our plants, looks of high quality and it looks like it's in the right varieties and hybrids to sell to the market, and we think we'll pretty much sell out of all the sorghum and sorghum-Sudan material inventory that we have coming in. And, in fact, we were able to raise prices little bit both on grain sorghum and sorghum-Sudan because we thought our demand was actually more than the crop we actually were harvesting.

So, all of that was very, very positive. One of the most valuable assets that we acquired with the Chromatin acquisition was of course their R&D effort. They had three breeders, they had a bunch of biotech sort of molecular biology people working in sorghum. They have developed one of the traits, I'll just mention now but will be in the third section when I talk about traits. But, they're working on herbicide resistance in sorghum, which we think could be a very valuable trait.

So just to reiterate quickly, the assets that we think were the most valuable. The farmer-dealer network at Chromatin, the International sales channels, the production plants, and farmer-grower network, and the R&D research that was being done on sorghums--grain sorghum in Texas by Chromatin, which is now our--which are now our programs.

So, we're very, very pleased with the acquisition. We're very pleased with the reception that we've received from the Chromatin employees. I have to say the integration has gone reasonably seamlessly. We have, I think, good morale within the company, whether the employees were part of S&W previously or were, came to us through the Chromatin acquisition. So, both sides of I think the aisle are clapping together. We are very pleased with the reception that we've received by all the employees that were Chromatin employees, and we're firing at least on six of our eight cylinders. And we're very, very happy with the performance and the morale of all of the people, both the S&W and Chromatin employees.

So, a lot of times--so one of the things to remember is we had to make these very quick organizational changes because we were afraid of those giant losses that Chromatin had incurred. So, when we say \$14 million to \$15 million in sales coming from Chromatin in this partial fiscal year of 2019 and that we're going to be EBITDA breakeven, you know, remember that those assets lost \$30 million the year before. So, EBITDA breakeven might not be a heroic event to some people, but frankly, to the S&W



employees, whether they came from Chromatin or they were part of S&W, it's a heroic event. I mean, the fact that we think our numbers are still good, when we did the due diligence we had hugely redacted documents. A lot of the times we were just guessing as to what the results and the efficiency of some of the assets and effectiveness of the assets were. We had for three months eight to 10 people, mostly our senior people, and we're not a big company, so that was a huge commitment on our part to looking at the data room, talking to the Chromatin employees, working through the investment bank that did a good job at sort of funneling us the information, not telling us everything. That's what investment banks do and--but we got through all that and we came out with a really, I think, accurate estimate of what our sales are going to be and good cost control so that we don't have these hidden losses that were going to lower our return on investment on these assets. So, if I sound very optimistic and pleased at this point it's because I am. It could have not been this good, and I'm really happy that things are coming out the way they are. And, my thanks to all of the S&W employees and all of the Chromatin employees who are now part of S&W, because you all have done a heck of a job and your CEO is very appreciative.

So, let me just stop there a second and say to you that we're a company that believes in continuous improvement. And, so you might sit back and say, gee, we've got a new organization and we've got a focus on two market opportunities, the Americas and International. Things are going pretty well. We're going to take a little time off. But, you know, that's not the kind of company we are. And, we think it's a difficult task. We think there's opportunity, but we think it's a difficult task to make a profitable, growing company in the middle market biotech seed biotechnology business. That's from my experience of 40 years and having done it three times before. You know, it's not an easy thing to do.

So, we are now on our second set of issues that we think need attention. And, so I'll just recount three of those for you, because I think it's important for the public, since we're a public company, to understand the kind of things we're doing. So, one thing that we're doing is looking at our IT support and efficiency of our IT system. We are in the process with a consultant of evaluating all of our IT requirements, their capabilities--what capabilities we have now against what we see as the needs for our company in the next five years. We do plan on making some other acquisitions, so it's very important that we have a system that can absorb more sales, more operations around the world, more employees, and provide information that is accurate, consolidated or not. Whenever we want the information, we want to be able to break information down into the various pieces to make better decisions. And so, we're working on that project now, and over the quarters I'll give you some updates on sort of how we're doing on that. Right now we're just at the beginning. As I said, it's 100 days since we closed, but these are clearly issues in our organization that need attention and we are paying attention to them.

The second thing we're doing is making sure that our production, which is really worldwide production in alfalfa but not so much worldwide production yet in sorghum, most of our sorghum's produced in Texas, but that we are efficient in where we produce, where we clean the seed and ship the seed from, you know, from the basis of providing our customers with the best service and the lowest freight cost. So, we're working on a project to look at all of our crops and to make sure that the new organization has communication between the Americas and International so that we don't drop the ball on shipments and production schedules and the like of those kind of things.



The third thing that we are doing, and these are just the most important, obviously, there's a lots of smaller things we're doing, is we are making sure all of the R&D is coordinated. So, sometimes this is a more difficult task than other times. In the case of alfalfa, most of our alfalfa breeding is done in the US. A small amount is done in Australia, but most is done in the US, so that is not as difficult as maybe sorghum, where we have a fairly large breeding commitment in Australia. And, also with the Chromatin acquisition, we have the majority of our breeding effort and molecular biology effort in Lubbock, Texas, in the US. So, we just want to make sure those programs are talking to each other, that we're not doing the same things twice, that simple things, like having the same molecular marker map for our sorghum selections is what we're doing. And, there's just a lot of sort of blocking and tackling on the sorghum side, which is our most complicated crop in terms of the potential overlaps in breeding.

Sunflower is more like alfalfa. It's almost, for us, the majority of the breeding is being done in Eastern Europe. But Australia, again, has a sunflower breeding program, and we want to make sure that those are aligned and coordinated and are helping each other in the sunflower side. Stevia is mostly a US crop, but we've made some changes there. We now believe from our trials we've put out that stevia is going to do a lot better in a more humid growing environment than maybe the San Joaquin Valley, although, we're still doing trials in the San Joaquin. So, most of our new trials in stevia is on the East Coast, in North Carolina specifically, but we've also had some trials in some of the other Southern states.

So we're on to kind of--once we focused the new organization on the two geographic groups, the Americas and International, we're now working on the issues that we see as coordination issues between the Americas and International groups. And, we will continue to do that and continue to provide you on the call with updates on our progress on those. So, that's what I wanted to say about the integration. And again, I'm very pleased with how it's going. And again, my thanks to all of our employees for their huge effort. It doesn't seem like 100 days. It seems like we've been doing this for a long time, but it has only been a 100 days and we have made significant progress in making sure that we are doing all the things that good seed companies do--make our sales, clean our crops, do our research, keep track of it all, and bill our customers, and make good planning of our business going forward.

And so, point number two, the sort of sales picture. As I said, we're comfortable now that, at least the Chromatin sorghum sales we think are going to come in that \$14 million to \$15 million range. Matt's going to talk a little bit about the specific numbers, but we're seeing some, finally some improvement in the MENA alfalfa markets, and we're pretty optimistic that finally we're going to get some of the lost sales back in that region. But again, Matt will have some details on that.

My third point was just to talk a little bit about trait development. I think you remember that we look at lots of different traits, but we want to now--because we have a broader crop focus, we want to rank both in terms of opportunity and risk all of the different traits we're working on in the different crops against each other. You'll be hearing more about that in the future, but in alfalfa, we continue to work on the digestibility trait that we have been working on for the last couple of years. We've got materials from Calyxt now and they're in the field. We're doing selection work on those. And, I mentioned that on the Chromatin side, in grain sorghum we're working on herbicide resistance. We have materials again that we're evaluating in the field in Texas to look at the strength of our herbicide resistance and make sure that we have products that will be acceptable to the market in terms of the resistance to these different herbicides.



The fourth thing I wanted to just talk about is the stevia program in a little bit more detail. So, we put some trials out last year. We made some decisions about where stevia production on a per-acre basis, where our leaf yields, because remember we're in leaf business, we're not selling seed in stevia. We're selling leaf to the processor—the processors and the food companies that will use it in their products. So, we are in the process of putting in a six-line trial, I'll call it. So, we've picked our best stevia lines from the criteria of taste, because it's not how sweet the stevia is, it's plenty sweet. It's 200 to 300 times sweeter than sugar. It's, you know, that it has the right taste profile for whatever the customers' products are.

So, we are doing a six-line trial bulking up enough material, growing that in the fields and planting in the spring. As you remember in stevia, you have to plant clones. You can't plant seeds. So, you make cuttings off of mother plants and you multiply those and then you plant those in the field, and so we're in the process of doing all that. We've let a contract with a cloning company to help us with the cuttings. And, we are in the process of putting that trial in and our cooperator, which is our partner who is in the beverage business, is going to take those four different—excuse me, six different lines and take the stevia leaf that we get from each of them and evaluate them in several of their products. So, that's a big step forward. We actually have materials that are going to a real user and that user is going to evaluate them not on the basis of their yield in a field but on the basis of the taste and on the basis of making a real product that could be sold to consumers. So, that's a big step forward for the company, and you'll hear more about that as we move forward.

I'd just like to conclude and say, you know, there are a lot of moving parts, but that's on purpose. We have said many times that we need more shots on goal and that in agriculture, especially in the difficult market that we're in worldwide right now, you can't depend on everything being working well. Sometimes, the market tells you how things are going to go and it's not up to you. So, we need to have more shots on goal, which we're doing. But, we also need to control that growth, right? We cannot grow helter-skelter, so you will—in the next couple of quarters, we'll be working on a long-range plan as part of our 2020 budget cycle. So, that would be before July 1, when our 2020 fiscal year starts, and I will—once we complete that, I will be giving the market some of the conclusions of where we think that long-range plant study is telling us to go, what it's telling us to do in the different crops, in the different geographic markets in the world after we get that done. So, controlled growth but pushing growth is where we are. And then making sure that we're as an efficient a company as we can be, making sure our two new sales-oriented organizations, our groups are focused on the customers and then giving them the support that they need to get the job done.

So, again, a project in IT company-wide, a project looking at coordination of the R&D, and then a worldwide production evaluation to make sure that we're being as efficient as we can in our production and delivery of our products to the customers that will maximize our margins. So, that's what I wanted to say today.

We will be happy, Matt and I, to take some questions. But, right now I think I'll turn it over to you, Matt.

Matthew Szot

Thank you, Mark, and thanks to everyone on the call today. As we discussed last quarter, we adopted accounting standard ASC 606 on July 1, 2018, which impacts the timing of when we recognize revenue from our agreements with Pioneer but not the total amount recognized during our fiscal year. It's really



an acceleration, which shifted Pioneer revenues to the first half of our fiscal year. We have provided additional disclosures in our press release to further clarify the impact of ASC 606 so that there can be a better comparability of current financial results to prior fiscal periods. I will walk through this with additional detail and encourage you to ask questions if there is a need to further clarify.

On a reported basis, which includes the impact of 606, revenue for the second quarter was \$18.6 million compared to \$20.5 million in the second quarter of the prior year. Had we reported under the same accounting standards as last year, revenue would have been \$24.9 million in the second quarter of fiscal 2019. As we mentioned in our press release, we recognized approximately \$1.5 million in revenue from the two-month contribution of Chromatin during Q2. If we exclude the impact of the accounting standard change as well as the contribution from Chromatin and look at our business on an organic basis, revenue would have been \$23.4 million for the second quarter, or a 14% organic improvement from the second quarter of the prior year. Taking this a step further, if you exclude the revenue to Pioneer and the recent acquisition and look to the remainder of the business, revenues would have been \$7.4 million in Q2, a more than 40% increase over the second quarter of the prior year.

Now, as we look to the first half of the year, we experienced growth as well. On a reported basis, which includes the impact of 606, revenue for the first half was \$44.7 million compared to \$31.2 million for the first half of the prior year. Had we reported under the same accounting standards as last year, revenue for the first half of fiscal '19 would have been \$33.7 million. Again, when you exclude the impact from the accounting change--accounting standard change as well as the impact of the Chromatin acquisition, we grew revenue on an organic basis by 3% for the first half of the year.

A couple points I want to make is as we look to the remainder of the year. On an annual basis, as we discussed over the last couple of conference calls, we expect revenue to Pioneer to be approximately \$31 million, which is down approximately \$8 million from 2018. Conversely, we're anticipating organic growth, excluding Chromatin, of upwards of \$8 million related to other aspects of our business, which should largely offset the decrease we are experiencing with the Pioneer contract. So, to place a finer point on this, as it relates to the portion of our operations where we have the most direct influence from a sales perspective, in other words, the non-Pioneer portion of our business, we are anticipating a 30%-plus increase in revenue in 2019. This improvement is primarily coming from a partial rebound in the MENA region and growth in our hybrid business in Australia.

As we discussed during our conference call in November, we closed on our Chromatin acquisition on October 25th, and therefore, we will have approximately eight months of financial activity in the fiscal year 2019 from this acquisition. As Mark mentioned, we expect the newly acquired business to generate approximately \$14 million to \$15 million in revenue in 2019 and \$17 million to \$20 million of revenue in fiscal 2020.

Now turning to gross margins. Gross margins during the second quarter of 2019 were 25.2% compared to 22.8% in the prior year. Gross margins during the first half of the year were 22.7% compared to 22.4% in the first half of the prior year. The increase in gross profit margins was primarily due to product sales mix during the current periods, where we had a higher concentration of higher margin products, including hybrids and dormant alfalfa seed.

We talked about this last quarter, but as a reminder, we estimate that gross margins of our organic business, excluding any impact from the Chromatin acquisition, will slightly decrease from 2018 due to



the anticipated sales mix and less revenue during 2019 will come from our Pioneer business. And, once again as a reminder, we expect gross margins from our sorghum operation, the recently acquired sorghum operation, will be higher than our historical operations. We currently estimate that the new newly acquired operations to generate margins ranging from 30% to 40%, depending on specific sorghum hybrid.

Adjusted operating expenses were \$6.2 million in the second quarter of 2019 compared to \$4.2 million in the second quarter of the prior year. As we mentioned in our press release, during the second quarter, we incurred \$587,000 of transaction expenses related to our acquisition. The increase in operating expenses for the second quarter of '19 is primarily related to the acquisition of Chromatin coupled with additional investments in sales and marketing and product development. Now, we went through some of this data last quarter, but we'd like to clarify that including the Chromatin operation, we expect the following: SG&A to be approximately \$15.1 million for fiscal '19 and \$15.3 million in 2020, and this excludes transaction costs but is inclusive of stock-based compensation; research and development expenses will be approximately \$6.3 million in 2019 and \$7.1 million in 2020; and depreciation and amortization will be approximately \$4.4 million in 2019 and \$5.1 million in 2020. Adjusted EBITDA for the second quarter of 2019 was a \$241,000 loss compared to \$1.6 million of positive EBITDA in the second quarter of the prior year. The decrease in adjusted EBITDA is largely due to the timing of revenue recognition. Adjusted EBITDA for the first half of 2019 was \$1.9 million compared to \$617,000 in the first half of the prior year. A complete reconciliation is available in the press release. As we discussed last quarter, we expect positive adjusted EBITDA contribution in 2020 from the Chromatin operations with minimal impact to adjusted EBITDA in 2019.

Now, moving to the balance sheet. On an inventory front, we are making measured progress in better aligning our seed inventory balances with our sales demand. As we've discussed over the last several quarters, we are carrying higher levels of inventory this year. We planted very few new acres for crop year 2019. Accordingly, the production volumes from the upcoming harvest will continue to decrease and we expect our inventory balances to further decrease over the next 12-to-18 months. As the inventory levels come down, this will translate to significant improvements in operating cash flows.

A couple of other items I want to point out. First, in December of 2018 we expanded the size of our working capital facility with KeyBanc to \$45 million and extended the maturity date to December 2020. We did this to support the future growth initiatives, including our acquisition of Chromatin, and are very pleased with the additional flexibility this provides us. Second, those that have had an opportunity to review the balance sheet will notice that there is a line item titled Assets Held for Sale. As we continue to integrate the Chromatin assets, we have identified additional synergies and efficiencies. To this point, we've recently sold \$400,000 of excess equipment that came along with the Chromatin acquisition. In addition, we have listed at sale a storage facility in Plainview, Texas, which was also included in the acquired assets. The Plainview facility is carried on our balance sheet for approximately \$1.9 million. In addition, while we have not officially listed this property for sale yet, we're also anticipating consolidating our R&D facility in Arlington, Wisconsin into the Nampa, Idaho facility to drive further efficiencies.

I know we went a bit longer here than normal due to financial section, due to the changes in the accounting standards as well as the recent acquisition, but we want to make sure everyone has a clear understanding. As Mark discussed and I highlighted, we are very pleased with the results that have



occurred due to the strategic initiatives put forth over the past year. We are showing a partial recovery in MENA and organic growth in the segment of our business that we have the most control over and have expectations for organic growth to continue for the remainder of the year. We are layering in the Chromatin acquisition, which we will be--which we expect to be progressively accretive in the years to come, and we are focused on driving growth and efficiencies in all segments of our business.

Let me turn it back over to Mark.

Mark Wong

Thank you, Matt. Before we take questions, let me just conclude with a couple of points. So, we are very pleased with our new focused marketing organization, focused on markets. We think that the Americas and the European International focus are the right things to do for our growth. We are pleased with the value that we estimated and closed on in the Chromatin acquisition, and we think that will bring value to S&W for many years in the future. And lastly, we are creating a company that's not so dependent on alfalfa, but has alfalfa as one of its key products, but we want a more balanced product line in alfalfa, sorghum, sunflower, and stevia.

So with that, I'll conclude. And operator, we're happy to take questions now. Thank you very much, everyone.

QUESTIONS & ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. To ask a question, you may press star (*), then one (1) on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*), then two (2). At this time we will pause momentarily to assemble our roster.

The first question will come from Sarkis Sherbetchyan with B. Riley FBR. Please go ahead.

Sarkis Sherbetchyan

Hi, morning, and thanks for taking my question here.

Mark Wong

Good morning, Sarkis.

Matthew Szot

Good morning.

Sarkis Sherbetchyan

So, thanks for the incremental color on the Chromatin acquisition. It seems like the integration is going well and you're still on plan to generate I think it was the \$14 million to \$15 million in top line for the balance of the year. And, you did mentioned the cost structure, it seems like it's in line with what you provided on the prior calls. I guess if you can just kind of step back and remind us, what would the cadence be of the incremental sales and also how do we think about layering in that cost structure you mentioned?



**Mark Wong**

Matt, do you want to take that?

Matthew Szot

Yes, Sarkis. So, thanks for that question. So, as we think about that \$15 million in revenues, incremental revenues that we're expecting from Chromatin, which would be sort of on the high-end of the guidance we gave, which we feel good about at this point. In Q2, we did about \$1.5 million, or 10% of that and I would say about \$4 million would happen in Q3, the quarter ended March; with the remaining say \$10 million or so coming in the fourth quarter. I think that sort of cadence is a pretty good indication what FY20 would look like as well.

Sarkis Sherbetchyan

Understood. So, it's more weighted towards 4Q, the sales?

Matthew Szot

Yes, the third and fourth quarter are definitely the sales quarters where most of the sales are concentrated.

Sarkis Sherbetchyan

That's helpful. And, then with respect to the cost structure as you layer that into your existing business or the P&L, if you will. Is the cost structure pretty similar, kind of call it quarter-in quarter-out, or are there any kind of material variances?

Matthew Szot

I would say that the operating costs would be incurred relatively evenly throughout each of the fourth quarters, Sarkis.

Sarkis Sherbetchyan

Great. That's helpful. And, then I think as you kind of look to the book of business that you have from the asset. I think you mentioned a pretty wide range, you know, call it 30% to 40% gross margin. Any indication on where you stand today? Is it kind of in the mid-point, is it towards the low end? Just kind of give us a reference point, if you will?

Matthew Szot

Well, as we're working through the first year sales orders, we want to be cautious. We're certainly expecting that over time this program should be generating 40% gross margins. But, I think in this first year to err on the side of caution, we'd probably in the lower end, sort of in the low-30% range.

Sarkis Sherbetchyan

Got it. And, if I take that in the context of having, call it the DuPont Pioneer sale kind of out of the way in the first half of your fiscal year and as we kind of look towards the back half, how do we think about the consolidated gross margin? I mean, is it—the first half looks stronger than the back half. Just kind of help us frame that please?

Matthew Szot

Yes, I think, Sarkis, as we look to the sort of full-year results, we're expecting margins to be in that 23%, 24% range. Certainly, as we're going to continue to generate some revenues from Pioneer in Q3, those are higher margin sales. And, as the hybrids season kicks in here over Q3 and Q4, that, those will certainly be incremental and help us expand our gross margins in the second half of the year. Mark, do you want to add anything to that?

Mark Wong

No, I think that's a good summary, Matt.

Sarkis Sherbetchyan

Thanks. And, I know you mentioned a little bit of recovery that you're seeing in MENA. Can you maybe talk about from the organic growth of, I think, you said \$8 million or so for the fiscal year, how much of that are you attributing to MENA and some of the softer spots we've seen versus some of the other programs?

Matthew Szot

So, Sarkis, of that \$8 million of what we would call some Saudi sales starting to come back, again, if you recall, Saudi used to represent about \$30 million worth of revenues for us. So, by no means are we at the stage were we think we are coming back to recovering anywhere close to that level of sales, but we are--of that \$8 million improvement over our existing business, excluding Pioneer and Chromatin, it's primarily coming from Saudi as well as Sudan. Sudan is a growth opportunity for us, but as you can imagine, that market also has certain geopolitical risks and certain customers have issues with accessing US dollars. So, while we're optimistic about what can be done in Sudan, we are also cautious.

Sarkis Sherbetchyan

Thanks for that. I'll hop back in the queue.

Operator

Once again as a reminder, if you would like to ask a question please press star (*), then one (1).

The next question comes from Soraya Benitez with Cougar Capital. Please go ahead.

Soraya Benitez

That's a nice interpretation. Hi, It's Soraya Benitez from Cougar Capital. Thanks for the color. Just a quick question on the inventory build. You know, looking here at your balance sheet, is that tied to the Chromatin sorghum assets? And, sort of if you could just walk through working capital for the year? You talked about sort of a low planting season for 2018, but how should we sort of see that move throughout the year?

Matthew Szot

Yes, sure. So, yes, the December inventory balances certainly include the Chromatin inventory balances, so when we think about our balances compared to December of '17 or the same time last year, that is certainly driving an increase. But, as we've talked about for the last several quarters, we are carrying higher levels of alfalfa and we're expecting those inventory balances to work down over the next 12 to 18 months. Our harvest that occurred in the fall of 2018 was down about \$20 million from the prior



year and the harvest, or the crop that's in the ground now that will be harvested in the fall of 2019, that harvest should be roughly half the size of the 2018 year crop. So, after that harvest, that will really be the pivotal amount, pivotal timeframe where we start seeing meaningful reductions and work-throughs in our inventory levels. And, as those inventory levels come down, we'll see meaningful improvements in our operating cash flows.

Soraya Benitez

Thank you.

Operator

Once again, if you would like to ask a question, please press star (*), then one (1). Ladies and gentlemen, this concludes our question-and-answer session.

I would like to turn the conference back over to Mark Wong for any closing remarks.

CONCLUSION

Mark Wong

Thank you, Chad. So, I'd just like to thank everyone for listening to the call today. We went a little bit longer than normally we do on these calls, but we had a lot of information to convey and, as Matt and I both said, we're very optimistic now and through the second quarter that 2019 is going to be a very nice year for us.

We expect a good performance in terms of sales and control of expenses, but it's really a growth year, right? We're visiting a lot of new customers, we're still hiring salespeople, and we are introducing those customers to all of the products that we have coming out of our research. So, thank you—thanks again for listening to the call today, and we appreciate everyone's interest in S&W Seeds. Bye-bye now.

Operator

And, thank you sir. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.

