



S&W Seed Company
(NASDAQ: SANW)



First Quarter Fiscal Year 2020 Financial Results
Conference Call

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11:00AM Eastern

CORPORATE PARTICIPANTS

Mark Wong – President and Chief Executive Officer, S&W Seed Company

Matthew Szot – Executive Vice President and Chief Financial Officer, S&W Seed Company

Robert Blum – Managing Partner, Lytham Partners, LLC

PRESENTATION

Operator

Good day, and welcome to the S&W Seed Company reports First Quarter Fiscal Year 2020 Financial Results Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the * key followed by 0. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press *, then 1 on your telephone keypad. To withdraw your question, please press *, then 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 first quarter of fiscal year 2020 ended September 30, 2019.

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'll open the call for a question-and-answer session.

Before I 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 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 risks 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, 2019, and other filings made by the company with the Securities and Exchange Commission.

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

Mark Wong

Thank you very much. Good morning, everybody. I think the first thing to say is just on our S&W announcement for this quarter, it says that Longmont, Colorado, is now our home for at least our Americas' business, and we have moved about 25 people here to Longmont, which is on the front range of Colorado, within easy commute of DIA International Airport and also much closer to our key customers in the western Corn Belt and in the central Corn Belt. So, we're happy to have that move behind us and all of our senior executives in the Americas group here with me in Longmont, Colorado.

And just on that same note, I'd like to continue to remind everybody just of a little history of what's happened in the last year, year and a half. As you remember, we purchased Chromatin in a bankruptcy, so we got it reasonably cheaply. That acquisition brought us much improved product line in grain sorghum and forage sorghum. It brought us some new technology in herbicide resistance in sorghum. It brought us a sales organization, although it needs a little bit of work, which we've been putting in. It brought us a sales organization that we did not have before, and along those lines, we had a brand that came with that acquisition called Sorghum Partners.

And we've now strengthened our U.S. operations to include Alfalfa Partners, which is our second brand in the alfalfa area. Most of our sales in the Americas were in an S&W brand before or directly through our contract with Pioneer, but now, we have our own brand in alfalfa, which matches our sorghum brand, and we're moving forward in the markets to make sure that people understand that these crops are our breeding crops and that we are basic in those industries. That means we do all of the R&D, all of the production, all of the sales and marketing, all the distribution.

So, we're very, very pleased by all of those programs. We've realigned our sales territories in the U.S. We filled in all of our sales reps, and at least so far, the comparison in our core business to last year, we're ahead significantly 36% over where we were last year. So, we're very optimistic, but remember that the first quarter is always a small quarter for sales for any feed company. It is kind of the winter quarter, fall quarter. Our U.S. programs for early-order discounts and those kind of shipping discounts starts in December. So, we should know more in the second quarter as to what our sales really start looking like, as we get into the real meat of the quarter, and we head towards planting times in April in the U.S.

We are continuing to sell off assets that we are not using in the core business. We sold about 1.8 million of extra plants in a breeding station, and we're pretty optimistic that things are going well in the Americas, as they are in our international business.

So on the international side, just a couple of details. There is a drought that continues in the northern part of Australia. We think, though, that in the southern part of Australia our sales for sorghum, especially grain sorghum, are very, very strong. What's happening in Australia is an economy where crops are raised as fodder and hay to feed animals, and when there's a drought in one part of the country, then the part of the country that has water needs to grow the fodder and hay to feed all the animals in the northern part of the country, which does not have water.

So, it's always that way in agriculture. Sometimes, one area's bad weather builds sales in another area. That's why it's so important to be an international company and to be diversified in crops, and so, we're seeing some benefits from that in our Australia business. Remember also that we bought the Dow wheat business last quarter, and that continues to look very, very promising. We're having field days to demonstrate two of the leading varieties that we got with that program, DS Bennett and DS Pascal, and we believe that we're going to start to see end point royalties come from the harvest season this year from Australia.

Sorghum sales have also been pretty good internationally, mainly in places like Pakistan and parts of Africa. We have two new varieties registered for trials there, and we're hopeful that we're going to start seeing some sales in the next few years from those materials that we've introduced in those markets.

And just a note, which you all know, that is kind of the status of our business in many markets. We have put in the time and the effort to get through breeding, to produce the seed at a reasonable cost, to introduce the seed now in these markets is kind of the growth pattern that we're on. So, lots of our crops and varieties and hybrids are being introduced in many, many markets around the world.

That also includes our sunflower business. Remember that Eastern Europe is our target market. In 2020, we have our first introductions there. A couple of varieties now have been released to Romania, Hungary, and Slovakia. So, we're looking forward to that also.

Alfalfa is still under some pressure. The pressures now again coming from the fact that there's more supply than there is demand. In this case now, European alfalfas are competing with us in the South American market and other places, so that is an issue to watch in the next couple of quarters. But our sorghum business, our forage sorghum business, and the beginnings of our sunflower business seem to be very, very strong.

So with that, I think I will give over the presentation to Matt, who will take you through some of the financial results of the company. Thank you very much.

Matthew Szot

Thank you, Mark, and thanks to everyone on the call today. As we discussed in detail last quarter, due to the Pioneer transaction, which accelerated revenues and cash flows into fiscal 2019, our year-over-year financial results are somewhat skewed and not comparable.



Now to provide greater transparency, we will now disclose core revenue as a metric track performance of our business on a go-forward basis. Core revenue is defined as revenue excluding product sales and license revenue to Pioneer. During the quarter, core revenue totaled 9.0 million, compared to 6.6 million in the first quarter of the prior year, an increase of 36%.

The 2.4 million increase in core revenue was driven by 1 million from alfalfa operations and sunflower operations coupled with 1.4 million from our sorghum operations, which we acquired in October of 2018. The year-over-year improvements were concentrated in Nina, Australia, and Mexico. Now given the trend of decreasing revenue from our organic operations during the last few years, we are pleased with the transition that we've made over the last two quarters to once again be driving growth in our core business.

Total revenue for the first quarter, which includes shipments to Pioneer, was 12.3 million. The decrease in total revenue versus the first quarter of the prior year was driven by a \$16 million decrease in product sales to Pioneer, partially offset by the organic growth I just mentioned.

We continue to reiterate our previously-issued guidance for fiscal 2020. Excluding any acquisitions, we are estimating core revenues of approximately 41 to 44 million, which would represent organic growth of 9% to 16%, compared to fiscal 2019. Including revenue contributions from Pioneer, we expect total revenue for fiscal 2020 to be in the range of 64 to 67 million.

Now turning to gross margins, total gross profit margins for the first quarter were 25.1%, compared to 20.9% in Q1 of the prior year. The increase in gross profit margins was realized across the board with improvements in all of our core crops, including alfalfa, sorghum, and sunflower. We believe this improvement in gross margin is a strong indicator of the initiatives we put in place to better showcase the value attributes of our proprietary high-growth and varieties. Now as we look to fiscal 2020, we are expecting gross margins of approximately 25% for the full year, as we continue to experience strong pricing in our proprietary sorghum and sunflower hybrids.

Adjusted operating expenses during the first quarter were 7 million, compared to 4.3 million in the first quarter of the prior year. The increase can be attributed to additional expenses from our newly-acquired sorghum operations and additional investments in our sales and marketing and R&D functions.

On the R&D front, consistent with what we've discussed over the last few quarters, we have increased our investment in our hybrid sorghum, and sunflower programs. We expect R&D spend for fiscal 2020 to increase, as we continue to invest in these growth programs. Given the recent events, we'd like to reiterate guidance for fiscal 2020 operating expenses.

So in summary, we expect SG&A to be approximately 19 million in fiscal 2020, which includes stock-based compensation of approximately 1 million. We expect R&D to be approximately 8.2 million, and we expect depreciation and amortization to be approximately 5 million for 2020. Again, this excludes any potential acquisitions we may enter into.

Adjusted EBITDA loss for the first quarter was 2.7 million, compared to 2.1 million of positive EBITDA in the first quarter of the prior year. As a reminder, the license agreement with Pioneer essentially accelerated the earnings and cash flows we otherwise would've released over the next five years. This



transaction and the acceleration of cash flows dramatically strengthened our balance sheet, but it also created a near-term disconnect between our operating infrastructure and our revenue base.

So, 2020 will no doubt be a year of investment and transition for us. We are expecting a return to positive EBITDA in fiscal 2021, simply from our organic operations, and if we complete the strategic acquisitions available to us and increase utilization of our existing platforms, we believe there is significant opportunity in the coming periods.

Now, a couple of quick items before I turn the call back over to Mark. At the end of the quarter, there was significant availability on our working capital lines. At quarter end, we had zero drawn on the US line and 10 million drawn on the Australian line. These lines of credit remain in place and should enable us to deploy capital for acquisitions, which will be accretive and drive further revenue and earnings growth.

And one last note, subsequent to the quarter end and as Mark briefly mentioned, we did sell two properties -- one in Arlington, Wisconsin, and another in Plainview, Texas. We received approximately 1.8 million from these two properties and used approximately 750,000 to pay down long-term debt with the remaining going into working capital. We're going to continue to focus on improving the efficiency of our operations and leverage the strength of our balance sheet.

And with that said, I'll turn it back over to Mark.

Mark Wong

Thank you, Matt. Just in summary, I'd like to just remind everybody of the high points of the call. So, we're excited that the year has gotten off to such a very good start, but I would caution everyone that it is our smallest quarter in the year. So the next two quarters will be obviously very, very important to our overall success this year.

But I feel comfortable that the guidance of our core business for this sort of \$41 to \$44 million level that we've stated before is definitely achievable this year, and I also did not mention acquisitions, but we've been working hard on a couple of acquisition. We expect to at least close one of those in this fiscal year, and in general, there's seed companies around the world, usually in the \$20 to \$35 million range in sales and all profitable because we want to only acquire profitable seed companies at this point. And frankly, the market is very, very weak in agriculture. Lots of people are in trouble. And so, we're one of the few middle-market buyers, and we think that's going to eventually give us opportunities and especially after the market turns.

So, we're very, very excited about this year. We're excited about our new home in Longmont. We're having a good year so far, both in sales and margins, and we expect to have some moves on acquisitions in the next couple of quarters.

And with that, I'll turn it over to the operator, who will field your questions. Thank you so much.





QUESTION AND ANSWERS

Operator

We will now begin the question-and-answer session. To ask a question, you may press *, then 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 *, then 2. At this time, we will pause momentarily to assemble our roster.

Our first question is from Sarkis Sherbetchyan with B. Riley. Please go ahead.

Sarkis Sherbetchyan

Good morning, and thanks for taking my question here. So, saw the reiteration of the guidance for the core business. Certainly, encouraging top-line results for this quarter, which is seasonally soft, as you mentioned. On the last quarter's call, you also kind of gave guidance on EBITDA loss of \$6-to-8 million for the fiscal year. Is that still the framework to think about for fiscal '20?

Matthew Szot

Yes, Sarkis. At this date, I think that's a reasonable range to assume. Obviously, we're going to be trying to improve that throughout the year, but given that we're only in the first quarter of the year, I think that that's a good range to continue to assume.

Sarkis Sherbetchyan

Again in the prepared remarks, you mentioned returning to positive EBITDA in fiscal '21 just from the organic business. Help us understand the drivers for that. Is that a few product lines, which you're very confident on? Is that a margin story? Help us bridge the gap between the single-digit million EBITDA loss in this year versus the return to positive EBITDA next year.

Matthew Szot

So, we're not going to get into providing specific guidance for 2021, but certainly, our expectation is that the legacy business is going to return to profitability. We're projecting not only top-line revenue growth across all of our core crops, but we're also, we're expecting meaningful margin improvements. Similar to what we're experiencing in 2020, we're thinking that that sort of margin improvement will continue into 2021 as well, and as more of our revenues are concentrated in our hybrid crops, which carry much higher margin profiles closer to 50% range, those are really the driving factors to returning to profitability.

Mark Wong

Sarkis, if I can jump in, the decision on the part of the company to move to hybrid crops is definitely based on the fact that margins are much higher on a per-pound, per-kilo basis, and that the inventory management issues are much simpler.

So in the annual hybrid crops, you have a production contract that's also a one-year contract, whereas in the alfalfa, which is a perennial, you have production contracts, which can be up to three-year contracts sometimes. In Australia, you're looking at longer than that.

What the industry has seen in alfalfa after a decade of growth is that once that growth is over, it's really hard to turn the spicket off on the supply side. So, we are not alone in the situation that's sort of a three-to-four worldwide leading alfalfa companies face, which is we've got more alfalfa than the market can absorb, and we have to be disciplined about selling that into the market. Obviously, we're careful about germination. We don't want to write seed off. We don't think that surpluses are so large that that's the situation, but there's huge price pressure on the alfalfa side with this giant overhang of inventory for the industry, and some of our competitors are in worse shape we believe than we are, but it doesn't make any difference.

Everybody's going after every sale that's a large sale all around the world, and they're competing on price. Sorghum and sunflower and wheat but not a hybrid which has an End Point Royalty system in Australia that precludes this kind of seed company problem. So, our mix over time is going to be more profitable and more stable in sales. And I think that is something that we've seen in the 40 years that I've been in the industry, and that's something that maybe people don't understand, investors don't understand, but we're sure that's the direction that we're going.

Sarkis Sherbetchyan

Thanks for that explanation, Mark, and I think from our angle it seems like the upside to next year is likely to be driven from the sorghum and sunflower seed sales. Is that the right way to think about it, especially given those margins you outlined?

Mark Wong

Yes, that's exactly the right way to think about it, Sarkis.

It's an interesting option for us now that we've bought the Australian program from Dow. We just don't really know yet. The weeks are early. It's like a lot of our products, whether it's sunflowers in Eastern Europe or sorghums in Pakistan and Africa. We're in the first year or two of sales, and we could see substantial improvement, or we could see some of these new introductions have a tough time for a year or two before they go to a successful kind of market share.

But we have so many shots on goal that I'm pretty confident some will not be as good as we think, but some will be better than we think, and on average, our projections will be hopefully close to what we can really achieve in all of these markets.

But you know, we've talked before about our problem of having basically too much cost after gross profits or the kind of sales number that we have now, and maybe, it will turn out to be a good bet. Maybe, it'll turn out to be a poor bet, but we've bet that we can build these market positions in the different worldwide markets and crops that have not been part of the S&W historical product lines. But it's my experience and it's now the experience of many people that we brought into the company that's added to that cost but given us the depth of experience that will allow us to be successful implementing that strategy. And that's all the way from breeding to doing the production on a reasonable cost-per-unit basis to strengthening our sales and marketing, and then distributing efficiently to our farmer



dealers or our dealers the seeds that they have purchased. So, we're pretty optimistic. It's a happy time at S&W right now.

Sarkis Sherbetchyan

Thanks, and one last one for me, and I'll hop in the queue. Can you just maybe talk about or remind us about the digestibility alfalfa trait you're collaborating with Calyxt. Is that to be launched in calendar '21? How do we think about that portfolio line?

Mark Wong

We're pushing hard to have an introduction in small volume in '21, but it's probably not going to be substantially accretive to our sales until '22. But understand again the situation in alfalfa. Farmers are being pressured on farm margins. So, I heard the other day, I think you probably saw that Dean Foods has gone into bankruptcy, and they're trying to sell the whole company to the biggest coop here in the U.S. That's a huge indication, because I think they have 40% of the U.S. milk distribution market. And that just tells you how badly dairy farmers are suffering and how badly the distribution and everything else in the U.S. dairy industry is suffering.

So, when farmers can't make money on the milk that they're producing, and we know that many, many farms, especially sort of 500 head or lower are under huge pressure and going out of business. The market family farm is definitely changing in the dairy industry, and remember, alfalfa's highest use is to dairy farms.

So, when dairy farmers are under margin pressure, their ability to spend more money on technology that's going to improve the amount of milk they produce per cow, the amount of the metric there is a 100 weight of milk per cow per day, when they aren't making money on that business already, which is their obviously main business, although about 40% of the dairy business, the value of that is hamburger that's left when we send the cows to slaughter after year four. It's very hard to introduce new traits that give value to the farmer, the dairy farmer.

We see our competitors having a very, very difficult time with market penetration. So, historically, market penetration in corn, soybeans, cotton, canola -- which are the big GM crops, have topped out quickly over three years, four years at 98% of the market for almost every one of those four giant crops. And in alfalfa, the penetration rate for the traits that our competitors are selling is about 25%.

So, we have no thought that this is going to be an easy thing to introduce, even though we believe our trait is very, very good, and we have developed technology. We've developed a marker system to sort through the germplasm, things that we needed to do to implement a commercialization strategy. Those are going to be extremely helpful, but the market is very, very difficult in alfalfa, and introducing a trait in alfalfa is going to be very, very difficult. And I don't think that we're taking that very lightly. And so, we're trying to look at pricing of the trait and all of the other things that make a trait successful. We're trying to look at those in the context of a very, very difficult market in alfalfa.

But I don't want to be a downer there, but we've had these calls before. I've never sort of made something bad, not admitted that it can be a problem, but on the other hand, the rest of our businesses, wheat, sorghum, sunflower, all look very, very good. And that's why we're in multiple crops because all crops do not move in the same direction in any one year and in any one market.



Sarkis Sherbetchyan

Thank you for the candor there. I'll hop back in the queue.

Operator

Again, if you'd like to ask a question, please press *, then 1.

Our next question comes from Ben Klieve with National Securities Corp. Please go ahead.

Ben Klieve

Thanks for taking my questions. Just a couple of quick ones for me here. First with regards to the Pioneer revenues in the quarter. When the divestiture was announced in May, the first kind of waterfall payment was going to be \$5.5 million on September 15th. You noted today that revenues from Pioneer were like \$3 million, \$3.5 million. Am I missing something in kind of comparing those two numbers, or did the timing and schedule itself just change?

Matthew Szot

Yes. So, Ben, you're referring to the cash flow streams, and those are defined contractually and they'll be picked to the day. So, we did receive \$5.5 million of cash in September, and we'll receive similar payments in January and February of 2020, and then again, into next fiscal year, we'll receive those scheduled payments just as previously disclosed. There's no departure to that. But that is timing of cash flow receipts. The timing of revenue recognition to Pioneer is dependent on when we actually deliver the seed to Pioneer. So, they're two completely different streams there.

Ben Klieve

Got it. Okay, perfect.

Mark Wong

So, when we book a sale, it depends on when Pioneer's marketing organization tells us to ship the seeds, and so, that can have a little variation on depending how their season is going and how the weather is in the U.S. because it's all seed for the U.S. But the actual cash is contractually locked in. So, those payments that you understand that we announced are going to come in whether they take the seed or not.

Ben Klieve

One other question on the quarter itself, the CapEx ticked up a little bit. Can I assume that that was tied to that headquarter move to Longmont or was there some other driver that brought CapEx up a little bit? And then, as a follow-up to that, what are your expectations for CapEx to the balance of the year?

Matthew Szot

Yes. I think, so, Ben, probably for the year we're looking at roughly a CapEx spend of approximately \$2 million. Yes, the CapEx in Q1 was primarily for leasehold improvements built out of our Longmont office here in Colorado coupled with some machinery enhancements that we made in Australia. And throughout the remainder of the year, we're going to be also spending some additional money to really bring our IT infrastructure up to sort of best-in-class standards.



Ben Klieve

And then, last one for me. Mark, your comments on the kind of increased competitive pressure that you're seeing from European peers, I'm wondering if you can elaborate on a couple of fronts on that.. One, to what degree did you really see headwind in the first quarter? And then second, is that pressure really concentrated in South America, or do you think you're going to be seeing increased pressure, particularly in kind of the EMEA region?

Mark Wong

Yes, great question. So, remember first though that our alfalfa breeding program, which obviously was Pioneer's program before we purchased it five-to-six years ago, it's deemed by the industry to be the best program in the industry for disease resistance. And for that reason, growers want to have our alfalfa variety, right? And we had hoped that we would get some beginning of sales even in Europe because of that disease resistance profile that we have. And so, we had a program where we had four-or-five production companies under contract with us to take our germplasm and increase it for European sales.

So, margins are so thin that you have to produce the seed where it's going to be sold because you can't afford to put freight into it. So, those plans are kind of on hold now because the Europeans also have a surplus of alfalfa and their cutting prices like crazy. They have traditionally very, very cheap production. And so, our efforts, number one, you asked about markets in Europe are kind of on hold because those programs that we thought might take hold, frankly, haven't.

But the biggest really affect is in South America. And prices both in Mexico, which is a big, big market, and in Brazil and Argentina, Argentina probably being the bigger and more important market, are really under price pressure also. And this time, it's not from U.S. alfalfa, although that's still in surplus, it's from European alfalfa, which has a bit of a cheaper unit cost per kilogram than U.S. alfalfa does, and we're seeing the pressure from that.

Ben Klieve

Got it. That's helpful. I think that does it for me. Thank you both for your time. And I'll jump back in queue.

Matthew Szot

You're welcome. Thanks again for being on the call.

CONCLUSION

Operator

This concludes our question-and-answer session. I'd like to turn the conference back over to Mark Wong, Chief Executive Officer, for any closing remarks.



Mark Wong

Thank you very much, operator. We're optimistic this year. It's been a couple years, as I mentioned, sort of building the company, acquiring the Chromatin assets, strengthening our balance sheet with the sale of the production contract back to Pioneer, where we obviously kept all of the production facilities and R&D program intact, which we're now selling under our Sorghum Partners and Alfalfa Partners brands in the U.S. And we're optimistic, even though it's a poor ag market worldwide, we're optimistic that there are real opportunities for us. And thank you for all who are on the call today and your interest in S&W, and I think the best is obviously yet to come, as people like to say. And we're all very pleased with our progress so far. So, thanks again, everybody. And have a good rest of the day.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.

