S&W Seed Company
(NASDAQ: SANW)

Second Quarter Fiscal Year 2020 Financial Results Conference Call

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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 Second Quarter Fiscal Year 2020 and Acquisition of Pasture Genetics 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 can press star (*), then one (1) on your touchtone phone. 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
Thanks so much, Allie, 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 2020 ended December 31, 2019, as well as S&W's acquisition of Pasture Genetics, which was announced on Tuesday, February 18, 2020. With us on the call representing the company today are Mr. Mark Wong, President and Chief Executive Officer; and Mr. 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 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, Robert, and good morning to everyone on the call today. It is a very exciting call for all of us at S&W. We are now in our third year of rebuilding the company, and if I can just take a couple of minutes and remind everybody about the main components of that effort. We basically have four areas, four basic principles that we are working on. So, as we have said in past calls, we are trying to expand our distribution first, that is started when a year plus ago we acquired Chromatin from a bankruptcy purchase. With that acquisition, we acquired a much stronger sales and marketing organization than we had traditionally, historically had. We acquired as we talked about before, a farmer-dealer network and the network of distribution through distributors, and we had spent a huge amount of time this year building that farmer-dealer network, building our relationships with distributors, training our sales force to do that effectively. And so, we have gone on to the second piece of that expansion in distribution, which is building the same kind of capability internationally. So now we, today, can announce the acquisition of Pasture Genetics. That is going to close probably next week. We will put all the documentation assigned, and as Robert said, we have announced that, and Matt and I will be giving you some more detail on the company and why we think it is such a great acquisition for S&W and a great partnership with the Pasture Genetics founding family.

The second thing that we have been working on is converting our single-crop focus, which as all of you remember was originally alfalfa, to a multi-crop focus, which is now alfalfa, both dormant and non-dormant; is Sorghum, both grain and forage sorghum; is sunflower, the oil part of the sunflower seed business and, of course, wheat with our acquisition from Dow of the Australian wheat program that they had been funding for the last few years.

The third piece of our four basic principles is really to refocus the organization, now that we have this additional marketing power to both farmer dealers and distributors. So, in past calls, we have talked about our new organization. We have all of our international businesses organized under one Executive Vice President, who is in-charge of building that business. And then we have the Americas, which includes both North America and South America organized under another Executive Vice President. And things are moving along really well there in our basic core business in both international and The Americas.

The fourth piece of what we have been looking at doing--and this is really to increase our margins over time is invest in technology. So, you have heard before that we have had a deal with Calyxt to work on digestibility, lignin, genes. In alfalfa, that work, we are very excited about and continue that work in alfalfa for technical reasons, due to the fact that alfalfa is an open pollinated variety, takes a little bit longer to sort of stabilize the genes and make selections of our elite lines that we are going to be taking for trialing, and then eventually sales to farmers versus the other piece of technology that we have, which is the herbicide resistance in hybrid sorghum.

So, when you are in a hybrid crop, it is easier to manage the gene that you are looking at because you have a male and female line, and so your timelines are a bit faster. We really like the herbicide resistance that we have seen in the hybrids that we have tested last year. So, we have made an aggressive effort to do an extra seed increase this year. So, we have gone to a Winter Nursery, a location where we are producing hybrid seed with our herbicide gene of interest, and we hope to have seed back that we can plant in the spring planting in the U.S.

Right now, we are on a U.S.- focused herbicide hybrid sorghum introduction, and we are hoping to have those seeds back in time for spring planting in the U.S. by this year 2020. So those efforts are all continued to be the focus of the company, that has not changed. We have tested our strategy as the market continued to be very tough in agriculture, and we think that our strategy is still is the one that is going to lead to financial success for the company and improvement of both our product line profitability and our ability to introduce proprietary products with technology to our customer base, both farmer-dealers and distributors.

So that all moves ahead, and we are very, very happy with the progress that we are making. I would say that Pasture Genetics is the deal, if I can change a direction a little bit and focus in on the acquisition itself. So, we have been working on this deal for quite a long time, over a year. We are happy to have come to agreement, and as some of you may know the Australian market has been pretty tough in the sense that there has been a big drought. There have been fires that have made the news here, at least in America, obviously, in Australia too. Those are now past history, as it has begun to rain, and the farmers are getting excited about purchasing seeds and planting for next planting season. And those planting seasons do vary a little bit if there is some of the forage crops like alfalfa or if there is some of the hybrid crops like sorghum, sunflower, which we hope to introduce through the Pasture Genetics distribution system.

So, when you combine Pasture with the S&W existing sales force, we end up with one of the larger integrated seed company efforts in Australia, where we would be competitive to the other two big seed companies: Heritage Seeds and Advanta Seeds. So, we are going to be kind of excited about competing on an even basis with those companies, who we have not been able to do before. The basic strategy is to continue through Pasture with the sales of their traditional products, which have been really, as the name implies, Pasture and Forage Seeds. Remember that the Australian market is a little bit different than the U.S. market. There is a big matching of forage products that are then fed to animals and the animals are the final product that is exported. It is not like the U.S. where there is a corn and soybean commodity production market that produces exports of those two grains.

In Australia, a lot of the market is developed by feeding these Pasture products to animals, and the animals are exported mainly to the Asian market. So, we look at Australia now as a strong distribution and product opportunity for S&W Seeds, but as I said, we are as strong in terms of headcount of sales, people in the field as the leading companies in Australia now, and we are looking forward to taking the hybrid sorghum and hybrid sunflower varieties that we have been developing and putting those through this new distribution system that we'll be creating by combining the sales force of S&W and Pasture Genetics.

The Australian market is a pretty big seed market. So, I do not want people to think that it is a small market. We believe our market research shows it is about $400 million market plus--about $130 million, $135 million of that are pasture products that are fed to animals, as I have said. So, we are talking about forage, sorghum, perennial ryegrass, alfalfa, and then some of the clover and other pasture-like products that Pasture Genetics has traditionally sold. The hybrid crops, which include the bigger ones being grain, sorghum, cotton, and canola are maybe another $150 million. And then the endpoint royalty crops, these are really the wheat and barleys, both the barleys that are grown for feed and the barleys that are grown as malting barleys, are kind of another $105 million or so, and end point royalties. But those endpoint royalties, remember, have huge margins. Because of the endpoint royalty system, the seed companies basically provide R&D support for those crops, but the sales and marketing expenses absorbed by the individual growers and distributors of the seed before it gets to a final sale to an end-user, usually a noodle company in Asia somewhere are the main buyers for the product.

So, it is a big market, $400 million plus, and growing. For us, the Pasture Genetics acquisition solidifies our efforts to add distribution power, which we always think it is important, as I said many times before, being able to present your proprietary products to farmers, and show them why they should use your products, why they are better than other companies' products for their particular soil and climate conditions, is what the seed industry--the successful seed companies do and that is what, obviously, we want to do.

Crops that we now offer to farmers, again, being alfalfa both dormant and non-dormant, the sorghum being grain and forage, sunflower oil crops, and wheat in Australia. So, we are really pleased with the fact that the acquisition is going to be completed in the coming weeks. We are happy that the market has finally had natural rain come and that farmers are excited about purchasing seeds for this coming planting season. And we think, as I said, that this acquisition of Pasture Genetics solidifies our position in Australia. And we look forward to building Pasture Genetics sales competing with leading other integrated seed companies in Australia and adding our proprietary sorghum and sunflower hybrids to the Pasture Genetics product mix to increase our margins and our profits.

Now, with a lot of work yet to be done though in Australia, we turn our focus on Asia. And so, we believe that Australia is the jumping off place, both because of distance and because of politics, for our efforts in Asia. We are trying to sort through opportunities in Southeast Asia versus China proper. David Callachor, who is our Executive Vice President, who runs International for S&W, has direct experience in previous positions in Southeast Asia. So, he is a real resource there. And you will be hearing more about our strategy there in the next six months or so as we sort through the opportunities that are available.

So, we do a lot of things, that is what seed companies need to do. Sometimes people say, we have to be careful that we do not take our eye off the ball, and I am telling you that we do not. I personally, as you know, have 40 years of experience in the industry. I have done this many times before, and I am super excited about the opportunities at S&W, and how our team is going about systematically evaluating the best opportunities, closing on those, and integrating those into one company that is growing both in sales and profits.

So, my last comment is just that the second quarter for us is, as most of you know, a fairly small quarter relative to the third and fourth quarters, which, obviously, we will be reporting on here in the next six months or so. So, things are going really well, but sorghum and alfalfa sales mostly in the Northern Hemisphere at least have some way to go. Just in timing, farmers will not make final decision in sorghum sometimes till as late as late April, May, or early May. And so, we will have more to say about our guidance, but things are going really well. We think once we see a few more months go by and we are ready to report on our third quarter earnings that we will be able to give some positive input to our guide.

Things are really going well. We are very, very happy here at S&W with our progress and we are very, very pleased to add Pasture Genetics to the family of companies that S&W has integrated into our single integrated vertically--sales and marketing production and R&D company.

So, with that, just I will turn over the presentation to Matt. Matt, please go ahead.

Matthew Szot
Thanks, Mark, and thanks everyone joining us today. This is--as Mark mentioned, this is definitely an exciting time for us. So, as the financial results through December have been published for more than a week now, I am sure most of you had a chance to review them. I am just going to spend a few minutes discussing the year-to-date and Q2 numbers and provide some additional context where I think, it might be helpful for you, and then also spend some time discussing the financial aspects of the Pasture Genetics acquisition, and changes to the financial model going forward.

So, for the year-to-date and Q2 results, revenue was in line with our internal expectation as most of the sales and marketing efforts during the second quarter were really focused on gearing up for the higher volume sales season, which commenced earlier this month.

Core revenue for the first half of 2020 was up 17% to $18.2 million versus $15.5 million in the comparable period of the prior year. As our second quarter is typically lighter for sorghum sales, most of the revenue contribution during the second quarter came from our alfalfa business. And as Mark mentioned, we feel good about the position we are in as we head into the remainder of the fiscal year and we are reiterating our core revenue guidance of $41 million to $44 million and total revenue to be between $64 million and $67 million, and this revenue guidance does not reflect the additional revenue contributions from Pasture Genetics, which I am going to touch on shortly.

Gross margins for the second quarter were lower than Q1, which reflects the product mix, as I mentioned this was mainly an alfalfa quarter. We certainly expect to see improvement in gross margins as the hybrid sorghum sales season ramps up, and for the full year, excluding the contribution from Pasture Genetics, we expect gross margins to be in the range of 23% to 25%.

Our operating expenses for Q2 remained in line with our expectations as we continue to make additional investments in sales and marketing and product development functions, and then, we also looked at tuck-in acquisitions that can leverage our existing operating infrastructure, and then Pasture Genetics being case in point.

Just a couple of last items before I touch on the acquisition. As I mentioned last quarter, we planted very minimal acres of alfalfa production as we continue to work through our existing inventory levels. So, when you look at our inventory levels at December '19 versus December '18, our balances are down nearly $13 million, or 15%. This decrease reflects our ongoing efforts to reduce alfalfa inventory balances and convert this inventory to cash. And I also want to point out that approximately $19 million of inventory on hand at the end of December was currently reserved for Pioneer, and they are obligated to take this product over the next 12 months. While more work is ahead of us, we believe we are on track to reduce our inventory balances to more optimal levels by June of 2021.

Also, as we announced in late December, we did close on a new $35 million revolving credit facility with CIBC Bank. This new credit facility has a number of advantages to us, including a reduction in the cost of capital and enhanced structure. There is more flexibility to pursue our growth strategy, and the bank, CIBC has really demonstrated that they have got a strong understanding of our go-forward business, which obviously includes both organic growth and M&A to build upon the infrastructure that has been created today.

So, with that as a segue, and as Mark mentioned, we are really excited about the acquisition of Pasture Genetics. Operationally, this is a great fit, and financially, we acquired the business at an attractive valuation, and really structured the deal in a non-dilutive accretive manner. So, I will go into a few more details on that.

Pasture Genetics has a highly diversified customer base with approximately 80% of its revenues coming from the Australia domestic market, and as a point of reference, our existing S&W Australia business is approximately 20% domestic and 80% export. So, this adds to our focus in Australia and allows for us to leverage the Pasture Genetics sales force and customer base to cross-sell our proprietary products.

We have a slide presentation on our website, and if you look to Slide 6, you will see that Pasture Genetics sells a number of different products with not one crop accounted for more than 25% of revenues. Further, their sales are diversified across the various states, New South Wales, Victoria, Queensland State, and we are even getting exposure to Western Australia, where we currently have a minimal presence. So, as you adjust your financial models, we are estimating that Pasture Genetics will contribute approximately $15 million of revenue for this stub period from now until the end of June, and then we expect Pasture Genetics to contribute $20 million to $25 million of revenue in fiscal '21. We believe there is a significant opportunity to achieve revenue growth in the future as we integrate the operations and execute on these various sales synergies.

Now turning to the Pasture Genetics gross margins. Historically, margins have been roughly 20%, and we expect margin expansion as we layer our business–as we layer that business into our production network and sell our higher margin proprietary products. So, with our legacy business, having gross margins in the 23% to 25% range, coupled with new gross margins from Pasture Genetics, we are expecting our blended gross margins to be in the range of 22% to 24% for fiscal 2020.

Given the recent events with the acquisition and a change to our operating structure, I would like to provide updated guidance for our 2020 operating expenses. In summary, we expect SG&A to be approximately $21 million for fiscal 2020, which includes Pasture Genetics for the stub period from now until the end of June; research and development to be approximately $8 million in 2020, which again includes the operations of Pasture Genetics for the stub period; and we expect depreciation and amortization to be approximately $5 million for 2020.

As we mentioned in our press release, we are expecting EBITDA margins of approximately 8% to 10% once we have the opportunity to integrate the operations and execute on these synergies, and certainly leverage our existing infrastructure.

So, I am just going to give you a quick recap of the acquisition price and structure. Overall, the transaction was validated up to US $ 13.5 million, the transaction was actually denominated in Australian dollars, but I am going to refer to U.S. dollars here for simplicity. Upfront consideration consisted of only $700,000 in cash, with the remainder of the debt–with the remainder of the consideration coming from a debt refinancing in the approximate amount of $7.4 million. And I want to clarify that this debt is supported by existing AR and inventory on the balance sheet.

There is also an earn-out provision, which is based on certain financial performance criteria for up to an additional $5.4 million; and the earn-out, if any, will be payable in September of 2022, and is payable in a combination of cash and at our election, shares of common stock.

So to summarize, our year-to-date results are consistent with our original expectations, we are feeling optimistic that we are well positioned to meet and hopefully exceed our targets for the remainder of the year, and we believe we have acquired an exciting business at an attractive valuation, which can drive multiple synergies to other aspects of our business and further leverage our existing operating infrastructure.

And with that, I am going to turn the call back over to Mark.

Mark Wong
Thank you, Matt. I will just make a couple of closing remarks. We believe that with Pasture Genetics now added to the S&W family, our ability from a sales and marketing standpoint to provide proprietary products and proprietary product information to our farmer dealers and our distributor customers is enhanced, both in Australia and in the U.S. through the Chromatin and Pasture Genetics acquisitions that we have now made. It is a pretty simple concept, right? We have got a much broader, stronger product line of proprietary products that we have added to alfalfa, so that every salesman on every sales call to a farmer, dealer, or a distributor can maximize the amount of products--of our proprietary high-margin products that he is selling -- he or she is selling to our customers.

On top of that, we are very excited about technology. The digestibility alfalfa project continues to move forward, and you are going to hear more about herbicide resistance in sorghum in the next month or so. As you remember, both of these projects are non-GMO digestibility alfalfa came to us in our partnership with Calyxt and uses gene editing as its technology base, and our herbicide resistance in sorghum comes from our own proprietary tissue culture process, which has generated the materials that we are now testing for sales to our customers.

So, it is really an exciting and bright time for S&W. All of our employees are excited about the opportunities that we have created for ourselves with our strategy, and we look forward to reporting those results to all of you through this year and through next year, when significant progress is going to be made for company.

So, thank you again, and operator, we will turn it back to you, and we will be happy to take questions.

QUESTION AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star (*), then one (1) on your touchtone phone. 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).

Our first question today comes from Sarkis Sherbetchyan with B. Riley FBR.

Sarkis Sherbetchyan
Hi, Good morning guys and congrats on the acquisition.

Mark Wong
Thank you, Sarkis.

Matthew Szot
Good morning, Sarkis.

Sarkis Sherbetchyan
One thing I would like to kind of ask around on Pasture Genetics and bring some seed coating technology, can you maybe give us some more color on how you expect to leverage that technology across your portfolio of products? And then I have a few follow-ups.

Mark Wong
Yes. So, the seed testing technology that they have was originally developed by Pioneer in Australia and acquired by Pasture. So, we think that that technology can be used in other markets that we are exporting our alfalfa seeds from--that are produced in Australia. Traditionally, if we needed to have coatings put on those seeds, we had to bring them to the U.S. and then coat them and then send them to our international customers. But now we will be able to take our Australian-grown production, mill it and clean it in Australia, and through the Pasture facilities, add this coating and then send that to our customers from Australia directly. So that should add margin for us and, obviously, save costs. So, I am pretty excited about that.

Sarkis Sherbetchyan
That is super helpful, and I think if I go back to the presentation comments, it sounds like the Pasture Genetics gross margin profiles, call it the 20% range, it sounded alike. Is there an opportunity to bring that business's gross margin up over time? How do we think about that?

Mark Wong
Yes. For sure, we expect that the Pasture Genetics gross profit margins will increase. Pasture Genetics is the sales and marketing company. So, it is a bit different than the Chromatin acquisition, where we got, as we have talked about in past calls, R&D and breeding materials along with the farmer dealer and distribution assets that we acquired there. Pasture is really more of a pure distribution company. So, the addition of our proprietary sorghum, alfalfa, and sunflower variety--hybrids and varieties should add to the profit margins overtime. We have a pretty aggressive cross-selling integration plan to put those products into the Australian market, and most of them have been tested in Australia already, and have been bred through our own programs in Australia. So, we are pretty confident that they will get some market share over the next couple of years.

Sarkis Sherbetchyan
Great. One more for me and I will hop into queue. So, in the press release you had called out progress in S&W's new sorghum product with the ATS trials, can you maybe walk through what type of--maybe incremental sales or margins you would expect from that line on the first year and building from there?

Mark Wong
Yes. So, I think to answer that question and kind of inform our callers, there has not been a situation where a seed company--integrated seed company, like S&W, has gone forward with herbicide resistance. And it is important, I think, to understand the economics. So, when a farmer decide that herbicide resistant is going to help him basically produce more yield and produce a higher return on his planted acres, he has to look at the price of the herbicide and the price of the trait that he is paying for, and how much weed control that is going to give him, and therefore, what our trials would show his improved yields are going to be.

So, it is important that he understands both the herbicide cost and the trait cost. Those are the two pieces that are– here is additional cost and his benefit, of course, is higher yield due to better weed control. So, we have been discussing a partnership with several ag chem companies, where we would form a partnership to offer the trait and the herbicide costs in one package with cross marketing, so the ag chem product logo label would be on our bags of seed and our logo, and in this case, we are selling under the Sorghum Partners brand, one of the old brands of the Chromatin acquisition. Those would be cross-referenced on all the labels of the ag chem products that go with this herbicide resistance.

So, it would be a joint marketing and sales program starting in the U.S. and then spreading worldwide wherever we both see opportunity for herbicide resistance in grain sorghums, which grain sorghums are our first target, because they have the highest margins and the best returns for farmers, and so we want to put the herbicide resistance in those hybrids first. So, you will be hearing more about that in the next month, but I hope that answers your question, Sarkis.

Sarkis Sherbetchyan
Yes. Thanks for that all. I will hop back in the queue.

Mark Wong
You are welcome.

Operator
Our next question comes from Ben Klieve with National Securities Corp.

Mark Wong
All right. Ben, good morning.

Ben Klieve
Hi guys. Thanks for taking my questions here. First a couple of questions on the acquisition. Mark, you talked about the Australian fires kind of dying down now with the rain. Can you talk a bit about how catastrophic fire season has impacted Pasture's business? I guess, not only this year, but maybe how the drought has impacted it over the past couple of years? And to what degree you considered the kind of longer-term implications of those conditions as you made the acquisition?

Mark Wong
Sure. So, again, the Australian market is different, for instance, than the U.S. market, even though we are selling some of the same crops in both of those markets. The Australian market has poorer soils than the U.S. And so, this traditional relationship between producing forage products, sometimes grasses or clovers, sometimes forage sorghums, and then partnering those by feeding them to animals, and then selling the animal products, the meat, in Asian markets or in the local Australian market, has been the business model for Australian farming.

In addition to the poorer soils, there is--because of just the way the rain patterns are and wind directions and stuff like that, there are times when there are droughts in Australia. We have gone back before we completed this acquisition and studied the last four or five droughts, over the last 25 years, and we are convinced that the industry always--this is the integrated seed company industry, always bounces back after these droughts.

It is very tough for farmers, and it is very tough for seed companies to get their own seed produced, because there are some losses sometimes through these droughts. But the study of the last five droughts basically says that the market comes back. So, we are pretty confident that, obviously, we put our good money down to purchase the company that that will continue and that there will be additional opportunities in the market, even though there will be droughts every so often. They do come to an end, even though it is hard to see that when there are fires and horrible things happening to wildlife and things like that, but they do come to an end.

Ben Klieve
Got it, okay. Thank you, and then, Matt, in your comments regarding the revenue contribution that you are targeting here, you talked about 2021, potentially providing up to $25 million in revenue from Pasture. That is up pretty likely from $20 million kind of annualized contribution you are looking at today. Can you kind of highlight the drivers that are in place that you think could potentially lead that to

the high end of that range? What really are the main drivers of growth from that business that you are hoping for, for next year?

Matthew Szot
Sure, Ben. So, Pasture is currently not really selling any forage or grain sorghum. So certainly, pushing and making available our proprietary hybrid products and cross selling those products will certainly help. We think the Pasture Genetics business will help also contribute to the marketing of our wheat program as well. And certainly, we believe that our existing legacy business alfalfa varieties are superior to the current product portfolio. So, we are looking to push those proprietary products through as well. So, a combination of those three things are really going to be the primary driver. And plus, hopefully we get a bit of tailwinds here with–now that the farms are actually getting a bit of rain.

Ben Klieve
Got it. Okay. Perfect. I guess a couple of other quick questions outside of the acquisition. Looking forward to hearing more information about the herbicide tolerance, sorghum here over the next month. And it sounds like we are not going to hear anything about the improved quality alfalfa that you have partnered with Calyxt maybe for another few quarters. Can you kind of give us an update on kind of expected timing regarding when we can really know what the benchmarks are with that product?

Mark Wong
Sure, Ben. So, on the digestibility of alfalfa, improved digestibility, the problem with alfalfa is it is a perennial variety, right? So, it is not a hybrid crop. It just takes longer to sort through the germplasm and define the elite lines that perform well in the field, so that you can then increase the seed amounts and then do trials, because we sell lots of different climates and soil types--microclimates and soil types. And we want to make sure that we understand where our products perform well, and that is part of our new improved sales and marketing power is we are spending a lot of time and effort being able to deliver those results through social media and through more traditional means to our farmer customers.

So, that there is both push and pull, pushing our salesman to discuss these products with our customers, but also providing information to pull the products through our farmer dealers and our distributors. So, that is always an effort, but it takes a little bit longer in alfalfa than it takes in a hybrid crop, like grain sorghum. And so, we are just able to move a little bit quicker with herbicide resistance in the grain sorghum. The other thing that you might–you are a smart guy, that you might surmise is it is pretty easy to test the grain sorghum, right? So, we produced the hybrids and then we spray them with the herbicide. And if they die, then I guess we did not do a very good job. So, in our case, we are very happy that they are performing well. So, we are doing this special seed increase in the Caribbean this year to have more seeds to provide to the market in the Spring.

It is more difficult to evaluate in alfalfa, improved the digestibility gene, which is a quality trait, right? So, the same kind of alfalfa we believe will produce more milk. So that is a long process of not only picking the right seed lines, but then testing them with dairy herds and understanding what the benefits really are.

And we could go into a long discussion sometime about what is driving the dairy industry. The dairy industry is having some problems, but basically dairy farmers get paid for protein and fat. And so, you want to have your genes produced on a percentage basis relatively more protein and fat in the same weight of milk as products did before you are in production. So, we are having to evaluate a much more complicated criteria for product performance in the alfalfa than we are in the herbicides resistance sorghum as we can just spray the sorghum with the herbicide, and we know the answer to the question if the product is performing or not.

Ben Klieve
Got it.

Mark Wong
That is why there is a difference. Yes, there is a natural difference that just, even with the experience you guys like all of our breeding and development people are, you just cannot make it go faster. You make it go as fast as they can, but it is still slower in alfalfa than it is going to be in sorghum.

Ben Klieve
Got it, fair enough. All right. We will–I second the motion on congratulations on closing this. I look forward to hearing about continued progress and I will jump back in queue.

Operator
Again, if you have a question, you can press star (*), then one (1).

And our next question will come from Gerry Sweeney with ROTH Capital.

Gerry Sweeney
Good morning, Mark and Matt, thanks for taking my call.

Mark Wong
Yes. Good morning Gerry.

Matthew Szot
Good morning Gerry.

Gerry Sweeney
I wanted to take a little bit more of a holistic view and ask a question. As we look at your portfolio, maybe discuss wants versus needs. It sounds like you next step is taking a look in Asia. Now, what do you need to be successful there? And what would you want to be successful there? And do you--or are they just operating in tandem?

Mark Wong
Well, the first, I think screen of any market for us is to look at our base of proprietary products, right? These are the products that we spend money on every year to continue breeding, making selections, adding technology like herbicide resistance or digestibility in case of alfalfa. And these are the products that are generating our gross profit margins. And the first screen is to see what the market offers in these other areas where we have not had sales for what opportunities for our existing product line is there? And then the second question, if we are convinced that there is an opportunity for our existing product line, because you have to spread those R&D dollars over as much sales as you can. I mean we have EBITDA losses now, all of you who follow us understand that. And we have to have more sales

volume to absorb those expenses, and we keep reporting to you on our relative level of expenses so that you understand those, but we also try to report on our gross profit margins and our sales pictures so that you understand what our product growth is, so that you can calculate for yourselves the absorption of those expenses over higher and higher volumes, because that in the end the key to profitability, which we think is coming in the next year or two is basically selling a product that you are already spending development money on--breeding and development money. And then selling those in all the markets where there is additional opportunity for sales and margin.

Gerry Sweeney
So, that is the lead into actually my second question which was, and I think you have answered it to a degree, but your distribution as it stands today, even with Pasture Genetics, do you see enough distribution to see improvement leverage in fiscal 2021 as you are starting to push more products through broader distribution, and if more products coming in? I suspect we should start to see this leverage, maybe next year then accelerating. Is that a fair sort of assumption?

Mark Wong
Yes. I mean, so we do three- and five-year plan. That helps us to size our expenditures in terms of what we spend on sales and marketing and R&D and G&A. It helps us to understand what our balance sheet has to look like in terms of seed inventories to support the kind of sales growth that we are projecting. And it helps us understand the risks of what we are producing in terms of newer products and what we are producing in terms of maybe some older products that have been in the market a while and different price points. So, it is a complicated process, but we have been in the industry a long time. This is second nature to us, not taken for granted, always well thought through. We have an exceptional team of people to add their input and their experience to these management discussions, but--it is a complicated process.

We have some pretty aggressive three-year plans. And we think there will be a profitability improvement next year and the year after. We are a little hesitant to express those to the general public until we are convinced that we can achieve those, right. Because in our planning process, we are looking at different scenarios and different risk levels. And sometimes we are right, we are human, sometimes we are not. So, we only like to convey to the market what we think we can deliver. And we are pretty optimistic right now. I sit here kind of with my socks rolling up on my feet, wanting to tell you guys what we really think is going to happen in the next two years. But I am little bit careful because you are going to hold me to it, and I want to make sure we can make it before I get all excited and just share with you what makes us here, so excited about the prospects of this. So, you have to--you have to give me a little more time.

Gerry Sweeney
No, it is fair. I mean, certainly, on paper, I mean, with the Chromatin and farmer-dealer network, the Pasture Genetics. I get it. It is distribution and then you have the technology in the background that is kind of come out of the …

Mark Wong
Yes, we have got a lot of ---

Gerry Sweeney
Out of the [unintelligible] per se and yes.

Mark Wong
We have got a lot of proprietary germplasm that we spend money to develop. We have got these new technologies. I can tell you that some of our projections, especially for herbicide resistance, significantly increased our EBITDA for the company by measures that, obviously, help us to get the profitability much quicker. And so, we cannot wait to share that when we have more detail and more information.

Gerry Sweeney
Got it. A good distribution channel is a sustainable competitive advantage, so looking forward to it. I appreciate it. I will jump back in line. Thanks.

Mark Wong
Thank you so much, Gerry.

Operator
Our next question comes from Jim Barrett with Barrett Asset Management.

Jim Barrett
Good morning everyone.

Mark Wong
Good morning Jim.

Jim Barrett
Hi, I have a question for you. Excluding Pasture Genetics and the $19 million of inventory slated to be sold to Pioneer, can you tell us in broad strokes, what you would expect the normalized level of inventory to be by, as you mentioned ’22. And I realized you have to adjust for organic growth and seasonality, but again, just trying to get a broad sense as to how much of an opportunity is there in inventory reduction?

Matthew Szot
Sure. I mean, I think, excluding Pasture Genetics, optimal levels, as we look to roughly June of 2021, would it be in that $30 million to $35 million range, Jim.

Jim Barrett
Range, okay.

Matthew Szot
So, from moving from here to there, that is going to generate a meaningful amount of operation, cash flows from operation.

Jim Barrett
It certainly would. All right, thank you very much and good luck.

Matthew Szot
Thank you, Jim.

Operator
Our next question comes from Walter Young.

Walter Young
Hi, could you all discuss the Australian exchange rate and the prospect of the U.S. dollar getting even stronger, and whether you plan to have a hedge strategy?

Mark Wong
Matt, you want to take?

Matthew Szot
Yes. Sure. I mean in our market; the Australian dollar has weakened over the last period of time. That certainly has made our--the cost of this acquisition is denominating Australian dollars, so certainly reduced the actual true cost to us. And what we are producing seed in Australia, and that seed is shipped to areas or throughout the world.

So, a weaker Australian dollar certainly helps our business. Now with that being said, we do not--we do hedge, but we are really just hedging to protect the balance sheet. We do not take on hedges for cash flow perspectives and nor are we really prospecting. We are just hedging to protect the balance sheet. Does that answer your question, Walter?

Walter Young
Sure, thanks.

Operator
This will conclude our question-and-answer session. I would like to turn the conference back over to Mark Wong for any closing remarks.

CONCLUSION

Mark Wong
Thanks very much operator, and to all of you who listened to our call today, thank you for your interest in S&W, and for your attention to our strategy and your fine questions. As I said a couple of times, we have got big smiles on our faces over here. We are pretty excited about what is happening with the company. And we think that that is going to be in the very near future reflected in our sales and our earnings. And so, we look forward to conveying that information through all of you as it becomes closer to each fiscal quarter. So, thank you so much for your interest in the company and thank you so much for attending the call today. Bye-bye now.

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