

S&W Seed Co  
Form 10-Q  
February 13, 2019

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-34719

S&W SEED COMPANY

(Exact name of Registrant as Specified in its Charter)

**Nevada**

(State or Other Jurisdiction of Incorporation or Organization)

**27-1275784**

(I.R.S. Employer Identification Number)

106 K Street, Suite 300  
Sacramento, California 95814

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(Address of Principal Executive Offices, including Zip Code)

(559) 884-2535

(Registrant's Telephone Number, including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days.  YES  NO

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).  YES

NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

As of February 12, 2019, 33,271,678 shares of the registrant's common stock were outstanding.

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S&W SEED COMPANY  
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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which are subject to the "safe harbor" created by those sections. These forward-looking statements include but are not limited to, any statements concerning projections of revenue, margins, expenses, tax provisions, earnings, cash flows and other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements regarding our ability to raise capital in the future; any statements concerning expected development, performance or market acceptance relating to our products or services or our ability to expand our grower or customer bases or to diversify our product offerings; any statements regarding future economic conditions or performance; any statements of expectation or belief; any statements regarding our ability to retain key employees; and any statements of assumptions underlying any of the foregoing. These forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "designed," "estimate," "expect," "intend," "may," "plan," "potential," "project," "seek," "should," "target," "will," "would," and similar expressions or variations intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We have based these forward-looking statements on our current expectations about future events. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Risks, uncertainties and assumptions include the following:

- whether we are successful in securing sufficient acreage to support the growth of our seed business,
- our plans for expansion of our business (including through acquisitions) and our ability to successfully integrate acquisitions into our operations;
- the continued ability of our distributors and suppliers to have access to sufficient liquidity to fund their operations;
- trends and other factors affecting our financial condition or results of operations from period to period;
- the impact of crop disease, severe weather conditions, such as flooding, or natural disasters, such as earthquakes, on crop quality and yields and on our ability to grow, procure or export our products;
- the impact of pricing of other crops that may be influence what crops our growers elect to plant;
- whether we are successful in aligning expense levels to revenue changes;
- whether we are successful in monetizing our stevia business;
- the cost and other implications of pending or future legislation or court decisions and pending or future accounting pronouncements; and
- other risks that are described herein including but not limited to the items discussed in "Risk Factors" below, and that are otherwise described or updated from time to time in our filings with the Securities Exchange Commission.

You are urged to carefully review the disclosures made concerning risks and uncertainties that may affect our business or operating results, which include, among others, those listed in Part I, Item 1A. "Risk Factors" of our Annual Report on Form 10-K, for the fiscal year ended June 30, 2018, as updated in Part II, Item 1A. "Risks Factors" of this Quarterly Report on Form 10-Q.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, level of activity, performance or achievements. Many factors discussed in this Quarterly Report on Form 10-Q, some of which are beyond our control, will be important in determining our future performance. Consequently, these statements are inherently uncertain and actual results may differ materially from those that might be anticipated from the forward-looking statements. In light of these and other uncertainties, you should not regard the inclusion of a forward-looking statement in this Quarterly Report on Form 10-Q as a representation by us that our plans and objectives will be achieved, and you should not place undue reliance on such forward-looking statements. All forward-looking statements included herein are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Furthermore, such forward-looking statements represent our views as of, and speak only as of, the date of this Quarterly Report on Form 10-Q, and such statements should not be read to indicate that we have conducted an exhaustive inquiry into, or review of, all potentially available relevant information. We undertake no obligation to publicly update any forward-looking statements, or to update the reasons why actual results could differ materially from those anticipated in any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

When used in this Quarterly Report on Form 10-Q, the terms "we," "us," "our," "the Company," "S&W" and "S&W Seed" refer to S&W Seed Company and its subsidiaries or, as the context may require, S&W Seed Company only. Our fiscal year ends on June 30, and accordingly, the terms "fiscal 2019," "fiscal 2018" and "fiscal 2017" in this Quarterly Report on Form 10-Q refer to the respective fiscal year ended June 30, 2019, 2018 and 2017, respectively, with corresponding meanings to any fiscal year reference beyond such dates. Trademarks, service marks and trade names of other companies appearing in this report are the property of their respective holders.

## Part I

## FINANCIAL INFORMATION

## Item 1. Financial Statements

**S&W SEED COMPANY**  
**CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

| <b>ASSETS</b>  | <b>December 31,<br/>2018</b> | <b>June 30,<br/>2018</b> |
|--|------------------------------|--------------------------|
| <b>CURRENT ASSETS</b>  |                              |                          |
| Cash and cash equivalents  | \$ 2,471,381                 | \$ 4,320,894             |
| Accounts receivable, net   | 23,178,997                   | 13,861,932               |
| Unbilled accounts receivable, net  | 11,206,984                   | -                        |
| Inventories, net   | 88,455,980                   | 60,419,276               |
| Prepaid expenses and other current assets  | 1,158,738                    | 1,279,794                |
| Assets held for sale   | 1,930,400                    | -                        |
| <b>TOTAL CURRENT ASSETS</b>  | <b>128,402,480</b>           | <b>79,881,896</b>        |
| Property, plant and equipment, net   | 22,731,765                   | 13,180,132               |
| Intangibles, net   | 39,823,195                   | 33,109,780               |
| Goodwill   | 11,865,811                   | 10,292,265               |
| Other assets   | 1,302,705                    | 1,303,135                |
| <b>TOTAL ASSETS</b>  | <b>\$ 204,125,956</b>        | <b>\$ 137,767,208</b>    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                              |                          |
| <b>CURRENT LIABILITIES</b>   |                              |                          |
| Accounts payable   | \$ 31,594,475                | \$ 5,935,454             |
| Deferred revenue   | 2,443,574                    | 212,393                  |
| Accrued expenses and other current liabilities   | 3,471,881                    | 3,114,799                |
| Lines of credit, net   | 46,310,464                   | 32,630,559               |
| Current portion of long-term debt, net   | 991,140                      | 503,012                  |
| <b>TOTAL CURRENT LIABILITIES</b>   | <b>84,811,534</b>            | <b>42,396,217</b>        |
| Long-term debt, net, less current portion  | 12,264,273                   | 12,977,087               |
| Other non-current liabilities  | 656,994                      | 651,780                  |
| <b>TOTAL LIABILITIES</b>   | <b>97,732,801</b>            | <b>56,025,084</b>        |
| <b>STOCKHOLDERS' EQUITY</b>  |                              |                          |
| Preferred stock, \$0.001 par value; 5,000,000 shares authorized;<br>no shares issued and outstanding   | -                            | -                        |
| Common stock, \$0.001 par value; 50,000,000 shares authorized;<br>33,246,141 issued and 33,221,141 outstanding at December 31, 2018;<br>24,367,906 issued and 24,342,906 outstanding at June 30, 2018; | 33,246                       | 24,367                   |
| Treasury stock, at cost, 25,000 shares   | (134,196)                    | (134,196)                |
| Additional paid-in capital   | 136,495,216                  | 108,803,991              |
| Accumulated deficit  | (23,906,501)                 | (21,161,376)             |
| Accumulated other comprehensive loss   | (6,116,283)                  | (5,790,662)              |
| Noncontrolling interests   | 21,673                       | -                        |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>  | <b>106,393,155</b>           | <b>81,742,124</b>        |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>  | <b>\$ 204,125,956</b>        | <b>\$ 137,767,208</b>    |

See notes to consolidated financial statements.

**S&W SEED COMPANY**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

|   | <b>Three Months Ended</b> |               | <b>Six Months Ended</b> |                |
|---|---------------------------|---------------|-------------------------|----------------|
|   | <b>December 31,</b>       |               | <b>December 31,</b>     |                |
|   | <b>2018</b>               | <b>2017</b>   | <b>2018</b>             | <b>2017</b>    |
| Revenue   | \$ 18,580,996             | \$ 20,532,796 | \$ 44,701,133           | \$ 31,244,512  |
| Cost of revenue   | 13,897,455                | 15,860,629    | 34,554,463              | 24,236,757     |
| Gross profit  | 4,683,541                 | 4,672,167     | 10,146,670              | 7,007,755      |
| Operating expenses  |                           |               |                         |                |
| Selling, general and administrative expenses              | 4,342,696                 | 2,446,955     | 7,230,074               | 5,361,035      |
| Research and development expenses                         | 1,373,554                 | 855,164       | 2,365,667               | 1,597,081      |
| Depreciation and amortization                             | 1,035,606                 | 870,981       | 1,890,714               | 1,759,233      |
| Disposal of property, plant and equipment loss (gain)     | 3,463                     | (15,413)      | 3,463                   | (81,776)       |
| Total operating expenses                                  | 6,755,319                 | 4,157,687     | 11,489,918              | 8,635,573      |
| Income (loss) from operations                             | (2,071,778)               | 514,480       | (1,343,248)             | (1,627,818)    |
| Other expense   |                           |               |                         |                |
| Foreign currency (gain) loss                              | (32,987)                  | 7,472         | (58,430)                | 22,030         |
| Change in derivative warrant liabilities                  | -                         | 341,199       | -                       | (431,300)      |
| Interest expense - amortization of debt discount          | 68,914                    | 33,100        | 135,392                 | 67,099         |
| Interest expense  | 641,479                   | 383,894       | 1,298,709               | 731,623        |
| Loss before income taxes                                  | (2,749,184)               | (251,185)     | (2,718,919)             | (2,017,270)    |
| Provision for income taxes                                | (4,801)                   | 148,702       | 4,533                   | 200,123        |
| Net loss including noncontrolling interests               | \$ (2,744,383)            | \$ (399,887)  | \$ (2,723,452)          | \$ (2,217,393) |
| Net income attributed to noncontrolling interest          | 21,673                    | -             | 21,673                  | -              |
| Net loss attributed to S&W Seed Company                   | \$ (2,766,056)            | \$ (399,887)  | \$ (2,745,125)          | \$ (2,217,393) |
| Net loss attributed to S&W Seed Company per common share: |                           |               |                         |                |
| Basic   | \$ (0.09)                 | \$ (0.02)     | \$ (0.10)               | \$ (0.11)      |
| Diluted   | \$ (0.09)                 | \$ (0.02)     | \$ (0.10)               | \$ (0.11)      |
| Weighted average number of common shares outstanding:     |                           |               |                         |                |
| Basic   | 29,153,852                | 21,130,960    | 26,996,483              | 20,643,973     |
| Diluted   | 29,153,852                | 21,130,960    | 26,996,483              | 20,643,973     |

See notes to consolidated financial statements.



S&W SEED COMPANY  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
 (UNAUDITED)

|   | <b>Three Months Ended</b> |              | <b>Six Months Ended</b> |                |
|---|---------------------------|--------------|-------------------------|----------------|
|   | <b>December 31,</b>       |              | <b>December 31,</b>     |                |
|   | <b>2018</b>               | <b>2017</b>  | <b>2018</b>             | <b>2017</b>    |
| Net loss  | \$ (2,744,383)            | \$ (399,887) | \$ (2,723,452)          | \$ (2,217,393) |
| Foreign currency translation adjustment, net of income taxes  | (143,198)                 | (41,223)     | (325,621)               | 115,430        |
| Comprehensive loss  | \$ (2,887,581)            | \$ (441,110) | \$ (3,049,073)          | \$ (2,101,963) |
| Comprehensive income attributable to noncontrolling interests | 21,673                    | -            | 21,673                  | -              |
| Comprehensive loss attributable to S&W Seed Company           | \$ (2,909,254)            | \$ (441,110) | \$ (3,070,746)          | \$ (2,101,963) |

See notes to consolidated financial statements.

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S&W SEED COMPANY  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(UNAUDITED)

|  | Preferred Stock |        | Common Stock |           | Treasury Stock |              | Additional         | Accumulated     | Accumulated                    | Noncontrolling | Total          |
|--|-----------------|--------|--------------|-----------|----------------|--------------|--------------------|-----------------|--------------------------------|----------------|----------------|
|  | Shares          | Amount | Shares       | Amount    | Shares         | Amount       | Paid-In<br>Capital | Deficit         | Other<br>Comprehensive<br>Loss | Interests      | Equity         |
| <b>Balance, June 30, 2017</b>                          | -               | \$ -   | 18,004,681   | \$ 18,004 | (25,000)       | \$ (134,196) | \$ 83,312,518      | \$ (16,436,286) | \$ (5,538,385)                 | \$ -           | \$ 61,221,000  |
| Stock-based compensation - restricted stock, RSUs      | -               | -      | -            | -         | -              | -            | 451,033            | -               | -                              | -              | 451,033        |
| Issuance to RSUs                                       | -               | -      | 88,619       | 89        | -              | -            | (113,777)          | -               | -                              | -              | (113,777)      |
| Proceeds from sale of common stock, net of expenses    | -               | -      | 6,260,000    | 6,260     | -              | -            | 22,512,956         | -               | -                              | -              | 22,519,216     |
| Classification of warrants on expiration               | -               | -      | -            | -         | -              | -            | 2,405,300          | -               | -                              | -              | 2,405,300      |
| Other comprehensive income                             | -               | -      | -            | -         | -              | -            | -                  | -               | 115,430                        | -              | 115,430        |
| Loss   | -               | -      | -            | -         | -              | -            | -                  | (2,217,393)     | -                              | -              | (2,217,393)    |
| <b>Balance, September 30, 2017</b>                     | -               | \$ -   | 24,353,300   | \$ 24,353 | (25,000)       | \$ (134,196) | \$ 108,568,030     | \$ (18,653,679) | \$ (5,422,955)                 | \$ -           | \$ 84,381,000  |
| <b>Balance, June 30, 2018</b>                          | -               | \$ -   | 24,367,906   | \$ 24,367 | (25,000)       | \$ (134,196) | \$ 108,803,991     | \$ (21,161,376) | \$ (5,790,662)                 | \$ -           | \$ 81,742,000  |
| Stock-based compensation - restricted stock, RSUs      | -               | -      | -            | -         | -              | -            | 377,458            | -               | -                              | -              | 377,458        |
| Issuance to RSUs                                       | -               | -      | 35,518       | 36        | -              | -            | (25,534)           | -               | -                              | -              | (25,534)       |
| Proceeds from sale of preferred stock, net of expenses | 7,235           | 7      | -            | -         | -              | -            | 22,420,455         | -               | -                              | -              | 22,427,687     |
| Conversion of preferred stock to common stock          | (7,235)         | (7)    | 7,235,000    | 7,235     | -              | -            | (7,228)            | -               | -                              | -              | 7,230,007      |
| Proceeds from sale of common stock, net of expenses    | -               | -      | 1,607,717    | 1,608     | -              | -            | 4,926,074          | -               | -                              | -              | 4,927,399      |
| Other comprehensive income                             | -               | -      | -            | -         | -              | -            | -                  | -               | (325,621)                      | -              | (325,621)      |
| Loss   | -               | -      | -            | -         | -              | -            | -                  | (2,745,125)     | -                              | 21,673         | (2,723,452)    |
| <b>Balance, September 30, 2018</b>                     | -               | \$ -   | 33,246,141   | \$ 33,246 | (25,000)       | \$ (134,196) | \$ 136,495,216     | \$ (23,906,501) | \$ (6,116,283)                 | \$ 21,673      | \$ 106,393,000 |

See notes to consolidated financial statements.

**S&W SEED COMPANY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

|  | <b>Six Months Ended</b> |                |
|--|-------------------------|----------------|
|  | <b>December 31,</b>     |                |
|  | <b>2018</b>             | <b>2017</b>    |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                         |                |
| Net loss   | \$ (2,723,452)          | \$ (2,217,393) |
| Adjustments to reconcile net loss from operating activities to net cash used in operating activities |                         |                |
| Stock-based compensation   | 377,458                 | 451,033        |
| Change in allowance for doubtful accounts  | (154,364)               | 20,547         |
| Depreciation and amortization  | 1,890,715               | 1,759,233      |
| Loss (gain) on disposal of property, plant and equipment   | 3,463                   | (81,776)       |
| Change in foreign exchange contracts   | 2,626                   | 100,864        |
| Change in derivative warrant liabilities   | -                       | (431,300)      |
| Amortization of debt discount  | 135,392                 | 67,099         |
| Changes in:  |                         |                |
| Accounts receivable  | (8,336,183)             | (1,960,907)    |
| Unbilled accounts receivable   | (11,206,984)            | -              |
| Inventories  | (21,513,547)            | (38,850,545)   |
| Prepaid expenses and other current assets  | 123,752                 | (377,920)      |
| Other non-current asset  | -                       | (4,963)        |
| Accounts payable   | 23,698,244              | 25,606,471     |
| Accounts payable - related parties   | -                       | (216,112)      |
| Deferred revenue   | 1,458,655               | (614,523)      |
| Accrued expenses and other current liabilities   | 384,628                 | (67,000)       |
| Other non-current liabilities  | (40,855)                | 148,147        |
| Net cash used in operating activities  | (15,900,452)            | (16,669,045)   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                         |                |
| Additions to property, plant and equipment   | (336,623)               | (815,063)      |
| Additions to internal use software   | (43,000)                | -              |
| Proceeds from disposal of property, plant and equipment  | 24,106                  | 46,218         |
| Acquisition of business, net of cash acquired  | (26,354,951)            | -              |
| Net cash used in investing activities  | (26,710,468)            | (768,845)      |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                         |                |
| Net proceeds from sale of common stock   | 4,927,682               | 22,519,216     |
| Net proceeds from sale of preferred stock  | 22,420,462              | -              |
| Taxes paid related to net share settlements of stock-based compensation awards                       | (25,497)                | (113,688)      |
| Borrowings and repayments on lines of credit, net  | 14,299,326              | 38,574         |
| Payment of contingent consideration obligation   | -                       | (2,500,000)    |
| Borrowings of long-term debt   | 2,369,071               | 12,500,000     |
| Debt issuance costs  | (354,589)               | (257,964)      |
| Repayments of long-term debt   | (2,682,056)             | (10,113,415)   |
| Net cash provided by financing activities  | 40,954,399              | 22,072,723     |
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>   | (192,992)               | 74,860         |
| <b>NET (DECREASE) INCREASE IN CASH &amp; CASH EQUIVALENTS</b>  | (1,849,513)             | 4,709,693      |
| <b>CASH AND CASH EQUIVALENTS, beginning of the period</b>  | \$ 4,320,894            | \$ 745,001     |
| <b>CASH AND CASH EQUIVALENTS, end of period</b>  | \$ 2,471,381            | \$ 5,454,694   |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>   |                         |                |
| Cash paid during the period for:   |                         |                |
| Interest   | \$ 1,106,256            | \$ 776,882     |
| Income taxes   | 13,304                  | 42,244         |

See notes to consolidated financial statements.

S&W SEED COMPANY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

NOTE 1 - BACKGROUND AND ORGANIZATION

Organization

S&W Seed Company, a Nevada corporation (the "Company"), began as S&W Seed Company, a general partnership, in 1980 and was originally in the business of breeding, growing, processing and selling alfalfa seed. We then incorporated a corporation with the same name in Delaware in October 2009, which is the successor entity to Seed Holding, LLC, having purchased a majority interest in the general partnership between June 2008 and December 2009. Following the Company's initial public offering in May 2010, the Company purchased the remaining general partnership interests and became the sole owner of the general partnership's original business. Seed Holding, LLC remains a consolidated subsidiary of the Company.

In December 2011, the Company reincorporated in Nevada as a result of a statutory short-form merger of the Delaware corporation into its wholly-owned subsidiary, S&W Seed Company, a Nevada corporation.

On April 1, 2013, the Company, together with its wholly-owned subsidiary, S&W Holdings Australia Pty Ltd, an Australia corporation (f/k/a S&W Seed Australia Pty Ltd "S&W Holdings"), consummated an acquisition of all of the issued and outstanding shares of Seed Genetics International Pty Ltd, an Australia corporation ("SGI"), from SGI's shareholders. In April 2018, SGI changed its name to S&W Seed Company Australia Pty Ltd ("S&W Australia").

Business Overview

Since its establishment, the Company, including its predecessor entities, has been principally engaged in breeding, growing, processing and selling agricultural seeds. The Company owns seed cleaning and processing facilities, which are located in Five Points, California, Nampa, Idaho, Dumas, Texas, New Deal, Texas and Keith, South Australia. The Company's seed products are primarily grown under contract by farmers. The Company began its stevia initiative in fiscal year 2010 and is currently focused on breeding improved varieties of stevia and developing marketing and distribution programs for its stevia products.

The Company has also been actively engaged in expansion initiatives through a combination of organic growth and strategic acquisitions, including in December 31, 2014, when the Company purchased certain alfalfa research and production facilities and conventional (non-GMO) alfalfa germplasm assets and assumed certain related liabilities ("the Pioneer Acquisition") of Pioneer Hi-Bred International, Inc. ("DuPont Pioneer").

The Company has a long-term distribution agreement with DuPont Pioneer regarding conventional (non-GMO) varieties, the term of which extends into 2024. The Company's production agreement with DuPont Pioneer (relating to GMO-traited varieties) terminates on May 31, 2019. Although the production agreement will terminate on May 31, 2019, the Company expects that the DuPont Pioneer distribution agreement will continue to be a significant source of the Company's annual revenue through December 2024.

In May 2016, the Company acquired the assets and business of SV Genetics, a private Australian company specializing in the breeding and licensing of proprietary hybrid sorghum and sunflower seed germplasm, which represented the Company's initial effort to diversify its product portfolio beyond alfalfa seed and stevia.

In October 2018, the Company acquired substantially all of the assets of Chromatin, Inc., a U.S.-based sorghum genetics and seed company, as part of the Company's efforts to expand its penetration into the hybrid sorghum market.

The Company's operations span the world's seed production regions with operations in the San Joaquin and Imperial Valleys of California, Texas, five other U.S. states, Australia, and three provinces in Canada, and the Company sells its seed products in more than 30 countries around the globe.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation and Principles of Consolidation

The consolidated financial statements include the accounts of S&W Seed Company and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements were prepared in accordance with U.S. GAAP and include the assets, liabilities, revenue and expenses of all wholly-owned subsidiaries and majority-owned subsidiaries over which the Company's exercises control. Outside stockholders' interests in subsidiaries are shown on the condensed consolidated financial statements as Noncontrolling interests.

### Unaudited Interim Financial Information

The Company has prepared the accompanying consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial reporting. These consolidated financial statements are unaudited and, in the Company's opinion, include all adjustments, consisting of normal recurring adjustments and accruals, necessary for a fair presentation of the Company's consolidated balance sheets, statements of operations, comprehensive income (loss), cash flows and stockholders' equity for the periods presented. Operating results for the periods presented are not necessarily indicative of the results to be expected for the full year ending June 30, 2019. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended June 30, 2018, as filed with the SEC.

### Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates are adjusted to reflect actual experience when necessary. Significant estimates and assumptions affect many items in the financial statements. These include allowance for doubtful trade receivables, inventory valuation, revenue recognition, asset impairments, provisions for income taxes, grower accruals (an estimate of amounts payable to farmers who grow seed for the Company), contingent consideration obligations, derivative

liabilities, contingencies and litigation. Significant estimates and assumptions are also used to establish the fair value and useful lives of depreciable tangible and certain intangible assets, goodwill as well as valuing stock-based compensation. Actual results may differ from those estimates and assumptions, and such results may affect income, financial position or cash flows.

#### Certain Risks and Concentrations

The Company's revenue is principally derived from the sale of seed, the market for which is highly competitive. One customer accounted for 52% and 75% of its revenue for the three months ended December 31, 2018 and 2017, respectively. One customer accounted for 65% and 58% of its revenue for the six months ended December 31, 2018 and 2017, respectively.

Three customers accounted for 28% of the Company's accounts receivable at December 31, 2018. One customer accounted for 35% of the Company's accounts receivable at June 30, 2018.

In addition, the Company sells a substantial portion of its products to international customers. Sales to international markets represented 33% and 23% of revenue during the three months ended December 31, 2018 and 2017, respectively. Sales to international markets represented 23% and 38% of revenue during the six months ended December 31, 2018 and 2017, respectively. The net book value of fixed assets located outside the United States was 11% of total assets at December 31, 2018. The net book value of fixed assets located outside the United States was 20% at June 30, 2018. Cash balances located outside of the United States may not be insured and totaled \$286,823 and \$369,803 at December 31, 2018 and June 30, 2018, respectively.

The following table shows revenue from external sources by destination country:

|               | Three Months Ended December 31, |      |               |      | Six Months Ended December 31, |      |               |      |
|---------------|---------------------------------|------|---------------|------|-------------------------------|------|---------------|------|
|               | 2018                            |      | 2017          |      | 2018                          |      | 2017          |      |
| United States | \$ 12,464,626                   | 67%  | \$ 15,740,706 | 77%  | \$ 34,204,005                 | 77%  | \$ 19,265,254 | 62%  |
| Australia     | 1,040,480                       | 6%   | 438,468       | 2%   | 1,370,150                     | 3%   | 557,998       | 2%   |
| Mexico        | 986,303                         | 5%   | 1,664,618     | 8%   | 1,379,253                     | 3%   | 4,380,626     | 14%  |
| Saudi Arabia  | 863,982                         | 5%   | 513,000       | 2%   | 1,570,275                     | 4%   | 844,908       | 3%   |
| Libya         | 800,375                         | 4%   | 563,673       | 3%   | 1,798,750                     | 4%   | 752,673       | 2%   |
| Argentina     | 556,227                         | 3%   | 1,183,423     | 6%   | 562,164                       | 1%   | 2,742,619     | 9%   |
| Pakistan      | 464,936                         | 3%   | -             | 0%   | 730,583                       | 2%   | -             | 0%   |
| Peru          | 299,245                         | 2%   | 313,688       | 2%   | 709,495                       | 2%   | 608,413       | 2%   |
| Other         | 1,104,822                       | 5%   | 115,220       | 0%   | 2,376,458                     | 4%   | 2,092,021     | 6%   |
| Total         | \$ 18,580,996                   | 100% | \$ 20,532,796 | 100% | \$ 44,701,133                 | 100% | \$ 31,244,512 | 100% |

#### International Operations

The Company translates its foreign operations' assets and liabilities denominated in foreign currencies into U.S. dollars at the current rates of exchange as of the balance sheet date and income and expense items at the average exchange rate for the reporting period. Translation adjustments resulting from exchange rate fluctuations are recorded in the cumulative translation account, a component of accumulated other comprehensive income (loss). Gains or losses from foreign currency transactions are included in the consolidated statement of operations.

## Revenue Recognition

The Company adopted the provisions of ASC Topic 606, *Revenue from Contracts with Customers* ("Topic 606") as of July 1, 2018. See Note 3 for further discussion.

## Cost of Revenue

The Company records purchasing and receiving costs, inspection costs and warehousing costs in cost of revenue. When the Company is required to pay for outward freight and/or the costs incurred to deliver products to its customers, the costs are included in cost of revenue.

## Cash and Cash Equivalents

For financial statement presentation purposes, the Company considers time deposits, certificates of deposit and all highly liquid investments with original maturities of three months or less to be cash and cash equivalents. At times, cash and cash equivalents balances exceed amounts insured by the Federal Deposit Insurance Corporation.

## Accounts Receivable

The Company provides an allowance for doubtful trade receivables equal to the estimated uncollectible amounts. That estimate is based on historical collection experience, current economic and market conditions and a review of the current status of each customer's trade accounts receivable. The allowance for doubtful trade receivables was \$430,964 and \$584,202 at December 31, 2018 and June 30, 2018, respectively.

## Inventories

Inventories consist of seed and packaging materials.

Inventories are stated at the lower of cost or net realizable value, and an inventory reserve permanently reduces the cost basis of inventory. Inventories are valued as follows: Actual cost is used to value raw materials such as packaging materials, as well as goods in process. Costs for substantially all finished goods, which include the cost of carryover crops from the previous year, are valued at actual cost. Actual cost for finished goods includes plant conditioning and packaging costs, direct labor and raw materials and manufacturing overhead costs based on normal capacity. The Company records abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) as current period charges and allocates fixed production overhead to the costs of finished goods based on the normal capacity of the production facilities.

The Company's subsidiary, S&W Australia, does not fix the final price for seed payable to its growers until the completion of a given year's sales cycle pursuant to its standard contract production agreement. S&W Australia records an estimated unit price; accordingly, inventory, cost of revenue and gross profits are based upon management's best estimate of the final purchase price to growers.

Inventory is periodically reviewed to determine if it is marketable, obsolete or impaired. Inventory that is determined to be obsolete or impaired is written off to expense at the time the impairment is identified. Inventory quality is a function of germination percentage. Alfalfa seed quality is very stable under proper



storage conditions therefore, inventory obsolescence for alfalfa seed is not a material concern. Hybrid crops (sorghum and sunflower) seed quality may be affected by warehouse storage pests such as insects and rodents. The Company maintains a strict pest control program to mitigate risk and maximize hybrid seed quality.

The Company sells its inventory to distributors, dealers and directly to growers.

Components of inventory are:

|                            | <b>December 31,<br/>2018</b> | <b>June 30,<br/>2018</b> |
|----------------------------|------------------------------|--------------------------|
| Raw materials and supplies | \$ 955,372                   | \$ 344,620               |
| Work in progress           | 22,820,169                   | 2,775,398                |
| Finished goods             | 64,680,439                   | 57,299,258               |
|                            | \$ 88,455,980                | \$ 60,419,276            |

### Property, Plant and Equipment

Property, plant and equipment is depreciated using the straight-line method over the estimated useful life of the asset - periods of 5-35 years for buildings, 3-20 years for machinery and equipment, and 2-5 years for vehicles.

### Intangible Assets

Intangible assets acquired in business acquisitions are reported at their initial fair value less accumulated amortization. Intangible assets are amortized using the straight-line method over the estimated useful life of the asset. Periods of 10-30 years for technology/IP/germplasm, 5-20 years for customer relationships and trade names and 3-20 for other intangible assets. The weighted average estimated useful lives are 27 years for technology/IP/germplasm, 17 years for customer relationships and 18 years for trade names and other intangible assets.

### Goodwill

Goodwill is assessed at least annually, or when certain triggering events occur, for impairment using fair value measurement techniques. These events could include a significant change in the business climate, legal factors, a decline in operating performance, competition, sale or disposition of a significant portion of the business, or other factors. The Company first assesses qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. If management concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, management then develops a detailed estimate of the reporting unit's fair value. The Company uses market capitalization and an estimate of a control premium, as well as a discounted cash flow analysis to estimate the fair value of its one reporting unit. Management then compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. The Company performed a qualitative assessment of goodwill at December 31, 2018 and determined that goodwill was not impaired.

### Equity Method Investments

Investee companies that are not consolidated, but over which the Company exercises significant influence, are accounted for under the equity method of accounting. Whether or not the Company exercises significant influence with respect to an investee depends on an evaluation of several factors including, among others, representation on the investee company's board of directors and ownership level, which is generally a 20% to 50% interest in the voting securities of the investee company. Under the equity method of accounting, an investee company's accounts are not reflected within the Company's consolidated balance sheets and statements of operations; however, the Company's share of the earnings or losses of the investee company is reflected in the caption "Loss on equity method investment" in the consolidated statements of operations. The Company's carrying value in an equity method investee company is included in the Company's consolidated balance sheets. When the Company's carrying value in an equity method investee company is reduced to zero, no further losses are recorded in the Company's consolidated financial statements unless the Company guaranteed obligations of the investee company or has committed additional funding. When the investee company subsequently reports income, the Company will not record its share of such income until it equals the amount of its share of losses not previously recognized.

### Cost Method Investments

Investee companies not accounted for under the consolidation or the equity method of accounting are accounted for under the cost method of accounting. Under this method, the Company's share of the earnings or losses of such investee companies is not included in the consolidated balance sheet or statement of operations. However, impairment charges are recognized in the consolidated statement of operations. If circumstances suggest that the value of the investee company has subsequently recovered, such recovery is not recorded.

### Research and Development Costs

The Company is engaged in ongoing research and development ("R&D") of proprietary seed and stevia varieties. All R&D costs must be charged to expense as incurred. Accordingly, internal R&D costs are expensed as incurred. Third-party R&D costs are expensed when the contracted work has been performed or as milestone results have been achieved. The costs associated with equipment or facilities acquired or constructed for R&D activities that have alternative future uses are capitalized and depreciated on a straight-line basis over the estimated useful life of the asset.

### Income Taxes

Deferred tax assets and liabilities are determined based on differences between the financial statement and tax basis of assets and liabilities, as well as a consideration of net operating loss and credit carry forwards, using enacted tax rates in effect for the period in which the differences are expected to impact taxable income. A valuation allowance is established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized. The Company's effective tax rate for the three and six months ended December 31, 2018 and 2017 has been affected by the valuation allowance on the Company's deferred tax assets.

## Net Income (Loss) Per Common Share Data

Basic net income (loss) per common share ("EPS"), is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting both the numerator (net income (loss)) and the denominator (weighted-average number of shares outstanding) for the dilutive effects of potentially dilutive securities, including convertible preferred stock, options, restricted stock awards, and common stock warrants.

The treasury stock method is used for common stock warrants, stock options, and restricted stock awards. Under this method, consideration that would be received upon exercise (as well as remaining compensation cost to be recognized for awards not yet vested) is assumed to be used to repurchase shares of stock in the market, with net number of shares assumed to be issued added to the denominator.

The calculation of Basic and Diluted EPS is shown in the table below. Classes of securities identified in the table with no adjustments in the calculation of Diluted EPS were determined to be antidilutive for the applicable periods.

|  | Three Months Ended<br>December 31, |              | Six Months Ended<br>December 31, |                |
|--|------------------------------------|--------------|----------------------------------|----------------|
|  | 2018                               | 2017         | 2018                             | 2017           |
| <b>Numerator:</b>  |                                    |              |                                  |                |
| Net loss attributed to S&W Seed Company  | \$ (2,766,056)                     | \$ (399,887) | \$ (2,745,125)                   | \$ (2,217,393) |
| Numerator for basis EPS  | (2,766,056)                        | (399,887)    | (2,745,125)                      | (2,217,393)    |
| Effect of dilutive securities:   |                                    |              |                                  |                |
| Warrants   | -                                  | -            | -                                | -              |
| Numerator for diluted EPS  | \$ (2,766,056)                     | \$ (399,887) | \$ (2,745,125)                   | \$ (2,217,393) |
| <b>Denominator:</b>  |                                    |              |                                  |                |
| Denominator for basic EPS -<br>weighted-average shares                                       | 29,153,852                         | 21,130,960   | 26,996,483                       | 20,643,973     |
| Effect of dilutive securities:   |                                    |              |                                  |                |
| Employee stock options   | -                                  | -            | -                                | -              |
| Employee restricted stock units  | -                                  | -            | -                                | -              |
| Warrants   | -                                  | -            | -                                | -              |
| Dilutive potential common shares   | -                                  | -            | -                                | -              |
| Denominator for diluted EPS -<br>adjusted weighted average shares<br>and assumed conversions | 29,153,852                         | 21,130,960   | 26,996,483                       | 20,643,973     |
| Basic EPS  | \$ (0.09)                          | \$ (0.02)    | \$ (0.10)                        | \$ (0.11)      |
| Diluted EPS  | \$ (0.09)                          | \$ (0.02)    | \$ (0.10)                        | \$ (0.11)      |

## Impairment of Long-Lived Assets

The Company evaluates its long-lived assets for impairment annually or more often if events and circumstances warrant. Events relating to recoverability may include significant unfavorable changes in business conditions, recurring losses or a forecasted inability to achieve break-even operating results over an extended period. The Company evaluates the recoverability of long-lived assets based upon forecasted undiscounted cash flows. Should impairment in value be indicated, the carrying value of long-lived assets will be adjusted, based on estimates of future discounted cash flows resulting from the use and ultimate disposition of the asset.

## Derivative Financial Instruments

### Foreign Exchange Contracts

The Company's subsidiary, S&W Australia, is exposed to foreign currency exchange rate fluctuations in the normal course of its business, which the Company at times manages through the use of foreign currency forward contracts.

The Company has entered into certain derivative financial instruments (specifically foreign currency forward contracts), and accounts for these instruments in accordance with ASC Topic 815, "Derivatives and Hedging", which establishes accounting and reporting standards requiring that derivative instruments be recorded on the balance sheet as either an asset or liability measured at fair value. The Company's foreign currency contracts are not designated as hedging instruments under ASC 815; accordingly, changes in the fair value are recorded in current period earnings.

### Derivative Liabilities

The Company reviews the terms of the common stock, preferred stock, warrants and convertible debt it issues to determine whether there are embedded derivative instruments, including embedded conversion options and redemption options, which are required to be bifurcated and accounted for separately as derivative financial instruments.

## Fair Value of Financial Instruments

The Company discloses assets and liabilities that are recognized and measured at fair value, presented in a three-tier fair value hierarchy, as follows:

- Level 1. Observable inputs such as quoted prices in active markets;
- Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The assets acquired and liabilities assumed in the Chromatin acquisition were valued at fair value on a non-recurring basis as of October 25, 2018. No assets or liabilities were valued at fair value on a non-recurring basis as of December 31, 2018 or June 30, 2018.

The carrying value of cash and cash equivalents, accounts payable, short-term and all long-term borrowings, as reflected in the consolidated balance sheets, approximate fair value because of the short-term maturity of these instruments or interest rates commensurate with market rates. There have been no changes in operations and/or credit characteristics since the date of issuance that could impact the relationship between interest rate and market rates.

Assets and liabilities that are recognized and measured at fair value on a recurring basis are categorized as follows:

|                                     | Fair Value Measurements as of December 31, 2018 Using: |           |         |
|-------------------------------------|--|-----------|---------|
|                                     | Level 1  | Level 2   | Level 3 |
| Foreign exchange contract liability | \$ -   | \$ 98,071 | \$ -    |
| Total                               | \$ -   | \$ 98,071 | \$ -    |

|                                     | Fair Value Measurements as of June 30, 2018 Using: |            |         |
|-------------------------------------|--|------------|---------|
|                                     | Level 1  | Level 2    | Level 3 |
| Foreign exchange contract liability | \$ -   | \$ 100,138 | \$ -    |
| Total                               | \$ -   | \$ 100,138 | \$ -    |

#### Recently Adopted Accounting Pronouncements

The Company adopted Accounting Standards Update No. 2017-04, *Simplifying the Test for Goodwill Impairment* ("ASU 2017-04") effective July 1, 2018. This standard eliminates Step 2 from the goodwill impairment test. Instead, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The adoption did not have a material impact on the consolidated financial statements.

The Company adopted Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers*, ("Topic 606") as of July 1, 2018. This ASC topic outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most previously existing revenue recognition guidance under U.S. GAAP. The core principle of Topic 606 is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services.

The Company adopted Topic 606 using the modified retrospective approach, in which the cumulative effect of applying the new standards to open contracts as of July 1, 2018 was to be recognized as a cumulative effect adjustment. The adoption did not result in a cumulative effect adjustment as of July 1, 2018.

The adoption of Topic 606 had a significant effect on the Company's accounting for its distribution and production agreements with Pioneer for the three and six months ended December 31, 2018. There were no other changes in the Company's accounting as a result of the adoption of Topic 606.

The change in the accounting for the distribution and production agreements with Pioneer arises from the provisions of Topic 606 regarding the determination of whether a performance obligation is satisfied at a point in time or over time. Under those provisions, a performance obligation is considered to be satisfied over time if the company's performance creates an asset that the customer controls as the asset is created or enhanced; or the work to satisfy the performance obligation does not create an asset with alternative future use to the vendor and the customer has an obligation to pay for work completed. Under the agreements, Pioneer submits a demand plan to the Company in advance of the growing season specifying the amount of seed that it intends to order for the upcoming sales year. Once the demand plan is submitted, Pioneer cannot cancel or reduce the amount of seed that it is obligated to purchase under the agreements. In addition, the Company is not permitted to sell products produced for Pioneer under the agreements to other customers. Therefore, under Topic 606, the performance obligation is satisfied, and revenue is recognized, over time, as the Company takes delivery of, processes, and packages the seed.

The Company has concluded that cost is the best measure of progress under the Pioneer contracts because no other measure adequately reflects the value added to the product by each of the Company's major tasks - having the crop grown, processing, and packaging. As the Company contracts out the growing of seed to third parties, the vast majority of the Company's costs under these agreements are incurred, and therefore the vast majority of the revenue from such agreements is recognized, when the raw seed is purchased from the third-party contract growers. The rest of the costs are incurred, and therefore the rest of the revenue is recognized, as the Company processes and packages the product. Because revenue is recognized as costs are incurred, no inventory costs related to performance under the Pioneer contract are capitalized as inventory - instead, they are recognized as expenses as they are incurred.

Prior to the adoption of Topic 606, revenue related to the Pioneer agreement was recognized when seed was delivered to Pioneer. Costs incurred to purchase and process seed were capitalized as inventory until the product was delivered. As the Company adopted Topic 606 using the modified retrospective approach, figures for fiscal 2018 have not been adjusted and continue to reflect the prior accounting policies.

The change in accounting for the Pioneer contract did not result in a cumulative effect adjustment, because all seed produced for Pioneer in previous growing seasons had been delivered, and revenue recognized, prior to July 1, 2018, and no seed had been received prior to July 1, 2018 related to the current growing season. However, the change materially affected the amount of revenue and costs recognized during the three and six months ended December 31, 2018. The effects of the new accounting for the Pioneer contracts on the Company's financial statements are shown below:

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|   | Three Months Ended<br>December 31, 2018 |              |  | Six Months Ended<br>December 31, 2018 |                 |  |
|---|---|--------------|--|---------------------------------------|-----------------|--|
|   | As Reported                             | Adjustments  | Balances Without<br>Adoption of ASC<br>606 | As Reported                           | Adjustments     | Balances Without<br>Adoption of ASC<br>606 |
| Revenue   | \$ 18,580,996                           | \$ 6,288,847 | \$ 24,869,843                              | \$ 44,701,133                         | \$ (11,050,488) | \$ 33,650,645                              |
| Cost of revenue                                       | 13,897,455                              | 5,927,174    | 19,824,629                                 | 34,554,463                            | (7,158,038)     | 27,396,425                                 |
| Gross profit  | 4,683,541                               | 361,673      | 5,045,214                                  | 10,146,670                            | (3,892,450)     | 6,254,220                                  |
| Operating expenses                                    |   |              |  |                                       |                 |  |
| Selling, general and administrative expenses          | 4,342,696                               | -            | 4,342,696                                  | 7,230,074                             | -               | 7,230,074                                  |
| Research and development expenses                     | 1,373,554                               | -            | 1,373,554                                  | 2,365,667                             | -               | 2,365,667                                  |
| Depreciation and amortization                         | 1,035,606                               | -            | 1,035,606                                  | 1,890,714                             | -               | 1,890,714                                  |
| Disposal of property, plant and equipment gain        | 3,463                                   | -            | 3,463                                      | 3,463                                 | -               | 3,463                                      |
| Total operating expenses                              | 6,755,319                               | -            | 6,755,319                                  | 11,489,918                            | -               | 11,489,918                                 |
| Income (loss) from operations                         | (2,071,778)                             | 361,673      | (1,710,105)                                | (1,343,248)                           | (3,892,450)     | (5,235,698)                                |
| Other expense   |   |              |  |                                       |                 |  |
| Foreign currency (gain) loss                          | (32,987)                                | -            | (32,987)                                   | (58,430)                              | -               | (58,430)                                   |
| Change in derivative warrant liabilities              | -                                       | -            | -  | -                                     | -               | -  |
| Interest expense - amortization of debt discount      | 68,914                                  | -            | 68,914                                     | 135,392                               | -               | 135,392                                    |
| Interest expense                                      | 641,479                                 | -            | 641,479                                    | 1,298,709                             | -               | 1,298,709                                  |
| Income (loss) before income taxes                     | (2,749,184)                             | 361,673      | (2,387,511)                                | (2,718,919)                           | (3,892,450)     | (6,611,369)                                |
| Provision for income taxes                            | (4,801)                                 | 15,944       | 11,143                                     | 4,533                                 | (51,091)        | (46,558)                                   |
| Net income (loss) before noncontrolling interests     | \$ (2,744,383)                          | \$ 345,729   | \$ (2,398,654)                             | \$ (2,723,452)                        | \$ (3,841,359)  | \$ (6,564,811)                             |
| Net income attributed to noncontrolling interest      | 21,673                                  | -            | 21,673                                     | 21,673                                | -               | 21,673                                     |
| Net loss attributed to S&W Seed Company               | \$ (2,766,056)                          | \$ 345,729   | \$ (2,420,327)                             | \$ (2,745,125)                        | \$ (3,841,359)  | \$ (6,586,484)                             |
| Net income (loss) per common share:                   |   |              |  |                                       |                 |  |
| Basic   | \$ (0.09)                               | \$ 0.01      | \$ (0.08)                                  | \$ (0.10)                             | \$ (0.14)       | \$ (0.24)                                  |
| Diluted   | \$ (0.09)                               | \$ 0.01      | \$ (0.08)                                  | \$ (0.10)                             | \$ (0.14)       | \$ (0.24)                                  |
| Weighted average number of common shares outstanding: |   |              |  |                                       |                 |  |
| Basic   | 29,153,852                              | -            | 29,153,852                                 | 26,996,483                            | -               | 26,996,483                                 |
| Diluted   | 29,153,852                              | -            | 29,153,852                                 | 26,996,483                            | -               | 26,996,483                                 |

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|   | December 31, 2018     |                       |   |
|---|-----------------------|-----------------------|---|
|   | As Reported           | Adjustments           | Balances<br>Without<br>Adoption of<br>ASC 606 |
| <b>ASSETS</b>   |                       |                       |   |
| <b>CURRENT ASSETS</b>   |                       |                       |   |
| Cash and cash equivalents   | \$ 2,471,381          | \$ -                  | \$ 2,471,381                                  |
| Accounts receivable, net  | 23,178,997            | -                     | 23,178,997                                    |
| Unbilled accounts receivable, net   | 11,206,984            | (11,206,984)          | -   |
| Inventories, net  | 88,455,980            | 7,158,038             | 95,614,018                                    |
| Prepaid expenses and other current assets   | 1,158,738             | -                     | 1,158,738                                     |
| Assets held for sale  | 1,930,400             | -                     | 1,930,400                                     |
| <b>TOTAL CURRENT ASSETS</b>   | <b>128,402,480</b>    | <b>(4,048,946)</b>    | <b>124,353,534</b>                            |
| Property, plant and equipment, net  | 22,731,765            | -                     | 22,731,765                                    |
| Intangibles, net  | 39,823,195            | -                     | 39,823,195                                    |
| Goodwill  | 11,865,811            | -                     | 11,865,811                                    |
| Other assets  | 1,302,705             | -                     | 1,302,705                                     |
| <b>TOTAL ASSETS</b>   | <b>\$ 204,125,956</b> | <b>\$ (4,048,946)</b> | <b>\$ 200,077,010</b>                         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                       |   |
| <b>CURRENT LIABILITIES</b>  |                       |                       |   |
| Accounts payable  | \$ 31,594,475         | \$ -                  | \$ 31,594,475                                 |
| Deferred revenue  | 2,443,574             | -                     | 2,443,574                                     |
| Accrued expenses and other current liabilities  | 3,471,881             | (156,496)             | 3,315,385                                     |
| Lines of credit, net  | 46,310,464            | -                     | 46,310,464                                    |
| Current portion of long-term debt, net  | 991,140               | -                     | 991,140                                       |
| <b>TOTAL CURRENT LIABILITIES</b>  | <b>84,811,534</b>     | <b>(156,496)</b>      | <b>84,655,038</b>                             |
| Long-term debt, net, less current portion   | 12,264,273            | -                     | 12,264,273                                    |
| Other non-current liabilities   | 656,994               | (51,091)              | 605,903                                       |
| <b>TOTAL LIABILITIES</b>  | <b>97,732,801</b>     | <b>(207,587)</b>      | <b>97,525,214</b>                             |
| <b>STOCKHOLDERS' EQUITY</b>   |                       |                       |   |
| Preferred stock, \$0.001 par value; 5,000,000 shares authorized;<br>no shares issued and outstanding                                    | -                     | -                     | -   |
| Common stock, \$0.001 par value; 50,000,000 shares authorized;<br>33,246,141 issued and 33,221,141 outstanding at December 31,<br>2018; | 33,246                | -                     | 33,246  |
| 24,367,906 issued and 24,342,906 outstanding at June 30, 2018;  | 33,246                | -                     | 33,246  |
| Treasury stock, at cost, 25,000 shares  | (134,196)             | -                     | (134,196)                                     |
| Additional paid-in capital  | 136,495,216           | -                     | 136,495,216                                   |
| Accumulated deficit   | (23,906,501)          | (3,841,359)           | (27,747,860)                                  |
| Accumulated other comprehensive loss  | (6,116,283)           | -                     | (6,116,283)                                   |
| Noncontrolling interest   | 21,673                | -                     | 21,673  |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | <b>106,393,155</b>    | <b>(3,841,359)</b>    | <b>102,551,796</b>                            |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>   | <b>\$ 204,125,956</b> | <b>\$ (4,048,946)</b> | <b>\$ 200,077,010</b>                         |

Topic 606 also requires enhanced disclosures about the nature, amount, timing, and uncertainty of revenues and cash flows arising from contracts with customers. Those disclosures can also be found in Note 3.

#### Recently Issued, but Not Yet Adopted, Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update No. 2016-02: *Leases* ("ASU 2016-02"). This standard amends various aspects of existing accounting guidance for leases, including the recognition of a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of operations. This standard also introduces new disclosure requirements for leasing arrangements. For public business entities, ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective approach, and provides for certain practical expedients. The Company is evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements and related disclosures.





## NOTE 3 - REVENUE RECOGNITION

The Company adopted the provisions of Topic 606 as of July 1, 2018. As the Company adopted Topic 606 using the modified retrospective approach, comparative figures have not been revised and are still reported under prior accounting standards.

The Company derives its revenue from 1) the sale of seed, 2) milling services and 3) research and development services.

The following table disaggregates the Company's revenue by type of contract<sup>1</sup>:

|  | Three Months Ended<br>December 31, |               |               | Six Months Ended<br>December 31, |               |               |
|--|------------------------------------|---------------|---------------|----------------------------------|---------------|---------------|
|  | 2018                               |               | 2017          | 2018                             |               | 2017          |
|  | ASC 606                            | ASC 605       | ASC 605       | ASC 606                          | ASC 605       | ASC 605       |
| Distribution and production agreements - Pioneer | \$ 9,677,988                       | \$ 15,966,835 | \$ 15,313,310 | \$ 29,185,614                    | \$ 18,135,126 | \$ 18,101,800 |
| Other product sales                              | 8,761,172                          | 8,761,172     | 5,033,204     | 15,336,201                       | 15,336,201    | 12,767,630    |
| Services   | 141,836                            | 141,836       | 186,282       | 179,318                          | 179,318       | 375,082       |
|  | \$ 18,580,996                      | \$ 24,869,843 | \$ 20,532,796 | \$ 44,701,133                    | \$ 33,650,645 | \$ 31,244,512 |

<sup>1</sup>2018 information provided under ASC 605 to provide for comparison to 2017.

#### Distribution and Production Agreements with Pioneer

Under the production and distribution agreements with Pioneer, the Company grows, processes, and delivers alfalfa seed for and to Pioneer. The Company has concluded that none of the individual activities performed under these contracts are distinct, as the customer is contracting for processed and packaged product.

Pioneer submits a demand plan to the Company in advance of the growing season specifying the amount of seed that it intends to order for the upcoming sales year. The Company is required to use commercially reasonable efforts to arrange for the requisite amount of seed to be grown and to process and package the product as provided for in the contract. Once the demand plan is submitted, Pioneer cannot cancel or reduce the amount of seed that it is obligated to purchase under the agreements. In addition, the Company is not permitted to sell products produced for Pioneer under the agreements to other customers. Therefore, as provided in Topic 606, the Company recognizes revenue from these agreements over time, as it incurs costs to fulfill its obligations.

To the extent the Company produces more product than Pioneer has specified in its demand plan, the Company must first offer such product to Pioneer. If Pioneer does not purchase such excess product, the Company may sell such product to other customers subject to certain limitations. Revenue from such excess product is recognized as other product revenue, as discussed below.

The agreements specify prices per finished unit which are adjusted each year, up or down, based on current market conditions, by a maximum of 4% per year. The prices for a given crop year are determined one year in advance of the beginning of the sales season.

The Company believes that cost is the best measure of progress under these contracts because no other measure adequately reflects the value added to the product by each of the Company's major tasks - having the crop grown, processing, and packaging. As the Company typically contracts out the growing of seed to third parties, the vast majority of the Company's costs under these agreements are incurred, and therefore the vast majority of the revenue from such agreements is recognized, when the raw seed is purchased from the third-party contract growers. The rest of the costs are incurred, and therefore the rest of the revenue is recognized, as the Company processes and packages the product. Prior to the adoption of Topic 606, revenue from these agreements was recognized when risk and title to the product was transferred, which generally occurs upon shipment.



## Other Product Sales

Revenue from other product sales is recognized at the point in time at which control of the product is transferred to the customer. Generally, this occurs upon shipment of the product. Pricing for such transactions is negotiated and determined at the time the contracts are signed. We have elected the practical expedient that allows us to account for shipping and handling activities as a fulfillment cost, and we accrue those costs when the related revenue is recognized.

The Company has certain contracts with customers that offer a limited right of return on certain branded products. The products must be in an unopened and undamaged state and must be resalable in the sole opinion of the Company to quality for refund. Returns are only accepted on product received by August 31<sup>st</sup> of the current sales year. The Company uses the three-year historical returns percentage to estimate the refund liability and records a reduction of revenue in the period in which revenue is recognized.

## Services

Revenue from milling services, which are performed on the customer's product, is recognized as services are completed and the milled product is delivered to the customer.

Revenue from research and development services is recognized over time as the services are performed. R&D services are generally paid for in advance. In fiscal 2019, R&D revenue relates to a single contract in which the customer may decide annually whether to continue the arrangement. Revenue is recognized straight-line over time, as services are expected to be provided roughly evenly throughout the year.

## Payment Terms and Related Balance Sheet Accounts

Accounts receivable represent amounts that are payable to the Company by its customers subject only to the passage of time. Payment terms on invoices are generally 30 to 120 days. As the period between the transfer of goods and/or services to the customer and receipt of payment is less than one year, the Company does not separately account for a financing component in its contracts with customers.

Unbilled receivables represent contract assets that arise when the Company has partially performed under a contract, but is not yet able to invoice the customer until the Company has made additional progress. Unbilled receivables arise from the distribution and production agreements with Pioneer for which the Company recognizes revenue over time, as the Company bills for these arrangements upon product delivery, while revenue is recognized, as described above, as costs are incurred. Unbilled receivables may arise as much as three months before billing is expected to occur. Unbilled receivables are generally expected to be generated in the first and second fiscal quarters, and to be billed in the second, third and fourth fiscal quarters.

Losses on accounts receivable and unbilled receivables are recognized if and when it becomes probable that amounts will not be paid. These losses are reversed in subsequent periods if these amounts are paid. During the six months ended December 31, 2018, the Company recognized a gain of \$211,200 from collection of a previously impaired accounts receivable.

Deferred revenue represents payments received from customers in advance of completion of the Company's performance obligation.

## Transaction Price Allocated to Remaining Performance Obligations

Total estimated revenue remaining on uncompleted contracts is \$86.8 million. This is comprised of \$1.9 million remaining on the Pioneer distribution and production agreements which is expected to be recognized in fiscal 2019, an estimated \$84.9 million related to fiscal years 2020 - 2023 based on the minimum purchase requirements in the Pioneer distribution agreement and \$0.1 million remaining on a research and development services agreement expected to be recognized in fiscal 2019.

## NOTE 4 - BUSINESS COMBINATIONS

On October 25, 2018, the Company completed the acquisition of substantially all of the assets of Chromatin, Inc. (together with certain of its subsidiaries and affiliates in receivership, "Chromatin"), as well as the assumption of certain contracts and limited specified liabilities of Chromatin, for an aggregate cash purchase price of approximately \$26.5 million (the "Acquisition"), pursuant to the terms of its Asset Purchase Agreement, dated September 14, 2018, with Novo Advisors, solely in its capacity as the receiver for, and on behalf of, Chromatin ("Novo").

The acquisition expanded the Company's sorghum production capabilities, diversified its product offerings and provided access to new distribution channels.

The Acquisition has been accounted for as a business combination, and the Company valued and recorded all assets acquired and liabilities assumed at their estimated fair values on the date of the Acquisition.

Management has not yet finalized the fair value of assets held for sale and certain other intangible assets. The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed at the acquisition date of October 25, 2018:

|                                     | <b>October 25,<br/>2018</b> |
|-------------------------------------|-----------------------------|
| Cash                                | \$ 95,049                   |
| Accounts receivable                 | 947,015                     |
| Inventory                           | 6,959,936                   |
| Prepaid expenses                    | 16,501                      |
| Property, plant and equipment       | 10,193,620                  |
| Assets held for sale                | 1,930,400                   |
| In-process research and development | 380,000                     |
| Technology/IP - germplasm           | 7,200,000                   |
| Trade names                         | 150,000                     |
| Goodwill                            | 1,573,546                   |
| Current liabilities                 | (2,881,198)                 |
| Noncurrent liabilities              | (114,869)                   |
| Total acquisition cost allocated    | \$ (26,450,000)             |

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Management determined that one of the facilities acquired as part of the Chromatin acquisition would not be operated and is being held for sale. The components of that facility are:

|                            |              |
|----------------------------|--------------|
| Land and improvements      | \$ 320,000   |
| Buildings and improvements | 1,380,000    |
| Machinery and equipment    | 332,000      |
| Less: Costs to sell        | (101,600)    |
| Assets held for sale       | \$ 1,930,400 |

Management expects the sale to be completed within 12 months and plans to settle short-term debt with the proceeds, accordingly, these held for sale assets are presented as current assets.

The estimated fair value of accounts receivable acquired is \$947,015, with the gross contractual amount totaling \$2,164,476, less \$1,217,461 expected to be uncollectible. The current liabilities assumed relate to inventory acquired in the acquisition as well as customer deposits. The excess of the purchase price over the fair value of the net assets acquired, amounting to \$1,573,546, was recorded as goodwill on the consolidated balance sheet. The primary item that generated goodwill was the premium paid by the Company for the ability to control the acquired business, technology, and the distribution channels. Goodwill is not amortized for financial reporting purposes, but is amortized for tax purposes.

Management assigned fair values to the identifiable intangible assets through a combination of the relief from royalty method, the multi-period excess earnings method, and the replacement cost method.

The values and useful lives of the acquired intangibles are as follows:

|                                      | <b>Estimated<br/>Useful Life<br/>(Years)</b> | <b>Estimated<br/>Fair Value</b> |
|--------------------------------------|--|---------------------------------|
| In-process research and development  | 3  | \$ 380,000                      |
| Technology/IP - germplasm            | 30   | 7,200,000                       |
| Trade names                          | 5  | 150,000                         |
| Total identifiable intangible assets |  | \$ 7,730,000                    |

The Company incurred acquisitions costs of \$586,800 and \$995,316 during the three and six months ended December 31, 2018 that have been recorded in selling, general and administrative expenses on the consolidated statement of operations.

The following unaudited pro forma financial information presents results as if the Acquisition occurred on July 1, 2017.

| (unaudited) | <b>Six Months Ended<br/>December 31,</b> |                |
|-------------|--|----------------|
|             | <b>2018</b>                              | <b>2017</b>    |
| Revenue     | \$ 46,374,310                            | \$ 39,910,879  |
| Net loss    | \$ (4,889,152)                           | \$ (7,784,946) |

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For purposes of the pro forma disclosures above, the primary adjustments for the six months ended December 31, 2018 include: (i) the elimination of acquisition charges of \$995,316; (ii) amortization of acquired intangibles of \$132,222; and iii) depreciation of acquired property, plant and equipment of \$358,273.

For purposes of the pro forma disclosures above, the primary adjustments for the six months ended December 31, 2017 include: (i) amortization of acquired intangibles of \$198,333; and ii) depreciation of acquired property, plant and equipment of \$537,410.

NOTE 5 - GOODWILL AND INTANGIBLE ASSETS

The following table summarizes the activity of goodwill for the six months ended December 31, 2018 and the year ended June 30, 2018, respectively.

|          | <b>Balance at<br/>July 1, 2018</b> | <b>Additions</b> | <b>Balance at<br/>December 31, 2018</b> |
|----------|------------------------------------|------------------|---|
| Goodwill | \$ 10,292,265                      | \$ 1,573,546     | \$ 11,865,811                           |

|          | <b>Balance at<br/>July 1, 2017</b> | <b>Additions</b> | <b>Balance at<br/>June 30, 2018</b> |
|----------|------------------------------------|------------------|-------------------------------------|
| Goodwill | \$ 10,292,265                      | -                | \$ 10,292,265                       |

Intangible assets consist of the following:

|                                     | <b>Balance at<br/>July 1, 2018</b> | <b>Additions</b> | <b>Amortization</b> | <b>Balance at<br/>December 31, 2018</b> |
|-------------------------------------|------------------------------------|------------------|---------------------|---|
| Trade name                          | \$ 1,159,826                       | \$ 150,000       | \$ (47,240)         | \$ 1,262,586                            |
| Customer relationships              | 1,156,955                          | -                | (50,604)            | 1,106,351                               |
| Non-compete                         | 62,720                             | -                | (18,871)            | 43,849                                  |
| GI customer list                    | 71,639                             | -                | (3,582)             | 68,057                                  |
| Supply agreement                    | 1,077,783                          | -                | (37,816)            | 1,039,967                               |
| Distribution agreement              | 6,344,253                          | -                | (192,251)           | 6,152,002                               |
| Grower relationships                | 1,753,208                          | -                | (52,704)            | 1,700,504                               |
| Intellectual property               | 20,873,393                         | 7,200,000        | (601,518)           | 27,471,875                              |
| In process research and development | -                                  | 380,000          | (21,111)            | 358,889                                 |
| Internal use software               | 610,003                            | 43,000           | (33,888)            | 619,115                                 |
|                                     | \$ 33,109,780                      | \$ 7,773,000     | \$ (1,059,585)      | \$ 39,823,195                           |

|                        | <b>Balance at<br/>July 1, 2017</b> | <b>Additions</b> | <b>Amortization</b> | <b>Balance at<br/>June 30, 2018</b> |
|------------------------|------------------------------------|------------------|---------------------|-------------------------------------|
| Trade name             | \$ 1,244,306                       | -                | \$ (84,480)         | \$ 1,159,826                        |
| Customer relationships | 1,258,163                          | -                | (101,208)           | 1,156,955                           |
| Non-compete            | 102,035                            | -                | (39,315)            | 62,720                              |
| GI customer list       | 78,803                             | -                | (7,164)             | 71,639                              |
| Supply agreement       | 1,153,415                          | -                | (75,632)            | 1,077,783                           |
| Distribution agreement | 6,728,753                          | -                | (384,500)           | 6,344,253                           |
| Production agreement   | 111,670                            | -                | (111,670)           | -                                   |
| Grower relationships   | 1,858,616                          | -                | (105,408)           | 1,753,208                           |
| Intellectual property  | 21,725,539                         | 295,034          | (1,147,180)         | 20,873,393                          |
| Internal use software  | 677,779                            | -                | (67,776)            | 610,003                             |
|                        | \$ 34,939,079                      | \$ 295,034       | \$ (2,124,333)      | \$ 33,109,780                       |

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Amortization expense totaled \$552,967 and \$555,471 for the three months ended December 31, 2018 and 2017, respectively. Amortization expense totaled \$1,059,585 and \$1,128,392 for the six months ended December 31, 2018 and 2017, respectively. Estimated aggregate remaining amortization is as follows:

|                      | <b>2019</b>  | <b>2020</b>  | <b>2021</b>  | <b>2022</b>  | <b>2023</b>  | <b>Thereafter</b> |
|----------------------|--------------|--------------|--------------|--------------|--------------|-------------------|
| Amortization expense | \$ 1,178,739 | \$ 2,355,136 | \$ 2,336,313 | \$ 2,252,980 | \$ 2,204,355 | \$ 28,795,672     |

**NOTE 6 - PROPERTY, PLANT AND EQUIPMENT**

Components of property, plant and equipment were as follows:

|                                     | <b>December 31,<br/>2018</b> | <b>June 30,<br/>2018</b> |
|-------------------------------------|------------------------------|--------------------------|
| Land and improvements               | \$ 2,532,053                 | \$ 2,068,742             |
| Buildings and improvements          | 11,291,516                   | 8,888,196                |
| Machinery and equipment             | 12,656,650                   | 5,731,293                |
| Vehicles                            | 1,580,518                    | 1,130,276                |
| Construction in progress            | 313,852                      | 220,089                  |
| Total property, plant and equipment | 28,374,589                   | 18,038,596               |
| Less: accumulated depreciation      | (5,642,824)                  | (4,858,464)              |
| Property, plant and equipment, net  | \$ 22,731,765                | \$ 13,180,132            |

Depreciation expense totaled \$482,639 and \$315,510 for the three months ended December 31, 2018 and 2017, respectively. Depreciation expense totaled \$831,130 and \$630,842 for the six months ended December 31, 2018 and 2017, respectively.



## NOTE 7 - DEBT

Total debt outstanding is presented on the consolidated balance sheet as follows:

|  | December 31,<br>2018 | June 30,<br>2018 |
|--|----------------------|------------------|
| Working capital lines of credit  |                      |                  |
| KeyBank  | \$ 38,836,070        | \$ 25,050,464    |
| National Australia Bank Limited  | 7,870,247            | 7,697,040        |
| Debt issuance costs  | (395,853)            | (116,945)        |
| Total working capital lines of credit, net                                     | \$ 46,310,464        | \$ 32,630,559    |
| Current portion of long-term debt  |                      |                  |
| Capital leases   | \$ 451,089           | \$ 27,241        |
| Keith facility (building loan) - National Australia Bank Limited               | 77,649               | 3,701            |
| Keith facility (machinery & equipment loans) - National Australia Bank Limited | 212,852              | 198,251          |
| Unsecured subordinate promissory note  | 100,000              | 100,000          |
| Secured real estate note - Conterra  | 238,693              | 229,789          |
| Secured equipment note - Conterra  | -                    | 37,824           |
| Debt issuance costs  | (89,143)             | (93,794)         |
| Total current portion, net   | 991,140              | 503,012          |
| Long-term debt, less current portion   |                      |                  |
| Capital leases   | 1,623,504            | -                |
| Keith facility (building loan) - National Australia Bank Limited               | 254,124              | 421,857          |
| Keith facility (machinery & equipment loans) - National Australia Bank Limited | 420,550              | 431,754          |
| Secured real estate note - Conterra  | 10,048,597           | 10,170,211       |
| Secured equipment note - Conterra  | -                    | 2,062,176        |
| Debt issuance costs  | (82,502)             | (108,911)        |
| Total long-term portion, net   | 12,264,273           | 12,977,087       |
| Total debt, net  | \$ 13,255,413        | \$ 13,480,099    |

On September 22, 2015, the Company entered into a credit and security agreement (the "KeyBank Credit Facility") with KeyBank. Key provisions of the KeyBank Credit Facility, as amended, include:

- An aggregate principal amount that the Company may borrow, repay and reborrow, of up to \$45.0 million in the aggregate, subject to a requirement that the Company maintain a reduced loan balance of (i) not more than \$20.0 million for at least 30 consecutive days over the prior twelve months (measured each quarter on a trailing 12 month basis) and (ii) not more than \$25.0 million for at least 60 consecutive days over the prior twelve months (measured each quarter on a trailing 12 month basis).
- All amounts due and owing, including, but not limited to, accrued and unpaid principal and interest, will be payable in full on December 31, 2020.
- A borrowing base of up to 85% of eligible domestic accounts receivable and 90% of eligible foreign accounts receivable, plus up to the lesser of (i) 75% of the cost eligible inventory (provided that eligible inventory acquired by the Company in its recent Chromatin acquisition is initially subject to a rate of 25%, potentially increasing to 75% if the Company delivers an appraisal of the acquired inventory that is satisfactory to KeyBank) or (ii) 90% of the net orderly liquidation value of the inventory, subject to lender reserves.
- Loans may be based on a Base Rate or Eurodollar Rate (which is increased by an applicable margin of 2.9% per annum for Eurodollar Loans and 1.0% for Base Rate Loans) (both as defined in the KeyBank Credit Facility), generally at the Company's option. In the event of a default, at the option of KeyBank, the interest rate on all obligations owing will increase by 3% per annum over the rate otherwise applicable.



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- Subject to certain exceptions, the KeyBank Credit Facility is secured by a first priority perfected security interest in all of the Company's now owned and after acquired tangible and intangible assets and its domestic subsidiaries, which have guaranteed the Company's obligations under the KeyBank Credit Facility. The KeyBank Credit Facility is further secured by a lien on, and a pledge of, 65% of the stock of its wholly-owned subsidiary, S&W Holdings Australia Pty Ltd.
- At December 31, 2018, the Company was in compliance with all KeyBank debt covenants.

On December 31, 2014, the Company issued a three-year secured promissory note to DuPont Pioneer in the initial principal amount of \$10,000,000 (the "Pioneer Note"), with a maturity date of December 31, 2017. The Pioneer Note accrued interest at 3% per annum. Interest was payable in three annual installments, in arrears, commencing on December 31, 2015. On December 31, 2014, the Company also issued contingent consideration to DuPont Pioneer which required the Company to increase the principal amount of the Pioneer Note by up to an additional \$5,000,000 if the Company met certain performance metrics during the three-year period following December 31, 2014. The earn out payment to DuPont Pioneer was finalized in October 2017 and this amount of \$2,500,000 was added to the Pioneer Note in October 2017. On December 1, 2017, the Company repaid the Pioneer Note. The repayment amount included the \$2.5 million earn-out payment related to the Pioneer Acquisition that was added to the principal amount of the Pioneer Note in October 2017.

On November 30, 2017, the Company entered into a secured note financing transaction (the "Loan Transaction") with Conterra Agricultural Capital, LLC ("Conterra") for \$12.5 million in gross proceeds. Pursuant to the Loan Transaction, the Company issued two secured promissory notes (the "Notes") to Conterra as follows:

- Secured Real Estate Note

. The Company issued one Note in the principal amount of \$10.4 million (the "Secured Real Estate Note") that is secured by a first priority security interest in the property, plant and fixtures (the "Real Estate Collateral") located at the Company's Five Points, California and Nampa, Idaho production facilities and its Nampa, Idaho and Arlington, Wisconsin research facilities (the "Facilities"). The Secured Real Estate Note matures on November 30, 2020, which, subject to Conterra's approval, may be extended to November 30, 2022. The Secured Real Estate Note bears interest of 7.75% per annum. The Company has agreed to make semi-annual payments of interest and amortized principal on a 20-year amortization schedule, for a combined payment of \$515,711, starting July 1, 2018, in addition to a one-time interest only payment on January 1, 2018. The Company may prepay the Secured Real Estate Note, in whole or in part, at any time after it has paid a minimum of twelve months of interest on the Secured Real Estate Note.

- Secured Equipment Note

. The Company issued a second Note in the principal amount of \$2.1 million (the "Secured Equipment Note") that was secured by a first priority security interest in certain equipment not attached to real estate located at the Facilities. The Secured Equipment Note was also secured by the Real Estate Collateral. The Secured Equipment Note was scheduled to mature on November 30, 2019. The Secured Equipment Note bore an interest rate of 9.5% per annum. The Company agreed to make semi-annual payments of interest and amortized principal on a 20-year amortization schedule, for a combined payment of \$118,223, starting July 1, 2018, in addition to a one-time interest only payment on January 1, 2018. The Company may prepay the Secured Equipment Note, in whole or in part, at any time.

On August 15, 2018, the Company completed a sale and leaseback transaction with American AgCredit involving certain equipment located at the Company's Five Points, California and Nampa, Idaho production facilities. Due to its terms, the sale and leaseback transaction is required to be accounted for as a financing arrangement. Accordingly, the proceeds received from American AgCredit were accounted for as proceeds from a debt financing. Under the terms of the transaction:

- The Company sold the equipment to American AgCredit for \$2,106,395 million in proceeds. The proceeds were used to pay off in full a note (in the principal amount of \$2,081,527, plus accrued interest of \$24,868) held by Conterra Agricultural Capital, LLC, which had an interest rate of 9.5% per annum and was secured by, among other things, the equipment.
- The Company entered into a lease agreement with American AgCredit relating to the equipment. The lease agreement has a five-year term and provides for monthly lease payments of \$40,023 (representing an annual interest rate of 5.6%). At the end of the lease term, the Company will repurchase the equipment for \$1.

S&W Australia finances the purchase of most of its seed inventory from growers pursuant to seasonal credit facilities with National Australia Bank Ltd ("NAB"). The current facilities (the "2016 NAB Facilities") were amended as of April 13, 2018 and expire on March 30, 2020. As of December 31, 2018, AUD \$11,149,237 (USD \$7,870,247) was outstanding under the 2016 NAB Facilities.

The 2016 NAB Facilities, as currently in effect, comprise two distinct facility lines: (i) an overdraft facility (the "Overdraft Facility"), having a credit limit of AUD \$1,000,000 (USD \$705,900 at December 31, 2018) and a borrowing base facility (the "Borrowing Base Facility"), having a credit limit of AUD \$12,000,000 (USD \$8,470,800 at December 31, 2018).

The Borrowing Base Facility permits S&W Australia to borrow funds for periods of up to 180 days, at S&W Australia's discretion, provided that the term is consistent with its trading terms. Interest for each drawdown is set at the time of the drawdown as follows: (i) for Australian dollar drawings, based on the Australian Trade Refinance Rate plus 1.5% per annum and (ii) for foreign currency drawings, based on the British Bankers' Association Interest Settlement Rate for the relevant foreign currency for the relevant period, or if such rate is not available, the rate reasonably determined by NAB to be the appropriate equivalent rate, plus 1.5% per annum. As of December 31, 2018, the Borrowing Base Facility accrued interest on Australian dollar drawings at approximately 5.53% per annum calculated daily. The Borrowing Base Facility is secured by a lien on all the present and future rights, property and undertakings of S&W Australia, the mortgage on S&W Australia's Keith, South Australia property and the Company's corporate guarantee (up to a maximum of AUD \$15,000,000).

The Overdraft Facility permits S&W Australia to borrow funds on a revolving line of credit up to the credit limit. Interest accrues daily and is calculated by applying the daily interest rate to the balance owing at the end of the day and is payable monthly in arrears. As of December 31, 2018, the Overdraft Facility accrued interest at approximately 6.77% per annum calculated daily.

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For both the Overdraft Facility and the Borrowing Base Facility, interest is payable each month in arrears. In the event of a default, as defined in the NAB Facility agreements, the principal balance due under the facilities will thereafter bear interest at an increased rate per annum above the interest rate that would otherwise have been in effect from time to time under the terms of each facility (*i.e.*, the interest rate increases by 4.5% per annum under the Borrowing Base Facility and the Overdraft Facility rate increases to 13.92% per annum upon the occurrence of an event of default).

Both facilities constituting the 2016 NAB Facilities are secured by a fixed and floating lien over all the present and future rights, property and undertakings of S&W Australia and are guaranteed by the Company as noted above. The 2016 NAB Facilities contain customary representations and warranties, affirmative and negative covenants and customary events of default that permit NAB to accelerate S&W Australia's outstanding obligations, all as set forth in the NAB facility agreements. S&W Australia was in compliance with all NAB debt covenants at December 31, 2018.

In January 2015, NAB and S&W Australia entered into a new business markets - flexible rate loan (the "Keith Building Loan") and a separate machinery and equipment facility (the "Keith Machinery and Equipment Facility"). In February 2016, NAB and S&W Australia also entered into a master asset finance facility (the "Master Assets Facility"). The Master Asset Facility has various maturity dates through 2021 and have interest rates ranging from 4.86% to 5.31%.

The Keith Building Loan and Keith Machinery and Equipment Facility are used for the construction of a building on S&W Australia's Keith, South Australia property, purchase of adjoining land and for the machinery and equipment for use in the operations of the building. The Keith Building Loan matures on November 30, 2024. The interest rate on the Keith Building Loan varies from pricing period to pricing period (each such period approximately 30 days), based on the weighted average of a specified basket of interest rates (6.45% as of December 31, 2018). Interest is payable each month in arrears. The Keith Machinery and Equipment Facility bears interest, payable in arrears, based on the Australian Trade Refinance Rate quoted by NAB at the time of the drawdown, plus 2.9%. The Keith Credit Facilities contain customary representations and warranties, affirmative and negative covenants and customary events of default that permit NAB to accelerate S&W Australia's outstanding obligations, all as set forth in the facility agreement. They are secured by a lien on all the present and future rights, property and undertakings of S&W Australia, the Company's corporate guarantee and a mortgage on S&W Australia's Keith, South Australia property.

The annual maturities of short-term and long-term debt are as follows:

| <b>Fiscal Year</b> | <b>Amount</b> |
|--------------------|---------------|
| 2019               | \$ 576,583    |
| 2020               | 1,011,523     |
| 2021               | 10,628,888    |
| 2022               | 607,263       |
| 2023               | 466,531       |
| Thereafter         | 136,270       |
| Total              | \$ 13,427,058 |

NOTE 8 - WARRANTS

The following table summarizes the total warrants outstanding at December 31, 2018:

Exercise  
Price

Expiration

Outstanding as

Outstanding as

Issue Date

Per Share

Date

of June 30, 2018

New Issuances

Expired

of December 31, 2018

Warrants

Dec 2014

\$  
4.32

June 2020

2,699,999

-  
40



-

2,699,999

2,699,999

-

-

2,699,999

The following table summarizes the total warrants outstanding at June 30, 2018:

|          | Issue Date | Exercise Price Per Share | Expiration Date | Outstanding as of June 30, 2017 | New Issuances | Expired | Outstanding as of June 30, 2018 |
|----------|------------|--------------------------|-----------------|---------------------------------|---------------|---------|---------------------------------|
| Warrants | Dec 2014   | \$ 4.32                  | June 2020       | 2,699,999                       | -             | -       | 2,699,999                       |
|          |            |                          |                 | 2,699,999                       | -             | -       | 2,699,999                       |

#### NOTE 9 - EQUITY

On September 5, 2018, the Company entered into a Securities Purchase Agreement (the "Securities Purchase Agreement") with MFP Partners, L.P. ("MFP"), pursuant to which the Company sold to MFP 1,607,717 shares of common stock of the Company (the "Common Shares") at a purchase price of \$3.11 per share at an initial closing, and agreed to sell, subject to the satisfaction of certain conditions, 7,235 shares of newly designated Series A Convertible Preferred Stock of the Company ("Preferred Shares") to MFP at a purchase price of \$3,110 per share at a second closing (the "Second Closing").

The Second Closing was completed on October 23, 2018, for aggregate gross proceeds of approximately \$22.5 million, which was used primarily to fund the Chromatin Acquisition. The Preferred Shares carried no voting rights and were automatically convertible into shares of common stock at the rate of 1,000 shares of common stock per Preferred Share upon the approval of the Company's stockholders for the issuance of the requisite shares of common stock. Pursuant to the Securities Purchase Agreement, the Company agreed to use its reasonable best efforts to solicit the approval of its shareholders for the issuance of stock upon the conversion of the Preferred Shares at a special meeting of shareholders, and at each annual meeting of shareholders thereafter, if necessary. Approval was obtained at a Special Meeting of Stockholders held on November 20, 2018, and the Preferred Shares automatically converted into 7,235,000 shares of common stock on that same day.

#### NOTE 10 - FOREIGN CURRENCY CONTRACTS

The Company's subsidiary, S&W Australia, is exposed to foreign currency exchange rate fluctuations in the normal course of its business, which the Company manages through the use of foreign currency forward contracts. These foreign currency contracts are not designated as hedging instruments; accordingly, changes in the fair value are recorded in current period earnings. These foreign currency contracts had a notional value of \$3,218,800 at December 31, 2018 and their maturities range from January 2019 to June 2019.

The Company records an asset or liability on the consolidated balance sheet for the fair value of the foreign currency forward contracts. The foreign currency contract liabilities totaled \$98,071 at December 31, 2018 and \$100,138 at June 30, 2018. The Company recorded a gain on foreign exchange contracts of \$35,836 and a loss of \$61,560, which is reflected in cost of revenue for the three months ended December 31, 2018 and 2017, respectively. The Company recorded a loss on foreign exchange contracts of \$2,626 and \$100,864, which is reflected in cost of revenue for the six months ended December 31, 2018 and 2017, respectively.

## NOTE 11 - COMMITMENTS AND CONTINGENCIES

### Contingencies

Based on information currently available, management is not aware of any other matters that would have a material adverse effect on the Company's financial condition, results of operations or cash flows.

### Legal Matters

The Company may be subject to various legal proceedings from time to time. The results of any future litigation cannot be predicted with certainty, and regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources, and other factors. Any current litigation is considered immaterial and counter claims have been assessed as remote.

## NOTE 12 - RELATED PARTY TRANSACTIONS

On July 19, 2017, the Company entered into a Securities Purchase Agreement with certain purchasers, including MFP Partners, L.P. ("MFP"), a stockholder of the Company, and certain entities related to Wynnefield Capital Management LLC (collectively, "Wynnefield"), pursuant to which MFP purchased approximately \$3.7 million of shares of its common stock and Wynnefield purchased approximately \$3.0 million of shares of its common stock. Each of MFP and Wynnefield is a beneficial owner of more than 5% of the Company's common stock. Alexander C. Matina, a member of the Company's Board, is Vice President, Investments of MFP. Robert D. Straus, a member of the Company's Board since January 9, 2018, is a Portfolio Manager at Wynnefield.

On October 11, 2017, the Company entered into a Securities Purchase Agreement with Mark W. Wong, the Company's President and Chief Executive Officer, pursuant to which the Company sold and issued an aggregate of 75,000 shares of its Common Stock at a purchase price of \$3.50 per share, for aggregate gross proceeds of \$262,500.

On December 22, 2017, the Company completed the closing of its previously announced rights offering. At the closing, the Company sold and issued an aggregate of 2,594,923 shares of its Common Stock at a subscription price of \$3.50 per share pursuant to the exercise of subscriptions and oversubscriptions in the rights offering from its existing stockholders. Pursuant to an Investment Agreement, dated October 3, 2017, between the Company and MFP, MFP agreed to purchase, at the subscription price, all of the shares not purchased in the Rights Offering (the "Backstop Commitment"). Accordingly, on December 22, 2017, the Company and MFP completed the closing of the Backstop Commitment, in which the Company sold and issued 905,077 shares of its Common Stock to MFP. Combined, the Company sold and issued an aggregate of 3,500,000 shares of its common stock for aggregate gross proceeds of \$12.25 million.

On September 5, 2018, the Company entered into the Securities Purchase Agreement with MFP, pursuant to which the Company sold the Common Shares at the Initial Closing and the Preferred Shares at the Second Closing. The Initial Closing was completed on September 5, 2018 and the Second Closing was completed on October 23, 2018. See Note 9 for further discussion on the Second Closing.

On December 18, 2018, the Company entered into a Loan and Security Agreement (the "MFP Loan Agreement") with MFP, pursuant to which the Company may borrow up to \$5,000,000, in minimum increments of \$1,000,000, from MFP during the period beginning on December 18, 2018 and ending on the earlier to occur of (i) March 18, 2019 and (ii) certain specified events of default. Pursuant to the MFP Loan Agreement, interest will accrue on outstanding principal at a fixed per annum rate of 6.0%. In addition, the Company is obligated to pay to MFP a fee equal to 2.0% of each advance under the MFP Loan Agreement. Concurrently with the execution of the MFP Loan Agreement, the Company drew down \$1,000,000 under the MFP Loan Agreement, which was disbursed to the Company on December 21, 2018. On December 31, 2018 the Company repaid in full the \$1,000,000 disbursed to the Company. As of December 31, 2018, no amounts remain outstanding under the MFP Loan Agreement.

#### NOTE 13 - EQUITY-BASED COMPENSATION

In October 2009 and January 2010, the Company's Board of Directors and stockholders, respectively, approved the 2009 Equity Incentive Plan (as amended and/or restated from time to time, the "2009 Plan"). The plan authorized the grant and issuance of options, restricted shares and other equity compensation to the Company's directors, employees, officers and consultants, and those of the Company's subsidiaries and parent, if any. In October 2012 and December 2012, the Company's Board of Directors and stockholders, respectively, approved the amendment and restatement of the 2009 Plan, including an increase in the number of shares available for issuance as grants and awards under the Plan to 1,250,000 shares. In September 2013 and December 2013, the Company's Board of Directors and stockholders, respectively, approved an amendment of the 2009 Plan to increase the number of shares available for issuance as grants and awards under the Plan to 1,700,000 shares. In September 2015 and December 2015, the Company's Board of Directors and stockholders, respectively, approved an amendment of the 2009 Plan to increase the number of shares available for issuance as grants and awards under the Plan to 2,450,000 shares.

The term of incentive stock options granted under the 2009 Plan may not exceed ten years, or five years for incentive stock options granted to an optionee owning more than 10% of the Company's voting stock. The exercise price of options granted under the 2009 Plan must be equal to or greater than the fair market value of the shares of the common stock on the date the option is granted. An incentive stock option granted to an optionee owning more than 10% of voting stock must have an exercise price equal to or greater than 110% of the fair market value of the common stock on the date the option is granted.

The Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. Stock options issued to non-employees are accounted for at their estimated fair value. The fair value of options granted to non-employees is re-measured as they vest. The Company amortizes stock-based compensation expense on a straight-line basis over the requisite service period.

The Company utilizes a Black-Scholes-Merton option pricing model, which includes assumptions regarding the risk-free interest rate, dividend yield, life of the award, and the volatility of the Company's common stock to estimate the fair value of employee options grants.

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Weighted average assumptions used in the Black-Scholes-Merton model for awards granted during the period are set forth below:

|                                | <b>December 31,</b> |               |
|--------------------------------|---------------------|---------------|
|                                | <b>2018</b>         | <b>2017</b>   |
| Risk free rate                 | 2.72% - 2.99%       | 1.72% - 1.91% |
| Dividend yield                 | 0%                  | 0%            |
| Volatility                     | 40.36% -            |               |
| Average forfeiture assumptions | 45.47%              | 45.3% - 45.5% |
|                                | 1.4%                | 1.4%          |

During the six months ended December 31, 2018, the Company granted options to purchase 353,822 shares of its common stock to certain of its Directors, members of the executive management team and other employees at exercise prices ranging from \$2.79 - \$3.30. These options vest in either quarterly or annual periods over one to three years, and expire ten years from the date of grant.

A summary of stock option activity for the six months ended December 31, 2018 and the year ended June 30, 2018 is presented below:

|  | <b>Number<br/>Outstanding</b> |    | <b>Weighted -<br/>Average<br/>Exercise Price<br/>Per Share</b> |  | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Life (Years)</b> |    | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|--|-------------------------------|----|--|--|---|----|--|
| Outstanding at June 30, 2017                                   | 990,528                       | \$ | 5.12   |  | 4.3   | \$ | 100,344                                  |
| Granted  | 103,283                       |    | 3.45   |  | -   |    | -  |
| Exercised  | (49,000)                      |    | 3.95   |  | -   |    | -  |
| Canceled/forfeited/expired                                     | (252,737)                     |    | 6.46   |  | -   |    | -  |
| Outstanding at June 30, 2018                                   | 792,074                       |    | 4.55   |  | 6.3   |    | 10,413                                   |
| Granted  | 353,822                       |    | 2.98   |  | -   |    | -  |
| Exercised  | -                             |    | -  |  | -   |    | -  |
| Canceled/forfeited/expired                                     | (96,500)                      |    | 6.12   |  | -   |    | -  |
| Outstanding at December 31, 2018                               | 1,049,396                     |    | 3.87   |  | 7.7   |    | -  |
| Options vested and exercisable at<br>December 31, 2018         | 544,288                       |    | 4.46   |  | 6.1   |    | -  |
| Options vested and expected to vest as of<br>December 31, 2018 | 1,048,087                     | \$ | 3.87   |  | 7.7   | \$ | -  |

The weighted average grant date fair value of options granted and outstanding at December 31, 2018 was \$1.08. At December 31, 2018, the Company had \$528,553 of unrecognized stock compensation expense, net of estimated forfeitures, related to the options under the 2009 Plan, which will be recognized over the weighted average remaining service period of 2.2 years. The Company settles employee stock option exercises with newly issued shares of common stock.

During the six months ended December 31, 2018, the Company issued 99,902 restricted stock units to certain members of the executive management team and other employees. The restricted stock units vest immediately, in annual installments over one-year or quarterly periods over three-years. The fair value of the awards totaled \$306,047 and was based on the closing stock price on the date of grants.

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The Company recorded \$222,431 and \$311,067 of stock-based compensation expense associated with grants of restricted stock units during the six months ended December 31, 2018 and 2017, respectively. A summary of activity related to non-vested restricted stock units is presented below:

**Six Months Ended December 31, 2018**

|  | <b>Number of<br/>Nonvested<br/>Restricted<br/>Stock Units</b> | <b>Weighted-<br/>Average<br/>Grant Date<br/>Fair Value</b> | <b>Weighted -<br/>Average<br/>Remaining<br/>Contractual<br/>Life (Years)</b> |
|--|---|--|--|
| Beginning nonvested restricted units outstanding | 89,193  | \$ 3.98  | 1.1  |
| Granted  | 99,902  | 3.06   | 2.8  |
| Vested   | (44,507)  | 3.72   | -  |
| Forfeited  | -   | -  | -  |
| Ending nonvested restricted units outstanding    | 144,588   | \$ 3.43  | 2.1  |

At December 31, 2018, the Company had \$288,327 of unrecognized stock compensation expense related to the restricted stock units, which will be recognized over the weighted average remaining service period of 2.11 years.

At December 31, 2018, there were 350,343 shares available under the 2009 Plan for future grants and awards.

Stock-based compensation expense recorded for stock options, restricted stock grants and restricted stock units for the three months ended December 31, 2018 and 2017, totaled \$222,153 and \$193,571, respectively. Stock-based compensation expense recorded for stock options, restricted stock grants and restricted stock units for the six months ended December 31, 2018 and 2017, totaled \$377,458 and \$451,033, respectively.

**NOTE 14 - NON-CASH ACTIVITIES FOR STATEMENTS OF CASH FLOWS**

The below table represents supplemental information to the Company's consolidated statements of cash flows for non-cash activities during the six months ended December 31, 2018 and 2017, respectively.

|                               | <b>Six Months Ended<br/>December 31,</b> |             |
|-------------------------------|--|-------------|
|                               | <b>2018</b>                              | <b>2017</b> |
| Fair value of assets acquired | \$ 29,446,067                            | \$ -        |
| Cash paid for the acquisition | (26,450,000)                             | -           |
| Liabilities assumed           | (2,996,067)                              | -           |

**NOTE 15 - SUBSEQUENT EVENTS**

At the Annual Meeting of Stockholders of the Company, held on January 16, 2019 (the "Annual Meeting"), the Company's stockholders approved the S&W Seed Company 2019 Equity Incentive Plan (the "2019 Plan") as a successor to and continuation of the Company's Amended and Restated 2009 Equity Incentive Plan (the "2009 Plan"). Subject to adjustment for certain changes in the Company's capitalization, the aggregate number of shares of the Company's common stock that may be issued under the 2019 Plan will not exceed 4,246,878 shares, which is the sum of (i) 2,750,000 new shares, plus (ii) 353,431 shares that remained available for grant under the 2009 Plan as of January 16, 2019, plus (iii) 1,143,447 shares subject to outstanding stock awards granted under the 2009 Plan.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

You should read the following discussion of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included in Part I, Item 1, "Financial Statements" of this Quarterly Report on Form 10-Q. In addition to our historical consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates, and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements as referred to on page 2 of this Quarterly Report on Form 10-Q. Factors that could cause or contribute to these differences include those discussed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018, particularly in Part I, Item 1A, "Risk Factors", as updated in Part II, Item 1A. "Risks Factors" of this Quarterly Report on Form 10-Q.

Executive Overview

Founded in 1980 and headquartered in Sacramento, California, we are a global agricultural company. Grounded in our historical expertise and what we believe is our present leading position in the breeding, production and sale of alfalfa seed, we continue to build towards our goal of being recognized as the world's preferred proprietary forage, grain and specialty crop seed company. In addition to our primary activities in alfalfa seed, we have recently expanded our product portfolio by adding hybrid sorghum and sunflower seed, which complement our alfalfa seed offerings by allowing us to leverage our infrastructure, research and development expertise and our distribution channels, as we begin to diversify into what we believe are higher margin opportunities. We also continue to conduct our stevia breeding program, having been granted four patents by the U.S. Patent and Trademark Office (the "USPTO").

Following our initial public offering in fiscal year 2010, we expanded certain pre-existing business initiatives and added new ones, including:

- diversifying our production geographically by expanding from solely producing seed in the San Joaquin Valley of California to initially adding production capability in the Imperial Valley of California, then expanding into Australia (primarily South Australia) and, adding production in other western states and Canada;
- expanding from solely offering non-dormant varieties to now having a full range of both dormant and non-dormant varieties;
- expanding the depth and breadth of our research and development capabilities in order to develop new varieties of both dormant and non-dormant alfalfa seed with traits sought after by our existing and future customers;
- diversifying into complementary proprietary crops by acquiring the assets of a Queensland, Australia company specializing in breeding and licensing of hybrid sorghum and sunflower seed;
- expanding our distribution channels and customer base, initially through the acquisition of the customer list of a key international customer in the Middle East in July 2011, and thereafter, through certain strategic acquisitions;
- expanding our sales geographically both through the expansion of our product offerings and through an expansion of our sales and marketing efforts generally; and
- implementing a stevia breeding program focused on the potential development of new stevia varieties that incorporate the most desirable characteristics of this all-natural, zero calorie sweetener.





We have accomplished these expansion initiatives through a combination of organic growth and strategic acquisitions, foremost among them:

- the acquisition in July 2011 of certain intangible assets, including the customer information, related to the field seed and small grain business of Genetics International, Inc., which had previously operated in the Middle East and North Africa ("MENA") and which began our transition into selling directly to MENA distributors;
- the acquisition of Imperial Valley Seeds, Inc. ("IVS") in October 2012, which enabled us to expand production of non-GMO seed into California's Imperial Valley, thereby ensuring a non-GMO source of seed due to the prohibition on GMO crops in the Imperial Valley, as well as enabling us to diversify our production areas and distribution channels;
- the acquisition of a portfolio of dormant alfalfa seed germplasm in August 2012 to launch our entry into the dormant market;
- the acquisition of the leading local producer of non-dormant alfalfa seed in South Australia, S&W Seed Company Australia Pty Ltd (f/k/a Seed Genetics International Pty Ltd, "S&W Australia") in April 2013, which greatly expanded our production capabilities and geographic diversity;
- the acquisition of the alfalfa production and research facility assets and conventional (non-GMO) alfalfa germplasm from DuPont Pioneer in December 2014 (the "Pioneer Acquisition"), thereby substantially expanding upon our initial entrance into the dormant alfalfa seed market that began in 2012 and enabling us to greatly expand our production and research and product development capabilities;
- the acquisition, in May 2016, of the assets and business of SV Genetics Pty Ltd ("SV Genetics"), a private Australian company specializing in the breeding and licensing of proprietary hybrid sorghum and sunflower seed germplasm, which represents our initial effort to diversify our product portfolio beyond alfalfa seed breeding and production and stevia R&D; and
- the acquisition of a portfolio of sorghum germplasm in April 2018 to expand our portfolio of sorghum products to include biofuel types.
- the acquisition of substantially all of the assets of Chromatin in October 2018, to accelerate and substantially expand our penetration into the hybrid sorghum market, and enable us to expand our production and research and our product development capabilities.

We believe our 2013 combination with S&W Australia created the world's largest non-dormant alfalfa seed company and gave us the competitive advantages of year-round production in that market. With the completion of the acquisition of dormant alfalfa seed assets from DuPont Pioneer in December 2014, we believe we have become the largest alfalfa seed company worldwide (by volume), with industry-leading research and development, as well as production and distribution capabilities in both hemispheres and the ability to supply proprietary dormant and non-dormant alfalfa seed. Our operations span the world's alfalfa seed production regions, with operations in the San Joaquin and Imperial Valleys of California, five additional Western states, Australia and three provinces in Canada.

Our May 2016 acquisition of the hybrid sorghum and sunflower germplasm business and assets of SV Genetics, our April 2018 acquisition of a portfolio of sorghum germplasm, and our October 2018 acquisition of the assets and business of Chromatin signal management's commitment to our strategy of identifying opportunities to diversify our product lines and improve our gross margins.



We continue to have a long-term distribution agreement with DuPont Pioneer regarding conventional (non GMO) varieties, the term of which extends into 2024. Our production agreement with DuPont Pioneer (relating to GMO-traited varieties) terminates on May 31, 2019. As a result, DuPont Pioneer's minimum purchase commitments from us will be reduced by approximately \$6 million annually, commencing with our Fiscal Year 2020. Although the production agreement will terminate on May 31, 2019, we expect that the DuPont Pioneer distribution agreement will continue to be a significant source of the Company's annual revenue through December 2024.

We are in discussions with DuPont Pioneer regarding the orderly transition of activities previously conducted by us under the production and research agreements (relating to GMO-traited varieties), as well as the possibility of certain ongoing commercial relationships between us relating to GMO-traited varieties, among other things.

## Components of Our Statements of Operations Data

### Revenue and Cost of Revenue

#### Revenue

We derive most of our revenue from the sale of our proprietary alfalfa seed varieties. We expect that over the next several years, a majority of our revenue will continue to be generated from the sale of alfalfa seed, although we are continually assessing other possible product offerings or means to increase revenue, including expanding into other, higher margin crops. In late fiscal year 2016, we began that expansion with the acquisition of the hybrid sorghum and sunflower business and assets of SV Genetics. In October 2018, we continued this expansion with our acquisition of the assets and business of Chromatin. Revenue from the SV Genetics germplasm will be primarily derived from the sale of sorghum and sunflower seed as well as royalty-based payments set forth in various licensing agreements. Revenue from the Chromatin transaction is expected to be derived from the sale of hybrid sorghum seed.

Fiscal year 2016 was the first full fiscal year in which we had a full range of non-dormant and dormant alfalfa seed varieties. This is expected to enable us to significantly expand the geographic reach of our sales efforts. The mix of our product offerings will continue to change over time with the introduction of new alfalfa seed varieties resulting from our robust research and development efforts, including our potential expansion into gene edited varieties in future periods. Currently, we have a long-term distribution agreement with DuPont Pioneer, which we expect will be the source of a significant portion of our annual revenue through December 2024.

Our revenue will fluctuate depending on the timing of orders from our customers and distributors. Because some of our large customers and distributors order in bulk only one or two times per year, our product revenue may fluctuate significantly from period to period. However, some of this fluctuation is offset by having operations in both the northern and southern hemispheres.

Our stevia breeding program has yet to generate any meaningful revenue. However, management continues to evaluate this portion of our business and assess various means to monetize the results of our effort to breed new, better tasting stevia varieties. Such potential opportunities include possible licensing agreements and royalty-based agreements.

## Cost of Revenue

Cost of revenue relates to sale of our seed varieties and consists of the cost of procuring seed, plant conditioning and packaging costs, direct labor and raw materials and overhead costs.

## Operating Expenses

### Research and Development Expenses

Seed and stevia research and development expenses consist of costs incurred in the discovery, development, breeding and testing of new products incorporating the traits we have specifically selected. These expenses consist primarily of employee salaries and benefits, consultant services, land leased for field trials, chemicals and supplies and other external expenses. With the acquisition of the assets of Chromatin in October 2018, additional costs are now being incurred as we continue the research and development efforts in the development of new sorghum hybrids. Because we have been in the alfalfa seed breeding business since our inception in 1980, we have expended far more resources in development of our proprietary alfalfa seed varieties throughout our history than on our stevia breeding program, which we commenced in fiscal year 2010.

In fiscal year 2013, we made the decision to shift the focus of our stevia program away from commercial production and towards the breeding of improved varieties of stevia. We have continued that effort, which has resulted in the granting by the USPTO of four patents covering stevia plant varieties SW 107, SW 201, SW 129 and SW 227.

Our research and development expenses increased significantly with the acquisition of the alfalfa research and development assets of DuPont Pioneer in December 2014. We also have expanded our genetics research both internally and in collaboration with third parties. In addition, we acquired additional research and development operations in connection with our October 2018 acquisition of the assets of Chromatin that we expect will factor into an overall increase in R&D expense. Overall, we have been focused on controlling research and development expenses, while balancing that objective against the recognition that continued advancement in product development is an important part of our strategic planning. We expect our research and development expenses will fluctuate from period to period as a result of the timing of various research and development projects.

Our internal research and development costs are expensed as incurred, while third party research and development costs are expensed when the contracted work has been performed or as milestone results have been achieved. The costs associated with equipment or facilities acquired or construed for research and development activities that have alternative future uses are capitalized and depreciated on a straight-line basis over the estimated useful life of the asset.

### Selling, General and Administrative Expenses

Selling, general, and administrative expenses consist primarily of employee costs, including salaries, employee benefits and share-based compensation, as well as professional service fees, insurance, marketing, travel and entertainment expense, public company expense and other overhead costs. We proactively take steps on an ongoing basis to control selling, general and administrative expense as much as is reasonably possible.

### Depreciation and Amortization

Most of the depreciation and amortization expense on our statement of operations consists of amortization expense. We amortize intangible assets, including those acquired from DuPont Pioneer in December 2014, SV Genetics in May 2016, and Chromatin in October 2018 using the straight-line method over the estimated useful life of the asset, consisting of periods of 10-30 years for technology/IP/germplasm, 5-20 years for customer relationships and trade names and 3-20 years for other intangible assets. Property, plant and equipment is depreciated using the straight-line method over the estimated useful life of the asset, consisting of periods of 5-35 years for buildings, 3-20 years for machinery and equipment and 2-5 years for vehicles.

### Other Expense

Other expense consists primarily of foreign currency gains and losses, changes in the fair value of derivative liabilities related to our warrants, changes in the fair value of our contingent consideration obligations and interest expense in connection with amortization of debt discount. In addition, interest expense primarily consists of interest costs related to outstanding borrowings on our credit facilities, including our current KeyBank revolving line of credit and on S&W Australia's credit facilities, our three-year secured promissory note issued in December 2014 in connection with the DuPont Pioneer Acquisition which was paid off on December 1, 2017, and our secured promissory note with Conterra Agricultural Capital, LLC ("Conterra").

### Provision (Benefit) for Income Taxes

Our effective tax rate is based on income, statutory tax rates, differences in the deductibility of certain expenses and inclusion of certain income items between financial statement and tax return purposes, and tax planning opportunities available to us in the various jurisdictions in which we operate. Under U.S. GAAP, if we determine that a tax position is more likely than not of being sustained upon audit, based solely on the technical merits of the position, we recognize the benefit. Tax regulations require certain items to be included in the tax return at different times than when those items are required to be recorded in the consolidated financial statements. As a result, our effective tax rate reflected in our consolidated financial statements is different from that reported in our tax returns. Some of these differences are permanent, such as meals and entertainment expenses that are not fully deductible on our tax return, and some are temporary differences, such as depreciation expense. Temporary differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in our tax return in future years for which we have already recorded the tax benefit in our consolidated statements of operations. In the fourth quarter of fiscal year 2017, we recorded a valuation allowance against all of our deferred tax assets. The full valuation allowance was recorded during the fiscal year 2017 as a result of changes to our operating results and future projections, resulting from a recent decline in export sales to Saudi Arabia. In addition, our available tax planning strategies are currently not expected to overcome the uncertainty of the Saudi Arabian market. As a result of these factors, we don't believe that it is more likely than not that our deferred tax assets will be realized.

## Results of Operations

Three Months Ended December 31, 2018 Compared to the Three Months Ended December 31, 2017

## Revenue and Cost of Revenue

Revenue for the three months ended December 31, 2018 was \$18.6 million compared to \$20.5 million for the three months ended December 31, 2017. The \$1.9 million decrease in revenue for the three months ended December 31, 2018 was primarily due to a \$5.6 million decrease in revenues from DuPont Pioneer primarily attributable to timing of revenue recognition pursuant to our adoption Topic 606. The decrease in revenues to Pioneer was partially offset by increases of other product revenue of \$3.6 million; including \$1.5 million from the recently acquired sorghum operations, coupled with increases in Australia and Pakistan. We expect full year revenues from DuPont Pioneer in fiscal 2019 to be down compared to fiscal year 2018.

We recorded sales of approximately \$9.7 million from our distribution and production agreements with DuPont Pioneer during the three months ended December 31, 2018, which was a decrease of \$5.6 million from the comparable period in the prior year amount of \$15.3 million. Our production agreement with DuPont Pioneer (relating to GMO-traited varieties) terminates on May 31, 2019. As a result, DuPont Pioneer's minimum purchase commitments from us will be reduced by approximately \$6.0 million annually, commencing with our Fiscal Year 2020. Although the production agreement will terminate on May 31, 2019, we expect sales to DuPont Pioneer under our distribution agreement will continue to represent a significant portion of our domestic sales, as well as overall sales, through December 2024.

The following table disaggregates our revenue by type of contract. The current period information is presented under both ASC 606 and ASC 605 to provide comparison to the second quarter of fiscal 2018.

|  | Three Months Ended December 31, |               | 2017          |
|--|---------------------------------|---------------|---------------|
|  | ASC 606                         | ASC 605       | ASC 605       |
| Distribution and production agreements - Pioneer | \$ 9,677,988                    | \$ 15,966,835 | \$ 15,313,310 |
| Other product sales                              | 8,761,172                       | 8,761,172     | 5,033,204     |
| Services   | 141,836                         | 141,836       | 186,282       |
|  | \$ 18,580,996                   | \$ 24,869,843 | \$ 20,532,796 |

Sales into international markets represented 33% and 23% of revenue during the three months ended December 31, 2018 and 2017, respectively. Domestic revenue accounted for 67% and 77% of our total revenue for the three months ended December 31, 2018 and 2017, respectively. The decrease in domestic revenue as a percentage of total revenue is primarily attributable to timing of revenue recognition associated with our distribution and production agreements with DuPont Pioneer.

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The following table shows revenue from external sources by destination country:

|               | <b>Three Months Ended December 31,</b> |                   |             |             |                   |             |
|---------------|--|-------------------|-------------|-------------|-------------------|-------------|
|               | <b>2018</b>                            |                   |             | <b>2017</b> |                   |             |
| United States | \$                                     | 12,464,626        | 67%         | \$          | 15,740,706        | 77%         |
| Australia     |  | 1,040,480         | 6%          |             | 438,468           | 2%          |
| Mexico        |  | 986,303           | 5%          |             | 1,664,618         | 8%          |
| Saudi Arabia  |  | 863,982           | 5%          |             | 513,000           | 2%          |
| Libya         |  | 800,375           | 4%          |             | 563,673           | 3%          |
| Argentina     |  | 556,227           | 3%          |             | 1,183,423         | 6%          |
| Pakistan      |  | 464,936           | 3%          |             | -                 | 0%          |
| Peru          |  | 299,245           | 2%          |             | 313,688           | 2%          |
| Other         |  | 1,104,822         | 5%          |             | 115,220           | 0%          |
| <b>Total</b>  | <b>\$</b>                              | <b>18,580,996</b> | <b>100%</b> | <b>\$</b>   | <b>20,532,796</b> | <b>100%</b> |

Cost of revenue of \$13,897,455 for the three months ended December 31, 2018 was 74.8% of revenue, while the cost of revenue of \$15,860,629 for the three months ended December 31, 2017 was 77.2% of revenue. Cost of revenue decreased on a dollar basis primarily due to the decrease in revenue discussed above.

Total gross profit margin for the three months ended December 31, 2018 was 25.2% compared to 22.8% in the three months ended December 31, 2017. The increase in gross profit margins was primarily due to product sales mix during the current period where we had a higher concentration of higher margin products including hybrids and dormant alfalfa seed.

### Selling, General and Administrative Expenses

Selling, General and Administrative ("SG&A") expense for the three months ended December 31, 2018 totaled \$4,342,696 compared to \$2,446,955 for the three months ended December 31, 2017. We incurred non-recurring transactions expenses of \$586,800 during the three months ended December 31, 2018 related to the acquisition of Chromatin. Excluding transaction costs from the three months ended December 31, 2018 and 2017, SG&A expenses increased \$1,314,725 from the comparable period of the prior year. The increase in SG&A expense was primarily due to a \$463,000 increase from the recent Chromatin acquisition as well as other increases in sales and management personnel and related costs as we focus on the anticipated growth in operations in the United States and Australia.

### Research and Development Expenses

Research and development expenses for the three months ended December 31, 2018 totaled \$1,373,554 compared to \$855,164 for the three months ended December 31, 2017. The \$518,390 increase in research and development expense versus the comparable period of the prior year is driven by additional research and development activities in connection with the recent Chromatin acquisition coupled with additional investment in our hybrid programs. We expect our research and development spend for fiscal 2019 to increase as we expand our hybrid sorghum and sunflower programs.

### Depreciation and Amortization

Depreciation and amortization expense for the three months ended December 31, 2018 was \$1,035,606 compared to \$870,981 for the three months ended December 31, 2017. Included in the amount was amortization expense for intangible assets, which totaled \$552,967 for the three months ended December 31, 2018 and \$555,471 for the three months ended December 31, 2017. The \$164,625 increase in depreciation and amortization expense over the prior year is primarily driven by additional depreciation and amortization of assets acquired from the recent Chromatin acquisition.

### Foreign Currency (Gain) Loss

We incurred a foreign currency gain of \$32,987 for the three months ended December 31, 2018 compared to a loss of \$7,472 for the three months ended December 31, 2017. The foreign currency gains and losses are associated with S&W Australia, our wholly-owned subsidiary in Australia.

### Interest Expense - Amortization of Debt Discount

Non-cash amortization of debt discount expense for the three months ended December 31, 2018 was \$68,914 compared to \$33,100 for the three months ended December 31, 2017. The expense in the current period represents the amortization of the debt issuance costs associated with our KeyBank working capital facility, our secured property note, and our equipment capital lease. The expense in the comparable period in the prior year represents the amortization of the debt issuance costs associated with our KeyBank working capital facility and our secured property note.

### Interest Expense

Interest expense for the three months ended December 31, 2018 totaled \$641,479 compared to \$383,894 for the three months ended December 31, 2017. Interest expense for the three months ended December 31, 2018 primarily consisted of interest incurred on the working capital credit facilities with KeyBank and NAB, and the secured property loan entered into in November 2017. Interest expense for the three months ended December 31, 2017 primarily consisted of interest incurred on the working capital credit facilities with KeyBank and NAB and the secured property loan entered into in November 2017. The \$257,585 increase in interest expense for the three months ended December 31, 2018 is primarily driven by interest on the secured property and equipment loans as well as additional interest on the working capital credit facilities due to increased levels of borrowings and interest rates.



Provision for Income Taxes

Income tax benefit totaled \$4,801 for the three months ended December 31, 2018 compared to income tax expense of \$148,702 for the three months ended December 31, 2017. Our effective tax rate was 0.2% for the three months ended December 31, 2018 compared to (59.1%) for the three months ended December 31, 2017. The increase in our effective tax rate for the three months ended December 31, 2018 over the comparable period of the prior year is attributable to the full valuation allowance established against our deferred tax assets which was recorded during the fourth quarter of fiscal 2017. Due to the valuation allowance, we do not record the income tax expense or benefit related to the vast majority of our current year operating results, as such results are generally incorporated in our net operating loss deferred tax asset position, which has a full valuation allowance against it. However, in prior years we did record tax expense related to certain other factors occurring throughout the year. For example, we have certain intangible assets with indefinite lives for financial reporting purposes. All net operating losses generated in fiscal year 2019 and forward are now indefinite lived as well. Due to this, we have reduced the deferred tax liability balance on the indefinite lived intangibles. Our effective tax rate is a function of the projected benefit from the decrease in our deferred tax liability over projected pre-tax book losses for the year. In addition, we are expecting a small tax provision related to our new joint ventures in South Africa. We have recorded a benefit for our pre-tax losses in the US for the three months ending December 31, 2018, which is offset partially by the income tax expense we have recorded related to our operations in South Africa.

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (the "Tax Act"). We applied the guidance in SAB 118 when accounting for the enactment-date effects of the Tax Act in 2018. At June 30, 2018, we had not yet completed our accounting for all of the enactment-date income tax effects of the Act under ACS 740, Income Taxes, including the accounting for the following aspects: remeasurement of deferred tax assets and liabilities and the one-time transition tax. As of December 31, 2018, we have now completed our accounting for all of the enactment-date income tax effects of the Act, with no net changes to our net deferred tax balances or income tax provision.

Six Months Ended December 31, 2018 Compared to the Six Months Ended December 31, 2017

### Revenue and Cost of Revenue

Revenue for six months ended December 31, 2018 was \$44,701,133 compared to \$31,244,512 for the six months ended December 31, 2017. The \$13.5 million increase in revenue is primarily attributable to timing of revenue recognition on our distribution and production agreements with DuPont Pioneer pursuant to our adoption Topic 606.

The following table disaggregates our revenue by type of contract. The current period information is presented under both ASC 606 and ASC 605 to provide comparison to the six months ended December 31, 2017.

|  | Six Months Ended December 31, |               |               |
|--|-------------------------------|---------------|---------------|
|  | 2018                          | 2017          |               |
|  | ASC 606                       | ASC 605       | ASC 605       |
| Distribution and production agreements - Pioneer | \$ 29,185,614                 | \$ 18,135,126 | \$ 18,101,800 |
| Other product sales                              | 15,336,201                    | 15,336,201    | 12,767,630    |
| Services   | 179,318                       | 179,318       | 375,082       |
|  | \$ 44,701,133                 | \$ 33,650,645 | \$ 31,244,512 |

We recorded sales of approximately \$29.2 million from our distribution and production agreements with DuPont Pioneer during the six months ended December 31, 2018, which was an increase of \$11.1 million from the prior year amount of \$18.1 million. We expect DuPont Pioneer to represent a significant portion of our domestic sales, as well as overall sales, for the foreseeable future.

The remaining increase in revenue from the comparable period in the prior year is attributable to \$1.5 million of revenue from the recently acquired sorghum operations as well as increases in the MENA region.

Sales into international markets represented 23% and 38% of revenue during the six months ended December 31, 2018 and 2017, respectively. Domestic revenue accounted for 77% and 62% of our total revenue for the six months ended December 31, 2018 and 2017, respectively.

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The following table shows revenue from external sources by destination country:

|               | Six Months Ended December 31, |            |      |      |            |      |
|---------------|-------------------------------|------------|------|------|------------|------|
|               | 2018                          |            |      | 2017 |            |      |
| United States | \$                            | 34,204,005 | 77%  | \$   | 19,265,254 | 62%  |
| Australia     |                               | 1,370,150  | 3%   |      | 557,998    | 2%   |
| Mexico        |                               | 1,379,253  | 3%   |      | 4,380,626  | 14%  |
| Saudi Arabia  |                               | 1,570,275  | 4%   |      | 844,908    | 3%   |
| Libya         |                               | 1,798,750  | 4%   |      | 752,673    | 2%   |
| Argentina     |                               | 562,164    | 1%   |      | 2,742,619  | 9%   |
| Pakistan      |                               | 730,583    | 2%   |      | -          | 0%   |
| Peru          |                               | 709,495    | 2%   |      | 608,413    | 2%   |
| Other         |                               | 2,376,458  | 4%   |      | 2,092,021  | 6%   |
| Total         | \$                            | 44,701,133 | 100% | \$   | 31,244,512 | 100% |

Cost of revenue of \$34,554,463 for the six months ended December 31, 2018 was 74.8% of revenue, while the cost of revenue of \$15,860,629 for the six months ended December 31, 2017 was 77.3% of revenue. Cost of revenue increased on a dollar basis primarily due to the decrease in revenue discussed above.

Total gross profit margin for the six months ended December 31, 2018 was 22.7% compared to 22.4% in the six months ended December 31, 2017. The increase in gross profit margins was primarily due to product sales mix during the current period where we had a higher concentration of higher margin products including hybrids and dormant alfalfa seed.

### Selling, General and Administrative Expenses

Selling, General and Administrative ("SG&A") expense for the six months ended December 31, 2018 totaled \$7,230,074 compared to \$5,361,035 for the six months ended December 31, 2017. We incurred non-recurring transactions expenses of \$995,316 during the six months ended December 31, 2018 related to the acquisition of Chromatin. Excluding transaction costs from the six months ended December 31, 2018 and 2017, SG&A expenses increased \$908,670 from the comparable period of the prior year. The increase in SG&A expense was primarily due to a \$463,000 increase from the recent Chromatin acquisition as well as other increases in sales and management personnel and related costs as we focus on the anticipated growth in operations in the United States and Australia.

### Research and Development Expenses

Research and development expenses for the six months ended December 31, 2018 totaled \$2,365,667 compared to \$1,597,081 for the six months ended December 31, 2017. The \$768,586 increase in research and development expense versus the comparable period of the prior year is driven by additional research and development activities in connection with the recent Chromatin acquisition coupled with additional investment in our programs. We expect our research and development spend for fiscal 2019 to increase as we expand our hybrid sorghum and sunflower programs.

### Depreciation and Amortization

Depreciation and amortization expense for the six months ended December 31, 2018 was \$1,890,714 compared to \$1,759,233 for the six months ended December 31, 2017. Included in the amount was amortization expense for intangible assets, which totaled \$1,059,585 for the six months ended December 31, 2018 and \$1,128,392 for the six months ended December 31, 2017. The \$131,481 increase in depreciation and amortization expense over the prior year is primarily driven by additional depreciation and amortization of assets acquired from the recent Chromatin acquisition.

### Foreign Currency (Gain) Loss

We incurred a foreign currency gain of \$58,430 for the six months ended December 31, 2018 compared to a loss of \$22,030 for the six months ended December 31, 2017. The foreign currency gains and losses are associated with S&W Australia, our wholly-owned subsidiary in Australia.

### Interest Expense - Amortization of Debt Discount

Non-cash amortization of debt discount expense for the six months ended December 31, 2018 was \$135,392 compared to \$67,099 for the six months ended December 31, 2017. The expense in the current period represents the amortization of the debt issuance costs associated with our KeyBank working capital facility, our secured property note, and our equipment capital lease. The expense in the comparable period in the prior year primarily represents the amortization of the debt issuance costs associated with our KeyBank working capital facility and our secured property note.

### Interest Expense

Interest expense for the six months ended December 31, 2018 totaled \$1,298,709 compared to \$731,623 for the six months ended December 31, 2017. Interest expense for the six months ended December 31, 2018 primarily consisted of interest incurred on the working capital credit facilities with KeyBank and NAB, the secured property loan entered into in November 2017, and equipment capital leases. Interest expense for the six months ended December 31, 2017 primarily consisted of interest incurred on the working capital credit facilities with KeyBank and NAB, interest on the note payable issued to DuPont Pioneer which was paid off in November 2017, the secured property loan entered into in November 2017 and equipment capital leases. The \$567,086 increase in interest expense for the six months ended December 31, 2018 is primarily driven by interest on the secured property and equipment loans as well as additional interest on the working capital credit facilities due to increased levels of borrowings and interest rates.

### Provision for Income Taxes

The Company's tax provision or benefit is determined using an estimate of its annual effective tax rate, which is adjusted for discrete items that are taken into account in the relevant period. Income tax expense totaled \$4,533 for the six months ended December 31, 2018 compared to income tax expense of \$200,123 for the six months ended December 31, 2017. Our effective tax rate was (0.2%) for the six months ended December 31, 2018 compared to (9.9%) for the six months ended December 31, 2017. The change in our effective tax rate for the six months ended December 31, 2018 is attributable to the full valuation allowance established against our deferred tax assets which was recorded during the fourth quarter of fiscal 2017. Due to the valuation allowance, we do not record the income tax expense or benefit related to the vast majority of our current year operating results, as such results are generally incorporated in our net operating loss deferred tax asset position, which has a full valuation allowance against it. However, in prior years we did record tax expense related to certain other factors occurring

throughout the year. For example, we have certain intangible assets with indefinite lives for financial reporting purposes. All net operating losses generated in fiscal year 2019 and forward are now indefinite lived as well. Due to this, we have reduced the deferred tax liability balance on the indefinite lived intangibles. Our effective tax rate is a function of the projected benefit from the decrease in our deferred tax liability over projected pre-tax book losses for the year. In addition, we are expecting a small tax provision related to our new joint ventures in South Africa. We have recorded a benefit for our pre-tax losses in the US for the second quarter of the current fiscal year, which is offset by the income tax expense we have recorded related to our operations in South Africa, resulting in a small year to date provision expense for the six months ended December 31, 2018.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted. The Tax Act significantly revises the U.S. corporate income tax by, among other things, lowering the statutory corporate income tax rate ("federal tax rate") from 35% to 21% effective January 1, 2018, implementing a modified territorial tax system, and imposing a mandatory one-time transition tax on accumulated earnings of foreign subsidiaries.

In December 2017, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 118, which addresses how a company recognizes provisional estimates when a company does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete its accounting for the effect of the changes in the Tax Act. The measurement period ends when a company has obtained, prepared, and analyzed the information necessary to finalize its accounting, but cannot extend beyond one year. The final impact of the Tax Act may differ from the above provisional estimates due to changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, by changes in accounting standard for income taxes and related interpretations in response to the Tax Act, and any updates or changes to estimates used in the provisional amounts. We had previously calculated a provisional income inclusion of approximately \$2.1 million related to the transition tax on accumulated foreign earnings. As of December 31, 2018, we have concluded our analysis with respect to the transition tax accounting, recording an income inclusion of approximately \$2.0 million. However, due to the Company's valuation allowance, there is no impact to the Company's net deferred tax balance or income tax expense. There was no net impact to our tax balances for the re-measurement of our deferred tax balances from the provisional estimates to the final calculations.

The Tax Act includes a Global Intangible Low-Taxed Income ("GILTI") provision that imposes U.S. tax on certain foreign subsidiary income in the year it is earned. Our accounting policy is to treat tax on GILTI as a current period cost included in tax expense in the year incurred.

#### Liquidity and Capital Resources

Our working capital and working capital requirements fluctuate from quarter to quarter depending on the phase of the growing and sales cycle that falls during a particular quarter. Our need for cash has historically been highest in the second and third fiscal quarters (October through March) because we historically have paid our North American contracted growers progressively, starting in the second fiscal quarter. In fiscal year 2018, we paid our North American growers approximately 50% of amounts owed to them in October 2017 and the balance was paid in February 2018. This payment cycle is expected to be similar in fiscal year 2019. S&W Australia, our Australian-based subsidiary, has a production cycle that is counter-cyclical to North America; however, this also puts a greater demand on our working capital and working capital requirements during the second, third and fourth fiscal quarters based on timing of payments to growers in the second through fourth quarters.

Historically, due to the concentration of sales to certain distributors, our month-to-month and quarter-to-quarter sales and associated cash receipts are highly dependent upon the timing of deliveries to and payments from these distributors, which varies significantly from year to year. The timing of collection of receivables from DuPont Pioneer, which is our largest customer, is defined in the distribution agreement with DuPont Pioneer and consists of three installment payments, the first on September 15th, the second on January 15th, and the third payment on February 15th. Our future revenue and cash collections pertaining to the distribution agreement with DuPont Pioneer

is expected to provide us with greater predictability.

We continuously monitor and evaluate our credit policies with all of our customers based on historical collection experience, current economic and market conditions and a review of the current status of the respective trade accounts receivable balance. Our principal working capital components include cash and cash equivalents, accounts receivable, inventory, prepaid expense and other current assets, accounts payable and our working capital lines of credit.

In addition to funding our business with cash from operations, we have historically relied upon occasional sales of our debt and equity securities and credit facilities from financial institutions, both in the United States and South Australia.

In recent periods, we have consummated the following equity and debt financings:

On December 31, 2014, in connection with the Pioneer Acquisition, we issued a secured promissory note (the "Pioneer Note") payable by us to DuPont Pioneer in the initial principal amount of \$10,000,000 (issued at closing), and a potential earn-out payment (payable as an increase in the principal amount of the Pioneer Note) of up to \$5,000,000 based on our sales under the distribution and production agreements entered into in connection with the Pioneer Acquisition, as well as other sales of products we consummate containing the acquired germplasm in the three-year period following the closing. The earn-out payment of \$2,500,000 to DuPont Pioneer was finalized in October 2017 and this amount was added to the Pioneer Note in October 2017. The Pioneer Note accrued interest at 3% per annum. Interest was payable in three annual installments, in arrears, commencing on December 31, 2015. On December 1, 2017, we repaid the Pioneer Note. The repayment amount included the \$2.5 million earn-out payment related to the Pioneer Acquisition that was added to the principal amount of the Pioneer Note in October 2017.

On November 30, 2017, we entered into a secured note financing transaction (the "Loan Transaction") with Conterra for \$12.5 million in gross proceeds. Pursuant to the Loan Transaction, we issued two secured promissory notes (the "Notes") to Conterra as follows:

- Secured Real Estate Note

. We issued one Note in the principal amount of \$10.4 million (the "Secured Real Estate Note") that is secured by a first priority security interest in the property, plant and fixtures (the "Real Estate Collateral") located at our Five Points, California and Nampa, Idaho production facilities and our Nampa, Idaho and Arlington, Wisconsin research facilities (the "Facilities"). The Secured Real Estate Note matures on November 30, 2020, which, subject to Conterra's approval, may be extended to November 30, 2022. The Secured Real Estate Note bears interest of 7.75% per annum. We have agreed to make semi-annual payments of interest and amortized principal on a 20-year amortization schedule, for a combined payment of \$515,711, starting July 1, 2018, in addition to a one-time interest only payment on January 1, 2018. We may prepay the Secured Real Estate Note, in whole or in part, at any time after we have paid a minimum of twelve months of interest on the Secured Real Estate Note.

- Secured Equipment Note

. We issued a second Note in the principal amount of \$2.1 million (the "Secured Equipment Note") that was secured by a first priority security interest in certain equipment not attached to real estate located at the Facilities. The Secured Equipment Note was also secured by the Real Estate Collateral. The Secured Equipment Note had a maturity date of November 30, 2019. The Secured Equipment Note bore an interest rate of 9.5% per annum. We agreed to make semi-annual payments of interest and amortized principal on a 20-year amortization schedule, for a combined payment of \$118,223, starting July 1, 2018, in addition to a one-time interest only payment on January 1, 2018. We may prepay the Secured Equipment Note, in whole or in part, at any time.

On December 1, 2017, we used the proceeds from the Loan Transaction to repay the Pioneer Note.

On August 15, 2018, we closed on a sale and leaseback transaction with American AgCredit involving certain equipment located at our Five Points, California and Nampa, Idaho production facilities. Under the terms of the transaction:

- We sold the equipment to American AgCredit for \$2,106,395 million in proceeds. The proceeds were used to pay off in full the Secured Equipment Note mentioned above.

- We entered into a lease agreement with American AgCredit relating to the equipment. The lease agreement has a five-year term and provides for monthly lease payments of \$40,023 (representing an annual interest rate of 5.6%). At the end of the lease term, we will repurchase the equipment for \$1.

On September 22, 2015, we entered into a credit and security agreement (the "KeyBank Credit Facility") with KeyBank. Key provisions of the KeyBank Credit Facility, as amended, include:

- An aggregate principal amount that we may borrow, repay and reborrow, of up to \$45.0 million in the aggregate, subject to a requirement that we maintain a reduced loan balance of (i) not more than \$20.0 million for at least 30 consecutive days over the prior twelve months (measured each quarter on a trailing 12 month basis) and (ii) not more than \$25.0 million for at least 60 consecutive days over the prior twelve months (measured each quarter on a trailing 12 month basis).
- All amounts due and owing, including, but not limited to, accrued and unpaid principal and interest, will be payable in full on December 31, 2020.
- A borrowing base of up to 85% of eligible domestic accounts receivable and 90% of eligible foreign accounts receivable, plus up to the lesser of (i) 75% of the cost eligible inventory (provided that eligible inventory acquired by us in our recent Chromatin acquisition is initially subject to a rate of 25%, potentially increasing to 75% if we deliver an appraisal of the acquired inventory that is satisfactory to KeyBank) or (ii) 90% of the net orderly liquidation value of the inventory, subject to lender reserves.
- Loans may be based on a Base Rate or Eurodollar Rate (which is increased by an applicable margin of 2.9% per annum for Eurodollar Loans and 1.0% for Base Rate Loans) (both as defined in the KeyBank Credit Facility), generally at our option. In the event of a default, at the option of KeyBank, the interest rate on all obligations owing will increase by 3% per annum over the rate otherwise applicable.
- Subject to certain exceptions, the KeyBank Credit Facility is secured by a first priority perfected security interest in all our now owned and after acquired tangible and intangible assets and our domestic subsidiaries, which have guaranteed our obligations under the KeyBank Credit Facility. The KeyBank Credit Facility is further secured by a lien on, and a pledge of, 65% of the stock of our wholly-owned subsidiary, S&W Holdings Australia Pty Ltd.
- At December 31, 2018, we were in compliance with all KeyBank debt covenants.

S&W Australia finances the purchase of most of its seed inventory from growers pursuant to a seasonal credit facility with National Australia Bank Ltd ("NAB"). The current facility, referred to as the 2016 NAB Facilities, was amended as of April 13, 2018 and expires on March 30, 2020. As of December 31, 2018, AUD \$11,149,237 (USD \$7,870,247) was outstanding under the 2016 NAB Facilities.

The 2016 NAB Facilities, as currently in effect, comprises two distinct facility lines: (i) an overdraft facility (the "Overdraft Facility"), having a credit limit of AUD \$1,000,000 (USD \$705,900 at December 31, 2018) and a borrowing base facility (the "Borrowing Base Facility"), having a credit limit of AUD \$12,000,000 (USD \$8,470,800 at December 31, 2018).



The Borrowing Base Facility permits S&W Australia to borrow funds for periods of up to 180 days, at S&W Australia's discretion, provided that the term is consistent with its trading terms. Interest for each drawdown is set at the time of the drawdown as follows: (i) for Australian dollar drawings, based on the Australian Trade Refinance Rate plus 1.5% per annum and (ii) for foreign currency drawings, based on the British Bankers' Association Interest Settlement Rate for the relevant foreign currency for the relevant period, or if such rate is not available, the rate reasonably determined by NAB to be the appropriate equivalent rate, plus 1.5% per annum. As of December 31, 2018, the Borrowing Base Facility accrued interest on Australian dollar drawings

at approximately 5.53% per annum calculated daily. The Borrowing Base Facility is secured by a lien on all the present and future rights, property and undertakings of S&W Australia, the mortgage on S&W Australia's Keith, South Australia property and the Company's corporate guarantee (up to a maximum of AUD \$15,000,000).

The Overdraft Facility permits S&W Australia to borrow funds on a revolving line of credit up to the credit limit. Interest accrues daily and is calculated by applying the daily interest rate to the balance owing at the end of the day and is payable monthly in arrears

. As of December 31, 2018, the Overdraft Facility accrued interest at approximately 6.77% per annum calculated daily.

For both the Overdraft Facility and the Borrowing Base Facility, interest is payable each month in arrears. In the event of a default, as defined in the NAB Facility agreements, the principal balance due under the facilities will thereafter bear interest at an increased rate per annum above the interest rate that would otherwise have been in effect from time to time under the terms of each facility (*i.e.*, the interest rate increases by 4.5% per annum under the Borrowing Base Facility and the Overdraft Facility rate increases to 13.92% per annum upon the occurrence of an event of default).

Both facilities constituting the 2016 NAB Facilities are secured by a fixed and floating lien over all the present and future rights, property and undertakings of S&W Australia and are guaranteed by the Company as noted above. The 2016 NAB Facilities contain customary representations and warranties, affirmative and negative covenants and customary events of default that permit NAB to accelerate S&W Australia's outstanding obligations, all as set forth in the NAB facility agreements. S&W Australia was in compliance with all NAB debt covenants at December 31, 2018.

In January 2015, NAB and S&W Australia entered into a new business markets - flexible rate loan (the "Keith Building Loan") and a separate machinery and equipment facility (the "Keith Machinery and Equipment Facility"). In February 2016, NAB and S&W Australia also entered into a master asset finance facility (the "Master Assets Facility"). The Master Asset Facility has various maturity dates through 2021 and have interest rates ranging from 4.86% to 5.31%.

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The Keith Building Loan and Keith Machinery and Equipment Facility are used for the construction of a building on S&W Australia's Keith, South Australia property, purchase of adjoining land and for the machinery and equipment for use in the operations of the building. The Keith Building Loan matures on November 30, 2024. The interest rate on the Keith Building Loan varies from pricing period to pricing period (each such period approximately 30 days), based on the weighted average of a specified basket of interest rates (6.45% as of December 31, 2018). Interest is payable each month in arrears. The Keith Machinery and Equipment Facility bears interest, payable in arrears, based on the Australian Trade Refinance Rate quoted by NAB at the time of the drawdown, plus 2.9%. The Keith Credit Facilities contain customary representations and warranties, affirmative and negative covenants and customary events of default that permit NAB to accelerate S&W Australia's outstanding obligations, all as set forth in the facility agreement. They are secured by a lien on all the present and future rights, property and undertakings of S&W Australia, the Company's corporate guarantee and a mortgage on S&W Australia's Keith, South Australia property.

On July 19, 2017, we entered into a Securities Purchase Agreement with certain purchasers, pursuant to which we sold and issued an aggregate of 2,685,000 shares of our Common Stock at a purchase price of \$4.00 per share, for aggregate gross proceeds of \$10.74 million.

On October 11, 2017, we entered into a Securities Purchase Agreement with Mark W. Wong, our President and Chief Executive Officer, pursuant to which we sold and issued an aggregate of 75,000 shares of our Common Stock at a purchase price of \$3.50 per share, for aggregate gross proceeds of \$262,500.

On December 22, 2017, we completed the closing of our rights offering of 3,500,000 shares of our Common Stock. At the closing, we sold and issued an aggregate of 2,594,923 shares of our Common Stock at a subscription price of \$3.50 per share (the "Subscription Price"). Pursuant to a backstop commitment with MFP Partners, L.P. ("MFP"), concurrently with the closing of rights offering, we sold and issued the remaining 905,077 shares of our Common Stock not purchased in the rights offering to MFP at the subscription price of \$3.50 per share. Combined, we sold and issued an aggregate of 3,500,000 shares of our common stock for aggregate gross proceeds of \$12.25 million.

On September 5, 2018, we entered into a Securities Purchase Agreement (the "2018 Securities Purchase Agreement") with MFP, pursuant to which we sold 1,607,717 shares of our common stock to MFP at a purchase price of \$3.11 per share at an initial closing held on September 5, 2018, for gross proceeds of approximately \$5.0 million.

On October 23, 2018, we completed the second closing under the 2018 Securities Purchase Agreement with MFP. At the second closing, we issued to MFP 7,235 shares of a newly designated Series A Convertible Preferred Stock (the "Preferred Shares") at a purchase price of \$3,110 per share, for aggregate gross proceeds of approximately \$22.5 million. The Preferred Shares carried no voting rights and were automatically convertible into shares of our common stock at the rate of 1,000 shares of common stock per Preferred Share upon the approval of the Company's stockholders for the issuance of the requisite shares of common stock. Pursuant to the 2018 Securities Purchase Agreement, we agreed to use reasonable best efforts to solicit the approval of our shareholders for the issuance of stock upon the conversion of the Preferred Shares at a special meeting of shareholders, and at each annual meeting of shareholders thereafter, if necessary. Approval was obtained at a Special Meeting of Stockholders on November 20, 2018, and the Preferred Shares were converted to 7,235,000 shares of our common stock on that same day.

## Summary of Cash Flows

The following table shows a summary of our cash flows for the six months ended December 31, 2018 and 2017:

|  | <b>Six Months Ended<br/>December 31,</b> |                 |
|--|--|-----------------|
|  | <b>2018</b>                              | <b>2017</b>     |
| Cash flows from operating activities                 | \$ (15,900,452)                          | \$ (16,669,045) |
| Cash flows from investing activities                 | (26,710,468)                             | (768,845)       |
| Cash flows from financing activities                 | 40,954,399                               | 22,072,723      |
| Effect of exchange rate changes on cash              | (192,992)                                | 74,860          |
| Net (decrease) increase in cash and cash equivalents | (1,849,513)                              | 4,709,693       |
| Cash and cash equivalents, beginning of period       | 4,320,894                                | 745,001         |
| Cash and cash equivalents, end of period             | \$ 2,471,381                             | \$ 5,454,694    |

## Operating

*Activities*

For the six months ended December 31, 2018, operating activities used \$15,900,452 in cash. Net loss plus and minus the adjustments for non-cash items as detailed on the statement of cash flows used \$468,162 in cash, and changes in operating assets and liabilities as detailed on the statement of cash flows used \$15,432,290 in cash. The decrease in cash from changes in operating assets and liabilities was primarily driven by increases in inventories of \$21,525,192, increases in unbilled accounts receivable of \$11,206,984, and an increase in accounts receivable of \$8,336,183, partially offset by an increase in accounts payable of \$23,698,244.

For the six months ended December 31, 2017, operating activities used \$16,669,045 in cash. Net loss plus and minus the adjustments for non-cash items as detailed on the statement of cash flows used \$471,624 in cash, and changes in operating assets and liabilities as detailed on the statement of cash flows used \$16,197,421 in cash. The decrease in cash from changes in operating assets and liabilities was primarily driven by increases in inventory of \$38,850,545 due to timing of the US harvest, partially offset by a corresponding increase in accounts payable of \$25,606,471.

## Investing Activities

Investing activities during the six months ended December 31, 2018 used \$26,710,468 in cash. The Chromatin Acquisition accounted for \$26,354,951 of the cash used in investing activities. We also had additions to property, plant and equipment of \$336,623 consisting primarily equipment purchases for our facility in Keith, Australia.

Investing activities during the six months ended December 31, 2017 used \$768,845 in cash. These activities consisted primarily of additions to a build out of a new research and development facility in Nampa, Idaho.

## Financing Activities

Financing activities during the six months ended December 31, 2018 provided \$40,954,399 in cash. During the six months ended December 31, 2018, we completed a private placement of common stock which raised net proceeds of \$4,927,682 in cash and a private placement of preferred stock which raised net proceeds of \$22,420,462. During the six months ended December 31, 2018, we also had net borrowings on the working capital lines of credit of \$13,983,464. On August 15, 2018, we closed on a sale and leaseback transaction involving certain equipment located at our Five Points, California and Nampa, Idaho production facilities. Under the terms of the transaction, we sold the equipment for \$2,106,395 million in proceeds. The proceeds were used to pay off in full the Secured Equipment Note mentioned above.



Financing activities during the six months ended December 31, 2017 provided \$22,072,723 in cash. We completed two separate private placements of common stock during the six months ended December 31, 2017 which raised net proceeds of \$10.7 million in cash. In December 2017, we also completed the closing of our rights offering and backstop commitment with MFP. Pursuant to the rights offering and backstop commitment with MFP, we sold and issued an aggregate of 3,500,000 shares of our common stock in December 2017 for aggregate net proceeds of \$11.8 million. On November 30, 2017, we entered into a secured note financing transaction for \$12.5 million in proceeds. The proceeds from the secured note financing were used to repay the Pioneer Note. The repayment amount included the \$2.5 million earn-out payment related to the Pioneer Acquisition that was added to the principal amount of the Pioneer Note in October 2017.

#### Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations, including our revenue and income from continuing operations. However, if our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

#### Off Balance Sheet Arrangements

We did not have any off-balance sheet arrangements during the three and six months ended December 31, 2018.

#### Capital Resources and Requirements

Our future liquidity and capital requirements will be influenced by numerous factors, including:

- the extent and duration of future operating income;
- the level and timing of future sales and expenditures;
- working capital required to support our growth;
- investment capital for plant and equipment;
- our sales and marketing programs;
- investment capital for potential acquisitions;
- our ability to renew and/or refinance our debt on acceptable terms;
- competition; and
- market developments.

## Critical Accounting Policies

The accounting policies and the use of accounting estimates are set forth in the footnotes to our consolidated financial statements.

In preparing our financial statements, we must select and apply various accounting policies. Our most significant policies are described in Note 2 - Summary of Significant Accounting Policies of the footnotes to the consolidated financial statements. In order to apply our accounting policies, we often need to make estimates based on judgments about future events. In making such estimates, we rely on historical experience, market and other conditions, and on assumptions that we believe to be reasonable. However, the estimation process is by its nature uncertain given that estimates depend on events over which we may not have control. If market and other conditions change from those that we anticipate, our results of operations, financial condition and changes in financial condition may be materially affected. In addition, if our assumptions change, we may need to revise our estimates, or to take other corrective actions, either of which may also have a material effect on our results of operations, financial condition or changes in financial condition. Members of our senior management have discussed the development and selection of our critical accounting estimates, and our disclosure regarding them, with the audit committee of our board of directors, and do so on a regular basis.

We believe that the following estimates have a higher degree of inherent uncertainty and require our most significant judgments. In addition, had we used estimates different from any of these, our results of operations, financial condition or changes in financial condition for the current period could have been materially different from those presented.

### Revenue Recognition

We adopted the provisions of ASC Topic 606, *Revenue from Contracts with Customers* ("Topic 606") as of July 1, 2018. Prior to the adoption of Topic 606, we had recognized revenue from product sales primarily when product was shipped. However, Topic 606 requires that companies evaluate their contracts with customers to determine whether any of three criteria is met with relation to an obligation to transfer goods or services to the customer. If so, revenue is recognized over time, generally during performance of the service or production of the goods, rather than only upon completion of the service or delivery of the goods. One criterion that requires recognition of revenue over time is met if i) the vendor's performance does not create an asset with an alternative use to the vendor, and ii) the customer does not have the ability to cancel its order without payment to the vendor for all work performed.

We have determined that our production and distribution agreements with Pioneer meet this criterion. Once Pioneer submits a demand plan for a particular growing season, we are required to use commercially reasonable efforts to arrange for the requested quantity of seed to be produced, and we are not permitted to sell the ordered seed to other customers. In addition, once Pioneer submits a demand plan, Pioneer cannot cancel or reduce the amount of seed that it is obligated to purchase under the contracts and must pay us for the requested quantity as long as we comply with the contracts. Therefore, the seed produced to meet Pioneer's demand plan has no alternative use to us, and Pioneer has an obligation to pay us for all seed ordered. As such, we began recognizing revenue under the Pioneer agreement over time as of July 1, 2018. This requires us to estimate our progress toward satisfying our obligation to produce and deliver seed to Pioneer. We have concluded that cost is the best measure of progress under the Pioneer contract because no other measure adequately reflects the value added to the product by each of our major tasks - having the crop grown, processing, and packaging. As

we contract out the growing of seed to third parties, the vast majority of our costs under these agreements are incurred, and therefore the vast majority of the revenue from such agreements is recognized, when the raw seed is purchased from the third-party contract growers. The rest of the costs are incurred, and therefore the rest of the revenue is recognized, as we process and package the product. Changes in estimates of costs to process and package seed, as well as changes in the timing of purchase of raw seed from third-party growers, could result in significant changes to the timing of revenue recognition, although they will not alter the total amount of revenue recognized under the contract in a growing season.

### Intangible Assets

All amortizable intangible assets are assessed for impairment whenever events indicate a possible loss. Such an assessment involves estimating undiscounted cash flows over the remaining useful life of the intangible. If the review indicates that undiscounted cash flows are less than the recorded value of the intangible asset, the carrying amount of the intangible is reduced by the estimated cash-flow shortfall on a discounted basis, and a corresponding loss is charged to the consolidated statement of operations. Significant changes in key assumptions about the business, market conditions and prospects for which the intangible asset is currently utilized or expected to be utilized could result in an impairment charge.

### Stock-Based Compensation

We account for stock-based compensation in accordance with FASB Accounting Standards Codification Topic 718 Stock Compensation, which establishes accounting for equity instruments exchanged for employee services. Under such provisions, stock-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense, under the straight-line method, over the employee's requisite service period (generally the vesting period of the equity grant).

We account for equity instruments, including stock options issued to non-employees, in accordance with authoritative guidance for equity-based payments to non-employees (FASB ASC 505-50). Stock options issued to non-employees are accounted for at their estimated fair value. The fair value of options granted to non-employees is re-measured as they vest.

We utilize the Black-Scholes-Merton option pricing model to estimate the fair value of options granted under share-based compensation plans. The Black-Scholes-Merton model requires us to estimate a variety of factors including, but not limited to, the expected term of the award, stock price volatility, dividend rate, risk-free interest rate. The input factors to use in the valuation model are based on subjective future expectations combined with management judgment. The expected term used represents the weighted-average period that the stock options are expected to be outstanding. We have used the historical volatility for our stock for the expected volatility assumption required in the model, as it is more representative of future stock price trends. We use a risk-free interest rate that is based on the implied yield available on U.S. Treasury issued with an equivalent remaining term at the time of grant. We have not paid dividends in the past and currently do not plan to pay any dividends in the foreseeable future, and as such, dividend yield is assumed to be zero for the purposes of valuing the stock options granted. We evaluate the assumptions used to value stock awards on a quarterly basis. If factors change, and we employ different assumptions, share-based compensation expense may differ significantly from what we have recorded in the past. When there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. To the extent that we grant additional equity securities to employees, our share-based compensation expense will be increased by the additional unearned compensation resulting from those additional grants.

### Income Taxes

We regularly assess the likelihood that deferred tax assets will be recovered from future taxable income. To the extent management believes that it is more likely than not that a deferred tax asset will not be realized, a valuation allowance is established. When a valuation allowance is established or increased, an income tax charge is included in the consolidated financial statements and net deferred tax assets are adjusted accordingly. Changes in tax laws, statutory tax rates and estimates of our future taxable income levels could result in actual realization of the deferred tax assets being materially different from the amounts provided for in the consolidated financial statements. If the actual recovery amount of the deferred tax asset is less than anticipated, we would be required to write-off the remaining deferred tax asset and increase the tax provision, resulting in a reduction of earnings and stockholders' equity.

### Inventories

All inventories are accounted for on a lower of cost or net realizable value. Inventories consist of raw materials and finished goods. Depending on market conditions, the actual amount received on sale could differ from our estimated value of inventory. In order to determine the value of inventory at the balance sheet date, we evaluate a number of factors to determine the adequacy of provisions for inventory. The factors include the age of inventory, the amount of inventory held by type, future demand for products and the expected future selling price we expect to realize by selling the inventory. Our estimates are judgmental in nature and are made at a point in time, using available information, expected business plans and expected market conditions. We perform a review of our inventory by product line on a quarterly basis.

Our subsidiary, S&W Australia, does not fix the final price for seed payable to its growers until the completion of a given year's sales cycle pursuant to its standard contract production agreement. We record an estimated unit price accordingly, inventory, cost of revenue and gross profits are based upon management's best estimate of the final purchase price to our S&W Australia growers. To the extent the estimated purchase price varies from the final purchase price for seed, the adjustment to actual could materially impact the results in the period when the difference between estimates and actuals are identified. If the actual purchase price is in excess of our estimated purchase price, this would negatively impact our financial results including a reduction in gross profits and earnings.

### Allowance for Doubtful Accounts

We regularly assess the collectability of receivables and provide an allowance for doubtful trade receivables equal to the estimated uncollectible amounts. That estimate is based on historical collection experience, current economic and market conditions and a review of the current status of each customer's trade accounts receivable. Our estimates are judgmental in nature and are made at a point in time. Management believes the allowance for doubtful accounts is appropriate to cover anticipated losses in our accounts receivable under current conditions; however, unexpected, significant deterioration in any of the factors mentioned above or in general economic conditions could materially change these expectations.



Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We are a smaller reporting company and therefore, we are not required to provide information required by this item of Form 10-Q.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Our management, with the participation of our Principal Executive Officer and our Principal Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2018 (the "Evaluation Date"). The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of December 31, 2018, our Principal Executive Officer and Principal Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) or in other factors that occurred during the period of our evaluation that have significantly affected, or are reasonably likely to significantly affect, our internal control over financial reporting.

Part II

OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

You should carefully consider the factors discussed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018, which could materially affect our business, financial condition, cash flows or future results. Except for the risk factors set forth below, there have been no material changes in our risk factors included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

The risks described in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018 are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

We may be unable to successfully integrate the businesses we have recently acquired and may acquire in the future with our current management and structure.

As part of our growth strategy, we have acquired and may continue to acquire additional businesses, product lines or other assets. We may not be able to locate or make suitable acquisitions on acceptable terms, and future acquisitions may not be effectively and profitably integrated into our business. Our failure to successfully complete the integration of the businesses we acquire could have an adverse effect on our prospects, business activities, cash flow, financial condition, results of operations and stock price. Integration challenges may include the following:

- assimilating the acquired operations, products and personnel with our existing operations, products and personnel;
- estimating the capital, personnel and equipment required for the acquired businesses based on the historical experience of management with the businesses with which they are familiar;
- minimizing potential adverse effects on existing business relationships with other suppliers and customers;
- developing and marketing the new products and services;
- entering markets in which we have limited or no prior experience; and
- coordinating our efforts throughout various distant localities and time zones.

In connection with any such transactions, we may also issue equity securities, incur additional debt, assume contractual obligations or liabilities or expend significant cash. Such transactions could harm our operating results and cash position and negatively affect the price of our stock.

For example, on October 25, 2018, we completed the acquisition of substantially all of the assets of Chromatin, Inc. (together with certain of its subsidiaries and affiliates in receivership, "Chromatin"), as well as the assumption of certain contracts and limited specified liabilities of Chromatin, for an aggregate cash purchase price of approximately \$26.5 million (the "Acquisition"), pursuant to the terms of our previously disclosed Asset Purchase Agreement, dated September 14, 2018, with Novo Advisors (f/k/a Turnaround Advisory Group Inc.), solely in its capacity as the receiver for, and on behalf of, Chromatin ("Novo"). To fund the Chromatin Acquisition, cover transaction expenses and provide additional working capital, we entered into a Securities Purchase Agreement (the "September SPA") with MFP Partners, L.P. ("MFP"), pursuant to which we agreed to sell and issue to MFP 1,607,717 shares of our common stock (the "Common Shares") for approximate gross proceeds of \$5.0 million at an initial closing (the "Initial Closing") and, subject to the satisfaction of certain conditions, 7,235 shares of newly designated Series A Convertible Preferred Stock of the Company ("Preferred Shares") for aggregate gross proceeds of \$22.5 million at a second closing (the "Second Closing"), each in a private placement. The Initial Closing was completed on September 5, 2018 and the Second Closing was completed on October 23, 2018.

We cannot guarantee that the Chromatin Acquisition will yield the results we have anticipated. In addition, there can be no assurance that we will achieve the revenues, growth prospects and synergies expected from this acquisition, our prior acquisitions or any future acquisitions, or that we will achieve such revenue, growth prospects and synergies in a manner consistent with our expectations. Our failure to do so could adversely affect our business, operating results and financial condition.

Raising additional capital may cause dilution to our stockholders or restrict our operations.

From time to time, we expect to finance our cash needs through a combination of equity and debt financings, as well as potentially entering into collaborations, strategic alliances and licensing arrangements. To the extent that we raise additional capital through the sale of equity or convertible debt securities, your ownership interest could be diluted and the terms of these securities may include liquidation or other preferences that adversely affect your rights as a common stockholder. Debt financing may involve agreements that include covenants limiting or restricting our ability to take specific actions, such as incurring additional debt, making capital expenditures or declaring dividends and may be secured by all or a portion of our assets.

For example, on September 5, 2018, we entered into the September SPA with MFP, pursuant to which we have issued the Common Shares and Preferred Shares for aggregate gross proceeds of approximately \$27.5 million. As a result of these issuances, our investors other than MFP experienced substantial dilution of their ownership interests.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit

No.

Description

3.1<sup>(1)</sup>

Registrant's Articles of Incorporation

3.2<sup>(2)</sup>

Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock

3.3<sup>(3)</sup>

Registrant's Amended and Restated Bylaws, together with Amendments One, Two and Three thereto

4.1

Reference is made to Exhibits 3.1, 3.2 and 3.3

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|-----------------------|---|
| 4.2 <sup>(4)</sup>    | <u>Form of Common Stock Certificate.</u>  |
| 4.3 <sup>(5)</sup>    | <u>Form of Common Stock Purchase Warrant</u>  |
| 10.1 <sup>(6)</sup> + | <u>Seventh Amendment Agreement, dated December 18, 2018, by and between the Company and KeyBank National Association.</u>   |
| 10.2 <sup>(7)</sup>   | <u>Loan and Security Agreement, dated December 18, 2018, by and between the Company and MFP Partners, L.P.</u>  |
| 10.3 <sup>(8)</sup>   | <u>Eighth Amendment Agreement, dated December 27, 2018, by and between the Company and KeyBank National Association.</u>  |
| 31.1                  | <u>Certification of Chief Executive Officer Pursuant to Rule 13-14(a) of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 31.2                  | <u>Certification of Chief Financial Officer Pursuant to Rule 13-14(a) of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 32.1**                | <u>Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>                              |
| 32.2**                | <u>Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>                              |
| 101.INS               | XBRL Instance Document  |
| 101.SCH               | XBRL Taxonomy Extension Schema Document   |
| 101.CAL               | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.LAB               | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE               | XBRL Taxonomy Extension Presentation Linkbase Document  |
| 101.DEF               | XBRL Taxonomy Extension Definition Linkbase Document  |

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- (1) Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed on December 19, 2011 (File No. 001-34719).
- (2) Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed on October 25, 2018 (File No. 001-34719).
- (3) Incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K, filed on September 28, 2015 (File No. 001-34719).
- (4) Incorporated by reference to Exhibit 4.3 to the Registrant's Registration Statement on Form S-3, filed on August 4, 2017 (File No. 333-219726).

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- (5) Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K, filed on December 31, 2014 (File No. 001-34719).
- (6) Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed on December 26, 2018 (File No. 001-34719).
- (7) Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed on December 26, 2018 (File No. 001-34719).
- (8) Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed on December 28, 2018 (File No. 001-34719).

+ Portions of this exhibit have been omitted pursuant to an Order Granting Confidential Treatment under the Securities Exchange Act of 1934, as amended.

\*\* This certification accompanies the Quarterly Report on Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Registrant under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

S&W SEED COMPANY

Date: February 12, 2019

By: /s/ Matthew K. Szot

Executive Vice President of Finance and  
Administration and Chief Financial Officer  
*(On behalf of the registrant in his capacity  
as Principal Financial and Accounting Officer)*

