

# Zacks Small-Cap Research

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## Swiss Water Decaffeinated Coffee Inc. (SWP.TO-TSX)

**SWSSF: Benefitting From Rising Demand for Decaffeinated Coffee & Natural Beverages, Initiating Coverage**

Swiss Water Decaffeinated Coffee is a leading specialty coffee company and premium green coffee decaffeinator focused on producing **chemical-free decaffeinated coffee** using its proprietary Swiss Water® Process. The company is poised to benefit from several trends, we believe, including rising consumption of decaffeinated coffee, growing consumer demand for natural and more healthful food and beverages (F&B) and the expanding popularity of the premium coffee category.

Current Price (10/4/24) **\$3.50**  
Valuation **\$6.10**

### OUTLOOK

Consumption of decaffeinated coffee is rising and outpacing the expansion of the overall coffee beverage category, yet still represents only about 15% and 12%, respectively, of total coffee consumption in the U.S. and Western Europe. This implies substantial growth prospects for Swiss Water, we believe, as sales of decaffeinated coffee continue to increase and as consumers' demand for natural food & beverages and premium coffees continues to rise. We believe the company's natural decaffeinated process is a key factor that could drive demand for Swiss Water decaffeinated coffee within the category and which has a positive tailwind from coffee consumption trends.

### SUMMARY DATA

52-Week High	<b>\$4.29</b>
52-Week Low	<b>\$2.40</b>
One-Year Return (%)	<b>37</b>
Beta	<b>1.76</b>
Average Daily Volume (sh)	<b>3,850</b>
Shares Outstanding (mil)	<b>10</b>
Market Capitalization (\$mil)	<b>\$35</b>
Short Interest Ratio (days)	<b>1</b>
Institutional Ownership (%)	<b>N/A</b>
Insider Ownership (%)	<b>N/A</b>
Annual Cash Dividend	<b>\$0.00</b>
Dividend Yield (%)	<b>0.00</b>
5-Yr. Historical Growth Rates	
Sales (%)	<b>N/A</b>
Earnings Per Share (%)	<b>N/A</b>
Dividend (%)	<b>N/A</b>
P/E using TTM EPS	<b>N/A</b>
P/E using 2024 Estimate	<b>N/A</b>
P/E using 2025 Estimate	<b>N/A</b>

Type of Stock  
Industry

Small-Value  
N/A

### ZACKS ESTIMATES

#### Revenue

(in millions of C\$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2022	38 A	48 A	46 A	44 A	177 A
2023	49 A	43 A	33 A	41 A	166 A
2024	39 A	43 A	44 E	41 E	168 E
2025					176 E

#### Loss/share or EPS (C\$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2022	\$0.15 A	\$0.16 A	-\$0.02 A	-\$0.03 A	\$0.26 A
2023	-\$0.08 A	-\$0.06 A	-\$0.05 A	\$0.10 A	-\$0.06 A
2024	-\$0.10 A	\$0.07 A	-\$0.03 E	-\$0.04 E	-\$0.09 E
2025					-\$0.16 E

Quarters might not sum due to rounding & share count

Disclosure page 19

## KEY POINTS

- SWP is a leading specialty coffee company and premium green coffee decaffeinator focused on producing **chemical-free** decaffeinated coffee using its proprietary Swiss Water® Process. The company is poised to benefit from several trends, we believe, including rising consumption of decaffeinated coffee and growing consumer demand for natural and more healthful food and beverages (F&B), as well as the ongoing expansion of the premium decaf category. We believe the company's natural decaffeinated process is an important factor that could drive demand for its product within the decaffeinated coffee category.
- Coffee consumption in general is rising and consumption of decaffeinated coffee is outpacing the growth of the overall coffee category. Nevertheless, at this point the decaffeinated niche represents only about 15% and 12% of total coffee consumption in the U.S. and in Western Europe, respectively, implying substantial growth prospects for Swiss Water, if sales of decaffeinated coffee continue to rise as anticipated.
- The growing popularity of decaffeinated coffee reflects a number of factors, including that people increasingly seek to manage caffeine intake for health reasons and to minimize disruptions to sleep patterns, while decaf options within the popular (a recent NCA study indicates that 41% of U.S. consumers responded that they had enjoyed a specialty coffee "in the past day") premium category are improving. At the same time, we expect rising consumer focus on natural F&B to be another growth driver for Swiss Water, reflecting its chemical free decaffeination process. A 2023 [study](#) from U.C. Davis notes that "Swiss water decaffeination is increasing in popularity..."
- North America and Europe are key markets for coffee consumption generally and therefore for Swiss Water. In 2023, Swiss Water's largest geographical market by volume was the U.S., followed by Canada and then international markets.
- To upgrade and expand production capacity, Swiss Water opened a new state-of-the-art production facility in British Columbia in 2020 and in 2023 installed a second production line. SWP has derived operational benefits from consolidating operations in one site that is located close to its warehouse operations.
- Year-over-year sales comparisons in 2024 have not been apples-to-apples reflecting some short-term disruptions in plant activity during the recent plant upgrade, but we expect normalized sales patterns to resume in 2025 and anticipate further growth as the market trends discussed in this report are expected to continue.

## COMPANY BACKGROUND

### *Rising Consumption of 'Decaf' Important Growth Driver...*

British Columbia-based Swiss Water Decaffeinated Coffee Inc. (OTC:SWSSF, TSX: SWP) is a leading specialty coffee company and premium green coffee decaffeinator focused on producing chemical-free decaffeinated coffee. Swiss Water owns the Swiss Water® trademark exclusively and operates a decaffeination business using its proprietary Swiss Water® Process, which, as noted, is a chemical-free way to decaffeinate coffee described below. The process is certified organic by the Organic Crop Improvement Association.

The company is poised to benefit from several factors, we believe, including rising consumption of decaffeinated coffee and the growing consumer trend towards natural and more healthful food and beverages (F&B), as Swiss Water's proprietary decaffeination process is 100% chemical-free. Importantly, at the same time, the process is designed to maintain the full flavor of the green coffee beans. In a report on the market for decaffeinated coffee, U.C. Davis notes that the Swiss Water method includes the benefit of flavor retention. Decaffeination using the Swiss Water® Process began almost 40 years ago and management believes that over the years, the company has fine-tuned the process, which requires substantial technological and operational expertise that likely provides competitive advantages and also creates barriers to entry.

### *... Meeting growing demand: production facility upgrade, expansion...*

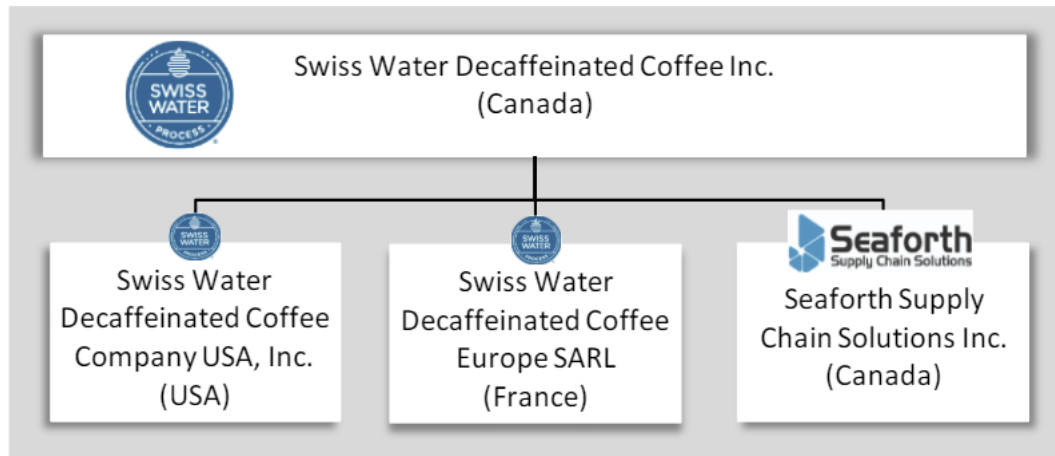
To upgrade and expand production capacity, Swiss Water opened a new state-of-the-art production facility in the city of Delta, British Columbia in 2020. Once the plant was up and running, SWP began production of coffee there in September 2020. Reflecting growing demand and the need to increase capacity, Swiss Water completed the construction of its second production line in the facility in 2023 and has consolidated all production and operations at this plant, with both lines fully operational since 3Q23.

### *...Operational benefits from consolidating operations in one site closer to warehouse*

The consolidation of operations in one location has enabled Swiss Water to obtain some production efficiencies. In addition, the proximity of the facility to its warehouse operations also has led to some operational benefits.

Shifting production from an older facility in the city of Burnaby to the new plant and then installing the second line there has also led to some timing shifts in fulfilling sales. Order backlogs increased during the transition from the Burnaby plant to the Delta facility. Given the short-term disruptions in plant activity, year-over-year sales comparisons have not been apples-to-apples in 2024 (see below). Much of the backlog was processed and shipped in the back half of 2023 and we expect normalized sales patterns to resume in 2025 and anticipate continued growth as the market trends discussed in this report are expected to continue.

Swiss Water operates through three wholly-owned subsidiaries that focus on coffee decaffeination and distribution. One subsidiary, Seaforth Supply Chain Solutions, provides integrated coffee handling services primarily to Swiss Water and to other coffee importers and coffee roasting companies, as well. Swiss Water Decaffeinated Coffee Company USA (SWUS) supports business development and marketing activities in North America. In 2019, the company expanded activities to target opportunities in the European market and established its Swiss Water EU (SWEU) subsidiary.

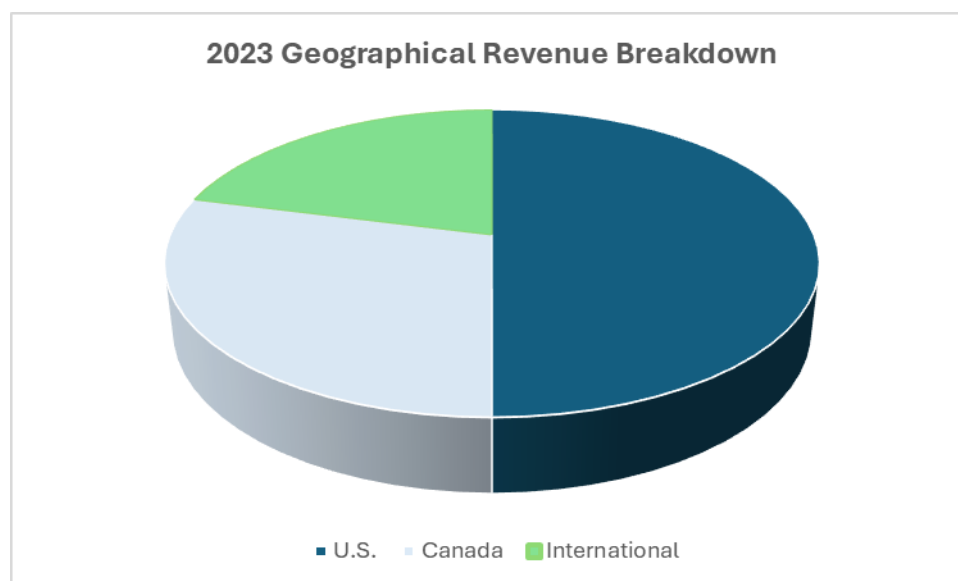


Source: Company reports

### Seaforth Supply Chain Solutions

Seaforth, which is a wholly-owned subsidiary of Swiss Water, began operations in 2012. It provides green coffee handling, storage and logistics services to coffee importers and roasting companies. Although Seaforth provides services to external coffee roasters and importers, Swiss Water is its largest customer.

Seaforth operates a leased warehouse located in the city of Delta, British Columbia that is within close proximity (about two kilometers) to Swiss Water’s Delta production facility and strategically situated between two shipping ports: the Fraser Surrey Docks and GCT Canada/ Delta Port. The facility also has easy access to the South Fraser Perimeter Road, which is a four-lane highway used to transport goods in the metropolitan Vancouver region. Seaforth also handles local transportation of coffee to and from Swiss Water’s production facility. Prior to the decaffeination process, green coffees are stored at Seaforth’s Delta warehouse. Following the decaffeination process, finished goods are shipped directly to Swiss Water’s customers or stored at Seaforth’s facility, which serves as Swiss Water’s local distribution center.



Source: [Company reports](#)

## Swiss Water Decaffeinated Coffee Company Sales & Distribution

North America and Europe are key markets for coffee consumption generally and therefore for Swiss Water. Swiss Water® Process decaffeinated green coffees are distributed to specialty roaster retailers, specialty coffee importers, and commercial coffee roasters throughout North America. In 2023, Swiss Water's largest geographical market by volume was the U.S., followed by Canada and then international markets. In terms of dollar value, 50% of sales were to U.S. customers, 29% to Canadian customers, and the remaining 21% were to international customers.

These relative contributions were consistent through the first half of 2024, with the U.S. representing about 50% of sales by dollar value, Canada 27% and international the remaining 23%. The U.S. is the world's leading market for aggregate coffee consumption, as discussed below. Moreover, until recently, the U.S. led other markets as the world leader in branded coffee shops, with more than 40,000 outlets as of 2024. In the near-term, the company's strategy to drive future growth focuses on key markets of North America and Europe, and includes expanding its presence in European markets. We believe the company's growth strategy has a positive tailwind from coffee consumption trends in these markets.

For example, currently only roughly 15% of coffee consumed in the U.S. is decaffeinated, and decaffeinated coffee represents about 12% of all cups consumed in Western Europe, according to the NCA. Nevertheless, decaffeinated coffee is gaining market share. We believe this implies substantial growth prospects for Swiss Water, as sales of decaffeinated coffee is expected to continue to increase.

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## COMPANY'S DECAFFEINATION PROCESS

### Most decaffeination processes involve chemical solvents...

Decaffeination is the process of removing caffeine from coffee beans. The process of decaffeination first began in the early 20th century, according to National Coffee Association of U.S.A. The caffeine is removed in the green bean stage before the coffee is roasted. To remove the caffeine, the green beans are warmed and soaked in a liquid solution that generally contains solvents, according to the National Coffee Association of U.S.A.

The process is regulated to ensure that all but trace amounts of the chemical solvents are removed before the coffee is roasted and that the caffeine has been largely removed. The U.S. Food and Drug Administration (FDA) mandates that at least 97% of the caffeine be removed in order for coffee to be labeled decaffeinated. Certain decaffeination processes incorporate the use of methylene chloride. The FDA has deemed the use of methylene chloride safe in the decaffeination process, indicating that only trace amounts remain in the beverage. However, as it is considered a possible carcinogen, many countries do not allow the importation of coffee that has been decaffeinated with it. In fact, many of the various solvents used in most commercial decaffeination processes are considered carcinogenic or toxic but since only trace amounts wind up in the finished goods following the decaffeination process, these methods have been deemed safe and the majority of worldwide decaffeination capacity utilizes chemical decaffeination methods.

However, we believe that rising awareness about the use of solvents in some processes, combined with growing interest in consuming natural foods and beverages could be likely growth drivers for Swiss Water's natural decaffeination process. In fact, overall global capacity appears to be moving toward less chemical solvent based methods, reflecting consumers' growing health preferences. According to a [study](#) from U.C. Davis, "Solvent-based methods are still the most prevalent method due to their low cost and ease of use. [However,] Swiss water decaffeination is increasing in popularity..."

## ***Regulatory & grassroots pushback to the use of chemicals in the decaffeination process***

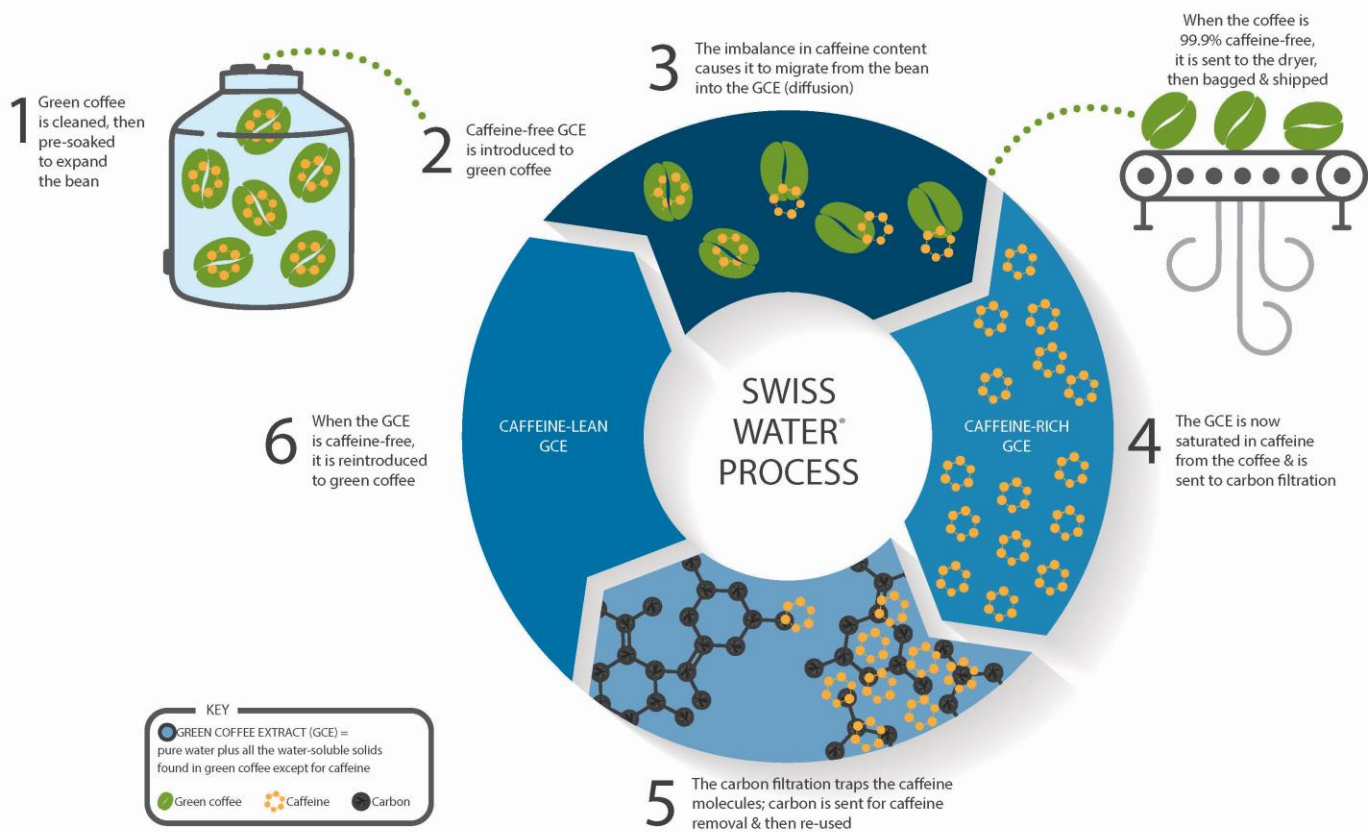
Moreover, there have been regulatory and grassroots efforts to limit the use of chemicals in the decaffeination process. Despite being deemed safe by the FDA and other regulators, in March 2024, California considered a proposal to ban decaffeinated coffee using methylene chloride or to require that coffee be labeled as such for improved consumer transparency beginning January 1, 2027.

In addition, the FDA has been petitioned to ban four toxic chemicals in food uses, including in many decaffeination processes. In 2023, the U.S. Environmental Protection Agency (EPA) proposed to eliminate or minimize uses of certain chemicals regulated under the Toxic Substances Control Act (TSCA), reflecting their potential risks for cancer and other serious health issues. The FDA, however, continues to allow many of these chemicals because of what it notes are trace elements in the ultimate food or beverage product.

However, in January of this year, the Environmental Defense Fund, Breast Cancer Prevention Partners, Center for Environmental Health, Environmental Working Group (EWG), and an environmental health consultant (Lisa Lefferts) submitted a petition to the FDA calling for the ban on many of these. This initiative has met with mixed responses within the coffee industry, as some within the industry feel that this would severely limit the availability of decaffeinated coffee. If this is correct, it would also likely lead to price increases, at least in the short-term, that could mitigate demand for decaffeinated coffee, in our view.

### ***... But Swiss Water Process 100% natural...***

The Swiss Water Process is 100% chemical-free, as noted. It is based on the principle of diffusion. The first step in the process is to immerse a batch of green coffee beans in hot water, which prepares the cellular structure of the bean for caffeine removal. The company uses fresh water from British Columbia's coastal mountains. The beans are then introduced to the company's Green Coffee Extract (GCE), which consists only of water and the naturally occurring soluble solids in green coffee — except for caffeine. The imbalance in caffeine between the green coffee bean and the GCE triggers the diffusion process. Once the beans are 99.9% caffeine free, they are dried and prepared for shipment to the company's customers or storage at the Seaforth Delta city warehouse. Importantly, the company believes its natural process removes caffeine from the beans without deterioration of flavor, which is consistent with UC Davis findings, as well.



Source: [Company reports](#)

### Many roasters advertise the use of the Swiss Water Process to consumers

Reflecting factors noted throughout this report, including consumer demand for more healthful ingredients and products, it appears that many roasters incorporate that they rely on the use of the Swiss Water process in their brand advertising to consumers, using words such as “cleanest,” and “healthiest” and “flavorful” in their branding.

As the overall market for decaffeinated coffee expands, the company expects that the market for chemical free decaffeination will continue to grow, particularly given people’s continued trend towards health consciousness and awareness of environmentally friendly practices.

## CONSUMPTION OF DECAFFEINATED COFFEE ON THE RISE

As the decaffeinated segment grows, we anticipate ongoing growth for Swiss Water reflecting multiple trends discussed in this report, including:

- Rising consumer trends towards healthier food and beverage choices
- Grassroots and other initiatives to shift to natural decaffeination process
- Growing decaffeination choices in the premium coffee segment
- Consumers managing caffeine intake while maintaining coffee consumption

### *Increased focus on natural and premium decaf category help drive growth*

According to consumer research from [StudyLogic](#), the amount of decaffeinated coffee consumed has grown annually since 2017 in both the U.S. and Western Europe. This growth was temporarily interrupted in 2020, but that disruption is primarily attributed to the impact of the pandemic. Research suggests that the key demographic driving growth is the young adult consumer market. The US National Coffee Association (NCA) conducted a study in 2017 that found that the largest demographic consuming decaffeinated coffee in the U.S. was comprised of adults aged 18 to 24, which represented roughly 19% of total decaf consumers in the U.S. market.

Based on data aggregated by UC Davis, the overall decaffeinated coffee market is expected to grow at CAGR of 5-7% in the 2021 to 2031 period. This growth in consumption of decaffeinated coffee comes as coffee consumption generally is rising. The NCA places the number of U.S. adults who have had coffee in the past day “at its highest level in more than 20 years,” and up about 37% since 2004. NCA’s Spring 2024 National Coffee Data Trends (NCDT) report reveals that 67% of American adults had coffee in the past day (more than any other beverage, including tap or bottled water), which compares to 49% in 2004. The spring 2024 study also found that 75% of U.S. adults had consumed coffee in the past week, which represents a 4% year-over-year advance compared to the Spring 2023 study.

### *Expanding specialty coffee segment*

Decaffeinated coffee continues to play a role in the growing ‘specialty coffee’ category, which gives consumers more choices within the premium coffee segment (see below). A growing focus on specialty decaffeinated coffee – or premiumization – is an important factor contributing to the expansion of the decaf category and Swiss Water’s strategic focus is largely on the premium specialty coffee segment. Specialty coffees are premium varieties of coffees and include coffee brewed from high-quality beans, particularly Arabica, as well as coffee drinks such as espressos, cappuccinos, and lattes, among others. A recent NCA study indicates that 41% of U.S. consumers responded that they had enjoyed a specialty coffee “in the past day.”

According to an NIH study, “Specialty coffee and tea houses and beverages have become a cultural phenomenon.” The NCA notes that specialty coffee has recorded “significant growth.” Based on NCA’s Spring 2024 National Coffee Data Trends report, some 57% of U.S. adults reported having a specialty coffee in the past week. This represented a 7.5% year-on-year increase. The annual increase was highest for the espresso-based category, which advanced 10% compared to the same period of 2023. Lattes lead this category; about 18% of U.S. adults responded that they had a latte in the past week, followed by espresso (16%) and cappuccinos (14%).

Moreover, many people opt for limiting their caffeine intake later in the day in order to maintain healthy sleep patterns, as they manage their caffeine intake while maintaining coffee consumption. The company’s data suggest that about 62% of coffee consumers believe that limiting their caffeine consumption is important. According to the NCA, 66% of coffee drinking consumers believe that “it is important to limit my caffeine intake.” Consumer awareness of health-related issues is increasing the appreciation for food safety, food provenance, and healthier or “better for you” food options. According to UC Davis, “the small amount of caffeine [in decaffeinated coffee] isn’t really enough to affect most people... But that also depends on a few factors: Those include caffeine sensitivity (which is largely genetic) and caffeine tolerance (which develops with regular intake). People who are “mildly or moderately sensitive to caffeine and/or consume caffeine regularly are unlikely to be affected by the small amount of caffeine in decaf...”

The growth of the premium or specialty coffee category would also align with growing willingness to pay for both specialty drinks and healthier options, we believe. For example, studies examining the results of multiple experiments conducted in the F&B sector concluded that consumers are generally willing to pay for healthier food products across a range of food retail environments, presumably including coffee bars and retailers. Specifically, 23, or 88.5% of a total of 26 experiments included in the review, found that consumers were willing to pay a price premium for healthier options. The premium ranged from 5.6% to 91.5%, with a mean of 30.7%.

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## CONSUMER TRENDS TOWARDS HEALTHY FOOD & BEVERAGES

### *Growing trend towards healthy food and beverage (F&B), premium coffee choices, expansion of decaffeinated coffee category likely growth drivers for Swiss Water*

The growing trend among consumers across the globe to seek out healthy food and beverage (F&B) choices, combined with the ongoing expansion of the decaffeinated coffee category, presents potential growth opportunities for Swiss Water, in our view. The company believes that its natural decaffeinated process is an important factor that differentiates the Swiss Water process and makes the company increasingly relevant and in demand within the decaffeinated coffee category.

The trend toward healthier and natural F&B can be seen in the coffee choices consumers make, a trend that is also consistent with the growing popularity of organic and natural food options. Demand for organic coffee continues to rise. In fact, 39% of consumers indicate that they are more likely to purchase coffee that is certified organic, and 59% are more likely to purchase coffee if it is grown in an environmentally sustainable way. According to Coffee Intelligence, the 2021 global organic market was valued at \$133 billion, which represented a 24.6% year-over-year advance. Demand for organic coffee is highest in North America, followed by Germany and France. Moreover, it would appear that consumer awareness of methylene chloride in many decaffeinated coffees is rising, as well, as reflected in the recent California bill proposal and the above noted FDA petition.

A 2022 NIH-published study notes that “[i]n recognition of the growing concerns around public health, the types of food and beverage products sold through the hospitality sector are experiencing major changes...” According to Forbes,

“Consumers continue to expand their awareness of the impact their food and beverage choices have on both their own bodies and our planet. Food and beverage companies are responding to this trend by reformulating their products to incorporate healthier and more sustainable ingredients. This includes using organic foods, reducing the use of artificial additives and preservatives, sourcing ingredients locally or from sustainable suppliers, and adopting environmentally friendly packaging.”

Moreover, at the same time, the growth of the decaffeinated category also comes as the organic coffee category is expanding. The publication Coffee Intelligence notes that despite the price premium, organic coffee is recording steady growth. It places the 2021 value of the global organic coffee market at \$133 billion and notes that demand for organic coffee is highest in North America, Germany and France. Coffee Intelligence further notes that organic coffee sales saw the highest annual growth in 2021 compared to 2020, with a 24.6% year-over-year advance.

## LARGEST COFFEE CONSUMER MARKETS

As noted, North America and Europe are key markets for coffee consumption generally and for Swiss Water. The U.S. is the company's largest geographical market, followed by Canada and then international markets. Given the size of the population, the U.S. is the largest market for coffee consumption in the world, although it does not rank #1 based on per capita coffee consumption.

According to data from [World Population Review](#), although it does not rank among the top ten markets based on *per capita* coffee consumption, the U.S. is the world's leading market for total coffee consumption, reflecting the size of the population combined with per capita coffee consumption trends.

Rank	Country	Total Coffee Consumption 2020-21 (1000s of 60-lb bags)	Market Population (millions)
1	United States	26,982	333
2	Brazil	22,400	215
3	Japan	7,386	125
4	Indonesia	5,000	275
5	Russia	4,681	144
6	Canada	4,011	39
7	Ethiopia	3,798	123
8	Philippines	3,312	115
9	Vietnam	2,700	98
10	South Korea	2,513	52

Source: [World Population Review](#), World Bank, US Census Bureau

Various sources place the percent of the U.S. population consuming coffee on a daily basis at levels well above 50%. This is consistent with a recent study titled "[Coffee Drinking Is Widespread in the United States, but Usual Intake Varies by Key Demographic and Lifestyle Factors](#)" concluded that coffee is widely consumed in the U.S. and per capita consumption varies by lifestyle and demographic factors, "most notably by age." Given SWP's near-term focus on North American and European markets, we believe the company has a positive tailwind from the market size and expected growth.

According to the publication [The Telegraph](#) the majority of the world's leading markets ranked by per capital consumption of coffee are in Europe. In fact, on a per capita basis, all but one of the top ten coffee consumption markets are in Europe, implying – we believe – strong opportunities for decaffeinated coffee consumption.

Rank	Country	Per capita consumption per year (kg)
1	Finland	12.0
2	Norway	9.9
3	Iceland	9.0
4	Denmark	8.7
5	Netherlands	8.4
6	Sweden	8.2
7	Switzerland	7.9
8	Belgium	6.8
9	Luxembourg	6.5
10	Canada	6.2

Source: Zacks from The Telegraph data

Given the high per capita consumption of coffee overall in many European markets, as illustrated in the table above, we believe there are opportunities for Swiss Water if, as we believe likely, trends in those markets follow global trends, with decaf gaining share as consumers worldwide increasingly focus on consuming natural and organic foods and beverages. This trend is already becoming apparent, according to industry trade publications. According to [Tea & Coffee Journal](#), “Decaf coffee’s popularity is rising in European markets where there is a significant consumption of caffeinated beverages and where consumers are paying more attention to health and wellbeing... Amid the ever growing desire of the young European population to limit their caffeine consumption, the demand for decaf coffee in the region remains strong. The increase of decaf coffee consumption in Europe is currently part of the global trend of the rising consumer health awareness and a higher demand for products, which are free from preservatives, caffeine and other various hazardous substances.”

The company is focused on opportunities in European markets. According to a 2022 Euromonitor analysis, as in the overall coffee segment, there is an increasing trend toward premium or specialty decaffeinated beverages. Euromonitor also indicates that consumers are willing to pay higher prices for better quality decaffeinated coffee. Euromonitor’s Product Claim and Prime Positioning System report notes that the number of decaf coffee SKUs available online is significant increased between 2019 and 2021 in Western Europe.

## MANAGEMENT

Management has extensive experience in the food and beverage (F&B) industry.

### President and CEO...

Frank Dennis, the company’s President and CEO, has more than 30 years of experience in the coffee industry. His background is in packaged goods marketing, with previous roles at Braun Canada and Kraft Foods Canada. Mr. Dennis led the \$300 million Kraft coffee portfolio in the late 1990s and was also responsible for the sale of the Swiss Water Division to private equity interests in 2000.

Under his helm as president and CEO, Swiss Water has opened its newly constructed production facility and expanded the brand into many new regions. Mr. Dennis has served on the boards of several companies, including Grounds For Health, a charity dedicated to reducing cancer in women living in

coffee-producing regions, the World Coffee Research Foundation, and the Canadian Coffee Association. He has been a director on the Swiss Water board since 2002.

## CFO...

Iain Carswell has been Swiss Water's Chief Financial Officer since 2018. He is responsible for the company corporate finance, external financial reporting, compliance, risk management, and investor relations. He is an experienced financial executive in large multisite manufacturing environments, and has broad experience operating in international markets. Prior to joining Swiss Water, e. Carswell spent 15 years with Mars Inc, a global food and confectionary company. He moved to Swiss Water from his role as CFO of Mars Turkey.

In March 2024, the company's board adopted a share ownership policy to further aligns the interests of the CEO and CFO with those of the company and public shareholders. The new policy stipulates that the CEO and CFO hold shares at a level based on their respective salaries within five years of the policy being put in place.

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## RECENT RESULTS

### Y/Y 1H24 decline in volumes had been anticipated as new production line ramped last year

SWP reported revenue of C\$43.4 million in 2Q24, just ahead of C\$43.4 million in 2Q23. The company recorded gross profit of C\$7.7 million, which represents an increase of about C\$4.3 million compared to 2Q23. The improvement primarily relates to the cost savings and efficiencies garnered from the consolidation of all Swiss Water production and operations at the Delta, BC plant, as well as the positive impact of a \$2.1 million one-time decrease in year-over-year depreciation expenses. Change in estimate? The gross profit margin was 18%, up from 8% in 2Q23. SWP's net income was C\$0.9 million or C\$0.10 per share, compared to (C\$0.4) million and (C\$0.04) respectively in 2Q23. Adjusted EBITDA was C\$4.5 million, compared to C\$1.8 million 2Q23.

Total processing volumes increased 12% year-over-year, as the company experienced strong demand for its chemical-free decaffeinated coffee. However, results are not entirely apples-to-apples, as the distribution of quarterly sales volumes in 2023 did not follow normal seasonal patterns because the company opened a new production line during the year. Short-term capacity limitations during this period in turn led to substantially higher than normal volume growth and financial results during 1Q23 and 4Q23.

Specifically, customer sales orders were unusually front loaded last year in anticipation of the temporary production constraints resulting from SWP's closing its legacy Burnaby production site in 2Q23 prior to the full commissioning its second new decaffeination line at the Delta, BC facility. Once this line went operational in 2Q23, 4Q23 orders were also unusually high reflecting timing delays for customers that otherwise would have placed orders in 2Q and 3Q. Specifically, with the new Delta Line 2 fully ramped by the end of 2023 and all production consolidated in one location, the backlog of orders were processed and shipped during 4Q23. Thus, the year-over-year decline in volumes for 1H24 had been anticipated.

Volumes and revenue are returning to normal patterns in 2024. However, geopolitical pressures are also leading to indications that coffee prices are rising – coffee futures price for Arabica coffee was volatile in 2Q24, peaking at US\$2.48/lb in mid-April – which potentially could constrain sales in the short-term. Specifically, in turn, this could hamper consumer demand for coffee and, as a result, constrain SWP's volume shipments in the short-term.

## Balance sheet

The company had cash and equivalents of C\$18.4 million at June 30, 2024 and combined short-term and long-term borrowings of C\$ 98.3 million. Swiss Water targets paying down debt and accumulate cash deposits, while concurrently managing inventory levels to ensure that it has sufficient inventory on hand to support operations and expected near-term growth. Moreover, Swiss Water is scheduled to fully repay \$15.8 million debenture with warrants held by Mill Road Capital in 4Q24. SWP had \$18.4 million in cash reserves at the end of 2Q24 and anticipates that the repayment will be funded primarily using available cash and cash generated from operations or adjusted EBITDA.

## VALUATION

We are optimistic about Swiss Water's growth prospects, reflecting the positive trends for consumption of decaffeinated coffee and rising consumer interest in natural food and beverages. As the company has expanded its production capacity with the recent expansion of its plant, we believe the company is well-positioned to benefit from this anticipated growth. We believe it is difficult to compare Swiss Water shares to those of other publicly traded companies, as there are no other public companies that directly compete with Swiss Water Decaffeinated Coffee and therefore there does not seem to be a direct public competitor.

Therefore, we believe using an EV/EBITDA multiple, particularly as the fluctuations in commodity prices of coffee beans impacts the company's revenue, but this impact is generally offset at the adjusted EBITDA level. Over the past few years, the EV/EBITDA for the S&P 500 has generally been a range of about 13x to 17x. We believe, however, that smaller cap companies likely trade at lower average EV/EBITDA multiples and we therefore apply a discount to the above noted S&P 500 average.

Swiss Water generated adjusted EBITDA of C\$13.4 million in 2023. We forecast adjusted EBITDA of C\$14.4 million in 2025. The company had cash and equivalents of C\$18.4 million and combined short-term and long-term borrowings of C\$ 98.3 million at June 30, 2024, for net debt of about C\$79.9 million. Adding this to the company's market capitalization, on this basis, we believe the shares trade below 8x our 2025E adjusted EBITDA forecast on an EV/EBITDA basis. We expect multiple expansion and derive a near-term valuation of about US\$4.00 to US\$5.00 per share, \$4.50 or C\$6.10 at the midpoint, which is still well below the multiple the S&P 500 commands. We also believe our forecast could prove conservative, given the trends discussed in this report.

If the company delivers milestones on its growth initiatives earlier than anticipated, it could impact the multiple. Any delay or failure in successful execution of the strategy or short-term constraint in market demand could represent a potential risk to the company's valuation and cause the share price to decline. The company believe the risk / reward ratio could be attractive for investors who have a higher than average risk tolerance and longer time horizon.

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## RISKS

We believe risks to Swiss Water achieving its goals, and to our valuation, include the following, among others.

- Swiss Water might not gain market share as quickly as the company expects, which could lead to slower than anticipated revenue ramp.
- The company could incur unanticipated costs associated with market initiatives.
- Competition could increase.
- The company might need to raise capital to support its strategy that might be dilutive to current shareholders.
- Demand might exceed the company's production capacity, which would likely impose constraints on revenue growth.
- Commodity bean prices fluctuate. Although the impact is usually offset at the company's adjusted EBITDA level, there could be lags that in the short-term impact results more than anticipated.
- Given that the majority of Swiss Water revenue is generated outside of its home market of Canada, foreign exchange rates might have a greater impact on consolidated revenue and results than anticipated.

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## RECENT NEWS

- Swiss Water reported 2Q24 results on August 1, 2024.
- On May 9, 2024, the company reported voting results from its annual general meeting.
- Swiss Water reported 1Q24 results on May 2, 2024.
- Swiss Water launched its second production line in the Delta, BC facility on November 6, 2023.
- The company completed its second production line in Delta, BC on August 8, 2023.

## APPENDIX: COFFEE MARKET

Given the company's near-term focus on North American and European markets, we believe the company has a positive tailwind from the market size and expected growth. Coffee is the second-most-exported commodity in the world after [oil](#). The highest annual per-person consumption is in European markets, particularly in various [Scandinavian countries](#). The average per capita coffee consumption in the U.S. is about three cups daily, placing the U.S. at the 25th ranking in terms of per capita consumption. The growth in decaffeinated coffee consumption is outpacing that of caffeinated coffee, but that category is also growing, suggesting that overall coffee consumption is expanding.

### *U.S. and Europe*

As noted, the U.S. does not rank #1 based on per capita coffee consumption, but it is the largest market for coffee consumption in the world, according to data from [World Population Review](#), reflecting the size of the population combined with per capita coffee consumption trends. It is a key market for Swiss Water. Various sources place the percent of the U.S. population consuming coffee on a daily basis at levels well above 50%.

Nevertheless, coffee consumption in the U.S. has continued to climb, with the growth in consumption of decaffeinated coffee outpacing that of regular coffee, as noted. Consistent with the trend towards increased consumption of decaffeinated coffee, [NCA's 2023 US Coffee Data Trends Report](#) indicates that 7% of respondents drink decaffeinated coffee the prior day, and 11% in the past week. Among younger consumers, the metrics are higher, with more than 13% having decaffeinated coffee in the past week. In fact, the NCA report supports other studies indicating that younger consumers are driving the growth in decaffeinated coffee consumption, with consumption growth highest in the 18-39 segment. It is the same segment driving the growth of specialty coffee.

Moreover, most studies also indicate that drinking decaffeinated coffee and caffeinated coffee has multiple potential health benefits, including contributing to increased longevity and decreased risk of multiple cancers. A study using UK Biobank data found that drinking three cups of any kind of coffee per day was associated with a 12% reduction in overall mortality.

The majority of the world's leading markets ranked by per capital consumption of coffee are in Europe, as noted. Given the high per capita consumption of coffee overall in many European markets, there are opportunities for Swiss Water if, as we believe likely, trends in those markets follow global trends, with decaf gaining share as consumers worldwide increasingly focus on consuming natural and organic foods and beverages.

Various benefits believed to be associated with consumption of both caffeinated and decaffeinated coffee are illustrated below:

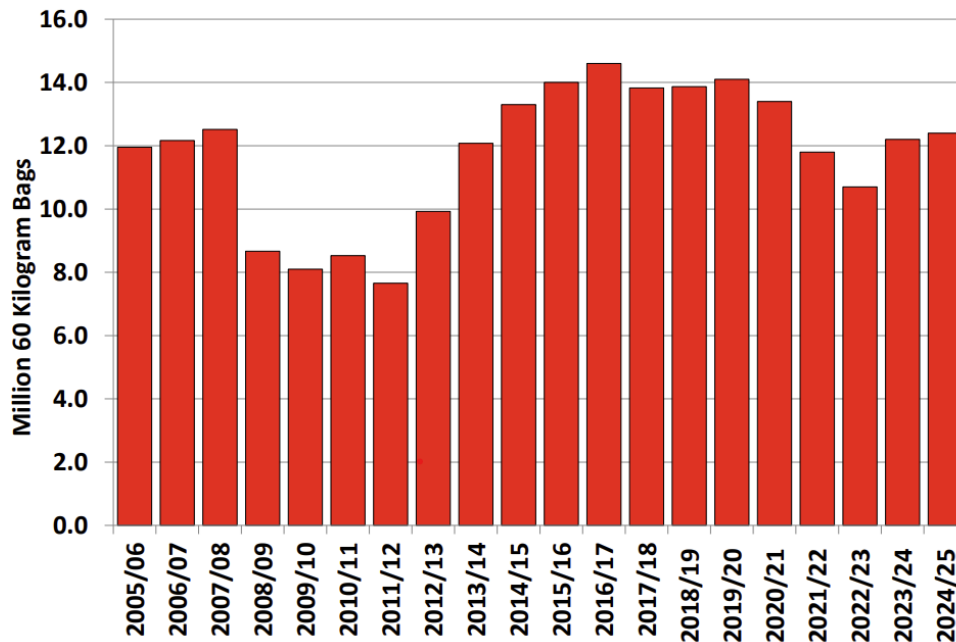
- In 2016, the World Health Organization's International Agency for Research on Cancer (IARC) put drinking coffee in its lowest risk category, determining that coffee is not likely to cause cancer and may be protective against some cancers.
- California's state scientific agency in separate reviews concluded: "A very large number of human studies, taken together, show inadequate evidence that drinking coffee causes cancer. Drinking coffee even appears to reduce the risk of liver cancer and endometrial cancer."
- The American Cancer Society updated in 2020 its dietary guidelines for cancer prevention and concluded that coffee reduces the risk of skin, mouth, and throat cancer and likely reduces the risk of liver and endometrial cancer.

- The American Institute for Cancer Research recommends consuming coffee “regularly.”
- The World Cancer Research Fund says “...there is strong evidence that coffee decreases the risk of liver and womb cancers. There’s also some evidence that coffee decreases the risk of mouth, pharynx and larynx, and skin cancers.”

**Commodity coffee bean prices play significant role in consumer prices**

Commodity prices of the coffee beans, which fluctuate, plays a significant role in prices to consumers. According to [CoBank](#), which provides credit to the U.S. rural and agribusiness sector, prices of U.S. imported coffee increased by a sizable 65% from 2021 to 2023 and have remained volatile in 2024. Factors that explain this include challenging conditions in key growing markets such as Colombia, Brazil and Vietnam and increasing overall global coffee demand, among other factors.

**Colombia Production: Two Periods of Sharp Decline**



Source: [USDA](#)

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## PROJECTED FINANCIALS

Swiss Water Decaffeinated Coffee Inc (\$000 Canadian except per share amounts)

	1Q23	2Q23	3Q23	4Q23	2023	1Q24	2Q24	3Q24E	4Q24E	2024E	2025E
Revenue	49,045	43,368	32,627	41,237	166,277	38,730	43,372	44,046	41,443	167,592	175,971
COGs	44,151	39,956	29,051	34,321	147,479	33,615	35,707	39,201	36,884	145,408	156,614
Gross profit	4,894	3,412	3,576	6,916	18,798	5,115	7,665	4,845	4,559	22,184	19,357
Administration exp	2,697	2,182	1,865	2,315	9,059	2,837	2,947	2,423	2,279	10,486	9,678
Sales & marketing exp	773	1,154	953	1,229	4,109	914	970	661	622	3,166	2,640
Total OpEx	3,470	3,336	2,818	3,544	13,168	3,751	3,917	3,083	2,901	13,652	12,318
Operating income	1,424	76	758	3,372	5,630	1,364	3,748	1,762	1,658	8,532	7,039
Gain (loss) risk mgmt ac	111	350	(360)	356	457	(149)	(519)				
Gain (loss) fair value em	(968)	860	310	(126)	76	(891)	83				
Other gains	-	175	-	-	175	-	-				
Finance income	437	426	274	492	1,629	460	446				
Finance expense	(1,837)	(2,075)	(2,027)	(2,326)	(8,265)	(2,288)	(2,293)				
FX gain (loss)	(84)	(38)	265	(377)	(234)	380	206	-	-	-	-
Total other	(2,341)	(302)	(1,538)	(1,981)	(6,162)	(2,488)	(2,077)	(2,000)	(2,000)	(8,565)	(8,908)
Pretax income (loss)	(917)	(226)	(780)	1,391	(532)	(1,124)	1,671	(238)	(342)	(33)	(1,869)
Taxes	(216)	145	(363)	438	4	(224)	724	(60)	(86)	355	(467)
Net income (loss)	(701)	(371)	(417)	953	(536)	(900)	947	(179)	(257)	(388)	(1,402)
EPS	(\$0.08)	(\$0.06)	(\$0.05)	\$0.10	(\$0.06)	(\$0.10)	\$0.07	(\$0.03)	(\$0.04)	(\$0.09)	(\$0.16)
Avg shares out*	9,186	9,213	9,213	9,213	9,213	9,224	9,502	9,502	9,502	9,433	9,533

Source: Company reports, Zacks estimates

\*Ex RUSs

## HISTORICAL STOCK PRICE



Source: Yahoo Finance

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