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Zacks Small-Cap Research

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

SWP.TO: SWP Optimizing Operational Efficiency, Financial Flexibility

Amid increases in coffee future prices, an uncertain economic outlook & industry volatility, SWP's 4Q24 volume sales were higher than expected, although margins were lower. The industry outlook could remain uncertain in the near-term, we believe, reflecting multiple factors including macroeconomic concerns. SWP's strategy is to retain financial and inventory flexibility in order to support its customers during this period of industry and economic uncertainty.

Current Price (3/17/25)	$3.36
Valuation	**$6.00**

OUTLOOK

SWP has built up its inventory in key locations to ensure customer deliveries. SWP also strengthened its balance sheet with the complete repayment of $15.9m of debentures with warrants. The company remains focused on optimizing performance and optimizing working capital & financial flexibility to remain well-positioned and responsive to customers. If/when tariffs are imposed by the U.S., SWP expects they will not be applied to its coffee but the prospective impact to the overall economy and FX rates could continue to overhang the industry, in our view.

SUMMARY DATA

52-Week High	**$4.29**
52-Week Low	**$3.02**
One-Year Return (%)	**-1**
Beta	**1.73**
Average Daily Volume (sh)	**4,061**
Shares Outstanding (mil)	**10**
Market Capitalization ($mil)	**$33**
Short Interest Ratio (days)	**1**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2025 Estimate	**N/A**
P/E using 2026 Estimate	**N/A**

Type of Stock	**Small-Value**
Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of C$)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (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	42 A	49 A	173 A
2025	39 E	44 E	44 E	49 E	176 E

Loss/share or EPS (C$)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (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	-$0.08 A	$0.21 A	$0.13 A
2025	$0.03 E	$0.01 E	$0.03 E	$0.10 E	$0.17 E

Quarters might not sum due to rounding & share count

Disclosure page 11

COFFEE INDUSTRY IMPACTED BY EXOGENOUS FACTORS

Believe 2024 results reflect the quality / popularity of SWP coffee amid difficult industry environment …

British Columbia-based Swiss Water Decaffeinated Coffee Inc. (OTC:SWSSF, TSX: SWP), a leading specialty coffee company and premium green coffee decaffeinator focused on producing chemical-free decaffeinated coffee, reported 4Q/2024 results last week and provided a business update. Amid the backdrop of a difficult industry environment and ongoing economic / industry uncertainty, the company's 4Q24 results reflect the popularity of SWP coffee, in our view. Factors creating industry volatility include increases in coffee future prices and the uncertain economic outlook, among others. SWP's 4Q24 volume sales were higher than expected but margins were lower compared to the prior year quarter when normal seasonal patterns were impacted by fulfillment of orders from a backlog that had increased as the company transitioned to its new production facility. As a result, 4Q24 revenue advanced 19% year-over-year to C$49.2 million, while 4Q24 gross profit improved 1% year-over-year to C$7.0 million. Results were impacted by changes in exchange rates, as well as higher volumes. The 4Q24 performance contributed to a 4% year-over-year revenue increase to C$173.1 million and 39% improvement in gross profit to C$18.8 million. For the year, EPS of C$0.13 compared to a loss per share of (C$0.06) recorded in 2023. Year-over-year EPS comparisons are not entirely apples-to-apples, as last year's loss per share included 1-time expenses related to the transition from the Burnaby plant to the new Delta facility. Adjusted EBITDA advanced 7% year-over-year to C$14.3 million.

Key Takeaways

- SWP's 2024 results reflect both ongoing economic / industry uncertainty and popularity and quality of the company's coffee, in our view.
    - Amid increases in coffee future prices, an uncertain economic outlook and industry volatility, 4Q24 volume sales were higher than expected but margins were lower.
    - Stronger than expected 4Q24 results contributed to a 4% year-over-year revenue increase in 2024 to C$173.1 million and 39% improvement in gross profit to C$18.8 million.
- The industry outlook could remain uncertain in the near- to medium-term, we believe, reflecting factors including poor harvests, recession concerns and the geopolitical backdrop.
- Some SWP customers appear to be building inventory ahead of what could be difficulties obtaining product, while others seem to be drawing down existing inventory and awaiting price improvements.
- SWP's strategy is to provide flexibility to its customers. The company was able to build inventory in key locations to ensure customer deliveries.
- SWP also strengthened its balance sheet with the complete repayment of $15.9 million of debentures with warrants held by Mill Road Capital.
- SWP expects that if/when tariffs are imposed by the U.S., they will not be applied to its coffee (see below). Nevertheless, the prospect of their potential impact to the overall economy and FX rates could continue to overhang the industry, in our view.

Industry outlook likely remains unclear in the near to medium-term …

We believe that price increases of coffee beans and, in turn, beverages could continue to have a temporary negative impact on demand. As the company has noted, coffee customers appear to be taking various strategies regarding orders, with some building inventory ahead of what could be difficulties obtaining product and others drawing down existing inventory and awaiting improved prices. Coffee futures price for Arabica coffee have been volatile, signaling potential increases in coffee prices that could constrain sales in the short-term particularly given expected tariff impositions. If so, we view the impact as short-term.

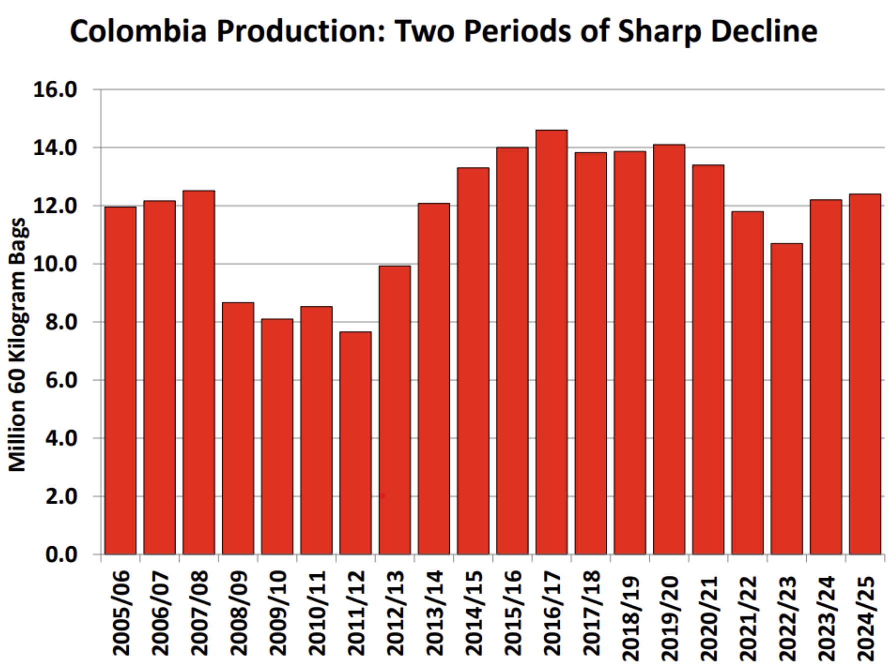
The industry outlook could remain uncertain in the near- to medium-term, we believe, reflecting factors, including poor crop harvests, recession concerns and the geopolitical backdrop. The latter includes not only the threat of disrupted trade patterns among trading partners including the U.S. and Canada, but shipping and distribution disruptions, as well. For instance, in 2024, there were significant disruptions in traffic at the Suez Canal as attacks by foreign players persisted.

Coffee prices have increased, reflecting a variety of factors including the expected imposition of tariffs. According to *Coffee Intelligence*, prices broke the $4 per pound level last month, which represented a new high. The Coffee C futures contract, which is the global benchmark for Arabica coffee, recently reached their highest levels since the early 1970s. Combined with the potential for tariff impositions and greater regulator focus on sustainable sourcing, there could be further upward pressure on coffee prices as 2025 progresses. The trade publication notes that the upward pressure reflects factors including climate conditions that have hurt the production of coffee such as a recent severe drought in Brazil and geopolitical tensions including expected tariffs.

Coffee Futures

Source: Yahoo Finance

Notably, the company's decaffeination process is classified as non-transformational and therefore its shipments to international customers exports retains the designation of the country of origin. The company therefore expects that if/when tariffs are imposed by the U.S., they will not be applied to the coffee it ships to the U.S unless the beans were grown in Mexico. However, the prospect of impact to the overall economies and FX rates could also impact the industry and the company.



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Source: USDA

Not surprisingly, commodity prices of the coffee beans 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 remained volatile in 2024. Factors that explain this include geopolitical tensions and challenging conditions in key growing markets such as Colombia, Brazil and Vietnam and increasing overall global coffee demand, among other factors.

The impact of commodity bean prices fluctuations is usually offset at the company's adjusted EBITDA level. However, given current industry dynamics and the likelihood of tariffs, we note that there could be price increases that impact consumption patterns in the short run.

Company remains focused on optimizing performance…

The company noted that order volume surged in December 2024, as many customers sought to build inventory ahead of what might be persistent difficulties in obtaining product. As a result, 4Q24 quarterly volumes were the 2nd highest the company has recorded, according to management. Swiss Water's strategy is to retain financial flexibility in order to provide flexibility to its customers. The company was able to build inventory in key locations to ensure customer deliveries. SWP ended 2024 with inventory of C$44.5 million, up from C$30.3 million at year-end 2023.

… and optimizing financial flexibility to remain well-positioned to support customers

The company is also working to lower its carrying cost where possible. Moreover, the company also strengthened its balance sheet with the repayment in full of $15.9 million Mill Road debentures with warrants. The company is also focused on optimizing production and operational efficiencies. Given the transition to Delta, the company is realizing improvements in both production and logistics. The company expects that, despite potential near-term industry volatility, it remains well-positioned to continue to gain share within the decaffeinated coffee space, reflecting its natural decaffeination process and strategies.

LONGER TERM EXPECT COFFEE TRENDS SUPPORT POSITIVE OUTLOOK

Coffee ranks among top beverage choices; potential constraints on consumption likely temporary

In response to higher coffee prices, many coffee shops are raising prices of the beverages they prepare for customers. In fact, *Coffee Intelligence* estimates that retail prices could rise by 20% to 25%. In turn, this could hamper consumer demand for coffee in the short-term, we believe, and potentially constrain SWP's volume shipments in the short-term. In fact, the company had indicated that it anticipates that rising futures prices could have a temporary constraining impact on demand in the immediate aftermath of prices climbing, potentially pressuring Swiss Water volume shipments to coffee roasters.

It would not surprise us if consumer purchases and overall consumption of coffee declined *temporarily*, but we believe the popularity of coffee beverages will lead consumers to find ways to continue coffee consumption patterns. Coffee ranks among the top beverages consumed. According to the National Coffee Association's (NCA's) Spring 2024 National Coffee Data Trends (NCDT) report, daily coffee consumption in the U.S. reached a 20-year high in 2024, with some 67% of American adults reporting that they "had coffee in the past day (more than any other beverage). 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 their Spring 2023 study.

Believe impact of price increases likely to be temporary

Given the popularity of coffee – particularly decaffeinated and specialty coffees – we would expect any decline in consumption to be temporary. In fact, *Coffee Intelligence* notes that "historically, the coffee industry has weathered periods of volatility." While unfortunately it would not surprise us to see some smaller coffee establishments hurt, perhaps even shuttered, we believe that consumers will get past the initial sticker shock and return to normal consumption patterns in time.

Thus, we continue to believe that over time, Swiss Water is poised to benefit from several factors, including rising consumption of decaffeinated coffee and – reflecting its 100% chemical-free decaffeination process – the growing consumer trend towards natural and more healthful food and beverages (F&B). In fact, several F&B industry studies expect 2025 trends that we see as positive for the company. For example, according to beverage industry consultancy Ripples, "Health and wellness trends will influence coffee consumption. As people become more health-conscious, they will seek healthier options." Moreover, Ripple notes that with specialty coffee "gaining popularity,"…. When heading out to a cafe, more coffee drinkers are looking for unique flavors and an unparalleled experience. In 2025… expect a rise in artisanal roasters..."

Key expected long-term catalysts for Swiss Water growth

- Rising consumption of coffee generally
- Market share gains of the decaf category
- Growing popularity of specialty coffee beverages and company focus on premium category
- Consumer concerns around drinking caffeine later in the day
- Growing consumer interest in natural, chemical free food and beverages

Moreover, reflecting consumer demand for more healthful ingredients and products, among other factors, 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.

We believe that as the overall market for decaffeinated coffee expands, 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. A 2025 outlook report from food conglomerate Nestle points out that about "82% of U.S. consumers currently view wellness as a top or important priority in their lives." This is a likely factor behind why demand for organic coffee continues to rise. About 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. on. According to Coffee Intelligence, the 2021 global organic coffee 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.

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"

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.

The Nestle report cited above also anticipates a growing focus on specialty coffee, which it notes "is increasingly considered a "little treat," especially among Gen Z consumers. Decaffeinated choices within the premium segment are expanding, which we believe is another positive for Swiss Water.

Specifically, 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%.

Reflecting the factors noted above, the decaf segment is growing and that trend is expected to continue, which we view as growth driver for Swiss Water. 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.

Moreover, there is significant upside opportunity for the decaf category to gain market share, as decaf currently comprises only roughly 15% of coffee consumed in the U.S. and about 12% of coffee consumed in Western Europe, according to the NCA, but is gaining market share. North America and Europe are key markets for coffee consumption generally and therefore for Swiss Water. 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.

VALUATION

We remain 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 noted, we would anticipate that any potential constraints on consumption arising from upward pressure on coffee beans and beverages will likely be temporary.

We believe the company is well-positioned to benefit from anticipated growth in consumption of decaffeinated coffee over time. 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.

We forecast adjusted EBITDA of C$14.7 million in 2025, up from C$14.3 million generated in 2024. We believe the shares trade below 8x our 2025E adjusted EBITDA forecast on an EV/EBITDA basis. We expect multiple expansion over the long-term, although we believe the multiple could be constrained in the near-term reflecting uncertainty and volatility discussed above. We derive a near-term valuation of about C$5.65 to C$7.00 (about US$4.00 to US$5.00) per share, or about C$6.00 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.

RISKS

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

- Tariffs could have a greater impact on prices and price increases could have a greater or more sustainable impact on consumption and company sales than we currently anticipate.
- 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, FX rates might have a greater impact on consolidated revenue and results than anticipated.
- Futures prices and consequently likely increased coffee prices could constrain demand for coffee more than currently anticipated.

RECENT NEWS

- Swiss Water reported 4Q24 results on March 12, 2025.
- On May 9, 2024, the company reported voting results from its annual general meeting.
- 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.

PROJECTED FINANCIALS

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

	2023	1Q24	2Q24	3Q24A	4Q24A	2024A	1Q25E	2Q25E	3Q25E	4Q25E	2025E
Revenue	166,277	38,730	43,372	41,778	49,249	173,129	39,117	43,806	43,867	48,936	175,726
COGs	147,479	33,615	35,707	35,342	42,275	146,939	32,607	37,707	37,463	41,943	149,718
Gross profit	18,798	5,115	7,665	6,436	6,974	26,190	6,511	6,099	6,404	6,993	26,007
Administration exp	9,059	2,837	2,947	2,747	2,803	11,334	2,852	2,800	2,761	2,535	10,948
Sales & marketing exp	4,109	914	970	909	1,008	3,801	923	980	918	826	3,647
Total OpEx	13,168	3,751	3,917	3,656	3,811	15,135	3,775	3,779	3,679	3,361	14,595
Operating income	5,630	1,364	3,748	2,780	3,163	11,055	2,735	2,320	2,726	3,632	11,413
Gain (loss) risk mgmt ac	457	(149)	(519)	(1,970)	477	(2,161)					
Gain (loss) fair value em	76	(891)	83	144	(315)	(979)					
Other gains	175	-	-								
Finance income	1,629	460	446	509	334	1,749					
Finance expense	(8,265)	(2,288)	(2,293)	(2,294)	(1,865)	(8,740)					
FX gain (loss)	(234)	380	206	(269)	1,070	1,387	-	-	-	-	-
Total other	(6,162)	(2,488)	(2,077)	(3,880)	(299)	(8,744)	(2,388)	(2,195)	(2,328)	(2,182)	(9,094)
Pretax income (loss)	(532)	(1,124)	1,671	(1,100)	2,864	2,311	347	124	398	1,450	2,319
Taxes	4	(224)	724	(309)	851	1,042	83	30	95	391	556
Net income (loss)	(536)	(900)	947	(791)	2,013	1,269	264	95	302	1,058	1,762
EPS	($0.06)	($0.10)	$0.07	($0.08)	$0.21	$0.13	$0.03	$0.01	$0.03	$0.10	$0.17
Avg shares out*	9,213	9,224	9,502	9,518	9,518	9,440	9,518	9,518	9,518	9,518	9,518

Source: Company reports, Zacks estimates *Ex RUSs

HISTORICAL STOCK PRICE

Source: Yahoo Finance

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