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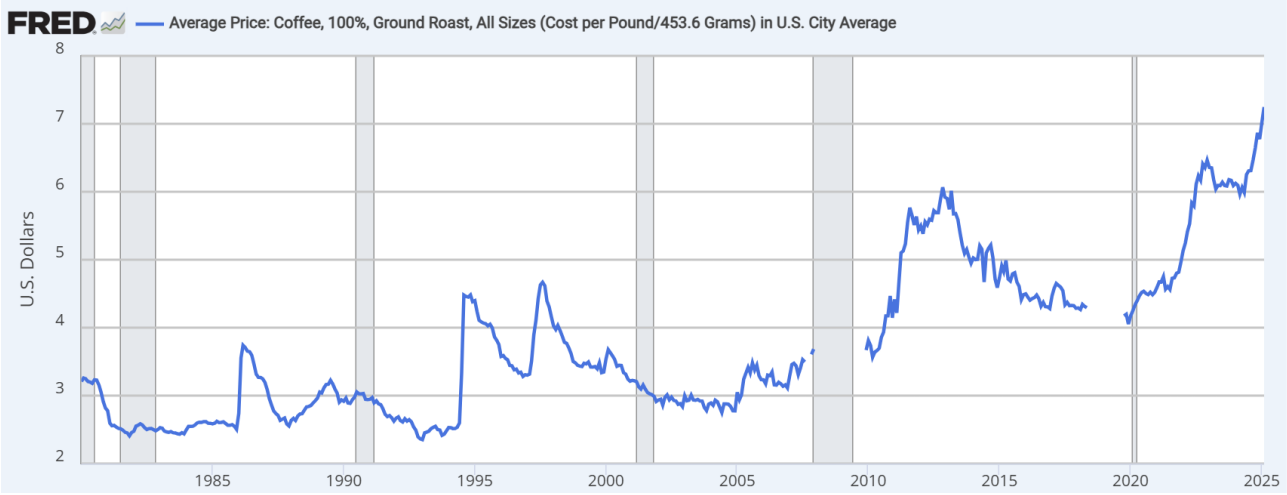
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Swiss Water Decaffeinated Coffee Inc. (SWP.TO-TSX)

SWP.TO: Expect Inventory Position Helps SWP Support Customers Amid Impact of Coffee Price Increases

Research Note

Trade publications are reporting that coffee prices have reached record levels, a trend we have noted in prior reports. Coffee price increases reflect a variety of factors including weather related crop conditions, distribution and logistics disruptions and expected imposition of tariffs. According to *Coffee Intelligence*, the Coffee C futures contract, which is the global benchmark for Arabica coffee, recently reached their highest levels since the early 1970s. 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. There could be further upward pressure on coffee prices as 2025 progresses, we believe, if/as these factors persist.



Source: FRED (Federal Reserve Economic Data) based on US Bureau of Labor Statistics data

According to *Coffee Intelligence*, prices broke the $4 per pound level recently, 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.

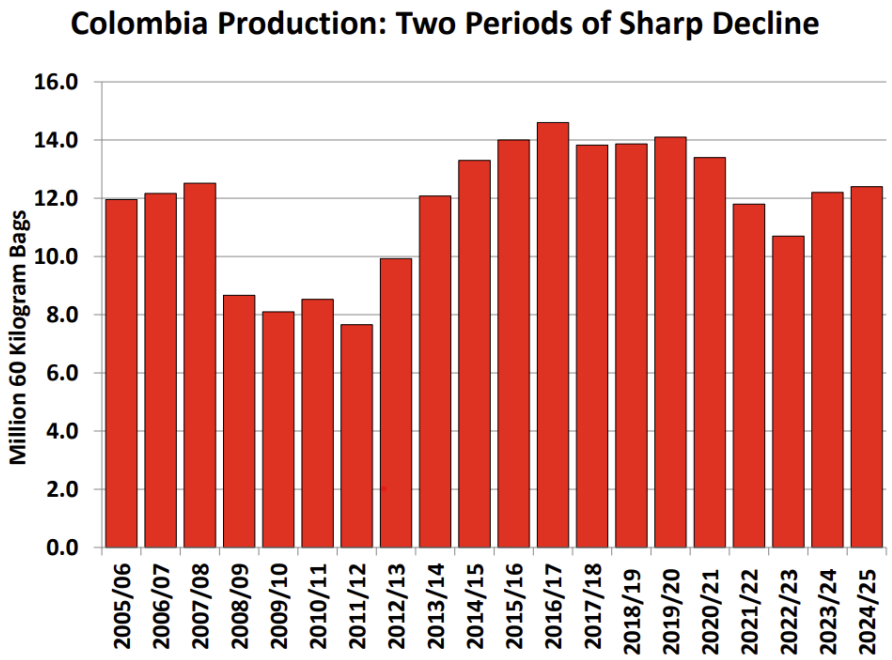
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Coffee Futures



Source: Yahoo Finance

In terms of tariffs, the company's decaffeination process is classified as non-transformational and therefore its shipments to international customers retain the designation of the country of origin. SWP therefore expects that if/when tariffs are imposed by the U.S. on trade with Canada, they will not be applied to the coffee SWP ships to the U.S unless additional tariffs are imposed on countries where the beans were grown. If the U.S. imposes new tariffs on coffee growing countries such as Mexico, Colombia and Brazil, there could be upward pressure impacting SWP product. Moreover, the prospect of tariffs impacting the overall economies and FX rates could also impact the industry and the company.



Source: USDA

Not surprisingly, commodity prices of the coffee beans plays a significant role in prices to consumers, as there could be price increases passed on to consumers that we believe impact consumption patterns in the short run. Swiss Water's 4Q24 results reflect that roasters and other SWP customers appear to be taking divergent strategies regarding their coffee inventories, with some building inventory ahead of what could be difficulties obtaining product, while others seem to be drawing down existing inventory and awaiting price improvements. Order volume surged in December 2024, as many customers sought to build inventory ahead of what might be persistent difficulties in obtaining product and SWP 4Q24 volume sales were higher than expected and the 2nd highest quarterly volumes the company has recorded, according to management.

Company has built inventory to ensure customer deliveries…

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. Given the uncertain backdrop, 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 ended 2024 with inventory of C$44.5 million, up from C$30.3 million at year-end 2023.

…And is focused on optimizing performance & optimizing financial flexibility to remain well-positioned to support customers

The company is also working to lower its carrying cost where possible. Moreover, SWP 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 recent transition to its Delta production plant, SWP is realizing improvements in both production and logistics. The company expects that, despite potential near-term industry volatility, it remains well-positioned within the decaffeinated coffee space, reflecting its natural decaffeination process and strategies.

Believe impact of price increases likely to be temporary, as coffee consumption continues to rise and consumption decaf coffee outpaces overall growth

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.

Given the popularity of coffee – including 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.

… and that SWP's chemical free, organic decaffeination process aligns with consumers growing focus on health and wellness

Thus, we continue to believe that over time, Swiss Water is poised to benefit from ongoing rise in consumption of decaffeinated coffee. This trend is also expected to be supported by the FDA recently authorizing that coffee can be labeled as a healthy beverage and by what Euromonitor terms "three pivotal trends shaping the future of coffee: luxury, wellness, and permissible indulgence," as consumers increasingly seek products that are aligned with their health goals. SWP is focused on producing chemical-free decaffeinated coffee and its decaf process is certified organic by the Organic Crop Improvement Association.

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