

# SWISS WATER DECAFFEINATED COFFEE INC.

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## Management Discussion and Analysis

For the first quarter ended March 31, 2020

### MANAGEMENT DISCUSSION AND ANALYSIS

*This Management's Discussion and Analysis ("MD&A") of Swiss Water Decaffeinated Coffee Inc. ("Swiss Water" or the "Company"), dated as of May 6, 2020, provides a review of the financial results for the three months ended March 31, 2020 relative to the comparable period of 2019. The three month period represents the first quarter ("Q1") of our 2020 fiscal year. This MD&A should be read in conjunction with Swiss Water's condensed consolidated interim financial statements for the three months ended March 31, 2020, the audited consolidated financial statements for the year ended December 31, 2019 and the Annual Information Form, which are available on [www.sedar.com](http://www.sedar.com).*

*All financial information is presented in Canadian dollars, unless otherwise specified.*

### FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements, including statements regarding the future success of our business and market opportunities. Forward-looking statements typically contain words such as "believes", "expects", "anticipates", "continue", "could", "indicates", "plans", "will", "intends", "may", "projects", "schedule", "would" or similar expressions suggesting future outcomes or events, although not all forward-looking statements contain these identifying words. Examples of such statements include, but are not limited to, statements concerning: (i) expectations regarding Swiss Water's future success in various geographic markets; (ii) future financial results, including anticipated future sales and processing volumes; (iii) future dividends; (iv) the expected actions of the third parties described herein; (v) factors affecting the coffee market including supplies and commodity pricing; (vi) the expected cost to complete the production facility and production line currently under construction; and (vii) the business and financial outlook of Swiss Water. In addition, this MD&A contains financial outlook information that is intended to provide general guidance for readers based on our current estimates, which based on numerous assumptions and may prove to be incorrect. Therefore, such financial outlook information should not be relied upon by readers. These statements are neither promises nor guarantees but involve known and unknown risks and uncertainties that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed in or implied by these statements. These risks include, but are not limited to, risks related to processing volumes and sales growth, operating results, supply of coffee, supply of utilities, general industry conditions, commodity price risks, technology, competition, foreign exchange rates, construction timing, costs and financing of capital projects, general economic conditions and those factors described herein under the heading 'Risks & Uncertainties'.

The forward-looking statements contained herein are also based on assumptions that we believe are current and reasonable, including but not limited to, assumptions regarding: (i) trends in certain market segments and the economic climate generally; (ii) the financial strength of our customers; (iii) the value of the Canadian dollar versus the US dollar ("US\$"); (iv) the expected financial and operating performance of Swiss Water going forward; (v) the availability and expected terms and conditions of debt facilities; and (vi) the expected level of dividends payable to shareholders; (vii) the potential impact of the COVID-19 pandemic. We cannot assure readers that actual results will be consistent with the statements contained in this MD&A. The forward-looking statements and financial outlook information contained herein are made as of the date of this MD&A and are expressly qualified in their entirety by this cautionary statement. Except to the extent required by applicable securities law, Swiss Water undertakes no obligation to publicly update or revise any such statements to reflect any change in our expectations or in events, conditions, or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those described herein.

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### EXECUTIVE SUMMARY

For the three months ended March 31, 2020, Swiss Water's gross profit, operating income, net income and EBITDA were all up year-over-year, although the company recorded lower volumes and revenues when compared to Q1 of last year. Swiss Water volumes were affected by a move in commodity prices for coffee in late 2019 and through the first quarter. The New York 'C' ("NY'C" or "'C' ") Arabica Futures Contract moved to a peak 45% above the 2019 average by the end of December 2019. Volumes remained strong through Q4 2019 but began to weaken markedly in the following first quarter of 2020 as has been the case with previous NY'C spikes. The average NY'C for January to November 2019 was approximately US\$0.98. The 'C' peaked in December at US\$1.45. Many customers slowed purchases while awaiting for the 'C' to soften because they had good physical coverage and could work their inventories down. Entering into the second quarter the 'C' retreated back to US\$1.20 and, by early May 2020, traded at approximately US\$1.10/lb.

Despite the New York futures price receding, the onset of the COVID-19 pandemic has begun to influence the Company's business. In the very short term the Company has witnessed strong volume demands from those customers that supply the retail grocery trade. Consumer hoarding and pantry loading has created a short term demand peak. Over time we expect to see weakness in the specialty market emerge, as purchases from shuttered out of home specialty coffee shops decline. This will likely persist until food service establishments start to re-open.

Swiss Water is currently well positioned with green coffee inventory, and will be able to support short term demand increases as and when they happen, Swiss Water remains in close contact with its customers, however it is clear that most of the Company's food service customers do not have visibility as to when widespread re-opening of their outlets will occur.

In \$000s except per share amounts (unaudited)	3 months ended March 31,	
	2020	2019
Sales	\$ 21,817	\$ 24,170
Gross profit	4,206	3,544
Operating income	2,035	976
Net income	1,448	(9)
EBITDA <sup>1</sup>	2,640	2,312
EBITDA excluding IFRS 16-Leases <sup>2</sup>	1,981	1,573
Net income per share – basic <sup>3</sup>	\$ 0.16	\$ –
Net income per share – diluted <sup>3</sup>	\$ 0.02	\$ –

<sup>1</sup> EBITDA is defined in the 'Non-IFRS Measures' section of this MD&A and is a "Non-GAAP Financial Measure" as defined by CSA Staff Notice 52-306.

<sup>2</sup> EBITDA excluding the impact of IFRS 16 - Leases is defined as EBITDA, less lease payments made during the year.

<sup>3</sup> Per-share calculations are based on the weighted average number of shares outstanding during the periods.

### Operational highlights

- Total shipped volumes in the first quarter declined by 16% compared to the same period in 2019. For the last 12 quarters we consistently continued to win new business as coffee industry participants migrated away from chemical decaffeination processes. The first quarter of 2020 is the Company's first quarterly volume decline in 12 quarters and was driven by a spike in the New York Arabica Futures market and a coincident increase in Colombia coffee quality differentials
- Our largest geographical market by volume in Q1 of 2020 continued to be the United States, followed by Canada, Europe and other international markets. By dollar value, for the three months period ended

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March 31, 2020, 47% of our sales were to customers in the United States, 34% were to Canada, and the remaining 19% were to other countries. As we continue to expand our business in Europe, we anticipate revenues from our international markets to increase in both dollar and percentage terms.

- The Company's operations have been deemed essential services, and as such, we have maintained our best efforts to supply decaffeinated coffee to food manufacturers and retailers who are supporting consumers around the world. During these unprecedented times, Swiss Water has remained committed to continuing our decaffeination process and operations, while prioritizing safety for our customers, vendors and employees. To protect our stakeholders we have implemented best health practices and social distancing in our factory, warehouses and our offices as recommended by appropriate health authorities.

### Financial highlights

- First quarter revenue decreased by 10% to \$21.8 million compared to the same period in 2019. The decrease was due to lower processing volumes that were driven by an increase in the New York Arabica Futures market. The volume decline was sufficient to overcome an increase in the dollar value of coffee sold during the quarter.
- Gross profit for Q1 of this year was \$4.2 million. On a year-over-year basis, gross profit was up from \$3.5 million in Q1 2019. Our Q1 gross profit of this year benefited from lower natural gas costs, a higher proportion of regular volumes in our sales mix, improved supply chain efficiencies, and our ongoing efforts to control operating costs. These enhancements were diluted by the impact of higher labour costs and a decrease in shipments during Q1 2020.
- Operating expenses decreased by 15% to \$2.2 million in the first quarter, compared to the same period in 2019. The Q1 2020 decrease in operating expenses was due to a stock based compensation cost recovery, lower than expected travel expenses and reduced recruitment fees.
- Operating income increased by \$1.1 million, or 109%, to \$2.0 million in the first quarter compared to the same period last year.
- First quarter net income was \$1.4 million compared to net loss of \$0.01 million in Q1 2019. This year's improved operating income was enhanced by net gains in non-operating expenses. The non-operating expense gains were driven by a significant gain on the revaluation of an embedded derivative, net of a smaller loss on risk management activities.
- EBITDA increased by \$0.3 million, or 14%, to \$2.6 million in the first quarter, when compared to the same period in 2019. EBITDA, excluding the impact of IFRS 16, increased by \$0.4 million, or 26%, to \$2.0 million in Q1 of 2020. Operationally, the improvement in EBITDA was driven by the normalization of natural gas costs when compared to the unusually high costs absorbed in Q1 2019. This improvement was complemented by ongoing efforts to enhance cost recovery and an increased financial contribution from Seaforth, our supply chain subsidiary.

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### OUTLOOK

The Company is limiting guidance for the fiscal 2020 year due to the uncertainty of the effect of the COVID-19 pandemic. The Company is experiencing strong short term volume pull from customers that service the retail grocery trade in one form or another. Retail grocery supplies the At Home coffee market. Due to personal quarantining and concurrent pantry loading during the COVID-19 pandemic the grocery channel is experiencing a strong resurgence. We expect the At Home market to level off following a heavy consumer pantry load immediately after the COVID-19 outbreak. The Out Of Home coffee market is a much more susceptible channel to serious disruptions from the world wide food service shut down during the pandemic. Despite the turbulence created by COVID-19, some coffee outlets have stayed open to service take-away customers, and others have good drive-through services available. However, at this point, the Company cannot reliably predict the ultimate impact of the COVID-19 pandemic on the Out of Home channel. There is a risk that Swiss Water will report an overall volume decline in 2020.

Operationally Swiss Water continues to run both production lines on the usual 24/7 basis. Both Swiss Water and Seaforth have stayed open and fully resourced to supply customers during the pandemic. We have taken precautions within the organizations operating sites to ensure appropriate personal protective equipment has been available to employees and contractors, and that ongoing deep cleans by internal and third party sources have been performed continuously. There was a brief shutdown of one of our operating lines to mitigate the possible risk of a province-wide work stoppage occurring during the early stages of the pandemic. However, during this period, the Company took the opportunity to complete scheduled maintenance on this line, and it is now once again up and running.

We continue to commission the new Delta, BC facility. The commissioning process is proceeding well on the areas that we can continue to manage internally. There are a few external vendor machine packages that require external support. These vendors are based in the United States and are therefore currently prevented from traveling to Canada to complete these areas of commissioning. Our near term view of volume weakness has us covered by the existing capacity from our Burnaby facility, therefore we will not try to unnecessarily speed the operationalization of the Delta facility at additional cost or risk. Further, given the current externally mandated levels of travel restrictions around COVID-19, we have decided not to complete commissioning until the end of Q2 2020.

We have begun the necessary engineering work to prepare a complete cost estimate for an additional production line at our Delta location. An additional production line is required to ensure long term volume growth for our clean chemical free decaffeinated coffees. The recent sale of our Burnaby manufacturing site to a new landlord has predicated an earlier than previously anticipated second line build out. While our lease on this property, which expires in June 2023, provides for an additional five-year extension (to 2028), this extension is at the sole discretion of the new landlord. Under the terms of the lease, the landlord has until June 2021 to inform us of their intentions – just two years before we have to vacate should an extension not be granted. In assessing the impact of this change of ownership, we have concluded that the potential risk it poses to our ability to continue operations at the Burnaby site beyond 2023 is unacceptable. Accordingly, in order to provide the capacity we will need to meet future demand for our coffees, we are moving forward with analysis to build a second production line in Delta before the lease in Burnaby expires.

We are in the process of completing the strategic funding approach for the additional replacement capacity in Delta. Based on current engineering, the targeted endpoint capacity would be at least 40% greater than the current existing capacity of the two lines at the Burnaby site, giving the Company a runway for continued growth in the next 5-6 years. We intend to fund a significant portion of the build out internally and with an as

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yet to be determined mix of low cost debt and possibly other equity sources. The funding strategy will be determined throughout the balance or 2020.

### **BUSINESS OVERVIEW**

Swiss Water is a premium green coffee decaffeinator located in Burnaby and in Delta, British Columbia. We employ the proprietary Swiss Water® Process to decaffeinate green coffee without the use of chemical solvents, leveraging science-based systems and controls to produce coffee that is 99.9% caffeine free. Our process is certified organic by the Organic Crop Improvement Association and is the world's only consumer-branded decaffeination process. Decaffeinating premium green coffee without the use of harmful chemical solvents is our primary business.

Our Seaforth subsidiary provides a complete range of green coffee logistics services including devanning coffee received from origin; inspecting, weighing and sampling coffees; and storing, handling and preparing green coffee for outbound shipments. Seaforth provides all of Swiss Water's local green coffee handling and storage services. In addition, Seaforth handles and stores coffees for several other coffee importers and brokers, and is the main green coffee handling and storage company in Metro Vancouver. Seaforth is organically certified by Ecocert Canada.

Swiss Water's shares trade on the Toronto Stock Exchange under the symbol 'SWP'. As at the date of this report, 9,078,780 shares were issued and outstanding.

### **Swiss Water Decaffeinated Coffee Company's Business**

We carry an inventory of premium-grade Arabica coffees that we purchase from the specialty green coffee trade, decaffeinate and then sell to our customers (our "regular" or "non-toll" business). Revenue from our regular business includes both processing revenue and green coffee cost recovery revenue.

We also decaffeinate coffee owned by our customers for a processing fee under toll arrangements (our "toll" business). The value of the coffee processed under toll arrangements does not form part of our inventory, our revenue or our cost of sales. Revenue from toll arrangements consists entirely of processing revenue.

Our cost of sales is comprised primarily of the cost of green coffee purchased for our regular business, plant labour and other processing costs directly associated with our production facility. This incorporates an allocation of fixed overhead costs, which includes depreciation of our production equipment and amortization of our proprietary process technology. For our regular business, we work with coffee importers to source premium-grade green coffees from coffee-producing countries located in Central and South America, Africa and Asia. The purchase price is based on the NY'C coffee futures price on the Intercontinental Exchange, plus a quality differential. The NY'C component typically makes up more than 80% of the total cost of green coffee, while the quality differential typically accounts for less than 20%. Both the NY'C price and the quality differential fluctuate in response to fundamental commodity factors that affect supply and demand.

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The chart below shows the movement in the NY'C' for the last eight quarters:



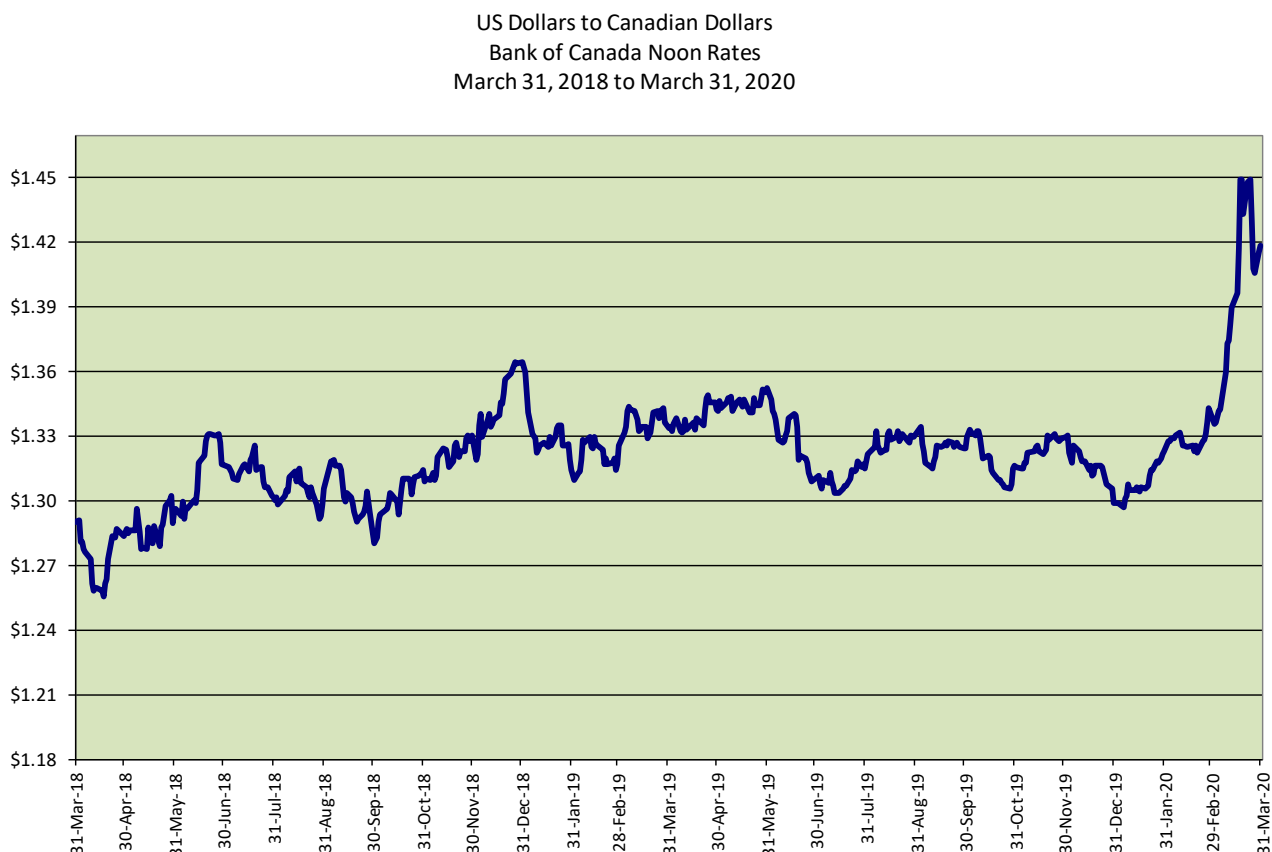
In Q1 2020, the NY'C' averaged US\$1.11/lbs compared to an average of US\$0.99/lbs in Q1 2019. The rise and fall of the NY'C' affects our volume of shipments, our revenues and our cost of sales. In an upward trending market, our customers tend to consume their inventories rather than build them. When the NY'C' declines over a sustained period, our customers tend to add to their inventories and vice versa.

The majority of our revenues are generated in US dollars ("US\$"), while a significant portion of our costs is paid in Canadian dollars. We, therefore, have exposure to changes in the US\$/C\$ exchange rates. This is managed, in part, through derivative financial instruments. All other factors being equal, our profitability and cash from operations will be higher when the US dollar appreciates relative to the Canadian dollar. A long-term depreciation of the Canadian dollar will improve our long-term profitability and cash generation.

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The chart below illustrates the US\$ to Canadian dollar (“C\$”) exchange rates for the last eight quarters:



In Q1 2020, the US\$ averaged C\$1.3449, an increase of 1.2% over the same period in 2019. When the US\$ depreciates (appreciates), it decreases (increases) our gross profit on green coffee revenues.

## OPERATING RESULTS

### Revenue

We categorize our customers by the nature of their business: either coffee importers or roasters. Coffee importers act like grocery stores to roasters, sourcing and importing green coffee from various origins and carrying a selection of different origins and quality levels for roasters to choose from. Importers buy from us in order to resell our coffees to roasters when and where they need it. Roasters are in the business of roasting and packaging coffee for sale to consumers in their own coffee shops, or for home or office use. Roasters either buy directly from Swiss Water, or they buy from an importer. Roasters generally carry lower inventories, as they tend to take delivery of green coffee shortly before roasting it. As such, when compared one period to period, shipments to roasters are more stable when compared to shipments to importers.

We also monitor and report our revenue in three categories. “Process revenue” represents the amount we charge our customers for decaffeinating green coffee, and it generally increases as our processing volumes increase. “Green coffee cost recovery revenue”, or “green revenue”, is the amount we charge our customers for the green coffee we purchase for decaffeination. “Distribution revenue” consists of shipping, handling,

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and warehousing charges billed to our customers. It typically rises with our processing volumes and with the growth of Seaforth's business. Our revenue by category for the indicated period was:

In \$000s (unaudited)	3 months ended March 31,	
	2020	2019
Process revenue	\$ 5,750	\$ 6,460
Green revenue	14,404	15,870
Distribution revenue	1,663	1,840
Total revenue	\$ 21,817	\$ 24,170

For the quarter, ended March 31, 2020, sales totaled \$21.8 million, a decrease of \$2.4 million, or 10%, compared to the same quarter in 2019 driven by the impact of an increase in the New York Arabica Futures market.

The decreases in our sales in the first quarter of 2020 by revenue category are as follows:

- Process revenue decreased by \$0.7 million, or 11% in Q1 2020. The decrease reflects a decline in our processing volumes.
- Green revenue decreased by \$1.5 million, or 9% in Q1 2020. The decrease was due to lower green coffee sales volumes, offset by a higher coffee futures price, NY'C' in the period.
- Distribution revenue was lower by \$0.2 million, or 10% in Q1 2020. Decreased distribution revenue has been driven by lower shipment volumes and worldwide disruption in the supply chain.

The sales volumes by geographical segment are impacted by the COVID-19 pandemic. The decreases in our sales volume in the first quarter of 2020 by geographical segment are as follows:

- Sales volume in North America decreased by 20% in Q1 2020
- Sales volume in Europe decreased by 5% in Q1 2020
- Sales volume in the Asia Pacific increased by 7% in Q1 2020

### Cost of Sales

Cost of sales includes the cost of green coffee purchased for our regular business, the plant labour and other processing costs directly associated with our production facility, customer-specific hedges and commodity hedges. The cost of sales incorporates an allocation of fixed overhead costs, which includes depreciation of our production equipment and amortization of our proprietary process technology. In addition, cost of sales includes the costs of operating Seaforth's warehouses.

Our first quarter cost of sales decreased by \$3 million, or 15%, to \$17.6 million compared to the same period in 2019. The decrease in Q1 this year is reflective of the decrease in business activities during this period. The decrease was also caused by lower variable production costs driven by the decline in sales volumes and lower natural gas prices. These were partially offset by an increase in annual labour cost inflation.

### Gross Profit

Gross profit increased by \$0.7 million or 19% to \$4.2 million for the first quarter of 2020, as lower cost of sales offset the decrease in revenues. These positive results were impacted by revenue management initiatives, and leveraging enhanced cost recovery, while maintaining the quality of our coffee. In addition, the cost of sales in Q1 2019 was unusually high when compared to the current year's quarter because of a temporary



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spike in natural gas prices. In Q1 2019, natural gas prices spiked after British Columbia experienced a shortage in natural gas supply due to a polar vortex and an explosion in a pipeline in northern BC. There was no such equivalent spike in gas prices in Q1 2020. As an offset, in Q1 2020 we recorded a small provision of \$0.1 million in inventory obsolescence. Generally, we sell that aged coffee at a discount.

### Administration Expenses

Administration includes general management, inbound and outbound logistics, finance and accounting, quality control and assurance, engineering, research and development, and other administrative or support functions. Administration expenses include compensation expenses, travel and other personnel-related expenses for administrative staff, directors' fees, investor relations expenses, professional fees, depreciation of office-related equipment, and amortization of the brand asset.

Administration expenses for Q1 2020 totaled \$1.0 million, a decrease of \$0.7 million, or 42%, when compared to the same period last year. The decrease is largely due to a cost recovery of share based compensation, which is based on estimates using the Black Scholes model, with inputs from the Company's share price, and risk free interest rates. During this year's quarter, the Company's share price and the risk free interest rate dropped. It resulted in an estimated stock based compensation cost recovery whereas, in the prior year's quarter, we recorded an expense. Administration expenses were also lower due to reduced travel costs and less recruiting activities.

### Sales and Marketing Expenses

Sales and marketing expenses include compensation and other personnel-related expenses for sales and marketing staff, consumer and trade advertising and promotion costs, as well as related travel expenses.

Sales and marketing expenses increased by \$0.3 million, or 36%, to \$1.1 million in Q1 2020 compared to the same period in 2019. The increase was driven by phasing changes in advertising and marketing campaign activities.

### Occupancy Expenses

Occupancy expenses include the cost of renting offices for sales, marketing and administrative use. Occupancy costs for the first quarter were largely unchanged from the prior year.

### Finance Expenses and Income

Finance income reflects the charges we bill to customers for financing coffee inventories and interest earned on cash balances and short-term investments. Finance expenses include interest costs on bank debts, other borrowings, the accretion expense on our asset retirement obligation, interest expense on the convertible debenture and interest expense on finance leases.

Net finance expenses were \$0.5 million for the first quarter in 2020 compared to net finance expense of \$0.4 million in the same period last year. The interest expenses on a convertible debenture, credit facility and on finance leases, due to the adoption of IFRS 16 in 2019, accounted for the majority of the change.

Interest on the convertible debenture is expensed at an effective interest rate of 12.15% (a rate determined by management in accordance with IFRS), while the contractual interest paid on this loan is at a rate of 6.85%, causing the amortization of the bond discount to change over time.

The adoption of IFRS 16 Leases in 2019 resulted in interest expenses of \$0.1 million during the three months ended March 31, 2020, compared to \$0.2 million in the same period in 2019.

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During the construction phase of our Delta facility, interest expense related to the construction loan and related lease liability is capitalized in property plant and equipment.

### Gains and Losses on Risk Management Activities

Under hedge accounting, gains or losses on designated hedges are included in either revenue or cost of sales, held on the balance sheet or included in other comprehensive income for future transactions (see 'Hedge Accounting', above). Thus, 'Gain on risk management activities' includes only those gains and losses on derivative financial instruments or portions of such instruments that are not designated as hedging instruments.

For the three months ended March 31, 2020 we recorded a loss of \$0.3 million compared to gains of \$0.5 million for the same period in 2019, these gains and losses correspond with fluctuations in the foreign exchange rates and the coffee prices on NY'C.

### Fair Value Adjustment on Embedded Option

Swiss Water entered into a convertible debenture in October 2016. Under IFRS, this instrument is deemed to contain an embedded option that must be revalued at each balance sheet date. The fair value of the derivative liability was determined using the Black-Scholes Option Pricing Model. The variables and assumptions used in computing the fair value are based on management's best estimate at each balance sheet date.

The revaluation on this embedded option resulted in a gain of \$1.5 million in the first quarter of 2020 compared to a loss of \$0.7 million in the same period of last year.

### Gains and Losses on Foreign Exchange

We realize gains and losses on transactions denominated in foreign currencies when they occur, and on assets and liabilities denominated in foreign currencies when they are translated into Canadian dollars as at the financial statement date.

During the first quarter of 2020, we recorded a loss on foreign exchange of \$0.7 million, compared to a loss of \$0.3 million in the same period last year.

### Income before Taxes and Net Income

In the first quarter of 2020, we recorded income before taxes of \$2.0 million, compared to \$0.04 million in the same period in 2019. Current and deferred income tax expenses reduced our net income by \$0.6 million for the quarter, compared to a net income tax expense of \$0.05 million in Q1 2019. Deferred income taxes arise mainly from temporary differences between the depreciation and amortization expenses deducted for accounting purposes, and the capital cost allowances deducted for tax purposes, as well as changes in corporate income tax rates as adjusted for substantively enacted higher future tax rates. The latter are offset by the tax benefit of loss carryforwards recognized. Overall, we recorded a net income of \$1.4 million in Q1 2020, compared to a loss of \$0.01 million in the same quarter last year.

### Other Comprehensive Income

Gains or losses on our designated revenue hedges that will mature in a future period are recorded in other comprehensive income, net of income tax expense. Other comprehensive income, net of tax, for the first quarter of 2020 was a loss of \$5.0 million, compared to a gain of \$1.2 million in the same period of 2019. The decreases are related to fluctuations in the value of the Canadian dollar versus the US dollar.

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### Basic and Diluted Earnings per Share

Basic earnings per share are calculated by dividing net income by the basic weighted average number of shares outstanding during the period. Similarly, diluted earnings per share are calculated by dividing net income adjusted for the effects of all dilutive potential common shares, by the diluted weighted average number of shares outstanding. For the purposes of the calculation, under IFRS we are required to assume that the maximum number of shares issuable under the convertible debenture will be issued, even though the debenture contains a net share settlement provision (which if exercised would result in far fewer shares being issued).

In the first quarter of 2020, both potential common shares issuable under the RSU Plan and common shares issuable for the convertible debenture are dilutive and therefore included in the calculation of diluted earnings per share in such period. In comparison, for the same period of 2019, all potential common shares issuable were anti-dilutive, hence excluded from the dilution calculation.

The calculations of basic and diluted earnings per share for the current and prior period are shown in the following table:

In 000s except for per share data (unaudited)	3 months ended March 31,	
	2020	2019
<b>Basic earnings per share</b>		
Net income (loss) attributable to shareholders	\$ 1,448	\$ (9)
Weighted average number of shares	9,068,354	9,061,210
Basic earnings per share	\$ 0.16	\$ -
<b>Diluted earnings per share</b>		
Net income (loss) attributable to shareholders	1,448	(9)
Effect of diluted securities: RSUs	(63)	-
Interest on convertible debenture	280	-
Gain on fair value adjustment of the embedded option	(1,474)	-
Net income (loss) after effect of diluted securities	\$ 191	\$ (9)
Weighted average number of shares – basic	9,068,354	9,061,210
Effect of diluted securities: RSUs	226,611	-
Effect of diluted securities: convertible debenture	1,818,182	-
Weighted average number of shares - diluted	11,113,147	9,061,210
Diluted earnings per share	\$ 0.02	-

### EBITDA and EBITDA which excludes the impact of IFRS 16 - Leases

EBITDA is often used by publicly traded companies as a measure of cash from operations, as it excludes financing costs, taxation and non-cash items. The reporting of EBITDA is intended to assist readers in the performance of their own financial analysis. However, since this measure does not have a standardized meaning prescribed by IFRS, it is unlikely to be comparable to similar measures presented by other entities.

We define EBITDA as net income before interest, depreciation, amortization, impairments, share-based compensation, gains/losses on foreign exchange, gains/losses on disposal of property and capital equipment, fair value adjustments on embedded options, and provision for income taxes. Our definition of EBITDA also excludes unrealized gains and losses on the undesignated portion of foreign exchange forward contracts.

EBITDA for the three months ended March 31, 2020 was \$2.6 million, up by 14% compared to Q1 2019. For the three months ended March 31, 2019 EBITDA, which excludes the impact of IFRS 16, was \$2.0 million, up

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by 26% compared to Q1 2019. Operationally, the change in EBITDA was driven by successful and continuous efforts across the Company to enhance cost recovery, an increased financial contribution from Seaforth and lower costs for natural gas. The positive impacts were offset by lower sales volumes, an annual increase in labour costs, and a strategic investment in the sales team and initiatives. The reconciliation of net income to EBITDA is as follows:

In \$000s (unaudited)	3 months ended March 31,	
	2020	2019
Income (loss) for the period	\$ 1,448	\$ (9)
Income taxes	585	54
Income before tax	\$ 2,033	\$ 45
Finance income	(74)	(154)
Finance expenses	568	600
Depreciation & amortization	849	864
Unrealized (gain) on foreign exchange forward contracts	614	(334)
Fair value (gain) loss on the embedded option	(1,474)	728
Loss on foreign exchange	700	290
Share-based compensation (recovery) expense	(576)	273
EBITDA	\$ 2,640	\$ 2,312
Impact of IFRS 16, which was adopted in the year 2019	(659)	(739)
EBITDA excluding the impact of IFRS 16	\$ 1,981	\$ 1,573

To help readers better understand our financial results, the following table shows the reconciliation of operating income to EBITDA:

In \$000s (unaudited)	3 months ended March 31,	
	2020	2019
Operating income for the period	\$ 2,035	\$ 976
Depreciation & amortization	849	864
Share-based compensation	(576)	273
Gain (loss) on risk management activities	(282)	533
Unrealized loss (gain) on foreign exchange forward contracts	614	(334)
EBITDA	\$ 2,640	\$ 2,312
Impact of IFRS 16, which was adopted in the year 2019	(659)	(739)
EBITDA excluding the impact of IFRS 16	\$ 1,981	\$ 1,573

# SWISS WATER DECAFFEINATED COFFEE INC.

## Management Discussion and Analysis For the first quarter ended March 31, 2020

### QUARTERLY INFORMATION / SEASONALITY

The following table summarizes results for each of the eight most recently completed fiscal quarters. For comparative purposes, we have also provided the averages for the previous 8-quarters:

In \$000s except for per share amounts (unaudited)	8 Quarter Average	Q1 2020	Q4 2019	Q3 2019	Q2 2019	Q1 2019	Q4 2018	Q3 2018	Q2 2018
Sales	23,471	21,817	25,023	23,645	24,392	24,170	22,979	23,087	22,658
Gross profit	4,097	4,206	4,106	4,737	4,106	3,544	3,686	4,439	3,952
Operating income	1,534	2,035	539	2,291	1,356	976	1,618	1,927	1,528
EBITDA <sup>1</sup>	2,453	2,640	1,454	3,485	3,097	2,312	2,050	2,717	1,868
EBITDA excluding IFRS 16 <sup>2</sup>	1,995	1,981	797	2,696	2,278	1,573	2,050	2,717	1,868
Net income (loss)	1,054	1,448	716	884	1,353	(9)	919	1,828	1,294
<b>Per Share<sup>3</sup></b>									
Net income (loss) - basic	0.12	0.16	0.08	0.10	0.15	-	0.10	0.20	0.14
Net income (loss) - diluted	0.08	0.02	0.08	0.10	0.14	-	0.03	0.18	0.10

<sup>1</sup> EBITDA is defined in the section on 'Non-IFRS Financial Measures' along with details of its calculation.

<sup>2</sup> EBITDA excluding the impact of IFRS 16 - Leases is defined as EBITDA, less lease payments made during the year.

<sup>3</sup> Per-share calculations are based on the weighted average number of shares outstanding during the period.

There is an element of seasonality in our business, in that the second half of the year tends to have higher volumes and revenues.

### RELATED PARTY TRANSACTIONS

We provide toll decaffeination services and/or sell finished goods to, and purchase raw material inventory from a company that is related to one of Swiss Water's Directors, Roland Veit.

The following table summarizes related party sales and purchases during the period:

In \$000s (unaudited)	3 months ended March 31,	
	2020	2019
Sales	\$ 69	\$ 106
Purchases of raw materials	\$ 1,260	\$ 720

All transactions were in the normal course of operations and were measured at the fair value of the consideration received or receivable, which was established and agreed to by the related parties. As at March 31, 2020, our accounts receivable balance with this company was \$0.01 million (December 31, 2019: \$0.01 million) while our accounts payable balance with this company was \$0.3 million (December 31, 2019: \$0.5 million).

On March 16, 2017, a subsidiary of Swiss Water and a member of Key Management (the borrower) entered into a promissory note in the amount of US\$0.1 million. For as long as the borrower remains an employee, the obligation to repay the principal is forgiven against current and future awards under the RSU Plan, by forfeiture of awards. The loan is interest-free other than in the event of default, in which case the promissory note shall bear simple interest at a rate of 10% per annum.

# SWISS WATER DECAFFEINATED COFFEE INC.

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## Management Discussion and Analysis For the first quarter ended March 31, 2020

### LIQUIDITY AND CAPITAL RESOURCES

#### Operating activities

For the three months ended March 31, 2020, we used \$2.1 million in net cash from operating activities, compared to using \$1.6 million in the same period last year.

#### Inventory

Our inventory increased in value by 20% and in volume by 22% between December 31, 2019 and March 31, 2020. The increase reflects additions to raw materials inventory and finished goods.

Under hedge accounting, gains/losses on derivative instruments for coffee to be sold in future period are recorded in inventory. The hedge accounting component of inventory, as at March 31, 2020 was a gain of \$1.3 million compared to a gain \$1.3 million at the end of 2019.

#### Accounts Receivable

Our accounts receivable decreased by \$1.9 million, or 13%, between December 31, 2019 and March 31, 2020 compared to an increase of \$0.7 million, or 5%, between December 31, 2018 and March 31, 2019. 76% of Swiss Water accounts receivable are current as at March 31, 2020.

#### Investing Activities

Cash outflows in investing activities for Q1 2020 were \$4.1 million, compared to cash outflows of \$2.9 million in Q1 2019. In both years, the majority of our cash outflows were for capital expenditures related to our plant expansion in Delta, BC.

#### Financing Activities

During the three months ended March 31, 2020, Swiss Water paid \$0.6 million in dividends to shareholders. This is unchanged from 2019. During the first three quarters of 2020, we received proceeds from our credit facility, in the amount of \$5.3 million, while during the first quarter of 2019 we obtained \$2.7 million from our construction loan. The funds drawn during the first quarter of 2020 were mainly used to settle costs relating to our new plant in Delta, and support working capital management following the emergence of the COVID-19 pandemic.

#### Credit Facilities and Liquidity

On October 18, 2019, Swiss Water entered into a revolving credit facility agreement (“Credit Facility”), with a Canadian Bank, for borrowings up to the lower of the Borrowing Base and \$30.0 million. The Credit Facility’s Borrowing Base margins eligible inventories and accounts receivable, commodity hedging account equity margin plus its market-to-market gains, which are netted against any losses in the commodity account and foreign exchange contract facility. Amounts can be drawn in either Canadian or in US\$ dollars and can be borrowed, repaid, and re-borrowed to fund operations, capital expansions, letters of credit and for general corporate purposes. The maturity date is October 18, 2022, however, we can repay the Credit Facility at any time on or before the maturity date as long as the outstanding balance is not in excess of the borrowing base. The maturity date can be extended, subject to the lenders’ approval.

The Credit Facility has multiple interest rate options that are based on the Canadian Prime Rate, Base Rate, LIBO Rate, Bankers’ Acceptance Rate plus an acceptance fee, in addition to an Applicable Margin for each of these rates. Fees apply to outstanding letters of credit and the unused portion of the credit. The Company

# SWISS WATER DECAFFEINATED COFFEE INC.

## Management Discussion and Analysis

### For the first quarter ended March 31, 2020

has pledged substantially all of its assets, except for assets pledged to BDC under the Term Loan (see below, Construction Loan).

In addition, as a part of the Credit Facility, we have a US\$8.0 million foreign exchange and commodity futures contract facility, which allows us to enter into spot, forward and other foreign exchange rate transactions with our bank with a maximum term of 60 months.

Our facilities are collateralized by general security agreements over all of the assets of Swiss Water and a floating hypothecation agreement over cash balances.

We have certain bank covenants that relate to the maintenance of specified financial ratios and we were in compliance with all covenants as at March 31, 2020.

### Contractual Obligations

The following table outlines our contractual obligations and commitments as at March 31, 2020:

In \$000s (unaudited)	Total	Less than 1 year	2-3 years	4-5 years	Over 5 years
Long-term debt <sup>1</sup>	\$ 35,093	\$ 84	\$ 2,927	\$ 18,333	\$ 13,749
Lease liabilities <sup>2</sup>	14,338	2,765	5,641	2,929	3,003
Credit facility <sup>3</sup>	8,848	-	8,848	-	-
Purchase obligations <sup>4</sup>	42,439	40,109	2,330	-	-
Total contractual obligations	\$ 100,718	\$ 42,958	\$ 19,746	\$ 21,262	\$ 16,752

<sup>1</sup> Long-term debt represents the principal amounts of the convertible debenture and construction loan.

<sup>2</sup> Minimum obligations for our finance leases.

<sup>3</sup> Credit facility matures in 2022.

<sup>4</sup> Purchase obligations represent outstanding capital, coffee and natural gas purchase commitments.

The Company leases the following offices, warehouses and equipment:

On August 26, 2016, Swiss Water signed a lease agreement for a build-to-suit production facility. The lease has an initial term of five years and can be renewed at the Company's option in five-year increments up to a total of 30 years. The lease commenced in July 2018. Under the lease, the Company has multiple options to buy-out the lease starting at the end of the second five-year term. The buy-out value will be equal to the fair market value of the property as determined by an appraisal process, subject to specified maximum and minimum values.

Swiss Water leases a facility that houses its decaffeination plant and offices. The lease expires in May 2023. Beyond expiry in 2023, the landlord has to approve any subsequent renewal of the lease.

Swiss Water leases a sales office in France, which expires in October 2027.

Seaforth lease a warehouse facility, the lease expires in June 2027 and the lease has two options to renew the lease for an additional term of five years each.

The Company leases a truck and other equipment. These equipment leases expire in April 2023 and January 2025, respectively.

Swiss Water Decaffeinated Coffee Company USA, Inc. leases a sales office in Seattle, Washington, which expires in October 2022. The former lease expired in March 2020.

# SWISS WATER DECAFFEINATED COFFEE INC.

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## Management Discussion and Analysis

For the first quarter ended March 31, 2020

### Construction Loan

In Q4 2018, the Company completed a transaction with the Business Development Bank of Canada (“BDC”) for a term loan facility (“Term Loan”) of up to \$20.0 million. The purpose of the Term Loan is to assist in the financing of new equipment for the facility being built in Delta, British Columbia. The Term Loan bears interest at 4.95% per annum over 12 years with principal repayment commencing on July 1, 2021.

The Term Loan matures on June 1, 2033. Only interest will be paid on the outstanding balance, monthly, prior to July 1, 2021. The Term Loan is secured by a general security agreement and a first security interest on all existing equipment and machinery plus new equipment and machinery financed with the Term Loan. Seaforth has provided a guarantee for the Term Loan. As of March 31, 2020, the loan amount outstanding was \$20.0 million with interest accrued of \$0.08 million.

### OFF-BALANCE SHEET ARRANGEMENTS

Swiss Water has no off-balance sheet arrangements.

### RISKS AND UNCERTAINTIES

During March 2020, the World Health Organization declared a global pandemic known as COVID-19. The impacts on global commerce are expected to be far reaching. This may impact the demand for our products and services in the near term and possibly impact the efficiency of our supply chain. It may also impact expected credit losses on our amounts due from customers and whether the entity continues to meet the criteria for hedge accounting. For example, if a hedged forecast transaction is no longer highly probable to occur, hedge accounting is discontinued. Swiss Water may experience disruptions to its business operations if any of its employees, or those of its customers or suppliers, are quarantined and unable to work. It may impact demand for our products and services and the capability of our supply chains, our liquidity, expected credit losses on our amounts due from customers and whether the entity continues to meet the criteria for hedge accounting. There may be significant disruptions and delays in our ongoing business or in the start-up procedures at our new facility, in Delta, BC.

Cash from operations may fluctuate with the performance of the business, which can be susceptible to a number of risks. These risks may include, but are not limited to, foreign exchange fluctuations, labour relations, coffee prices (notwithstanding hedging programs, as exact hedging correlation is not attainable), the availability of coffee, competition from existing chemical and other natural or chemical free coffee decaffeinator, competition from new entrants with alternate processing methods or agricultural technologies, environmental and regulatory risks, terms of credit agreements, commodity futures losses, ability to maintain organic certification, adequacy of insurance, risks related to information technology, dependence on key personnel, product liability, uncollectable debts, and general economic downturns. The future effect of these risks and uncertainties cannot be quantified or predicted.

In addition, Swiss Water leases the building in Burnaby, BC, that houses two decaffeination lines. The lease on this facility expires in 2023 and provides for an additional five-year renewal term (to 2028), subject to the approval of the landlord. The ownership of this facility changed in mid-February of 2020. Following this change, the probability of a lease renewal being granted was re-assessed. Swiss Water has concluded that the renewal risk has increased, and believes the likelihood of a lease renewal beyond 2023 is now much more uncertain. Relocating the existing production equipment would result in significant capital expenditures and the payment of the asset retirement obligation (currently recorded as a long-term liability on our financial statements).



# SWISS WATER DECAFFEINATED COFFEE INC.

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## Management Discussion and Analysis

For the first quarter ended March 31, 2020

### CRITICAL ACCOUNTING JUDGMENTS AND ESTIMATES

Critical accounting judgments and estimates used in preparing our unaudited condensed consolidated interim financial statements are described in the Swiss Water's annual MD&A and annual consolidated financial statements for the year ended December 31, 2019. The preparation of consolidated financial statements in accordance with IFRS requires us to make both estimates and assumptions that could materially affect the amounts recognized in the financial statement. By their nature, judgments and estimates may change in light of new facts and circumstances in the internal and external environment.

Effective January 1, 2019, we adopted IFRS 16 Leases in accounting for leases of our offices, warehouses, and equipment. Estimates and assumptions were made and applied, including the useful lives of right-of-use assets and the implicit borrowing rates. The useful lives of right-of-use assets are estimated to be the length of the related lease terms, ranging from 2 to 20 years. The weighted average implicit borrowing rate is 4.92% per annum which was based on borrowing rates available to the Company.

An accounting estimate is deemed critical only if it requires us to make assumptions about matters that are highly uncertain at the time the accounting estimate is made, and different estimates that we could have used in the current period would have a material impact on our financial condition or results of operations.

### CHANGES IN ACCOUNTING STANDARDS

The following standard became effective for annual periods beginning on or after January 1, 2020.

- IFRS 9/ IAS 39 and IFRS 7 relate to interest benchmark reform and has amendments that provide temporary relief from applying specific hedge accounting requirement to hedging relations ships directly affected by IBOR reform and that required certain disclosures; IAS 1 and IAS 8 redefined materiality; IFRS 3 was amended to revise the definition of a business; Conceptual Framework replaces the conceptual framework for financial reporting issued by IASB in September 2010.

These standards are effective for periods beginning after January 1, 2020 and the Company does not anticipate a material impact on its financial statements:

- IFRS 10 and IAS28 relate to sale or contributions of assets between an investor and associate joint venture; IFRS 17 relates to insurance contracts; IAS 1 amendments address the classification of liabilities between current and non-current.

### HEDGE ACCOUNTING

We account for hedges using IFRS 9, as we enter into three types of hedges:

- 1) Commodity price risk hedges on our coffee purchase commitments and inventory ("commodity hedges");
- 2) Foreign currency risk hedges on future US\$ process revenues ("revenue hedges"); and
- 3) Customer-specific foreign currency risk hedges on US\$ purchases of green coffee ("customer-specific hedges").

Each type of hedge is discussed below.

# SWISS WATER DECAFFEINATED COFFEE INC.

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## Management Discussion and Analysis

For the first quarter ended March 31, 2020

### Commodity Hedges

When we enter into a purchase commitment to buy green coffee, the contract specifies that the purchase price will be based, in part, on the future (to-be-determined) coffee futures price, or NY'C'. We agree on or 'fix' the NY'C' price with the vendor on or before receiving the coffee into inventory. When we bear the economic risk of a change in the commodity price, we offset this risk by selling short a futures contract on the Intercontinental Exchange. When we later sell such coffee at a fixed price to a customer, we cover our short by going long on a futures contract on the Intercontinental Exchange.

At each period-end, commodity hedges are re-measured to their fair value. Under hedge accounting, gains/losses for hedged coffee purchase commitments and inventory are recorded in the statement of financial position until such coffee is sold, at which time the gains/losses on our commodity hedges are recognized in cost of sales. In this way, gains/losses on our commodity hedges are matched to our sales in the period.

### Revenue Hedges

We enter into forward contracts to sell US\$ at future dates to hedge the foreign exchange cash flow variability of expected US\$ processing fee revenue up to 60 months in advance. The hedged process revenue includes both process revenue from tolling arrangements (processing of customer-owned coffee) as well as the US\$ processing fee layer of inventory sales agreements. This enables us to more reliably predict how much Canadian currency we will receive for our US\$ process revenue. Cash flows in the immediate 12-month period are hedged at a higher percentage of expected future revenues than those farther out, reflecting greater uncertainty in the 13-to 60-month period.

At each period end, revenue hedges are re-measured to their fair value. Under hedge accounting, unrealized gains/losses for open revenue hedges are recorded in other comprehensive income. When a revenue hedge matures, the realized gain/loss on that contract is reclassified from accumulated other comprehensive income to process revenue.

### Customer-Specific Hedges

We enter into forward contracts to buy US\$ for green coffee inventory which, once decaffeinated, will be sold at a fixed C\$ price pursuant to a customer-specific contract. To mitigate the exposure to margin changes on these transactions arising from fluctuations in the US\$/C\$ exchange rate, we enter into US\$ forward purchase contracts which economically lock in the US\$/C\$ exchange rate, and effectively locks in the C\$ cost of inventory to be sold at the fixed C\$ amount.

Hedge accounting allows for better matching of US\$ purchases with the associated gains/losses on the forward contracts used to economically hedge these items. At each period-end, customer-specific hedges are re-measured to their fair value. Under hedge accounting, the gains/losses on these hedges are deferred on the statement of financial position until the inventory is sold, at which time the gains/losses are recorded in cost of sales on the income statement.

## FINANCIAL INSTRUMENTS

We use financial instruments to mitigate economic risks associated with our business. The three types of hedges we enter into, and the hedging instruments used, are discussed in more detail under 'Hedge Accounting' above.

We classify our financial assets and financial liabilities in the following measurement categories (i) those to be measured subsequently at fair value (either through other comprehensive income or through profit or loss);

# SWISS WATER DECAFFEINATED COFFEE INC.

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## Management Discussion and Analysis

For the first quarter ended March 31, 2020

and (ii) those to be measured at amortized cost. We have implemented the following classifications for financial instruments other than derivatives:

- Cash and cash equivalents and short-term investments are classified as assets at fair value and any period change in fair value is recorded through interest income in the consolidated statement of income, as applicable.
- Accounts receivable and other receivables are classified as assets at amortized cost using the effective interest rate method. Interest income is recorded in the consolidated statement of income, as applicable.
- Accounts payable, credit facilities, the debt portion of the convertible debenture and other liabilities are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest expense is recorded in the consolidated statement of income, as applicable.

### Commodity Price Risk

Commodity price risk is the risk that the fair value of inventory or future cash flows will fluctuate as a result of changes in commodity prices. Swiss Water utilizes futures contracts to manage our commodity price exposure and also buys and sells futures contracts for coffee on the Intercontinental Exchange in order to offset our inventory position and fix the input cost of green coffee.

As at March 31, 2020 we had futures contracts to buy 9.8 million lbs of green coffee with a notional value of US \$11.7 million, and contracts to sell 16.1 million lbs of green coffee with a notional value of US\$19.1 million. The furthest contract matures in May 2021. (December 31, 2019: buy 3.6 million lbs of green coffee with a notional value of US\$4.7 million, and contracts to sell 6.6 million lbs of green coffee with a notional value of US\$8.3 million).

### Foreign Currency Risk

We realize a significant portion of our sales in US dollars and we purchase green coffee in US\$ which is, in some cases, sold to customers in C\$ dollars. We enter into forward exchange contracts to manage our exposure to currency rate fluctuations and to minimize the effect of exchange rate fluctuations on business decisions. These contracts relate to our future net cash flows in US\$ from sales. In addition, we enter into forward contracts to purchase US\$ for coffee that we resell in C\$ dollars.

As at March 31, 2020, the Company had forward currency contracts to buy US\$1.3 million and sell US\$64.0 million (December 31, 2019: buy US\$3.8 million and sell US\$53.0 million) from April 2020 through to February 2025 at various Canadian exchange rates ranging from \$1.2147 to \$1.4410.

### INTERNAL CONTROLS OVER FINANCIAL REPORTING & DISCLOSURE CONTROLS AND PROCEDURES

The Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”) of Swiss Water are responsible for establishing and maintaining adequate internal control over financial reporting (“ICFR”) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Under the supervision and with the participation of management, we conducted an evaluation of the design and effectiveness of our ICFR as of March 31, 2020, based on the updated framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO 2013”). Based on this assessment, the CEO and CFO concluded that, as of March 31, 2020, Swiss Water’s ICFR was effective.

# **SWISS WATER DECAFFEINATED COFFEE INC.**

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## **Management Discussion and Analysis**

**For the first quarter ended March 31, 2020**

The CEO and CFO are also responsible for establishing and maintaining adequate disclosure controls and procedures. Disclosure controls and procedures are controls and other procedures designed to provide reasonable assurance that information required to be disclosed in documents filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation and includes controls and procedures designed to ensure that information required to be disclosed in documents filed or submitted under securities legislation is accumulated and communicated to Swiss Water's management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

The CEO and CFO evaluated or caused to be evaluated under supervision, the effectiveness of our disclosure controls and procedures and based on this evaluation, the CEO and CFO concluded that, as of March 31, 2020, Swiss Water's disclosure controls and procedures were effective. There were no changes in our ICFR that occurred during the period beginning on January 1, 2020 and ended on March 31, 2020 that have materially affected or are reasonably likely to materially affect, Swiss Water's ICFR.