MANAGEMENT DISCUSSION AND ANALYSIS

This Management's Discussion & Analysis ("MD&A") of Swiss Water Decaffeinated Coffee Inc. ("Swiss Water" or the "Company"), dated as of March 12, 2019, provides a review of the financial results for the three and year ended December 31, 2018 relative to the comparable periods of 2017. The three-month period represents the fourth quarter ("Q4") of our 2018 fiscal year. This MD&A should be read in conjunction with Swiss Water's audited consolidated financial statements for the year ended December 31, 2018, and in conjunction with the Annual Information Form which are available at 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, but which is 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; (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. 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.

EXECUTIVE SUMMARY

For the three months and year ended December 31, 2018, Swiss Water recorded higher processing volumes and revenues than during the same periods last year. We continued to gain market share against our competitors, increased our existing production capacities, and improved our operational efficiencies while remaining focused on producing high-quality premium decaffeinated coffee. To drive future growth, our plans include expanding our presence in Europe and increasing awareness of the Swiss Water brand by targeting specific customer groups in North America. A summary of our financial results is in the table below:

In $000s except per share amounts (unaudited)	3 months ended December 31, 2018	3 months ended December 31, 2017	Year ended December 31, 2018	Year ended December 31, 2017
Sales	$ 22,979	$ 20,662	$ 89,939	$ 83,755
Gross Profit	3,686	3,178	14,921	12,590
Operating income	1,618	958	5,631	4,812
Net income	919	(380)	4,531	4,160
EBITDA[1]	2,050	1,334	7,745	6,923
Net income - basic[2]	$ 0.10	$ (0.04)	$ 0.50	$ 0.46
Net income - diluted[2]	$ 0.03	$ (0.04)	$ 0.35	$ 0.42

[1] 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.
[2] Per-share calculations are based on the weighted average number of shares outstanding during the periods.

Operational highlights

- Our total volumes shipped in the fourth quarter and for the year grew by 8% and 11% respectively compared to the same periods in 2017. Since the beginning of this year, we have continued to gain new business and win more business with existing customers. In 2018 our global reach extended to 56 different countries, and we exported volume to customers on every continent.
- Shipments to roasters grew by 11% in the fourth quarter and for the year over 2017 levels. Shipments to importers remained flat in Q4 and increased by 11% for the year-to-date, compared to the same periods last year. The growth in roaster volumes reflects gains in market share, due in part to a reduction in global decaffeination capacity due to plant shutdowns by competitors in 2017 and in the summer of 2018.
- Volumes shipped to our specialty accounts grew by 2% in the fourth quarter and by 11% in the year, compared to the same periods in 2017.
- Shipments to our commercial accounts increased by 12% and 11% in the fourth quarter and for the year respectively when compared to the same periods last year.
- As expected, our largest geographical market by volume in this year was the United States, followed by Canada, and other international markets. By dollar value, 51% of our sales were to customers located in the United States, 36% were to Canada, and the remaining 13% were to other countries. As we continue to expand our business in Europe, we anticipate revenues from our international markets will increase in both dollar and percentage terms.

Financial highlights

- Quarterly revenue increased by 11% over Q4 2017 to $23.0 million and revenue for the year improved by 7% to $89.9 million. The increases were due to growth in our processing volumes, partially offset by a lower coffee futures price ("NY'C'") and fluctuations in the US dollar ("US$") exchange rate.

- Gross profit for Q4 2018 was $3.7 million, or a margin of 16%. This represents a $0.4 million increase over Q4 2017, and a 1% increase in margin. Year-to-date gross profit improved to $14.9 million (or a margin of 17%), compared to $12.6 million (or a margin of 15%) during the same period last year. The improvement in our results is due to management's efforts in continuing to increase processing volumes and ongoing efforts to control Swiss Water's operating costs. These initiatives have helped offset the margin compression we recorded during the first half of this year. We continue to pursue margin maintenance and improvements initiatives, following a recent period of inflationary pressure on our cost base. We also continue to seek ways to reduce our variable and fixed costs, without sacrificing the quality of our product.
- Operating expenses decreased by 7% to $2.1 million in the fourth quarter, and increased by 19% to $9.3 million for the year-to-date, compared to the same periods last year. In both periods, there were increases due to higher staffing and staff-related expenses, in addition to investment in advertising and consumer initiatives; however, in Q4 2018, the increase was offset by income tax credit for research and development. During 2018 we enhanced our sales and marketing capabilities ahead of the new production capacity we have coming online in 2019.
- Operating income increased by $0.7 million, or 69%, to $1.6 million in the fourth quarter and by $0.8 million, or 17%, to $5.6 million for 2018.
- Fourth quarter net income increased to $0.9 million, compared to a loss of $0.4 million in Q4 2017. The increase in net income is a result of increased gross profit, in addition to lower non-operating expenses related to the revaluation of an embedded derivative and risk management activities, partially offset by higher income tax expenses. Net income for the year-to-date was $4.5 million, compared to $4.2 million in the same period of 2017. The increase in net income is a result of improved gross profit of $2.3 million offset by increased operating expenses of $1.5 million, a loss on foreign exchange of $0.3 million and an increase in income tax expense of $0.1 million
- EBITDA for Q4 was $2.0 million, up by $0.7 million, or 53%, over the same period last year. EBITDA for the year increased, from $6.9 million in 2017 to $7.7 million, or 12% in 2018. The increase is related to improved processing volumes, in addition to significant efforts across the company to enhance cost recovery. We will continue to invest in our production infrastructure and human resources to prepare for the significant growth we anticipate.

AMALGAMATION

On September 28, 2018, Swiss Water amalgamated and concurrently changed its corporate name from Ten Peaks Coffee Company Inc. to Swiss Water Decaffeinated Coffee Inc. The name change was undertaken in order to better leverage the considerable brand equity in the "Swiss Water" name, as well as the related trademarks and intellectual property of the Swiss Water® Process. Additionally, the new company's simplified structure will allow for shareholders and potential investors to more readily associate the investment opportunity with our proprietary Swiss Water® Process, while modestly decreasing our future compliance costs.

OUTLOOK

Looking ahead, we expect to record a strong year-over-year increase in our annual volumes in 2019. During 2018, we saw growth in volumes shipped to roasters, importers, specialty and commercial accounts. This reflects the fact that we have won business with new roasters and increased business with existing customers who have grown their distribution, locations or expanded their product offerings. Some of our new business is from roasters who previously obtained their decaffeinated coffees from a decommissioned CO_2 plant in Europe, while other account wins are related to the recent closure of a CO_2 plant in Houston, Texas.

We believe these plant closures have tightened the chemical free decaffeination coffee market and that the resulting drop in available decaffeination services will allow us to more rapidly utilize the additional production capacity we have coming online in 2019.

Furthermore, in 2018 we have seen an acceleration of customers converting from chemical decaffeination to our chemical free process. Recognition of the Swiss Water brand continues to develop within our expanding portfolio of customers, and coffee consumers. We now export to 56 countries globally. We expect increased marketing and sales investments in 2019 to drive further gains in recognition and conversion going forward.

Construction of our new Swiss Water® Process decaffeination facility, which is located in Delta, British Columbia, Canada, is progressing well. Initially, this facility will house one new production line, although the site is large enough to accommodate further expansion as momentum behind chemical free decaffeination accelerates. The new production line is expected to be commissioned in the fourth quarter of 2019.

In anticipation of more immediate growth in demand, we completed an efficiency enhancement project in Q2 2018 to increase capacity at our current facility. These changes, together with the capacity that was added at the same facility in Q1 2016, are expected to be sufficient to meet anticipated growth in demand for our premium Swiss Water® Process coffees until the new production line is operational. Overall, we continue to gain market share, particularly in the premium decaffeination market.

As a part of our ongoing evaluation of the Company's cost structure and with the goal of increasing overall margins, we are reviewing cost recovery opportunities for both Swiss Water and its subsidiary, Seaforth Supply Chain Solutions Inc. ("Seaforth"). While Seaforth's operating costs rose substantially in the first half of 2018, there has been an improvement in operating costs in the subsequent two quarters.

The market for decaffeinated coffee continues to be strong. On a year-over-year basis, the growth rate of the decaffeinated coffee market has increased and continues to outpace growth in the US coffee market as a whole. We believe this is due, in part, to the premiumization of the coffee market, as well as growing awareness and consumption of premium decaffeinated coffee. Over the past 5 years the largest consumers of decaffeinated coffee are 18 to 24 year olds[1]. This demographic want to drink great-tasting coffee throughout the day without worrying about the potential side effects of excess caffeine.

Younger consumers are more conscious of, and concerned about, artificial ingredients and chemicals in the production of their food and beverages. As a result, we have seen increased demand for our chemical free and sustainable Swiss Water® Process coffees, as more food companies now employ our branded coffees to help them respond to this growing consumer demand. Demand for organic coffee continues to grow and is the most broadly purchased certification: 39% of consumers say they are much more likely to buy coffee that is Certified Organic coffee, and 49% of consumers say they're more likely to buy coffee if it is grown in an environmentally sustainable way. [1]

Various media sources[2] have recently underscored the health and environmental hazards associated with methylene chloride (the primary chemical used by our competitors to decaffeinate coffee). Additionally, multiple major retailers in the U.S. are banning paint strippers that contain methylene chloride. We believe

[1] National Coffee Association 2018 Coffee Drinking Trends

[2] New York Times has published (https://www.nytimes.com/2017/10/21/us/epa-toxic-chemicals.html) and podcasted https://www.nytimes.com/podcasts/the-daily?_r=0 a piece on EPA regulations, as the EPA is highlighting methylene chloride as a key chemical that isn't, but should be, regulated, because it's a hazard to people's health. In 2018, New Scientist published a report (https://www.newscientist.com/article/2138753-ozone-layer-recovery-will-be-delayed-by-chemical-leaks/) about how methylene chloride is slowing the regeneration of the ozone layer.

this rise in consumer awareness is helping to drive demand for our 100% chemical free coffees, and we will continue to proactively employ positive messaging to accentuate the benefits of our amazing coffees without caffeine.

Over the near future, our primary focus will be to position Swiss Water to maintain our current growth momentum and enhance our operating margins. In January 2019, we completed the company registration for our European subsidiary. We believe that opening a European sales office will give us a solid footprint to better serve customers in the largest decaffeinated coffee market in the world. In addition, we are expanding our ability to target specific customer groups in the United States. Developing our European and US sales teams has and will continue to increase our expenses somewhat, but we expect these initiatives to generate increased sales orders in the longer term to drive major account wins. As converting large customers to Swiss Water® Process coffees typically takes several quarters, we believe strengthening our sales capability now is a critical part of our preparation to ramp up orders and win new business as we add significant capacity with our new facility in 2019.

BUSINESS OVERVIEW

Swiss Water is a premium green coffee decaffeinator located in Burnaby, BC. Swiss Water employs the proprietary Swiss Water® Process to decaffeinate green coffee without the use of chemicals, leveraging science-based systems and controls to produce coffee that is 99.9% caffeine free. It 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 chemicals is our primary business.

Seaforth 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', formerly TPK. As at the date of this report 9,061,210 shares were issued and outstanding.

Swiss Water'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.

KEY PERFORMANCE DRIVERS

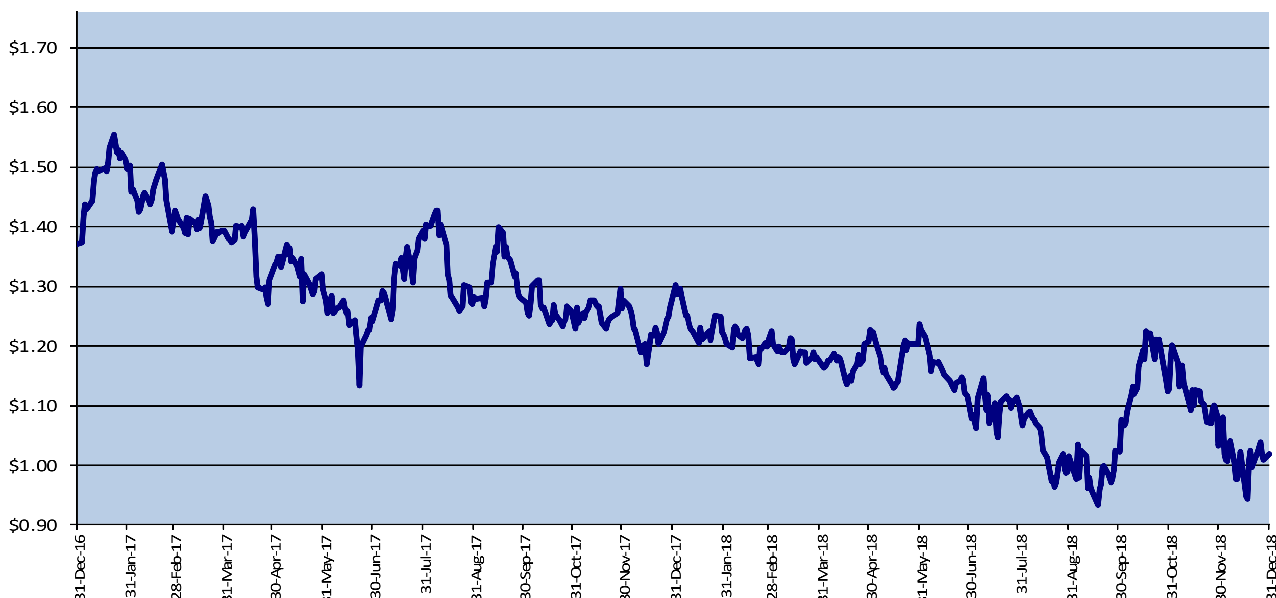
The following key performance drivers are critical to the successful implementation of our strategy and ability to improve profitability and cash from operations:

External Factors

- *Coffee Futures Prices* – We buy and sell coffees based on the NY'C' plus the quality differentials for specified coffees, both of which rise and fall in response to changes in supply and demand. We manage our exposure to changes in the NY'C' futures price on the value of our inventories through a commodity hedging program (discussed under 'Hedge Accounting' below), but cannot hedge our exposure to changes in quality differentials. In addition to the price risks associated with holding coffee inventories, our revenue and cost of sales are affected by changes in the underlying commodity price. Commodity price increases (decreases) raise (lower) the green coffee cost recovery revenue generated through our non-toll business, as well as the costs of green coffee sold to customers to generate sales.

  Changes in the NY'C' also affect our statement of financial position, and the amount of working capital we use in our business. When coffee prices rise (fall), our inventory values gradually increase (decrease) as we replace coffee at higher prices. Our accounts receivable and our accounts payable also rise and fall with the NY'C'. Finally, there is no open market to hedge the quality differential component of our green coffee cost. We sell coffee at replacement quality differentials, and as such, in a period of falling (rising) differentials we will generate differential cost recovery losses (gains), as green coffee revenues will be less than (exceed) green coffee costs.

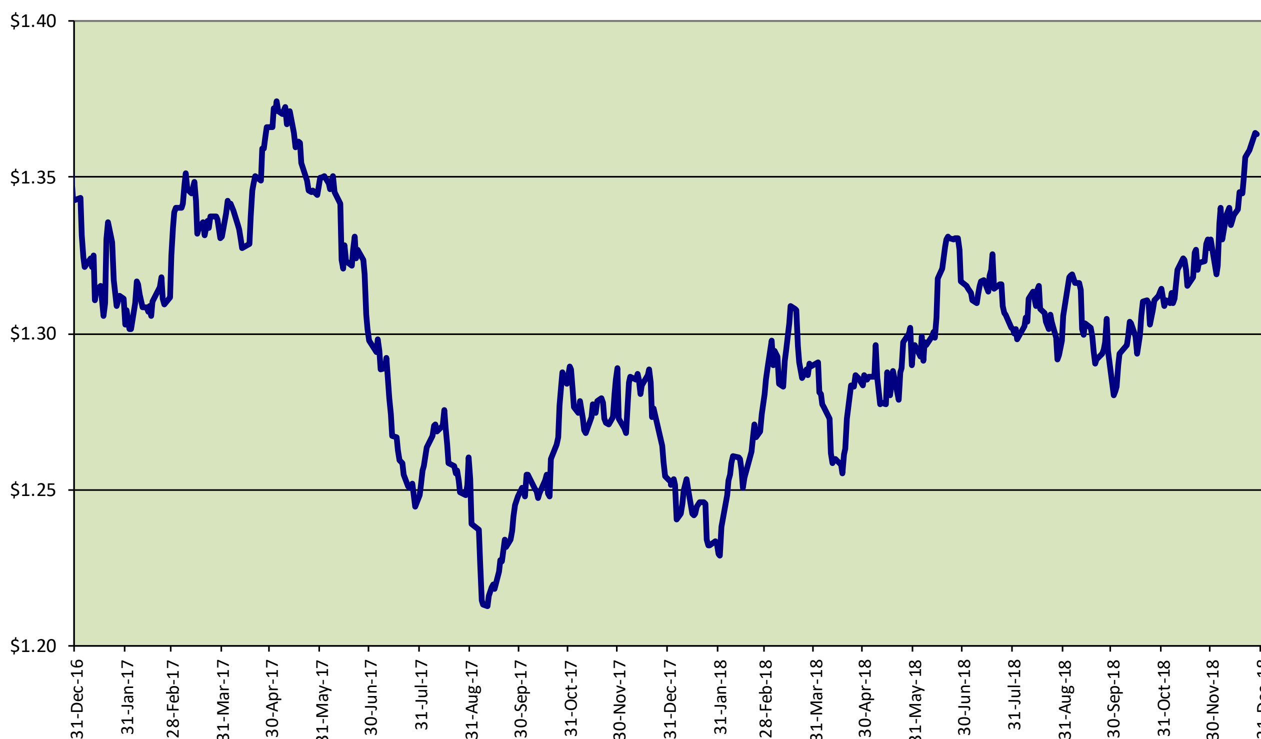
The chart below shows the movement in the NY'C' for the last eight quarters:



In Q4 2018, the NY'C' averaged US$1.09/lb compared to an average of US$1.25/lb in Q4 2017. For 2018, the NY'C averaged US$1.12/lb, compared to US$1.33/lb for 2017. 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 (as it has for the past 12 months), our customers tend to add to their inventories.

- *US$/C$ Exchange Rates* – As noted above, the majority of our revenues are generated in US dollars, while a significant portion of our costs are 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 Canadian dollar. A long-term depreciation of the Canadian dollar will improve our long-term profitability and cash generation.

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



In Q4 2018, the US$ averaged C$1.32, an increase of 3.9% over the same period in 2017. During the year, the US$ averaged C$1.2956, a decrease of 0.2% over the same period last year. During 2017, the US$ ranged between C$1.21 and C$1.37. In 2018, it ranged between C$1.23 and C$1.36. When the US$ depreciates (appreciates), it decreases (increases) our gross profit on green coffee revenues.

Internal Factors

- *Sustainability and Environmental Responsibility* – The Swiss Water® Process is a 100% chemical free

decaffeination process that enables us to consistently deliver high-quality coffee. Our approach to sustainability is to continually improve and innovate this process to be more efficient by actively managing resource usage in a safe and environmentally responsible manner. In addition to carefully managing our operations, we take steps to ensure sustainable coffee supply by purchasing sustainably certified coffees and organic coffees. We promote social sustainability by participating in programs within the coffee industry that advance the health of women and their families living in coffee-growing communities (Grounds for Health) and that foster research-based approaches to advancing coffee cultivation (World Coffee Research).

- *Processing Volumes* – Our decaffeination facility generates a certain level of fixed operating costs that are incurred regardless of the volume of coffee processed. Accordingly, our profitability and cash from operations will increase as processing volumes increase. Processing volume is a key performance indicator ("KPI") that we monitor continuously.
- *Process Consistency* – We manage our operations in order to reduce variability in production and drive continuous improvement. Production consistency results in improved product quality. We have developed a number of KPIs designed to monitor process consistency, and have set targets for continuous process improvement.
- *Product Quality* – Quality control is a key part of our operations. We operate under the Food Safety Systems Certification (FSSC) 22000, which manages our food safety, as well as HACCP (Hazard Analysis Critical Control Points) and quality assurance programs. All green coffees delivered to our processing facility are weighed and inspected and are subject to rigorous internal quality-control evaluations. Each lot of green coffee processed is monitored throughout the decaffeination process, and a certificate of analysis is prepared for each lot. A sample from each production lot is also roasted, brewed and cupped to ensure quality. In addition, our focus on reducing the size of production lots and increasing inventory turnover results in fresher coffee being provided to our customers. Production batch size and inventory turns are two other KPIs that we monitor regularly.
- *Order Fulfillment* – Our integrated supply chain management strategy includes maintaining inventories of finished goods at various coffee warehouses throughout North America, and of raw goods for improved inventory replenishment times. Our order fulfillment rates are monitored regularly. An improved order fulfillment rate has contributed to our volume growth and improved customer service levels.
- *Employee Safety* – We are focused on operating our business in a safe manner, and reducing the likelihood that employees will be injured at work. We track employee safety metrics by department, and our safety committee proactively seeks ways to reduce the risks inherent in our operating environment. While we cannot completely eliminate workplace incidents or accidents, we have significantly reduced the number of safety-related incidents over the past few years. We are proud of the fact that SWDCC has not had a lost-time incident in more than four years. We believe that ensuring employee safety leads to improved employee retention and morale, increased efficiency and lower operating costs.

CAPACITY TO DELIVER RESULTS

The following resources allow us to deliver on our business strategy:

- *Proprietary Chemical Free Production Lines* – We have two decaffeination production lines. This enables us to align our production capacity with changes in demand throughout the year. We operate

one line when demand is lower, and both lines when demand is higher, giving us better control over our variable costs. As discussed above, we completed an efficiency enhancement project in Q2 2018 to increase capacity at our current operating facility and in 2016, we expanded the capacity of one of our production lines, which enables us to meet near-term growth in demand for our products. Construction of the new facility in Delta is expected to be complete by the fourth quarter of 2019 which will enable us to meet our long term growth ambition.

- *Consumer Branding as the Premium, 100% Chemical Free Method of Decaffeinating Green Coffee* – We have been successful in establishing our brand as a leading chemical free processor of green decaffeinated coffee. Consumers and participants in the coffee trade are increasingly aware of the value of the chemical free Swiss Water® Process due to its quality and taste. We believe that there is significant potential to continue to broaden consumer awareness of the benefits of the Swiss Water® Process.
- *Established Customer Base* - The Swiss Water® Process has an established customer base across North America and in many international markets. Our customers include some of North America's largest roasters, roaster-retailers and leading coffee brands.
- *Broad Distribution Channels* - Green coffee decaffeinated using the Swiss Water® Process is sold through the coffee market's key distribution channels: roaster retailers, commercial roasters and coffee importers. This diversity ensures that we access all key segments of the specialty coffee trade and consumer coffee markets.
- *Working Capital and Expansion Capital* –In 2015, 2016 and 2018, we raised equity and debt which is being used to fund the construction of our third production line (to be housed in the new production facility noted above). In 2019, we will continue to revisit our budgets and financing strategy to ensure that we have sufficient funds to execute on our business strategy. We expect to utilize internally generated and external funds to finance the capital costs associated with the new production facility and future growth.
- *Management Expertise* – Swiss Water is highly regarded in the coffee industry for our senior management team's substantial experience, our close attention to consumer trends in the specialty coffee market, and our in-depth knowledge of green and roasted coffee. In particular, our intense focus on premium product quality and commitment to science-driven insight is well recognized. To maximize these strengths, we have invested significant resources in enhancing our team's industry-related skills and talents over the past few years. Going forward, we intend to leverage our exceptional experience with, and knowledge of, the specialty coffee industry to continue to build our business.

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 us, 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, shipments to roasters are more stable from period to period than those 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 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 periods was:

(In $000s)	3 months ended December 31		Year ended December 31	
(unaudited)	2018	2017	2018	2017
Process revenue	$ 5,974	$ 5,652	$ 23,894	$ 21,781
Green revenue	15,406	13,800	60,197	57,177
Distribution revenue	1,599	1,210	5,848	4,797
	$ 22,979	$ 20,662	$ 89,939	$ 83,755

For the quarter ended December 31, 2018 sales totaled $23.0 million, an increase $2.3 million, or 11%, compared to the same quarter in 2017.

The increases in our fourth quarter sales by category reflect an increase in our processing volumes:

- Process revenue increased by $0.3 million, or 6%
- Green revenue increased by $1.6 million, or 12%
- Distribution revenue rose by $0.4 million, or 32%

Sales for 2018 totaled $89.9 million, an increase of $6.2 million, or 7%, over the same period last year. The increases in our annual sales by category reflect an increase in our processing volumes:

- Process revenue increased by $2.1 million, or 10%
- Green revenue increased by $3.0 million, or 5%
- Distribution revenue rose by $1.1 million, or 22%

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. 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 fourth quarter cost of sales increased by $1.8 million, or 10%, to $19.3 million this year, compared to the same period in 2017. For 2018, our cost of sales was $75.0 million, up by $3.9 million, or 5%, over the same period last year. The increase for the year-to-date is consistent with our increased business activities during the periods. While higher freight charges and variable production costs associated with the significant growth in our volumes accounted for some of the increase, green coffee costs, which is a significant portion of our cost of sales, also increased.

In the fourth quarter of 2018, we also absorbed higher gas cost as there was a pipeline explosion in October 2018 in Northern British Columbia which significantly reduced the supply of gas. Our average gas cost per month was approximately three times higher in the fourth quarter versus the first nine months of 2018.

Swings in the US$/C$ exchange rate can create negative margins on green coffee revenue between the time we bring green coffee into inventory and the time it is sold.

Gross Profit

Gross profit increased by 16% to $3.7 million for the fourth quarter of this year, as higher revenues more than offset the increases in our cost of sales. Gross profit for 2018 increased by 19% to $14.9 million, compared to the same period last year. The improvements are largely related to efforts by management to proactively review Swiss Water's cost structure and improve Swiss Water's margin by leveraging enhanced cost recovery, without sacrificing the quality of our coffee.

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 Q4 2018 totaled $0.9 million. This was a decrease of $0.6 million, or 39%, compared to the same period last year. Approximately $0.4 million of the decrease related to an income tax credit from the Canada Revenue Agency for conducting research and development. Administration expenses for 2018 increased by 6% to $5.4 million. The increase largely reflects costs incurred to support strategic growth initiatives for 2018, including staffing and employee-related expenses and recruitment expenses to establish and expand our teams in Europe and the United States to support our growth momentum.

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. We differentiate ourselves from other decaffeinators by investing in research regarding the behavior of decaffeinated coffee consumers. This research enables us to create effective consumer advertising and promotion, and is the cornerstone of our focused marketing strategy and activities, and of the consultative services it provides to our customers. We also aim to grow brand awareness with both the coffee trade and consumers. We employ a range of marketing activity to achieve this, including digital and print advertising, social media communications and trade show exhibiting and sponsorship at key industry events.

Sales and marketing expenses were up by $0.4 million, or 55%, to $1.1 million in Q4 2018 and by $1.2 million, or 47%, to $3.8 million during the year. The increases are due to our expansion into Europe and United States, and higher investment in brand awareness activities, in support of our strategic growth initiatives.

Occupancy Expenses

Occupancy expenses include the cost of renting offices for sales, marketing and administrative use. Occupancy costs for the fourth quarter and 2018 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 debt, other borrowings and the interest expense on the convertible debenture and construction loan.

Net finance expenses were $0.2 million and $0.9 million for the three months and year ended December 31, 2018, respectively, compared to net finance expense of $0.2 million and $0.8 million in the same periods last year. 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%. Due to this difference, the amortization of the bond discount changes over time, which resulted in a slightly higher interest expense in Q4 2018 compared to the same period a year ago.

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', below). 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 December 31, 2018, we recorded a loss of $0.6 million, compared to a gain of $0.4 million for the same period in 2017. A slight loss of $0.01 million was reported for the year, compared to a gain of $1.2 million in 2017.

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 which 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 $0.8 million in the fourth quarter of 2018 and a gain of $1.8 million for the year-to-date, compared to a loss of $0.3 million and a gain of $0.6 million, respectively, in the same periods 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.

For the three months ended December 31, 2018, we recorded no effective net foreign exchange gain or loss, compared to a loss of $0.8 million for the same period in 2017. A loss of $0.3 million was reported for 2018, compared to no effective net foreign exchange gain or loss in 2017.

Income Before Taxes and Net Income

In the fourth quarter of 2018, we recorded income before taxes of $1.6 million, compared to $0.1 million in the same period last year. Current and deferred income taxes reduced our net income by $0.7 million for the quarter, compared to $0.5 million in Q4 2017. 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 carry forwards recognized. Overall, we recorded net income of $0.9 million for the fourth quarter, compared to a loss of $0.4 million for the same period last year.

For the year-to-date, we recorded pre-tax income of $6.2 million, up from $5.8 million in 2017. This was reduced by income tax expenses of $1.7 million, compared to income taxes of $1.6 million in the same period last year. Overall, we recorded annual net income of $4.5 million, compared to $4.2 million a year ago.

Basic and Diluted Earnings per Share

Basic earnings per share is calculated by dividing net income by the basic weighted average number of shares outstanding during the period. Similarly, diluted earnings per share is 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 fourth quarters and years of 2018 and 2017, the potential common shares issuable under the Restricted Share Unit ("RSU") Plan are anti-dilutive, and as such they are excluded from the calculation of diluted earnings per share in the quarter.

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

(In $000s except for per share amounts)	3 months ended December 31		Year ended December 31	
(unaudited)	2018	2017	2018	2017
Basic EPS				
Net income attributable to shareholders	$ 919	$ (380)	$ 4,531	$ 4,160
Weighted average number of shares	9,061,210	9,038,862	9,058,149	9,038,862
Basic EPS	$ 0.10	$ (0.04)	$ 0.50	$ 0.46
Diluted EPS				
Net income attributable to shareholders	919	(380)	4,531	4,160
Interest on convertible debenture	272	-	1,063	1,035
Loss (gain) on fair value adjustment of embedded option	(813)	-	(1,799)	(604)
Net income after effect of diluted securities	$ 378	$ (380)	$ 3,795	$ 4,591
Weighted average number of shares – basic	9,061,210	9,038,862	9,058,149	9,038,862
Effect of diluted securities: convertible debenture	1,818,182	-	1,818,182	1,818,182
Weighted average number of shares - diluted	10,879,392	9,038,862	10,876,331	10,857,044
Diluted EPS	$ 0.03	$ (0.04)	$ 0.35	$ 0.42

Other Comprehensive Income

Gains or losses on our designated revenue hedges that will mature in future periods are recorded in other comprehensive income, net of income tax expense. Other comprehensive loss, net of tax, for the fourth quarter of 2018 was $2.6 million, compared to $0.3 million in the same period last year. Other comprehensive loss, net of tax, for the year-to-date was a loss of $4.0 million, compared to income of $1.1 million in the same period of 2017. The increase and decreases are related to the fluctuations in the value of the Canadian dollar versus the US dollar.

NON-IFRS MEASURES

EBITDA

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 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.

The reconciliation of net income to EBITDA is as follows:

(In $000s)	3 months ended December 31		Year ended December 31	
(unaudited)	2018	2017	2018	2017
Income for the period	$ 919	$ (380)	$ 4,531	$ 4,160
Income taxes	718	454	1,689	1,606
Income before tax	$ 1,637	$ 74	$ 6,220	$ 5,766
Finance income	(143)	(174)	(530)	(580)
Finance expenses	373	368	1,457	1,414
Depreciation & amortization	426	583	1,689	2,172
Unrealized loss (gain) on foreign exchange forward	626	(679)	188	(1,462)
Fair value (gain) loss on embedded option	(813)	305	(1,799)	(604)
(Gain) loss of foreign exchange	(38)	751	278	6
Share-based compensation	(18)	106	242	211
EBITDA	$ 2,050	$ 1,334	$ 7,745	$ 6,923

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

(In $000s)	3 months ended December 31		Year ended December 31	
(unaudited)	2018	2017	2018	2017
Operating income for the period	$ 1,618	$ 958	$ 5,631	$ 4,812
Add back:				
Depreciation & amortization	426	583	1,689	2,172
Share-based compensation	(18)	106	242	211
(Gain) loss on risk management activities	(602)	366	(5)	1,190
Deduct:				
Unrealized loss (gain) on foreign exchange forward	626	(679)	188	(1,462)
EBITDA	$ 2,050	$ 1,334	$ 7,745	$ 6,923

EBITDA for the three months ended December 31, 2018 was $2.0 million, up by 53% compared to Q4 2017. For the year, EBITDA increased by 12% to $7.7 million, compared to the same period in 2017.

SELECTED ANNUAL INFORMATION

(In $000s except per share amounts) (unaudited)	December 31, 2018	December 31, 2017	December 31, 2016
Balance Sheet			
Total assets	86,881	72,848	67,899
Total long-term liabilities	27,284	19,497	17,733
Income Statement			
Sales	89,939	83,755	81,927
EBITDA(1)	7,745	6,923	5,772
Net income	4,531	4,160	4,149
Dividends paid	2,262	2,260	2,256
Per share, basic(2)			
EBITDA(1)	0.85	0.77	0.64
Net income	0.50	0.46	0.46
Dividends paid	0.25	0.25	0.25
Per share, diluted(2)			
EBITDA(1)	0.71	0.64	0.63
Net income	0.35	0.42	0.46

(1) EBITDA is defined in the section 'Non-IFRS Financial Measures' along with details of its calculation.
(2) Per-share calculations are based on the weighted average number of shares outstanding during the period.

Our total assets and our total liabilities have increased in each of the last two years following an equity offering in 2015 and a convertible debenture offering in 2016. Proceeds from the equity offering in 2015 were used to increase the capacity of one production line in 2016, resulting in an increase in fixed assets, and repayment of short-term debt. Proceeds from the debt and equity offerings are also being used to construct a new production line, which will be housed in a new production facility that is currently under construction (see 'Outlook' section, above).

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-quarter period:

In $000s except for per share amounts (unaudited)	8 Quarter Average	Q4 2018	Q3 2018	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Sales	21,712	22,979	23,087	22,658	21,215	20,662	21,955	21,915	19,223
Gross Profit	3,439	3,686	4,439	3,952	2,842	3,178	3,014	3,364	3,035
Operating income	1,305	1,618	1,927	1,528	555	958	1,117	1,470	1,267
EBITDA[1]	1,833	2,050	2,717	1,868	1,106	1,334	1,678	2,235	1,677
Net income (loss)	1,086	919	1,828	1,294	489	(380)	1,385	1,720	1,435
Per Share[2]									
Net income (loss) - basic	0.12	0.10	0.20	0.14	0.05	(0.04)	0.15	0.19	0.16
Net income (loss) - diluted	0.09	0.03	0.18	0.10	0.03	(0.04)	0.15	0.17	0.08

[1] EBITDA is defined in the section on 'Non-IFRS Financial Measures' along with details of its calculation.
[2] Per-share calculations are based on the weighted average number of shares outstanding during the period.

LIQUIDITY AND CAPITAL RESOURCES

Operating activities

For the three months and year ended December 31, 2018, we generated $2.5 million and $5.7 million, respectively, in net cash from operating activities, compared to using $1.3 million and generating $1.7 million in the same periods last year.

Inventory

Our inventory decreased in value by 6% and decreased in volume by 5% between December 31, 2017 and December 31, 2018. The decreases reflect a lower NY'C in the current year, as well as a decrease in volume in both finished goods and raw materials inventory.

Under hedge accounting, gains/losses on derivative instruments for coffee to be sold in future periods are recorded in inventory. The hedge accounting component of inventory as at December 31, 2018 was a loss of $0.6 million, compared to a minor gain 2017.

Accounts Receivable

Our accounts receivable increased by $2.2 million, or 18%, between December 31, 2017 and December 31, 2018, compared to an increase of $0.4 million, or 4%, between December 31, 2016 and December 31, 2017.

Investing Activities

Cash outflows in investing activities for Q4 2018 were $10.7 million, compared to cash inflows of $8.8 million in Q4 2017. Cash outflows in investing activities for 2018 were $14.2 million, compared to cash outflows of $2.5 million in the same period last year. In Q4 and 2018, our cash outflows for capital expenditures were $10.7 million and $21.3 million, which related to our plant expansion in Delta, British Columbia. This compares to cash outflows for capital expenditures of $3.0 million in Q4 2017 and $8.1 million during 2017, which also related to our expansion plans. In Q3 2017, $11.1 million was placed into short-term investments but no similar investments occurred in the same period of 2018.

Financing Activities

During the year ended December 31, 2018, we paid $2.3 million in dividends to shareholders. This is unchanged from the same period in 2017. In Q4 2018, the Company received proceeds for a term loan of $9.4 million from the Business Development Bank of Canada ("BDC").

Credit Facilities and Liquidity

Our current credit facilities include a $14.5 million revolving operating line of credit and a $1.5 million revolving swing line, each of which bears an interest rate of prime plus 0.75%. Any US$-denominated debt under the revolving operating line of credit or swing line can be financed using LIBOR loans at the LIBOR rate plus 2.35% per annum.

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

Our credit facilities are collateralized by a general security agreement and first security over present and after-acquired personal property and second security over existing and new machinery and equipment and a floating hypothecation agreement over cash balances.

We have certain bank covenants which relate to the maintenance of specified financial ratios and we were in compliance with all covenants as at December 31, 2018.

BDC 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 twelve years with principal repayment commencing on September 1, 2020. The Term Loan matures on August 1, 2032. Interest only will be paid on the outstanding balance on a monthly basis prior to September 1, 2020. 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 December 31, 2018, the loan amount outstanding was $9.4 million with interest accrued of $0.02 million. The interest has been capitalized during the construction phase.

Contractual Obligations

The following table sets forth our contractual obligations and commitments as at December 31, 2018:

(In $000s) *(unaudited)*	Total	Less than 1 year	2-3 years	4-5 years	Over 5 years
Long-term debt[(1)]	$ 24,400	$ -	$ 1,044	$ 1,567	$ 21,789
Operating leases[(2)]	8,451	2,702	3,176	2,573	-
Purchase obligations[(3)]	119	119	-	-	-
Total contractual obligations	$ 32,970	$ 2,821	$ 4,220	$ 4,140	$ 21,789

[1] Long-term debt represents the principal amounts of the convertible debenture and construction loan.

[2] Minimum obligations for our operating leases.

[3] Represents outstanding coffee and natural gas purchase commitments.

Swiss Water leases a facility which houses its decaffeination plant and offices. The current lease term expires in 2023.

Seaforth leases warehouses in two locations for its primary operations. These leases expire in June 2019 and November 2019.

Swiss Water Decaffeinated Coffee Company USA, Inc. holds a lease for its Seattle, Washington, USA sales office, which expires on March 2020.

In 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 Swiss Water's option in five-year increments up to a total of 30 years. The lease commenced in July 2018. Under the lease, Swiss Water 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.

The lease also includes a construction management agreement for the construction of a highly specialized building to house the production plant. The landlord agreed to finance a portion of the building, with loan payments commencing on the earlier of substantial completion of construction and January 1, 2019. During 2017, the Company accrued $0.8 million for the construction loan. As of December 31, 2018, the Company repaid the construction loan and interest of $6.1 million and $0.1 million respectively. The interest was capitalized as it is in the construction phase.

As at December 31, 2018, our estimated costs to complete the production line and facility located in Delta, BC are $23.9 million. This amount includes costs for the production line, the construction of the specialized portion of the facility which will house the production equipment, leasehold improvements, and ancillary costs necessary to bring the production line into productive use. This is expected to be funded through cash on hand, working capital or other debt facilities, a construction loan, and cash from operations.

OFF-BALANCE SHEET ARRANGEMENTS

Swiss Water has no off-balance sheet arrangements.

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 periods:

(In $000s)	Year ended December 31	
(unaudited)	2018	2017
Income for the period	$ 393	$ 303
Purchases of raw materials	$ 5,957	$ 6,934

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 December 31, 2018, our accounts receivable balance with this company was $0.01 million (December 31, 2017: $0.02 million) while our accounts payable balance with this company was $0.3 (December 31, 2017: $nil).

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.

RISKS AND UNCERTAINTIES

Swiss Water's ability to pay dividends is dependent upon the earnings and cash flow generated from the Company's operations, as well as our current and planned future investments in capital equipment. 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 decaffeinators, 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 that houses two decaffeination lines. The option to renew this lease for an additional five-year term has been exercised, with the new lease term expiring in 2023. The lease also provides for an additional five-year renewal term (to 2028), subject to the express approval of the landlord. Any plans to relocate the 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).

ENVIRONMENTAL RISKS

The Canadian Securities Administrators ("CSA") identifies five categories of risks: litigation, physical, regulatory, reputational and business model, for which issuers are asked to identify material risks and if they are reasonably likely to affect financial statements in the future.

Environmental matters relate to a broad range of issues, including those related to air, water, waste and land. As a small company with limited human and financial resources, we focus on only those risks that we believe could have a materially adverse impact on our operations and/or financial results within our planning horizon, rather than seeking to identify all possible future risks. Risk assessment involves judgment, uncertainty and estimates, which can provide only reasonable, rather than absolute, assurance that all the applicable risks and their expected impacts on Ten Peaks are considered.

The most pervasive environmental risks that we face relate to the fact that we buy, sell and store an agricultural commodity. The supply of green coffee can be impacted by numerous environmental conditions such as frosts, drought, plant disease and insect damage, which can impact the quality and size of the coffee crop. In addition, certain environmental conditions, such as excessive rains, can hamper crop harvesting. A shortage of coffee can impact our processing volumes and revenues. We seek to mitigate the risks of coffee shortages by maintaining an extensive list of coffee suppliers; by dealing with importers who themselves have multiple suppliers rather than contracting directly with farmers or coffee co-operative organizations; by maintaining up to three months of coffee inventories at any time; by developing and modifying coffee blends that take into consideration coffee availability and cost from various coffee origins; and, by entering into purchase contracts with suppliers for future delivery of coffee (rather than relying on 'spot' deliveries). In addition, the coffee commodity price is closely tied to available supplies of coffee globally. We mitigate the commodity price risk through our commodity price risk management policy.

Our leased facilities are located in the Metro Vancouver area of British Columbia. Vancouver is considered to be at high risk of a major earthquake. Any significant earthquake in the vicinity could have a material impact on our operations for a period of time, depending on the extent of the damage to the facilities, our equipment, and the transportation infrastructure in the region. In short, a major earthquake could have a material adverse impact on our revenues. We carry property and business interruption insurance, including earthquake coverage, which would help offset the cash flow impact of such an event. In addition, we keep some finished goods inventory in third-party coffee warehouses in other regions, and we would be able to sell these finished goods even if our production and distribution of coffee were temporarily interrupted by an earthquake. Nevertheless, the financial and operational impact of a major earthquake cannot be reasonably predicted.

We are subject to a number of environmental laws and regulations related to our facilities in British Columbia, which mandate, among other things, the maintenance of air and water quality. We routinely monitor our compliance with these standards. Based on our compliance record and our maintenance programs, as well as currently enacted laws and regulations, we do not believe that these regulatory risks are material.

We expect to incur increased costs for energy and water consumption over time. If we cannot pass on such increased costs to our customers, our profitability may be adversely impacted.

We believe that all known environmental obligations and provisions have been appropriately reflected in our financial statements. We have not identified any material litigation, reputational, or business model risks related to environmental matters. Nevertheless, we may be subject to potential unknown or unforeseeable environmental impacts arising from, or related to, our business. Costs associated with such issues could be material.

We believe that the trend toward increased environmental awareness creates an opportunity for us to grow our business, as consumers and coffee industry participants place greater emphasis on reducing their impact on the environment. As one of the few chemical free decaffeinators in the world, we believe that an increased focus on environmental matters will allow us to win more business away from decaffeinators that use chemicals such as methylene chloride to decaffeinate coffee.

CRITICAL ACCOUNTING JUDGMENTS AND ESTIMATES

Measurement Uncertainty

The preparation of financial statements in accordance with IFRS requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates are used when accounting for asset retirement obligations, share-based compensation and convertible debt with embedded derivatives and income taxes. Actual results may be different from these estimates.

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.

Asset Retirement Obligation

The undiscounted future value of the asset retirement obligation ("ARO") in respect of our leased decaffeination facility is estimated at $0.9 million. This estimate assumes that we relocate from the current location upon expiry of the third lease renewal term in 2023. Further, the estimate reflects the expected costs of vacating the leased facility in 2023, having regard for the contract language in the lease, the expected useful lives of our plant and equipment, and the expected costs that would be paid to a third party to remove equipment.

Convertible Debenture with Embedded Derivatives

On October 11, 2016, the Company issued an unsecured subordinated convertible debenture for gross proceeds of $15,000,000. The convertible debenture bears interest at a rate of 6.85% per annum to be paid quarterly in arrears and is due on October 11, 2023. The convertible debenture is convertible into common shares of the Company at a conversion price of $8.25 per common share. Under the terms of the agreement, Swiss Water has the option to pay interest-in-kind for the first two years. If elected, this option will increase the principal sum by the interest owing. This option was not elected.

The convertible debenture also includes a Net Share Settlement feature that allows Swiss Water, upon conversion, to elect to pay cash equal to the face value of the convertible debenture and to issue common shares equal to the excess value of the underlying equity above the face value of the convertible debenture. If the Net Share Settlement option is elected, it will result in fewer common shares being issued. In 2016, the Company paid financing costs of $0.5 million in respect of issuing the convertible debenture.

Under IFRS, we are required to estimate the interest rate on a similar instrument of comparable credit status and providing for substantially the same cash flows, on the same terms, but without the equity conversion option, in order to estimate the fair value of the liability portion of the convertible debenture upon initial recognition. We have estimated the effective interest rate to be 12.15%, such that the fair value of the liability component of the convertible debenture was initially measured at $11.2 million. During 2018, the company estimated and recorded $1.5 million in interest expense (2017: $1.4 million) and paid $1.0 million (2017: $1.0 million).

We are also required to estimate the fair value of the embedded derivative liability related to the convertible debenture at initial recognition, and at the end of each reporting period. We use the residual value method to allocate the fair value of the convertible debenture between the liability component and the derivative liability. Under this method, the value of the derivative liability was determined to be $3.3 million at inception. 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. The value varies with different variables of certain subjective assumptions.

Inputs into the Black-Scholes Option Pricing Model to determine the fair value of the conversion option:

	December 31, 2018		December 31, 2017	
Share price	$	4.97	$	6.70
Exercise price	$	8.25	$	8.25
Option life		4.78 years		5.79 years
Volatility		37%		40%
Risk-free interest rate		1.88%		1.90%
Dividend yield		5.03%		3.73%

Income Taxes

We compute income taxes using the liability method, under which deferred income taxes are provided for the temporary differences between the financial reporting bases and the tax bases of our assets and liabilities. Deferred tax assets and liabilities are measured using the enacted and substantively enacted income tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Deferred tax assets also reflect estimates of the recoverability of non-capital loss carry forwards. We have recognized the benefit of loss carry forwards to the extent that it is probable that taxable income will be available in the future against which our non-capital loss carry forwards can be utilized. As at December 31, 2018, Swiss Water and its subsidiaries had combined non-capital tax loss carry forwards totaling $0.6 million, which can be used to reduce income taxes payable in future years.

The financial reporting bases of our assets reflect the useful lives of depreciable assets, as well as the carrying amounts of assets with indefinite useful lives. Accordingly, management estimates that impact the carrying amounts of depreciable and non-depreciable assets also have an impact on deferred income tax assets and liabilities.

Leases

The preparation of consolidated financial statements requires that the Company's management make assumptions and estimates on the classification of operating and finance leases. When assessing the classification of a lease agreement, certain estimates and assumptions need to be made and applied, which include, but are not limited to, the determination of the expected lease term and minimum lease payments, the assessment of the likelihood of exercising options, and estimation of the fair value of the lease property at lease inception.

CHANGES IN ACCOUNTING STANDARDS

The following standards became effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

- *IFRS 15: Revenue from Contracts with Customers:* replaces IAS 11, IAS 18, IFRIC 13, IFRIC 15, IFRIC 18 and SIC-31. IFRS 15 establishes principles to address the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The core principle of IFRS 15 is that revenue related to the transfer of promised goods or services should be recognized when the control of the goods or services passes to customers. Swiss Water has evaluated the impact of applying IFRS 15, analyzing its decaffeination services, decaffeinated coffee sales and distribution agreements. We concluded there is no material change in the timing of revenue recognized under the new standard as the point of transfer of risk and reward for goods and services and transfer of control occurs at the same time. Accordingly, we applied IFRS 15 retrospectively with no impact of transitioning to IFRS 15 on retained earnings as at January 1, 2018. In addition, IFRS 15 requires entities to apportion revenue earned from contracts to distinct performance obligations on a relative standalone selling price basis. The impact of this change on the amount of revenue recognized in a year is insignificant. IFRS 15 contains additional presentation and disclosure requirements which are more detailed than the current standards. It is effective for annual periods beginning on or after January 1, 2018.

We have adopted these amended standards and interpretations, and we assessed that there was no material impact on our consolidated financial statements. Additional disclosures have been included in Swiss Water's condensed consolidated interim financial statements for the period ended December 31, 2018.

A number of new standards are effective for annual periods beginning on or after January 1, 2019. The Company has not yet adopted any of these new and amended standards or interpretations. Of those standards that are not yet effective, IFRS 16 Leases is expected to have a material impact on the Company's financial statements in the period of initial application.

IFRS 16: Leases: The Company is required to adopt IFRS 16 from January 1, 2019. The Company has assessed the estimated impact that the initial application of IFRS 16 will have on its consolidated financial statements as described below. The actual impacts of adopting the standard on January 1, 2019 may change because the Company has not finalized the testing and assessment of controls over its system, and because the new accounting policy is subject to change until the Company presents its first financial statements that include the date of initial application.

IFRS 16 introduces a single, on-balance sheet accounting model for lessees that is similar to the current finance lease accounting, with limited exceptions for short-term leases or leases of low value assets. Lessees recognizes a right-of-use asset representing its rights to use the underlying asset and a lease liability representing its obligation to make lease payments.

The Company expects to recognize new right-of-use assets of approximately $19.0 million and lease liabilities of approximately $19.0 million for its operating leases of office and warehouse facilities. The Company intends to provide additional disclosure for these leases as required under IFRS 16.

The nature of expenses related to those leases will now change because the Company will recognize a depreciation charge for right-of-use assets and interest expense on lease liabilities. Previously, the Company recognized operating lease expense on a straight-line basis over the term of the lease. In addition, the Company will include the payments due under the lease in its lease liability.

A lessee can choose to apply IFRS 16 using either a full retrospective or a modified retrospective approach. The Company plans to apply IFRS 16 as at January 1, 2019 and intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. Right-of-use assets for property leases will be measured on transition as if the new rules

had always been applied. All other right-of-use assets will be measured at the amount of the lease liability on adoption (adjusted for any prepaid or accrued lease expenses).

IFRS 16 replaces existing leases guidance, including IAS 17, Leases, IFRIC 4: Determining whether an Arrangement contains a Lease, SIC-15: Operating Leases – Incentives and SIC-27: Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The following amended standards and interpretations are not expected to have a significant impact on the Company's consolidated financial statements:

Annual Improvements to IFRS Standards 2015–2017 Cycle: IFRS 3 Business Combinations; IFRS 9: Financial Instruments: prepayment features with negative compensation; IFRS 11: Joint arrangement; IAS 12: Income taxes: amendments related to recognition of current and deferred tax related to dividends; IAS 19: Employee Benefits: amendments to plan amendment, curtailment or settlement; IAS 23: Borrowing costs: amendments related to recognition of borrowing costs eligible for capitalization; IFRIC 23: Uncertainty over Income Tax Treatments: clarifies the application of recognition and measurement required per IAS 12: Income taxes, where there is uncertainty over income taxes; IFRS 10: Consolidated Financial Statements and IAS 28: Investments in Associates and Joint Ventures.

HEDGE ACCOUNTING

We adopted the hedge accounting provisions of IFRS 9 on January 1, 2016 in order to reduce volatility in our financial results, by better matching our accounting practices to our hedging practices. We did ***not*** change our risk management strategies with the adoption of hedge accounting. The economic impact of our hedges is unchanged from before January 1, 2016, even though the accounting for these derivative instruments has changed.

We enter into three types of hedges:

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

Each type of hedge is discussed below.

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 collected 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 reclassed 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 changing margin 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.

The adoption of 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); 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 December 31, 2018, we had futures contracts to buy 4.5 million lbs of green coffee with a notional value of US$4.7 million, and contracts to sell 4.7 million lbs of green coffee with a notional value of US$4.7 million. The furthest contract matures in in December 2019 (December 31, 2017: buy 2.2 million lbs of green coffee with a notional value of US$2.7 million, and contracts to sell 4.5 million lbs of green coffee with a notional value of US$5.5 million).

Foreign Currency Risk

We realize a significant portion of our sales in US dollars, and 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.

At December 31, 2018, we had forward currency contracts to buy US$6.6 million and sell US$65.0 million (2017: buy US$7.2 million and sell US$46.2 million) from January 2019 through to April 2023 at various Canadian exchange rates ranging from $1.2147 to $1.3820.

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 December 31, 2018, 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 December 31, 2018, Swiss Water’s ICFR was effective.

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 December 31, 2018, 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, 2018 and ended on December 31, 2018 that have materially affected, or are reasonably likely to materially affect, Swiss Water’s ICFR.

SUBSEQUENT EVENTS

On January 15, 2019, the Company paid an eligible dividend in the amount of $0.6 million ($0.0625 per share) to shareholders of record on December 31, 2018.

On January 22, 2019, the Company incorporated a subsidiary in France, Swiss Water Decaffeinated Coffee Europe SARL.

In February 2019, the Company granted 98,000 RSUs pursuant to the Restricted Share Unit Plan.

On March 11, 2019, the Company declared an eligible dividend of $0.0625 per share, to be paid on April 15, 2019 to shareholders of record on March 29, 2019.

Subsequent to year end, Seaforth entered into an agreement to lease a warehouse facility in British Columbia. The term of the lease is eight years and three months starting April 1, 2019. Minimum payments over the term of the lease with renewal options are $9.7 million.