

May 10, 2012

Dear clients and colleagues,

“Housing prices are too high. Chinese demand for resources is creating a two-speed economy. Infrastructure is crumbling. High taxes leave the nation uncompetitive. Education requires an overhaul.”

No, this is not Canada; rather, it is from the Australia Herald Sun’s April 26th edition.

For those who have read our past comments on Australia, there are many parallels between the two countries.

We spent the last two weeks in Australia, visiting companies, doing site visits and attending the Macquarie Australian equities conference. This year’s conference was the largest ever for Macquarie, bringing over 100 companies and 500 investors. We had the opportunity to meet over 30 different companies during our stay.

The tone from the conference was very optimistic. Following a record 2011 for resource infrastructure spending, 2012 should establish a new record. BHP Billiton, the largest metals company in the world, has A\$120 billion of capital expenditures planned for the next five to seven years. Oilfield developments in Western Australia and the Timor Sea are expected to exceed \$200 billion in the next seven years.

This obviously has benefited Australia’s economy. Federal government tax revenues from the resource sector have gone from A\$5 billion in 2005 to A\$35 billion in 2012. Investment spending on resource projects will be 9% of GDP in 2012.

Yet, outside the booming resource sector, Australia’s economy is struggling to grow. Households, many with high mortgage debt, continue to de-lever and save. The savings rate is now above 10%. As a result of the slow growth, the Australian Central Bank (RBA) reduced rate by a greater than expected 50 bps early May hoping to restart growth.

The RBA took comfort in relatively low inflation numbers in April, less than 3% (the lowest in years). Looking at the details, however, shows a very different picture. Non-tradable goods inflation was above 5%. For example, electricity prices were up 14% and daycare was up 9%. What went down? Imports, for one thing, helped by a strong dollar and fruits, for another, thanks to good weather. The RBA has followed other central banks around the world in only giving lip service to an inflation mandate in pursuit of growth. A sure recipe for future inflation.

Looking at the housing market, Australia’s real estate market has been one of the top performing in the last decade and is now one of the most expensive globally. Limited new supply partly explains the rise. Nonetheless, the market exhibits many signs of a bubble. Home ownership is one of the highest in the world at 75%, compared to the US which peaked at 69% in 2006. Many homeowners are struggling to make home

This report is provided solely for informational purposes and nothing in this document constitutes an offer or a solicitation of an offer to purchase any security. This report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient and does not constitute a representation that any investment strategy is suitable or appropriate to a recipient’s individual circumstances. Global Alpha Capital Management Ltd. (Global Alpha) in no case directly or implicitly guarantees the future value of securities mentioned in this document. The opinions expressed herein are based on Global Alpha’s analysis as at the date of this report, and any opinions, projections or estimates may be changed without notice. Global Alpha, its affiliates, directors, officers and employees may buy, sell or hold a position in securities of a company(ies) mentioned herein. The particulars contained herein were obtained from sources, which Global believes to be reliable but Global Alpha makes no representation or warranty as to the completeness or accuracy of the information contained herein and accepts no responsibility or liability for loss or damage arising from the receipt or use of this document or its contents.

Performance figures are stated in Canadian dollars and are net of trading costs and gross of operating expenses and management fees. Further information about the Global Small Cap Composite is available by contacting the firm. Global Alpha Capital Management Ltd. (Global Alpha) claims compliance with the Global Investment Performance Standards (GIPS[®]) and has prepared and presented this report in compliance with the GIPS. Global Alpha has not been independently verified.

payments; banks have been increasing reserves for a few quarters now. Over 15% of households are late in their utility payments. Another sign of a bubble is the rental market. 1.7 million Australians are landlords, i.e. they own to rent. 66% are losing money, hoping to gain from price appreciation. In 2011, they lost A\$4.8 billion renting.

Australia's equity market is very developed. There are over 1800 listed companies with a market cap of less than A\$1 Billion on the Australia stock exchange. Australia reformed its retirement system in the early 90's, forcing every Australian and their employer to set aside money for retirement. This is now set at 9% of earnings, soon going to 12%. As a result, the Superannuation system has over A\$1.4 trillion in assets today. For many reasons, these funds have a higher allocation to equities: A less developed bond market, high dividend yields, favorable taxation, etc. That in turn has encouraged many smaller companies to list their shares on the exchange to raise money for growth.

Despite challenges, Australia has many opportunities ahead and many companies will benefit.

We have a few Australian companies in the portfolio such as Panoramic Resources and Slater Gordon. We came away from our trip with many ideas, some old, some new. It is likely that a few will be added to the portfolio in the coming months.

Have a nice weekend.

The Global Alpha team

This report is provided solely for informational purposes and nothing in this document constitutes an offer or a solicitation of an offer to purchase any security. This report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient and does not constitute a representation that any investment strategy is suitable or appropriate to a recipient's individual circumstances. Global Alpha Capital Management Ltd. (Global Alpha) in no case directly or implicitly guarantees the future value of securities mentioned in this document. The opinions expressed herein are based on Global Alpha's analysis as at the date of this report, and any opinions, projections or estimates may be changed without notice. Global Alpha, its affiliates, directors, officers and employees may buy, sell or hold a position in securities of a company(ies) mentioned herein. The particulars contained herein were obtained from sources, which Global believes to be reliable but Global Alpha makes no representation or warranty as to the completeness or accuracy of the information contained herein and accepts no responsibility or liability for loss or damage arising from the receipt or use of this document or its contents.

Performance figures are stated in Canadian dollars and are net of trading costs and gross of operating expenses and management fees. Further information about the Global Small Cap Composite is available by contacting the firm. Global Alpha Capital Management Ltd. (Global Alpha) claims compliance with the Global Investment Performance Standards (GIPS[®]) and has prepared and presented this report in compliance with the GIPS. Global Alpha has not been independently verified.