

June 28, 2019

Dear clients and colleagues,

Early June is very busy as companies plan their investor meetings before the summer slowdown. During this period, we meet a lot of companies in all regions of our investment universe. Notably, our Australia trip allowed us to meet some of our present holdings such as Orora Ltd. and Costa group.

Orora Ltd. (ORA) is a leading global packaging company providing fiber, aluminum and glass packaging and distribution solutions to the consumer end markets. The company has 43 manufacturing plants and 91 distribution sites in 7 countries.

Costa Group (CGC) is Australia's largest fresh fruit and vegetable grower, packer and marketer. It operates in three segments:

- Produce (84%): berries, mushrooms, greenhouse tomatoes, citrus and avocados.
- International (11%): licensing of proprietary berry varieties and berry farms in Morocco and China.
- Farms & Logistics (5%): wholesale/marketing and logistics operations within Australia.

Over the past decades, Australia's economy, which is the same size as Spain's, has grown at a similar rate as Canada's. This is expected as both countries have important natural resource components to their economies. In 2017, Sydney, Melbourne, Adelaide, Brisbane and Perth all ranked among the top 30 most expensive housing markets globally. However, house prices have fallen through 2018-19, with some urban areas down 20%. The decline in housing prices was brought about by tougher rules imposed by the Australian Prudential Regulation Authority, a slowdown in immigration and weaker capital inflows from China. Although there are signs of stabilization, the downside risk remains palpable in the financial sector as 50% of bank credit is linked to residential property. The house-price-to-income ratio continues to be a concern. The ratio for Australia and New Zealand is 6 versus 3.5 for the United States.

On the positive side, Australia's unemployment rate remains low at 5.2%, the decline in mining investment has bottomed out and the construction of public infrastructure continues to contribute to growth. This should help to offset the sharp slowdown in real estate investment and housing construction activity.

China imports \$62 billion of iron ore from Australia (82% of production). Iron ore and coal are Australia's key exports, together worth more than \$120 billion, or 30% of total exports. They are followed by education services, which brings in \$32.4 billion (or 8% of the nation's total exports) from international students. With China slowing and the current trade wars, Australia's exposure to China should be closely monitored.

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In 2018, China was by far Australia's largest trading partner, contributing \$194.6 billion worth to imports and exports. This was more than the combined value of trade with Japan and the United States (\$147.8 billion). One weakness: Australia has the same quantity of technology exports as Norway, which is five times less populated. Also, Australia is not known for a robust electronic equipment manufacturing sector.

Nevertheless, there are investment themes that will positively affect all global regions and many of the sectors we invest in, and this includes companies in Australia and in sectors such as consumer discretionary. As an example, we are nearing an inflection point in digitalization. The cost of implementation represents a much lower investment risk than it did five years ago. Firms that properly digitalized their operations will reap the benefits on margins and revenues. Both Orora and Costa Group have important inventory and operational management systems that will benefit greatly from real time data and analytics at the their fingertips.

We were further able to monitor the digitalization theme at the 2019 William Blair Investor Conference in Chicago where many of the leading digital technology providers showcased their capabilities. Corporations are hiring digital consultants at a frantic pace.

For companies that sell goods, the Internet of Things is a requirement for proper digitalization. We saw examples in such industries as clothing. The entire textile industry, from production to sale, will be overhauled with controls, and data points such as RFID (radio-frequency identification) will follow each piece of clothing along its journey. Further, connected digital garment printers will reduce the design-to-store cycle from months to days. Storefronts will be showcases with minimal inventory on hand.

We met with Kornit Digital (KRNT), a Global Alpha holding. Kornit Digital develops, manufactures and markets industrial digital printing technologies for the garment, apparel and textile industries. Kornit enables web-to-print, on-demand and mass customization concepts. Kornit is launching the Konnect System, a cloud-based solution to monitor equipment with proactive maintenance, direct ink monitoring and automatic re-ordering. Clients will be identified and profiled in a data acquisition strategy (for example, if you order a Manchester United shirt, you will be tagged as a superfan). Companies will have an in-depth understanding of your design choices and will attempt to predict your future buying patterns.

Have a good weekend.

The Global Alpha Team