COMMENTARY

April 3, 2020

Dear Clients and Colleagues:

Over the past few weeks, the rapid changes to our personal and professional lives have taken many by surprise. Two months ago, many people were shocked by China's moves to shut down the Hubei province and subsequently the whole country. Today, about 2.6 billion people worldwide are under some form of lockdown, which is approximately a third of the world's population.

While many countries are still in the toughest phase of combating COVID-19, China is starting to get back to work. Shopping malls, restaurants and offices are already open. Operations have resumed at approximately 98% of the major industrial companies, and nearly 90% of their employees are back to work. However, the government is still cautious about opening densely populated locations such as movie theatres, sports venues and concert facilities. Primary and secondary schools in most provinces and cities are still closed and a timeframe to reopen has not been given. Only in a few less affected provinces, including Qinghai, Guizhou and Xinjiang, are students back in classrooms and the schools are required to test students' temperatures and watch for symptoms. Universities remain closed and classes are taught online. China's national college entrance examination, also known as Gaokao, has been postponed by one month until July 7 and 8. More than 10.7 million students are expected to sit for the two-day exam.

There has been debate on whether there will be a sharp V-shape recovery. Official data showed China's manufacturing activity returned to growth in March. The Purchasing Managers Index (PMI) rose to 52, above analysts' expectations of 45. However, the National Bureau of Statistics (NBS) attributed the surprise rebound in PMI to its record low base in February of 35.7, and cautioned that the readings do not signal a stabilization in economic activity.

We believe China still faces a few major risks at the moment:

Slumping overseas demand. China's exports fell by 17.2% in January and February. Considering that major Western countries began lockdown measures around the beginning of March, this number is expected to worsen. Ting Lu, Chief China Economist at Nomura, estimates that exports will contract by 25% in March compared to the same time last year, and then shrink 30% to 45% in the second quarter. This is estimated to cause 18 million job losses out of the 60 million workers employed in the export sector.

Second wave of COVID-19. While there has been a decrease in the number of new cases originating within China, the number of imported cases has increased. As of March 31, the National Health

Commission (NHC) reported the number of confirmed cases in China has fallen to 2,004, but the total number of imported confirmed infections has increased to 806. This number is still growing by 40-70 cases per day. As a result, China temporarily closed its borders to all foreigners as of March 28 and implemented a much stricter 14-day quarantine for all Chinese citizens returning from overseas.

Slow domestic consumption recovery. While travel restrictions have been lifted in most parts of China, they will remain in place for Wuhan until April 8. The government is encouraging consumers to go out; however, people are still wearing masks, avoiding close contact with each other in public and at work and many people are continuing to work from home. Restaurants are open but have not received many customers, so to help increase consumption, local governments have issued pre-paid vouchers in certain areas. It may take some time for the public to return to their normal activities.

To help the enterprises that are most affected by the lockdowns, China has rolled out stimulus measures including injecting liquidity, providing special-purpose loans and cutting rates, taxes, fees, utility charges and high-way tolls. On March 27, the Chinese Communist Party's Politburo, China's top decision-making body, introduced several new measures, including raising the fiscal deficit ratio and issuing special treasury bonds. While the details have yet to be revealed, the size of the special treasury bond could be in a range of 2 to 4 trillion renminbi (equivalent to US$280 billion to US$560 billion), which is about 2%-4% of GDP.

At Global Alpha, we have been actively communicating with the companies we hold in our portfolios. Many of them have businesses or productions in China, and we would like to share the following update regarding some of our portfolio companies.

L'Occitane is a global manufacturer and retailer of natural cosmetics and well-being products; it has over 3,400 retail locations in 90 countries. In China, L'Occitane has about 200 retail stores, and almost all are open for business at this moment. In late January and February, the company's retail sales fell, but online sales growth was in the mid- to high-single digits. As of March, the drop in retail sales is narrowing, showing that China is in a gradual recovery.

Kerry Logistics is a leading third-party logistics services provider in Asia. This week, the company reported solid 2019 results, with revenue up 8% and core operating profit up 17%. Kerry Logistics has a strong presence in domestic Asian markets, including Mainland China, Hong Kong, Taiwan and Thailand. It is well positioned to accommodate the shift to a more domestic-based supply chain for daily necessities.

Vitasoy makes plant-based beverages and foods and the majority of its revenue comes from Mainland China and Hong Kong. The pandemic had a very negative impact on the business, disrupting both its plant in Wuhan and its supply chain in China. Many small stores, which are important sales channels for Vitasoy, were closed during the lockdown. However, the Wuhan plant has resumed operations, and sales channels have recovered to about 70% of their pre-crisis levels.

Raffles Medical Group is a Singapore-based integrated healthcare group. In China it operates a hospital in Chongqing, which is up and running and expected to breakeven on its earnings before interest, taxes, depreciation, and amortization (EBITDA) in 2021. The opening of a new hospital in Shanghai will be delayed by four to six months due to COVID-19.

Gentherm is a leading manufacturer of climate control seat systems. China accounts for about 10% of the company's revenue. While 90% of employees have returned to work at the company's plants in China, it is starting to see negative impacts in Europe and North America, where many original equipment manufacturers (OEMs) are halting production. However, with a solid balance sheet, Gentherm will be able to weather the storm.

Palfinger is an Austria-based company that provides hydraulic lifting solutions. Its products are distributed in more than 130 countries all over the world. Palfinger and China-based Sany Mobile Cranes established a 50-50 joint venture in China, Sany Palfinger, which makes truck-mounted cranes and aerial work platforms for Chinese and international markets. The joint venture holds the top market share in terms of value in China.

De'Longhi is an Italian household appliance manufacturer and distributor. Although the Italian plant temporarily closed on March 23, the company expects the impact to be minor as it had already increased production in Italy to prepare for the shutdown. Production at the company's Romanian plant has not been interrupted and its plant in China was expected to reach 100% capacity by the end of March.

Nihon Kohden is a Japanese medical electronic equipment maker with a global footprint. Its in-house patient monitors and ventilators are currently in high demand in Europe and the United States. They plan to prioritize and at least double their production capacity for these two products within a few months. Apart from the main plant in Japan, they also have a production facility in Shanghai, which makes lower-end patient monitors and automated external defibrillators. This plant accounts for 10% of total production and is in full operation.

Asics is a global manufacturer of sports shoes, sportswear and sports equipment. Asics has about 140 stores in China, of which more than 85% have reopened. During the lockdown period, wholesale business was weak, but e-commerce business was trending up. Online channels account for about 25% of sales in China.

LINTEC is a Japanese maker of adhesive products, including adhesive films and paper used for labels for household goods and surface production tapes for semiconductor wafers. It has a plant in Suzhou, China that mainly supports the local businesses of its Japanese customers. Today, demand from clients is slowly resuming, and the plant is open and running at about 70% - 80% capacity.

Mabuchi Motor Company produces small- and mid-sized electric motors used in automobiles (e.g. motors for power windows and power seats) as well as in consumer and industrial products. Production in China, which accounts for 50% of the company's total volume, has resumed and is already back to more than 80% of its pre-crisis output. The demand from car manufacturers remains low, but the company has an extremely strong net cash balance, therefore we see very little risk in the business.

Have a great weekend.

The Global Alpha team