

December 18, 2020

Dear Clients and Colleagues:

On November 10, 2020, the European Commission adopted the European Union's (EU) Circular Economy Action Plan. A circular economy is a way of doing business that extracts as much value as possible from resources by recycling, repairing, reusing, repurposing, or refurbishing products and materials, thereby eliminating waste and greenhouse gas emissions at the design stage.

Businesses can use circular designs to save money or open up new market opportunities, from turning pulp and paper mill waste into renewable bioproducts, to launching product buy-back programs that enhance customer interaction and recover usable materials. A circular economy is based on the principles of designing out waste and pollution, while keeping products and materials in a closed loop system. If material reaches a landfill and then transforms, it is a semi-closed loop.

A closed loop product naturally reduces the need for resources. In 2019, over 92 billion tonnes of materials were extracted and processed, contributing to about half of global CO2 emissions. Today, 8.6% of the world is circular. According to the World Economic Forum, closed-loop recycling reduces energy consumption by up to 75%. Large market opportunities are still untapped and ready to be addressed, unlocking an estimated \$4.5 trillion in economic growth. Here are four measures that drive the circular economy:

Regulations

The smaller the gap between the new product cost and recycled product cost, the easier it will be for regulators to push over the tipping point without drastic moves in the consumer price tag. This is done by either regulating recycled content requirements or de-balancing a pricing equation where intervention is possible. An example would be landfill waste disposal in the United Kingdom (UK) and Australia; landfill prices have been set high enough for recycling and waste to energy projects to become profitable. This is exemplified by one of our portfolio companies, Biffa (BIFF:LN).

Biffa is a leading integrated waste management company, providing collection, recycling, treatment, disposal and energy generation services to businesses and households across the UK. Biffa has over 195 sites, covering 95% of postal codes and employing 7,900 people. With 80.4 MW of installed energy generation capacity, Biffa is a significant provider of renewable energy.

Following the lead of the European circular economy plan, regulations that promote the creation of closed loop markets will intensify with time and certainly accelerate under the new US administration.

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The European action plan's first effort is to set recycling obligations on car batteries. Manufacturers will need to ensure the circularity. That is only the beginning of the plan, and it could extend to other items such as bumpers, radiators, and steering wheels, to name a few. The automotive industry is a good start but this also applies to a multitude of discretionary expenditures. Business models will also change with increased rental and maintenance. The "as a service" model in durable goods will grow exponentially.

Technology

Technology also eases the cost gap between old and new. Through technological advances such as sensors, robotics or tracking, we have become logistical sorting masterminds. Remember, Maytag will have to track every year and every model of their washing machines, then either fix or sell for parts.

Some of the technology enablement will come from metallurgy and chemistry. Let's discuss one of the most important one, plastics. Made from synthetic or semi-synthetic materials, plastics come in all prices and forms, relative to strength, durability and other performance measures. As you can probably guess, chemically upgrading ultraviolet degraded plastic from the ocean to a high performance plastic was up until recently, an expensive proposition. As technology closes the cost gap on making inexpensive, good recycled plastic, recycled plastics can address much larger and profitable markets other than low margin park benches and backyard decks.

Inflation

Unparalleled stimulus and low interest rates are certainly setting the stage for an inflationary environment in the event of global GDP recovery. High commodity prices lead to a search for substitutes in most price-sensitive markets. Thus, an environmentally friendly substitute becomes harder to displace.

Employment availability

We previously discussed the logistical complexity of closed loops. Technology is not enough for the sorting, cleaning, and buffing. Most product-centric recycling operations require an important labour force. Companies that will flourish will require the knowledge to operate globally. Global Alpha is exposed to environmental, logistical and labour complexity through Motorcar Parts of America (MPAA:US).

In terms of circular economy and closed loops, Motorcar Parts of America (MPA) is a true gem. MPA is a manufacturer and remanufacturer of automotive aftermarket parts (alternators, starters, wheel hub

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assembly products, brake master cylinders). MPA is a global leader in the remanufacturing of auto parts, with 4,700+ employees in 13 locations, across seven countries and two continents. MPA's product offerings include thousands of individual products for nearly every vehicle on- and off-highway. We believe that MPA would be a targeted acquisition in the event of stiffer environmental regulations, if only for a major original equipment manufacturer (OEM) to understand the complexity of remanufacturing.

New era for shareholders?

Consumer goods company and plastic polluter, Unilever, has announced plans to let shareholders vote on its climate transition plans. Unilever, whose brands range from Dove soap to Hellmann's mayonnaise, will share its climate transition action plan with investors in the first quarter of 2021, before a vote at its annual meeting on May 5, 2021.

The company, listed on London's FTSE 100 index, said it was "the first time a major global company has voluntarily committed to put its climate transition plans before a shareholder vote". Unilever has already pledged to completely eliminate carbon dioxide emissions from its own operations by 2030. Unilever products will produce net zero emissions by 2039.

This is important to Global Alpha. We have seen ESG become more and more prevalent in proxy voting activity. Up until now, this has mostly concerned matters related to governance and social responsibilities. With the Unilever case, we can deepen our discussions with our holdings regarding environmental issues and their plans to remediate them.

Additionally, Unilever plastic bottles are abundant in oceans and on beaches. Many soaps and chemicals cannot use biodegradable bottles. As the company develops better recyclable plastics, a trend towards a circular economy will emerge, helping to preserve our oceans and beaches so they can be enjoyed for years to come.

As this is our last weekly of the year, we would also like to offer our best wishes. We hope the year ahead brings health to all, in addition to pandemic relief. As highlighted in recent commentaries, we are excited by the incredible investment opportunities found in small caps in 2021 and beyond.

Happy holidays!

The Global Alpha team

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