

January 28, 2013

Dear clients and colleagues,

Although the northern part of Europe sits on stronger foundations than its southern counterparts, the 2013 macroeconomic situation for the Eurozone shouldn't differ much from 2012. Growth outlook for the region is being revised down while unemployment rates are trending up. Now, it looks like France's public deficits target of 3% of its GDP is unachievable for this year.

Most of the fiscal measures announced by president Hollande were concentrated on the revenue side, like the proposal to tax the high earners at 75%. In a context of economic slowdown and the rise of French expats, corporate and income tax should fall short of expectations. We feel like too little efforts are made to address the huge public spending size which represents 55% of its economy. A mere one third of the €35 Billion needed to respect the 3% deficit is expected to come from public spending cuts.

We believe that structural reforms are seriously needed in France. Within the span of a few years, France's market share in the euro zone has declined from 18% to 12%. Led by a lack of competitiveness and a rigid labour market, its costs of production have soared drastically. At 34 euros the hour, France's labour costs cannot compete with Germany (30 euros), Italy (26 euros) or Spain (20 euros).

However, the new labor reform negotiated this month shows the government's willingness to take on major changes. This historic pact stipulates that businesses will be allowed to adjust wages and working hours in periods of economic difficulties. Germany's economic success was in part due to similar labour law reform adopted in 2003.

We had the privilege to meet with 60 European companies in January. Here are some of our observations:

- Visibility in the Eurozone area is very low; consumers in the Southern part are still under pressure
- U.S and Latin America should perform better than expected. Companies are allocating more resources to those markets
- Companies remain very selective with their capital expenditure, cash flow generation is the main focus
- Businesses have maintained their R&D spending overtime. That might explain why Thomson Reuter has ranked France number 3 in its Top 100 Global Innovators study
- Balance sheets are healthy and stock valuations are still undemanding compared to their U.S. peers

Although the macroeconomic picture looks disturbing, the French government seems determined to launch a series of reforms that would rejuvenate its industries and help regain some competitiveness vis-à-vis its European neighbors.

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.

We recently reduced our exposure in France but portfolios remain invested in France. Our holdings are world-class companies that are financially healthy. These companies have grown faster than their peers and have positioned themselves to benefit from International markets such as; Latin America, Asia and the U.S. Reforms will certainly take some time to reach their full impact but we believe that France's positioning in the long term will be reinforced.

Despite these uncertainties, our approach has delivered good performance overtime. Thanks to a sound stock selection, our French holdings in our international fund have achieved a 43% return in 2012, outperforming their local benchmark by 15%.

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.