

January 18, 2019

Dear clients and colleagues,

As we begin 2019, Global Alpha is energized and eager to create value for our clients. Although global growth may not be as synchronized as it was in 2017 or early 2018, the business prospects of our portfolio companies continue to keep us optimistic. When faced with a slower economy, corporations must concentrate their efforts on higher-growth markets, productivity and technology, and themes become an even more pertinent analysis tool.

As we look for above-average growth, themes certainly allow us to identify addressable markets (TAM) that are growing faster than global GDPs. When a company's TAM grows faster than global GDPs this usually leads to good top-line growth scenarios. How do we identify these fast-growing markets? It can be demographics and other themes, but in addition, it can also come down to two simple measures: cost and timing. The cost/price of a novel technology or service needs to fall low enough to reach a tipping point where market gains flow at a rapid pace. This is right out of the Elon Musk textbook with his low-priced electric cars and the massive losses at Tesla being a self-created timing. Buying market share is a definite red flag at Global Alpha.

The result of a cost- or, to an extent, productivity-driven economy is certainly measured in inflationary terms. Today we remain below the 100-year inflation growth average even after completing the largest quantitative easing exercise in history. As well, if we take out the oil and gas meltdown of 2014, total factor productivity is solidly in positive territory, reaching 2.17% in Q3/2018.

In the past, Global Alpha has benefitted when correctly assessing a cost and timing scenario. Back in early 2016, we invested in SolarEdge, a solar inverter manufacturer, based on our belief that solar energy capex and operating costs had reached lower levels than most other energy-production methods in select regions. Since then, the company has experienced excessive revenue growth. Another example of a changing market is digital printing (highlighted in a recent weekly commentary), an industry where large markets are shifting on cost reductions. The list of shifting markets continues to robotics and others.

Financials is also an important industry affected by accelerated change. The transformation of financial services is certainly upon us, and lowering costs will allow new entrants access to old markets. As an example, the cost of Banking as a service (BaaS) has dropped low enough that large corporations, such as Uber and Walmart, have decided to offer bank accounts to their employees/partners and compete with mainstream banks. This represents a tipping point in banking.

Here is another example in payments. Visa and Mastercard dominate a \$40 billion commercial transaction industry. Visa has \$21 billion in revenues and \$14 billion in EBITDA. The company

processed \$11 trillion in 182 billion transactions in 2018, and its growth rates are above 10%, which is even more impressive.

At a price of \$0.11 per transaction, are consumers complaining about the cost of using a credit card? Not really – that explains the margins. Visa’s cost per transaction is \$0.04, including \$0.016 in SGA (selling, general and administrative expenses). So what if technology allows costs to fall to \$0.01 per transaction? With a 400 billion transaction industry, that’s a \$4 billion TAM, and a tangible market opportunity in financial technology. There is also the \$0.024 of savings that will help to drive the change. This savings will be divided between Visa, Mastercard, other companies and hopefully the consumer. When does it start? Visa and Mastercard are already working with some fintechs towards this goal.

How do we gain exposure to such an opportunity without paying ridiculous valuations? Global Alpha owns ACI Worldwide®.

ACI Worldwide® (ACIW - \$28.14) powers electronic payments and bank transactions for more than 5,100 organizations around the world. It has more than 40 years of payments expertise and customers in over 80 countries, including:

- 18 of the top 20 banks worldwide
- Over 300 leading retailers globally
- Over 3,600 organizations utilize its electronic bill payment solutions
- Over 1,500 banks, financial intermediaries and merchants use its solutions to prevent fraud

Completing 150 billion transactions per year, ACIW is no technological slouch; the company is a global leader in processing transactions for the banking sector. According to ACIW, the price per transaction in the banking sector is now below \$0.01, the lowest in financial services industry segments (compared to intermediaries, corporates and merchants).

ACIW continues its steady growth while increasing its bookings. The company has \$1.07 billion in revenue and \$285 million in EBITDA. Already a banking sector leader, its goal is to leverage cloud and open source infrastructure to gain efficiencies that will allow it participate in all financial transaction markets including the merchant segment.

As you can see, it is possible to gain exposure to sizeable novel markets without negative cash flow risk.

Have a good weekend.

The Global Alpha team

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