

May 15, 2015

Dear clients and colleagues,

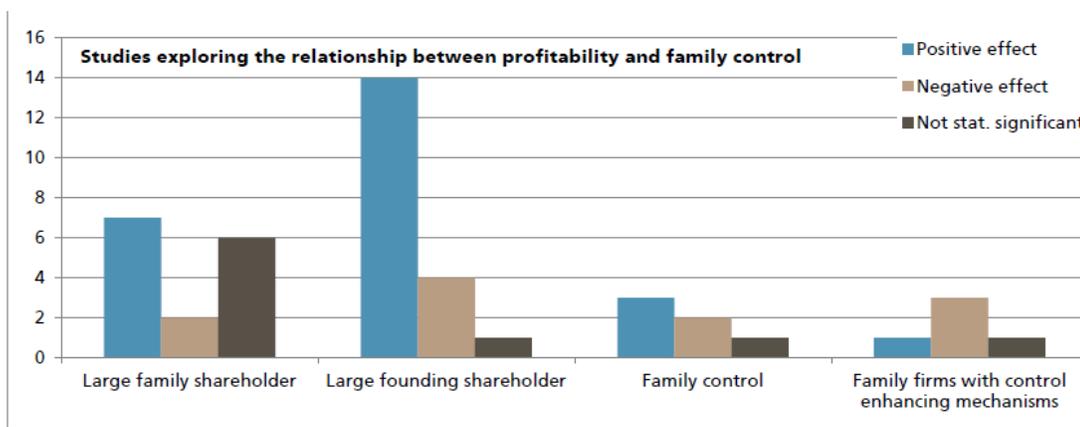
At Global Alpha, one of the key steps in our investment process is evaluating a company's management. We believe that companies with higher insider ownership (family or an insider with a substantial stake) will outperform their competitors over the long term.

This week, we shall focus on the importance of insider ownership and its impact on wealth creation.

What does academia say?

Academic researchers have found common characteristics among companies with insider ownership in terms of their attitude towards debt, risk-taking, and capital allocation. These characteristics include:

- High correlation between insider ownership and profitability
- Risk aversion due to lower debt levels
- A solid operation rationale behind diversification, rather than “empire building”
- Having a family as a large shareholder can be an effective governance set-up, whether the owner is sitting on the board or not



Source: EDHEC Business School – *Family firms and performance: where do we stand?* (September 2014)

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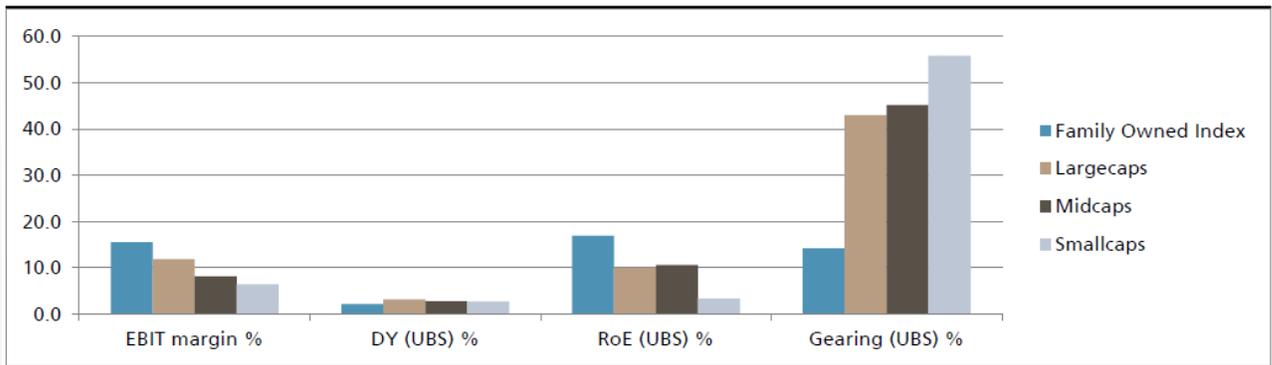
Performance figures are stated in Canadian dollars and are net of trading costs and gross of operating expenses and management fees. Further information about the Global Small Cap Composite is available by contacting the firm. Global Alpha Capital Management Ltd. (Global Alpha) claims compliance with 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.

What does the real world look like as compared to academic research?

The real world outcome is similar to that found by academics. Research by UBS found the following traits when it compared family-owned companies to the wider universe of large and midcap companies:

- EBIT margins were 30% higher than those of large caps (11.9%) and midcaps (8.2%)
- Lower dividend yields due to valuation premium
- Higher ROEs from effective governance and a disciplined attitude towards capital allocation
- 10%-plus annual earnings growing at a steady pace

Global: Fundamentals of family firms vs. large and midcaps – five-year average



Source: UBS

Is there regional bias in family ownership?

Due to corporate evolution, foreign small-caps are in an earlier stage of development as compared to their US counterparts. Europe and Asia dominate when it comes to family ownership, as opposed to the US.

Dividends, hidden Return on Investments

In most cases, the family depends on dividends for cash flows and prefers receiving a dividend to selling shares for profit – a common practice in the US. We benefit as investors in companies with higher insider ownership, as they are committed to returning money to investors.

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How does this impact the portfolio?

The average insider ownership in our Global Small Cap fund is approximately 10%, while it is much higher in our International portfolio.

We continue to find investment ideas where the top management teams have their skin in the game. Investing alongside executives who are fully invested in their business can be rewarding for them and their investors.

Have a great weekend.

The Global Alpha Team

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