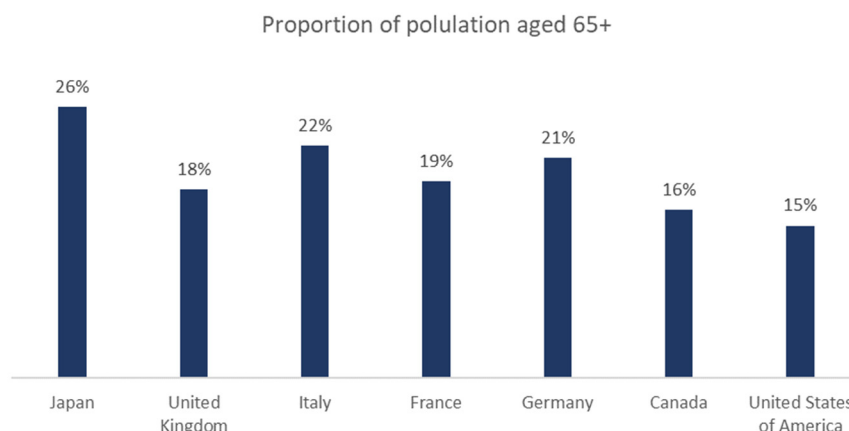


August 3, 2018

**Dear clients and colleagues,**

While the United States, which has welcomed close to 50 million immigrants up until the end of 2017, begins to restrict immigration and foreign worker visas, Japan, known for its resistance to immigration, has moved towards opening its doors to more foreign workers.

Famous for its sushi, anime and cameras, Japan is also often associated with the phrase “aging population”. Among the G7 countries, Japan has the highest proportion of people aged 65 or older. Seniors make up 26% of the Japanese population, 11% more than in the United States. This creates issues such as labour shortages. In its *June 2018 Tankan Summary, 177<sup>th</sup> Short-Term Economic Survey of Enterprises in Japan*, the Bank of Japan noted that Japanese employers are facing severe labour shortage issues. The ratio of companies claiming to have an insufficient, rather than excessive, labour force hasn’t been this high since 1992. As a result, the cost of labour has increased for many industries. Some less popular industries, such as farming, cannot find enough workers. This dampens economic development.



Data source: United Nations, Department of Economic and Social Affairs, Population Division (2017). World Population Prospects: The 2017 Revision

According to Reuters, there are currently 1.28 million foreign workers in Japan, or 1% of the population, double the 2008 amount of 486,000. To date, the government has only welcomed highly skilled workers, such as IT engineers, out of concern that unskilled workers may be a burden to, or cause issues for, society. However, in a recent move, Prime Minister Abe announced plans to attract an additional 500,000 foreign workers by 2025 via the creation of a new type of five-year work permit for unskilled workers. This new work permit will apply to the construction, agriculture, lodging, nursing and shipbuilding and related manufacturing industries.

With the 2020 Tokyo Olympics approaching and various other large infrastructure upgrade projects underway, including construction of the new Shinkansen railway, the construction industry is experiencing an intensifying labour crunch. According to Nikkei, the construction industry is expected to face a shortage of 780,000 to

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 Alpha 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.

930,000 workers by 2025. The government aims to accept 300,000 foreign construction workers through the new visa program. This will address the sector's labour shortage issue to some extent.

Due to the shortage of workers, another risk for construction companies is increasing labour costs. Based on a report by Nomura (*Public works: recent moves and policies*), the estimated unit labour cost for general construction workers has increased rapidly in recent years, reaching over 17,000 yen (\$152) per day. The unit labour cost for specialized workers, such as steel frame and slope protection workers, is even higher at above 22,000 yen (\$197) per day. The new worker permit policy is positive news for employers and hopefully will help to ease labour shortages.

Our portfolio is exposed to the Japanese construction industry through Sho-Bond Holdings Co., Ltd. We have held Sho-Bond for a few years and we speak with the management team every year. In May 2018, we had a conference call with the president for a business update, and it reconfirmed our confidence in the company.

Founded in 1958, Sho-Bond is Japan's largest specialist in reinforcing, repairing and maintaining heavily used bridges, tunnels and other concrete structures. It also manufactures in-house filler for concrete measures, resin sheets to prevent concrete collapse and materials used in installing dampers for earthquake resistance.

Seventy-five percent of the land in Japan is mountainous, so there is a need for long tunnels and bridges for roads and railways. According to the Road Bureau study, in 2016, 20% of the 730,000 bridges in Japan were aged 50 years or older, and that number will grow to 44% by 2026. In 2013, the Japanese government and municipalities began major infrastructure maintenance work following a tunnel collapse in Tokyo. As a specialist in the repair and reinforcement of concrete structures, Sho-Bond is involved in a large percentage of the bridge repair projects currently underway and will benefit from the fast-growing demand.

Apart from orders from national and local governments, in recent years an increasing portion (27% in 3Q FY2018) of Sho-Bond's revenue has come from expressway companies, which have larger scale, longer duration projects that have higher margins than government projects. According to Sho-Bond, expressway companies plan to spend approximately 4 trillion yen over the next 15 years to upgrade infrastructure.

Although there are still concerns that the influx of foreigners might break the social order, increase job competition and weaken traditions, Japan is in need of foreign workers to boost its economy. We are glad to see that both the Japanese government and people are becoming more willing to accept foreigners.

Have a great weekend.

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<sup>®</sup>) and has prepared and presented this report in compliance with the GIPS. Global Alpha has not been independently verified.