



November 4, 2011

Dear clients and colleagues,

One of the themes in the portfolio is healthcare. It is the 2nd largest part of the economy after consumption. In 2008, healthcare was 9% of GDP across OECD developed countries. In the United States, healthcare is 16% of the economy, France and Switzerland at 11% come next. With an aging population, developed economies are facing a big challenge due to increasing costs and limited budgets. Emerging markets like China and India on another hand are increasing spending on healthcare, currently less than half that of developed economies. It is a way to redistribute wealth and provide their citizens with adequate medical care and encourage them to spend more on consumption as opposed to saving for unforeseen medical costs.

There are tremendous opportunities for companies that are well positioned to address this big and growing market. Our approach at Global Alpha is not to invest in risky early stage biotech companies or large mature pharmaceutical companies. We are looking for companies that are established, growing and provide a cost-effective solution to the healthcare administration. In the last few weeks, our largest holding, Pharmaceutical Product Development Inc. (PPDI US), one of the largest Drug Contract Research Organization was taken private by Carlisle Group. Although the price paid represented a premium of 20%, we would have preferred to continue to own the company as its revenues and profit growth rates for the next 5 years were projected at over 20% per year. We can expect Carlisle to IPO the company again in 2 or 3 years at much higher valuation. To keep our exposure to the sector, we have added a company that we have known for at least 7-8 years Merit Medical Systems (MMSI US - \$13.20) www.merit.com

Business overview and history

Founded in 1987, Merit Medical Systems is a Utah USA headquartered company that employs 2,300 employees at 5 manufacturing facilities located in the US, Ireland, Netherlands and France. In addition, the company has regional offices in Denmark and China. The company develops, manufactures and distributes proprietary disposable medical devices used in interventional and diagnostic procedures, particularly in cardiology, radiology and endoscopy. Its primary products consist of inflation devices used in angioplasty and stent placement; diagnostic and therapeutic catheters used for various procedures in cardiology and radiology; diagnostic and hydrophilic products used to manage and monitor the administration of contrast media and other fluid solutions; thrombolytic catheters and fluid dispensing systems; and embolotherapeutic products for the treatment of uterine fibroids, hypervascularized tumors, and arteriovenous malformations.

The market

The target markets include cardiology, radiology, gastroenterology, pulmonology, vascular surgery, interventional nephrology, cardiothoracic surgery, pain management and thoracic surgery. Large and growing markets. Cardiovascular diseases continue to be a leading cause of death in the US.

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Competitive advantages and competition

The company's expertise is in process engineering and precision plastic injection molding. Its ability to combine and customize devices, kits and trays at the request of customers gives it an advantage over larger competitors. In addition, the company owns more than 200 US and international patents. Finally vertical integration from design to manufacturing and its direct sales force are an advantage.

The market is fragmented but a few large multinational such as J&J, CR Bard, Abbott, Boston Scientific dominate the mass applications.

Barriers to entry are high as the market is regulated by the FDA in the US and local regulators in other markets.

Growth strategy

The company's strategy main growth strategy is new product development and geographical expansion. In 2010, the company opened an office in China, and in 2011, Sales were up 77% to almost 6% of total sales. With new product approvals, China should continue to grow rapidly.

Management

Fred Lampropoulos the president and CEO founded the company in 1987 and own around 3%. Kent Stanger, the CFO and Treasurer is also a co-founder and own around 2%. Compensation for the management team is approximately 15% of their peer average.

Risks

The company does not have any product nor client representing more than 10% of sales. Risks however are related to rapidity of innovation and success in acquiring new products.

Market data

Market Cap US\$550M, P/E trailing, 16.8x, P/E (12/12) 14.9x, EV/EBITDA (12/12) 7.5x, no long term debt, working capital/share: \$1.40, dividend yield, nil, 5-year sales growth: 15.3%, projected sales growth next 5 years: 12-15%

Valuation

We use a DCF model with a growth rate of 12% for the next 7 years and a growth rate at maturity of 8% and a risk premium of 8%. Our target price is US\$27.25

Have a good week.

The Global Alpha Team

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