

May 27, 2016

Each year, the American Public Health Association (APHA) publishes a report showing health scores for the US population. The findings are widely used and scrutinized by decision makers in government and corporate market research. We can certainly use this data to help us understand underlying market trends affecting our investment universe, especially for the health care, staples and discretionary sectors.

A high-level overview of the 2015 report card is as follows:

Positive trends: Smoking is down 5% to 18.1% of the population year over year. Vaccine coverage is up 5% to 71.6%. Other on-going winners on a 10-year trend are: pollution down 24%, cancer deaths down 4%, cardiovascular disease down 24%, infant mortality down 24% and crime down 51%.

Negative trends: In the past 2 years, obesity increased 7% to 29.6% of adults. Drug-related deaths increased 4% year over year while child poverty increased 6% in the same period.

The United Health Foundation is even more critical of the nation's health. It attracted news this week with its recent report supporting the APHA findings. In the report, it also stated that baby boomers will drive up diabetes rates by 55% in the coming decade.

From these data points we get confirmation of important secular trends for some of our investments.

Almost one-third of US adults are overweight. An estimated \$190.2B is spent on the problem each year, representing 21% of annual medical spending. Overweight adults spend on average 42% more on health care than healthy weight adults.

Global Alpha is exposed to this trend through Nutrisystem (NTRI;NASDAQ). The company has carved out a solid franchise in a growing but competitive \$10B weight loss industry. Nutrisystem continues to innovate with new diet meal plans (with some specifically designed for diabetics) and timely acquisitions of popular brands such as the South Beach Diet. Nutrisystem focuses on the fact that we have less time to pay attention to our diet, good nutrition is getting harder to evaluate and each individual has a different metabolism.

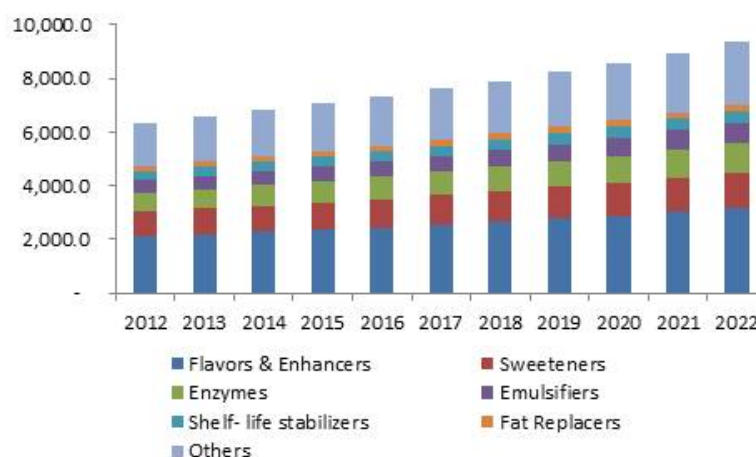
NTRI is the number one home delivery weight loss company. Products are sold directly to the consumer through nutrisystem.com, by phone, and at select retailers, all with convenient home delivery. The programs are based on 40 years of nutrition research and offer a variety of great tasting, satisfying, good carbohydrate meals that are designed to be heart healthy. The program has no membership fees and provides weight management support and counselling by trained weight loss coaches and online and mobile weight management tools free of charge. Nutrisystem holds approximately 5% market share. As confirmed by the report, there are still great opportunities available within the weight management industry for Nutrisystem and others.

So why do we continue to fail at achieving a healthy weight? In addition to sedentary living and a pre-disposition to gain weight, obesity is partly caused by fundamental changes to our food sources that are hard to detect by the untrained person.

- Genetically, flavour drives us in our food selection, as highly flavoured ingredients contain more good nutrients. (Dr. Klee, 2006)
- At \$7B in size, the food flavour additive industry could be seen as influencing, to a certain extent, our capacity to identify nutritious foods.
- The world food basket is decreasing in flavour and quality is declining at the expense of high productivity (hence the growth in the \$88B organic industry).

The US food additive industry grows at a compound rate of 5% per year. A Strong organic movement coupled with a decreasing reliance on synthetic chemicals, owing to their adverse effects on human health, is likely to challenge overall industry growth and also impact the food additives market price trend. Not surprisingly, the global organic food and beverage market, valued at USD 88B in 2014, is expected to reach over USD 300B by 2022, growing at a CAGR of 17.3% up to 2022.

U.S. food additives market size, by product, 2012 - 2022 (USD Million)



Source: GMI Research, 2016

Global Alpha is exposed to this market through a position in Frutarom (FRUT:TASE), a market leader in the production of natural flavours. The company has positioned itself as a key provider of natural additives to a diverse set of industries.

Frutarom Industries develops, manufactures and markets flavours and fine ingredients used in food and beverage products, pharma-nutraceuticals, flavours and fragrances, personal care products and cosmetics, as well as other products. The company operates through two divisions, Flavors and Specialty Fine Ingredients. The company also engages in the trading and marketing of various raw materials used in the production of flavours and fine ingredients. Frutarom Flavors division accounts for 72% of sales and 79.1% of operating income (OI) while the Fine Ingredients division accounts for 18% of sales and 19.8% of OI.

With a \$23Bn TAM globally, the market is fragmented with 19% of companies being small/local (<\$100mn), 500+ firms. Further consolidation is expected.

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COMMENTARY cont.



Frutarom Flavors products contain fruit and/or vegetable ingredients while its Fine Ingredients division sells natural extracts. Its above-industry growth rate of 10% for 2017, 20% margins and strategic position in this growing market warrants our continued support of this company.

Have a good week,

The Global Alpha Team