

**October 10, 2014**

**Dear clients and colleagues,**

At Global Alpha, one of our competitive advantages is finding undiscovered growth companies, names which are overlooked by many investors. Our “on the ground” approach helps us discover many such companies. Over the last three months, the Global Alpha Team has spent considerable time on three continents.

Today’s weekly will highlight our view on Germany. During our time there we interviewed many German and Austrian companies.

### **Economy & Companies:**

Although the latest IFO survey showed business activity continuing to weaken, and geopolitical tensions remain high, strong foreign demand for German products should counter any negative impact on expansion.

With a strong labour market, cheap credit and real wage growth, we think the environment for private consumption will remain favourable and could partly offset some of the weakness observed in other parts of the economy.

Even though the economic environment has remained difficult, many companies mentioned they are still able to generate growth. On the other hand, several organizations noted they are initiating new cost-saving programs in order to deal with this challenging situation.

Since nearly 44% of German revenues are generated outside of continental Europe, a weaker euro will have a positive translation effect for many companies.

Manufacturing capacity utilization rates are expected to remain at a similar level. In some cases, capacity has been added in Eastern Europe, Asia or in the Americas. The high levels of investments that we have seen in the last number of months are expected to drop for next year.

German companies remain much less leveraged than their European counterparts. Most of the firms we spoke to have an indebtedness level of less than 30%. Thanks to favourable financing conditions, the cost of debt continues to decline. Finally, many companies signaled their intention to return more capital to shareholders.

### **Impact of Russian sanctions?**

With 3.5% of exports going to Russia, the German economy is certainly affected by Russian sanctions. The German government noted that the political turmoil could endanger up to 25,000 jobs in the country. According to Deutsche Bank, 0.5% of GDP growth is at risk.

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.

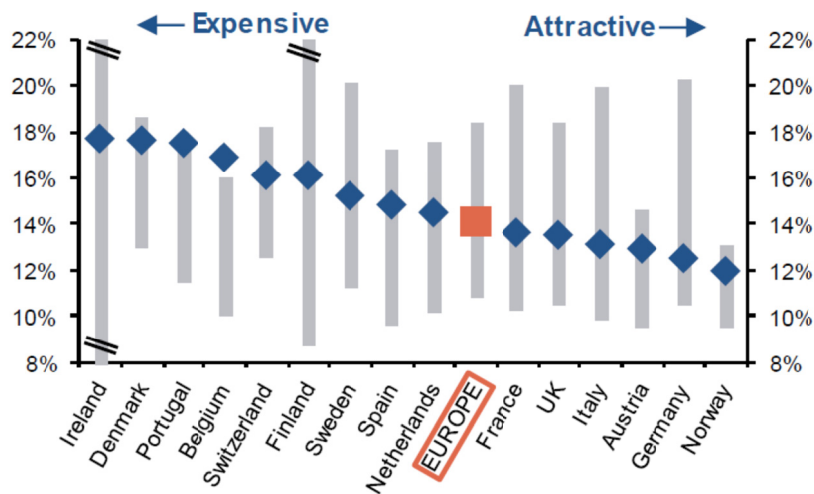
Performance figures are stated in Canadian dollars and are net of trading costs and gross of operating expenses and management fees. Further information about the Global Small Cap Composite is available by contacting the firm. Global Alpha Capital Management Ltd. (Global Alpha) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS. Global Alpha has not been independently verified.

Negative sentiment and sanctions have pulled down Russian consumption. The decline is penalizing many western industries such as engineering, automotive, distributors, and food and beverage. Commercial real estate is also being affected. Some companies have been forced to take radical measures. Volkswagen recently shut down its Russian assembly lines for a two-week period in order to adjust to the falling demand.

While most of the companies we met had yet to see any meaningful impact from the sanctions, some worry about the consequences of a disruption in the supply chain and weaker consumer sentiment. Moreover, companies remain vulnerable to a depreciating ruble that could decline even further.

**German equities:**

Compared with non-euro countries, Germany has underperformed year to date. Its “safe haven” gains made during the debt crisis have more or less disappeared. From a valuation perspective, Germany’s equity market is now close to a 10-year low relative to the rest of Europe. Looking at a forward price-to-earnings ratio, Germany is in a good position.



Source: SG Research

Overall, we believe that German equities look attractively valued compared to their European peers. We expect the German market to turn and outperform the wider European equity market once the geopolitical situation improves.

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