

QUARTERLY COMMENTARY

September 30, 2022

Investors usually look forward to the summer as the markets tend to be quieter. Not this year: macro and economics news have been flowing left and right, leaving investment managers with much to digest. Global Alpha is not macro driven in its investment process but let us share some of the news that caught our attention.

Japanese citizens have been navigating a more turbulent environment than they have been accustomed to. The main headline has been the assassination of former Prime Minister Abe Shinzo, one of the most prominent figures of modern Japanese politics, in a country where violent crimes are the lowest in the world. However, the more impactful news to our strategies have been on the economic front. The Japanese government intervened on the foreign exchange markets for the first time in almost 25 years to prop up the weakening yen, which hit an historical low of 145. Their central bank had previously announced their intent to keep rates low, going against the worldwide trend to raise rapidly. Given that the ex-food and energy inflation is still in the low single digits, it appears unlikely that they will need to drastically change course.

Europe is kept busy with the Ukraine/Russia conflict and more specifically the incoming winter and potential energy crisis. The strategic ambiguity strategy that Russia had so far been applying to the Nord Stream 1 pipeline was made clearer: energy

supply is to be used as leverage. Even on an ex-energy basis, inflation is still excessively high in the Eurozone which prompted the European Central Bank to raise rates in July for the first time in a decade and again in September for a total increase of 1.5%. Further measures to alleviate the pressure on consumers, such as a Euro-wide windfall tax on energy companies, are being put forward in addition to country specific initiatives. The probability of at least a mild recession in Europe, which in spring appeared as a minor risk, is now a near certainty.

The UK had a busy couple of months where they elected Liz Truss as their new leader following Boris Johnson's resignation, experienced some of the worst inflation in the developed world, and saw their longest reigning queen die. Nonetheless the FSTE100 index saw one of the better relative performances during the period, as it appears much of the negative sentiment has been priced in by investors who have been dealing with Brexit and political uncertainty for the better part of a decade at this point. It is worth noting that the UK small cap index did not see the same resilience and is now priced at highly discounted multiples.

US monetary and economic policies are still the most scrutinized. The Jackson Hole symposium in August reinforced the message that the Fed has been communicating for months: inflation is the priority, and they will not budge on their plan to continue raising rates until they see improvements. The effects of the aggressive hikes are quickly being felt: house sales in America have been falling sharply, mortgage applications are at their lowest level since 2000, and markets are trending downward across the world.

Overall consumer sentiment is steadily trending downward, despite a surprisingly resilient labor market and strong US dollar.

China, which is not within our investment universe but quite impactful, is dealing with its own set of issues. Economic growth is weak resulting from a mix of COVID lockdowns, property downturn that is not showing signs of improvements, and risk-averse consumers that are reluctant to take any kind of leverage. It is unlikely that any significant policy shift will be implemented before the CCP National Congress takes place in October as Xi Jinping will attempt to present the existing policies as a success.

Heatwaves worldwide have been creating outsized demand for electricity consumption. In Japan, the government had to ask roughly 37 million people to reduce their electricity consumption to avoid blackouts after its worst heatwave since 1875 and following the earthquake in March, where multiple power plants were shut down. The extreme heatwave in Europe has been well documented already and multiple unfortunate records have been smashed. Even the US saw 28 states issue extreme heat warnings. It might just be an outlier year, but the likelier option is that this will be closer to the new normal and, needless to say, that the current energy infrastructure is ill-equipped to deal with it.

BACK TO INTERNATIONAL SMALL CAP

During the third quarter, the MSCI EAFE Small Cap Index underperformed the MSCI EAFE Cap Index but outperformed the MSCI Emerging Markets Index.

Within the MSCI EAFE Small Cap Index, Energy, which represents 3% of the index, was the strongest performing sector, delivering a return of 3.4%. At the opposite end of the spectrum, Communication Services was the worst performing sector, returning -14.9% for the quarter, with an index weight of 4%.

PERFORMANCE HIGHLIGHTS

For the third quarter, our International Small Cap composite delivered a return of -11.1% gross (-11.3% net), underperforming the MSCI EAFE Small Cap Index by 1.3% gross (-1.5% net).

Our top performer for the quarter was Ormat Technologies Inc. (ORA IS). Based in Israel, Ormat is one of the largest geothermal power producers in the US and the only pure-play provider of products and services to the geothermal power industry. It designs, constructs, owns, and operates geothermal and recovered energy generation power plants.

Geothermal energy is a small but quickly growing segment of the global sustainable energy market and Ormat stands out as a leading owner and operator of high-quality assets. As such, the company is poised to benefit disproportionately from the increasing size of the market.

So, what drove the stock up?

Ormat reported very strong top and bottom-line results. The company further reaffirmed its annual targets giving confidence to investors in the current unpredictable economic environment. Besides strong execution, Ormat shares also benefitted from being added to the S&P Dow Jones MidCap 400 Index in early July, which led to high demand for the share from index trackers. Increased possibility of President Biden's infrastructure development plan passing in the United States, could help the green energy field through massive government support.

Another top contributor this last quarter was Raffles Medical Group Ltd (RFMD SG). It is a leading integrated healthcare group in Asia with three main segments: primary care, inpatient care and specialist care. With over 100 clinics across 13 cities in five countries, Raffles employs over 370 physicians, 850 nurses and serves more than 2 million patients.

The company ticks many boxes of the secular themes we like to invest in: it benefits from an aging global population, the growing Asian middle-class, and finally an increasing demand for health care. The co-founder, Dr. Loo Choon Yong owns more than 60% of the shares.

What drove the stock up?

The company was a top contributor this quarter, driven by its strong results in the first half of 2022, beating the consensus. Revenue was up 11%, thanks to the return of local and foreign patients seeking treatment in Singapore, as the country loosens COVID-19 related restrictions and fully reopens its border to foreign travelers. Outpatient volume is reaching pre-COVID level. Raffles Medical hospital has gained new patients coming out of the pandemic. Profits increased by over 50%, year over

year, thanks to the recovery of higher margin services and the improvement of operation efficiency. The company has a healthy balance sheet with net cash position.

Our top detractor for the quarter was Norway Royal Salmon Asa (NRS NO), an independent Norwegian salmon farmer that sells its volume via its own organization. Founded in 1992 on a membership model, it currently operates through 35 fish farming licenses and exports 95% of its sales.

The global market for salmon was estimated at 2.1675 million Kilograms in 2016, with half of it being produced in Norway, and the top 50 producers accounting for 80% of all farmed salmon. With the industry growing roughly 6-8% annually, the salmon market is uniquely positioned to benefit from trends toward healthy diets and food safety. Within that market, Norway Royal Salmon is among the lowest cost producers and one of the most innovative.

What drove the stock down?

NRS was a top performer last quarter. However, on September 28th the Norwegian Prime Minister and Finance Minister unexpectedly announced plans for a 40% resource tax on conventional salmon farming in Norway. In addition to corporate tax of 22%, this would take the marginal tax rate to 62% on earnings from farming activities in Norway. This extra tax is already levied on hydropower and oil and gas operations but marks the most dramatic change in the salmon farming industry's regulatory framework since its inception. Upon this announcement, the NRS share price fell 23% in one day along with other Norwegian peers in the salmon industry.

Operationally, second quarter results were a little disappointing as price achievement was negatively

impacted by the fish suffering from winter wounds and profitability impacted by a loss on fixed price contracts. We continue to hold the position as it is currently trading below the cash and share offer price from its potential acquirer, Salmar. Although the deal is still pending approval, completion could come before the end of 2022.

NEW POSITION

During the quarter we initiated a new position in M&A Capital Partners Co (6080 JP). Founded in 2005, M&A Capital Partners is the second-largest M&A advisory firm in Japan and provides succession services for SMEs in a wide range of industries. With a consultant base of over 150 experts that generate an average of Y135m, the highest in the industry, it seeks to obtain new businesses from direct marketing methods instead of only referrals.

M&A Capital Partners benefits from the Japanese demographic situation: over 2.45 million companies have owners over 70 years old of which more than half does not have a successor. More specific to their target market, at least 260,000 profitable firms with owners aged 60 or over do not have a succession plan in place. Furthermore, the company offers lower fees compared to competitors and does not charge any commencement fees. This is a significant differentiator to competitors as entrepreneurs depend on the proceeds from the sale to fund their retirement. We like the exposure that the name provides us and decided to initiate given the attractive valuation.

OTHER NEW BUYS AND SELLS

During the quarter we exited OSG Corp as we had similar capital goods names with the same exposure and decided to consolidate to higher conviction names.

WHAT IS OUR EAR-TO-THE-GROUND APPROACH TELLING US?

Global Alpha is busy travelling to conferences. The equity markets industry consensus coming out of COVID 19 is that live conferences are required by institutional investors. Therefore, we expect a mix of remote and live conferences to become the norm. We also expect an increasing amount of non-deal road shows by corporations to our offices. However, we expect broker analyst live road shows to decline post COVID as banks and brokerage firms concentrate on remote interactions with their analysts. The team is also preparing reverse road shows where plants and corporate head offices become part of a travelling route.

As companies reported earnings during the summer, it became clear that the comparison to last year's earnings were challenging and that expectations had to be reset. Many corporations that saw double or triple digits growth in 2021 are either seeing no growth or some decline in sales. The goal is now to understand which companies will continue their downward trend and which will be able to build on the growth they saw during the pandemic.

INTERNATIONAL SMALL CAP

In this macro environment, we continue to put our focus on our holdings balance sheet, favoring companies with little debt and strong cash flow generation, as well a well-defined secular trend that will drive growth for years to come. We do not make material sector or country adjustments to the portfolio because of these expectations and maintain a diversified list of holding companies with defensible business models that are trading at a discount to their intrinsic value. Our portfolio remains well diversified across the many countries, currencies and industries that compose our benchmarks.

The Global Alpha team

About Global Alpha Capital Management Ltd.

Global Alpha Capital Management Ltd. (Global Alpha) is an independent and privately owned investment management firm focused exclusively on global and International small cap portfolio management. The team believes that portfolios built from the bottom up using a global thematic perspective and a risk-controlled, low turnover approach are key to generating consistent added value for clients over time.

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