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July 13, 2020

Dear Investor,

We trust you and your family continue to remain both healthy and safe. Without a doubt it has been a strange couple of months, as we have radically adapted how we live our day-to-day lives. All of us at Robotti & Company have settled into new work habits and daily routines. It is a testament to the resiliency of human nature that we can adjust so drastically in such a short amount of time.

When I penned the year-end letter, I noted the dawn of a new decade, one that would be different than the last – well that was perhaps more of an understatement than I could have predicted at the time. The accelerating and potentially radically changing global economic environment is contrasted by securities markets that are responding with more of the same - a further flight to fixed income and other securities providing yield, which further reduces any income and puts valuations at risky levels. For equity markets, they have become increasingly dominated by a small number of securities making up the bulk of outperformance as measured by popular benchmarks. Yes, the S&P 500 is almost flat for the year… but that overshadows the fact that 2/3 of all U.S. public stocks are down for the year with 45% of these stocks down more than 20%!

As outperformance has been increasingly limited to a small number of technology companies (i.e. FAANG stocks), investors have become increasingly convinced that they have one of two choices: (1) invest in securities driving market returns regardless of valuation, or (2) hide their money under the mattress. We would argue there is a third option, one firmly grounded in the tradition of Benjamin Graham who said "In the short run, the market is a voting machine but in the long run, it is a weighing machine." We continue to believe, however, that market valuations will be based on the discounted accumulated future cash flows a company generates. There are many smaller companies with near-term headwinds that are likely to exhibit stellar cash flow characteristics in the near future. This is where we continue to concentrate our efforts as we remain confident in our process and our investments. We continue to remain invested alongside you, our long-term partners.

Redoubling Our Efforts & Bargain Hunting

As many of you know, one of our favorite pockets to search for new investment opportunities is in areas that are out of favor. Today there is no shortage of businesses and industries for us to research. At the onset of this ongoing pandemic our priority was to review each and every investment thesis, speak to the management teams of all our core holdings, and determine whether short-term events would have a meaningful impact on our long-term intrinsic value estimates. Our conclusion was that despite the many challenges caused by COVID-19, most of our underlying theses remained intact, and in certain cases it's likely COVID's onset accelerated positive trends. Additionally, within the mayhem, we are finding opportunities in new investments.

Turbulence in the Airline Industry

When the range of outcomes for individual companies, industries and the general economy are both wide and uncertain, it can be a benefit to the diligent stock picker. Panic selling, interlaced with panic buying driven by FOMO (fear of missing out), has been rampant for months now, as evidenced by the tremendous amount of volatility in the market. This has provided us the opportunity to hunt for new investments. In many cases, the market has overreacted to the short-term impacts of the pandemic, thus losing sight of the longer-term implications.

One industry hit particularly hard, and with good reason, has been air travel. Despite some pockets of recovery, most of us are still too afraid to fly. As contrarian investors this was one of the first places we began to comb through for potential opportunities. We had multiple analysts review different parts of the industry, starting with the airlines themselves and moving to adjacent businesses including suppliers and travel management companies. From this, we found an especially mispriced opportunity not in the well-known airlines, but in the more perpetual business of aircraft leasing: AerCap Holdings N.V. (NYSE:AER).

AerCap purchases and owns planes that they lease out to the major airlines (think American Airlines, Air France, Emirates etcetera). Today AerCap owns a fleet of more than 900 aircraft with an average age of around 6 years. I can hear what a lot of you are thinking: if so few people are flying, how is it an overreaction for investors to sell a company that owns planes? This is a fair question and was the crux of what we were trying to answer when doing our due diligence. The vast majority of its fleet capacity is leased out for the next three years, and the company's global footprint reduces its exposure to individual air routes and geographies. No one airline accounts for more than 8% of the lease revenue.

We believe the market has overreacted to the current crisis caused by the global pandemic and is missing the true long-term potential of the business.

What we found was that even the worst-case scenarios predict air travel to recover in 3 years. The planes owned by AerCap are multi-decade assets that will retain value. Yes, the airlines themselves may see winners and losers but the individual planes preserve value. Companies may go bankrupt but long dated value assets do not. (We realize these assets can lose value, but even discounting 3 full years on multi-decade assets leaves a lot of value). Specifically, we have found that AerCap has ample liquidity and enough contract coverage from viable lessors to be a survivor (and in some cases a savior) even in very draconian outcomes.

The core of our investment thesis is predicated on three elements:

(1) The planes that AerCap owns will eventually fly again, reviving their cash flows;
(2) The company has the necessary liquidity to survive the downturn, protect its balance sheet and minimize any equity dilution;
(3) Investors have discounted in a scenario far worse than 3 years of lost revenue.

We don't expect a straight-line recovery. When catching a "falling knife" there is always the risk of getting cut before clutching the handle. However, we believe there remains an ample runway (pun fully intended!) of opportunistic growth for AerCap going forward. For example, there is no question their airline lessors will be in dire need of capital working through this depression. One potential source is the sale/lease back of their owned aircraft. AerCap has been out of this market due to aggressive capital pricing, but the table is now reset for well financed industry participants (including AerCap) to provide capital to anxious airlines in need of it.

While air travel is a new industry for us, the tenets of our thesis fit the same tried and true process for which we have been known for decades.

Anew with Renewable Energy

For years now, we have looked closely at the continually improving economics of renewable energy as the changing economics here are critical to our investments in conventional energy. We fully understand and appreciate the growing role of renewables as part of the world's energy mix. Originally the economics in renewables was largely predicated on government subsidies, and even as that model changed over the years, investor excitement led to valuations which prevented us from investing. After spending many years studying the renewable energy industry, the market turmoil of 2020 finally provided us an opportunity.

Canadian Solar Inc. (NYSE:CSIQ) is a leading manufacturer of solar modules, and also builds and operates solar utility scale farms. Operating both as a manufacturer and a utility scale farmer, we hold the view that the company can better design products by understanding how they will be practically used in the field. This structure also provides Canadian Solar with a natural hedge against the potential commoditization of solar panels. Their long history of project development gives them an advantage in permitting and contract negotiation – the bulk of the time and effort of developing a new solar field. Canadian Solar has over $800m of cash on the balance sheet. We estimate that based on conservative EBITDA multiples and the company's current backlog, the two businesses are worth nearly $3B combined (bringing the valuation to $3.8B). With an enterprise value of $2.8B, we believe the company is trading for roughly $1B less than it is worth.

Canadian Solar has significant insider ownership aligning our interest as minority owners. That level of insider ownership, along with it being a Canadian listed company doing business in multiple jurisdictions and with creative structures (developing solar field in Japan, etc., and retaining ownership interests), makes the stock one that has limited "investor appeal." Passive owners including BlackRock, Vanguard et al., own only 12% of the shares making the stock an orphan in today's funds flow valuation world. All these idiosyncratic facts are what allowed us to make our investment in renewables at a discount valuation and with excellent growth prospects.

Adding Wind into the Mix

In the second quarter, our core holding, Subsea 7 (OB:SUBC), which provides engineering and construction services to the offshore energy industry announced 3 new contracts awards for the installation of windfarms offshore of the Netherlands, Scotland, and Germany. Combined, these projects will add between $1.0 - $1.5 billion of total contract revenue to the backlog. These offshore renewable projects should allow Subsea 7 to deliver its highest quarterly intake since 2013 and the renewables segment now accounts for approximately 30% of total backlog.

The importance of differentiating between a good management team and a great one in a cyclical industry cannot be overstated. When a cyclical industry falters, investors with experience investing over several full cycles have a tremendous advantage. It is obviously important to identify the survivors, but it is almost equally important to find those managers with a history of strategically (and opportunistically) managing its business.

Subsea 7 did a tremendous job of pivoting an asset to take advantage of a new opportunity. Seaway Heavy Lifting was originally a 50/50 JV between Subsea 7 and Lukoil. It owns two heavy lift vessels designed for

the installation and decommission of the world's largest offshore oil and gas platforms. Starting in 2009, the company secured business for one of its vessels to install the monopile foundations for a large UK windfarm in the North Sea. Then in 2016, Subsea 7 announced a $1.3 billion windfarm EPIC contract with Beatrice Offshore Windfarm that would be jointly executed with Subsea Heavy Lifting. Recognizing their capability and the opportunity, Subsea 7 made two acquisitions.

In 2016, Subsea 7 purchased the remaining 50% of its Seaway Heavy Lift JV it did not already own. This was followed up by the purchase of Siem Offshore Contractors in 2018. This acquisition added an inter-array cable lay vessel to install the deep-water cables that connect wind turbines to an offshore substation, and a support vessel. This provides Subsea 7 the capabilities to do comprehensive offshore windfarm engineering and installation. It also gives Subsea 7 the ability to provide recurring repair and maintenance services to the global offshore renewable industry.

Windfarm installations are projected to grow at a 16% CAGR over the next 10 years with a growing trend towards deeper water installations. With very modest capital investment, management has opportunistically repositioned assets, expanded its engineering capabilities and augmented its service offerings into renewables by strategically increasing its exposure to wind as a growing source of clean energy. As a result of management's intelligent investing, Subsea 7 is organically building out a new leg to its business.

Closing Thoughts – Carpe Diem!

There is still an uncertain road ahead of us and more changes ahead to be sure, as I am impressed by the resiliency of my team to adapt, I am also impressed by the adaptability of the world to change. Conversely, the flow of funds continues to move ever increasing amounts of their bets to double down on what has worked well previously and, in the process, increased the valuations and maybe changed the odds of those same bets.

Given the extraordinary opportunities we are seeing at the moment, please look out for more communications from us, follow us on social media (LinkedIn, Twitter and blog) and importantly, we encourage you to consider adding more to your existing investment. This is a once in a generation entry point – Carpe Diem!

We appreciate your continued support, wish you and your family good health, and, as always, welcome any questions. As many of you have seen, heard or "Zoomed" over the past months and weeks, we have increased the frequency of our social media and direct communications (please take a look at our website at advisors.robotti.com or on Twitter at @BobRobotti). We have enjoyed connecting with so many of you virtually and look forward to doing so until it is safe to meet in person once again.

All the best,

Bob

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