Robotti
Value Investors

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Dear Client,

As we reflect on the first quarter of 2026, we continue to see significant disruptive forces in the world, and the subsequent impacts they have on securities and commodity markets continue unabated. Despite this, we are happy to report positive performance in Q1, which significantly outperformed the indices. In this letter we will spend time on what we believe are the drivers of our performance, how they may be different from what you might think and, most importantly, how recent events in the global energy industry, and specifically with regard to energy security, are likely to affect our portfolio.

Oil & Gas: Accelerating the Structural Opportunity

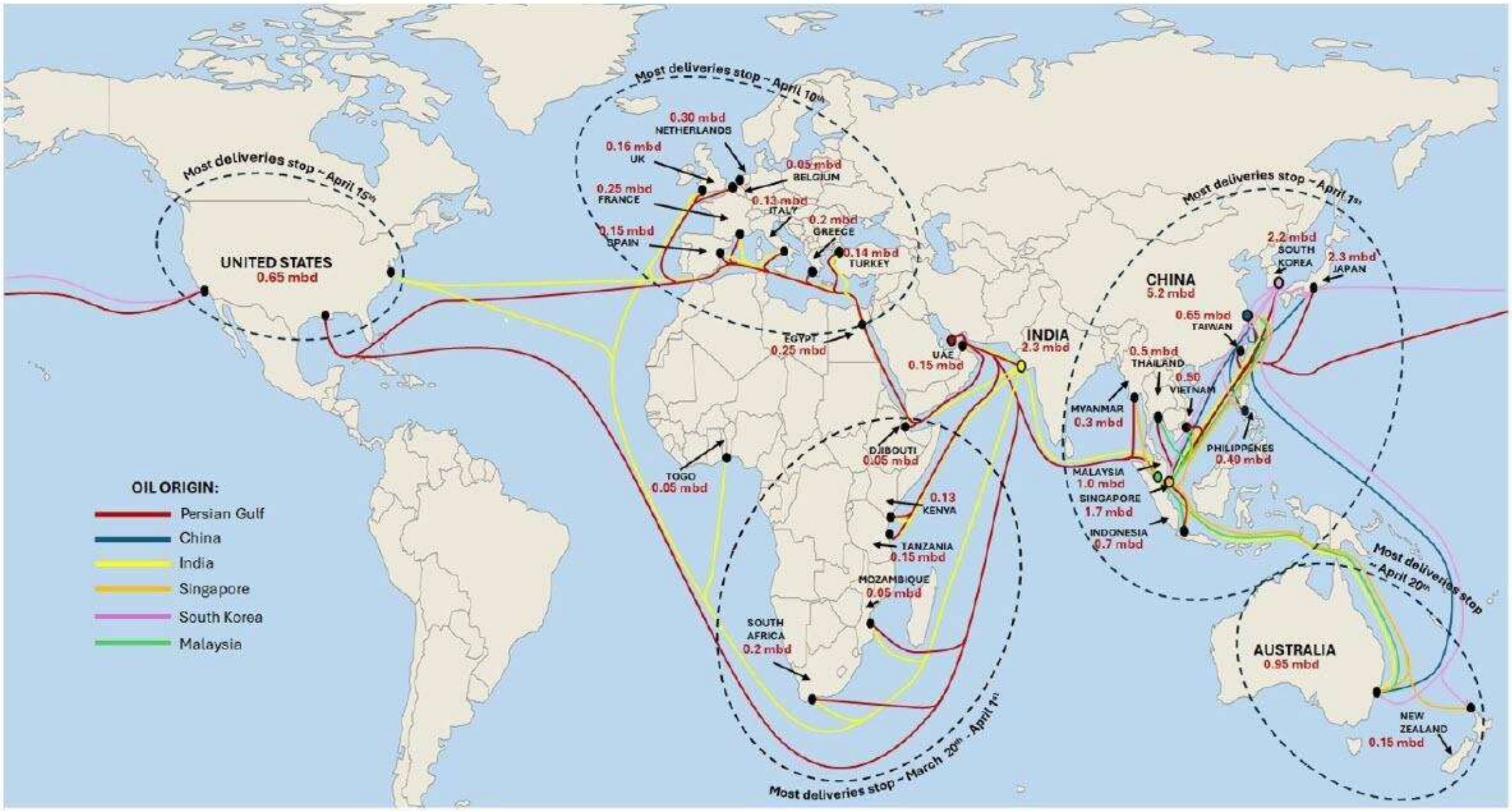
Two significant developments last year set the stage for what we saw in the first quarter. First, the International Energy Agency (IEA), a long-time leading advocate on the clean-energy transition, released its annual World Energy Outlook with a new current policy scenario showing oil demand continuing to rise well past 2030, projecting oil demand may well continue rising through 2050. This reflected a major shift in the IEA's modeling. Second, the world's major international oil companies (IOCs) reached a similar conclusion. The European IOCs (Shell, BP, Total, ENI, and Equinor) reevaluated their prior pivot toward renewables and shifted focus to their traditional businesses of developing hydrocarbons. Their earlier concern that investment in oil and gas reserves would result in stranded assets was reversed as they recognized the persistent need for hydrocarbons as an integral part of the world's energy needs. The strong returns and long-life reserve profiles now offer some of the most compelling investment opportunities available. It is significant to note this recommitment to hydrocarbon development occurred in a world that witnessed oil price declines. Oil had slumped from $80 per barrel to the low-to-mid $60 range. Even in that lower price environment, these investments were compelling. All of this is set against a backdrop of growing global energy demand and increasing need for energy security. Renewables will continue to grow substantially, and current events should further accelerate their build out, but the scale of energy required is such that all forms of energy production need to grow.

This structural shift exposed a decade of damage to the industry. Since 2015, the dearth of activity caused the offshore services sector to collapse. Years of underinvestment and bankruptcies dramatically reduced capacity. The survivors rebuilt with conservative balance sheets, consolidated fleets, and replacement costs far above asset values. In January and February, the market recognized that the offshore demand profile had already shifted, driving a meaningful repricing of our holdings in Tidewater and Subsea 7.

While the outbreak of the war against Iran on February 28th led to a spike in oil and natural gas prices, our results for March were down slightly. Higher prices did not bring about a rerating. This is logical. Futures markets highlight the expectation that it won't take long for prices to retrace earlier levels. The Strait of Hormuz has largely been closed to marine traffic for some time now, essentially halting 20% of the world's oil consumption leaving it trapped and unavailable. The supply disruption has been brought into focus. Responses will now be pursued.

So, what has this closure affected? Outside of the myriad geopolitical ramifications that we have neither the expertise nor inclination to expound upon, it has exposed a simple truth. **Supply shocks create urgency, whereas physical scarcity creates responses.**

Figure 1: Oil flows from the Persian Gulf and South East Asia



Source: J.P. Morgan Commodities Research, Kpler

As the above chart shows, the disruption to oil flows from the Persian Gulf is not a single event, but a cascading process. This is true for most economic factors, since we live in an economically interconnected world where shocks to one system are rarely contained. The effect on prices was instant, but as cargoes already in transit have continued to arrive at their destinations, it has masked the true scale of the disruption. That cushion is now running out. As the last en-route deliveries reach their destinations, countries across Europe, Asia and the Pacific have already begun to feel the physical shortage of molecules. For many, it's a question of "Can I get supplies?" where price is a secondary concern. In recent days, we have heard repeated commentary on scenario planning which concerned this event, but the risk has been severely discounted. Governments and industry are confronting the reality of depleted inventories without replacement supply. Disruption to yet another part of supply chain will drive structural responses and changes.

Supply chain issues are not just about oil! Roughly 20% of the world's export Liquefied Natural Gas ("LNG") flows through (or in this case, does not flow through) the Strait of Hormuz. Once again this highlights another ongoing structural change in the energy business. Offshore exploration was once exclusively an oil story, where natural gas discoveries were mostly uneconomic. With the growing importance of LNG, that is no longer the case. This development has substantially increased the markets available for offshore development resulting in increased demand for Tidewater and Subsea 7 services. We can see that in the outlook already. Approximately a third of the major service companies' backlogs now involve gas development. Turkey is the poster child; they discovered gas in the Black Sea, went directly to service companies, and rapidly reduced their dependence on Russian and Iranian imports. That calculus has now sharpened for similarly positioned countries like Egypt, Cyprus, the UK, India, Australia, Indonesia, and even Mozambique, where development has resumed after years of force majeure, with all production destined for an LNG market desperate to secure supply.

Current Middle East disruptions will further propel increased investment in offshore oil and gas developments as the world seeks to diversify sources of energy supply across traditional hydrocarbons and across all geographies.

LSB Industries: Positioned for Multiple Tailwinds

The closure of the Strait of Hormuz has disrupted more than just oil. Fertilizers, ammonia and other derivatives of oil and gas have also been cut off from global markets. We have been investors in LSB Industries ("LSB") for several years. LSB produces ammonia, some of which is sold in the merchant market, with the balance upgraded into nitrogen-based fertilizers and nitric acid.

A growing component of the business has been this nitric acid, a key ingredient in the production of explosives. Freeport-McMoRan, a major consumer, is using these explosives extensively in its mining operations, which highlights a source of demand that continues to grow alongside global mining activity. LSB also has the opportunity through its main facility in El Dorado, Arkansas, to capture most of the carbon currently released in its production process. That carbon capture project has been underway for years and should begin operation sometime next year, enabling the production of nitric acid from blue ammonia with dramatically less CO_2 byproduct. Freeport-McMoRan has agreed to pay an increased price for nitric acid produced under this process.

The current Middle East supply disruption (compounded by damage to critical facilities) combined with the structural changes to this business favor North American based producers like LSB.

Home Building: The Market Giveth, The Market Taketh Away

As we have noted many times, Mr. Market's manic-depressive behavior creates opportunity in both directions. Capital flows overshoot when an industry is left for dead and capital flees aggressively. When sentiment shifts, capital rushes back just as forcefully. We invest in these abandoned corners and must be prepared for the discomfort that comes with the territory.

From our prior letters you may recall the history of Builders FirstSource: It was abandoned by the market's response to the housing implosion which was a major impetus of the Global Financial Crisis in 2008. In response, the building products distribution industry went through a substantial and radical consolidation. Builders FirstSource and our legacy position in BMC were two companies that aggressively consolidated that market, and their eventual combination in 2021 solidified a commanding position. A strong period of home building activity allowed the combined company to generate dramatic free cash flow and aggressively repurchase 40% of their outstanding shares demonstrating a structural shift in the industry. In recognition of these economic facts, the security soared to over $200 per share for an extended period. Capital flows to the winners, often in excess.

Fast forward to today and housing activity continues to slump, specifically new home construction. We are all aware that the cost of mortgages today is more realistic, and that the free money environment is now firmly a matter of history. In our view, a housing recovery is not predicated on the pipe dream of significantly lower mortgage rates. Our investment thesis is predicated on demographics and on the aging housing stock. These dynamics can be obscured but not reversed.

The home building market has responded to higher costs and the resulting reduced affordability, temporarily impacting demand for new construction. In the process, these securities have been repriced. Builders FirstSource has fallen below $80. Yet in our view, the earnings potential of the business, its commanding position in its industry, its continued efforts to increase the value of what it offers, and its clear ability to generate cash flows in excess of the needs of the business that can be deployed opportunistically, all remain intact. The market is focused on the probability of earnings compression over the next year or two. As long-term investors we believe the present value of the future cash flows far exceeds the current trading price.

We have seen this pattern before. In our 2025 year-end letter, we noted that Builders FirstSource, despite being one of the ultimate winners of the post-2008 housing consolidation, retraced nearly 50% from interim highs on several occasions along the way. Those pullbacks were not signs of failure, but part of the process. Recoveries are rarely linear. The direction of travel and the ultimate destination are what matter, and in our view, those have not changed. Over the good times, we have repeatedly pared back our holdings in Builders FirstSource, leaving us well positioned to capitalize going forward.

So even as portions of our portfolio are being recognized by the market and dramatically repricing upward, other positions are experiencing the same forces in exactly the reverse direction. This is not a contradiction. It is the nature of investing in businesses through cycles, and it is precisely the dynamic that creates long-term opportunity for patient capital.

Black Swans – A Common Bird

I think we should quickly discuss a black swan event. You know a black swan event when you see it. Clearly, COVID-19 was one. Most investors agree that Russia's invasion of Ukraine was a black swan event. I am less certain that we can characterize the U.S. invasion of Iran, Liberation Day, and all the tariffs we have introduced as true black swan events. It seems to me that disruptive events are now occurring on a semi-regular basis. I would posit that America's election of Donald Trump (someone whose modus operandi is to pursue aggressive and radical action) means that the outcomes we are living with are, in some sense, part of the bargain. We have institutionalized these kinds of events we may have previously viewed as black swans.

Markets, however, are not recalibrating to this new reality. After years of "buy the dip" conditioning (which is sound advice when applied with discipline) investors have developed a reflexive tendency to under-recognize large-scale risks. Companies are seeing their stock prices rise despite real and material headwinds specific to their businesses. That is not disciplined buying of improved valuations; it is buying momentum and hope. It is worth noting that today when market observers refer to "the market," they are largely talking about the narrow group of companies that dominate the major capitalization-weighted indices - precisely where we are not invested.

Disruptive Forces

We do have concern about a world in which we see the continued cyclical incursion of inflationary forces. As we stated in our letter last year, it is inflation that controls the interest rate, not the Fed. The Fed has no miracle cure. The current war on Iran and its impact on world economies are disruptive. Trade wars and tariffs are disruptive, the responsive and continual deficit spending of governments around the world is problematic. Many of these are disruptive actions and cause inflationary pressures. If inflation runs at five to six percent for some time, markets and capital will push for a real rate of return - at least one to two percentage points higher. A world in which the 10-year Treasury is priced with 7% yield seems a credible possibility, and almost a likelihood, over the coming decade. That is a world in which all cash flows for every financial instrument are worth less in real dollar terms. Multiples will compress and cause a repricing of all financial assets. In 2022, we experienced what happens to markets then. This risk might be the next Black Swan event.

Where we *are* invested, the picture is quite different. Our results are largely uncorrelated to the price movements of the major market-capitalization weighted indices. The businesses we own are not riding the same wave of momentum. Rather they are seeing their fundamentals improve in the current environment, as we highlighted above for Tidewater and Subsea 7. They are priced at very large discounts to the present value of cash flows (even calculating a higher rate environment). Risks are being underpriced where the crowd is concentrated, and opportunities are being overlooked where the crowd has yet to fully arrive.

As always, we appreciate the relationship we have with you and look forward to the years ahead.

All the best,

Bob

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