Robotti
Value Investors

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Dear Client,

The Obsession and Its Appetite

The stock market has a long history of obsessions, and currently it is artificial intelligence. In the span of a few years, AI has gone from a research curiosity to a fundamental driver of the market: capital spending measured in the hundreds of billions, valuations that embed decades of flawless execution, and a daily news cycle in which every announcement, new model, new chip, or new data center can move hundreds of billions of dollars of market value. Over time markets have experienced euphorias driven by railroads, radio, conglomerates, the internet, and housing. Each was built on a real and durable change in the world. Each also taught the same lesson that the significance of a technology and the returns to its most celebrated stocks are two very different things.

What makes this situation genuinely interesting is not the software but its appetite. Unlike prior digital revolutions, which famously ran on bits, not atoms, artificial intelligence is ravenous for atoms. Whether that’s electricity in quantities that strain grids built for a different century, copper and steel, gas turbines, cooling water, transformers, or transmission lines that take a decade to permit and build, they all are in high demand. For the first time in a generation, the binding constraint on technology's ambition is not code or capital but the physical world's capacity to deliver. Importantly that capacity, after years of underinvestment, is short.

For investors, this is where it gets interesting. The market has bid the recognized beneficiaries of AI to prices that leave little room for disappointment, while the physical economy that must be built to realize any version of the AI future remains largely ignored or valued, in many cases, as though the last decade's indifference will simply continue. One does not need to predict which model wins, or whether today's spending proves too much or too little, to observe that the demand for machines, materials, energy, and infrastructure is rising, straining supply that cannot quickly respond. That asymmetry, where enthusiasm concentrates in one place while necessity accumulates in another, is precisely the kind of gap between narrative and reality where we have always done our best work. It is also the backdrop for everything that follows in this letter.

Real Assets, Publicly Owned

For more than a decade, investment capital has flowed into digital over physical, intangible over tangible, and the promise of growth over the discipline of supply. The result is enormous sums concentrated into a narrow set of alluring assets that boast intriguing headlines and hold great promise, while the companies that own and operate physical assets (ships, factories, mines, machinery, roads, and other various infrastructure assets the world depends on) have been orphaned by the public markets. As we have written before, asset allocation has quietly become asset concentration, with everything else priced accordingly.

We believe one of the most compelling propositions available to investors in some time is emerging directly from these neglected hard assets. Headlines are awash with exciting predictions of exactly how an unknown future will look. Investors are so captivated by the promise of emerging technology and AI that they overlook any implications for physical assets, leaving them underappreciated. No matter how the future unfolds, more machines, materials, energy and transportation will be required to take us there.

Private real-asset and infrastructure funds have taken note and continue to raise record sums, acquiring energy, industrial, and property assets at negotiated premiums, with valuations marked periodically by appraisal and capital locked up for a decade. In our view, the most attractive way to profit from this opportunity is not to buy these hard assets privately, but to buy discounted fractional interests of the public companies that operate them. Mr. Market offers daily, liquid pricing on public companies that own the very same categories of assets, frequently at discounts to replacement cost that no private negotiation would ever produce. Rather than investing in private funds with limited life spans, long-term incentives are better aligned with permanent capital invested in conservative balance sheets rebuilt through the last downturn, and, in many of our holdings, owner-operators whose personal wealth is invested alongside ours. Real assets, real pricing, better structure, greater alignment, always focused on the price we pay vs. the value we receive - the same philosophy we have applied for over forty years. Owning assets that capital is increasingly recognizing and wanting to own.

Weather, Not Forecasts

We view the broad economic environment much the same as we view the weather - something to guide us, not something to be forecasted. In our experience, portfolios are best built asset by asset, from the bottom up, on individual mispricing which provides a margin of safety. We perform what we call *grassroots macroeconomics* to build a bottom-up understanding of the macro environment by weaving together all that we learn when researching individual businesses, understanding the industry landscape and speaking to executives and industry insiders – the people standing in it. Today that research affirms for us that two of the market's loudest storylines, artificial intelligence and the flood of capital chasing it, lead directly back to an increasing demand for the physical economy.

Start with artificial intelligence. We claim no edge in predicting which models or platforms will win, and we have no interest in paying extraordinary prices to find out. Our approach is the same one we apply to every technological sea change. We avoid the businesses most vulnerable to disruption and look instead for the forgotten, often “boring” assets that are necessary to usher in the coming change. The digital economy's next chapter is being written in the physical world: incremental power generation, transmission, cooling, copper, steel, and the abundant low-cost natural gas that increasingly underwrites North American electricity. One need not know which AI model wins to know that all of them consume electrons and materials. The critical picks and shovels of this gold rush are real assets.

The competing demands for capital now stacking up across the technology complex, whether it’s model developers, chip fabrication, data centers, or the utilities that must power them, run into trillions of dollars. Capital, like any commodity, is affected by supply and demand, and demands of this magnitude can pressure prices – the prices of real asset inputs (inflationary pressures) and the price of capital itself – both are headwinds to valuation. On the flip side, when investment of this scale must flow into physical infrastructure, the scarcity value accrues to those who already own the productive assets with the capacity to build. Years of underinvestment have left the physical economy short precisely what the digital economy now demands.

Staying disciplined through the capital cycle is paramount for extracting this value. Suffering through the consolidations, exits, recapitalizations and demand shocks (already reflected in cumulative performance) allows us to capitalize on the eventual repricing. As we like to say, good things happen to stocks that are cheap, and eventually when constrained capacity meets rising demand, cash flows respond and drag along valuations.

Where We Find Real Asset Opportunities Today

Offshore energy has reemerged as a clear expression of this pattern. A decade of underinvestment and a brutal winnowing down of more than a dozen liquidated, absorbed, or exited competitors has left a consolidated industry with reduced supply now well positioned for returning and increasing demand. The predictable result is accelerating revenues, enhanced margins and increasing cash flows. These are facts that are appreciated and rewarded, even in today's markets. Furthermore, with renewed pricing power, extensive backlogs, and replacement costs that far exceed the market value of surviving fleets (constraining new supply), the earnings outlook is clear. Against that positive industry economic outlook is the transformational combination of Subsea 7 with Saipem which will create a differentiated global leader with an extensive backlog across subsea and renewables, an expanded addressable market (given the increased worldwide concerns for energy security), and increased pricing power. Additional opportunities will result from optimized capabilities and the geographic flexibility of the merged fleet. Furthermore, Subsea 7 shareholders can expect to receive a substantial dividend in connection with the transaction. Providing support to the outlook, the pipeline of major offshore projects continues to build across Brazil, the Gulf of Mexico, West Africa, and newer basins such as Guyana, Suriname, and Namibia. These projects are not driven by speculative enthusiasm but by the economic necessity of replacing declining production and the interest of many countries in securing energy independence.

The North American industrial renaissance is a second broad megatrend providing clear and identifiable investment opportunities. An abundance of stranded, low-cost natural gas gives energy-intensive consumers on this continent a durable, structural cost advantage over the rest of the developed world. This advantage is now compounded by reshoring (or, as we call it, part of Globalization 2.0) and by the technology sector's newly voracious appetite for power. Fertilizer, chemicals, steel, and other prosaic businesses hidden in plain sight stand to benefit for a decade or more. These are precisely the ugly ducklings the market has been trained to ignore. Once again, the "cyclical" label obscures a structurally improved economic reality.

Housing and building products remain a third opportunity – and one of our core competencies. America's housing shortage is a demographic fact, not a forecast, and the consolidation that reshaped building-products distribution after the financial crisis (Builders FirstSource for example) continues to compound value through the inevitable interim drawdowns. (We are once again witnessing this reset today as Builders FirstSource trades in the 70's.) Alongside these, our holdings in metals and materials and in Canadian oil and gas reflect the same underlying arithmetic of constrained supply, growing demand, and public valuations that sit well below what a private buyer would pay for the underlying assets.

Conclusion

Rudiger Dornbusch's observation that in economics *things take longer to happen than you think they will, and then happen faster than you thought they could* has served as a recurring frame in these letters because it keeps proving true. The fundamentals beneath the physical economy have been improving for years even while the narrative lagged. When recognition arrives, it tends to arrive quickly. We believe the most durable way to participate is the one we have practiced since 1983 – owning the real assets through shares of the public companies that operate them, bought at discounts, held with patience, owned alongside operators whose wealth is invested with ours and, when useful, engaged with actively.

We want to thank you for your continued trust and partnership. Our approach requires shared conviction and a willingness to let time do part of the work, and we do not take that willingness for granted. We remain committed to staying disciplined, curious, and aligned with your long-term interests. As always, we appreciate the relationship we have with you and look forward to the years ahead.

All the best,

Bob Robotti

Bob

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