ROBOTTI & COMPANY ADVISORS, LLC

Investment Securities

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Dear Clients,

Models allow us to simplify the realities of the natural world by taking an abstract, theoretical idea and putting it into a form that we can understand and manipulate. A common model that we are familiar with is the solar year. By definition, however, this model is a simplification which has shortcomings, namely that it has limitations in evaluating investments. Regardless, custom dictates that the two should be correlated. As such, we take time at the end of each year to review what has transpired in our portfolio since the last culmination of our journey around the sun.

Our Results

	Value Equity Composite, Net	Benchmark[1]
2013	17.67%	33.32%
COMPOUND ANNUAL GROWTH RATE (THROUGH YEAR END 2013)		
3 Year	8.48%	15.25%
5 Year	17.86%	19.82%
10 Year	11.78%	8.95%
20 Year	12.50%	9.21%

The Robotti Value Equity Composite returned 17.67% in 2013. While we would generally be pleased with this absolute return, our emotions are tempered by the fact that we substantially underperformed our benchmark in 2013. We remain faithful to the belief that focusing on short-term performance can be detrimental to long-term returns and that in order to outperform the market, periods of underperformance are unavoidable. While enduring these periods is always painful, they are ultimately a byproduct of what we view as a winning long-term investment strategy. We also realize, however, that each short-term period contributes to the long-term, and as such, we must do better for our clients than we did this past year.

[1] *On September 1, 2011, the benchmark for the Composite was changed from the Russell 2000 Index to the Russell 2500 Value Index. The benchmark was changed to better reflect the Composite's holdings as well as its buy-and-hold strategy. Over time, holdings that were small-cap when purchased may have grown or merged to become mid-cap or larger companies. In addition, the Advisor believes that holding larger cap positions is a natural evolution of the Composite's strategy. The Russell 2500 Value Index measures the performance of the small to mid-cap value segment of the U.S. equity markets. It includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000 Index measures the performance of those Russell 2000 companies which represent the 2000 smallest companies in the Russell 3000 Index. As the Russell 2500 Value includes both small and mid-cap companies, the Advisor believes it is a more appropriate benchmark for the Composite.*

Our Investment Edge

It has become conventionally accepted that there are three broad categories of advantages that allow an investor to outperform the market. The first, an *analytical edge*, is when an investor analyzes well-known information in a unique or creative manner to arrive at a different conclusion than the rest of the market.

The second, an *informational edge*, is achieved when an investor has connected a broad array of publicly available information to create a mosaic of information not yet understood by the rest of the market.

While it is certainly possible to develop an analytical edge or an informational edge alone, we do not feel confident in our ability to repeat such unique situations. For our investment approach, an analytical or informational edge can only be built upon a foundation of the third type of edge: a *behavioral edge*. This edge is defined by the ability to identify behavioral biases, overcome emotions, and react to well-known information in a rational manner.

At Robotti & Company we focus our entire research effort on understanding the handful of factors most likely to affect the outcome of an investment over a long-time horizon. Our long-term conviction is supported by our ability to tolerate losing money before we make it. By taking a longer-term view, defined as three to five years or longer, we analyze data through a different lens and seek out information for a very different purpose than the average investor. As a result, our investment process concentrates on understanding the long-term normalized earning power of a business well before the rest of the market gains interest.

This behavioral edge is the foundation of Robotti & Company's entire investment process.

2013 in Review

The single largest factor contributing to our relative underperformance in 2013 was the market price depreciation of our largest investment, Subsea 7 (OB:SUBC). It is important to distinguish between a company's market price, which in this case fell 21.3%[2] in 2013, and an estimate of a company's intrinsic value, which we believe grew over the same period. We have long preached that the market price of a security does not necessarily indicate its true economic worth. We certainly believe this to be the case for Subsea 7 which, in our view, has only become a more attractive investment at its current price.

This year has not only tested our intestinal fortitude, but also our commitment to maintaining a behavioral edge. We recently read an interview in a well-known value investing publication where an investor explained that one of his advantages comes from not committing additional capital to a stock that declines in price. While that strategy may work for some, the opposite has proven to be successful for us. In fact, as we have said in the past, we often assume that our initial purchases will be among the most expensive. For us, an ideal situation is one where our conviction rises while the stock price falls. Subsea 7 is a good example of this situation and we have committed additional capital to take advantage of what we perceive to be an overlooked opportunity.

[2] Data taken from Bloomberg from 1/2/2013 – 12/31/2013

Robotti & Company Turns 30

In 2013 we celebrated a tremendous milestone - our 30th anniversary. Over the past two years I have been invited to speak at some of the premier value investing conferences in both the U.S. and abroad. Preparing presentations for these conferences with the help of two of our research analysts, David Kessler and Theo van der Meer, has forced me to reflect on how we have been able to achieve above average results over the past 30 years and how we will continue to produce those results.

We have had numerous discussions on this topic, covering the whole spectrum from skill to luck. I am very aware of the role that good fortune plays in investing specifically and in life in general. Some of my colleagues might say that I overweight the contribution of that fact. However, it also seems logical that the length of our record reduces the likelihood that just luck explains our performance.

One question asked at almost every event where I have been invited is whether a value investor should focus on the macroeconomic data. While this has always been something of a 'hot topic' for value investors, it has become a particular focus for many since the global financial crisis.

Our answer is that investors are asking the wrong question. Value investing has always been about understanding companies from a bottom up perspective. That being said it would be foolish to think that the companies we invest in operate in a vacuum. The real necessity to our investment approach is to determine and understand the handful of specific issues that will determine whether a particular investment yields a poor, average, or superior return, understanding that often some of those drivers will happen to be macro based.

Connecting Theory to Practice

Offshore oil and gas exploration and development is an area we have followed for decades and over that time we have been exposed to countless management teams. We have accumulated significant information and knowledge in this area over the past 30 years.

The data we have acquired gives us appropriate conviction that the number of offshore fields to be brought from discovery to production in the coming years is poised to grow significantly. Years, and even decades, of investments by major oil companies have created a tremendous set of opportune economic projects that, when Subsea 7 completes its work, should produce decades of cash flow.

Hydrocarbons remain the world's primary source of energy and, as a result, the largest energy producers continue to invest vast amounts of money into its production and development. Over the past few years we have observed a shift in this industry from the development of multiple smaller projects to the development of significantly larger 'megaprojects.' The consolidation of producers' resources into fewer big projects increases the risk profile of each individual project and, with riskier projects in more complicated and unpredictable environments, big oil needs to hire established companies like Subsea 7.

When we digest the information from competitors, as well as Subsea 7's performance, and watch project backlog balloon from $8 to $12 billion in 2013, we feel confident that the ultra-deepwater oil and gas sector and Subsea 7 are very well positioned. We believe this even though the price has fallen substantially this year, mostly due to what we and the company believe to be a one-time event in Brazil.

For more information on the events that contributed to Subsea 7's market price decline, I would refer you to my 2013 second quarter letter, where I expounded on it in more depth.

One might conclude that we do not focus much on macroeconomic issues since we do not have a precise forecast for the price of oil or gas in 2014, nor do we have a precise estimate of the volume of hydrocarbons that will be produced in 2014. Our focus is not on these specific data points, but instead we want to understand how the events of the past few years will affect the dynamics of the next few years. Our ability to predict oil prices next year is limited, but to make an informed decision, one does not need that level of specificity. Our belief is echoed by Warren Buffet who said, "Using precise numbers is, in fact, foolish; working with a range of possibilities is the better approach."

Heavy Equipment Distribution

As we have discussed, our investment philosophy requires us to develop a deep understanding of specific businesses and the industries in which they operate. While this analysis leads us to determine and better understand the handful of specific issues that will determine the outcome of a particular investment, it also has another advantage. Very often we discover additional attractive investment opportunities along the way.

We have owned shares of Toromont industries (TSE:TIH), the second largest Caterpillar dealer in Canada, since 2009 when it acquired Enerflex (TSE:EFX). Not even a year later, Enerflex was spun back out of Toromont and we ended up with shares in both standalone companies. This unique series of events provided us with insight into a previously unfamiliar industry that meets many of our investment criteria.

The equipment distribution business is a great business marked by significant barriers to entry, high free cash flow generation and above average returns on capital. Fortunately for us, the business has historically been, and we believe will continue to be, cyclical. Most investors want or even demand steadily rising returns. As contrarians with a long time horizon, we are comfortable with lumpy returns, as long as we can understand the potential outcomes over an entire business cycle.

Original equipment manufacturers ("OEMs") that make large mining, construction and agricultural equipment include companies such as Caterpillar and Deere. These OEMs outsource their sales and distribution, allowing them to focus on their core competency: the production and innovation of heavy equipment. The OEMs employ the services of distributors who enjoy barriers to entry in the form of exclusive territory rights bestowed upon them by an OEM. The equipment distributors not only sell new and used equipment, but they also service machines and provide other aftermarket services within their territories.

Through the course of our research to better understand the drivers of the equipment distribution industry, we met with the management of Wajax Corp in Missauaga, Ontario. Wajax is a distributor that instead of being captive to any one OEM distributes machines made by several companies such as Hitachi and JCB. Even with the diversity of companies Wajax can distribute, they still have exclusivity on certain lines. While we were intrigued by the industry which had just started recovering from the global financial crisis, we were less clear about the magnitude of the opportunity for Wajax. Over the following months, as the outlook for mining deteriorated significantly and the company lowered its dividend, shares fell almost

40% to a low of $27.18 by the end of June. In June we initiated a position in Wajax at prices we feel were opportune.

Conclusion

For more than three decades, we have had excellent success investing in good businesses facing near-term headwinds at very depressed valuations. We believe that history has proven this to be a successful investment approach. So why isn't it practiced by more professional investors? Not only do we need to have the behavioral edge to invest as we have, but we need our clients to share the same edge. Investors can only be as good as their clients. Thirty years have flown by, and there is no question in my mind that we are now better investors than we were in 1983. Very few firms make it ten years let alone thirty, and today I am more thrilled than ever when I reflect on the long tenure that many of you have had with the firm. I sincerely thank all of you for your continued confidence, trust and patience. You are what makes this a successful firm, and with our continued hard work and collective patience I believe our success will continue.

Most Sincerely,

Bob Robotti

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