ROBO Global Index 3Q24 Commentary

September 30, 2024

The [ROBO Global Robotics and Automation Index (ROBO)] returned 5.6% during the third quarter of 2024, with earnings season commentary and macro events showing signs of recovery that indicate we may be past the bottom of the cycle. As an example, **Omnicell**, one of the top performers of the quarter (+58.9%), trades at just 1.8x Forward EV/Sales and is still down 4% year-over-year at the end of Q3. Similarly, Germany-based (+12.4%) companies in the portfolio also trade at relatively low valuations, albeit with slower and steady revenue growth compared to mega caps, such as **Duer** (+17%), which trades at 0.45x Forward EV/Sales and 2.45x Forward P/E.

This complex landscape of valuations and performance within the robotics sector suggests opportunities as the market recovers. The sector is currently experiencing a lag between new robotics deployments and ongoing revenues, due to factors such as the election year, pull-through from end markets, record high manufacturing construction in the US, and the emerging benefits and applications of AI in robotics.

Q3 2024 saw notable developments across various aspects of the robotics sector. Japan constituents, representing 20.7% of ROBO, were up 7.8% for Q3, demonstrating resilience despite temporary market fluctuations, namely the Japanese reverse carry trade. The initiation of interest rate reductions bodes well for the capital-intensive robotics space, with potential post-election clarity likely to amplify this positive effect. Technological advancements continue apace, with ongoing development in humanoid and autonomous mobile robotics across various applications. Major players are also entering the field, exemplified by **Apple's** reported internal launch into home robotics. It's worth noting that while ROBO includes many recognizable brands, it also comprises numerous "behind-the-scenes" players that contribute significantly to the sector's value and innovation.

The **sensing** subsector (+17.1%) exemplifies the strength and diversity within ROBO. It includes rising stars like **Samsara** (+41%), which excels in physical automation tracking, alongside established Japanese companies such as **Omron** (+40.3%) and **Keyence** (+13.7%). These firms provide crucial industrial automation sensing solutions, playing a vital role in empowering manufacturing and automation processes worldwide. Their strong performance underscores the growing importance of advanced sensing technologies in the global robotics and automation landscape.

Computing and AI, the weakest subsector this quarter (5.1%), experienced a cooling off period for some of its recent high performers. Companies like **Microchip** (-11.6%), **Qualcomm** (-14.3%), and **Cadence Design Systems** (-10.9%) saw a slowdown after nearly two years of strong AI-driven momentum since the Q3 2022 low. This shift suggests a more diverse pattern of returns emerging within the sector. Notably, even industry leader **NVIDIA** (-1.7%) found itself in the bottom third of performers, indicating a potential rebalancing of growth across the AI and computing landscape.

ROBO's Q2 earnings season delivered positive surprises on both top and bottom lines. However, overall year-over-year EPS declined by 7.7%. Despite this, full-year estimates remain optimistic at +8.6%, with expectations of a stronger Q4 to end the year. Looking further ahead, projections indicate a robust 20.7% growth in 2025 (based on weighted-average FactSet consensus as of Sept. 27, 2024). Notably, the portfolio's profitability profile is set to improve, with the percentage of profitable constituents expected to increase from 95% in 2024E to 99% by 2026E, underscoring the sector's growing maturity and financial stability.

The late-quarter rebound in China has primarily benefited larger tech players, but the effects of stimulus measures are expected to spread to the broader economy, potentially boosting companies with Chinese exposure, including many of our Japanese constituents. ROBO's recent addition of **Hon Hai Precision Industry** (commonly known as **Foxconn**), with an estimated 75% of its operations in China, reflects this trend. However, **Foxconn's** expanding automation capabilities in countries like India and Vietnam also highlight a broader shift towards diversifying manufacturing bases, a development that could reshape the robotics and automation landscape in Asia.

We believe the manufacturing cycle has reached its nadir, signaling potential upside for our largest subsector and tech areas such as **Actuation**. While projections for full-year 2024 show year-over-year sales declines for 27 out of 78 constituents, the outlook for 2025 is significantly more positive. Only three constituents are expected to see declining sales in 2025, with the overall portfolio anticipated to achieve 10.6% sales growth (based on weighted-average FactSet consensus as of Sept. 27, 2024). This forecast underscores our confidence in the sector's recovery and growth potential.

Looking ahead, numerous promising applications are on the horizon, with immediate catalysts emerging in semiconductor and energy manufacturing. However, current valuations do not yet fully reflect this potential, presenting what we believe to be attractive long-term opportunities as this new cycle unfolds. Importantly, the impact of AI on robotics is still in its early stages and should not be underestimated. As this synergy develops, it could drive significant innovation and growth in the robotics sector, potentially reshaping the industry landscape in the coming years.

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