O'Keefe Stevens Advisory

Q2 2026 Investor Letter

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O'KEEFE STEVENS
ADVISORY, INC.

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During Q2 2026, we saw market dispersion between the perceived or true AI losers and the AI winners. We positioned early in the AI infrastructure stack even if, at the time, AI was an unknown. We were able to harvest gains as the market repriced those positions higher. In some cases, we trimmed despite business materially improving, because the stock price had moved ahead of the underlying thesis. Our positions in NVIDIA, Qualcomm, and Corning were put on almost a decade prior to the AI boom. Q2 gave us the opportunity to take some gains.

The second quarter delivered one of the strongest equity rallies in two decades. The S&P 500 returned 15.2%, the Nasdaq surged 21.4%, and both posted their largest quarterly gains since the second quarter of 2020. The Russell 2000 returned 21.5%, capping the best first half for small caps since 1991. The advance was broad; nine of eleven sectors rose, and by quarter-end, leadership had expanded well beyond the names that dominated earlier in the year.

The Software Selloff

The software sector's collapse presents a different kind of opportunity, though not one we pursued in the quarter. The iShares Software ETF (IGV) declined ~27% through April before rallying meaningfully in May and June, and at one point was positive on the year. When outcomes are wide, expect there to be volatility along the way. This volatility is the opportunity.

Software stocks whose platforms can be vibe-coded or applications that can be coded in-house cheaper and designed specifically for companies have come under the most pressure. The market is a discounting mechanism; when the long term becomes highly uncertain, discount rates increase and stocks reprice lower. What's challenging is that near term, these companies are unlikely to show material deterioration in their financials; assessing the durability and moat of the asset is likely going to take time. Thus, one must be willing to potentially sit on dead money until the disruption risk is priced at a lower level.

We often look for opportunities in areas where there is significant perceived risk, and nobody wants to own it. Today's software sector fits that description. We suspect investors are using software shorts to fund purchases of perceived AI winners on the long side. Current market structure creates a funding relationship: selling software, buying semiconductors and infrastructure. If that dynamic ever flips, if the perceived AI winners become sellers or funding shorts themselves, the rotation back into software stocks could be a violent whiplash. We are not yet buyers. But we are watching. Thus far, our internal focus on implementing AI and using it as a key tool in our research has allowed us to identify which companies are most at risk.

New Position: Sotera Health (SHC)

We have been following Sotera Health for several years. The business is exceptional: a sterilization duopoly with Sterigenics and Steris combined controlling an estimated 70% of the sterilization market. Sotera's Sterigenics business boasts 50% EBITDA margins, mission-critical regulated services, and cobalt-60 production that is nearly impossible to replicate. Yet we never bought it because of one thing: Warburg Pincus held a material stake and was consistently selling into the market. We do not buy high-quality businesses where forced sellers will pressure the stock regardless of fundamental improvement. We look for situations where forced sellers create dislocation, allowing us to buy a stock for cheaper than what it would trade for without such selling pressure. On the flip side, we look to sell into forced buyers pushing stock prices up irrespective of fundamentals. In early 2026, Warburg sold its last share. Combined with a valuation that was cheap given the quality of the business model, we thought it made sense to purchase the stock.

At their November 2024 Investor Day, management outlined a 2025-2027 plan targeting 5%-7% organic revenue growth and 5%-8% adjusted EBITDA growth, with at least 50bps of EBITDA margin expansion annually. Sterigenics represents over 60% of revenue, and we expect it to grow at mid to high single digits organically. The company targets cumulative free cash flow of $500m-$600m over the three-year period, which we expect will be much higher post-2027 when capex runs at a more normalized level.

Sotera recently completed capacity expansions and greenfield buildouts, which elevated capex. As those projects mature, capacity is absorbed, and CapEx will normalize and decline, driving higher cash conversion. Cash flow will go toward debt reduction, with net leverage currently at 3.2x. Outstanding ethylene oxide litigation, concentrated in California and Georgia, is expected to be resolved by the end of 2027. When litigation risk abates and the balance sheet improves, the market will price the business on its fundamental quality: a duopoly sterilization franchise with 50% EBITDA margins, 20 consecutive years of revenue growth, and management executing a credible margin improvement plan. Today, the stock is depressed by litigation headlines and a balance sheet that is more levered than we would like, in conjunction with the potential legal payout.

In May 2026, Alton Shader took over as CEO. Shader comes from Viant Medical, where he served as CEO since 2019, and holds a Stanford MBA. Prior CEO Petras, who scaled the company from $600m in 2016 revenue to $1.6B in 2025, remains as executive chairman focused on investor relations, commercial operations, and litigation strategy. We believe this is a step in the right direction. Petras had to balance operational management with significant litigation oversight. Shader can dedicate substantially all of his time to operating the business efficiently. Our experience is that when management has ongoing time spent outside the core business, even a high-quality business is not immune to bloat and less-than-perfect operational practices. When these distractions end, operational improvements typically follow. Sotera's 20 years of consecutive revenue growth and 50% EBITDA margins suggest a very high-quality business. Steris has not gone through similar litigation, and thus has taken share during this. We expect a focused management team to regain share.

The business model's durability stems from three interlocking dynamics. First, switching costs are extraordinarily high. Once a medical device is validated for sterilization at a specific facility, changing that facility requires extensive regulatory work, testing, and approval. A device sterilized in one location cannot simply move to another without undergoing significant re-qualification. That regulatory friction creates a durable moat. Customers are effectively locked in.

Second, the sterilization service represents a low single-digit percentage of the total manufacturing cost of a medical device. Because it is such a small percentage of overall device cost, customers are willing to pay for convenience and reliability rather than shop aggressively on price. Geography matters enormously. Shipping a device from Michigan to Arizona (for example) for sterilization becomes economically irrational when a facility exists nearby. Sotera's geographic footprint means customers pay a premium for proximity and certainty, not to compete on commodity pricing.

Third, regulation has created supply-side dynamics that favor consolidated operators. In April 2024, the EPA finalized stricter ethylene oxide emissions standards for sterilization facilities. Sterigenics responded by committing roughly $200m of capital to upgrade its facilities to comply with the strictest version of the rule. In 2026, this capex should total ~$50m and will largely complete facility improvements.

In July 2025, the Trump administration granted two-year compliance extensions to 41 sterilization facilities, acknowledging that the 2024 rule would force closures. Even with those extensions, smaller operators are under pressure. KPR's Augusta, Georgia facility is closing, affecting over two hundred employees. Cosmed Group filed for bankruptcy under EtO litigation exposure. As supply comes offline and capacity remains constrained, Sotera will capture displaced volume at improved pricing. In March 2026, the Trump administration proposed rescinding and relaxing key portions of the 2024 rule, citing concerns about facility closures and domestic medical device supply chain disruption. The public comment period closed May 15, 2026, and the EPA should finalize a decision within the next year.

Regardless of which direction the final rule takes, Sotera stands to benefit. Industry-wide sterilization capacity is running tight. Sotera targets 80% utilization across its portfolio, and management reports a good operational position globally despite occasional regional pinch points. If the EPA finalizes the strict 2024 rule, Sotera's capital spend is justified, and competitors without the scale to absorb compliance costs will exit. If the agency relaxes the standards, the majority of Sotera's compliance capex is already behind them and should lower the probability of future litigation risk. We see 50% near-term upside; however, we are planning to own this durable business for many years. Post-litigation, we would label this as a compounder.

Portfolio Activity: Trimming Qualcomm & Corning

Beyond Sotera, we repositioned within our existing AI infrastructure holdings. Qualcomm and Corning both appreciated materially in Q2. We trimmed both positions using a combination of options and stock sales.

Qualcomm faced a long-standing structural challenge: customer concentration in Apple, which is internally developing its own modem and transitioning away from Qualcomm silicon. Qualcomm hosted an investor day in June, with all eyes focused on their AI and datacenter strategy. Qualcomm has long been seen as a loser in AI stemming from higher memory prices driving down phone demand, and in turn QCOM's handset business. Qualcomm's diversification strategy continues to play out.

At the investor day, Qualcomm doubled its fiscal 2029 non-handset revenue goal to $40 billion, lifted its automotive revenue target to $10 billion, and struck a deal with Meta to supply data center CPUs for AI infrastructure, with production of its Dragonfly C1000 slated for 2028. We trimmed due to the position becoming oversized in the portfolio, and risk/reward was no longer as attractive.

Corning appreciated over 20% in Q2. Corning spent the second quarter signing up the biggest names in AI as customers and partners. In May, Nvidia and Corning announced a multiyear commercial and technology partnership under which Corning will increase its U.S. optical connectivity manufacturing capacity tenfold and expand U.S. fiber production by more than 50%, including three new plants in North Carolina and Texas. Nvidia paid $500 million for rights to Corning shares, including warrants on up to 15 million shares at a $180 exercise price; if exercised in full, Nvidia's total equity investment could reach $3.2 billion. In June, Amazon signed a multiyear, multibillion-dollar agreement for Corning to supply the optical fiber, cable, and connectivity for its expanding U.S. data centers. These follow the up to $6 billion supply agreement Meta signed in January. Historically, data centers used copper cables to connect their technology, some of which is switching to fiber. Corning's fiber may be a future bottleneck. As legacy data centers convert to newer, fiber-connected racks, Corning contends with new data centers demanding fiber and replacement racks demanding fiber.

Q2 2026 Winners and Losers

Winners	Q2 2026 Performance	Losers	Q2 2026 Performance
GLW	87.50%	HCC	-13.00%
SPHR	47.50%		
QCOM	43.80%		
CALY	35.50%		

Sphere Entertainment (SPHR)

During the quarter, Sphere continued its strong performance as the market realizes the strong underlying unit economics, in the face of weaker Las Vegas Strip attendance. Continued success in Vegas makes selling future Spheres easier. Sphere Abu Dhabi remains on track, which, given the ongoing war, was a concern. Finally, Sphere announced a new immersive experience, "Rocky Horror Picture," which should add incremental, high-margin shows to the slate, increasing utilization. While the Sphere story has largely played out (at least episode 1), we are inclined to let an N=1 asset the leeway to become a large position even though the valuation is much different today. Great assets and management teams often have longer right tails than one may initially underwrite. While most believe Vegas is forever in decline, visitation trends were positive y/y in May and represented the 3rd month of the year with positive y/y growth. Visitation and comps are substantially easier, concerts continue to perform well, and new films should drive visitation and revisitation at strong rates, even with The Wizard of Oz coming up to its first anniversary. While the Sphere show slate is nearing the optimal/maximum number of shows per year, the exosphere is an incremental high-margin opportunity that will become an important revenue driver.

Callaway Golf (Ticker: CALY)

Post the announced sale of their TopGolf business, the next catalyst to the story is demonstrating the clean, high-quality business of the remaining club, ball, and apparel business. Q1 net sales rose 9.2% to $687.5m, adjusted EBITDA climbed 31.1% to $163.7 million, and non-GAAP net income from continuing operations increased 96%, with gross margin up roughly 260 basis points, absorbing about $18m of incremental tariff expense. Management raised its full-year outlook, and the summer thus far has been a net positive for the golf industry. On capital return, through April 30, Callaway repurchased 5.6 million shares at an average cost of $14.08 ($79 million of the $200 million authorization), and on May 1 the company settled its $258 million of convertible notes in cash and remains in a net cash position. Our thesis continues to play out, and while the stock has materially appreciated, we still see upside to numbers. Management is acting exactly as expected, reducing debt, returning capital – a complex-to-simple story easy for all to understand better.

Warrior Met Coal (HCC)

Unsurprisingly, a commodity-producing company's stock experienced significant volatility during the quarter. Had the quarter ended one month prior, it's possible we would have been talking about Warrior as a top performer during the quarter. On May 23, 2026, a gas explosion at a coal mine in Shanxi province killed 82 workers, making it China's deadliest coal mining accident since at least 2009. The blast occurred at the privately owned Liushenyu mine in the coal-belt region of Shanxi, and a deadly gas explosion occurred at the Liushenyu Coal Mine in Qinyuan county with 247 workers underground; all four coal mines under Tongzhou Group suspended operations following the incident, driving met coal prices higher. Blue Creek remains the next leg of the story. Increasing production and sales volume at this mine should drive revenue and EPS growth, even in the face of an overall weaker met coal pricing environment.

Closing

We enter the third quarter positioned much as we have all year: with cash as one of our largest holdings for the third consecutive quarter. We hold cash not because we predict a decline, but because the number of businesses trading at prices that justify deployment remains small, though increasing. Sotera is one example; however, when everyone focuses on the shiny AI object, investors often overlook other sectors, which increases the odds of finding a bargain.

We have also taken steps to protect what the market has given us. On our larger appreciated positions, including Qualcomm and Corning, we used options to hedge downside risk in addition to trimming. We expect wide fluctuations in AI-related stocks to continue. The out years of AI capital spending remain an unknown. What model(s) are the winners is unknown. Do token budgets start to get reigned in? Does AI materially start to displace white-collar jobs, driving up unemployment? Many unknowns, and the market tries to reprice these odds daily, resulting in significant volatility.

Geopolitics added a second source of volatility. The war with Iran has closed and reopened the Strait of Hormuz, damaged refining capacity across the Gulf, and combined with strikes on refineries to take millions of barrels per day of refining capacity offline. Gasoline is back above $4/gallon, and refining margins sit at record levels. Events like these are not predictable. Owning durable businesses at reasonable prices, holding cash when prices are not reasonable, and hedging concentrated gains is how we prepare for what we cannot predict.

As always, we thank you for your trust.

Portfolio Top 5 Holdings

At the end of the quarter, our top 5 positions were Cash, NVDA, SPHR, GLW, and CALY.

Regards,

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