Suncoast Equity Management, Inc.

January 7, 2008

Dear Client:

The conclusion of 2007 marks SEM's tenth year of preserving capital and making it grow. The first ten years have yielded solid investment returns for SEM clients, while the nation was experiencing; two stock market based manias, several financial crises, and various global events, particularly September 11, 2001, that will be remembered always. Looking forward, we believe that continuing to implement the **SEM Disciplined Investment System (SEM-DIS)** will result in above market results while incurring less risk.

The past ten years, and especially the stunning volatility of 2007, hold numerous instructions for intelligent investing that we can learn from and take forward. Bringing to light a few of these and reviewing our investment process will keep us on track to achieve the similarly good results earned in the first decade.

Investment Results – First Ten Years

For the first ten years SEM accounts advanced at a rate of three points (net of all fees) above the Standard & Poor's 500. The summary results are presented below:

	Annualized Return	Cumulative Return	Growth of $1 million
SEM	+8.88%	134%	$2,342,500
S&P 500	+5.88%	77%	$1,771,800

For 2007, SEM earned 10.13% (net of all fees) versus 5.48% for the S&P 500. At the end of our letter we have included a year by year review of our results and the customary table showing the performance for various periods.

We believe that our relative performance earned of plus three points during our first ten years is sensible to expect over a ten year period or longer. We always work to improve that performance though we will never jeopardize our strategy of taking less risk. During our first decade, the equity market posted a return meaningfully below its historical average of the 10% level. Stock market predictions by us, or anyone for that matter, are not worth the paper they are written on. Notwithstanding, we will climb out on the proverbial limb by telling you that duplication of the first ten years is a reasonable base to work from.

<u>Lessons of the First Ten Years -</u>

Human behavior in the past, present and future is the ultimate albatross for most investors looking to achieve market or better returns. The mistakes most investors make are deeply rooted in the human factors that we all have in common, social proof (the tendency to do what everybody else is doing) by chasing hot trends, need for instant satisfaction, temptation, and other emotions and actions that are counter to calm and patience.

Human behavior makes the marketplace. It can be wild at times, with 2007 a great example. As can be seen in the following graph of the 2007 performance of the S&P 500, the volatility was stunning as the index touched breakeven or went negative three times (early March, mid August and mid to late November) and rose to double digit positive returns twice (mid July and early October), only to settle at +5.48% at year end.

Without a doubt, 2007 would have been a year to travel to a deserted island and return at year-end; however, the stock market is open five days a week and participants can't help themselves. The action is far too enticing to pass up. Cramer, the "sage" of CNBC, is now flanked nightly by a cast of five characters in a mosh pit exchange aptly named "Fast Money." On the eve of **Nike**'s (NKE) quarterly earnings report on December 19th, one of panelists of "Fast Money" was quoted as saying "…as a trade I would sell the stock (NKE). NKE will beat earnings (expectations) but I think the street will sell on the news. However, as an investment I believe NKE is a good hold." *Someone please interpret this gibberish for me!* The sources to get instant advice will only increase and yet they don't add any value to successful investing. If you had not seen a single show all year you are to be congratulated for finding a more productive use of your time. The ride of 2007 is an awesome demonstration that you can never tell how the market will perform in any short term period and that attempting to time the market is a complete waste of effort.

The first ten years have gone by quickly and a lot of curveballs have been thrown at investors to swing at and some fastballs to brush us off home plate completely. Below is a list, since our inception in 1998, of the events that knocked many market participants for a loop.

Event	Year
Asian Financial Crisis & Long Term Capital Collapse	1998
U.S. Embassy Bombings Kenya and Tanzania	1998
Clinton Impeachment	1998
Fears of Y2K Computer Glitch	1999
Technology Bubble Burst and Severe Market Correction	2000 - 2002
Terrorist Attack on U.S. World Trade Center and Pentagon	2001
Anthrax in the Mail	2001
U.S. Economic Recession & Enron Collapse	2001
MCI/Worldcom Files Chapter 11 bankruptcy	2002
U.S. Enters Iraq	2003
Space Shuttle Columbia Tragedy	2003
Indian Ocean Earthquake, Tsunami kills 200,000	2004
Hurricanes - Katrina hits New Orleans	2005
Crude Oil Rises from low $30 to $100 per Barrel	2004 - 2007
Commodity (Aluminum, Copper, Gold, Grain) Prices Soar	2004 - 2007
Housing Bubble	2007
Subprime Mortgage Mess and Credit Crisis	2007

Close your eyes and imagine this is the beginning of 1998. If someone gave you a crystal ball (or the headlines from the New York Times, minus the stock tables and related data) and you knew all of the above events were forthcoming, but didn't know when they would hit during the ten year period, what would you have done with your portfolio of investments? Stayed in cash? Most likely and you would have lost out on the solid returns earned by SEM clients.

So how did most investors fare over the last ten years? Not much better than cash, but again this is attributable to the shortcomings of human behavior. The information below is from the research firm Dalbar and it shows that average mutual fund investors have a hard time sticking with their selections and the consequences of their actions.

Annualized Returns	1 Year	3 Year	5 Year	10 Year	20 Year
Average Equity Fund Investor	8.3%	15.3%	1.6%	5.8%	3.9%
S&P 500 (Buy and Hold)	4.9%	14.4%	5.0%	9.1%	11.9%

Source: Dalbar, Inc. - Data through 12/31/2005, which represents most current data available as of 12/31/06.

John Bogle, the well-respected former CEO of index pioneer Vanguard, recently corroborated the above study with his own that revealed over the last ten years, the average mutual fund investor earned about 3% annually, well below that of the market and average mutual fund. The data, though it differs a little among the supplier, tells an important story. Improving investor's actual returns depends more on correcting human behavior than on the performance of their investments. The conclusion is easy to see but hard for many to accept. That old saying, you can lead a horse to water but you can't make it drink, is apropos.

*We want to thank you and congratulate you for staying the course with **SEM – DIS**…the studies show it is the right thing to do.* We have little expectation that the Dalbar statistics above will improve when we revisit them in ten years. I care more and hope, that you will still be here with us as clients in 2018. If you have engaged a manager with a solid record who practices their investment discipline with consistency and low risk, just stay put.

Investing 2008-2018

As we turn towards the next ten years, you should know that **SEM-DIS** is as relevant going forward as it was in the past. The implementation is tweaked over time as changes in the global economy evolve but by and large it is ***basic business analysis and good judgment.***

What has always separated SEM from most other market participants, "professionals" as well as all those consumed by CNBC, is our adaptation of the sound principles first laid down by the father of investment analysis Benjamin Graham:

1. **We invest in businesses, not stocks**
2. **Our "Margin of Safety" attitude**
3. **Our approach to the stock market**

We invest in businesses, not stocks. We have partial ownerships in dynamic businesses that have real value. Most investors don't consider this thought as they look at the line item on their brokerage statement or the symbol and stock price flashing across their TV or computer monitor.

Margin of Safety is making every effort to prevent a permanent loss of capital. Each practitioner of the Graham/Buffett way defines margin of safety within their own process. However, Buffett summed it up best by saying there are only two rules in investing everyone should adhere to; (1) Don't lose and (2) Don't forget the first rule. We discuss below how we work to reduce risk and minimize loss by establishing specific parameters within **SEM-DIS.**

Approach to the stock market. When we value the business, we don't look to the stock market price for guidance. There are two prices for every stock: the daily price on the exchange and the price (intrinsic value) of the business that accrues to a shareholder in the long term ownership of that business or the negotiated price (intrinsic value) realized when a business is purchased by another party. We assess price (intrinsic value) through our objective business analysis. Often times, the stock market assigns an irrational price to a particular stock and a de-link between price and intrinsic value exists. It is our responsibility to compare the approximate intrinsic value of the business to its stock price and perhaps take action when huge differences exist.

We put these principles to work in a framework we call **SEM-Disciplined Investment System.** **SEM-DIS** is our measured process for selecting high quality company ownership for the long term. Here is how it works. As can be seen in the graphic on the final page of this letter, we begin with a universe of approximately 3,500 companies. This covers companies from small market capitalizations to the largest market capitalizations of U.S. publicly traded companies (we own a few of the top 10 largest including **General Electric**, **Microsoft**, **Procter & Gamble** and **Berkshire Hathaway**). We cast a large net that includes many international domiciled companies available to U.S. investors through the American Depository Receipts program. One example of this in our portfolio is **Nokia** (NOK).

Our preference, within Graham's principles, is to own low risk, higher quality growing businesses. So our first step is to identify, update and track in our system the few hundred companies that broadly meet our basic criteria of an above average business. We have explained in the past that the stock market has earned a total return of approximately 10% over the very long run, appropriately reflecting the aggregate return on total capital earned by American businesses. Consequently, our first cut is focused on businesses that earn stronger returns on capital and do so without the heavy use of borrowings. Seeking companies that have low debt to total capital or cash flow provides a company with meaningful advantages versus its competition during economic slowdowns. The business must also be free cash flow positive; if you think about owning a business in its most basic form, this is the most important element. If we were partners in a bowling alley and every last dollar that flowed into the cash register was subsequently removed to pay for shoe supplies, snack shop costs, bowling balls and new equipment and repairs, what is the value of that business to you or any one of us? The answer is $0! Many publicly traded businesses have breakeven cash flow; or worse, they experience very long periods in which investors hope that one day the cash flow will turn positive. Our inclination is to pass and invest in enterprises with proven free cash flow.

This first step also handles some additional margin of safety elements. For one, it eliminates those companies that we have less confidence in assessing their potential risk level or that fall outside the line of businesses we have experience or comfort analyzing their financials. Companies that fit this general profile for us include many financial companies or commodity specific companies such as metals and mining stocks.

Our knowledge of the few hundred companies that make the first cut is cumulative. We have been studying these same couple of hundred companies for over fifteen years and as a whole the group doesn't change too much. You have a few, perhaps between 15-25, that enter and exit each year. The economics of most businesses don't drastically change over a five year or so time frame, and that is what we are looking for. Though that is not to say that companies or industries don't strengthen or weaken over time and some undergo permanent change (newspapers come to mind). To illustrate our primary point, although the economics for health care products company **Johnson & Johnson** have softened over the years, the company still meets our basic criteria and we continue to keep a watchful eye. At the other extreme the return on capital for **General Motors** has not changed from a very low level during the last 30 years, and it has never met our criteria and most likely never will.

Since price and value de-link often, especially in a very volatile stock market, we regularly screen the group of companies that meet our basic criteria for attractive value situations.
As we drill down in our coverage universe this comprises a hundred or so companies that we actively review and stay current on. We examine these companies to understand their business and hunt for markers that drive intrinsic value. We examine fundamentals and take note of product, service or franchise innovation, as well as operational strengths that include large scale or low cost advantages. We look at changes in the growth outlook for the business and review the sustainability and reasonableness of company forecasts, especially in relation to its own

history. As we review the company financial statements we also seek information about management's abilities and the position of the company within its industry.

When we assess the intrinsic value of a business, both qualitative factors and quantitative factors play a part. We look at all the angles. In its purest form the valuation range that is assessed resembles our best judgment of what the present value of future profits of that company will be. On the qualitative side you have to decide if that particular business can keep up or strengthen it's offerings and monitor it on a going forward basis. Margin of safety reenters the picture as you can tell that those businesses that have a clear opportunity to repeat and build upon their present success have more predictable valuations. The requirement of predictable and consistent business growth explains our bias towards larger and more established companies with longer records of success. From a quantitative perspective, we also constantly monitor the stock price to value relationship in comparison to other opportunities that we can invest in be it other publicly available businesses or fixed rates of returns.

When we identify a suitable business for the portfolio, we monitor it very closely in comparison to our current holdings. Our portfolio is fairly concentrated and it will remain so, always maintaining 15 to 25 companies. The 26th, 50th or 75th best ideas are not likely to be as valuable. Portfolio weightings per position average 4% to 6%. Any variation can be attributable to relative business strength and relative valuation attractiveness.

<u>Bringing it all home</u>

As Warren Buffett once remarked about proper investing, you either get it or you don't. This generation of investors seems to be a group that doesn't get it, based on both anecdotal evidence (information age overload) and the data compiled for the average mutual fund investor shown above. My grandparent's generation "got it" and we have clients that "get it", including some that have been part owners of companies like **GE, MSFT** for a decade or so prior to SEM's beginning.

In order to succeed, we don't have to predict every economic or global event ahead, recessions included, or have an opinion on all 3,500 stocks in our universe. In spite of our solid returns in 2007 and for the ten year period, there will be times in the next ten years when it seems that nothing works and having the knowledge of how our process works from this and our earlier letters may help you to continue the journey through the tough periods.

I thank you and congratulate you for staying in the **SEM** saddle and understanding that long term ownership of high quality companies will produce satisfying returns. We look forward to the next 10, 20, 30 and hopefully 40+ years ahead (Buffett is 77 and I'm only 41) as the building blocks are in place and growing at SEM to continue and support our passion and desire to work hard on your behalf. Again many thanks for your consideration and support. Please call any time.

Best wishes for a Happy and Healthy 2008!

Sincerely,

Donald R. Jowdy
President

Performance results versus the Standard & Poor's 500 Index

Time Period (Ended 12/31/07)	SEM % Return*	S&P 500 % Return	SEM - Value of $1,000,000	S&P 500 - Value of $1,000,000
2007	+10.13%	+5.48%	$ 1,101,300	$ 1,054,800
Three-Year	+5.84%	+8.59%	$ 1,185,500	$ 1,280,600
Five-Years	+9.88%	+12.81%	$ 1,602,300	$ 1,827,500
Seven- Years	+5.25%	+3.28%	$ 1,431,400	$ 1,253,300
Ten Years (Since Inception)	+8.88%	+5.88%	$ 2,342,500	$ 1,771,800

* Composite results of all SEM managed accounts, net of all fees.
Note: Results for the three, five, seven and since inception periods represent the annual average rates of return.

SEM Composite Account vs. the Standard & Poor's 500			
			Relative
Year	**SEM***	**S&P 500**	**Results**
1998	26.19%	28.57%	-2.38%
1999	24.10%	21.03%	3.07%
2000	4.50%	-9.15%	13.65%
2001	0.35%	-11.91%	12.26%
2002	-10.98%	-22.15%	11.17%
2003	20.12%	28.62%	-8.50%
2004	12.52%	10.96%	1.56%
2005	-0.51%	4.86%	-5.37%
2006	8.20%	15.77%	-7.62%
2007	10.13%	5.48%	4.65%
Overall Gain 1998-2007	134.25%	77.18%	57.07%
Average Annual Gain	8.88%	5.88%	3.00%

Suncoast Equity Management's (SEM) performance is Net of All Fees.

Highlight denotes years of meaningful underperformance.

Suncoast Equity Management, Inc.
Disciplined Investment System (SEM-DIS)

3,500 Stock Universe

Identify High Quality Businesses
- Strong ROIC
- Low Debt to Total Capital & Free Cash Flow
- Free Cash Flow Positive
- Growing Businesses

300-400 Candidates

Monitor & Assess Primary Candidates
- Financial Strength Review
- Consistency (Historical 5 to 10 years)
- Operating & Net Income Margin Trends
- Valuation Review

100-125 Coverage Universe

Select & Conduct In-depth Financial Review
- Product, Services and Franchise Strength
- Competitive Advantages & Barriers to Entry
- Operational Advantages (Advantages of Scale, Low Cost Producer)
- Sustainability (Over the Next 10 Years)
- Management-Owner Oriented, Candid & Communicative
- Valuation - Relative & Absolute

15-25 Portfolio Holdings

Portfolio Selection & Management
- Concentrated Portfolio
- Business Momentum & Development
- Margin of Safeties Remain or Build Strength
- Concentrated Portfolio
- Portfolio Weighting Emphasis on Best Performing/Best Value