



## Suncoast Equity Management, Inc.

April 2, 2003

Dear Client,

**Suncoast Equity Management's (SEM)** performance results versus the Standard & Poor's 500 Index for various periods ended March 31, 2003:

	SEM	S&P 500	SEM - Value	S&P 500 - Value
<u>Time Period (Ended 3/31/03)</u>	<u>% Return*</u>	<u>% Return</u>	<u>of \$1,000,000</u>	<u>of \$1,000,000</u>
Three Months	-0.20%	-3.10%	\$ 998,000	\$ 969,000
One-Year	-14.11%	-24.76%	\$ 858,900	\$ 752,400
Three-Year	-3.11%	-16.11%	\$ 909,500	\$ 590,500
Five-Year	+5.57%	-3.78%	\$ 1,311,500	\$ 824,500
Since Inception (5 1/4 Years)	+7.37%	-1.18%	\$ 1,452,600	\$ 939,500

\* Composite results of all SEM managed accounts, net of all fees.

**Note:** Performance results for three-year, five-year and since inception periods represent the annual average rates of return.

Portfolio changes in the first quarter of 2003 included the sale of our remaining holdings in Catalina Marketing for the reasons that were discussed in the December portfolio update letter. We increased Colgate to a full weighting and raised the funds to accomplish this by slightly reducing Amgen. In addition, we added to our Harley-Davidson position and lowered our ownership of Symantec.

Enclosed with this quarter's mailing is SEM's five-year fact sheet. I would like to recall from our last letter and fact sheet, that our **objective** is to *earn investment returns above the results of the market and most other money managers while incurring less risk*. Our **philosophy** and **methodology**, the **Suncoast Equity Management, Inc. - Disciplined Investment System (SEM-DIS)**, is implemented to achieve this objective. Its principles are also communicated in the enclosed fact sheet. The **SEM-DIS** methodology is a five step process, and we discussed most of step one, **Financial Performance and Strength**, in our last letter. Another company specific criteria and final contributor to financial performance and strength is free cash flow.

What is free cash flow? Free cash flow is the true profits earned by a business which are available to the owners at the end of each period, fiscal year, or other time period. Regardless of the size or type of

business entity, free cash flow from an owner's standpoint, is the excess dollars that show up in the cash register after all expenses have been paid. For example; if we owned a newspaper stand, free cash flow would equal sales less all expenses including buying the publications, the cost to rent the stand and to buy the cash register to count the collection of sales. It would equal our nightly deposit in our bank account. As part owners of **Hershey Foods**, it is the sales less the expenses, including the ingredients, the cost of the machines to make the product, and the complicated software to track and record all the information and accounting transactions. For large stock exchange listed companies, versus a single proprietor newsstand, important adjustments are needed to get an accurate measure of this number, though it is not that hard to calculate if you have the experience and accounting background as we do.

Why is free cash flow important to us as investors? It is one of the most important measures of the value of a business. For example, if you owned a newspaper stand and decided to retire and sell your business, a rational prospective buyer would want to understand to the best of their ability, how much free cash flow the business earns today and potentially into the future. That figure, though rough as it is because it involves predictions, helps determine what the buyer will pay for the business. The value of a business today is the present value of all the free cash flow profits that the business will earn in the future.

Certain businesses have economic characteristics that have consistently yielded an abundance of free cash flow year-in and year-out, whereas other businesses throughout their history have generated very low and in some cases negative amounts of free cash flow. **Johnson & Johnson** is an example of the former and most any paper producing company, for example **International Paper**, is an example of the latter. Over time, if a business never generates positive free cash flow, it will not appreciate in value for the owner. A long term historical review of **International Paper** proves this out. The stock price barely budged in 15 years as it properly reflects the very tough economics of a business that generates little to no free cash flow on a year-in year-out basis.

**The SEM-DIS** focuses its efforts on owning a collection of businesses whose economic characteristics earn an abundance of free cash flow each and every year and can grow that amount as time moves ahead. Another important factor in measuring the value of a business is how skilled management is in handling the free cash flow that is generated by the company. We will talk about this in future letters.

We believe that the **SEM-DIS** portfolio will continue to prove its value to you over the long-run. We hope you enjoy the attached fact sheet and please let us know if we can send a copy to a friend or family member. Thank you for your confidence and I look forward to speaking with you soon.

Sincerely,

*Don Jowdy*

President