## SEM Dividend Growth Portfolio Management Commentary

*Third Quarter 2022 (October 3, 2022)*

Our **Dividend Growth Portfolio (SEM-DG)** continues to hold up somewhat better than the index but like equities and fixed income in general, the total return remains negative year to date, -19.0% compared to the S&P 500 -23.9%. Despite the performance this year, we believe dividend paying companies are a valuable hedge against inflation and tend to be less volatile than non-dividend paying companies. We discuss the distinction between SEM DG and Dividend or Fixed "Income" portfolios, as well as how our dividend growth will be meaningfully above normal levels this year since two of our portfolio holdings significantly increased their payouts. Our companies regularly make allocation decisions between returning free cash flow to shareholders in the form of dividends and stock buybacks. Or they invest in organic growth and make external investments including equity stakes or acquisitions. A recent investment by one of our core holdings for long-term distribution rights in a fast-growing category is reviewed.

<u>SEM Dividend Growth versus "Income"</u>

SEM's "Dividend Growth" strategy is to own companies that generate a rising income stream over time. Our portfolio is not built to be an "income" portfolio, so it is unlike a "Dividend Income" or "Fixed Income" Strategy. Both of these strategies would have a higher yield than our current 2.1% dividend yield. A "Dividend Income" initial yield would be higher, but its year over year growth would be minimal. Companies like Verizon and AT&T that have dividend yields close to 7% are not in a position to increase them like our companies, since sales and earnings are not growing and they are very leveraged. REITs (real estate investment trusts) which are required to distribute 90% of their income to shareholders as dividends, are another example of businesses with higher yields but very little (if any) free cash flow and very large amounts of debt. Fixed income can serve a purpose for more conservative investors with specific maturities and less volatility. But even with higher current rates as discussed in our Investment Management Commentary, fixed income will not offset the current rate of inflation of 8% (there are I bonds that adjust for inflation but they are only available for up to $20,000 per investor). This is why we believe our SEM Dividend Growth portfolio can be a better inflation fighter longer term than either Dividend or Fixed "Income" portfolios.

Superior Dividend Growth in 2022

As we've discussed many times before, our **SEM-Disciplined Investment System** (DIS) keeps us focused on underlying business momentum, as well as pricing power, which becomes even more important in an inflationary environment. We believe it is no coincidence that our companies have the financial strength to increase their dividend payouts every year, which is helping shareholders "ride out the storm" of uncertainty this year from war, inflation, higher interest rates and even natural disasters (our hearts go out to those impacted by Hurricane Ian). Two of our companies had huge dividend hikes that we highlighted in our first quarter letter, **Advanced Auto Parts (AAP)** and **Tractor Supply (TSCO),** and as you can see in the following table, the vast majority of our portfolio holdings increased their dividends by double digits this year.

| | | Dividend Growth 2022 |
|---|---|---|
| Accenture | ACN | 16% |
| Advanced Auto Parts | AAP | **140%** |
| Automatic Data Processing | ADP | 12% |
| Broadridge | BR | 12% |
| Hershey Foods | HSY | 13% |
| Home Depot | HD | 15% |
| Eli Lilly | LLY | 15% |
| Microsoft | MSFT | 13% |
| Nike | NKE | 11% |
| Stryker Corporation | SYK | 10% |
| Tractor Supply | TSCO | **77%** |
| T. Rowe Price | TROW | 11% |
| UnitedHealth Group | UNH | 14% |
| | | |
| Total Portfolio Average | | **21%** |

Year over year increases in dividends are not impacted by the emotional swings of stock prices, but rather by the fundamental strength of the business and management's confidence. For example, Accenture announced its board of directors approved a quarterly dividend of $1.12 per share in September up from the previous rate of $0.97. Total dividends paid in 2022 will be $4.18, which is +16% compared to $3.61 in 2021. We are confident there will be no cuts to these quarterly dividends and look for our businesses to increase them again next year, although closer to or slightly below our historical rate of +10% after such a strong year in 2022.

Company Highlight

Our core holding **Pepsi (PEP)** announced a $550 million investment for an 8.5% equity stake in lifestyle energy drink company **Celsius Holdings (CELH)** (not to be confused with the bankrupt crypto lender Celsius Network), as part of a long-term distribution deal. CELH markets its products as "healthy" energy drinks since they contain ingredients like ginger and green tea with no artificial preservatives or sugar, which appeals to younger, more active consumers. The partnership will allow Celsius to take advantage of PEP's global delivery network and gain shelf space, while PEP will gain market share in the fastest growing nonalcoholic beverage category and complement its purchase of energy drink maker Rockstar in 2020 for $3.85 billion. In fact, Celsius U.S. revenue more than tripled to $124 million in its most recent quarter. Last year we wrote about similar strategic moves by PEP to focus on faster-growing beverage categories when it sold the majority of Tropicana, since consumers' tastes have shifted away from juice, as well as soda over the last decade. Although CELH is a much smaller company than PEP with $84 billion in expected 2022 sales, we like to see our businesses monitoring consumer trends to maintain their market leadership, especially in a slowing economy. So far, PEP has been able to pass along rising costs through +11% price increases while maintaining volumes +2.5%. Although the strong U.S. dollar is a headwind for the global snack and beverage company, PEP increased its 2022 organic growth target to 10% which may be a sign of resiliency since they offer affordable consumption versus big-ticket items like autos, homes or appliances.

Outlook

As always, we look for business momentum in sales and earnings, as well as consistently increasing dividend streams. With earnings season starting in two weeks, we will watch each report closely for data points that confirm our investment thesis. We are here to answer any questions and are grateful for your confidence.

Sincerely,

| | |
|---|---|
| *Amy* | *Don* |
| Amy A. Lord, CFA | Donald R. Jowdy |
| Senior Vice President/ Co-Portfolio Manager | CIO |



5550 W.Executive Drive, Suite 320 • Tampa, FL 33609 • 813-963-0502 • www.suncoastequity.com

*Suncoast Equity Management, LLC*

Performance results versus the Standard & Poor's 500 Index

| Time Period | SEM % Return* | S&P 500 % Return | SEM - Growth of $1,000,000 | S&P 500 - Growth of $1,000,000 |
|---|---|---|---|---|
| Year to Date 2022 (Sept 30th) | -19.0% | -23.9% | $ 810,300 | $ 761,300 |
| One-Year | -4.5% | -15.5% | $ 955,400 | $ 845,300 |
| Three-Year | +10.5% | +8.2% | $ 1,347,300 | $ 1,265,400 |
| Five-Year | +13.2% | +9.2% | $ 1,860,600 | $ 1,555,500 |
| ***Inception (5 ¾ Years)*** | ***+13.6%*** | ***+10.5%*** | ***$ 2,082,600*** | ***$ 1,777,000*** |

* Composite results of all SEM Dividend Growth managed accounts, net of all fees.
Note: Performance for the three and since inception year periods represent the annual average rates of return

## *Performance Disclosure*

Suncoast Equity Management, LLC is an independent investment management firm established in 1997. Suncoast Equity Management is primarily an equity investment manager that invests in U.S.-based securities. As of December 2016, SEM also offers a Dividend Growth Composite. The Dividend Growth Composite includes all discretionary, fee-paying portfolios managed within this strategy. The creation and inception date of the Dividend Growth composite is 12/31/2016.

Bundled fees include management consultant fees, custodial, trading, and advisor fees. Performance is calculated gross of all foreign withholding taxes. Additional information regarding policies for valuing investments, calculating performance, and preparing GIPS Reports, as well as a complete list and description of composites, is available upon request.

For the non-bundle fee accounts, the performance results presented are net of actual investment advisory fee and net of all transaction costs. For the bundle fee accounts, the performance results presented are net of actual investment advisory fee and net of all transaction costs and expenses. Investment advisory fees are described in Part II of Suncoast Equity Management, LLC's Form ADV. The management fee schedule is as follows: 1.00% fee on assets managed. The Firm does not assess performance-based fees.

It is impossible to invest directly in an index. The performance of an index does not reflect any transaction costs, management fees, or taxes. The index used for comparison is the Standard and Poor's 500 Total Return Index; an unmanaged index with no expenses, which covers 500 industrial, utility, transportation, and financial companies in the U.S. markets. It is a capitalization-weighted index calculated on a total return basis with dividends reinvested.

Valuations and returns are computed and stated in U.S. Dollars. The Firm does not use leverage or derivatives to implement the intended strategies.

Beginning in June 2002, accounts that experience cash flows in excess of 10% of the account's market value are temporarily removed from the composite. These accounts are added back to the composite when they are considered fully invested. The minimum account value for inclusion in the composite is $100,000. Additional information regarding the treatment of significant cash flows is available upon request.

Past performance does not guarantee future results. Investment returns and principal value will fluctuate. Investments may be worth more or less than their original cost when sold. It should not be assumed that investment decisions we make in the future will be profitable. Current performance may be lower or higher than the performance data shown. Returns include the reinvestment of all income.

Suncoast Equity Management claims compliance with the Global investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Suncoast Equity Management has been independently verified for the periods 12/31/97 – 12/31/20. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The Dividend Growth composite has had a performance examination for the periods 12/31/16 – 12/31/20. The verification and performance examination reports are available upon request. For any additional information, please contact the Chief Compliance Officer at (813) 963-0502.

This is not a solicitation or recommendation to purchase the securities mentioned herein. An actual portfolio may not hold some or any of these securities. These securities may or may not be purchased by Suncoast Equity Management LLC in the future. This piece is solely the opinion of Suncoast Equity Management LLC. The information presented here is believed to be accurate as of the time of this writing.



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