Second Quarter 2021

July 2, 2021

In the first half of 2021, **SEM's Select Growth** was +16.2% slightly ahead of the overall market with the S&P 500 +15.3%. Earnings strength supported SEM; whereas the S&P 500 index was supported by appreciation in sectors SEM has not traditionally participated in, primarily financials and energy. The latter benefitted as commodity prices rose. The pandemic caused many companies to add considerable debt, but SEM's portfolio company balance sheets are the strongest they have ever been.

<u>Debt Stress? SEM Not! For Others, Pandemic Drives Record Borrowings</u>

Across our three portfolios, the **SEM-DIS (Disciplined Investment System)** seeks safety by only owning companies with strong balance sheets. Low debt, or even better net cash positions, are the bedrock of financial strength. Businesses hurt most by the pandemic had to borrow, adding to their debt pile, and could face difficulties down the road. That will not be the case for SEM's portfolio companies, as we discuss below.

It seems to go without saying that if you must borrow money during an economic decline, it is out of weakness not strength. Before we talk about the corporate debt boom, the circumstances, and inherent risks to watch, let's share with you why it will not be a concern for investors in SEM's portfolios. Below is a table of some of the top holdings in our *Select Growth* portfolio and their financial strength:

Company	Net Cash in $Billions (including Marketable Securities)
Alphabet (Google)	$121.2
Apple	$82.7
Microsoft	$67.3
Facebook	$64.2
Amazon	$41.4
Berkshire Hathaway	$30.9
Accenture	$9.1
Regeneron	$5.1
PayPal	$4.1
Nike	$3.1
Intuit	$2.1
Tractor Supply	$0.2
Total	$431.4

As you see in the table, many of our companies have net cash positions on their balance sheets. In fact, 60% of our 20 holdings are cash positive in a meaningful way. The aggregate total of $431 billion of net cash on our portfolio company balance sheets should be very comforting and a symbol of great strength. While we highlight holdings from our *Select Growth* Portfolio, our *Dividend Growth* portfolio, with several holdings that overlap, shares similar strength. The same low debt level rules apply to our *Small-to-Midcap* portfolio. However, the excess cash is less so, as our smaller companies tend to reinvest a greater percentage back into the business more quickly, while some of our larger companies accumulate more cash.

Driven out of both luxury (low interest rates) and necessity (stressed companies at the peak of the pandemic), corporate debt surged during the last two years or so. According to a recent *The Wall Street Journal* report, the Federal Reserve (Fed) reported that at the end of March total U.S. corporate debt was $11.2 trillion, or about half the size of the U.S. economy. In 2020 nonfinancial companies issued $1.7 trillion of new bonds, nearly $600 billion more than the previous high. Debt is at high levels because prior to the pandemic, U.S. companies were borrowing at low interest rates. The pandemic then forced businesses such as airline carriers, manufacturers, movie theatres cruise ships and others to issue more debt; in some cases, it was issued at higher interest rates, which spiked because of the pandemic.

The stressed businesses needed to replace lost revenue with borrowed cash to keep their operations going. At the height of the pandemic the Fed supported issuers and broke new ground by buying up corporate debt. In the past this had been left to the private market and well-healed investors, such as **Berkshire Hathaway,** that would find select opportunities.

Later in 2020, as rates came down and vaccinations appeared on the horizon, increased borrowings continued. Some companies replaced long term bonds rolling off at higher rates, or recently placed short-term debt with lower rate long term debt. In one example AT&T reported in the first quarter of 2021 that it reduced its interest expense by $150 million from the year earlier period, in part by replacing bonds maturing in five years with a new issue of lower interest rate bonds and a maturity range of 7.5 to 40 years.

Savings from lower interest rates are helpful, and these high corporate borrowers should benefit from a return to normal where operations support interest expenses and potential debt paydown. However, the overall debt increases have been substantial, and these companies may be weakened for an extended period. Carnival Cruise Lines tripled its debt to $33 billion from the end of 2019, Boeing nearly doubled to $64 billion, and Delta also doubled to $35 billion. These traditionally high, capital-intensive businesses, that are perennial borrowers, may get short term relief from low interest rates and reconfiguring their maturities. But there is a lot of pressure and they may need an extended period of general economic prosperity before the next recession weakens operations once again. We feel very comfortable that the **SEM-DIS** incorporates rules to avoid companies with significant debt and weak balance sheets.

<u>Portfolio Activity and Highlights</u>

Essentially no changes in the portfolio during the quarter other than the sale in early June of **Organon (OGN)**. **Merck (MRK)** completed its tax-free spinoff of **OGN** as an independent, publicly traded company by issuing 1 share of OGN for every 10 shares of MRK. OGN paid MRK $9 billion to redistribute some of the debt, but as a result OGN is more leveraged in the short run. That combined with slower growing, less profitable business lines, led us to sell our negligible OGN position. We see the spinoff as a catalyst for MRK, since it allows the company to focus on its faster growing, more profitable segments such as oncology, vaccines, and animal health. Furthermore, MRK expects to generate $1.5 billion in cost savings over the next three years which will significantly increase margins.

<u>Looking Ahead</u>

While many businesses will benefit from the economic recovery, the **SEM-DIS** works to identify and own companies that can grow earnings at double-digit rates for many years into the future. Investors will notice that there has been very little activity in our portfolios during the first half of the year. This may prompt some to wonder whether we are properly engaged. Fear not, we are paying close attention as always. We would submit that sometimes, doing nothing is the best strategy. As previously discussed, our companies' balance sheets are stronger, in some cases, than ever. Also, our companies' earnings per share are higher, in most cases, than ever. This strikes us as a good time to hold our positions and let the story continue to develop. We stand ready to make prudent changes should the situation change, or if we find better opportunities. Thank you for your continued support and please contact us at any time as we welcome all discussion.

Sincerely,

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

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
First Half (2021)	+16.2%	+15.3%	$ 1,161,500	$ 1,152,500
One-Year	+40.3%	+40.8%	$ 1,403,100	$ 1,407,900
Three-Year	+22.7%	+18.7%	$ 1,849,000	$ 1,671,300
Five-Years	+21.8%	+17.7%	$ 2,676,000	$ 2,253,600
Seven-Years	+16.4%	+14.1%	$ 2,891,300	$ 2,517,500
Ten-Years	+16.8%	+14.8%	$ 4,712,100	$ 3,989,300
Inception (23 1/2 Years)	***+10.7%***	***+8.6%***	***$ 10,841,800***	***$ 6,885,300***

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

Performance Disclosure

Suncoast Equity Management, LLC (SEM) 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. SEM also invests in high-grade fixed income. The Suncoast Equity Management Composite includes all discretionary, fee-paying portfolios managed within this strategy. The equity composite was created on 12/31/1997.

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 portfolios, calculating performance, and preparing compliant presentations, 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. It is 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. Suncoast Equity Management has been independently verified for the periods 12/31/97-12/31/19. Verification assesses whether: (1) the Firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The SEM Equity composite has been examined for the period of 12/31/97 to 12/31/19. The verification and performance examination reports are available upon request. Suncoast Equity Management adheres to the GIPS valuation hierarchy Principles. For any additional information, please contact the Chief Compliance Officer at (813) 963-0502.

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