SEM Small to Mid-Capitalization (SMID) Growth Portfolio Management Commentary

Fourth Quarter 2022 (January 3, 2023)

The **Suncoast-SMID Portfolio** (SEM-SMID) improved during the fourth quarter but still closed -25.3% versus the S&P 400 Growth benchmark at -19.0% for 2022. Since inception, 5 1/2 years ago we have outperformed, earning an annualized return of 11.0% versus 7.4% for the comparable S&P 400 index. We are excited about the long-term potential of this portfolio, and we keep building our knowledge and experience base. During the quarter we sold **Zebra Technologies (ZBRA)** and purchased two new positions **MSA Safety (MSA)** and **Nice LTD (NICE).** We also provide an update on portfolio holdings **Pool Corporation (POOL), Veeva Systems (VEEV)** and **Deckers Outdoor (DECK).**

Just getting started

SEM-SMID crossed the 5-year mark in 2022. We continue to deepen our knowledge of the universe of companies that meet our criteria. The same selection process applies as for our **SEM-Select Growth** portfolio. Our universe is formed by our mandatory standards for each company: (1) Companies must earn above-average return on capital, (2) Business must generate free cash flow, and (3) Employ moderate to low debt (or preferably net cash on the balance sheet). Our next steps are to study the company and determine if it is a business we can understand, does it have competitive advantages, and what is its potential runway for growth and business momentum. We also review management history and their capital allocation decisions.

Much like our SEM-Select Growth Portfolio, we will have a mix of what we refer to internally as “Safety” and “Growth” businesses. Simply put a “Safety” business is less easily disrupted and may have a longer business history. **Cintas (CTAS),** which we own, fits the “Safety” label and is a very profitable, but perhaps mundane, company specializing in uniform and facilities (mats, mops, restroom supplies) services. A “Growth” business example that we own is **EPAM Systems (EPAM),** a software and digital platform engineering services company. Regardless of how we label it internally, all our businesses have growth characteristics.

This SEM mindset of “Growth” and “Safety” connects with the personality and preferences of the portfolio management team, as we have most all our personal savings invested in the same companies and undoubtedly are trying to grow our capital alongside our clients.

Portfolio Activity

During the quarter we purchased two new positions **MSA Safety (MSA)** and **Nice LTD (NICE)** and we sold **Zebra Technologies (ZBRA). MSA Safety** is a global leader in the development and manufacturing of safety products that protect people and facility infrastructures. MSA makes safety products including fire and rescue helmets, breathing apparatuses, gas detection and retardant systems, among other products serving broad markets including oil and gas as well as fire service, construction, mining, and the military to name a few. MSA has positioned itself to be the leader in this space. **Cintas (CTAS)**, discussed earlier in this letter, provides safety products to consumers in different settings. Covid intensified the need for Personal Protective Equipment (PPE) and MSA products are considered the safest option to protect workers from accidents and harsh working conditions. The PPE marketplace is expected to almost double, exceeding $100 billion by 2032 according to Fact.MR. The strong order pace and strong margins have rewarded MSA in this challenging environment and that is what attracted us to the company. We are excited to add MSA to the portfolio.

Nice LTD (NICE) is a global provider of cloud and on-premises software solutions serving the customer engagement and financial crime and compliance markets. NICE serves companies including those we own in our **SEM-Select Growth** portfolio such as **Accenture (ACN)** and **Visa (V).** Whether you fly American Airlines or use Aetna for healthcare coverage NICE's solutions are a staple in their business, like a personal assistant improving productivity, workflow, and quality control. Every organization has business goals to fuel them forward and NICE's solutions support that effort. Our initial attraction was their cloud transformation that accelerated growth and profitability. With more than half of revenues coming from the cloud and surpassing $1 billion in sales, it is driving operating earnings and margins higher. We look forward to seeing what NICE does going forward.

We purchased **Zebra Technologies** in 2019 and it performed well in the 3 ½ years we held it, with a nearly 65% return. This year they faced some difficulties with softening demand and ongoing supply chain constraints weighing on margins. Going into 2023 Zebra's biggest headwind will be the soft demand even though supply constraints and logistic costs will alleviate. With better business momentum in MSA and NICE noted above, we felt this was the right time to exit our position.

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Portfolio Highlights

Pool Corporation (POOL), a company we have owned since inception of our SEM-SMID strategy, is the world's largest wholesale distributor of pool supplies and is as big as its top fifty competitors combined. Thrown into the fast lane thanks to Covid 19, POOL benefitted significantly as folks locked-up during the pandemic spent heavily on their first and in some cases second or third homes. Revenue will have nearly doubled, and net income may reach $750 million this year, up from $262 million in just the past 3 years. So where do we go from here? We do not expect the same growth as in the past three years and earnings growth for POOL could decline next year, so we slightly reduced our position. We will continue to own a company if its competitive position remains strong and the impact of economic conditions on the business proves temporary. POOL is a capital projects and regular maintenance products and service company, which is to say it is impacted by both discretionary and non-discretionary spending.

POOL's revenue sources are currently split 20% from new construction, 20% renovation and remodeling and 60% from maintenance and repair. The beauty of the company is that 60% of revenue is non-discretionary. Post pandemic, the installed swimming pool base is now about 6% higher and will require regular maintenance. Also in November 2021, POOL expanded beyond its wholesale products and services when it purchased Tampa-based retailer of services and products, Pinch A Penny. At the time of the deal Pinch A Penny had approximately 260 independently owned and operated franchised stores in several southern states and it is expected to bring POOL a vast opportunity for expansion. During the 2007-2009 recession, recurring maintenance did not show any signs of weakness and this part of the business should continue to perform without disruption.

While new construction will undoubtedly contract, if employment stays strong throughout an economic slowdown, the pool renovation and remodeling business may hold up since the average North American pool is about 25 years old.

We are confident in our current position, though we expect near term business results to contract before they resume an upward growth track. We believe the company's competitive position is still gaining strength, in spite of its already dominant market share.

Veeva Systems (VEEV) is another company we have held for some time that has entered a ten-year strategic partnership with one of our **Select Growth** and **Dividend Growth** positions, **Merck (MRK)**. This partnership extends the existing 12-year agreement out for another decade and will accelerate MRK's digital strategy. MRK will become more efficient in evaluating, purchasing, operating, and creating value from Veeva products and services. The strategic plan will benefit both companies and give MRK better insight into Veeva's product roadmap.

Deckers Outdoor Corp (DECK) is known for its winter favorite UGG brand. But in fact, DECK is bigger than UGG and can cater to all seasons and lifestyles. In 2013, DECK acquired HOKA performance footwear and it has become the #2 brand in specialty running shoes. Although it has a small market share, it is on the heels (pun intended) of the larger brands. The highly cushioned running shoes in the HOKA line have fueled a new level of growth that will benefit DECK long term. Reaching $1 Billion in sales, this differentiated brand has increased its contribution to sales and profitability. As we follow the free cash flow at DECK this year, much has been absorbed by inventory, similar to many other apparel and footwear companies. The pandemic related supply chain issues and the shift and seasonal timing of consumer purchases has wreaked havoc on inventory management. **Nike**, which we own in **SEM-Select Growth** and **Dividend Growth**, seems to be managing through with positive comments on their latest earnings call held at the end of December. We will keep an eye on DECK's inventory management, but its affluent customer base and strong brands should give it pricing power and for now we will maintain our core position.

<u>Looking ahead to 2023</u>

We have a great collection of businesses, and as economic challenges arise, we will keep a close watch on how it impacts our companies' ability to maintain or potentially enhance their competitive positions. We are grateful for your confidence, and we wish you a peaceful and successful 2023. We love what we do, and we are always available for further discussion.

Sincerely,

Don	*Cheeroke*
Donald R. Jowdy	Cheeroke Townsend
CIO	Co-Portfolio Manager, Analyst

Suncoast Equity Management, LLC

Performance results versus the Standard & Poor's 400 Growth Index

Time Period	SEM % Return*	S&P 400 % Return	SEM - Growth of $1,000,000	S&P 400 -Growth of $1,000,000
One-Year (2022)	-25.3%	-19.0%	$ 746,800	$ 810,400
Three-Year	+6.4%	+5.8%	$ 1,204,700	$ 1,182,900
Five-Year	+10.6%	+6.0%	$ 1,656,400	$ 1,339,400
Inception (5 ½ years)	***+11.0%***	***+7.4%***	***$ 1,772,900***	***$ 1,480,000***

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

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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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