Third Quarter 2022 (October 3, 2022)

The Suncoast-Select Growth composite was -29.7% versus the S&P 500 market index at -23.9% for the first nine months of 2022, further down than the mid-year results. Business activity for many of our companies has proven resilient, in spite of a very volatile shift in consumer spending and inflationary pressures rising out of the post pandemic period. Some of our companies are heading towards lower levels of growth from the heights of the post pandemic economic boom. We increased our portfolio weighting in **UnitedHealth Group** this quarter and share its current attributes below.

The **SEM – Disciplined Investment System** (SEM-DIS) is approaching the completion of its 25th year and is focused on the long-term ownership of wealth-building companies that generate excess cash. The excess cash accumulates and is reinvested for growth in several opportunistic buckets including organic growth efforts or in acquisitions, or it is returned to shareholders via dividends and stock buybacks. Reviewing our managements' capital allocation decisions is distinctive to us versus many other money managers because we are long-term owners (not short-term traders); and we invest in the upper echelon of businesses that regularly face these decisions themselves, as they consistently accumulate more cash than companies with less desirable economics and operating performance. Sometimes the stock market will "vote", and painfully so, on a management's capital allocation decision, as it did with **Adobe's** stock price decline in September in reaction to its planned purchase of **Figma.** We review our ownership thoughts with you. While there is a lot to be said for the benefit of long-term experience, which we have; at the same time, we also understand and appreciate that we never stop learning each new year forward.

<u>Portfolio Activity</u>

We increased our portfolio weighting in **UnitedHealth Group (UNH)**. UNH is the largest healthcare service company in the U.S. and globally. Healthcare, which represents almost 10% of U.S. household spending, is attracting big technology companies including some we own like **Amazon**, **Apple** and **Microsoft**. UNH has made leading investments in digitization and technology in an attempt to deliver better healthcare at lower prices. The company is a leader in healthcare insurance and it also owns Optum, which it bought in 2011.

Optum accounts for over 50% of UNH's profits and offers a variety of services including prescription pharmaceuticals, approaching 1.5 billion annually, and medical services, with 60,000 doctors in over 2,000 locations, serving 20+ million people. To broaden its suite of offerings, UNH is in the process of closing two pending acquisitions, **Change Healthcare (CHNG)** and **LHC Group (LHCG)**. UNH's unit OptumInsight first announced its intention to acquire CHNG in January 2021 for $7.8 billion in cash as it expands its faster growing, higher margin healthcare technology business. CHNG is a leader in healthcare technology, connectivity and advanced clinical decision, administrative and financial support capabilities to help modernize the healthcare system and improve health outcomes. After a judge ruled in favor of UnitedHealth on September 19th, despite Department of Justice claims the proposed deal was anti-competitive, the transaction should close very soon. With 30% operating margins, CHNG is expected to be accretive to earnings immediately. Similarly, UNH agreed to pay $5.4 billion for LHC Group in March, a provider of post-acute home healthcare mostly for Medicare beneficiaries. In June UNH and LHCG received a second request from the Federal Trade Commission regarding worker pay which may be pressured if there are only a few large providers of home healthcare. UNH CEO Andrew Witty noted on the July earnings call that he sees the deal as "a strategically critical way of extending better care" and that Optum Health and Optum Rx platforms cover the spectrum of care settings from virtual to post-acute, to clinic, to in the home. If the deal closes, LHC is expected to be neutral to earnings in the first year and accretive thereafter. UNH's strong organic growth, expanding margins and high returns on capital give it the financial flexibility to supplement its offerings through acquisitions like these. We look for the company to continue growing its sales and earnings double digits.

<u>Setback – like a kid in a candy store</u>

In mid-September our core holding **Adobe Software's (ADBE)** stock price declined by 22% following fiscal third quarter earnings report and an announcement to make its largest acquisition, yet. **Figma** is a graphics editing platform whose competitive advantage has been that it allows collaboration simultaneously across various platforms with people designing projects together using web browser-based tools. ADBE plans to spend in the neighborhood of $20 billion in cash and stock to acquire the privately held company which is co-owned by one of its founders Dylan Field along with venture capital firms, including Sequoia Capital and Greylock Partners.

We will continue to hold ADBE for now and will take you through our thoughts. It is a beneficial strategic acquisition which is expected to close next year, but the price offered makes it appear as if they have done it out of weakness and implies the return for shareholders is far off and difficult to measure near-term.

The rich offer price for Figma was immediately recognized by the market; the market capitalization declined by almost twice the value of the deal.

ADBE believes this is a promising investment since it is acquiring a competitor that will allow the company to create new markets, expand adjacent opportunities and accelerate growth. It estimates two-thirds of Figma's users are potential new users to ADBE's platform and existing clients would also benefit. Figma generates approximately $400 million in revenue with industry-leading gross margins of 90% and positive cash flow. ADBE should reach $17 billion+ in revenues this fiscal year ending November and should generate about $6.8 billion in free cash flow excluding acquisitions. David Wadhwani, president of ADBE's digital media business believes that Figma's total addressable market is $16 billion while the market for ADBE's Creative Cloud is $63 billion.

Within the **SEM-Disciplined Investment System** we only own companies that generate excess free cash flow. The generation of that excess cash flow is both a margin of safety and it supports the future intrinsic growth for a company. We believe that the equity market is efficient in the long run and those companies that can grow their intrinsic value over time (free cash flow and earnings) on a prudent capital base get rewarded, just like we do from ownership over many years. From a growth perspective, a company that generates excess cash can apply that towards research and development to create new products or services, acquisitions to add to organic growth or several other operating levels including investing to build scale. From a margin of safety standpoint, a business that accumulates cash and has little to no debt can better withstand temporary global economic declines. So excess cash generation supports growth and safety, two essential elements for successful investment results.

As we only own companies that create excess free cash flow and have cash (or low debt) on the balance sheet, one of most important qualitative judgements we often need to make is whether management teams are utilizing excess cash wisely. Management can act like a proverbial kid in a candy store and spend it all! Other options include returning it to their parents, or in our case shareholders.

In the past Adobe spent it wisely, supporting organic growth with acquisitions in 2021 like Frame.io ($1.275 billion) and Workfront ($1.5 billion) as well as Marketo ($4.75 billion) and Magento ($1.68 billion) in 2018. All of which helped ADBE grow the following years and continue to broaden their portfolio of offerings for users.

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We first became part-owners of Adobe over five years ago as the company was successfully transitioning to a subscription model that now supports its business and competitive advantages. SEM's average cost is $166 per share over three purchases, so at the current price of $275, we have gained 66% or +11% annualized rate of return even after a strong recent stock price decline. During that period ADBE's net income has risen to $6 billion from $2.1 billion or 185%, but understandably clients that joined us this year have not had an enjoyable experience with ADBE or the overall market.

ADBE's core business in Digital Media and Experience Cloud continues to grow mid- teens, which is down from 20%+ during the pandemic but still a healthy rate of growth. While the proposed **Figma** acquisition is expensive, we believe CEO Shantanu Narayen deserves the benefit of time to prove the added value, since he was a visionary a decade ago when he first transitioned from a licensing to a subscription business model with recurring revenue and higher margins. The deal does not weaken ADBE's financial strength, and the swift stock price decline already reflects the concerns. We will watch for data points and management corporate actions in the coming months and into next year to ensure ADBE is executing well.

<u>Looking Ahead</u>

As we enter the final quarter of 2022, our businesses continue to grow and at the same time face cost challenges and dramatic shifts in consumer consumption patterns. SEM's earnings growth is tracking +12% for 2022 with an early look into 2023 at about the +10% level. This compares to estimates for the S&P 500 which are tracking 10% this year supported by higher energy earnings but fall to +4% in 2023. If we enter a deeper economic slowdown, SEM will do what it always does – invest in growth businesses. In our 25-year history, SEM portfolio's lowest period of earnings (intrinsic) growth was mid-single digits back in the recession of 2009. Thank you for your ongoing support and please contact us anytime as we welcome discussion

Sincerely,

Don	*Amy*
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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)	-29.7%	-23.9%	$ 703,400	$ 761,300
One-Year	-23.3%	-15.5%	$ 766,600	$ 845,300
Three-Year	+7.1%	+8.2%	$ 1,227,600	$ 1,265,400
Five-Years	+11.0%	+9.2%	$ 1,683,400	$ 1,555,500
Ten-Years	+11.7%	+11.7%	$ 3,022,100	$ 3,024,400
Inception (24 3/4 Years)	***+9.0%***	***+7.4%***	***$ 8,362,500***	***$ 5,853,900***

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

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 creation and inception date of the Suncoast Equity Management composite is 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 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 indices 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 Suncoast Equity Management composite has had a performance examination for the periods 12/31/97 – 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.

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