Fourth Quarter 2023 (January 2, 2024)

The fourth quarter closed out a much stronger year in the economy and the stock market than most expected at the beginning of the year, with the **SEM Select Growth** portfolio +31.4% after fees compared to the S&P 500 +26.3% for 2023. While we always try to observe data points rather than predict them (especially economic data points), we are seeing solid business growth for our portfolio holdings, lower inflation in certain areas of the economy and shifts in consumer spending. Consequently, we purchased **McKesson** and **Salesforce** during the quarter with the proceeds from our sale of **Home Depot**. We welcome back **McKesson** after our previous ownership and highlight what it takes for a company to return to the portfolio. We also observed more scrutiny in mergers and acquisitions which impacted our portfolio holding **Adobe.**

Portfolio Activity

We reestablished an ownership position in **McKesson (MCK),** which is a healthcare services leader that partners with biopharma companies, pharmacies, manufacturers, and governments to deliver more accessible and affordable products and services.

Due to the strict quality criteria of our **SEM- Disciplined Investment System (SEM-DIS)** including high returns on capital, revenue, earnings, and free cash flow growth as well as a strong balance sheet, there are only a few hundred out of 3500 or so in our universe of publicly traded companies that qualify. As we review each company that meets our criteria, we look further for business drivers the company might be experiencing which would enhance growth and profitability in the foreseeable future. Our portfolio choices are relative as well, as we prefer to hold a select group of twenty, give or take, companies versus market indexes that may hold several hundred positions. If another company has stronger business catalysts and a similar or more attractive valuation, we may favor that company over a current holding in the portfolio.

The **SEM-DIS** process sometimes leads us to repurchase a business we have owned before, as we have recently done with MCK. Long term clients may remember we owned MCK from 2008 to 2016. Back then MCK benefitted from business catalysts of an aging population, economies of scale and significant conversion of pharmaceuticals it distributed transitioning from proprietary to generic, which tend to generate higher margins for wholesalers like MCK. These developments helped drive a 50% increase in operating margins, albeit at a low level, and

consequently similar improvements in profitability and intrinsic value. As those business levers wound down, including a peak in operating margins, we sold MCK.

As we welcome back MCK to the portfolio it remains the largest of three leading domestic branded, generic and specialty pharmaceutical distributors. One of the others is **Cencora (COR)** which we have owned in the **SEM Dividend Growth** strategy since 2020. The three combined supply over 90% of the U.S. market.

While the growth drivers of an aging population and economies of scale are still in place, MCK is also benefiting from the launch of weight loss drugs with prescription volumes increasing from retail national accounts, specialty products and GLP-1s medications (diabetes and weight loss drugs). Complementary to drug distribution, MCK also has a prescription technology solutions segment which grew 12% year over year in the recent quarter and makes the process of medication prior authorizations more efficient with its clinical workflow software that improves patient care and produces healthier outcomes. We discuss GLP-1s diabetes and weight loss drugs Wegovy, Ozempic, Mounjaro and Zepbound more in depth in our **Dividend Growth** letter this quarter since we own **Eli Lilly (LLY)** in that portfolio, which makes Mounjaro and Zepbound. Overall, MCK should post +10% revenue growth and increase its earnings growth target to +14-17% driven by strength in its U.S. Pharmaceutical segment. The company is using its significant free cash flow to buy back shares and has reduced its share count by 29% since 2018. Our goal is to increase our position as our investment thesis plays out.

We initiated a position in **Salesforce (CRM)** during the quarter, which is a cloud-based software company that allows customers to manage and share information about revenues, customer relationships, marketing, and data analytics. As their website says, “We build bridges between companies and customers.” More than 90% of CRM’s revenue comes from recurring subscriptions and support, which has led to consistent sales growth over time as well as high visibility into upcoming quarters, especially with a 92% retention rate. In other words, once customers begin using the company’s suite of applications like Sales Cloud, Service Cloud, Marketing or Commerce Cloud, they benefit from the market-leading portfolio of offerings and are unlikely to switch to another vendor. With advances in artificial intelligence, CRM can add more value to its client offerings by adding its own set of generative AI tools to its products. After another solid report, CRM raised its revenue target to +11% for the year ending January. But profitability is the real story and looks to be at an inflection point after incorporating its 2021 acquisition of Slack for $28 billion, which is a collaboration and messaging app similar to Microsoft’s Teams.

Management boosted its operating margin target for the second time in 2023 and at the current rate of 22-23% would be about 50% higher than it was three years ago. We look for consistent double-digit growth in sales and earnings in the coming year.

We sold our small position in **Home Depot (HD)** after reducing it in June**.** We first purchased HD in 2017 when interest rates were much lower and mortgage rates were about 4%. The company posted consistently solid results for several years until the pandemic hit in 2020, when sales and earnings spiked as consumers spent heavily on home renovations, appliances, and landscaping. As noted in our Investment Commentary, consumer spending has shifted in the last year from home improvements to experiences such as travel, live concerts and dining out. In fact, we used the proceeds from the HD reduction in June to increase our position in online travel company, **Bookings (BKNG),** which is benefiting from this shift**.** It may take a few years before HD starts to grow sales and earnings from its 2022 levels. We will watch for that progress and may choose to re-enter the position at that time should its business momentum qualify for our SEM-DIS**.** But for now, we believe the proceeds are better allocated to CRM and MCK.

<u>Portfolio Update</u>

In December **Adobe (ADBE)** terminated its deal to buy graphics editing platform, Figma for $20 billion. We wrote extensively about the deal in our 2022 Select Growth third quarter letter. Our thinking at the time was that since the offer price was $10 billion in cash plus $10 billion in ADBE stock, which was roughly 50x Figma's revenue, the valuation was rich and likely done out of weakness. However, we felt CEO Shantanu Narayen deserved the benefit of the doubt since his history includes many successful acquisitions. Additionally, he pioneered the transition from licensing to SaaS (subscription-as-a-service) revenue model more than 10 years ago. More than a year later with regulators in the US, UK and European Union questioning how the acquisition might limit competition, ADBE chose to pay the $1 billion breakup fee rather than continue to pursue Figma. With its industry-leading Creative Cloud platform ADBE's development team has been building out its competing offering, XD Solution, which will allow multiple users to edit a single work product in real-time.

We also believe Adobe's shift in focus towards generative AI, as it rapidly surfaced, and the market opportunity to serve its clients in this area may have been a factor in not pursuing Figma. The company just announced solid results for its fiscal year ending in November and should be able to increase margins while growing double digits in 2024.

Outlook

As we close out another solid year in our Select Growth portfolio, we believe it is well positioned for 2024 with above average companies that should grow faster than the market. Wishing you and yours a Happy New Year!

Sincerely,

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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**
One-Year 2023	+31.4%	+26.3%	$ 1,314,400	$ 1,262,900
Three-Year	+ 8.7%	+10.0%	$ 1,283,100	$ 1,331,000
Five-Years	+17.2%	+ 15.7%	$ 2,206,500	$ 2,072,100
Ten-Years	+12.5%	+12.0%	$ 3,240,100	$ 3,114,900
Inception (26 Years)	***+ 10.0%***	***+ 8.3%***	***$ 11,976,700***	***$ 7,951,700***

* 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

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 Select Growth composite includes all discretionary, fee-paying portfolios managed within this strategy. The creation and inception date of the Select Growth composite is 12/31/1997. As of 6/30/2020, the Suncoast Equity Management composite was renamed the Select Growth composite.

The Select Growth composite is an equity only composite employing the principles of Benjamin Graham & Warren Buffett. The discipline is a bottom-up fundamental approach and blends value and growth parameters. The portfolio consists of between 18-22 stocks.

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 are as follows: The Standard and Poor's 500 Total Return Index 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.

Suncoast Equity Management adheres to the GIPS valuation hierarchy principles.

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 – 12/31/22. 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 Select Growth composite has had a performance examination for the periods 12/31/97 – 12/31/22. 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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