1st Quarter 2000

EDMP, INC. Quarterly Review

PRESIDENT'S MESSAGE

We Got Cash

The first quarter of the new millennium was very good to EDMP and our valued clients. Our properly diversified and well-balanced portfolios outperformed the major indices by a wide margin. The majority of our clients enjoyed solid performance while the rest of the world endured unprecedented volatility and weak results. Our disciplined philosophy of building diversified portfolios of good businesses bought at sound and reasonable valuations once again proved its mettle.

While the rest of the investing world went to fantasyland to ride the wild and woolly roller coasters of the so-called new economy, with its new paradigm of investing rules, we stayed the course tried and true. The problem with roller coasters is that at best, after an exhilarating journey you end up back where you started from. On the other hand the superhighway of prudence and sound economic principles leads to the destination we all seek. Perhaps it's not as exciting as the thrill ride, but it does take you where you need to go.

As an aside, we would like to comment on the currently popular notion of the new economy versus the old economy. Plainly speaking, the whole concept is, to us at least, utter nonsense. In truth there is only one economy, we will call it "the economy". The principles of economics and the mathematical realities underneath it will simply never change. A dollar is a dollar and it makes no difference whether it comes from your favorite high flying tech stock or the stodgy old economy food stock. Consequently, the value of a so called old economy basic industry company growing at twenty to thirty percent per year is worth no more and no less than a tech stock growing at the same rate and vice versa. Since people will forever-and-a-day need to feed and shelter themselves and their families, old economy companies will be with us and have value for a long time to come. On the other hand, the promise of technology is real and is most certainly enhancing the productivity and ultimately the future prosperity of mankind. Economically speaking, this is a good thing, but there are practical and rational limits. In other words, technology is helping to make "the economy" stronger, it's not however a new economy or paradigm. The soundest investing strategy, is to invest in good companies, technology or otherwise, at reasonable valuations, and as long as the market lets you, hold for the long run and you will inevitably do quite well.

Recently, many so-called investors became smitten with tech stocks. With a finite supply and seemingly insatiable appetite or demand, tech stocks enjoyed a parabolic advance. The more they went up, the more people bought them. Ignoring all the principles and rules of sound investing people wanted tech and nothing else. Consequently, they were willing to pay any price or valuation, for it mattered not- techs were rising. In reality, no matter how good a company or industry is, once its price rises to a level beyond its ability to internally generate a real long term rate of return, it becomes a risky holding with only short term promise. If you do not time it perfectly, meaning hold this kind of investment too long, even by a mere day or lately even a mere hour you can suffer significant losses. In contrast the beauty of a reasonably priced growing business is, the longer you hold it the more you make.

At EDMP we also believe in the enormous promise of technology. We also recognize the earnings power of the current cycle. A quick glance at your cost basis will clearly indicate, however, that we were only willing to buy them when they were priced or valued in line with a realistic return. More importantly, we were diversified with tech representing an appropriate percentage of your total portfolios. Of equal importance, as tech stock prices rose to irrationally exuberant levels, we prudently pared back. In most cases we took our cost and an attractive profit out, and put it in our pockets.

We admit to speculating with our excessive profits to take advantage of the crowd's "buy at any price" mentality but we did it with prudence and a locked in gain. As the immortal Ben Graham so aptly put it, "to win you must not lose". Since we already had our principal back, plus a healthy profit often in excess of reasonable expectations, we can't lose. Its simply better, and safer to gamble with house money than your own.

The result of our prudent behavior is, outperformance, when it matters most. It's true that much of our returns came from our technology holdings. More importantly, the tech stocks we own are real companies with real current earnings and excellent long term prospects. On the other hand, our Rodney Dangerfield (we get no respect) so called old economy holdings have more recently been contributing quite nicely, thank you very much. As tech stocks have become volatile, a euphemism for

precipitously falling, it's nice to be diversified, isn't it?

This leads us to a few comments on the concept of valuation or worth. We have steadfastly argued that sound investing begins with a mastery of the economic principles of value (intrinsic value) or true worth of a business, any business. When and only when you have a solid foundation of cash flows and earnings underneath your holdings, are you truly investing. Otherwise, your are merely speculating. More precisely, you are simply trying to guess where short term traders are going to pour their money next.

The media adds fuel to the fire by enthusiastically reporting the enticing rapid moves of the stocks in favor. Magic stories of the wonderful future of these companies are correctly shouted about even though the current prices and values already discount their future economic potential. The problem is that you are hearing the stories of the companies that have already gone up; this is too late. To make money safely, you need to know this information in advance.

I for one would have more respect if all the seers would start accurately telling me what the companies' prices were going to do next week, month, or year. The point is, they cannot possibly tell me what will happen, they can only report what has happened. Since I already know this, it offers me scant value. Guessing tomorrow's stock price is folly. Evaluating the future promise of a sound business and its economic worth is a scholarly pursuit that lowers risk and reliably creates wealth. Gambling is not necessarily a bad thing if done with awareness. It becomes most dangerous, however, when it is done in a complacent or self denial manner. More importantly it is most dangerous when you break gambling's cardinal rule: Never gamble with money you can't afford to lose.

Knowledge, of course is the antidote. When investors know the true worth of the business they own, in contrast to what an often irrational stock market may be currently pricing it at, they are in a most powerful and safe position. For example in recent conversations with many of you I have pointed out that Clayton Homes is worth approximately $20 per share. I base this on the facts that Clayton Homes has an impeccable operating record, both historic and current, less that 10 percent debt and powerful demographics behind its future growth potential. My $20 value applies a 15 to 20 P/E ratio with Clayton Homes currently trading at a PE ratio of approximately 10. The simple fact that others are offering me half of what sound economic principles dictate it to be worth doesn't bother me. First of all I didn't buy it to sell today, and as I have emphatically stated "you can't buy my Clayton Homes for a mere $8 or $10 per share, no way". The knowledge of Clayton Homes worth or value, makes me immune to their ludicrous offers. On the other hand, offer me $40 per share and I'll sell.

In essence, this is what we have been recently doing with your tech holdings. We bought them at value or below, and are currently selling at prices dramatically north of their true worth. This prudent and with all the humility we can muster, intelligent behavior also provides another powerful benefit. **We got cash!** Let us say this again **"we got cash!"**

With all the hoopla-surrounding tech stocks and this new paradigm nonsense some very important facts have been flying under the radar screens of most investors. Since the spring of 1998, the majority of stocks, excluding tech stocks, have been in a bear market. Our greatest, most established, blue chip companies with superb future prospects have become cheap. Let us say it again, - **we got cash!**

At this point I would like to quote from and recommend an excellent book I've recently read on investing. The book's title is <u>It's a Sure Thing</u> by Robert Metz and George Stasen with illustrations by Henry Martin. The authors are well credentialed. Robert Metz is a Harvard Nieman Fellow and award winning financial reporter. For 17 years he was the chief financial columnist for the New York Times, then chief financial correspondent for FNN. George Stasen is a veteran Wall Street professional and was a founding member of the American Stock Exchange's Oversight Committee for the Emerging Company marketplace. The illustrator Henry Martin is a cartoonist whose work appears regularly in The New Yorker and is syndicated nationally. The book has lots of great cartoons. I quote from Chapter 19 titled "Working Money", as it clearly and succinctly points out the value of cash in a declining market: *"Cash equivalent reserves are often maligned as not "working". The fact is that when the bond and stock markets are both in declining trends, reserves are the hardest working investments in the portfolios because they are not deteriorating in value and when ultimately reemployed should buy cheaper and larger positions."*

It is important to clarify the rationale behind our cash reserves. Generally speaking, it is not our policy to hold cash and it is emphatically not our policy to time the market. What has put us in our current posture is valuation based, pure and simple. Tech stocks became, as an understatement, grossly overvalued, so we sold and generated cash. Simultaneously great blue chip companies, which were previously overvalued, began to fall and come to value. This is a very exciting phenomenon for business perspective,

value/growth managers like EDMP Inc. It has been many years since we have seen so many great names selling at attractive long-term prices and values. For the past three to five years it has been difficult to find good companies at sensible values to place in your portfolios. Today the reverse is true. We see a virtual cornucopia of great names to buy. Some are still overvalued, but getting close, others are at fair and reasonable values and several are down right cheap. You will soon see us deploying some of our cash to buy these great bargains: we have already begun to use the remaining cash to buy down or accumulate more of the fine companies you're currently holding.

It's generally accepted, and we believe a true fact that hitting the exact top or bottom of a market or stock price is impossible with the exception of luck. We further believe that the surest way to get as close as practically possible to a top or bottom is to base your decisions on worth or valuation. When prices are too high sell a little, if they rise further sell a little more. The same philosophy applies on the buy side. When prices are reasonable, buy a little, and if they fall further buy more. Although these strategies don't guarantee a perfect top or bottom, they are quite rational and more often than not get you as close to the top or bottom as possible, not withstanding pure luck.

The secret to doing this successfully is, as previously pointed out, knowing the true worth or value of a business. Admittedly there is a little art to this process, but it is mostly founded on math or science. From a historical perspective this process is mostly fact, the art comes into play when forecasting the future. However, even though forecasting cannot be done with perfect precision there is a process that stacks the results in your favor. This is summarized in our EDMP brochure under the section 'Forecasting.' The concluding remarks from this section are quoted as follows: "We cannot escape the obligation to forecast--our results depend on it. Our forecasts are not prophecy. We do not guess. We do not play hunches. We calculate reasonable probabilities based on all factual information that we assemble. Analytical methods are then employed based upon our underlying earnings driven rationale, providing us reason to believe that the relationships producing earnings growth will persist in the future."

As clients of EDMP, you enjoy what we believe to be an incredible advantage most investors don't have. This advantage is the fundamentally earnings driven EDMP charts or graphs. These powerful tools illustrate a company's true worth based on earnings and cash flows. These charts should not be ignored. We hope all of you are using them. If you need help interpreting them please call us or your consultant for assistance.

It remains our privilege to serve you. And, as always, remember; Earnings Determine Market Price, always have, always will.

Sincerely,

Charles C. Carnevale
President