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John Doe

EDMP, INC. Quarterly Review

PRESIDENT'S MESSAGE

Buy Low Sell High

The second quarter of 1998 showed many novice investors that the stock market does not always rise. Over the past five or six years stock prices, especially for the large cap blue chip companies, have risen to valuations rarely, and in some cases, never seen before. These great companies are selling at multiples of earnings, revenues, book value, cash flows and every other valuation barometer that far exceed historical norms. How long this can last is a question that defies a logical answer. There is one fact, however, of which we are certain. There is no long-term attractive amount of money to be made by investing in or even holding these companies from here. In short, it's too late to buy them; the real money has already been made.

The current market scenario creates a very serious dilemma for prudent and sensible value/growth, "business perspective", managers like EDMP. Our clients, new and old, watch a stock market surging to dazzling heights while we currently invest your money in stocks many of which are not immediately participating. Obviously this makes you question our judgment as money managers. Therefore the purpose and theme of this quarter's letter is to help you see, understand and appreciate not only the soundness of our approach, but more importantly, the significant opportunity it offers for the long-term financial success we feel you so richly deserve.

Our position and opinion are both simple and straightforward. The only reason for using an investment strategy like ours is because it will generate a higher long-term return at significantly lower risk than any other. We clearly understand and are quite sensitive to the short-term turmoil and anguish that this current market environment may cause you. Therefore, we recognize it to be our solemn responsibility to clearly and effectively communicate the power and protection of value/growth, "business perspective", investing. We are confident that this is a challenge we can conquer based solely on the validity, soundness and proven realities of this magnificent investing philosophy. Our methodology will be to appeal to your reasoning ability and your common sense.

There is one indisputable tenant of investing that virtually all investors of all styles and philosophies can agree on. The only reliable and practical way to make money through investing is to **buy low and sell high**. This is the one attribute that any sound investing strategy must adhere to. This is simple basic commonsense. Any other behavior is mere speculation and not investing. We do not, and will not, speculate with our clients' money.

As discussed in previous letters to you, buying low in overheated markets like we have today presents very unique challenges. For a good or great business to have a low stock price (valuation) in a market like we have today there has to be a reason. There must exist some factor or factors that are causing people to avoid or sell these companies. However, it is even more important to understand **that the reasons are not necessarily valid**. The job of the money manager is to identify those companies that are being unjustifiably penalized by investors/speculators. We believe we are up to the task and are confident we have already accomplished this mission for you.

At EDMP, we practice two extremely important behaviors on your behalf. First, we thoroughly research each company we invest in for you before and after we buy it. Secondly, we think with a long-term perspective that we believe enables us to exploit other's folly. Most investors are so enthralled with short-term immediate gratification that they lose their perspective and reasoning ability. Short-term volatility taps into their emotions and either fear or greed drives their decision making process. This inevitably causes mistakes which lead to poor long-term performance and high risk.

Some insights into our current behavior and the logic behind it will hopefully clarify and illustrate the soundness of our approach. There are two broad and diverse industries loosely called Technology and Healthcare that appear enormously attractive to us today. Healthcare is broadly comprised of pharmaceuticals, medical products, hospitals, rehabilitation and home health care.

Obviously this is too broad a subject to cover in the scope of this letter, therefore one example may prove useful. For most new and several more established clients we are investing in Genesis Health Ventures (GHV) one of the leading, most innovative, comprehensive, and best managed companies in the under-served and huge elder care market. Believe it or not, over half of the world's population that ever reached the age of 65 years of age are still alive today. Furthermore, right behind this age demographic are 75 million baby boomers entering their 50's. Fear of federal government machinations of Medicare reform, (unfairly we might add - Genesis gets less than 5% from Medicare) coupled with strategic investments the company is making that impact near-term earnings, have spooked investors into selling. The result is in our view the opportunity to accumulate a virtual lay up long-term investment at a bargain basement price. Own Genesis for the requisite 3-5 years and the long-term payoff should be extraordinary.

Another case in point is technology which can be further viewed to include telecommunications. Here again we find an industry or industries experiencing short-term turmoil and uncertainty. However, anyone with a longer term perspective, of which we have admitted to, must surely see the vast and nascent opportunities. Clearly we are on the brink of a great information revolution that will virtually change the way people all over the world will work, play and conduct business. The internet and its impact on the entire technology industry is profound and just at the beginning of its growth cycle. The impact it will have on our lives is enormous. Technology is moving at a rapid rate with areas such as voice recognition, faster and more powerful data transmission and the connecting of billions of people throughout the world enabling us to efficiently tap into unlimited resources of knowledge and information. The potential for mankind and the accompanying investing opportunities are mind boggling. We call it a quasi cyclical robust growth industry, with the emphasis on growth. The rapid dynamic of this industry does cause short-term interruptions in earnings and operating results. Of course this unsettles short-term oriented speculative investors causing them to panic and sell, therefore lowering the stock prices of the fine businesses in this industry. Yet we ask you, can you think of an industry that can more predictably be called growth? Yes, they are out of favor now, and yes they are not at this short-term moment in time participating in the huge bull (double meaning intended), yet think of the certainty of this long-term opportunity.

Technology companies that are poised to benefit and grow significantly include: networkers such as 3COM, Cabletron, Cisco, and Newbridge Networks; telecommunication companies such as Pairgain, Andrew, Century Telephone and Motorola; computer chip and semiconductors such as Atmel, Intel, Kemet, Applied Materials, Analog Devices, and C-Cube; software and services such as Microsoft, Oracle, Computer Associates, and EDS; computers and peripherals such as TechData, Compaq, and Hewlett Packard. As previously discussed, we believe these companies have extraordinary long-term growth potential, and due to mostly temporary and transitional issues, the majority are significantly undervalued. For some strange reason, people seem to fear or avoid cheap companies, yet isn't that where the future money is to be made?

We are confident that we are accumulating for your long-term benefit extraordinary companies on sale. For those of you who have been our clients for three years or more, you have first-hand experience of the benefit of this strategy. Some of your holdings originally bought on sale have become overpriced. We have been, and in the immediate future will continue to be modestly paring back these holdings in order to take advantage of the current exciting opportunities discussed above. For those of you who have been clients for one to three years you are beginning to see the benefit of intelligent patience based on a sound strategy. Some of your holdings have already moved from low to high. Many others are just starting to perform. A few are still languishing or still drifting lower. To these we will be adding where possible. In simple terms, if we liked them higher, and we obviously did, (and nothing other than the stock price has significantly changed), then we must love them now, and we do. The opportunity to buy these great businesses so cheap will pay off handsomely in the long run.

To our newest of clients, we can only reiterate what has already been said. We are, and have bought for you great businesses and, in some cases, at ridiculously low prices and values. We are not perfect or clairvoyant and therefore do not always buy at the absolute bottom. However, we are most confident that they were all bought right (cheap).

To illustrate how significant the benefits of our approach can be, we would like to share one dramatic and extreme example. On June 30, 1994, we bought our first shares of EMC, Corp. for clients at approximately $7 per share. EMC is the world leader in data storage for mainframe and client server computers. The transition from mainframes to servers caused a temporary lull in earnings growth. With our long-term perspective it was clear to us that due to the explosive growth of computing, the future need for enormous amounts of data storage was a certainty. Initially after purchase, the stock went down and by December 31, 1995, 18 months later, EMC was selling at $7.68, only slightly above our $7.00 purchase price. The value was there and the decision was correct with EMC finally validating our confidence by rising to $44.81 by June 30, 1998. The net result was a compound 60% annual rate of return over a four year holding period. This 60% annual return clearly illustrates the power of getting your money in front of an undervalued opportunity. The end result was certainly more than ample reward for enduring the first 18 months of poor performance. This is just one of numerous examples where our value growth philosophy has been successful.

We would also like to take this opportunity to share with you some general portfolio strategies we are making. Proper diversification, not too much or too little, is a critical element of a properly balanced portfolio. As you know, our core philosophy is to be long-term shareholder/owners of great businesses bought at attractive valuations. Often the strategy works too well, a case in point being the EMC experience discussed above. The share price of EMC after finally catching fire has risen so sharply so quickly that it has dominated the portfolio representing 10% - 15% or more of the total portfolio of those clients who owned it. (Almost every seasoned portfolio that we manage has one or more of these success stories. For some, it is Intel, Microsoft, Compaq, Cisco, etc.). Even though we still like EMC very much, prudence dictates that 10-15% in any one company, no matter how good, is too much. Therefore we will be selling parts of EMC to properly balance the portfolio. This strategy creates some very attractive advantages. First in most, every case we will be taking out our original investment plus a significant profit (even after taxes for taxable accounts), thereby virtually eliminating risk. It's important to note that EMC is currently fully to somewhat overvalued, however, in our opinion not dangerously so. Therefore, a partial sale allows us to continue to participate in a significant growth story essentially risk free. Additionally, we can use the proceeds to either average down companies that we did not buy at the perfect bottom or add new compelling opportunities that we are using for our newest clients. Similar tactics are being applied to holdings such as Mylan Labs, Shaw Industries, Home Depot, Walmart, Carnival Cruise Lines and others. As an aside it was this very strategy that turned Mylan Labs, Shaw Industries, Home Depot, and Walmart from mediocre to superior investments. Each of the companies are examples where we purchased prior to the ultimate bottom, creating the opportunity to buy more, cheaper, before they surged upward in value.

The moral of the tale is that undervalued companies, with good long-term prospects, cannot stay down forever, and when they move, they move fast (the same can be said for overvalued stocks in reverse). Therefore, we always find it more prudent to be early than late. All too often late can mean never.

In closing, we know it is difficult and frustrating for newer clients to watch the raging bull market rise and not be participating. We are certain that buying overvalued hot stocks is the wrong long-term thing to do. We would rather lose you than knowingly be a party to hurting you. Buying great businesses at value, then exercising the intelligent patience to reap the reward is a lucrative and safe long-term strategy. **Regarding investing, there is nothing more powerful than buying a good business undervalued, there is nothing more sound than buying a good business at value and you buy risk when you pay too much**. We have strong confidence in your portfolio and hope you do too.

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

Sincerely,

Charles C. Carnevale
President