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EDMP, INC. Quarterly Review

PRESIDENT'S MESSAGE

Value Matters A Lot

The third quarter of 1998 was painful and disconcerting for investors. For the first time in six years we are in a bear market. Professional advisors and their clients experienced unnerving bouts of extreme volatility which burst many bubbles of irrational modern conventional wisdom. All of a sudden, fashionable concepts like relative valuation gave way to the more rational tried and true valuation realities. No investor enjoys going through a bear market. They are painful and scary to say the least. There is an old adage that comes to mind that is helpful to ponder, "in every cloud there lies a silver lining". When you think about it, and review history, the clouds of bear markets are lined with gold.

Bear markets bring a significant benefit to investors that is easy to overlook while experiencing the pain. Today's bear market is no different than previous ones, and is in effect ringing out the risk of overvaluation. A market with less risk is a good thing. The future becomes more secure and the long-term upside becomes even greater.

We have for some time now pointed out to our clients and consultants that recent market valuations were anomalies and therefore not sustainable. With the aid of our fundamental charts our clients have understood that large cap blue chip companies, as good as they are regarding the quality of their businesses and future prospects, were massively and unrealistically overvalued. We realized and discussed in earlier newsletters that the wonderful performance being enjoyed with the blue chips (S&P 500, Dow Jones, etc.) was an illusion and a very dangerous one at that. Most times of adversity, however, provide valuable lessons for future prosperity. As we have often stated, it is our belief that volatility is not risk, rather it is the reaction to volatility that defines risk.

Knowledge is truly power and it remains and always will remain the foundation for investment success. Therefore, it is the primary objective of this quarter's letter to examine what can be learned from recent events and, more importantly, how to profit from this knowledge in the future. A second yet equally important objective of this letter will be to clarify and report on the strategies we have been recently deploying as well as what you should expect to see going forward.

During this past quarter we had the opportunity to talk to many of you. We appreciated the opportunity to take the time to discuss with you the companies in your portfolios, their intrinsic values, and future business prospects, instead of the day to day gyrations of stock prices and stock markets. The companies we own and their future performance is what will ultimately build wealth and provide you with the opportunity to achieve your financial goals and objectives. Valuing a business and the risks and rewards of business perspective investing is our expertise, not the short-term forecasting of the markets.

There is one issue relating to stock prices however that is actually paramount. Our examination of investing history clearly points out that the most successful investors all share a common perspective regarding stock prices. Successful investors realize and recognize the undeniable fact that stock prices do not necessarily reflect a company's true worth. The root of this disparity from value can be best understood through the analysis and understanding of two major but divergent camps of professional investors. One camp holds the view of the efficient market that precisely digests all information and therefore prices things perfectly. The other camp sees the market as random and reactive acts of emotion that cannot be trusted. At EDMP we believe both are correct and differ only in their timing. In the short-run, reactions to events, especially events that surprise, can and will cause knee jerk reactions from fear or greed. The passage of time enables the digestive process to function properly and rationality prevails. Markets are quite efficient in the long run and quite random in the short run. Stated simply, the stock market at any given time can irrationally overvalue or undervalue a company. The best investors have clearly demonstrated the ability to recognize either anomaly and consequently make rational long-term investing decisions accordingly. If stock prices are too high they either avoid or sell them. If stock prices are too low they aggressively accumulate them and if continued irrational behavior drives prices lower, they buy more. They position their portfolios on sound fundamental valuation and exercise the intelligent patience to win the long-term investing game.

At EDMP we refer to this universal attribute that successful investors possess as PIP: Perspective Intelligence Patience. When you have a clear perspective of value, you can draw on your innate intelligence, unclouded by emotion, and therefore exercise the patience to trust that true value will inevitably manifest itself. In essence you draw confidence from the knowledge of what your portfolio is actually worth rather than what an irrational emotion-gripped market psychosis says it is worth in the short run. Unless you need to sell due to some emergency or event beyond your control you would never sell when the market undervalues your holdings. You know what you have and therefore do not allow others to take advantage of you. The opposite is also true. When the market, through mass hysteria driven by greed, drives the prices of your companies beyond reasonable levels, you sell them. Prudence and your financial security dictates this even though you still have confidence in your companies' future prospects.

There is one other aspect of short-term stock price movements that is worthy of review during times like these. The stock market, as defined as the "store" where you buy stocks, is broad and diverse. Indices like the S&P 500, the Dow Jones Industrial 30, the Russell 2000, etc., are in theory utilized to provide you a broad perspective of overall stock price levels and financial conditions. Perhaps they do a credible job of this in general. However, it is important to remember and realize that there are many thousands of companies that can actually be bought regardless of the level of these indices. In reality many companies rise dramatically in bear markets and many companies fall dramatically in bull markets. Therefore, there will always be companies that can be bought at reasonable prices even when the averages are overvalued and vice versa. At EDMP we have always taken the position that it is more important to focus on the specific prospects of the actual businesses you own rather than market generalities that may or may not be relevant to your holdings.
The point in all this is that **valuation matters, in fact it matters a lot**. When investors own companies that are ridiculously overpriced at unprecedented levels like we have recently experienced, they should be concerned. Unfortunately the end to this "irrational exuberance" struck suddenly and brutally. These companies did not drift lower, they fell off a

cliff. A few examples of some well known companies clearly illustrate this point as follows: Gillette (declined 42% in two months), Procter & Gamble (declined 28% in two months), General Electric (declined 25% in three months), Citicorp (declined 53% in three months), Walt Disney (declined 42% in four months), American Express (declined 40% in three months), etc.

Our EDMP fundamental charts showed the overvaluations quite vividly and are a powerful advantage our clients and consultants have that no other competing firm we know of enjoys. A critical and often overlooked and misunderstood validity of our charts relates specifically to overvaluation. We believe that our charts which correlate a company's stock price to its fundamental true operating value are most profound when used to illustrate or identify overvaluation. The logic and evidence behind this statement is quite sound and relates to real world probabilities. In plain English, it is quite difficult for a company to meet or exceed consistent and superior operating results. This is a true and formidable challenge to even the best managers and even harder when the company is large. Even though we use median estimates that are conservatively projected, hitting these targets every quarter or even every year are tough, and especially so when these expectations are above average. The reality is that with Wall Street being what it is, even a small misstep can cause disappointing results with devastating consequences to price. This is true even if the disappointment is temporary, short lived or non-recurring. When this happens to a company while its stock price is reasonable, it can be bad for its market price, but when this happens when prices are high, it's valuation Armageddon. The higher you are the farther you have to fall. Most importantly, and the key to understanding this vital concept, is logic. If a company falls from a dramatic overvaluation it would have to go back to irrational levels to get even. In the almost thirty years since I have been in this business, massive overvaluation has only occurred three or four times. In other words, once every 8 or 10 years. That is long-term. On the other hand, if a company's stock price falls from value to undervalued, it is only logical to expect it to return to normal in a reasonably short period of time. Plus or minus reasonable variances, normal is how the market behaves most of the time. Therefore, the norm should be the focus on which our investment decisions are based. Our charts are very reliable and effective when used to determine overvaluation. They should not be ignored and even we have been somewhat guilty of this in the recent past ... it won't happen again.

Regarding using our charts to depict under-valuation the same principles described above still apply. As we have pointed out in the past, there are fundamentally only two questions a successful investor needs to answer: (1). What company to buy? (2). What price (valuation) to pay? Ultimately, the money is made from buying right, even when right is not the perfect bottom. Our valuation driven charts are powerful tools in assisting us to make rational buying decisions. However, they are only worthwhile when accompanied by the necessary research and due diligence. Their purpose is not to forecast short-term price movements, their value stems from helping us make rational long-term investing decisions based on our expectations of future cash flows and earnings. Their most salient feature is their ability to help us identify our companies' true worth and then be empowered to measure that against current market price. If used correctly our charts can elegantly enable us to determine if our portfolios are overvalued, fairly valued or undervalued. This is a major advantage most investors do not enjoy. Most investors are left to the mercy of often irrational market movements and therefore lack PIP (Perspective Intelligence Patience). This is why most investors buy at the tops and sell at the bottoms.

Using the above general discussion as a backdrop, we would now like to turn our discussion toward our recent and future behavior and strategies. First of all, it is important to state that what we have recently done and will be doing in the future has been and will be consistent and within our investing discipline. There are only four general reasons we would sell a "fine" business we originally bought at a reasonable price. 1. The fundamentals deteriorate without the prospect of recovery in a reasonable time frame: We recently came to this conclusion on Stewart & Stevenson and Toys 'R Us. When we originally bought them, good value was dear. Today however, we have many potentially exceptional alternatives where we can place this money. 2. The company becomes extremely overvalued: With much sadness and disappointment the market forced us to leave great names like Merck, Johnson & Johnson, Microsoft, Home Depot, Walmart, Lucent, Pfizer, etc. Our confidence and belief in these companies did not change, it was not their fault that the market drove their stock prices to dangerous levels. This is not a market timing decision, based on fear, this is a fundamental significant overvaluation decision based on our value driven discipline. In the future we are confident and committed to owning them again when rational valuation returns. 3. The company's price rises faster than other holdings causing an imbalance in the portfolio: This happened with Cisco, EMC, Carnival etc. and forces us to pare back and re-balance even if massive overvaluation does not exist. This is an important and prudent aspect of our discipline. Its purpose is not to maximize, but to protect. However, it can also be a very profitable technique because it allows us to add a new exciting opportunity or fill in a hole that irrational market hysteria created. This occurred in companies such as Mylan Labs, Shaw Industries, Michael Stores, etc. They originally fell after we first bought them. We pared other imbalances to add to them at lower prices, therefore, dramatically lowering our initial cost basis. Eventually, as expected, their prices returned to rational levels, often only back to our original cost. Suddenly our quote, unquote, losers became significant winners and we pared them back to a normal 5% with profits in our pockets. 4. We sell to generate tax losses to offset capital gains: We sell a company that is temporarily grounded, to establish a tax loss to offset gains we took or will take in the future. Taking advantage of the tax code, we lower the tax bite and still end up with our long-term opportunity, by buying it back in 31 days. Tax planning is one of the many advantages of custom designed individual portfolio management. We recently did this with Olsten, Sports Authority, Landry's etc. (Note: We did not sell in tax sheltered accounts, i.e. IRA's and Pension Plans). There are circumstances wherein these specific companies may not be bought back, such as the stock price moves back up sharply within the 31 day period, or a more compelling opportunity presents itself. However, our intent is to buy them back.

At EDMP each client portfolio is custom designed. A client hiring us today may have a portfolio entirely different than a client that, for example, hired us five years ago. The investing discipline and philosophy used are the same. We strive to find quality companies with excellent long-term business prospects selling at reasonable, or if we are lucky, low current valuations. Our intent is to be permanent long-term owners of these fine businesses. That will not and has not changed. From time to time events occur or circumstances change that dictate our deviating from these core objectives. During the last five or six years we have witnessed in many cases both unprecedented and dramatic aberrations from normal values and sound investing principles. Only the naive or ill informed could see this as anything other than it is, exceptions to normal and reasonable. No rational investor should ever ignore the realities of sound business and basic mathematics.

To our newest clients we would like to say the following. We are confident that we have constructed for your long-term benefit portfolios of good companies bought at reasonable value. We understand that this is difficult to believe since the prices of so many of them have fallen dramatically. We have done our homework, we know these companies and believe, based on careful and thorough analysis in their futures. We are confident that short-term market mania has temporarily driven their prices to ridiculously low levels. Many of these companies are as extremely undervalued today as the big caps were overvalued yesterday. As their stock prices begin to advance, the very names you now think are dreadful because the stock price is down will become your most cherished investments.

Past experience has evidenced an effect that I refer to as the "diving board" rebound. The more you pull the board down, the more powerfully it propels you upwards. A review of each of these companies' ten year historical graphs we provided you, will illustrate how consistent this pattern is and how quickly it can happen. It is our challenge to find sensible ways to accumulate more shares at these unbelievably attractive prices. We intend to do this even if its means selling a portion of other holdings to exploit these opportunities. We have often done this in the past with excellent results. There are numerous recent examples of this occurring during the month of September: Oracle recovered 53% from $19 to $29 in 27 days; Cabletron recovered 60% from $7 to $11 in 27 days; Reynolds & Reynolds recovered 38% from $13 to $18 in 20 days and the list goes on. Intrinsic value or true worth is a relevant and powerful force and whether overvalued or undervalued, a company's stock price can gravitate to it in the blink of an eye.

To clients that have been with us 3 to 5 years or more, these have been most extraordinary times. Selling some of the great companies we have owned for so long is akin to saying good-bye to old friends or even family. It was painful, but we believe it had to be done. The good news is we are seeing more opportunities as a result of the current malaise than we have seen in over a half decade. In short, we see compelling opportunities to re-deploy our capital. We are not, considering current market conditions, in a hurry; we will do it prudently.

We will continue to aggressively take advantage of the incredible opportunities unfolding before us. After all, that is what you are paying us to do. The best time to buy is when prices and values are low, the worst time to buy is when they are high. In fact, we cannot remember a better time to add to your account.

A few comments on the U.S. and world economies are also in order. First of all, there are real problems out there, especially in Asia, Japan, Russia, and parts of South America that will have an impact on our economy. We do not take these issues lightly for this would be folly. However, the word perspective once again comes into play. It was not too long ago that these same worries were directed to Mexico and Europe. Economic cycles for both businesses and economies are realities and facts of life that no one can predict with any degree of certainty. These are problems and challenges that must and will be addressed. They are however, solvable simply because they must. The world is not going to end, people around the world are not going to quit living and striving for a better life. We will persevere, help each other, endure and succeed. It is implicit in investing to assume a positive and successful resolution to major economic crises. This has always been the ultimate outcome. When panic sets in, investors often go to the extreme expecting their investments to go to zero. This, in fact, has never happened and there is no safe haven if it did, short of dried foods, ammunition and a well fortified bunker. In reality, today's problems become tomorrow's opportunities and the world goes on.

Finally, many of these issues are already factored in or rapidly becoming factored into stock prices. That makes them "cheap" and creates buying opportunities.. Wall Street will continue to "handicap" this quarter's earnings reports and pine about economic uncertainties wherever they may be. It is important to note that stock prices will begin to improve when economic conditions seem terrible because they will start to discount the coming recovery. This is why so many investors end up selling at the bottom! Myopic and short sighted focus will continue and therefore stock prices will remain volatile. For those of us with a more level headed longer term perspective this is what dreams are made of. We at EDMP, our investors and consultants think our way through it, not react to it.

The last five or six years of stock market appreciation should be seen for what it is, an aberration or anomaly. It has been neither normal nor rational. Those of us who follow and understand sound business principles and valuations have been surprised only by the duration of this anomaly and not its recent consequences. Also, it is important to point out that many of the companies we have recently and currently been buying have been in their own bear market for some time now. Regarding stock markets in general, there are several past precedents where these somewhat smaller yet sound companies led the market out of past bears, and outperformed the blue chips for many subsequent years. However, the more relevant and reliable expectations lie in the well defined and exceptional future prospects of their respective businesses in general and their individual opportunities more specifically. In other words, these are sound and well managed companies in industries that have bright growth ahead. I covered this more specifically in last quarter's report. Last and perhaps best of all they are very cheap.

In order to put all that I have said so far into focus, I would like to offer an analysis of a specific company we have been accumulating for the past year or so with our newest accounts. Since our more established accounts now have cash, you will soon own it also, so it applies broadly to our entire client base. The company is Andrew Corporation. Incorporated in 1937, this 61 year old S&P 500 company has been a stalwart of consistent growth and operating excellence. Through the calendar decade ending December 31, 1997 (see our 10 year chart) Andrew delivered a 33.75% compounded return to shareholders turning a $10,000 investment into $183,192. This enviable record, which is more than double the growth rate, and four times the dollar result (power of compounding) of the S&P 500, occurred at a closing price of $24 down from its 1997 high of $42.58. Even at its current price of approximately $13 per share, which I am going to try to establish as a ridiculously almost bizarre undervaluation, Andrew still has a long-term record that is more than double the S&P 500 over the current decade through September 1998. Andrew's capital structure shows less than 6% debt and the current earnings estimates of $1.18 to $1.20 for 1998 will be the second most profitable year in their long history. Last year (1997) was the most profitable at $1.23 per share. Its financial condition is superb and its current profit margins and even its book value are the highest they have been in a decade. Most importantly, Andrew is the industry leader in what has to be one of, if not the most exciting, fastest potentially growing, clearly forecastable industries in existence, period. And if that were not enough, Andrew has recently announced several new product offerings and improvements that establish its industry prowess and leadership.

Obviously, it would be prudent to ask that if everything is so wonderful why is the stock price down 70% from its high and almost 50% from last year's close? In a few words, market shortsightedness. If you look at our 10 year chart, at $42.58 Andrew was grossly overpriced (greed at the top). A glance at our forecasting chart would illustrate that it is currently, and I might add from my perspective, compellingly cheap at

$13 (fear at the bottom). This is what I referred to earlier as "handicapping" current earnings. It is true that Andrew's current results are slightly weaker than last year's. However, analysis would tell you that Andrew is merely suffering as are all other companies in its industry from a temporary lull in a business that will almost certainly enjoy explosive and dramatic growth well into the next century. We believe that there is greater risk in being out of Andrew than there is in owning it. The company's business is wireless communications. Its products include coaxial cable, buildings and towers, base station antennas, terrestrial microwave antennas, television and cellular antennas, radar systems and cellular phone accessories. Today the world economies are driven by information exchange. This cannot be done without the ability to communicate, and wireless is the future. The temporary softness in this industry is only delaying the inevitable. The demand is becoming significantly pent-up and not lost. The point is that Andrew and its competitors will over the next five to ten years be scrambling to produce and sell into the enormous demand they will enjoy. Today Andrew is selling at eleven times this year's earnings and less than ten times next year's. Its normal PE ratio is 19 times earnings and has on numerous occasions traded as high as forty times earnings over the last five years. It is my opinion that anyone that ignores or avoids this opportunity today will deeply regret that decision tomorrow.

In closing, a similar analysis could be offered on at least the majority of the companies we have been buying over the last year or two. Genesis Health Ventures, U.S. Filter, Reynolds & Reynolds, Richfood Holdings, Invacare, 3Com, Cabletron and on and on, are compellingly cheap and undervalued in an otherwise overvalued market. Even after their recent corrections, many Blue Chip Big Cap companies are still selling at multiples of earnings, cash flows, dividends, book values etc. that are higher than normal. The companies we are currently buying are cheaper than normal with above average prospects for growth ahead even considering the many global economic problems. Even more ironically most are generating excellent operating results with only the fear of an unknown event that may or may not happen causing weakness in their current price levels. On the other hand, the big caps are already experiencing problems from their international exposure and even after falling are still overpriced. Simply stated it is our view based on careful analysis and the undeniable realities of long term rational valuations that our holdings are cheap and actually worth significantly more than the market is currently pricing them at. These imbalances will correct, they always have before and will again, and we will all be richer for it.

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

Sincerely,

Charles C. Carnevale
President