3rd Quarter 2003

EDMP, INC. Quarterly Review

EDMP
Earnings Determine Market Price

The third quarter of 2003 brought modest but attractive performance results. Year to date shows a good year in the making, assuming it continues on this trend. However, it's important to remember that in the shorter run anything can and will happen in the, quote-un-quote, stock market. The last day of this third quarter and the day after represent an example of how crazy the short run can be.

On September 30th, the last day of the quarter, the market sold off dramatically. This is very frustrating to money managers like EDMP because that sell-off lowered our quarterly results, which we will now have to report forever. What's frustrating is that on October 1st, the very next day, the market surged powerfully upward. Oh my, what a difference a day makes. The point is you would have liked your results a lot better if you measured them through close of business on October 1st than on September 30th. The short run can be quite crazy indeed.

In last quarter's letter entitled "THE TRUTH ABOUT INVESTING**,"** we pointed out that the short run always becomes the long run. Therefore, like it or not, all of us, in reality, end up as long-term investors. Consequently, logic would dictate that it makes more sense to focus our attention more on the long run than on the short run. Unfortunately, very few of us, due to human nature being what it is, are equipped to pull this feat off. Our penchant for immediate gratification, and our natural fear of what the future may bring, creates emotional turmoil that is hard to control or ignore. As a result, it's understandable how short-term volatility can cause us to want to do foolish things, like sell at the bottom (fear) or buy at the top (greed). Sometimes we just can't control ourselves even though our common sense tells us we are being foolish.

Another classic symptom of emotions corroding our intellect is the inability to distinguish between a temporary bout of unrealized market depreciation, a down day, week, month, quarter, or year where stocks, or as we like to say, companies, become temporarily undervalued or cheap versus a permanent impairment of capital. Prices will inevitably recover from the former, but rarely or never from the latter. This is why we are constantly preaching that it's more important to focus on the true worth® of the businesses instead of what the mostly irrational short-term stock market may be pricing it at. Unfortunately, this is difficult if not impossible to do for most people, professional money managers included.

Fortunately, however, the EDMP fundamental charts and graphs are profound and powerful tools to help you fight off these dangerous emotional responses. In fact, it is our firm belief that this perspective of true worth® represents the greatest value we offer you, our valued clients. In other words, this perspective of true worth® is even more valuable to you than the safe, reliable, and above-average results our prudent approach provides you.

Recent stock market history clearly validates the truth behind this statement. From 1995 to 2000, people were so enamored with the high gains they were seeing that they were completely blinded to the present danger. Greed had dominated their intellect. Conversely, gripped with fear, these same previously over-confident investors sold into the teeth of the subsequent bear market suffering devastating losses. This didn't happen to EDMP clients due largely to our perspective of true worth® as provided by our valuable fundamental charts and graphs.

This powerful research, that we alone are blessed with, provides numerous benefits to us all. There are two benefits however that stand out amongst the rest. First, these tools provide clear and indisputable evidence that ***Earnings Determine Market Price*** in the long run. Second, they clearly illustrate dangerous overvaluation right in your face. More simply put, overvaluation is clearly evident if you only look. And, when you do, no *new paradigms* or *it's different this time* nonsense can steer you off course. Once you know this smart —not perfect, but smart— buy, sell or hold concept, decisions can be effectively made.

The track record EDMP has achieved for the benefit of our clients over the past 10 years is evidence of the validity of this hypothesis. From our point of view, it's not just the numbers themselves that are important. Rather, it's the prudent and sound manner in which they were generated that truly counts. This is especially evident when you examine how well our prudent approach to investing protected capital during the terrible bear market of 2000 – 2003.

So if it's true that ***Earnings Determine Market Price*** in the long run, and we confidently present that truth as self-evident, then forecasting future earnings is the key to future success. Since it worked so well in the past, there is no reason to believe it won't work going forward. Therefore, the remainder of this quarter's letter will be focused on our view of why we believe earnings growth over the next three to five years should be exceptional.

However, there are a few positioning statements and/or caveats that need to be stated and addressed before we delve into our general forecast of future earnings. First of all, even though it's true that ***Earnings Determine Market Price***, this only leads to profitable investment results if those future earnings are bought at sound and attractive valuations. If you pay too much for even the best of companies and they succeed in delivering the earnings you expect, you will nevertheless suffer mediocre to bad performance and you are taking too high a risk to get those poor returns.

Secondly, due to the recent rally in stock prices, many great businesses have once again become overvalued. This new bout of overvaluation applies to the stock market in general, but DOES NOT APPLY TO YOUR PORTFOLIOS. We did not generate the results we mentioned above by being like the stock market. Most importantly, we don't expect to create superior results going forward from the stock market. We expect to generate safe and superior future results from purchasing safe and superior businesses at attractive prices. Our future results will come solely from the superior earnings we expect our portfolio companies to deliver that were bought at or below true worth®. You make your money on the buy side. The stock market, on the other hand, has little to do with our future results, except of course in the short run and only the short run. As previously stated, our focus is on the more reliable long run instead of the totally unpredictable short run.

In order to clearly articulate our view of the future earnings growth of our portfolio companies, we are going to borrow some information from an October 6, 2003, article in BusinessWeek Magazine titled: <u>U.S. Corporate America Reaches Its Fighting Weight.</u> This article mirrors our own opinions of the future and therefore we will paraphrase some of it and quote some of it. The sub-headline of the article summarizes the view nicely, and I quote, "Trim, flush, and productive businesses are ready to answer growing demand."

I once read that in every adversity there exists the seed of a greater or equivalent benefit. The recent bear market and, more precisely, recession that we went through could be looked at as a cloud with a silver lining. Corporate America had become bloated with the excesses of the 1995-2000 irrationally exuberant period. The subsequent recession served as a reality check putting America's best companies on a serious diet. Consequently, today we find them leaner and meaner than we have seen in quite some time. In short, U.S. companies are now fit and ready to roll. They are back in shape and their financial health has been restored. They have cut the fat of unproductive assets and bloated inventories and are once again the formidable and productive competitors they have always been known to be.

This improved financial fitness is the primary reason that we see strong and growing earnings over the next three to five year period. This point is especially relevant to the companies we already own as well as several we are considering for purchase. After all, these are the companies that we do know the best. However, we believe this also applies generally to the broader U.S. Corporate American companies as well. The only difference being that our portfolio holdings are generally fairly valued today.

The bottom line on all this is that our companies are now in such good shape that any new business or revenues that they can generate should fall straight to their bottom line. In other words, the opportunity for these companies to grow their earnings has not been this bright for many years.

And, as we hope you all agree: in the long run ***Earnings Determine Market Price***. Always have, and always will.

Sincerely,

Charles C. Carnevale
Chief Investment Officer