

EDMP, Inc.

Quarterly Review 2nd Quarter 2010

A Tale of Two Quarters

The second quarter of 2010 has mercifully come to an end. From our perspective, our portfolios experienced two radically different performances. Regarding stock prices, the only reason our stocks went down is because other fearful investors were selling their positions, our stocks were not down based on weak fundamentals. Even though the majority of our companies continued to report excellent earnings growth, generated strong cash flows, and possess very strong balance sheets, their stock prices fell along with the rest of the market. We consider this unfair, but it is just how the market works when emotions run high. In the shorter run (less than three years) the emotions of fear and/or greed can cause the stock market to behave in very irrational ways. However, it's important to never forget that in the long run earnings determine market price.

As we look back on the second quarter of 2010 and review the business results of our excellent portfolio companies, we are very pleased. Healthy companies display characteristics that are generally precursors to strong future performance. When earnings growth is strong and management confidence high, companies that pay dividends will reward shareholders with dividend increases. Most of our companies that pay dividends have a legacy of increasing their dividends, and many of our dividend paying stocks raised their dividends last quarter.

Another good sign is stock buybacks, when companies perceive their shares to be undervalued they will aggressively buy back their own stock. Many of our portfolio companies have done just that this last quarter. And in addition to buying their own stock, many of our companies have taken advantage of the current market weakness by making strategic acquisitions of complementary businesses on sale. Therefore, future growth potential is enhanced.

As we have steadfastly pointed out, the operating results of the businesses we own is much more important than their price action. Business results are tangible and can be measured accurately, while stock price volatility is mostly emotional and therefore, highly unpredictable in the short run. Therefore, common sense dictates that it is much easier to calculate intrinsic value, or what we like to call the True Worth™ of a business, than it is to try to guess where the stock price may go over the next week or month or quarter. We are confident that our EDMP, Inc. F.A.S.T. Graphs™ provide an accurate perspective of True Worth™ valuation versus current stock price.

Therefore, we highly encourage you, our valued clients, to log on to your EDMP, Inc. account on our website and review your portfolio through the lens of our EDMP F.A.S.T. Graphs™. We are confident this will help you see your portfolios in a more enlightened perspective. Not only can you see where each position was bought or sold, you can also see what its valuation in relationship to its earnings looked like. This can reduce any fear based on uncertainty. We know no other manager that offers such transparency to their clients on their portfolios. Since a picture is worth 1000 words we encourage you to take advantage of this perspective.

As a preview of how valuable this perspective can be we offer the following five examples utilizing our EDMP, Inc. F.A.S.T. Graphs™. These examples are offered as a representative cross-section of your total portfolio. Our goal is to get you to see how valuable these companies are based on earnings or operating results, while simultaneously, to see how irrationally the stock market is currently pricing them.

As you review the figures below, we suggest you focus on the following important factors and attributes of the historical performance these graphs represent. **The orange line with white triangles is the most important attribute to examine and understand.** This line plots the earnings-per-share

of each company based on established formulas for fair value. In other words, this line represents the True Worth™ value of the business. Especially note how smooth and consistent these orange lines with white triangles are. This is indicative of the fact that a companies true value rarely changes very much from one year to the next, while price can change from minute to minute. As your portfolio managers, we feel this is not only the most important line on the graph, it is also the one that we focus on most. Since we believe that this is where real value exists, when this line is growing or rising, then the value of the portfolio is rising as well.

History has taught us, that if stock prices are not accurately reflecting that value, they inevitably will. The black line, the price line, is obviously much more erratic or jagged then the earnings line, (the orange line with white triangles). Just looking at these black lines clearly illustrates how emotional short-term price movement can be. However, take special note of how this black line moves in tandem with the orange line with white triangles over long periods of time.

To be clear, when the black line touches the orange line fair value exists, when the black line is above the orange line overvaluation exists, and when the black line is below the orange line undervaluation exists. The point here is that in the long run earnings determine market price, while in the short run emotions can create temporary volatility. Therefore, investors need to be much more concerned with the orange line than the black line. However, since we are emotional beings we understand how difficult that can be. These graphs can help if we just give them a chance.

Figure 1 below looks at Johnson & Johnson, a blue-chip stalwart with a strong dividend yield (the light blue shaded area on the graph) that we purchased in the spring of 2009. First, note how the stock market had consistently overvalued Johnson & Johnson until the "great recession of 2008". Next, note how even though earnings have remained consistent the stock price has fallen below the earnings justified value line. We see this as an opportunity to buy Johnson & Johnson on sale.

Figure 1 JNJ 20yr EPS Growth Correlated to Price

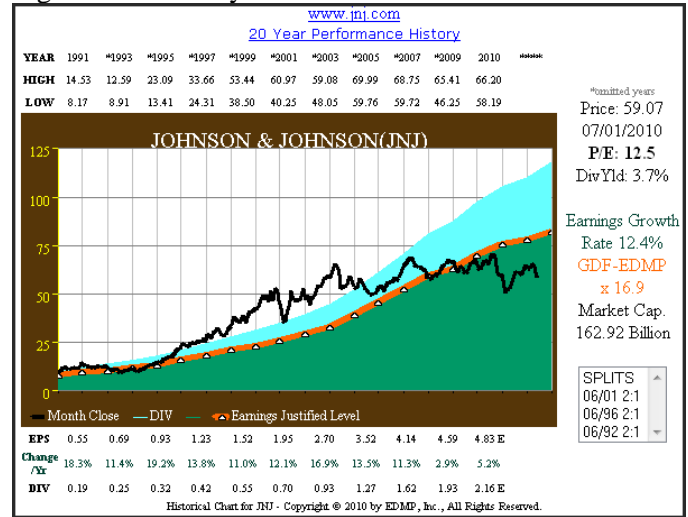
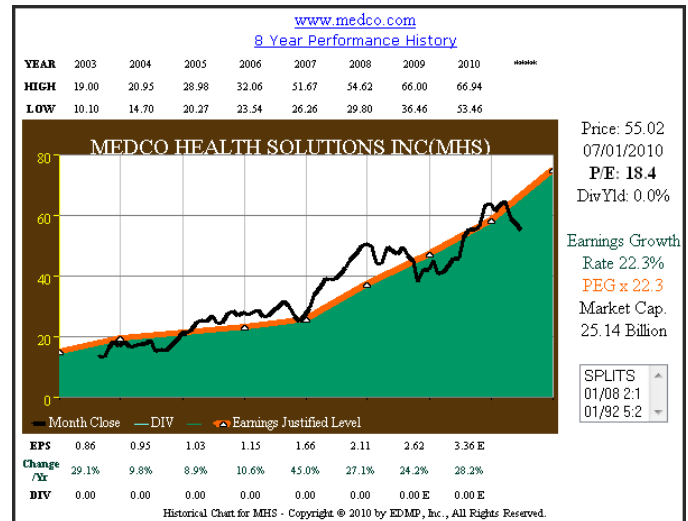


Figure 2 looks at Medco Health Solutions Inc., another new addition to the portfolio that came in value in 2009 thanks to the "great recession of 2008". This is a very fast growing healthcare company that we believe is part of the healthcare solution, rather than the problem. Earnings growth of this fine company is not only very fast, it's also been very consistent. The black stock price line has clearly tracked earnings growth since this fine business was spun off by Merck & Co. in the fall of 2003. As you can see, the price has fallen below the earnings justified value during the second quarter of 2010 while earnings have continued to advance. Therefore, we see this as an undervalued selection today.

Figure 2 Medco 8yr EPS Growth Correlated to Price



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Figure 3 looks at Nike since calendar year 1991 and offers a very clear perspective of the undeniable relationship between stock prices and earnings. Although the stock price for Nike has sometimes been volatile over short periods of time, in the long run price clearly went where earnings went.

As the graph depicts, Nike became slightly overvalued during the first quarter of 2010 after recovering from significant undervaluation in 2009. Currently, we believe Nike is very attractively priced and in value.

Figure 3 Nike 20yr EPS Growth Correlated to Price

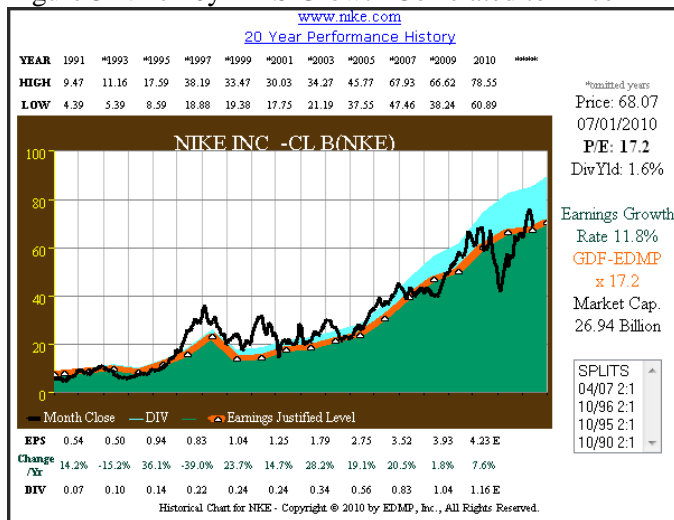


Figure 4 looks at Fiserv, a stock we have owned since 2004 that came into value after being overvalued for many years starting in 1996.

Once again, the importance of earnings is clearly evident. When the stock price is above the earnings line it inevitably returns to fair value, and conversely when the price gets below the earnings line it likewise returns to fair value.

The selloff in Fiserv's stock price in the second quarter of 2010 is not indicative of the stellar earnings growth they have achieved.

EDMP, Inc.

Figure 4 Fiserv 20yr EPS Growth Correlated to Price

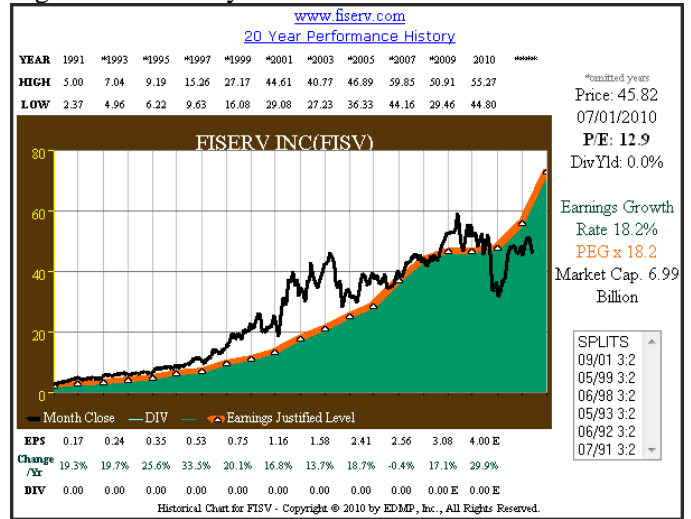
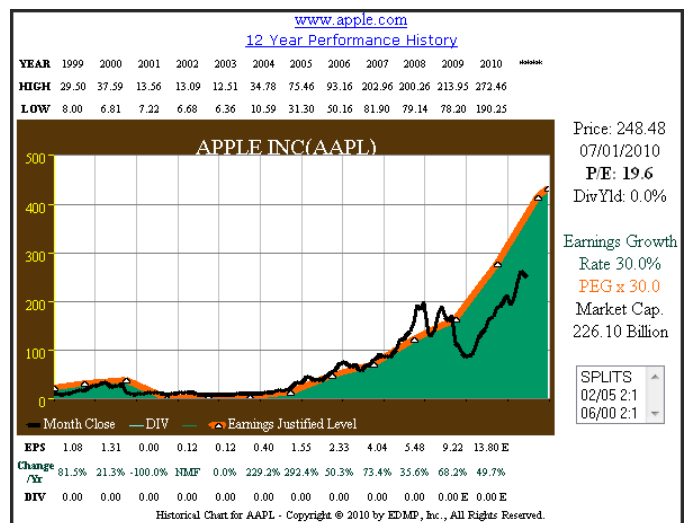


Figure 5 reviews Apple Inc., one of the newest additions to your portfolio of above-average growing businesses. In the case of Apple Inc., the relationship between earnings and stock price is undeniable. Apple Inc. is currently a very popular stock as well as a strong earnings generator. However, even this Wall Street darling saw its stock price fall from a high of over \$270 to its approximately \$250 price at the end of the second quarter of 2010. This is another testament to the fact that in the short run emotions can cause stock values to be out of sync with True Worth™ value.

Figure 5 Apple 12yr EPS Growth Correlated to Price



When investors are gripped with fear or greed the emotional response generally creates opportunity for those with a level head. When you have a clear perspective of what your portfolio companies are worth, you can make rational buy sell decisions and ultimately exploit other people's folly as the venerable Warren Buffett encourages his followers to do.

In other words, when market forces overprice your holdings, the opportunity to sell for more than your investment is worth becomes manifest. On the other hand, when the market under-prices your holdings the opportunity to buy more at bargain levels becomes available. In our experience, we have seen both overvaluation and undervaluation in every market. Obviously, during bull markets, there are more overvaluation situations and during bear markets, there will be more undervaluation situations. As your managers, it is our responsibility to recognize both when they exist and act accordingly on your behalf.

During the second quarter of 2010, we have taken advantage of both overvaluation and undervaluation situations in order to strengthen your portfolios. Additionally, we have also executed some rebalancing transactions in order to raise the capital to exploit opportunities as they have presented themselves.

Three holdings that gave us great performance in 2009 and through the first quarter of 2010 also became very large positions as a result of out-performance. Although we still like these three companies, prudence dictated that we reduce their size down to more appropriate levels. These three companies were Coach, Cognizant Technologies and NII Holdings. This provided an additional benefit of generating funds to be used to purchase new companies like Apple Inc.

In our opinion, the recent weakness in stock prices has created an opportunity for enhanced future returns. Keep in mind that our portfolio companies endured the recent "great recession of 2008", and in many cases, actually saw their businesses flourish. Today's weakness pales in comparison to that

period. As Warren Buffett has said, "*be greedy when others are fearful, and fearful when others are greedy.*" It's ironic that investors will often flee the market just when common stocks become attractively priced. The investment principle of buying low and selling high is one that investors should never forget.

As we look to the future we remain supremely confident of the growth prospects of the excellent companies we own on your behalf. Not only are the prospects for future earnings growth exceptional, the majority of our holdings are currently undervalued. Strong growth and low valuation has historically been a recipe for above-average gain at below average risk.

We acknowledge that the market is currently gripped with fear, however, we do not acknowledge that the fears are justified. Even when looking at the market in general, today's valuations are historically normal and therefore attractive. On the other hand, when you look at the low valuations of our above-average portfolio holdings today, enhanced future returns should be expected. During times of stress, it's easy to forget that all bear markets end with a bull market.

And as always, remember; Earnings Determine Market Price, always have, always will.

Sincerely,



Charles C. Carnevale
Chief Investment Officer

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