

SHAKER INVESTMENTS

A RESEARCH-DRIVEN GROWTH APPROACH TO EQUITY PORTFOLIO MANAGEMENT

Volume 2 Issue 1



Note From Edward Hemmelgarn

This newsletter continues our mission of providing investors with “news from the front” of leading edge industries. Bryan Moloney, research associate, provides an overview of the growing electronic payments industry. He notes that debit card transactions are expected to surpass credit card transactions by 2010.

This issue also includes an interview with Kenneth J. Saunders, Chief Financial Officer of HNC Software, Inc., which develops, markets and supports predictive software solutions for leading service industries. Kenneth discusses the many applications of predictive technology, including its use in telecommunications, insurance and banking.

Shaker Investments’ professional staff continues to expand. I am pleased to introduce two key additions to our growing Shaker family, Robert J. Conrad, our new Managing Director, Mutual Funds, and Tim Carneval, who recently joined us as Vice President, Client Services.

Bob Conrad is responsible for marketing and distribution of our recently introduced mutual fund, Shaker Fund. The Fund, which employs our flagship investment approach is focused on small and medium-sized companies, is designed for both institutional and individual investors. Tim Carneval is responsible for meeting the client service needs of Shaker’s clients.

We’re confident that Bob and Tim will add considerable value to our clients as well as to Shaker Investments. ■



Analyst’s View

Debit Cards Provide Boost to Electronic Payments Industry
Bryan Moloney, Analyst

Credit card growth continued nearly unabated through the 1990’s, but over the next decade debit cards may surpass the use of credit cards in the U.S. By 2010, debit card transactions are expected to rise from the current 6.5 billion to 28.5 billion, versus 28 billion for credit cards. This has major implications for the major electronic payment processors.

The success of debit cards is not just consumer-driven. Retailers have welcomed debit cards and are actively encouraging customers to use them. Major supermarket chains and other retailers have begun to provide shoppers with the added convenience of using their debit cards to obtain cash at check out registers and to earn free air miles.

The primary reason vendors have thrown their support behind debit cards is the extremely low cost involved in processing a debit card payment. Vendors are charged a 10-cent flat fee to obtain a debit card authorization versus a percentage of the dollar transaction, which can run as high as 2.5% for a credit card.

Credit and debit card payments are settled via electronic payment systems — clearing networks owned by credit card processors — through which vendors request and obtain payment authorizations. Currently, three companies are responsible for a major portion of electronic payments in large, small and medium merchant tiers of this market: First Data Corporation, Nova and Concord.

First Data Corporation, the largest processor, focuses only on the largest retail chains throughout the U.S. Nova (recently acquired by U.S. Bancorp) provides its processing services primarily to small merchants with low yearly volume of payments. Concord covers the largest share of the middle market.

Of these three, Concord is the best positioned within the electronic payments industry. Two of its key market segments — supermarkets and gas stations — are experiencing the fastest growth in the industry. Concord EFS dominates these segments with 75% and 50% market share, respectively.

Concord championed the cause to introduce electronic payments into supermarkets, and made gas stations a focus early in the game. Both these segments are still experiencing positive mix shifts from cash to electronic forms of payment. The major drivers are consumers’ growing preference for debit cards versus check writing in the supermarket checkout line, and the convenience of pay-at-the-pump.

Concord’s focus on the supermarket and gas markets has enabled it to grow transactions at a rate of 19% versus an industry average of 10%. This has allowed Concord to continue to gain significant economies of scale. The company is now positioned to compete with First Data Corp. for larger end merchants, as evidenced by its recent penetration into the #1 retailer in the U.S., Wal-Mart. Until recently, Wal-Mart was the exclusive domain of First Data Corp. ■

PORTFOLIO AT-A-GLANCE

As of May 31, 2001

TOP 10 HOLDINGS

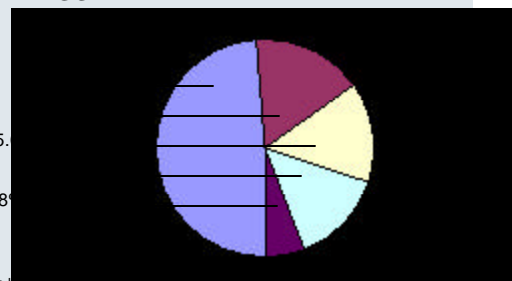
Microchip Technology
Retek Inc.
Cree Inc.
HNC Software
Conseco
Royal Caribbean Cruises
Titan Pharmaceuticals
BMC Software
Getty Images, Inc.
Brocade Communications Systems

AVERAGE PORTFOLIO CHARACTERISTICS

Number of Holdings	44
Wtd Forward P/E	42X
Wtd Sustainable	
Growth Rate	44%
Median Market Cap	\$2.4 bil

SECTOR WEIGHTINGS*

Technology	48.4%
Health Care	16.5%
Financial Services	15.0%
Other Energy	14.3%
Consumer Discret	5.8%



*based on sector definitions by



Executive Insights

Kenneth J. Saunders, CFO
HNC Software, Inc. [NASDAQ: HNCS]

Q: What is predictive technology?

A: Predictive technology seeks to predict future trends by analyzing past and current events and patterns. It's used in various industries to help identify and forecast customers' needs and future purchasing trends, as well as to anticipate the likelihood of fraudulent transactions.

Q: Who are the big users of predictive technology?

A: Predictive software is used mainly in three industries — telecommunication, insurance and banking — to derive more value from customer relationship management (CRM) and enterprise resource planning (ERP) programs. Predictive technology can provide companies with a more proactive approach to modeling an immense wealth of customer-based data.

Q: What percentage of this market does HNC own?

A: Currently, the top 100 names in the telecommunication, insurance and banking sectors employ HNC's solutions. In the credit card fraud protection sector, HNC accounts for 50% and 75% of the worldwide and domestic markets, respectively. In addition, 35% of the domestic insurance market employs our decision management software applications for medical bill review. These markets are expanding rapidly, particularly the latter.

Q: How large is the overall predictive technology market?

A: The current estimated value of this market is approximately \$6 billion and is expected to reach \$16 billion in 2004.

Q: What are the main applications for HNC's predictive software solutions?

A: HNC's software provides applications in three specific categories. The most basic of these is intelligence response platforms, which are employed as a customer service tool. A second key category is decision management engines, which are used to acquire and manage client relationships. The third category can broadly be described as customer analytics. These applications are designed to help identify risk and opportunities within clients' portfolios.

"The growth of E-commerce continues to fuel the demand for fraud prevention technology."

Q: Who are the major players in predictive technology?

A: Two companies stand out in terms of size and scope — Autonomy and ourselves. I wouldn't describe either of us as dominant, at this time. However, all of the other companies in our industry are quite small and concentrate on limited, niche markets.

Q: How does HNC differentiate its Predictive Technology products from its competitors?

A: Our true value-added is our access to a large in-house repository of data from the telecom, insurance and banking industries. This allows us to use neural-network technology to measure individual transactions against millions of other transaction patterns specific to these industries.

Q: In tangible terms, what does that mean for your clients?

A: Here's a recent example. A leading insurance company used our technology to evaluate their medical bill review process, by identifying specific patterns and trends among individual customers and groups of customers. The actions they took based on this information resulted in a drop from \$12 to \$1 in the cost of this process.

Q: Is there a link or common platform between the growth of predictive technology and E-commerce?

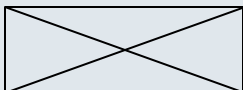
A: The growth of E-commerce continues to fuel the demand for fraud prevention technology. In 1999, we launched E-Falcon, our online fraud prevention software, which was based on an earlier off-line product. E-Falcon has become the application of choice for industry leaders such as First Data Corporation, the world's largest credit card processor.

Q: Which area of fraud applications do you expect to grow fastest?

A: We believe healthcare, insurance and telecommunications will be the next major growth segments for these applications. However, we expect continued demand for HNC fraud protection from the major credit card providers.

Q: What will HNC look like in five years, in terms of size?

A: HNC's internal management goal is to grow revenues from the current \$255 million to \$1 billion in five years. To achieve this, we have made our company extremely horizontal, so that all decisions and technical innovations are made closer to the marketplace. We are confident that this will enable us to continue to be an industry leader in a market whose needs and expectations are constantly evolving.



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