

# SHAKER INVESTMENTS

A RESEARCH-DRIVEN GROWTH APPROACH TO EQUITY PORTFOLIO MANAGEMENT

Volume 4 Issue 1



**Note From**  
Edward  
Hemmelgarn

**Greed and Fear.** In the late 1990s and early 2000 it was clear that the dominant investor sentiment was greed. Fear is now the driving force, as investors are more afraid of losing money than missing an opportunity.

The current investor sentiment is understandable given the losses suffered in the last three years. But it is the magnitude and duration of losses that have now reduced valuations and decreased competition to levels that make investment gains more likely in the future.

In fact, historically, three consecutive years of stock market losses are very rare and have always led to positive returns in the following five years. Since 1928, the S&P 500 Index has lost money three years in a row only three times prior to 2000-2002. In the five years after each of these three year periods, the S&P 500 produced returns that averaged 123% but at a minimum were 86% or 13.2% per year. Obviously, it is impossible to predict if the next five years will produce similar returns, but I am confident that investors have less to fear now than three years ago.

Looking forward, I believe investments in companies in sectors with better growth potential and attractive valuations should do well. One such area of opportunity, featured in this month's newsletter is healthcare IT, which is reviewed by analyst Lynn Laws. This issue also includes an interview with the CEO of Eclipsys Corporation, one of the fastest growing companies in this niche. ■



## Secular Trends Create Selective Opportunities in the Healthcare Sector

Lynn Laws, Research Associate

Secular trends impacting the Healthcare sector remain strong. The average age of the population is increasing in the United States and better healthcare is also helping people live longer. The elderly utilize more healthcare than the rest of the population – they consume more pharmaceuticals, have more and longer hospitalizations, and require more long-term care. As the baby boomers reach their sixties and older, health care use should continue to grow.

Despite these positive long-term secular trends, the valuations of healthcare stocks are near all time lows versus the market. We think there are two key factors adversely affecting these stocks. First, there is concern that funding for Medicare and Medicaid might be cut or that price controls may be implemented. Healthcare spending grew at three times the rate of the economy in 2001 to 14.1% of the gross domestic product (GDP), according to a recent report by the Centers for Medicare and Medicaid Services (CMS). This rise in health care spending has sparked considerable debate in Washington and at the state level about how to manage it, and although it is unpopular, Medicare and Medicaid cuts and price controls are possible.

The second factor is that prescription drug sales have slowed recently from unsustainably high growth rates of 17-19% in 1999 and 2000 to a more normal growth rate of 12% in 2002. Pharmaceutical sales are expected to remain robust with estimates of 11-14% growth over the next several years (IMS Health). The anticipated Medicare prescription drug benefit would augment these sales by allowing more seniors to afford the drugs they are prescribed.

We believe that the noise surrounding these factors has unfairly punished the stocks of some good companies in the Healthcare sector and provides us with an opportunity to purchase growth stocks at attractive prices. Our strategy is to avoid companies that have high Medicaid and Medicare exposure because of the risk to these programs from government cuts and to focus on industries and companies that provide products and services designed to help the healthcare system operate more efficiently. These include pharmaceutical distributors, pharmacy benefit managers, and companies that provide healthcare information solutions.

Pharmaceutical distributors save the healthcare system billions of dollars per year by reducing the number of transactions that must take place in delivering pharmaceuticals from the manufacturers to the pharmacies. Pharmaceutical growth and increased operating efficiencies are responsible for the strong fundamentals of the two pharmaceutical distributors we own, AmerisourceBergen and McKesson.

Pharmacy benefit managers (PBMs) help to manage spending on pharmaceuticals by encouraging the use of better, less expensive drugs, especially generics, through the use of multi-level co-pays. Caremark Rx is a company that Shaker Investments particularly favors, because of its strong employer client base, mail order dominance, and specialty pharmaceutical distribution business, which have enabled Caremark to achieve the best margins in the business.

The healthcare information solutions industry addresses an area of critical need in the Healthcare sector. The software solutions provided by this industry have the capacity to improve patient care, reduce medical errors, and make hospital operations more efficient through labor cost reductions and productivity increases. The three companies that Shaker Investments owns in this industry are Cerner, Eclipsys, and McKesson HBOC.

We believe that the long-term growth prospects for the healthcare companies we own are excellent, and they are all selling at a discount to this growth. ■

## PORTFOLIO AT-A-GLANCE

As of March 31, 2003

### TOP 10 HOLDINGS

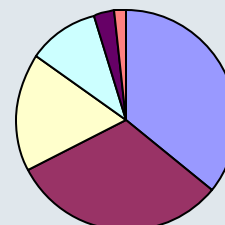
AmerisourceBergen  
Caremark Rx Inc.  
Cerner Corporation  
Fair Isaac & Co.  
International Rectifier  
Invitrogen Corp.  
McKesson HBOC, Inc.  
Microchip Technology  
Qiagen, N.V.  
Xilinx Inc.

### AVERAGE PORTFOLIO CHARACTERISTICS

Number of Holdings	41
Wtd Forward P/E	19.7
Wtd Sustainable Growth Rate	27%
Median Market Cap	\$1.6 bil
Wtd Price Book Value	2.5

### SECTOR WEIGHTINGS\*

Technology	35.7%
Healthcare	31.6%
Consumer Discret	17.5%
Financial Services	10.6%
Other Energy	2.8%
Materials & Process	1.8%



\*based on sector definitions by Frank Russell Co.



# Executive Insights

**Paul Ruffin, CEO**  
**Eclipsys Corporation, [NASDAQ: ECLP]**

**Q:** How large is the healthcare information technology industry?

**A:** Healthcare information technology (HIT) is currently estimated to be a \$35.3-billion industry. It is growing at a projected 8.5% annual rate and is expected to reach \$46.4 billion by 2005. The area poised to experience the fastest growth is core clinical solutions, which includes such functions as physician order entry, result reporting, and electronic medical records. Less than 10% of U.S. hospitals have computerized physician order entry (CPOE) systems live and only a handful have a paperless environment. By 2005, it is estimated that 50% of hospitals will have installed one or more components or modules of CPOE.

**Q:** Who are Eclipsys' major competitors?

**A:** Currently, the major players in the HIT industry, along with Eclipsys, are McKesson, Siemens, Cerner, IDX and Epic.

**Q:** What have been the main drivers behind the development of Eclipsys solutions?

**A:** The demand for our systems has increased as healthcare providers continue to identify significant issues that can be effectively addressed with information technology. Patient safety, quality of care, workforce shortages and revenue cycle management remain at the top of CEO priority lists.

**Q:** Where is Eclipsys experiencing the most growth?

**A:** Eclipsys' Sunrise™ suite of solutions, including Sunrise Clinical Manager and the latest generation of our solutions, SunriseXA™, has proven to be attractive to hospitals and integrated hospital/healthcare systems of all sizes. We also have experienced significant growth in the customer base for our advanced enterprise core clinical solutions and have had

considerable success marketing Eclipsys' service offerings, including outsourcing, remote hosting, network services and business transformation.

---

*“Less than 10% of U.S. hospitals have computerized physician order entry systems.”*

---

**Q:** What advantages does Eclipsys have over the competition?

**A:** Eclipsys solutions continue to consistently earn top industry rankings. For two consecutive years, our Sunrise Clinical Manager solution has achieved top rankings in virtually every major industry survey, enabling us to significantly outshine our closest competitors in the core clinical space. For three consecutive years, our CPOE solution has been named the top industry choice by Five Rights Consulting, and in 2002, Clinical Manager received two Medical Records Institute Electronic Patient Record Awards. Eclipsys has received special recognition from KLAS Enterprises for being a multiyear annual top performer. KLAS has reported that more hospitals and physicians use Eclipsys CPOE solutions to improve patient safety than any other product. KLAS has also cited Eclipsys CPOE solutions as providing more value and actual benefits than any other system.

**Q:** How important is Eclipsys' relationship with Microsoft as a competitive advantage?

**A:** We are a Microsoft strategic partner and a member of the Early Adopter Program, which enables us to lead the industry in bringing true, comprehensive, Web-native solutions to market. Eclipsys' technology is based on the Microsoft .NET framework, which provides our customers with a proven infrastructure and an integrated platform that reduces the total cost of ownership for our customers.

**Q:** Tell us more about what differentiates your newest solution, SunriseXA.

**A:** SunriseXA is focused on enhancing the workflows of a healthcare organization to improve processes and achieve operational efficiency. This helps healthcare organizations implement best practices and achieve the best-possible clinical, financial and customer-satisfaction outcomes. SunriseXA components share the same underlying Health Data Repository database and CPR (computer-based patient record), so information isn't kept in multiple databases. That provides comprehensive and easy access to information across the healthcare enterprise. And because functionality isn't duplicated within components, SunriseXA is a more cost-effective solution to implement and maintain. Also, it ensures that there aren't disparate “silos of information”, which often can occur with application-based software products. SunriseXA is the only system that has this capability.

**Q:** Would cuts in funding in Medicare and Medicaid have a negative impact on Eclipsys?

**A:** The healthcare industry faces a number of serious challenges, including cuts in Medicare and Medicaid. This has prompted Eclipsys to change its business model to a subscription model, to enable a large number of capital- and cash-constrained organizations to subscribe to our solutions. This provides them with our capabilities at a fraction of the significant upfront cash outlay typically required for such a system. The new fee-based business model is a more-conservative way to recognize revenue and will enable Eclipsys to maintain a solid revenue stream regardless of market forces.

**Q:** Will Eclipsys at some point be an attractive acquisition candidate?

**A:** Becoming an acquisition target is not in our plans. ■



One Chagrin Highlands  
2000 Auburn Drive  
Suite 300  
Cleveland, OH 44122  
216 292 2950  
216 292 2951 fax

280 Park Avenue  
Suite 3900  
West Building  
New York, NY 10017  
212 622 7700  
212 622 7727 fax

1763 East Route 70  
Suite 202  
Cherry Hill, NJ 08003  
856 761 0540

1750 Montgomery Street  
San Francisco, CA 94111  
415 954 7135  
415 954 8598 fax