

J. L. BAINBRIDGE
& COMPANY, INC.

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Dear Mr. & Mrs. Client:

A key to investment success is the identification of long-term trends that are enabling some companies to grow much faster than the long-term growth of the world economy. The most important of these trends is the aging of the world's population which will be in force throughout our lives. Not surprising the industry benefiting the most from this trend is healthcare. However while the sales of pharmaceuticals are as one would expect growing rapidly, this industry is facing both pricing pressure and patent expirations of major products. At the same time their research programs have encountered a number of failures and thus there are few new products hitting the market. Therefore investments in this industry have higher risk than our investment program will tolerate which is why over the past two years we sold Merck and Pfizer.

Without large drug companies in our portfolio, we developed a strategy of investing in other segments of healthcare. Hence our portfolio currently includes Cardinal Health whose drug and medical supply businesses and hospital automation systems directly benefit from higher demand for these products and are not affected by drug pricing pressure. In addition because government and insurance companies have little involvement in dental care, pricing is not as much an issue. Consequently, we own Henry Schein and Dentsply because profits are excellent and patients over age fifty spend the most on dental care. We also own Walgreens which is also growing independent of the problems impacting the large drug companies and is benefiting from the growth of generics because their profit margin is higher on generic drugs versus brand name drugs. In addition we own Johnson & Johnson which is widely diversified with total sales divided equally over their Consumer Products, Medical Devices and Pharmaceutical divisions and each of these divisions derive almost half of their sales internationally. Lastly we own Forest Laboratories which is a domestic drug company with unique products. However because their business is subject to the risks of their industry, we invest a smaller amount of funds in Forest than our other holdings.

Other areas that benefit from higher spending by the age group over fifty are garden and lawn care as well as pet care. Consequently Scotts and Petsmart offer another avenue to participate in the aging of the population. Both of these companies have strong market shares and are experiencing double-digit revenue growth and expanding profit margins. Also of note Henry Schein has a growing veterinary supply distribution business.

Jerry L. Bainbridge, President