THE Neal Spelce AUSTIN LETTER

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Dear Client:

High-tech executives are borrowing less money and accumulating less credit. A couple of weeks ago we reported on a PricewaterhouseCoopers study indicating a large number of high-tech executives were revisiting their investment and employment expansion plans in light of recent market corrections and higher interest rates. A companion survey likewise shows that only 21% of fast growth executives are completing new bank loans, down 4% from the 1Q 2000 and 1999.

While fewer high tech companies are borrowing right now, those that are, tend to borrow more. "Though they are shrinking in numbers, today's borrowers are on a roll," reports **Tracy Lefteroff**, private equity leader for PricewaterhouseCoopers. "This group is on the fastest of tracks. As interest rates have steadily escalated, most 'Trendsetter' companies have been content to finance growth from their consistently strong gross margins."

"But these high flyers are different, Lefteroff notes. "They have been supplementing with outside financing because their market momentum and new opportunities are so much greater. Still, with volatile stock markets and the Fed's persistent increases, it appears only a matter of time before even these extraordinary companies will also have to cut back on the expense of borrowing, and correspondingly place a limit on their momentum."

Even prior to the Federal Reserve Board's 50-basis point rate increase in May, interest rates for bank financing for both product and service companies reached 9.34% — 25 points higher than the first quarter of the year and a significant 106 points higher than the same period in 1999. More subtly, service companies, which had been getting a slight break on rising interest rates (9.05% versus 9.14% for product companies), are now paying slightly more. In other words, during 2Q 2000, **interest rates for fast-growth service providers rose more than 50% faster than for their product counterparts**.

As Lefteroff points out, "We've returned to an environment where **businesses with hard assets are paying less for their financing**." While this certainly doesn't mean the Internet boom is over, it does mean that both borrowers and lenders are becoming more cautious. This trend is further confirmed by the fact that fewer high growth companies are searching out alternative financing: venture capital, angel equity, or private placements. Of course, it's all relative -- fast growing companies are still growing fast. Maybe instead of white-hot growth, we're just going to have red-hot growth.

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One of the key measures of economic vitality of a region is the level of air operations and Austin's passenger traffic is up more than 16% over last year's record-breaking totals. Analyzing the most recent numbers (through May), you also see that Southwest Airlines continues its dominance carrying 36.6% of the traffic, trailed by American Airlines with 25.6%.

Your personal medical information could soon be better protected from disclosure under rules proposed by the US Department of Health and Human Services (HHS).

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) requires HHS to adopt regulations ensuring the confidentiality of patient data. More than three years later, HHS has finally promulgated the regulations, which require health plans, health care providers, and health care clearinghouses to control the information practices of entities with which they do business (life insurers, financial institutions, pharmaceutical manufacturers, marketers, etc.).

Moreover, the HHS rule covers the so-called "paper progeny" of electronically maintained or transmitted health information. Prior to the rule, a patient's confidential medical record could have lost its protection simply by being printed.

As we have reported in previous issues of the Austin Letter, various Texas legislative committees are studying aspects of the privacy issue. Recently, you may have seen an op-ed piece in the *Austin American-Statesman* by Senator **Jane Nelson** (R-Flower Mound), who chairs the Senate Health Services Committee. Senator Nelson's committee is focusing on ways to enhance the confidentiality of medical information, and her op-ed strongly challenged the view held by some health insurers and others, that the HHS regulations should be sufficient to protect patient privacy.

> Nelson's primary concern appears to be the **use of personal medical information for marketing purposes.** Specifically, she worries that a pharmaceutical manufacturer can access data on a particular patient's medical condition and the types of drugs he or she is prescribed and attempt to market a different drug directly to that patient.
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> Her concern parallels that of the Texas Medical Association, which fears that direct marketing of pharmaceutical products to consumers **circumvents the physician's traditional prescription authority**. In other words, among other things, doctors don't like getting calls from their patients requesting prescriptions for drugs they see advertised on television or on the Internet.

It is unclear how this issue will be dealt with in the next legislative session. Senator Nelson is making it clear she intends to do something about it. But it is hard to see how a state legislature could block FDA-approved national advertising or keep consumers from educating themselves about pharmaceutical options.

Two recent mega-acquisitions are changing the face of the Texas forest industry – and that has changed the ownership of Texas lands unlike anything in the history of Texas. In one of the largest mergers the industry has ever seen, New York-based International Paper Company (IP) has acquired Champion International Corporation, headquartered in Stamford, Connecticut. IP will pay $75 per share for all outstanding shares of Champion common stock. Champion shareholders will receive two-thirds of the per share price in cash, and one-third in exchange for IP stock.

Why is this important to Texas? Well, prior to the merger, Champion and Temple-Inland (based in Lufkin and Austin) were among the state's largest landowners, each with more than one million of acres of East Texas forestland. By adding Champion's 1.1 million acres to the 400,000 acres it already owns in the state, **IP is now the Texas' biggest landowner, surpassing the King Ranch and other historic giant ranches.**

IP is also the largest private landowner in the United States, as well as the world's largest paper and forest products company, employing more than 100,000 people in 50 countries. IP's extensive Texas operations are based in Dallas and northeast Texas, but its acquisition of Champion will give the company a significant presence in Huntsville and Deep East Texas.

In another move affecting the Texas forest products industry, New York-based Westvaco Corporation has acquired Temple-Inland's state-of-the-art bleached paperboard mill in Evadale, Texas, just outside of Beaumont. The Evadale mill is Westvaco's initial presence in Texas, and that will grow with the company's new focus on global, high-value packaging markets.

Westvaco has likewise acquired IMPAC Group, a leading global supplier of specialty packaging and printing solutions for consumer products, including entertainment, cosmetics, and health and beauty aids. For the $500 million purchase price, Westvaco becomes the leading supplier of **audio and multimedia entertainment packaging** in North America and Europe, and the top North American producer of packaging for cosmetics and personal care items. For example, IMPAC makes the paper inserts for CD DVD packaging, plus the paperboard, plastic and window folding cartons, rigid paperboard set-up boxes, and litholaminated packaging.

Texas wealth used to be in land, cattle, and oil, but IP's acquisition of Champion and Westvaco's entry into the state demonstrate that **renewable resources and agricultural processing are becoming one of the state's major sources of future wealth**. While we are enjoying the fruits of the New Economy, we can't print it and package it without the old.

The next big move on whether Austin will jump headlong into light rail will come in August. That's when the Greater Austin Chamber of Commerce Blue Ribbon Light Rail Task Force will present its position paper to the Chamber Board. The Task Force this week ended its series of "Issue Days" and is now preparing its' "white paper" recommendation.

When the Metropolitan Club in One American Center served its last lunch and conducted its last aerobics class , it left only two downtown private clubs still in business. By the way, if you remember the Citadel Club in the Driskill Hotel, the Driskill Club, the Capital Club in the former Capital National Bank building, and the University and Quorum Clubs in the former United Bank building, you were probably part of Austin's first real estate boom. (Let's just hope you weathered the bust better than those clubs did!)

At any rate, the only clubs left standing in downtown Austin are the venerable **Headliners Club** and the **Austin Club**. The Headliners, founded in the early 1950's as a business-press gathering place (but now predominantly professional and UTAustin-oriented), occupies the top two floors of Bank One Tower and plans to stay there — contrary to persistent rumors that it will move to the nearby Carr America building when it is completed.

The Austin Club, where you can schmooze any noontime with lobbyists and legislators, may be the last place in town that features one or more ongoing card games — with money usually at stake. If cards are not your game, on just about any given day during election season you can watch the Austin lobby at work in one of several simultaneous political fundraising events.

In recent years, Austin associations and lobbyists have developed a practice of co-hosting receptions for three or four state legislators at the same time, usually, but not always, in different rooms in the club. That way you can bundle your checks and deliver them all at once. It's convenient, effective, and close to the Capitol (where members can no longer accept political contributions). And it looks like the practice will go on for a long time; the Club has no plans to change venues.

So this is farewell to the Metropolitan, known for its sumptuous buffet line and world-class exercise facilities. **It couldn't work out an extension of its lease with Equity Office** and has become part of Austin's club lore. It's just too profitable these days to rent quality space to high-paying tenants who don't want or need club amenities. It will be missed.

Speaking of dining clubs, **Dr. Louis Overholster** wonders if it's just a coincidence that *stressed*, when spelled backwards, is *desserts*!

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