Volume 13, No. 3 | Summer 2001

RTFC

CAPITAL CONNECTIONS

A Quarterly News Bulletin

IN THIS ISSUE

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Telecom Financing Faces Challenges

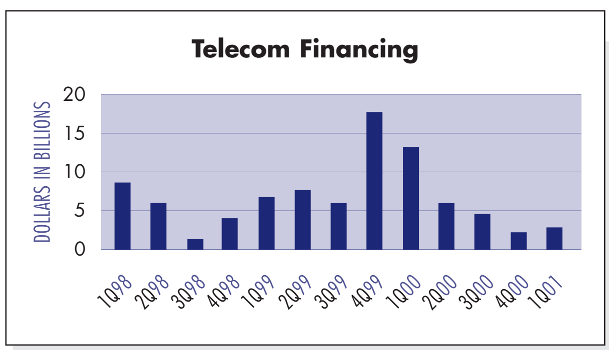
The first quarter of this year saw a 77-percent reduction in telecommunications financing compared to the same period in 2000 — from $12.9 billion to $2.9 billion.

Since the second quarter of 2000, the numerous failures of dot coms, Internet Service Providers, data LECs and CLECs — and the resulting losses incurred by their stockholders, bondholders, and senior secured and unsecured lenders — caused a tremendous lack of liquidity in the telecom market. These snowballing failures even negatively impacted equipment suppliers' bottom lines, sending their stock prices and bond ratings plummeting. The turmoil has tainted the entire telecom industry in the eyes of most lenders.

"After a threefold spike in loan volume in the last quarter of '99, the telecom market reached saturation in the first quarter of 2000," said Andrew Don, RTFC director of Financial Products. "Since that time, we've seen not only a dramatic drop in lending but also greater scrutiny of the industry and its lenders from wary analysts."

Wall Street's rating agencies have assumed a negative perception of telecom financing in general that has forced many banks to reduce their telecommunications portfolios in order to maintain their access to the lowest-cost capital.

"Our mission at RTFC is to be the industry's low-cost lender; that's how we add value. Because of the rating agencies' present negative view of telecom — and RTFC's need to keep our cost of capital as low as possible — we're now focusing on financing the core business of rural telephone companies and cooperatives," said Hank Buchanan, RTFC vice president, Industry Affairs.



Telecoms seeking syndicated transactions for larger deals have found that the shrinking banking universe and market saturation also are contributing to their borrowing challenges.

"How long this distress in the telecom financing marketplace will last is anybody's guess, but the smart money is thinking it will likely persist at least into the first quarter of 2002," Buchanan said.

RTFC Supports Campaign

NTCA's Foundation for Rural Service has launched an image and education campaign spotlighting "Community Based Telecom Providers." Featuring the tagline "Local Touch • Global Reach," the promotion is sponsored by RTFC.

The campaign's goals are to generate awareness of the role local telecom providers play in a community's quality of life and to build grass-roots advocacy of public policies that affect rural telecommunications.

"This campaign is another great opportunity for our members to be heard by their legislators and other policymakers who are making decisions today that could affect rural telecommunications tomorrow," said RTFC Senior Vice President Larry Zawalick. "Sponsoring this endeavor is just one way RTFC is fulfilling its steadfast commitment to cooperative education and rural America."

Resource kits with fact sheets, a sample press release, camera-ready graphics and window clings were mailed to all NTCA members the first week of July.

For more information about the campaign, contact Lisa Lopinsky, foundation director, at 703-351-2013.

CLEC Study Reveals Success Factors

A solid business strategy was the key to success for new competitive local exchange carriers who entered the market in the wake of the 1996 Telecommunications Act, according to a study recently presented at a USTA press conference. The study found that incomplete business plans and over-expansion were more to blame for CLEC failures in the last two years than market fluctuations.

"Since December 1999, the CLEC share of the nation's access lines has expanded rapidly. Unfortunately, many of the entrants were not able to survive the large decline in the market for high-technology equity shares that began in March 2000. These companies generally had faulty business plans that were exposed when a declining stock market severely reduced their ability to raise capital," reports Robert Crandall, senior fellow at the Brookings Institution.

"Instead of focusing on fundamentals, too many CLECs opted for rapid expansion," Crandall said. "They put short-term growth ahead of long-term success, and when the capital markets dried up, they paid the price."

The 75-page report, which serves as a timely and comprehensive analysis of the CLEC industry, can be downloaded from the "Newsroom" section of USTA's Web site, www.usta.org.

Have You Staked a Claim?

Telephone cooperatives soon will be receiving an e-mail detailing the process for online pre-authorization of Internet addresses with the .coop domain name.

Coordinated by NRTC and NCBA, the e-mails provide a confidential user name, password and Internet link giving the cooperative access to the .coop registration Web site.

The pre-registration allows telephone cooperatives to preserve an address before it's available to other businesses and to go "live" on the first day of Internet operations with the new domain.

If you do not receive this e-mail and are interested in staking a claim to .coop property, contact NRTC's Kelli Laski, klaski@nrtc.org.

Grants to Aid Schools, Communities

In a new grant program recently approved by the Foundation for Rural Education and Development's board, RTFC is funding technology and training grants for rural schools and teachers in OPASTCO members' service areas.

The deadline is October 31 to apply for the first award of these grants worth up to $10,000 each for technology improvements in schools and $2,000 each for teacher education and training.

Designed to provide rural schools and educators with the tools and training they need to bridge the digital divide in OPASTCO member communities, these grants will be available on an annual basis.

"Technology is a powerful tool to improve both teaching and learning, and we're happy to help OPASTCO members provide these opportunities for their communities," said RTFC Vice President Hank Buchanan.

All grant applications must be accompanied by a letter of support from an OPASTCO member. For more information on recipient eligibility or for an application, contact Program Coordinator Kerry Holtmeier at 202-659-5990, or kmh@opastco.org.

The first award winners will be announced at OPASTCO's 2002 Winter Convention in January.

McCormick Takes USTA Lead

USTA named Walter B. McCormick its new president and CEO. A veteran trade association president and lobbyist, McCormick has a strong background in telecom law and policy.

Legg Nominated for RUS Administrator

Hilda Gay Legg has been nominated for the position of administrator of the Rural Utilities Service. Legg most recently was executive director and CEO of The Center for Rural Development in Somerset, Kentucky. Senate Confirmation had not yet been received at press time.

Inside the Economy

Economy Slowing, Confidence Rising

Weak corporate profits, slower business spending on new equipment and sluggish economies in other parts of the world continue to weigh on the U.S. economy, prompting the Federal Reserve to cut short-term interest rates by 25 basis points at its June meeting.

The Fed also has reduced its target rate for overnight loans to 3.75 percent, the lowest in more than seven years.

The good news is that inflation remains under control even after six rate cuts over the past six months. Future rate movements remain unclear, although the market has priced a 50-50 chance of a 25-basis point cut at the Fed's August 21 meeting.

Although the Fed has significantly lowered short-term interest rates this year, long-term Treasury yields have actually risen by more than 30 basis points, creating a disconnect between short- and long-term borrowing rates.

The yield on the 2-year Treasury note has fallen more than 90 basis points in the past six months, sending short-term lending rates lower. The divergence in rate movement highlights the fact that the market views the Fed rate cuts as a short-term solution and expects short-term rates to rise in the future.

The U.S. unemployment rate rose in June; payrolls declined more than expected as businesses followed through on job cuts announced months ago. The unemployment rate rose to 4.5 percent, the highest since March of 1998.

Consumer confidence, however, rose to a six-month high in June, a sign that shoppers will keep the record economic expansion moving along. The manufacturing sector received a boost as new orders for durable goods unexpectedly rose as businesses continue to pare inventories. U.S. sales of new homes are on pace to set a record of 954,000 homes this year, a sign that housing has remained strong throughout the economic slowdown.

In corporate bond issuance news, France Telecom issued 225 billion in Yen, or approximately $1.8 billion in U.S dollars. The issue was grown from the original 175 billion Yen, and made it the largest-ever corporate Yen issue.

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Banking Industry Still Shrinking, Streamlining to Boost Profits

The lender universe is not only shrinking but also getting choosier as banks pursue profits today.

Competition has intensified pressure on banks to expand their market share, improve efficiency and offer a broader range of financial products. The number of commercial banks insured by the Federal Deposit Insurance Corporation (FDIC) dropped by almost 80 banks in the first quarter of this year alone.

"The merger trend is likely to continue as the promise of greater efficiency has generated an 'acquire or be acquired' mentality among bank managers," said Andrew Don, RTFC director of Financial Products. "Future consolidations will seek to not only boost profits but also expand an institution's regional footprint or market share."

In their latest move to increase profits, many large lenders are severing ties with corporate customers interested only in borrowing and not in buying other services from the lender, such as cash management. Loans to corporate giants with good credit make the least margin for the banks that are eyeing fees and value-added services to boost profits from such clients.

Bank One, the fifth-largest lender to the telecommunications industry, announced this month that the company is ending relationships with large corporate customers that don't bring them additional business beyond loans.