Fox Rothschild Podcast
Featuring Corporate Finance Partner David Jaffe in Pittsburgh

We are talking today with David Jaffe on Fox Rothschild Podcast. David is a partner with Fox Rothschild in Pittsburgh, and he advises business clients on corporate finance transactions, mergers and acquisitions, and governance.

Question—David in the wake of the credit crisis and stock market meltdown, how have your clients been affected?

David Jaffe—At this point in the business cycle, the sentiment is still pretty negative. Most clients are talking about the slowdown in business, and the reduced availability of credit, as having adversely affected their operations. While this will come to an end eventually, the end is not currently in sight. Business sentiment is likely to remain negative for several more months at least.

Question—What are you hearing from banks about the availability of commercial credit?

David Jaffe—Uniformly, the lending officers at large regional banks are talking about the tightening of loan covenants and more rigorous underwriting standards, both for existing borrowers and for new relationships. Companies that find themselves out of covenant, whether over-advanced against inventory or with declining collateral values in real estate or other hard assets, are being forced to pay higher rates and fees to the banks, and in some cases the banks are looking to exit borrowing relationships altogether, forcing borrowers to seek alternative sources of credit.

So in this climate, I am advising my clients to be proactive in managing their lending relationships. The last thing bankers want in this environment is surprises. If you engage early and often with your banker, it's going to be the best way to weather the storm and build the relationship with your primary lender for the long term.

Question—How has the crisis affected other financial sectors, such as private equity or venture capital finance?

David Jaffe—Those sectors have been adversely affected as well. In the private equity realm, there is ample evidence that investor defaults are on the rise. Declining asset values have resulted in disproportionate portfolio allocations so institutional limited partners are looking to re-balance their portfolios away from the sector – which leads to more resistance when funds make capital calls on the LPs.

That said, not all funds are experiencing the downturn in the same way. Funds that have so-called "dry powder" – capital available for new investments – are in a relatively better position as compared to those fund managers that are actively trying to raise capital for new funds.

Private equity finance is a business like any other, so it's not immune to market forces. I would fully expect to see the industry undergo its own restructuring and shakeout over the next two years, just as the underlying industries in which private equity invests have currently experienced.

Question—What do you recommend to clients who still need access to working capital? Will the Stimulus Bill help?

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David Jaffe—Clients that can position themselves to seek public sector work in the form of government contracts can benefit under the Stimulus Bill in the form of direct participation in the so called "shovel ready projects." The ripple effect of the "stim" will be felt up and down the food chain as well, as the federal dollars begin to pulse their way through the economy. So we are working with our clients and advising them to reposition their businesses to the extent possible to take advantage of the opportunities that will be forthcoming in the Stimulus Bill, directly and indirectly.

Question—Will the market crisis restrict the ability of mid-market companies to pursue major deals involving large amounts of capital?

David Jaffe—Acquisition transactions involving large amounts of capital will need to be funded with relatively larger amounts of equity capital and smaller amounts of debt. The acquisition multiples that are being paid in M&A transactions have declined substantially, and that's due largely to the reduction in the amount of senior debt and mezzanine debt available to pursue those transactions. So buyers have to put more equity on the table to fund the deals that they are interested in doing, and it is likely to remain that way for the foreseeable future. I do not foresee lending institutions coming back to the table into deals with two or three turns of debt on pricing multiples of six to eight times cash flow for quite some time, if ever. The "good ole" days of highly leveraged M&A would appear to be over for now – at least until the next bubble begins.

Question—For those clients looking for an exit strategy through buyout, merger or acquisition, what are you recommending?

David Jaffe—Now will not be the best time to sell your company. If you can use the time over the next 12 to 18 months to repair your balance sheet, refine your business processes, refine operations and wait out the downturn, you will be in a much better position coming out of this cycle in mid-to-late 2010 if your objective is to pursue a sale.

Question—For clients looking to take best advantage of conditions in this economy or as a survival technique, is now an especially good time to acquire assets whose short term value may have dropped?

David Jaffe—It really depends on the nature and quality of the assets that you are examining. Certain values will have declined dramatically – but no one knows precisely where the bottom is, so it's a bit like trying to catch the proverbial falling knife.

Companies that have strong balance sheets and strong cash positions may very well be poised to take advantage of depressed historically low prices in acquiring capital assets. The same is also true for the M&A marketplace where distressed companies, companies with good operations or good management but bad balance sheets, are going to be selling for a fraction of their value in the previous market cycle. So industrial competitors, strategic competitors that have strong balance sheets and cash may very well be able to pick up companies at historically low multiples and values.

Well thank you David. To speak with David directly on questions of corporate finance, please contact him at 412-391-6410 or at djaffe@foxrothschild.com.

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