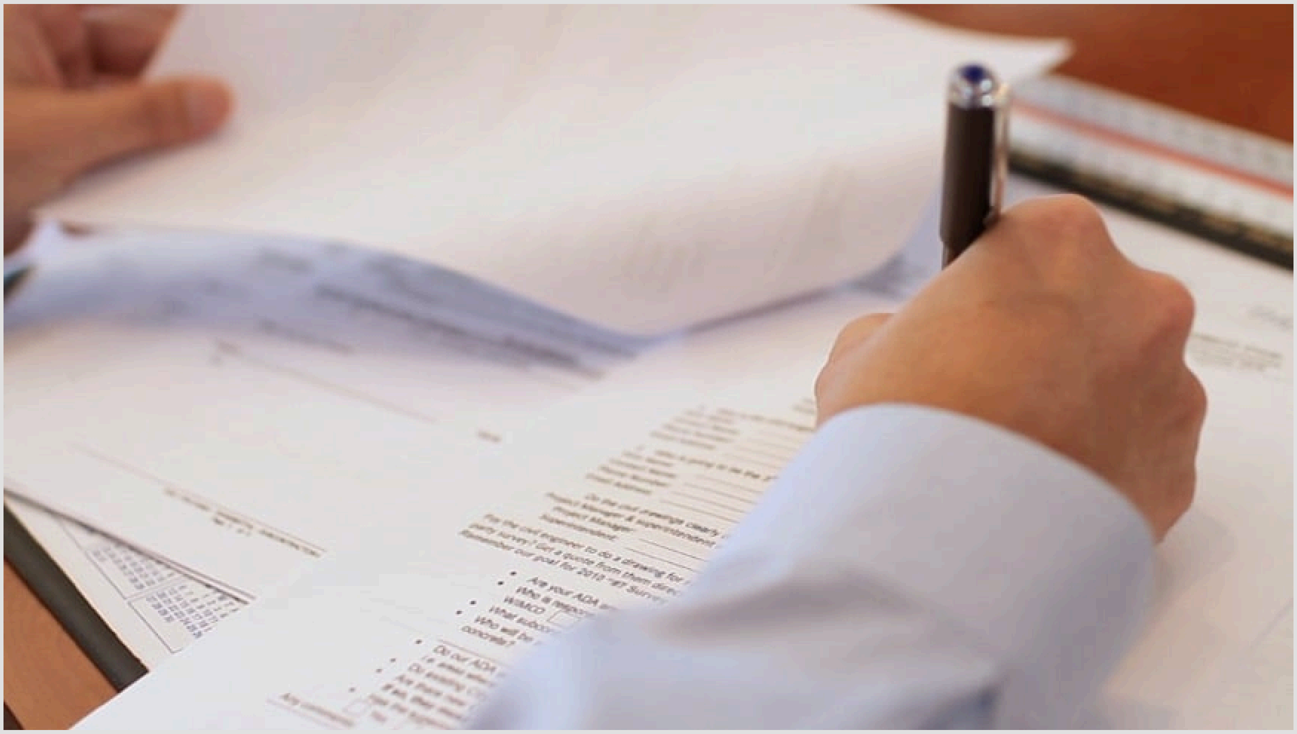
vertical IQ



Law Firms

NAICS: 541110
SIC: 8111

prepared February 18th, 2022

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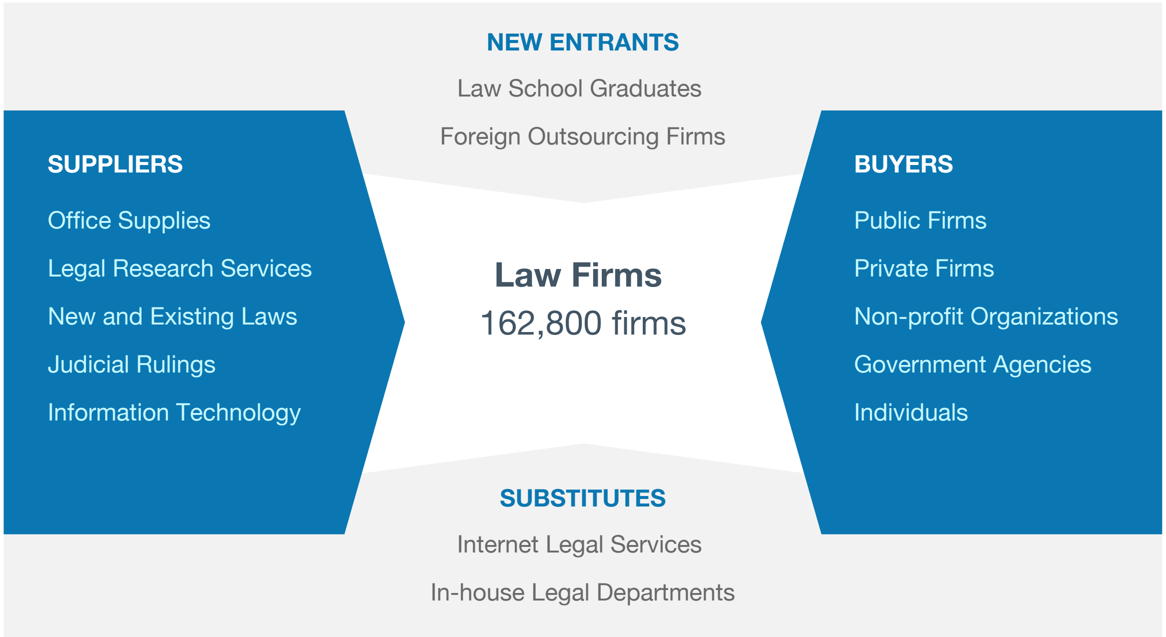
Coronavirus Update

Feb 12, 2022 -- Virtual Firms Draw Top Talent

- Big Law partners are increasingly landing at virtual law firms, according to The American Lawyer. Big Law is the term used in the legal industry to describe the country's largest and most successful law firms, which are usually headquartered in major cities, such as New York, San Francisco, Chicago, or Los Angeles. A virtual law firm is a legal practice that operates from the homes or satellite offices of its lawyers rather than a single bricks-and-mortar location. Virtual firms without billable hours requirements have been drawing top-talent since the pandemic began. The ability to work from anywhere and greater freedom to manage personal time are cited as key draws, but many attorneys are pointing to the billable hours requirement on which much of the industry has predicated its success as an area that is ripe for change.
- The legal industry's approach to reopening offices has shifted along with the waves of the pandemic, according to Reuters news service. The Delta variant prompted many law firms to tighten vaccine mandates and delay widespread returns until this fall, while some opted to wait for next year. Firms are now balancing fears of a potential Omicron wave with optimism that vaccines are reducing the severity of COVID-19, even if it's here to stay.
- Many law firm clients are now open to continuing litigating in a virtual environment when the pandemic ends, according to a study commissioned by insurance law firm Wilson Elser Moskowitz Edelman & Dicker. The vast majority (87%) of respondents said that they had favorable reactions to virtual workers' compensation hearings during the pandemic, versus 13% who had negative reactions, while 76% of respondents had favorable reactions to virtual mediations versus 24%. Barely half of respondents (54%) had a positive opinion toward conducting depositions virtually. Almost three-quarters of respondents who had experienced a virtual trial (72%) said that they found them to be more detrimental than beneficial. The virtual medium is increasingly seen as the way forward for some litigation management techniques. Almost 80% of respondents said that they now preferred virtual strategy meetings as a default way of doing business, while just over half said that a virtual venue should be the default for settlement conferences. Only 49% felt that mediations should regularly be virtual, while just 43% supported the virtual environment as the default for non-plaintiff depositions.
- The Biden administration has asked law firms and law schools to help fight evictions following a US Supreme Court decision to block an eviction moratorium which the Biden administration put in place in early August. More than 40 major law school deans have since committed their students and law clinics to the endeavor, according to Biden administration officials. These include Harvard, Yale, Stanford, Columbia, Howard University, and UCLA Legal Services Corporation. The American Bar Association and the National Housing Law Project have also made commitments.
- Some industry experts expect an uptick in lawsuits if the Biden administration requirement that all civilian federal workers provide their Covid-19 vaccination status or face strict testing measures, social distancing and masking requirements, and limited travel prompts employers to follow suit. "Employers have the right to set the terms and conditions of employment," says Perley Masling, a partner and director of workplace culture consulting at the employment law firm Morgan Lewis. Employers creating a vaccine requirement must, however, "entertain requests for reasonable accommodations as required by law," such as for workers who refuse for religious or medical reasons, including pregnancy, Masling added. The legality of some requests may need to be settled in courtrooms.
- Some businesses that took Small Business Administration (SBA) Paycheck Protection Program (PPP) loans in 2020 but don't apply for forgiveness soon will need to start making payments on the loan plus interest. The PPP loans will automatically convert to a standard loan at 1% interest if a small business does not apply to the SBA for forgiveness within 10 months of the end of the covered period under which they had to spend the money. For some businesses that received a loan when the PPP launched in April 2020, there was an eight-week covered period, which would put the forgiveness application deadline in the middle of July. For most loans operating under the more popular 24-week covered period, that meant a deadline in September 2021.
- A predicted wave of lawsuits alleging workplace violations of coronavirus safety rules has not emerged during the pandemic, according to Bloomberg Law. Pro-business groups and some politicians expected lawsuits stemming from social distancing requirements and death from lack of protective equipment to increase significantly, according to Bloomberg Law, but workers' compensation laws, arbitration clauses, and existing steep bars to bringing negligence and recklessness claims have largely stemmed the tide.

- Employment at law firms increased 3% year over year in December 2021.

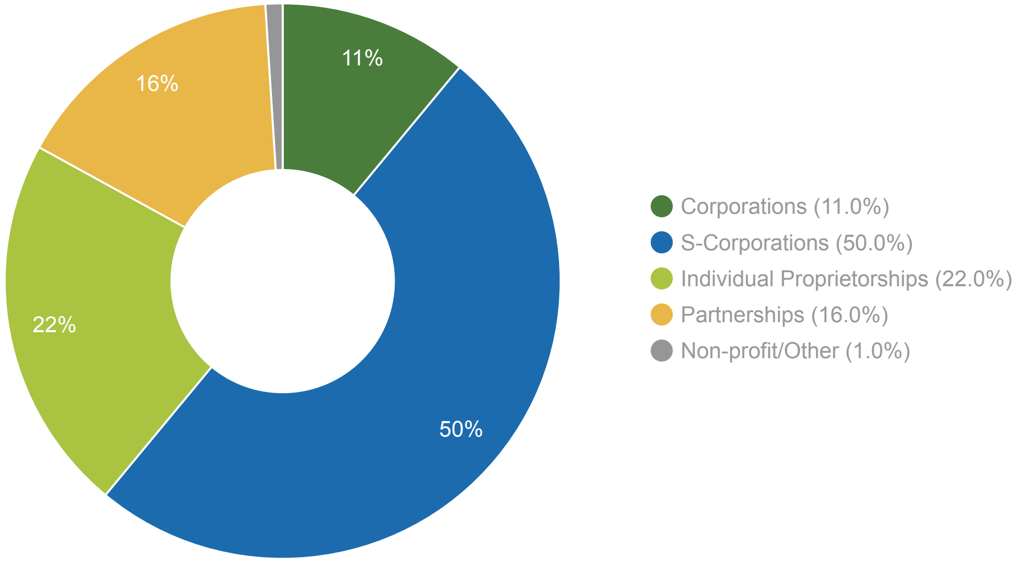
Industry Structure



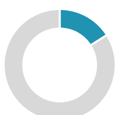
The average law firm operates a single location, has 6-7 employees and generates $1.8 million in annual revenue.

- There are about 162,800 law firms in the US with over 1 million employees and generating about $295 billion in annual revenue.
- Another 292,500 lawyers practice solo.
- The industry is highly fragmented with the 20 largest law firms representing less than 10% of revenue.
- The largest US law firms by revenues are Baker McKenzie; Skadden, Arps, Slate, Meagher & Flom; Latham & Watkins; Jones Day; and Kirkland & Ellis.

Industry Demographics

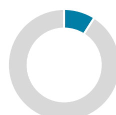


Source: US Census Bureau



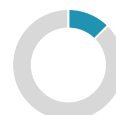
Female Owned

16.0%



Minority Owned

9.0%



Veteran Owned

12.5%

Source: Census Bureau

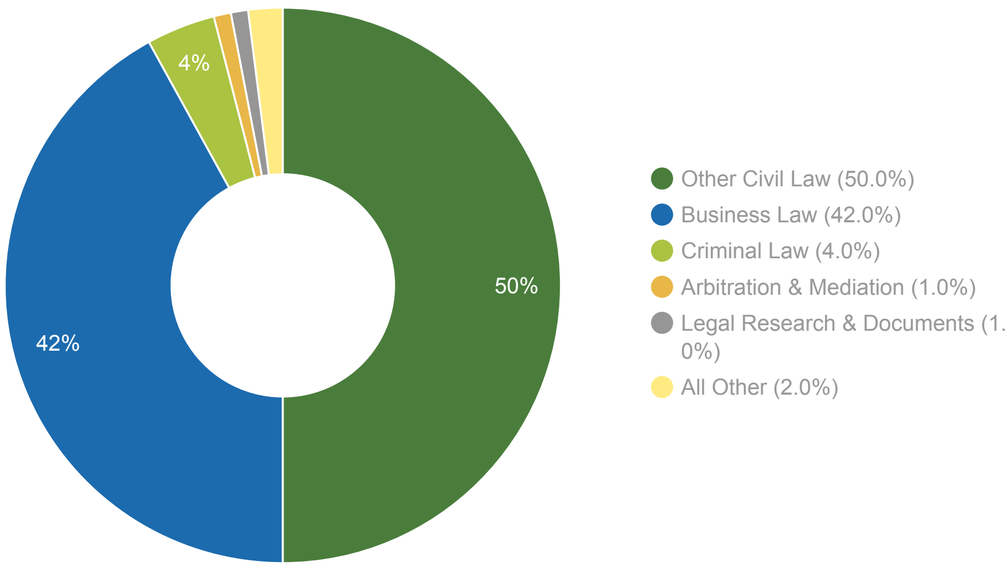
How Firms Operate

Products and Operations

Law firms provide advocacy and advisory services to businesses, non-profit organizations, individuals, and government agencies.

- The practice of civil law accounts for 94% of the legal industry's revenue. The largest categories of civil law are business law, civil negligence, real estate law, labor and employment law, family law, and wills, estates and trusts.
- While criminal law dominates the activity of lawyers on TV, it accounts for only 4% of total industry revenue. Less than a third of law firms practice criminal law.
- Other services provided by law firms include arbitration and mediation, legal research and document preparation, patent and intellectual property filings, notarization and certification services, and legal translation services.

Law Firms Revenue



Source: US Census Bureau

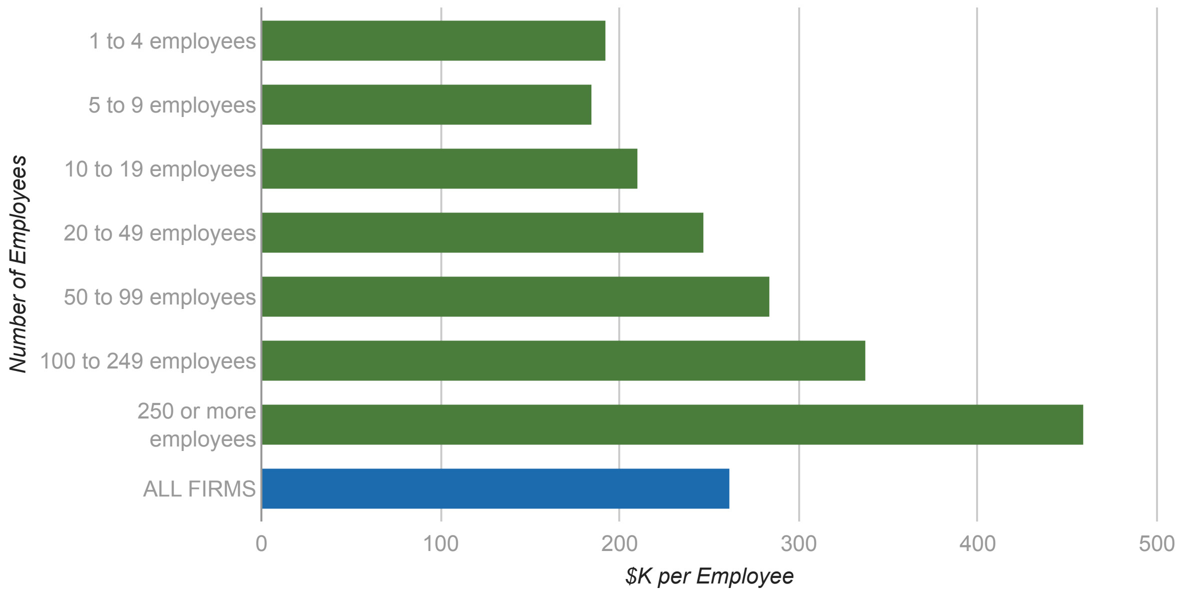
Law firms are usually organized around various practice areas or groups, headed by one or more partners. Practice areas may be grouped by type of law, such as business law or family law, or by type of client, such as a government or healthcare practice.

Recent law school graduates hired as potential partners are known as associates. They are expected to work long hours in the hope of becoming an equity partner in the firm within 7 to 10 years. The average starting salary for new associates is about $60,000, but varies from $45,000 to $87,000, with salaries higher at large firms in major cities.

Firms also employ staff attorneys and paralegals to handle routine legal matters and provide legal research and other support services. Staff attorneys are not on a track to become partners and earn less money, but work fewer hours than associates. Senior lawyers who do not make partner often leave a firm, or they may become "of counsel" and stay if they have a legal specialty that the firm values.

Law firms mainly rely on referrals and personal relationships to develop new clients. Partners and associates are active in local business and charitable organizations to network with business owners and create a positive image for the firm. Bankers and accountants are a common source for referrals. Firms engaged in consumer law, such as personal injury law, may advertise on TV and in local publications. Small firms may belong to a legal network or consortium to share leads and offer a broader range of services to clients.

Revenue per Employee by Establishment Size



Source: US Census Bureau

Profit Drivers

Increasing Utilization Rate

Firms set annual minimums for billable hours for both associates and partners. Annual minimums vary, but they average between 1,800 and 1,900 hours. Large firms may have annual billable minimums of 2,000 hours. According to CLIO, about 31% of hours worked per day are billable.

Higher Net Billing Rate

Billing rates vary depending on the experience of the lawyer, the level of expertise required for the work, the size of the practice, and the location of the practice. Across the US, billing rates average about $380 per hour for all firms, with firms with over 750 lawyers averaging $575 per hour. Rates are highest in the Northeast and lowest in the Midwest. Merger and acquisition work is the practice area with the highest average rates, followed by finance law.

Overhead Expense Management

As revenue growth has slowed in recent years, law firms have focused on maintaining profits by reducing expenses. Firms have used information technology and outsourcing of some services to increase staff productivity and reduce overhead.

Increasing Leverage

Law firms measure their performance based on net profit per partner. Large firms have used leverage, the ratio of associates to partners, to increase profits per partner. By increasing the number of associates, firms have been able to bill more hours and generate higher revenue and profits per partner. However, during an economic downturn, firms may possess more associates than they can bill to clients, causing profits to shrink. As a result, some firms are looking to other sources of leverage besides hiring associates, such as using contract lawyers.

Global Perspective

Global Market Size

The global legal services market had an estimated value of nearly $714 billion in 2020 and is expected to experience average annual growth of 4.9%, reaching more than $908 billion by 2025, according to The Business Research Company. North America is the largest regional market for legal services and accounted for about 56% of worldwide revenue in 2020; Western Europe was the second-largest market. However, global growth will primarily be driven by emerging markets. South America is expected to be the fastest-growing market through 2025 with average annual growth of 14%, followed by Africa with 8%. Asia Pacific and Eastern Europe will each see average growth of about 7%.

Large Companies

COMPANY	HOME COUNTRY
Allen & Overy	UK
Baker McKenzie	US
Clifford Chance	UK
DLA Piper	US
Gowling WFG	Canada
Kim & Chang	South Korea
King & Wood Mallesons	China
Kirkland & Ellis LLP	US
Latham & Watkins LLP	US
Linklaters	UK
Linklaters	UK

Key Global Trends

Growth in Emerging Markets – Some large law firms are increasingly turning to markets outside their home countries for growth, especially in developing nations. Due to growing regulatory and judicial requirements that stem from rapid industrialization, the Asia Pacific region is a key target for growth, particularly China and India. Cross-border legal services to corporate clients are driving firms based in North America, Western Europe, and the UK to pursue acquisitions in emerging markets, and forge strategic relationships and collaborations with local partners. Some firms are forming cross-border legal networks made up of small firms that provide locally-tailored services and offer centralized billing.

Mergers and Acquisitions – A big uptick in global mergers and acquisitions (M&A) activity is boosting demand for deal-related legal services. The pandemic initially slowed M&A activity, but a combination of pent-up deal funding, low interest rates, and weakened economies have since driven companies to look for bolt-on growth. Global M&A activity in the third quarter of 2021 was more than $1.07 trillion, according to S&P Global Market Intelligence. Average transaction value in the first nine months of 2021 jumped to $86.54 million, nearly a 30% increase over the same period in 2020. The US and Canada led in the number of deals and in total deal value, followed by Europe and Asia Pacific. Deals in the Middle East posted the largest year-over-year deal value growth in Q3 2021 with a rise of 250%. The top sectors for deals in 2021 included real estate, financial, industrial, information technology, energy, and healthcare. With interest rates expected to remain low and organic growth harder to come by, industry experts suggest relatively high levels of

M&A are likely to continue.

Cybersecurity – The exponential increases in global cybercrime present challenges and opportunities for law firms. Some firms offer consulting services to help clients safeguard against cybercrimes including embezzlement, counterfeiting, and fraud. Because they have access to large amounts of sensitive client data, law firms may also be targets of cybercriminals. Data breaches and other attacks can be difficult to defend against if they originate from state sponsors or highly-organized criminal gangs outside a firm's home country. Global cybercrime costs are expected to grow by 15% annually, reaching $10.5 trillion by 2025, according to Cybersecurity Ventures. Industry experts suggest law firms that specialize in corporate or property law are particularly vulnerable to cyberattacks because of the potential financial gains. Small firms are also seen as soft targets. More law firm employees working from home during the pandemic and sharing data via the cloud has increased the potential for gaps in firms' data security.

Industry Trends

Trends are affected by the COVID-19 pandemic.

Changes in revenue, employment, business practices, trade and forecasts are occurring rapidly and data reporting by the government lags the changes. We are tracking changes in the “Coronavirus Update” chapter.

Alternative Fee Arrangements

Driven by client demands for cost containment, firms are offering alternatives to the traditional billable hour model. These alternative fee arrangements (AFAs) include fixed fees for all or parts of an engagement, caps on hours charged, contingency fees, and billing rates tied to achievement of specific outcomes. As technology has reduced the time required to conduct research and prepare documents, clients are questioning the fees billed for such tasks. While hourly billing is expected to remain the primary billing method for law firms, use of AFAs is expected to grow.

Legal Outsourcing

Pressure to reduce fees and costs is increasing the outsourcing of work to onshore or offshore legal service providers. Onshore service providers include contract lawyers, paralegals and other administrative specialists who work offsite and online to provide legal support services to the firm’s specifications. Offshore legal service providers, typically located in India, can reduce the cost of transcription, research, patent searches, data entry and billing services by up to 80%. The ABA has approved the use of outsourcing, given that the outsourcing lawyer is responsible for all the work done and clients are informed of the arrangement.

Lower Leverage Ratio

Leverage is the ratio of associate lawyers to partners at a firm. Higher leverage allows firms to generate more revenue per partner and delegate work to lower cost associates. Leverage has been a key element of the business model at large law firms, but these firms expect reduced leverage to be an on-going trend as they rely more on contract lawyers and clients balk at paying billing rates for recent law school graduates. A recent survey of large law firms found that about half of respondents had clients who refused to pay for work done by first- or second-year associates.

Fewer Equity Partners

To boost profits per partner in the face of flat or slow revenue growth, many law firms are reducing the number of equity partners. Some are lengthening the traditional 7-10 year time period before associates are eligible to become partners. Some have created the position of “non-equity partner” as either a stepping stone to equity-partnership or as an alternate career path altogether for associates. Many large firms are asking under-performing partners to leave the firm or are “de-equitizing” them.

Efficiencies From Technology

Law firms continue to use information technology to improve productivity and reduce costs. The time required to conduct legal research, prepare documents, and create client presentations has been greatly reduced by searchable online legal databases and personal productivity tools. The use of electronic documents reduces costs for delivery services and records storage. Small law firms are also adopting Software-as-a-Service (SaaS) practice management systems to eliminate to cost of maintaining in-house servers and software.

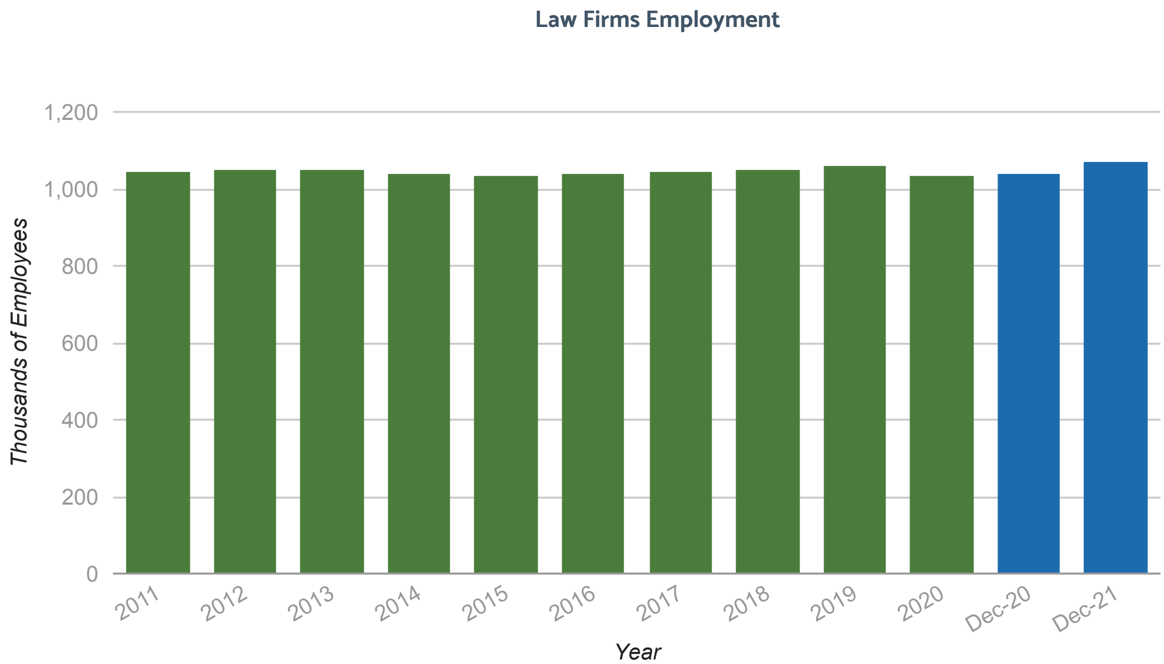
Mergers and Acquisitions

Slowing growth in demand for legal services has forced some firms to turn to mergers and acquisitions to achieve increases in revenue. Altman Weil reported that mergers involving US law firms totaled 102 in 2017, 106 in 2018, and 115 in 2019. This was the highest number since the consultancy began tracking merger activity in 2007. Law firms largely halted their strategic growth plans in Spring 2020, due to the Covid-19 pandemic. At mid-year, firms reassessed their financial positions and returned to M&A activity in the second half of the year, executing a total of 65 deals.

Employment and Wage Trends

Employment by law firms increases

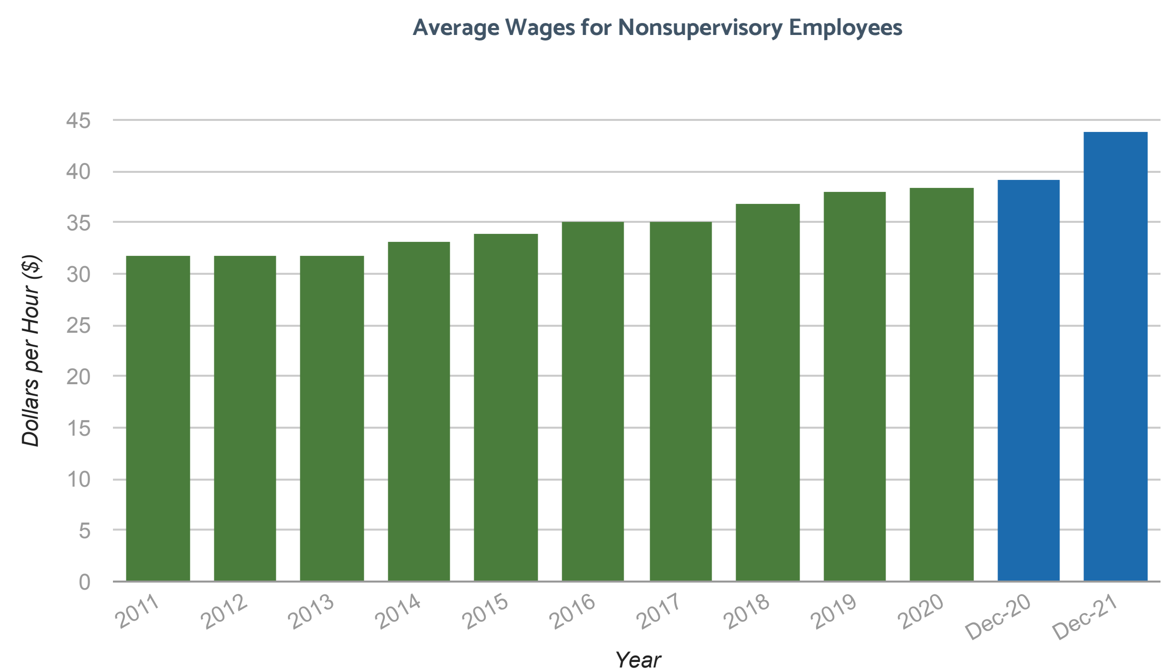
Overall employment by law firms changed 3.0% in December compared to a year ago, according to the latest data from the Bureau of Labor Statistics.



Source: Bureau of Labor Statistics

Wages at law firms rise

Average wages for nonsupervisory employees at law firms were $43.89 per hour in December, a 11.9% change compared to a year ago.



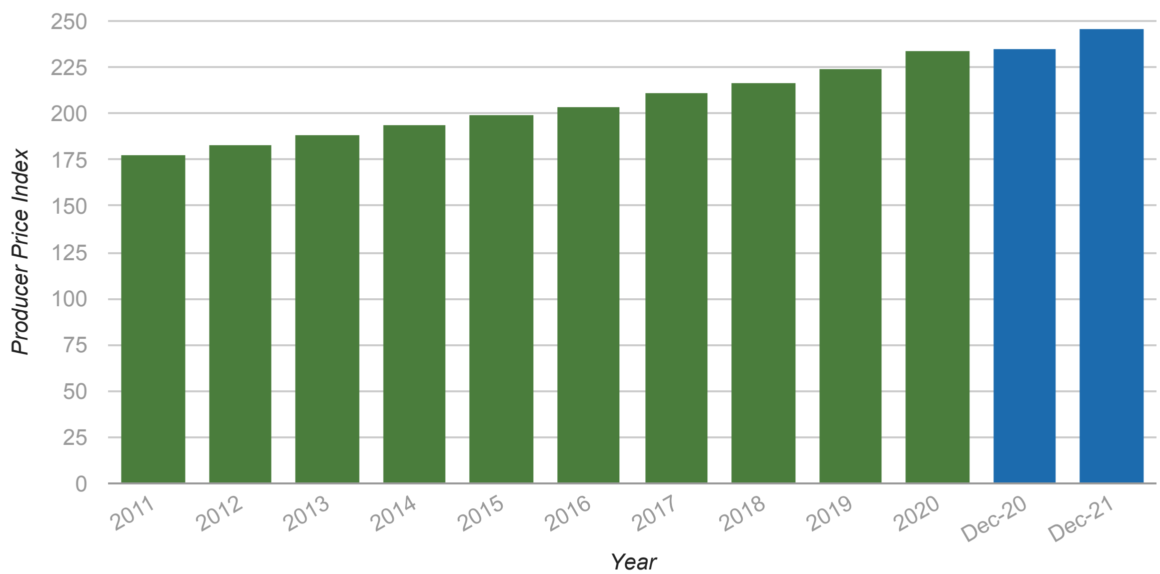
Source: Bureau of Labor Statistics

Price Trends

Producer Prices for law firms rise

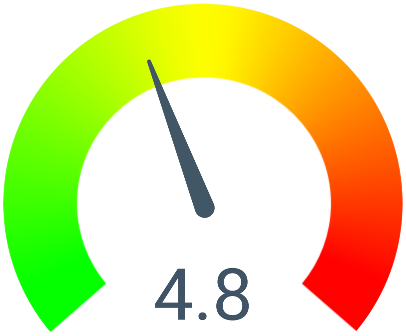
The Producer Price Index for law firms changed 4.24% in December compared to a year ago, according to the latest data from the Bureau of Labor Statistics.

Producer Price Index for law firms



Source: Bureau of Labor Statistics

Credit Underwriting and Risks



Industry Risk Rating:
Stable/Satisfactory

Business Exit Rates:	6.0	Higher than US average for all businesses
Cyclical Sensitivity:	5.0	Moderate sensitivity
Barriers to Entry:	4.3	Low initial capital; high regulatory/technical barriers; very low concentration
External Risk:	5.0	Moderate external risk
Industry Outlook:	5.3	Comparable to GDP; some cyclical risk
Financial Summary:	2.5	Very high margins; high liquidity; low leverage

Key Metrics

METRIC	VALUE	COMPARISON
Performance During 2007–2009 Recession	-0.9%	0.0% GDP
Business Exit Rate 2019–2020	10.46%	9.0% All Industries
Compound Annual Growth Forecast (2020–2025)	4.89%	6.1% GDP
SBA 7(a) Default Rate by Number of Loans (2010-2019)	2.98%	3.82% All Industries
SBA 7(a) Default Rate by Gross Loan Amount (2010-2019)	0.83%	1.21% All Industries

Underwriting Considerations

- How many years in business? How many Partners?
- Compare Key Financial Ratios (above chart) to the company's financials. Law firms will typically be looking for a lower rate for Lines of Credit. Make sure the company's financial strength is commensurate with the pricing.
- Most law firms distribute out profits. Make sure that the bank can limit distributions is the company has financial challenges.

Industry Risks

Weak Growth In Demand

Growth in demand for legal services fell during the last recession and has been slow to improve. Overall demand grew about 6% annually from 2004 through 2007, but stagnated in 2012-2017 and grew just 1% annually in 2018 and 2019. Demand fell 0.3% in 2020, despite growth in the practice areas of tax, corporate and bankruptcy. Declines were experienced in litigation, real estate transactions, patent protection and labor law. Traditional law firms have been losing market share to in-house corporate legal departments and alternative legal service providers, such as contract lawyers and offshore services.

Client Cost Cutting

Businesses have cut the budgets of their legal departments, forcing them to reduce spending on outside legal services. Clients are carefully scrutinizing legal bills and questioning or refusing to pay for line items they consider unreasonable. Law firms have been forced to discount billing rates or perform work for fixed fees. Some clients refuse to pay for "soft costs" they consider covered by overhead rates, such as charges for copying, scanning and faxing.

Protecting Client Confidentiality

Breaches of confidentiality can lead to lost clients and expose the firm to lawsuits or fines. The confidentiality of client information has always been a strong ethic for lawyers, but the conversion to electronic communications is creating new challenges for maintaining confidentiality. Law firms are being forced to invest in enhanced information security systems and develop new policies on proper use of emails, electronic documents, mobile computing, and social networking tools.

Changing Laws And Regulations

Law firms invest in legal research services and training to keep their staff current with the latest laws, regulations, and court rulings. State bar associations require lawyers to complete minimum or mandatory continuing legal education (MCLE) to maintain their license. Requirements vary by state, but typically involve 10-15 hours of coursework per year, including 1-5 hours on legal ethics. The complexity of new legislation, such as healthcare reform and financial regulations, creates both a challenge and opportunity for law firms as businesses seek their advice on compliance issues.

Compensation Changes

Many law firms are reexamining their compensation systems for staff given the changing business environment. Traditionally, associates simply received salary increases in “lockstep,” regardless of performance, and becoming a partner was the big motivator. As firms cut back on the number of partners, some are moving to more complex merit-based pay systems to reward associates and other staff. The risk is that poor implementation of these new systems can hurt staff morale and create unwanted staff turnover.

Company Risks

Management Skills

Firms may suffer from weak business management because the skills to be an effective lawyer don’t always translate into being an effective business manager. Most lawyers obtained liberal arts degrees before law school and have little, if any, business training. Firms designate a “managing partner” to handle the business aspects of the firm, but surveys report that over 70% of managing partners don’t have a job description and most partners don’t know what they do. Even in larger firms, the position is usually a part-time role.

Client Concentration

Firms face higher risk when they become overly dependent on one or more large clients. As one legal consultant put it, “any client with over 10% of a law firm’s revenue is a dangerous client.” The danger is not only that the client may choose to change firms, but also that they have the power to dictate billing rates and contract terms.

Unclear Succession Plans

As baby boomers reach retirement age, law firms will see a number of senior partners leaving the firm. Yet most firms do not have plans in place for transitioning management responsibilities and client relationships for retiring partners.

High Overhead Culture

As clients become more aggressive in demanding lower bills and more value from law firms, some firms may have difficulty transitioning from a culture built around high overhead rates. Partners and associates may still expect opulent office furnishings, lavish expense account meals, first-class travel, and the other perks they’ve become accustomed to.

Industry Forecast

Sales for the US law firms industry are forecast to grow at a 4.89% compounded annual rate from 2020 to 2025, slower than the growth of the overall economy.

Vertical IQ forecasts are based on the Inforum inter-industry economic model of the US economy. Inforum forecasts were prepared by the Interindustry Economic Research Fund, Inc.

Last Update: August 2021

Source: Interindustry Economic Research Fund, Inc.

Working Capital

Sell and invoice

> 31% of law firms said they go to their accountant or bookkeeper for cash flow advice, while 19% turn to a colleague and 18% to their banker and 53% do not seek advice, according to a survey of small businesses by Barlow Research Associates.
>
> *Source: Barlow Research Associates.*

The primary sources of new business for law firms are referrals from clients, accountants, and bankers. Likewise, lawyers are good referral sources for bankers. Partners also meet potential clients by getting involved in local business organizations and community service activities. A client engagement letter is used to define the scope, timeframe, and fees for new work. Routine legal work may involve competitive bids to an RFP from the client.

Most law firms bill clients monthly for work performed. The accounting department prepares a "pre-bill" which is reviewed and adjusted by the partner in charge of the engagement. Partners may discount rates, hours, or other charges that clients are likely to dispute. Most fees are based on billable hours, though use of fixed fees or caps for more routine work is increasing. Soft costs, such as copying, faxing, and scanning charges, may be bundled into the overhead rate or charged as separate line items.

60% of law firms report that their typical sales transaction is between $1,000 and $5,000, according to a survey by Barlow Research Associates.

Collect

Collection periods average 14 to 16 days, though many firms experience 55 to 60 days. Firms often require an up-front retainer from new clients. This retainer is put into a trust account for the client and may be used for collection purposes, with the client's permission, if payments are overdue. Separate trust accounts are created for each client if the separate funds are large enough to earn interest for the client. Small or short-term amounts that would not earn interest on their own may be placed in a pooled trust account. Under the IOLTA (Interest on Lawyers' Trust Accounts) program, the interest on this pooled account goes to the State to fund legal services for the poor.

Manage Cash

Law firms can experience cash shortfalls in the first quarter due to aggressive receivables collection at the end of the year and annual bonus payments made in the fourth quarter to partners and staff. Most carry a line of credit of $1-3 million to cover any shortfalls. For example, a 30-attorney firm specializing in intellectual property law carries a $1.5 million line of credit. In some firms, partners may loan money back to the firm to cover first quarter shortfalls.

Pay

Salaries are the biggest expense for law firms and average 22-23% of revenue for staff and another 11-12% for partners. Rent averages about 3-4% of revenue. Other expenses include office furnishings, computer systems, legal research, insurance, and education and training.

Report

After-tax net profit averages 18-20% of revenue. Law firms use legal practice management systems to track billable hours by lawyer and client. Key metrics tracked by law firms include billable hours (utilization), realization rate, value of work completed but not billed, collections period, net client fees per lawyer and net profit per partner.

Cash Management Challenges

Delays Due To Disputed Bills

Clients are increasingly demanding discounts or refusing to pay for fees they deem unreasonable. Disputes over the hours or billing rate charged for work delays collection and often results in negotiated discounts. Clearly setting client expectations about fees in the engagement letter can help avoid billing disputes.

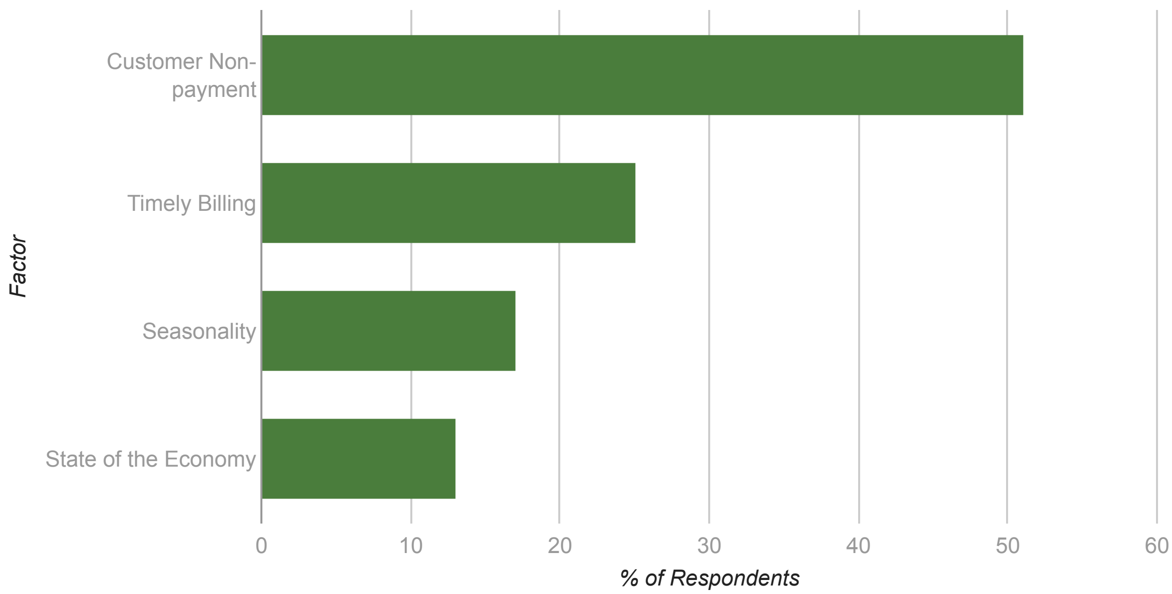
Increased Billing Complexity

Law firms are being asked to modify the traditional billable hour model by clients seeking cost containment. The addition of fixed fees for certain work, caps on billable hours, or variable billing rates adds complexity to the billing system. This additional complexity can negatively impact the timeliness of invoicing and lead to more disputes over line item charges.

First Quarter Cash Shortfalls

Law firms often face a cash shortfall in the first quarter, following the payment of year-end partner and staff bonuses. First quarter collections are also often lower due to aggressive collections in November and December to maximize year-end performance. Some firms require partners to loan money back to the firm to cover this cash shortfall.

Factors Causing Cash Flow Stress: Law Firms



Source: Barlow Research Associates

Capital Financing

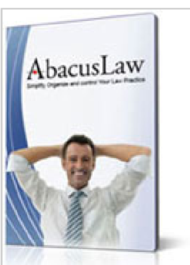
Capital spending at law firms is limited to information technology, phone systems, and office furnishings. Firms invest in information technology to increase staff productivity and help manage the business side of their practice. Firms typically lease, rather than own, their office space. This is especially true for firms located in downtown high-rise buildings close to courts and government offices. Partners at firms located in smaller towns and suburban areas may choose to invest in office condos or entire buildings.

Law firms typically invest in legal practice management systems designed to handle their unique accounting and billing needs. Capabilities of legal practice management systems vary, but the systems typically provide time tracking, expense tracking, client and matter management, calendaring, billing, and accounting functions. These systems are now available in Software-as-a-Service (SaaS) or "cloud computing" versions that are accessible via the Internet, eliminating the need to purchase and maintain servers in-house. SaaS legal practice management systems are available for about $50 per attorney per month.

Firms also invest in laptop computers, tablets, printers, scanners, office productivity software, email systems, document management systems, and mobile computing solutions to increase staff productivity. The increase in electronic documents and remote access to information has led to expanded needs for data and network security solutions to protect the confidentiality of client information.

Law firms rarely use loans for capital purchases, unless they choose to own their office space. They fund purchases of computers, phone systems, and office furnishings through retained cash or a line of credit. Many law firms choose to lease technology investments to conserve working capital and lines of credit. Leasing companies will often cover installation, training, consulting and maintenance fees in technology leases.

Examples of Equipment Purchases



Legal Practice Management Software

$4,000 - 8,000 per year

Price shown is annual fee for 10 users. Automates accounting, billing, time tracking, contact management, case management, practice performance metric tracking, and other functions for managing a law practice.

Time and Billing Software

$2,000 - 5,000 per year

Price shown is annual fee for 10 users. Automates time tracking and supports multiple types of billing methods for clients.

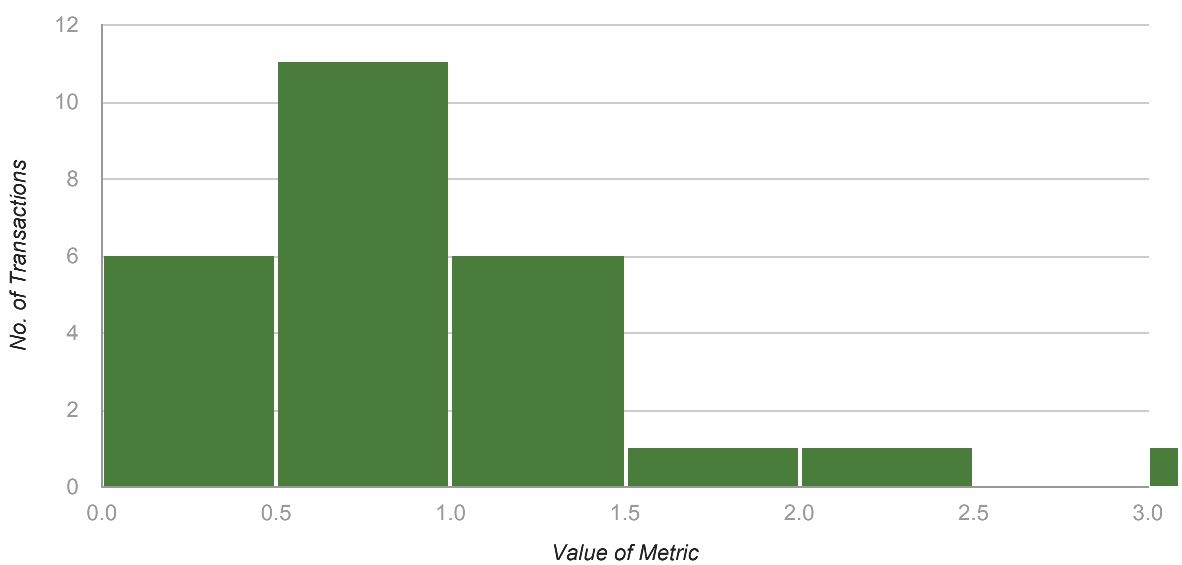
Business Valuation

This data on business valuations is supplied by DealStats, an online database with the most complete financial details on nearly 36,000 acquired companies. These companies are mostly small and medium-sized private firms.

Summary Valuation Data for Law Firms

	MEDIAN	MEAN	# TRANSACTIONS	DATES
Price to Net Sales	0.82	0.93	26	06/28/1996–10/23/2018
Price to Gross Profits	0.94	1.47	23	06/28/1996–10/23/2018
Price to EBITDA	3.29	9.38	17	06/28/1996–10/23/2018
Price to EBIT	2.48	7.3	22	06/28/1996 –10/23/2018

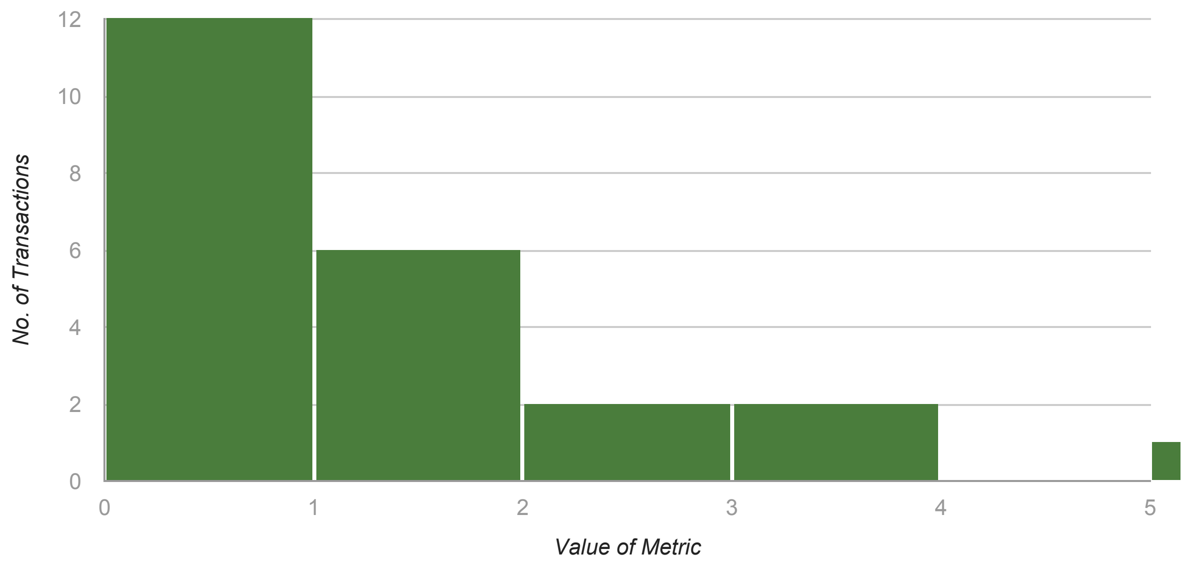
Click on the metric below to see a distribution of transactions for the industry:



Source: DealStats

Count: 26 **Min:** 0.14 **Max:** 3.46 **Mean:** 0.93 **Median:** 0.82

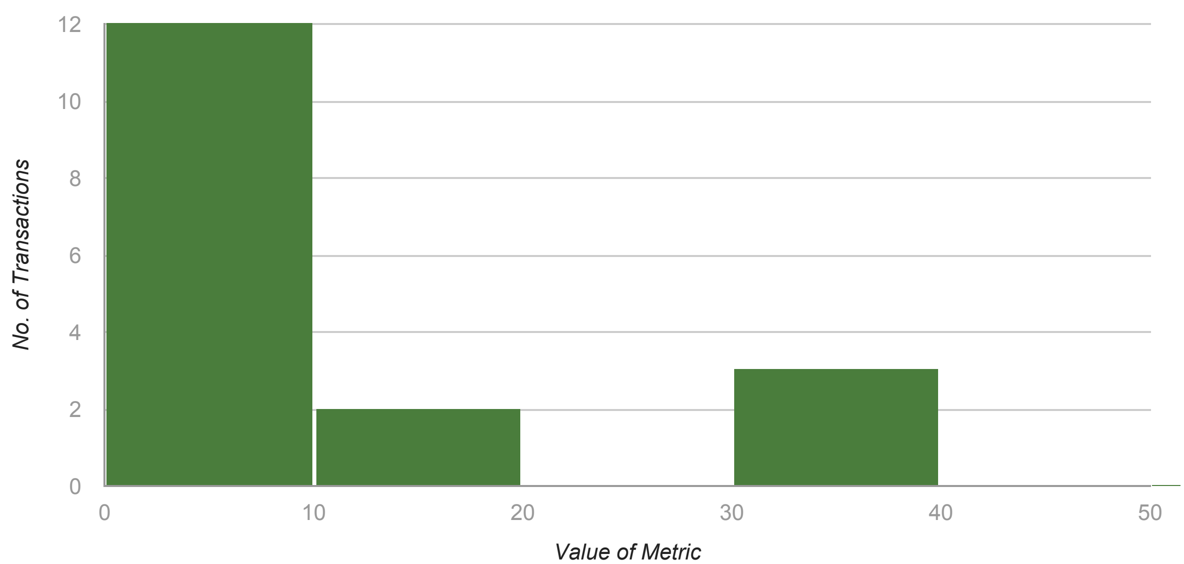
Price to Sales = Selling Price/Net Sales
Date range: 06/28/1996 - 10/23/2018



Source: DealStats

Count: 23 **Min:** 0.14 **Max:** 8.28 **Mean:** 1.47 **Median:** 0.94

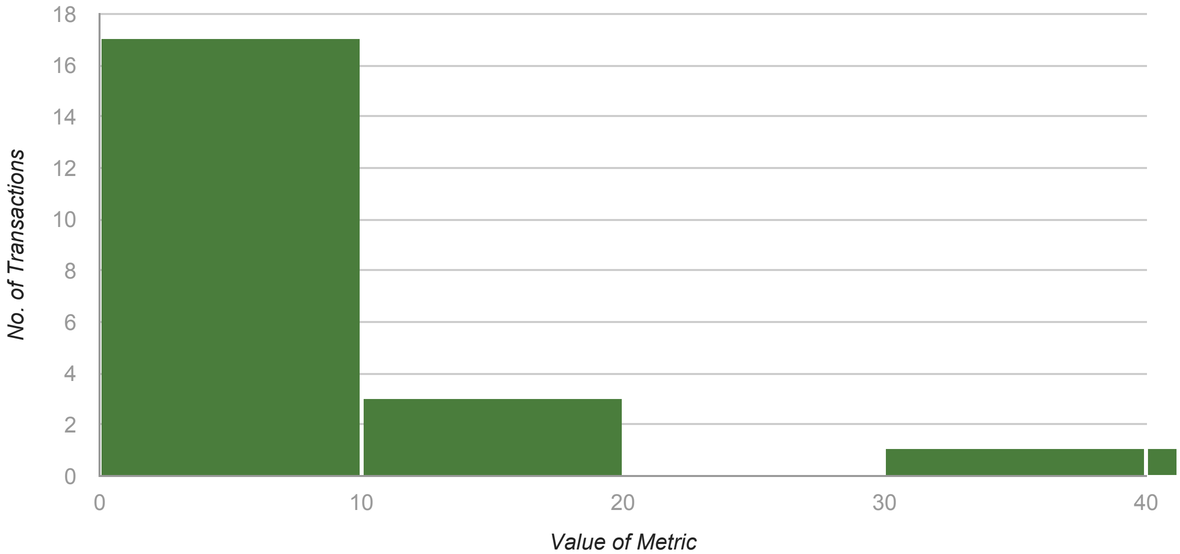
Price to Gross Profit = Selling Price/Gross Profit
Date range: 06/28/1996 - 10/23/2018



Source: DealStats

Count: 17 **Min:** 0.25 **Max:** 35.01 **Mean:** 9.38 **Median:** 3.29

Price to EBITDA = Selling Price/Operating Profit + Depreciation & Amortization
Date range: 06/28/1996 - 10/23/2018



Source: DealStats

Count: 22 **Min:** 0.93 **Max:** 48.39 **Mean:** 7.3 **Median:** 2.48

Price to EBIT = Selling Price/Operating Profit
Date range: 06/28/1996 - 10/23/2018

Selling Price, also known as MVIC (Market Value of Invested Capital) *is the total consideration paid to the seller and includes any cash, notes and/or securities that were used as a form of payment plus any interest-bearing liabilities assumed by the buyer. The MVIC price includes the noncompete value and the assumption of interest-bearing liabilities and excludes (1) the real estate value and (2) any earnouts (because they have not yet been earned, and they may not be earned) and (3) the employment/consulting agreement values. In an Asset Sale, the assumption is that all or substantially all operating assets are transferred in the sale. In an Asset Sale, the MVIC may or may not include all current assets, non-current assets and current liabilities (liabilities are typically not transferred in an asset sale).*

Source: DealStats 2019 (Portland, OR; Business Valuation Resources LLC). Used with permission. DealStats is available at https://www.bvresources.com/learn/dealstats

Financial Benchmarks

The following financial benchmark data is based on annual financial statements submitted by member institutions of the Risk Management Association from Q2 of the first year listed through Q1 of the following year.

Financial Ratios (Law Firms, Industry-wide)

MEASURE	2018-19	2019-20	2020-21
Current Ratio	1.78	1.70	2.18
Quick Ratio	1.46	1.31	1.78
Days Inventory	3.98	3.63	4.41
Days Receivables	16	14	14
Days Payables	11.11	8.37	7.68
Pre-tax Return on Revenue	25.16%	25.25%	28.34%
Pre-tax Return on Assets	103.79%	110.37%	100.27%
Pre-tax Return on Net Worth	212.90%	222.52%	183.97%
Interest Coverage	105.93	132.46	153.84
Current Liabilities to Net Worth	.77	.78	.59
Long Term Liabilities to Net Worth	0.29	0.24	0.25
Total Liabilities to Net Worth	1.05	1.02	.83
Number of Firms Analyzed	*1,822*	*1,550*	*1,103*

Income Statement (Law Firms, Industry-wide)

ITEM	2018-19	2019-20	2020-21
Revenue	100.0%	100.0%	100.0%
Cost of Sales	25.31%	25.14%	21.54%
Gross Margin	74.69%	74.86%	78.46%
Officers Compensation	11.82%	11.61%	12.22%
Salaries-Wages	22.36%	22.33%	24.67%
Rent	3.89%	4.03%	2.86%
Taxes Paid	2.21%	2.25%	2.43%
Advertising	1.13%	1.16%	0.89%
Benefits-Pensions	2.67%	2.65%	3.0%
Number of Firms Analyzed	*1,822*	*1,550*	*1,103*

ITEM	2018-19	2019-20	2020-21
Repairs	0.44%	0.42%	0.42%
Bad Debt	0.11%	0.11%	0.16%
Other SG&A Expenses	8.08%	8.1%	9.41%
EBITDA	21.98%	22.2%	22.4%
Amortization-Depreciation	0.96%	0.89%	0.95%
Operating Expenses	53.67%	53.55%	57.01%
Operating Income	21.02%	21.31%	21.45%
Interest Expense	0.92%	0.83%	1.05%
Other Income	0.22%	0.46%	-1.21%
Pre-tax Net Profit	19.88%	20.02%	21.6%
Income Tax	0.37%	0.4%	0.01%
After Tax Net Profit	19.51%	19.62%	21.59%
Number of Firms Analyzed	*1,822*	*1,550*	*1,103*

Balance Sheet (Law Firms, Industry-wide)

ASSETS	2018-19	2019-20	2020-21
Cash	38.63%	38.02%	47.89%
Receivables	12.3%	12.35%	9.9%
Inventory	0.89%	0.81%	0.95%
Other Current Assets	14.12%	15.31%	12.16%
Total Current Assets	65.94%	66.49%	70.9%
Net Fixed Assets	15.9%	16.05%	13.02%
Net Intangible Assets	3.77%	2.73%	3.68%
Other Non-Current Assets	14.39%	14.74%	12.39%
Total Assets	*100.0%*	*100.0%*	*100.0%*

LIABILITIES			
Accounts Payable	2.75%	2.57%	2.58%
Loans/Notes Payable	24.49%	21.66%	21.71%
Other Current Liabilities	34.61%	33.81%	32.85%
Number of Firms Analyzed	*1,822*	*1,550*	*1,103*

LIABILITIES

Total Current Liabilities	61.85%	58.04%	57.15%
Total Long Term Liabilities	17.0%	16.94%	25.42%
Total Liabilities	78.85%	74.98%	82.57%
Net Worth	21.15%	25.02%	17.42%
Total Liabilities & Net Worth	100.0%	100.0%	100.0%
Number of Firms Analyzed	*1,822*	*1,550*	*1,103*

Vertical IQ financial benchmark data is based on data provided by the Risk Management Association (RMA) and Powerlytics, Inc. RMA's Annual Statement Studies provide comparative industry financial benchmarks based on financial statements of small and medium business clients of RMA's member institutions. Additional detail on income statement line items is provided using Powerlytics financial benchmarks, which are based on reporting submitted to the IRS. Additional detail on these data sources can be found at RMA and Powerlytics.

Bank Product Usage

Top Bank Products Used by Law Firms

The following table provides the frequency of bank product usage by Law Firms with less than $10 million in annual revenue. It is provided by Barlow Research Associates, Inc., the premier market research firm in the financial services industry.

BANK PRODUCT	% OF FIRMS
Business checking account services	97.0
Wire transfer services	64.0
Business debit card or business check card	62.0
Automated clearing house services (ACH)	59.0
Point-of-sale credit card processing	57.0
Overdraft protection for business checking	55.0
Business savings or money market account	53.0
Electronic payments initiated through the Internet (Bill Payment)	53.0
Business credit card issued in your company's name (Visa, MasterCard, Amex, etc.)	52.0
Remote deposit capture (scanning checks at your office or by mobile device for electronic deposit)	43.0
SBA loans	30.0
Payroll processing	26.0
Unsecured short-term loans or working capital line of credit (less than one year)	22.0
Company sponsored 401(k), SEP, pension or profit sharing plan	21.0
Money market mutual funds or short-term investments	20.0
Certificates of deposit	20.0
Credit lines secured by receivables, inventory, property or other assets	18.0
Commercial real estate mortgage	14.0
International (foreign exchange, import/export letters of credit)	13.0
Account reconciliation processing (ARP)	12.0
Overnight investment or sweep accounts	12.0
Commercial real estate mortgage (company occupied building)	11.0
Term loans or equipment financing (one year +)	11.0
Equipment leasing	9.0
Commercial real estate mortgage (investment property)	8.0
Accounts receivable collection (lockbox)	6.0

Barlow's Small Business Banking program is a multi-client research program sponsored by leading banks. Each quarter, a stratified random sample of businesses throughout the United States with sales between $100,000 to $10 million compiled from an independent list provider are invited to participate in a comprehensive banking survey of over 100 questions. The results measure channel adoption, bank satisfaction, brand power, account management, service quality, business product usage and the selling abilities of leading providers. The results in this chapter are calculated directly from the business product usage section and represent usage for the average small business ($100K-<$10MM).

For more information on Barlow's banking research, go to http://www.barlowresearch.com/

Quarterly Insight

1st Quarter 2022

Federal Infrastructure Funding Presents Opportunities

President Biden signed an infrastructure funding bill into law in late 2021. Law firms are poised to reap a windfall in deal making, litigation, and lobbying fees as a result, according to Reuters news service. The infrastructure bill will cost $1.2 trillion over eight years. The top five sectors, by amount of money allocated, include $110 billion for roads, bridges and other transportation infrastructure; $73 billion for the country's electric grid and power structures; $66 billion for rail services; $65 billion for broadband; $55 billion for water infrastructure. Many analysts say that President Biden's $2 trillion Build Back Better Agenda, the portion of a federal spending proposal that the President calls "human" or "social" infrastructure, is unlikely to pass the US legislature. Parts of it still could become a reality though, according to White House economist Cecilia Rouse.

4th Quarter 2021

Cannabis Practices Multiply As Legalization Spreads

Big law firms are building cannabis practice groups as a rising number of states legalize recreational and medicinal use, according to Bloomberg Law. Cannabis companies need advice on intellectual property, employment, taxes, license and regulatory compliance, lending and financial transactions, mergers and acquisitions, and a host of other specialty practice areas. Law firms' aversion to the cannabis industry has subsided somewhat, as 19 states have passed laws permitting recreational and medicinal cannabis and 34 allow medicinal use, but considerable uncertainty remains because the drug remains largely banned under federal law. "The law comes first. The expertise comes first and then you serve that industry with that. That's what makes you a good lawyer for the industry, knowing what it is you're talking about and applying it to the nuances of the industry," said Shabnam Malek, founding president of the International Cannabis Bar Association.

3rd Quarter 2021

Internal Issues Draw Firms' Attention

Law firms' concerns have shifted away from business-building and remote work to an increased focus on factors related to employee well-being and job satisfaction, according to Bloomberg Law's 2021 Law Firm Benchmarks Survey. The challenges with the largest shifts from 2020 to 2021 were retaining talent, attorneys feeling overworked, lack of personnel to handle the current workload, and low office morale. The main challenge that firms face this year is being able to meet an expected increased demand for legal services.

2nd Quarter 2021

Federal Infrastructure Proposal May Boost Revenues

Law firms are poised to reap a windfall in deal making, litigation, and lobbying fees from federal infrastructure spending proposals that may become law during the Biden administration, according to Reuters news service. Law firms have begun organizing internal, firmwide task forces focused on the infrastructure bill. The proposed influx of dollars in the economy has implications for lobbying, project finance, government contracting, False Claims Act litigation, tax, and many other practices.

1st Quarter 2021

High-tech Adoption Increases

More than three-quarters of law firms responding to Bloomberg Law's 2020 Legal Operations Survey said that they are increasing the use of legal technology like artificial intelligence (AI). About 84% of respondents said that technology has increased efficiency, while 64% say it has resulted in better workflows for their attorneys. AI allows standard legal functions such as data collection, eDiscovery, legal research, document review, and due diligence to be done in less time and for less cost than with a more traditional approach.

4th Quarter 2020

Cutbacks Rolled Back

Forty eight of the largest 100 law firms in the country resorted to some combination of pay reductions and delays, furloughs, or layoffs due to the coronavirus pandemic, according to Bloomberg Law. Twenty seven of them have restored pay in part or completely, according to a Bloomberg Law analysis. Some of the most profitable firms have even given out “pandemic bonuses” of up to $40,000 a piece for associates. Many industry leaders who prepared for a 20 to 40% revenue decline have seen just a 5% to 10% dip, with variations depending on practice areas, according to Thomas Clay a consultant at Altman Weil, who works closely with large law firms.

3rd Quarter 2020

Demand for Services Falls, Rates Rise

Demand for legal services declined 5.9% year over year during Q2, marking the largest drop in year-over-year quarterly demand since 2009, according to the Q2 peer monitor index from Thomson Reuters. The average rate billed rose 5.2%, however. Productivity across all fee earners declined 7.2% as a result of significant growth in lawyer headcount compared to the same period a year earlier. Partners completed a higher proportion of work by volume. The cause for this is two-fold, according to Thomson Reuters. First, partners with a more “eat-what-you-kill” mindset are focused on staying the course to achieve their own billable hour goals. Second, law firm clients have an increased need for advisory services that cannot be completed by less experienced lawyers. The result is the all-time high rate growth of 5.2%.

2nd Quarter 2020

Revenue Declines

Revenues have declined at about 81% of law firms during the coronavirus pandemic, according to survey results published in mid-May by Martindale-Avvo. About 27% of firms that reported declining revenue to Martindale-Avvo said that revenue declined by more than half. About 62% of respondents to the Martindale-Avvo survey said that they believe it will take anywhere from four months to a year for their firm to return back to where they were financially pre-COVID-19. Almost 50% of the more than 1,000 consumers surveyed in April said they would likely delay seeking legal help until after the COVID-19 crisis has relented, according to a survey by legal software firm Clio. About 22% thought that lawyers had stopped providing legal services entirely. The Clio survey also found that 56% of law firms have seen a substantial decrease in requests for legal assistance. “We’ve seen no indication that the need for legal services has subsided during the pandemic, but for many people, dealing with them right now isn’t top of mind,” said Clio CEO and co-founder Jack Newton.

Industry Terms

Alternative Fee Arrangements

Charging for work that is not based strictly on billable hours.

Billable Hours

The primary method for billing clients and evaluating lawyers.

IOLTA

Interest on Lawyers' Trust Accounts is a method for raising money for charitable purposes.

Leverage

The ratio of associates to partners at a law firm.

MCLE

Mandatory or minimum continuing legal education required by States.

Net Profit per Partner

Key measure of law firm performance.

Paralegal

A person without a law degree who performs legal work under the supervision of a lawyer.

Realization Rate

Ratio of net client fees to gross fees.

Utilization Rate

Ratio of billable hours to total available hours.

Web Links

American Bar Association
News, policies, white papers, and education.

American Lawyer.com
News and rankings of law firms.

Law Practice Division
Monthly magazine on law practice management by the ABA.

Legal Profession Statistics
Law practice statistical data from ABA.

Association of Legal Administrators
News and articles for law firm managers.

NALP
Statistics from an association for legal professionals.

Altman Weil, Inc.
Articles and blogs from a legal consulting firm.

Related Profiles

CPA Practices

NAICS: 541211 SIC: 8721

Tax Preparation Services

NAICS: 541213 SIC: 7291

Title Abstract and Settlement Offices

NAICS: 541191 SIC: 6541

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Bankruptcy Lawyers

NAICS: 541110 SIC: 8111

Employment Lawyers

NAICS: 541110 SIC: 8111

Estate Planning Attorneys

NAICS: 541110 SIC: 8111

Immigration Lawyers

NAICS: 541110 SIC: 8111

Patent Attorneys

NAICS: 541110 SIC: 8111

Personal Injury Lawyers

NAICS: 541110 SIC: 8111

Real Estate Lawyers

NAICS: 541110 SIC: 8111
