



## What is your Law firm worth?

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**Not as much as you think!!!**

# What does 2 + 2 make?

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- Ask an accountant – what do you want it to make?!
- If in disagreement try to avoid having two different firms of accountants doing a valuation
- “Art not a science”
- Worth what a buyer will pay
- Wide variations not unusual
- Different values for different purposes



# Agenda

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- Different types of practice
- Methodologies
- Net assets basis
- Earnings basis
- Incoming and outgoing partners
- Tax
- Achieving best “price”
- Questions on your seats



# Different types of practice

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- Process driven, volume transactions
  - Profits less dependant on the skills of the staff and partner
  - A goodwill driver
- More traditional “collegiate” full service firm
  - Profits less identified with the business & more with its people
  - Is there goodwill at all?



# Methodologies

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- Net assets
- Earnings
- Others methodologies are probably unreliable
  - Multiple of fee income
  - Yield
  - DCF



# Net assets basis

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- By far the easiest
- Adjust for values of underlying assets
- Other liabilities e.g. PII run off, redundancy, close down costs
- WIP subject to CFA often not included
- Discounts will apply
- Goodwill – unlikely for a non-specialist “collegiate” practice



# Goodwill and CFA WIP

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- Goodwill
  - Excess of value over net assets
  - Genuine goodwill is unusual – especially for collegiate firms
- CFA WIP
  - Usually called goodwill as on sale likely to be taxed at 10%
  - Time records usually unreliable
  - Eliminate “dead” cases
  - Number of cases X average value achieved % 50% (to represent ½ way through)
  - Apply a discount (see later on market conditions)
  - Role of specialist valuers
- FRS 105 – back to the future!!





# What would you pay/ask for the following

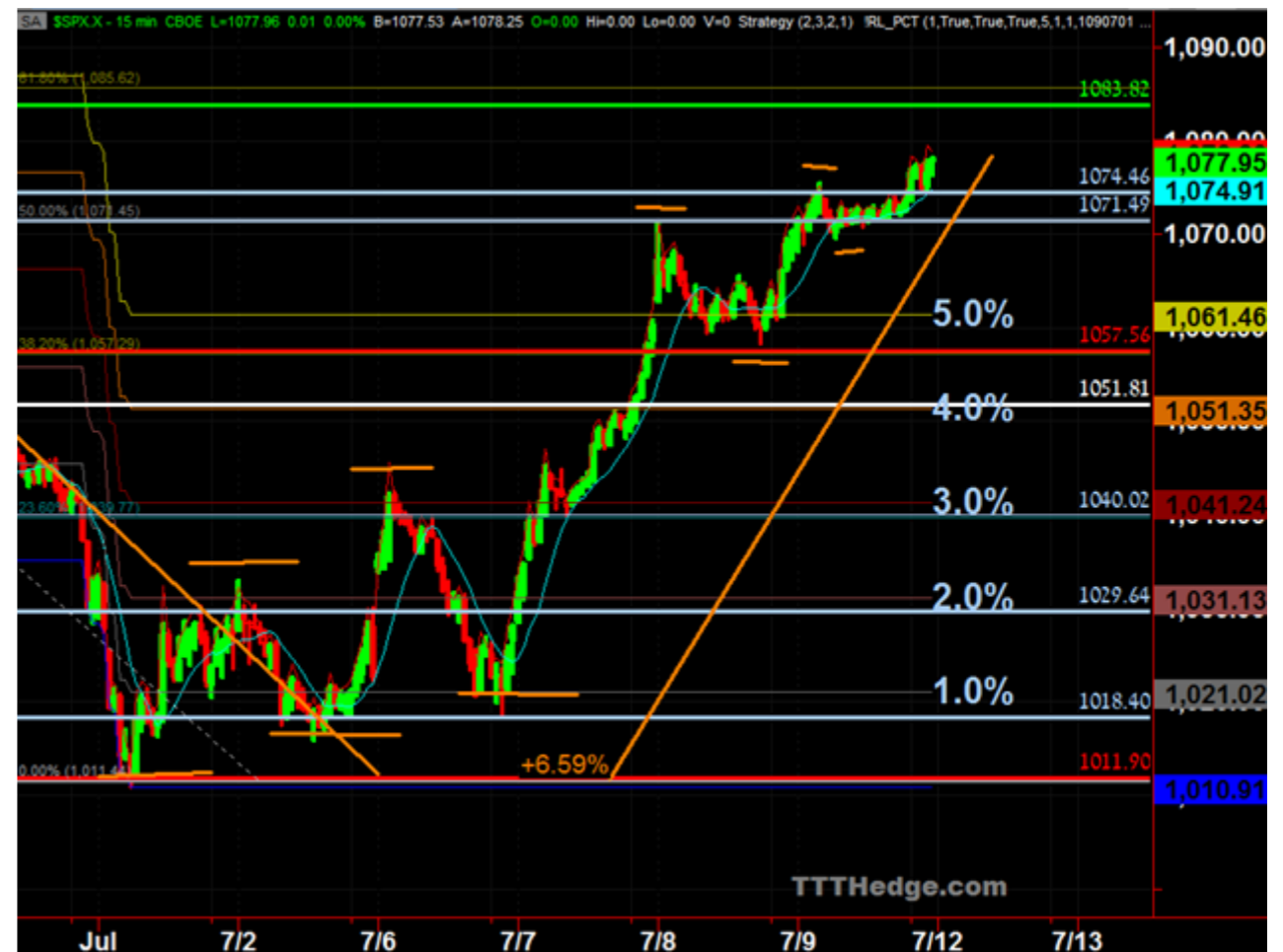
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- 1,000 homogenous contingent cases
- Average value realised of £1,000 across all cases accepted
- On average half way through = £500k realised
- If
  - A buyer
  - A seller
  - Up front
  - On realisations basis



# Earnings basis

- Goodwill = sale value less net assets
- Higher of net assets basis or earnings basis
- Maintainable recurring profits X multiplier
- Variables



# Variables

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- Maintainable profit
  - Recent results
  - Major contracts
  - Legislation
- Exceptional items
  - Redundancy & reorganisation
  - Surplus on sale of assets
- Partners reward
  - “Salaries” for “doing the job” excluding risk return.
  - Open market salaries/bonuses
  - Difficult to determine
- Weighting
  - How many years?
  - Management accounts
  - What weighting?
- Tax
  - Assume pre tax
  - BUT quoted indices are post tax

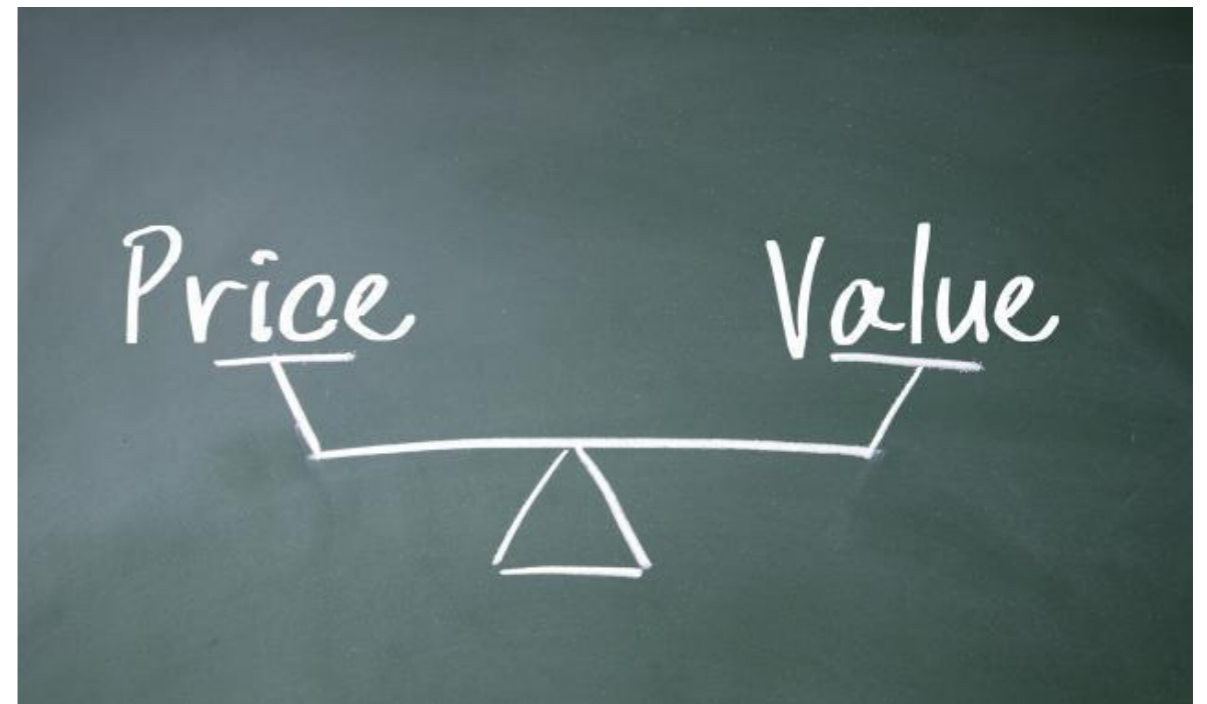


	<u>2XX6</u>	<u>2XX5</u>	<u>2XX4</u>
Profit for the year per the accounts	1,000,000	900,000	1,300,000
Adjust abnormal items			
Redundancy and reorganisation costs	100,000	400,000	0
Surplus on sale of assets	(200,000)	0	(50,000)
	<u>900,000</u>	<u>1,300,000</u>	<u>1,250,000</u>
Less commercial salaries for partners			
Partner 1	(100,000)	(100,000)	(100,000)
Partner 2	(50,000)	(50,000)	(50,000)
Partner 3	(75,000)	(75,000)	(75,000)
Partner 4	(75,000)	(75,000)	(75,000)
Normalised trading profit	<u>600,000</u>	<u>1,000,000</u>	<u>950,000</u>
Weighting	<u>3</u>	<u>2</u>	<u>1</u>
	<u>1,800,000</u>	<u>2,000,000</u>	<u>950,000</u>
Weighted average maintainable profits	<u>791,667</u>		
Indicative values			
Using multiplier of 3	<u>2,375,000</u>		
Using multiplier of 6	<u>4,750,000</u>		
Using multiplier of <b>4.5</b>	<u><b>3,562,500</b></u>		
Net assets	3,000,000		
Overall value	<u>3,562,500</u>		
Goodwill	<u><b>562,500</b></u>		

# What multiplier would you apply?

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- To EBITDA
- Maintainable
- No exceptionals
- After fair salaries for partners
- For simplicity assume no earn-out
- If
  - You are a buyer
  - If you are a seller
  - To a collegiate practice
  - To a PI practice given the MoJ announcement last week



# What multiplier?

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- THE most difficult
- Sector, size & economy
- BDO PCPI
- FTSE non financials
- Smaller co. bigger discount



# Incoming/outgoing partners

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- Separate talk in itself
- General partnerships
- LLPs / Limited companies
- Contribution to capital
  
- New partners viewpoint
- Exiting partners viewpoint
- Firm's viewpoint
- War story



# Tax

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- Entrepreneurs relief (ER)
  - 10% upto £10m
  - One year ownership of at least 5%
  - Employee or owner
  - Sale of business (so just of property not eligible)
- Goodwill and CFA WIP called goodwill - ER available at 10%
- Limited company
  - Can sell shares or assets
  - Buyer usually prefers assets and will usually pay more
  - Seller usually prefers shares and will usually accept less

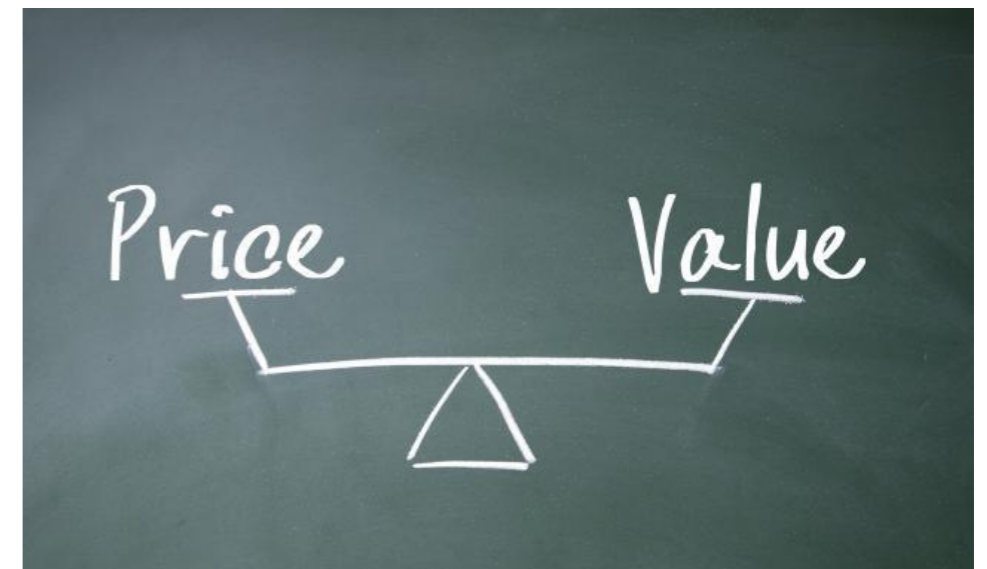




# Achieving best price - how

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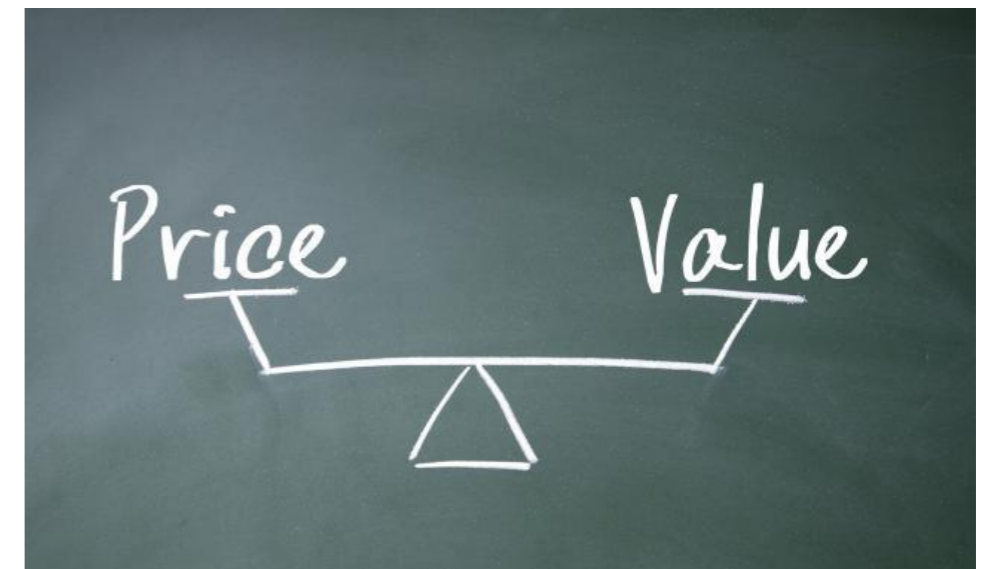
- Price is only one element but is it a merger or sale?
- Use a lead adviser
  - Independence
  - Confidential approaches
  - Market knowledge
  - Play “hard ball”
- The process
  - Create a competitive market
  - Prepare Information Memorandum
  - Identify targets
  - The process
- Six to nine months timescale



# Achieving best price – the process (1)

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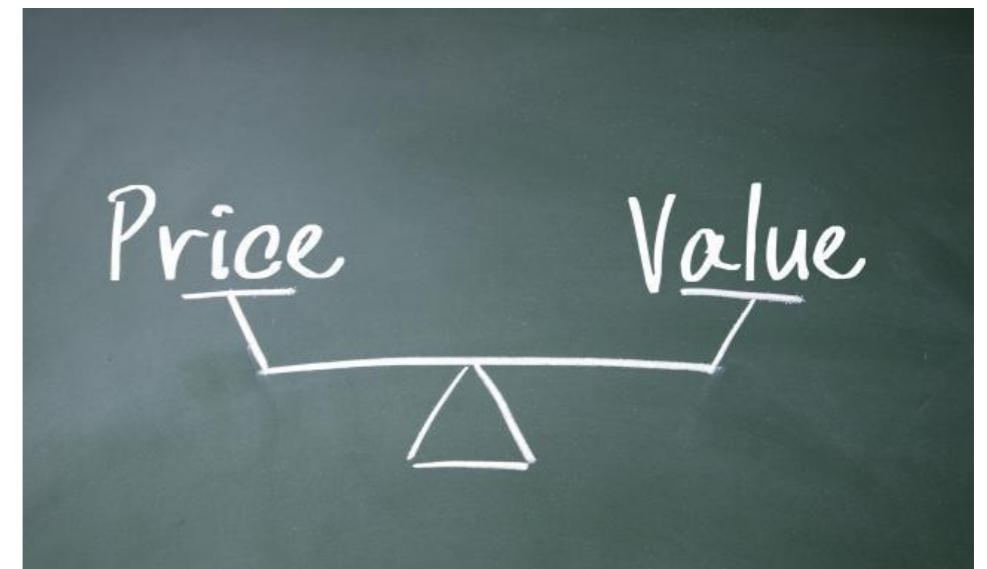
- The IM
  - A sales document
  - Paints the picture with adjusted results
  - MUST be available before market approaches
  - Aids in market value assessment
  - Aids negotiating position and SWOT
  - Do not indicate expected price
  - What you want to know about “them”
- Identifying targets
  - Blanket approach dangerous
  - Use “lead adviser”
  - Perhaps a doz. down to final 2 or 3



# Achieving best price – the process (2)

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- Stage 1 to indicative offers
  - Initial personal approach
  - Taster
  - NDA
  - Issue numbered IM
  - Meet targets – two way exchange
  - Indicative offers
- Stage 2 to formal agreement
  - Assess offers
  - Clarify & negotiate
  - Preferred party – exclusivity
  - DD and final negotiation
  - Signed agreement





# Feedback

# Questions ??

## What is your Law firm worth?



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