

What is my law firm worth?

18th July 2013

Howard Hackney

Jon Miller

What does 2 + 2 make?

- Ask an accountant – what do you want it to make?!
- “Art not a science”
- Worth what a buyer will pay
- Wide variations not unusual
- Different values for different purposes
- Q&A session at conclusion



Proposed agenda

- Different types of practice
- Methodologies
- Goodwill & CFA WIP
- Tax
- Market conditions
- Achieving best “price”
- Anything else?



Different types of practice

- 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

- Net assets
- Earnings
- Others methodologies are probably unreliable



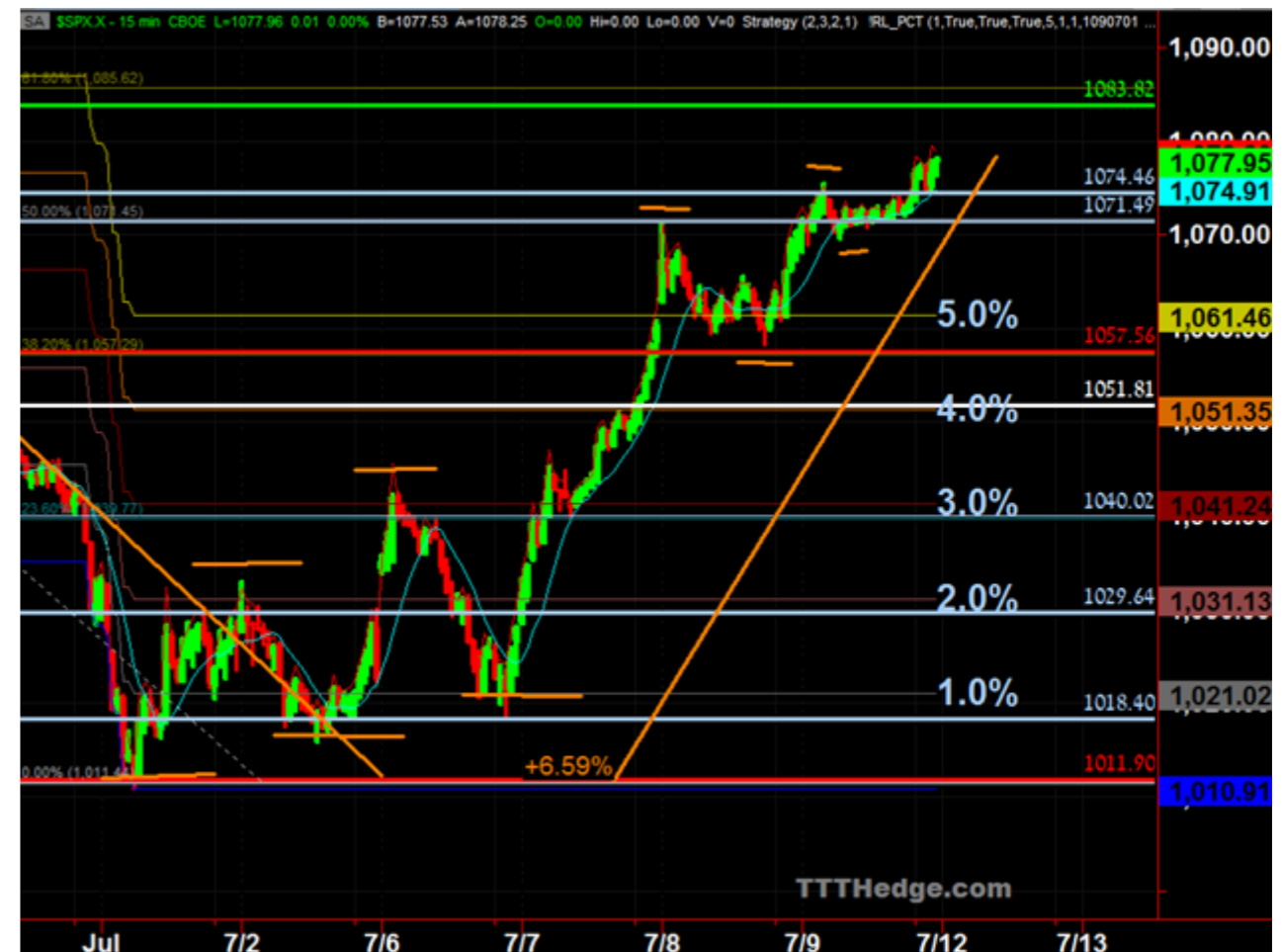
Net assets basis

- By far the easiest
- Adjust for market values
- 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



Earnings basis

- Goodwill = sale value less net assets
- Higher of net assets basis or earnings basis
- Maintainable profits X multiplier
- Variables
 - Maintainable
 - Exceptional items
 - Management reward
 - Weighting
 - Tax
 - Multiplier
- See template



	2XX3	2XX2	2XX1
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>
Less tax at between 20% and 25%	(135,000)	(235,000)	(222,500)
	<u>465,000</u>	<u>765,000</u>	<u>727,500</u>
Weighting	<u>3</u>	<u>2</u>	<u>1</u>
	<u>1,395,000</u>	<u>1,530,000</u>	<u>727,500</u>
Weighted average maintainable profits		<u>608,750</u>	
Indicative values			
Using multiplier of 4		<u>2,435,000</u>	
Using multiplier of 8		<u>4,870,000</u>	
Using multiplier of 6		<u>3,652,500</u>	
Net assets		3,000,000	
Overall value		<u>3,652,500</u>	
Goodwill		<u>652,500</u>	

Variables

- 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
 - Multipliers are post tax
 - What tax rate to use?



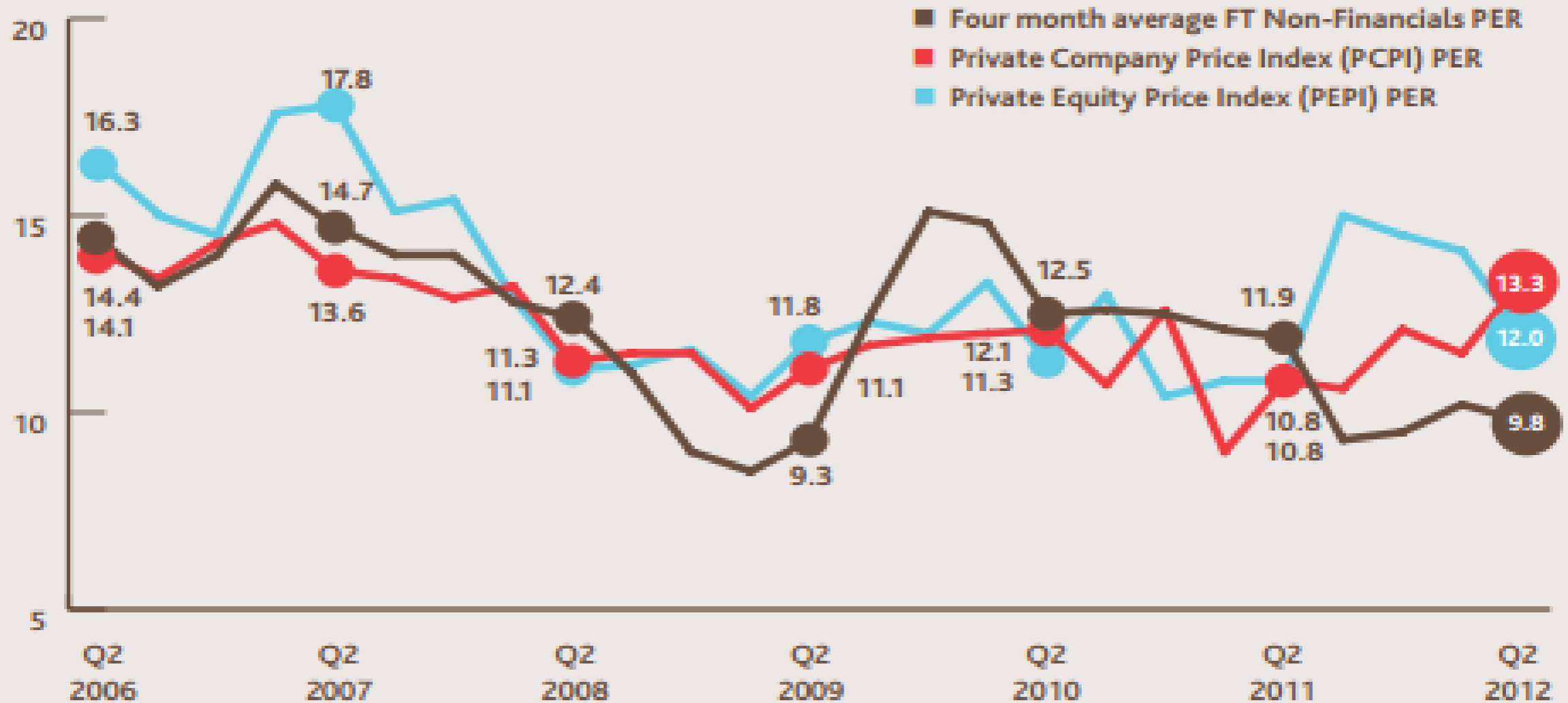
What multiplier?

- THE most difficult
- Sector, size & economy
- BDO PCPI 13.3 up from 11.5
- FTSE non financials 9.8
- Smaller co. bigger discount
- Rule of thumb 4-8
- Even this perhaps optimistic in this climate



BDO index

PCPI v PRIVATE EQUITY Q2 2006 – Q2 2012



Goodwill and CFA WIP

- 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



What's going on?



What's going on? – earnings based deals

- Based on real life deals we have seen
- Multiplier expected by HMRC approx 3 x pre tax profits or 80% to 100% of fee income = just under 4 x post tax profits
- A specialist firm
 - Pre tax 2 – 4.5 = 2.7 to 6.0 post tax
 - | | |
|--|-------------|
| Cash | 25% |
| Shares | 40% |
| Deferred over 3 years subject to performance | 35% |
| | <u>100%</u> |
- An AMC acquisition:
 - all out of future profits of target



What's going on? – May 2013

- Slater & Gordon acquire Goodmans, Simpson Millar and Taylor Vinter
- Mixture of PI, volume and mainstream legal services
- Collectively valued at £23m
- Pre-tax profits disclosed as £5.2m - £6.5m
- Assuming 25% tax, earnings multiple range is from 4.7x to 5.9x
- No details as to how much payable in cash and how much in shares or other consideration.



What's going on? – asset based deals

- CFA WIP
 - Realisations 35% to 75%
 - Upfront 60% best – most will not take the risk
- Debtors – usually on collections less 10% admin fee
- Fixed assets – 10% of book value
- Unrecognised liabilities
 - Dilapidations
 - PII run off
 - TUPE
- Watch solvency of acquirer
- Considerable market uncertainty : especially PI firms = opportunities



Tax

- 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%
 - Non connected Limited company acquirer obtains tax relief on write off
- 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 (1)

- Price is only one element but is it a merger or sale?
- Use a lead adviser
 - Independence
 - Confidential approaches
 - Markey 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 (2)

- 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
- 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

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Howard Hackney
Jon Miller

Any questions?



howard hackney^{LLP}

Firscroft, Firs Lane, Appleton, Cheshire WA4 5LD
01925 211270
www.howardhackney.co.uk

Howard Hackney // Partner
howard.hackney@hshadvice.co.uk
07968 059363

Jon Miller // Associate
jrpm@h2llp.co.uk
07766 137759
