THE GLOBAL LEGAL POST

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A very mixed picture at best: the listed law firms' roller coaster ride

While some fortunes have been made, Tony Williams argues the Covid-19 pandemic has underlined the enduring strength of the traditional law firm partnership model

By Tony Williams

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We now have a range of legal businesses listed on the London Stock Market (although most are on the AIM junior market) so it is appropriate to examine their track record and any lessons that can be learnt.

But first some background. The proponents of the listed law firm model claim that a corporate model with direct access to the capital markets is a far more modern and efficient model compared to a more traditional limited liability partnership.

The business is subject to scrutiny from analysts but in turn has access to significant amounts of equity capital so enabling the business to invest in new opportunities without being constrained by an accounting and taxation model in an LLP which militates towards the distribution of all profits to partners every year.

In addition, as the business succeeds the owners reap the benefit of an increased share price and only pay 10-20% capital gains tax on the increase in value. Conversely, partners in the law firm pay about 50% tax on their income being 45% income tax, 3.25% national insurance and at least 1.75% non-tax-deductible business expenses. What is there not to like?

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> *The position is not quite as rosy as the proponents would have you believe*

Well the position is not quite as rosy as the proponents would have you believe. First, in many structures, the former partners will become employees of the business in which case the business will need to pay 15.05% employer's national insurance contributions on their salaries (some do use LLPs within a corporate structure, but this can add to the complexity of the governance structure).

Furthermore, some profits will be retained for future investment and other profits utilised to pay dividends. As a result a former partner's annual income from the business is likely to be less than 50% of the profit share the partner previously received. This will be supplemented by the dividends received on that former partner's shares plus the value of that partner's shares when the partner is entitled to start selling them (often from three to five years after the float). Fortunately, any profit on the sale of the shares will only be taxable as a capital gain.

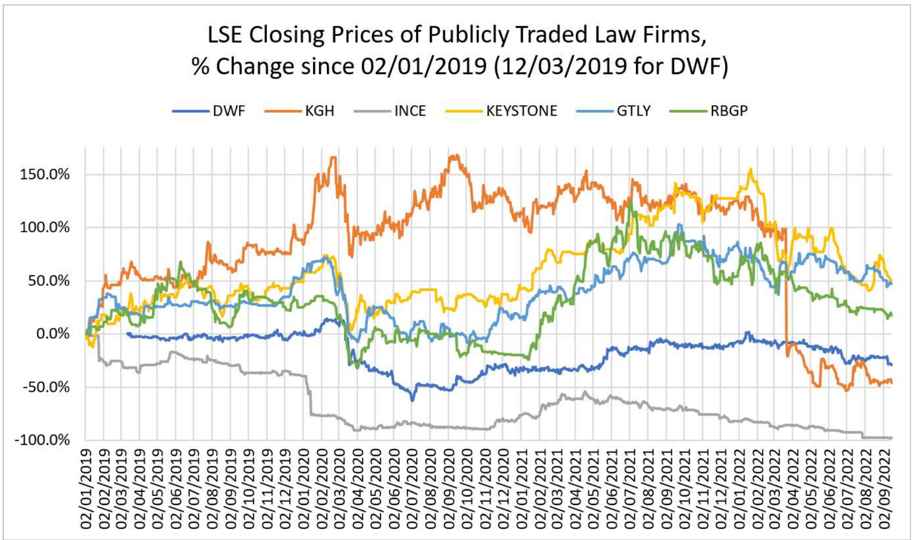
Such a model may well suit partners whose main lifetime expenditure is behind them - mortgages, school fees etc - and may be especially appealing to partners within, say, five years of retirement because in a traditional model the retiring partner realises no value other than the repayment of their original capital contribution. However, for partners at a time of peak personal expenditure the promise of tax efficient riches tomorrow may be a poor substitute for cash today.

It is appropriate to examine the progress of the listed legal businesses since floatation (see table).

Date Of Float	**Business**	**Float Price (Pence)**	**20 September 2022**
June 2015	Gateley	95	193
August 2015	Gordon Dadds (now Ince)	140	4.3
November 2015	Keystone Law	160	512
June 2016	Knights Group	145	99.4
May 2018	Rosenblatt	95	90.8
March 2019	DWF	122	88

Some care needs to be taken as restructurings such as share reorganisations may make direct comparisons inappropriate, but the direction of travel is clear.

The chart below shows the share price change in percentage terms since January 2019 or later float.



These performances provide some important messages.

1. Don't surprise or disappoint the market. Gateley has tended to meet or very slightly exceed analysts' forecasts every six months. It has been very measured in its acquisitions and over seven years its share price has doubled. Hardly spectacular but a respectable performance. Conversely, Knights was a market darling until earlier this year when it spooked the market and has yet to recover.

2. Big acquisitions are dangerous. Gordon Dadds had been quietly consolidating small to medium sized firms until it took over Ince and rebranded itself. It is now in very challenging financial territory and its founder and CEO have gone.

3. External forces matter. The onset of the Covid pandemic in March 2020 caused a major sell off in all shares including the legal shares. Many of these shares - 30 months on - have still not topped their pre-Covid highs. As we now know, the Covid pandemic had no discernible negative impact on most traditional law firms.

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4. If the share price falls so may the CEO. Both DWF and Ince parted company with their CEOs when the share price came under pressure. The need for public disclosure and the clinical response of investors may mean that a CEO has nowhere to hide when things get difficult.

5. Alternative businesses may present a compelling model. The virtual firm Keystone Law has a relatively low-cost base and a model apparently aligned with flexibility and working from home. As a result, although like its peers its share price suffered with the onset of the Covid pandemic, it quickly recovered as investors started to understand its model (although its share price has weakened recently) and is now priced at over three times its float price. Indeed, it is the stand out performer of the listed legal businesses.

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For tightly held equity a listing is a no brainer

6. For tightly held equity a listing is a no brainer. With the exception of Gateley and DWF, all of the listed law businesses were owned by a handful of individuals and institutions. In these circumstances the prospect of a multimillion-pound windfall sale is too good to miss. Some of this may be realised on the float or, subsequently, when initial sale restrictions expire. For example, David Beech the CEO of Knights Group sold 15.7m shares at 390p in January 2021 raising approximately £61m before expenses. For founders or partners facing the prospect of life changing amounts of money, the challenges of a float may well be worth accepting. For other partners, the risk/reward ratio may be more finely balanced.

7. Share Capital is a currency in good times. The possibility of using share capital as currency for acquisitions is often cited as a benefit of a float. It is clear that this can be the case but when, after its share price fell, Knights Group earlier this year bought Coffin Mew for £11.5m, only £1m of the consideration was satisfied in shares.

8. Share incentives may be used to motivate and reward staff. However, given the absence of traditional partnership rewards and the volatility of the share price combined with a very competitive market for lawyers, share incentives are likely to be insufficient to retain and incentivise the most marketable staff.

Earlier this year, Mishcon de Reya abandoned what would have been the largest law firm float to date. A range of firms were watching to see how the Mishcon float performed before dusting down their own plans. It remains to be seen whether market conditions in 2023 will permit a float by Mishcon and if so, whether this will produce a new wave of law firm floats.

The performance of the listed law businesses to date provides a very mixed picture at best.

For investors it has been a roller coaster ride with two thirds still trading at below their float price. Only the new model Keystone Law has been a strong performer.

For the individual shareholder with a major shareholding, depending on the timing of their share sales, some fortunes have been made. However, traditional law firms have performed very strongly in revenue and profitability terms throughout the Covid pandemic. This performance combined with their widely held ownership structure is unlikely to cause them to look with envy at the generally unimpressive share price performance of the listed legal businesses.

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