THE LAWYER "Brush up on contract drafting to avoid disputes"

Six things to consider if you want to float your law firm

Nothing comes for free – before going for the IPO firms need to understand six key points.


Tony Williams

With the recent wave of law businesses coming to the stock market or considering whether to do so, it is worth considering what is driving this surge and the factors to consider.

Gateley was the first UK law firm to list in June 2015 and has grown its revenues to about £84m and pre-tax profits to about £18m. It has been a great listed company, slightly exceeding expectations every six months and making small, relatively inexpensive and focused acquisitions. As a result, its share price is up about 90 per cent since its float and it has a market capitalisation of £188m. It trades on a multiple of about 2.25 times revenue with a price/earnings (P/E) ratio of 18.4.

Full comparison with the more recent IPOs is challenging as most have not disclosed full year figures post IPO. But, Gordon Dadds is now valued at about 1.7 times revenue, Keystone at about 3 times revenue and Rosenblatt at an impressive 6.25 times revenue. These disparities are largely accounted for by the different profitability and growth expectations of the business. Using a somewhat more conventional approach, it appears that, on a non-exceptional basis, listed law businesses are achieving a P/E ratio of close to 20. This is roughly the same as FTSE 100 companies.

Given these high valuations it is understandable that firms are queuing up to float. In many of the recent listings a small number of individuals owned the bulk of the business. The possibility of realising many millions of pounds and only paying capital gains tax at 10 per cent on the first £10m of gains (if entrepreneur relief applies) or 20 per cent otherwise is probably too compelling for many to resist.

But nothing comes for free so before going for the IPO firms need to understand:

Partner Profits: There will be an incentive, with such high P/E ratios, for the remuneration allocated to partners as an expense of the Plc to be as low as possible. Accordingly, the day job remuneration is likely to be fixed at a relatively low figure.

Dividends: Law firms are reasonably reliable cash generators so most have committed to distribute most of their profits by way of dividend (Gateley committed to 70per cent). If on float, a firm sells 20 per cent of its shares the former partners will retain 80 per cent. If 70 per cent of profits are distributed, the partners receive 80 per cent x 70 per cent = 56 per cent of the profits of the business.

Capital Gains: While some partner's shares may be sold as part of the IPO there will often be lock in provisions restricting further sales (Gateley used three and five-year periods). When such former partners can cash out, will they? And what will that mean for the business? Only time will tell.

The Next Generation: Those who do not benefit from the IPO may ask what the future holds for them in a listed law firm. Most have extensive share option schemes to help to attract or retain staff (not just lawyers). Whether these when combined with their remuneration package will be sufficient will depend upon the business model and its reliance or otherwise on high profile and mobile lawyers. Many of the legal businesses that have floated have fundamentally different business and service delivery models compared to traditional law firms.

International: England and Wales is one of the few jurisdictions that permits outside ownership of law firms. For firms with a significant international presence a float will create challenges. New structures using verein type arrangements or otherwise may be available but will require a significant culture and operational change.

The Accountants: It is notable that despite their size and business acumen, none of the Big 4 accountants have sought a stock exchange listing (although Accenture did after its split from Arthur Andersen). Even in the next tier and despite Smith & Williamson having outside investment, none have so far come to the market. The smaller firms that did mostly crashed and burned. Perhaps if such sophisticated businesses have decided not to list this should give pause for thought.

The growing number of listed legal businesses is starting to create an asset class which attracts the attention of analysts and investors. Those floated to date have secured some blue chip institutional investors looking for relatively stable businesses with a reliable dividend stream. The float proceeds and additional currency in the form of shares provides opportunities to expand by acquisition (as in the case of Gordon Dadds) or to develop a war chest for litigation funding (as is the case of Rosenblatt). But, the lessons of Slater and Gordon should not be forgotten. Overpaying for businesses, failing to integrate them effectively and hubris have been the downfall of many a good business.

For the owners of a significant stake in a legal business an IPO may appear to be a no-brainer. But, the fact that someone wants to sell is not necessarily a good reason to buy. People businesses are inevitably about people. Changing the structure, culture and business model of such a business is fraught with challenge. So, it is too early to tell whether the listed law firm model will succeed and if it does whether it will justify the current valuations. Caveat emptor.

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