Legal Sector Breakfast Briefing

Newcastle
25 January 2023

Working with The Law Society

Armstrong Watson®
Accountants, Business & Financial Advisers

Legal Sector Breakfast Briefing

Welcome & Introduction

Andy Poole, Corporate Finance Partner - Legal Sector
Armstrong Watson

Legal Sector Breakfast Briefing

8.00am	-	Arrival and breakfast
8.30am	-	Welcome
8.35am	-	Briefing
9.30am	-	Q & A
10.00am	-	Close

Tackling today's industry challenges

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Who we are

1. We can increase your profits by 5-15% of turnover in 12-24 months
2. We guarantee to improve your customer service, costs, cash and risk
3. You gain a competitive advantage and an investment in your team

"They rolled up their sleeves and were impressive at sensitively challenging the scope we set and finding alternative approaches when challenges appeared during delivery. They have helped us deliver cost savings, and improved our visibility and control of key risks."
CFO
UK Top 50 law firm

"Feedback from across the business on their approach and output was excellent, including from our Executive Leadership Team."
Managing Director
Consumer Legal Services

The next 60 minutes

1. The importance of marginal gains
2. Cost of acquisition
3. Direct costs
4. Reducing indirect costs and losses
5. Exploding some market myths with data

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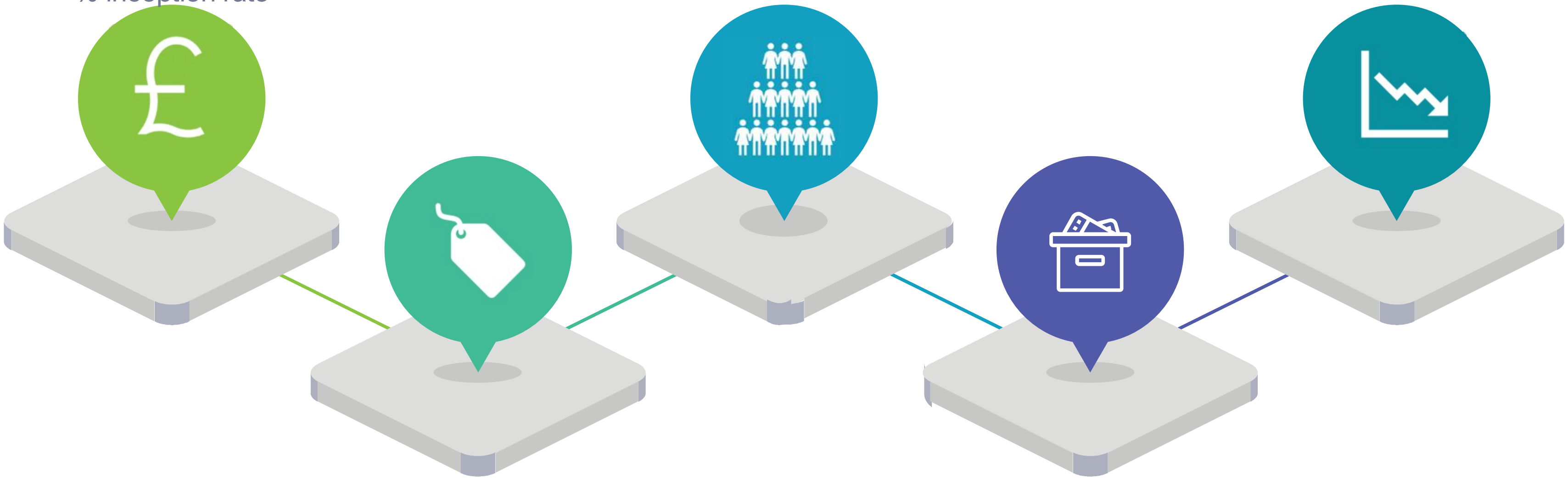
Margin or Cost Improvement

Case volume
No of enquiries
Cost per enquiry
% inception rate

Direct costs
Fee earner and support costs

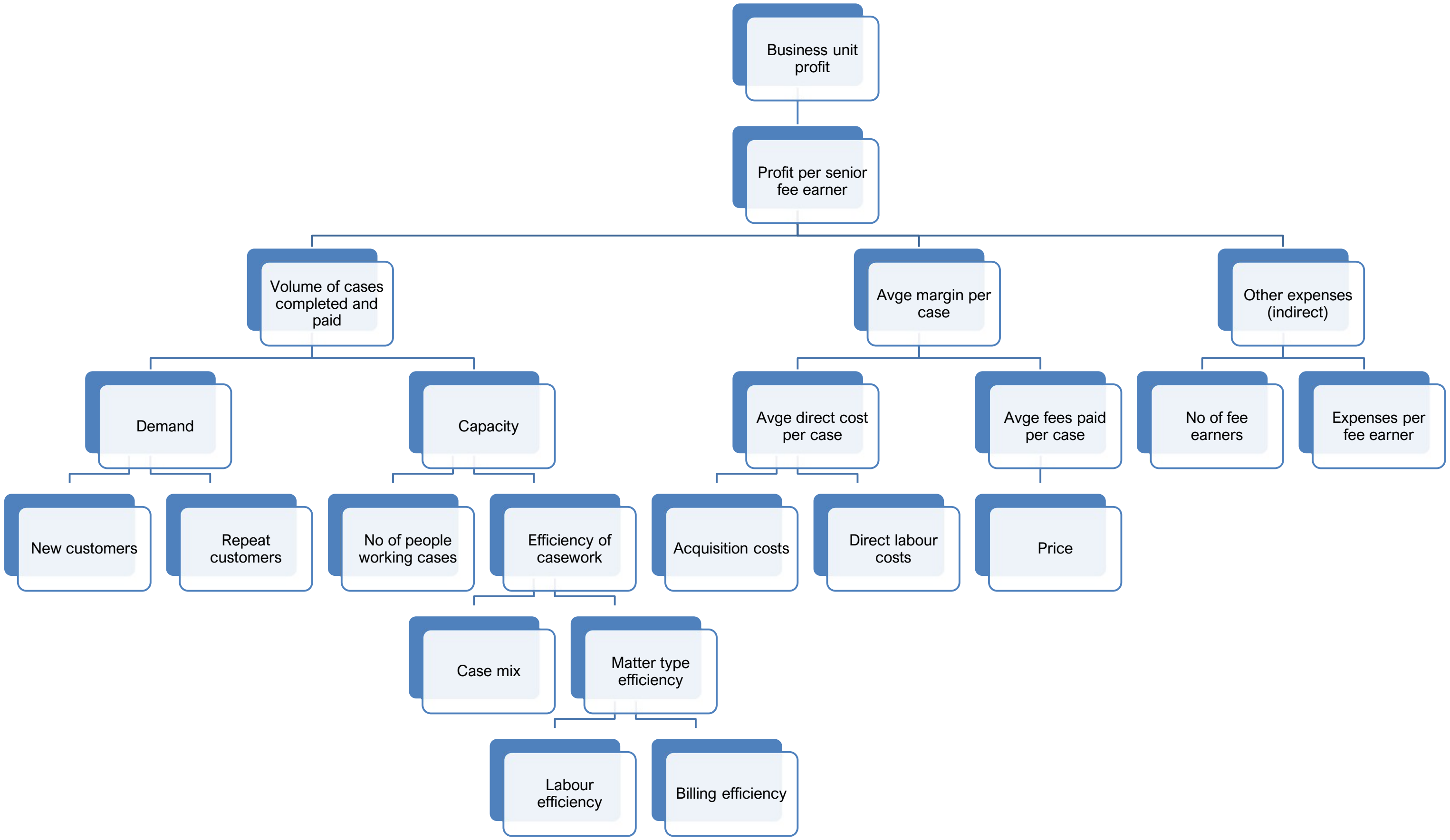
Losses
WIP write-off
Duplicate disbursement payments
Uninsured losses



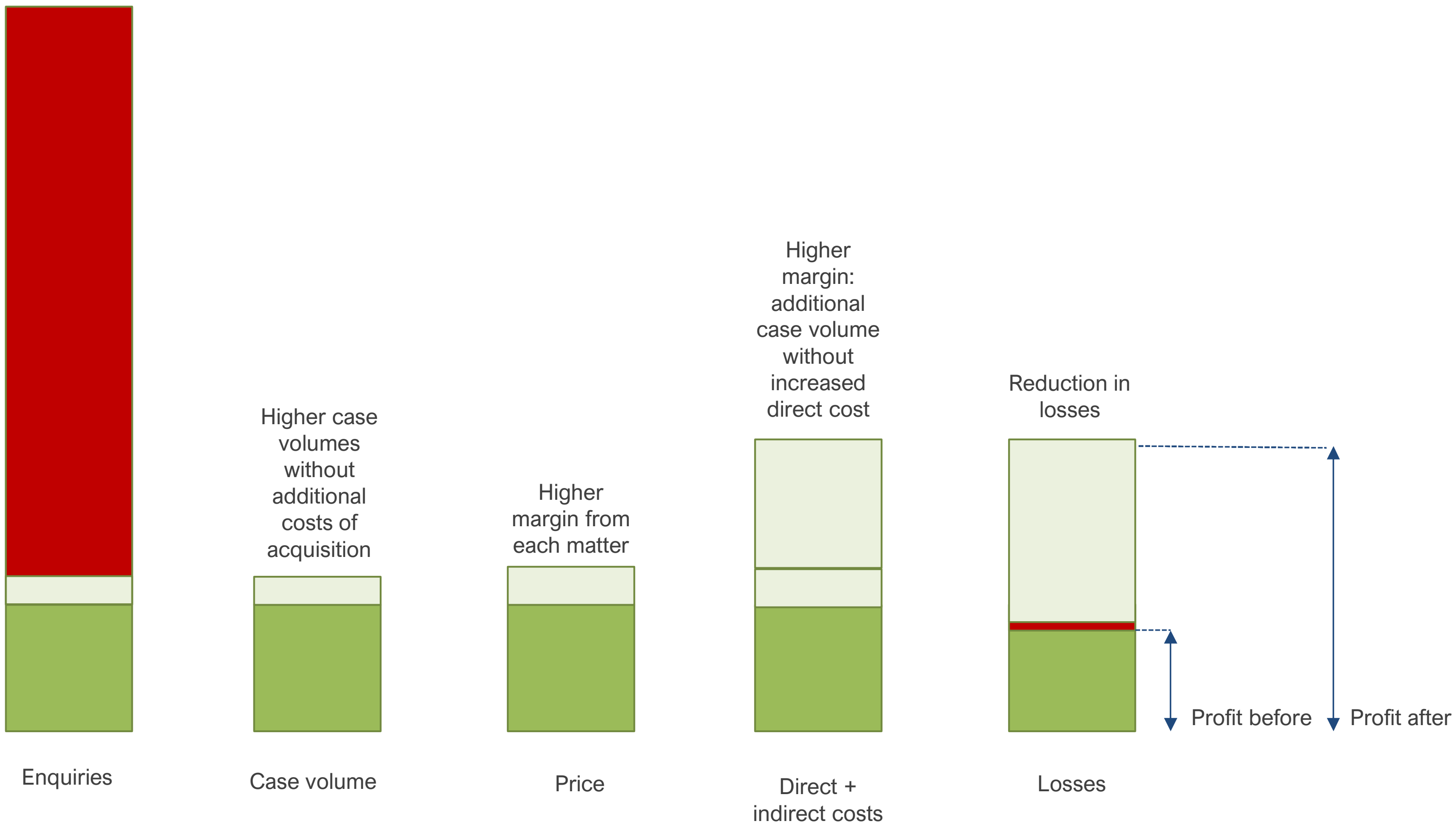
Pricing
Price point
Payment terms

Indirect (admin costs)
Everything else

The firm needs to understand the causes of performance



Marginal gains can lead to big improvements in cost and profit



ACQUISITION COSTS

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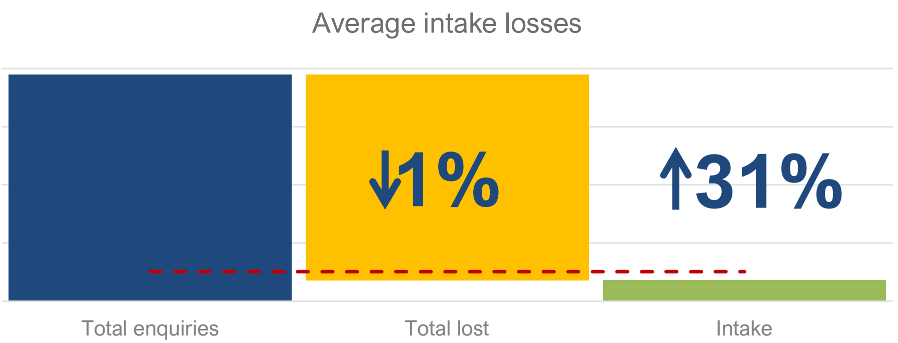
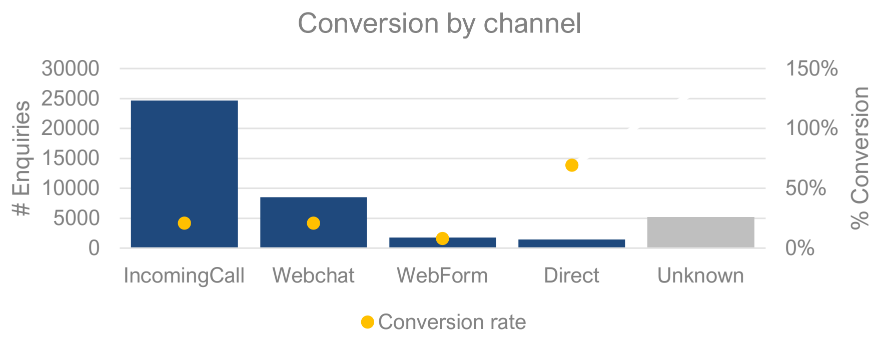
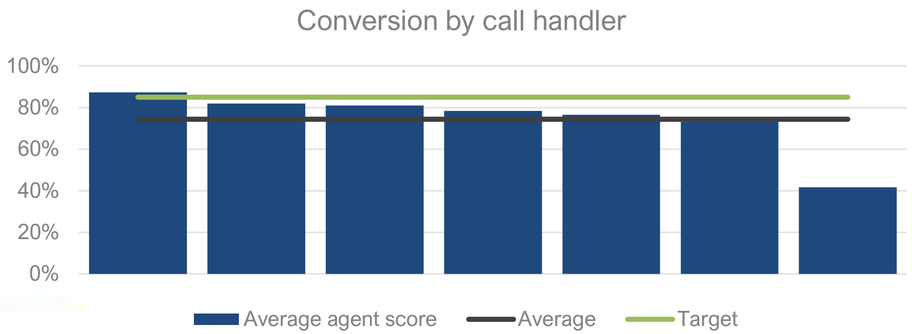
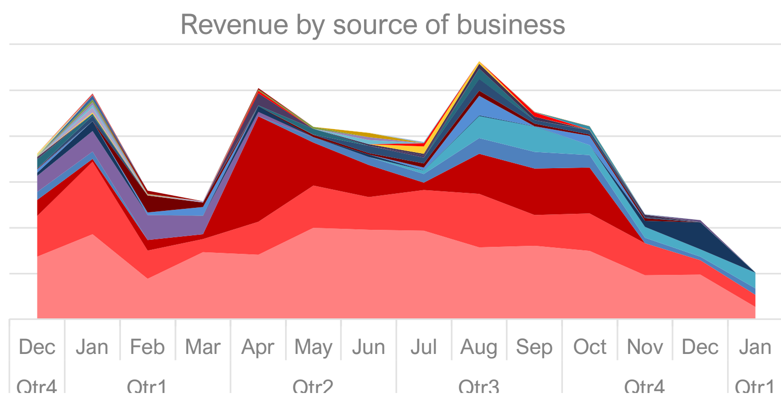
You have more control over client intake than you think



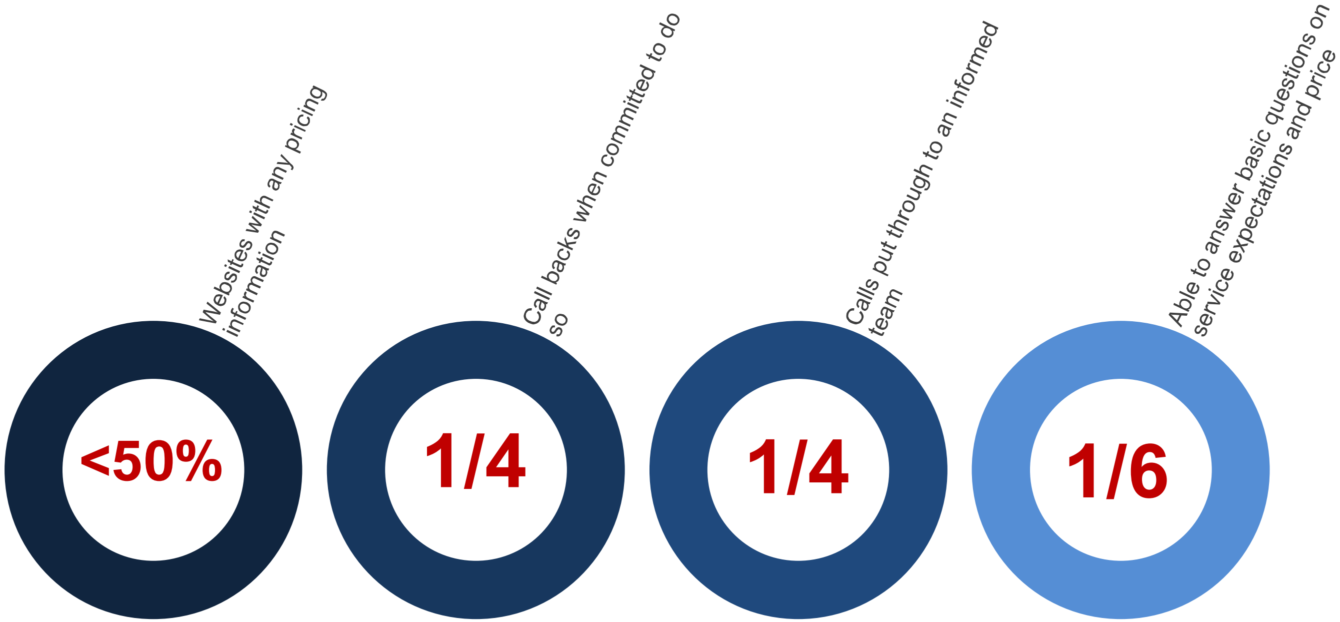






Get customers at zero cost by responding to enquiries

- 23% of customers shop around for legal services
- Secret shopping data gathered from top five and bottom five consumer law firms by Trustpilot score
- Personal injury
- Residential conveyancing
- Wills



Deliver consistent customer service at scale

Effective standards and processes → Spot and address issues early → Resolution and recovery → Continuous improvement

1 Effective customer service standards and processes

- Understand your customers’ expectations in detail
- Build your SLAs and processes around these
- Make your people aware, and incentivise them to deliver
- Check expectations are being met with data and monitoring

2 Spot and address any deviation from excellent early on

- Flag predictable lapses in service early,
- Train and empower staff to recover minor slips
- Be available to customers and provide timely, accurate information

3 Resolution and recovery of any complaints

- Follow best practice for complaint resolution (quick, bespoke, empathetic)
- Go above and beyond
- Resolve public complaints openly

4 Embed continuous performance improvement

- Understand and measure the drivers of performance
- Diagnose issues to root cause
- Review with action in mind
- Ensure time and skills for taking action
- Check expected changes in performance are delivered

DIRECT COSTS

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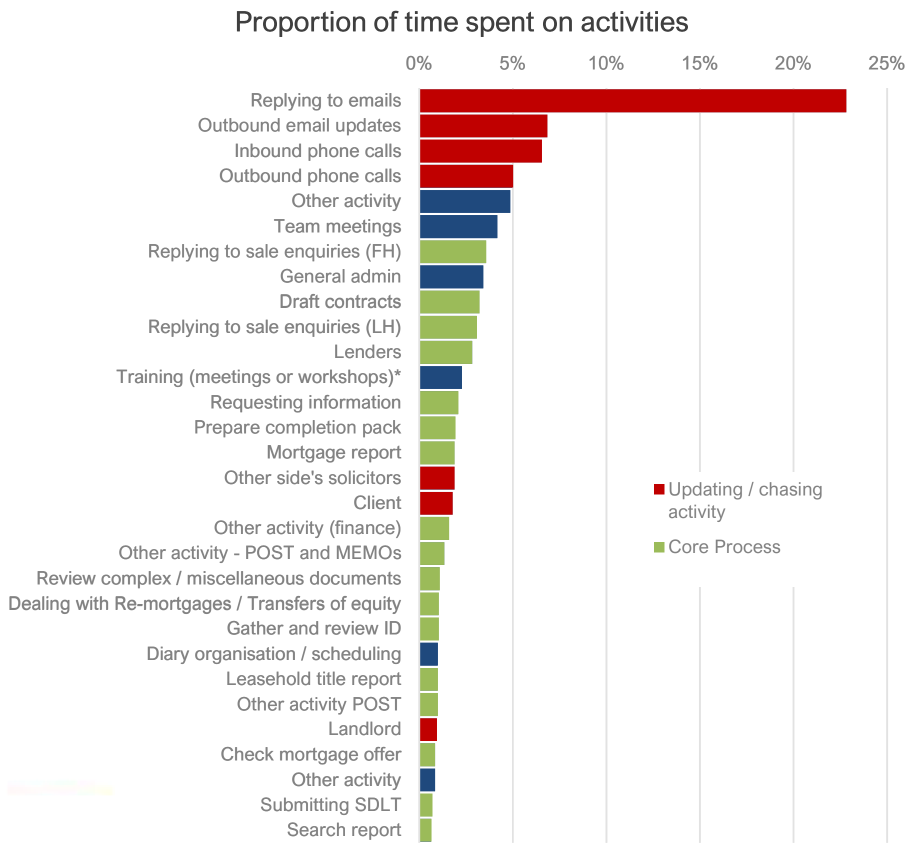
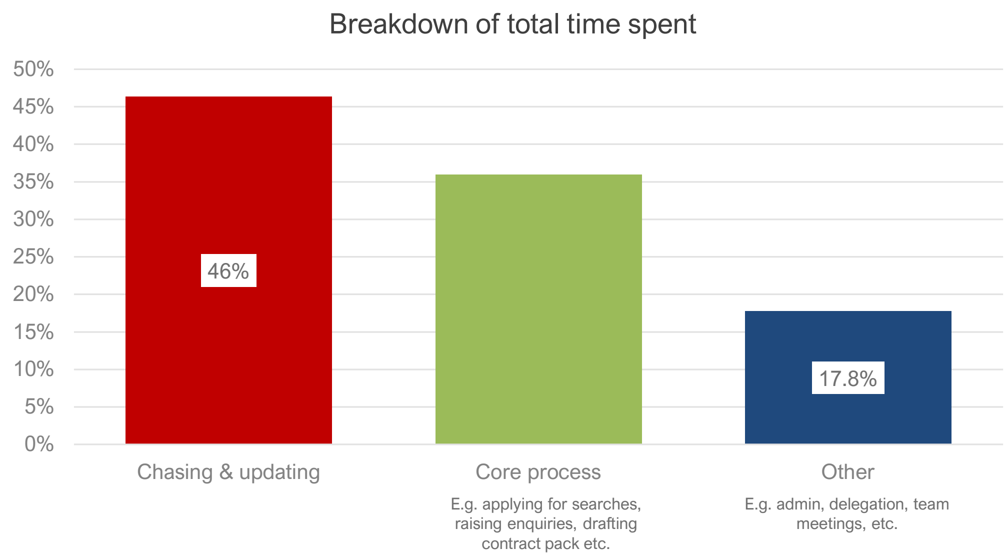
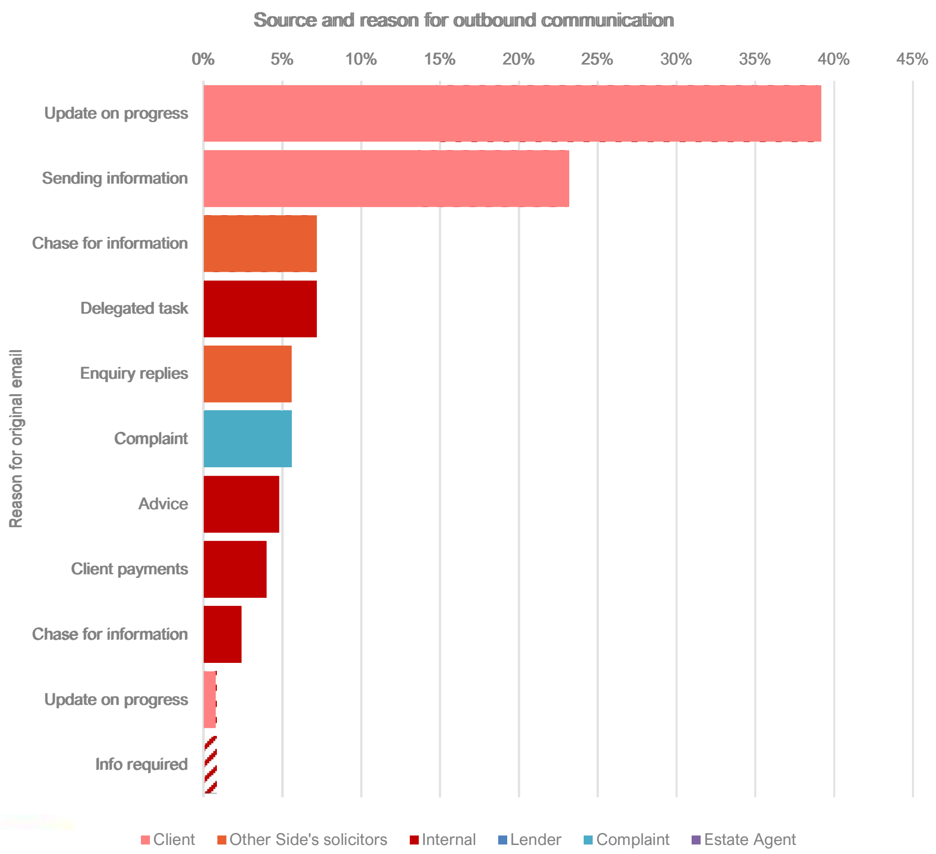
Understand where the time goes





Fix the biggest issues in sequence



- Client-update templates
- Automated requests for information and chasers
- Portal updates and automated emails
- Recovers 42% of time spent on outbound communication
- This saved 20% of staff time
- This allows 20% more cases to be processed without any increase in fee earner costs

…but understand and manage the complexity

Complex content
Case updates
Bespoke advice
Interpretation of technical documents

Unambiguous content
Discovery process
Progress updates
Appointment booking
Financial and billing

Emotive content
Court + tribunal outcomes
Complaints
Delays and increased costs

Suitability for automation

Suitable for automation

Unsuitable for automation

Delegate wherever possible

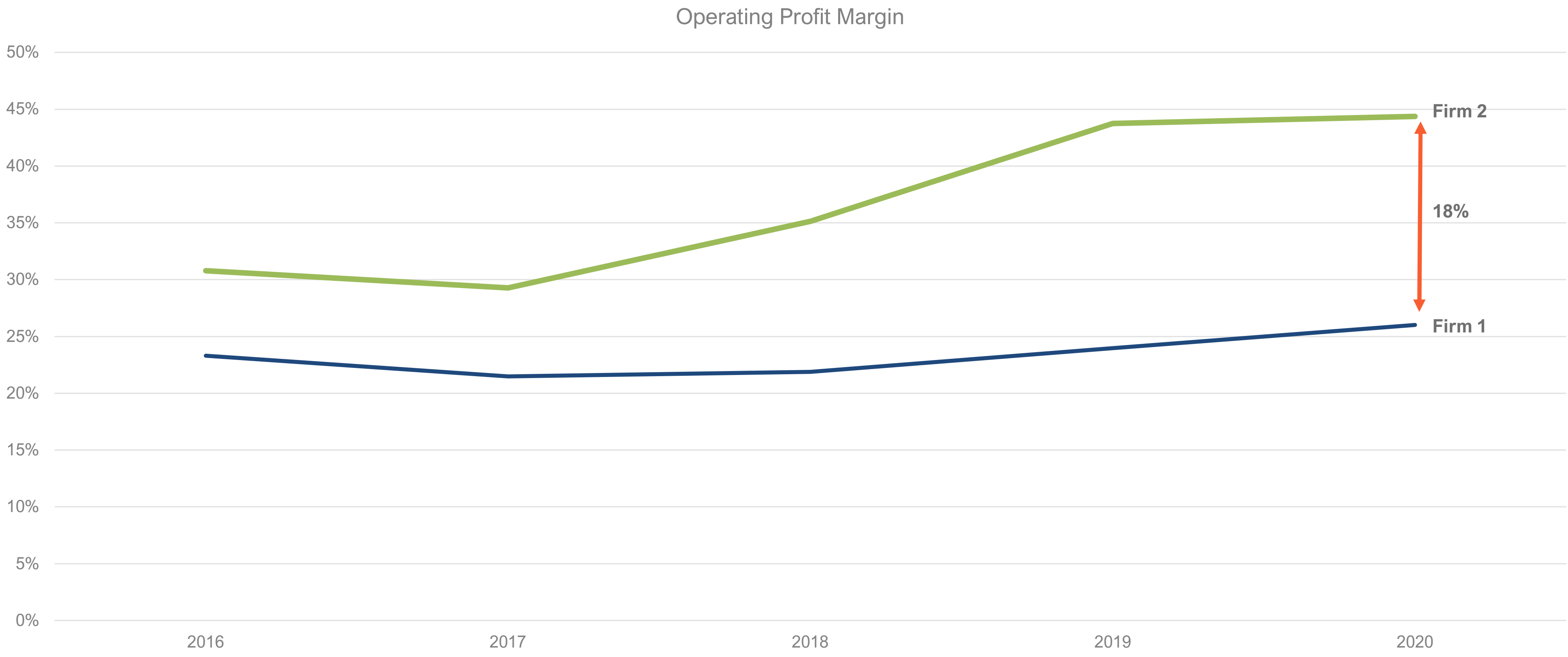
63%

The amount of fee earner time that could be delegated

Task	Can it be delegated?	Who to?	time (FTE)
Delegating tasks / management / supervision	Y	Team Leader	0.15
Other activity - approving payments	Y	Team Leader	0.1
Team meetings	N	Solicitor	0.79
Other activity	N	Solicitor	0.54
Review complex / miscellaneous documents	N	Solicitor	0.42
Other activity (finance)	N		
General admin	N		
Leasehold title report	N		
Training (meetings or workshops)*	N		
Review Leasehold title check	N		
Waiting for step to run	N		
Diary organisation / scheduling	N		
Check replies to enquiries	Y		
Review Freehold title check	Y		
Draft completion statement	Y		
Freehold title report	Y		
Replying to sale enquiries (LH)	Y		
Review Source & proof of funds	Y		
Search report	Y		
Check Searches	Y		
Replying to sale enquiries (FH)	Y		

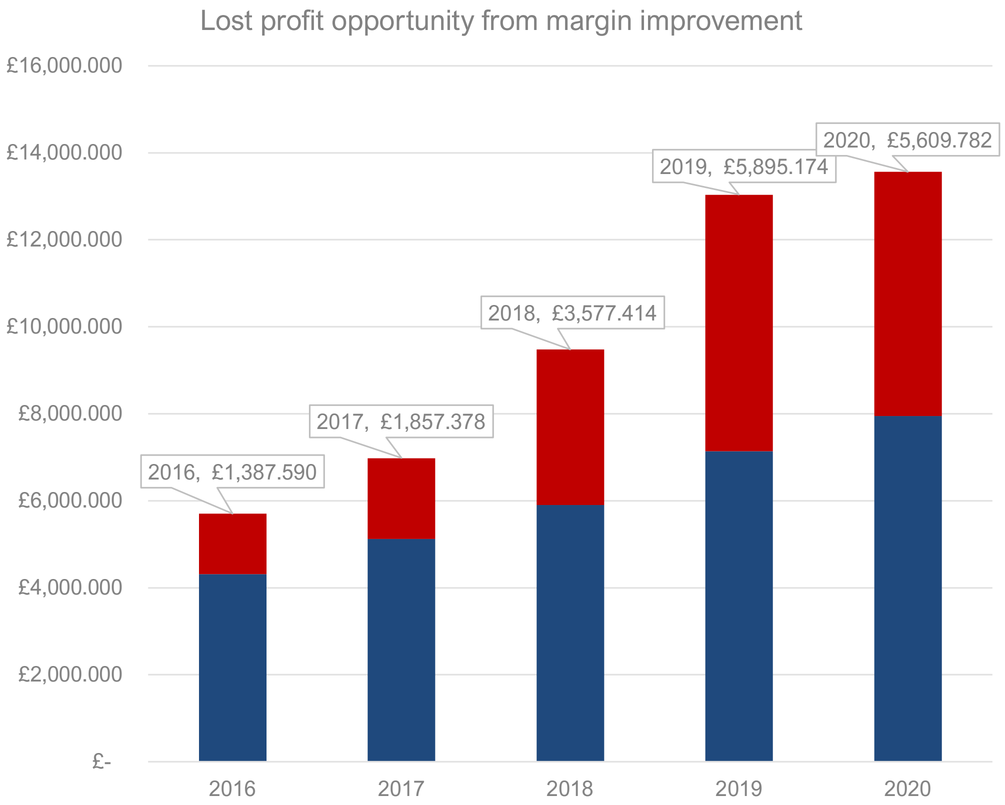
Task	Can it be delegated?	Who to?	Time (FTE)
Mortgage report	Y	L1 or L2	0.25
Check mortgage offer	Y	L1 or L2	0.15
Draft contracts	Y	L1	0.11
Gather and review ID	Y	L1	0.06
Submitting SDLT	Y	L1	0.06
Review Proof of ID & Address	Y	L1	0.06
Running milestones	Y	L1	0.06
Chasing Other side's solicitors	Y	L1	0.04
Completion letters	Y	L1	0.02
Requesting information	Y	L1	0.02
Replying to emails	Y	Paralegal - all levels	3.01
Outbound phone calls	Y	Paralegal - all levels	0.69
Outbound email updates	Y	Paralegal - all levels	0.65
Inbound phone calls	Y	Paralegal - all levels	0.29
Dealing with other client issues / queries	Y	Paralegal - all levels	0.06
Other activity - dealing with completions	Y	Paralegal - all levels	0.04
Rework due to system crashes	Y	Paralegal - all levels	0.02

Staff capacity and effectiveness matters



Source: Statutory annual accounts published at Companies House

The impact on the bottom line is significant for firm 1

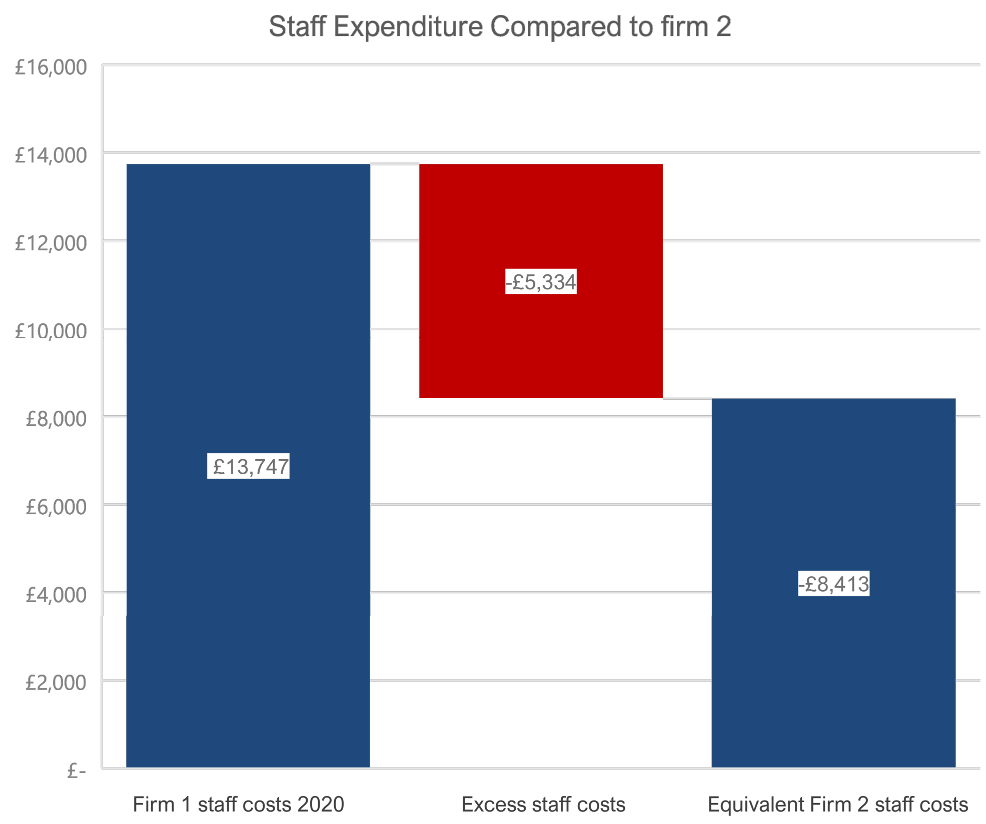


£18.3M

The profits sacrificed through lower margins over 5 years

Source: Statutory annual accounts published at Companies House

Staff costs are the cause of the difference

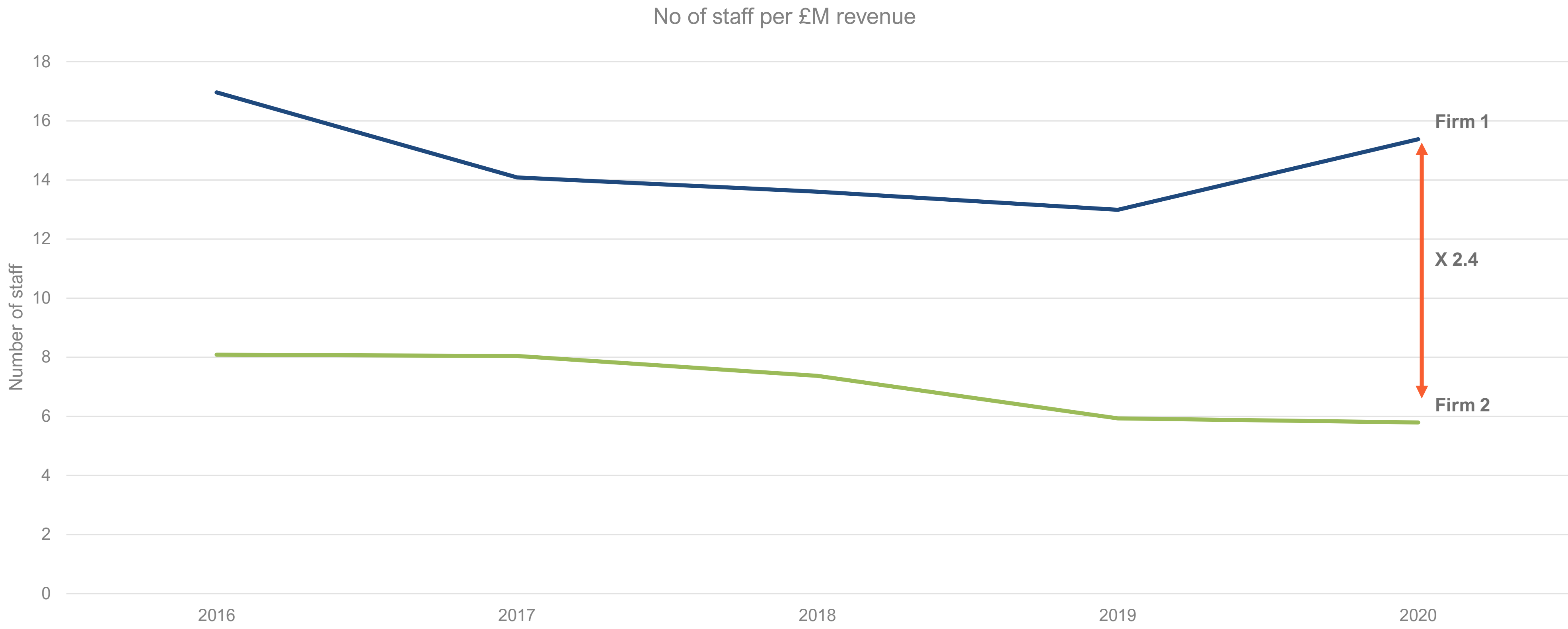


95%

The proportion of the difference in profitability explained by staff costs

Source: Statutory annual accounts published at Companies House

Firm 1 has 2.4 times as many staff per unit revenue



Source: Statutory annual accounts published at Companies House

INDIRECT COSTS AND LOSSES

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Indirect costs

Example Projects

Cost

- Finance process automation
- Finance process redesign to reduce duplicate payments

£700k savings

Cash-Lock up

- Payment terms amended in line with industry standard
- Improvements to billing processes

£2.5m cash release

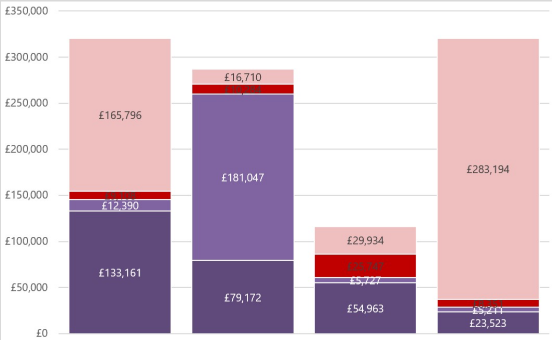
Risk

- Introduce key dates, ATE funding and limitation management
- Introduce risk governance framework and policies

£750k reduction in uninsured losses

Losses

All fee, complaint, and disbursement write-offs and remediation costs were quantified



Example Opportunity: Design out customer complaints

Most common words for customers rating positively:

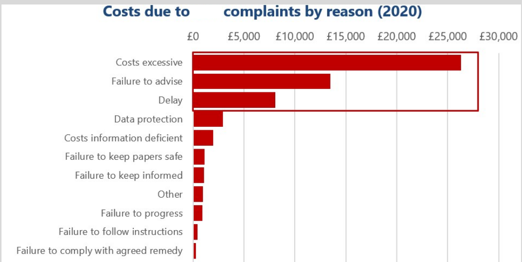
Support
Advice
Explained
Knowledgeable
Empathy
Professionalism

Most common words for customers rating negatively:

Phone
Email
Communication
Informed
Updated
Response

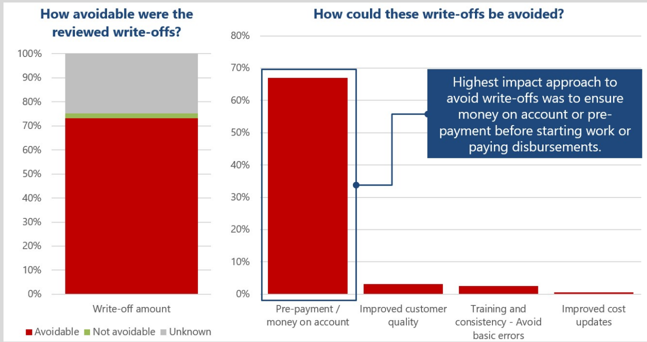
- 80% of all negative feedback coming from one practice area

Example Opportunity: Addressing remediation costs



- Payment terms
- Standardised client comms
- Improved tracking of case progress

Example Opportunity: Resolving write-offs



EXPLODING SOME MYTHS

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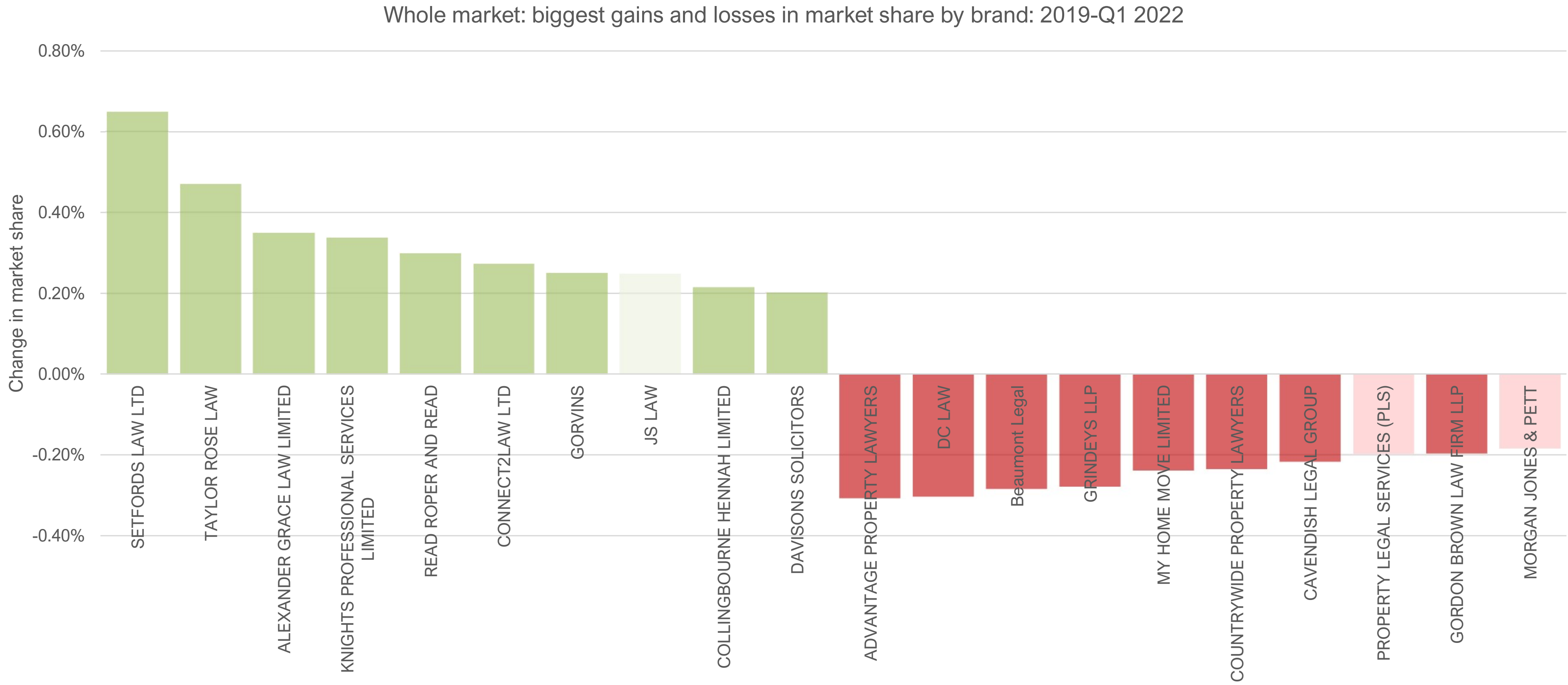
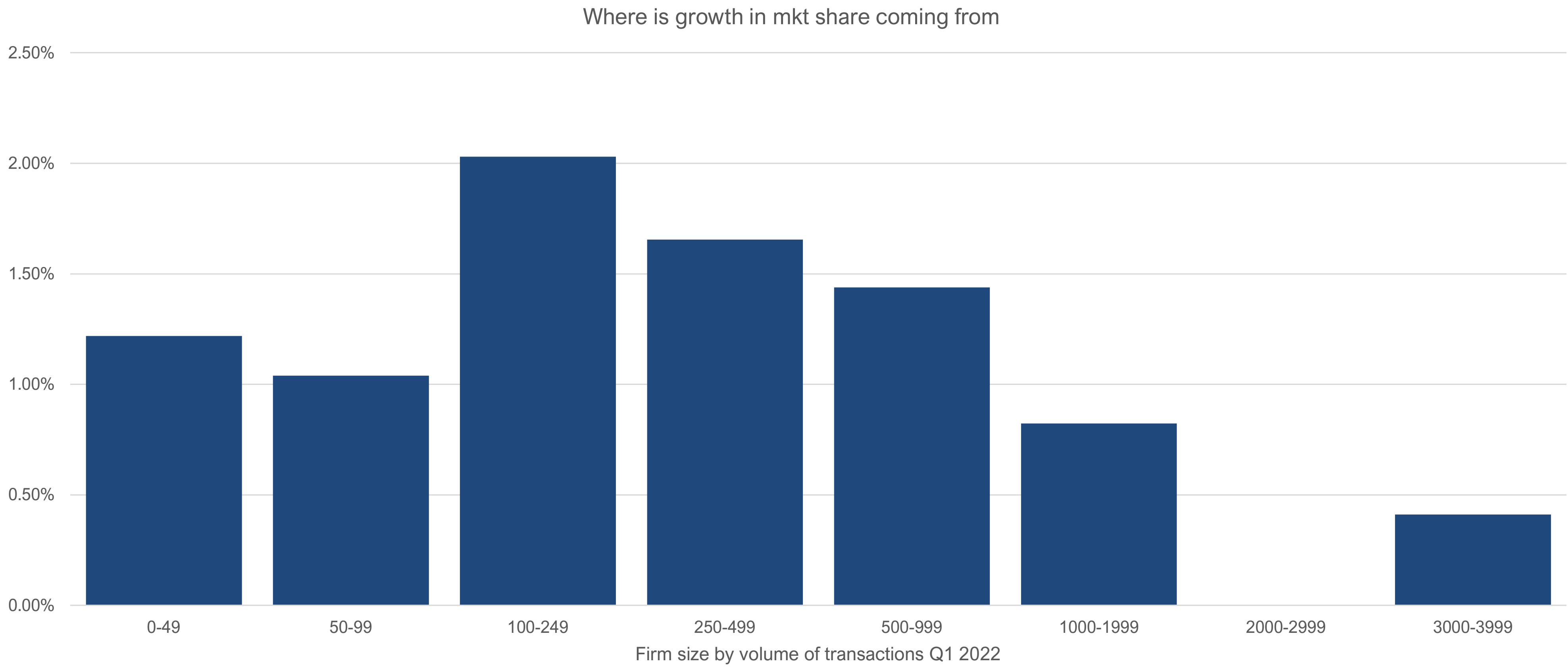
Results Delivered

Organic growth drives gains, corporate ownership drives losses



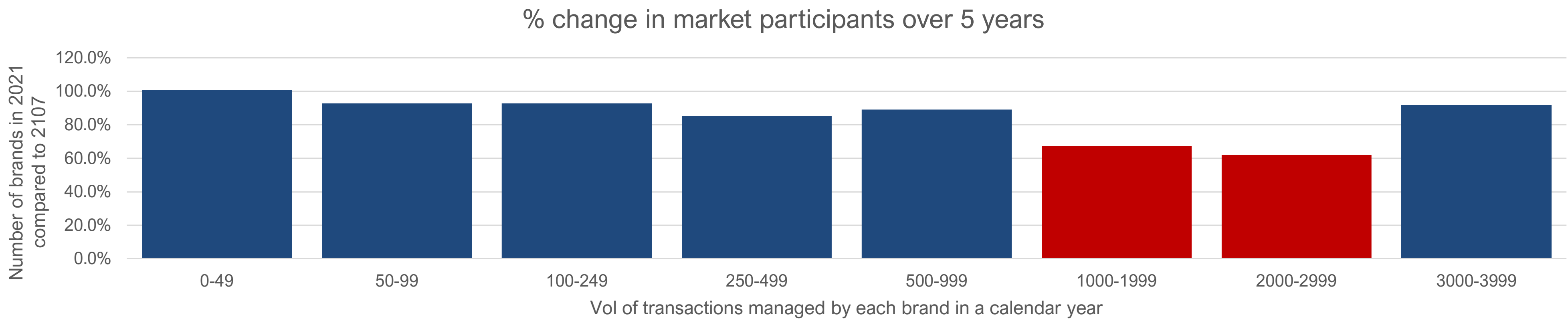
Sources: Land Registry; Transaction data; Number and types of applications by all account customers; monthly date from Jan2017-Mar 2022: https://use-land-property-data.service.gov.uk/datasets/td/download
Companies House: Persons with Significant Control: https://find-and-update.company-information.service.gov.uk/

Size is no barrier to superior performance



Source: Land Registry; Transaction data; Number and types of applications by all account customers; monthly date from Jan2017-Mar 2022: https://use-land-property-data.service.gov.uk/datasets/td/download

Consolidation hits the mid-market hardest but remains insignificant



3.1%

Market share of Palamon Capital Partners brands:
(biggest market participant by volume)

Sources: Land Registry; Transaction data; Number and types of applications by all account customers; monthly date from Jan2017-Mar 2022: https://use-land-property-data.service.gov.uk/datasets/td/download
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External capital and consolidation is not an immediate threat

PE CONSOLIDATOR/CONGLOMERATE

DESCRIPTION: Private Equity Partnerships seeking to buy firms operating in the same market to achieve scale and efficiency and link them with other firms that provide complimentary services.

Representative firms included:
- Palamon Capital Partners
- Inflexion Private Equity

OWNER MANAGED

DESCRIPTION: Regardless of corporate structure a firm in which the owners of the business are principally engaged in the day-to-day activities of the firm:

Representative firms included:
•Read Roper and Read
•Gorvins
•Ison Harrison
•Talbots Law Limited
- JMW Solicitors LLP
- Birchall Blackburn
- Shoosmiths
- Property Legal Services

CORPORATE CONGLOMERATE

DESCRIPTION: A firm operating within a group structure in which other firms serve complimentary services

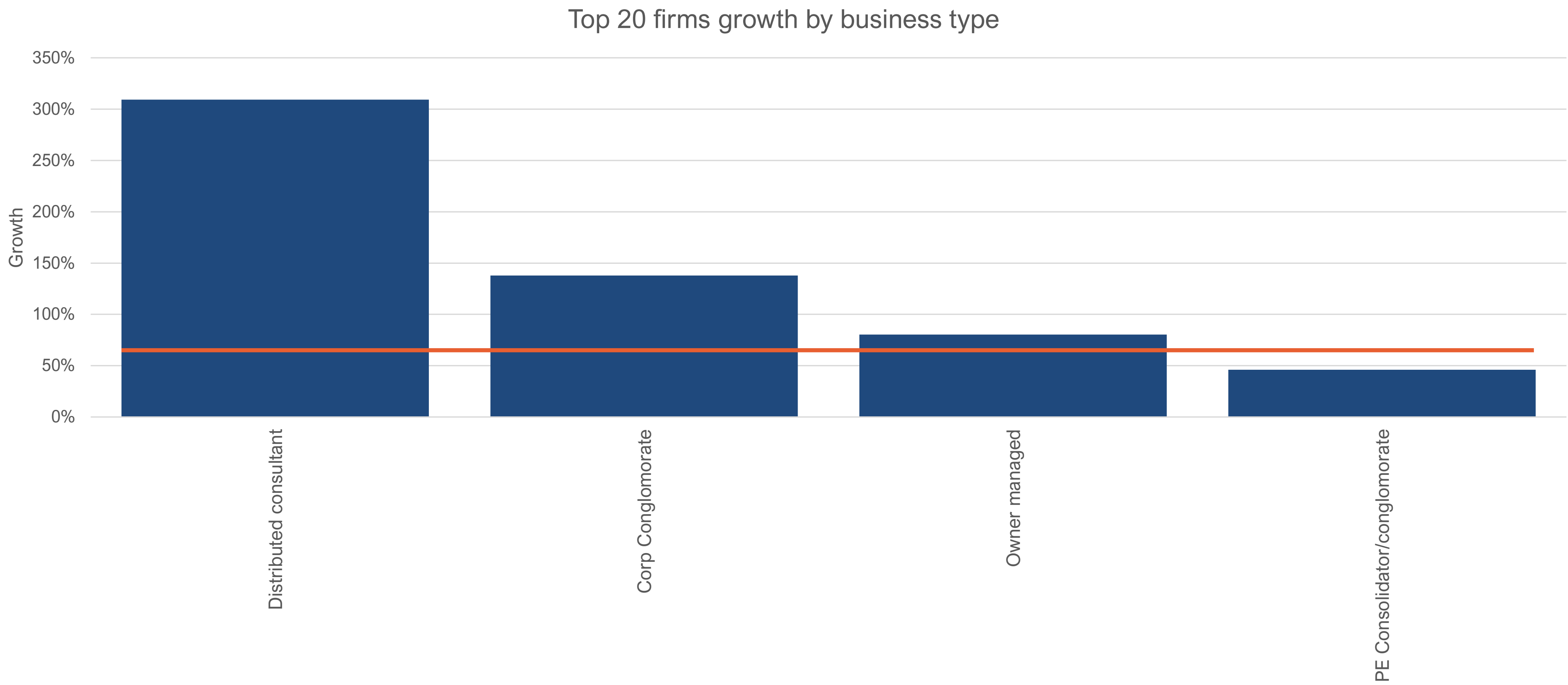
Representative firms included:
•Skipton Holdings Ltd (Countrywide)
•Keenans Estate Agents (Alexander Grace Law Limited)
•Metamorph Group Ltd (Beaumont legal)
•Knights Professional Services Ltd

DISTRIBUTED CONSULTANT

Description: A firm whose delivery is managed in whole or in part by fee earners who are engaged as consultants rather than employees and whose growth is principally driven organically than through acquisition:

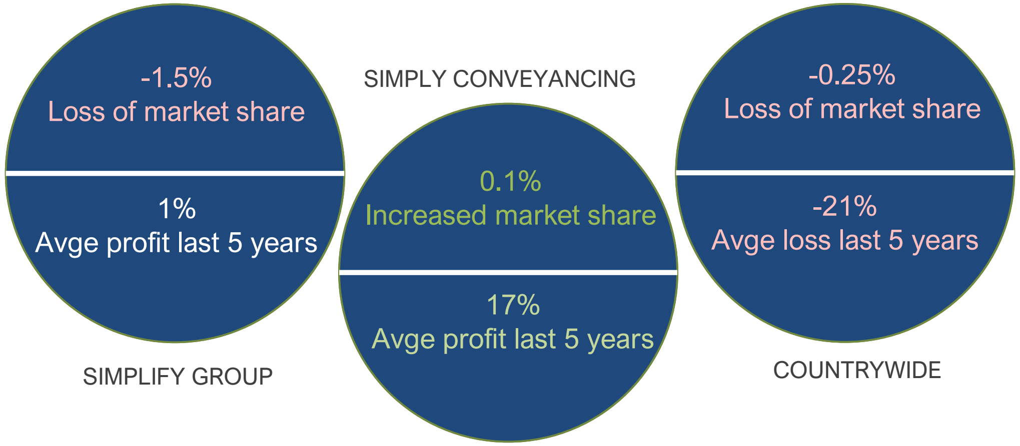
Representative firms included:
•Setfords (Owned by Phoenix Equity Partners)
•Taylor Rose

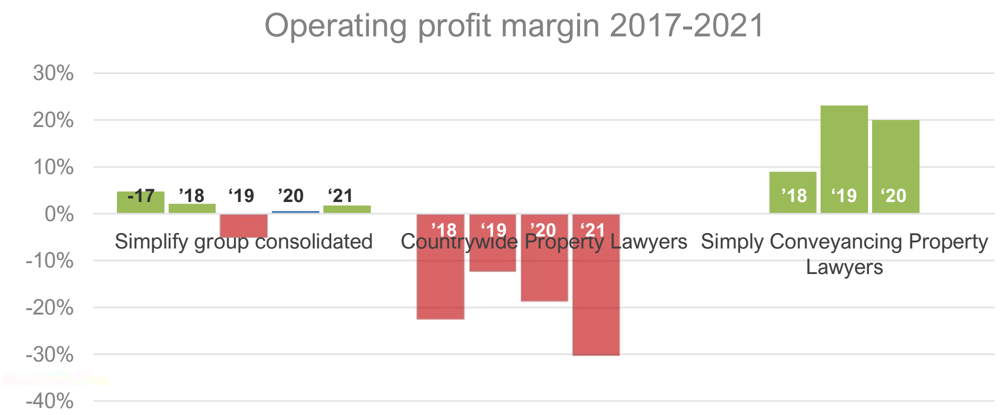
Distributed consultants are growing most rapidly



Source: Land Registry; Transaction data; Number and types of applications by all account customers; monthly date from Jan2017-Mar 2022: https://use-land-property-data.service.gov.uk/datasets/td/download

PE consolidators and conglomerates are not yet adding value





Palamon Capital Partners LP: Simplify group:

Palamon Capital Partners originally invested in the sector in Aug 2014 and made a number of relevant acquisitions in 2016/17 to drive the scale and breadth of services offered. Typically a Private Equity investment would expect to see positive growth and profitability by year 2/3 and to exit its investment in year 5. Its portfolio of Residential Conveyancing firms was making lower profits in 2021 than they were in 2017 and they have not averaged more than a 2% operating profit since that time. The stated strategy of the group is to achieve growth through M&A activity and organic growth and achieve economies of scale through the use of best-in-class technology, diversified customer and channel mix and a national footprint.

Livingbridge: Simply Conveyancing Property Lawyers

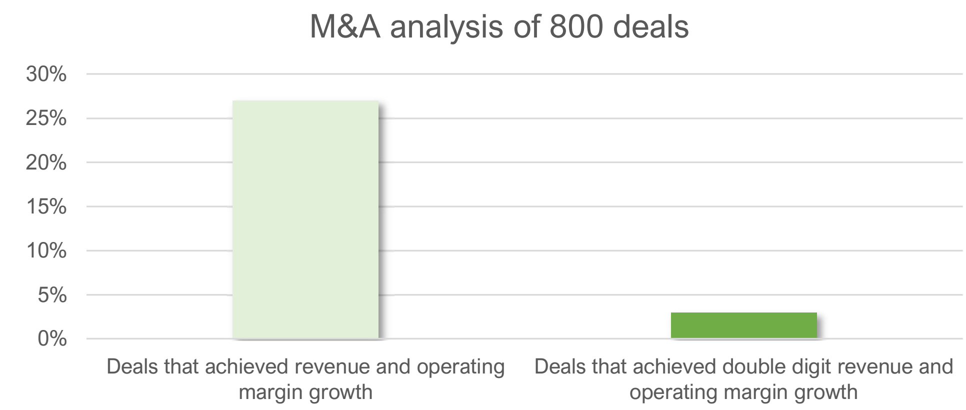
Simply Conveyancing have achieved and maintained an operating profit margin of 20% or more by focussing on investments in technology and process, but this was achieved before Livingbridge invested in July 2019. Their stated strategy has been to invest further in their proprietary platform, eConvey and they have recently grown with the acquisition of Pirie Palmann in October 2021

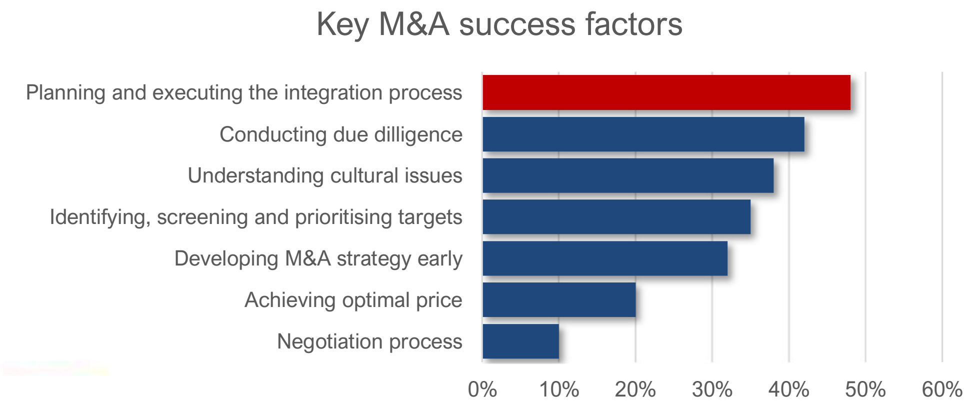
Skipton Group: Connells Group: Countrywide Property Lawyers

Countrywide group was bought as part of the Connells Group by Skipton in March 2021 and so it is too early to assess the impact of the purchase on the performance of Countrywide property lawyers. It should be noted that the conveyancing practice has been part of Countrywide Group since 2016 since when it has made continuous losses within the context of a profitable group. It's current owners; Skipton Group consider Connells Group a complimentary offering to existing lending services focussed on the Countrywide brand and branch network rather than on the conveyancing business

Sources: Land Registry; Transaction data; Number and types of applications by all account customers; monthly date from Jan2017-Mar 2022: https://use-land-property-data.service.gov.uk/datasets/td/download
Companies House: Persons with Significant Control: https://find-and-update.company-information.service.gov.uk/
Companies House: Transaction history/Statement of Accounts 2017-2021 where available: https://find-and-update.company-information.service.gov.uk/

M&A is more difficult than it looks





"More value is destroyed by acquisitions than any other single action taken by companies."

Aswath Damadoran; Stern School of Business, 2012

Only a quarter of M&A deals deliver revenue and operating margin growth and only 3% deliver double-digit growth. These figures have not changed significantly since the 1990's*.

Despite the low success rate, the strategy remains popular, given its allure of rapid growth and profitability and the expectation by participants that their deal will be the exception to the rule.

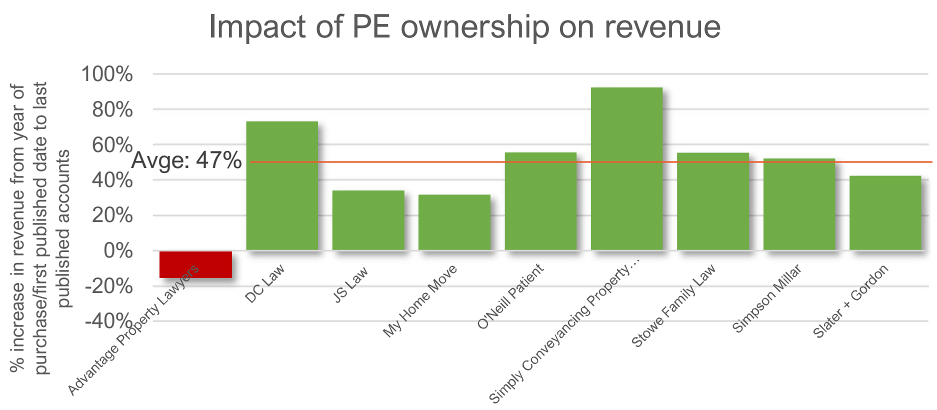
When surveyed in retrospect, management teams across industries report that planning and the effective implementation of the integration process is the most significant factor impacting the success or otherwise of a transaction.

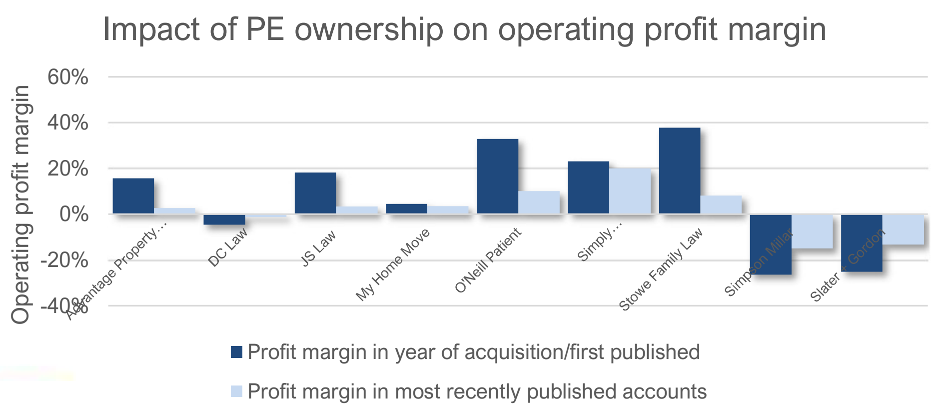
From our own experience, it is also the element through which any shortcomings in other areas of the deal can be best mitigated.

Source: top graphic: Accenture Strategy; Analysis of 800 global M&A transactions; https://www.accenture.com/gr-en/insights/strategy/coronavirus-mergers-acquisitions-value
Source bottom graphic: Accenture and Economist Intelligence Unit; Global M&A survey

* Tetenbaum, 1999, "Beating the odds of merger and acquisition failure, Seven key practices that improve the chance for expected integration and synergies." Organisational dynamics, 28(2), pp22-36

PE ownership grows revenues but reduces profitability





PE ownership focussed on consolidation has resulted in a significant growth in revenues in all but one legal services firm as described in the top graphic opposite.

The average of 47% increase in revenue from point of purchase or closest available datum is a reflection of consolidation activity, growth in the conveyancing market that underpins the majority of these firms business models and the use of relatively well understood industry levers for deploying capital to business development and marketing activity to achieve growth.

The firms studied have not enjoyed the same success at growing margins. None of the firms studied has a positive and increased operating profit margin in their most recently published results compared to when they were acquired, as shown in the bottom graphic opposite. DC Law, Simpson Millar and Slater+Gordon are making proportionally smaller operating losses than they were when acquired, which may reflect PE focus on rapid cost control post acquisition and the divestiture of loss-making business units, but given the length of PE involvement in each of these firms, published results would be expected to more favourable at this point in the deal lifecycle.

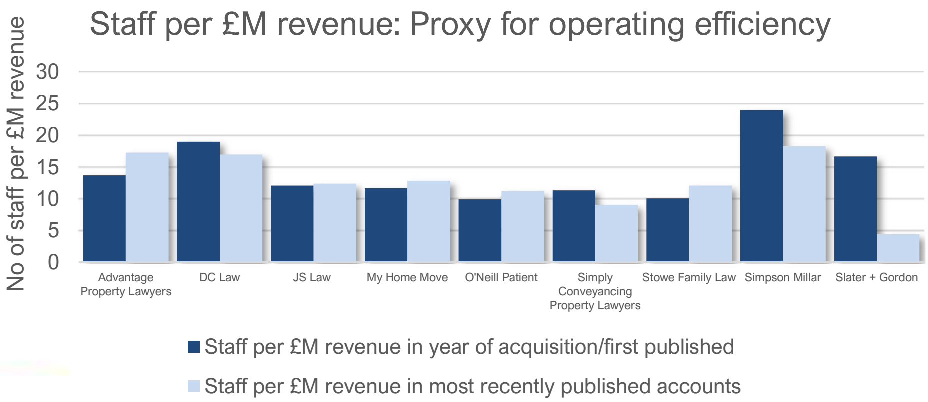
We note reference to COVID disruption and the investment in WIP relating to Personal Injury cases in the industry press as reasons why these firms are yet to demonstrate profitability, however, in the majority of cases, the figures stated include Financial Year 2021 results which were strong* across the industry. Given the length of PE ownership of Simpson Millar and Slater+Gordon, it is increasingly unlikely that continued losses can be explained by Work In Progress yet to be monetised.

Source: top graphic: Statutory accounts; Companies House: https://find-and-update.company-information.service.gov.uk/
Source bottom graphic: Statutory accounts; Companies House: https://find-and-update.company-information.service.gov.uk

*Law Society, Law Management Section, Financial Benchmarking Survey 2022 Report: https://communities.lawsociety.org.uk/Uploads/v/h/g/lmsfinancialbenchmarkingsurvey2022_664819.pdf

Economies of scale and synergies are rarely achieved

> *"While the idea that many costs will largely stay the same as two companies combined is alluring, it's also far more difficult to achieve in practice than most managers are willing to admit."*
>
> Kison Patel, CEO and Founder of DealRoom



One way of getting insight into whether legal firms are achieving synergies and economies of scale is to look at how their level of staffing changes over time. If a firm is able to effectively combine back-office functions, streamline process, and deploy technology to reduce workloads, then we should expect to see that less labour is needed for a given volume of work.

In the bottom graphic opposite this is calculated by presenting the number of staff employed to service each £1M of revenue. The results are striking.

Less than half of the firms studied are using less staff per unit revenue than they were at the point of acquisition. For the majority, who are employing relatively higher proportions of staff they now need 14% more labour to deliver an equivalent unit of revenue than pre-deal, evidence of the diseconomies prevalent in the majority of sector acquisitions.

The minority of firms that are delivering work more efficiently have made significant gains averaging a 33% improvement in the ratio of staff to revenue. As we have described on the previous page, this has not resulted in improved margins which we will account for later in this report.

Source bottom graphic: Statutory accounts; Companies House: https://find-and-update.company-information.service.gov.uk

The most common challenges in post merger integration

Benefits planning and management
- Synergies are over-estimated
- Benefits are double-counted
- Disbenefits are not acknowledged
- Change is rushed

Effective governance
- Lack of clarity on synergies and the levers to achieve them
- Lack of clarity on the sequencing of activity required to deliver benefits at max pace and at lowest risk
- Lack of visibility and focus on the KPI's and milestones to achieve them

Change management
- Lack of focus on soft elements during due diligence and integration planning
- Lack of skills to effectively diagnose and take effective action to create an effective team

External factors
- Unforeseen factors invalidate the deal strategy
- Unanticipated events increase time to value
- Unanticipated events reduce size of benefits available

The graphic opposite summarises the key themes that underpin our experience of the challenges of Post Merger Integration. These can best be brought to light with practical examples from the legal sector:

Benefits planning and management: During integration planning a systems implementation was identified to have the potential to reduce costs in core-operations. A separate project initiated elsewhere in the business identified an opportunity to restructure fee earning teams and introduce a new way of working to save time and resources. The two projects were incompatible as the system changes were not consistent with the new way of working proposed by the second project and both projects had double-counted related workforce efficiencies that could only be delivered once.

Effective governance: In an effort to turn around a loss making business at speed 37 projects were initiated across the firm. Although the firm had a Projects Board no effective prioritisation or coordination of effort was made resulting in slow or no progress from projects competing for internal resources. Projects with competing aims destroyed value by, for example, reducing head-count in customer acquisition teams while efforts were made elsewhere to improve customer conversion by routing more enquiries to the team. Burnout and attrition amongst staff also increased to over 20% per annum. The firm's financial performance did not improve.

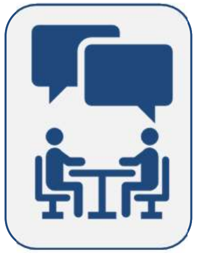
Change management : Post integration, changes to supervision practices were imposed on fee earners from the acquired firm, which many objected to on the basis they were unnecessary and restricted autonomy. This practice was however an essential failsafe to prevent missed key dates and limitations in the acquiring firm who did not have the robust protocols built into systems that had been in use in the legacy system retired by the acquisition. The result was higher staff attrition but also an increase in insured and uninsured claims against the firm over time.

External factors: A firm with a significant Personal Injury Practice saw an opportunity to invest in proprietary technology to manage OIC portal claims following changes in regulation. The technology was developed and books of business identified to achieve the scale required to justify the investment. In practice OIC volumes were 30-40% less than anticipated and continue to fall, creating a loss making business and destroying value.

Summary

1 The importance of marginal gains

- Marginal gains across the matter lifecycle can have a big impact on costs and profits
- This is especially true when improved conversion of enquiries can be combined with improved fee earner productivity to service additional work at no/low cost
- There are usually significant time and customer service losses in how we communicate with clients



2 Market consolidation and growth

- Consumer law remains viable for firms of all sizes
- Organic growth remains the most reliable way to scale
- PE firms and consolidators have yet to show they add value
- Market consolidation is limited and is driven by external capital and legislative change, not economies of scale and tech investment
- Watch the future of the Distributed Consultant model more closely than M&A deals
- M&A is a more difficult way to grow and should not be considered without previous successful experience or specialist support

3 Top tips

1. A modern law firm is built and managed on data, use it to understand where your improvement focus should be
2. Understand where the time in your firm goes and how to improve the effectiveness of your internal and external communications
3. Organic growth is the least risky approach, pursue other options with care and expert guidance

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Legal Sector Breakfast Briefing

Questions & Conclusion

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