

# Mergers & Acquisitions - what to look out for

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# Mergers & Acquisitions

## - what to look out for

- Why merge/acquire/sell?
- The merger process
- The sellers perspective
  - Grooming the business
  - Appropriate structures
- The buyers perspective
- Due diligence
- Taxation issues
- Practice valuations
- Cultural issues
- ➡ Regulatory and Risk perspective



# Why merge, acquire or sell?

## - the drivers

- Retirement/succession
- Legal Services Act
- Legal aid reform
- Personal injury reform
- Difficult trading conditions
- Regulatory reform



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# The Merger Process

- Starting point – look at your own firm
  - SWOT analysis
    - Strengths/Weaknesses
    - Opportunities/Threats
    - Staff Contributions
  - Benchmarking information
    - Armstrong Watson Survey
    - LMS Survey



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# Armstrong Watson Benchmarking

- Less than six partners
  - Net profit per equity partner £78,345
  - Fee income per equity partner £244,500
- Six or more partners
  - Net profit per equity partner £123,563
  - Fee income per equity partner £438,151
- Detailed benchmarking review available



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# The Merger Process

- Starting point – look at your own firm cont...
  - Identify key objectives – partners as individuals and firm as a whole
  - Business planning – e.g. working capital requirements
  - Client needs – how this may change
  - Staff and resources review



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# The Merger Process

- If the partners' objectives cannot be met by other means then the merger/acquisition should be explored
- External review
  - What are the key features required, scale, location, client base, work types?
  - Identify firms meeting these criteria
  - What are your competitors doing in this marketplace?
  - Plan vision for the future practice – work out what you want to buy/sell and the post merger vision
- Start the process – draw up a shortlist of firms to approach and agree it among partners



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# The Merger Process

- Make the approach
- Confidentiality agreements
- Identify the deal breakers and Heads of Terms
- Due diligence
- Deal evaluation
  - Consider results of due diligence
  - Review against key objectives
  - Discuss with key stakeholders
- Post merger business planning



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# The Sellers Perspective

- Grooming the business
  - Same issues whether wanting a complete sale, a merger or to attract external investment
  - Make the business attractive
  - Get your house in order – don't get caught in a fire sale
    - Accounting records/management systems
    - Old debt/WIP
    - Taxation compliance
  - Accounting policies
  - Business plans
    - Projections
    - Operational matters
    - Management



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# The Sellers Perspective

- Grooming the business cont.
  - Timing – income profiles and profit trends
  - Strong profit track record coupled with demonstrable future growth
  - Build market share and critical mass
  - Not dependent on partners
  - Leverage
  - Systems and IT



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# The Sellers Perspective

- Grooming the business cont.
  - Structure
    - Partnership?
    - LLP?
    - Limited Company?
    - Who selling to?
    - Separate parts of business into different entities?
    - Hybrid structures?



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# The Buyers Perspective – due diligence

- Areas of operations to review will include:
  - Fees
  - Other financial information
  - Risk
  - Staff
  - IT systems
  - Governance
  - Legal due diligence



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# Due Diligence

- Fees
  - Client base
  - Average fees per client
  - Average fees per partner
  - Average fees per fee earner
  
- Trends and projections
- Departments



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# Due Diligence

- Other financial information
  - Analysis of historic results
  - Analysis of projected future results
  - Profitability by department
  - Profitability by partner
  - Accounting policies
  - Net assets
  - WIP
    - Valuation method
    - Recoverability
    - Success rates



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# Due Diligence

- Other financial information cont.
  - Contingencies and commitments
  - Partner annuities, loans and capital/current accounts



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# Due Diligence

- Risk
  - Work types
  - Quality control procedures
  - SRA visits
  - SAR reports
  - Claims history
  - PII Insurance premium



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# Due Diligence

- Staff
  - Numbers
  - Departments
  - Ratios
  - Structure
  - Salary rates
  - Qualifications
  - Status
  - Training



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# Due Diligence

- IT systems
  - Information
  - Compatibility
- Governance
  - Partnership agreement
- Legal due diligence
  - Client confidentiality



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# The Merger Process

- Business planning will be essential and cover the following areas:
  - New practice trading structure
  - Governance arrangements, managing partner/management team/chief executive. Drafting new documentation to support the business
  - How to retain “old” arrangements for future partner retirement, dealing with inconsistencies between the firms
  - Future partner terms



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# The Merger Process

- Business planning will be essential and cover the following areas cont:
  - Financial modelling, important to demonstrate key areas of future practice, namely cashflow requirements and partner profit share arrangements
  - Property arrangements, in case of merger to quickly establish to the outside world “one firm”



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# Taxation Issues

- Compliance – transfer of VAT and PAYE
- Merger – continuation of business and no overlap relief crystallisation
- Acquisition/Sale – cessation of retiring partners and overlap relief claimed
- Different status for different partners
- CGT issues with disposal of goodwill
- Opportunities to consider
  - Trading as a company/hybrid



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# Options

- Larger practice taking on small practice
  - consolidators?
- Merger of two similar sized practices
- External investment/ownership



Merger or Acquisition?



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# Merger

- Rare to see a pure merger
- No payments
- No goodwill
- Work in progress and debtors paid as collected
- Agree profit sharing ratios



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# Acquisition

- Acquiring a practice (or share) at an agreed value
- Paid for in cash
- Paid for in shares?
- Potential deferred payment
  - Retention of clients?
- Valuation based on profitability or fee ratio
- Pay for net assets plus uplift for goodwill
- Pure valuation of practice



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# Practice Valuations

- Value of any investment is the sum of future economic benefits at today's value
- Professional service firms – focus on goodwill
- Subjectivity
- Valuation: use of multiples is common



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# Practice Valuations - Issues

- Roles of partners in post merger firm
- Work types
- Projections – maintainable earnings
- Property
- WIP valuations



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# Practice Valuations - Issues

- Value multiples
  - Client base
  - Staff
  - Systems
  - Services
  - Distribution
  - Position/brand
  - Scale
- But – already reflected in profit?



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# Practice Valuations

Value to acquiring practice:

- Consider integration costs, such as redundancy or lease break clauses
- Must look forward to what expected change in their own results may be, for example:
  - Synergies will vary
  - Former partners taken on consultancy basis, or retiring after first year
  - Support staff spare capacity?
  - Fee earners fully occupied with work coming from existing sources?



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# Cultural Issues

- A definition of culture:

“A set of beliefs, values and assumptions that are shared within a group”

“the way we do things around here”



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# Cultural Issues

- A cultural mismatch is just as dangerous as a strategic mismatch....
- Never analysed in as much depth
- Understanding your own culture is a major step to identifying the potential for cultural compatibility



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# Cultural Issues

- Culture is learned over time
- New people join and become absorbed into this culture
- Putting two firms together is likely to lead to at least some incompatibility
- How realistic is it to talk of creating a “new culture” post merger?



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# Cultural Issues

- Examine the culture in both organisations
- Don't assume that similarity in systems means cultural similarity
- Think of cultural adaptation rather than cultural change
- Think about blending cultural elements from each firm



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# Cultural Harmony

- Explore the attitude and behaviour of the people
- Culture is often ignored – tight timetables
- Use outside help
- Identify at least some cultural harmony at the outset



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# Cultural Post Merger

- Accept that deep seated cultural beliefs will never change in the short term
- Focus on the positive aspects of the combined firm's culture
- Don't trumpet "new values"
  - Implied the old ones lacked merit



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# Regulatory and risk perspective

- Financial due diligence
- Projections
- Taxation
- Legal due diligence
- Quality marks
- Supervision procedures
- Merging the teams
- Changing processes
- Claims records/PII premiums
- Registering with/approval from the SRA



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# How Armstrong Watson can help

- General support, advice and management of the process
- Finding targets
- Brokering the deal
- Practice valuations
- Due diligence
- Merger checklists



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# Summary

- Legal service market
- Identify strategic goals
- Does merger fit with strategy?
- Planning the process
- The sellers perspective
- Grooming the business
- Appropriate structure
- The buyers perspective
- Due diligence
- Practice valuations
- Cultural issues
- Regulatory and risk perspective



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