Attempts to float law firms on the London Stock Exchange have had limited success

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# Private equity — the latest financing revolution for legal firms

## Some experts claim that cash injections into law practices are building valuable businesses, but others caution that selling such companies can be tricky

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Eighteen-year-old reforms that were meant to usher in a rush of stock exchange listings for legal services businesses can only be described as a damp squib.

Of the six firms that have floated since the Legal Services Act 2007 took effect, only three — Gateley, Keystone Law and Knights — remain. And three years ago, what was billed to become the highest profile initial public offering by Mishcon de Reya crashed as the firm pulled its flotation, citing "market conditions".

But now private equity is touted as the latest financing revolution for legal practices. Within the past fortnight, the UK house August Equity invested in Higgs, a law firm in the West Midlands; and two of the City's big legal profession beasts — David Morley and Wim Dejonghe, oversaw a private equity deal involving six Swedish law firms.

Morley and Dejonghe are both former global senior partners at what was the "magic circle" firm, Allen & Overy (A&O), before it merged with a New York practice. They now run a consultancy business that advises on private equity investment in law firms.

Morley disputes suggestions that private equity for law firms is being overhyped and will ultimately go the same way as public listings. Instead, he describes private equity as "a major shift", arguing that "investor appetite has surged" over the past year and that his consultancy has "spoken" to 50-plus investment houses and "dozens of law firms of all sizes" since the spring.

But other old hands with experience of private equity in legal services are more cautious. Nigel Savage, a former non-executive director of Fletchers, a firm specialising in personal injury cases that was bought by Sun European Partners four years ago, says that "private equity investment has been very successful in the consumer sector by putting cash into firms to make them more valuable, whereas partner models tend to focus on extracting funds out of the firm in partner drawings".

Savage notes that Fletchers has grown revenues between 30 and 40 per cent annually since the sale by investing all the cash they have generated with a "small amount" of debt.

But Savage warns that he is “not convinced such growth can be applied to the business-to-business sector. Consumer law firms have a large number of individual cases and more diverse sources of work, making them less risky to invest in, whereas corporate firms are dependent on a narrower set of relationships held by rainmakers, who want to take their share of the value and are pretty mobile.”

Other experts are even more cautious. “Right now, it feels like a gold rush without any goldmines,” says Jeff Zindani, the managing director of Acquira Professional Services, a merger and acquisition broker for law firms.

Zindani argues that private equity-backed firms “risk becoming stranded assets — over-leveraged, operationally flat and unattractive to buyers”. And he warns that any high-profile failures are likely to trigger a harsh gaze from regulators — “especially where high debt threatens client protection”.

The magic formula behind private equity deals generally is the “buy-to-build” model, which relies on doubling the purchase price and then selling. But exiting — selling — can be tricky, and, Zindani says, “law firms, with their partnership structures and cultural resistance, are even harder”.

But somewhat predictably, Morley remains buoyant. He argues that private equity investment has “transformed” a cross-section of professional services, including veterinary practices, accountancy and architect firms as well as restructuring consultancies.

“The legal sector stands alone as the largest and most profitable” but still mostly untouched professional field, the former A&O boss says. He maintains that UK law firms “have been open to outside capital for a decade, but early IPO attempts were cautionary tales. Now, those old stigmas are fading, private equity buyers bring a smarter approach than IPOs, and consolidation is a mega-trend across all professional services — firms need capital for mergers and acquisitions, technology and talent in a fiercely competitive market.”

Hywel Pegler, a partner at RSM UK, a tax and audit consultancy, agrees that private equity activity in the legal profession will continue, adding that it is particularly attractive for “mid-market” practices.

It will be “too hard for some firms to ignore”, Pegler adds, “particularly those with financial challenges” — and he points to some successful recent private equity “exits” in the accountancy profession that “produced very strong multiple values on exit, and therefore to some extent prove the concept can work”.

And private equity is by no means the only source of capital “circling UK law firms”, says Zindani, who points to other investors, including family offices, sovereign wealth funds and individuals being “in the mix”.

Nonetheless, Zindani points out that his business’s private equity tracker provides ballast to those who argue for caution around private equity. The research shows that while last year’s deal value stood at £534 million; this year so far it has not even reached a quarter of that figure. Traditional mergers and acquisitions in the legal market “still dwarfs private equity”, Zindani says.

Although he adds that “what is shifting is the scale of interest”. Larger funds, particularly those from technology backgrounds, are “beginning to scan the UK top 100” law firms, Zindani says.

“That suggests bigger plays ahead in the next 12 months,” he predicts. Which is certainly more than can be said for the IPO market in the law.