

US Law Firm Mergers Will the Pace Continue?

By Ward Bower

The 70 US law firm mergers announced in 2008, a year in which the US was in recession for all four quarters, represent a 17% increase over 2007. As the recession deepened in the first quarter of 2009, 24 additional mergers were announced, up 33% over the 18 announced in the first quarter of 2008.

What's behind this merger mania? First it's actually acquisition mania. The average ratio of size of the larger to smaller firms in 2008-announced mergers was 252 lawyers to 28 lawyers, or 9:1. In the first quarter of 2009 it was 370 to 22, or 17:1. Only six of the 70 mergers in 2008 involved a combination of firms where the smaller firm was over half the size of the larger firm. That was the case in only three of the 24 mergers in the first quarter of 2009. An analysis of 2007 through 2009 law firm merger data seems to suggest there are two phenomena at work here.

One is the defensive merger — smaller firms seeking a “white knight” to acquire them and either ensure their survival (albeit as part of a larger firm) or provide them with greater security in the future — a broader, deeper platform and a larger, more diverse client base. Consider the following chart:

Size of Acquired Firm (as a percentage of all mergers)			
	101+ Lawyers	21 to 100 Lawyers	1 to 20 Lawyers
2007	14%	23%	63%
2008	9%	23%	68%
First Quarter, 2009	4%	13%	83%

The increasing percentages of firms of 1 to 20 lawyers that are being acquired likely reflect an increase in defensive mergers as smaller firms seek security as the recession deepens.

The second phenomenon is the clear trend toward creation of a broader geographic platform by firms pursuing regional, super-regional, national and international geographic

strategies. One strategy in a recessionary economy is to hunker down, cut costs and hope to hold on until the recovery. Another, for firms with a strong capital base and clean balance sheet, is to use an economic downturn as an opportunity to expand geographically and to increase market share. The second chart, below, suggests this is happening now, as mergers involving firms in more than one region of the US increased from 19% of all reported mergers (2008) to 37% in the first quarter of 2009.

Mergers by Region (as a percentage of all mergers)			
	2007	2008	2009
New England	0%	3%	0%
Mid-Atlantic	10%	19%	13%
South	17%	31%	17%
Midwest	13%	17%	17%
West	20%	9%	8%
Multi-Region	28%	19%	37%
Cross-Border	12%	3%	8%

In the first quarter of 2009, there were two mergers reported between US and non-US firms, one in Mexico and one in England. In both cases the US firms (Jones Day and McGuireWoods) were huge in comparison to the firms in Mexico and London (2,500 versus 20 lawyers; 900 versus 36 lawyers, respectively). It is not unusual for cross-border combinations to take the form of acquisition of a much smaller overseas firm by a large firm. This facilitates integration and is less threatening to the larger of the two firms.

Do law firm mergers and acquisitions really work? Most do, but some do not. A 2007 study by Altman Weil examined all combinations involving at least one AmLaw 200 firm (whose fundamental economic data are published) between the years 2000 and 2005 (to allow for post-merger figures to be evaluated). The primary metric examined was profits per

continued on page 4



Ward Bower

US Law Firm Mergers... *continued from page 3*

partner, based on the assumption that rational firms would not do a merger to become less profitable (although some strategic mergers will sacrifice short-term profitability for long-term profit growth). A few findings of the 2007 study:

- 77% of the law firm mergers studied resulted in an increase in profits per partner in the first year post-merger.
- Year on year, profits per partner increased to the point that 94% showed year three to year four increases in profitability.
- The amount of increase in profitability (profit per partner) year on year ranged from 9% in year one to 8% in year five.
- Cumulative 2000 through 2005, the increase in profits per partner of merged firms was 54%, versus a 44% increase for all the AmLaw 200 firms (which included the merged firms).
- Cumulative profitability increases through year three were greatest (32%) for geographic scope mergers (adding new offices) than for practice area scope mergers (adding new practices—28%) or pure scale mergers (increasing depth in existing practice areas and locations—26%). This may help explain the current increases in multiregional and cross-border combinations.

So what do we see in the remainder of 2009 and beyond? First, recession-induced mergers are likely to wane with the recovery. Some economists predict that recovery may begin to happen by third quarter 2009. Others think mid-2010 or even 2011 is more realistic. That is one consideration.

Regardless of the economy, we do not expect the first quarter statistics from MergerLine™ to extend

throughout 2009, which would result in almost 100 mergers. In 2008, only 26 of the 70 merger announcements occurred in the third and fourth quarters. We expect the volume of mergers announced in the second half of 2009 to decrease, as well. We also expect the trend toward acquisition of much smaller firms by larger ones to continue.

One area which is unpredictable is that of cross-border deals. Altman Weil and its London-based strategic alliance partner, Jomati Consultants, are under instructions by firms on both sides of the Atlantic with regard to possible cross-border combinations. Our other international strategic alliance partner, Professional Development Asia, is also seeing an increase in interest by US and UK firms in possible combinations, particularly in China. Cross-border deals are likely to take longer to develop and even where targets are identified, the protagonists may wait to see when the economy recovers and how the current fiscal year turns out before entering into serious merger discussions.

Prediction is risky in a period of unprecedented change. Even a year ago, almost no one predicted the demise and/or nationalization of major international banks, the disappearance of investment banks as we know them, bankruptcy of two of the US Big Three automakers, multibillion dollar government bailouts and stimulus plans, and the demise of major US law firms like Heller Ehrman, Thelen Reid & Priest, Thacher Proffitt & Wood and Wolf Block. Even so, we at Altman Weil predict that merger activity in US law firms will continue throughout 2009 into 2010, but that despite first quarter figures for 2009, we will not see a significant annual increase in the number of US law firm mergers over the 70 announced in 2008. ♦

¹ Data on law firm mergers is from Altman Weil MergerLine™ (www.altmanweil.com/mergerline), an online tracking service that logs all law firm mergers publicly reported that involve at least one US firm. Although 70 mergers were announced in 2008, 66 were effective during the year. The 70 announced included 14 not effective until 2009, but the 60 reported in 2007 included 10 effective in 2008.

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