

## When Evaluating a Merger, Be A Data Whisperer

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As 2014 draws to a close, it's clear that the pace of merger and acquisition discussions remains quite high. The first nine months of 2014 saw deals closing at a higher pace than 2013's high activity level, and the number of ongoing negotiations (some publicly disclosed, most not) continues at extraordinary levels. If we include the many deals that didn't "close" (which, by count, is always far more numerous than the ones that did) it becomes clear that there is a vast amount of due diligence activity occurring in the legal industry right now. What is less clear is whether much of that due diligence results in a proper deal evaluation...particularly given the magnitude, risk and importance of the decision at hand.

When two interested parties start the evaluation process, they usually exchange a small mountain of data. Turning that mountain of data into the proper support for a go/no-go decision to proceed with discussions requires a blend of a) a process to organize the data into a useful format, b) an understanding of how the business of law is translated into metrics, and c) the ability to interpret the data at a sophisticated level...to see the underlying storyline. Absent this ability to let the data "speak to you," you might reach the incorrect conclusion with respect to the viability of your deal.

The process for applying data in an organized manner includes three basic steps:

*1) Organize the data* – After the basic exchange of P&L's, balance sheets, staffing tables, billing records, partner performance metrics, etc., present all of the data in a format that features a side-by-side comparison of the data at a line item level. Data comparability (aka an apples-to-apples comparison) will require some translation and reclassification of expenses. Success requires "data contacts" – someone in each firm who is very familiar with the chart of accounts and can explain the nature of the entries in any given account.

*2) Translate the data into metrics* – Data, in and of itself, is of little value. Comparability between firms of different sizes, for example, isn't valid until the data points are presented on a common basis (e.g., per partner or per lawyer), thus turning the data into information. For example, a revenue comparison between firms of different sizes is meaningless. A revenue per lawyer comparison is, however, valid and very valuable.

Many firms have a small set of metrics that are important to them and are used to measure internal progress year over year. Some of these firms conclude that a reasonable level of comparability on these key statistics suggests that a good deal is at hand. Others dig deeper and produce a laundry list of key metrics that cover every aspect of law firm operations and evaluate each significant variance in a vacuum. While this step is useful, a higher level of work exists that elevates this exercise from a review to an analysis that is an integral part of a due diligence exercise.

*3) Interpret the data* – This is where the experienced deal makers distinguish themselves from the neophytes. Those who know how to do this look at the key statistics en masse, know the relationships between the statistics, follow the data from issue to issue, ask questions, and gain a deep understanding of the underlying storyline. In doing so, they turn information into knowledge. Sound management decisions are based on knowledge...not comparisons and reviews.

For example, two firms can have identical results for revenue per lawyer and profits per equity partner, yet a combination of the two could be a disaster because –

- The work processes – the manner in which each firm generates money and profits (generally – at a firm wide level) – may be completely different. Related metrics include the ratio of non-equity lawyers per equity partner, ratio of administrative staff per lawyer, average timekeeper utilization levels, and realization rates.
- Debt/borrowing/financing philosophies may differ dramatically. Related metrics include the debt to equity ratio, average capital per equity partner, average debt per partner, and other metrics that focus on the total value that an average partner from each side is bringing to the potential deal.
- Relative positions in the evolution of the business of law may be significantly different. Related metrics include technology spending per lawyer, percent of revenue generated under fixed fees, the ratio of cost/pricing/profitability specialists per lawyer, and percent of non-partner track lawyers.

When looking at a transaction that is as important and transformational as a merger, your due diligence needs to be the best that is can possibly be. There are no do-overs once the vote has been taken. Elevate your game well beyond the “we look similar” level. Stare at the data. Ask yourself “why?” often and follow the information to its logical conclusion. This process will tell you about deal-killers that are not identified by a mis-alignment on one particular metric. Examples include a mis-match between the two firms’ cultures, business models, work ethics, compensation philosophies, or many other topics.

This critical level of analysis is possible only if you are willing to listen to the gathered data and the information. Be inquisitive. Be patient. Be open-minded. Be knowledgeable about your firm’s non-negotiable deal points. Be a data whisperer.