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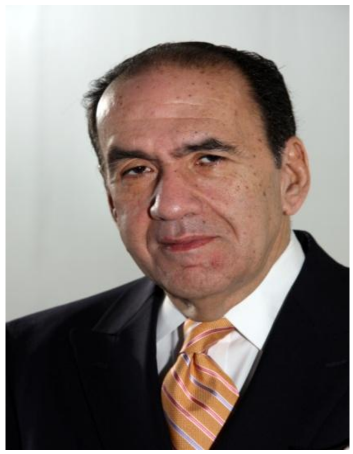

Citibanks' Fourth Quarter Report on Law Firm Profitability: Bleak, But, on the Bright Side, That's As Good As It Gets

Jerome Kowalski

Kowalski & Associates

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Don't have enough to fret about?

Citibanks' report for law firms for the fourth quarter of 2011 is out for and there is little in it that brings cheer. It also gives some us some sense of prescience in that our 2012 forecasts seem to be being realized. Earlier observations on Citibank's third quarter report and its midyear report, all read in sequence, paint a rather unhappy portrait.

Consistent with what we all have all been seeing in recent weeks as law firms begin announcing results for 2011, last year generally saw a barely perceptible rise in revenues (4.1%) and continued rising expenses. The continued escalation on the expense side is of some serious concern as law firm managers continue to devote substantial energy to irradiate an ever metastasizing wave of expenses, with the wave of rising expenses seemingly unstoppable.

Here is some of the other disturbing news:

- Citibank noted that in the second half of 2011, demand for legal services, "**particularly in transactional work, withered away and has yet to bloom again**." In our view, we do not see transactional work flowering soon because of the moribund capital markets, the decline in asset value and the business world's disinclination to take risk in uncertain times.
- The report notes that profits per equity partner at the law firms surveyed rose an average of 3.3% in 2011. However, by hewing to the PPEP artifice, the report does not report how much of this increased profit was derived by de-equitazation, "**shortening of the collection cycle**," expense deferrals or other accounting legerdemain. While Citi did report that "**equity partner head count grew only marginally, reinforcing the view … it has become a lot harder to become an equity partner and remain an equity partner**."
- While hourly rates increased slightly, realizations declined. Of course, that's like the law firm partner who, when asked what his hourly rates are replies "$1,000 an hour when I can get it, but that's rare, otherwise it's $450."
- Headcount grew marginally more than demand, resulting in a decline in productivity.
- In order to get to the modest increase in PPEP, law firms slogged the living daylights out of their accounts receivable. Well, that's good for the take home pay for partners in 2011, but it adds to the challenges of 2012, since both demand is weak and there is less A/R in inventory to turn into cash in the current year.

What does this all mean for the current year? Citi tells us "**all said, not a bad year and we suspect likely to be the new definition of a good year for the legal industry at least for the foreseeable future**." In other words, this is about as good as it gets. By that, could it be that like Jack Nicholson's character, could we find happiness in this somewhat addled state?

Citi is also telling law firms that it's time to trim the herd again in order to increase productivity and realizations. So, I am afraid that we will see another round of layoffs, lateral moves, de-equitizations, and mandatory retirements. If you are a partner in law firm, pay very close attention to how your firm is doing, since there is a strong likelihood that we will sadly see some law firm failures; you need to be prepared and not caught by surprise. And if you are a vendor or service provider to law firms, look for cutbacks and a longer remittance cycle.

Jerry Kowalski is the founder of Kowalski & Associates, a consulting firm serving the legal profession exclusively. Jerry is a regular contributor to a variety of publications and is a frequent (always engaging and often humorous) speaker to a variety of forums. Jerry can be reached at jkowalski@kowalskiassociates.com or at 212 832 9070, Extension 310.