

How to sell or merge your legal practice: Step-by-step guide, including 10 common mistakes to avoid

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Welcome.

If you are thinking of selling or merging your legal practice, reading this booklet is the first important step on what I hope will be a rewarding and successful journey for you. In addition to this booklet, I'll be sending you extra information by email over the next few weeks. These tools will help you plan and prepare for your own successful deal.

Many of my clients have achieved great satisfaction in building profitable practices from humble beginnings, often dealing with challenging circumstances along the way. But the greatest satisfaction for my clients often follows a successful practice sale or merger. A profitable and successful deal is the ultimate reward for hard work and substantial investment.

I have been fortunate to work with many legal practice owners over more than 18 years as a professional services and business lawyer. In my experience, a successful sale or merger relies heavily on preparation and getting small details right. Make sure you don't get caught out.

If you find you have further questions after working through this booklet, I'd like to extend a personal invitation for you to contact me to discuss how I can help you achieve your own successful practice sale or merger.

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Step 1.

WHY do I want to sell or merge?

Asking yourself and answering the 'why' question should be the first step in every legal practice sale or merger process, whether you are a budding entrepreneur looking for the next opportunity or a career practitioner looking for an exit strategy or the next step for your firm.

Asking why you want to sell or merge helps you understand what you are trying to achieve. Setting goals for the sale or merger process helps you remain focused on an outcome that is acceptable to you.

You must be able to convince other key stakeholders involved in your legal practice (for example, other partners, owners, financiers, staff, loyal clients and suppliers), that selling or merging is a good idea. You cannot do this unless you know the answer and can articulate it yourself.

In my experience, these are some of the most common 'why' factors driving legal practice sales and mergers:

'I want to realise the capital value in my legal practice and plan for my retirement'

'I want to secure future employment opportunities for the practice's employees'

'I want to give my senior employees the opportunity to own the practice'

'I have great clients and staff, but financial, regulatory or competitive pressures mean that my practice is at risk of becoming less profitable over time if I don't merge now'

'There are 'cached-up' or larger practices out there which will be interested in buying or merging with my practice'

'I have a unique client service or product offering, but don't have the money needed to grow the practice and make it profitable'

'My competitors want to buy me out'

COMMON MISTAKE #1

Some legal practice owners get overwhelmed by the process and details of the sale/merger, such as how and what they will sell or merge and for what price. They decide early on that it is too hard to sell or merge. They never achieve a successful sale or merger.

They have glossed over the fundamental question of why they want to sell or merge. Asking the why question and setting goals gives legal practice owners the drive and focus to achieve a successful deal.

Step 2.

WHAT do I have to offer?

Potential buyers or merger partners need to be convinced that they are getting value for their money. Many practice owners think that the answer to the question of ‘what do I have to offer?’ is obvious. But you need to ask this question from the perspective of a potential buyer or merger partner – after all, they will be paying you for it or taking on additional responsibilities or liabilities.

In order to quantify what you have to offer to a buyer or merger partner, you need to identify both the tangible and intangible assets of your practice:

- Tangible assets are physical things you can touch. These typically include your debtors and unbilled work in progress, office equipment and premises. They may or may not be of value to a prospective buyer.
- Intangible assets are things that can't be touched but may be quite valuable, such as intellectual property, brand names, client databases, unique practice systems and processes, and practice goodwill. These assets are much harder to value because they often don't have a readily identifiable market price that can be used as a reference point.

Achieving the best possible price for your practice sale or merger outcome will be largely dependent on your ability to identify these intangibles as transferrable assets. You must be able to convince a buyer or merger partner that the perceived value of these intangible

assets will continue for the buyer's benefit or the benefit of the merged firms after the sale/merger.

In my experience, buyers or potential merger partners will ask:

- How loyal are the clients?
- Is there a history of client turnover or disputes?
- Does the practice have client relations or feedback processes in place?
- Is there a systematic process of client relationship management?
- Is the practice overly reliant on a few clients, or is there a broad client base?
- Could any major clients come and go without much warning or are there long-term engagements in place?
- What is the state of the client database?
- Does the practice have positive brand recognition and reputation in the market?
- Is the intellectual property in the brand protected by the usual trade mark registrations?

In the case of many privately owned legal practices, an overriding question is often the extent to which the ‘goodwill’ of the practice is really goodwill that is wholly or predominantly attributable to the owner of the practice.

Most buyers won't pay you for your own personal goodwill – and even if they do agree to pay you something, there will be conditions attached.

COMMON MISTAKE #2

Some practice owners spend so much time working in their practice that they lose sight of what would make their practice valuable in the eyes of a prospective buyer or merger partner, and what assets a prospective acquirer will be willing to pay for.

Professionals who own their own practices don't put enough focus on working on their practice to make it attractive to potential buyers or merger partners, and place too much value on their personal contributions.

Step 3.

WHO am I going to sell to or merge with?

The critical importance of this question was brought home to me recently when I worked on the sale of an insurance business. The most logical group of prospective buyers was other insurance businesses which, it was thought, would be attracted by synergistic benefits and economies of scale by merging our client's business with theirs.

Fortunately, the vendor's CEO had the foresight to place a public advertisement to which the eventual buyer responded. The buyer didn't have an existing insurance business and if not for the public advertisement, would never have been in the equation.

The answer to the 'who' question is crucial in determining the method for putting your practice up for sale or merger. The way in which you advertise your legal practice for sale or merger will depend on the type of practice you run, your areas of expertise, and your networks and contacts in the industry.

If you are fortunate enough to have a number of prospective buyers or merger partners for your legal practice, the answer to the 'who' question will also dictate the type of buyer or merger partner that you would prefer to deal with. You may wish to consider the following factors when assessing your preferred buyer or merger partner:

- Credit-worthiness and capacity to pay.
- Experience and reputation in the industry.
- Future plans for the practice, including plans for the transition of your employees.
- Buyers or merger partners who may offer different services to your practice, but who may be strategically attracted by the new or complementary service offerings of your practice.
- Buyers or merger partners who want more than just your revenue – buyers who are willing to pay for strategic benefits such as key customer relationships, intellectual property or key employees that will enhance their existing business when merged with yours.
- Buyers or merger partners who have a similar client base to your practice to whom your services may also be attractive.

COMMON MISTAKE #3

Legal practice owners sometimes have a predetermined or narrow view of who the most likely buyer or merger partner for their practice would be. It is a mistake to discount a potentially broader field of buyers or merger partners.

Step 4.

HOW and WHEN am I going to sell or merge?

Thinking about the 'how' and 'when' of a practice sale or merger leads to many questions that must be addressed to achieve the best possible outcome. For example:

- If I am being forced to sell or merge because of adverse financial circumstances, how much time do I have? What can I do to buy more time to prepare?
- How much time do I have to sell or merge in order to take advantage of current market conditions or opportunities?
- Should I sell the entire practice now, or sell it in stages over time, particular if my potential buyers are already working in the practice?
- What sort of tender or bidding process is most suitable?
- How much information should I share with prospective buyers or merger partners?
- What is my practice worth?
- Should I sell the practice assets or the shares in the practice entity?
- Am I better off merging my practice with another practice, and then selling my share of the combined practices?
- Could I do a management buy-out?

These questions raise a series of issues that cut across a range of professional disciplines including accounting, taxation, legal, valuation, market analysis, sales and marketing, and financial advice.

Most of the transactions that I work on involve significant input from the practice owner's other professional advisors. They will often prepare financial information about the practice, and help with determining the best transaction structure and setting the practice owner's expectations around practice value.

Some practice owners will engage a specialist investment banker, practice broker or commercial advisor, particularly if the practice can be marketed to a range of prospective buyers or merger parties or via a publicly advertised process.

A lawyer will usually be engaged at this initial stage to assist with getting the practice sale or merger ready, and with preparing legal documents such as confidentiality agreements and draft sale or merger agreements.

In some circumstances, specialist advice may also be required, particularly regarding taxation, environmental, operational or regulatory issues.

At this stage, many practice owners find that their existing advisors don't have the capacity or expertise to properly handle a legal practice sale or merger transaction. They need to find alternative advisors who are more qualified to help them.

COMMON MISTAKE #4

Some legal practice owners who have had success in running their own practices believe that they can be equally successful in handling the sale or merger of their practice on their own. Perhaps the biggest mistake that a practice owner can make is not getting appropriate professional advice to help them navigate the complexities of the sale or merger process.

Step 5.

Getting your practice ready for sale or merger

In some ways, selling or merging your legal practice is no different to selling your home – you need to present it in a state that is likely to attract interest from at least one buyer or merger prospect who is willing to do the deal that you are looking for.

There are some basic tasks that legal practice owners should attend to before putting their practice on the market – like the clean out and fresh coat of paint you might give your house before putting it up for auction:

- Make sure your financials are in order.
- Check that your practice registrations are up-to-date.
- Update company secretarial registers.
- Tidy up practice records, including financial, customer and employee records.
- Prepare financial and valuation information for prospective buyers or merger partners.
- Resolve outstanding disputes or legal claims.
- Collect or write off overdue, bad or doubtful debts.
- Review and pull back on unnecessary expenditure.
- Review your 'work in progress' or inventory .
- Get your practice premises ready for a walk-through inspection.

The most successful practices that attract the best deal for the practice owner are either set up and managed to be ready for sale or merger from the very beginning, or strategically prepared for sale or merger over an extended period of time. Ideally, this means preparing for years rather than weeks or months.

Preparing for sale or merger can involve:

- Implementing new financial, client and practice management systems and processes – particularly if the practice is overly reliant on the direct management or participation of the practice owner, or the existing systems and processes are inadequate or outdated.
- Positioning for future revenue growth by acquiring other practices or key personnel before selling.
- Negotiating and documenting long-term contracts with major clients or suppliers.
- Renewing or extending practice premises leases (a word of warning – this can be a negative if the premises are not required by the buyer or merger partner).
- Creation of risk management or contingency plans in case of practice interruption or loss of key personnel.

In my experience, it is never too early to start planning because you never know when an opportunity to sell or merge may present itself.

COMMON MISTAKE #5

Most businesses are rarely ready for sale or merger all of the time. Many legal practice owners don't have a strategy or don't give themselves enough time to get their practice ready before they decide or are forced to sell, or receive an approach from a prospective buyer or merger partner.

Step 6.

Preparing an information package about your practice

It is essential that you can credibly and confidently explain to potential buyers the things that have made the legal practice successful in the past, and how the profitability and value of the practice can be maintained and increased in the future under the buyer's ownership.

You will need to prepare an information package about your practice, with the assistance of your professional advisors.

This information package needs to be attractive from a marketing point of view, in order to present your practice in the best possible light and support the value or price that you have attached to it. It also needs to be factually correct to ensure that prospective buyers or merger partners are not misled in the process.

The document could include the following:

- A brief history of the practice and how it has evolved.
- General information about the areas and industries in which the practice operates, and where opportunities lie.
- Key financial information as evidence of past performance and projections (with appropriate qualifications) in support of future performance.
- Business strengths and opportunities and how these have been or could be utilised.
- Business challenges or weaknesses and how these have been addressed by the practice owner or could be addressed by the buyer or merger partner.
- Analysis of competitors and how the practice is positioned to meet competition in the market.
- Summary of key personnel.
- Comparable sales data or other relevant market information.

COMMON MISTAKE #6

Many practice owners are unable or unprepared to explain the things that make their practice valuable and attractive to prospective buyers or merger partners.





Checklist

It's good at this point of the process to stop and reflect on everything that you've just read.

There has been a large volume of information to digest.

As a short activity, if you feel ready, have a read of the below checklist and work through it in your own time:

- Think about and write down the reasons why you might want to consider selling or merging your legal practice.
- Identify the assets of your practice, both tangible and intangible.
- Write down the names or demographics of some prospective buyers or merger partners of your legal practice, why do you think they would be attracted to buying or merging with your practice?
- Identify 5 main things that you need to do to get your legal practice ready for a sale or merger.
- Identify 2 key selling points and 2 key challenges or weaknesses for your legal practice that would need to be explained to prospective buyers or merger partners in your information document.

Step 7.

Confidentiality and protecting your practice

Confidentiality is critical to every legal practice sale or merger that I have been involved in – a breach of confidentiality can be extremely damaging to the interests of all parties, and weaken practice value.. For example:

- Leaks can cause employees to become hesitant and concerned about their positions. Employees may be prompted to leave.
- Industry gossip can cause uncertainty among practice clients and key suppliers.

Maintaining confidentiality is often extremely difficult, particularly if the sale or merger process is drawn-out, involves many people or requires the sharing of large volumes of information. To protect your practice and maintain confidentiality:

- Be ready to answer questions about a possible practice sale or merger – have a pre-prepared statement ready.
- Limit the number of people who know about or are involved in the sale or merger process.
- Require all prospective bidders and their personnel to execute a non-disclosure agreement before sharing information and as a condition of their participation in the process.
- Use a practice broker, lawyer or accountant to handle initial enquires from prospective buyers or merger partners.

- Use a postal or email address for correspondence that doesn't disclose the identity of your practice.
- Advertise your practice on a no-names basis.
- Ask prospective buyers or merger partners for information about themselves and their intentions so you can pre-qualify them.
- Only provide more specific information that could be used to identify your practice to pre-qualified parties who have signed a non-disclosure agreement.
- Use a private email address for communications with your advisors, particularly if other people in your organisation have access to your emails.
- Use a secure virtual data room to manage the disclosure of due diligence information to prospective buyers and their advisors.
- Delay the disclosure of the most-sensitive information about your practice until terms of sale or merger are agreed.
- Agree on a process for disclosure of the sale in consultation with the buyer or merger partner.

In summary, try and keep details of the potential sale or merger to yourself and your trusted advisors and personnel who have a 'need to know'.

COMMON MISTAKE #7

Practice owners who decide to embark on a sale or merger process sometimes don't take the necessary steps to adequately protect their confidential information and maintain the confidential nature of the sale process.

Step 8.

Document the deal in writing

It is surprisingly common for parties to agree on what seems to be a great deal at the time, but fail to sign a legally enforceable contract.

Often this type of arrangement is justified on the basis that it will save money. Parties sometimes claim that 'a handshake is good enough for me', or that 'the substantive terms have all been agreed' or that 'they've got no choice but to do the deal now'. In other cases, the parties are happy to rely on a memorandum of understanding or heads of agreement, even if not all terms have been fully spelt out.

In many cases, the absence of a legally enforceable contract may turn out to be inconsequential if ownership of the practice is transferred and the price is paid in full, or the merger takes place smoothly. However, the consequences can be disastrous if things don't go to plan and the buyer or merger partner reneges on the deal.

Here are some key things to include in a written contract with the buyer or merger partner:

- The buyer or merger partner should be accurately identified and described in the contract. If the buyer or merger partner is a corporate entity, a company search should be performed to ensure that it is a properly incorporated legal entity.
- There should be a definitive date on which the transfer or merger of the practice and payment of the price should occur, or an agreed method for determining that date.
- If the buyer or merger partner fails to pay or complete the deal on time, there should be an agreed default and termination procedure available to the seller.
- Ideally, the buyer or merger partner should be required to provide a deposit or some other form of security for completion of the deal. If the buyer or merger partner defaults, the deposit or other security can be used to compensate the practice owner for their loss and practice disruption.
- Avoid 'agreements to agree' – or terms that require future negotiation between the parties. They can often be used as 'get out' opportunities by buyers or merger partners who change their mind and decide not to proceed with the deal.
- If you are required to give warranties about the practice to the purchaser or merger partner, make sure the warranties are appropriately limited and qualified by reference to information that you have provided to the buyer or merger partner in the due diligence process.

You should always engage an appropriately qualified lawyer to prepare and/or negotiate the contract on your behalf, and ensure that it is properly signed and exchanged by the parties.

COMMON MISTAKE #8

Sellers place their interests at great risk if they agree on terms with a prospective buyer but fail to have the terms documented in writing in a legally enforceable contract.

Step 9.

Plan for your future

If you stand to gain substantial wealth following a sale or merger of your practice, then you also need to ensure that your wealth is protected so that you can enjoy the benefits in the future.

A personal wealth protection plan would normally include the following elements:

- Properly considered investment of the proceeds of sale or merger and other personal assets.
- Asset protection strategies and investment structures to ensure that the proceeds of sale or merger are not unduly exposed to the risk of future claims against key individuals, particularly purchaser warranty claims.
- A valid Will to ensure that personal assets pass to intended beneficiaries upon death in a tax effective manner.
- Valid powers of attorney to ensure that personal assets can be managed by trusted individuals in the event of disability or incapacity.

COMMON MISTAKE #9

Any practice owners spend years building successful practices, but put their personal wealth at risk with poor planning and management of their personal affairs.

Step 10.

Completing the deal

Normally there will be a period of time between the signing of the sale or merger contract and the date that possession of the legal practice transfers to the purchaser and the price is paid or the merger is finalised.

Often, this time is needed to enable the seller or merger partner to obtain the necessary approvals for the sale or merger to take place. For example, if a sale involves the transfer of a lease for the practice premises, the seller will ordinarily be required to obtain the consent of the landlord to the transfer. Key clients will need to be consulted.

If there is some delay between signing and completion of the sale or merger, the practice owner is also normally required to ensure that the practice continues to be carried on in the ordinary course until completion. There may be specific restrictions on the sale or purchase of practice assets, and hiring or termination of employees.

The financiers of the practice owner and the buyer or merger partner also typically need time to prepare for the sale or merger. Mortgages and other security interests that are held by the practice owner's financier over the practice assets may need to be released. The buyer or merger partner's financier will need time to arrange its own securities and borrowing arrangements with the buyer or merger partner.

Your lawyer should assist you to prepare a detailed list of tasks that need to be attended to in order to complete the sale or merger transaction.

COMMON MISTAKE #10

Some practice owners mistakenly believe that their job is done when a sale or merger contract is signed. In fact, there are often many tasks that a practice owner needs to attend to before a sale or merger transaction can be completed.



Message



Thanks so much for downloading and reading this guide. Hopefully it's a useful tool for you.

As mentioned previously there will be a few emails that follow with some further information to get you thinking over the next few weeks. If you don't find the information relevant, you can unsubscribe at any time.

I'll also be holding a webinar on the topic where you can ask your questions and have them answered, the invitation to this will also come via email.

In my experience, a successful sale or merger relies heavily on preparation and the small details. Make sure you don't get caught out.

If you have any further questions in the meantime please feel free to contact me.

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