

# PEER MONITOR INDEX

Q3 2015 EXECUTIVE REPORT - ISSUED 10.26.15

## PMI Declines in Third Quarter Demand Softens, Rates & Productivity Drop

The third quarter was a good news/bad news scenario for the legal market. The THOMSON REUTERS PEER MONITOR ECONOMIC INDEX (PMI)<sup>1</sup>, after holding steady for two consecutive quarters, slipped two points to 52.

The good news portion is that demand for large law firm services rose for the seventh consecutive quarter. However, growth was an anemic 0.2% – and the rate of growth has been diminishing as 2015 wears on. Year-to-date demand is up only 0.4%.

Meanwhile, worked rate growth continues to slide – rates rose only 2.6% in the quarter, the lowest quarterly rate growth in the history of PMI.

Productivity fell another 1.1% amidst rising headcount, while expense growth moved slightly higher.

### Demand by Practice Areas

The familiar trend of the last few years exerted itself again in the third quarter, with the transactional practices showing strength, while litigation declined.

For the first time this year, all the transactional practices were up. Corporate work rose 2.7%, and is up 2.3% year-to-date. Real estate gained 3.7%, and is up 3.9% for the year. Tax work rebounded after two consecutive down quarters, and rose 1.2%, however year-to-date it is basically flat.

Litigation was down 1.0% and is down 0.7% year-to-date. Litigation hasn't shown a positive quarter since Q1 2012. Patent litigation was down 0.7% in the third quarter, and is down 1.6% year-to-date.

Patent prosecution has been a consistently strong performer, and has risen every quarter so far this year, up another 2.6% for the quarter, and is up 1.7% year-to-date. Labor and employment fell for a second consecutive quarter, falling 3.5% and is down 1.9% year-to-date.

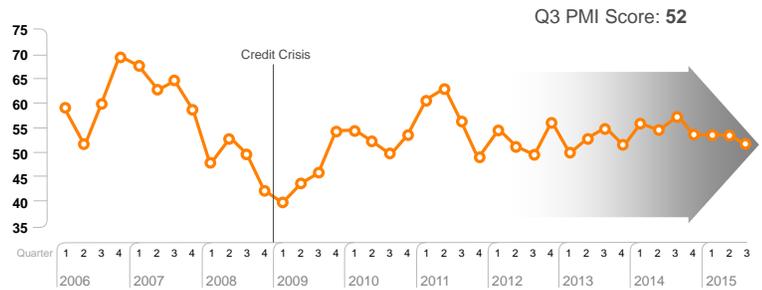
Bankruptcy dropped 2.1% and is down 4.4% year-to-date.

### Performance by Market Segment

Am Law 100 continues to outperform the other market segments, with demand rising for the seventh consecutive quarter, up 2.2% for the quarter, and 1.6% year-to-date. Am Law 100 has had the strongest demand growth of any segment for every quarter so far this year.

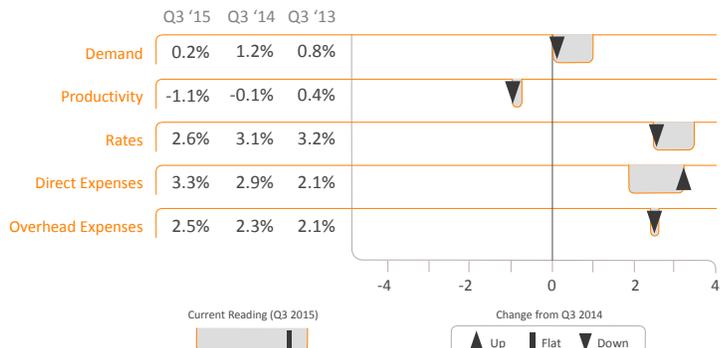
Midsized also managed another positive quarter – up 0.2% and is up 0.3% year-to-date. Am Law Second Hundred was the only segment to show a decline in demand for Q3 had its second consecutive down quarter, falling 1.3% and year-to-date has now turned negative, down 0.4%.

### PEER MONITOR ECONOMIC INDEX (PMI)

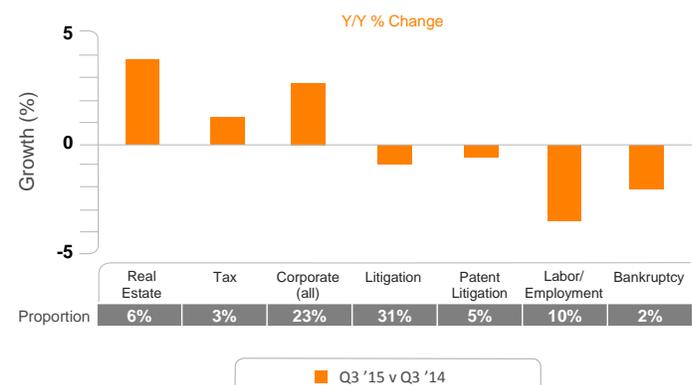


The PMI represents the relative rate of change among the major factors influencing law firm performance. These factors are tracked individually in the graph below.

### PMI KEY FACTORS



### DEMAND GROWTH BY PRACTICE



<sup>1</sup> The PMI is a composite index score, representing the quarter-over-quarter change in drivers of law firm profitability, including rates, demand, productivity and expenses. Positive factors driving firm profitability will produce a higher score. A score exceeding 65 generally indicates a healthy operating environment.

Am Law Second Hundred, once again however, had much higher rate growth than the other segments – and was the only segment to show higher rate growth this quarter, up 3.3%, and up 3.2% year-to-date. Am Law 100 rate growth slipped to 2.4% for the quarter, and is up 2.8% for the year. Midsize rate growth was also 2.4% for the quarter, and is up 2.3% year-to-date.

## Rates

Worked rate growth was only 2.6% in the quarter, down from Q2, and is up 2.8% year-to-date. Standard rates, meanwhile, were up 2.8% in Q3, down from 2.9% in Q2.

Collected realization, meanwhile, hit a record low at 82.9% in Q3. Weakening rate growth and realization continue to be a major threat to profitability.

Cash collections rose 2.0% - somewhat weaker than the 4.2% growth for the same period a year ago.

## Expenses<sup>2</sup>

Expense growth accelerated after falling for two consecutive quarters.

Direct expenses turned sharply higher, growing 3.3%. Headcount rose 1.4% after rising only 1.1% in Q2. The attorney replenishment ratio<sup>3</sup> was 1.2, the same as in Q2.

Overhead expenses crept up slightly to 2.5% compared with 2.4% in Q2.

## Productivity<sup>4</sup>

Productivity fell 1.1% in the third quarter, the seventh consecutive quarterly decline. Firms continue to add positions faster than current demand warrants.

## Wrong Direction?

While the seventh consecutive quarter of demand growth is inarguably a positive, nearly all of the PMI indicators took a slight turn for the worse in the third quarter.

Demand growth slowed, rate growth hit an all-time low, expense growth accelerated, and productivity continues to decline. While none of the movements were particularly sharp, the movements were clearly in the wrong direction.

Firms are facing external pressures – such as continuing weak demand for litigation practices, and pricing pressure from clients. But what is particularly worrisome is that factors that are more directly under a firm's control, such as headcount and overhead expenses, are now adding to profitability pressures. Expenses have been growing faster than demand for the past several quarters, and the gap is now beginning to widen.

Firms need to find a way to manage against slowing demand and rates, while keeping tighter control on costs. Anything less may be a recipe for watching profits evaporate if current trends persist.

For more information on the PMI, and how Peer Monitor can help your firm successfully manage through today's economy, please contact **Mike Abbott** at **651-848-4114** or [michael.abbott@thomsonreuters.com](mailto:michael.abbott@thomsonreuters.com) or visit [peermonitor.thomsonreuters.com](http://peermonitor.thomsonreuters.com).

## Special Focus: Transactional & Litigation Practices – By the Numbers

The secular shift that has been taking place for the past few years among the major practice areas has been well chronicled in these reports: growth in transactional practices has helped make up for a steady, long-term decline in litigation.

But a closer look at the data reveals a somewhat more complex picture.

By segment, Am Law 100 was much stronger for transactional practices in Q3 (4.1%) than either Am Law Second Hundred or Midsize (both up 2.0%). At the same time, the overall decline in litigation was primarily attributable to Am Law Second Hundred, which was down a sharp 5.0%, while both Am Law 100 (1.3%) and Midsize (0.6%) were actually positive for the quarter.

There were also notable regional variations in practice area growth. Transactional practices have been strongest in the West region this year, and were up another 4.3% in Q3. Conversely, the Southwest region has been the weakest, and fell another 1.1%.

Litigation, meanwhile, has been somewhat more volatile among the regions than transactional practices. Although litigation has been relatively strong in the Southwest this year, the region stumbled in the third quarter, falling 1.3%. The Southeast had the best litigation performance during the quarter, rising 1.6%.

For further discussion on strategies for practice areas, contact your Peer Monitor consultant.

<sup>2</sup> Includes both direct expenses (salaries, fringe benefits and professional fees associated with billable timekeepers) and overhead expenses (all other nondirect expenses, including staff compensation, marketing, technology, occupancy, office expenses and research).

<sup>3</sup> Attorney replenishment is the ratio of new attorneys to the firm divided by those departing. A result greater than 1 indicates growing capacity, while a result less than 1 signals a contraction.

<sup>4</sup> Productivity is defined as hours worked per attorney and represents the ratio of capacity to market demand.