HILDEBRANDT BAKER ROBBINS | PEER MONITOR INDEX

Q4 2010 EXECUTIVE REPORT
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PMI Rises in Fourth Quarter, Flat for 2010

Law Firm Market Demand and Productivity Rise

The HILDEBRANDT BAKER ROBBINS Peer Monitor Economic Index (PMI) [1] rose three points to 55 in the fourth quarter of 2010, as the law firm market finished the year with signs of some renewed strength. The fourth-quarter PMI resumed the gradual upward trend that began in early 2009.

The fourth-quarter increase in PMI was driven by growth in demand [2] for legal services – up 1 percent compared with the same period a year earlier. This marks the first measurable growth in year-over-year demand in more than two years, and provides positive year-end momentum moving into 2011. Transactional and litigation practices were stronger, while continued cost controls and restraint in adding new lawyers bolstered productivity and profitability. Rate growth remained weak and will continue to be an area of keen focus in 2011.

For the year as a whole, flat demand and a small rise in rates, combined with staff reductions and tight cost controls, improved profits. Demand was flat and collected rates increased about 2 percent, resulting in average revenue growth of approximately 2 percent. Direct and overhead costs fell, helping grow profits-per-equity partner (PPEP) by 3 to 6 percent for the industry overall for the year, although there exists wide variation among individual firm performance.

Demand Analysis by Practice Area

Litigation demand rose 2 percent for the quarter, with slightly higher growth in IP litigation. The growth in litigation at year end, after being flat for most of 2010, bodes well for the market as we move into 2011, as litigation composes the largest practice area, accounting for approximately one-third of overall billings.

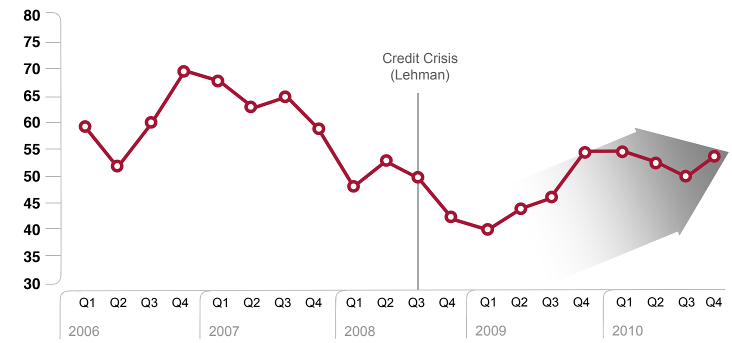
Transactional practices continued to improve in the fourth quarter as they did throughout 2010, with merger work up almost 5 percent. Capital markets rose almost 2 percent, while general corporate work was up 3 percent. Corporate work showed gradual improvement throughout the year, reflecting slow but uneven improvements in the overall economy. Real estate work was up 2 percent, showing gradual recovery in the fourth quarter and the entire year.

Bankruptcy dropped 7 percent in the quarter, and was down overall in the final half of the year, although it remains strong by historical cyclical patterns.

1 *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.*

2 *Demand is defined as the growth in billable hours.*

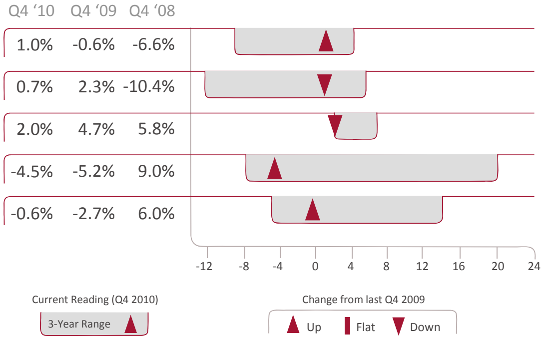
PEER MONITOR ECONOMIC INDEX (PMI)



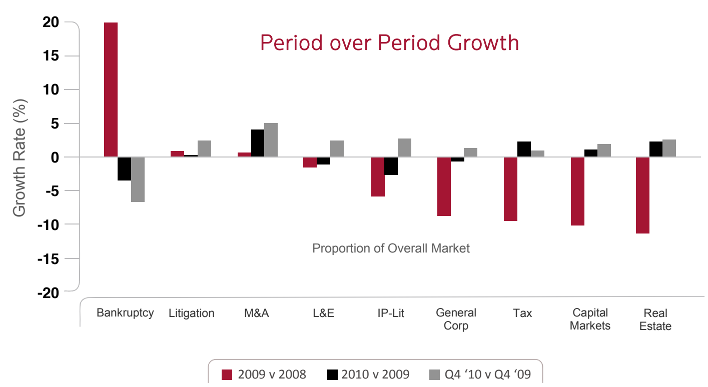
The PMI represents the relative rate of change among the major factors influencing law firm performance. These factors are tracked individually in the graph below.

PMI KEY FACTORS

	Q4 '10	Q4 '09	Q4 '08
Demand	1.0%	-0.6%	-6.6%
Productivity	0.7%	2.3%	-10.4%
Rates	2.0%	4.7%	5.8%
Direct Expenses	-4.5%	-5.2%	9.0%
Overhead Expenses	-0.6%	-2.7%	6.0%



DEMAND GROWTH BY PRACTICE: ALL SEGMENTS



Demand Analysis by Market

Los Angeles was the strongest major market in the fourth quarter with demand up 4 percent. After showing a greater drop in demand than most major markets in 2009, Los Angeles rebounded steadily throughout 2010.

Chicago and Houston were up about 3 percent for the quarter. Washington, D.C., was up about 1 percent, while Boston and San Francisco were basically flat compared with a year earlier. New York City was down 1.5 percent.

Demand in London was up more than 1 percent in the fourth quarter.

Rates

Despite signs of improving demand, rates remain weak. Although negotiated or discounted rates were up 2 percent for the quarter, rate growth has been steadily declining for several years and is currently at the low end of its three-year range. Even if demand continues to improve in 2011, there are no imminent signs of a return of pricing power. However, on a firm-by-firm basis, we are noticing a widening – rather than a compression – in the range of realized rates, meaning that some firms are doing markedly better than others in raising rates.

Collected realization sustained its level of 87 percent through the fourth quarter, after having declined steadily for several years. Realization rates, however, remain near historic lows. Nonetheless, any respite from further declines in realization was welcome news, particularly in the fourth quarter – which is normally the busiest collection period for firms and is when the pressure to discount can be the heaviest.

Expenses [3]

Firms continued to cut expenses in the fourth quarter, as they have for the past several quarters. However, as we anticipated, the cost reductions are moderating. For the past two-plus years, aggressive cost cutting – including particularly legal and nonlegal staff reductions – has been the primary means for firms to maintain profitability against weak demand and pricing.

Direct expenses fell another 4.5 percent in the fourth quarter. While this drop is still significant, direct expense reductions reached their highest level in Q2 2010, and have shown lessening declines since then. During that time, firms have been selectively hiring, with more firms adding associates in 2010 compared with 2009. As a result, attorney headcount was flat for the second half of 2010. The attorney replenishment ratio [4] is neutral for the overall attorney population, as new hires are offsetting retirements, layoffs and other departures.

Overhead expenses were down half a percent in the fourth quarter. This is a significant change from 3 to 4 percent declines seen earlier in the year, and may be an indication that current strategies for reducing overhead expenses may be reaching their limit. (In the Special Focus section found later in this report, we examine the potential for new approaches to cutting overhead.)

As the overall economy improves, firms may be positioning themselves for a potential shift from defense to offense in 2011 – moving from belt tightening to preparing for growth if further improvement in the market materializes.

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3 Includes both direct expenses and overhead expenses. Direct expenses are salaries, fringe benefits and professional fees associated with billable timekeepers. Overhead expenses include all other non-direct expenses, including staff compensation, marketing, technology, occupancy, office expenses and research.

4 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.

5 Productivity is defined as hours per attorney and represents the ratio of capacity to market demand.

Productivity [5]

Productivity or hours-per-lawyer rose 0.7 percent in the fourth quarter continuing a string of recent gains, broken only by a slight downward tick in the third quarter. Slightly higher demand coupled with neutral headcount growth translated into a small productivity gain for the fourth quarter, adding to improvements seen in the third quarter.

The first half of each year is typically the strongest period for billable hours. So productivity gains in 2011 will hinge on firms' abilities to continue to balance headcount with demand. Overhiring in anticipation of higher demand could easily dampen productivity.

2010 Outlook

In 2010, the legal market reflected the ups and downs of the overall economy – stabilizing early in the year, and suffering slight setbacks in mid-year. We entered 2011 on a more positive note, as the uptick in demand seen at the end of 2010 across many important cyclical practices like corporate, real estate and litigation is encouraging.

It appears that momentum will carry over and demand will continue to rise this year, supported by an improving overall economy. But even with further gains, demand for 2011 is expected to be below pre-recession levels.

Rates will remain a challenge as clients build on the success they have realized over the past few years in requiring firms to become even more efficient and deliver greater value. Clients are becoming more sophisticated buyers of legal services both in terms of managing their relationships with firms and in their use of management tools and information to track progress and assess performance.

Overall, the near-term outlook for the industry is improving as the economy continues to regain its footing. However, while law firms should experience a more positive operating environment, pressure for change will continue. The key will be for firms to determine the right strategy for their particular situations, and to recognize that the nature and degree of change required may be unclear at times and differ significantly from one firm to another.

Even with marginal improvement in demand and rates in the months ahead, the keys to profitability will include effectively managing client matters and relationships, carefully deploying effective rate strategies, continuing to control costs, increasing efficiency and operating flexibly to take advantage of emerging opportunities in the market.

For more information on the PMI, and how Peer Monitor can help your firm successfully manage through today's economy, please contact **Mark Medice at 412-203-2155** (email: mmedice@hbrconsulting.com) or visit peermonitor.hbrconsulting.com.

Special Focus:
2011 Cost-Cutting Considerations and Staffing Models

As firms encounter increasing client resistance to rate increases, they have focused on cost reductions to maintain profitability. For several quarters, firms have aggressively trimmed overhead expenses. However, now that much of the "low-hanging fruit" has been harvested, firms must decide the next phase of their strategy.

Peer Monitor recently launched its Staffing Ratio program for 2011, which will analyze more than 40 roles in the firm and calculate staffing-to-attorney ratios, along with associated investment costs, against categories like operations, secretaries, technology, business development and others. This program will help law firms assess how their investments in this area compare with their peers. Peer Monitor subscribers will be able to combine this data with the detailed expense analysis in the program for a complete picture of their overhead expenses.

For more information, contact your Peer Monitor consultant to learn about best practices for successful cost control strategies in today's challenging market conditions.

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