THOMSON REUTERS INSTITUTE & FINANCIAL INSIGHTS

Law Firm Financial Index

Q1 2024 Executive Report | Issued 5.6.2024

Law firms ascend with record revenues and slower expenses

Law firms rose back into a healthy financial state in the first quarter as counter-cyclical[1] demand held fast, and a new season of rates bloomed brightly. With every composite metric moving in a positive direction, the Thomson Reuters® Institute Law Firm Financial Index[2] (LFFI) rose 2 points to a **score of 59**.

The year's rate setting season did not disappoint, **setting a new high** in terms of worked-rate growth compared to last year. As an interesting point, Midsize law firms raised their rates faster than the Am Law Second Hundred, a relative rarity in a year's first quarter, having happened only three other times since 2011. Perhaps more significantly for law firm finances, the degree of real[3] rate growth was also tied for the highest level since the Great Financial Crisis in 2007-'08.

There has also been a considerable change in the status quo in terms of where demand growth manifests. Whereas 2023 was dominated by the smaller end of the law firm market, 2024 has seen the center of gravity **move more to the middle**. Am Law Second Hundred firms led in demand growth in Q1, overtaking the previously dominant players of 2023, the Am Law 51-100 and Midsize segments. While the worked-rate advantage of the Am Law 51-100 helped push those firms ahead in fees-worked growth (a pre-realization proxy for revenue growth), both segments outperformed the Am Law 50 and Midsize segments. Midsize firms are not fading away however,

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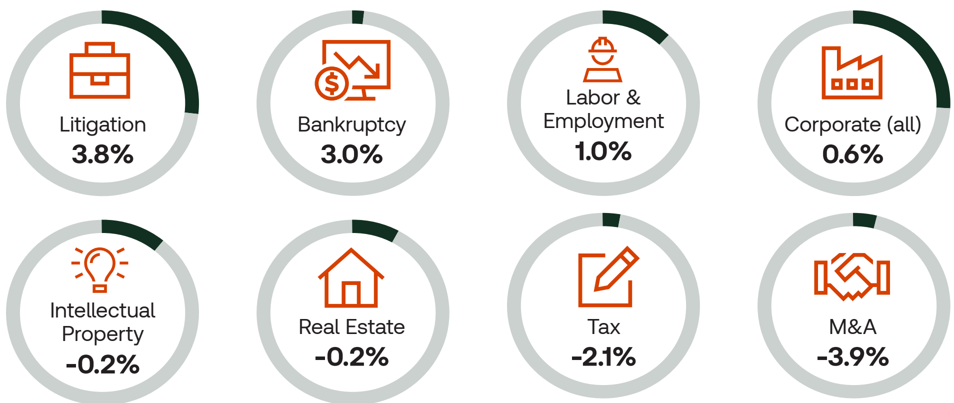
Practice demand growth

Y/Y Change | Q1 '24 vs. Q1 '23

Circular band surrounding practice is equal to proportion of hours worked in 2023.

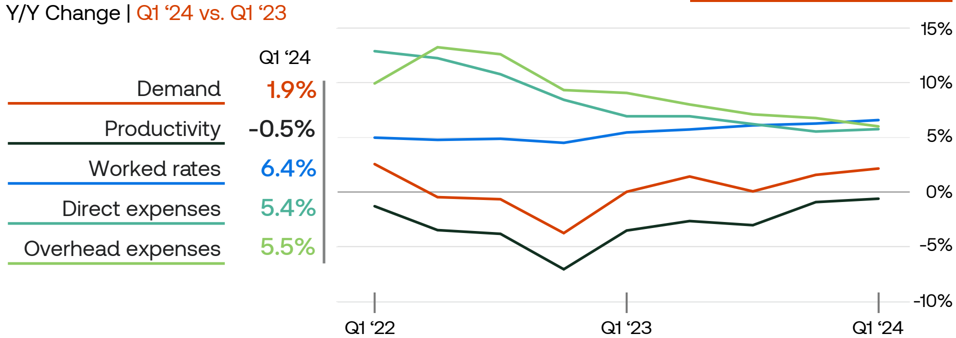


Source: Thomson Reuters 2024

LFFI key factors

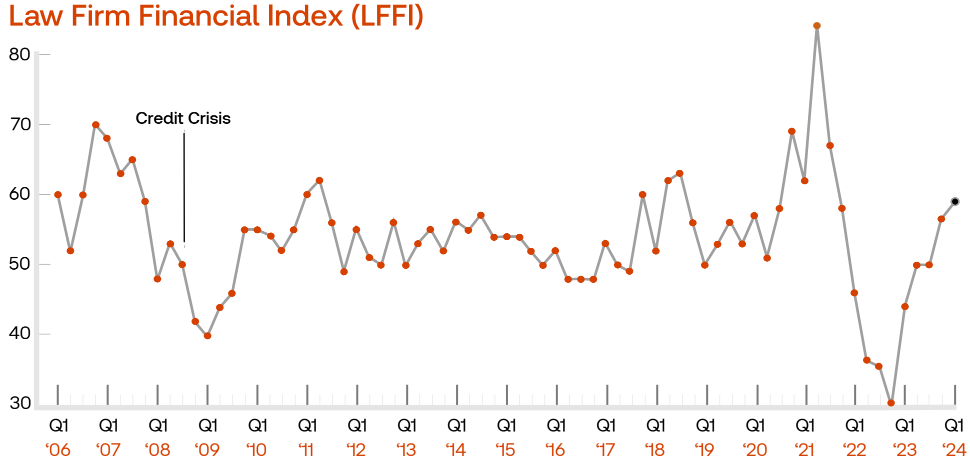
LFFI SCORE: 59 ⬆ 2

Y/Y Change | Q1 '24 vs. Q1 '23



Source: Thomson Reuters 2024

Law Firm Financial Index (LFFI)



Source: Thomson Reuters 2024

even though their pace slowed mostly to due measuring against last year's success. Meanwhile, the Am Law 50 continues to trade demand for record rate growth, a transaction that seems to be working in their favor thus far. Still, the advantage seems to have shifted notably in the market to the point at which segments that were struggling mere quarters ago are now **finding significant new footing**.

The defining trait of law firms in regard to demand can be seen in one practice area in particular: litigation. Growth in this practice, at its strongest since the post-pandemic snap back in 2021, falls perfectly in line with each segment's overall demand growth. While other counter-cyclical practices have faded somewhat in their growth, **litigation has only accelerated**. On the transactional practice side, firms have managed to stabilize with small amounts of growth found in some components. While this may not seem like much, merely holding steady has allowed the new rates in a premium practice to contribute greatly to increasing firm revenue.

Convergence in expenses and revenue marks a decided shift for the industry

In the first quarter, we noticed that all four of the major general ledger metrics — direct expenses, overhead expenses, revenue, and profit — **all converged** to come in around 5%.

Direct expense came out to 5.4% growth on aggregate, a stark deceleration from its double-digit growth just a few years ago. A major change however is that the **Am Law 100 firms have accelerated** in recent quarters to the same pace of growth as the other segments after seeing multiple quarters in which they drove our market averages lower. The other segments are continuing to cool

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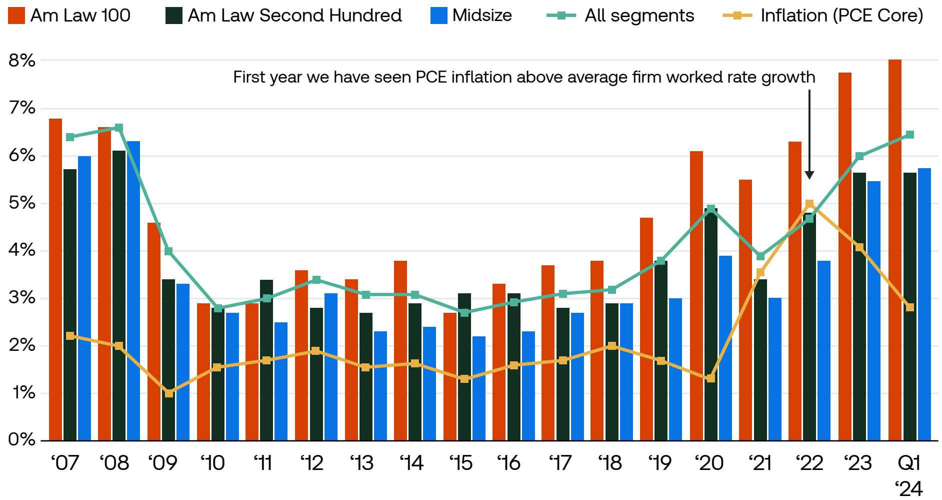
Worked rate growth

Y/Y Change | By segment

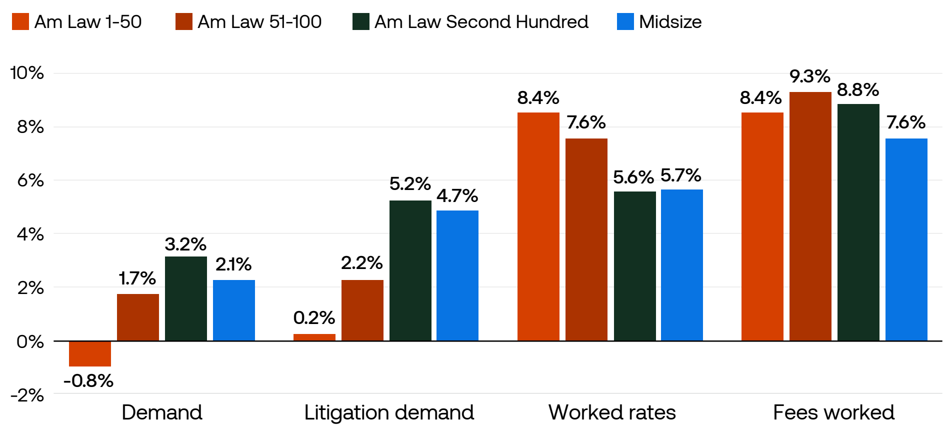


PCE Inflation measure = Personal Consumption Expenditures Excluding Food and Energy

Source: Thomson Reuters 2024

Demand, rates, and fees worked growth

Y/Y Change | Q1 '24 vs. Q1 '23 | By segment

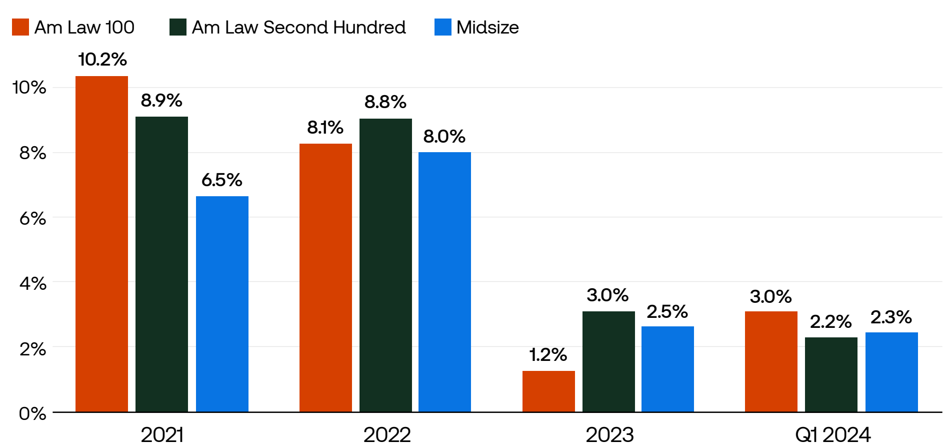


All timekeepers. Billable time type; non-contingent matters.

Source: Thomson Reuters 2024

Direct expense per lawyer (FTE) growth

Rolling 12-month Y/Y Change | By segment



Source: Thomson Reuters 2024

as they try to control wage growth after the pitched war for talent in 2021 and 2022, but they are experiencing a slower recovery than their Am Law 100 counterparts which have already reversed course.

Overhead expenses came in with a 5.5% increase, a notable continuation of its cooling even as **spending on technology remains hot**. In terms of real tech investment, or the growth in spending on tech minus inflation, law firms are investing in technology at the most rapid pace since at least 2014. The generative artificial intelligence (GenAI) evolution in legal seems to be having an impact on firms' expenses, firms' successes in controlling their costs in other areas are keeping those investments from breaking the bank.

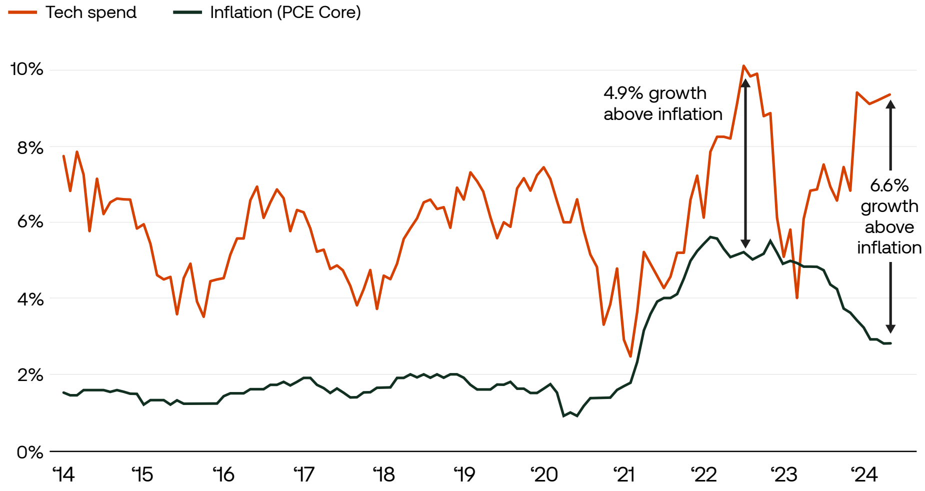
Revenue likewise came in at nearly the same level of 5.7% over the past 12 months, as the previously discussed combination of rates and demand continues to lift firms from their profit contraction from only a couple of quarters ago. As a result of firms' relatively high profit margins combining with the general ledger trends above, **firm profits grew 5.8%**, creating the four-way convergence in this quarter's financial results.

Although the LFFI score only rose by 2 points, firms are now being compared with less horrible baselines than in previous quarters, and that is working to slow the pace of improvements that firms may have felt. The rise in the Index score thus signals that **firms' current financial situation is more stable** and maintaining the current trajectory would be a positive outcome for the large law firm industry.

This report utilizes information from the Thomson Reuters Financial Insights competitive intelligence platform. For additional details on the data which underpins these reports, please contact Brent Turner at 763-326-6625. To uncover the latest granular and narrowly tailored information on the large law firm industry, visit the customer support ***website*** *or email* ***brent.turner@thomsonreuters.com****.*

Technology spending growth vs. inflation

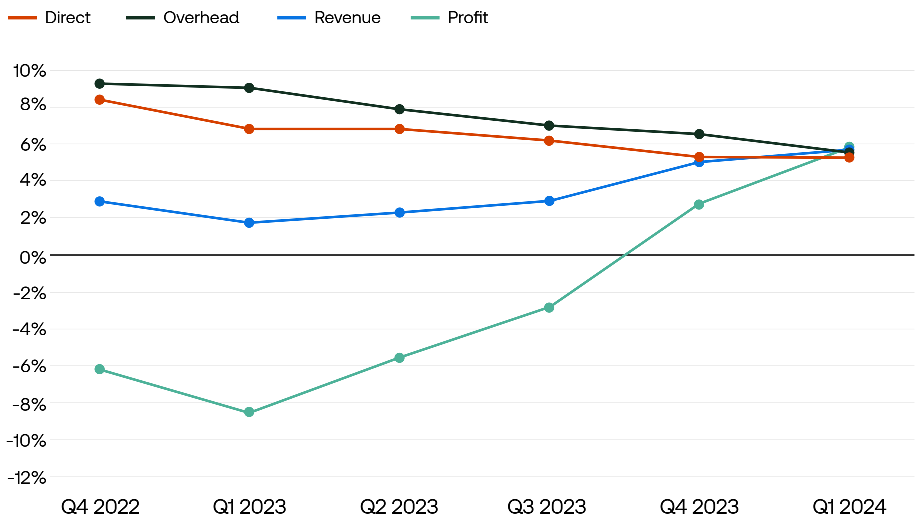
Rolling 12-month Y/Y change



Source: Thomson Reuters 2024

Expenses, revenue and profit growth

Rolling 12-month Y/Y change



Source: Thomson Reuters 2024

1 Counter-cyclical practices are those that succeed during periods of economic hardship and struggle in periods of economic upswing, moving counter to the business cycle.

2 The LFFI is a composite 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.

3 Real rate growth in this case refers to the growth in rates adjusted for inflation. For these purposes, we use the PCE Core inflation measure (Personal Consumption Expenditures Excluding Food and Energy) both because it is the standard inflation measurement of the Federal Reserve and because we believe it is the most reliable indicator of the rate of inflation experienced by law firms.

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