

Law Firm Financial Index

Q3 2024 Executive Report | Issued 11.11.2024

Firms' profits reach new heights on wave of resurgent demand

Law firms continue their upwards ascent, returning to all-time highs as they approach the end of 2024. The Law Firm Financial Index¹ (LFFI) score rose 4 points in Q3 to an impressive score of 71 — the second-highest score of all time.

In their seventh consecutive quarter of improvement, firms not only notched one of the best historic scores but perhaps look fundamentally stronger than in any period in recent history. Behind much of this strength was a resurgence in legal demand and further gains in productivity, all of which made a small uptick in expense growth look like the minor cost of doing business. In all, it looks like clear sailing for firms to outperform all but their profit heights of 2021.

Demand growth for firms was incredibly broad, with practice areas as diverse as litigation, real estate, labor & employment, and corporate work all performing at increased levels. Only one major practice group (intellectual property) declined, and only by a fraction of a percentage point. In the first two quarters of 2024, there were signs of a counter-cyclical² practice slowdown which threatened firm performance even as transactional demand ticked up. In Q3, it appears these concerns were raised a bit early as counter-cyclical demand hit its strongest growth pace in more than a year, achieving growth even on top of its 10-year-high.

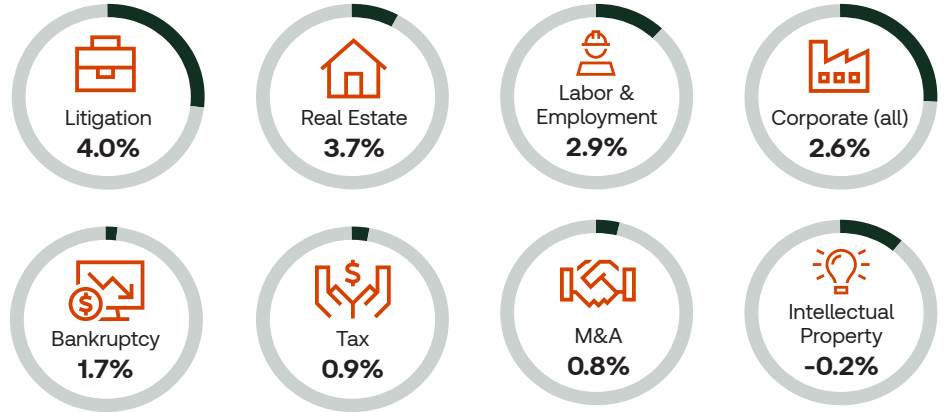
Transactional demand, meanwhile, continued to push to its best performance since early 2022. Part of the explanation for this is that the United States' economy itself has

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Practice demand growth

Y/Y Change | Q3 2024 vs. Q3 2023

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

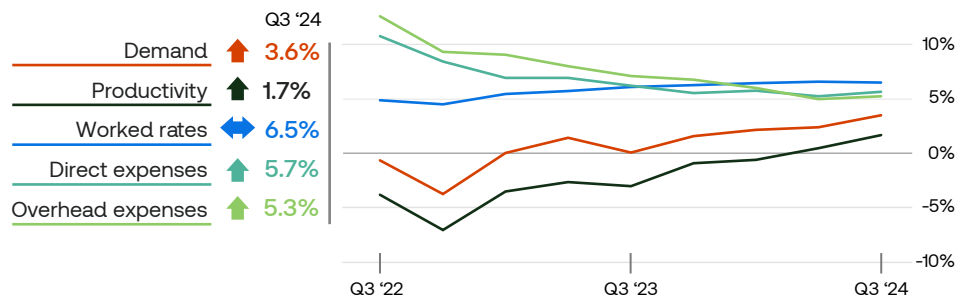


Source: Thomson Reuters 2024

LFFI key factors

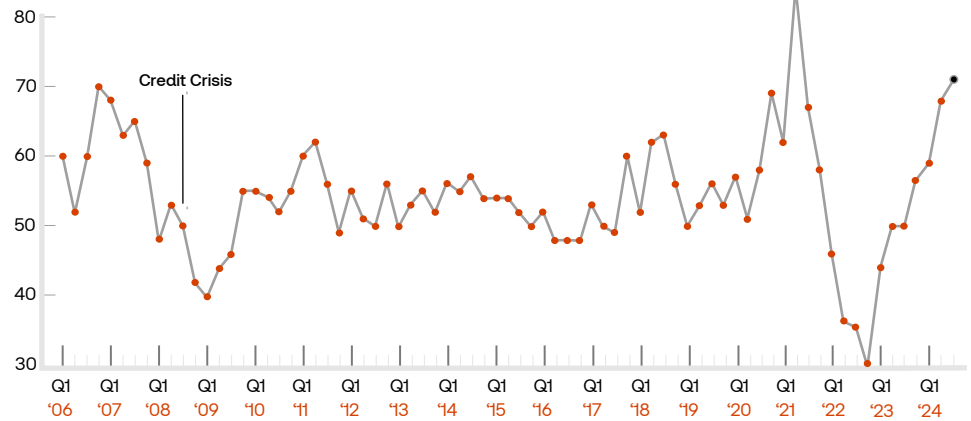
LFFI SCORE: 71 ↑ 4

Y/Y Change | Q3 '24 vs. Q3 '23



Source: Thomson Reuters 2024

Law Firm Financial Index (LFFI)



Source: Thomson Reuters 2024

proven far healthier and more stable than some would have expected a few quarters ago. Worries about sustained inflation, a wobbly labor market, and slow economic growth have so far proven unfounded, and the strong economic performance in Q3 helped translate to a remarkable performance for many large law firms.

Overall, demand growth for firms is nearing the peak levels last seen during the post-pandemic boom *without* the blatantly unsustainable transactional demand growth that powered that period. In other words, the current growth appears far healthier and more sustainable. Considering how often counter-cyclical practices have reaccelerated as well as transactional demand's continued upward pace, many law firms are looking towards a strong close at the end of the year.

In a further positive development, law firm productivity³ continued an upward bounce despite the lawyer headcount growth that firms typically experience in the latter half of the year. In Q2, the majority of law firms experienced productivity growth for the first time in years; and in Q3, that figure rose even further to almost two-thirds (64%) of firms.

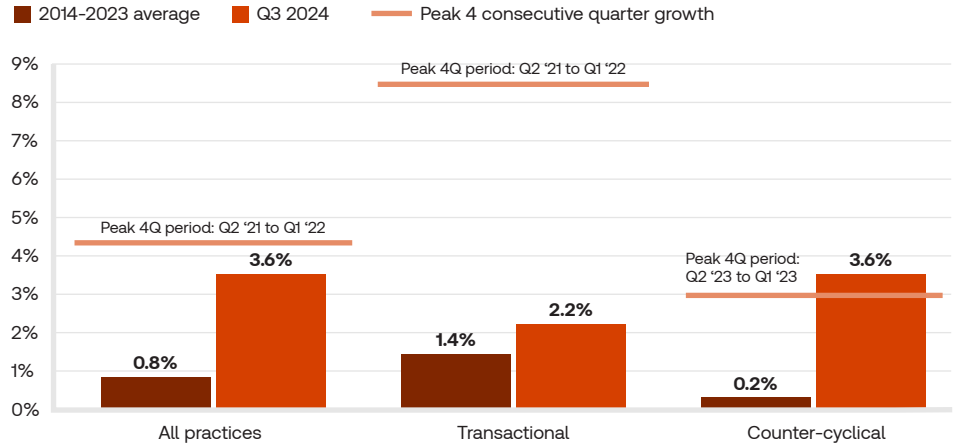
Part of this productivity boost came from the aforementioned acceleration of demand, however, another aspect of it was the modest level of hiring from many firms, which, while continuing to grow headcount, did not hit the excess levels seen in 2021 and 2022. Further, some segments were more likely to ramp up hiring than others, with segments experiencing the fastest growth in demand — Midsize and the Second Hundred — also growing headcount the fastest while the Am Law Top 50 held to a more constrained strategy.

The result is that Q3 achieved both full time equivalent (FTE) growth as well as notching productivity gains, making Q3 the first hiring season in which firms have achieved such in the last three years. It's easy to see how firm profits are on the rise if firms are increasing both the number

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The strength of the demand environment in Q3 2024

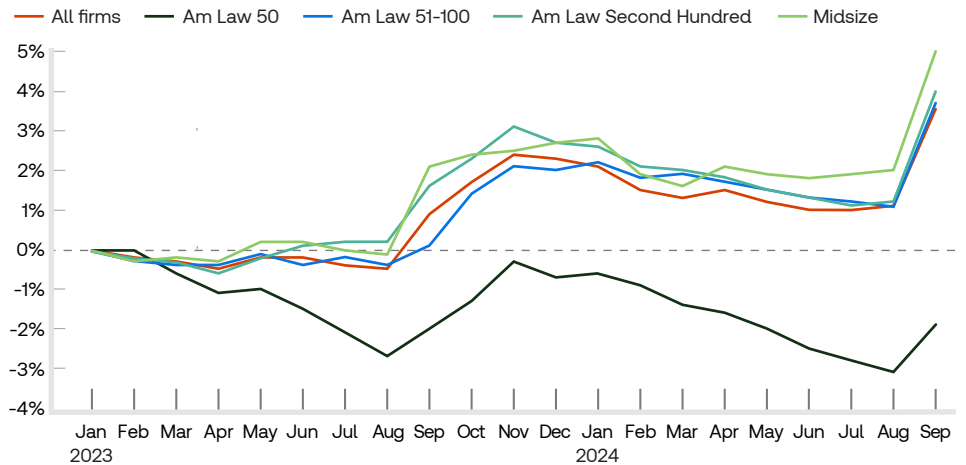
Y/Y Change | 2014-2023 average vs. Q3 2024



Source: Thomson Reuters 2024

Lawyer FTE growth

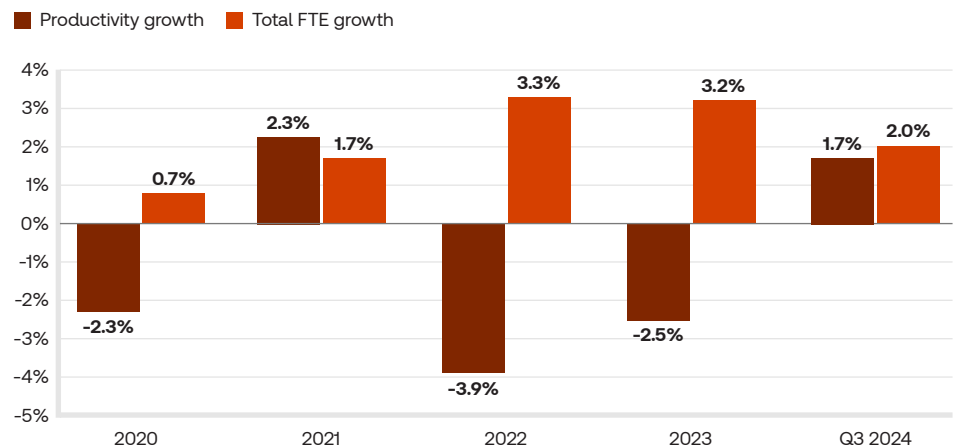
Percent change since January 2023 | By segment



Source: Thomson Reuters 2024

Productivity growth vs. FTE growth

Y/Y Change | All segments



Source: Thomson Reuters 2024

of lawyers able to bill hours and the hourly prices they charge (at a record high pace), all the while getting more out of each lawyer at the same time.

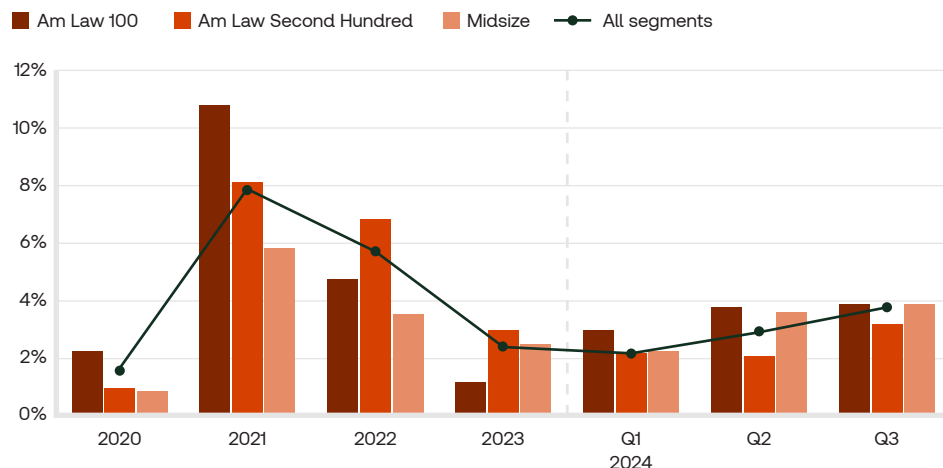
This hiring did correspond to a slight acceleration in expense growth for both direct and overhead expenses, which remain elevated compared to historical levels of the 2010s. The slight uptick of expense growth may give firms uncomfortable flashbacks to 2022 and 2023, when inflation-driven costs burned away their profits. However, the upwards thrust coming from revenue is so strong that this relatively minor increase on top of historically elevated expenses hardly registers as turbulence in regard to profits.

The current law firm landscape, characterized by exceptionally high revenues, naturally results in increased expenses, particularly in the competitive race for talent as well as end-of-year bonuses. For firms however, these elevated expenses have still allowed them to achieve acceptable profit margins as well as grant the capacity to pre-pay certain types of expenses in 2025, potentially alleviating expense pressure in the new year. With profit growth peaking and inflation waning, however, the grounds for negotiating higher rates are considerably weakened, thus providing a potential headwind to the start of next year. Looking further ahead, GDP trends are anticipated to be more moderate in 2025 compared to 2024. Again, however, there remains potential for upside, as the lowering of interest rates and acceleration of transactional work could suggest increased transactional demand in 2025. Ultimately, firms look set for a strong close to the year, with eyes increasingly moving to 2025.

It is unlikely that law firms' climb will continue much higher in light of the latent challenges that might erupt in 2025, yet they're not looking to experience the overheating and corresponding two-year hangover which beset them after 2021. It also seems that firms have not only the potential to once again reach these lofty heights, but this time, to also settle in for a gentler, more sustainable cruise afterwards.

Direct expense per lawyer (FTE) growth

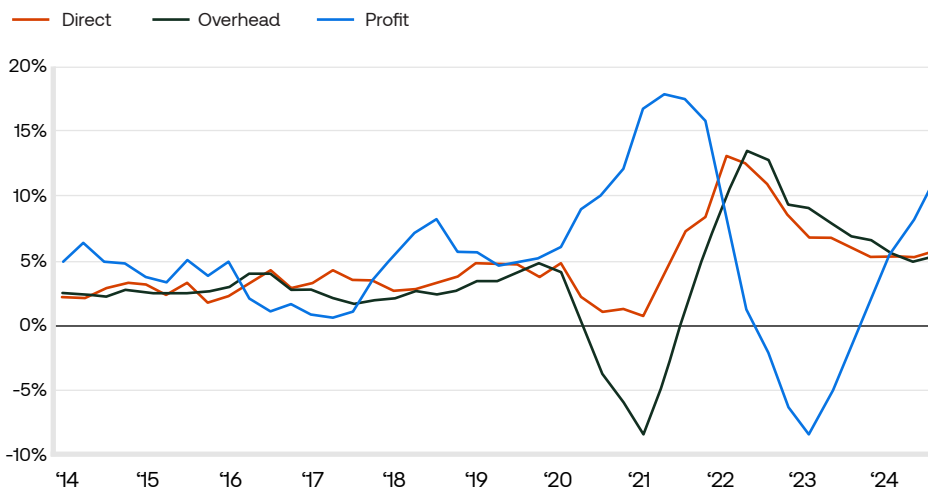
Rolling 12-month Y/Y Change | By segment



Source: Thomson Reuters 2024

Expense and profit growth

Rolling 12-month Y/Y Change | All segments



Source: Thomson Reuters 2024

- 1 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.
- 2 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.
- 3 Measured on an hours-worked-per-lawyer basis.

This report utilizes information from the Thomson Reuters Financial Insights competitive intelligence platform. For additional details on the data underpinning these reports, please contact Isaac Brooks at 612-270-5728. To uncover the latest granular and tailored information on the large law firm industry, visit the customer support [website](#) or email isaac.brooks@thomsonreuters.com.

