



Case Study: Acquisition of a legal services firm

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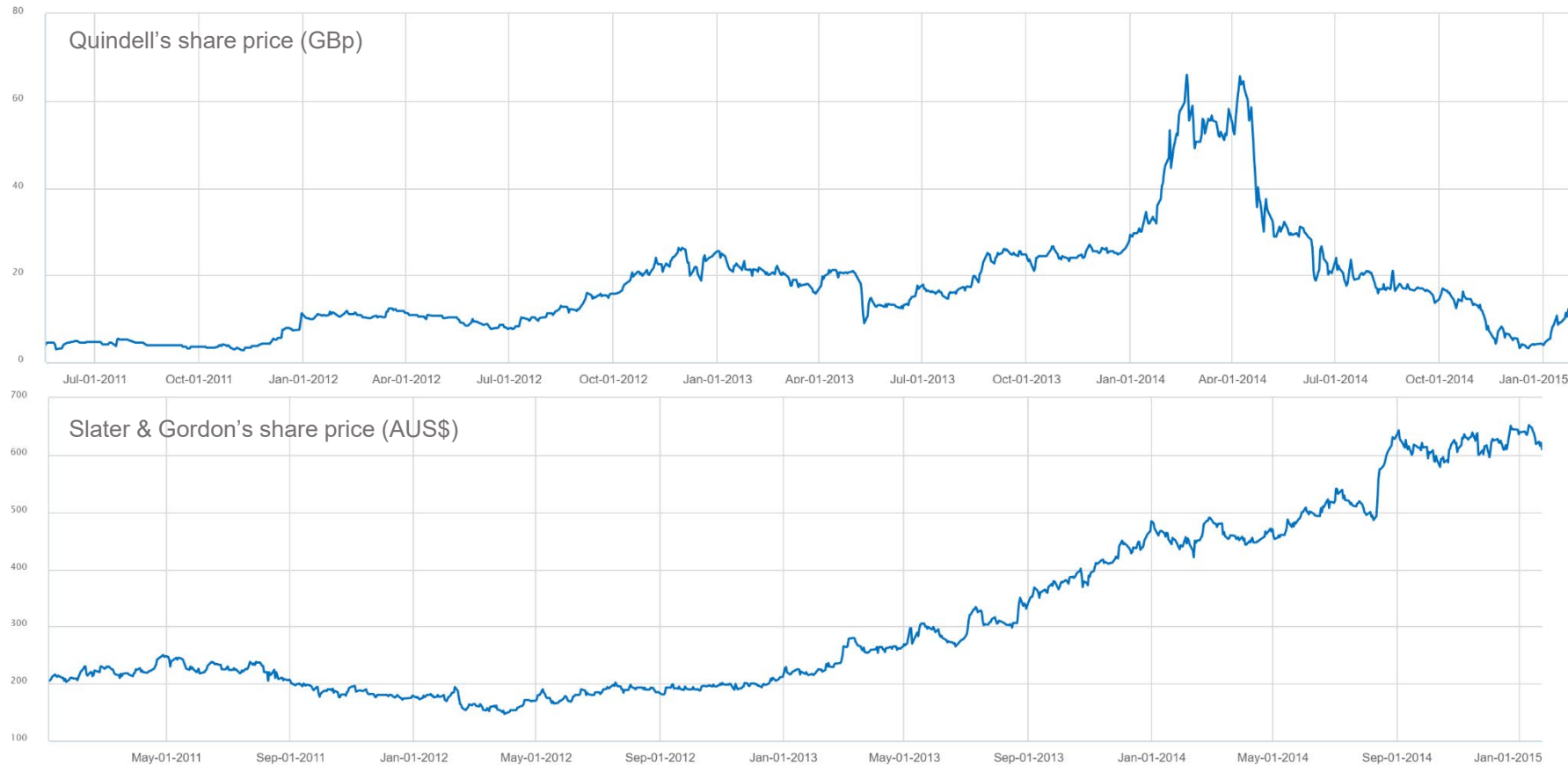
The company: Quindell

- Quindell Plc is a legal services and technology firm
- One of the largest law firms in the UK, processing large volumes of personal injury law suits, often a no win no fee business. Its business model involves investing in insurance claims, months before any cash is received. It recognises revenues while it processes the claims.
- The company also has a digital solutions business and develops, among other things, telematics for cars
- The company is also pursuing a novel line of business, taking on thousands of cases related to industrial deafness. The deafness cases can take 18 months to two years to conclude. As the law firm undertakes the work it makes assumptions about what it will eventually be paid for doing so, but reports that as revenues before it receives payment.
- The company has been aggressively expanding its case work and has over the past year or so come under pressure from a group of short sellers for its business model and generous pay packages for its executives.

The acquisition

- In Jan 2015 Slater & Gordon, an Australian law firm, enters into talks to buy Quindell's professional service division for \$930 million dollars in a bid to penetrate the highly fragmented UK personal injury market.
- Slater & Gordon is seeking to raise \$700 million in new equity to fund the acquisition. Quindell's shares rise as much as 30% in the morning of the announcement. Slater & Gordon drop 2%.
- Slater & Gordon explains the rationale for the acquisition as aiming to create the number one personal injury law firm in the UK and further diversify the firms sources of legal work, broadening access to claims management companies, insurers and insurance brokers
- Analysts suspect the quality of Quindell's cases to be low, but that there might be opportunities for Slater & Gordon to acquire some quality cases at depressed prices
- Excerpts from the firms' financial statements are provided on the next few pages.

Share price developments of both firms



Quindell's income statements and balance sheets

	2013 £'000	2012 £'000
Revenue	380,131	137,558
Analysed as:		
- Solutions	80,441	30,068
- Services	299,690	107,490
Cost of sales	(197,815)	(69,562)
Gross profit	182,316	67,996
Administrative expenses		
- Normal	(61,441)	(20,702)
- Share based payments	(2,819)	-
- Exceptional costs	(13,744)	(5,265)
- Total administrative expenses	(78,004)	(25,967)
Other income	4,186	336
Share of results of associates	242	(19)
Group operating profit	108,740	42,346
Finance income	383	127
Finance expense	(2,077)	(1,232)
Profit before taxation	107,046	41,241
Taxation	(24,350)	(9,339)
Profit for the year	82,696	31,902

	2013 £'000	2012 £'000
Non-current assets		
Goodwill	235,621	144,570
Other intangible assets	55,659	29,639
Property, plant and equipment	9,357	7,296
Interests in associates	49,869	-
Investments	3,188	7,143
	353,694	188,648
Current assets		
Inventories	318	160
Trade and other receivables	327,873	177,871
Cash	199,596	48,050
	527,787	226,081
Total assets	881,481	414,729
Current liabilities		
Bank overdraft	(19,642)	(15,871)
Borrowings	(26,501)	(6,280)
Trade and other payables	(125,942)	(95,238)
Corporation tax	(24,346)	(7,460)
Obligations under finance leases	(610)	(479)
Deferred tax liabilities	(56)	(533)
	(197,097)	(125,861)
Non-current liabilities		
Borrowings	(11,961)	(7,475)
Trade and other payables	(1,896)	(6,032)
Obligations under finance leases	(661)	(568)
Deferred tax liabilities	(2,348)	(2,633)
	(16,866)	(16,708)
Total liabilities	(213,963)	(142,569)
Net assets	667,518	272,160

Quindell's receivables

21. TRADE AND OTHER RECEIVABLES

		Restated See Note 2a
	2013 £'000	2012 £'000
Trade receivables (net of impairment provision)	85,632	73,694
Other receivables:		
- relating to legal disbursements due from insurance companies	57,473	26,549
- other	20,120	7,977
Prepayments	12,955	8,426
Accrued income	151,693	47,928
Derivative financial instruments (See note 32)	-	13,297
	327,873	177,871

Included above within gross Trade receivables (i.e. excluding impairment provisions) due from third parties is £91,270,000 (2012: £70,487,000) relating to debts over which security (by way of fixed and floating charges) has been taken as part of the provision of invoice discounting facilities to companies in the Group, further details of which are provided in note 24. The directors consider that the net carrying amount of Trade receivables approximates to their fair value.

Quindell's cash flow statement

	Note	2013 £'000	2012 £'000
Cash flows from operating activities			
Cash generated from operations before exceptional costs, net finance expense and tax	30	10,433	20,459
Cash outflow from exceptional costs		(7,268)	(2,101)
Cash generated from operations before net finance expense and tax		3,165	18,358
Net finance expense paid		(1,694)	(1,235)
Corporation tax paid		(10,409)	(2,514)
Net cash (used by)/generated from operating activities		(8,938)	14,609
Cash flows from investing activities			
Purchase of property, plant and equipment		(2,484)	(1,317)
Purchase of intangible fixed assets		(21,359)	(2,899)
Proceeds on disposal of property, plant and equipment		360	36
Proceeds from sale of subsidiary undertaking and sale of operations	36	2,480	-
Acquisition of subsidiaries net of cash acquired		(11,533)	(49,072)
Purchase of associated undertakings		(20,068)	-
Purchase of fixed asset investments		-	(4,101)
Deposits held in escrow		(1,500)	-
Loans to investments and other parties		(4,898)	-
Dividends received from associates		109	-
Net cash used in investing activities		(58,893)	(57,353)
Cash flows from financing activities			
Issue of share capital		200,406	90,953
Finance lease repayments		(635)	(888)
Additional/(repayment of) secured loans		12,125	(3,790)
Additional unsecured loan monies received		518	520
Receipts/(payments) on Equity Swap		3,192	(15,583)
Net cash generated from financing activities		215,606	71,212

Slater & Gordon's balance sheet

	2014	2013		Note	2014	2013
	\$'000	\$'000			\$'000	\$'000
Current assets			Current liabilities			
Cash and cash equivalents	25,270	20,056	Payables	15	194,850	92,003
Receivables	229,368	130,499	Short term borrowings	16	9,467	20,103
Work in progress	470,609	299,859	Current tax liabilities	6	1,960	3,941
Other current assets	12,403	9,554	Other current liabilities	17	10,103	-
Total current assets	737,650	459,968	Provisions	18	16,468	13,883
			Total current liabilities		232,848	129,930
Non-current assets			Non-current liabilities			
Plant and equipment	12,964	12,219	Payables	15	19,187	6,238
Work in progress	2,730	2,337	Long term borrowings	16	116,864	32,032
Intangible assets	130,190	108,296	Deferred tax liabilities	6	97,619	78,015
Other non-current assets	11,844	16,108	Derivative financial instruments		1,020	656
Total non-current assets	157,728	138,960	Provisions	18	4,760	2,850
Total assets	895,378	598,928	Total non-current liabilities		239,450	119,791
			Total liabilities		472,298	249,721
			Net assets		423,080	349,207
			Equity			
			Contributed equity	19	233,638	212,373
			Reserves	20	9,090	3,710
			Retained profits	21	180,139	132,963
			Total equity attributable to equity holders in the Company		422,867	349,046
			Non-controlling interest	22	213	161
			Total equity		423,080	349,207

Slater & Gordon's income statement

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2014

	Note	2014 S'000	2013 S'000
Revenue			
Fee revenue	4	411,813	294,210
Other income	4	6,653	3,753
Total revenue and other income		418,466	297,963
Less Expenses			
Salaries and employee benefit expense		(200,270)	(145,517)
Rental expense		(22,005)	(14,095)
Advertising and marketing expense		(32,786)	(23,775)
Administration and office expense		(36,391)	(25,018)
Consultant fees		(4,928)	(2,580)
Finance costs	5	(8,412)	(7,653)
Bad and doubtful debts	5	(6,904)	(4,531)
Depreciation and amortisation expense	5	(6,955)	(4,973)
Costs associated with acquisitions		(4,054)	(282)
Other expenses		(11,312)	(8,198)
Profit before income tax expense		84,449	61,341
Income tax expense	6	(23,344)	(19,820)
Profit for the year		61,105	41,521

Questions to consider

- Why is Quindell an attractive target for Slater & Gordon?
- If you were advising Slater & Gordon on their due diligence of Quindell's business, which particular areas/items of Quindell's financial statements would you pay most attention to given its business model?
- What are the risks of the acquisition for Slater & Gordon?
- How is Slater & Gordon financing the acquisition and why?
- How is the market reacting to the acquisition and why?
- If you were managing partner at Slater & Gordon, what would be your biggest concern?