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PRE PAID LEGAL SERVICES INC  
Form 10-Q  
October 27, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
-----

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For The Quarterly Period Ended September 30, 2004

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For The Transition Period From \_\_\_\_\_ to \_\_\_\_\_  
-----

Commission File Number: 1-9293

PRE-PAID LEGAL SERVICES, INC.  
(Exact name of registrant as specified in its charter)

Oklahoma  
(State or other jurisdiction of  
incorporation or organization)

73-1016728  
(I.R.S. Employer  
Identification No.)

One Pre-Paid Way, Ada, Oklahoma  
(Address of principal executive offices)

74821-5813  
(Zip Code)

(Registrants' telephone number, including area code): (580) 436-1234

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

The number of shares outstanding of the registrant's common stock as of October 22, 2004 was 15,509,388.

# Edgar Filing: PRE PAID LEGAL SERVICES INC - Form 10-Q

PRE-PAID LEGAL SERVICES, INC.

FORM 10-Q

For the Quarter Ended September 30, 2004

## CONTENTS

### Part I. Financial Information

#### Item 1. Financial Statements:

- a) Consolidated Balance Sheets  
as of September 30, 2004 (Unaudited) and  
December 31, 2003
- b) Consolidated Statements of Income  
(Unaudited) for the three months and nine months  
ended September 30, 2004 and 2003
- c) Consolidated Statements of Comprehensive Income  
(Unaudited) for the three months and nine months  
ended September 30, 2004 and 2003
- d) Consolidated Statements of Cash Flows  
(Unaudited) for the nine months ended  
September 30, 2004 and 2003
- e) Notes to Consolidated Financial Statements (Unaudited)

Item 2. Management's Discussion and Analysis of Financial Condition  
And Results of Operations

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

### Part II. Other Information

Item 1. Legal Proceedings

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 6. Exhibits

Signatures

ITEM 1. FINANCIAL STATEMENTS

PRE-PAID LEGAL SERVICES, INC.

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## CONSOLIDATED BALANCE SHEETS (Amounts in 000's, except par values)

### ASSETS

|  |    | September<br>2004 |
|--|----|-------------------|
|  |    | -----             |
| Current assets:                                    |    | (Unaudit          |
| Cash and cash equivalents.....                     | \$ | 50,9              |
| Available-for-sale investments, at fair value..... |    | 1                 |
| Membership fees receivable.....                    |    | 4,7               |
| Inventories.....                                   |    | 1,3               |
| Refundable income taxes.....                       |    | 1,6               |
| Deferred member and associate service costs.....   |    | 14,9              |
| Deferred income taxes.....                         |    | 4,5               |
|  |    | -----             |
| Total current assets.....                          |    | 78,4              |
| Available-for-sale investments, at fair value..... |    | 17,0              |
| Investments pledged.....                           |    | 4,3               |
| Property and equipment, net.....                   |    | 47,6              |
| Deferred member and associate service costs.....   |    | 2,4               |
| Other assets.....                                  |    | 7,2               |
|  |    | -----             |
| Total assets.....                                  | \$ | 157,1             |
|  |    | -----             |

### LIABILITIES AND STOCKHOLDERS' EQUITY

|  |    |        |
|--|----|--------|
| Current liabilities:   |    |        |
| Membership benefits.....   | \$ | 10,0   |
| Deferred revenue and fees.....   |    | 23,7   |
| Current portion of capital leases payable.....   |    | 8      |
| Current portion of notes payable.....  |    | 18,0   |
| Treasury stock tender offer payable.....   |    | 25,4   |
| Accounts payable and accrued expenses.....   |    | 12,6   |
|  |    | -----  |
| Total current liabilities.....   |    | 90,7   |
| Capital leases payable.....  |    | 1,0    |
| Notes payable.....   |    | 31,5   |
| Deferred revenue and fees.....   |    | 3,3    |
| Deferred income taxes .....  |    | 2,4    |
| Other non-current liabilities.....   |    | 2,4    |
|  |    | -----  |
| Total liabilities.....   |    | 131,5  |
|  |    | -----  |
| Stockholders' equity:  |    |        |
| Common stock, \$.01 par value; 100,000 shares authorized; 20,352 and<br>21,674 issued at September 30, 2004 and December 31, 2003, respectively..... |    | 2      |
| Retained earnings.....   |    | 123,7  |
| Accumulated other comprehensive income.....  |    | 6      |
| Treasury stock, at cost; 4,852 shares held at<br>September 30, 2004 and December 31, 2003.....   |    | (99,0) |
|  |    | -----  |
| Total stockholders' equity.....  |    | 25,6   |
|  |    | -----  |
| Total liabilities and stockholders' equity.....  | \$ | 157,1  |
|  |    | -----  |

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The accompanying notes are an integral part of these financial statements.

PRE-PAID LEGAL SERVICES, INC.  
CONSOLIDATED STATEMENTS OF INCOME  
(Amounts in 000's, except per share amounts)  
(Unaudited)

|  | Three Months Ended |           | Ni     |
|--|--------------------|-----------|--------|
|  | September 30,      |           |        |
|  | 2004               | 2003      | 20     |
| <b>Revenues:</b>                             |                    |           |        |
| Membership fees.....                         | \$ 89,317          | \$ 82,695 | \$ 264 |
| Associate services.....                      | 6,132              | 6,033     | 18     |
| Other.....                                   | 1,404              | 1,296     | 4      |
|  | 96,853             | 90,024    | 286    |
| <b>Costs and expenses:</b>                   |                    |           |        |
| Membership benefits.....                     | 31,100             | 27,956    | 90     |
| Commissions.....                             | 30,097             | 28,443    | 88     |
| Associate services and direct marketing..... | 7,304              | 7,411     | 21     |
| General and administrative.....              | 11,083             | 9,896     | 32     |
| Other, net.....                              | 2,526              | 2,175     | 7      |
|  | 82,110             | 75,881    | 240    |
| Income before income taxes.....              | 14,743             | 14,143    | 46     |
| Provision for income taxes.....              | 5,086              | 4,705     | 15     |
| Net income.....                              | \$ 9,657           | \$ 9,438  | \$ 30  |
| Basic earnings per common share.....         | \$ .59             | \$ .54    | \$ 1   |
| Diluted earnings per common share.....       | \$ .58             | \$ .54    | \$ 1   |

The accompanying notes are an integral part of these financial statements.

PRE-PAID LEGAL SERVICES, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Amounts in 000's)

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(Unaudited)

|   | Three Months Ended<br>September 30, |          | Ni<br>20 |
|---|-------------------------------------|----------|----------|
|   | 2004                                | 2003     |          |
| Net income.....   | \$ 9,657                            | \$ 9,438 | \$ 30    |
| Other comprehensive income (loss), net of tax:  |                                     |          |          |
| Foreign currency translation adjustment.....  | 119                                 | 15       |          |
| Unrealized gains (losses) on investments:   |                                     |          |          |
| Unrealized holding gains arising during period.....   | (71)                                | (197)    |          |
| Reclassification adjustment for realized losses (gains)<br>included in net income.....  | (13)                                | 35       |          |
|   | (84)                                | (162)    |          |
| Other comprehensive income, net of income taxes<br>of \$(45) and \$(87) for the three months and (\$122) and \$158<br>for the nine months ended September 30, 2004 and 2003,<br>respectively..... | 35                                  | (147)    |          |
| Comprehensive income.....   | \$ 9,860                            | \$ 9,291 | \$ 30    |

The accompanying notes are an integral part of these financial statements.

PRE-PAID LEGAL SERVICES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Amounts in 000's)  
(Unaudited)

|  | Nine Mon<br>Septem |
|--|--------------------|
|  | 2004               |
| Cash flows from operating activities:  |                    |
| Net income.....  | \$ 30,285          |
| Adjustments to reconcile net income to net cash provided<br>by operating activities: |                    |
| Provision for deferred income taxes.....   | 756                |
| Depreciation and amortization.....   | 5,840              |
| Tax benefit on exercise of stock options.....  | 214                |
| Contribution of stock to ESOP.....   | 231                |
| Cash provided by operating activities before changes in assets and liabilities       | 37,326             |

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|   |             |
|---|-------------|
| (Increase) decrease in Membership income receivable.....                    | (141)       |
| (Increase) decrease in inventories.....                                     | (500)       |
| Decrease in income tax receivable.....                                      | -           |
| Increase in other current assets.....                                       | (1,280)     |
| (Increase) decrease in deferred member and associate service costs.....     | (810)       |
| Increase in other assets.....   | (2,162)     |
| Increase in accrued Membership benefits.....                                | 742         |
| Decrease in deferred revenue and fees.....                                  | (24)        |
| (Decrease) increase in accounts payable and accrued expenses and other..... | (2,646)     |
|   | -----       |
| Net cash provided by operating activities.....                              | 30,505      |
|   | -----       |
| Cash flows from investing activities:                                       |             |
| Additions to property and equipment.....                                    | (6,340)     |
| Purchases of investments - available for sale.....                          | (7,919)     |
| Maturities and sales of investments - available for sale.....               | 16,154      |
|   | -----       |
| Net cash provided by (used in) investing activities.....                    | 1,895       |
|   | -----       |
| Cash flows from financing activities:                                       |             |
| Proceeds from exercise of stock options.....                                | 1,442       |
| Decrease in capital lease obligations.....                                  | (12)        |
| Proceeds from issuance of debt.....   | 19,000      |
| Repayments of debt.....   | (12,826)    |
| Purchases of treasury stock.....  | (10,481)    |
|   | -----       |
| Net cash used in financing activities .....                                 | (2,877)     |
|   | -----       |
| Net increase (decrease) in cash and cash equivalents.....                   | 29,523      |
| Cash and cash equivalents at beginning of period.....                       | 21,459      |
|   | -----       |
| Cash and cash equivalents at end of period.....                             | \$ 50,982   |
|   | -----       |
| Supplemental disclosure of cash flow information:                           |             |
| Cash paid for interest, net of amount capitalized.....                      | \$ 1,127    |
|   | -----       |
| Cash paid for income taxes.....   | \$ 16,000   |
|   | -----       |
| Increase in treasury stock tender offer payable.....                        | \$ 25,495   |
|   | -----       |
| Purchases of treasury stock.....  | \$ (25,495) |
|   | -----       |
| Non-cash activities - capital lease obligations incurred.....               | \$ -        |
|   | -----       |

The accompanying notes are an integral part of these financial statements.

PRE-PAID LEGAL SERVICES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Except for per share amounts, dollar amounts in tables are in  
thousands unless otherwise indicated)  
(Unaudited)

Note 1 - Basis of Presentation

The accompanying consolidated financial statements and notes thereto have

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been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2003 Annual Report on Form 10-K.

The consolidated financial statements include the financial statements of the Company and its wholly owned subsidiaries, as well as those of PPL Agency, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited financial statements as of September 30, 2004, and for the three and nine month periods ended September 30, 2004 and 2003, reflect adjustments (which were normal and recurring) which, in the opinion of management, are necessary for a fair statement of the financial position and results of operations of the interim periods presented. Results for the three and nine month periods ended September 30, 2004 are not necessarily indicative of results expected for the full year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Stock-Based Compensation

The Company has a stock-based employee compensation plan. The Company accounts for this plan under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board Statement ("FASB") No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

|  | Three Months Ended<br>September 30, |          | Nine Mon<br>Septem |
|--|-------------------------------------|----------|--------------------|
|  | 2004                                | 2003     | 2004               |
| Net income, as reported.....   | \$ 9,657                            | \$ 9,438 | \$ 30,285          |
| Deduct: Total stock-based employee compensation expense<br>determined under fair value based method for all awards,<br>net of related tax effects..... | -                                   | (177)    | (441)              |
| Pro forma net income.....  | \$ 9,657                            | \$ 9,261 | \$ 29,844          |
| Earnings per share:  |                                     |          |                    |
| Basic - as reported.....   | \$ .59                              | \$ .54   | \$ 1.83            |
| Basic - pro forma.....   | \$ .59                              | \$ .53   | \$ 1.80            |
| Diluted - as reported.....   | \$ .58                              | \$ .54   | \$ 1.82            |
| Diluted - pro forma.....   | \$ .58                              | \$ .53   | \$ 1.79            |

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### Note 2 - Contingencies

The Company and various of its executive officers have been named as defendants in a putative securities class action originally filed in the United States District Court for the Western District of Oklahoma in early 2001 seeking unspecified damages on the basis of allegations that the Company issued false and misleading financial information, primarily related to the method the Company used to account for commission advance receivables from sales associates. On March 5, 2002, the Court granted the Company's motion to dismiss the complaint, with prejudice, and entered a judgment in favor of the defendants. Plaintiffs thereafter filed a motion requesting reconsideration of the dismissal which was denied. The plaintiffs have appealed the judgment and the order denying their motion to reconsider the judgment to the Tenth Circuit Court of Appeals. In August 2002 the lead institutional plaintiff withdrew from the case, leaving two individual plaintiffs as lead plaintiffs on behalf of the putative class. As of December 31, 2003, the briefing in the appeal had been completed. On January 14, 2004 oral argument was held in the appeal. The Company is unable to predict when a decision will be made on this appeal, and the ultimate outcome of the case is not determinable.

Beginning in the second quarter of 2001 multiple lawsuits were filed against the Company, certain officers, employees, sales associates and other defendants in various Alabama and Mississippi state courts by current or former members seeking actual and punitive damages for alleged breach of contract, fraud and various other claims in connection with the sale of Memberships. During 2003, there were at one time as many as 30 separate lawsuits involving approximately 285 plaintiffs in Alabama. As of October 26, 2004, as a result of dismissals, summary judgments, or settlements for nominal amounts, the Company was aware of approximately 17 separate lawsuits involving approximately 64 plaintiffs that have been filed in multiple counties in Alabama. As of October 26, 2004, the Company was aware of 17 separate lawsuits involving approximately 430 plaintiffs in multiple counties in Mississippi. Certain of the Mississippi lawsuits also name the Company's former provider attorney in Mississippi as a defendant. Proceedings in several of the eleven cases which name the Company's provider attorney as a defendant had been stayed pending the Mississippi Supreme Court's ruling on the Pre-Paid defendants' appeal of a trial court's granting of a partial summary judgment that the action is not required to be submitted to arbitration. On April 1, 2004, the Mississippi Supreme Court affirmed the trial court's partial summary judgment that arbitration should not be had in one of the cases on appeal. Pre-Paid asked the Mississippi Supreme Court to rehear that issue but that motion was denied on June 3, 2004 and Pre-Paid sought certiorari on that issue with the United States Supreme Court on September 1 and 8, 2004. At this time, Pre-Paid is unable to predict whether or not the Court will grant certiorari review of the issue. At least three complaints have been filed by the law firm representing plaintiffs in eleven of the cases on behalf of certain of the Mississippi plaintiffs and others with the Attorney General of Mississippi in March 2002, December 2002 and August 2003. The Company has responded to the Attorney General's requests for information with respect to these complaints, and as of October 26, 2004, the Company was not aware of any further actions being taken by the Attorney General. In Mississippi, the Company has filed lawsuits in the United States District Court for the Southern and Northern Districts of Mississippi in which the Company seeks to compel arbitration of the various Mississippi claims under the Federal Arbitration Act and the terms of the Company's Membership agreements. One of the federal courts has ordered arbitration of a case involving 8 plaintiffs. These cases are all in various stages of litigation, including trial settings in Alabama in November 2004, and in Mississippi in February 2005, and seek varying amounts of actual and punitive



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damages. The first trial in Mississippi on these cases resulted in a unanimous jury verdict in the Company's favor, including other named defendants, on all claims on October 19, 2004. While the amount of Membership fees paid by the plaintiffs in the Mississippi cases is \$500,000 or less, certain of the cases seek damages of \$90 million. Additional suits of a similar nature have been threatened. The ultimate outcome of any particular case is not determinable.

On April 19, 2002, counsel in certain of the above-referenced Alabama suits also filed a similar suit against the Company and certain of its officers in the District Court of Creek County, Oklahoma on behalf of Jeff and Jana Weller individually and doing business as Hi-Tech Auto making similar allegations relating to the Company's Memberships and seeking unspecified damages on behalf of a "nationwide" class. The Pre-Paid defendants' preliminary motions in this case were denied, and on June 17, 2003, the Oklahoma Court of Civil Appeals reversed the trial court's denial of the Pre-Paid defendants' motion to compel arbitration, finding that the trial court erred when it denied Pre-Paid's motion to compel arbitration pursuant to the terms of the valid Membership contracts, and remanded the case to the trial court for further proceedings consistent with that opinion. There have been no material developments in this case since the June 17, 2003 Court of Appeals decision. The ultimate outcome of this case is not determinable.

On June 29, 2001, an action was filed against the Company in the District Court of Canadian County, Oklahoma. In 2002, the petition was amended to add five additional named plaintiffs and to add and drop certain claims. This action was originally a putative class action brought by Gina Kotwitz, later adding, George Kotwitz, Rick Coker, Richard Starke, Jeff Turnipseed and Aaron Bouren, on behalf of all sales associates of the Company. The amended petition seeks injunctive and declaratory relief, with such other damages as the court deems appropriate, for alleged violations of the Oklahoma Uniform Consumer Credit Code in connection with the Company's commission advances, and seeks injunctive and declaratory relief regarding the enforcement of certain contract provisions with sales associates, including a request stated in June 2003 for the imposition of a constructive trust as to earned commissions applied to the reduction of debit balances and disgorgement of all earned renewal commissions applied to the reduction of debit balances. On September 23, 2003 the court entered an order dismissing the class action allegations upon the motion of the plaintiffs. The order provides that the action will proceed only on an individual basis, and that the hearing on plaintiffs' motion for class certification previously set for February 2004 was cancelled. Oral argument on the Company's motion for summary judgment was held on July 2, 2004 and the court has taken the motion under advisement. The ultimate outcome of this case is not determinable.

On March 1, 2002, an action was filed in the United States District Court for the Western District of Oklahoma by Caroline Sandler, Robert Schweikert, Sal Corrente, Richard Jarvis and Vincent Jefferson against the Company and certain executive officers. This action is a putative class action seeking unspecified damages filed on behalf of all sales associates of the Company and alleges that the marketing plan offered by the Company constitutes a security under the Securities Act of 1933 and seeks remedies for failure to register the marketing plan as a security and for violations of the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with representations alleged to have been made in connection with the marketing plan. The complaint also alleges violations of the Oklahoma Securities Act, the Oklahoma Business Opportunities Sales Act, breach of contract, breach of duty of good faith and fair dealing and unjust enrichment and violation of the Oklahoma Consumer Protection Act and negligent supervision. This case is subject to the Private Litigation Securities Reform Act. Pursuant to the Act, the Court has approved the named plaintiffs and counsel and an amended complaint was filed in August 2002. The Pre-Paid defendants filed motions to dismiss the complaint and to strike the class action allegations on September 19, 2002, and discovery in the action was stayed pending a ruling on the motion to dismiss. On July 24,

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2003, the Court granted in part and denied in part the Pre-Paid defendants' motion to dismiss. The claims asserted under the Securities Exchange Act of 1934 and the Oklahoma Securities Act were dismissed without prejudice. The motion was denied as to the remaining claims. On September 8, 2004, the Court denied plaintiffs motion for class certification. Plaintiffs have petitioned the Tenth Circuit Court of Appeals for permission to appeal the class certification ruling, and that matter has been fully briefed. At this time, the Company is unable to predict when the determination of whether or not an interlocutory appeal of the denial of class certification will be allowed. The ultimate outcome of this case is not determinable.

On January 30, 2003, the Company announced that it had received a subpoena from the office of the United States Attorney for the Southern District of New York requesting information relating to trading activities in the Company's stock in advance of the January 2003 announcement of recruiting and Membership production results for the fourth quarter of 2002. The Company also received notice from the Securities and Exchange Commission that it is conducting an informal inquiry into the same subject and requesting that the Company voluntarily provide certain information. The Company has and will continue to respond to any such requests, the last of which occurred in July 2003. As of October 26, 2004, the Company was not aware of any further inquiries in either of these matters. The ultimate outcome of these matters is not determinable.

The Company is a defendant in various other legal proceedings that are routine and incidental to its business. The Company will vigorously defend its interests in all proceedings in which it is named as a defendant. The Company also receives periodic complaints or requests for information from various state and federal agencies relating to its business or the activities of its marketing force. The Company promptly responds to any such matters and provides any information requested.

While the ultimate outcome of these proceedings is not determinable, the Company does not currently anticipate that these contingencies will result in any material adverse effect to its financial condition or results of operation, unless an unexpected result occurs in one of the cases. The costs of the defense of these various matters are reflected as a part of general and administrative expense in the consolidated statements of income. The Company has established an accrued liability it believes will be sufficient to cover estimated damages in connection with various cases (exclusive of ongoing defense costs which are expensed as incurred), which at September 30, 2004 was \$3.0 million. The Company believes it has meritorious defenses in all pending cases and will vigorously defend against the plaintiffs' claims. However, it is possible that an adverse outcome in certain cases or increased litigation costs could have an adverse effect upon the Company's financial condition, operating results or cash flows in particular quarterly or annual periods.

### Note 3 - Treasury Stock Purchases

The Company announced on April 6, 1999, a treasury stock purchase program authorizing management to acquire up to 500,000 shares of the Company's common stock. The Board of Directors has increased such authorization from 500,000 shares to 10 million shares during subsequent board meetings. At September 30, 2004, the Company had purchased 9.0 million treasury shares under these authorizations for a total consideration of \$209.4 million, an average price of \$23.19 per share. The Company purchased and formally retired 1.0 million and 1.4 million shares of its common stock during the 2004 third quarter and nine month period for \$26.8 million and \$36.0 million, or an average price of \$25.98 and \$25.58, reducing its common stock by \$10,309 and \$14,064 and its retained earnings by \$26.8 million and \$36.0 million, respectively. See Note 5 below. At September 30, 2004 there was an accrued expense of \$25.5 million, reflecting an amount owed (and subsequently paid on October 5, 2004) to purchase 980,518 shares in a Dutch auction tender offer which expired on September 28, 2004.

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Given the current interest rate environment, the nature of other investments available and the Company's expected cash flows, management believes that purchasing treasury shares enhances shareholder value and may seek alternative sources of financing to continue or accelerate the program. Any additional treasury stock purchases will be made at prices that are considered attractive by management and at such times that management believes will not unduly impact the Company's liquidity.

### Note 4 - Earnings Per Share

Basic earnings per common share are computed by dividing net income by the weighted average number of shares of common stock outstanding during the year. Diluted earnings per common share are computed by dividing net income by the weighted average number of shares of common stock and dilutive potential common shares outstanding during the year. The weighted average number of common shares is also increased by the number of dilutive potential common shares issuable on the exercise of options less the number of common shares assumed to have been purchased with the proceeds from the exercise of the options pursuant to the treasury stock method; those purchases are assumed to have been made at the average price of the common stock during the respective period.

|   | Three Months<br>Ended September 30, |          | Ende |
|---|-------------------------------------|----------|------|
|   | 2004                                | 2003     | 20   |
| Basic Earnings Per Share:                           |                                     |          |      |
| Earnings:   |                                     |          |      |
| Net income.....                                     | \$ 9,657                            | \$ 9,438 | \$ 3 |
| Shares:   |                                     |          |      |
| Weighted average shares outstanding.....            | 16,481                              | 17,335   | 1    |
| Diluted Earnings Per Share:                         |                                     |          |      |
| Earnings:   |                                     |          |      |
| Net income.....                                     | \$ 9,657                            | \$ 9,438 | \$ 3 |
| Shares:   |                                     |          |      |
| Weighted average shares outstanding.....            | 16,481                              | 17,335   | 1    |
| Assumed exercise of options.....                    | 100                                 | 70       |      |
| Weighted average number of shares, as adjusted..... | 16,581                              | 17,405   | 1    |

Options to purchase shares of common stock are excluded from the calculation of diluted earnings per share when their inclusion would have an anti-dilutive effect on the calculation. Options to purchase 553,000 shares and 753,000 shares for the three months and 593,000 shares and 809,000 shares for the nine months ended September 30, 2004 and 2003, respectively, with an average exercise price of \$27.85, \$28.19, \$27.58, and \$27.79, respectively, were excluded from the calculation of diluted earnings per share for the respective periods.

### Note 5 - Notes Payable and Capital Leases

On June 11, 2002, the Company entered into two line of credit agreements totaling \$30 million with a commercial lender providing for a treasury stock

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purchase line and a real estate line for funding of the Company's new corporate office complex. The treasury stock line of credit provided for funding of up to \$10 million to finance treasury stock purchases and has been repaid. The real estate line of \$20 million was fully funded in December 2003 with interest at the 30 day LIBOR Rate plus 2.25%, adjusted monthly, and repayments began in December 2003 with monthly principal payments of \$191,000 plus interest with a balloon payment on September 30, 2008. The loan is primarily collateralized by a first mortgage on the 87 acre construction site, the 170,000 square foot home office complex, the Company's rights to receive Membership fees on a portion of its Memberships and by a security interest covering all equipment. The interest rate at September 30, 2004 was 3.92%. The real estate loan agreement provides for financial covenants substantially the same as those described below for the amended stock purchase loan.

During the 2003 third quarter, the Company arranged \$25 million in additional financing from a group of banks, consisting of Bank of Oklahoma, Comerica Bank and First United Bank and Trust. The \$25 million was fully funded on November 30, 2003. The financing provided up to \$25 million for treasury stock purchases with scheduled monthly principal payments of \$1.4 million beginning December 31, 2003 through May 31, 2005 with interest at the 30 day LIBOR Rate plus three percent, adjusted monthly. During August 2004, the Company amended the terms of the loan agreement with these banks to increase the loan amount to \$31.5 million. The amended loan agreement provides for treasury stock purchases of up to \$31.5 million of which the Company has \$5.9 million available as of October 26, 2004. The Company fully funded the loan on September 30, 2004 which resulted in a net increase in credit of \$19.0 million above the outstanding balance of its existing treasury stock term loan of \$12.5 million at the time. Proceeds of this loan together with existing cash resources were used to purchase treasury shares. The amortization of the amended loan has been modified to provide for repayment over 24 months in equal monthly principal payments beginning October 31, 2004 and ending September 30, 2006 with the same interest rate of the 30 day LIBOR rate plus 3%. The interest rate at September 30, 2004 was 4.67%. The monthly principal payment will be \$1.3 million compared to the monthly payment on the prior loan of \$1.4 million. The amended loan agreement continues all of the covenants of the prior agreement with certain modifications to permit additional stock purchases and/or dividends while the loan is outstanding generally in an amount no greater than 50% of net income and modifies the debt service coverage ratio definition slightly. Additionally \$4.8 million (50% of 3rd quarter 2004 net income) is available for stock purchases and/or dividends.

The loan is primarily collateralized by the Company's rights to receive Membership fees on a portion of its Memberships and a pledge of the stock of its subsidiaries. The definitive agreement contains covenants prohibiting the Company from pledging assets, incurring additional indebtedness and selling assets. In addition to customary events of default, an additional event of default occurs if Harland C. Stonecipher ceases to be the chairman and Chief Executive Officer of the Company for 90 days. Pre-payment of the loan is permitted. The loan agreements contain the following financial covenants: (a) the Company's quarterly Debt Coverage Ratio (as defined in the loan agreements) shall not be less than 125%; (b) the Company's cancellation rate on contracts less than or equal to twelve months old shall not exceed 45% on a trailing 12 month basis, calculated on a quarterly basis; (c) the Company shall maintain a rolling twelve month average retention rate of Membership contracts in place for greater than eighteen months of not less than 70%, calculated on a monthly basis; (d) the Company shall not pay dividends or purchase treasury shares, which during any fiscal quarter, on a combined basis, would exceed fifty percent (50%) of the Company's cumulative net income for all previous fiscal quarters beginning July 1, 2004 less any dividends or stock purchases in such previous fiscal quarters, with provisions for carry forwards of unused availability; and, (e) the Company's tangible net worth shall not fall below \$10 million for the period of time dating from September 30, 2004, \$15 million beginning March 31,

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2005 and \$25 million beginning December 31, 2005.

A schedule of outstanding balances and future maturities as of September 30, 2004 follows:

|   |    |          |
|---|----|----------|
| Real estate loan.....                       | \$ | 18,095   |
| Stock purchase loan.....                    |    | 31,500   |
|   |    | -----    |
| Total notes payable.....                    |    | 49,595   |
| Less: Current portion of notes payable..... |    | (18,036) |
|   |    | -----    |
| Long term portion.....                      | \$ | 31,559   |
|   |    | -----    |
| Repayment Schedule commencing October 2004: |    |          |
| Year 1.....                                 | \$ | 18,036   |
| Year 2.....                                 |    | 18,036   |
| Year 3.....                                 |    | 2,285    |
| Year 4.....                                 |    | 11,238   |
| Year 5.....                                 |    | -        |
|   |    | -----    |
| Total notes payable.....                    | \$ | 49,595   |
|   |    | -----    |

During 2003, the Company entered into a capital lease in the amount of \$2.4 million to acquire new computer hardware to supplement its current information technology platform and provide redundancy for its critical business systems. The capital lease requires the Company to make annual payments of \$792,000 beginning January 2003 through January 2005.

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operation in the Company's Form 10-K for the year ended December 31, 2003, which describes, among other things, the Company's basic business model, critical accounting policies, measures of Membership retention, and basic cash flow characteristics of the Company's business. The following tables set forth changes in the principal categories of revenues and expenses and Membership and recruiting activity for the third quarter of 2004 compared to the third quarter of 2003 and the second quarter of 2004 and the nine months ended September 30, 2004 compared to the nine months ended September 30, 2003 (Amounts in 000's):

| Three Months Ended September 30, 2004<br>compared to<br>Three Months Ended September 30, 2003 | Three<br>Months<br>Ended<br>Sept. 30,<br>2004 | % of<br>Total<br>Revenue | %<br>Change<br>from<br>Prior<br>Year | %<br>Change<br>from<br>Sequential<br>Period | Three<br>Months<br>Ended<br>Sept. 30,<br>2003 | % of<br>Total<br>Revenue |
|---|---|--------------------------|--------------------------------------|---|---|--------------------------|
| Revenues:   |   |                          |                                      |   |   |                          |
| Membership fees.....  | \$89,317                                      | 92.2                     | 8.0                                  | 1.4   | \$82,695                                      | 91.9                     |
| Associate services.....   | 6,132   | 6.3                      | 1.6                                  | 3.6   | 6,033   | 6.7                      |
| Other.....  | 1,404   | 1.5                      | 8.3                                  | 0.9   | 1,296   | 1.4                      |
|   | -----   | -----                    | -----                                | -----                                       | -----   | -----                    |
|   | 96,853  | 100.0                    | 7.6                                  | 1.5   | 90,024  | 100.0                    |

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|  |          |      |       |       |          |      |
|--|----------|------|-------|-------|----------|------|
| Costs and expenses:                          |          |      |       |       |          |      |
| Membership benefits.....                     | 31,100   | 32.1 | 11.3  | 2.1   | 27,956   | 31.1 |
| Commissions.....                             | 30,097   | 31.1 | 5.8   | 1.7   | 28,443   | 31.6 |
| Associate services and direct marketing..... | 7,304    | 7.5  | (1.4) | 9.0   | 7,411    | 8.2  |
| General and administrative.....              | 11,083   | 11.4 | 12.0  | 1.6   | 9,896    | 11.0 |
| Other, net.....                              | 2,526    | 2.6  | 16.1  | 0.8   | 2,175    | 2.4  |
|  | 82,110   | 84.8 | 8.2   | 2.4   | 75,881   | 84.3 |
| Income before income taxes.....              | 14,743   | 15.2 | 4.2   | (3.5) | 14,143   | 15.7 |
| Provision for income taxes.....              | 5,086    | 5.3  | 8.1   | (3.5) | 4,705    | 5.2  |
| Net income.....                              | \$ 9,657 | 10.0 | 2.3   | (3.5) | \$ 9,438 | 10.5 |

|  | Nine Months Ended Sept. 30, 2004 | % of Total Revenue | % Change from Prior Year | Nine Months Ended Sept. 30, 2003 | % of Total Revenue |
|--|----------------------------------|--------------------|--------------------------|----------------------------------|--------------------|
| Revenues:                                    |                                  |                    |                          |                                  |                    |
| Membership fees.....                         | \$264,187                        | 92.1               | 7.3                      | \$246,123                        | 91.2               |
| Associate services.....                      | 18,607                           | 6.5                | (6.5)                    | 19,900                           | 7.4                |
| Other.....                                   | 4,097                            | 1.4                | 3.4                      | 3,963                            | 1.5                |
|  | 286,891                          | 100.0              | 6.3                      | 269,986                          | 100.0              |
| Costs and expenses:                          |                                  |                    |                          |                                  |                    |
| Membership benefits.....                     | 90,835                           | 31.7               | 10.4                     | 82,271                           | 30.5               |
| Commissions.....                             | 88,960                           | 31.0               | 4.7                      | 84,974                           | 31.5               |
| Associate services and direct marketing..... | 21,611                           | 7.5                | (1.0)                    | 21,820                           | 8.1                |
| General and administrative.....              | 32,033                           | 11.2               | 19.5                     | 26,817                           | 9.9                |
| Other, net.....                              | 7,215                            | 2.5                | 15.3                     | 6,256                            | 2.3                |
|  | 240,654                          | 83.9               | 8.3                      | 222,138                          | 82.3               |
| Income before income taxes.....              | 46,237                           | 16.1               | (3.4)                    | 47,848                           | 17.7               |
| Provision for income taxes.....              | 15,952                           | 5.6                | (2.3)                    | 16,333                           | 6.1                |
| Net income.....                              | \$30,285                         | 10.6               | (3.9)                    | \$31,515                         | 11.7               |

| New Memberships: | Three Months Ended |           |           |
|------------------|--------------------|-----------|-----------|
|                  | 9/30/2004          | 9/30/2003 | 6/30/2003 |
|                  |                    |           |           |

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|   |           |           |          |
|---|-----------|-----------|----------|
| New legal service membership sales.....                                     | 157,058   | 168,356   | 137,39   |
| New "stand-alone" IDT membership sales.....                                 | 4,906     | -         | 5,44     |
|   | -----     | -----     | -----    |
| Total new membership sales.....   | 161,964   | 168,356   | 142,83   |
|   | -----     | -----     | -----    |
| New "add-on" IDT membership sales.....                                      | 87,136    | -         | 77,80    |
| Active Memberships:   |           |           |          |
| Active legal service memberships at end of period.....                      | 1,422,444 | 1,420,860 | 1,413,66 |
| Active "stand-alone" IDT memberships at end of period (see note below)..... | 21,302    | -         | 17,57    |
|   | -----     | -----     | -----    |
| Total active memberships at end of period.....                              | 1,443,746 | 1,420,860 | 1,431,24 |
|   | -----     | -----     | -----    |
| Active "add-on" IDT memberships at end of period (see note below).....      | 247,370   | -         | 201,71   |
| New sales associates recruited.....   | 37,216    | 22,987    | 13,73    |
| Average Membership fee in force.....  | \$271.77  | \$257.57  | \$269.1  |

(Note - reflects 3,642 transfers from "add-on" status to "stand-alone" status during the quarter)

Identity Theft Shield ("IDT") memberships sold in conjunction with new legal plan memberships or "added-on" to existing legal plan memberships sell for \$9.95 per month and are not counted as "new" memberships but do increase the average premium and related direct expenses (membership benefits and commissions) of the Company's membership base, while "stand alone" Identity Theft Shield memberships are not attached to a legal plan membership and sell for \$12.95 per month.

Beginning June 28, 2004, and running through July 31, 2004, the Company began a special promotion for single parents allowing single parents that entered into a performance agreement with the Company whereby they committed to attend training and hold private business receptions within a specified time frame to become a Fast Start associate for \$49 rather than \$249 which was in place for all other new associates. Beginning August 1, 2004, the cost to become a Fast Start sales associate reverted back to \$249 for all new associates unless the new sales associate executed the performance agreement. The majority of new sales associates that enrolled during the current quarter were either single parents (at \$49) or other associates who executed the performance agreement and were allowed to join for \$149, otherwise all new Fast Start sales associates paid \$249. The fee to become a new Fast Start sales associate was \$149 during the comparable period of 2003. The Company's recruiting and new Membership sales improved in the third quarter of 2004 compared to the second quarter and the Company expects to continue to make efforts to grow its Membership base.

Results of Operations - First nine months of 2004 compared to first nine months of 2003

The Company reported net income of \$30.3 million, or \$1.82 per diluted common share, for the nine months ended September 30, 2004, down 4% from net income of \$31.5 million, or \$1.78 per diluted common share, for the comparable period of the prior year due to the Company incurring after-tax losses of \$7.8 million related to the Identity Theft Shield membership base in the 2004 nine month period compared to none in the 2003 comparable period. These after-tax losses are primarily created since the Company advances significant commissions at the time a membership is sold and are expensed during the first month of the membership. Since approximately 95% of membership fees are collected on a monthly basis, a significant cash flow deficit and after-tax loss is created at the time a membership is sold. This deficit and loss are reduced as monthly membership fees are remitted and no additional commissions are paid on the

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membership until all previous unearned advance commission balances have been fully recovered. Diluted earnings per share increased 2% due to an approximate 6% decrease in the weighted average number of outstanding shares.

Membership fees totaled \$264.2 million during 2004 compared to \$246.1 million for 2003, an increase of 7%. Membership fees and their impact on total revenues in any period are determined directly by the number of active Memberships in force during any such period and the monthly amount of such Memberships. The active Memberships in force are determined by both the number of new Memberships sold in any period together with the renewal rate of existing Memberships. New Membership sales decreased 10% during the nine months ended September 30, 2004 to 467,629 from 518,356 during the comparable period of 2003. At September 30, 2004, there were 1,443,746 active Memberships in force compared to 1,420,860 at September 30, 2003, an increase of 2%. Additionally, the average annual fee per Membership has increased from \$258 for all Memberships in force at September 30, 2003 to \$272 for all Memberships in force at September 30, 2004, as a result of a larger number of Legal Shield subscribers, increased sales of the Company's business oriented Memberships and the introduction of the Identity Theft Shield during the fourth quarter of 2003.

Associate services revenue decreased 7% from \$19.9 million for the first nine months of 2003 to \$18.6 million during the comparable period of 2004 primarily as a result of approximately 13% fewer new associates recruited. Total new associates enrolled during the first nine months of 2004 were 65,723 compared to 75,489 for the same period of 2003. As a result of the 13% lower overall recruiting, associate fees decreased 8% from \$11.8 million for the first nine months of 2003 to \$10.9 million during the comparable period of 2004. Beginning June 28, 2004, and running through July 31, 2004, the Company began a special promotion for single parents allowing single parents that entered into a performance agreement with the Company whereby they committed to attend training and hold private business receptions within a specified time frame to become a Fast Start associate for \$49 rather than \$249 which was in place for all other new associates. Beginning August 1, 2004, the cost to become a Fast Start sales associate reverted back to \$249 for all new associates unless the new sales associate executed the performance agreement. The majority of new sales associates that enrolled during the current quarter were either single parents (at \$49) or other associates who executed the performance agreement and were allowed to join for \$149, otherwise all new Fast Start sales associates paid \$249. The fee to become a new Fast Start sales associate was \$149 during the comparable period of 2003. Future revenues from associate services will depend primarily on the number of new associates enrolled, the price charged for the Fast Start program and the number who choose to participate in the Company's eService program, but the Company expects that such revenues will continue to be offset by the direct and indirect cost to the Company of training (including training bonuses paid), providing associate services and other direct marketing expenses.

Other revenue increased slightly to \$4.1 million for the first nine months of 2004 compared to \$4.0 million for the comparable period of 2003.

Primarily as a result of the increase in Membership fees, total revenues increased to \$286.9 million for the nine months ended September 30, 2004 from \$270.0 million during the comparable period of 2003, an increase of 6%.

Membership benefits totaled \$90.8 million for the nine months ended September 30, 2004 compared to \$82.3 million for the comparable period of 2003, and represented 34% and 33% of Membership fees for the 2004 and 2003 periods, respectively. This Membership benefit ratio (Membership benefits as a percentage of Membership fees) should remain near current levels as substantially all active Memberships provide for a capitated cost in the absence of any changes in the capitated benefit level, which has not changed significantly since 1993. However, the higher benefit ratio of the Identity Theft Shield Membership may



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increase the blended benefit ratio if the Company continues to increase the number of Identity Theft Shield Memberships in force.

Commissions to associates increased 5% to \$89.0 million for the nine months ended September 30, 2004 compared to \$85.0 million for the comparable period of 2003, and represented 34% and 35% of Membership fees for such periods. Commissions to associates are primarily dependent on the number of new Memberships sold during a period. New Memberships sold during the nine months ended September 30, 2004 totaled 467,629, a 10% decrease from the 518,356 sold during the comparable period of 2003. Commissions to associates per new Membership sold were \$190 per Membership for the nine months ended September 30, 2004 compared to \$164 for the comparable period of 2003. The average commission per new Membership sold varies depending on the compensation structure that is in place at the time a new Membership is sold, the amount of the Membership fee and the amount of any charge-backs (recoupment of previous commission advances) that are deducted from amounts that would otherwise be paid to the various sales associates that are compensated for the Membership sale. Should the Company add additional commissions to its compensation plan or reduce the amount of chargebacks collected from its associates as it has from time to time, the commission cost per new Membership will increase accordingly.

Associate services and direct marketing expenses decreased very slightly to \$21.6 million for the nine months ended September 30, 2004 from \$21.8 million for the comparable period of 2003. These expenses also include the costs of providing associate services and marketing expenses.

General and administrative expenses during the nine months ended September 30, 2004 and 2003 were \$32.0 million and \$26.8 million, respectively, and represented 12% and 11%, respectively, of Membership fees for each period. The increases in general and administrative expense reflect higher levels of expenses related to bank services charges, legal and professional fees, salaries and benefits and franchise and other taxes. The Company should experience cost efficiencies as a result of certain economies of scale in some areas but expects such cost savings for the remainder of 2004 to be largely offset by higher levels of expenses related to legal fees, expenses related to its new corporate headquarters and increased compliance costs as a result of new requirements of the Sarbanes-Oxley Act of 2002.

Other expenses, net, which include depreciation and amortization, interest expense and premium taxes reduced by interest income, was \$7.2 million for the period ended September 30, 2004 compared to \$6.3 million for the 2003 comparable period. Depreciation increased to \$5.8 million for the first nine months of 2004 from \$5.3 million for the comparable period of 2003 primarily due to capital expenditures during the last 12 months and interest expense increased to \$1.4 million during the 2004 period from \$15,000 during the comparable period of 2003. During the 2003 period, substantially all interest costs were capitalized in connection with the construction of the Company's new corporate headquarters. Premium taxes decreased from \$2.0 million for the nine months ended September 30, 2003 to \$1.3 million for the comparable period of 2004. The decrease in 2004 was due to a change in the tax structure of one of the states in which the Company pays premium taxes. Interest income increased by approximately \$94,000 for the first nine months of 2004 to \$1.2 million from \$1.1 million for the 2003 period due to an increase in balances of interest bearing assets.

The Company has recorded a provision for income taxes of \$16.0 million (34.5% of pretax income) for the first nine months of 2004 compared to \$16.3 million (34.1% of pretax income) for the same period of 2003.

Results of Operations - Third quarter of 2004 compared to third quarter of 2003

Net income increased 2% for the third quarter of 2004 to \$9.7 million from \$9.4 million for the prior year's third quarter even though the Company incurred

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after-tax losses of \$2.8 million related to the Identity Theft Shield membership base in the 2004 third quarter period compared to none in the 2003 comparable period. These after-tax losses occur for the reasons discussed above. Diluted earnings per share increased 7% to 58 cents per share from 54 cents per share for the prior year's comparable quarter due to an approximate 5 percent decrease in the weighted average number of outstanding shares.

Membership fees totaled \$89.3 million during the 2004 third quarter compared to \$82.7 million for 2003, an increase of 8%. Membership fees and their impact on total revenues in any period are determined directly by the number of active Memberships in force during any such period and the monthly amount of such Memberships. The active Memberships in force are determined by both the number of new Memberships sold in any period together with the renewal rate of existing Memberships. New Membership sales decreased 4% during the three months ended September 30, 2004 to 161,964 from 168,356 during the comparable period of 2003. At September 30, 2004, there were 1,443,746 active Memberships in force compared to 1,420,860 at September 30, 2003, an increase of 2%. Additionally, the average annual fee per Membership has increased from \$258 for all Memberships in force at September 30, 2003 to \$272 for all Memberships in force at September 30, 2004, as a result of a larger number of Legal Shield subscribers, increased sales of the Company's business oriented Memberships and the introduction of the Identity Theft Shield during the fourth quarter of 2003.

Associate services revenue increased only 2% from \$6.0 million for the third three months of 2003 to \$6.1 million during the comparable period of 2004 even though 62% more new associates were recruited. Total new associates enrolled during the third quarter of 2004 were 37,216 compared to 22,987 for the same period of 2003. Associate fees increased 2% from \$3.6 million for the third three months of 2003 to \$3.7 million during the comparable period of 2004. Beginning June 28, 2004, and running through July 31, 2004, the Company began a special promotion for single parents allowing single parents that entered into a performance agreement with the Company whereby they committed to attend training and hold private business receptions within a specified time frame to become a Fast Start associate for \$49 rather than \$249 which was in place for all other new associates. Beginning August 1, 2004, the cost to become a Fast Start sales associate reverted back to \$249 for all new associates unless the new sales associate executed the performance agreement. The majority of new sales associates that enrolled during the current quarter were either single parents (at \$49) or other associates who executed the performance agreement and were allowed to join for \$149, otherwise all new Fast Start sales associates paid \$249. The fee to become a new Fast Start sales associate was \$149 during the comparable period of 2003. Future revenues from associate services will depend primarily on the number of new associates enrolled, the price charged for the Fast Start program and the number who choose to participate in the Company's eService program, but the Company expects that such revenues will continue to be offset by the direct and indirect cost to the Company of training providing associate services and other direct marketing expenses.

Other revenue increased slightly to \$1.4 million for the third quarter of 2004 compared to \$1.3 million for the comparable period of 2003.

Primarily as a result of the increase in Membership fees, total revenues increased to \$96.9 million for the three months ended September 30, 2004 from \$90.0 million during the comparable period of 2003, an increase of 8%.

Membership benefits totaled \$31.1 million for the three months ended September 30, 2004 compared to \$28.0 million for the comparable period of 2003, and represented 35% and 34% of Membership fees for the 2004 and 2003 periods, respectively. This Membership benefit ratio (Membership benefits as a percentage of Membership fees) pertaining to legal service plans should remain near current levels as substantially all active Memberships provide for a capitated cost in the absence of any changes in the capitated benefit level, which has not changed

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significantly since 1993. However, the higher benefit ratio of the Identity Theft Shield Membership may increase the blended benefit ratio if the Company continues to increase the number of Identity Theft Shield Memberships in force.

Commissions to associates increased 6% to \$30.1 million for the three months ended September 30, 2004 compared to \$28.4 million for the comparable period of 2003, and represented 34% of Membership fees for both periods. Commissions to associates are primarily dependent on the number of new memberships sold, including add-on membership sales, during a period. New memberships sold during the three months ended September 30, 2004 totaled 161,964, a 4% decrease from the 168,356 sold during the comparable period of 2003. Commissions to associates per new membership sold were \$186 per membership for the three months ended September 30, 2004 compared to \$169 for the comparable period of 2003. The average commission per new membership sold varies depending on the compensation structure that is in place at the time a new membership is sold, the amount of the Membership fee and the amount of any charge-backs (recoupment of previous commission advances) that are deducted from amounts that would otherwise be paid to the various sales associates that are compensated for the membership sale. Should the Company add additional commissions to its compensation plan or reduce the amount of chargebacks collected from its associates as it has from time to time, the commission cost per new Membership will increase accordingly.

Associate services and direct marketing expenses decreased to \$7.3 million for the three months ended September 30, 2004 from \$7.4 million for the comparable period of 2003. The Company offers the Player's Club incentive program to provide additional incentives to its associates as a reward for consistent, quality business. Associates can earn the right to receive additional monthly bonuses by meeting monthly qualification requirements for the entire calendar year and maintaining certain personal retention rates for the Memberships sold during the calendar year. These expenses also include the costs of providing associate services and marketing expenses.

General and administrative expenses during the three months ended September 30, 2004 and 2003 were \$11.1 million and \$9.9 million, respectively, and represented 12% of Membership fees for both periods. The 2004 third quarter reflects increased franchise and other taxes, professional fees, and increased expenses related to licenses and fees and bank service charges due to the increases in legal plans and Identity Theft Shield Memberships. The Company should experience cost efficiencies as a result of certain economies of scale in some areas but expects any such cost savings for the remainder of 2004 to be largely offset by higher levels of expenses related to legal fees, expenses related to its new corporate headquarters and increased compliance costs as a result of new requirements of the Sarbanes-Oxley Act of 2002.

Other expenses, net, which include depreciation and amortization, interest expense and premium taxes reduced by interest income, was \$2.5 million for the period ended September 30, 2004 compared to \$2.2 million for the 2003 comparable period. Depreciation increased to \$1.9 million for the third quarter of 2004 from \$1.8 million for the comparable period of 2003 primarily due to capital expenditures during the last 12 months and interest expense increased to \$500,000 during the 2004 period from \$7,000 during the comparable period of 2003. During the 2003 period, substantially all interest costs were capitalized in connection with the construction of the Company's new corporate headquarters. Premium taxes decreased from \$683,000 for the three months ended September 30, 2003 to \$441,000 for the comparable period of 2004 primarily due to one of the states changing the type of taxes that the Company is required to pay instead of premium taxes.

The Company has recorded a provision for income taxes of \$5.1 million (34.5% of pretax income) for the third quarter of 2004 and a provision of \$4.7 million (33.3% of pretax income) for the 2003 comparable period.

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Results of Operations - Third Quarter of 2004 compared to the Second Quarter of 2004

Third quarter 2004 membership fees increased one percent to \$89.3 million from \$88.1 million for the second quarter of 2004. Associate services revenues increased during the 2004 third quarter by approximately \$214,000 to \$6.1 million from \$5.9 million for the 2004 second quarter and associate services and direct marketing expenses increased by \$600,000 during the same period. Membership benefits totaled \$31.1 million in the third quarter of 2004 compared to \$30.4 million for the second quarter and represented 35% of membership fees for both periods. Commissions to associates totaled \$30.1 million in the third quarter of 2004 compared to \$29.6 million for the second quarter and represented 34% of membership fees for both periods. General and administrative expenses increased during the 2004 third quarter to \$11.1 million compared to \$10.9 million for the second quarter of 2004 and represented 12.4% of membership fees for both periods.

### Liquidity and Capital Resources

#### General

Consolidated net cash provided from operating activities for the first nine months of 2004 decreased 23 percent to \$30.5 million from \$39.6 million for the 2003 period, although cash provided from operating activities before changes in working capital items remained unchanged at \$37.3 million for both periods. Approximate \$10.3 million negative cash flow resulted from sales of Identity Theft Shield ("IDT") memberships during the 2004 period. This negative cash flow is created since the Company advances significant commissions at the time a membership is sold. Since approximately 95% of membership fees are collected on a monthly basis, a significant cash flow deficit loss is created at the time a membership is sold. This deficit is reduced as monthly membership fees are remitted and no additional commissions are paid on the membership until all previous unearned advance commission balances have been fully recovered. The decrease of \$9.1 million resulted primarily from the decrease in net income of \$1.2 million (which includes the effect of the IDT negative cash flow), a net increase in the change in other assets (both current and non-current) of \$2.2 million, an increase in deferred member and associate service costs of \$1.9 million and a net decrease in the change in accounts payable and accrued expenses of \$4.9 million.

Consolidated net cash provided by investing activities was \$1.9 million for the first nine months of 2004 compared to net cash used in investing activities of \$21.8 million for the comparable period of 2003. This \$23.7 million increase in cash provided by investing activities resulted from the \$13.7 million decrease in additions to property and equipment, an increase of \$12.3 million in maturities and sales of investments partially offset by a \$2.3 million increase in purchases of available-for-sale investments.

Net cash used in financing activities during the first nine months of 2004 was \$2.9 million compared to \$26.1 million for the comparable period of 2003. This \$23.2 million change was primarily comprised of the \$23.7 million decrease in purchases of treasury stock, a \$2.7 million increase in debt proceeds partially offset by an increase of \$4.5 million in payments on debt obligations.

During the nine months ended September 30, 2004, the Company purchased and formally retired 1.4 million shares of treasury stock (including the 980,518 shares acquired pursuant to the tender offer) reducing its common stock accounts by \$14,064 and retained earnings by \$36.0 million. The Company had a consolidated working capital deficit of \$12.3 million at September 30, 2004, an increase of \$476,000 compared to a consolidated working capital deficit of \$11.9 million at December 31, 2003. The increase was primarily due to a \$21.8 million increase in accounts payable and accrued expenses partially offset by the \$19.5 million increase in cash and cash equivalents and available-for-sale

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investments. The \$12.3 million working capital deficit at September 30, 2004 would have been a \$3.5 million working capital deficit excluding the current portion of deferred revenue and fees in excess of the current portion of deferred member and associate service costs. These amounts will be eliminated by the passage of time without the utilization of other current assets or the Company incurring other current liabilities. The Company does not expect any difficulty in meeting its financial obligations in the short term or the long term.

At September 30, 2004 the Company reported \$68 million (including approximately \$19 million of loan proceeds related to the Company's tender offer which had not yet been utilized) in cash and cash equivalents and unpledged investments compared to \$47.4 million at December 31, 2003. The Company's investments consist of common stocks, investment grade (rated Baa or higher) bonds primarily issued by corporations, the United States Treasury, federal agencies, federally sponsored agencies and enterprises as well as mortgage-backed securities and state and municipal tax-exempt bonds.

The Company generally advances significant commissions at the time a Membership is sold. During the nine months ended September 30, 2004, the Company advanced commissions, net of chargebacks, of \$81.1 million on new Membership sales compared to \$83.7 million for the same period of 2003. Since approximately 95% of Membership fees are collected on a monthly basis, a significant cash flow deficit is created on a per Membership basis at the time a Membership is sold. Since there are no further commissions paid on a Membership during the advance period, the Company typically derives significant positive cash flow from the Membership over its remaining life.

The Company expenses advance commissions ratably over the first month of the related Membership. As a result of this accounting policy, the Company's commission expenses are all recognized over the first month of a Membership and there is no commission expense recognized for the same Membership during the remainder of the advance period. The Company tracks its unearned advance commission balances outstanding in order to ensure the advance commissions are recovered before any renewal commissions are paid and for internal purposes of analyzing its commission advance program. While not recorded as an asset, unearned advance commission balances from associates as of September 30, 2004, and related activity for the nine month period then ended, were:

|   | (Amounts in 000) |
|---|------------------|
| Beginning unearned advance commission payments (1).....   | \$ 191,894       |
| Advance commission payments, net.....   | 81,119           |
| Earned commissions applied.....   | (87,027)         |
| Advance commission payment write-offs.....  | (2,075)          |
| <hr style="border-top: 1px dashed black;"/>   |                  |
| Ending unearned advance commission payments before<br>estimated unrecoverable payments (1)..... | 183,911          |
| Estimated unrecoverable advance commission payments (1).....                                    | (27,514)         |
| <hr style="border-top: 1px dashed black;"/>   |                  |
| Ending unearned advance commission payments, net (1).....                                       | \$ 156,397       |
| <hr style="border-top: 1px dashed black;"/>   |                  |

(1) These amounts do not represent fair value, as they do not take into consideration timing of estimated recoveries.

The ending unearned advance commission payments, net, above includes net unearned advance commission payments to non-vested associates of \$33.5 million. As such, at September 30, 2004 future commission payments and related expense

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should be reduced as unearned advance commission payments of \$123 million are recovered. Commissions are earned by the associate as Membership premiums are earned by the Company, usually on a monthly basis. For additional information concerning these commission advances, see the Company's Annual report on Form 10-K under the heading Commissions to Associates in Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

The Company believes that it has significant ability to finance expected future growth in Membership sales based on its recurring cash flow and existing amount of cash and cash equivalents and unpledged investments at September 30, 2004 of \$68 million (including approximately \$19 million of loan proceeds related to the Company's tender offer which had not yet been utilized). The Company expects to maintain cash and investment balances, including pledged investments, on an on-going basis of approximately \$20 to \$30 million in order to meet expected working capital needs and regulatory capital requirements. Cash balances in excess of this amount would be used for discretionary purposes such as additional treasury stock purchases to the extent permitted by the terms of the Company's amended stock purchase loan.

On June 11, 2002, the Company entered into two line of credit agreements totaling \$30 million with a commercial lender providing for a treasury stock purchase line and a real estate line for funding of the Company's new corporate office complex. The treasury stock line of credit provided for funding of up to \$10 million to finance treasury stock purchases and has been repaid. The real estate line of \$20 million was fully funded in December 2003 with interest at the 30 day LIBOR Rate plus 2.25%, adjusted monthly, and repayments began in December 2003 with monthly principal payments of \$191,000 plus interest with a balloon payment on September 30, 2008. The loan is primarily collateralized by a first mortgage on the 87 acre construction site, the 170,000 square foot home office complex, the Company's rights to receive Membership fees on a portion of its Memberships and by a security interest covering all equipment. The interest rate at September 30, 2004 was 3.92%. The real estate loan agreement provides for financial covenants substantially the same as those described below for the amended stock purchase loan.

During the 2003 third quarter, the Company arranged \$25 million in additional financing from a group of banks, consisting of Bank of Oklahoma, Comerica Bank and First United Bank and Trust. The \$25 million was fully funded on November 30, 2003. The financing provided up to \$25 million for treasury stock purchases with scheduled monthly principal payments of \$1.4 million beginning December 31, 2003 through May 31, 2005 with interest at the 30 day LIBOR Rate plus three percent, adjusted monthly. During August 2004, the company amended the terms of the loan agreement with these banks to increase the loan amount to \$31.5 million. The amended loan agreement provides for treasury stock purchases of up to \$31.5 million of which the company has \$5.9 million available as of October 26, 2004. The Company fully funded the loan on September 30, 2004 which resulted in a net increase in credit of \$19.0 million above the outstanding balance of its existing treasury stock term loan of \$12.5 million at the time. Proceeds of this loan together with existing cash resources were used to purchase treasury shares. The amortization of the amended loan has been modified to provide for repayment over 24 months in equal monthly principal payments beginning October 31, 2004 and ending September 30, 2006 with the same interest rate of the 30 day LIBOR rate plus 3%. The interest rate at September 30, 2004 was 4.67%. The monthly principal payment will be \$1.3 million compared to the monthly payment on the prior loan of \$1.4 million. The amended loan agreement continues all of the covenants of the prior agreement with certain modifications to permit additional stock purchases and/or dividends while the loan is outstanding generally in an amount no greater than 50% of net income and modifies the debt service coverage ratio definition slightly. Additionally \$4.8 million (50% of 3rd quarter 2004 net income) is available for stock purchases and/or dividends.

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The loan is primarily collateralized by the Company's rights to receive Membership fees on a portion of its Memberships and a pledge of the stock of its subsidiaries. The definitive agreement contains covenants prohibiting the Company from pledging assets, incurring additional indebtedness and selling assets. In addition to customary events of default, an additional event of default occurs if Harland C. Stonecipher ceases to be the chairman and Chief Executive Officer of the Company for 90 days. Pre-payment of the loan is permitted. The loan agreements contain the following financial covenants: (a) the Company's quarterly Debt Coverage Ratio (as defined in the loan agreements) shall not be less than 125%; (b) the Company's cancellation rate on contracts less than or equal to twelve months old shall not exceed 45% on a trailing 12 month basis, calculated on a quarterly basis; (c) the Company shall maintain a rolling twelve month average retention rate of Membership contracts in place for greater than eighteen months of not less than 70%, calculated on a monthly basis; (d) the Company shall not pay dividends or purchase treasury shares, which during any fiscal quarter, on a combined basis, would exceed fifty percent (50%) of the Company's cumulative net income for all previous fiscal quarters beginning July 1, 2004 less any dividends or stock purchases in such previous fiscal quarters, with provisions for carry forwards of unused availability; and, (e) the Company's tangible net worth shall not fall below \$10 million for the period of time dating from September 30, 2004, \$15 million beginning March 31, 2005 and \$25 million beginning December 31, 2005.

### Parent Company Funding and Dividends

Although the Company is the operating entity in many jurisdictions, the Company's subsidiaries serve as operating companies in various states that regulate Memberships as insurance or specialized legal expense products. The most significant of these wholly owned subsidiaries are Pre-Paid Legal Casualty, Inc. ("PPLCI") and Pre-Paid Legal Services Inc. of Florida ("PPLSIF"). The ability of PPLCI and PPLSIF to provide funds to the Company is subject to a number of restrictions under various insurance laws in the jurisdictions in which PPLCI and PPLSIF conduct business, including limitations on the amount of dividends and management fees that may be paid and requirements to maintain specified levels of capital and reserves. In addition PPLCI will be required to maintain its stockholders' equity at levels sufficient to satisfy various state or provincial regulatory requirements, the most restrictive of which is currently \$3 million. Additional capital requirements of PPLCI or PPLSIF, or any of the Company's regulated subsidiaries, will be funded by the Company in the form of capital contributions or surplus debentures. During February 2004, the Company made a capital contribution to a wholly-owned subsidiary of PPLCI, Pre-Paid Legal Services of Tennessee, Inc. in the amount of \$600,000. At September 30, 2004, PPLSIF did not have funds available for payment of substantial dividends without the prior approval of the insurance commissioner. At September 30, 2004 PPLCI had approximately \$750,000 available for payment of an ordinary dividend.

### Contractual Obligations

There have been no material changes outside of the ordinary course of business in the Company's contractual obligations from those disclosed in the Company's annual report on Form 10-K for the year ended December 31, 2003, other than as it relates to the amended treasury stock term loan as described above which increased the amount of the Company's indebtedness by \$19.0 million, but reduced the Company's monthly payment obligation by \$100,000 as a result of an extension of the repayment period.

### Critical Accounting Policies

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are affected by management's

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application of accounting policies. If these estimates or assumptions are incorrect, there could be a material change in the Company's financial condition or operating results. Many of these "critical accounting policies" are common in the insurance and financial services industries; others are specific to the Company's business and operations. The Company's critical accounting policies include estimates relating to revenue recognition related to Membership and associate fees, deferral of Membership and associate related costs, expense recognition related to commissions to associates, accrual of incentive awards payable and accounting for legal contingencies. Each of these accounting policies and the application of critical accounting policies and estimates was discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2003. There were no significant changes in the application of critical accounting policies or estimates during the first nine months of 2004. The Company is not aware of any reasonably likely events or circumstances which would result in different amounts being reported that would materially affect its financial condition or results of operations.

### Capital Plans

The Company recently completed a tender offer to repurchase 980,518 shares of its Common Stock at a price of \$26 per share. The Company continues to evaluate possible additional share repurchases and expects to resume its open market repurchase program in the near future as it has existing authorization from the Board to purchase an additional 969,082 shares. The Company also continues to evaluate additional sources of financing that may enable it to accelerate the repurchase program at prices management believes are attractive. The Company also continues to evaluate the possibility of paying a cash dividend. Any decisions on additional share repurchases or dividends will be based on the Company's financial condition, available resources and market conditions, as well as compliance with the covenants in the Company's amended treasury stock term loan which limit the Company's ability to repurchase shares or pay cash dividends.

### Forward-Looking Statements

All statements in this report concerning Pre-Paid Legal Services, Inc. (the "Company") other than purely historical information, including but not limited to, statements relating to the Company's future plans and objectives, discussions with the staff of the SEC, expected operating results, and the assumptions on which such forward-looking statements are based, constitute "Forward-Looking Statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are based on the Company's historical operating trends and financial condition as of September 30, 2004 and other information currently available to management. The Company cautions that the Forward-Looking Statements are subject to all the risks and uncertainties incident to its business, including but not limited to risks described below. Moreover, the Company may make acquisitions or dispositions of assets or businesses, enter into new marketing arrangements or enter into financing transactions. None of these can be predicted with certainty and, accordingly, are not taken into consideration in any of the Forward-Looking Statements made herein. For all of the foregoing reasons, actual results may vary materially from the Forward-Looking Statements. The Company assumes no obligation to update the Forward-Looking Statements to reflect events or circumstances occurring after the date of the statement.

### Risk Factors

There are a number of risk factors that could affect our financial condition or results of operations. See Note 2 - Contingencies and Part II, Item 1 - Legal Proceedings. Please refer to page 39 and 40 of the Company's 2003 Annual Report on Form 10-K for a description of other risk factors.



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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's consolidated balance sheets include a certain amount of assets and liabilities whose fair values are subject to market risk. Due to the Company's significant investment in fixed-maturity investments, interest rate risk represents the largest market risk factor affecting the Company's consolidated financial position. Increases and decreases in prevailing interest rates generally translate into decreases and increases in fair values of those instruments. Additionally, fair values of interest rate sensitive instruments may be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, liquidity of the instrument and other general market conditions.

As of September 30, 2004, substantially all of the Company's investments were in investment grade (rated Baa or higher) fixed-maturity investments, interest-bearing money market accounts and a collateralized repurchase agreement. The Company does not hold any investments classified as trading account assets or derivative financial instruments.

The table below summarizes the estimated effects of hypothetical increases and decreases in interest rates on the Company's fixed-maturity investment portfolio. It is assumed that the changes occur immediately and uniformly, with no effect given to any steps that management might take to counteract that change. The hypothetical changes in market interest rates reflect what could be deemed best and worst case scenarios. The fair values shown in the following table are based on contractual maturities. Significant variations in market interest rates could produce changes in the timing of repayments due to prepayment options available. The fair value of such instruments could be affected and, therefore, actual results might differ from those reflected in the following table (dollars in 000's):

|   | Fair Value | Hypothetical change in<br>interest rate<br>(bp=basis points) |
|---|------------|--|
|   | -----      | -----  |
| Fixed-maturity investments at September 30, 2004 (1)..... | \$ 18,551  | 100 bp increase  |
|   |            | 200 bp increase  |
|   |            | 50 bp decrease   |
|   |            | 100 bp decrease  |
| <br>  |            |  |
| Fixed-maturity investments at December 31, 2003 (1).....  | \$ 27,052  | 100 bp increase  |
|   |            | 200 bp increase  |
|   |            | 50 bp decrease   |
|   |            | 100 bp decrease  |
| -----   |            |  |

(1) Excluding short-term investments with a fair value of \$2.5 and \$2.4 million at September 30, 2004 and December 31, 2003, respectively.

The table above illustrates, for example, that an instantaneous 200 basis point increase in market interest rates at September 30, 2004 would reduce the estimated fair value of the Company's fixed-maturity investments by approximately \$2.1 million at that date. At December 31, 2003, an instantaneous 200 basis point increase in market interest rates would have

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reduced the estimated fair value of the Company's fixed-maturity investments by approximately \$2.1 million at that date. The definitive extent of the interest rate risk is not quantifiable or predictable due to the variability of future interest rates, but the Company does not believe such risk is material.

The Company primarily manages its exposure to interest rate risk by purchasing investments that can be readily liquidated should the interest rate environment begin to significantly change.

### Interest Rate Risk

The Company is exposed to market risk related to changes in interest rates. As of September 30, 2004, the Company had \$49.6 million in notes payable outstanding at interest rates indexed to the 30 day LIBOR rate that exposes it to the risk of increased interest costs if interest rates rise. Assuming a 100 basis point increase in interest rates on the floating rate debt, annual interest expense would increase by approximately \$496,000. As of September 30, 2004, the Company had not entered into any interest rate swap agreements with respect to the term loans.

### Foreign Currency Exchange Rate Risk

Although the Company is exposed to foreign currency exchange rate risk inherent in revenues, net income and assets and liabilities denominated in Canadian dollars, the potential change in foreign currency exchange rates is not a substantial risk, as approximately 1% of the Company's revenues are derived outside of the United States.

## ITEM 4. CONTROLS AND PROCEDURES

The Company's Principal Executive Officer and Principal Financial Officer have reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 240.13a-14(c)) as of the end of the period covered by this report. Based on that evaluation, the Principal Executive Officer and the Principal Financial Officer have concluded that the Company's current disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

See Note 2 of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this report for information with respect to legal proceedings.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

#### Issuer Purchases of Equity Securities

The following table provides information about the Company's purchases of stock in the open market during the third quarter of 2004.

| Total Number<br>of Shares | Average Price | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or | Maximum Number<br>Shares that May<br>Be Purchased Under<br>the Plans or |
|---------------------------|---------------|--|---|
|---------------------------|---------------|--|---|

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| Period              | Purchased | Paid per Share | Programs  | Programs (1) |
|---------------------|-----------|----------------|-----------|--------------|
| July 2004.....      | 32,800    | \$ 23.25       | 32,800    | 967,200      |
| August 2004.....    | 17,600    | 23.23          | 17,600    | 1,949,600    |
| September 2004..... | 980,518   | 26.12          | 980,518   | 969,082      |
| Total.....          | 1,030,918 | \$ 25.98       | 1,030,918 |              |

(1) The Company announced on April 6, 1999, a treasury stock purchase program authorizing management to acquire up to 500,000 shares of the Company's common stock in the open market. The Board of Directors has subsequently from time to time increased such authorization from 500,000 shares to 10,000,000 shares. The most recent authorization was for 1,000,000 additional shares on August 9, 2004 and there has been no time limit set for completion of the repurchase program. In addition, the Company completed a tender offer for 980,518 shares in September 2004.

See Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operation-Liquidity and Capital Resources" for a description of loan covenants that limit the Company's ability to repurchase shares and pay dividends.

ITEM 6. EXHIBITS.

(a) Exhibits:

| Exhibit No. | Description  |
|-------------|--|
| 3.1         | Amended and Restated Certificate of Incorporation of the Company, as amended (Incorporated by reference to Exhibit 4.1 of the Company's Report on Form 8-K dated January 10, 1997)   |
| 3.2         | Amended and Restated Bylaws of the Company (Incorporated by reference to Exhibit 3.1 of the Company's Report on Form 10-Q for the period ended June 30, 2003)  |
| *10.1       | Employment Agreement effective January 1, 1993 between the Company and Harland C. Stonecipher (Incorporated by reference to Exhibit 10.1 of the Company's Annual Report on Form 10-KSB for the year ended December 31, 1992)   |
| *10.2       | Agreements between Shirley Stonecipher, New York Life Insurance Company and the Company regarding life insurance policy covering Harland C. Stonecipher (Incorporated by reference to Exhibit 10.21 of the Company's Annual Report on Form 10-K for the year ended December 31, 1985)                |
| *10.3       | Amendment dated January 1, 1993 to Split Dollar Agreement between Shirley Stonecipher and the Company regarding life insurance policy covering Harland C. Stonecipher (Incorporated by reference to Exhibit 10.3 of the Company's Annual Report on Form 10-KSB for the year ended December 31, 1992) |
| *10.4       | Form of New Business Generation Agreement Between the Company and Harland C. Stonecipher (Incorporated by reference to Exhibit 10.22 of the  |

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- Company's Annual Report on Form 10-K for the year ended December 31, 1986)
- \*10.5 Amendment to New Business Generation Agreement between the Company and Harland C. Stonecipher effective January, 1990 (Incorporated by reference to Exhibit 10.12 of the Company's Annual Report on Form 10-KSB for the year ended December 31, 1992)
  - \*10.6 Amendment No. 2 to New Business Generation Agreement between the Company and Harland C. Stonecipher effective January, 1990 (Incorporated by reference to Exhibit 10.13 of the Company's Annual Report on Form 10-K for the year ended December 31, 2002)
  - \*10.7 Stock Option Plan, as amended effective May 2000 (Incorporated by reference to Exhibit 10.6 of the Company's Annual Report on Form 10-K for the year ended December 31, 2000)
  - 10.8 Loan agreement dated June 11, 2002 between Bank of Oklahoma, N.A. and the Company (Incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the six-months ended June 30, 2002)
  - 10.9 Security Agreement dated June 11, 2002 between Bank of Oklahoma, N.A. and the Company (Incorporated by reference to Exhibit 10.2 of the Company's Quarterly Report on Form 10-Q for the six months ended June 30, 2002)
  - 10.10 Form of Mortgage dated July 23, 2002 between Bank of Oklahoma, N.A. and the Company (Incorporated by reference to Exhibit 10.3 of the Company's Quarterly Report on Form 10-Q for the six months ended June 30, 2002)
  - \*10.11 Deferred compensation plan effective November 6, 2002 (Incorporated by reference to Exhibit 10.14 of the Company's Annual Report on Form 10-K for the year ended December 31, 2002)
  - 10.12 Loan Agreement dated September 19, 2003 between Registrant and Bank of Oklahoma, N.A., Comerica Bank and First United Bank & Trust (Incorporated by reference to Exhibit 10.1 of the Company's Report on Form 10-Q for the period ended September 30, 2003)
  - 10.13 First Amendment to Loan Agreement dated August 26, 2004 among Pre-Paid Legal Services, Inc., Bank of Oklahoma N.A., Comerica Bank and First United Bank & Trust. (Incorporated by reference to Exhibit (b)(i) to the Company's Schedule TO filed on August 27, 2004)
  - 10.14 First Amendment to Security Agreement dated August 26, 2004 among Pre-Paid Legal Services, Inc., Bank of Oklahoma, N.A., Comerica Bank and First United Bank & Trust (Incorporated by reference to Exhibit (b)(iii) to the Company's Schedule TO filed on August 27, 2004)
  - 10.15 First Amendment to Pledge Agreement dated August 26, 2004 among Pre-Paid Legal Services, Inc., Bank of Oklahoma, N.A., Comerica Bank and First United Bank & Trust (Incorporated by reference to Exhibit (b)(iv) to the Company's Schedule TO filed on August 27, 2004)
  - 31.1 Certification of Harland C. Stonecipher, Chairman, Chief Executive Officer and President, Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, filed under Exhibit 31 of Item 601 of Regulation S-K.
  - 31.2 Certification of Steve Williamson, Chief Financial Officer, Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, filed under Exhibit 31 of Item 601 of Regulation S-K.
  - 32.1 Certification of Harland C. Stonecipher, Chairman, Chief Executive Officer

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and President, Pursuant to 18 U.S.C. Section 1350, filed under Exhibit 32 of Item 601 of Regulation S-K.

32.2 Certification of Steve Williamson, Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, filed under Exhibit 32 of Item 601 of Regulation S-K.

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\* Constitutes a management contract or compensatory plan or arrangement required to be filed as an exhibit to this report.

### SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PRE-PAID LEGAL SERVICES, INC.

Date: October 26, 2004 /s/ Harland C. Stonecipher

-----  
Harland C. Stonecipher  
Chairman, Chief Executive  
Officer and President  
(Principal Executive Officer)

Date: October 26, 2004 /s/ Randy Harp

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Randy Harp  
Chief Operating Officer  
(Duly Authorized Officer)

Date: October 26, 2004 /s/ Steve Williamson

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Steve Williamson  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

Exhibit 31.1

### CERTIFICATION

I, Harland C. Stonecipher, Chief Executive Officer, certify that:

- (1) I have reviewed this quarterly report on Form 10-Q of Pre-Paid Legal Services, Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

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- (4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)) for the registrant and have:
- (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Omitted pursuant to Exchange Act Release 34-47986
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 26, 2004      /s/ Harland C. Stonecipher

-----  
Harland C. Stonecipher  
Chairman, Chief Executive  
Officer and President

Exhibit 31.2

CERTIFICATION

I, Steve Williamson, Chief Financial Officer, certify that:

- (1) I have reviewed this quarterly report on Form 10-Q of Pre-Paid Legal Services, Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of

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a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Omitted pursuant to Exchange Act Release 34-47986
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 26, 2004 /s/ Steve Williamson

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Steve Williamson  
Chief Financial Officer

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Certification Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. ss. 1350, the undersigned officer of Pre-Paid Legal Services, Inc. (the "Company"), hereby certifies that the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 26, 2004 /s/ Harland C. Stonecipher

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Harland C. Stonecipher  
Chairman, Chief Executive  
Officer and President

Exhibit 32.2

Certification Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. ss. 1350, the undersigned officer of Pre-Paid Legal Services, Inc. (the "Company"), hereby certifies that the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 26, 2004 /s/ Steve Williamson

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Steve Williamson  
Chief Financial Officer