

# Legal Problems Don't Hamper Growth Here

BY ADELIA CELLINI LINECKER  
INVESTOR'S BUSINESS DAILY

A company hired to help folks deal with legal issues had to overcome some legal problems of its own recently.

That company, Pre-Paid Legal Services Inc., develops and sells legal service plans across North America through multilevel marketing.

Its problems stemmed from a Securities and Exchange Commission probe into its accounting practices.

The SEC last year ruled that Pre-Paid's accounting failed to comply with generally accepted standards. The main issue was the company's old method of reporting expenses incurred from paying advance commissions to sales reps.

To attract top-notch salespeople, Pre-Paid advances its agents three years' worth of commissions for every plan they sell. The company used to report these advances as assets. The result: higher reported earnings than if they were treated as expenses.

Pre-Paid justified the practice by saying it's commonplace in the insurance industry, which has been a model for its own business. The theory? The advances are recovered as members pay their monthly fees.

But the SEC determined that companies have to put advances down as expenses as soon as they're paid. Pre-Paid complied. But the change forced Pre-Paid to restate its 2000 and 2001 earnings.

That led shareholders to file a federal securities class action lawsuit against the company. But two weeks ago, the U.S. District Court for the Western District of Oklahoma dismissed the suit.

"We're just so happy," said Pre-Paid Chief Executive Harland Stonecipher. "We knew all along the complaint was without merit."

Wall Street was glad to hear the news, too. Pre-Paid's stock jumped nearly \$3 to 29 a share after the firm spread the news.

With the class-action suit and accounting probe behind him, Stonecipher is ready to refocus all of his energy on growing the company.

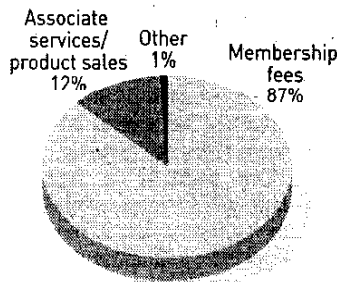
"It caused a lot of extra work," he said. "But our results speak for themselves."

Those results have been strong of late. Pre-Paid earned 36 cents a share during last year's fourth quar-

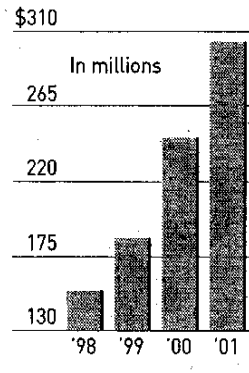
## Legal Eagles

Pre-Paid Legal Services is battling some lawsuits of its own, but its business keeps growing

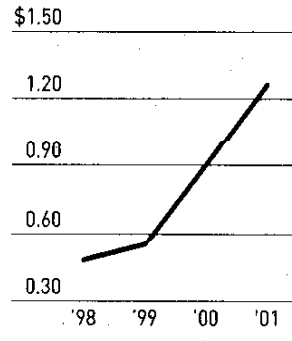
### 2001 revenue breakdown



### Annual revenue



### Annual earnings per share



### Services offered

- Letters and phone calls
- Contract and document review
- Traffic violations defense
- IRS audit representation
- Civil defense/job related criminal defense

Sources: Company reports, Robotti & Co.

ter, up 57% from the year before. Revenue climbed 23% to \$80.3 million. Full-year earnings ticked up 39% to \$1.28.

Pre-Paid was launched 30 years ago to make legal services affordable for middle-class Americans. Members pay about \$300 a year to retain a lawyer for services such as will preparation, traffic violation defense and attorney consultation.

"It's really changing the way legal services are delivered to people in North America," said Alan Weber, who follows the company for Robotti & Co. "It really offers middle-income Americans the access to legal services in an affordable manner."

Pre-Paid Legal has more than 1.2 million members in the U.S. and Canada. It has a network of law firms in the U.S. and Canada. And its sales force is massive, with 286,000 agents in North America.

The firm's revenue comes mainly from membership fees. Indepen-

dent sales agents market the services in return for up to a 25% commission on each policy sold. Pre-Paid pays contracted law firms a third of each policy fee and pockets the rest.

Pre-Paid also generates revenue from training its sales staff and selling them products. That portion makes up about 12% of revenue.

The company's balance sheet is strong. It ended last year with \$38 million in cash after spending \$27.9 million during 2001 to repurchase 1.5 million shares of its stock at an average cost of \$18.64 per share.

Weber says the balance sheet is a sign that Pre-Paid is not another Enron-type firm with accounting issues.

"Enron did not have the cash flow that Pre-Paid Legal has," he said. "(Pre-Paid Legal) is debt-free."

Pre-Paid's potential lies in the vast untapped market for its product, analysts say. While it has more than a million members, that represents

only about 2% of the market.

But a key challenge is retaining members during their first year. Many cancel their membership early. The drop-off rate of new customers in the first year is about 40%. That falls to 3% after three years.

Company research shows that members who don't use any of the legal services early on tend to be the ones who drop out.

"People who actually call the law firm and use the service once tend to stay," Stonecipher said. "So we try to get them to do that immediately."

Law firms also benefit from the partnerships. The products they offer through Pre-Paid are relatively common legal services. In the process, the law firms establish relationships with clients who might need lengthier, more expensive legal help later on. In effect, Pre-Paid is taking on some of the law firms' marketing costs.

"We're providing them with a clientele they would not have had," said Melanie Lawson, a financial analyst for Pre-Paid.

But Pre-Paid also keeps tabs on the performance of those law firms. Its data processing center tells Stonecipher how long it takes firms to return members' calls.

"Lawyers are notorious for bad customer service," Stonecipher said. "We monitor their level of service."

If there's a problem, Pre-Paid Legal notifies the firm. If the issue persists, it sends workers on site to fix things. If the firm can't improve service, it's dropped as a client.

Another risk is numerous pending lawsuits from policyholders and sales reps. But analysts are upbeat about its chances of winning these battles.

"(Lawsuits) are never positive," Weber said. "But I don't think any of the lawsuits are well founded."

## Pre-Paid Legal Services Inc. prepaidlegal.com

Ticker	PPD
Share price	Near 30
12-month sales	\$303 mil
5-year profit growth rate	89%

### IBD SmartSelect Corporate Ratings

Earnings Per Share	96
Relative Price Strength	95
Industry Group Relative Strength	A-
Sales+Profit Margins+KUT	A
Accumulation/Distribution	A

See Investors.com for more details