

Pre-Paid Legal Services Inc. (PPD)



HARLAND C. STONECIPHER is the Founder, CEO and Chairman of the Board of Pre-Paid Legal Services, Inc. A former school teacher and insurance salesman, Mr. Stonecipher founded Pre-Paid Legal Services, Inc. in 1972 shortly after he was involved in a head-on car accident. Although he had auto, life and medical insurance, Mr. Stonecipher was not prepared financially or emotionally for the legal problems that arose. This experience prompted him to develop the concept of legal expense plans,

evolving into what is now a nationally known New York Stock Exchange listed company. Today, Pre-Paid Legal Services, Inc. has a nationwide network of thousands of top-rated attorneys across the US and Canada to service its members. A real “rags to riches” entrepreneur who has attained the American dream, Mr. Stonecipher is featured in such magazines as Success, Fortune, The Wall Street Journal, Investors Business Daily, Money Magazine, Equities Magazine and Forbes. Forbes listed Pre-Paid Legal Services, Inc. among “The 200 Best Small Companies in America” for the past five years. Mr. Stonecipher has made numerous national television appearances including CNN, MSNBC and most recently as a guest on “The O’Reilly Factor” on the Fox News Network. Mr. Stonecipher and his wife Shirley continue to live in Ada and are committed to building Pre-Paid Legal Services, Inc. into a billion dollar company with a goal of making “Equal Justice Under Law” a reality in America.

SECTOR: – BUSINESS SERVICES

(PAX100) TWST: Can we begin with a brief historical sketch of Pre-Paid Legal Services and then a quick picture of where you are and what you are doing today?

Mr. Stonecipher: Pre-Paid Legal Services Inc. is the same thing to the attorney’s fees that medical insurance is to doctor bills. So what we do is provide middle- income North Americans with a way to afford access to the legal system. We know that the wealthiest top 10% in America today are really the only ones that can actually afford legal services; the bottom 10% — people who are flat broke and on public aid — many times would have

access to the public defender system, which sometimes works, but in most cases it doesn’t work. Middle-income North Americans don’t know lawyers; they are intimidated by lawyers and they are concerned about what it costs. So our company is designed to bring together that group of people out there today, which is over a 100 million middle-income working American families, bring them together with top quality lawyers and give them unlimited access to the lawyers at a price that they can afford. Of course our company is a publicly held company. It is a company that is listed on the New York Stock Exchange; a company that was incorporated in 1972. A company right now

that has 36 consecutive quarters of uninterrupted growth, and we expect to announce our 37th consecutive quarter sometime in July.

TWST: How many members at present?

Mr. Stonecipher: About 1.3 million families today and it has taken us 30 years to get to 1.3 million families. There are over a 100 million families that really need our product out there today. Most of them do not know about it and most of them have never heard of it. So it's a huge market. It's a market that we are certainly not going to saturate within our time.

TWST: What are the legal services that you provide? Is there a selection of plans available?

Mr. Stonecipher: Yes, let me talk about our most common plan. We do have several different types of plans for particular niche markets, but let me talk about just the standard family plan: Let's say that you are working somewhere and you enroll with us as a payroll deduction, then that would cover you and your spouse and it will also cover any dependant children up to the age of 21. So we are talking about giving your entire family affordable access to a top quality law firm. We are talking about a law firm that in most cases is AV rated and that's the highest rating that any law firm can have. So you are dealing with top quality lawyers. And then you have the ability to simply pick up the telephone. You can certainly go by, if you like, and sit in our office, but in most cases people don't want to do that and most people don't do that any more. They like to use the telephone. So you have toll-free numbers, so it doesn't cost you anything to make the telephone call, and you can call about anything of a legal nature. One of the things that is used a lot is consumer related problems. A lot of people today buy a washing machine, for example, that won't wash. But as a middle-income American

what are they going to do about that? They can't afford to go and hire a lawyer because the cost of the lawyer in many cases is more than the cost of the washing machine. So there is not much they can do about that. But with Pre-Paid Legal Service membership, the law firm is there to assist them with that problem, to make telephone calls on their behalf, to write letters on their behalf or to do this on any type of a consumer related matter. It's amazing the type of results you'll see when they get the letter from this law firm that has all of these partners' names down both sides of the letterhead. So consumer related type programs.

Now, average North Americans, 70% of them, don't have something as simple and as important as a will. This plan provides a free comprehensive will under the cost of the membership and it can be updated once every year, so that's a very valuable benefit. Review contracts: we have middle-income North Americans where the biggest financial deal they ever enter into is the buying and selling of a home, but many times they rely on the bank's attorney and the real estate attorney. They don't have their own attorney to review this. So under the contract review provision, they can have the contracts reviewed by their own attorney to make sure that what's being done is in their best interests and not just in the best interest of the real estate company or the best interest of the particular law firm that may represent the bank or whatever the financial institution is. So it's really under what we call our "title one" benefit.

Another area commonly needed is if your children are having a problem, let's say, in school. You may want to know what your rights are, and again you have the ability to just pick up the telephone and call that law firm. These law firms normally are all large enough that they have the specialists. They may specialize in particular areas

of the law, so that you are talking to somebody there who is a specialist in that particular area. If you want to talk about the divorce, you don't need to be talking with somebody who specializes in real estate. So that's what it does. You can call the law firm as many times as you want to on a daily basis or a weekly basis and so forth. And that is really the benefit of the title one benefit.

Title two is our traffic-related area and again it covers such things as traffic tickets. I don't want to give the impression that we can fix tickets, that's not what we do. But, for example, I was talking with a member yesterday who has gotten a speeding ticket and he said to me that it was the first speeding ticket he had gotten in 10 years. If the points go on his record, it will cost him about a \$1000 a year increase in his insurance cost. The insurance company will see the points and will raise the cost of your insurance. He said he would have a three-year increase in insurance of about a \$1000 a year to \$3000. By using his Pre-Paid membership he still paid the fine, but the Pre-Paid lawyer was able to negotiate no points. For teenage drivers, this is a particularly valuable benefit because teenager insurance is always tremendously expensive and again having somebody there to help keep those points off your records and so forth is very important.

We then have protection in the event that you are involved in something more serious out there. One of things that we have covered, for example, is criminal charges related to that automobile unless drugs or alcohol are involved. Many people think their automobile insurance will cover this but that is just absolutely not true. Their automobile insurance only covers the civil side of the damages. If somebody gets killed in an accident out there, there is a good chance that the state is going to file criminal charges against you, and your automobile insurance will not provide you with any coverage for

that. So, we see our members being able to utilize that type of representation. Again, if you are in danger of losing your driver's license, you have the ability to use a lawyer to help you keep your driver's license. If you have a small fender bender out there, you really can't afford to go and hire a lawyer to represent you. If you are trying to collect from another party's insurance company or trying to collect as an uninsured motorist, you can't afford a lawyer to do that. So your Pre-Paid lawyer will help you in that and, in most cases, without any charge. So that's the second area.

The third area is in the legal defense area. We are talking about if you are the one being sued. Murder, rape or burglary are some of the things that we do *not* cover. But if your neighbor has sued you because your dog barks at night and keeps him awake or even if you have been charged with some type of criminal charge that is directly related to your job responsibilities, then you have numerous hours of help available to you, and if the matter requires more time, that is available at a 25% discount, which is a sizable discount. And it's also important to know that up through the fifth membership year, the longer you are a member of Pre-Paid, more and more hours are available to you in this category, if you want them. So that's in the event of lawsuits.

Then the next area is IRS. I notice that the IRS is getting more stringent today and beginning to do more audits. But if you get a letter from Uncle Sam and you think their assessment is wrong, then you have up to 50 hours available to you and lawyers that you can call who have experience in this particular area. They can assist you with the IRS examination, or even if you go ahead and pay what the IRS says that you owe, then you can turn around and sue them to get that back. You have a law firm there available to help you with that. In addition, when any of these services, as I said ear-

lier, require more time than what is specified in the Pre-Paid contract, our law firms will continue to serve you at a 25% discount on anything that exceeds the things that I have talked about, and even things that are not covered. I talked about murder, rape or burglary - those things are not covered. But still, as a Pre-Paid member, you would be entitled to a 25% discount, which is a substantial discount, for assistance in such areas.

So, that's a quick rundown. Really, it covers most of the things that are likely to happen to the average middle-income working American and it does that at a cost of either \$16 a month or \$25 month. If you want the added trial defense benefits under title three then that's \$25 a month, or \$16 without those added benefits. So, it's certainly affordable. It is something that everybody needs, everybody can afford and almost nobody has today.

TWST: Are members signed up per month or per annum?

Mr. Stonecipher: It can be set up on a monthly basis. Most of our memberships are set up as a monthly bank draft, credit card or they are set up as an employee benefit and of course deducted from that employee's check on a monthly basis and the company remits one check once a month. So the majority of our memberships are monthly and we like it that way because they tend to stay. It doesn't place a burden on the family as it's all set up and is just an automatic billing system whereby we actually deduct the money from their account each month. And they don't have to worry about trying to remember when it is due and whether they paid it.

TWST: What is the selection process for partnering up with a law firm and what monitoring systems are in place to ensure standards are maintained and that the customer receives the right level of service?

Mr. Stonecipher: We have a very strict selection process, although fortunately we don't have to do much selection anymore because we have the law firms in most of the states already in place and these are seasoned law firms. But again today we can have basically whoever we want because, for example in the Texas Law Firm, we paid them \$1.1 million for the last month; the same with our law firm out in California — around \$1.2 million for the month. So it's a great business for lawyers and normally if a state becomes open we have a waiting list. First we have them just submit their various information to us in writing and we do the first round of elimination by going through and looking at the information that they submit about their firm. One of the things we are going to look for is not so much the biggest law firms in a state, but for those that have certain areas of specialty because we know there are certain things that the members use most often, like real estate issues. They are going to need to have a real estate department or real estate lawyer and somebody that specializes in consumer complaints and helping consumers to be taken care of. So we look for those things first and those law firms that don't have that would get eliminated fairly quickly. We will then get that down to around 10 law firms. Then we will take another look at them and probably talk to them by phone as well as continuing to review all of the written material about them and then bring it down to the last three law firms. We then ask them to come in. They come to Ada Oklahoma and we sit down with each of those firms and we go through a selection process. We have an attorney resource department headed up by a very competent lady, Leslie Fisher, who has been with us for a number of years and is really in charge of that. But in the selection process I am usually involved in that, along with several other officers in the company. We meet with those last three and

make a decision then on which one will become the ultimate provider law firm. And, as you suggest, we do monitor those firms. We have firms who have been with us now for 8-10 years that we still monitor on a daily basis, everyday. For example, if I want to know how many calls that a law firm out in California has had for today, then I can simply walk down to our data processing center and I can pull that up. I can see exactly how many calls they have taken today. In addition to that I can see how many times the telephone rang before they answered it and of course if it rang more than three times then that's too many. We do our monitoring by hi-tech and hi-touch and we send out actual written surveys to our members every 45 days to see how they felt about the service that they received, and we have them assess this as excellent, good, fair and poor. At the end of every month we prepare what we would really call a legal report card and the law firms know they are going to be receiving that. We compile all of this data and we give them that report card and hopefully they all are going to have a passing grade. If they don't have a passing grade then we are going to be there to work with them and either help them get it up to where it is a passing grade or we would then certainly think about replacing their firm. So the level of service is very closely monitored. We don't get involved in the legal service itself; that's attorney-client privilege. But we do get into the customer service and that's the part that lawyers are normally terrible at. They have a terrible reputation for returning calls and doing things as promptly as they should for that individual. With Pre-Paid Legal lawyers, they do it very promptly. We have a way of knowing if they are doing it promptly and if they don't then we are going to be talking to them. Because we are the largest client they have and with the number of dollars that we are paying them, they tend to be very accountable to us.

TWST: It sounds like you have a strong IT infrastructure in place?

Mr. Stonecipher: Yes, we do.

TWST: You touched on the number of members you have and the market size available to you. With that in mind, can you provide an idea of what you would expect to accomplish over the next two or three years? How much of that market opportunity can you expect to realize?

Mr. Stonecipher: We really have to only get a very small percentage, since it's such a big market. But it is my belief that in the next two to five years we should become a billion-dollar company. We should have revenues in the area of a billion dollars with the size of the markets out there and we would be talking still about less than 10% penetration of that market to reach that goal. I think that's the goal that certainly we can achieve and we really should achieve it since the market is as receptive as it is.

TWST: How do you go about penetrating the market and reaching that growth?

Mr. Stonecipher: It all depends on our sales associates because that's where we get our business. We don't get much direct business here in Ada, Oklahoma. It comes through the sales associates we have all over North America, in the United States and in the four provinces of Canada. As we increase those numbers, then in direct proportion to that we increase our revenues. So if we know how many associates we are going to recruit this year then we know basically how much new business we are going to write this year. And we have developed a set of tables over a period of some 30 years that pretty well tell us that. For example, this week we will probably recruit over 4000 new sales associates, which is more sales associates than many companies will recruit in a year. And if we continued at that rate it would be 200,000 new sales associates for the year. As long as we are recruiting at that pace, that

would give us a very rapid growth rate, and I see no reason why we can't because there is just such a tremendous opportunity for people to market Pre-Paid legal because it is such a great product. It meets such a great need and it's affordably priced, so people that are willing to really go out and work at marketing this product can earn a lot of money. So our ability to recruit people really is unlimited. It's just about getting out there and letting people know about what the job opportunity is, the product that underlies that job opportunity and the marketing. I mean the reason that we do well all ties back to the product. We have a great product, but we have to have somebody out there to let people know about that product. The product is tested, it's proven, and it's tried. We know it works and the consumer, the member, always gets the best end of the deal. As we get more people out there marketing our product, revenue goes up in direct proportion to that.

TWST: Do you have training programs in place?

Mr. Stonecipher: We have one of the very best training programs in place. One of the first things that we do is encourage people to take advantage of what we call our "fast start to success" training program, which is a training program for new people to take, typically at a cost of \$184. We have mapped out the success of people who go through the "fast start to success" program versus those who don't. And those who complete the fast start training normally do much better. So we strongly encourage that participation and right now 94% to 95% of the people we are recruiting will do the "fast start to success" training. It also gives them the ability to move up; the more business in their organization, the greater the commission; they get a larger over-write. Then every week in their area we have a training program and normally that would be on a Tuesday night or Thursday night, so they have

the access and ability to go to that. That's normally either a \$5 or \$10 charge to attend and, again, that is a weekly program being taught by qualified and experienced people. In fact, you can't be a meeting holder, you can't be a trainer, unless you have been approved by us here at the home office.

TWST: Is it applicable or relevant to talk about acquisitions as a component of the growth strategy? Does that type of activity figure into the game plan?

Mr. Stonecipher: It's really doesn't. There isn't anything that we are looking at today in the realm of acquisitions. We believe the best use of our dollars is to use them to just acquire members. And the second best use then, if we don't use all it to acquire new members, which we haven't been, is to buy back our stock. So we really are not looking at any acquisitions at this time.

TWST: You have been quite substantial about buying back the stock as well in the past?

Mr. Stonecipher: We have. We spent about \$20 million during the first quarter to purchase 852,000 shares. Since April 1999, we have repurchased 4.1 million shares, about 17% of our total outstanding shares, at a cost of \$95.3 million and we are continuing to do that. In fact, we even have a line of credit in place that we can draw on. Right now we don't have any debt. We used our own cash flow to buy back nearly \$100 million worth of our stock and decrease the number of shares outstanding and that, as a result, improves the earnings per share. So we plan to continue to do that using the excess cash flow. We generated round about \$38 million cash flow last year, and the first quarter this year, we generated \$18 million. So we ought to generate around \$50 million positive cash at the end this year. And again we will use that to buy back stock, plus, if it gets down to a price where we are willing and want to take on

debt and want to exercise the line of credit, then we will do and purchase even more.

TWST: Is it fair to say that your business is not really vulnerable to downturns in the economy?

Mr. Stonecipher: Yes, it's correct. We tend to do well in either a bad economy or in a good economy. In a good economy, you have a lot of things happening, people buying things or merging and so on. In a bad economy, you have people with legal problems, perhaps thinking about bankruptcy, about how to do this and how to do that. So actually, our company and our product seem to do about equally as well in a good economy or in a bad economy. I think probably the worst is that the economy will be flat line, although I don't know whether that necessarily has a bad impact. In good economy we do well; in a bad economy we do well.

TWST: What does the competitive environment look like today? Is this a sparsely populated space?

Mr. Stonecipher: We know there are some other companies out there, but they are not public. We are the only publicly held pre-paid legal service company in North America. So we don't really know about how many members or the amount of revenue that these other companies have. But we have had a chance to look at some of them and have had an opportunity to either buy them or to merge them; so far we haven't done that. As we stand today, we believe we have more revenues than the other companies combined. But it's just such a huge market there really. There is a lot of room for a lot more companies to be in here before we would even run into one another.

TWST: How do you see the landscape evolving? Are there any large-scale social, demographic or public policies that may have an impact looking out to the next one, two, three years?

Mr. Stonecipher: The market just gets better all the time. The thing that the American people right now are probably most concerned about, particularly the small business American, is the litigiousness of the society today as we know it. The plaintiffs' lawyers have become so aggressive, and one of the biggest problems today that businesses, small businesses in particular, have is the issue of being sued. One lawsuit can wipe out a small business person. So the market is just shaping up to be a better market for us than it ever has been. And I might say something about 9/11: As bad as that was and as terrible as it was, it caused people to start getting their affairs in order and getting their legal affairs in order. So many people thought it was not necessary to get a will done because death is normally associated with old age. It was something that they would do when they got older. But the fact is that most of those who died in the twin towers were not elderly people. These were young people in the prime of their lives. And, as we know, many of them did not have any type of estate plan, many of them did not have any type of will, and many had not provided for who might pick up their children from the day care center. As a result, some of those children stayed there for a long time because grandmother and grandfather can't go there and get them unless it's been set up that way by the parents, and the court has to make that determination. So a lot of people became aware of things that they never really thought about, and a lot of people were saying, "Well, I don't have many assets so I don't want to do a will." But they realized the biggest asset they have is their children, and that they ought to make provisions for that. The other thing is that people begin to realize that, even if they don't have many assets with a lot of financial value, they may have some family heirloom or some rings or a favorite chair that's been in the

family for generations, and if they don't determine to whom that's going to be given at the time of their death, then many times that just totally destroys families. Really, when you get right down to it, it has very little financial value, but it does have real sentimental value. And so more people begin to realize that they may not have a tremendous amount of assets and maybe they don't have any children, but there are things that they have within the family that the other family members are going to want, and they need therefore to make some provision. And they can do that in the form of a will. So the market just gets better for us all the time. That's the reason I say within 2 to 5 years we should be a billion-dollar company because it's just a more receptive market.

TWST: Is there anything that stands out to you as a potential challenge, at least a possible limitation, to this growth opportunity?

Mr. Stonecipher: I don't think we have many limitations. Number one, we are not limited financially, which is normally the reason why companies are unable to grow. Right now, we are generating excess positive cash flow, so we could grow at a much more rapid rate and be able to finance that. We are not restricted from being able to process a much larger volume business because we are processing today in 2002 more business in one day than we did for the year of 1990. So we have proven that we have the ability to process large amounts of business and could process much larger amounts than even today at the growth rate that we are growing. The other thing is that the market is certainly not going to restrict us, it is a huge market. We are not going to be saturated within our time and even if several other companies do get in, that's still not going to saturate that market. So there are not many restrictions. We just have to continue doing what we do and do it well.

And that is to get in and to recruit a lot of people, to train them well and to make sure that our law firms continue to provide the service. But that is all part of our business model. We think we are good at that and it is just the fact that we need to continue doing that. As long as we continue doing that, I don't see many challenges out there. It's just a process that we have to go through.

TWST: How would you describe the corporate culture at Pre-Paid, and could you perhaps highlight a couple of the key members in the company and some of the important skill sets they bring?

Mr. Stonecipher: That's one of most important things about our company. We have a great home office staff. We have about 700 people. We are in rural America, here in Ada, Oklahoma. And the reason we are still here is because we get people in this part of the country that have a great work ethic and a great attitude. Many of our people have been with us a long time. Melanie Lawson has been with us about 22 years now. Melanie started when she was in high school and then went to college, became an accountant and is now our financial analyst. So she is just a part of Pre-Paid and Pre-Paid is a part of her. If you take Randy Harp, the COO, he has been here about 12 years. He has served as CFO and COO for a number of years and is a great individual who does a super job. We have also brought on board Steve Williamson, who is the CFO of the company and a very bright young man who does a great job of going out and telling the Pre-Paid story. Kathy Pinson who heads up our regulatory compliance area, has also been here about 22 years, starting with us back at a very young age. So we just have so many outstanding people. When you look at the home office staff and the type of attitude that they have, the type of work ethic that they have, then you can see we have outstanding

people. Then you look at our sales force. We have a sales force that really has a great business opportunity and when they really start doing well, it becomes a cause for them. They get into the idea that we are changing the legal system; we are changing how legal services are delivered in America. We have a couple earning a million dollars a year. Dave Savula, for example, earned a million dollars the third year he was here, which shows you what a tremendous opportunity it is for people who are willing to get out there and help people and make them aware of what a tremendous product we have. So we have a great group of people there. And it is the same with the provider law firms. These people again get caught up in the cause and they get to do really what they went to law school for, which is to help people and not have to worry about whether they can pay for it because they have already paid for it. So when you look at the numbers of outstanding people we have in the provider law firms, the number of outstanding people we have in our sales force, and then you couple that with a great home office staff, you just have a win, win, win situation, which also makes for the win situation for our shareholders.

TWST: How well is this all understood by the investment community?

Mr. Stonecipher: I think it's not understood well enough. There are some people — our long-term shareholders — who understand what we are doing. But many don't understand that we are the only company out there of this type in North America. We have been hit by the short sellers who intentionally try to muddy the water and to mislead people as to what this company is all about, but we have a very simple business plan that works very well. More people are beginning to understand this as time goes along, but it is somewhat of an education process with the investment com-

munity because we don't have other companies that we can refer to or point to and say well that's how it's been done for the last 20 years. We are the only company who is doing this. That's a tremendous advantage. We have also had some disadvantage and that stems from the fact that we are a pioneer. Ray Kroc back in the 1950s, 1960s, was pioneering the fast food industry and many people thought he was crazy. People were saying he can't make a living by selling 15-cent hamburgers, but as time went along and more companies got involved and people got more familiar with the fast food industry, then of course the rest is pretty much history. We think that's what will happen here. As time goes along and we continue to do well, we continue to generate positive cash, keep our debt down, buy back our stock, continue to grow at a very rapid pace, a lot of people are going to figure out that this is good company.

TWST: So are you expecting more competitors to enter?

Mr. Stonecipher: I certainly think so and I don't think that's bad. I think there will be other companies somewhere along the road who will get in, but there is plenty of room out there. In fact, another good company or two could help things out because then we would have more people to work with to get the same things done from a regulatory standpoint and so that necessarily wouldn't be negative to us.

TWST: If I were a potential investor, what metrics or milestone would you encourage me to look at to gauge your progress effectively over the next couple of years?

Mr. Stonecipher: The first thing I would tell you is to look at our business model and make sure you understand attorney provider costs and then G&A. It's very simple and it allows us to bring down around 15% before taxes. So if you look at

that and understand that, then you are going to understand that it is a good situation and a very profitable situation with a good margin. The second thing that I would encourage you to look at is the fact that cash is king and in the last year and quarter we actually generated more cash flow than what our earnings were. So today, we report strictly on a cash flow basis, and it is therefore pretty easy to take a look at it and see what we are doing based on how much cash we generated in each quarter. And again you have to look at whether that membership base is continuing to grow. So there are really only about three things to look at. Look at the business model, understand that very simply and you will see what it allows to bring down the bottom line. Look at the past 36 quarters, look at the 37th coming up, and see how much cash we are generating. If we are doing all of this and continuing to grow at the same time, then I think that is all you need to know to make a good business decision.

TWST: As a summary, what two or three main reasons would you give investors to take a look at your stock to day?

Mr. Stonecipher: The first thing is that you need to look at the market itself. There are a lot of good ideas but with a very limited market. This is a huge market; we have a product that meets the need; we have the proper business plan, and take a look at the amount of cash that we are generating. I think if you look at those things, there is a good likelihood that you will become an investor.

TWST: Thank you.

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