

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

PRE PAID LEGAL SERVICES INC

Form 10-Q

July 26, 2005

=====

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 June 30, 2005

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: 001-09293

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)

74820-5813
(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 July 22, 2005 was 15,443,553.

=====

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

PRE-PAID LEGAL SERVICES, INC.

FORM 10-Q

For the Quarter Ended June 30, 2005

CONTENTS

Part I. Financial Information

Item 1. Financial Statements:

- a) Consolidated Balance Sheets
as of June 30, 2005 (Unaudited) and December 31, 2004
- b) Consolidated Statements of Income (Unaudited)
for the three months and six months ended June 30, 2005 and 2004
- c) Consolidated Statements of Comprehensive Income (Unaudited)
for the three months and six months ended June 30, 2005 and 2004
- d) Consolidated Statements of Cash Flows (Unaudited)
for the six months ended June 30, 2005 and 2004
- 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 4. Submission of Matters to a Vote of Security Holders

Item 6. Exhibits

Signatures

<

ITEM 1. FINANCIAL STATEMENTS

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

PRE-PAID LEGAL SERVICES, INC.
CONSOLIDATED BALANCE SHEETS
(Amounts in 000's, except par values)

ASSETS

		June 30 2005
Current assets:		(Unaudited)
Cash and cash equivalents.....	\$	22,211
Available-for-sale investments, at fair value.....		4,813
Membership fees receivable.....		1,377
Inventories.....		16,700
Refundable income taxes.....		5,000
Deferred member and associate service costs.....		51,219
Deferred income taxes.....		19,442
Total current assets.....		194,422
Available-for-sale investments, at fair value.....		4,250
Investments pledged.....		50,329
Property and equipment, net.....		2,985
Deferred member and associate service costs.....		8,500
Other assets.....		136,886
Total assets.....	\$	136,886

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Membership benefits.....	\$	11,226
Deferred revenue and fees.....		26,403
Current portion of capital leases payable.....		318
Current portion of notes payable.....		18,414
Common stock dividends payable.....		14,600
Accounts payable and accrued expenses.....		71,113
Total current liabilities.....		132,064
Capital leases payable.....		1,377
Notes payable.....		19,800
Deferred revenue and fees.....		3,600
Deferred income taxes.....		3,400
Other non-current liabilities.....		102,400
Total liabilities.....		102,400
Stockholders' equity:		
Common stock, \$.01 par value; 100,000 shares authorized; 20,270 and 20,464 issued at June 30, 2005 and December 31, 2004, respectively.....		20,464
Retained earnings.....		132,700
Accumulated other comprehensive income.....		400
Treasury stock, at cost; 4,852 shares held at June 30, 2005 and December 31, 2004.....		(99,000)
Total stockholders' equity.....		34,400

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

Total liabilities and stockholders' equity..... \$ 136,8

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		Si
	June 30,		
	2005	2004	200
Revenues:			
Membership fees.....	\$ 97,093	\$ 88,120	\$ 189
Associate services.....	7,175	5,918	14
Other.....	1,351	1,391	2
	105,619	95,429	206
Costs and expenses:			
Membership benefits.....	33,710	30,449	66
Commissions.....	38,820	29,591	70
Associate services and direct marketing.....	7,963	6,704	17
General and administrative.....	12,337	10,904	23
Other, net.....	2,326	2,505	4
	95,156	80,153	182
Income before income taxes.....	10,463	15,276	24
Provision for income taxes.....	3,610	5,270	8
Net income.....	\$ 6,853	\$ 10,006	\$ 15
Basic earnings per common share.....	\$.45	\$.61	\$
Diluted earnings per common share.....	\$.44	\$.60	\$
Dividends declared per common share.....	\$.30	\$ -	\$

The accompanying notes are an integral part of these financial statements

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

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

	Three Months Ended June 30,		Six Months Ended June 30,
	2005	2004	
Net income.....	\$ 6,853	\$ 10,006	\$ 15,801
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustment.....	(1)	(21)	
Unrealized (losses) gains on investments:			
Unrealized holding (losses) gains arising during period....	163	(310)	
Reclassification adjustment for realized losses (gains) included in net income.....	7	(12)	
	170	(322)	
Other comprehensive income (loss), net of income taxes of \$110 and (\$196) for the three months ended and (\$311) and (\$99) for the six months ended June 30, 2005 and 2004, respectively.....	169	(343)	
Comprehensive income.....	\$ 7,022	\$ 9,663	\$ 15,801

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)

	Six Months Ended June 30,
	2005
Cash flows from operating activities:	
Net income.....	\$ 15,801
Adjustments to reconcile net income to net cash provided by operating activities:	
(Benefit) provision for deferred income taxes.....	(549)
Depreciation and amortization.....	3,695
Tax benefit on exercise of stock options.....	659
Contribution to ESOP.....	-

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

Cash provided by operating activities before changes in assets and liabilities	19,606
Decrease (increase) in Membership income receivable.....	77
Decrease (increase) in inventories.....	271
Decrease in income tax receivable.....	509
(Increase) decrease in deferred member and associate service costs.....	(1,704)
Increase in other assets.....	(962)
Increase in accrued Membership benefits.....	903
Increase (decrease) in deferred revenue and fees.....	2,568
Increase in other non-current liabilities.....	616
Decrease in accounts payable and accrued expenses and other.....	(846)

Net cash provided by operating activities.....	21,038

Cash flows from investing activities:	
Additions to property and equipment.....	(2,819)
Purchases of investments - available for sale.....	(3,569)
Maturities and sales of investments - available for sale.....	9,550

Net cash provided by (used in) investing activities.....	3,162

Cash flows from financing activities:	
Proceeds from exercise of stock options.....	3,246
Proceeds from issuance of debt.....	2,314
Decrease in capital lease obligations.....	(329)
Common stock dividends paid.....	(12,412)
Repayments of debt.....	(9,095)
Purchases of treasury stock.....	(11,621)

Net cash used in financing activities	(27,897)

Net decrease in cash and cash equivalents.....	(3,697)
Cash and cash equivalents at beginning of period.....	25,972

Cash and cash equivalents at end of period.....	\$ 22,275

Supplemental disclosure of cash flow information:	
Cash paid for interest.....	\$ 1,212

Cash paid for income taxes.....	\$ 7,615

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 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

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

included in our 2004 Annual Report on Form 10-K. Terms such as "we", "our" and "us" are sometimes used as abbreviated references to Pre-Paid Legal Services, Inc.

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

In our opinion, the accompanying unaudited financial statements as of June 30, 2005, and for the three month and six month periods ended June 30, 2005 and 2004, reflect adjustments (which were normal and recurring) which, in our opinion, are necessary for a fair statement of our financial position and results of operations of the interim periods presented. Results for the three month and six month periods ended June 30, 2005 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 us 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

We have a stock-based employee compensation plan and account 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 we 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. No stock options were issued during the 2005 periods.

	Three Months Ended June 30,		Six
	2005	2004	2005
Net income, as reported.....	\$ 6,853	\$ 10,006	\$ 15,8
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects.....	-	-	
Pro forma net income.....	\$ 6,853	\$ 10,006	\$ 15,8
Earnings per share:			
Basic - as reported.....	\$.45	\$.61	\$ 1.
Basic - pro forma.....	\$.45	\$.61	\$ 1.
Diluted - as reported.....	\$.44	\$.60	\$ 1.
Diluted - pro forma.....	\$.44	\$.60	\$ 1.

Note 2 - Contingencies

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

We and various 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 we issued false and misleading financial information, primarily related to the method we used to account for commission advance receivables from sales associates. On March 5, 2002, the Court granted our 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 and as of July 22, 2005, a decision was pending. We are 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 us, 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 2004, there were at one time as many as 30 separate lawsuits involving approximately 285 plaintiffs in Alabama. As of July 22, 2005, as a result of dismissals, summary judgments, or settlements for nominal amounts, we were aware of approximately 8 separate lawsuits involving approximately 11 plaintiffs that have been filed in multiple counties in Alabama. As of July 22, 2005, we were aware of 15 separate lawsuits involving approximately 425 plaintiffs in multiple counties in Mississippi. Certain of the Mississippi lawsuits also name our former provider attorney in Mississippi as a defendant. 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. We have responded to the Attorney General's requests for information with respect to these complaints, and as of July 22, 2005, we were not aware of any further actions being taken by the Attorney General. In Mississippi, we filed lawsuits in the United States District Court for the Southern and Northern Districts of Mississippi in which we seek to compel arbitration of the various Mississippi claims under the Federal Arbitration Act and the terms of our 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 September 2005, and in Mississippi in November and December 2005, and seek varying amounts of actual and punitive damages. The first trial in Mississippi on these cases resulted in a unanimous jury verdict in our favor, including other named defendants, on all claims on October 19, 2004, while the second and third trials in Mississippi resulted in insubstantial plaintiffs' verdicts on February 15, 2005 and May 9, 2005 respectively. As of July 22, 2005, post trial motions are pending on both plaintiffs' verdicts. On July 18, 2005 the Circuit Judge in the May 9, 2005 trial entered an order granting plaintiff's motion to reconsider the submission of the issue of punitive damages to the jury, and set the case for trial on that issue in November 2005. Pre-Paid is seeking post trial and appellate relief from the final judgment in that case and the recent order. Although 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 us and certain officers in the District Court

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

of Creek County, Oklahoma on behalf of Jeff and Jana Weller individually and doing business as Hi-Tech Auto making similar allegations relating to our 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. On December 3, 2004, the District Court ordered the plaintiffs to proceed with the arbitration. The ultimate outcome of this case is not determinable.

On June 29, 2001, an action was filed against us 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 our sales associates. 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 our 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. On December 17, 2004 the District Court granted our motion for summary judgment. On January 27, 2005 three of the five plaintiffs filed a motion to vacate and/or for new trial (the claims of the other two plaintiffs had been dismissed with prejudice upon our waiver of costs). The motion to vacate and/or for new trial was denied and during further proceedings the claims of the remaining three plaintiffs were dismissed with prejudice on June 30, 2005 upon our waiver of costs. This matter is therefore concluded and will not appear on this note in the future.

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 us and certain executive officers. This action is a putative class action seeking unspecified damages filed on behalf of our sales associates and alleges that the marketing plan offered by us 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, 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 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 petitioned the Tenth Circuit Court of Appeals

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

for permission to appeal the class certification ruling, and the Tenth Circuit Court of Appeals denied the petition for interlocutory appeal. The ultimate outcome of this case is not determinable.

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

While the ultimate outcome of these proceedings is not determinable, we do not currently anticipate that these contingencies will result in any material adverse effect to our 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. We have established an accrued liability we believe will be sufficient to cover estimated damages in connection with various cases (exclusive of ongoing defense costs which are expensed as incurred), which at June 30, 2005 was \$2.7 million. We believe that we have 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 our financial condition, operating results or cash flows in particular quarterly or annual periods.

Note 3 - Treasury Stock Purchases

We announced on April 6, 1999, a treasury stock purchase program authorizing management to acquire up to 500,000 shares of our common stock. The Board of Directors has increased such authorization from 500,000 shares to 10 million shares during subsequent board meetings. At June 30, 2005, we had purchased 9.4 million treasury shares under these authorizations for a total consideration of \$222.5 million, an average price of \$23.64 per share. We purchased and formally retired 46,100 shares of our common stock during the 2005 second quarter for \$1.7 million, or an average price of \$35.87, reducing our common stock by \$461 and our retained earnings by \$1.7 million. See Note 6 below. Given the current interest rate environment, the nature of other investments available and our expected cash flows, we believe 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 we consider attractive and at such times that we believe will not unduly impact our 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 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
Ended June 30,

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

Basic Earnings Per Share:	2005	2004	2003
	-----	-----	-----
Earnings:			
Net income.....	\$ 6,853	\$ 10,006	\$ 10,006
Shares:			
Weighted average shares outstanding.....	15,397	16,485	16,485
Diluted Earnings Per Share:			
Earnings:			
Net income.....	\$ 6,853	\$ 10,006	\$ 10,006
Shares:			
Weighted average shares outstanding.....	15,397	16,485	16,485
Assumed exercise of options.....	273	73	73
Weighted average number of shares, as adjusted.....	15,670	16,558	16,558

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 557,000 shares for the three months and 597,000 shares for the six months ended June 30, 2004, respectively, with an average exercise price of \$27.84 and \$27.57, respectively, were excluded from the calculation of diluted earnings per share for the respective periods. No options were excluded for the three months and six months ended June 30, 2005.

Note 5 - Recent Issued Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" ("FAS No. 123R"). FAS No. 123R requires companies to recognize compensation expense in an amount equal to the fair value of the share-based payment (including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans) issued to employees. FAS No. 123R applies to all transactions involving issuance of equity by a company in exchange for goods and services, including employee services. Registrants were initially required to adopt FAS No. 123R as of the beginning of the first interim period that begins after June 15, 2005. On April 14, 2005, during our 2005 second quarter, the Securities and Exchange Commission adopted a new rule that allows companies to implement FAS No. 123R at the beginning of their next fiscal year, instead of the next reporting period that begins after June 15, 2005. We will adopt FAS No. 123R at the beginning of our 2006 fiscal year. We estimate the adoption of FAS No. 123R, using the modified prospective method, which results in no restatement of the Company's previously issued annual consolidated financial statements, will not have a material impact on the consolidated financial position, results of operations or cash flows of the Company.

Note 6 - Notes Payable

On June 11, 2002, we 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 our 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

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

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, our rights to receive Membership fees on a portion of our Memberships and by a security interest covering all equipment. The interest rate at June 30, 2005 was 5.39%. 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, we arranged \$25 million in additional financing for treasury stock purchases 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 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, we amended the terms of the loan agreement with these banks to increase the loan amount to \$31.5 million and allow for additional treasury stock purchases of up to \$31.5 million. We 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 our 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 interest at the 30 day LIBOR rate plus 3%. The interest rate at June 30, 2005 was 6.14%. The monthly principal payment will be \$1.3 million compared to the monthly payment on the prior loan of \$1.4 million. During May 2005 we amended the loan agreement further. The second 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 65% (increased from 50%) of net income and lowered the debt service coverage ratio from 125% to 110%.

The loan is primarily collateralized by our rights to receive Membership fees on a portion of our Memberships and a pledge of the stock of our subsidiaries. The definitive agreement contains covenants prohibiting us 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 our chairman and Chief Executive Officer for 90 days. Pre-payment of the loan is permitted. The loan agreements contain the following financial covenants: (a) our quarterly Debt Coverage Ratio (as defined in the loan agreements) shall not be less than 110%; (b) our 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) we 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 quarterly basis; (d) we shall not pay dividends or purchase treasury shares, which during any fiscal quarter, on a combined basis, would exceed sixty-five percent (65%) of our 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) our 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. We were in compliance with the above covenants at June 30, 2005.

In April 2005, we entered into a loan with a commercial lender providing for financing of our existing aircraft. The aircraft loan provided for funding of \$2.3 million at the 30 day LIBOR rate plus 2.25%, adjusted monthly, and repayments began in May 2005 with monthly principal payments of \$38,560 plus interest with a balloon payment on April 30, 2010. The loan is primarily collateralized by a first lien and security interest on the two corporate aircraft. The interest rate at June 30, 2005 was 5.39%.

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

A schedule of outstanding balances as of June 30, 2005 is as follows:

Real estate line of credit.....	\$	16,381
Stock purchase line of credit.....		19,688
Aircraft.....		2,236

Total notes payable.....		38,305
Less: Current portion of notes payable.....		(18,498)

Long term portion.....	\$	19,807

A schedule of future maturities as of June 30, 2005 is as follows:

Repayment Schedule commencing July 2005:

Year 1.....	\$	18,498
Year 2.....		6,686
Year 3.....		2,748
Year 4.....		9,987
Year 5.....		386

Total notes payable.....	\$	38,305

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 our Form 10-K for the year ended December 31, 2004, which describes, among other things, our basic business model, critical accounting policies, measures of Membership retention, and basic cash flow characteristics of our business. The following tables set forth changes in the principal categories of revenues and expenses and Membership and recruiting activity for the second quarter of 2005 compared to the second quarter of 2004 and the first quarter of 2005 and for the six months ended June 30, 2005 compared to the comparable period of 2004 (Amounts in 000's):

Three Months Ended June 30, 2005 compared to Three Months Ended June 30, 2004 and compared to Three Months Ended March 31, 2005	Three Months Ended June 30, 2005	% of Total Revenue	% Change from Prior Year	% Change from Sequential Period	Three Months Ended June 30, 2004	% of Total Revenue
-----	-----	-----	-----	-----	-----	-----

Revenues:

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

Membership fees.....	\$97,093	91.9	10.2	5.0	\$ 88,120	92.3
Associate services.....	7,175	6.8	21.2	1.9	5,918	6.2
Other.....	1,351	1.3	(2.9)	.2	1,391	1.5
	-----	-----	-----	-----	-----	-----
	105,619	100.0	10.7	4.7	95,429	100.0
	-----	-----	-----	-----	-----	-----
Costs and expenses:						
Membership benefits.....	33,710	31.9	10.7	3.0	30,449	31.9
Commissions.....	38,820	36.8	31.2	22.6	29,591	31.0
Associate services and direct marketing.....	7,963	7.5	18.8	(12.5)	6,704	7.0
General and administrative.....	12,337	11.7	13.1	11.2	10,904	11.4
Other, net.....	2,326	2.2	(7.2)	(11.9)	2,505	2.6
	-----	-----	-----	-----	-----	-----
	95,156	90.1	18.7	9.1	80,153	84.0
	-----	-----	-----	-----	-----	-----
Income before income taxes.....	10,463	9.9	(31.5)	(23.4)	15,276	16.0
Provision for income taxes.....	3,610	3.4	(31.5)	(23.4)	5,270	5.5
	-----	-----	-----	-----	-----	-----
Net income.....	\$ 6,853	6.5	(31.5)	(23.4)	\$ 10,006	10.5
	-----	-----	-----	-----	-----	-----

	Six Months Ended June 30, 2005	% of Total Revenue	% Change from Prior Year	Six Months Ended June 30, 2004	% of Total Revenue
Six Months Ended June 30, 2005 compared to Six Months Ended June 30, 2004:	-----	-----	-----	-----	-----
Revenues:					
Membership fees.....	\$189,597	91.8	8.4	\$174,870	92.0
Associate services.....	14,217	6.9	14.0	12,475	6.6
Other.....	2,700	1.3	.3	2,693	1.4
	-----	-----	-----	-----	-----
	206,514	100.0	8.7	190,038	100.0
	-----	-----	-----	-----	-----
Costs and expenses:					
Membership benefits.....	66,431	32.2	11.2	59,735	31.4
Commissions.....	70,497	34.1	19.8	58,863	31.0
Associate services and direct marketing.....	17,059	8.3	19.2	14,307	7.5
General and administrative.....	23,436	11.3	11.9	20,950	11.0
Other, net.....	4,967	2.4	5.9	4,690	2.5
	-----	-----	-----	-----	-----
	182,390	88.3	15.0	158,545	83.4
	-----	-----	-----	-----	-----
Income before income taxes.....	24,124	11.7	(23.4)	31,493	16.6
Provision for income taxes.....	8,323	4.0	(23.4)	10,865	5.7
	-----	-----	-----	-----	-----
Net income.....	\$15,801	7.7	(23.4)	\$20,628	10.9
	-----	-----	-----	-----	-----

Three Months Ended

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

New Memberships:	6/30/2005	3/31/2005	6/30/2004
-----	-----	-----	-----
New legal service membership sales.....	174,202	173,348	137,39
New "stand-alone" IDT membership sales.....	8,588	7,531	5,44
	-----	-----	-----
Total new membership sales.....	182,790	180,879	142,83
	-----	-----	-----
New "add-on" IDT membership sales.....	116,723	103,777	77,80
Average Annual Membership fee.....	\$341.81	\$331.48	\$324.4
Active Memberships:			
Active legal service memberships at end of period.....	1,490,276	1,453,702	1,413,66
Active "stand-alone" IDT memberships at end of period (see note below).....	39,071	32,400	17,57
	-----	-----	-----
Total active memberships at end of period.....	1,529,347	1,486,102	1,431,24
	-----	-----	-----
Active "add-on" IDT memberships at end of period (see note below).....	397,749	337,868	201,71
New Sales Associates:			
New sales associates recruited.....	69,790	52,944	13,73
Average enrollment fee paid by new sales associates.....	\$51.45	\$68.68	\$229.5
Average Membership fee in force:			
Average Annual Membership fee.....	\$281.91	\$277.54	\$269.2

Note - reflects 5,345 net 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 our membership base, while "stand alone" Identity Theft Shield memberships are not attached to a legal plan membership and sell for \$12.95 per month.

Recent Issued Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" ("FAS No. 123R"). FAS No. 123R requires companies to recognize compensation expense in an amount equal to the fair value of the share-based payment (including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans) issued to employees. FAS No. 123R applies to all transactions involving issuance of equity by a company in exchange for goods and services, including employee services. Registrants were initially required to adopt FAS No. 123R as of the beginning of the first interim period that begins after June 15, 2005. On April 14, 2005, during our 2005 second quarter, the Securities and Exchange Commission adopted a new rule that allows companies to implement FAS No. 123R at the beginning of their next fiscal year, instead of the next reporting period that begins after June 15, 2005. We will adopt FAS No. 123R at the beginning of our 2006 fiscal year. We estimate the adoption of FAS No. 123R, using the modified prospective method, which results in no restatement of the Company's previously issued annual consolidated financial statements, will not have a material impact on the consolidated financial position, results of operations or cash flows of the Company.

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

Results of Operations - Second Quarter of 2005 compared to

Second Quarter of 2004

Net income decreased 32% for the second quarter of 2005 to \$6.9 million from \$10.0 million for the prior year's second quarter primarily due to an increase in commission expense of \$9.2 million caused by more new memberships sold during the 2005 second quarter, an increase in Membership benefits expense of \$3.3 million and an increase in general and administrative expenses of \$1.4 million partially offset by a \$9.0 million increase in Membership fees. Diluted earnings per share decreased 27% to 44 cents per share from 60 cents per share for the prior year's comparable quarter due to the 32% decrease in net income partially offset by an approximate 5% decrease in the weighted average number of outstanding shares.

Membership fees totaled \$97.1 million during the 2005 second quarter compared to \$88.1 million for 2004, an increase of 10%. 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 increased 28% during the three months ended June 30, 2005 to 182,790 from 142,833 during the comparable period of 2004. At June 30, 2005, there were 1,529,347 active Memberships in force compared to 1,431,241 at June 30, 2004, an increase of 7%. Additionally, the average annual fee per Membership has increased from \$269 for all Memberships in force at June 30, 2004 to \$282 for all Memberships in force at June 30, 2005, primarily as a result of a larger number of Identity Theft Shield memberships.

Associate services revenue increased 21% from \$5.9 million for the second three months of 2004 to \$7.2 million during the comparable period of 2005 with a 408% increase in new associates recruited. Total new associates enrolled during the second quarter of 2005 were 69,790 compared to 13,733 for the same period of 2004. Average enrollment fees paid by new sales associates during the 2005 second quarter was \$51 compared to \$230 for the comparable period of 2004 due to specialized \$49 enrollment programs aimed at varying market niches. We expect to continue some form of reduced enrollment programs for the remainder of the year. Associate fees decreased from \$3.5 million for the second three months of 2004 to \$3.3 million during the comparable period of 2005. Future revenues from associate services will depend primarily on the number of new associates enrolled, the average enrollment fee paid and the number who choose to participate in our eService program, but we expect that such revenues will continue to be offset by the direct and indirect cost to us of training, providing associate services and other direct marketing expenses. The eService fees increased 32% to \$2.5 million during the second quarter of 2005 compared to \$1.9 million for the comparable period of 2004.

Other revenue remained unchanged at \$1.4 million for both the 2005 second quarter and the comparable period of 2004.

Primarily as a result of the increase in Membership fees, total revenues increased to \$105.6 million for the three months ended June 30, 2005 from \$95.4 million during the comparable period of 2004, an increase of 11%.

Membership benefits totaled \$33.7 million for the three months ended June 30, 2005 compared to \$30.4 million for the comparable period of 2004, and represented 35% of Membership fees for both the 2005 and 2004 periods. 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

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

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

Commissions to associates increased 31% to \$38.8 million for the three months ended June 30, 2005 compared to \$29.6 million for the comparable period of 2004, and represented 40% and 34% of Membership fees for the respective 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 June 30, 2005 totaled 182,790, a 28% increase from the 142,833 sold during the comparable period of 2004. Commissions to associates per new membership sold were \$212 per membership for the three months ended June 30, 2005 compared to \$207 for the comparable period of 2004. 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 we add additional commissions to our compensation plan or reduce the amount of chargebacks collected from our associates as we have from time to time, the commission cost per new Membership will increase accordingly.

Associate services and direct marketing expenses increased to \$8.0 million for the three months ended June 30, 2005 from \$6.7 million for the comparable period of 2004. The increase was primarily a result of increased costs for incentive trips and bonuses and increased costs for materials sent to new associates due to large increase in the number of new associates enrolled during the quarter. We offer the Player's Club incentive program to provide additional incentives to our 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 June 30, 2005 and 2004 were \$12.3 million and \$10.9 million, respectively, and represented 13% and 12% of Membership fees for the respective periods. The 2005 second quarter reflects increased accounting fees and consulting fees related to our Sarbanes-Oxley compliance efforts and increased expenses related to bank service charges due to the increases in legal plans and Identity Theft Shield Memberships and increased employee costs. We should experience cost efficiencies as a result of certain economies of scale in some areas but expect any such cost savings for the remainder of 2005 to be largely offset by higher levels of expenses related to 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 \$2.3 million for the three months ended June 30, 2005 compared to \$2.5 million for the 2004 comparable period. Depreciation decreased slightly to \$1.8 million for the second quarter of 2005 from \$2.0 million for the comparable period of 2004. Interest expense increased to \$633,000 during the 2005 period from \$406,000 during the comparable period of 2004 as a result of higher indebtedness and a higher average interest rate. Premium taxes increased from \$481,000 for the three months ended June 30, 2004 to \$499,000 for the comparable period of 2005, primarily as a result of increases in Membership fees in certain jurisdictions where we pay premium taxes. Interest income increased \$39,000 to \$378,000 for the three months ended June 30, 2005 from \$339,000 for the comparable period of 2004, primarily due to higher average interest rates.

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

We have recorded a provision for income taxes of \$3.6 million and \$5.3 million (34.5% of pretax income) for the second quarter of 2005 and 2004, respectively.

Results of Operations - Second Quarter of 2005 compared to the First Quarter of

2005

Second quarter 2005 membership fees increased 5% to \$97.1 million from \$92.5 million for first quarter of 2005. Associate services revenues increased slightly during the 2005 second quarter by approximately \$133,000 to \$7.2 million from \$7.0 million for the 2005 first quarter and associate services and direct marketing expenses decreased by \$1.1 million during the same period. Membership benefits totaled \$33.7 million in the second quarter of 2005 compared to \$32.7 million for the first quarter and represented 35% of membership fees for both periods. Commissions to associates totaled \$38.8 million in the second quarter of 2005 compared to \$31.7 million for the first quarter and represented 40% and 34% of membership fees for the respective periods. General and administrative expenses increased during the 2005 second quarter to \$12.3 million compared to \$11.1 million for the first quarter of 2005 and represented 13% and 12% of membership fees, respectively, for each period.

Results of Operations - First six months of 2005 compared to first six months of

2004

Net income decreased 23% for the first half of 2005 to \$15.8 million from \$20.6 million for the prior year's comparable period primarily due to an increase in commission expense of \$11.6 million caused by more new memberships sold during the 2005 period, an increase in Membership benefits expense of \$6.7 million and an increase in general and administrative expenses of \$2.5 million partially offset by a \$14.7 million increase in Membership fees. Diluted earnings per share decreased 19% to \$1.00 per share from \$1.24 per share for the prior year's comparable six month period due to the 23% decrease in net income partially offset by an approximate 6% decrease in the weighted average number of outstanding shares.

Membership fees totaled \$189.6 million during the first half of 2005 compared to \$174.9 million for the comparable period of 2004, 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. 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 increased 19% during the six months ended June 30, 2005 to 363,669 from 305,665 during the comparable period of 2004. At June 30, 2005, there were 1,529,347 active Memberships in force compared to 1,431,241 at June 30, 2004, an increase of 7%. Additionally, the average annual fee per Membership has increased from \$269 for all Memberships in force at June 30, 2004 to \$282 for all Memberships in force at June 30, 2005, primarily as a result of a larger number of Identity Theft Shield memberships.

Associate services revenue increased 14% from \$12.5 million for the first six months of 2004 to \$14.2 million during the comparable period of 2005 primarily as a result of approximately 331% more new associates recruited offset by a significantly lower enrollment fee. Total new associates enrolled during the first six months of 2005 were 122,734 compared to 28,507 for the same period of 2004. Although overall recruiting was 331% higher, associate fees decreased 6% from \$3.5 million for the first six months of 2004 to \$3.3 million during the comparable period of 2005. We expect to continue some form of reduced enrollment

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

programs for the remainder of the year. 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 largely offset by the direct and indirect cost to the Company of training (including training bonuses paid), providing associate services and other direct marketing expenses. The eService fees increased 27% to \$4.7 million during the first half of 2005 compared to \$3.7 million for the comparable period of 2004.

Other revenue remained unchanged at \$2.7 million for both the 2005 and 2004 six-month periods ending June 30.

Primarily as a result of the increase in Membership fees, total revenues increased to \$206.5 million for the six months ended June 30, 2005 from \$190.0 million during the comparable period of 2004, an increase of 9%.

Membership benefits totaled \$66.4 million for the six months ended June 30, 2005 compared to \$59.7 million for the comparable period of 2004, and represented 35% and 34% of Membership fees for the 2005 and 2004 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 increase the blended benefit ratio if the Company continues to sell significant numbers of Identity Theft Shield Memberships.

Commissions to associates increased 20% to \$70.5 million for the six months ended June 30, 2005 compared to \$58.9 million for the comparable period of 2004, and represented 37% and 34% 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 six months ended June 30, 2005 totaled 363,669, a 19% increase from the 305,665 sold during the comparable period of 2004. Commissions to associates per new membership sold were \$194 per membership for the six months ended June 30, 2005 compared to \$193 for the comparable period of 2004. 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 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 we add additional commissions to our 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 increased to \$17.1 million for the six months ended June 30, 2005 from \$14.3 million for the comparable period of 2004. The increase was primarily a result of increased costs for incentive trips and bonuses and increased costs for materials sent to new associates due to large increase in the number of new associates enrolled during the quarter. We offer the Player's Club incentive program to provide additional incentives to our 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 six months ended June 30, 2005 and 2004 were \$23.4 million and \$21.0 million, respectively, and represented 12% of Membership fees for both periods. The increases in general and administrative expense reflect higher levels of expenses related to

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

accounting fees and consulting fees related to our Sarbanes-Oxley compliance efforts and increased expenses related to bank service charges due to the increases in legal plans and Identity Theft Shield Memberships and increased employee costs. We should experience cost efficiencies as a result of certain economies of scale in some areas but expect any such cost savings for the remainder of 2005 to be largely offset by higher levels of expenses related to 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 \$5.0 million for the six months ended June 30, 2005 compared to \$4.7 million for the 2004 comparable period. Depreciation decreased slightly to \$3.7 million for the first half of 2005 from \$3.9 million for the comparable period of 2004. Interest expense increased to \$1.2 million during the 2005 period from \$868,000 during the comparable period of 2004 as a result of higher indebtedness and a higher average interest rate. Premium taxes increased from \$851,000 for the six months ended June 30, 2004 to \$1.1 million for the comparable period of 2005, primarily as a result of increases in Membership fees in certain jurisdictions where we pay premium taxes. Interest income decreased \$44,000 to \$769,000 for the six months ended June 30, 2005 from \$813,000 for the comparable period of 2004, primarily due to lower average balance of investments.

We have recorded a provision for income taxes of \$8.3 million (34.5% of pretax income) for the first six months of 2005 compared to \$10.9 million (34.5% of pretax income) for the same period of 2004.

Liquidity and Capital Resources

General

Consolidated net cash provided from operating activities for the first six months of 2005 remained relatively unchanged at \$21.0 million compared to \$20.8 million for the 2004 period, although cash provided from operating activities before changes in working capital items decreased \$5.3 million from \$24.9 million to \$19.6 million. The decrease of \$5.3 million resulted primarily from the decrease in net income of \$4.8 million.

Consolidated net cash provided by investing activities was \$3.1 million for the first six months of 2005 compared to net cash used in investing activities of \$6.8 million for the comparable period of 2004. This \$9.9 million change in investing activities resulted from the \$2.3 million decrease in additions to property and equipment, a \$3.1 million decrease in investment purchases and a \$4.5 million increase in the maturities and sales of investments.

Net cash used in financing activities during the first six months of 2005 was \$27.9 million compared to \$18.0 million for the comparable period of 2004. This \$9.9 million change was primarily comprised of the \$12.4 million increase in common stock dividends paid and the \$2.4 million increase in purchases of treasury stock partially offset by a \$2.6 million increase in proceeds from exercise of stock options and a \$2.3 million increase in proceeds from issuance of debt.

We purchased and formally retired 335,000 shares of our common stock during the first half of 2005 for \$11.6 million, or an average price of \$34.69, reducing our common stock by \$3,350 and our retained earnings by \$11.6 million. We had a consolidated working capital deficit of \$19.9 million at June 30, 2005, a decrease of \$1.8 million compared to a consolidated working capital deficit of \$21.7 million at December 31, 2004. The decrease was primarily due to a \$7.8 million decrease in common stock dividends payable and a \$1.3 million increase in deferred member and associate service costs partially offset by a \$3.7 million decrease in cash and cash equivalents and a \$2.8 million increase in deferred revenue and fees. The \$19.9 million working capital deficit at June 30,

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

2005 would have been a \$10.2 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 us incurring other current liabilities. We do not expect any difficulty in meeting its financial obligations in the short term or the long term.

At June 30, 2005 we reported \$41.9 million in cash and cash equivalents and unpledged investments compared to \$52.2 million at December 31, 2004. Our 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.

We generally advance significant commissions at the time a Membership is sold. During the six months ended June 30, 2005, we advanced commissions, net of chargebacks, of \$71.8 million on new Membership sales compared to \$52.4 million for the same period of 2004. 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, we typically derive significant positive cash flow from the Membership over its remaining life.

We expense advance commissions ratably over the first month of the related Membership. As a result of this accounting policy, our 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. We track our 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 June 30, 2005, and related activity for the six month period then ended, were:

	(Amounts in 000's)
Beginning unearned advance commission payments (1).....	\$ 183,060
Advance commission payments, net.....	71,761
Earned commissions applied.....	(63,616)
Advance commission payment write-offs.....	(1,170)

Ending unearned advance commission payments before estimated unrecoverable payments (1).....	190,035
Estimated unrecoverable advance commission payments (1).....	(29,957)

Ending unearned advance commission payments, net (1).....	\$ 160,078

(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 \$36.5 million. As such, at June 30, 2005 future commission payments and related expense should be reduced as unearned advance commission payments of \$124 million are recovered. Commissions are earned by the associate as Membership premiums are earned by us, usually on a monthly basis. For additional information concerning these commission advances, see our 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.

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

We believe that we have significant ability to finance expected future growth in Membership sales based on our recurring cash flow and existing amount of cash and cash equivalents and unpledged investments at June 30, 2005 of \$41.9 million. We expect 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 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 our amended stock purchase loan.

On June 11, 2002, we 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 our 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, our rights to receive Membership fees on a portion of our Memberships and by a security interest covering all equipment. The interest rate at June 30, 2005 was 5.39%. 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, we arranged \$25 million in additional financing for treasury stock purchases 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 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, we amended the terms of the loan agreement with these banks to increase the loan amount to \$31.5 million and allow for additional treasury stock purchases of up to \$31.5 million. We 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 our 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 interest at the 30 day LIBOR rate plus 3%. The interest rate at June 30, 2005 was 6.14%. The monthly principal payment will be \$1.3 million compared to the monthly payment on the prior loan of \$1.4 million. During May 2005 we amended the loan agreement further. The second 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 65% (increased from 50%) of net income and lowered the debt service coverage ratio from 125% to 110%.

The loan is primarily collateralized by our rights to receive Membership fees on a portion of our Memberships and a pledge of the stock of our subsidiaries. The definitive agreement contains covenants prohibiting us 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 our chairman and Chief Executive Officer for 90 days. Pre-payment of the loan is permitted. The loan agreements contain the following financial covenants: (a) our quarterly Debt Coverage Ratio (as defined in the loan agreements) shall not be less than 110%; (b) our 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) we shall maintain a rolling twelve month average retention rate of Membership

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

contracts in place for greater than eighteen months of not less than 70%, calculated on a quarterly basis; (d) we shall not pay dividends or purchase treasury shares, which during any fiscal quarter, on a combined basis, would exceed sixty-five percent (65%) of our 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) our 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. We were in compliance with the above covenants at June 30, 2005.

In April 2005, we entered into a loan with a commercial lender providing for financing of our existing aircraft. The aircraft loan provided for funding of \$2.3 million at the 30 day LIBOR rate plus 2.25%, adjusted monthly, and repayments began in May 2005 with monthly principal payments of \$38,560 plus interest with a balloon payment on April 30, 2010. The loan is primarily collateralized by a first lien and security interest on the two corporate aircraft. The interest rate at June 30, 2005 was 5.39%.

Parent Company Funding and Dividends

Although we are the operating entity in many jurisdictions, our 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 us 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 our regulated subsidiaries, will be funded by us in the form of capital contributions or surplus debentures. At June 30, 2005, neither PPLCI nor PPLSIF had funds available for payment of substantial dividends without the prior approval of the insurance commissioner. In April 2005, PPLCI and another of our wholly owned subsidiaries, Legal Service Plans of Virginia, Inc., paid ordinary dividends to us of \$4.1 million and \$3.7 million, respectively.

Contractual Obligations

There have been no material changes outside of the ordinary course of business in our contractual obligations from those disclosed in our annual report on Form 10-K for the year ended December 31, 2004.

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 application of accounting policies. If these estimates or assumptions are incorrect, there could be a material change in our financial condition or operating results. Many of these "critical accounting policies" are common in the insurance and financial services industries; others are specific to our business and operations. Our 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 our Annual Report on Form 10-K for the year ended December 31, 2004. There were no significant

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

changes in the application of critical accounting policies or estimates during the first six months of 2005. We are not aware of any reasonably likely events or circumstances which would result in different amounts being reported that would materially affect our financial condition or results of operations.

Capital and Dividend Plans

We continue to evaluate the desirability of possible additional share repurchases and additional cash dividends. We declared a \$0.30 per share on April 4, 2005 and have previously announced that we will continue shares repurchases, pay a dividend, or both, depending on our financial condition, available resources and market conditions, as well as compliance with the covenants in our amended treasury stock term loan which limit our ability to repurchase shares or pay cash dividends. We expect to resume our open market repurchase program in the near future as we have existing authorization from the Board to purchase an additional 587,182 shares. We also continue to evaluate additional sources of financing that may enable us to accelerate the repurchase program at prices we believe are attractive.

Forward-Looking Statements

All statements in this report other than purely historical information, including but not limited to, statements relating to our future plans and objectives, 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 our historical operating trends and financial condition as of June 30, 2005 and other information currently available to management. We caution that the Forward-Looking Statements are subject to all the risks and uncertainties incident to our business, including but not limited to risks described below. Moreover, we 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. We assume 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 38 and 39 of our 2004 Annual Report on Form 10-K for a description of other risk factors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our consolidated balance sheets include a certain amount of assets and liabilities whose fair values are subject to market risk. Due to our significant investment in fixed-maturity investments, interest rate risk represents the largest market risk factor affecting our consolidated financial position. Increases and decreases in prevailing interest rates generally translate into decreases and increases in fair values of those instruments. Additionally, fair

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

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 June 30, 2005, substantially all of our investments were in investment grade (rated Baa or higher) fixed-maturity investments and interest-bearing money market accounts including certificates of deposit. We do 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 our fixed-maturity investment portfolio. It is assumed that the changes occur immediately and uniformly, with no effect given to any steps that we 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:

	(In 000's) Fair value	Hypothetical change in interest rate (bp = basis points)	E ch
	-----	-----	-----
Fixed-maturity investments at June 30, 2005 (1).....	\$ 21,014	100 bp increase 200 bp increase 50 bp decrease 100 bp decrease	
Fixed-maturity investments at December 31, 2004 (1)....	\$ 27,023	100 bp increase 200 bp increase 50 bp decrease 100 bp decrease	

(1) Excluding short-term investments with a fair value of \$2.5 million at June 30, 2005 and December 31, 2004.

The table above illustrates, for example, that an instantaneous 200 basis point increase in market interest rates at June 30, 2005 would reduce the estimated fair value of our fixed-maturity investments by approximately \$2.3 million at that date. At December 31, 2004, an instantaneous 200 basis point increase in market interest rates would have reduced the estimated fair value of our fixed-maturity investments by approximately \$3.0 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 we do not believe such risk is material.

We primarily manage our 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

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

We are exposed to market risk related to changes in interest rates. As of June 30, 2005, we had \$38.3 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, interest expense would increase by approximately \$383,000. As of June 30, 2005, we had not entered into any interest rate swap agreements with respect to the term loans or the floating rate municipal bonds.

Foreign Currency Exchange Rate Risk

Although we are 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 our revenues are derived outside of the United States.

ITEM 4. CONTROLS AND PROCEDURES

Our Principal Executive Officer and Principal Financial Officer have reviewed and evaluated the effectiveness of our 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 our current disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit 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. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2005 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

As previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2004, we concluded that we were unable to complete the required management assessment of our internal control over financial reporting as of December 31, 2004, primarily because the documentation and assessment of our computer programs responsible for processing financially-significant transactions had not been adequately documented as we had expected. Our independent registered public accounting firm, Grant Thornton, issued a "disclaimer" opinion, included in Item 8 of our Form 10-K, indicating that they do not express an opinion as to management's assessment and as to the effectiveness of our internal control over financial reporting as of December 31, 2004. This lack of documentation and our internal control over our commission processes have been identified as material weaknesses in our internal control over financial reporting.

In response, we have been aggressively engaged in a process to address these weaknesses, which will include documentation and assessment of application controls in general, and documentation and implementation of additional controls on the commission expense application. We have substantially completed the documentation of application controls and controls on the commission expense application. During the third quarter we began evaluation, testing and remediation of a substantial number of the application controls. We expect to

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

complete our assessment of internal control over financial reporting during the fourth quarter of 2005.

Nothing has come to the attention of management, as of July 25, 2005, which would cause us to believe that the material weaknesses described above have resulted in any material inaccuracies or errors in our financial statements as of June 30, 2005 or any prior period. However, it is possible during the completion of additional documentation, evaluation and testing we will identify one or more errors, significant deficiencies or material weaknesses.

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 our purchases of stock in the open market during the second quarter of 2005.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number Shares that May Be Purchased U the Plans or Programs (2)
-----	-----	-----	-----	-----
April 2005.....	6,200	\$ 34.40	6,200	627,082
May 2005.....	161,162 (1)	35.95	39,900	587,182
June 2005.....	-	-	-	587,182
-----	-----	-----	-----	-----
Total.....	167,362	\$ 35.89	46,100	
-----	-----	-----	-----	

(1) Includes 121,262 shares previously owned by optionees which were surrendered in conjunction with employee option exercises.

(2) We announced on April 6, 1999, a treasury stock purchase program authorizing management to acquire up to 500,000 shares of our 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, we 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 our ability to repurchase shares

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

and pay dividends.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

The 2005 Annual Meeting of Shareholders of the Company (the "Annual Meeting") was held on May 23, 2005. Voting on Proposals 1 through 4 was concluded at such meeting but voting on Proposal 5 was extended until June 22, 2005. The following matters were submitted to a vote of the Company's shareholders at the Annual Meeting.

Proposal 1 - Election of Directors.

The results of the election for the director were as follows:

	Votes For	Abstentions and Votes Withheld
	-----	-----
Martin H. Belsky	13,421,902	89,008
Harland C. Stonecipher	13,441,043	69,867

The number of members of the Board of Directors is divided into three classes equal in size, with the term of office of one class expiring each year. The new terms of service of Mr. Stonecipher and Belsky will expire in 2008. The terms of the other four directors of the Company did not expire at the Annual Meeting. The names of such other directors and the year of expiration of their respective terms are as follows: John W. Hail - 2006; Thomas W. Smith - 2006; Peter K. Grunebaum - 2007 and Orland G. Aldridge - 2007.

Proposal 2 - Ratify the selection of Grant Thornton LLP as our independent registered public accounting firm.

Votes For	Votes Against	Abstentions
-----	-----	-----
13,456,118	43,353	11,439

Proposal 3 - Amend our Restated Certificate of Incorporation to authorize the Board to effect a reverse stock split immediately followed by a forward stock split to reduce number of odd-lot holders

Votes For	Votes Against	Abstentions
-----	-----	-----
10,999,101	71,833	14,679

Proposal 4 - Approve voting rights for control shares owned, or to be acquired, directly or indirectly, by Thomas W. Smith and certain of his associates.

Votes For	Votes Against	Abstentions
-----	-----	-----
5,490,040	356,712	53,880

Proposal 5 - Amend our Restated Certificate of Incorporation to eliminate certain anti-takeover provisions by repealing the previous Article Eighth which requires the affirmative vote of 80% of the voting power of the outstanding stock for certain transactions.

Votes For	Votes Against	Abstentions
-----	-----	-----

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

12,413,377

208,585

133,673

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 3.1 of the Company's Report on Form 8-K dated June 27, 2005)
3.2	Amended and Restated Bylaws of the Company (Incorporated by reference to Exhibit 3.2 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-K 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, 1992)
*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 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 2003 (Incorporated by reference to Exhibit 10.7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2004)
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 period 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 period 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 period ended June 30, 2002)
*10.11	Deferred compensation plan effective November 6, 2002 (Incorporated by reference to Exhibit 10.11 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,

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

- Bank and First United Bank & Trust (Incorporated by reference to Exhibit 10.1 of 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 Serv of Oklahoma N.A., Comerica Bank and First United Bank & Trust. (Incorporated by 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 Bank of Oklahoma, N.A., Comerica Bank and First United Bank & Trust (Incorporated 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 Se of Oklahoma, N.A., Comerica Bank and First United Bank & Trust (Incorporated by r Exhibit (b) (iv) to the Company's Schedule TO filed on August 27, 2004)
- 10.16 Aircraft purchase agreement dated December 9, 2004 by and between S&S Aviation, L (Incorporated by reference to Exhibit 10.13 of the Company's Report on Form 10-K December 31, 2004)
- 10.17 Aircraft purchase agreement dated December 9, 2004 by and between Harland C. Ston Shirley A. Stonecipher and Stonecipher Aviation, LLC and the Company (Incorporate Exhibit 10.14 of the Company's Report on Form 10-K for the year ended December 31
- 10.18 Assignment and Assumption of Lease dated December 20, 2004 between Harland C. and Stonecipher and the Company (Incorporated by reference to Exhibit 10.15 of the Co Form 10-K for the year ended December 31, 2004)
- *10.19 Amended Deferred Compensation Plan effective January 1, 2005 (Incorporated by ref 10.16 of the Company's Report on Form 10-K for the year ended December 31, 2004)
- 10.20 Promissory Note dated April 30, 2005 between us and Bank of Oklahoma N.A. (Incorp reference to Exhibit 10.1 of the Company's Report on Form 8-K dated May 3, 2005)
- 10.21 Loan Agreement dated April 30, 2005 between us and Bank of Oklahoma, N.A. (Incorp reference to Exhibit 10.2 of the Company's Report on Form 8-K dated May 3, 2005)
- 10.22 Security Agreement dated April 30, 2005 between us and Bank of Oklahoma, N.A. (In reference to Exhibit 10.3 of the Company's Report on Form 8-K dated May 3, 2005)
- 10.23 Second Amendment to Loan Agreement dated May 6, 2005 among us, Bank of Oklahoma, Bank and First United Bank & Trust. (Incorporated by reference to Exhibit 10.4 of Report on Form 8-K dated May 3, 2005)
- 31.1 Certification of Harland C. Stonecipher, Chairman, Chief Executive Officer and Pr to Rule 13a-14(a) under the Securities Exchange Act of 1934, filed under Exhibit Regulation S-K.
- 31.2 Certification of Steve Williamson, Chief Financial Officer, Pursuant to Rule 13a- Securities Exchange Act of 1934, filed under Exhibit 31 of Item 601 of Regulation
- 32.1 Certification of Harland C. Stonecipher, Chairman, Chief Executive Officer and Pr 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. filed under Exhibit 32 of Item 601 of Regulation S-K.

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

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

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: July 25, 2005

/s/ Harland C. Stonecipher

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

Date: July 25, 2005

/s/ Randy Harp

Randy Harp
Chief Operating Officer
(Duly Authorized Officer)

Date: July 25, 2005

/s/ Steve Williamson

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;
- (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)) and internal control over financial reporting (as defined in Exchange Act Rule 13 (a)-15(f)) 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;

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

- (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (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: July 25, 2005

/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 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

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

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)) and internal control over financial reporting (as defined in Exchange Act Rule 13 (a)-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (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: July 25, 2005

/s/ Steve Williamson

Steve Williamson
Chief Financial Officer

Exhibit 32.1

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

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

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 June 30, 2005 (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: July 25, 2005 /s/ Harland C. Stonecipher

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 June 30, 2005 (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: July 25, 2005 /s/ Steve Williamson

Steve Williamson
Chief Financial Officer