

10 TO WATCH Short-sellers have tried more than once to take down Pre-Paid Legal Services. They picked the wrong target.



Legal insurance for 20 bucks a month: Pre-Paid founder Stonecipher.

the capital markets to Pre-Paid. The company had to pay down \$24 million in debt from internal cash flow. Between 1987 and 1991 the company lost \$1.1 million—partly because it had been selling so-called open panel contracts; instead of sending customers to preselected law firms, it let them use their own lawyers, who would, of course, bill as high as they wanted. Painfully expensive, of course.

That window has been mostly closed. And with wider exposure to attorney practices, Pre-Paid collected actuarial data that now enable it to predict everything from how much it costs to handle

Fixing the product

By Seth Lubove

YOU'D THINK THAT SELLING insurance to protect people against lawsuits would be a winner. But it nearly busted Harland Stonecipher, 60.

Stonecipher founded the predecessor to Ada, Okla.-based Pre-Paid Legal Services (1997 revenues: \$93 million) in 1972. It was a bold idea for an insurance product. For about \$20 a month anyone can buy a package that provides legal services in times of need—unlimited telephone consultations with an attorney, will preparation, IRS audit defense, basic trial defense and a 25% discount on any other legal services not covered by the plan.

In a litigious society, buying such insurance provides peace of mind

for many people.

Stonecipher sold legal services insurance the same way Amway sells soap—pyramid-style. Paying \$65 to \$249 apiece these days, thousands of folks signed up to become sellers of his policies, taking a 25% commission. Buyers often became salespeople; whenever they sold policies, they shot a part of their commission back to those who recruited them. The system helped create a sales force of more than 110,000.

So far, so good. But, to stimulate sales, Stonecipher had to pay three years of sales commissions up front before the premiums were collected—yet accounted for them as if they were paid out over three years instead of recording an instant hit to earnings. That practice, while legal, caught the eye of FORBES, which warned, "The balance sheet remains shaky" (*June 6, 1986*). It also drew so many short-sellers in 1987 that Pre-Paid asked the American Stock Exchange to investigate manipulation of its stock.

All that negative attention closed off

simple legal matters (\$400 for a will in Oklahoma, \$250 to fight a traffic ticket) to how many people are calling law offices at 9 a.m. every Monday.

Armed with such information, Pre-Paid made deals with law firms to provide its customers with what they needed; in return for the huge volume of business, the law firms quoted low prices to Pre-Paid. Parker & Stanbury in Los Angeles and Ross & Matthews of Fort Worth have found it so profitable that Pre-Paid has become their largest single client.

The short-sellers have been bloodied—and FORBES' skepticism put to rest. The stock is up more than fourteenfold in five years, and its net margins are over 20%, compared with barely 2% five years ago.

Still committed to multilevel marketing, Stonecipher has developed policies for police officers, teachers and small businesses. "We haven't scratched the surface of need for this product," he says. "We haven't even scratched the scratch."

RANK	COMPANY (consecutive years on list) business	PROFITABILITY		GROWTH				SALES	NET INCOME	MARKET VALUE*	EPS	P/E	RECENT PRICE	
		RETURN ON EQUITY	DEBT/EQUITY	SALES		EPS		latest 12 mos (\$ mil)	latest 12 mos (\$ mil)		1999E	1999E		
		5-year average	latest 12 mos	5-year average	latest 12 mos	5-year average	latest 12 mos			(\$ mil)	(\$)		(\$)	
5	Pre-Paid Legal Services (3) paying a preset fee gives members access to, or reimbursement for, legal svcs	24	33	0	46	49	94	49	111	23.0	426	1.53	12	19.00