

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

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended June 30, 1997

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

*Commission File Number: 1-9293*

**PRE-PAID LEGAL SERVICES, INC.**

(Exact name of registrant as specified in its charter)

Oklahoma  
(State or other jurisdiction of  
incorporation or organization)  
No.)

73-1016728  
(I.R.S. Employer  
Identification

321 East Main Street  
Ada, Oklahoma  
(Address of principal executive offices)

74821-0145  
(Zip Code)

(405) 436-1234  
(Registrants' telephone number, including area code)

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 the number of shares outstanding of each of the issuer's classes of common stock as of July 25, 1997:

**Common Stock \$.01 par value 22,233,595**

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

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

**ASSETS**

	June 30,	December
31,	1997	1996
-----		
	(Unaudited)	
Current assets:		
Cash .....	\$19,586	\$14,831
Held-to-maturity short-term investments .....	500	500
Accrued membership income .....	2,001	1,710
Commission advances - current portion .....	12,235	9,108
	-----	-----
Total current assets .....	34,322	26,149
	-----	-----
Held-to-maturity investments .....	2,943	1,757
Investments pledged .....	2,772	2,772
Commission advances, net .....	28,974	21,744
Property and equipment, net .....	2,925	2,955
Other .....	2,229	2,155
	-----	-----
Total assets .....	\$74,165	\$57,532
	=====	=====

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Current liabilities:		
Membership benefits .....	\$ 2,334	\$ 1,862
Accounts payable and accrued expenses .....	1,720	912
	-----	-----
Total current liabilities .....	4,054	2,774
Deferred income taxes .....	13,772	9,284
	-----	-----
Total liabilities .....	17,826	12,058
	-----	-----
Stockholders' equity:		
Preferred stock, \$1 par value; authorized 400 shares; issued and outstanding as follows:		
\$3.00 Cumulative Convertible Preferred Stock, authorized 5 shares; shares outstanding; liquidation value of \$78 at June 30, 1997 and \$84 at December 31, 1996, respectively .....		
	5	5
Special preferred stock, \$1 par value; authorized 500 shares, issued and outstanding in one series designated as follows:		
\$1.00 Non-Cumulative Special Preferred Stock, 32 shares authorized, issued and outstanding at June 30, 1997 and December 31, 1996; liquidation value of \$413 at June 30, 1997 and \$430 at December 31, 1996 .....		
	32	32
Common stock, \$.01 par value; 100,000 shares authorized; 22,952 and 22,459 issued at June 30, 1997 and December 31, 1996, respectively .....		
	230	225
Capital in excess of par value .....	43,570	41,039
Retained earnings .....	14,679	6,350
Less: Treasury stock, at cost; 747 shares .....	(2,177)	
	-----	-----
Total stockholders' equity .....	56,339	45,474
	-----	-----
-----		
Total liabilities and stockholders' equity .....	\$ 74,165	\$ 57,532
	=====	=====

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)

Six Months Ended  
June 30,

-----	1997	1996
-----	-----	-----
Revenues:		
Membership premiums .....	\$34,609	
\$22,565		
Associate services .....	5,635	
2,854		
Interest income .....	745	
597		
Other .....	935	
875		
	-----	
	41,924	
26,891		
	-----	
Costs and expenses:		
Membership benefits .....	11,634	
7,579		
Commissions .....	7,570	
5,041		
General and administrative .....	3,983	
2,798		
Associate services and direct marketing expenses .....	5,100	
2,222		
Depreciation .....	325	
266		
Premium taxes .....	488	
169		
	-----	
	29,100	
18,075		
	-----	
Income before income taxes .....	12,824	
8,816		
Provision for income taxes .....	4,488	
3,086		
	-----	
Net income .....	8,336	
5,730		
Less dividends on preferred shares .....	7	
8		
	-----	
Net income applicable to common shares .....	\$ 8,329	\$
5,722		
	=====	
Earnings per common and common equivalent share .....	\$ .37	\$
.26		
	=====	
Earnings per common share - assuming full dilution .....	\$ .37	\$
.26		
	=====	

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)

Ended	Three Months	
	June 30,	
-----	1997	1996
-----	-----	
Revenues:		
Membership premiums .....	\$18,390	
\$12,261		
Associate services .....	2,935	
1,603		
Interest income .....	364	
314		
Other .....	510	
359		
	-----	
	22,199	
14,537		
	-----	
Costs and expenses:		
Membership benefits .....	6,187	
3,981		
Commissions .....	4,087	
2,618		
General and administrative .....	2,095	
1,620		
Associate services and direct marketing expenses .....	2,811	
1,231		
Depreciation .....	164	
128		
Premium taxes .....	155	
97		
	-----	
	15,499	
9,675		
	-----	
Income before income taxes .....	6,700	
4,862		
Provision for income taxes .....	2,345	
1,702		
	-----	
Net income .....	4,355	
3,160		
Less dividends on preferred shares .....	4	
4		
	-----	
Net income applicable to common shares .....	\$ 4,351	\$
3,156		
	=====	
Earnings per common and common equivalent share .....	\$ .19	\$
.14		
	=====	
Earnings per common share - assuming full dilution .....	\$ .19	\$
.14		
	=====	

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,	
	1997	1996
Cash flows from operating activities:		
Net income .....	\$ 8,336	\$ 5,730
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation .....	325	266
Provision for deferred income taxes .....	4,488	3,086
Provision for associate stock options .....	--	318
Increase in accrued membership income .....	(291)	
(283)		
Increase in commission advances .....	(10,357)	
(9,843)		
Increase in other assets .....	(74)	
(274)		
Increase in membership benefits .....	472	256
Increase in accounts payable and accrued expenses ...	808	74
	3,707	
Net cash provided by (used in) operating activities		
(670)		
Cash flows from investing activities:		
Additions to property and equipment .....	(295)	
(344)		
Purchases of investments .....	(1,301)	
(1,082)		
Maturities of investments .....	115	400
	(1,481)	
Net cash used in investing activities		
(1,026)		
Cash flows from financing activities:		
Proceeds from sale of common and preferred stock .....	2,536	1,376
Dividends paid on preferred stock .....	(7)	
(8)		
	2,529	1,368
Net cash provided by financing activities		
Net increase in cash .....	4,755	
(328)		
Cash at beginning of period .....	14,831	14,489
	\$ 19,586	\$ 14,161
Cash at end of period .....		
Supplemental disclosure of cash flow information:		
Cash paid for interest .....	\$ 6	\$ 6
Cash paid for taxes .....	\$ --	\$ 15

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

**PRE-PAID LEGAL SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

The consolidated balance sheet as of June 30, 1997, the related statements of income for the three-month and six-month periods ended June 30, 1997 and 1996 and the statements of cash flows for the six-month periods ended June 30, 1997 and 1996 are unaudited; in the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included.

These financial statements and notes are prepared pursuant to the rules and regulations of the Securities and Exchange Commission for interim reporting and should be read in conjunction with the Company's financial statements and notes included in the 1996 Annual Report on Form 10-K. Certain reclassifications have been made to conform to current year presentation.

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

Statement of Financial Accounting Standards 128, Earnings Per Share, ("SFAS 128") was issued in February, 1997. This statement provides new accounting and reporting standards for earnings per share and will replace the currently used primary and fully diluted earnings per share with basic and diluted earnings per share. Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share represents the potential dilution that could occur if all stock options and other stock-based awards, as well as convertible securities, were exercised and converted into common stock. SFAS 128, effective for year-end 1997 financial statements, requires that prior period earnings per share be restated. The Company does not expect adoption of this statement to have a material impact on earnings per common share amounts.

Statement of Financial Accounting Standards 130, Reporting Comprehensive Income, ("SFAS 130") was issued in June, 1997. This statement establishes standards for reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. This statement requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. SFAS 130, effective for fiscal years beginning after December 15, 1997, requires reclassification of financial statements for earlier periods provided for comparative purposes. The Company does not expect adoption of this statement to have a material impact on earnings per common share amounts.

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

### **RESULTS OF OPERATIONS**

#### **FIRST SIX MONTHS OF 1997 COMPARED TO FIRST SIX MONTHS OF 1996**

The Company reported net income applicable to common shares of \$8.3 million, or \$.37 per share assuming full dilution, for the six months ended June 30, 1997 compared to \$5.7 million, or \$.26 per share, for the comparable period of 1996. As a percentage of total revenues, net income applicable to common shares was 20% in the first six months of 1997, down slightly from 21% in the first six months of 1996. The decline in this margin is attributable to increased expenses associated with the implementation of a new program which became available in January, 1997. The new combination classroom and field training program, titled Fast Start to Success ("Fast Start"), is aimed at increasing the level of new membership sales per associate. The positive impact of the program is reflected in the increase in new memberships written and new sales associates recruited per Fast Start associate.

Revenues rose 56% to \$41.9 million from \$26.9 million for the prior year's comparable period. Income before income taxes for the first half of 1997 increased 45% to \$12.8 million, or 31% of revenues, from \$8.8 million, or 33% of revenues for the comparable period of 1996.

Membership premiums totaled \$34.6 million during the first half of 1997 compared to \$22.6 million for the same period of 1996, an increase of 53%. The increase in membership premiums was primarily the result of increased new membership sales resulting in a higher number of active memberships in force. New membership sales during the first six months of 1997 were 133,607 compared to 92,529 during the 1996 period, an increase of 44%. At June 30, 1997, there were 359,579 active memberships in force compared to 253,091 at June 30, 1996, an increase of 42%. Membership premiums and their impact on total revenues in any period are determined directly by the number and the average premium 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 persistency, or renewal rate, of existing memberships. The Company's overall membership persistency rate varies based on, among other factors, the relative age of total memberships in force. From 1981 through the year ended December 31, 1996, the Company's annual membership persistency rates have averaged approximately 76%.

Associate services revenue increased from \$2.9 million for the first half of 1996 to \$5.6 million during the same period of 1997 primarily as a

result of Fast Start which resulted in the Company receiving training fees of approximately \$2.6 million during the first six months of 1997. Fast Start requires a training fee of \$184 per new associate (\$25 for a limited time period for existing associates) and upon successful completion of the program provides for the payment of certain training bonuses. In order to be deemed successful for Fast Start purposes, the new associate must write three new memberships and recruit one new sales associate within 15 days of the associate's Fast Start training. The \$2.6 million in training fees was comprised of \$184 from each of approximately 12,100 new sales associates who elected to participate in Fast Start and training fees of \$25 from each of approximately 14,500 existing associates who participated in the program. New associates enrolled during the first six months of 1997 were 29,623 compared to 38,087 for the same period of 1996, a decrease of 22%. Future revenues from associate services will depend primarily on the number of new associates enrolled and the number who choose to participate in the Company's training 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 bonuses paid, providing associate services and other direct marketing expenses.

Interest income increased 25% to \$745,000 during the six months ended June 30, 1997 from \$597,000 for the comparable period of 1996 as a result of increases in the average investments outstanding and higher interest rates on investments. At June 30, 1997 the Company reported \$25.8 million in cash and investments compared to \$18.6 million at June 30, 1996.

Membership benefits totaled \$11.6 million for the first half of 1997 compared to \$7.6 million for the same period of 1996, an increase of 54%. However, the loss ratio (membership benefits as a percentage of membership premiums) for the 1997 period remained level with the loss ratio for the comparable period of 1996 at 34%. The loss ratio is expected to remain near 35% as the portion of active memberships which provide for a capitated benefit continues to increase.

Commission expense was \$7.6 million for the first half of 1997 compared to \$5.0 million for the same period of 1996, but remained level, as a percentage of membership premiums at 22%. Commission expense, as a percentage of membership premiums, is expected to gradually increase to near 25% of membership premiums in future years as a result of changes in the commission structure for memberships sold after March 1, 1995.

General and administrative expenses during the 1997 and 1996 six month periods were \$4.0 million and \$2.8 million, and represented 12% of membership premiums for such periods. These expenses are expected to remain at or near these levels and gradually decrease when expressed as a percentage of membership premiums as a result of certain economies of scale pertaining to the Company's operations.

Associate services and direct marketing expenses increased to \$5.1 million for the first half of 1997 from \$2.2 million for the same period of 1996 as a result of approximately \$1.7 million in Fast Start training bonuses paid, additional costs of supplies due to increased purchases by associates and higher administrative staffing requirements. These expenses also include the costs of providing associate services and marketing costs other than commissions which are directly associated with new membership sales.

Due to property and equipment additions, depreciation increased from \$266,000 during the first six months of 1996 to \$325,000 for the first six months of 1997. Premium taxes increased to \$488,000 during the first six months of 1997 from \$169,000 for the comparable period of 1996, primarily as a result of a \$200,000 accrual related to a prior year tax assessment.

The Company's expense ratio, which represents commissions, general and administrative expenses and premium taxes as a percentage of contract premiums, was 35% for both six month periods resulting in a combined loss and expense ratio of 68% for the first half of 1997 compared to 69% for the same period of 1996. The combined ratio does not measure total profitability because it does not take into account all revenues and expenses.

The Company has recorded a provision for income taxes of \$4.5 million (35% of pretax income) for the first half of 1997 compared to \$3.1 million (35% of pretax income) for the same period of 1996. The 1997 and 1996 provisions reflect the Company's expectation that it more likely than not will not be able to realize the future tax benefit of certain net operating loss carryforwards primarily as a result of tax deductions attributable to expected levels of commissions to be paid on new membership sales.

Dividends paid on outstanding preferred stock during the first six months of 1997 decreased to \$6,891 from \$7,508 during the same period of 1996. This decrease is attributable to the conversion of shares of \$3.00 Cumulative Convertible Preferred Stock into common stock.

## **SECOND QUARTER OF 1997 COMPARED TO THE SECOND QUARTER OF 1996**

The results of operations in the second quarter of 1997, compared to the second quarter of 1996, reflect increases in revenues and expenses primarily as a result of the same factors discussed in the comparison of the first six months of 1997 compared to the first six months of 1996.

Total revenues increased 53% or approximately \$7.7 million to \$22.2 million in the second quarter of 1997 compared to \$14.5 million in the second quarter of 1996, primarily as a result of increases in membership premiums. The membership premium increase of 50% primarily resulted from an increase in the number of average active memberships during the second quarter of 1997 compared to the similar period in 1996.

Membership benefits totaled \$6.2 million in the 1997 second quarter compared to \$4.0 million in the 1996 second quarter and resulted in a loss ratio of 34% and 32%, respectively. The Company's expense ratio for the second quarter of 1997 was 34% compared to 35% for the 1996 second quarter resulting in a combined loss and expense ratio of 68% for both periods. The combined ratio does not measure total profitability because it does not take into account all revenues and expenses.

The above factors resulted in a 1997 second quarter net income applicable to common shares of \$4.4 million, or \$.19 per share, assuming full dilution compared to \$3.2 million, or \$.14 per share, for the second quarter of 1996.

## **LIQUIDITY AND CAPITAL RESOURCES**

Consolidated net cash provided by operating activities was \$3.7 million for the first six months of 1997 compared to net cash used in operating activities of \$670,000 for the 1996 period. The increase of \$4.4 million in cash provided by operations during the first six months of 1997 compared to the same period of 1996 resulted primarily from increases in net income of \$2.6 million, increases in deferred income taxes of \$1.4 million, increases in accounts payable and accrued expenses of \$734,000 and only partially reduced by an increase in commission advances of \$514,000 related to the increase in new membership enrollments.

The Company had consolidated working capital of \$30.3 million at June 30, 1997, an increase of \$6.9 million compared to consolidated working capital of \$23.4 million at December 31, 1996 and an increase of \$10.2 million compared to consolidated working capital of \$20.1 million at June 30, 1996.

The Company advances significant commissions at the time a Membership is sold. During the six months ended June 30, 1997, the Company advanced commissions of \$17.2 million on new membership sales compared to \$14.1 million for the same period of 1996. Since approximately 92% of Membership premiums are collected on a monthly basis, a significant cash flow deficit is created at the time a Membership is sold. This deficit is reduced as monthly premiums are remitted and no additional commissions are paid on the Membership until all previous commission advances have been fully recovered. Commission advances were subsequently reduced by commission earnings of \$6.6 million and \$4.1 million for the six month periods ended June 30, 1997 and 1996, respectively. The Company has recorded an allowance of \$3.7 million to provide for estimated uncollectible balances which includes an increase in the allowance of \$300,000 during the six months ended June 30, 1997.

The Company's unsecured \$5 million revolving credit agreement with Bank One, Texas expired July 1, 1997. The Company had never borrowed under this agreement and is currently evaluating the need for such a credit facility. Should the determination be made that such a facility is warranted, the Company expects such a credit agreement with similar terms could be arranged in a timely manner.

Although the Company is the operating entity in many jurisdictions, the Company's subsidiaries serve as operating companies in various states which regulate memberships as insurance or specialized legal expense products. The most significant of these wholly-owned subsidiaries are Pre-Paid Legal Casualty, Inc. ("PPLCI") and Pre-Paid Legal Services, Inc. of Florida ("PPLSIF"). The ability of PPLCI and PPLSIF to provide funds to the Company is subject to a number of restrictions under various insurance laws in the jurisdictions in which PPLCI and PPLSIF conduct business, including limitations on the amount of dividends and management fees that may be paid and requirements to maintain specified levels of capital and reserves. In addition PPLCI will be required to maintain its stockholders' equity at levels sufficient to satisfy various state regulatory requirements, the most restrictive of which is currently \$3 million. Additional capital requirements of either PPLCI or PPLSIF will be funded by the Company in the form of capital contributions or surplus debentures.

## PART II. OTHER INFORMATION

### ITEM 2. CHANGES IN SECURITIES.

#### (c) Recent Sales of Unregistered Securities:

On May 6, 1997 and June 20, 1997, the Company issued to two sales associates of the Company a total of 5,000 shares (2,500 shares each) of Common Stock upon exercise of outstanding warrants to purchase Common Stock at an exercise price of \$8.25 per share. Such warrants were issued in connection with the achievement of certain sales levels within the Company.

Between May 6, 1997 and May 28, 1997, the Company issued to assignees of Roger T. Staubach a total of 58,000 shares of Common Stock upon exercise of outstanding warrants to purchase Common Stock at an exercise price of \$.50 per share. Such warrants were issued by the Company during 1993 in connection with a marketing services agreement entered into between the Company and Mr. Staubach.

On May 13, 1997, the Company granted to Francis A. Tarkenton, a director of the Company, options to purchase 120,000 shares of the Company's Common Stock at an exercise price of \$16.75 per share (the closing sale price of the Common Stock on the date of the grant as reported by the American Stock Exchange). The options were granted in recognition of Mr. Tarkenton's efforts in furtherance of the Company's marketing activities, including Mr. Tarkenton's agreement to participate in certain of the Company's sales associate marketing rallies.

All such options and shares of Common Stock were issued without registration under the Securities Act of 1933 in reliance on the exemption under Section 4(2) thereof.

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

The 1997 Annual Meeting of Shareholders of the Company was held on May 23, 1997. The following matters were submitted to a vote of the Company's shareholders:

1. The election of two directors for a term of three years. The results of the election for each such director are as follows:

and	Votes For -----	Abstentions Votes Withheld -----
Kathleen S. Pinson	15,987,759	132,325
Charles H. Walls	15,983,937	133,565

The Board of Directors of the Company consists of seven members and is divided into three classes as nearly equal in size as possible, with the term of office of one class expiring each year. The terms of the other five directors of the Company did not expire at the Annual Meeting. The names of such directors and the year of expiration of their respective terms are as follows: Peter K. Grunebaum - 1998; Randy Harp - 1998; Francis A. Tarkenton - 1998; Harland C. Stonecipher - 1999; and Wilburn Smith - 1999.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.**

(a) Exhibits: The following exhibits are filed as part of this Form 10-Q:

No.	Description
10.1 Company	Stock Option Agreement dated May 13, 1997 between the and Francis A. Tarkenton
11.1	Statement Regarding Computation of Per Share Earnings
27.1	Financial Data Schedule

(b) Reports on Form 8-K: There were no reports on Form 8-K filed by the Company during the quarter ended June 30, 1997.

**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 28, 1997*

*/s/ HARLAND C. STONECIPHER*

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*Officer*

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

*Date: July 28, 1997*

*/s/ RANDY HARP*

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*Randy Harp  
Chief Financial Officer and  
Chief Operating Officer  
(Principal Financial Officer)*

*Date: July 28, 1997*

*/s/ KATHY PINSON*

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*Kathy Pinson  
Controller  
(Principal Accounting Officer)*

## EXHIBIT INDEX

No.	Description
10.1	Stock Option Agreement dated May 13, 1997 between the Company and Francis A. Tarkenton
11.1	Statement Regarding Computation of Per Share Earnings
27.1	Financial Data Schedule

**Exhibit 10.1**

**PRE-PAID LEGAL SERVICES, INC.**  
**STOCK OPTION AGREEMENT**  
(Francis A. Tarkenton)

This Stock Option Agreement ("Agreement") is made this 13th day of May, 1997, between Pre-Paid Legal Services, Inc., an Oklahoma corporation (the "Corporation"), and Francis A. Tarkenton (the "Optionee").

WHEREAS, the Corporation develops, underwrites and markets legal service plans, in part through commissioned marketing associates;

WHEREAS, Optionee is a director of the Corporation;

WHEREAS, Optionee has agreed to appear and speak at not less than twelve of the Corporation's marketing rallies during the next twelve months; and

WHEREAS, in consideration for such services in furtherance of the Corporation's marketing efforts, the Corporation desires to grant to Optionee options to purchase shares of the Corporation's common stock, par value \$.01 per share ("Common Stock"), on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants hereinafter set forth, the parties hereby agree as follows:

1. **Grant of Stock Option.** Subject to the terms and conditions herein set forth, the Corporation hereby grants to Optionee the right and option ("Option") to purchase all or any part of an aggregate number of One Hundred Twenty Thousand (120,000) shares of Common Stock (which foregoing number of shares is subject to adjustment as hereinafter provided). Such Option is not intended to qualify as an incentive stock option under the Internal Revenue Code.
2. **Purchase Price.** Subject to adjustments as hereinafter provided, the purchase price under the Option for shares of Common Stock shall be \$16.75 per share, which represents the closing sale price of the Common Stock on the date hereof as reported by the American Stock Exchange. The purchase price of one share of Common Stock payable from time to time upon exercise of the Option (whether such price be the price specified above or an adjusted price determined as hereinafter provided) is referred to herein as the "Option Price."
3. **Vesting and Term.** The Option may not be exercised, in whole or in part, until May 13, 1998, at which time the Option shall become fully vested and immediately exercisable; provided, however, that it shall be a condition to the vesting of the option that Optionee shall not have voluntarily resigned or have been removed for cause from the Board of Directors on or prior to such vesting date. The right to exercise the Option, in whole or in part, shall expire on May 13, 2000.
4. **Adjustment of Option Price and Number of Shares.** The number and kind of securities issuable upon the exercise of the Option shall be subject to adjustment from time to time upon the happening of certain events as follows:
  - 4.1 **Adjustment for Dividends in Stock.** In case at any time or from time to time on or after the date hereof the holders of all of the outstanding Common Stock of the Corporation (or any shares of stock or other securities at the time receivable upon the exercise of the Option) shall have received or, on or after the record date fixed for the determination of eligible stockholders, shall have become entitled to receive, without payment therefore, other or additional stock of the Corporation by way of dividend, then and in each case, the Optionee shall, upon the exercise of the Option, be entitled to receive, in addition to the number of shares of Common Stock receivable thereupon, and without payment of any additional consideration therefor, the amount of such other or additional stock of the Corporation which Optionee would hold on the date of such exercise had he been the holder of record of such Common Stock on the date hereof and had thereafter, during the period from the date hereof to and including the date of such exercise, retained such shares and/or all other additional stock receivable by him as aforesaid during such period, giving effect to all adjustments called for during such period by Sections 4.2 and 4.3.
  - 4.2 **Adjustment for Reclassification, Reorganization or Merger.** In the event of any reclassification of the Common Stock or other capital adjustment of the Corporation effected without receipt of consideration or in the event of a merger or consolidation of the Corporation which does not result in a change of control of the Corporation (as determined in the sole discretion of the Board of Directors of the Corporation), then upon the exercise of the Option at any time after the consummation of such reclassification, capital adjustment, merger or consolidation, the Optionee shall be entitled to receive, in lieu of the stock or other securities and property receivable upon the exercise hereof prior to such consummation, the stock or other securities or property to which the Optionee would have been entitled upon such consummation if Optionee had exercised the Option immediately prior thereto, all subject to further adjustment as provided in Sections 4.1 and 4.3. In the event of a dissolution or liquidation of the Corporation or a merger or consolidation in which the Corporation is not the surviving or resulting corporation or which results in a change in control of the Corporation (as determined in the sole discretion of the Board of Directors of the Corporation) or a tender or exchange offer which results in a change in control of the Corporation (as determined in the sole discretion of the Board of Directors of the Corporation), the Board of Directors shall determine
    - (i) whether all or any part of the unexercised portion of the Option shall terminate or
    - (ii) in the case of such merger or consolidation, whether the Optionee shall, upon exercise hereof, be entitled to receive securities of the surviving or resulting corporation on the same basis as

described in the first sentence of this Section.

The existence of the Option shall not affect or restrict in any way the right or power of the Board of Directors or the shareholders of the Corporation to make or authorize any adjustment, recapitalization, reorganization or other change in the Corporation's capital structure or its business, any merger or consolidation of the Corporation, any issue of securities ahead of or affecting the Common Stock or the rights thereof, the dissolution or liquidation of the Corporation or any sale or transfer of all or any part of its assets or business or any other corporate act proceeding.

4.3 Stock Splits and Reverse Stock Splits. If at any time on or after the date hereof the Corporation shall subdivide its outstanding shares of Common Stock into a greater number of shares, the Option Price in effect immediately prior to such subdivision shall thereby be proportionately reduced and the number of shares receivable upon exercise of the Option shall thereby be proportionately increased; and, conversely, if at any time on or after the date hereof the outstanding number of shares of Common Stock shall be combined into a smaller number of shares, the Option Price in effect immediately prior to such combination shall thereby be proportionately increased and the number of shares receivable upon exercise of the Option shall hereby be proportionately decreased.

4.4 De Minimis Adjustments to Option Price. No adjustment in the Option Price shall be required unless such adjustment would require any increase or decrease of at least one percent or more of the Option Price; provided, however, that any adjustments which by reason of this Section 4.4 are not required to be made shall be carried forward and taken into account in any subsequent adjustment. All calculations under this Section 3 shall be made to the nearest cent.

5. Certificate of Adjustment. Whenever the Option Price is adjusted, as herein provided, the Corporation shall promptly deliver to Optionee a certificate of an officer of the Corporation setting forth the Option Price after such adjustment and setting forth a brief statement of the facts requiring such adjustment.

6. No Other Adjustments. Except as provided in Section 4, no adjustment will be made to the Option Price or the number or type of securities purchasable upon the exercise hereof.

7. No Fractional Shares. No fractional shares of Common Stock will be issued in connection with any exercise of the Option and any fractional shares resulting from any adjustment hereunder shall be eliminated.

8. No Stockholder Rights. The Option shall not entitle Optionee to any of the rights of a stockholder of the Corporation.

9. Reservation of Stock. The Corporation covenants that during the period that the Option is exercisable, the Corporation will reserve from its authorized and unissued Common Stock a sufficient number of shares to provide for the issuance of Common Stock upon the exercise of the Option. The Corporation agrees that its issuance of the Option shall constitute full authority to its officers who are charged with the duty of executing stock certificates to execute and issue the necessary certificates for shares of Common Stock upon the exercise of the Option.

10. Exercise of Option. The Optionee's ability to exercise the Option is subject to all applicable laws and to the Corporation having obtained prior to such exercise all necessary governmental approvals and the approval of any applicable stock exchange or consolidated trading system upon which the Common Stock may be listed. The Corporation shall use its best efforts to obtain such approvals prior to such exercise. Subject to the foregoing and the provisions of

Section 12 below, the Option may be exercised by the Optionee, in whole or in part, by the surrender of this Agreement at the principal office of the Corporation, accompanied by payment in full of the Option Price by certified or cashier's check payable to the Corporation, a completed Subscription Form in the form attached hereto and any other information, opinions or agreements required by the Corporation pursuant to the provisions hereof. The Corporation may also require, as a condition to the exercise of the Option and the issuance of any shares, that the Optionee remit an amount sufficient, in the Corporation's opinion, to satisfy applicable federal, state or local withholding tax requirements, if any. Upon partial exercise hereof, a new option agreement or agreements containing the same date and provisions as this Agreement shall be issued by the Corporation to the Optionee for the number of shares of Common Stock with respect to which the Option shall not have been exercised. The Option shall be deemed to have been exercised immediately prior to the close of business on the date of its surrender for exercise as provided above, and the person entitled to receive the shares of Common Stock issuable upon such exercise shall be treated for all purposes as the holder of such shares of record as of the close of business on such date. As promptly as practicable on or after such date, the Corporation shall issue and deliver to the person or persons entitled to receive the same a certificate or certificates for the number of full shares of Common Stock issuable upon such exercise.

11. Transfer of Option. The Option and all rights hereunder are not transferable, in whole or in part, except by will or the laws of descent and may be exercised during the lifetime of the Optionee only by him. The terms of the Option shall be binding upon the executors, administrators, heirs and successors of the Optionee.

12. Compliance with Securities Laws.

12.1 The Optionee represents and agrees that the Option has been acquired only for investment, for Optionee's own account, and without any

present intention to sell or distribute the Option or the shares issuable upon exercise thereof. Optionee further acknowledges that the Option may not be exercised and the shares will not be issued pursuant to the exercise of the Option unless the exercise of the Option and the issuance and delivery of such shares shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended (the "Securities Act"), and other federal and state securities laws and regulations and the requirements of any stock exchange or consolidated trading system upon which the Common Stock may then be listed.

12.2 If, at the time of the exercise of the Option, it is, in the sole opinion of the Corporation, necessary or desirable in order to comply with any applicable laws or regulations relating to the sale of the shares, the Optionee shall represent and warrant to, and agree with, the Corporation that the Optionee will purchase the shares for which the Option is being exercised for investment and not with any present intention to resell such shares and without a view to distribution. The Optionee shall, upon the request of the Corporation, execute and deliver to the Corporation an agreement to such effect.

12.3 The Optionee acknowledges and agrees that the Option and the shares issuable upon exercise thereof have not been registered under the Securities Act and accordingly will not be transferable except as permitted under the various exemptions contained in the Securities Act, or upon satisfaction of the registration and prospectus delivery requirements of the Securities Act. Therefore the Option and the shares must be held indefinitely unless they are subsequently registered under the Securities Act or an exemption from such registration is available. Optionee understands that any certificate evidencing the shares issuable upon exercise of the Option will be imprinted with a legend which prohibits the transfer of the shares unless they are registered or unless the Corporation receives an opinion of counsel reasonably satisfactory to the Corporation that such registration is not required. Optionee is aware of Rule 144 under the Securities Act and that the Corporation, at the time he wishes to sell the shares, may not be satisfying the current public information requirements of Rule 144, and, in such case, Optionee would be precluded from selling the securities under Rule 144. Optionee understands that a stop transfer instruction will be in effect with respect to transfer of shares consistent with the requirements of the securities laws.

13. Miscellaneous. The Option and the Agreement shall be governed by the laws of the State of Oklahoma. The headings in this Agreement are for purposes of convenience and reference only, and shall not be deemed to constitute a part hereof. Neither the Option nor any term hereof may be changed, waived, discharged or terminated orally but only by an instrument in writing signed by the Corporation and the Optionee. All notices and other communications from the Corporation to the Optionee shall be personally delivered or mailed by first-class registered or certified mail, postage prepaid, to the address furnished to the Corporation in writing by the Optionee.

IN WITNESS WHEREOF, the Corporation has caused this Agreement to be executed by its officer thereunto duly authorized, and Optionee has hereunto set his hand, all on the day and year first above written.

**"CORPORATION"**

**PRE-PAID LEGAL SERVICES, INC.**

By: /s/ HARLAND C.  
STONECIPHER

-----  
Name: Harland C. Stonecipher

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Title: Chairman of the Board  
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**"OPTIONEE"**

*/s/ FRANCIS A. TARKENTON*

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*Francis A. Tarkenton*

## SUBSCRIPTION FORM

(To be signed only upon exercise of Option)

**TO: PRE-PAID LEGAL SERVICES, INC.**

The undersigned, \_\_\_\_\_, the holder of the attached Option, hereby irrevocably elects to exercise the purchase right represented by that Option for, and to purchase under that Option, \_\_\_\_\_\* shares of Common Stock of Pre-Paid Legal Services, Inc. and herewith makes payment of \$ \_\_\_\_\_ for those shares, and requests that the certificates for the shares be issued in the name of and delivered to, the undersigned at the following address:

Dated: \_\_\_\_\_

(Signature must conform in all respects to name of holder as specified on the face of the attached Option)

\* Insert here the number of shares called for on the face of the Option (or, in the case of partial exercise, the portion as to which the Option is being exercised).

**Exhibit 11.1**

**EXHIBIT 11.1**

**PRE-PAID LEGAL SERVICES, INC.**  
**Statement re Computation of Per Share Earnings**  
(In 000's except per share amounts)

	Six Months Ended June 30,	
	----- 1997	----- 1996
<b>PRIMARY EARNINGS PER SHARE:</b>		
Computation for Statement of Income		
Earnings:		
Income applicable to common shares (a) .....	\$ 8,329	\$ 5,722
	=====	=====
Shares:		
Weighted average shares outstanding, (net of 747 shares of treasury stock) disregarding exercise of options or conversion of preferred stock .....	21,935	21,089
Assumed dilutive conversion of preferred stock .....	113	155
Assumed exercise of options and warrants based on the treasury stock method using average market price .....	408	1,086
	-----	-----
Weighted average number of shares, as adjusted .....	22,456	22,330
	=====	=====
Earnings per share (a) .....	\$ .37	\$ .26
	=====	=====
<b>FULLY DILUTED EARNINGS PER SHARE:</b>		
Computation for Statement of Income		
Earnings:		
Income applicable to common shares (a) .....	\$ 8,329	\$ 5,722
	=====	=====
Shares:		
Weighted average shares outstanding, (net of 747 shares of treasury stock) disregarding exercise of options or conversion of preferred stock .....	21,935	21,089
Assumed dilutive conversion of preferred stock .....	113	155
Assumed exercise of options and warrants based on the treasury stock method using closing market price if higher than average market price ..	479	1,163
Weighted average number of shares, as adjusted .....	22,527	22,407
	-----	-----
Earnings per share (a) .....	\$ .37	\$ .26
	=====	=====

(a) These amounts agree with the related amounts in the statements of income.

**EXHIBIT 11.1**  
(continued)

**PRE-PAID LEGAL SERVICES, INC.**  
**Statement re Computation of Per Share Earnings**  
(In 000's except per share amounts)

	Three Months Ended June 30,	
	----- 1997	1996 -----
<b>PRIMARY EARNINGS PER SHARE:</b>		
Computation for Statement of Income		
Earnings:		
Income applicable to common shares (a) .....	\$ 4,351	\$ 3,156
	=====	=====
Shares:		
Weighted average shares outstanding, (net of 747 shares of treasury stock) disregarding exercise of options or conversion of preferred stock .....	22,071	21,259
Assumed dilutive conversion of preferred stock .....	108	152
Assumed exercise of options and warrants based on the treasury stock method using average market price .....	336	1,115
	-----	-----
Weighted average number of shares, as adjusted .....	22,515	22,526
	=====	=====
Earnings per share (a) .....	\$ .19	\$ .14
	=====	=====
<b>FULLY DILUTED EARNINGS PER SHARE:</b>		
Computation for Statement of Income		
Earnings:		
Income applicable to common shares (a) .....	\$ 4,351	\$ 3,156
	=====	=====
Shares:		
Weighted average shares outstanding, (net of 747 shares of treasury stock) disregarding exercise of options or conversion of preferred stock .....	22,071	21,259
Assumed dilutive conversion of preferred stock .....	108	152
Assumed exercise of options and warrants based on the treasury stock method using closing market price if higher than average market price ..	408	1,115
	-----	-----
Weighted average number of shares, as adjusted .....	22,587	22,526
	=====	=====
Earnings per share (a) .....	\$ .19	\$ .14
	=====	=====

(a) These amounts agree with the related amounts in the statements of income.

**ARTICLE 5**

This schedule contains summary financial information extracted from the June 30, 1997 financial statements contained in Form 10-Q and is qualified in its entirety by reference to such financial statements.

MULTIPLIER: 1,000

CURRENCY: U.S. Dollars

PERIOD TYPE	6 MOS
FISCAL YEAR END	DEC 31 1997
PERIOD START	APR 01 1997
PERIOD END	JUN 30 1997
EXCHANGE RATE	1
CASH	19,586
SECURITIES	0
RECEIVABLES	2,001
ALLOWANCES	0
INVENTORY	0
CURRENT ASSETS	34,322
PP&E	2,925
DEPRECIATION	0
TOTAL ASSETS	74,165
CURRENT LIABILITIES	4,054
BONDS	0
PREFERRED MANDATORY	0
PREFERRED	37
COMMON	230
OTHER SE	56,072
TOTAL LIABILITY ANDEQUITY	74,165
SALES	34,609
TOTAL REVENUES	41,924
CGS	0
TOTAL COSTS	29,100
OTHER EXPENSES	0
LOSS PROVISION	0
INTEREST EXPENSE	0
INCOME PRETAX	12,824
INCOME TAX	4,488
INCOME CONTINUING	8,336
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	8,329
EPS PRIMARY	.37
EPS DILUTED	.37

# End of Filing