



# Mossberg's Investor Digest

## Best Idea Profile

Cornell Companies (NYSE: CRN)

### DESCRIPTION:

Headquartered in Houston, TX, Cornell Companies is the nation's third-largest private prison company, following #1 Corrections Corp (NYSE: CXW) and #2 GEO Group (NYSE: GEO). The company has 20,200 beds in 71 facilities in 15 states. The company operates three divisions; Adult Secure (50% of revenue) provides incarceration and related services, Abraxis Youth and Family Services (30% of revenue) provides juvenile detention and related services, and Adult Community-based (20% of revenue) provides halfway house and other services that help offenders transition back into their home communities. CRN has a 25-year operating history in the prison business and a 35-year history in the other divisions.

### KEY INVESTMENT CONSIDERATION:

#### Imbalance in demand and supply of prison beds

**Demand** – The demand for prison beds is not dependent on macroeconomic cycle. In fact, the Pew Charitable Trusts expects inmate populations in 10 states to increase by more than 25% from 2006 to 2011. Here are three factors driving demand for prison beds.

**1. Crackdown on illegal immigration** – There are 11.8 million unauthorized immigrants in the U.S., up from 8.5 million in 2000. Within this population about ½ million are criminal aliens and another ½ million are non-criminals, who have been ordered for deportation, but are still living here. By comparison, there are only 100,000 beds allocated to house illegal aliens.

**2. Lengthening of mandatory sentences for certain crimes**

**3. Overcrowded prisons** – The federal prison system operates at 135% of capacity and on average the state systems operate at 105% to 110%. To reduce occupancy to 100% of capacity would require 167,000 new beds.

**Supply** – Difficulties in credit markets combined with a tax base affected by weak economy and declining property values are likely to affect state, local and federal governments' ability to fund new projects. According to Bank of America equity research, there are approximately 30,000 new beds coming online over the next two years. This won't even come close to meeting the incremental demand of 67,000 new beds and is far less than the 167,000 needed to bring supply and demand into balance.

**Private prison industry has a lot of room to grow** - Private providers only represent 7.4% of the total \$65 billion corrections market. Because private operators, like Cornell, can consolidate prisoners from multiple areas and house them in facilities that are located where land, building and labor costs are low, outsourcing prisons can reduce cost by as much as 15%. (according to the Reason Foundation). In addition to volume increases, pricing has also been favorable. Pre-2006 prices per bed were approximately \$40...now they're over \$60.

**The bottom line should grow much faster than the top** – The company breaks even at around 65% of capacity. Due to capacity additions, occupancy at the end of the third quarter was at 90%, significantly below the prior year levels of 99.4%. As occupancy increases in the coming quarters, profitability should grow much faster than the top line.

### VALUATION:

Shares are currently trading near their 52 week low and at just 18% above their tangible book value. The enterprise value to EBITDA multiple of just 7x is quite an attractive valuation for one of the few companies that appears poised for growth in 2009 and beyond.

#### (NYSE: CRN)

Investment Data (as of 1/23/09)

|                                |                |
|--------------------------------|----------------|
| <b>Recent Price</b>            | <b>\$14.67</b> |
| 52-Week Range                  | 13.46 - 28.45  |
| Fiscal Year End                | December       |
| Dividend                       | N/A            |
| Yield                          | N/A            |
| Shares Outstanding             | 14.8 MM        |
| Average Trading Volume (3 mos) | 120,000        |
| <b>Market Capitalization</b>   | <b>217 MM</b>  |
| Cash                           | 1.8 MM         |
| Long Term Debt                 | 318 MM         |
| Enterprise Value (EV)          | 533 MM         |
| LT Debt/ Equity                | 1.5            |
| Tangible BV/ Share             | 12.34          |
| TTM Revenue                    | 337 MM         |
| <b>P/ Revenue</b>              | <b>0.6x</b>    |
| TTM EPS (non-GAAP)             | 1.38           |
| <b>P/ EPS</b>                  | <b>10.6x</b>   |
| TTM EBITDA                     | 74 MM          |
| <b>EV/ TTM EBITDA</b>          | <b>7.2x</b>    |

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