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INDUSTRY IN FOCUS

By Palash R. Ghosh

Private Prisons Have a Lock on Growth

With state-run prisons overflowing, outfits such as Corrections Corp. of America stand to benefit

Prisons in the U.S. are bursting at the seams and the nation's jail population is likely to keep growing at an estimated 3% to 5% a year. Private correctional facility operators such as Corrections Corp. of America ("[CXW](#)") and Geo Group ("[GGI](#)") are viewed by some experts as well-positioned to handle the overflow of convicts, thereby alleviating the congestion in state-run institutions, and at a lower cost.

According to the Justice Dept., U.S. prisons held about 2.19 million inmates as of midyear 2005, a 2.6% increase over the prior year. From 1995 to 2005, the country's imprisoned population ballooned by more than 600,000. Even more alarming, at midyear 2005, jail facilities were operating at 95% of capacity.

INCREASED DEMAND. Florida, one of the nation's largest prison systems, presents an interesting microcosm of the current crisis. According to the Florida Corrections Dept., the state's inmate population totaled 84,901 as of midyear 2005, a 3.6% gain from the prior year, a 19.2% rise over the five-year period, and a 37.0% jump over the past decade. Florida estimates that care of each prisoner costs \$18,101 annually—nearly \$50 per day.

The situation in California, which boasts the country's largest prison population with about 171,000 inmates, is particularly dire, with many jails already at double capacity. According to the California Corrections and Rehabilitation Dept., the price to the taxpayer for running these prisons totals about \$7 billion annually.

Wayne Willems, CEO of Brazos Capital Management, is bullish on the private prison industry because of the favorable supply-demand scenario. "States and the federal government are not willing to spend money to build more prisons, and the private sector is," he says. "They can take more inmates from state and federal institutions." Plus, private prison facilities are poised to increase business given the federal government's plan to catch and retain illegal immigrants, he says.

REDUCE RECIDIVISM. According to the Bureau of Justice Statistics, more than 12% of all federally sentenced offenders and about 6% of state prisoners are currently managed by private corrections companies, and these figures are growing. As such, the private prison subsector has significant upside, Willems says.

Texas, which has the nation's second largest prison complex, is committed to the privatization program. The state has more than 40 private jails and prisons capable of handling nearly 30,000 inmates, says Marc A. Levin, director of the Center for Effective Justice at the Texas Public Policy Foundation. In total, Texas prisons house about 152,600 inmates, and the state's Legislative Budget Board projects this figure will rise to 165,300 by 2010. Levin estimates that 16,000 Texas prisoners are currently housed in private facilities.

Levin believes private prisons are more economical than state institutions. "Savings in Texas from private prisons have been estimated at 10% to 14%," he says. "Moreover, private facilities, such as those run by Corrections Corp. of America, often provide far better access to programs such as drug treatment and job training. Such programs have also been demonstrated to reduce recidivism."

SAFE HAVEN. The Texas Criminal Justice Dept. estimates that it costs \$40 per day to incarcerate someone, not including construction costs and state administration. Based on that figure, Levin estimates that the current system costs \$2.2 billion. "We estimate that building another 14,000 units would cost approximately \$1.24 billion," Levin says. "However, we think that innovative policy changes can reduce or eliminate the need for new units and that any new capacity can more efficiently be created by leasing beds from private operators rather than by building new state-run prisons."

Corrections Corp. of America is a core holding in three of the Brazos mutual funds—Brazos Small Cap fund ("[BJSCX](#)"), Brazos Mid Cap fund ("[BJMCX](#)"), and Brazos Growth fund ("[BJGRX](#)"). Willems says he likes Corrections Corp. of America given its recurring revenue stream and the fact that the company has delivered upside earnings surprises over the past three quarters. "CXW can predictably provide 20% annual earnings growth," he says. "And considering the poor market climate we are now in, with the specter of rising interest rates and inflation, stocks like CXW offer a safe haven as they are not economically sensitive."

Corrections Corp. of America's stock price has risen 26% since the beginning of the year (see BusinessWeek.com, 6/2/06, "[Corrections Corp. Breaks Out](#)"). The company has approximately 71,000 beds in 63 facilities under contract for management in 19 states and Washington, D.C. The majority of these prisons are located in the South and Southwest, including 15 in Texas alone. About 62,000 inmates are currently under the company's supervision.

Its main rival, Geo, was spun off from Wackenhut several years ago and currently operates 62 correctional and residential treatment facilities—with capacity of about 51,000 beds—in the U.S., Australia, South Africa, Canada, and Britain. A third major player in this field, Cornell ("[CRN](#)"), has contracts to operate 82 facilities in 18 states and D.C. with a service capacity of 19,500.

Ghosh is a reporter for **Standard & Poor's Fund Advisor**

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