

CORRECTIONS CORP OF AMERICA

Form 10-Q

November 07, 2008



**CORRECTIONS CORPORATION OF AMERICA**  
**FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008**  
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CONSOLIDATED BALANCE SHEETS**

(UNAUDITED AND AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 28,736	\$ 57,968
Accounts receivable, net of allowance of \$3,059 and \$3,914, respectively	242,574	241,116
Deferred tax assets	14,789	12,250
Prepaid expenses and other current assets	20,700	21,133
Assets held for sale		7,581
Current assets of discontinued operations	175	615
Total current assets	<b>306,974</b>	340,663
Property and equipment, net	<b>2,456,949</b>	2,086,980
Restricted cash	6,669	6,511
Investment in direct financing lease	13,698	14,503
Goodwill	13,672	13,672
Other assets	21,907	23,411
Total assets	<b>\$ 2,819,869</b>	\$ 2,485,740
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Accounts payable and accrued expenses	\$ 219,021	\$ 212,749
Income taxes payable	8,905	964
Current portion of long-term debt	290	290
Current liabilities of discontinued operations	566	728
Total current liabilities	<b>228,782</b>	214,731
Long-term debt, net of current portion	<b>1,155,460</b>	975,677
Deferred tax liabilities	42,884	34,271
Other liabilities	39,505	39,086
Total liabilities	<b>1,466,631</b>	1,263,765
Commitments and contingencies		
Common stock \$0.01 par value; 300,000 shares authorized; 125,597 and 124,472 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively	<b>1,256</b>	1,245
Additional paid-in capital	<b>1,589,572</b>	1,568,736

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Retained deficit	<b>(237,590)</b>	(348,006)
Total stockholders' equity	<b>1,353,238</b>	1,221,975
Total liabilities and stockholders' equity	<b>\$ 2,819,869</b>	\$ 2,485,740

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

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**CORRECTIONS CORPORATION OF AMERICA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(UNAUDITED AND AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>REVENUE:</b>				
Management and other	\$ 410,664	\$ 377,069	\$ 1,193,530	\$ 1,085,158
Rental	1,221	1,187	3,617	3,375
	<b>411,885</b>	<b>378,256</b>	<b>1,197,147</b>	<b>1,088,533</b>
<b>EXPENSES:</b>				
Operating	292,599	273,450	850,220	778,937
General and administrative	20,866	18,362	60,222	54,497
Depreciation and amortization	23,564	20,074	67,152	57,272
	<b>337,029</b>	<b>311,886</b>	<b>977,594</b>	<b>890,706</b>
<b>OPERATING INCOME</b>	<b>74,856</b>	<b>66,370</b>	<b>219,553</b>	<b>197,827</b>
<b>OTHER EXPENSES (INCOME):</b>				
Interest expense, net	15,087	13,249	42,671	40,838
Other income	(360)	(200)	(356)	(281)
	<b>14,727</b>	<b>13,049</b>	<b>42,315</b>	<b>40,557</b>
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	<b>60,129</b>	<b>53,321</b>	<b>177,238</b>	<b>157,270</b>
Income tax expense	(22,038)	(20,170)	(66,765)	(59,275)
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>38,091</b>	<b>33,151</b>	<b>110,473</b>	<b>97,995</b>
Income (loss) from discontinued operations, net of tax	(200)	104	(57)	432
<b>NET INCOME</b>	<b>\$ 37,891</b>	<b>\$ 33,255</b>	<b>\$ 110,416</b>	<b>\$ 98,427</b>
<b>BASIC EARNINGS PER SHARE:</b>				

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Income from continuing operations	\$	<b>0.30</b>	\$	0.27	\$	<b>0.89</b>	\$	0.81
Income (loss) from discontinued operations, net of taxes								
Net income	\$	<b>0.30</b>	\$	0.27	\$	<b>0.89</b>	\$	0.81

**DILUTED EARNINGS PER SHARE:**

Income from continuing operations	\$	<b>0.30</b>	\$	0.26	\$	<b>0.87</b>	\$	0.79
Income (loss) from discontinued operations, net of taxes								
Net income	\$	<b>0.30</b>	\$	0.26	\$	<b>0.87</b>	\$	0.79

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

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**CORRECTIONS CORPORATION OF AMERICA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(UNAUDITED AND AMOUNTS IN THOUSANDS)

	For the Nine Months Ended September 30,	
	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 110,416	\$ 98,427
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	67,152	57,272
Amortization of debt issuance costs and other non-cash interest	2,900	2,972
Deferred income taxes	4,924	4,697
Income tax benefit of equity compensation	(8,800)	(17,672)
Other income	(356)	(281)
Non-cash equity compensation	7,205	5,369
Other non-cash items	674	223
Changes in assets and liabilities, net:		
Accounts receivable, prepaid expenses and other assets	(499)	22,648
Accounts payable, accrued expenses and other liabilities	22,518	22,823
Income taxes payable	16,741	18,362
Net cash provided by operating activities	222,875	214,840
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Expenditures for facility development and expansions	(423,423)	(161,645)
Expenditures for other capital improvements	(23,118)	(32,442)
Decrease in restricted cash		5,641
Proceeds from sale of investments		10,000
Purchases of investments		(3,205)
Proceeds from sale of assets	85	48
Increase in other assets	83	(967)
Payments received on direct financing leases and notes receivable	713	631
Net cash used in investing activities	(445,660)	(181,939)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of debt	223,500	
Principal repayments of debt	(43,500)	
Payment of debt issuance costs	(89)	
Income tax benefit of equity compensation	8,800	17,672
Purchase and retirement of common stock	(3,367)	(3,579)
Proceeds from exercise of stock options and warrants	8,209	13,328
Net cash provided by financing activities	193,553	27,421



<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(29,232)</b>	60,322
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<b>57,968</b>	29,121
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<b>\$ 28,736</b>	\$ 89,443

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:**

Cash paid during the period for:

Interest (net of amounts capitalized of \$11,282 and \$4,788 in 2008 and 2007, respectively)	<b>\$ 42,008</b>	\$ 46,269
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Income taxes	<b>\$ 39,474</b>	\$ 31,331
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The accompanying notes are an integral part of these consolidated financial statements.

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**CORRECTIONS CORPORATION OF AMERICA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008**  
(UNAUDITED AND AMOUNTS IN THOUSANDS)

	<b>Common Stock</b>		<b>Additional Paid-in</b>	<b>Retained</b>	
	<b>Shares</b>	<b>Par Value</b>	<b>Capital</b>	<b>Deficit</b>	<b>Total</b>
Balance as of December 31, 2007	124,472	\$ 1,245	\$ 1,568,736	\$ (348,006)	\$ 1,221,975
Comprehensive income:					
Net income				110,416	110,416
Total comprehensive income				110,416	110,416
Issuance of common stock	1		19		19
Retirement of common stock	(126)	(1)	(3,366)		(3,367)
Amortization of deferred compensation, net of forfeitures	(29)		4,397		4,397
Income tax benefit of equity compensation			8,800		8,800
Stock option compensation expense			2,789		2,789
Restricted stock grant	279	2	(2)		
Stock options exercised	1,000	10	8,199		8,209
<b>Balance as of September 30, 2008</b>	<b>125,597</b>	<b>\$ 1,256</b>	<b>\$ 1,589,572</b>	<b>\$ (237,590)</b>	<b>\$ 1,353,238</b>

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

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**CORRECTIONS CORPORATION OF AMERICA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007**  
(UNAUDITED AND AMOUNTS IN THOUSANDS)

	<b>Common Stock</b>		<b>Additional</b>	<b>Retained</b>	<b>Total</b>
	<b>Shares</b>	<b>Par Value</b>	<b>Paid-in Capital</b>	<b>Deficit</b>	
Balance as of December 31, 2006	122,084	\$ 1,221	\$ 1,527,608	\$ (479,148)	\$ 1,049,681
Comprehensive income:					
Net income				98,427	98,427
Total comprehensive income				98,427	98,427
Issuance of common stock	1		19		19
Retirement of common stock	(130)	(1)	(3,578)		(3,579)
Amortization of deferred compensation, net of forfeitures	(123)	(1)	3,717		3,716
Income tax benefit of equity compensation			17,672		17,672
Stock option compensation expense			1,634		1,634
Warrants exercised	75	1	832		833
Restricted stock grant	312	3	(3)		
Stock options exercised	1,832	18	12,477		12,495
Cumulative effect of accounting change				(2,231)	(2,231)
<b>Balance as of September 30, 2007</b>	<b>124,051</b>	<b>\$ 1,241</b>	<b>\$ 1,560,378</b>	<b>\$ (382,952)</b>	<b>\$ 1,178,667</b>

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

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**CORRECTIONS CORPORATION OF AMERICA AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2008**

**1. ORGANIZATION AND OPERATIONS**

As of September 30, 2008, Corrections Corporation of America, a Maryland corporation (together with its subsidiaries, the Company), owned 45 correctional, detention and juvenile facilities, three of which are leased to other operators. As of September 30, 2008, the Company operated 65 facilities, including 42 facilities that it owned, located in 19 states and the District of Columbia. The Company is also constructing an additional 2,232-bed facility in Adams County, Mississippi that is expected to be completed in the fourth quarter of 2008, a 3,060-bed facility in Eloy, Arizona that is expected to be completed in the first quarter of 2009, and a 2,040-bed facility in Trousdale County, Tennessee that is expected to be completed in the first quarter of 2010. Further, during the second quarter of 2008 the Company was awarded a contract by the Office of Federal Detention Trustee to design, build, and operate a new correctional facility in Pahrump, Nevada, which is currently expected to be completed during the second quarter of 2010.

The Company specializes in owning, operating and managing prisons and other correctional facilities and providing inmate residential and prisoner transportation services for governmental agencies. In addition to providing the fundamental residential services relating to inmates, the Company's facilities offer a variety of rehabilitation and educational programs, including basic education, religious services, life skills and employment training, and substance abuse treatment. These services are intended to reduce recidivism and to prepare inmates for their successful re-entry into society upon their release. The Company also provides health care (including medical, dental and psychiatric services), food services and work and recreational programs.

The Company's website address is [www.correctionscorp.com](http://www.correctionscorp.com). The Company makes its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and Section 16 reports under the Securities Exchange Act of 1934, as amended, available on its website, free of charge, as soon as reasonably practicable after these reports are filed with or furnished to the Securities and Exchange Commission (the SEC).

**2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying unaudited interim consolidated financial statements have been prepared by the Company and, in the opinion of management, reflect all normal recurring adjustments necessary for a fair presentation of results for the unaudited interim periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. The results of operations for the interim period are not necessarily indicative of the results to be obtained for the full

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fiscal year. Reference is made to the audited financial statements of the Company included in its Annual Report on Form 10-K as of and for the year ended December 31, 2007 (the 2007 Form 10-K ) with respect to certain significant accounting and financial reporting policies as well as other pertinent information of the Company.

**3. GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill was \$13.7 million as of September 30, 2008 and December 31, 2007 and was associated with the facilities the Company manages but does not own. This goodwill was established in connection with the acquisitions of two service companies during 2000.

The components of the Company's amortized intangible assets and liabilities are as follows (in thousands):

	September 30, 2008		December 31, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Contract acquisition costs	\$ 873	\$ (860)	\$ 873	\$ (859)
Contract values	(35,688)	28,875	(35,688)	25,977
Total	\$ (34,815)	\$ 28,015	\$ (34,815)	\$ 25,118

Contract acquisition costs are included in other non-current assets, and contract values are included in other non-current liabilities in the accompanying balance sheets. Contract values are amortized using the interest method. Amortization income, net of amortization expense, for intangible assets and liabilities during the three months ended September 30, 2008 and 2007 was \$1.2 million and \$1.1 million, respectively, while amortization income, net of amortization expense, for intangible assets and liabilities during the nine months ended September 30, 2008 and 2007 was \$3.5 million and \$3.4 million, respectively. Interest expense associated with the amortization of contract values for the three months ended September 30, 2008 and 2007 was \$0.2 million and \$0.3 million, respectively, while interest expense associated with the amortization of contract values for the nine months ended September 30, 2008 and 2007 was \$0.6 million and \$0.9 million, respectively. Estimated amortization income, net of amortization expense, for the remainder of 2008 and the five succeeding fiscal years is as follows (in thousands):

2008 (remainder)	\$ 1,166
2009	3,204
2010	2,534
2011	134
2012	134
2013	134

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In November 2007, the Company accepted an unsolicited offer to sell a facility located in Houston, Texas and leased to a third-party operator. In accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ( SFAS 144 ), the Company classified the \$7.6 million net book value of the facility as held for sale as of December 31, 2007. During February 2008, at the request of the operator the Company agreed to extend the proposed closing date and fix the sales price through June 30, 2008. During the second quarter of 2008, the third-party operator elected not to purchase the facility and instead signed a new lease for the facility effective July 1, 2008. As a result, the Company has reclassified the facility previously classified as held for sale as an asset to be held and used and the asset is now reported in property and equipment in the accompanying consolidated balance sheet. Further, in accordance with SFAS 144, the Company reclassified the results of operations of this facility to be included in income from continuing operations for all periods presented.

As a result of Shelby County's evolving relationship with the Tennessee Department of Children's Services ( DCS ) whereby the DCS prefers to oversee the juveniles at facilities under DCS control, the Company ceased operations of the 200-bed Shelby Training Center located in Memphis, Tennessee in August 2008. The Company reclassified the results of operations, net of taxes, and the assets and liabilities of this facility, excluding property and equipment, as discontinued operations upon termination of the management contract during the third quarter of 2008 for all periods presented. The property and equipment of this facility will continue to be reported as continuing operations, as the Company retained ownership of the building and equipment.

The following table summarizes the results of operations for this facility for the three and nine months ended September 30, 2008 and 2007 (amounts in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>REVENUE:</b>				
Owned and Managed	\$ 161	\$ 1,664	\$ 3,269	\$ 5,072
<b>EXPENSES:</b>				
Owned and Managed	476	1,496	3,354	4,378
<b>OPERATING INCOME (LOSS)</b>	<b>(315)</b>	168	<b>(85)</b>	694
Other income			2	
<b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS BEFORE INCOME TAXES</b>	<b>(315)</b>	168	<b>(83)</b>	694
Income tax (expense) benefit	115	(64)	26	(262)
<b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAXES</b>	<b>\$ (200)</b>	\$ 104	<b>\$ (57)</b>	\$ 432

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In addition to the foregoing, during 2006 and 2005, the Company transferred management of two facilities it did not own to other operators. The Company did not operate either of these facilities, and therefore there were no results of operations, during the three and nine months ended September 30, 2008 and 2007. The assets and liabilities of these two facilities, along with those associated with the management contract with the DCS at the Shelby Training Center, presented in the accompanying consolidated balance sheets are as follows (amounts in thousands):

	<b>September 30, 2008</b>	December 31, 2007
<b>ASSETS</b>		
Accounts receivable	\$ 158	606
Prepaid expenses and other current assets	17	9
Total current assets	\$ 175	\$ 615
<b>LIABILITIES</b>		
Accounts payable and accrued expenses	\$ 566	\$ 728
Total current liabilities	\$ 566	\$ 728

In May 2008, the Company notified the Bay County Commission of its intention to exercise the Company's option to terminate the operational management contract for the 1,150-bed Bay County Jail and Annex in Panama City, Florida, effective October 9, 2008. The Company currently expects to reclassify the results of operations, net of taxes, and the assets and liabilities of this facility as discontinued operations upon termination of operations in the fourth quarter of 2008 for all periods presented. The termination of the management contract is not expected to have a material effect on the Company's financial statements.

Pursuant to a re-bid of the management contracts, during September 2008, the Company was notified by the Texas Department of Criminal Justice ( TDCJ ) of its intent to transfer the management of the 500-bed B.M. Moore Correctional Center in Overton, Texas and the 518-bed Diboll Correctional Center in Diboll, Texas to another operator, upon the expiration of the management contracts on January 16, 2009. Both of these facilities are owned by the TDCJ. The Company currently expects to reclassify the results of operations, net of taxes, and the assets and liabilities of these two facilities as discontinued operations upon termination of operations in the first quarter of 2009 for all periods presented. The termination of the management contracts is not expected to have a material effect on the Company's financial statements.

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Debt outstanding as of September 30, 2008 and December 31, 2007 consists of the following (in thousands):

	<b>September 30, 2008</b>	December 31, 2007
Revolving Credit Facility, principal due at maturity in December 2012; interest payable periodically at variable interest rates.	<b>\$ 180,000</b>	\$ -
7.5% Senior Notes, principal due at maturity in May 2011; interest payable semi-annually in May and November at 7.5%.	<b>250,000</b>	250,000
7.5% Senior Notes, principal due at maturity in May 2011; interest payable semi-annually in May and November at 7.5%. These notes were issued with a \$2.3 million premium, of which \$0.8 million and \$1.0 million was unamortized at September 30, 2008 and December 31, 2007, respectively.	<b>200,750</b>	200,967
6.25% Senior Notes, principal due at maturity in March 2013; interest payable semi-annually in March and September at 6.25%.	<b>375,000</b>	375,000
6.75% Senior Notes, principal due at maturity in January 2014; interest payable semi-annually in January and July at 6.75%.	<b>150,000</b>	150,000
	<b>1,155,750</b>	975,967
Less: Current portion of long-term debt	<b>(290)</b>	(290)
	<b>\$ 1,155,460</b>	\$ 975,677

*Revolving Credit Facility.* During December 2007, the Company entered into a new \$450.0 million senior secured revolving credit facility (the "New Revolving Credit Facility") arranged by Banc of America Securities LLC and Wachovia Capital Markets, LLC. The New Revolving Credit Facility replaced the Company's previous \$250.0 million senior secured Revolving Credit Facility. The New Revolving Credit Facility will be utilized to fund development projects in anticipation of increasing demand by existing and potential new customers, as well as for working capital, capital expenditures and general corporate purposes. The Company capitalized approximately \$1.9 million during the fourth quarter of 2007 for the costs related to the issuance of the New Revolving Credit Facility in accordance with EITF 98-14, "Debtors Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements."

The New Revolving Credit Facility has an aggregate principal capacity of \$450.0 million and matures in December 2012. At the Company's option, interest on outstanding borrowings will be based on either a base rate plus a margin ranging from 0.00% to 0.50% or a London Interbank Offered Rate ("LIBOR") plus a margin ranging from 0.75% to 1.50%. The applicable margins are subject to adjustments based on the Company's leverage ratio. Based on the Company's current leverage ratio, loans under the New Revolving Credit Facility currently bear interest at the base rate plus a margin of 0.00% or at LIBOR plus a margin of 0.75%. As of September 30, 2008, the Company had \$180.0 million of outstanding borrowings under the New Revolving Credit Facility as well as \$32.8 million in letters of credit outstanding.



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The New Revolving Credit Facility has a \$20.0 million sublimit for swing line loans and a \$100.0 million sublimit for the issuance of standby letters of credit. The Company has an option to increase the availability under the New Revolving Credit Facility by up to \$300.0 million (consisting of revolving credit, term loans, or a combination of the two) subject to, among other things, the receipt of commitments for the increased amount.

None of the banks providing commitments under the New Revolving Credit Facility have failed to fund borrowings the Company has requested. However, no assurance can be provided that all of the banks in the lending group will continue to operate as a going concern in the future. If any of the banks in the lending group were to fail, it is possible that the capacity under the New Revolving Credit Facility would be reduced.

The New Revolving Credit Facility is secured by a pledge of all of the capital stock of the Company's domestic subsidiaries, 65% of the capital stock of the Company's foreign subsidiaries, all of the Company's accounts receivable, and all of the Company's deposit accounts.

The New Revolving Credit Facility requires the Company to meet certain financial covenants, including, without limitation, a maximum total leverage ratio, a maximum secured leverage ratio, and a minimum interest coverage ratio. As of September 30, 2008, the Company was in compliance with all such covenants. In addition, the New Revolving Credit Facility contains certain covenants which, among other things, limit both the incurrence of additional indebtedness, investments, payment of dividends, transactions with affiliates, asset sales, acquisitions, capital expenditures, mergers and consolidations, prepayments and modifications of other indebtedness, liens and encumbrances and other matters customarily restricted in such agreements. In addition, the New Revolving Credit Facility is subject to certain cross-default provisions with terms of the Company's other indebtedness.

*\$250 Million 7.5% Senior Notes.* Interest on the \$250.0 million aggregate principal amount of the Company's 7.5% unsecured senior notes issued in May 2003 (the "\$250 Million 7.5% Senior Notes") accrues at the stated rate and is payable semi-annually on May 1 and November 1 of each year. The \$250 Million 7.5% Senior Notes are scheduled to mature on May 1, 2011. The Company may currently redeem all or a portion of the notes at redemption prices as set forth in the indenture governing the \$250 Million 7.5% Senior Notes. The \$250 Million 7.5% Senior Notes are guaranteed on an unsecured basis by all of the Company's domestic subsidiaries.

*\$200 Million 7.5% Senior Notes.* Interest on the \$200.0 million aggregate principal amount of the Company's 7.5% unsecured senior notes issued in August 2003 (the "\$200 Million 7.5% Senior Notes") accrues at the stated rate and is payable semi-annually on May 1 and November 1 of each year. However, the notes were issued at a price of 101.125% of the principal amount of the notes, resulting in a premium of \$2.25 million, which is amortized as a reduction to interest expense over the term of the notes. The \$200 Million 7.5% Senior Notes were issued under the existing indenture and supplemental indenture governing the \$250 Million 7.5% Senior Notes.

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*\$375 Million 6.25% Senior Notes.* Interest on the \$375.0 million aggregate principal amount of the Company's 6.25% unsecured senior notes issued in March 2005 (the 6.25% Senior Notes) accrues at the stated rate and is payable on March 15 and September 15 of each year. The 6.25% Senior Notes are scheduled to mature on March 15, 2013. The Company may redeem all or a portion of the notes on or after March 15, 2009. Redemption prices are set forth in the indenture governing the 6.25% Senior Notes.

*\$150 Million 6.75% Senior Notes.* Interest on the \$150.0 million aggregate principal amount of the Company's 6.75% unsecured senior notes issued in January 2006 (the 6.75% Senior Notes) accrues at the stated rate and is payable on January 31 and July 31 of each year. The 6.75% Senior Notes are scheduled to mature on January 31, 2014. At any time on or before January 31, 2009, the Company may redeem up to 35% of the notes with the net proceeds of certain equity offerings, as long as 65% of the aggregate principal amount of the notes remains outstanding after the redemption. The Company may redeem all or a portion of the notes on or after January 31, 2010. Redemption prices are set forth in the indenture governing the 6.75% Senior Notes.

**6. STOCKHOLDERS' EQUITY**

**Restricted Stock**

During the first nine months of 2008, the Company issued 279,000 shares of restricted common stock to the Company's employees, with an aggregate fair value of \$7.5 million, including 218,000 restricted shares to employees whose compensation is charged to general and administrative expense and 61,000 restricted shares to employees whose compensation is charged to operating expense. During 2007, the Company issued 312,000 shares of restricted common stock to certain of the Company's employees, with an aggregate fair value of \$8.3 million, including 254,000 restricted shares to employees whose compensation is charged to general and administrative expense and 58,000 shares to employees whose compensation is charged to operating expense.

The Company established performance-based vesting conditions on the restricted stock awarded to the Company's officers and executive officers. Unless earlier vested under the terms of the restricted stock, shares issued to officers and executive officers are subject to vesting over a three-year period based upon the satisfaction of certain performance criteria. No more than one-third of such shares may vest in the first performance period; however, the performance criteria are cumulative for the three-year period. Unless earlier vested under the terms of the restricted stock, the shares of restricted stock issued to the other employees of the Company vest after three years of continuous service.

During the three months ended September 30, 2008, the Company expensed \$1.5 million, net of forfeitures, relating to restricted common stock (\$0.3 million of which was recorded in operating expenses and \$1.2 million of which was recorded in general and administrative expenses). During the three months ended September 30, 2007, the Company expensed \$1.2 million, net of forfeitures, relating to restricted common stock

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(\$0.3 million of which was recorded in operating expenses and \$0.9 million of which was recorded in general and administrative expenses).

During the nine months ended September 30, 2008, the Company expensed \$4.4 million, net of forfeitures, relating to restricted common stock (\$0.9 million of which was recorded in operating expenses and \$3.5 million of which was recorded in general and administrative expenses). During the nine months ended September 30, 2007, the Company expensed \$3.7 million, net of forfeitures, relating to restricted common stock (\$0.7 million of which was recorded in operating expenses and \$3.0 million of which was recorded in general and administrative expenses). As of September 30, 2008, 742,000 shares of restricted stock remained outstanding and subject to vesting.

**Stock Options**

During the nine months ended September 30, 2008, the Company issued to its directors, officers, and executive officers options to purchase 671,000 shares of common stock with an aggregate fair value of \$5.1 million, with a weighted average exercise price of \$26.61 per share. During 2007, the Company issued to its officers, executive officers, and non-employee directors options to purchase 567,000 shares of common stock with an aggregate fair value of \$4.9 million, with a weighted average exercise price of \$27.28 per share. The Company estimates the fair value of stock options using the Black-Scholes option pricing model. Unless earlier vested under their terms, one third of the stock options issued to the Company's executive officers vest on the anniversary of the grant date over a three-year period while one fourth of the stock options issued to the Company's other officers vest on the anniversary of the grant date over a four-year period.

During the three months ended September 30, 2008 and 2007, the Company expensed \$1.0 million and \$0.7 million, net of forfeitures, relating to its outstanding stock options. During the nine months ended September 30, 2008 and 2007, the Company expensed \$2.8 million and \$1.6 million, net of forfeitures, relating to its outstanding stock options. As of September 30, 2008, options to purchase 4.8 million shares of common stock were outstanding with a weighted average exercise price of \$14.14.

**Stock Warrants**

On August 8, 2007, 75,000 warrants were exercised at a price of \$11.10 per share. The holder of such warrants elected to satisfy the cost of the warrants using a net share settlement method, resulting in the issuance of 48,000 shares of stock by the Company. As of September 30, 2008, warrants to purchase approximately 150,000 shares of the Company's common stock at a price of \$11.10 per share remained outstanding and expire on December 31, 2008. On October 23, 2008, the holder of these warrants elected to exercise the warrants using a net share settlement method, resulting in the issuance of 77,000 shares of stock by the Company.

**7. EARNINGS PER SHARE**

In accordance with Statement of Financial Accounting Standards No. 128, Earnings Per Share, basic earnings per share is computed by dividing net income by the

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weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. For the Company, diluted earnings per share is computed by dividing net income as adjusted, by the weighted average number of common shares after considering the additional dilution related to restricted common stock plans and stock options and warrants.

A reconciliation of the numerator and denominator of the basic earnings per share computation to the numerator and denominator of the diluted earnings per share computation is as follows (in thousands, except per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>NUMERATOR</b>				
<b>Basic:</b>				
Income from continuing operations	\$ 38,091	\$ 33,151	\$ 110,473	\$ 97,995
Income (loss) from discontinued operations, net of taxes	(200)	104	(57)	432
Net income	\$ 37,891	\$ 33,255	\$ 110,416	\$ 98,427
<b>Diluted:</b>				
Income from continuing operations	\$ 38,091	\$ 33,151	\$ 110,473	\$ 97,995
Income (loss) from discontinued operations, net of taxes	(200)	104	(57)	432
Diluted net income	\$ 37,891	\$ 33,255	\$ 110,416	\$ 98,427
<b>DENOMINATOR</b>				
<b>Basic:</b>				
Weighted average common shares outstanding	124,696	122,939	124,366	122,269
<b>Diluted:</b>				
Weighted average common shares outstanding	124,696	122,939	124,366	122,269
Effect of dilutive securities:				
Stock options and warrants	1,596	2,307	1,722	2,605
Restricted stock-based compensation	255	385	214	329
Weighted average shares and assumed conversions	126,547	125,631	126,302	125,203
<b>BASIC EARNINGS PER SHARE:</b>				
Income from continuing operations	\$ 0.30	\$ 0.27	\$ 0.89	\$ 0.81
Income (loss) from discontinued operations, net of taxes				
Net income	\$ 0.30	\$ 0.27	\$ 0.89	\$ 0.81

**DILUTED EARNINGS PER SHARE:**

Income from continuing operations	\$	<b>0.30</b>	\$	0.26	\$	<b>0.87</b>	\$	0.79
Income (loss) from discontinued operations, net of taxes								
Net income	\$	<b>0.30</b>	\$	0.26	\$	<b>0.87</b>	\$	0.79

**8. COMMITMENTS AND CONTINGENCIES**

**Legal Proceedings**

*General.* The nature of the Company's business results in claims and litigation alleging that it is liable for damages arising from the conduct of its employees, inmates or others. The nature of such claims includes, but is not limited to, claims arising from

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employee or inmate misconduct, medical malpractice, employment matters, property loss, contractual claims, and personal injury or other damages resulting from contact with the Company's facilities, personnel or inmates, including damages arising from an inmate's escape or from a disturbance or riot at a facility. The Company maintains insurance to cover many of these claims, which may mitigate the risk that any single claim would have a material effect on the Company's consolidated financial position, results of operations, or cash flows, provided the claim is one for which coverage is available. The combination of self-insured retentions and deductible amounts means that, in the aggregate, the Company is subject to substantial self-insurance risk.

The Company records litigation reserves related to certain matters for which it is probable that a loss has been incurred and the range of such loss can be estimated. Based upon management's review of the potential claims and outstanding litigation and based upon management's experience and history of estimating losses, management believes a loss in excess of amounts already recognized would not be material to the Company's financial statements. In the opinion of management, there are no pending legal proceedings that would have a material effect on the Company's consolidated financial position, results of operations, or cash flows. Any receivable for insurance recoveries is recorded separately from the corresponding litigation reserve, and only if recovery is determined to be probable. Adversarial proceedings and litigation are, however, subject to inherent uncertainties, and unfavorable decisions and rulings could occur which could have a material adverse impact on the Company's consolidated financial position, results of operations, or cash flows for the period in which such decisions or rulings occur, or future periods. Expenses associated with legal proceedings may also fluctuate from quarter to quarter based on changes in the Company's assumptions, new developments, or by the effectiveness of the Company's litigation and settlement strategies.

**Guarantees**

Hardeman County Correctional Facilities Corporation (HCCFC) is a nonprofit, mutual benefit corporation organized under the Tennessee Nonprofit Corporation Act to purchase, construct, improve, equip, finance, own and manage a detention facility located in Hardeman County, Tennessee. HCCFC was created as an instrumentality of Hardeman County to implement the County's incarceration agreement with the state of Tennessee to house certain inmates. During 1997, HCCFC issued \$72.7 million of revenue bonds, which were primarily used for the construction of a 2,016-bed medium security correctional facility. In addition, HCCFC entered into a construction and management agreement with the Company in order to assure the timely and coordinated acquisition, construction, development, marketing and operation of the correctional facility.

HCCFC leases the correctional facility to Hardeman County in exchange for all revenue from the operation of the facility. HCCFC has, in turn, entered into a management agreement with the Company for the correctional facility. In connection with the issuance of the revenue bonds, the Company is obligated, under a debt service deficit agreement, to pay the trustee of the bond's trust indenture (the

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Trustee ) amounts necessary to pay any debt service deficits consisting of principal and interest requirements (outstanding principal balance of \$45.3 million at September 30, 2008 plus future interest payments). In the event the state of Tennessee, which is currently utilizing the facility to house certain inmates, exercises its option to purchase the correctional facility, the Company is also obligated to pay the difference between principal and interest owed on the bonds on the date set for the redemption of the bonds and amounts paid by the state of Tennessee for the facility plus all other funds on deposit with the Trustee and available for redemption of the bonds. Ownership of the facility reverts to the state of Tennessee in 2017 at no cost. Therefore, the Company does not currently believe the state of Tennessee will exercise its option to purchase the facility. At September 30, 2008, the outstanding principal balance of the bonds exceeded the purchase price option by \$11.3 million.

**9. INCOME TAXES**

Income taxes are accounted for under the provisions of Statement of Financial Accounting Standards No. 109,

Accounting for Income Taxes ( SFAS 109 ). SFAS 109 generally requires the Company to record deferred income taxes for the tax effect of differences between book and tax bases of its assets and liabilities.

Deferred income taxes reflect the available net operating losses and the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Realization of the future tax benefits related to deferred tax assets is dependent on many factors, including the Company s past earnings history, expected future earnings, the character and jurisdiction of such earnings, unsettled circumstances that, if unfavorably resolved, would adversely affect utilization of its deferred tax assets, carryback and carryforward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset.

The Company s effective tax rate was approximately 36.7% and 37.7% during the three and nine months ended September 30, 2008, respectively, compared with approximately 37.8% and 37.7% during the same periods in the prior year. The Company s overall effective tax rate is estimated based on the Company s current projection of taxable income and could change in the future as a result of changes in these estimates, the implementation of tax strategies, changes in federal or state tax rates, changes in tax laws, or changes in state apportionment factors, as well as changes in the valuation allowance applied to the Company s deferred tax assets that are based primarily on the amount of state net operating losses and tax credits that could expire unused.

**Income Tax Contingencies**

In July 2006, the Financial Accounting Standards Board issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ), which is an interpretation of SFAS 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The guidance prescribed in FIN 48 establishes a recognition threshold of more likely than not that a tax position will be sustained upon examination.

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The measurement attribute of FIN 48 requires that a tax position be measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

Upon adoption of FIN 48 on January 1, 2007, the Company recognized a \$2.2 million increase in the liability for uncertain tax positions net of certain benefits associated with state net operating losses, which was recorded as an adjustment to the January 1, 2007 balance of retained earnings. The Company has a \$6.4 million liability recorded for uncertain tax positions as of September 30, 2008, included in other non-current liabilities in the accompanying balance sheet. The Company recognizes interest and penalties related to unrecognized tax positions in income tax expense. The total amount of unrecognized tax positions that, if recognized, would affect the effective tax rate is \$5.7 million. The Company does not currently anticipate that the total amount of unrecognized tax positions will significantly increase or decrease in the next twelve months.

During the third quarter of 2008, the Company was notified that the Internal Revenue Service would commence an audit of the Company's federal income tax return for the year ended December 31, 2006. The audit has just recently begun and, therefore, it is too early to predict the outcome of the audit.

**10. SEGMENT REPORTING**

As of September 30, 2008, the Company owned and managed 42 correctional and detention facilities, and managed 23 correctional and detention facilities it did not own. Management views the Company's operating results in two reportable segments: (1) owned and managed correctional and detention facilities and (2) managed-only correctional and detention facilities. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in the notes to consolidated financial statements included in the Company's 2007 Form 10-K. Owned and managed facilities include the operating results of those facilities placed into service that were owned and managed by the Company. Managed-only facilities include the operating results of those facilities owned by a third party and managed by the Company. The Company measures the operating performance of each facility within the above two reportable segments, without differentiation, based on facility contribution. The Company defines facility contribution as a facility's operating income or loss from operations before interest, taxes, depreciation and amortization. Since each of the Company's facilities within the two reportable segments exhibit similar economic characteristics, provide similar services to governmental agencies, and operate under a similar set of operating procedures and regulatory guidelines, the facilities within the identified segments have been aggregated and reported as one reportable segment.

The revenue and facility contribution for the reportable segments and a reconciliation to the Company's operating income is as follows for the three and nine months ended September 30, 2008 and 2007 (dollars in thousands):



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	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenue:				
Owned and managed	\$ 314,351	\$ 279,542	\$ 908,543	\$ 803,875
Managed-only	94,744	93,167	279,195	269,373
Total management revenue	409,095	372,709	1,187,738	1,073,248
Operating expenses:				
Owned and managed	206,210	185,489	590,433	530,252
Managed-only	82,082	80,635	243,344	230,485
Total operating expenses	288,292	266,124	833,777	760,737
Facility contribution:				
Owned and managed	108,141	94,053	318,110	273,623
Managed-only	12,662	12,532	35,851	38,888
Total facility contribution	120,803	106,585	353,961	312,511
Other revenue (expense):				
Rental and other revenue	2,790	5,547	9,409	15,285
Other operating expense	(4,307)	(7,326)	(16,443)	(18,200)
General and administrative	(20,866)	(18,362)	(60,222)	(54,497)
Depreciation and amortization	(23,564)	(20,074)	(67,152)	(57,272)
Operating income	\$ 74,856	\$ 66,370	\$ 219,553	\$ 197,827

The following table summarizes capital expenditures for the reportable segments for the three and nine months ended September 30, 2008 and 2007 (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Capital expenditures:				
Owned and managed	\$ 108,136	\$ 105,413	\$ 422,694	\$ 208,392
Managed-only	893	4,008	3,644	8,152
Corporate and other	2,455	3,559	8,203	14,302
Total capital expenditures	\$ 111,484	\$ 112,980	\$ 434,541	\$ 230,846

The assets for the reportable segments are as follows (in thousands):

	<b>September 30, 2008</b>	December 31, 2007
Assets:		
Owned and managed	\$ 2,542,569	\$ 2,161,332
Managed-only	115,425	121,599
Corporate and other	161,700	202,194
Discounted operations	175	615
Total assets	\$ 2,819,869	\$ 2,485,740

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

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report.

This quarterly report on Form 10-Q contains statements as to our beliefs and expectations of the outcome of future events that are forward-looking statements as defined within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of current or historical fact contained herein, including statements regarding our future financial position, business strategy, budgets, projected costs and plans, and objectives of management for future operations, are forward-looking statements. The words anticipate, believe, continue, estimate, expect, intend, may, plan, projects, will, and similar expressions, as they relate to us, are intended to identify forward-looking statements. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from the statements made. These include, but are not limited to, the risks and uncertainties associated with:

fluctuations in operating results because of changes in occupancy levels, competition, increases in cost of operations, fluctuations in interest rates, and risks of operations;

changes in the privatization of the corrections and detention industry and the public acceptance of our services;

our ability to obtain and maintain correctional facility management contracts, including as the result of sufficient governmental appropriations, inmate disturbances, and the timing of the opening of new facilities and the commencement of new management contracts as well as our ability to utilize current available beds and new capacity as development and expansion projects are completed;

increases in costs to develop or expand correctional facilities that exceed original estimates, or the inability to complete such projects on schedule as a result of various factors, many of which are beyond our control, such as weather, labor conditions, and material shortages, resulting in increased construction costs;

changes in governmental policy and in legislation and regulation of the corrections and detention industry that adversely affect our business including, but not limited to, judicial challenges regarding the transfer of California inmates to out-of-state private correctional facilities;

the availability of debt and equity financing on terms that are favorable to us; and

general economic and market conditions.

Any or all of our forward-looking statements in this quarterly report may turn out to be inaccurate. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. They can be affected by inaccurate assumptions we might make or by known or unknown risks, uncertainties and assumptions, including the risks, uncertainties and assumptions described in Risk Factors disclosed in detail in our annual report on Form 10-K for the fiscal year ended December 31, 2007, filed with the Securities and Exchange Commission (the SEC) on February 27, 2008 (File No. 001-16109) (the 2007 Form 10-K) and in other reports we file with the SEC from time to time. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly revise these forward-looking statements to reflect events

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or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements contained in this report and in the 2007 Form 10-K.

**OVERVIEW**

**The Company**

As of September 30, 2008, we owned 45 correctional, detention and juvenile facilities, three of which we leased to other operators. As of September 30, 2008, we operated 65 facilities, including 42 facilities that we owned, with a total design capacity of approximately 82,000 beds in 19 states and the District of Columbia. We are also constructing an additional 2,232-bed facility in Adams County, Mississippi that is expected to be completed in the fourth quarter of 2008, a 3,060-bed facility in Eloy, Arizona that is expected to be completed in the first quarter of 2009, and a 2,040-bed facility in Trousdale County, Tennessee that is expected to be completed in the first quarter of 2010. Further, during the second quarter of 2008 we were awarded a contract by the Office of Federal Detention Trustee to design, build, and operate a new correctional facility in Pahrump, Nevada, which is currently expected to be completed during the second quarter of 2010.

We specialize in owning, operating, and managing prisons and other correctional facilities and providing inmate residential and prisoner transportation services for governmental agencies. In addition to providing the fundamental residential services relating to inmates, our facilities offer a variety of rehabilitation and educational programs, including basic education, religious services, life skills and employment training and substance abuse treatment. These services are intended to reduce recidivism and to prepare inmates for their successful re-entry into society upon their release. We also provide health care (including medical, dental and psychiatric services), food services and work and recreational programs.

Our website address is [www.correctionscorp.com](http://www.correctionscorp.com). We make our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and Section 16 reports under the Securities Exchange Act of 1934, as amended (the Exchange Act), available on our website, free of charge, as soon as reasonably practicable after these reports are filed with or furnished to the SEC.

**CRITICAL ACCOUNTING POLICIES**

The consolidated financial statements in this report are prepared in conformity with accounting principles generally accepted in the United States. As such, we are required to make certain estimates, judgments, and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. A summary of our significant accounting policies is described in our 2007 Form 10-K. The significant accounting policies and estimates which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

*Asset impairments.* As of September 30, 2008, we had \$2.5 billion in property and equipment. We evaluate the recoverability of the carrying values of our long-lived assets,

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other than goodwill, when events suggest that an impairment may have occurred. Such events primarily include, but are not limited to, the termination of a management contract or a significant decrease in inmate populations within a correctional facility we own or manage. In these circumstances, we utilize estimates of undiscounted cash flows to determine if an impairment exists. If an impairment exists, it is measured as the amount by which the carrying amount of the asset exceeds the estimated fair value of the asset.

*Goodwill impairments.* As of September 30, 2008, we had \$13.7 million of goodwill. We evaluate the carrying value of goodwill during the fourth quarter of each year, in connection with our annual budgeting process, and whenever circumstances indicate the carrying value of goodwill may not be recoverable. Such circumstances primarily include, but are not limited to, the termination of a management contract or a significant decrease in inmate populations within a reporting unit. We test for impairment by comparing the fair value of each reporting unit with its carrying value. Fair value is determined using a collaboration of various common valuation techniques, including market multiples, discounted cash flows, and replacement cost methods. Each of these techniques requires considerable judgment and estimations which could change in the future.

*Income taxes.* Income taxes are accounted for under the provisions of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ( SFAS 109 ). SFAS 109 generally requires us to record deferred income taxes for the tax effect of differences between book and tax bases of our assets and liabilities.

Deferred income taxes reflect the available net operating losses and the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Realization of the future tax benefits related to deferred tax assets is dependent on many factors, including our past earnings history, expected future earnings, the character and jurisdiction of such earnings, unsettled circumstances that, if unfavorably resolved, would adversely affect utilization of our deferred tax assets, carryback and carryforward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset.

We have approximately \$6.1 million in net operating losses applicable to various states that we expect to carry forward in future years to offset taxable income in such states. Accordingly, we have a valuation allowance of \$1.2 million for the estimated amount of the net operating losses that will expire unused, in addition to a \$5.6 million valuation allowance related to state tax credits that are also expected to expire unused. Although our estimate of future taxable income is based on current assumptions that we believe to be reasonable, our assumptions may prove inaccurate and could change in the future, which could result in the expiration of additional net operating losses or credits. We would be required to establish a valuation allowance at such time that we no longer expected to utilize these net operating losses or credits, which could result in a material impact on our results of operations in the future.

*Self-funded insurance reserves.* As of September 30, 2008, we had \$35.5 million in accrued liabilities for employee health, workers' compensation, and automobile insurance claims. We are significantly self-insured for employee health, workers' compensation, and automobile liability insurance claims. As such, our insurance expense is largely dependent on claims experience and our ability to control our claims. We have consistently accrued the estimated liability for employee health insurance claims based on our history of claims

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experience and the time lag between the incident date and the date the cost is paid by us. We have accrued the estimated liability for workers' compensation and automobile insurance claims based on a third-party actuarial valuation of the outstanding liabilities, discounted to the net present value of the outstanding liabilities. These estimates could change in the future. It is possible that future cash flows and results of operations could be materially affected by changes in our assumptions, new developments, or by the effectiveness of our strategies.

*Legal reserves.* As of September 30, 2008, we had \$15.4 million in accrued liabilities related to certain legal proceedings in which we are involved. We have accrued our estimate of the probable costs for the resolution of these claims based on a range of potential outcomes. In addition, we are subject to current and potential future legal proceedings for which little or no accrual has been reflected because our current assessment of the potential exposure is nominal. These estimates have been developed in consultation with our General Counsel's office and, as appropriate, outside counsel handling these matters, and are based upon an analysis of potential results, assuming a combination of litigation and settlement strategies. It is possible that future cash flows and results of operations could be materially affected by changes in our assumptions, new developments, or by the effectiveness of our strategies.

**RESULTS OF OPERATIONS**

Our results of operations are impacted by the number of facilities we owned and managed, the number of facilities we managed but did not own, the number of facilities we leased to other operators, and the facilities we owned that were not yet in operation. The following table sets forth the changes in the number of facilities operated for the periods presented.

	<b>Effective Date</b>	<b>Owned and Managed</b>	<b>Managed Only</b>	<b>Leased</b>	<b>Total</b>
Facilities as of December 31, 2006		40	25	3	68
Expiration of the management contract for the Liberty County Jail/Juvenile Center	January 2007		(1)		(1)
Completion of construction of the Saguaro Correctional Facility	June 2007	1			1
Facilities as of December 31, 2007		41	24	3	68
Activation of 1,020 beds at the La Palma Correctional Center	July 2008	1			1
Expiration of the management contract for the Camino Nuevo Correctional Center	August 2008		(1)		(1)
<b>Facilities as of September 30, 2008</b>		<b>42</b>	<b>23</b>	<b>3</b>	<b>68</b>

Our results of operations are also impacted by the number of beds created as a result of expansion projects completed at facilities we own or at facilities we manage but do not own. The following table sets forth the number of beds placed into service since January 1, 2007 as a result of facility expansion projects:

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<b>Facility</b>	<b>Quarter Completed</b>	<b>Expansion Beds</b>	<b>Owned or Managed-Only</b>
Citrus County Detention Facility	First quarter 2007	360	Managed-Only
Crossroads Correctional Center	First quarter 2007	96	Owned
Gadsden Correctional Institution	Third quarter 2007	384	Managed-Only
Bay Correctional Facility	Third quarter 2007	235	Managed-Only
North Fork Correctional Facility	Fourth quarter 2007	960	Owned
Tallahatchie County Correctional Facility	Fourth quarter 2007 Second quarter 2008	720 720	Owned Owned
Kit Carson Correctional Center	First quarter 2008	720	Owned
Eden Detention Center	First quarter 2008	129	Owned
Bent County Correctional Facility	Second quarter 2008	720	Owned
Leavenworth Detention Center	Second quarter 2008	266	Owned
Davis Correctional Facility	Third quarter 2008	660	Owned
		5,970	

**Three and Nine Months Ended September 30, 2008 Compared to the Three and Nine Months Ended September 30, 2007**

Net income was \$37.9 million, or \$0.30 per diluted share, for the three months ended September 30, 2008, compared with net income of \$33.3 million, or \$0.26 per diluted share, for the three months ended September 30, 2007. During the nine months ended September 30, 2008, we generated net income of \$110.4 million, or \$0.87 per diluted share, compared with net income of \$98.4 million, or \$0.79 per diluted share, for the nine months ended September 30, 2007.

Net income during the three and nine months ended September 30, 2008 was favorably impacted by the increase in operating income of \$8.5 million, or 12.8%, for the three-month period over the same period in the prior year and \$21.7 million, or 11.0%, for the nine-month period over the same period in the prior year. Contributing to the increase in operating income during 2008 compared with the previous year was an increase in inmate populations and the commencement of new management contracts, partially offset by increases in general and administrative expenses and depreciation and amortization.

**Facility Operations**

A key performance indicator we use to measure the revenue and expenses associated with the operation of the facilities we own or manage is expressed in terms of a compensated man-day, which represents the revenue we generate and expenses we incur for one inmate for one calendar day. Revenue and expenses per compensated man-day are computed by dividing facility revenue and expenses by the total number of compensated man-days during the period. We believe the measurement is useful because we are compensated for operating and managing facilities at an inmate per-diem rate based upon actual or minimum guaranteed occupancy levels. We also measure our ability to contain costs on a per-compensated man-





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day basis, which is largely dependent upon the number of inmates we accommodate. Further, per compensated man-day measurements are also used to estimate our potential profitability based on certain occupancy levels relative to design capacity. Revenue and expenses per compensated man-day for all of the facilities placed into service that we owned or managed were as follows for the three and nine months ended September 30, 2008 and 2007:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	<b>2008</b>	2007	<b>2008</b>	2007
Revenue per compensated man-day	\$ <b>57.23</b>	\$ 54.94	\$ <b>56.57</b>	\$ 54.27
Operating expenses per compensated man-day:				
Fixed expense	<b>30.50</b>	29.25	<b>29.74</b>	28.56
Variable expense	<b>9.83</b>	9.98	<b>9.97</b>	9.91
Total	<b>40.33</b>	39.23	<b>39.71</b>	38.47
Operating margin per compensated man-day	\$ <b>16.90</b>	\$ 15.71	\$ <b>16.86</b>	\$ 15.80
Operating margin	<b>29.5%</b>	28.6%	<b>29.8%</b>	29.1%
Average compensated occupancy	<b>95.3%</b>	97.9%	<b>96.3%</b>	98.1%
Average compensated population	<b>77,695</b>	73,740	<b>76,626</b>	72,439

Average compensated population for the quarter ended September 30, 2008 increased 3,955 from 73,740 in the third quarter of 2007 to 77,695 in the third quarter of 2008. The increase in average compensated population resulted primarily from the placement of 5,514 expansion beds into service since the end of the second quarter of 2007, and the opening and subsequent ramp-up in populations at our 1,896-bed Saguaro Correctional Facility in June 2007. Further, we also commenced operation at our La Palma Correctional Center by placing 1,020 beds into service during July 2008.

State revenues increased \$28.8 million, or 15.5%, from \$185.2 million for the three months ended September 30, 2007 to \$214.0 million for the three months ended September 30, 2008, and \$88.1 million, or 16.8%, from \$525.6 million for the nine months ended September 30, 2007 to \$613.7 million for the nine months ended September 30, 2008. State revenues increased as certain states, such as the state of California, turned to the private sector to help alleviate their overcrowding situations, while other states utilized additional bed capacity we constructed for them or contracted to utilize additional beds at our facilities. We were also successful in achieving certain per diem increases caused by a strong demand for prison beds. We are monitoring the challenges faced by our customers as a result of the downturn in the economy and the unusual financial environment. Although this environment increases the level of uncertainty in the short-term, we believe the long-term implications are very positive as states may defer or cancel plans for adding new prison bed capacity, which should ensure a continuation of the supply and demand imbalance that has been benefiting the private prison industry.

Business from our federal customers, including primarily the Federal Bureau of Prisons, or the BOP, the U.S. Marshals Service, or the USMS, and U.S. Immigration and Customs Enforcement, or ICE, continues to be a significant component of our business. Our federal customers generated approximately 39% and 41% of our total revenue for the nine months ended September 30, 2008 and 2007, respectively, increasing 5.4%, from \$443.2 million during the nine months ended September 30, 2007 to \$467.1 million during the nine months

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ended September 30, 2008. Similar to business from our state customers, we were successful in achieving per diem increases under several of our federal management contracts as a result of a strong demand for prison beds. Operating expenses totaled \$292.6 million and \$273.5 million for the three months ended September 30, 2008 and 2007, respectively, while operating expenses for the nine months ended September 30, 2008 and 2007 totaled \$850.2 million and \$778.9 million, respectively. Operating expenses consist of those expenses incurred in the operation and management of adult and juvenile correctional and detention facilities and for our inmate transportation subsidiary.

Fixed expenses per compensated man-day during the three-month periods increased 4.3% from \$29.25 in 2007 to \$30.50 in 2008. Fixed expenses per compensated man-day during the nine-month periods increased 4.1% from \$28.56 in 2007 to \$29.74 in 2008 primarily as a result of an increase in salaries and benefits. Salaries and benefits represent the most significant component of fixed operating expenses and represent approximately 64% of total operating expenses during both the three and nine months ended September 30, 2008. During the three and nine months ended September 30, 2008, facility salaries and benefits expense increased \$17.3 million and \$50.6 million, respectively. Salaries and benefits increased most notably at the aforementioned facilities such as our Saguaro facility that opened in June 2007, our La Palma facility that opened in July 2008, and at our North Fork and Tallahatchie facilities where expansion beds were placed into service.

Fixed costs per compensated man-day will be negatively impacted as we commence operations at newly developed facilities or as we hire additional staff at facilities we expand until the occupancy at such facilities reach stabilized levels. Further, as we fill our available beds, the opportunity to leverage our fixed costs, such as salaries and benefits, over a larger inmate population will be diminished. While we have also experienced tightening labor markets for staff, a softening economy could provide relief.

Although facility variable expenses decreased \$0.15 per compensated man-day during the three-month period in the current year compared with the prior year, facility variable expenses increased \$0.06 per compensated man-day during the nine months ended September 30, 2008 compared with the same period in the prior year. The increase in facility variable operating expenses during the nine-month period was largely due to increased costs at facilities where new beds were placed into service. Additionally, we experienced an increase in legal expenses during the first nine months of 2008 compared with the same period in the prior year. Expenses associated with legal proceedings may fluctuate from quarter to quarter based on new or threatened litigation, changes in our assumptions, new developments, or the effectiveness of our litigation and settlement strategies.

We continually evaluate the profitability of certain management contracts and may elect to terminate such contracts from time to time based on a variety of factors but primarily based on poor operating performance. Although generally more profitable, the operation of the facilities we own carries a higher degree of risk associated with a management contract than the operation of the facilities we manage but do not own because we incur significant capital expenditures to construct or acquire facilities we own. Additionally, correctional and detention facilities have a limited or no alternative use. Therefore, if a management contract is terminated on a facility we own, we continue to incur certain operating expenses, such as real estate taxes, utilities, and insurance, that we would not incur if a management contract

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were terminated for a managed-only facility. As a result, revenue per compensated man-day is typically higher for facilities we own and manage than for managed-only facilities. Because we incur higher expenses, such as repairs and maintenance, real estate taxes, and insurance, on the facilities we own and manage, our cost structure for facilities we own and manage is also higher than the cost structure for the managed-only facilities. The following tables display the revenue and expenses per compensated man-day for the facilities placed into service that we own and manage and for the facilities we manage but do not own:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>Owned and Managed Facilities:</b>				
Revenue per compensated man-day	\$ 66.14	\$ 63.67	\$ 65.35	\$ 62.68
Operating expenses per compensated man-day:				
Fixed expense	32.84	31.39	31.82	30.63
Variable expense	10.55	10.85	10.65	10.72
Total	43.39	42.24	42.47	41.35
Operating margin per compensated man-day	\$ 22.75	\$ 21.43	\$ 22.88	\$ 21.33
Operating margin	34.4%	33.7%	35.0%	34.0%
Average compensated occupancy	94.2%	97.5%	96.0%	98.4%
Average compensated population	51,664	47,726	50,738	46,976
<b>Managed Only Facilities:</b>				
Revenue per compensated man-day	\$ 39.56	\$ 38.93	\$ 39.36	\$ 38.75
Operating expenses per compensated man-day:				
Fixed expense	25.86	25.32	25.66	24.76
Variable expense	8.41	8.37	8.65	8.40
Total	34.27	33.69	34.31	33.16
Operating margin per compensated man-day	\$ 5.29	\$ 5.24	\$ 5.05	\$ 5.59
Operating margin	13.4%	13.5%	12.8%	14.4%
Average compensated occupancy	97.7%	98.6%	96.9%	97.7%
Average compensated population	26,031	26,014	25,888	25,463

*Owned and Managed Facilities*

Our operating margins at owned and managed facilities for the three months ended September 30, 2008 increased to 34.4% compared with 33.7% for the same three-month period in 2007. Additionally, operating margins at our owned

and managed facilities for the nine months ended September 30, 2008 increased to 35.0% compared with 34.0% for the same nine-month period in 2007. The increase in operating margins at our owned and managed facilities is largely the result of the increase in the average compensated population

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during the three and nine months ended September 30, 2008 as compared to the same periods in the prior year. The increase in average compensated population was largely the result of placing into service our 1,896-bed Saguaro Correctional Facility in June 2007 and the completion of approximately 2,400 expansion beds at our North Fork Correctional Facility and Tallahatchie County Correctional Facility. Further, the aforementioned demand experienced with our federal and state customers has resulted in an increase in the overall average revenue per compensated man-day resulting from new contracts at higher average per diems than on existing contracts and from annual per diem increases.

The most notable increases in inmate populations during 2008 occurred at the Saguaro facility due to its opening in June 2007, the North Fork facility resulting from higher inmate populations from various existing state customers, and the Tallahatchie facility resulting from the receipt of inmate populations from the state of California. Our total revenues increased by \$17.2 million and \$56.1 million at these three facilities during the three and nine months ended September 30, 2008, respectively, compared to the same periods in the prior year. As a result of the recently completed bed expansions, the North Fork and Tallahatchie facilities also have approximately 1,800 available beds as of September 30, 2008 that are expected to be used to house inmates from state customers.

The Saguaro Correctional Facility was constructed to provide the state of Hawaii the opportunity to consolidate its inmate populations into fewer facilities, while providing us with an additional supply of beds to meet anticipated demand. We completed construction of the Saguaro Correctional Facility in June 2007 at a cost of approximately \$102.6 million. While the consolidation of inmates from Hawaii did not result in a significant increase in total inmate populations, the consolidation created additional capacity at our Diamondback and Tallahatchie facilities, which was substantially utilized by additional inmate populations from the states of Arizona and California, respectively, pursuant to new management contracts. The consolidation also created additional capacity at our Red Rock Correctional Center, which was substantially utilized with additional inmate populations from the state of California during the second quarter of 2008.

On October 5, 2007, we announced that we had entered into a new agreement with the California Department of Corrections and Rehabilitation ( CDCR ) for the housing of up to 7,772 inmates from the state of California. The new contract replaced and superseded the previous contract we had with the CDCR, which provided housing for up to 5,670 inmates. In January 2008, this agreement was further amended to allow for an additional 360 CDCR inmates. As a result, we now have a contract that provides the CDCR with the ability to house up to 8,132 inmates in six of the facilities we own. The new agreement, which is subject to appropriations by the California legislature, expires June 30, 2011, and provides for a minimum payment based on the greater of the actual occupancy or 90% of the capacity made available to the CDCR at each facility in which inmates are housed. The minimum payments are subject to specific terms and conditions in the contract at each facility that houses CDCR inmates.

In October 2007, we announced that we would begin construction of our new 3,060-bed La Palma Correctional Center, which we expect to be fully utilized by the CDCR. We expect to complete construction of the new La Palma Correctional Center during the first quarter of 2009 at an estimated total cost of \$205.0 million. However, we opened a portion of the new facility and began receiving inmates from the state of California during the third quarter of 2008, and expect to continue to receive additional California inmates through completion of

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construction, as phases of the facility become available. As a condition of undertaking the substantial cost required to construct the La Palma Correctional Center, the CDCR agreed to occupy the beds allocated to it in accordance with a Phase-In Schedule, and to make a minimum payment based on the greater of the actual occupancy or 90% of the capacity available to CDCR according to the Phase-In Schedule.

We currently expect that we will ultimately provide the CDCR approximately 960 beds at our Florence Correctional Center, 80 beds at our West Tennessee Detention Facility, 2,592 beds at our Tallahatchie facility, 1,080 beds at our North Fork facility, 360 beds at our Red Rock facility, and 3,060 beds at the new La Palma facility, with the final transfer from California occurring during the second quarter of 2009. As of September 30, 2008, we held approximately 5,100 inmates from the state of California.

We remain optimistic that the state of California will continue to utilize out-of-state beds to alleviate its severe overcrowding situation. However, several legal proceedings have challenged the State's ability to send inmates out-of-state. Legislative enactments or additional legal proceedings, including a proceeding under federal jurisdiction that could potentially reduce the number of inmates in the California prison system, may prohibit the out-of-state transfer of inmates or could result in the return of inmates we currently house for the CDCR. If transfers from California are limited as a result of one or more of these proceedings, we would market the beds designated for the CDCR, including those that will be provided at our new La Palma Correctional Center, to other federal and state customers. While we currently believe we would ultimately be able to fill a substantial portion of such beds, the utilization would likely be at a much slower pace.

We have recently experienced delays in the intake of CDCR inmates compared to our previous expectations. These delays have been necessary to ensure that we are in compliance with certain medical requirements as set forth by a federal medical receiver appointed to oversee the healthcare delivery within the California correctional system.

However, we continue to expect the CDCR to fully utilize all of the 8,132 beds available under our contract.

Although, we can provide no assurance as to the timing of the receipt of inmates from the CDCR, the receipt of which could be delayed as a result of legal challenges, operational disruptions, or for unforeseen circumstances.

As a result of weakness in inmate populations from the District of Columbia, the 1,500-bed D.C. Correctional Treatment Facility experienced a decline in occupancy from 74% during the first nine months of 2007 to 61% during the first nine months of 2008, and from 74% during the third quarter of 2007 to 69% during the third quarter of 2008, negatively impacting margins on our owned and managed business. We have recently agreed with the District of Columbia to permit the utilization of available space by the USMS.

*Managed-Only Facilities*

Our operating margins decreased at managed-only facilities during the three months ended September 30, 2008 to 13.4% from 13.5% during three months ended September 30, 2007. Similarly, our managed-only operating margins also decreased during the nine months ended September 30, 2008 to 12.8% from 14.4% during the nine months ended September 30, 2007. The managed-only business remains very competitive which continues to put pressure on per diem rates resulting in only marginal increases in the managed-only revenue per

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compensated man-day. Revenue per compensated man-day increased 1.6% during both the three- and nine-month periods of 2008 compared with the same periods in the prior year.

Operating expenses per compensated man-day increased 1.7% to \$34.27 during the third quarter of 2008 from \$33.69 during the same period in the prior year. The increase in operating expenses per compensated man-day was caused in part by an increase in salaries and benefits largely due to annual merit increases.

Although the managed-only business is attractive because it requires little or no upfront investment and relatively modest ongoing capital expenditures, we expect the managed-only business to remain competitive. Any reductions to our per diem rates or the lack of per diem increases at managed-only facilities would likely result in a further deterioration in our operating margins.

During the three months ended September 30, 2008 and 2007, managed-only facilities generated 10.5% and 11.8%, respectively, of our total facility contribution, compared with 10.1% and 12.4%, for the nine months ended September 30, 2008 and 2007, respectively. We define facility contribution as a facility's operating income or loss before interest, taxes, goodwill impairment, depreciation, and amortization.

In April 2008, we agreed with the New Mexico Department of Corrections to suspend operations of the 192-bed Camino Nuevo Correctional Center in Albuquerque, New Mexico, and transfer existing populations to our New Mexico Women's Correctional Facility in Grants, New Mexico. Operations were suspended due to consistently low inmate populations that were not adequate to maintain efficient operations. The Camino Nuevo facility operated at a loss of \$0.1 million and \$0.6 million during the three and nine months ended September 30, 2008, respectively, compared with operating income of \$17,000 and \$0.3 million during the three and nine months ended September 30, 2007, respectively, inclusive of depreciation expense. During the third quarter of 2008, we mutually agreed with the New Mexico Department of Corrections to terminate the management contract for the Camino Nuevo Correctional Center.

In May 2008, we notified the Bay County Commission of our intention to exercise our option to terminate the operational management contract for the 1,150-bed Bay County Jail and Annex in Panama City, Florida, effective October 9, 2008. The Bay County Jail and Annex operated at a loss of \$0.3 million and \$1.0 million during the three and nine months ended September 30, 2008, respectively, compared with operating income of \$0.7 million and \$0.8 million during the three and nine months ended September 30, 2007 respectively, inclusive of depreciation expense. We expect to reclassify the results of operations, net of taxes, and the assets and liabilities of this facility as discontinued operations upon termination of operations in the fourth quarter of 2008 for all periods presented.

Pursuant to a re-bid of the management contracts, during September 2008, we were notified by the Texas Department of Criminal Justice ( TDCJ ) of its intent to transfer the management of the 500-bed B.M. Moore Correctional Center in Overton, Texas and the 518-bed Diboll Correctional Center in Diboll, Texas to another operator, upon the expiration of the management contracts on January 16, 2009. Both of these facilities are owned by the TDCJ. We currently expect to reclassify the results of operations, net of taxes, and the assets and liabilities of these two facilities as discontinued operations upon termination of operations in the first quarter of 2009 for all periods presented. Revenue and operating

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expenses for these two facilities was \$3.1 million and \$2.9 million for the three months ended September 30, 2008 compared with revenue and operating expenses of \$3.0 million and \$2.9 million for the three months ended September 30, 2007. Revenue and operating expenses for these two facilities was \$9.3 million and \$8.4 million for the nine months ended September 30, 2008 compared with revenue and operating expenses of \$8.9 million and \$8.2 million for the nine months ended September 30, 2007.

***General and administrative expense***

For the three months ended September 30, 2008 and 2007, general and administrative expenses totaled \$20.9 million and \$18.4 million, respectively, while general and administrative expenses totaled \$60.2 million and \$54.5 million, respectively, during the nine months ended September 30, 2008 and 2007. General and administrative expenses increased from 2007 primarily as a result of an increase in salaries and benefits for an increase in corporate staffing levels to help ensure the quality and effectiveness of our facility operations and to intensify our efforts on developing new bed capacity. Stock-based compensation also increased to \$2.2 million during the third quarter of 2008 from \$1.6 million during the third quarter of 2007, and to \$6.3 million for the first nine months of 2008 compared with \$4.6 million during the first nine months of 2007.

As a result of our intensified efforts to develop new capacity, we incurred charges of \$0.4 million and \$7,000 during the three months ended September 30, 2008, and 2007, respectively and \$1.0 million and \$0.2 million during the nine months ended September 30, 2008 and 2007, respectively, in connection with the abandonment of certain development projects. General and administrative expenses could increase in the future for the write-off of additional pre-acquisition costs we incur in the event we decide to abandon any such projects.

***Depreciation and amortization***

For the three months ended September 30, 2008 and 2007, depreciation and amortization expense totaled \$23.6 million and \$20.1 million, respectively. For the nine months ended September 30, 2008 and 2007, depreciation and amortization expense totaled \$67.2 million and \$57.3 million, respectively. The increase in depreciation and amortization from the comparable periods in 2007 resulted from the combination of additional depreciation expense recorded on various completed facility expansion and development projects, most notably our Saguaro Correctional Facility placed into service in June 2007 and our La Palma Correctional Center where we activated 1,020 beds in July 2008, and the additional depreciation on our investments in technology and other capital expenditures. We currently expect depreciation and amortization expense to increase in future quarters as we complete additional facility expansion and development projects.

***Interest expense, net***

Interest expense is reported net of interest income and capitalized interest for the three and nine months ended September 30, 2008 and 2007. Gross interest expense, net of capitalized interest, was \$15.9 million and \$16.4 million, respectively, for the three months ended September 30, 2008 and 2007 and was \$45.4 million and \$49.3 million, respectively, for the nine months ended September 30, 2008 and 2007. Gross interest expense is based on outstanding borrowings under our revolving credit facility, our senior notes, as well as the amortization of loan costs and unused facility fees. We expect gross interest expense to



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increase in future quarters as we utilize our revolving credit facility to fund our expansion and development projects. Further as a result of tightening credit markets, interest rates applicable to our revolving credit facility have increased. Gross interest income was \$0.8 million and \$3.1 million for the three months ended September 30, 2008 and 2007, respectively. Gross interest income was \$2.7 million and \$8.5 million for the nine months ended September 30, 2008 and 2007, respectively. Gross interest income is earned on cash collateral requirements, a direct financing lease, notes receivable, investments, and cash and cash equivalents, and decreased due to the lower cash and investment balances, which were used to fund our expansion and development projects.

Capitalized interest was \$3.6 million and \$1.7 million during the three months ended September 30, 2008 and 2007, respectively, and was \$11.3 million and \$4.8 million during the nine months ended September 30, 2008 and 2007, respectively. Capitalized interest was associated with various construction and expansion projects further described under *Liquidity and Capital Resources* hereafter.

***Income tax expense***

We incurred income tax expense of \$22.0 million and \$66.8 million for the three and nine months ended September 30, 2008, respectively, while we incurred income tax expense of \$20.2 million and \$59.3 million for the three and nine months ended September 30, 2007, respectively.

Our effective tax rate was 36.7% and 37.7% during the three and nine months ended September 30, 2008 compared with 37.8% and 37.7% during the three- and nine-month periods in the prior year. We currently expect our annual effective tax rate in 2008 to remain relatively consistent with the effective tax rate in 2007, as increases in our projected taxable income in states with higher statutory tax rates and the full year impact of an adverse change in Texas tax law are expected to be substantially offset by an increase in state tax credits resulting from certain tax planning strategies. Our effective tax rate is estimated based on our current projection of taxable income and could fluctuate based on changes in these estimates, the implementation of tax strategies, changes in federal or state tax rates, changes in tax laws, or changes in state apportionment factors, as well as changes in the valuation allowance applied to our deferred tax assets that are based primarily on the amount of state net operating losses and tax credits that could expire unused.

**LIQUIDITY AND CAPITAL RESOURCES**

Our principal capital requirements are for working capital, capital expenditures, and debt service payments. Capital requirements may also include cash expenditures associated with our outstanding commitments and contingencies, as further discussed in the notes to the financial statements and as further described in our 2007 Form 10-K.

Additionally, we may incur capital expenditures to expand the design capacity of certain of our facilities (in order to retain management contracts) and to increase our inmate bed capacity for anticipated demand from current and future customers. We may acquire additional correctional facilities that we believe have favorable investment returns and increase value to our stockholders. We will also consider opportunities for growth, including potential acquisitions of businesses within our line of business and those that provide complementary services, provided we

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believe such opportunities will broaden our market share and/or increase the services we can provide to our customers. As a result of increasing demand from both our federal and state customers and the utilization of a significant portion of our existing available beds, we have intensified our efforts to deliver new capacity to address the lack of available beds that our existing and potential customers are experiencing. We can provide no assurance, however, that the increased capacity that we construct will be utilized. The following addresses certain significant projects that are currently in process:

In July 2007, we announced the commencement of construction of a new 1,668-bed correctional facility in Adams County, Mississippi. During the second quarter of 2008, we announced that we would increase the size of the Adams County Correctional Center to 2,232 beds. Construction of the new Adams County facility is estimated to be completed during the fourth quarter of 2008 at an estimated aggregate cost of approximately \$130.0 million. In February 2008, we announced our intention to construct our new 2,040-bed Trousdale Correctional Center in Trousdale County, Tennessee. We have begun construction of our new Trousdale Correctional Center and expect to complete construction of the facility during the first quarter of 2010 at an estimated cost of approximately \$143.0 million. We do not currently have a management contract to utilize either of these facilities, but will market the new beds to various existing and potential customers.

In October 2007, we announced our intention to construct our new 3,060-bed La Palma Correctional Center located in Eloy, Arizona, which we expect to be fully utilized by the CDCR. We expect to complete construction of the new La Palma Correctional Center during the first quarter of 2009 at an estimated total cost of \$205.0 million. However, we opened a portion of the new facility and began receiving inmates from the state of California at this facility during the third quarter of 2008, and expect to continue to receive additional California inmates through completion of construction, as phases of the facility become available.

In May 2008, we announced that we were awarded a contract by the Office of the Federal Detention Trustee ( OFDT ) to design, build, and operate a new correctional facility located in Pahrump, Nevada, approximately 65 miles outside of Las Vegas, Nevada. Our new 1,072-bed Nevada Southern Detention Center is expected to house approximately 1,000 federal prisoners. The contract provides for a guarantee of up to 750 inmates or detainees and includes an initial term of five years with three five-year renewal options. Construction of our Nevada Southern Detention Center is expected to be complete during the second quarter of 2010, at an estimated cost of \$83.5 million.

The following table summarizes the aforementioned construction and expansion projects. Estimated costs include pre-acquisition costs (as applicable), land acquisition costs, design and construction costs, capitalized interest, as well as furniture, fixtures, and equipment required to operate the beds:

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Facility	No. of beds	Estimated completion date	Estimated remaining cost to complete as of September 30, 2008  (in thousands)
La Palma Correctional Center Eloy, AZ	3,060	Third quarter 2008 - First quarter 2009	\$ 20,765
Adams County Correctional Center Adams County, MS	2,232	Fourth quarter 2008	21,845
Trousdale Correctional Center Hartsville, TN	2,040	First quarter 2010	121,967
Nevada Southern Detention Center Pahrump, NV	1,072	Second quarter 2010	71,035
Total	8,404		\$ 235,612

In addition to the foregoing, the following expansions and development projects were completed during 2007 and during 2008:

Facility	No. of beds	Completion date	Cost (in thousands)
Citrus County Detention Facility Lecanto, FL	360	First quarter 2007	\$ 18,500
Crossroads Correctional Center Shelby, MT	96	First quarter 2007	5,000
Saguaro Correctional Facility Eloy, AZ	1,896	Second quarter 2007	102,600
Tallahatchie County Correctional Facility Tutwiler, MS	720	Fourth quarter 2007	40,000
	720	Second quarter 2008	45,500
	128	Fourth quarter 2008	8,000
North Fork Correctional Facility Sayre, OK	960	Fourth quarter 2007	53,000

Eden Detention Center Eden, TX	129	First quarter 2008	19,500(1)
Kit Carson Correctional Center Burlington, CO	720	First quarter 2008	42,000
Bent County Correctional Facility Las Animas, CO	720	Second quarter 2008	45,000
Leavenworth Detention Center Leavenworth, KS	266	Second quarter 2008	21,000(2)
Cimarron Correctional Facility Cushing, OK	660	Fourth quarter 2008	40,000
Davis Correctional Facility Holdenville, OK	660	Third quarter 2008	40,000
Total	8,035		\$ 480,100

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(1) The cost included a renovation of the facility pursuant to a new contract award from the BOP to house up to 1,558 federal inmates. These beds were substantially occupied by the end of the second quarter of 2008.

(2) The cost included a renovation of the existing building infrastructure to accommodate higher detainee populations.

We continue to pursue additional expansion and development opportunities in order to satisfy increasing demand from existing and potential customers. In order to help ensure the timely completion of pre-fabricated housing units and to help avoid potential increases in costs associated with constructing new bed capacity, during the fourth quarter of 2007, we entered into an agreement with a company to design, fabricate, and install pre-finished concrete modular housing structures for an aggregate cost of \$32.7 million. We may terminate the agreement at any time for any reason, including our convenience, without substantial penalty. We have designated \$22.0 million for housing structures at several of our new development and expansion projects pursuant to this agreement.

In order to retain federal inmate populations we currently manage in the San Diego Correctional Facility, we may be required to construct a new facility in the future. The San Diego Correctional Facility is subject to a ground lease with the County of San Diego. Under the provisions of the lease, the facility is divided into three different properties (Initial, Existing and Expansion Premises), all of which have separate terms ranging from June 2006 to December 2015.

Ownership of the Initial portion of the facility containing approximately 950 beds reverts to the County upon expiration of the lease on December 31, 2015. The County has the right to purchase the Initial portion of the facility, but no sooner than December 31, 2011, at a price generally equal to the cost of the premises, less an allowance for the amortization over a 20-year period. The lease for the Expansion portion of the facility containing approximately 200 beds expires December 31, 2011. However, the County may terminate the lease for the Expansion portion of the facility by providing us with 270 days notice after March 31, 2008. The third portion of the lease (Existing Premises) included 200 beds that expired in June 2006 and was not renewed.

Upon expiration of the lease for the Initial Premises, or should the County exercise its right to purchase the Initial Premises or terminate our lease for the Expansion Premises, we will likely be required to relocate a portion of the existing federal inmate population to other available beds within or outside the San Diego Correctional Facility, which could include the construction of a new facility. However, we can provide no assurance that we will be able to retain these inmate populations.

During the first nine months of 2008, we capitalized \$23.1 million of facility maintenance and technology related expenditures, compared with \$32.5 million during the first nine months of 2007. We expect to incur approximately \$20.3 million in facility maintenance and information technology expenditures during the remainder of 2008. We also currently expect to pay approximately \$55.0 million in federal and state income taxes during 2008, compared with \$51.3 million during 2007. Income taxes paid in 2008 reflect the favorable tax depreciation provisions on qualified assets under the Economic Stimulus Act of 2008 signed into law in February 2008, as well as on our Adams County Correctional Center, which is in

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a location that qualifies for accelerated depreciation under the Gulf Opportunity Zone Act of 2005. During December 2007, we entered into a new \$450.0 million senior secured revolving credit facility arranged by Banc of America Securities LLC and Wachovia Capital Markets, LLC. The new senior secured revolving credit facility replaces our previous \$250.0 million revolving credit facility. The new revolving credit facility will be utilized to fund development projects in anticipation of increasing demand by existing and potential new customers, as well as for working capital, capital expenditures and general corporate purposes. At our option, interest on outstanding borrowings is based on either a base rate plus a margin ranging from 0.00% to 0.50% or a London Interbank Offered Rate, or LIBOR, plus a margin ranging from 0.75% to 1.50%. The applicable margins are subject to adjustments based on our leverage ratio. The revolving credit facility currently bears interest at a base rate plus a margin of 0.00% or a LIBOR plus a margin of 0.75%.

We have the ability to fund our capital expenditure requirements, including the aforementioned construction projects, as well as our information technology expenditures, working capital, and debt service requirements, with cash on hand, net cash provided by operations, and borrowings available under our revolving credit facility.

As of September 30, 2008, our liquidity was provided by cash on hand of \$28.7 million, and \$237.2 million available under our \$450.0 million revolving credit facility. During the nine months ended September 30, 2008 and 2007, we generated \$222.9 million and \$214.8 million, respectively, in cash through operating activities, and as of September 30, 2008, we had net working capital of \$78.2 million. We currently expect to be able to meet our cash expenditure requirements for the next year utilizing these resources. None of our outstanding debt requires scheduled principal repayments, and we have no debt maturities until May 2011. We also have an option to increase the availability under our revolving credit facility by up to \$300.0 million subject to, among other things, the receipt of commitments for the increased amount. In addition, we have an effective shelf registration statement under which we may issue an indeterminate amount of securities from time to time when we determine that market conditions and the opportunity to utilize the proceeds from the issuance of such securities are favorable.

As a result of current economic conditions, including turmoil and uncertainty in the capital markets, credit markets have tightened significantly such that the ability to obtain new capital has become more challenging and more expensive. In addition, several large financial institutions have either recently failed or been dependent on the assistance of the federal government to continue to operate as a going concern. None of the banks providing commitments under the revolving credit facility have failed to fund borrowings we have requested. However, we can provide no assurance that all of the banks in our lending group will continue to operate as a going concern in the future.

If any of the banks that have made commitments under the revolving credit facility were to fail, it is possible that the capacity under our revolving credit facility would be reduced. In the unlikely event that the availability under our revolving credit facility was reduced significantly, we could be required to obtain capital from alternate sources in order to continue with our development and expansion initiatives. Our options for addressing such capital constraints would include, but not be limited to (i) obtaining commitments from the remaining banks in the lending group or from new banks to fund increased amounts under the

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terms of our revolving credit facility, (ii) accessing the public capital markets, or (iii) delaying certain of our existing construction projects. Although we believe we would be able to obtain additional capital if needed, such alternatives in the current market would likely be on terms less favorable than our existing terms, which could have a material effect on our consolidated financial position, results of operations, and cash flows.

At September 30, 2008, the interest rates on all our outstanding indebtedness are fixed, with the exception of the interest rate applicable to \$180.0 million outstanding under our revolving credit facility, with a total weighted average effective interest rate of 6.8%, while our total weighted average maturity was 3.8 years. Standard & Poor's Ratings Services currently rates our unsecured debt and corporate credit as BB-, while Moody's Investors Service currently rates our unsecured debt as Ba2.

**Operating Activities**

Our net cash provided by operating activities for the nine months ended September 30, 2008 was \$222.9 million, compared with \$214.8 million for the same period in the prior year. Cash provided by operating activities represents the year to date net income plus depreciation and amortization, changes in various components of working capital, and various non-cash charges, including primarily deferred income taxes. The increase in cash provided by operating activities for the nine months ended September 30, 2008 was primarily due to the increase in operating income caused by an increase in inmate populations under our management.

**Investing Activities**

Our cash flow used in investing activities was \$445.7 million for the nine months ended September 30, 2008 and was primarily attributable to capital expenditures during the nine-month period of \$446.5 million, including expenditures for facility development and expansions of \$423.4 million primarily related to the aforementioned facility expansion and development projects during the period. Our cash flow used in investing activities was \$181.9 million for the nine months ended September 30, 2007 and was primarily attributable to capital expenditures during the nine-month period of \$194.1 million, including expenditures for facility development and expansions of \$161.6 million. Cash flow used in investing activities during the first nine months of 2007 was net of the release of restricted cash of \$5.6 million for collateral previously required for a forward purchase agreement related to the Hardeman County Correctional Facility and also net of \$10.0 million of proceeds from the sale of investments.

**Financing Activities**

Our cash flow provided by financing activities was \$193.6 million for the nine months ended September 30, 2008 and was primarily attributable to \$180.0 million of net borrowings from our revolving credit facility, as well as the cash flows associated with the exercising of stock options, including the related income tax benefit of equity compensation, net of the purchase and retirement of common stock. Our cash flow provided by financing activities was \$27.4 million for the nine months ended September 30, 2007 and was primarily attributable to the cash flows associated with exercising stock options, including the related income tax benefit of equity compensation, net of the purchase and retirement of common stock.

**Table of Contents****Contractual Obligations**

The following schedule summarizes our contractual cash obligations by the indicated period as of September 30, 2008 (in thousands):

	Payments Due By Year Ended December 31,						
	2008 (remainder)	2009	2010	2011	2012	Thereafter	Total
Long-term debt	\$	\$	\$	\$ 450,000	\$ 180,000	\$ 525,000	\$ 1,155,000
Contractual facility expansions	5,457	59,553	12,164				77,174
Operating leases	489	3,508	3,629	3,066	2,089	6,309	19,090
Total contractual cash obligations	\$ 5,946	\$ 63,061	\$ 15,793	\$ 453,066	\$ 182,089	\$ 531,309	\$ 1,251,264

The cash obligations in the table above do not include future cash obligations for interest associated with our outstanding indebtedness. Further, the cash obligations in the table above also do not include future cash obligations for uncertain tax positions recorded pursuant to FIN 48, as defined below, as we are unable to make reliable estimates of the timing of such payments, if any, to the taxing authorities. During the nine months ended September 30, 2008, we paid \$53.3 million in interest, including capitalized interest. We had \$32.8 million of letters of credit outstanding at September 30, 2008 primarily to support our requirement to repay fees and claims under our workers' compensation plan in the event we do not repay the fees and claims due in accordance with the terms of the plan. The letters of credit are renewable annually. We did not have any draws under any outstanding letters of credit during the nine months ended September 30, 2008 or 2007.

**INFLATION**

We do not believe that inflation has had a direct adverse effect on our operations. Many of our management contracts include provisions for inflationary indexing, which mitigates an adverse impact of inflation on net income. However, a substantial increase in personnel costs, workers' compensation or food and medical expenses could have an adverse impact on our results of operations in the future to the extent that these expenses increase at a faster pace than the per diem or fixed rates we receive for our management services.

**SEASONALITY AND QUARTERLY RESULTS**

Our business is somewhat subject to seasonal fluctuations. Because we are generally compensated for operating and managing facilities at an inmate per diem rate, our financial results are impacted by the number of calendar days in a fiscal quarter. Our fiscal year follows the calendar year and therefore, our daily profits for the third and fourth quarters include two more days than the first quarter (except in leap years) and one more day than the second quarter. Further, salaries and benefits represent the most significant component of operating expenses. Significant portions of the Company's unemployment taxes are recognized during the first quarter, when base wage rates reset for state unemployment tax purposes. Finally, quarterly results are affected by government funding initiatives, the timing of the opening of new facilities, or the commencement of new management contracts and related start-up expenses which may mitigate or exacerbate the impact of other seasonal influences. Because of these seasonality factors, results for any quarter are not necessarily indicative of the results that may be achieved for the full fiscal year.



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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Our primary market risk exposure is to changes in U.S. interest rates. We are exposed to market risk related to our revolving credit facility because the interest rate on our revolving credit facility is subject to fluctuations in the market. If the interest rate for our outstanding indebtedness under the revolving credit facility was 100 basis points higher or lower during the three and nine months ended September 30, 2008, our interest expense, net of amounts capitalized, would have been increased or decreased by \$0.4 million and \$0.6 million, respectively.

As of September 30, 2008, we had outstanding \$450.0 million of senior notes with a fixed interest rate of 7.5%, \$375.0 million of senior notes with a fixed interest rate of 6.25%, and \$150.0 million of senior notes with a fixed interest rate of 6.75%. Because the interest rates with respect to these instruments are fixed, a hypothetical 100 basis point increase or decrease in market interest rates would not have a material impact on our financial statements.

We may, from time to time, invest our cash in a variety of short-term financial instruments. These instruments generally consist of highly liquid investments with original maturities at the date of purchase of three months or less. While these investments are subject to interest rate risk and will decline in value if market interest rates increase, a hypothetical 100 basis point increase or decrease in market interest rates would not materially affect the value of these investments.

**ITEM 4. CONTROLS AND PROCEDURES.**

An evaluation was performed under the supervision and with the participation of our senior management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 as of the end of the period covered by this quarterly report. Based on that evaluation, our senior management, including our Chief Executive Officer and Chief Financial Officer, concluded that as of the end of the period covered by this quarterly report our disclosure controls and procedures are effective in causing material information relating to us (including our consolidated subsidiaries) to be recorded, processed, summarized and reported by management on a timely basis and to ensure that the quality and timeliness of our public disclosures complies with SEC disclosure obligations. There have been no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS.**

See the information reported in Note 8 to the financial statements included in Part I, which information is incorporated hereunder by this reference.

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**ITEM 1A. RISK FACTORS.**

In addition to the other information set forth in this Report, you should carefully consider the risks and uncertainties previously reported under the caption Part I Item 1A. Risk Factors in the 2007 Form 10-K, the occurrence of which could materially and adversely affect our business, prospects, financial condition and operating results. The risks previously reported and described in the 2007 Form 10-K and in this Report are not the only risks facing our business. Additional risks and uncertainties not currently known to us or those we currently deem to be immaterial may also materially and adversely affect our business operations.

The following risk factor is updated from the 2007 Form 10-K to reflect updated or additional risks and uncertainties.

***We may be affected by general macroeconomic conditions.***

As a result of current economic conditions, including turmoil and uncertainty in the capital markets, credit markets have tightened significantly such that the ability to obtain new capital has become more challenging and more expensive. In addition, several large financial institutions have either recently failed or been dependent on the assistance of the federal government to continue to operate as a going concern. The Company can provide no assurance that all of the banks that have made commitments under its revolving credit facility will continue to operate as a going concern in the future.

If any of the banks in the lending group were to fail, it is possible that the capacity under the revolving credit facility would be reduced. In the event that the availability under the revolving credit facility was reduced significantly, the Company could be required to obtain capital from alternate sources in order to continue with its development and expansion initiatives. The Company's options for addressing such capital constraints would include, but not be limited to (i) obtaining commitments from the remaining banks in the lending group or from new banks to fund increased amounts under the terms of the revolving credit facility, (ii) accessing the public capital markets, or (iii) delaying certain of the Company's existing construction projects. Such alternatives in the current market would likely be on terms less favorable than under existing terms, which could have a material effect on the Company's consolidated financial position, results of operations, or cash flows.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

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

None.

**ITEM 5. OTHER INFORMATION.**

**Audit Committee Matters.**

Section 10A(i)(1) of the Exchange Act, as added by Section 202 of the Sarbanes-Oxley Act of 2002, requires that the Company's Audit Committee (or one or more designated members of the Audit Committee who are independent directors of the Company's board of directors) pre-approve all audit and non-audit services provided to the Company by its external auditor, Ernst & Young LLP. Section 10A(i)(2) of the Exchange Act further requires that the Company disclose in its periodic reports required by Section 13(a) of the Exchange Act any non-audit services approved by the Audit Committee to be performed by Ernst & Young.

Consistent with the foregoing requirements, during the third quarter, the Company's Audit Committee pre-approved the engagement of Ernst & Young for non-audit services, as defined by the SEC, including certain tax services pertaining to the audit by the Internal Revenue Service of the Company's 2006 federal income tax return.

**ITEM 6. EXHIBITS.**

The following exhibits are filed herewith:

Exhibit Number	Description of Exhibits
31.1	Certification of the Company's Chief Executive Officer pursuant to Securities and Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Company's Chief Financial Officer pursuant to Securities and Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Company's Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Company's Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**CORRECTIONS CORPORATION OF AMERICA**

Date: November 6, 2008

/s/ John D. Ferguson  
John D. Ferguson  
Chairman of the Board of Directors and  
Chief Executive Officer

/s/ Todd J Mullenger  
Todd J Mullenger  
Executive Vice President, Chief Financial  
Officer, and Principal Accounting Officer  
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