



CORNELL COMPANIES, INC.

2008 ANNUAL REPORT

Forward-Looking Statements. Any statements included in this Annual Report that are not historical facts, including without limitation statements regarding operations, strategic direction and financial results, are forward-looking statements within the meaning of applicable securities laws. Such statements are subject to numerous risks and uncertainties, including without limitation those set forth on pages 13-20 of this Annual Report, that could cause actual results to differ materially from those projected or anticipated. Each forward-looking statement speaks only as of the date of this Annual Report and we undertake no obligation to update or revise any such statement.

Dear Shareholders,

2008 was a year that many might prefer to forget. For Cornell, certainly we had a few setbacks. However, overall, in 2008 your company produced yet another year of solid growth, improved financial performance and most importantly, stable operations that reliably delivered to customer requirements.

I'm actually not going to dwell on the financial performance. The numbers speak loudly. Look at the financial statements in this Annual Report and compare them to prior years. You will see the payoff from the hard efforts of your 4,300 associates at Cornell in almost every dimension of comparative performance.

Let's look to 2009 and beyond. What do our customers value from us, how will we improve the consistency of the services we deliver and how will we profitably grow midst the turmoil of this continuing environment of extreme customer budget pressure?

Adult Secure Services:

Over the next few years, using private corrections operators is one of the few levers that a State or Federal agency can pull to meet their increasing demand for beds. The simple view of the numbers is that collectively, the already overcrowded State and Federal corrections systems need 35,000–40,000 beds per year in each of the next few years, while new construction is scheduled to only add 12,000–15,000 beds annually. At core, demand for beds results from high rates of recidivism among released offenders and an increasing length of sentence for those repeat offenders. Recidivism itself is highly correlated with employment opportunities for offenders; getting a job helps keep an ex-offender straight. Moreover, the probability of employment for an ex-offender increases substantially with in-prison programs for adult basic education, substance abuse treatment and vocational training followed by re-entry via a "halfway house" program.

Unfortunately, in this economy, these factors, unemployment and budget cuts to those in-prison treatment, education and vocational programs, lead one to conclude that demand for prison beds will likely remain strong, while the ability of government agencies to build their own beds remains constrained.

As an industry, private corrections can provide beds quickly and cost effectively. We operate to the standards of the national accreditation organizations and we adjust our processes to meet each customer's specific requirements. Data show that the operating outcomes at private facilities differ little, if at all, from those of the government agency's own facilities alongside which we operate.

For Cornell, we aren't trying to be all things to all customers. Our goal for the next few years is to deepen the relationship with current Federal and State customers. We do this by expanding existing facilities to scale as we did with our Great Plains, Oklahoma and D. Ray James, Georgia facilities this past year. We also selectively approve the construction at "Greenfield" locations that offer a platform for growth, as we did with the launch of construction at our Hudson, Colorado site. We look for locations that offer large and high-quality labor markets, strong transportation locations, and welcoming communities to serve both in-state and out-of-state customers. However, we will only deploy new capital in this environment when we believe that an opportunity produces a risk-adjusted return superior to the alternate use of capital to reduce debt or increase liquidity.

In addition to investment in facilities that provide strong return potential, Cornell will continue to invest in 2009, as we did in 2008, in supervisory and front-line staff training, the design and implementation of our quality assurance systems and risk management processes; all designed to reduce the probability of an operating variance to customer requirements. In sum, Adult Secure, our largest division has shown tremendous growth over the past few years that we expect to continue for years to come.

Adult Community-based Services:

The demand for community residential services, primarily halfway house beds and home confinement reporting and monitoring, remains strong among both Federal and State customers. Agencies and legislatures recognize that reintroducing offenders to their communities via a halfway house program reduces recidivism and provides strong return on investment for tax payers.

However, we expect the continuance of two factors that limit the growth of community corrections to a measured, steady pace: first, customers have budget pressures today that limit their ability to make new program commitments, regardless of the payback tomorrow. Second, communities consider warily the establishment of any new halfway house in their environs. As a result, existing halfway houses with good operating reputations have a strong and sustainable advantage in assuming new commitments from customers.

As one of the largest providers of community corrections services to the Federal government, Cornell has established a reputation for strong operations and adherence to customer and third party standards. For example, in 2008, our customers awarded Cornell 100% of the re-bid contracts we pursued. Also, last year, three programs received ACA accreditation, and our largest Federal program, our Taylor Street facility in San Francisco, achieved 100% scores on both mandatory and non-mandatory standards.

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As discussions among public policy makers continue to expand to include the more effective use of community corrections for offender transition back to their communities, Cornell is well positioned to offer customers strong treatment and re-entry programs across our portfolio of urban locations. Our future growth will come from the steady, measured increase in capacity and services at existing programs, while maintaining operating standards.

Abraxas Youth and Family Services:

Our smallest division serves primarily the juvenile justice community providing residential and community-based treatment for adolescents with specialized and acute needs. As we anticipated several years ago, in difficult budget environments, customers look for alternatives to residential placement for less acute youth. As a result, over the past few years, we have successfully migrated our Abraxas programs to meet customer requirements for their most challenging populations, and exited programs where we felt our services differed little from competitors.

Abraxas is one of the largest providers of residential services in the country with multiple specialized programs unmatched by any competitor. As we saw in 2008 to a greater extent than in prior years, the less specialized and smaller providers came under increasing pressure that caused some to exit the business and some to “cut corners” on quality. As we demonstrated in 2008, we will never compromise our operating standards to avoid short term financial pain. Also, Abraxas as part of a larger company demonstrated that it has the resiliency to work with customers as they navigate their budget difficulties. Other stand-alone providers could not draw on such resources. For 2009, and probably 2010, we believe the budget environment will only get worse for those youth service providers with generic programs or with compromised quality.

However, for Abraxas with our specialized approach to acute programs, we believe 2009 offers us the opportunity to increase our market share. We will continue to gradually fill our underutilized assets in 2009 by using our industry-leading marketing teams to bring our programs to the attention of new customers and deepen relationships with existing customers.

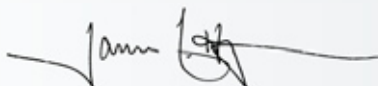
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Now turning to very specific objectives for 2009, here's our plan according to the same five dimensions of performance that I've discussed for the past four years.

- **Operating Excellence.** “We're only as good as the skills of our front-line supervisors and staff on the 2 a.m. shift on a Saturday night.” Focus everyone on the basics of corrections and treatment services, and meeting customer requirements consistently.
- **Underutilized Assets.** For Adult Secure, fill the spare capacity at our D. Ray James and RCC facilities, and prepare for the opening of Hudson. For ACB, make sure that we let customers know when we have a few spare beds to fill. For Abraxas, focus on gaining market share for our San Antonio programs, our A1 and Abraxas Academy facilities, and remaining capacity across the rest of our facilities.
- **Capital Effectiveness.** Use free cash to pay down debt or increase liquidity unless compelling growth opportunities emerge to use Cornell's balance sheet for facility expansions. Explore all alternatives to increase the risk-adjusted return on capital employed.
- **Portfolio Management.** Continue to determine how to adjust programs or services to meet evolving customer needs. Also, consider whether industry consolidation opportunities create value in this environment.
- **Operating Efficiency.** Continue to focus on the daily effectiveness of the money we spend to maintain the growth in operating margins that we have produced over the past several years.

In summary, 2008 was a strong year for us. We expect 2009 to be even stronger, and to set the platform for additional profitable growth in 2010 and beyond.

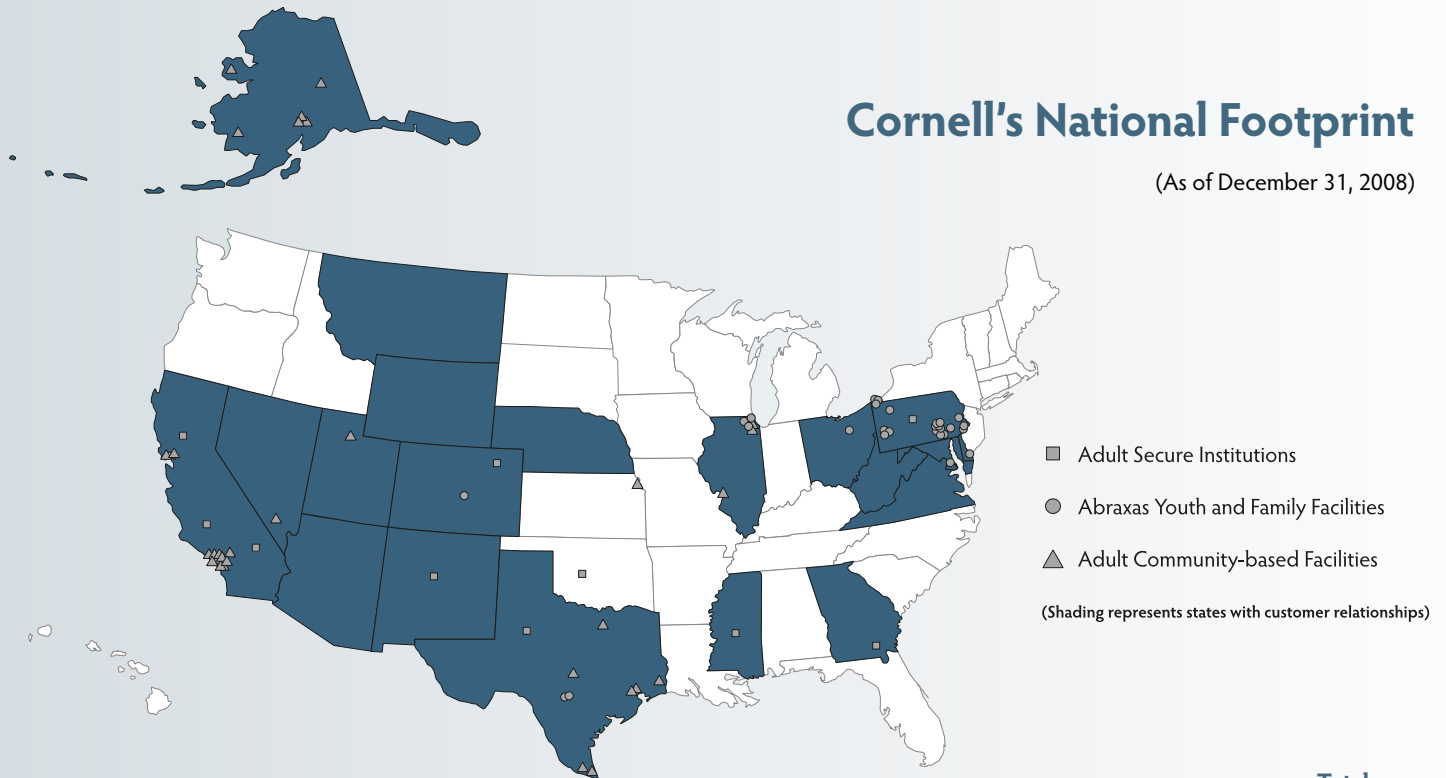
Sincerely,



James E. Hyman
Chairman, President & CEO

Cornell's National Footprint

(As of December 31, 2008)



Adult Secure Institutions

	Location	Gender	Total Capacity
Baker Community Correctional Facility	Baker, CA	Male	262
Big Spring Correctional Center	Big Spring, TX	Male	3,509
D. Ray James Prison	Folkston, GA	Male	2,170
Great Plains Correctional Facility	Hinton, OK	Male	2,048
High Plains Correctional Facility	Brush, CO	Female	272
Leo Chesney Community Correctional Facility	Live Oak, CA	Female	305
Mesa Verde Community Correctional Facility	Bakersfield, CA	Male	360
Moshannon Valley Correctional Center	Philipsburg, PA	Male	1,495
Regional Correctional Center	Albuquerque, NM	Male/Female	970
Walnut Grove Youth Correctional Facility	Walnut Grove, MS	Male	1,450
Adult Secure Institutions (10)			12,841

Abraxas Youth and Family Facilities

	Location	Gender	Total Capacity
Contact	Wauconda, IL	Female	51
Cornell Abraxas I	Marienville, PA	Male	274
Cornell Abraxas II	Erie, PA	Male	23
Cornell Abraxas III	Pittsburgh, PA	Male	24
Cornell Abraxas Academy	New Morgan, PA	Male/Female	214
Cornell Abraxas Center for Adolescent Females	Pittsburgh, PA	Female	108
Cornell Abraxas of Ohio	Shelby, OH	Male	108
Cornell Abraxas Youth Center	South Mountain, PA	Male/Female	72
Delaware Community Programs	Milford, DE	Male/Female	66
DuPage Adolescent Center	Hinsdale, IL	Male	38
Erie Residential Behavioral Health Program	Erie, PA	Female	17
Hector Garza Residential Treatment Center	San Antonio, TX	Male/Female	122
Harrisburg Day Treatment	Harrisburg, PA	Male/Female	45
Leadership Development Program	South Mountain, PA	Male/Female	120
Lebanon Alternative Education	Lebanon, PA	Male/Female	225
Lehigh Valley Community Programs	Lehigh Valley, PA	Male/Female	60

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Abraxas Youth and Family Facilities, continued	Location	Gender	Total Capacity
Non-Residential Detention/Non-Residential Treatment	Harrisburg, PA	Male/Female	91
Philadelphia Alternative Education	Philadelphia, PA	Male/Female	165
Philadelphia Community-based Programs	Philadelphia, PA	Male/Female	71
Psychosocial Rehabilitation Unit	Erie, PA	Male	13
Schaffner Youth Center	Steelton, PA	Male/Female	63
Southern Peaks Regional Treatment Center	Cañon City, CO	Male/Female	160
State Reintegration Program	Harrisburg, PA	Male/Female	225
Texas Adolescent Treatment Center	San Antonio, TX	Male/Female	124
Washington D.C. Facility	Washington, DC	Male/Female	70
Woodridge	Woodridge, IL	Male	122
WorkBridge	Pittsburgh, PA	Male/Female	600
York County Community Programs	Harrisburg, PA	Male/Female	36
Abraxas Youth and Family Facilities (28)			3,307

Adult Community-based Facilities	Location	Gender	Total Capacity
Alhambra City Jail	Alhambra, CA	Male/Female	75
Baldwin Park City Jail	Baldwin Park, CA	Male/Female	32
Beaumont Transitional Treatment Center	Beaumont, TX	Male/Female	180
Bell Gardens City Jail	Bell Gardens, CA	Male/Female	12
Cordova Center	Anchorage, AK	Male/Female	192
Dallas County Judicial Treatment Center	Wilmer, TX	Male/Female	300
Downey City Jail	Downey, CA	Male/Female	25
East St. Louis	East St. Louis, IL	Male/Female	164
El Monte Center	El Monte, CA	Male/Female	55
Fontana Jail	Fontana, CA	Male/Female	40
Garden Grove City Jail	Garden Grove, CA	Male/Female	16
Grossman Center	Leavenworth, KS	Male/Female	150
Las Vegas Community Correctional Center	Las Vegas, NV	Male/Female	100
Leidel Comprehensive Sanction Center	Houston, TX	Male/Female	190
LifeWorks	Joliet, IL	Male/Female	116
Marvin Gardens Center	Los Angeles, CA	Male	52
McCabe Center	Austin, TX	Male/Female	90
Mid Valley House	Edinburg, TX	Male/Female	96
Midtown Center	Anchorage, AK	Male/Female	32
Montebello City Jail	Montebello, CA	Male/Female	39
Northstar Center	Fairbanks, AK	Male/Female	135
Oakland Center	Oakland, CA	Male/Female	61
Ontario City Jail	Ontario, CA	Male/Female	25
Parkview Center	Anchorage, AK	Male	112
Reality House	Brownsville, TX	Male/Female	66
Reid Community Residential Facility	Houston, TX	Male	500
Salt Lake City Center	Salt Lake City, UT	Male/Female	78
Seaside Center	Nome, AK	Male/Female	48
Southwood	Chicago, IL	Male/Female	554
Taylor Street Center	San Francisco, CA	Male/Female	177
Tundra Center	Bethel, AK	Male/Female	85
Adult Community-based Facilities (31)			3,797

TOTAL FACILITIES AND SERVICE CAPACITY (69)19,945

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-K

(Mark One)

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

For fiscal year ended December 31, 2008

OR

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

For the transition period from _____ to _____

Commission File Number 1-14472

CORNELL COMPANIES, INC.

(Exact Name of Registrant as Specified In Its Charter)

Delaware

(State or Other Jurisdiction
of Incorporation or Organization)

1700 West Loop South, Suite 1500, Houston, Texas
(Address of Principal Executive Offices)

76-0433642

(I.R.S. Employer
Identification No.)

77027
(Zip Code)

Registrant's telephone number, including area code: **(713) 623-0790**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$.001 par value per share	New York Stock Exchange
Preferred Stock Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Check one.

Large accelerated filer ☐
Non-accelerated filer ☐

Accelerated filer ☒
Smaller Reporting Company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The aggregate market value of voting stock held by non-affiliates of the registrant was \$263,852,896 on June 30, 2008. The registrant has 14,766,758 shares of common stock outstanding on March 6, 2009.

Documents Incorporated by Reference

The information required by Part III of this Report, to the extent not set forth herein, is incorporated by reference from the registrant's definitive proxy statement relating to its Annual Meeting of Stockholders to be held in 2009, which definitive proxy statement will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

Cornell Companies, Inc.

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Forward-Looking Information

The statements included in this annual report regarding future financial performance and results of operations and other statements that are not historical facts are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements in this annual report include, but are not limited to, statements about the following subjects:

- revenues,
- revenue mix,
- expenses, including personnel and medical costs,
- results of operations,
- operating margins,
- supply and demand,
- market outlook in our various markets,
- our other expectations with regard to market outlook,
- utilization,
- parolee, detainee, inmate and youth offender trends,
- pricing and per diem rates,
- contract commencements,
- new contract opportunities,
- operations at, future contracts for, and results from our Regional Correctional Center,
- the timing (including construction, completion and ramp of facility population), cost of completion and other aspects of planned expansions, including without limitation the D. Ray James Prison and Walnut Grove Youth Correctional Facility expansions, and client contracts for such facilities,
- the construction and lease of the new facility in Hudson, Colorado and our contracts with the Colorado Department of Corrections,
- impact from Hurricane Ike,
- adequacy of insurance,
- debt levels,
- debt reduction,
- the effect of FIN No. 48,
- our effective tax rate,
- tax assessments,
- results and effects of legal proceedings and governmental audits and assessments,
- liquidity, including future liquidity and our ability to obtain financing,
- financial markets,
- cash flow from operations,
- adequacy of cash flow for our obligations,
- capital requirements,
- capital expenditures,
- effects of accounting changes and adoption of accounting policies,
- changes in laws and regulations,
- adoption of accounting policies,
- benefit payments, and
- changes in laws and regulations.

Forward-looking statements in this annual report are identifiable by use of the following words and other similar expressions among others:

- “anticipates”
- “believes”
- “budgets”
- “could”
- “estimates”

- “expects”
- “forecasts”
- “intends”
- “may”
- “might”
- “plans”
- “predicts”
- “projects”
- “scheduled”
- “should”

Such statements are subject to numerous risks, uncertainties and assumptions, including, but not limited to:

- those described under “Item 1A. Risk Factors,”
- the adequacy of sources of liquidity,
- the effect and results of litigation, audits and contingencies, and
- other factors discussed in this annual report and in the Company’s other filings with the SEC, which are available free of charge on the SEC’s website at www.sec.gov.

Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those indicated.

All subsequent written and oral forward-looking statements attributable to the Company or to persons acting on our behalf are expressly qualified in their entirety by reference to these risks and uncertainties. You should not place undue reliance on forward-looking statements. Each forward-looking statement speaks only as of the date of the particular statement, and we undertake no obligation to publicly update or revise any forward-looking statements.

PART I

ITEM 1. BUSINESS

Company Overview

Cornell Companies, Inc. (together with its subsidiaries and predecessors, unless the context requires otherwise, “Cornell,” the “Company,” “we,” “us” or “our”) was incorporated in Delaware in 1996. We are a leading provider of correctional, detention, educational, rehabilitation and treatment services outsourced by federal, state, county and local government agencies for adults and juveniles. We partner with these agencies to deliver quality, cost-efficient programs that we believe enable our customers to achieve their missions while saving taxpayers’ money. Our customers include the Federal Bureau of Prisons (“BOP”), U.S. Marshals Service (“USMS”), various state Departments of Corrections, and city, county and state departments of human services and similar agencies.

We offer a diverse portfolio of services in structured and secure environments throughout three operating divisions: (1) Adult Secure Services; (2) Abraxas Youth and Family Services; and (3) Adult Community-Based Services. Cornell, through predecessor entities, began juvenile operations in 1973, adult community-based programs in 1974, and adult secure operations in 1984. Our three divisions are our reportable operating segments. Financial information and a discussion concerning these segments for fiscal years 2008, 2007, and 2006 is included in “Note 15 — Segment Disclosure” of the “Notes to Consolidated Financial Statements” included in this Form 10-K.

As of December 31, 2008, we operated 68 facilities among the three operating divisions, representing a total operating service capacity of 19,875. We also had one facility that was vacant, representing additional service capacity of 70. Service capacity is comprised of the number of beds currently available for service in residential facilities and the average program capacity of non-residential community-based programs. Our facilities are located in 15 states and the District of Columbia.

Additional information about Cornell can be found on our website, www.cornellcompanies.com. We make available on our website, free of charge, access to our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to these reports as soon as reasonably practicable after such materials are electronically filed

with or furnished to the Securities and Exchange Commission (“SEC”). Information provided on our website is not part of this Form 10-K.

Company Operations

We provide a continuum of care to adults and juveniles in institutional, residential, and community-based settings. Regardless of operating division, each of our facilities emphasizes the importance of engaging in the community as a productive, responsible citizen. In many of our adult secure institutions, we offer vocational training curricula, as well as literacy and General Equivalency Diploma (“GED”) programs. In our adult community-based programs, we offer job placement services, instruction on personal finance management and other skill-based training. In most of our juvenile facilities, we provide family counseling services and behavioral counseling. In facilities throughout the organization, we provide drug and alcohol counseling for our clients.

We operate our facilities and programs under the framework of our Seven Key Principles of Care®. These principles state that our operations must maintain the safety and security of our clients, our employees, and the local community. In addition, the principles require that we hold the individuals in our care accountable for their actions and expect them to assume responsibility. Furthermore, we expect our employees to act as role models, to communicate effectively and professionally, and to treat our clients with dignity and respect. Finally, our principles call for us to manage physically clean and appropriately maintained facilities that are safe and conducive to an environment of care.

Quality of Operations

We operate our facilities in accordance with both company and facility-specific policies and procedures. Where required by contract or otherwise deemed appropriate for our service environments, these policies and procedures are designed to meet requirements set forth by independent industry oversight organizations, including the American Correctional Association (“ACA”), Joint Commission on Accreditation of Healthcare Organizations (“JCAHO”), and National Commission on Correctional Health Care (“NCCCHC”). Standards may also be implemented to meet the requirements of state departments of public welfare, departments of protective and regulatory services and departments of human services and education. We believe that accreditation and the corresponding standards of operation enhance our ability to provide quality programs and contribute to the public’s increased acceptance of our services.

Internal quality control, conducted by senior facility staff and senior management, takes the form of periodic operational, programmatic and fiscal audits; facility inspections; regular review of logs, reports and files; and strict maintenance of personnel standards, including an active training program. Each of our facilities is further subject to periodic audits and reviews performed by our contracting agencies.

Industry and Business Segment Summary

Incarceration, detention, education and treatment services for adults and juveniles have historically been provided by various government entities. In the United States, the incarcerated and sentenced populations of adults and juveniles has continued to increase while federal, state and local governments face continuing pressures to control costs and improve service quality. We believe these trends have caused growing consideration and acceptance towards outsourcing certain government services and functions. Moreover, the increasing demand facing governments (from areas such as healthcare, maintenance/development of public infrastructure, etc.) has also created competition for resources funding such services.

Services offered among our three divisions include incarceration and detention, transition from incarceration, drug and alcohol counseling and treatment, behavioral rehabilitation and treatment, vocational training and academic education for grades 3–12. Private-sector companies, like us, contract with government agencies to deliver these services, at what we believe are the same or higher quality and for a lower cost than what the agency can otherwise provide. Although outsourcing these services has historically faced opposition in the U.S., public and government acceptance has increased as standards of service improve and cost savings are documented. As government agencies face fiscal budget constraints, outsourcing to private providers can offer economically positive alternatives. In addition, as a cost relief measure, government agencies have sought alternatives to incarceration, including reentry, education, substance abuse and behavioral health programs — all of which are services we provide.

Outsourcing has a longer history in the juvenile justice and adult community-based corrections sectors. Increasingly, states, counties and local governments have used both for-profit and not-for-profit organizations to meet the needs of troubled youth and adults reintegrating into society after a time in residential treatment or prison. Governments have sought alternatives to the rising costs of incarceration for offenders who are non-violent and need treatment, education and rehabilitation. Adult community-based reentry programs as well as education, substance abuse and behavioral health programs that can successfully divert an offender from prison address this need.

Adult Secure Services

Increasingly, federal and state systems are relying upon private providers to address their incarceration needs. We also believe that the heightened attention that has been placed on border patrol and immigration enforcement will continue to drive demand for services such as those offered by private providers.

We believe that our adult secure services division is well positioned to respond to these marketplace conditions. We provide low-to-maximum-security incarceration and detention services. In doing so, we ensure public safety through the operation of a physically secure environment, which entails, among other security and safety measures, a routine patrol of the premises by trained correctional officers, alarmed fencing and razor wire and centralized monitoring of activity via closed circuit camera systems. While incarcerated, offenders are offered a variety of educational, counseling and vocational programs aimed at providing a successful return to the community and a subsequent reduction in recidivism.

As of December 31, 2008 we operated 10 adult secure facilities with an aggregate service capacity of 12,841. Within the division, we offer the following:

- Low-to-maximum-security incarceration and detention,
- Confinement of juveniles adjudicated as adults,
- Facility design, construction and operation,
- Use of modern security technology, including electronic controls and surveillance equipment,
- Education courses, including preparation and testing for the GED, English as a Second Language classes, and Adult Basic Education (“ABE”),
- Holistic healthcare services, including medical, dental, vision, psychiatric, and individual and group counseling services,
- Substance abuse counseling,
- Life skills training, including anger management, hygiene, personal finance, employment and housing issues, and parenting skills,
- Religious opportunities and culturally sensitive programs,
- Food and laundry service, and
- Recreational activities, including exercise programs.

Abraxas Youth and Family Services

The juvenile justice industry sector includes residential, detention, shelter care and community-based services, along with educational, rehabilitation and treatment programs. This sector is highly fragmented with several thousand providers operating across the country. Most of the private providers are small and operate in specific geographic areas.

Juvenile justice issues present a growing area of concern for many states due to the number of youth within the judicial system, as well as the related annual expenditures for placement and treatment. Beyond addressing capacity issues within the juvenile justice system, states are also facing challenges posed by the unique needs of specialized juvenile populations, such as those with mental/behavioral health issues. Partnerships with private providers such as Cornell can provide quality alternatives for care.

We believe that our Abraxas Youth and Family Services division is uniquely equipped to address the issues currently facing the juvenile justice system. While the market is fragmented with providers located across the country, we offer a national presence with locations in both urban areas as well as suburban and rural settings. We provide a broad array of services to youth, typically between the ages of 10 and 18, in residential and community-based settings. The programs and services provided at our facilities are designed to rehabilitate juveniles, hold them accountable for their actions and behaviors, and help them successfully reintegrate back into the community. An underlying principle of our juvenile programming is the

Balanced and Restorative Justice (“BARJ”) model, which provides a restorative component to the victim, be it an individual, family, or community. The use of the BARJ model, in connection with our Seven Key Principles of Care®, emphasizes accountability, competency development and community protection.

As of December 31, 2008, we operated 17 residential facilities and 10 non-residential community-based programs within our Abraxas division, representing operating service capacity of 3,237. We also had one vacant facility with a service capacity of 70. Within the division, we offer the following:

- Diverse treatment settings, including physically-secure, staff-secure, and community-based,
- Specialized treatment for unique populations, including females, drug addicts, sex offenders, fire starters, and families,
- Accredited alternative and special education services,
- Wilderness training programs and nationally accredited ropes course challenges,
- Individualized treatment planning and case management,
- Individual, group and family counseling and therapy, cognitive behavior therapy and stress and anger management instruction,
- Substance abuse counseling and treatment, relapse prevention and education,
- Life skills training, including hygiene, personal finance, employment and housing issues, and parenting skills,
- Holistic healthcare services, including medical, dental, behavioral health and psychiatric services, and
- Recreational activities, including exercise programs.

Adult Community-Based Services

Community-based corrections services involve the supervision of adult parolees and probationers. Parolees are persons who have served time in a correctional facility and have been released due to either mandatory conditional release or a parole board decision. Probationers have been charged with a crime but sentenced to probation in lieu of incarceration. Services provided to parolees and probationers include temporary housing, employment assistance, anger management instruction, personal finance management training, academic opportunities, vocational training and substance abuse or addiction counseling.

Community-based treatment services include both residential and outpatient substance abuse programs. Services include short-term and long-term residential care, counseling, HIV/AIDS testing, counseling and prevention education, substance abuse and addiction testing, detoxification and methadone maintenance.

We believe that our adult community-based programs provide positive environments of care for both corrections and treatment clients. The market is fragmented with providers located across the country. Whereas most providers in the industry are small and have limited geographic reach, Cornell offers a national presence with locations in large urban areas, as well as suburban and rural settings. The adult community-based programs provide an alternative to incarceration and a focus on transitioning offenders from a correctional facility back into society. Through a system of education, employment training, treatment, monitoring and accountability, clients are given the necessary tools to make positive life choices that can reduce the incidence of recidivism.

As of December 31, 2008, we operated 28 residential community-based facilities and three non-residential community-based programs with a combined total service capacity of 3,797. Within the division, we offer the following:

- Minimum-security and staff-secure residential services,
- Home confinement and electronic monitoring,
- Substance-abuse counseling and treatment, including detoxification, testing, 12-step programs and relapse prevention services,
- Employment training and assistance,
- Education, including preparation and testing for the GED, ABE, computer courses, college-level courses and access to libraries,
- Vocational training,

- Individual, group and family counseling and therapy, cognitive behavior therapy and stress and anger management instruction,
- Life skills training, including hygiene, personal finance, housing issues, and parenting skills, and
- Municipal jail management.

Facilities

At December 31, 2008, we operated 68 facilities and had one vacant facility. In addition to providing management services, we develop, design and/or construct many of our facilities.

Either through outright ownership or long-term leases, we control operating facilities representing a large majority of our revenues. We believe that such control increases the likelihood of contract renewal, allows us to expand existing facilities and thereby realize economies of scale, and enhances our ability to win new contracts and control repair costs. In addition, we believe that long-term control of our operating facilities allows us to better manage cost-escalation pressures.

The following table summarizes certain additional information with respect to our facilities as of December 31, 2008. As indicated, the majority of the facilities at which we provide services are either owned or leased under long-term leases, which are generally under terms ranging from one to 45 years.

Facility Name and Location	Total Service Capacity (1)	Initial Contract Date (2)	Company Owned, Leased or Managed (3)
<i>Adult Secure Services Facilities:</i>			
<i>Residential Facilities</i>			
Baker Community Correctional Facility			
Baker, California.....	262	1987	Owned
Big Spring Correctional Center			
Big Spring, Texas	3,509	1989	Leased (4)
D. Ray James Prison			
Folkston, Georgia	2,170	1998	Leased (4)
Great Plains Correctional Facility			
Hinton, Oklahoma.....	2,048	2007	Leased (4)
High Plains Correctional Facility			
Brush, Colorado	272	2007	Owned
Leo Chesney Community Correctional Facility			
Live Oak, California	305	1988	Leased
Mesa Verde Community Correctional Facility			
Bakersfield, California.....	360	2006	Leased
Moshannon Valley Correctional Center			
Philipsburg, Pennsylvania.....	1,495	2006	Owned
Regional Correctional Center			
Albuquerque, New Mexico	970	2004 (5)	Leased
Walnut Grove Youth Correctional Facility			
Walnut Grove, Mississippi	1,450	2004	Managed
<i>Abraxas Youth and Family Services Facilities:</i>			
<i>Residential Facilities</i>			
Contact			
Wauconda, Illinois	51	(6)	Owned
Cornell Abraxas Academy			
New Morgan, Pennsylvania	214	2006	Owned
Cornell Abraxas I			
Marienville, Pennsylvania	274	1973	Leased (4)
Cornell Abraxas II			
Erie, Pennsylvania	23	1974	Owned
Cornell Abraxas III			
Pittsburgh, Pennsylvania.....	24	1975	Owned
Cornell Abraxas Center for Adolescent Females			
Pittsburgh, Pennsylvania.....	108	1989	Owned
Cornell Abraxas of Ohio			
Shelby, Ohio	108	1993	Leased (4)
Cornell Abraxas Youth Center			
South Mountain, Pennsylvania	72	1999	Leased

***Abraxas Youth and Family Services Facilities:
Residential Facilities (Continued)***

DuPage Adolescent Center Hinsdale, Illinois.....	38	(6)	Owned
Erie Residential Behavioral Health Program Erie, Pennsylvania	17	1999	Owned
Hector Garza Residential Treatment Center San Antonio, Texas.....	122	2007 (7)	Leased (4)
Leadership Development Program South Mountain, Pennsylvania	120	1994	Leased
Psychosocial Rehabilitation Unit Erie, Pennsylvania	13	1994	Owned
Schaffner Youth Center Steelton, Pennsylvania.....	63	2001	Managed
Southern Peaks Regional Treatment Center Canon City, Colorado	160	2004	Owned
Texas Adolescent Treatment Center San Antonio, Texas.....	124	2003	Owned
Washington Facility Washington, D.C.	70	(8)	Owned
Woodridge Woodridge, Illinois.....	122	(6)	Owned

***Abraxas Youth and Family Services Facilities:
Non-Residential Facilities***

Delaware Community-Based Programs Milford, Delaware.....	66	1994	Leased
Harrisburg Day Treatment Harrisburg, Pennsylvania.....	45	1996	Leased
Lebanon Alternative Education Lebanon, Pennsylvania	225	2004	Managed
Lehigh Valley Community-Based Programs Lehigh Valley, Pennsylvania	60	1992	Leased
Non-Residential Detention/Non-Residential Treatment Harrisburg, Pennsylvania.....	91	1999	Leased
Philadelphia Alternative Education Philadelphia, Pennsylvania	165	2004	Managed
Philadelphia Community-Based Programs Philadelphia, Pennsylvania	71	1992	Owned
State Reintegration Program Harrisburg, Pennsylvania.....	225	1991	Managed
WorkBridge Pittsburgh, Pennsylvania.....	600	1994	Leased
York County Community Programs Harrisburg, Pennsylvania.....	36	1999	Leased

Adult Community-Based Services Facilities:
Residential Facilities.....

Beaumont Transitional Treatment Center Beaumont, Texas	180	2002	Owned
Cordova Center Anchorage, Alaska.....	192	1985	Leased (4)
Dallas County Judicial Treatment Center Wilmer, Texas.....	300	1991	Managed
El Monte Center El Monte, California	55	1993	Leased
Grossman Center Leavenworth, Kansas.....	150	2002	Leased
Las Vegas Community Correctional Center Las Vegas, Nevada	100	2004	Owned
Leidel Comprehensive Sanction Center Houston, Texas	190	1996	Leased (4)
Los Angeles County Jails (9) Los Angeles Metropolitan Area, California.....	264	(9)	Managed
Marvin Gardens Center Los Angeles, California	52	1981	Leased
McCabe Center Austin, Texas	90	1999	Owned
Mid Valley House Edinburg, Texas	96	1998	Leased
Midtown Center Anchorage, Alaska.....	32	1998	Owned
Northstar Center Fairbanks, Alaska	135	1990	Leased
Oakland Center Oakland, California.....	61	1981	Owned
Parkview Center Anchorage, Alaska.....	112	1993	Leased (4)
Reality House Brownsville, Texas	66	1998	Owned
Reid Community Residential Facility Houston, Texas	500	1996	Leased (4)
Salt Lake City Center Salt Lake City, Utah	78	1995	Leased
Seaside Center Nome, Alaska	48	1999	Leased
Taylor Street Center San Francisco, California.....	177	1984	Owned
Tundra Center Bethel, Alaska.....	85	1986	Leased (4)

Adult Community-Based Services Facilities:**Non-Residential Facilities**

East St. Louis East			
St. Louis, Illinois.....	164	(6)	Leased
LifeWorks			
Joliet, Illinois	116	(6)	Leased
Southwood			
Chicago, Illinois.....	554	(6)	Owned

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- (1) Residential service capacity is comprised of the number of beds currently available for service in our residential facilities. Non-residential service capacity is based on either contractual terms or our estimate of the number of clients to be served. We update these estimates at least annually based on the program's budget and other factors.
 - (2) Date from which we, or our predecessor, have had a contract for services on an uninterrupted basis.
 - (3) We do not incur any facility use costs, such as debt service, rent or depreciation for facilities that we operate under a management contract only; however, we are responsible for all other facility operating costs at these managed facilities.
 - (4) Facility was sold in August 2001 to Municipal Corrections Finance, L.P. ("MCF") as part of the 2001 Sale and Leaseback Transaction as discussed in "Note 11 — Derivative Financial Instruments and Guarantees" of the "Notes to Consolidated Financial Statements" in Item 8 of this Form 10-K.
 - (5) We lease the Regional Correctional Center from Bernalillo County, New Mexico. The lease commenced in January 2003 and we renovated the facility in 2003 and 2004. The facility commenced operations in July 2004 and the lease runs to June 2009, and we have five one-year renewal options. Refer to Item 7 — "Management's Discussion and Analysis of Financial Condition and Results of Operations - Significant 2008 Events — Regional Correctional Center" of this report for further discussion concerning this facility.
 - (6) These facilities are operated pursuant to the Cornell Interventions programs/facilities contract with numerous agencies throughout Illinois. Initial contract dates vary by agency and range from 1974 to 1997.
 - (7) We closed the Hector Garza Residential Treatment Center in the fourth quarter of 2005 and subsequently reactivated the facility in August 2007. Refer to Item 7 — "Management's Discussion and Analysis of Financial Condition and Results of Operations — Contractual Uncertainties Related to Certain Facilities — Hector Garza Residential Treatment Center" of this report for further discussion concerning this facility.
 - (8) We closed the formerly leased Washington D.C. Facility in 2005 (we acquired the facility in September 2007) and are currently considering several options for use, including the operation of a new program.
 - (9) Los Angeles County Jails represents eight individual locations in Los Angeles County, California and the surrounding area. Initial contract dates vary by agency and range from 1994 to 2008.

Marketing and Business Development

Our principal customers are federal, state and local government agencies responsible for adult and juvenile corrections, treatment and educational services. We manage our business development efforts to address opportunities available in all of our divisions and potential markets. While such opportunities necessarily include forming relationships with new customers, we also believe that further potential lies in the management of our existing relationships through improved bed management (including both utilization and customer mix) and through enhancements of our contract terms. From time to time, we will also evaluate opportunities for accretive acquisition.

In most instances, we pursue development opportunities through Requests for Proposal (“RFPs”) or Requests for Qualifications (“RFQs”), which are submitted in response to government agencies’ solicitations for bids. The decision to respond to such solicitations is based upon several factors, including management’s assessment of customer needs, our ability to service the needs in an operationally successful and acceptably profitable manner, and the fit of the potential program within our existing portfolio and strategic objectives. The solicitations generally require the bidder to demonstrate relevant operational experience. Furthermore, the response must also include descriptions of the services to be provided by the bidder and the price at which the bidder is willing to provide them. Services can include not only direct care, but also the design, construction, or renovation of the related facility.

If we believe a project described in an RFP is consistent with our strategic business plan, we will submit a proposal to the requesting agency. When responding to RFPs, we typically incur costs ranging from \$10,000 to \$100,000 per proposal. In addition, we could incur substantial costs to acquire options to lease or purchase land for a proposed facility or to lease or purchase an existing building to house a program. The preparation of a response usually requires four to 12 weeks. The award process usually takes an additional three to nine months. If new construction is required by the contract, the selected company’s operation of the facility generally begins between nine and 18 months following award announcement, although in some cases as early as four months. In instances where construction is required, our success depends, in part, upon our ability to acquire property that is not only satisfactory for programmatic needs but also that lies in a community where social opposition does not significantly impede our ability to operate. We may incur significant expenses in responding to such opposition, and our response may not be successful. In addition, we may choose not to respond to an RFP or may withdraw a submitted proposal if significant legal action or other forms of opposition are anticipated or encountered.

In addition to responding to RFPs, we also rely upon court-referrals, insurance- or managed care-referrals, and self-referrals for business growth, particularly in our juvenile and adult community-based treatment programs. In such instances, court and community liaisons play a significant role in developing our growing network of clients.

Contracts

Our facility operating contracts generally provide that we will be compensated via an occupant per diem rate, fees for treatment services, guaranteed take-or-pay terms, a fixed fee, or cost-plus reimbursement. Factors we consider in determining billing rates include (1) the specified programs provided for by the contract and the related staffing levels, (2) wage levels customary in the respective geographic area, (3) whether the proposed facility is to be leased or purchased, and (4) the anticipated average occupancy levels that we believe could reasonably be maintained (and the ramp up schedule required to reach stable populations). Compensation is invoiced in accordance with the applicable contract and is typically paid on a monthly basis. Some of our juvenile education contracts provide for annual payments.

We pursue new contracts that leverage our existing infrastructure and capabilities. A significant portion of our opportunities are contracts producing revenue that varies with the number of individuals housed or served, the types of services provided and/or the frequency of the service. The balance of our contracts are take-or-pay contracts, which provide a fixed minimum revenue stream regardless of occupancy.

Competition

Because our services encompass several diverse markets, we view our competition within these separate markets. We believe our principal non-governmental competitors in the Adult Secure market are Corrections Corporation of America, Inc., The Geo Group, Inc., and Management and Training Corporation. Within our two other segments — Abraxas Youth and Family Services and Adult Community-Based Services — we typically encounter a significantly more fragmented competitor base, which includes not only for-profit operators like ourselves but also not-for-profit organizations. Within the Abraxas Youth and Family Services division, some of our primary non-governmental competitors include ViaQuest, Youth and Family Centered Services, Securicor New Century and Ramsay Youth Services. Our larger non-governmental competitors in the adult community-based market include Dismas House, Bannum, Gateway, Salvation Army and Volunteers of America.

Employees

At December 31, 2008, we had 4,109 full-time employees and 300 part-time employees. We employ management, administrative and clerical, security, educational and counseling services, health services and general maintenance personnel. Approximately 828 employees at four of our facilities are represented by labor unions.

Regulations

The industry in which we operate is subject to federal, state and local regulations administered by a variety of regulatory authorities. Generally, prospective providers of correctional, detention, educational, treatment and community-based services must comply with a variety of applicable federal, state and local regulations, including correctional, education, healthcare, environmental and safety regulations. Our contracts frequently include extensive reporting requirements, including mandatory supervision with on-site monitoring by representatives of our contracting government agencies, as well as audits by these and other governmental departments.

In addition to regulations requiring certain contracting government agencies to enter into a competitive bidding procedure before awarding contracts, the laws of certain jurisdictions may also require us to award subcontracts on a competitive basis or to subcontract with businesses owned by women or members of minority groups.

Business Concentration

For the years ended December 31, 2008, 2007 and 2006, 34.2%, 32.6% and 29.1%, respectively, of our consolidated revenues were derived from multiple contracts with the BOP. No other single customer makes up greater than 10% of our consolidated revenues for these years.

Insurance

We maintain general liability insurance for all of our operations at an amount equal to \$10 million per occurrence per facility and in the aggregate. We also maintain insurance in amounts management deems adequate to cover property and casualty risks, workers' compensation, and directors' and officers' liability.

Our contracts and the statutes of certain states in which we operate typically require us to maintain insurance. Our contracts provide that, in the event we do not maintain such insurance, the contracting agency may terminate its agreement with us. We believe that we are in compliance in all material respects with these requirements.

Environmental Matters

We are subject to various federal, state, and local environmental laws and regulations, and these laws can impose strict liability for the discharge of hazardous or toxic substances. As an owner and operator of facilities, we are subject to these laws and could be responsible for the discharge of contaminants at our facilities. We are not currently incurring material costs associated with environmental compliance or remediation, although in the event we had an environmental issue at any of our current or previously-owned facilities, the cost of complying with these environmental laws could materially adversely affect our financial condition and results of operations.

ITEM 1A. RISK FACTORS

Our significant level of indebtedness could adversely affect our financial condition.

We have a significant amount of indebtedness. Our total consolidated indebtedness as of December 31, 2008 was approximately \$320.5 million. Our ability to make scheduled payments or to refinance our debt obligations depends on our financial and operating performance, which is subject to prevailing economic and competitive conditions and to certain other financial, business and other factors beyond our control. We cannot assure you that we will maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest and additional interest, if any, on our indebtedness. We may need to reduce or delay capital expenditures, sell assets, seek additional capital or restructure or refinance all or a portion of our indebtedness on or before maturity. However, we may not be able to complete these alternative measures on commercially reasonable terms or at all. Additionally, a significant portion of our assets is owned, and a significant percentage of our revenue is generated, by our subsidiaries. Our cash flows and our ability to repay our indebtedness depends upon the performance of these subsidiaries and their ability to make distributions. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

Certain of our borrowings, including any borrowings under our Amended Credit Facility, will be at variable rates of interest and expose us to interest rate risk. If interest rates increase, our debt service obligations on the variable rate indebtedness would increase even though the amount borrowed remained the same, and our net income would decrease.

The volatility and disruption of the capital and credit markets and adverse changes in the economy may negatively impact our ability to access financing, revenues and earnings.

The capital and credit markets have been experiencing extreme volatility and disruption for more than twelve months. Since the third quarter of 2008 and continuing through the first quarter of 2009, the volatility and disruption have reached unprecedented levels. The markets have exerted downward pressure on availability of liquidity and credit capacity for many issuers, including us. While we intend to finance our operations with existing cash, cash flow from operations and borrowing under our Amended Credit Facility, we may require additional financing to support our continued growth. However, due to the existing uncertainty in the capital and credit markets, access to capital, including capital through the accordion feature of our Amended Credit Facility, on terms acceptable to us may be limited or unavailable.

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. We can provide no assurance that all of the banks that have made commitments to us under our revolving credit facility will continue to operate as a going concern in the future or that such banks would be willing to participate in an expansion to the Amended Credit Facility in the event the Company desires to exercise the accordion feature of the Amended Credit Facility.

If any of the banks in the lending group were to fail or decline to participate in the expansion of the credit facility under the accordion feature, it is possible that the capacity under the revolving credit facility would not be expanded by the full amount that might be requested by us under the accordion feature and might even be reduced to below the existing committed availability. In the event that we could not obtain an increased commitment by virtue of the accordion feature of the Amended Credit Facility, we could be required to obtain capital from alternate sources in order to continue our growth through future 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 terms of the Amended Credit Facility, or its accordion feature, (ii) accessing the public capital markets, or (iii) delaying certain of the Company's planned expansion 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.

The restrictive covenants in our Senior Notes and Amended Credit Facility may affect our ability to operate our business successfully.

The indenture governing our Senior Notes and our Amended Credit Facility contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit our ability to, among other things: incur additional debt; pay dividends or other distributions; make certain types of investments; incur liens; restrict distributions from our subsidiaries; enter into transactions with affiliates; and consolidate or merge with or into, or sell substantially all of our assets to, another.

In addition, our Amended Credit Facility requires us to maintain specified financial ratios. Any failure to comply with the restrictions of our Amended Credit Facility and the indenture governing our Senior Notes or any other subsequent financing agreements may result in an event of default. An event of default may allow the creditors to accelerate the related debt as well as any other debt to which a cross-acceleration or cross-default provision applies and terminate all commitments to extend further credit. Furthermore, we have pledged a significant portion of our assets as collateral under our Amended Credit Facility. If we default on the financial covenants in our Amended Credit Facility, our lenders could proceed against the collateral granted to them to secure that indebtedness, which would have a material adverse effect on our business, results of operation and financial condition.

Despite current indebtedness levels, we may still be able to incur substantially more debt. This could further exacerbate the risks described above.

The terms of the indenture governing our Senior Notes and our Amended Credit Facility restrict our ability to incur but do not prohibit us from incurring significant additional indebtedness in the future. We have several ongoing expansion projects underway and anticipate commencing other projects, and we will likely need to finance these future outlays of capital since our cash on hand and cash flows from operations will not be sufficient to fully fund all of these potential

expenditures. Depending on market conditions and other factors, we will consider additional debt financing to fund these outlays of capital as well as to refinance a portion of our existing indebtedness. If new indebtedness is added to our and our subsidiaries' current debt levels, the related risks that we and they now face could intensify.

We are dependent on government appropriations, which may not be made on a timely basis or at all and may be adversely impacted by budgetary constraints at the federal, state and local levels.

Our cash flow is subject to the receipt of sufficient funding of and timely payment by contracting governmental entities. If the appropriate governmental agency does not receive sufficient appropriations to cover its contractual obligations, a contract may be terminated or the amounts payable to us may be deferred or reduced. Also, we are dependent upon funding for anticipated future contracts, including those for certain facility expansions and new construction projects that we have undertaken, such as those at D. Ray James and Hudson, Colorado.

Federal, state, county and local governments have encountered, and are expected to continue to encounter, significant budgetary constraints that may result in a reduction of spending on the outsourced services that we provide. Such budgetary limitations may cause the contractual commitments to be reduced or even eliminated, which would make it unprofitable to continue operating a certain facility and require us to find alternate customers or close such facility. Any delays in payment, or the termination of a contract, could have a material adverse effect on our cash flow and financial condition, which may make it difficult to satisfy our payment obligations on our indebtedness, including the Amended Credit Facility, in a timely manner.

In addition, as a result of, among other things, recent economic developments, federal, state and local governments have encountered, and may continue to encounter, unusual budgetary constraints. As a result, a number of state and local governments are under pressure to control additional spending or reduce current levels of spending which could limit or eliminate appropriations for the facilities that we operate. Additionally, as a result of these factors, we may be requested in the future to reduce our existing per diem contract rates or forego prospective increases to those rates. Budgetary limitations may also make it more difficult for us to renew our existing contracts on favorable terms or at all. Further, a number of states in which we operate are experiencing significant budget deficits for fiscal year 2009. We cannot assure that these deficits will not result in reductions in per diems, delays in payment for services rendered or unilateral termination of contracts. Recently, the State of California has notified vendors providing services to the state that it might have to temporarily issue IOU's. We have not received notice that our services will be subject to such IOU's and our outstanding receivables related to California are consistent with normal payment practices for the State.

As a result of this increased budgetary pressure, in certain cases we have granted a few of our customers relief from formulaic increase provisions in their agreements and some of our customers have not included in their appropriation legislation amounts that would increase the per diem rates payable to us or have otherwise attempted to reduce the contract value. Contractual rate increases are generally intended to offset increases in expenses and inflation. To the extent rates are not increased or are reduced, our profitability will be adversely affected. Examples of this budget pressure include the need of the federal government to operate under a continuing resolution as a result of its failure to pass a new 2008/2009 year budget and reported budget pressures in most states including Alaska, Arizona, California, Colorado, Georgia, Illinois, Pennsylvania and Texas.

We are subject to the short-term nature of government contracts.

Many governmental agencies are legally limited in their ability to enter into fixed long-term contracts that would bind elected officials responsible for future budgets. Therefore, many contracts with government agencies, including the BOP, typically either have a very short term or, even when for a longer term, are subject to termination on short notice without cause. The majority of our contracts have primary terms of one to three years. Our contracts with governmental agencies may contain one or more renewal options that may be exercised only by the contracting governmental agency. Some of these contracts may not be renewed by the governmental agency and no assurance can be given that the governmental agency will exercise a renewal option in the future. In addition, the governmental agency may elect to solicit bids pursuant to a RFP or RFQ rather than exercise a renewal option. We may not be successful in responding to a RFP or RFQ.

The non-renewal or termination of any of our significant contracts with governmental agencies, our inability to secure new facility management contracts from others or our failure to successfully respond to a RFP or RFQ could materially adversely affect our financial condition, results of operation and liquidity. To the extent we have made significant capital expenditures and have short-term contracts with our customers that are not renewed or extended, we may not recover our entire capital investment.

Our ability to win new contracts to develop and manage correctional, detention and treatment facilities depends on many factors outside our control.

Our growth is generally dependent upon our ability to win new contracts to develop and manage new or expanded correctional, detention and treatment facilities. This depends on a number of factors we cannot control, including crime rates and sentencing patterns in various jurisdictions. Accordingly, the demand for our facilities could be adversely affected by the relaxation of enforcement efforts, leniency in conviction and sentencing practices or through the legal decriminalization of certain activities that are currently proscribed by criminal laws. For instance, changes in laws relating to drugs and controlled substances or illegal immigration could reduce the number of persons arrested, convicted and sentenced, thereby potentially reducing demand for correctional facilities to house them and community-based services to transition offenders back into the community. Similarly, reductions in crime rates could lead to reductions in arrests, convictions and sentences requiring correctional facilities.

When seeking bids, most governmental entities evaluate the financial strength of the bidders. To the extent they believe we do not have sufficient financial resources, we will be unable to effectively compete for bids. Additionally, our success in obtaining new awards and contracts may depend, in part, upon our ability to locate land that can be leased or acquired on favorable terms. Furthermore, desirable locations may be in or near populated areas and, therefore, may generate legal action or other forms of opposition from residents in areas surrounding a proposed site.

Our profitability may suffer if the number of offenders occupying our correctional, detention and treatment facilities decreases or there is a shift in occupancy among our divisions.

Our correctional, detention and treatment facilities are dependent upon governmental agencies supplying offenders and we do not control occupancy levels at our facilities. We believe the rate of growth experienced in the adult secure sector during the late 1980s and early 1990s is stabilizing.

Historically, a substantial portion of our revenues has been generated under contracts that specify a net rate per day per resident, or a per diem rate, sometimes with no minimum guaranteed occupancy levels, even though most correctional facility cost structures are relatively fixed. Under such a per diem rate structure, a decrease in occupancy levels at a particular facility could have a material adverse effect on the financial condition and results of operations at such facility. A decrease in the occupancy of certain juvenile justice, education and treatment facilities would have a more significant impact on our operating results than a decrease in occupancy in the Adult Secure division due to higher per diem revenue at certain juvenile facilities.

Certain social commentators and various political or governmental representatives suggest that community-based corrections of adults may be emphasized in the future as alternatives to traditional incarceration. We have historically experienced higher operating margins in the Adult Secure and the Adult Community-Based sectors than in the juvenile services sector. A shift in occupancy among our segments of business operations could result in a decrease in our profitability.

A failure to comply with existing regulations could result in material penalties or non-renewal or termination of our contracts.

Our industry is subject to a variety of federal, state, county and local regulations, including education, environmental, health care and safety regulations, which are administered by various regulatory authorities. We may not always successfully comply with these regulations, and failure to comply could result in material penalties or non-renewal or termination of facility management contracts. The contracts typically include extensive reporting requirements and supervision and on-site monitoring by representatives of contracting governmental agencies. Corrections officers are customarily required to meet certain training standards, and in some instances facility personnel are required to be licensed and subject to background investigation. Certain jurisdictions also require that subcontracts be awarded on a competitive basis or that we subcontract with businesses owned by members of minority groups. The failure to comply with any applicable laws, rules or regulations and the loss of any required license could adversely affect the financial condition and results of operations at our affected facilities.

Governmental agencies may investigate and audit our contracts and, if any improprieties are found, we may be required to refund revenues we have received, and/or to forego anticipated revenues and may be subject to penalties and sanctions, including prohibitions on our bidding in response to RFPs.

Governmental agencies we contract with have the authority to audit and investigate our contracts with them. As part of that process, some governmental agencies review our performance on the contract, our pricing practices, our cost structure and our compliance with applicable laws, regulations and standards. If the agency determines that we have improperly allocated costs to a specific contract, we may not be reimbursed for those costs and we could be required to refund the amount of any such costs that have been reimbursed. If a government audit uncovers improper or illegal activities by us or we otherwise determine that these activities have occurred, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeitures of profits, suspension of payments, fines and suspension or disqualification from doing business with the government. Any adverse determination could adversely impact our ability to bid in response to RFPs in one or more jurisdictions and significantly reduce the probability of our success in the bid process for future contracts.

If we fail to satisfy our contractual obligations, our ability to compete for future contracts and our financial condition may be adversely affected.

Our failure to comply with contract requirements or to meet our client's performance expectations when performing a contract could materially and adversely affect our financial performance and our reputation, which, in turn, would impact our ability to compete for new contracts. Our failure to meet contractual obligations could also result in substantial actual and consequential damages. In addition, our contracts often require us to indemnify clients for our failure to meet performance standards. Some of our contracts contain liquidated damages provisions and financial penalties related to performance failures. Although we have liability insurance, the policy limits may not be adequate to provide protection against all potential liabilities.

Competitors in our industry may adversely affect the profitability of our business.

We must compete with government entities and other private operators on the basis of cost, quality and range of services offered, experience in managing facilities, reputation of personnel and ability to design, finance and construct new facilities on a cost effective competitive basis. While there are some barriers for companies seeking to enter into the management and operation of correctional, detention and treatment facilities, these barriers have not been sufficient to materially limit additional competition. Certain areas of our operation may not pose a significant barrier to entry into the market by private operators. For example, private operators may not find it as difficult to bid for juvenile treatment, educational and detention services and pre-release correctional and treatment services as they do adult correctional and detention services.

Further, our government customers may assume the management of a facility currently managed by us upon the termination of the corresponding management contract or, if such customers have capacity at their facilities, may take inmates currently housed in our facilities and transfer them to government run facilities. The resulting decrease in occupancy levels would reduce our revenue due to the per diem rate structure and could result in a significant decrease in the profitability of our business.

A disturbance or violent occurrence in one of our facilities could result in closure of a facility or harm to our business.

An escape, riot, disturbance or violent occurrence at one of our facilities could adversely affect the financial condition, results of operations and liquidity of our operations. Among other things, the negative publicity generated as a result of an event could adversely affect our ability to retain an existing contract or obtain future ones. In addition, if such an event were to occur, there is a possibility that the facility where the event occurred may be shut down by the relevant governmental agency. A closure of certain of our facilities could adversely affect the financial condition, results of operations and liquidity of our operations. Such negative events (including an occurrence at a competitor's facility) may also result in a significant increase in our liability insurance costs.

Negative media coverage, including inaccurate or misleading information, could adversely affect our reputation and our ability to bid for government contracts.

The media frequently focuses its attention on private operators' contracts with governmental agencies. If the media coverage of private operators is negative, it could influence government officials to slow the pace of outsourcing government services, which could reduce the number of RFPs. The media may also focus its attention on the activities of political consultants engaged by us, even when their activities are unrelated to our business, and we may be tainted by adverse media

coverage about their activities. Moreover, inaccurate, misleading or negative media coverage about us could harm our reputation and, accordingly, our ability to bid for and win government contracts.

We often incur significant costs before receiving related revenues, which could result in cash shortfalls and a risk of not recovering our investment.

When we are awarded a contract to manage a new facility, we may incur significant expenses before we receive contract payments. These expenses include purchasing real estate, constructing new facilities, leasing office space, purchasing office equipment and hiring and training personnel. As a result, when the government does not fund a facility's pre-opening and start-up costs, we may be required to invest significant sums of money before receiving related contract payments. In addition, payments due to us from governmental agencies may be delayed due to billing cycles or as a result of failures by our governmental customers to attain necessary budget approvals and finalize contracts in a timely manner. Several juvenile services contracts related to educational services provide for annual collection several months after a school year is completed. In addition, a contract may be terminated prior to its scheduled expiration and as a result we may not recover these expenses or realize any return on our investment.

We may choose to undertake development projects without written commitments to make use of such facilities. We may not be able to obtain contracts for these facilities in a timely fashion, if at all. To the extent we do not obtain contracts, we could be unable to recover our investment and our financial condition and results of operations would be adversely affected.

We may be unable to attract and retain sufficient qualified personnel necessary to sustain our business.

Our delivery of services is labor-intensive. When we are awarded a contract, we must hire operating management, security, case management and other personnel. The success of our business requires that we attract, develop, motivate and retain these personnel. Our ability to recruit and retain qualified individuals varies by facility and is related to the socio-economic factors in the particular community in which the facility operates. The Department of Labor wages we offer our employees are often higher than wages they could obtain elsewhere in the community. However, if the local economy where a facility is located is robust and unemployment is low, we may have difficulty hiring and retaining qualified personnel. In addition, there are inherent risks associated with the nature of the services we provide, which could cause certain qualified individuals to seek other employment opportunities. We have typically experienced high turnover of personnel in our juvenile and adult secure facilities within the first year of their employment. Our inability to hire sufficient personnel on a timely basis or the loss of significant numbers of personnel could adversely affect our business.

If we do not successfully integrate the businesses that we acquire, our results of operations could be adversely affected.

We may be unable to manage businesses that we may acquire profitably or integrate them successfully without incurring substantial expenses, delays or other problems that could negatively impact our results of operations. Acquisitions generally require the integration of facilities, some of which may be located in states in which we do not currently have operations.

Moreover, business combinations involve additional risks, including:

- diversion of management's attention;
- loss of key personnel;
- assumption of unanticipated legal or financial liabilities;
- our becoming significantly leveraged as a result of the incurrence of debt to finance an acquisition;
- unanticipated operating, accounting or management difficulties in connection with the acquired entities;
- amortization or possible impairment charges of acquired intangible assets, including goodwill; and
- dilution to our earnings per share.

Also, client dissatisfaction or performance problems with an acquired business could materially and adversely affect our reputation as a whole. Further, the acquired businesses may not achieve the revenues and earnings we anticipated.

Because environmental laws impose strict, as well as joint and several, liability for clean up costs, unforeseen environmental risks could prove to be costly.

Our facilities, and any facilities that we may acquire in the future, may be subject to unforeseen environmental risks. The federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) imposes strict, as well as joint and several, liability for certain environmental cleanup costs on several classes of potentially responsible parties, including current owners and operators of the property. Other federal and state laws in certain circumstances may impose

liability for environmental remediation, which costs may be substantial. Further, the operation of our facilities, and the development of new facilities, requires that we obtain, and comply with, permits and other authorizations under environmental laws. Obtaining such permits and authorizations may affect our existing facilities or could delay the opening of new facilities, which could have a material adverse effect on our business and results of operations.

We have in the past incurred, and may continue to incur, significant expenses for facilities that we no longer operate.

If we close a facility, we may remain committed to perform our obligations under the applicable lease, which would include, among other things, payment of the base rent for the balance of the lease term. We may also be required to incur other expenses with respect to such facilities. The potential losses associated with our inability to cancel leases may result in our keeping open underperforming facilities. As a result, ongoing lease operations at closed or under-performing facilities could impair our results of operations.

We may continue to operate under unprofitable contracts at facilities that we own to offset expenses associated with ownership of the facility.

If our operations are unprofitable at a leased facility or if the leased facility is performing significantly below targeted levels, we would typically terminate the contract and the lease. However, we may continue to operate our contract at an owned facility to offset the expenses associated with ownership. Continued performance of such a contract could have a material adverse effect on our business and results of operations.

We depend on a limited number of governmental customers for a significant portion of our revenues.

We currently derive, and expect to continue to derive, a significant portion of our revenues from the BOP and various state agencies. The loss of, or a significant decrease in, business from the BOP or those state agencies could seriously harm our financial condition and results of operations. Our BOP contracts accounted for approximately 34.2% of our total revenues for the year ended December 31, 2008 (\$132.3 million), 32.6% of our total revenues for the year ended December 31, 2007 (\$117.5 million) and 29.1% of our total revenues for the year ended December 31, 2006 (\$105.1 million). We expect to continue to depend upon the BOP and a relatively small group of other governmental customers for a significant percentage of our revenues.

Because our revenues can fluctuate from period to period, we may face short-term funding shortfalls from time to time.

Revenues can fluctuate from year to year due to changes in government funding policies, changes in the number of clients referred to our facilities by governmental agencies, the opening of new facilities or the expansion of existing facilities and the termination of contracts for a facility or the closure of a facility. Our revenues fluctuate from quarter to quarter, based on the number of contracted days in each quarter. Because our revenues can vary, we may face short-term funding shortfalls from time to time. In addition, full-year results are not likely to be a direct multiple of any particular quarter or combination of quarters.

Resistance to privatization of correctional and detention facilities could result in our inability to obtain new contracts or the loss of existing contracts.

Management of correctional and detention facilities, particularly of adult secure facilities, by private entities has not achieved complete acceptance by either the government or the public. The movement toward privatization of correctional and detention facilities has also encountered resistance from certain groups, such as labor unions, local sheriff's departments, religious organizations and groups believing that correctional and detention facility operations should only be conducted by government agencies. Changes in the dominant political party in any market in which correctional facilities are located could have an adverse impact on privatization. Furthermore, some government agencies are not legally permitted to delegate their traditional management responsibilities for correctional and detention facilities to private companies.

In addition, as a private prison manager, we are subject to government legislation and regulation restricting the ability of private prison managers to house certain types of inmates, such as inmates from other jurisdictions or inmates at medium or higher security levels. Legislation has been enacted in several states, and has previously been proposed in the United States House of Representatives, containing such restrictions. Any such legislation may have a material adverse effect on us.

Any of these resistances may make it more difficult for us to renew or maintain existing contracts, to obtain new contracts or sites on which to operate new facilities or to develop or purchase facilities and lease them to government or private entities, any or all of which could have a material adverse effect on our business.

We are subject to significant insurance costs.

Worker's compensation, employee health and general liability insurance represent significant costs to us. We may continue to incur increasing insurance costs, typically due to adverse claims experience or rising healthcare costs in general. Due to concerns over corporate governance and recent corporate accounting scandals, liability and other types of insurance have become more difficult and costly to obtain. In addition, stockholder lawsuits will generally serve to increase our directors' and officers' liability insurance. Unanticipated additional insurance costs could adversely impact our results of operations and cash flows, and the failure to obtain or maintain any necessary insurance coverage or the inability of an insurance carrier to perform under its obligations through issued coverage could have a material adverse effect on us.

We are subject to risks associated with ownership of real estate and related operation of our facilities.

Our ownership of correctional and detention facilities subjects us to risks typically associated with investments in real estate. Moreover, correctional and detention facilities are relatively illiquid and therefore, our ability to divest ourselves of one or more of our facilities promptly in response to changed conditions is limited. Investments in correctional and detention facilities subject us to risks involving potential exposure to uninsured loss. Our operating costs may be affected by the obligation to pay for the cost of complying with existing laws, ordinances and regulations, as well as the cost of complying with future legislation. Our facilities are also subject to hazards such as fire, hurricanes, earthquakes and other natural disasters. For example, Hurricane Ike that came ashore in Texas in September 2008 damaged our Beaumont Transitional Treatment Center, Leidel Comprehensive Sanction Center and Reid Community Residential Facility. See Item 7- "Management's Discussion and Analysis of Financial Condition and Results of Operations—Significant 2008 Events." In addition, although we maintain insurance for many types of losses, there are certain types of losses, such as losses from earthquakes, riots and acts of terrorism, which may be either uninsurable or for which it may not be economically feasible to obtain insurance coverage. As a result, we could lose both our capital invested in, and anticipated profits from, one or more of the facilities we own. Further, we could experience losses that may exceed the limits of our insurance coverage.

We may be adversely affected by inflation.

Many of our facility management contracts provide for fixed management fees or fees that increase by only small amounts during their term. If, due to inflation or other causes, our operating expenses, such as wages and salaries of our employees, and insurance, medical and food costs, increase at rates faster than increases, if any, in our management fees, then our profitability would be adversely affected.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

We lease office space for our corporate headquarters in Houston, Texas and a regional administrative office in Pittsburgh, Pennsylvania. We also lease various facilities we are currently operating or developing. For a listing of owned, leased and managed facilities, see "Business - Facilities" in Item 1 of this report.

ITEM 3. LEGAL PROCEEDINGS

We are party to various legal proceedings, including those noted below. While management presently believes that the ultimate outcome of these proceedings will not have a material adverse effect on our financial position, overall trends in results of operations or cash flows, litigation is subject to inherent uncertainties, and unfavorable rulings could occur. An unfavorable ruling could include monetary damages or equitable relief, and could have a material adverse impact on the net income of the period in which the ruling occurs.

Valencia County Detention Center

In April 2007, a lawsuit was filed against the Company in the Federal District Court in Albuquerque, New Mexico, by Joe Torres and Eufasio Armijo, who each alleged that he was strip searched at the Valencia County Detention Center ("VCDC") in New Mexico in violation of his federal rights under the Fourth, Fourteenth and Eighth amendments to the U.S. Constitution. The claimants also alleged violation of their rights under state law and sought to bring the case as a class action on behalf of themselves and all detainees at VCDC during the applicable statutes of limitation. The plaintiffs sought

damages and declaratory and injunctive relief. Valencia County is also a named defendant in the case and operated the VCDC for a significantly greater portion of the period covered by the lawsuit.

In December 2008, the parties agreed to a proposed stipulation of settlement and the Court has preliminarily approved the settlement. The settlement amount under the terms of the agreement is \$3.3 million. Cornell's portion of the stipulated settlement, based on the number of inmates housed at VCDC during the time Cornell operated the facility in comparison to the number of inmates housed at the facility during the time Valencia County operated the facility, is \$1.2 million and was funded principally through our general liability and professional liability coverage.

In the year ended December 31, 2007, we previously provided insurance reserves for this matter (as part of our regular review of reported and unreported claims) totaling approximately \$0.5 million. During the fourth quarter of 2008, we recorded an additional settlement charge of approximately \$0.7 million and the related reimbursement from our general liability and professional liability insurance. The charge and reimbursement were recognized in general and administrative expenses for the year ended December 31, 2008. The reimbursement was funded by the insurance carrier in the first quarter of 2009 into a settlement account, where it will remain until payments are made to the settlement class members. The Court granted preliminary approval of the settlement in the first quarter of 2009, and the claims administration process is underway. We expect the claims administration process to be completed and the final court approval of the settlement in the fourth quarter of 2009.

Shareholder Lawsuits

On October 19, 2006, a purported class action complaint was filed in the District Court of Harris County, Texas, 269th Judicial District (No. 2006-67413) by Ted Kinberg, an alleged stockholder of Cornell. The complaint names as defendants Cornell and each member of the board of directors at the time of the suit, as well as Veritas Capital Fund III, L.P. ("Veritas"). The complaint alleges, among other things, that (i) the defendants have breached fiduciary duties they assertedly owed to our stockholders in connection with our entering into the Agreement and Plan of Merger, dated as of October 6, 2006, with Veritas, Cornell Holding Corp., and CCI Acquisition Corp., and (ii) the merger consideration is unfair and inadequate. The plaintiffs sought, among other things, an injunction against the consummation of the merger. The proposed merger was rejected at a special meeting of our stockholders held on January 23, 2007. Consequently, we believe the case is moot and expect the plaintiffs to seek dismissal of their claims accompanied by a request for legal fees that may be owed. We do not expect the resolution of this matter to have a material adverse effect on our financial condition, results of operations or cash flows.

Other

We hold insurance policies to cover potential director and officer liability, some of which may limit our cash outflows in the event of a decision adverse to us in the matters discussed above. However, if an adverse decision in these matters exceeds the insurance coverage or if the insurance coverage is deemed not to apply to these matters, it could have a material adverse effect on us, our financial condition, results of operations and future cash flows.

Additionally, we currently and from time to time are subject to claims and suits arising in the ordinary course of business, including claims for damages for personal injuries or for wrongful restriction of or interference with offender privileges and employment matters. If an adverse decision in these matters exceeds our insurance coverage, or if our coverage is deemed not to apply to these matters, or if the underlying insurance carrier was unable to fulfill its obligation under the insurance coverage provided, it could have a material adverse effect on our financial condition, results of operations or cash flows.

While the outcome of such other matters cannot be predicted with certainty, based on the information known to date, we believe that the ultimate resolution of these matters will not have a material adverse effect on our financial condition, but could be material to operating results or cash flows for a particular reporting period.

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

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is listed on the New York Stock Exchange (“NYSE”) under the symbol “CRN.” As of March 6, 2009, there were approximately 504 shareholders of record of our common stock. The quarterly high and low closing sales prices for our common stock for fiscal years 2008 and 2007 are shown below.

	<u>High</u>	<u>Low</u>
2007:		
First Quarter.....	\$ 21.45	\$ 18.22
Second Quarter	25.43	20.32
Third Quarter	25.42	19.14
Fourth Quarter	27.69	21.44
2008:		
First Quarter.....	\$ 23.01	\$ 16.15
Second Quarter	24.50	20.16
Third Quarter	28.32	22.00
Fourth Quarter	26.00	16.50

We have never declared or paid cash dividends on our capital stock. We currently intend to retain excess cash flow, if any, for use in the operation and expansion of our business (which could include the reduction of outstanding borrowings) and do not anticipate paying cash dividends on our common stock in the foreseeable future. The payment of dividends is within the discretion of the Board of Directors and is dependent upon, among other factors, our results of operations, financial condition, capital requirements, restrictions, if any, imposed by financing commitments and legal requirements. Our 10.75% Senior Notes, as well as our revolving credit facility contain certain restrictions on our ability to pay dividends. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources — Long-Term Credit Facilities” in Item 7 of this report.

We did not purchase any of our common stock in the fourth quarter of 2008.

The following table summarizes as of December 31, 2008 certain information regarding equity compensation to our employees, officers, directors, and other persons under our plans:

<u>Plan Category</u>	<u>(A) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights</u>	<u>(B) Weighted-average Exercise Price of Outstanding Options, Warrants and Rights</u>	<u>(C) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column A)</u>
Equity compensation plans approved by security holders	408,825	\$ 15.82	746,317(1)
Equity compensation plans not approved by security holders	76,874	\$ 10.83	266,753(2)
Total.....	<u>485,699</u>	<u>\$ 15.03</u>	<u>1,013,070</u>

- (1) Includes 133,550 shares issuable pursuant to our Employee Stock Purchase Plan and 43,623 shares issuable pursuant to our 2000 Directors Stock Plan. The total number of shares issuable pursuant to our Amended and Restated 1996 Stock Option Plan is equal to the greater of 1,500,000 shares or 15.0% of the number of shares issued and outstanding immediately after the grant of any option under the Plan. Also includes 569,144 shares issuable pursuant to our 2006 Equity Incentive Plan.
- (2) Includes 100,000 shares issuable pursuant to our Deferred Compensation Plan and 166,753 shares issuable pursuant to our 2000 Broad-Based Employee Plan. The number of shares issuable pursuant to our 2000 Broad-Based Plan (2000 Plan) is equal to the greater of 400,000 shares or 4.0% of the shares issued and outstanding immediately after the grant of any option under the Plan.

Equity Compensation Plans Not Approved by Security Holders

Deferred Compensation Plan

We maintain a Deferred Compensation Plan for the purpose of providing deferred compensation for eligible employees. The Deferred Compensation Plan is a nonqualified plan.

A participant in the Deferred Compensation Plan may defer into an account a percentage of compensation each year up to 75.0% of the participant's compensation received from Cornell. In addition, we may make contributions to the Deferred Compensation Plan on behalf of each participant. Compensation deferred by a participant, or contributions made by us on behalf of a participant, will be invested in mutual funds or the common stock of Cornell. Participants are fully vested in their accounts and may elect to receive the amounts credited to their accounts either in a lump sum or in five or ten-year annual installment payments. In the event of a change of control (as defined in the Plan), the amounts in each participant's account will be paid to the participant in a lump sum.

Warrants

In conjunction with the issuance of subordinated notes in July 2000 (which notes are no longer outstanding), we issued warrants to purchase 290,370 shares of our common stock at an exercise price of \$6.70. The warrants could only be exercised by payment of the exercise price in cash to us, by cancellation of an amount of warrants equal to the fair market value of the exercise price, or by the cancellation of indebtedness owed to the warrant holder. During 2001, 168,292 shares of common stock were issued in conjunction with the exercise and cancellation of 217,778 warrants. During 2007, the remaining 72,592 shares of common stock were issued in conjunction with the exercise and cancellation of the remaining 72,592 warrants.

2000 Broad-Based Employee Plan

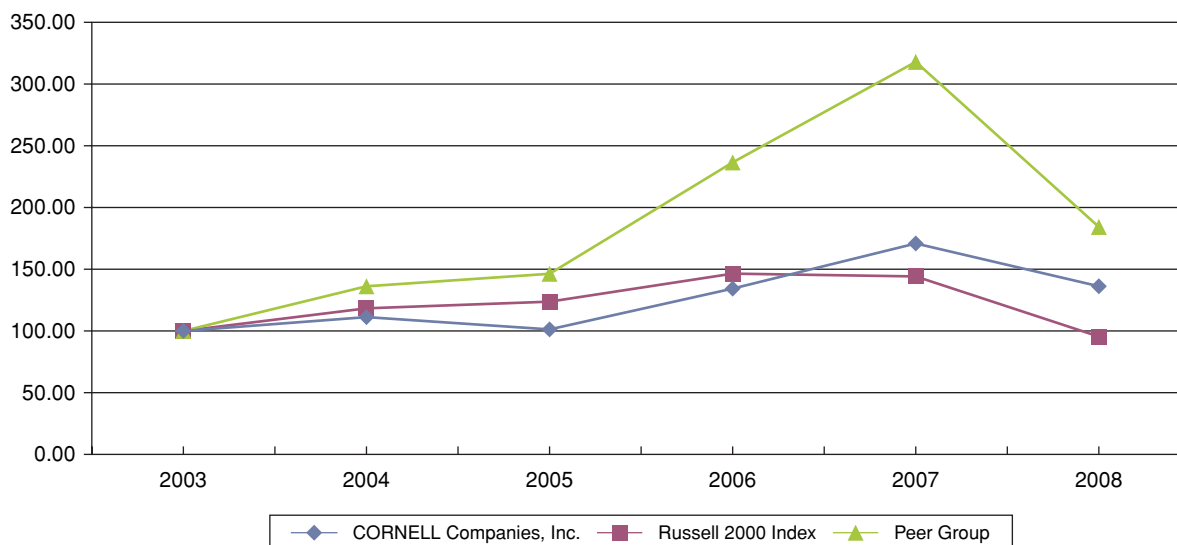
Under our 2000 Plan, we may grant non-qualified stock options to our employees, directors and eligible consultants for up to the greater of 400,000 shares or 4.0% of the aggregate number of shares of common stock issued and outstanding immediately after the grant of any option under the 2000 Plan. The 2000 Plan options vest over a period of up to five years and expire ten years from the grant date. The vesting schedule and term are set by the Compensation Committee of the Board of Directors. The exercise price of options issued pursuant to the 2000 Plan can be no less than the market price of our common stock on the date of grant.

Upon notice of an extraordinary transaction (as defined in the 2000 Plan), options granted under the 2000 Plan become fully vested. Upon consummation of the extraordinary transaction, such options, to the extent not previously exercised, automatically terminate.

Performance Graph

The following performance graph compares our cumulative total stockholder return at December 31, 2008 to the Russell 2000 Stock Index and the Company's peer group, assuming the investment of \$100 on January 1, 2004, at closing prices on December 31, 2003 and reinvestment of dividends. The peer group companies are Corrections Corporation of America and The Geo Group, Inc.

Comparison of 5 Year Cumulative Total Return
Assumes Initial Investment of \$100



Company Name	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08
Cornell Companies, Inc.	100.00	111.21	101.25	134.30	170.85	136.20
Peer Group	100.00	136.18	146.31	236.53	317.95	184.26
Russell 2000 Index	100.00	118.32	123.72	146.42	144.16	95.44

ITEM 6. SELECTED FINANCIAL DATA

The following data has been derived from our audited financial statements, including those included in this Form 10-K for the year ended December 31, 2008 and should be read in conjunction with the consolidated financial statements and notes thereto and Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this report.

	Year Ended December 31,				
	2008	2007	2006 (1)	2005 (2)	2004 (3)
	(in thousands, except per share data)				
Statements of Operations Data:					
Revenues.....	\$ 386,724	\$ 360,604	\$ 360,855	\$ 310,775	\$ 277,190
Income from operations	62,197	45,009	44,798	27,866	14,459
Income (loss) from continuing operations before provision (benefit) for income taxes and minority interest in consolidated special purpose entity.....	38,239	20,745	21,728	6,143	(8,256)
Income (loss) from continuing operations	22,636	11,910	12,580	3,928	(5,000)
Minority interest in consolidated special purpose entity.....	445	—	—	—	—
Discontinued operations, net of tax	—	—	(707)	(3,622)	(2,433)
Net income (loss).....	22,191	11,910	11,873	306	(7,433)
Earnings (loss) per share:					
• Basic					
• Income (loss) from continuing operations	\$ 1.55	\$.84	\$.90	\$.29	\$ (.38)
Discontinued operations, net of tax	—	—	(.05)	(.27)	(.18)
Net income (loss).....	<u>\$ 1.55</u>	<u>\$.84</u>	<u>\$.85</u>	<u>\$.02</u>	<u>(.56)</u>
Diluted					
Income (loss) from continuing operations	\$ 1.51	\$.82	\$.89	\$.29	(.38)
Discontinued operations, net of tax	—	—	(.05)	(.27)	(.18)
Net income (loss).....	<u>\$ 1.51</u>	<u>\$.82</u>	<u>\$.84</u>	<u>\$.02</u>	<u>(.56)</u>
Number of shares used to compute EPS:					
Basic	14,298	14,149	13,918	13,580	13,203
Diluted	14,698	14,480	14,059	13,695	13,203

	Year Ended December 31,				
	2008	2007	2006	2005	2004
(in thousands, except occupancy data)					
Operating Data:					
Residential:					
Service capacity (4) (9).....	17,592	15,634	14,659	14,682	13,494
Contracted beds in operation (end of period) (5) (9)	16,821	14,211	13,492	11,929	11,479
Average contract occupancy on contracted beds in operation (6) (7) (9).....	92.0%	99.6%	97.5%	96.0%	98.6%
Average contract occupancy excluding start-up operations (6) (7) (9).....	92.0%	99.6%	97.5%	100.4%	101.9%
Non-Residential:					
Service capacity (8) (9).....	2,353	2,953	3,921	4,792	3,852
Balance Sheet Data:					
Working capital	\$ 48,395	\$ 47,757	\$ 75,078	\$ 57,286	\$ 107,597
Total assets	636,921	562,287	523,533	510,628	507,631
Long-term debt, net of current portion.....	308,070	275,298	255,471	266,659	279,528
Stockholders' equity	227,722	200,449	181,564	165,461	161,312

Notes to Selected Consolidated Financial Data

- (1) Income from operations for the year ended December 31, 2006 includes a charge of approximately \$0.4 million to record impairments to the carrying value of two of our adult community-based facilities. Refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this report.
- (2) The statement of operations and balance sheet data presented for the year ended December 31, 2005 includes the assets, liabilities and operations of Correction Systems, Inc. ("CSI") acquired in April 2005.
- (3) Loss from continuing operations for the year ended December 31, 2004 includes a charge of \$9.3 million to record an impairment to the carrying value of the Cornell Abraxas Academy. Additionally, income (loss) from continuing operations includes a loss on extinguishment of debt of approximately \$2.4 million related to the early retirement of the Synthetic Lease Investor Notes A and B and the revolving line of credit under our amended 2000 Credit Facility. Discontinued operations, net of tax for the year ended December 31, 2004 include charges totaling \$0.8 million to record impairments to the carrying values of two of our juvenile facilities.
- (4) Residential service capacity is comprised of the number of beds currently available for service in our residential facilities.
- (5) At certain residential facilities, the contracted capacity is lower than the facility's service capacity. We could increase a facility's contracted capacity by obtaining additional contracts or by renegotiating existing contracts to increase the number of beds covered. However, we may not be able to obtain contracts that provide occupancy levels at a facility's service capacity or be able to maintain current contracted capacities in future periods.
- (6) Occupancy percentages reflect less than normalized occupancy during the start-up phase of any applicable facility, resulting in a lower average occupancy in periods when we have substantial start-up activities.
- (7) Average contract occupancy percentages are calculated based on actual occupancy for the period as a percentage of the contracted capacity for residential facilities in operation. These percentages do not reflect the operations of non-residential community-based programs. At certain residential facilities, our contracted capacity is lower than the facility's service capacity. Additionally, certain facilities have and are currently operating above the contracted capacity. As a result, average contract occupancy percentages can exceed 100% if the average actual occupancy exceeded contracted capacity.
- (8) Service capacity for non-residential programs is based on either contractual terms or an estimate of the number of clients to be served. We update these estimates at least annually based on the program's budget and other factors.
- (9) Data presented excludes discontinued operating facilities.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

Cornell is a leading provider of correctional, detention, educational, rehabilitation and treatment services outsourced by federal, state and local government agencies. We provide a diversified portfolio of services for adults and juveniles through our three operating divisions: (1) Adult Secure Services; (2) Abraxas Youth and Family Services; and (3) Adult Community-Based Services. At December 31, 2008, we operated 68 facilities with a total service capacity of 19,875 and had one facility with a service capacity of 70 beds that was vacant. Our facilities are located in 15 states and the District of Columbia.

The following table (which excludes data related to discontinued operating facilities) sets forth for the periods indicated total residential service capacity and contracted beds in operation at the end of the periods shown, average contract occupancy percentages and total non-residential service capacity.

	Year Ended December 31,		
	2008	2007	2006
Residential			
Service capacity (1) (2).....	17,592	15,634	14,659
Contracted beds in operation (end of period) (1) (3)	16,821	14,211	13,492
Average contract occupancy based on contracted beds in operation (1) (4) (5)	92.0 %	99.6 %	97.5 %
Average contract occupancy excluding start-up operations (1) (4) (5).....	92.0 %	99.6 %	97.5 %
Non-Residential			
Service capacity (1) (6).....	2,353	2,953	3,921

- (1) Data presented excludes discontinued operating facilities.
- (2) Residential service capacity is comprised of the number of beds currently available for service in our residential facilities.
- (3) At certain residential facilities, the contracted capacity is lower than the facility's service capacity. We could increase a facility's contracted capacity by obtaining additional contracts or by renegotiating existing contracts to increase the number of beds covered. However, there is no guarantee that we will be able to obtain contracts that provide occupancy levels at a facility's service capacity or that current contracted capacities can be maintained in future periods.
- (4) Occupancy percentages reflect less than normalized occupancy during the start-up phase of any applicable facility, resulting in a lower average occupancy in periods when we have substantial start-up activities.
- (5) Average contract occupancy percentages are calculated based on actual occupancy for the period as a percentage of the contracted capacity for residential facilities in operation. These percentages do not reflect the operations of non-residential community-based programs. At certain residential facilities, our contracted capacity is lower than the facility's service capacity. Additionally, certain facilities have and are currently operating above the contracted capacity. As a result, average contract occupancy percentages can exceed 100% if the average actual occupancy exceeded contracted capacity.
- (6) Service capacity for non-residential programs is based on either contractual terms or an estimate of the number of clients to be served. We update these estimates at least annually based on the program's budget and other factors.

Our operating results for 2008 were significantly impacted by a few major events. We completed and activated expansions at several facilities including the D. Ray James Prison (300 beds in February 2008), the Great Plains Correctional Facility (1,100 beds in September 2008) and the Walnut Grove Youth Correctional Facility (500 beds in September 2008). We also began an additional 700 bed expansion at D. Ray James Prison and started construction on a new 1,250 bed facility in Hudson, Colorado. Our 2008 results of operations were positively affected by a \$1.5 million contract-based revenue adjustment recorded in March 2008 related to the Regional Correctional Center and a \$1.55 million legal settlement (against which we incurred approximately \$0.2 million in expenses in 2008) we received relating to a lawsuit we had brought against certain parties with regard to the operation of the Cornell Abraxas Academy facility (see "—Significant 2008 Events").

Our operating results for 2007 were significantly impacted by a few major events. At our Great Plains Correctional Facility in Hinton, Oklahoma, we transitioned from our operating contract with the Oklahoma Department of Corrections ("OK DOC") to our new contract with the Arizona Department of Corrections. During the marketing and transition phases, that facility was idle from April 2007 to September 2007, when the current inmate ramp began. We also began expansions at several facilities including the Big Spring Correctional Facility, the D. Ray James Prison and the Great Plains Correctional

Facility. Our 2007 results of operations were also negatively impacted by a reduction of Immigration and Customs Enforcement (“ICE”) detainees at our Regional Correctional Center (“RCC”) and positively affected by a \$1.85 million legal settlement (against which we incurred approximately \$0.4 million in expenses in 2007) we received relating to legal representation provided to us in connection with the Southern Peaks Regional Treatment Center.

Although we believe we will continue to see steady demand across our various business segments and our customer base (federal, state and local) in 2009, we are monitoring the declining economic trends and related government budget plans and the effect tightened spending plans could have on our business. We expect a key driver for our performance in 2009 to be our ability to manage our various facility expansions currently in process and bring them on line. We also plan to remain focused on our operating margins, on increasing utilization (particularly in the Abraxas division) and improving customer mix as we believe those initiatives are key elements of our financial performance.

Management Overview

Demand. Our business is driven generally by demand for incarceration or treatment services, and specifically by demand for private incarceration or treatment services, within our three primary business segments: Adult Secure Services; Abraxas Youth and Family Services; and Adult Community-Based Services. The demand for adult and juvenile corrections and treatment services has generally increased at a steady rate over the past ten years, largely as a result of increasing sentence terms and/or mandatory sentences for criminals and as well a greater range of criminal acts, increasing demand for incarceration of illegal aliens and a public recognition of the need to provide services to juveniles that will improve the possibility that they will lead productive lives. Moreover, demand for our services is also affected by the amount of available capacity in the government systems to enable governments to provide the services themselves, as well as desire and ability of these systems to add additional capacity. In addition, the balance between community-based corrections treatment of adults as an alternative to traditional incarceration continues to be analyzed by many political and societal parties. Among other things, we monitor federal, state and industry communications and statistics relative to trends in prison populations, juvenile justice statistics and initiatives, and developments in alternatives to traditional incarceration or detention of adults for opportunities to expand our scope or delivery of services.

The federal government contracts with private providers for the incarceration of adults, whether they are serving prison sentences, detained as illegal aliens, detained in anticipation of pending judicial administration or transitioning from prison to society. Chief among the federal agencies which use private providers are the BOP, U.S. Immigration and Customs Enforcement (“ICE”) and USMS. We provide adult secure and adult community-based services to the federal government. Most of the federal involvement in juvenile administration in the federal system is handled via Medicare and Medicaid assistance to state governments. Although there are circumstances in which we may contract with a federal agency on a sole source basis, the primary means by which we secure a contract with a federal agency is via the RFP bidding process. From time to time, we contract to provide management services to a local governmental unit who then bids on a federal contract.

States and smaller governmental units remain divided on the issue of private prisons and private provision of juvenile and community-based programs, although a majority of states permit private provision for our services. We anticipate that increasing budget pressure on states and smaller governmental units may cause more states and smaller governmental units to consider utilizing private providers such as us to provide these services on a more economical basis. We believe capital budget constraints among prison agencies may encourage them to continue to explore outsourcing to private operators as an alternative to deploying their own capital for prison construction or major refurbishment. Although it varies from governmental unit to governmental unit, the primary political forces who typically oppose privatization of prisons are organized labor and religious groups.

Private juvenile and community-based programs are utilized by states and local governmental units and are organized on a profit and not-for-profit basis. We monitor opportunities in these segments via our corporate and business division development officials. Many opportunities are not published in any manner and, accordingly, we believe that taking the initiative at the state and local levels is key in developing sole source opportunities.

Performance. We track a number of factors as we monitor financial performance. Chief among them are:

- capacity (the number of beds within each business segment’s facilities),
- occupancy (utilization),
- per diem reimbursement rates,
- revenues,
- operating margins, and
- operating expenses.

Capacity. Capacity, commonly expressed in terms of number of beds, is primarily impacted by the number and size of the facilities we own or lease and the facilities we operate on behalf of a third party owner or lessee. We view capacity as one of the measures of our development efforts, through which we may increase capacity by adding new projects or by expanding existing projects (as we have done in 2007 and 2008 at several of our facilities including Great Plains Correctional Facility and D. Ray James Prison). As part of the evaluation of our development efforts, we will assess (a) whether a given development project was brought into service in accordance with our expectation as to time and expense; and (b) the number of projects in development or under consideration at the relevant point in time. In addition to the focus on new projects, capacity will reflect our success in renewing and maintaining existing contracts and facilities. It will also reflect any closure of programs or facilities due to underutilization or failure to earn an adequate risk-adjusted rate of return. We must also be cognizant of the possibility that state or local budgetary limitations may cause the contractual commitment to a given facility to be reduced or even eliminated, which would require us to either secure an alternate customer or close the operation.

Occupancy. Occupancy is typically expressed in terms of percentage of contract capacity utilized. We look at occupancy to assess the efficacy of both our efforts to market our facilities and our efforts to retain existing customers or contracts. Because revenue varies directly with occupancy, occupancy is a driver of our revenues. Our industry experiences significant economics of scale, whereby as occupancy rises, operating costs per resident decline. Some of our contracts are “take-or-pay,” meaning that the agency making use of the facility is obligated to pay for beds even though they are not used. Historically, occupancy percentages in many of our facilities have been high and we are mindful of the need to maintain such occupancy levels. As new development projects are brought into service, occupancy percentages may decline until the projects reach full utilization (as, for example, with the activation of the 1,100 bed expansion at Great Plains Correctional Facility during the fourth quarter of 2008). Where we have commitments for utilization before the commencement of operations, occupancy percentages reflect the speed at which a facility achieves full service/implementation. However, we may decide to undertake development projects without written commitments to make full use of a facility. In these instances, we have performed our own assessment, based on discussions with local government or other potential customer representatives and analysis of other factors, of the demand for services at the facility. There is no assurance that we would recover our initial investment in these projects. We will monitor occupancy as a measure of the accuracy of our estimation of the demand for the services of a development facility, and will incorporate this information in future assessments of potential projects.

Per Diem Reimbursement Rates. Per diem reimbursement rates are another key element of our gross revenue and operating margin since per diem contracts represent a majority of our revenues (54.0% for the year ended December 31, 2008). Per diem rates are a function of negotiation between management and a governmental unit at the inception of a contract or through the bidding process. Actual per diem rates vary dramatically across our business segments, and as well as within each business segment depending upon the particular service or program provided. The initial per diem rates often change during the term of a contract in accordance with a schedule. The amount of the change can be a fixed amount set forth within the contract, an amount determined by formulas set forth within the contract or an amount determined by negotiations between management and the governmental unit (often these negotiations are along the same lines as the original per diem negotiation — a review of expenses and approval of an amount to recompense for expenses and assure the potential of an operating profit). In recent years, as budgetary pressures on governmental units have increased, some of our customers have negotiated relief from formulaic increase provisions within their agreements or have declined to include in their appropriation legislation amounts that would increase the per diem rates payable under the contract. Based on the economic turmoil which began in the second half of 2008, we are expecting such pressures to continue in 2009 for many of our customers. In similar prior situations we have attempted to mitigate the impact of these developments by negotiating services provided, obtaining commitments for increased volume and other measures. We may also choose to consider terminating an existing relationship at a given facility and replacing it with a new customer (as was done with the Great Plains Correctional Facility in 2007).

Revenues. We derive substantially all of our revenues from providing adult corrections and treatment and juvenile justice, educational and treatment services outsourced by federal, state and local government agencies in the United States. Revenues for our services are generally recognized on a per diem rate based upon the number of occupant days or hours served for the period, on a guaranteed take-or-pay basis or on a cost-plus reimbursement basis. For the year ended December 31, 2008, our revenue base consisted of 54.0% for services provided under per diem contracts, 40.0% for services provided under take-or-pay and management contracts, 3.8% for services provided under cost-plus reimbursement contracts, 2.0% for services provided under fee-for-service contracts and 0.2% from other miscellaneous sources. For the year ended December 31, 2007, our revenue base consisted of 74.3% for services provided under per diem contracts, 18.6% for services provided under take-or-pay and management contracts, 4.7% for services provided under cost-plus reimbursement contracts, 2.1% for services provided under fee-for-service contracts and 0.3% from other miscellaneous sources. The increase in the percentage of revenues provided under take-or-pay and management contracts for 2008 was due primarily to the take-or-pay

contract awarded by the BOP to our Big Spring Correctional Center in 2007 and the 916 inmate take-or-pay contract awarded by the Arizona Department of Corrections at our Great Plains Correctional Facility under which we began operations in September 2007. The increase in the percentage of revenues provided under take-or-pay contracts was partially offset by 1) the transition of certain of our management contracts including the Donald W. Wyatt Detention Center (in July 2007) to the facility owner and 2) the termination of our management contract for the Harrisburg Alternative Education School Program for the 2007-2008 school year (due to lack of funding by the contracting agency). The decrease in the percentage of revenues provided under per diem contracts in 2008 as compared to the prior year was due primarily to the transition of the contracts at the Great Plains Correctional Facility and the Big Spring Correctional Center as previously noted. This decrease was partially offset by the addition of the High Plains Correctional Facility acquired in May 2007.

Revenues can fluctuate from year to year due to changes in government funding policies, changes in the number or types of clients referred to our facilities by governmental agencies, changes in the types of services delivered to our customers, the opening of new facilities or the expansion of existing facilities and the termination of contracts for a facility or the closure of a facility.

Factors considered in determining billing rates to charge include: (1) the programs specified by the contract and the related staffing levels; (2) wage levels customary in the respective geographic areas; (3) whether the proposed facility is to be leased or purchased; and (4) the anticipated average occupancy levels that could reasonably be expected to be maintained and the duration of time required to reach such occupancy levels.

Revenues-Adult Secure Services. Revenues for our Adult Secure Services division are primarily generated from per diem, take-or-pay and management contracts. For the years ended December 31, 2008, 2007 and 2006, we realized average per diem rates on our adult secure facilities of approximately \$54.07, \$54.69 and \$56.12, respectively. The decrease in the 2007 rate is due primarily to the increase in occupancy at the Moshannon Valley Correctional Center during 2007 over the prior year. This facility operates under a take-or-pay contract; as a result, the effective average per diem rate will decrease as the population at the facility increases. The 2006 average per diem rate also benefited from the receipt of a contract-based revenue adjustment for the contract year ended March 2006 in the amount of \$2.4 million at the RCC. We periodically have experienced pressure from contracting governmental agencies to limit or even reduce per diem rates. Many of these governmental entities are under severe budget pressures and we anticipate that governmental agencies may periodically approach us about per diem rate concessions (or decline to provide funding for contractual rate increases). Decreases in, or the lack of anticipated increases in, per diem rates could adversely impact our operating margin.

Revenues-Abraxas Youth and Family Services. Revenues for our Abraxas Youth and Family Services division are primarily generated from per diem, fee-for-service and cost-plus reimbursement contracts. For the years ended December 31, 2008, 2007 and 2006, we realized average per diem rates on our residential youth and family services facilities of approximately \$192.15, \$174.93 and \$170.33, respectively. The increase in the average per diem rate for 2008 reflects the continued ramp-up of the Cornell Abraxas Academy (reactivated in the fourth quarter of 2006), the reactivation of the Hector Garza Residential Treatment Center in August 2007 as well as changes in the mix of services provided and customers served at other facilities. For the years ended December 31, 2008, 2007 and 2006, we realized average fee-for-service rates for our non-residential community-based Abraxas Youth and Family Services facilities and programs, including rates that are limited by Medicaid and other private insurance providers, of approximately \$48.28, \$44.35 and \$37.59, respectively. The increase in the average fee-for-service rates for 2008 and 2007 is due to changes in the mix of services provided at our non-residential facilities. The majority of our Abraxas Youth and Family Services contracts renew annually.

Revenues-Adult Community-Based Services. Revenues for our Adult Community-Based Services division are primarily generated from per diem and fee-for-service contracts. For the years ended December 31, 2008, 2007 and 2006, we realized average per diem rates on our residential adult community-based facilities of approximately \$68.47, \$62.91 and \$61.71, respectively. For the years ended December 31, 2008, 2007 and 2006, we realized average fee-for-service rates on our non-residential Adult Community-Based Services facilities and programs of approximately \$11.00, \$13.70 and \$11.23, respectively. Our average fee-for-service rates fluctuate from year to year principally due to changes in the mix of services provided by our various Adult Community-Based Services programs and facilities.

Operating Margins. We have historically experienced higher operating margins in our Adult Secure Services and Adult Community-Based Services divisions as compared to our Abraxas Youth and Family Services division. Our operating margin, in a given period, will be impacted by those facilities which may either be dormant or have been reactivated during the period. As previously discussed, we have reactivated several facilities, including the Cornell Abraxas Academy and the Hector Garza Residential Treatment Center in 2006 and 2007, respectively. We have also expanded several of our Adult Secure facilities (D. Ray James Prison, Great Plains Correctional Facility and Walnut Grove Youth Correctional Facility, for example), which provides the opportunity to leverage existing infrastructure. Additionally, our operating margins within a

division can vary from facility to facility based on whether a facility is owned or leased, the level of competition for the contract award, the proposed length of the contract, the mix of services provided, the occupancy levels for a facility, the level of capital commitment required with respect to a facility, the anticipated changes in operating costs over the term of the contract and our ability to increase a facility's contract revenue. Under take-or-pay contracts, such as the contract at the Moshannon Valley Correctional Center, operating margins are typically higher during the early stages of the contract as the facility's population ramps up (as revenues are received at contract percentages regardless of actual occupancy). As the variable costs (primarily resident-related and certain facility costs) increase with the growth in population, operating margins will generally decline to a stabilized level. Following its activation in April 2006, we experienced such operating margin impact pertaining to the Moshannon Valley Correctional Center in the third and fourth quarters of 2006. A decline in occupancy at our Abraxas Youth and Family Services facilities can have a more significant impact on operating margins than our Adult Secure Services division due to the longer periods typically required to ramp resident population at a youth facility.

We have experienced and expect to continue to experience interim period operating margin fluctuations due to factors such as the number of calendar days in the period, higher payroll taxes (generally in the first half of the year) and salary and wage increases and insurance cost increases that are incurred prior to certain contract rate increases. Periodically, many of the governmental agencies with whom we contract may experience budgetary pressures and may approach us to limit or reduce per diem rates (including contractual price increases as well). We anticipate such customer behavior in 2009. Decreases in, or the lack of anticipated increases in, per diem rates could adversely impact our operating margin. Additionally, a decrease in per diem rates without a corresponding decrease in operating expenses could also adversely impact our operating margin.

Operating Expenses. We track several different areas of our operating expenses. Foremost among these expenses are employee compensation and benefits and expenses, risk related areas such as general liability, medical and worker's compensation, client/inmate costs such as food, clothing, medical and programming costs, financing costs and administrative overhead expenses. Increases or decreases in one or more of these expenses, such as our experience with rising insurance costs, can have a material effect on our financial performance. Operating expenses are also impacted by decisions to close or terminate a particular program or facility. Such decisions are based on our assessments of operating results, operating efficiency and risk-adjusted returns and are an ongoing part of our portfolio management. In addition, decisions to restructure employee positions will typically increase period costs initially (at the time of such actions), but generally reduce post-restructuring expense levels.

We are responsible for all facility operating costs, except for certain debt service and interest or lease payments for facilities where we have a management contract only. At these facilities, the facility owner is responsible for all debt service and interest or lease payments related to the facility. We are responsible for all other operating expenses at these facilities. We operated 14 facilities under management contracts at December 31, 2008, 15 facilities at December 31, 2007 and 18 facilities at December 31, 2006. Included in the 14 facilities under management contracts at December 31, 2008 were the Walnut Grove Youth Correctional Facility and the eight Los Angeles County Jails, which represented 1,714 beds of service capacity, or approximately 83% of the residential service capacity represented by management contracts.

A majority of our facility operating costs consists of fixed costs. These fixed costs include lease and rental expense, insurance, utilities and depreciation. As a result, when we commence operation of new or expanded facilities, fixed operating costs may increase. The amount of our variable operating costs, including food, medical services, supplies and clothing, depend on occupancy levels at the facilities. Our largest single operating cost, facility payroll expense and related employment taxes and expenses, has both a fixed and a variable component. We can adjust a facility's staffing levels and the related payroll expense to a certain extent based on occupancy at a facility; however a minimum fixed number of employees is required to operate and maintain any facility regardless of occupancy levels. Personnel costs are subject to increases in tightening labor markets based on local economic environments and other conditions.

We incur pre-opening and start-up expenses including payroll, benefits, training and other operating costs prior to opening a new or expanded facility and during the period of operation while occupancy is ramping up. These costs vary by contract (and the pace/scale of the activation and related population ramp). Since pre-opening and start-up costs are generally factored into the revenue per diem rate that is charged to the contracting agency, we typically expect to recover these upfront costs over the life of the contract. Because occupancy rates during a facility's start-up phase typically result in capacity under-utilization for at least 90 to 180 days, we may incur additional post-opening start-up costs. We do not anticipate post-opening start-up costs at any adult secure facilities operated under any future contracts with the BOP which are take-or-pay contracts, meaning that the BOP will pay at least 80.0% of the contractual monthly revenue once the facility opens, regardless of actual occupancy.

Newly opened facilities are staffed according to applicable regulatory or contractual requirements when we begin receiving offenders or clients. Offenders or clients are typically assigned to a newly opened facility on a phased-in basis over

a one- to six-month period. Our start-up period for new juvenile operations is 12 months from the date we begin recognizing revenue unless break-even occupancy levels are achieved before then. The actual time required to ramp a juvenile facility (with approximate capacity of 100 to 200 beds) may be a period of one to three years. Our start-up period for new adult operations is nine months from the date we begin recognizing revenue unless break-even occupancy levels are achieved before then. The approximate time to ramp an adult facility of approximately 1,000 beds may be a period of three to six months, depending upon the customer requirements. Although we typically recover these upfront costs over the life of the contract, quarterly results can be substantially affected by the timing of the commencement of operations as well as the development and construction of new facilities.

Working capital requirements generally increase immediately prior to commencing management of a new or expanded facility as we incur start-up costs and purchase necessary equipment and supplies before facility management revenue is realized.

General and administrative expenses consist primarily of costs for corporate and administrative personnel who provide senior management, legal, finance, accounting, human resources, investor relations, payroll and information systems, costs of business development and outside professional and consulting fees.

Significant 2008 Events

D. Ray James Prison

In February 2008, we completed the initial expansion of the D. Ray James Prison in Georgia to increase its service capacity by approximately 300 beds to a total service capacity of 2,170 beds.

In August 2007, we announced that we were initiating a second expansion of the D. Ray James Prison. This expansion project will increase the facility's service capacity by an additional 700 beds for a total service capacity of approximately 2,800 beds. This expansion project began in the first quarter of 2008 and is expected to be completed by the end of the first quarter of 2009. We are marketing this additional expansion to multiple customers but believe those beds are well suited for a Georgia Department of Corrections ("Georgia DOC") bid that requires expansion of an existing Georgia DOC-contracted facility. We can make no assurance that we will be awarded this contract. We currently estimate that the capital expenditures related to this expansion project will be approximately \$34.7 million. As of December 31, 2008, we had incurred and capitalized total costs (including interest) of approximately \$33.9 million related to this expansion. We believe that our existing cash flow and available balance under our Amended Credit Facility will provide adequate funding to complete this facility expansion.

Great Plains Correctional Facility

In May 2007, we were awarded a contract by the Arizona Department of Corrections ("Arizona DOC") for our Great Plains Correctional Facility in Hinton, Oklahoma. The contract calls for a total of 2,000 medium-security inmates to be housed at the facility. We initially housed approximately 916 inmates and the remainder was housed through the expansion of the existing facility which was completed in the fourth quarter of 2008. As of December 31, 2008 the ramp-up to approximately 2,000 inmates was complete.

Hudson, Colorado

In August 2008, we entered into an agreement pursuant to which we will lease a new 1,250 male bed adult secure facility in Hudson, Colorado. The facility is owned by a third party and is being built on land we sold to the third party. We retained approximately 270 acres out of the original 320 acres we acquired in 2007. We anticipate the construction, which began in the third quarter of 2008, to be completed in late 2009. We have signed an implementation agreement with the Colorado Department of Corrections ("Colorado DOC"), which governs the construction of the facility and contemplates a service agreement which can be entered into upon completion of the implementation agreement. We would expect to begin receiving inmates upon the activation of the facility. We expect to enter into a service agreement for the facility with the Colorado DOC but can make no assurances that we will do so (or what the possible timing might be).

Hurricane Ike

Hurricane Ike, which came ashore in Texas in September 2008, damaged our Beaumont Transitional Treatment Center, Leidel Comprehensive Sanction Center and Reid Community Residential Facility. These damages are covered by our insurance, subject to normal deductibles, for which we recorded a charge of approximately \$0.5 million in the year ended

December 31, 2008. The Leidel facility was able to continue near normal operations. The Beaumont facility reopened in mid-October 2008 at near normal capacity. The Reid facility reopened in mid-October 2008 at approximately 40 percent of its previous capacity of approximately 500. We believe the remainder of the operating capacity will be operational in the first quarter 2009. Reid generated revenues of approximately \$4.9 million and \$5.4 million in the years ended December 31, 2008 and 2007, respectively.

Regional Correctional Center

The Office of Federal Detention Trustee (“OFDT”) holds the contract for use of the Regional Correctional Center on behalf of ICE, USMS and the BOP with Bernalillo County through an intergovernmental services agreement, and we have an operating and management agreement with Bernalillo County. In August 2007, the Bureau of Immigration and Customs Enforcement (“ICE”) removed all ICE detainees from the Regional Correctional Center in Albuquerque, New Mexico. ICE informed us in February 2008 that it would not resume use of the facility. The facility is still being utilized by the USMS, and since May 2008 by the BOP, but not at its full capacity. In February 2008, the OFDT, attempted to unilaterally amend its agreement to reduce the number of minimum annual guaranteed mandays under the agreement from 182,500 to 66,300. Neither we nor Bernalillo County believe OFDT has the right to unilaterally amend the contract in this manner, and OFDT has been informed of our position. Although either party to the intergovernmental services agreement has the right to terminate upon 180 days notice, neither party has exercised such right as of December 31, 2008. Refer to “Results of Operations — Liquidity and Capital Resources - Contractual Uncertainties Related to Certain Facilities - Regional Correctional Center” for more information concerning this and other developments concerning the Regional Correctional Center. We recorded a contract-based revenue adjustment (in March 2008) of approximately \$1.5 million for the contract year ended March 2008, for which the related receivable is carried in accounts receivable — trade at December 31, 2008.

Walnut Grove Youth Correctional Facility

In August 2007, we were notified by the State of Mississippi that funding had been approved for a 500 bed expansion of the 941 bed Walnut Grove Youth Correctional Facility that we have been managing since 2004. Expansion of the facility, which was entirely funded by the State of Mississippi, began in the third quarter of 2007 and was completed and became operational in the third quarter of 2008.

Settlement of Claim

On December 12, 2008, we settled a lawsuit the Company had filed in the United States District Court for the Eastern District of Pennsylvania against the Borough of New Morgan (the “Borough”), New Morgan Borough Council and certain individual council members. The lawsuit involved the operation of the Company’s Abraxas Academy in New Morgan, Pennsylvania and a sewage treatment facility that is owned by the Borough.

In connection with the settlement, all claims have been terminated and finally settled, including those concerning the operation and occupancy of the facility and the sewage treatment plant. Neither party has admitted liability for any claim or contention made by the other party. The Company received \$1.55 million from the Borough and agreed to pay the Borough unpaid sewage treatment bills in the amount of \$0.2 million through September 30, 2008. The \$1.55 million settlement is reflected in operating expenses in the accompanying financial statements.

Critical Accounting Policies and Estimates

The preparation of our financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the balance sheet date and the amounts of revenues and expenses recognized during the reporting period. We analyze our estimates based on our historical experience and various other assumptions that we believe to be reasonable under the circumstances. However, actual results could differ from such estimates. The following is a discussion of our critical accounting estimates. Management considers an accounting estimate to be critical if:

- it requires assumptions to be made that were uncertain at the time the estimate was made; and
- changes in the estimate or different estimates that could have been selected could have a material impact on our consolidated financial position or results of operations.

For a summary of all of our significant accounting policies see “Note 2-Significant Accounting Policies” of the “Notes to Consolidated Financial Statements” in Item 8 of this Form 10-K.

Revenue Recognition

Substantially all of our revenues are derived from contracts with federal, state and local governmental agencies which pay either per diem rates based upon the number of occupant days or hours served for the period, on a take-or-pay basis, management fee basis, cost-plus reimbursement or fee-for-service basis. Revenues are recognized as services are provided under our established contractual agreements to the extent collection is considered probable.

Accounts Receivable and Related Allowance for Doubtful Accounts

We extend credit to the governmental agencies contracted with and other parties in the normal course of business. We regularly review our outstanding receivables and historical collection experience and provide for estimated losses through an allowance for doubtful accounts. In evaluating the adequacy of our allowance for doubtful accounts, we make judgments regarding our customers' ability to make required payments, economic events and other factors. As the financial condition of these parties change, circumstances develop or additional information becomes available, adjustments to the allowance for doubtful accounts may occur. If, after reasonable collection efforts have been made, a receivable is determined to be permanently uncollectible, it is written off.

Insurance Reserves

We maintain insurance coverage for various aspects of our business and operations. We retain a portion of losses that occur through the use of deductibles and retention under self-insurance programs. We regularly review our estimates of reported and unreported claims and provide for these losses through insurance reserves. These reserves are influenced by rising costs of health care and other costs, increases in claims, time lags in claims information and levels of insurance coverage carried. As claims develop and additional information becomes available to us, adjustments to the related loss reserves may occur. Our reserves for medical and worker's compensation claims are subject to change based on our estimate of the number and the magnitude of claims to be incurred.

Impairment or Disposal of Long-Lived Assets

We review our long-lived assets for impairment at least annually or when changes in circumstances or a triggering event indicates that the carrying amount of the asset may not be recoverable in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 requires that long-lived assets to be held and used recognize an impairment loss only if the carrying amount of the long-lived asset is not recoverable. Long-lived assets to be held and used are to be reported at the lower of their carrying amount or fair value. Assets to be disposed of by sale are recorded at the lower of their carrying amount or fair value less estimated selling costs. We estimate fair value based upon the best information available, which may include expected future discounted cash flows to be produced by the asset and/or available market prices. Factors that significantly influence estimated future discounted cash flows include the periods and levels of occupancy for the facility, expected per diem or reimbursement rates, assumptions regarding the levels of staffing, services and future operating and capital expenditures necessary to generate forecasted revenues, related costs for these activities and future rate of increases or decreases associated with these factors. We also consider the results of any appraisals on the properties when assessing fair value. These estimates may be highly subjective, particularly in circumstances where there is no current operating contract in place and changes in the assumptions and estimates could result in the recognition of impairment charges. The most subjective estimates made in this analysis for 2008 relate to Cornell Abraxas 1, the Regional Correctional Center and the Hector Garza Residential Treatment Center. The most subjective estimates made in this analysis for 2007 relate to the Regional Correctional Center and the Hector Garza Residential Treatment Center. We may be required to record an impairment charge in the future if we are unable to successfully negotiate a replacement contract on any of our facilities for which we currently have an operating contract.

Goodwill and Intangible Assets

We account for goodwill in accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," which states that there is no amortization of goodwill or intangible assets with indefinite lives. Impairment of these assets is assessed annually to determine if the estimated fair value of the reporting unit exceeds the net carrying value of the reporting unit, including the applicable goodwill. The estimates of fair value are based upon our estimates of the present value of future cash flows. We make assumptions regarding the estimated cash flows and if these estimates or their related assumptions change, an impairment charge may be incurred.

Results of Operations

Material fluctuations in our results of operations are principally the result of the level of new contract development activity, the timing and effect of facility expansions, occupancy or contract rates, contract renewals or terminations and facility closures and non-recurring charges.

The following table sets forth for the periods indicated the percentages of revenue represented by certain items in our Consolidated Statements of Income and Comprehensive Income (Loss).

	Year Ended December 31,		
	2008	2007	2006
Revenues.....	100.0%	100.0%	100.0%
Operating expenses.....	72.6	76.0	76.4
Pre-opening and start-up expenses.....	—	—	0.7
Depreciation and amortization.....	4.6	4.4	4.5
General and administrative expenses.....	6.7	7.1	6.0
Income from operations.....	16.1	12.5	12.4
Interest expense, net.....	6.2	6.7	6.4
Income from continuing operations before provision for income taxes.....	9.9	5.8	6.0
Provision for income taxes.....	4.0	2.5	2.5
Income from continuing operations.....	5.9	3.3	3.5
Minority interest in consolidated special purpose entity.....	0.2		
Discontinued operations, net of taxes.....	—	—	(0.2)
Net income.....	5.7%	3.3%	3.3%

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

Revenues. Revenues increased approximately \$26.1 million, or 7.2%, to \$386.7 million for the year ended December 31, 2008 from \$360.6 million for the year ended December 31, 2007.

Adult Secure Services. Adult Secure Services revenues increased approximately \$26.1 million, or 14.2%, to \$209.3 million for the year ended December 31, 2008 from \$183.2 million for the year ended December 31, 2007 due primarily to (1) an increase in revenues of \$17.6 million at the Great Plains Correctional Facility which began operating under a contract with the Arizona DOC in September 2007 (this facility was vacant from April through August 2007) as well as increased occupancy as a result of a facility expansion completed in September 2008, (2) an increase in revenues of \$10.1 million at the Big Spring Correctional Center due to increased occupancy resulting from a facility expansion completed in November 2007 related to the take-or-pay contract awarded to us by the BOP in 2007, (3) an increase in revenues of \$4.8 million at the D. Ray James Prison due to a facility expansion completed in February 2008, (4) an increase in revenues of \$2.0 million at the High Plains Correctional Facility which we acquired in May 2007 and (5) an increase in revenues of \$1.2 million at the Walnut Grove Youth Correctional Facility due to a facility expansion completed in September 2008. The increase in revenues due to the above was offset, in part, by (1) a decrease in revenues of \$8.0 million at the Donald W. Wyatt Detention Center due to the transition of our management contract to the facility's owner in July 2007 and (2) a decrease in revenues of approximately \$2.9 million at the Regional Correctional Center due to the withdrawal of all ICE inmates as of August 2007 (revenues for 2008 include a \$1.5 million contract-based revenue adjustment for the contract year ended March 25, 2008). The remaining net increase in revenues of approximately \$1.3 million was due to fluctuations in revenues at our other adult secure facilities.

Average contract occupancy was 91.8% for the year ended December 31, 2008 compared to 100.4% for the year ended December 31, 2007. The decrease in the average contract occupancy is primarily due to the additional capacity of approximately 1,600 beds brought into operations in September 2008 (at the Great Plains Correctional Facility and Walnut Grove Youth Correctional Facility), which we began ramping during the fourth quarter of 2008. The average per diem rate was \$54.07 for the year ended December 31, 2008 compared to \$54.69 for the year ended December 31, 2007.

Abraxas Youth and Family Services. Abraxas Youth and Family Services revenues decreased approximately \$2.0 million, or 1.9%, to \$107.3 million for the year ended December 31, 2008 from \$109.3 million for the year ended December 31, 2007 due primarily to (1) a decrease in revenues of \$5.1 million at the Cornell Abraxas I facility (“A-1”) due to decreased occupancy, (2) a decrease in revenues of \$1.6 million at the Texas Adolescent Treatment Center (“TATC”) due to decreased occupancy, (3) a decrease in revenues of \$1.8 million due to the termination of our management contract for the Harrisburg Alternative Education School Program for the 2007-2008 school year (due to lack of funding by the contracting agency), (4) a decrease in revenues of \$1.3 million due to the termination of our management contract for the Salt Lake Valley Detention Center as of September 2008 and (5) a decrease in revenues of \$1.2 million due to the termination of our management contract for the Reading Alternative Education School Program in June 2008. The decrease in revenues due to the above was offset, in part, by (1) an increase in revenues of \$4.5 million at the Cornell Abraxas Academy due to improved occupancy, (2) an increase in revenues of \$2.5 million at the Southern Peaks Regional Treatment Center due to improved occupancy and mix of clients at the facility, (3) an increase in revenues of \$1.6 million at the Cornell Abraxas of Ohio facility due to a new residential program activated in 2008 and (4) an increase in revenues of \$0.9 million at the Hector Garza Residential Treatment Center which we reactivated in August 2007. The remaining net decrease in revenues of approximately \$0.5 million was due to various insignificant fluctuations in revenues at our other Abraxas Youth and Family Services facilities and programs.

Average contract occupancy was 80.6% for the year ended December 31, 2008 compared to 92.0% for the year ended December 31, 2007. The decrease in the 2008 average contract occupancy reflects the under-utilization at certain facilities, including A-1 and TATC.

The average per diem rate for our Abraxas Youth and Family Services facilities was approximately \$192.15 for the year ended December 31, 2008 compared to approximately \$174.93 for the year ended December 31, 2007. The increase in the 2008 average per diem rate reflects the continued ramp-up of the Cornell Abraxas Academy (reactivated in the fourth quarter of 2006), the reactivation of the Hector Garza Residential Treatment Center in 2007 as well as changes in the mix of services provided at other facilities, including a new residential program at our Cornell Abraxas of Ohio facility. The average fee-for-service rate for our non-residential community-based Abraxas Youth and Family Services facilities and programs was approximately \$48.28 for the year ended December 31, 2008 compared to approximately \$44.35 for the year ended December 31, 2007. Our average fee-for-service rate can fluctuate from year to year depending on the mix of services provided at our various non-residential Abraxas Youth and Family Services facilities and programs.

Adult Community-Based Services. Adult Community-Based Services revenues increased approximately \$2.1 million, or 3.1%, to \$70.2 million for the year ended December 31, 2008 from \$68.1 million for the year ended December 31, 2007 due to (1) an increase in revenues of \$1.1 million at the Cordova Center due to improved occupancy, (2) an increase in revenues of \$0.5 million at the Midtown Center which was reactivated in September 2007, (3) an increase in revenues of \$0.6 million at Southwood due to increased occupancy, (4) revenues of \$0.3 million at a new jail (Bell Gardens Jail) we began operating in March 2008 and (5) an increase in revenues of \$0.5 million at the Oakland Center due to improved occupancy. The increase in revenues was offset, in part, by (1) a decrease in revenues of \$1.3 million due to the termination of our management contract for the Lincoln County Detention Center in May 2008 (we gave notice of early termination of our management contract for the facility in February 2008 due to continual staffing and other issues in the rural area. This contract generated revenues of approximately \$0.6 million and \$1.9 million in the years ended December 31, 2008 and 2007, respectively), (2) a decrease in revenues of \$0.9 million at the Grossman Center due to reduced occupancy and (3) a decrease in revenues of \$0.5 million at the Reid Correctional Facility as a result of decreased occupancy due to the damages caused by Hurricane Ike. The remaining net increase in revenues of \$1.8 million was due to various insignificant fluctuations in revenues at our various other adult community-based facilities and programs.

Average contract occupancy was 99.0% for the year ended December 31, 2008 compared to 101.1% for the year ended December 31, 2007.

The average per diem rate for our residential Adult Community-Based Services facilities was \$68.47 for the year ended December 31, 2008 compared to \$62.91 for the year ended December 31, 2007. The average fee-for-service rate for our non-residential Adult Community-Based Services facilities and programs was approximately \$11.00 for the year ended December 31, 2008 compared to approximately \$13.70 for the year ended December 31, 2007. Our average fee-for-service rates can fluctuate from year to year due to changes in the mix of services provided by our various non-residential Adult Community-Based Services facilities and programs.

Operating Expenses. Operating expenses, excluding depreciation and amortization, increased approximately \$6.5 million, or 2.4%, to \$280.6 million for the year ended December 31, 2008 from \$274.1 million for the year ended December 31, 2007.

Adult Secure Services. Adult Secure Services operating expenses increased approximately \$5.1 million, or 3.9%, to \$135.6 million for the year ended December 31, 2008 from \$130.5 million for the year ended December 31, 2007 due primarily to (1) an increase in operating expenses of \$8.8 million at the Great Plains Correctional Facility due to increased occupancy following the facility expansion completed in September 2008, (2) an increase in operating expenses of \$3.5 million at the D. Ray James Prison due to increased occupancy following the facility expansion completed in February 2008, (3) an increase in operating expenses of \$1.8 million at the High Plains Correctional Facility acquired in May 2007, (4) an increase in operating expenses of \$1.5 million at the Big Spring Correctional Center due to increased occupancy following a facility expansion completed in November 2007 and (5) an increase in operating expenses of \$1.3 million at the Walnut Grove Youth Correctional Facility due to increased occupancy following a facility expansion completed in September 2008. The increase in operating expenses due to the above was offset, in part, by (1) a decrease in operating expenses of \$7.5 million due to the transition of our management contract at the Donald W. Wyatt Detention Center to the facility's owner in July 2007 and (2) a decrease in operating expenses of \$3.1 million at the Regional Correction Center due to decreased occupancy following the removal of all ICE inmates in August 2007. The remaining net decrease in operating expenses of approximately \$1.2 million was due to various insignificant fluctuations in operating expenses at our other adult secure facilities and divisional operating expenses.

As a percentage of segment revenues, adult secure services operating expenses were 64.8% for the year ended December 31, 2008 compared to 71.2% for the year ended December 31, 2007. The 2008 operating margin was favorably impacted by the \$1.5 million contract-based revenue adjustment for the contract year ended March 2008 at the Regional Correctional Center. Additionally, the 2007 operating margin was negatively impacted by the termination of our contract at the Great Plains Correctional Facility in April 2007 as we transitioned to its reactivation in September 2007 under our new contract with the Arizona Department of Corrections.

Abraxas Youth and Family Services. Abraxas Youth and Family Services operating expenses increased \$2.1 million, or 2.2%, to approximately \$95.6 million for the year ended December 31, 2008 from \$93.5 million for the year ended December 31, 2007 due primarily to (1) an increase in operating expenses of \$1.7 million at the Cornell Abraxas Academy due to increased occupancy, (2) an increase in operating expenses of \$1.2 million at the Hector Garza Residential Treatment Center due to increased occupancy, (3) an increase in operating expenses of \$0.8 million at our Cornell Abraxas of Ohio facility due to the addition of a new residential program in 2008, and (4) an increase in operating expenses of \$0.4 million at the Southern Peaks Regional Treatment Center due to increased occupancy. The increase in operating expenses was offset, in part, by (1) a decrease in operating expenses of \$1.8 million due to the termination of our management contract for the Harrisburg Alternative Education School Program for the 2007-2008 school year (due to lack of funding by the contracting agency), (2) a decrease in operating expenses of \$0.9 million due to the termination of our management contract for the Salt Lake Valley Detention Center as of September 2008, (3) a decrease in operating expenses of \$0.9 million due to the termination of our management contract for the Reading Alternative Education School Program in June 2008 and (4) a decrease in operating expenses of \$0.6 million at the Texas Adolescent Treatment Center due to reduced occupancy. The remaining net increase in operating expenses of \$2.2 million was due to various insignificant fluctuations in operating expenses at our various Abraxas Youth and Family Services facilities and programs.

As a percentage of segment revenues, Abraxas operating expenses were 89.1% for the year ended December 31, 2008 compared to 85.5% for the year ended December 31, 2007. The 2008 operating margin was negatively impacted by the lower utilization at those facilities previously noted.

Adult Community-Based Services. Adult Community-Based Services operating expenses decreased \$0.7 million, or 1.4%, to \$49.4 million for the year ended December 31, 2008 from \$50.1 million for the year ended December 31, 2007 due primarily to (1) a decrease in operating expenses of \$1.2 million due to the termination of our management contract at the Lincoln County Detention Center as of September 2008, (2) a decrease in operating expenses of \$0.5 million at the Grossman Center due to reduced occupancy and (3) a decrease in operating expenses of \$0.1 million at the Reid Community Residential Facility due to reduced occupancy resulting from damages sustained during Hurricane Ike. The decrease in operating expenses was offset, in part, by (1) an increase in operating expenses of \$0.4 million at the Midtown Center which we reactivated in September 2007 and (2) operating expenses of \$0.3 million at a new jail we began operating in March 2008. The remaining net increase in operating expenses of \$0.4 million was due to various insignificant fluctuations in operating expenses at our numerous adult community-based facilities and programs.

As a percentage of segment revenues, the segment's operating expenses were 70.5% for the year ended December 31, 2008 compared to 73.5% for the year ended December 31, 2007. The 2008 operating margin was favorably impacted by increased operations driven by a change in the mix of services provided during the year.

Pre-Opening and Start-up Expenses. There were no pre-opening and start-up costs for the years ended December 31, 2008 and 2007. Pre-opening and start-up costs were approximately \$2.7 million for the year ended December 31, 2006 and were attributable to the Moshannon Valley Correctional Center. These expenses consisted primarily of personnel and related expenses, professional and recruiting expenses.

Depreciation and Amortization. Depreciation and amortization increased approximately \$1.9 million, or 11.9%, to \$17.9 million for the year ended December 31, 2008 from \$16.0 million for the year ended December 31, 2007. Depreciation increased approximately \$2.2 million due primarily to 1) an increase of \$1.2 million due to depreciation expense resulting from the facility expansion activations and related furniture, fixtures and equipment purchases at the Big Spring Correctional Center (in November 2007), the Great Plains Correctional Facility (in September 2008) and the D. Ray James Prison (in February 2008) and 2) additional depreciation expense of \$0.1 million as a result of the purchase of the High Plains Correctional Facility in May 2007 and the Washington, D.C. Facility in October 2007. Amortization of intangibles was approximately \$2.2 million and \$2.4 million the years ended December 31, 2008 and 2007, respectively.

General and Administrative Expenses. General and administrative expenses increased approximately \$0.5 million, or 2.0%, to \$26.0 million for the year ended December 31, 2008 from approximately \$25.5 million for the year ended December 31, 2007. General and administrative expenses for 2007 include our reimbursement to Veritas of approximately \$2.5 million of costs related to the Merger Agreement (see Note 13 to the consolidated financial statements concerning this Merger Agreement) and legal and professional fees and development costs of approximately \$1.2 million related to the Merger Agreement. Additionally, general and administrative costs for 2007 include a net \$1.5 million legal claims settlement received in August 2007.

Interest. Interest expense, net of interest income, decreased approximately \$0.3 million to \$24.0 million for the year ended December 31, 2008 from \$24.3 million for the year ended December 31, 2007. Interest income for the year ended December 31, 2008 includes a net gain of approximately \$1.2 million related to the change in fair value of certain derivative instruments pertaining to MCF, a special purpose entity (see Note 11 to the consolidated financial statements). Additionally, for the year ended December 31, 2008, we capitalized interest of \$2.9 million related to the facility expansion projects at the Great Plains Correctional Facility and the D. Ray James Prison. These were partially offset by increased interest expense of approximately \$2.4 million primarily driven by higher average borrowings outstanding in 2008 under our Amended Credit Facility, partially offset by a declining interest rate environment in 2008. For the year ended December 31, 2007, we capitalized interest of approximately \$1.2 million related to the facility expansion projects at the Big Spring Correctional Center, the D. Ray James Prison and the Great Plains Correctional Facility.

Income Taxes. For the year ended December 31, 2008, we recognized a provision for income taxes on our income from continuing operations at an estimated effective rate of 40.8%. For the year ended December 31, 2007, we recognized a provision for income taxes at an estimated effective rate of 42.6%. The reduction in the estimated income tax rate in 2008 is principally due to an increase in operating income across certain of our business segments, the decreased impact of certain nondeductible expenses and the utilization of various tax credits.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Revenues. Revenues decreased approximately \$0.3 million, or 0.08%, to \$360.6 million for the year ended December 31, 2007 from \$360.9 million for the year ended December 31, 2006.

Adult Secure Services. Adult Secure Services revenues increased approximately \$4.4 million, or 2.5%, to \$183.2 million for the year ended December 31, 2007 from \$178.8 million for the year ended December 31, 2006 due primarily to (1) an increase in revenues of \$9.7 million at the Moshannon Valley Correctional Center which opened in April 2006, (2) revenues of \$2.9 million at the High Plains Correctional Facility acquired in May 2007, (3) an increase in revenues of \$2.1 million at the Big Spring Correctional Center due to an increase in the effective per diem rate under our new take-or-pay contract with the BOP as well as increased occupancy as a result of the facility expansion completed in November 2007 and (4) an increase in revenues of approximately \$1.8 million at the Leo Chesney Community Correctional Facility and \$1.4 million at the D. Ray James Prison, both due primarily to per diem rate increases. The increase in revenues from the above was offset, in part, by (1) a decrease in revenues of \$7.2 million due to our termination of our management contract with OK DOC at the Great Plains Correctional Facility in April 2007 (the facility began receiving inmates under a new operating contract with the Arizona Department of Corrections in September 2007), (2) a decrease in revenues of approximately \$4.9 million at the Regional Correctional Center due to the withdrawal of inmates by ICE during the latter half of 2007 and (3) a decrease in revenues of \$2.1 million at the Donald W. Wyatt Detention Center due to the transition of our management contract to the facility's owner in July 2007. The remaining net increase in revenues of approximately \$0.7 million was due to various insignificant fluctuations in revenues at our other adult secure facilities.

Average contract occupancy was 100.4% for the year ended December 31, 2007 compared to 98.2% for the year ended December 31, 2006.

The average per diem rate was \$54.69 for the year ended December 31, 2007 compared to \$56.12 for the year ended December 31, 2006. The 2007 average per diem rate was unfavorably impacted by the increase in population at the Moshannon Valley Correctional Center which opened in April 2006. This facility is operated under a take-or-pay contract. As a result, the average per diem rate will decrease as population increases. The facility was ramping up in population subsequent to its April 2006 opening; as a result, the higher occupancy in 2007 lowered the average per diem rate for the Adult Secure Services division. Additionally, the 2006 average per diem rate benefited from the receipt of a contract based revenue adjustment for the contract year ended March 2006 in the net amount of \$2.4 million at the RCC. There were no revenues attributable to start-up operations for the years ended December 31, 2007 and 2006.

Abraxas Youth and Family Services. Abraxas Youth and Family Services revenues decreased approximately \$6.5 million, or 5.6%, to \$109.3 million for the year ended December 31, 2007 from \$115.8 million for the year ended December 31, 2006 due primarily to (1) a decrease in revenues of \$9.9 million due to the termination of our management contract at the Alexander Youth Services Center in January 2007, (2) a decrease in revenues of \$1.9 million due to the termination of our management contract at the South Mountain Secure Treatment Unit ("SMSTU") in June 2006 and (3) a decrease in revenues of \$1.2 million due to the termination of our management contract for the Harrisburg Alternative Education School Program. In July 2007, we were notified that the funding for this program was discontinued for the 2007-2008 school year. The decrease in revenues due to the above was offset, in part, by (1) an increase in revenues of \$3.5 million at the Cornell Abraxas Academy which we reactivated in October 2006, (2) revenues of approximately \$0.7 million at the Hector Garza Residential Treatment Center which we reactivated in August 2007 and (3) an increase in revenues of approximately \$1.6 million at the Leadership Development Program due to increased occupancy. The remaining net increase in revenues of approximately \$0.7 million was due to various insignificant fluctuations in revenues at our other Abraxas Youth and Family Services facilities and programs.

Average contract occupancy was 92.0% for the year ended December 31, 2007 compared to 93.2% for the year ended December 31, 2006.

The average per diem rate for our Abraxas Youth and Family Services facilities was approximately \$174.93 for the year ended December 31, 2007 compared to approximately \$170.33 for the year ended December 31, 2006. The increase in the 2007 average per diem rate was due primarily to the reactivation of the Cornell Abraxas Academy in October 2006 and the Hector Garza Residential Treatment Center in August 2007. Additionally, we received annual rate increases at certain of our other Abraxas Youth and Family Services residential facilities. The average fee-for-service rate for our non-residential community-based Abraxas Youth and Family Services facilities and programs was approximately \$44.35 for the year ended December 31, 2007 compared to approximately \$37.59 for the year ended December 31, 2006. Our average fee-for-service rate can fluctuate from year to year depending on the mix of services provided at our various non-residential Abraxas Youth and Family Services facilities and programs. There were no revenues attributable to start-up operations for the years ended December 31, 2007 and 2006.

Adult Community-Based Services. Adult Community-Based Services revenues increased approximately \$1.8 million, or 2.7%, to \$68.1 million for the year ended December 31, 2007 from \$66.3 million for the year ended December 31, 2006 principally due to an increase in revenues of approximately \$0.8 million from the operations of two jails in California which we began managing in January 2007 and an increase in revenues of approximately \$0.5 million at the Las Vegas Center due to increased occupancy. Additionally, we had a decrease in revenues of approximately \$0.9 million due to the termination of our management contract for the SWICC Turning Point Program in October 2006. The remaining net increase in revenues of \$1.4 million was due to various insignificant fluctuations in revenues at our various adult community-based facilities and programs.

Average contract occupancy was 101.1% for the year ended December 31, 2007 compared to 97.7% for the year ended December 31, 2006.

The average per diem rate for our residential Adult Community-Based Services facilities was \$62.91 for the year ended December 31, 2007 compared to \$61.71 for the year ended December 31, 2006. The average fee-for-service rate for our non-residential Adult Community-Based Services facilities and programs was approximately \$13.70 for the year ended December 31, 2007 compared to approximately \$11.23 for the year ended December 31, 2006. Our average fee-for-service rates can fluctuate from year to year due to changes in the mix of services provided by our various non-residential Adult Community-Based Services facilities and programs. There were no revenues attributable to start-up operations for the years ended December 31, 2007 and 2006.

Operating Expenses. Operating expenses decreased approximately \$0.9 million, or 0.3%, to \$274.1 million for the year ended December 31, 2007 from \$275.0 million for the year ended December 31, 2006.

Adult Secure Services. Adult Secure Services operating expenses increased approximately \$7.2 million, or 5.8%, to \$130.5 million for the year ended December 31, 2007 from \$123.3 million for the year ended December 31, 2006 due primarily to (1) an increase in operating expenses of \$7.9 million at the Moshannon Valley Correctional Center which opened in April 2006 (approximately \$2.7 million of operating expenses at this facility were included in pre-opening and start-up expenses in 2006), (2) an increase in operating expenses of \$2.6 million at the High Plains Correctional Facility purchased in May 2007, (3) an increase in operating expenses of \$0.8 million at the Big Spring Correctional Center due to increased occupancy following completion of a facility expansion in November 2007 and (4) an increase in operating expenses of \$0.5 million at the Leo Chesney Correctional Center due to increased occupancy. The increase in operating expenses due to the above was offset, in part, by (1) a decrease in operating expenses of \$2.2 million due to our termination of our contract at the Great Plains Correctional Facility with the OK DOC in April 2007 (the facility began receiving inmates under our contract with the Arizona Department of Corrections in September 2007) and (2) a decrease in operating expenses of \$1.7 million due to the transition of our management contract at the Donald W. Wyatt Detention Center to the facility's owner in July 2007. The remaining net decrease in operating expenses of approximately \$0.7 million was due to various insignificant fluctuations in operating expenses at our other adult secure facilities.

As a percentage of segment revenues, Adult Secure Services operating expenses were 71.2% for the year ended December 31, 2007 compared to 68.9% for the year ended December 31, 2006. The increase in the 2007 percentage reflects the stabilization of the operating margin at the Moshannon Valley Correctional Center (which operates under a take-or-pay contract) subsequent to its activation in April 2006. Additionally, the 2007 operating margin was negatively impacted by the termination of our contract at the Great Plains Correctional Facility in April 2007 as we transitioned to its reactivation in September 2007 under our new contract with the Arizona Department of Corrections.

Abraxas Youth and Family Services. Abraxas Youth and Family Services operating expenses decreased approximately \$6.6 million, or 6.6%, to approximately \$93.5 million for the year ended December 31, 2007 from \$100.1 million for the year ended December 31, 2006 due primarily to (1) a decrease in operating expenses of \$9.1 million due to the termination of our management contract at the Alexander Youth Services Center in January 2007, (2) a decrease in operating expenses of \$1.6 million due to the termination of our management contract at the SMSTU in June 2006 and (3) a decrease in operating expenses of \$0.7 million due to the termination of our management contract for the Harrisburg Alternative Education School Program (in July 2007, we were notified that the funding for this program was discontinued for the 2007-2008 school year). The decrease in operating expenses due to the above was offset, in part, by various increases (totaling approximately \$4.8 million) in operating expenses at both our residential and non-residential Abraxas Youth and Family Services facilities and programs, including an increase in operating expenses of approximately \$1.7 million due to the reactivation of the Cornell Abraxas Academy in October 2006, as well as an increase in operating expenses of \$0.6 million at our Washington, D.C. facility as 2006 operating expenses at this facility were reflected in discontinued operations in the year ended December 31, 2006.

As a percentage of segment revenues, Abraxas operating expenses were 85.5% for the year ended December 31, 2007 compared to 86.4% for the year ended December 31, 2006.

Adult Community-Based Services. Adult Community-Based Services operating expenses decreased approximately \$1.6 million, or 3.1%, to \$50.1 million for the year ended December 31, 2007 from \$51.7 million for the year ended December 31, 2006 due to various fluctuations in operating expenses at our numerous adult community-based facilities and programs including a decrease in operating expenses of approximately \$0.9 million due to the termination of our management contract for the SWICC Turning Point Program in October 2006 and a decrease in divisional administrative costs of approximately \$1.1 million. Additionally, we had an increase in operating expenses of approximately \$0.6 million from the two jails in California we began operating in January 2007.

As a percentage of segment revenues, the segment's operating expenses were 73.5% for the year ended December 31, 2007 compared to 78.0% for the year ended December 31, 2006. The 2007 operating margin was favorably impacted by lower divisional administrative costs in year ended December 31, 2007 as compared to the year ended December 31, 2006.

Pre-Opening and Start-up Expenses. There were no pre-opening and start-up costs for the year ended December 31, 2007. Pre-opening and start-up costs were approximately \$2.7 million for the year ended December 31, 2006 and were attributable to the Moshannon Valley Correctional Center. These expenses consisted primarily of personnel and related expenses, professional and recruiting expenses.

Depreciation and Amortization. Depreciation and amortization decreased approximately \$0.3 million, or 1.8%, to \$16.0 million for the year ended December 31, 2007 from \$16.3 million for the year ended December 31, 2006. Depreciation and amortization of property and equipment declined approximately \$0.6 million due to a decrease in depreciation expenses related to certain fully depreciated (in 2007) furniture and fixtures, computer and other equipment of approximately \$1.1 million, offset, in part, by an increase in building depreciation expense of approximately \$0.8 million related primarily to the Moshannon Valley Correctional Center which opened in April 2006, the High Plains Correctional Facility purchased in May 2007 and the purchase of the Washington, D.C. facility in October 2007. Amortization of intangibles was approximately \$2.4 million and \$2.2 million the years ended December 31, 2007 and 2006, respectively.

General and Administrative Expenses. General and administrative expenses increased approximately \$3.8 million, or 17.5%, to \$25.5 million for the year ended December 31, 2007 from approximately \$21.7 million for the year ended December 31, 2006 due primarily to (1) our reimbursement to Veritas of approximately \$2.5 million of costs related to the Merger Agreement (see Note 13 to the consolidated financial statements concerning this Merger Agreement), (2) an increase in legal and professional fees and development costs of approximately \$1.2 million related to the Merger Agreement and (3) an increase in stock-based compensation expense of approximately \$0.7 million. The increase in general and administrative expenses due to the above was offset, in part, by the net \$1.5 million legal claims settlement received in August 2007.

Interest. Interest expense, net of interest income, increased approximately \$1.2 million to \$24.3 million for the year ended December 31, 2007 from \$23.1 million for the year ended December 31, 2006. For the year ended December 31, 2007, we capitalized interest of approximately \$1.2 million related to the facility expansion projects at the Big Spring Correctional Center, the D. Ray James Prison and the Great Plains Correctional Facility. For the year ended December 31, 2006, we capitalized interest of approximately \$1.5 million related to the Moshannon Valley Correctional Center. Furthermore, we incurred interest expense of approximately \$0.4 million related to our Amended Credit Facility during the year ended December 31, 2007 (none incurred in 2006). The decrease was also due to a reduction in interest income from approximately \$3.1 million in the year ended December 31, 2006 to approximately \$2.0 million in the year ended December 31, 2007 (due to lower levels of invested funds (and rates) due to the on-going 2007 expansion projects and acquisitions). These were partially offset by reduced interest expense of approximately \$0.8 million on the MCF bonds due to a \$10.5 million principal payment made in July 2007.

Income Taxes. For the year ended December 31, 2007, we recognized a provision for income taxes on our income from continuing operations at an estimated effective rate of 42.6%. For the year ended December 31, 2006, we recognized a provision for income taxes at an estimated effective rate of 42.1%.

Liquidity and Capital Resources

General. Our primary capital requirements are for (1) purchases, construction or renovation of new facilities, (2) expansions of existing facilities, (3) working capital, (4) pre-opening and start-up costs related to new operating contracts, (5) acquisitions of businesses or facilities, (6) information systems hardware and software and (7) furniture, fixtures and equipment. Working capital requirements generally increase immediately prior to commencing management of a new facility (or activation of facility expansion) as we incur start-up costs and purchase necessary equipment and supplies before facility management revenue is realized.

Cash Flows From Operations. Cash provided by operating activities was approximately \$59.0 million for the year ended December 31, 2008 compared to approximately \$27.2 million for the year ended December 31, 2007. The increase over the prior year was principally due to higher net income as well as changes in certain working capital accounts (including principally accounts receivable and accounts payable) due to timing of payments received and made.

Cash Flows From Investing Activities. Cash used in investing activities was approximately \$81.7 million for the year ended December 31, 2008 due to (1) capital expenditures of \$79.9 million related primarily to the facility expansion projects at the Great Plains Correctional Facility and the D. Ray James Prison, (2) net payments to the restricted debt payment account of approximately \$2.9 million, (3) proceeds from the sale of fixed assets of \$0.8 million and (4) sales of investment securities of \$0.3 million. Cash used in investing activities was approximately \$64.5 million in the year ended December 31, 2007 due to (1) capital expenditures of approximately \$50.9 million related primarily to construction costs associated with the Big Spring Correctional Center and the D. Ray James Prison expansions and development of the Hudson, Colorado site, (2) net sales of investment securities of \$11.7 million, (3) the purchase of the Washington, D.C. facility for \$9.6 million, (4) the purchase of the High Plains Correctional Facility for approximately \$8.9 million, (5) the Hudson, Colorado site acquisition of approximately \$5.1 million and (6) net payments to the restricted debt payment account of approximately \$2.1 million.

Cash Flows From Financing Activities. Cash provided by financing activities was approximately \$34.3 million for the year ended December 31, 2008 due to (1) net borrowings on our Amended Credit Facility of \$45.0 million and (2) proceeds from the exercise of stock options of \$0.6 million, partially offset by payments on MCF bonds of \$11.4 million. Cash provided by financing activities was approximately \$21.8 million for the year ended December 31, 2007 due primarily to borrowings on our Amended Credit Facility of \$30.0 million, partially offset by a \$10.5 million payment on MCF's bonds in July 2007 and proceeds from the exercise of stock options and warrants of approximately \$2.8 million. Additionally, we recognized a tax benefit on stock option exercises of approximately \$0.4 million and had payments of approximately \$0.8 million for financing costs related to our Amended Credit Facility.

Long-Term Credit Facilities. Our Amended Credit Facility provides for borrowings up to \$100.0 million (including letters of credit), matures in December 2011 and bears interest, at our election depending on our total leverage ratio, at either the LIBOR rate plus a margin ranging from 1.50% to 2.25%, or a rate which ranges from 0.00% to 0.75% above the applicable prime rate. The available commitment under our Amended Credit Facility was approximately \$10.1 million at December 31, 2008. We had outstanding borrowings under our Amended Credit Facility of \$75.0 million and we had outstanding letters of credit of approximately \$14.9 million at December 31, 2008. Subject to certain requirements, we have the right to increase the commitments under our Amended Credit Facility up to \$150.0 million, although the indenture for our Senior Notes limits our ability, subject to certain conditions, to expand the Amended Credit Facility beyond \$100.0 million. We can provide no assurance that all of the banks that have made commitments to us under our Amended Credit Facility would be willing to participate in an expansion to the Amended Credit Facility should we desire to do so. The Amended Credit Facility is collateralized by substantially all of our assets, including the assets and stock of all of our subsidiaries. The Amended Credit Facility is not secured by the assets of MCF, a special purpose entity. Our Amended Credit Facility contains commonly used covenants including compliance with laws and limitations on certain financing transactions and mergers and also includes various financial covenants. We believe the most restrictive covenant under our Amended Credit Facility is the fixed charge coverage ratio. At December 31, 2008, we were in compliance with all of our debt financial covenants.

MCF is obligated for the outstanding balance of its 8.47% Taxable Revenue Bonds, Series 2001. The bonds bear interest at a rate of 8.47% per annum and are payable in semi-annual installments of interest and annual installments of principal. All unpaid principal and accrued interest on the bonds is due on the earlier of August 1, 2016 (maturity) or as noted under the bond documents. The bonds are limited, nonrecourse obligations of MCF and secured by the property and equipment, bond reserves, assignment of subleases and substantially all assets related to the facilities included in the 2001 Sale and Leaseback Transaction (in which we sold eleven facilities (as identified in Item 1 of this report) to MCF). The bonds are not guaranteed by Cornell.

In June 2004, we issued \$112.0 million in principal of 10.75% Senior Notes (the "Senior Notes") due July 1, 2012. The Senior Notes are unsecured senior indebtedness and are guaranteed by all of our existing and future subsidiaries (collectively, "the Guarantors"). The Senior Notes are not guaranteed by MCF (the "Non-Guarantor"). Interest on the Senior Notes is payable semi-annually on January 1 and July 1 of each year, commencing January 1, 2005. On or after July 1, 2008, we may redeem all or a portion of the Senior Notes at the redemption prices (expressed as a percentage of the principal amount) listed below, plus accrued and unpaid interest, if any, on the Senior Notes redeemed, to the applicable date of redemption, if redeemed during the 12-month period commencing on July 1 of each of the years indicated below:

<u>Year</u>	<u>Percentages</u>
2008	105.375 %
2009	102.688 %
2010 and thereafter	100.000 %

Upon the occurrence of specified change of control events, unless we have exercised our option to redeem all the Senior Notes as described above, each holder will have the right to require us to repurchase all or a portion of such holder's Senior Notes at a purchase price in cash equal to 101% of the aggregate principal amount of the notes repurchased plus accrued and unpaid interest, if any, on the Senior Notes repurchased, to the applicable date of purchase. The Senior Notes were issued under an indenture which limits our ability and the ability of our Guarantors to, among other things, incur additional indebtedness, pay dividends or make other distributions, make other restricted payments and investments, create liens, incur restrictions on the ability of the Guarantors to pay dividends or other payments to us, enter into transactions with affiliates, and engage in mergers, consolidations and certain sales of assets.

In conjunction with the issuance of the Senior Notes, we entered into an interest rate swap transaction with a financial institution to hedge our exposure to changes in the fair value on \$84.0 million of our Senior Notes. The purpose of this

transaction was to convert future interest due on \$84.0 million of the Senior Notes to a variable rate. The terms of the interest rate swap contract and the underlying debt instrument were identical. The swap agreement was designated as a fair value hedge. The swap had a notional amount of \$84.0 million and matured in July 2012 to mirror the maturity of the Senior Notes. Under the agreement, we paid, on a semi-annual basis (each January 1 and July 1), a floating rate based on a six-month U.S. dollar LIBOR rate, plus a spread, and receive a fixed-rate interest of 10.75%. For the year ended December 31, 2007, we recorded interest expense related to this interest rate swap of approximately \$0.1 million. Because the swap agreement was an effective fair-value hedge, there was no effect on our results of operations from the mark-to-market adjustment while the swap was in effect. In October 2007, we terminated the swap agreement. We received approximately \$0.2 million in conjunction with the termination, which is being amortized over the remaining term of the Senior Notes.

Future Liquidity

Our shelf registration statement on Form S-3 for potential offerings from time to time of up to \$75.0 million in gross proceeds of debt securities, common stock, preferred stock, warrants or certain other securities was declared effective by the Securities and Exchange Commission in September 2008.

We expect to use existing cash balances, internally generated cash flows and borrowings from our Amended Credit Facility to fulfill anticipated obligations such as capital expenditures, working-capital needs and scheduled debt maturities over at least the next twelve months. As of December 31, 2008 we have approximately \$10.1 million of available capacity under our Amended Credit Facility. We will continue to analyze our capital structure, including a potential refinancing of our Senior Notes and financing for our expected future capital expenditures, including any potential acquisitions. We will consider potential acquisitions from time to time. Our principal focus for acquisitions is anticipated to be in our Adult Secure and Adult Community-Based divisions, although we would also pursue attractively priced acquisitions in our Abraxas Youth and Family Services division. We may decide to use internally generated funds, bank financing, equity issuances, debt issuances or a combination of any of the foregoing to finance our future capital needs. At December 31, 2008 we believe we have sufficient liquidity necessary to complete those projects for which we have outstanding commitments.

Our internally generated cash flow is directly related to our business. Should the private corrections and juvenile businesses deteriorate, or should we experience poor results in our operations, cash flow from operations may be reduced. We have, however, continued to generate positive cash flow from operating activities over recent years and expect that cash flow will continue to be positive over the next year. Our access to debt and equity markets may be reduced or closed to us due to a variety of events, including, among others, restrictions under our Senior Notes indenture or our Amended Credit Facility, industry conditions, general economic conditions, market conditions, credit rating agency downgrades of our debt and/or market perceptions of us and our industry. The extreme volatility seen in the financial markets beginning in the third quarter of 2008 has continued into the first quarter of 2009 and is expected to be present for the near term. Such volatility could result in decreased availability of capital at economical terms and could also put additional financial and budgetary pressure on our customers. Such conditions could potentially result in our inability to pursue additional future growth opportunities (such as facility expansions or new facility construction) and, if coupled with unexpected client, operational or other issues affecting our cash flow, in a need to seek additional financing at terms we would otherwise not accept.

In addition, our accounts receivable are with federal, state, county and local government agencies, which we believe generally reduces our credit risk. However, it is possible that situations such as continuing budget resolutions, delayed passage of budgets or budget pressures, may increase the length of repayment of certain of these receivables.

Contractual Uncertainties Related to Certain Facilities

Regional Correctional Center. The Office of Federal Detention Trustee (“OFDT”) holds the contract for the use of the Regional Correctional Center on behalf of ICE, USMS and the BOP with Bernalillo County through an intergovernmental services agreement, and we have an operating and management agreement with Bernalillo County. In July 2007, we were notified by ICE that it was removing all ICE detainees from the Regional Correctional Center and the removal was completed in early August 2007. The facility is still being utilized by the USMS, and since May 2008 by the BOP, but not at its full capacity. In February 2008, ICE informed us that it would not resume use of the facility. In February 2008, OFDT attempted to unilaterally amend its agreement with the County to reduce the number of minimum annual guaranteed mandays under the agreement from 182,500 to 66,300. Neither we nor the County believe OFDT has the right to unilaterally amend the contract in this manner, and OFDT has been informed of our position. Although either party to the intergovernmental services agreement has the right to terminate upon 180 days notice, neither party has exercised such right as of December 31, 2008.

Also, there is a motion pending in a lawsuit against the County concerning the County jail system that could involve the Regional Correctional Center in such case. Jimmy McClendon and other plaintiffs sued the County in federal district court in

the District of New Mexico in 1994 over conditions at the county jail, which was then located at what is now the Regional Correctional Center and run by the County. The County subsequently built their new Metropolitan Detention Center to house the County inmates and also negotiated two stipulated agreements in 2004 designed to end the McClendon lawsuit. The court in that case is considering the application of the lawsuit to the Regional Correctional Center as a result of the County's ownership of the facility. The County has informed us that, should the court rule that the case applies to the facility, it plans to appeal the decision since the County does not believe McClendon should apply to the Regional Correctional Center. We do not believe we are contractually obligated to bear any incremental costs of complying with McClendon although the County has expressed its desire for us to absorb a portion of any costs that would be incurred. Should the court rule that the lawsuit applies to the facility, we would further discuss the matter with the County. We plan to continue to operate the facility and also continue with our marketing plans for the Regional Correctional Center.

Revenues for this facility were approximately \$9.9 million (including a \$1.5 million contract-based revenue adjustment for the contract year ended March 2008) and \$12.8 million for the years ended December 31, 2008 and 2007, respectively. The net carrying value of the leasehold improvements for this facility was approximately \$1.1 million and \$3.0 million at December 31, 2008 and 2007, respectively. Our lease for this facility requires monthly rent payments of approximately \$0.13 million for the remaining term of the lease (through June 2009). To date, we have brought in the BOP as an additional customer for this facility; however the facility still has available capacity. Our inability to expand the existing population with current or new customers could have an adverse effect on our financial condition, results of operations and cash flows. We believe that pursuant to the provisions of SFAS No. 144, no impairment to the carrying value of the leasehold improvements for this facility has occurred.

Hector Garza Residential Treatment Center. In October 2005, we initiated the temporary closure of this MCF leased facility in San Antonio, Texas. We reactivated the facility during the third quarter of 2007. The net carrying value for this facility was approximately \$4.0 million and \$4.2 million at December 31, 2008 and 2007, respectively. We believe that, pursuant to the provisions of SFAS No. 144, no impairment to the carrying value of this facility has occurred due to existing demand from current customers and anticipated incremental demand from additional multiple customers to whom the facility is being marketed.

Projects Under Development, Construction or Renovation

For a discussion of our expansion projects at the Great Plains Correctional Facility in Hinton, Oklahoma, the D. Ray James Prison in Folkston, Georgia and the Walnut Grove Youth Correctional Facility in Walnut Grove, Mississippi, see “-Significant 2008 Events.”

Treasury Stock Repurchases

We did not purchase any of our common stock in the years ended December 31, 2008 and 2007.

Under the terms of our Senior Notes and our Amended Credit Facility, we can purchase shares of our stock subject to certain cumulative restrictions.

Contractual Obligations and Commercial Commitments

We have assumed various financial obligations and commitments in the ordinary course of conducting our business. We have contractual obligations requiring future cash payments, such as management, consulting and non-competition agreements.

We maintain operating leases in the ordinary course of our business activities. These leases include those for operating facilities, office space and office and operating equipment, and the agreements expire between 2009 and 2075. As of December 31, 2008, our total commitment under these operating leases was approximately \$120.6 million.

The following table details the known future cash payments (on an undiscounted basis) related to various contractual obligations as of December 31, 2008 (in thousands):

	Payments Due by Period				
	Total	2009	2010 - 2011	2012 - 2013	Thereafter
Contractual Obligations:					
Long-term debt — principal					
• Cornell Companies, Inc.	\$ 112,000	\$ —	\$ —	\$ 112,000	\$ —
• Special Purpose Entities.....	134,100	12,400	28,000	33,000	60,700
Long-term debt — interest					
• Cornell Companies, Inc.	42,140	12,040	24,080	6,020	—
• Special Purpose Entities.....	55,936	11,358	19,482	14,534	10,562
Revolving line of credit-principal					
• Cornell Companies, Inc.	75,000	—	75,000	—	—
Revolving line of credit-interest					
• Cornell Companies, Inc.	6,518	2,205	4,313	—	—
Capital lease obligations					
• Cornell Companies, Inc.	26	12	14	—	—
Construction commitments	6,795	6,795	—	—	—
Operating leases.....	120,635	7,598	16,662	21,748	74,627
Consultative and non-competition agreements	324	324	—	—	—
Total contractual cash obligations	<u>\$ 553,474</u>	<u>\$ 52,732</u>	<u>\$ 167,551</u>	<u>\$ 187,302</u>	<u>\$ 145,889</u>

Approximately \$2.5 million of unrecognized tax benefits have been recorded as liabilities in accordance with FIN 48 but are not included in the contractual obligations table because we are uncertain as to if or when such amounts may be settled. Related to the unrecognized tax benefits not included in the table above, we have also recorded a liability for potential penalties of approximately \$0.1 million and for interest of approximately \$0.1 million.

We enter into letters of credit in the ordinary course of operating and financing activities. As of December 31, 2008, we had outstanding letters of credit of approximately \$14.9 million primarily for certain workers' compensation insurance and other operating obligations. The following table details our letter of credit commitments as of December 31, 2008 (in thousands):

	Total Amounts Committed	Amount of Commitment Expiration Per Period			
		Less than 1 Year	1-3 Years	4-5 Years	More Than 5 Years
Commercial Commitments:					
Standby letters of credit	\$14,854	\$13,604	\$1,250	\$ —	\$ —

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business, we are exposed to market risk, primarily from changes in interest rates. We continually monitor exposure to market risk and develop appropriate strategies to manage this risk. We are not exposed to any other significant market risks, including commodity price risk, foreign currency exchange risk or interest rate risks from the use of derivative financial instruments. In conjunction with the issuance of the Senior Notes, we had previously entered into an interest rate swap of \$84.0 million related to the interest obligations under the Senior Notes, in effect converting them to a floating rate based on six-month LIBOR. As discussed in Part II, Item 8, Note 8 to the accompanying financial statements, we terminated the interest rate swap in October 2007.

Credit Risk

Due to the short duration of our investments, changes in market interest rates would not have a significant impact on their fair value. In addition, our accounts receivables are with federal, state, county and local government agencies, which we believe generally reduces our credit risk. However, it is possible that such situations as continuing budget resolutions, delayed passage of budgets or budget pressures may increase the length of repayment of certain receivables.

Interest Rate Exposure

Our exposure to changes in interest rates primarily results from our Amended Credit Facility, as these borrowings have floating interest rates. The debt on our consolidated financial statements at December 31, 2008 with fixed interest rates consist of the 8.47% Bonds issued by MCF in August 2001 in connection with the 2001 Sale and Leaseback Transaction and \$112.0 million of Senior Notes. The detrimental effect of a hypothetical 100 basis point increase in interest rates on our current borrowings under our Amended Credit Facility would be to reduce income before provision for income taxes by approximately \$0.8 million for the year ended December 31, 2008. At December 31, 2008, the fair value of our consolidated fixed rate debt was approximately \$308.0 million based upon quoted market prices or discounted future cash flows using the same or similar securities.

Inflation

Other than personnel, resident/inmate medical costs at certain facilities, and employee medical and worker's compensation insurance costs, we believe that inflation has not had a material effect on our results of operations during the past two years. We have experienced significant increases in resident/inmate medical costs and employee medical and worker's compensation insurance costs, and we have also experienced higher personnel costs during the past two years. Most of our facility management contracts provide for payments of either fixed per diem fees or per diem fees that increase by only small amounts during the term of the contracts. Inflation could substantially increase our personnel costs (the largest component of our operating expenses), medical and insurance costs or other operating expenses at rates faster than any increases in contract revenues. Food costs (part of our resident/inmate care costs) have also been subject to rising prices in 2008. We believe we have limited our exposure through long-term contracts with fixed term pricing.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Cornell Companies, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and comprehensive income, of shareholders' equity, and of cash flows present fairly, in all material respects, the financial position of Cornell Companies, Inc. and its subsidiaries at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 7 to the consolidated financial statements, the Company changed the manner in which it accounts for uncertainty in income taxes effective January 1, 2007, in accordance with Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes."

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP
Houston, Texas
March 6, 2009

CORNELL COMPANIES, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	December 31,	
	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 14,613	\$ 3,028
Investment securities available for sale	—	250
Accounts receivable - trade (net of allowance for doubtful accounts of \$4,272 and \$4,372, respectively)	64,622	69,787
Other receivables (net of allowance for doubtful accounts of \$4,926 and \$5,126, respectively)	4,766	3,201
Debt service fund and other restricted assets	31,370	27,523
Deferred tax assets	9,151	6,750
Prepaid expenses and other	6,368	6,131
Total current assets	<u>130,890</u>	<u>116,670</u>
PROPERTY AND EQUIPMENT, net	450,354	383,952
OTHER ASSETS:		
Debt service reserve fund	23,750	23,638
Goodwill, net	13,308	13,355
Intangible assets, net	2,320	4,520
Deferred costs and other	16,299	20,152
Total assets	<u>\$ 636,921</u>	<u>\$ 562,287</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	\$ 69,093	\$ 57,502
Current portion of long-term debt	<u>12,412</u>	<u>11,411</u>
Total current liabilities	81,505	68,913
LONG-TERM DEBT, net of current portion	308,070	275,298
DEFERRED TAX LIABILITIES	17,491	13,226
OTHER LONG-TERM LIABILITIES	<u>1,688</u>	<u>4,401</u>
Total liabilities	408,754	361,838
MINORITY INTEREST	445	—
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.001 par value, 10,000,000 shares authorized, none issued	—	—
Common stock, \$.001 par value, 30,000,000 shares authorized, 16,238,685 and 16,068,677 shares issued and 14,732,522 and 14,553,631 shares outstanding, respectively	16	16
Additional paid-in capital	164,746	160,319
Retained earnings	73,318	51,127
Treasury stock (1,506,163 and 1,515,046 shares of common stock, at cost, respectively)	(12,034)	(12,105)
Accumulated other comprehensive income	1,676	1,092
Total stockholders' equity	<u>227,722</u>	<u>200,449</u>
Total liabilities and stockholders' equity	<u>\$ 636,921</u>	<u>\$ 562,287</u>

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

CORNELL COMPANIES, INC.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (LOSS)
(in thousands, except per share data)

	Year Ended December 31,		
	2008	2007	2006
REVENUES	\$ 386,724	\$ 360,604	\$ 360,855
OPERATING EXPENSES, EXCLUDING DEPRECIATION	280,630	274,110	275,395
PRE-OPENING AND START-UP EXPENSES	—	—	2,657
DEPRECIATION AND AMORTIZATION	17,943	15,986	16,285
GENERAL AND ADMINISTRATIVE EXPENSES	25,954	25,499	21,720
INCOME FROM OPERATIONS.....	62,197	45,009	44,798
INTEREST EXPENSE	26,946	26,215	26,130
INTEREST INCOME	(2,988)	(1,951)	(3,060)
INCOME FROM CONTINUING OPERATIONS BEFORE PROVISION FOR INCOME TAXES AND MINORITY INTEREST	38,239	20,745	21,728
PROVISION FOR INCOME TAXES	15,603	8,835	9,148
INCOME FROM CONTINUING OPERATIONS.....	22,636	11,910	12,580
MINORITY INTEREST IN CONSOLIDATED SPECIAL PURPOSE ENTITY	445	—	—
DISCONTINUED OPERATIONS, NET OF TAX BENEFIT OF \$381 in 2006	—	—	(707)
NET INCOME	<u>\$ 22,191</u>	<u>\$ 11,910</u>	<u>\$ 11,873</u>
EARNINGS PER SHARE:			
BASIC:			
Income from continuing operations	\$ 1.55	\$.84	\$.90
Loss from discontinued operations, net of tax	—	—	(.05)
Net income	<u>\$ 1.55</u>	<u>\$.84</u>	<u>\$.85</u>
DILUTED:			
Income from continuing operations	\$ 1.51	\$.82	\$.89
Loss from discontinued operations, net of tax	—	—	(.05)
Net income	<u>\$ 1.51</u>	<u>\$.82</u>	<u>\$.84</u>
NUMBER OF SHARES USED IN PER SHARE COMPUTATION:			
BASIC	14,298	14,149	13,918
DILUTED	14,698	14,480	14,059
COMPREHENSIVE INCOME (LOSS):			
Net income	\$ 22,191	\$ 11,910	\$ 11,873
Unrealized gain (loss) on derivative instruments, net of tax provision (benefit) of \$324, \$425 and (\$75), respectively	584	612	(108)
Comprehensive income	<u>\$ 22,775</u>	<u>\$ 12,522</u>	<u>\$ 11,765</u>

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

CORNELL COMPANIES, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share data)

	Common Stock		Additional	Retained	Treasury Stock		Deferred	Accumulated
	Shares	Par Value	Paid-In Capital	Earnings	Shares	Cost	Compensation	Other Comprehensive Income(Loss)
BALANCES AT JANUARY 1, 2006.....	15,352,159	15	151,329	27,091	1,562,987	(12,573)	(990)	589
EXERCISE OF STOCK OPTIONS.....	165,531	1	1,830	—	—	—	—	—
INCOME TAX BENEFIT FROM STOCK OPTION EXERCISES.....	—	—	224	—	—	—	—	—
ADOPTION OF SFAS NO. 123R.....	—	—	(990)	—	—	—	990	—
OTHER COMPREHENSIVE INCOME.....	—	—	—	—	—	—	—	(108)
DEFERRED AND OTHER STOCK COMPENSATION.....	58,327	—	1,622	—	—	—	—	—
ISSUANCE OF COMMON STOCK TO EMPLOYEE STOCK PURCHASE PLAN.....	—	—	—	—	(22,593)	265	—	—
ISSUANCE OF COMMON STOCK UNDER 2000 DIRECTOR'S STOCK PLAN.....	27,900	—	396	—	—	—	—	—
NET INCOME.....	—	—	—	11,873	—	—	—	—
BALANCES AT DECEMBER 31, 2006.....	15,603,917	16	154,411	38,964	1,540,394	(12,308)	—	481
ADOPTION OF FIN 48.....	—	—	—	253	—	—	—	—
EXERCISE OF STOCK OPTIONS AND WARRANTS.....	234,182	—	2,490	—	—	—	—	—
INCOME TAX BENEFIT FROM STOCK OPTION EXERCISES.....	—	—	355	—	—	—	—	—
OTHER COMPREHENSIVE INCOME.....	—	—	—	—	—	—	—	611
DEFERRED AND OTHER STOCK COMPENSATION.....	221,428	—	2,644	—	—	—	—	—
ISSUANCE OF COMMON STOCK TO EMPLOYEE STOCK PURCHASE PLAN.....	—	—	94	—	(25,348)	203	—	—
ISSUANCE OF COMMON STOCK UNDER 2000 DIRECTOR'S STOCK PLAN.....	9,150	—	325	—	—	—	—	—
NET INCOME.....	—	—	—	11,910	—	—	—	—
BALANCES AT DECEMBER 31, 2007.....	16,068,677	16	160,319	51,127	1,515,046	(12,105)	—	1,092
EXERCISE OF STOCK OPTIONS.....	36,390	—	444	—	—	—	—	—
INCOME TAX BENEFIT FROM STOCK OPTION EXERCISES.....	—	—	140	—	—	—	—	—
OTHER COMPREHENSIVE INCOME.....	—	—	—	—	—	—	—	584
DEFERRED AND OTHER STOCK COMPENSATION.....	120,137	—	3,271	—	—	—	—	—
ISSUANCE OF COMMON STOCK TO EMPLOYEE STOCK PURCHASE PLAN.....	—	—	82	—	(8,883)	71	—	—
ISSUANCE OF COMMON STOCK UNDER 2000 DIRECTOR'S STOCK PLAN.....	13,481	—	490	—	—	—	—	—
NET INCOME.....	—	—	—	22,191	—	—	—	—
BALANCES AT DECEMBER 31, 2008.....	16,238,685	\$ 16	\$ 164,746	\$ 73,318	1,506,163	\$ (12,034)	\$ —	\$ 1,676

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

CORNELL COMPANIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income.....	\$ 22,191	\$ 11,910	\$ 11,873
Adjustments to reconcile net income to net cash provided by operating activities			
Minority interest in consolidated special purpose entity.....	445	—	—
Impairment of long-lived assets	250	—	355
Depreciation.....	15,742	13,580	14,042
Amortization of intangibles and other assets	2,200	2,406	2,243
Amortization of deferred financing costs	2,728	1,552	1,772
Amortization of Senior Notes discount	184	184	184
Stock-based compensation	3,570	2,645	1,970
Provision for bad debts.....	2,741	2,063	2,702
Gain on derivative instruments.....	1,160	—	—
Loss/(gain) on sale of property and equipment	84	(190)	(119)
Deferred income taxes.....	1,458	397	3,216
Change in assets and liabilities, net of acquisitions:			
Accounts receivable.....	614	(3,757)	(10,432)
Other restricted assets.....	(1,058)	(665)	976
Other assets.....	1,783	2,060	44
Accounts payable and accrued liabilities	7,771	(4,890)	780
Other liabilities	(2,884)	(51)	58
Net cash provided by operating activities	58,979	27,244	29,664
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(79,915)	(50,890)	(12,317)
Purchases of investment securities	—	(241,425)	(427,600)
Sales of investment securities	250	253,100	422,925
Facility acquisitions	—	(18,554)	—
Site acquisition.....	—	(5,053)	—
Proceeds from sale of property and equipment	846	375	2,892
Payments to restricted debt payment account, net.....	(2,901)	(2,084)	(3,367)
Net cash used in investing activities	(81,720)	(64,531)	(17,467)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from line of credit.....	49,000	30,000	—
Payments of MCF bonds.....	(11,400)	(10,500)	(9,700)
Payments of line of credit	(4,000)	—	—
Payments of capital lease obligations.....	(11)	(10)	(11)
Payments for debt issuance and other financing costs.....	—	(845)	—
Tax benefit of stock option exercises.....	140	355	224
Proceeds from exercise of stock options and warrants	597	2,786	2,096
Net cash (used in) provided by financing activities.....	34,326	21,786	(7,391)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS.....	11,585	(15,501)	4,806
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	3,028	18,529	13,723
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 14,613</u>	<u>\$ 3,028</u>	<u>\$ 18,529</u>
SUPPLEMENTAL CASH FLOW DISCLOSURE:			
Interest paid, net of capitalized interest of \$2,886, \$1,172 and \$1,494, respectively	\$ 18,596	\$ 30,672	\$ 25,317
Income taxes paid	<u>\$ 12,048</u>	<u>\$ 7,613</u>	<u>\$ 3,947</u>
OTHER NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Decrease in fair value of interest rate swap.....	\$ —	\$ (1,053)	\$ (908)
Purchases and additions to property and equipment included in accounts payable and accrued liabilities.....	3,409	4,156	—
Common stock issued for board of directors fees	490	325	396
Equipment additions under capital leases	—	—	56

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

CORNELL COMPANIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF THE BUSINESS

Cornell Companies, Inc. (collectively with its subsidiaries and consolidated special purpose entities, unless the context requires otherwise, “Cornell,” the “Company,” “we,” “us,” or “our,”) a Delaware corporation provides integrated development, design, construction and management of facilities to governmental agencies within three operating segments: (1) Adult Secure Services; (2) Abraxas Youth and Family Services and (3) Adult Community-Based Services.

2. SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The accompanying consolidated financial statements include the accounts of the Company, our wholly-owned subsidiaries, and our activities relative to a financing of operating facilities. All significant intercompany balances and transactions have been eliminated. Minority interest in consolidated special purpose entities represents equity that other investors have contributed to the special purpose entities. Minority interest is adjusted for income and losses allocable to the owners of the special purpose entities. As the cumulative losses of the special purpose entity exceed the equity that is recorded as minority interest, the excess losses are recorded in our Statements of Operations and Comprehensive Income (Loss).

Cash and Cash Equivalents

We consider all highly liquid unrestricted investments with original maturities of three months or less to be cash equivalents. We invest our available cash balances in short term money market accounts, short term certificates of deposit and commercial paper.

Investment Securities

We had no investment securities at December 31, 2008. Our investment securities at December 31, 2007 consisted of certificates of deposit.

Our certificates of deposit which totaled approximately \$0.3 million at December 31, 2007 earned interest at a rate of 3.80% at December 31, 2007. They had original maturities of one year.

Our marketable securities were categorized as available-for-sale securities. Unrealized marketable securities gains and temporary losses were reflected as a net amount under the caption of accumulated other comprehensive income within the statement of stockholders’ equity. Realized gains and losses were recorded within the statement of income under the caption interest income or interest expense. For the purpose of computing realized gains and losses, cost was identified on a specific identification basis.

Contractual maturities of the underlying investment securities held at December 31, 2007 matured in less than one year.

Accounts Receivable and Related Allowance for Doubtful Accounts

We extend credit to the governmental agencies and other parties with which we contract in the normal course of business. We regularly review our outstanding receivables and historical collection experience, and provide for estimated losses through an allowance for doubtful accounts. In evaluating the adequacy of our allowance for doubtful accounts, we make judgments regarding our customers’ ability to make required payments, economic events and other factors. As the financial condition of these parties change, circumstances develop or additional information becomes available, adjustments to the allowance for doubtful accounts may occur. If, after reasonable collection efforts have been made, a receivable is determined to be permanently uncollectible, it will be written off.

At December 31, 2008 and 2007, other receivables include approximately \$4.9 million and \$5.1 million related to misappropriated escrow funds for the Southern Peaks Regional Treatment Center, which is fully reserved at December 31, 2008 and 2007.

The changes in allowance for doubtful accounts associated with trade accounts receivable for the years ended December 31, 2008, 2007 and 2006 are as follows (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Balance at beginning of period	\$ 4,372	\$ 3,644	\$ 3,278
Provision for bad debts	2,741	2,063	2,702
Write-offs of uncollectible accounts	(2,841)	(1,335)	(2,336)
Balance at end of period	<u>\$ 4,272</u>	<u>\$ 4,372</u>	<u>\$ 3,644</u>

Restricted Assets

Restricted assets at December 31, 2008 and 2007 include approximately \$27.9 million and \$25.0 million, respectively, of Municipal Correctional Finance, LP's ("MCF") restricted cash accounts. MCF's restricted accounts primarily consist of a debt service fund used to segregate rental payment funds from us to MCF for MCF's semi-annual debt service. MCF's funds are typically invested in short term certificates of deposit, money market accounts and commercial paper. They will be used to fund a portion of MCF's debt service due in the coming year.

At certain facilities, we maintain bank accounts for restricted cash belonging to facility residents, commissary operations and equipment replacement funds used in certain state programs. Restricted assets at December 31, 2008 and 2007 include approximately \$3.4 million and \$2.5 million, respectively, for these accounts. A corresponding liability for these obligations is included in accrued liabilities in the accompanying financial statements.

Property and Equipment

Property and equipment are recorded at cost. Ordinary maintenance and repair costs are expensed, while renewal and betterment costs are capitalized. Buildings and improvements are depreciated over their estimated useful lives of 30 to 50 years using the straight-line method. Prepaid facility use cost, which resulted from the July 1996 acquisition of the Big Spring Correctional Center and the December 1999 transfer of ownership of the Great Plains Correctional Facility to a leasehold interest, is being amortized over 50 years using the straight-line method. Furniture and equipment are depreciated over their estimated useful lives of 3 to 10 years using the straight-line method. Amortization of leasehold improvements (including those funded by landlord incentives or allowances) is recorded using the straight-line method based upon the shorter of the economic life of the asset or the term of the respective lease. Landlord incentives or allowances under operating leases are recorded as deferred rent and amortized as a reduction of rent expense over the lease term. See Note 4 to the consolidated financial statements for further details concerning our property and equipment balances at December 31, 2008 and 2007.

We review our long-lived assets for impairment at least annually or when changes in circumstances or a triggering event indicates that the carrying amount of the asset may not be recoverable in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 requires that long-lived assets to be held and used recognize an impairment loss only if the carrying amount of the long-lived asset is not recoverable from its undiscounted cash flows and to measure an impairment loss as the difference between the carrying value and the fair value of the asset. Assets to be disposed of by sale are recorded at the lower of their carrying amount or fair value less estimated selling costs. We estimate fair value based upon the best information available, which may include expected future discounted cash flows to be produced by the asset and/or available market prices. Factors that significantly influence estimated future discounted cash flows include the periods and levels of occupancy for the facility, expected per diem or reimbursement rates, assumptions regarding the levels of staffing, services and future operating and capital expenditures necessary to generate forecasted revenues, related costs for these activities and future rate of increases or decreases associated with these factors. We also consider the results of any appraisals on the properties when assessing fair value. These estimates may be highly subjective, particularly in circumstances where there is no current operating contract in place and changes in the assumptions and estimates could result in the recognition of impairment charges.

Capitalized Interest

We capitalize interest on facilities while under construction. Interest capitalized for the year ended December 31, 2008 was approximately \$2.9 million and related to the expansion projects at the D. Ray James Prison and the Great Plains Correctional Facility. Interest capitalized for the year ended December 31, 2007 was approximately \$1.2 million and related to the expansion projects at the Big Spring Correctional Center, the D. Ray James Prison and the Great Plains Correctional

Facility. Interest capitalized for the year ended December 31, 2006 was approximately \$1.5 million and related to construction of the Moshannon Valley Correctional Center.

Debt Service Reserve Fund

The debt service reserve fund was established at the closing of MCF's bond issuance and is to be used solely for MCF's debt service to the extent that funds in MCF's debt service accounts are insufficient. The debt service reserve fund is invested principally in short term commercial instruments. See Note 11 to the consolidated financial statements.

Intangible Assets

We evaluate the carrying value of our existing intangibles (which are the result of prior acquisitions — both business facilities and operating contracts) for impairment annually. We have evaluated the carrying value of our existing intangibles and believe there has not been impairment to the carrying value of our existing intangibles as of December 31, 2008. See Note 5 to the consolidated financial statements for further details concerning our intangible assets.

Deferred Costs

Costs incurred related to obtaining debt financing are capitalized and amortized over the term of the related indebtedness. At December 31, 2008 and 2007, we had net deferred debt issuance costs of approximately \$7.6 million and \$8.6 million, respectively. In the year ended December 31, 2007 we incurred approximately \$0.8 million in financing costs related to our Amended Credit Facility.

Revenue Recognition

Substantially all of our revenues are derived from contracts with federal, state and local governmental agencies, which pay either per diem rates based upon the number of occupant days or hours served for the period, on a take-or-pay basis, management fee basis, cost-plus reimbursement or fee-for-service basis. Revenues are recognized as services are provided under our established contractual agreements to the extent collection is considered probable.

Pre-opening and Start-up Expenses

Pre-opening and start-up expenses are charged to operations as incurred. Pre-opening and start-up expenses include payroll, benefits, training and other operating costs during periods prior to opening a new or expanded facility and during the period of operation while occupancy is ramping up. These costs vary by contract. Newly opened facilities are staffed according to applicable regulatory or contractual requirements when we begin receiving offenders or clients. Offenders or clients are typically assigned to a newly opened facility on a phased-in basis over a one-to-six month period. Our start-up period for new juvenile operations is 12 months from the date we begin recognizing revenue unless break-even occupancy is achieved before then. Our start-up period for new adult operations is nine months from the date we begin recognizing revenue unless break-even occupancy is achieved before then.

Proposal Costs

We incur various expenses in conjunction with our participation in the proposal process with government agencies for their procurement of our services. These costs include such items as payroll and related employee benefits and taxes, research, consulting, legal and reproduction costs and are expensed in the periods incurred.

Operating and General and Administrative Expenses

We incur various expenses within the normal course of our business. Included in operating expenses are direct expense items such as personnel/employee benefits, resident/inmate care expenses and building/utility costs pertaining to the operations of our facilities and programs. Included in general and administrative expenses are expense items such as personnel/employee benefits, professional services and building/utility costs pertaining to our corporate activities.

Business Concentration

Contracts with federal, state and local governmental agencies account for nearly all of our revenues. The loss of, or a significant decrease in, business from one or more of these governmental agencies could have a material adverse effect on our financial condition and results of operations. For the years ended December 31, 2008, 2007 and 2006, 34.2%, 32.6% and

29.1%, respectively, of our consolidated revenues were derived from contracts with the Federal Bureau of Prisons (“BOP”), the only customer constituting more than 10.0% of our revenues during each of these periods.

Self Insurance Reserves

We maintain insurance coverage for various aspects of our business and operations. We retain a portion of losses that occur through the use of deductibles and retention under self-insurance programs. These programs include workers compensation and employer’s liability, general liability and professional liability, directors and officers’ liability and medical and dental insurance. We maintain deductibles under these programs in amounts ranging from \$0.5 million to \$1.0 million. We maintain excess loss insurance for amounts exceeding our deductibles.

We regularly review our estimates of reported and unreported claims and provide for these losses through insurance reserves. These reserves are influenced by rising costs of health care and other costs, increases in claims, time lags in claim information and levels of insurance coverage carried. As claims develop and additional information becomes available to us, adjustments to the related loss reserves may occur. Our estimated reserves for workers compensation claims incorporate the use of a 5% discount factor. Our reserves for medical and worker’s compensation claims are subject to change based on our estimate of the number and magnitude of claims to be incurred.

Stock-Based Compensation

We have an employee stock purchase plan (“ESPP”) under which employees can make contributions to purchase our common stock. Participation in the plan is elected annually by employees. The plan year begins on January 1st (the “Beginning Date”) and ends on December 31st (the “Ending Date”). For 2007, however, the plan year began April 1, 2007. Purchases of common stock are made at the end of the year using the lower of the fair market value on either the Beginning Date or Ending Date, less a 15% discount. Under SFAS No. 123R, our employee-stock purchase plan is considered to be a compensatory ESPP, and therefore, we recognize compensation expense over the requisite service period for grants made under the ESPP.

Our stock incentive plans provide for the granting of stock options (both incentive stock options and nonqualified stock options), stock appreciation rights, restricted stock shares and other stock-based awards to officers, directors and employees of the Company. Grants of stock options made to date under these plans vest over periods up to seven years after the date of grant and expire no more than 10 years after grant.

At December 31, 2007, 127,500 shares of restricted stock outstanding were subject to performance-based vesting criteria (32,500 of these restricted shares were considered market-based restricted stock under SFAS No. 123R). There were also 79,000 stock options outstanding subject to performance-based vesting criteria. We recognized \$0.6 million of expense associated with these shares of restricted stock and stock options during the year ended December 31, 2007.

At December 31, 2008, 184,000 shares of restricted stock were outstanding subject to performance-based vesting criteria (32,500 of these restricted shares were considered market-based restricted stock under SFAS No. 123R). There were also 52,700 stock options outstanding subject to performance-based vesting criteria. We recognized \$1.1 million of expense associated with these shares of restricted stock and stock options during the year ended December 31, 2008.

The amounts above relate to the impact of recognizing compensation expense related to stock options and restricted stock. Compensation expense related to stock options (52,700 shares) and restricted stock (151,500 shares) that vest based upon performance conditions is not recorded for such performance-based awards until it has been deemed probable that the related performance targets allowing the vesting of these options and restricted stock will be met. We are required to periodically re-assess the probability that these performance-based awards will vest and record expense at that point in time. During the year ended December 31, 2008 it was deemed probable that certain performance targets pertaining to certain restricted stock and stock options would be achieved by their vesting date. Accordingly, compensation expense of approximately \$1.0 million was recognized in the year ended December 31, 2008 related to these performance-based awards.

We recognize expense for our stock-based compensation over the vesting period, which represents the period in which an employee is required to provide service in exchange for the award. We recognize compensation expense for stock-based awards immediately if the award has immediate vesting.

Assumptions

The fair values for the significant stock-based awards granted during the years ended December 31, 2008, 2007 and 2006 were estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	Years Ended December, 31		
	2008	2007	2006
Risk-free rate of return	3.35 %	4.56 %	4.31 %
Expected life of award.....	5.7 years	5.6 years	5 years
Expected dividend yield of stock	0 %	0 %	0 %
Expected volatility of stock	38.74 %	42.19 %	45.48 %
Weighted-average fair value.....	\$ 9.46	\$ 9.86	\$ 6.24

The expected volatility of stock assumption was derived by referring to changes in the Company's historical common stock prices over a timeframe similar to that of the expected life of the award. We currently have no reason to believe that future stock volatility will significantly differ from historical stock volatility. Estimated forfeiture rates are derived from historical forfeiture patterns. We believe the historical experience method is the best estimate of forfeitures currently available.

In accordance with SAB 107, we generally considered the "simplified" method for "plain vanilla" options to estimate the expected term of options granted during the periods noted (where appropriate). For those grants during these periods wherein we had sufficient historical or impartial data to better estimate the expected term, we have done so.

Stock-based award activity during the year ended December 31, 2008 was as follows (aggregate intrinsic value in millions):

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2005.....	739,056	\$ 12.25	5.0	\$ 9.1
Granted	158,000			
Exercised	(164,661)			
Forfeited or canceled	(78,648)			
Outstanding at December 31, 2006.....	653,747	12.87	6.1	\$ 8.4
Granted	72,950			
Exercised	(161,590)			
Forfeited or canceled	(74,265)			
Outstanding at December 31, 2007.....	490,842	14.19	7.3	\$ 7.0
Granted	45,000	22.68		
Exercised	(36,390)	12.20		
Forfeited or canceled	(13,753)	17.73		
Outstanding at December 31, 2008.....	<u>485,699</u>	\$ 15.03	6.5	\$ 7.3
Vested and expected to vest at December 31, 2008.....	<u>477,218</u>	\$ 14.93	6.5	\$ 6.9
Exercisable at December 31, 2008	<u>390,581</u>	\$ 14.77	6.3	\$ 5.8

The total intrinsic value of stock options exercised during the years ended December 31, 2008, 2007 and 2006 was \$0.5 million, \$1.5 million and \$0.6 million, respectively. Net cash proceeds from the exercise of stock options were approximately \$0.4 million, \$2.5 million and \$2.1 million for the years ended December 31, 2008, 2007 and 2006, respectively.

As of December 31, 2008, approximately \$0.2 million of estimated expense with respect to nonvested stock-based awards had yet to be recognized and will be amortized into expense over the employee's estimated remaining weighted average service period of approximately 7.9 months.

The following table summarizes information with respect to stock options outstanding and exercisable at December 31, 2008.

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 3.75 to \$10.00	20,855	2.6	\$ 5.90	20,855	\$ 5.90
10.01 to 13.50	156,519	5.6	12.82	143,576	12.81
13.51 to 14.50	193,500	6.7	13.95	135,000	13.87
14.51 to 25.00	114,825	8.2	21.52	91,150	21.21
	<u>485,699</u>	6.5	\$ 15.03	<u>390,581</u>	\$ 14.77

Stock-based award activity for nonvested awards during the year ended December 31, 2008 was as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2005	362,669	\$ 13.14
Granted.....	158,000	14.02
Vested	(191,919)	13.43
Canceled.....	<u>(8,093)</u>	<u>13.16</u>
Nonvested at December 31, 2006	320,657	13.40
Granted.....	72,950	21.40
Vested	(101,683)	15.68
Canceled.....	<u>(74,265)</u>	<u>13.48</u>
Nonvested at December 31, 2007	217,659	14.99
Granted.....	45,000	22.68
Vested	(153,788)	16.32
Canceled.....	<u>(13,753)</u>	<u>17.73</u>
Nonvested at December 31, 2008	<u>95,118</u>	<u>\$ 16.09</u>

Restricted Stock

We have previously issued restricted stock under certain employment agreements and stock incentive plans which vests either over a specific period of time, generally three to five years, or which will vest subject to certain market or performance conditions. During the year ended December 31, 2008, we issued restricted stock as part of our normal equity awards under our 2006 Equity Incentive Plan. These shares of restricted common stock are subject to restrictions on transfer and certain conditions to vesting.

Restricted stock activity for the year ended December 31, 2008 was as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2005	111,673	\$ 12.37
Granted	—	—
Vested	(15,676)	17.15
Canceled	(10,997)	17.15
Nonvested at December 31, 2006	85,000	10.87
Granted	287,000	22.30
Vested	(5,000)	21.33
Canceled	(64,000)	9.80
Nonvested at December 31, 2007	303,000	21.75
Granted	161,000	22.38
Vested	(33,876)	16.77
Canceled	(27,000)	21.47
Nonvested at December 31, 2008	<u>403,124</u>	<u>\$ 22.44</u>

We recognized \$1.5 million of expense associated with nonvested time-based restricted stock awards during the year ended December 31, 2008. As of December 31, 2008, approximately \$3.0 million of estimated expense with respect to nonvested time-based restricted stock awards had yet to be recognized and will be amortized over a weighted average period of 2.3 years. Approximately \$3.1 million of estimated expense with respect to nonvested performance-based restricted stock option awards had yet to be recognized as of December 31, 2008.

Income Taxes

We utilize the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying values of existing assets and liabilities and their respective tax bases based on enacted tax rates. In providing for deferred taxes, we consider current tax regulations, estimates of future taxable income and available tax planning strategies. If tax regulations, operating results or the ability to implement tax planning strategies vary, adjustments to the carrying value of tax assets and liabilities may occur. See Note 7 to the consolidated financial statements.

Earnings Per Share

Basic earnings per share (EPS) are computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted EPS reflects the potential dilution from common stock equivalents such as stock options and warrants. For the year ended December 31, 2008, there were 64,200 shares (\$23.24 average price) of stock options that were not included in the computation of diluted EPS because to do so would have been anti-dilutive. For the year ended December 31, 2007, there were 19,200 shares (\$24.56 average price) of stock options that were not included in the computation of diluted EPS because to do so would have been anti-dilutive. For the year ended December 31, 2006, there were no anti-dilutive shares.

The following table summarizes the calculation of income (loss) and the weighted average common shares and common equivalent shares outstanding for purposes of the computation of earnings (loss) per share (in thousands, except per share data):

	Year Ended December 31,		
	2008	2007	2006
Income from continuing operations.....	\$ 22,191	\$ 11,910	\$ 12,580
Loss from discontinued operations, net of tax	—	—	(707)
Net income.....	<u>\$ 22,191</u>	<u>\$ 11,910</u>	<u>\$ 11,873</u>
Weighted average common shares outstanding.....	14,298	14,149	13,918
Weighted average common share equivalents outstanding.....	<u>400</u>	<u>331</u>	<u>141</u>
Weighted average common shares and common share equivalents outstanding.....	<u>14,698</u>	<u>14,480</u>	<u>14,059</u>
Basic income (loss) per share:			
Income from continuing operations.....	\$ 1.55	\$.84	\$.90
Loss from discontinued operations, net of tax	—	—	(.05)
Net income.....	<u>\$ 1.55</u>	<u>\$.84</u>	<u>\$.85</u>
Diluted income (loss) per share:			
Income from continuing operations.....	\$ 1.51	\$.82	\$.89
Loss from discontinued operations, net of tax	—	—	(.05)
Net income.....	<u>\$ 1.51</u>	<u>\$.82</u>	<u>\$.84</u>

Financial Instruments

The carrying amounts of our financial instruments, including cash and cash equivalents, investment securities, accounts receivable and accounts payable and accrued expenses, approximate fair value due to the short maturities of these financial instruments. At December 31, 2008, the carrying amount of consolidated debt was \$320.5 million, and the estimated fair value was \$308.0 million. At December 31, 2007, the carrying amount was \$286.7 million, and the estimated fair value was \$303.2 million. The estimated fair value of long-term debt is based primarily on quoted market prices or discounted cash flow analysis for the same or similar issues.

Derivative Instruments

Derivatives are recognized at fair value in the consolidated balance sheet. For derivatives designated as hedging the exposure to changes in fair value of an asset or liability, the gain or loss is recognized in earnings together with the offsetting gain or loss on the hedged item. For derivatives designated as hedging the exposure of variable cash flows, the effective portion is reported in other comprehensive income and subsequently reclassified to earnings when the forecasted transaction affects earnings. For derivatives not designated or de-designated as a hedging instrument, the gain or loss is recognized in earnings in the period of change.

Use of Estimates

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, which require that we make certain estimates and judgments that affect our reported amounts of assets, liabilities, revenues and expenses and the disclosures of contingent assets and liabilities. We evaluate our estimates on an on-going basis, based on historical experience and on various other assumptions that we believe to be reasonable based on the information available. Actual results could differ from these estimates under different assumptions or conditions. The significant estimates that we make in the accompanying consolidated financial statements include the allowance for doubtful accounts, accruals for insurance and legal claims, accruals for compensated employee absences, valuation allowance for deferred tax accounts, the realizability of long-lived tangible and intangible assets and the fair value of financial instruments.

Reclassifications

Certain reclassifications have been made to the prior period financial statements contained herein to conform to current year presentation. The impairment charge of \$0.4 million in the year ended December 31, 2006 was reclassified to operating expenses in the accompanying Consolidated Statements of Income and Comprehensive Income (Loss).

3. NEW ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 157

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value within generally accepted accounting principles and expands disclosures about fair value measurements for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis in the financial statements. SFAS No. 157 became effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. This statement applies prospectively to financial assets and liabilities. In February 2008, the FASB issued FSP 157-2, which delayed the effective date of SFAS No. 157 by one year for nonfinancial assets and liabilities. Our adoption of SFAS No. 157 on January 1, 2008 with respect to financial assets and liabilities did not have a material financial impact on our consolidated results of operations or financial condition. We are currently evaluating the impact of implementation with respect to nonfinancial assets and liabilities on our consolidated financial statements.

We adopted SFAS No. 157 on January 1, 2008 for our financial assets and liabilities measured on a recurring basis. As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date ("exit price"). SFAS No. 157 requires disclosure that establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 requires that fair value measurements be classified and disclosed in one of the following categories:

- Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
- Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

As required by SFAS No. 157, financial assets and liabilities are classified based on the lowest level of input that is significant for the fair value measurement. The following table summarizes the valuation of our financial assets and liabilities by pricing levels, as defined by the provisions of SFAS No. 157, as of December 31, 2008:

Fair Value as of December 31, 2008 (in thousands)				
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and Cash Equivalents.....	\$ 14,613	\$ —	\$ —	\$ 14,613
Corporate Bonds.....	—	10,286	—	10,286
Money Market Funds.....	—	41,402	—	41,402

The corporate bonds and money market funds are carried in debt service fund and other restricted assets and the debt service reserve fund in the accompanying balance sheet. The derivative instrument was carried in other long term liabilities in the accompanying balance sheet. The derivative instrument was determined to have no fair value at December 31, 2008. See Note 11 to the consolidated financial statements.

SFAS No. 157 requires a reconciliation of the beginning and ending balances for fair value measurements using Level 3 inputs. The table below sets forth a reconciliation for assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the year ended December 31, 2008 (in thousands):

Derivative instruments as of December 31, 2007	\$ 2,151
Change in fair value.....	(2,151)
Derivative instruments as of December 31, 2008	<u>\$ —</u>

The counterparty to our derivative became insolvent in 2008. We did not record an asset due to the insolvency.

FASB Staff Position SFAS No. 157-3

In October 2008, the FASB issued FSP SFAS No. 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active” (“FSP SFAS 157-3”). This FSP clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This FSP was effective upon issuance, including prior periods for which financial statements have not been issued. We applied this FSP to financial assets measured at fair value on a recurring basis at December 31, 2008. The adoption of FSP SFAS 157-3 did not have a significant impact on our consolidated financial position, results of operations or cash flows.”

Statement of Financial Accounting Standards No. 159

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115” (“SFAS No. 159”). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 became effective for financial statements issued for fiscal years beginning after November 15, 2007, provided the entity elects to apply the provisions of SFAS No. 157. Our adoption of SFAS No. 159 on January 1, 2008 did not have any impact on our consolidated results of operations or financial condition as we have elected not to apply the provisions of SFAS No. 159 to our financial instruments or other eligible items that are not required to be measured at fair value.

New Accounting Pronouncements Not Yet Adopted

Statement of Financial Accounting Standards No. 141 (Revised)

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), “Business Combinations” (“SFAS No. 141R”). SFAS No. 141R significantly changes the accounting for business combinations. Under SFAS No. 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141R changes the accounting treatment for certain specific items, including acquisition costs, noncontrolling interests, acquired contingent liabilities, in-process research and development costs, restructuring costs and changes in deferred tax asset valuation allowances and income tax uncertainties subsequent to the acquisition date. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is not permitted.

FASB Staff Position No. FAS 142-3

This FASB Staff Position (“FSP”) amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets”. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141 (Revised 2007), “Business Combinations” and other U.S. generally accepted accounting principles. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is not permitted. We do not expect this FSP to have a significant impact on our consolidated financial position, results of operations or cash flows.

Statement of Financial Accounting Standards No. 160

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements — An Amendment of ARB No. 51” (“SFAS No. 160”). SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent’s equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. This statement clarifies that changes in a parent’s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited.

Statement of Financial Accounting Standards No. 161

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities — an Amendment of FASB Statement 133” (“SFAS No. 161”). SFAS No. 161 is intended to improve financial reporting about derivatives and hedging activities by requiring enhanced qualitative and quantitative disclosures regarding derivative instruments, gains and losses on such instruments and their effects on an entity’s financial position, financial performance and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the impact that this pronouncement may have on our consolidated financial statements.

Statement of Financial Accounting Standards No. 162

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles (“SFAS No. 162”). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States of America. SFAS No. 162 is effective sixty days following the SEC’s approval of Public Company Accounting Oversight Board amendments to AU Section 411, “The Meaning of ‘Present Fairly’ in Conformity with Generally Accepted Accounting Principles.” We do not expect this pronouncement to have a significant impact on our consolidated financial position, results of operations or cash flows.

FASB Staff Position No. EITF 03-6-1

This FASB Staff Position (“FSP”) addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share (“EPS”) under the two-class method described in FASB Statement No. 128, “Earnings Per Share”. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and the interim periods within those years. All prior-period EPS data will have to be adjusted retrospectively (including interim financial statements, summaries of earnings, and selected financial data) to conform to the provisions of this FSP. Early application is not permitted. We do not expect this FSP to have a significant impact on our earnings per share.

4. PROPERTY AND EQUIPMENT

Property and equipment were as follows (in thousands):

	December 31,	
	2008	2007
Land	\$ 43,005	\$ 38,763
Prepaid facility use.....	71,323	71,323
Buildings and improvements	353,093	284,041
Furniture and equipment	39,514	33,954
Construction in progress	41,154	38,261
Sub-total.....	548,089	466,342
Accumulated depreciation and amortization.....	(97,735)	(82,390)
Total property and equipment.....	<u>\$ 450,354</u>	<u>\$ 383,952</u>

The increase in land was due primarily to the Hudson, Colorado site acquisition. The increase in buildings and improvements was due primarily to the purchase of the High Plains Correctional Facility, the Washington, DC Facility and the facility expansion completed at the Big Spring Correctional Center. The increase in construction in progress was due primarily to development costs associated with the Hudson, Colorado site and construction costs related to the facility expansions at the D. Ray James Prison and the Great Plains Correctional Facility.

We review our long-lived assets for impairment at least annually or when changes in circumstances or a triggering event indicates that the carrying amount of the asset may not be recoverable in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 requires that long-lived assets to be held and used recognize an impairment loss only if the carrying amount of the long-lived asset is not recoverable from its undiscounted cash flows and to measure an impairment loss as the difference between the carrying value and the fair value of the asset. Assets to be disposed of by sale are recorded at the lower of their carrying amount or fair value less estimated selling costs. We estimate fair value based upon the best information available, which may include expected future discounted cash flows to be produced by the asset and/or available market prices. Factors that significantly influence estimated future discounted cash flows include the periods and levels of occupancy for the facility, expected per diem or reimbursement rates, assumptions regarding the levels of staffing, services and future operating and capital expenditures necessary to generate forecasted revenues, related costs for these activities and future rate of increases or decreases associated with these factors. We also consider the results of any appraisals on the properties when assessing fair value. These estimates may be highly subjective, particularly in circumstances where there is no current operating contract in place and changes in the assumptions and estimates could result in the recognition of impairment charges. The most subjective estimates made in this analysis for 2008 relate to Cornell Abraxas 1 and the Hector Garza Residential Treatment Center. The most subjective estimates made in this analysis for 2007 relate to the Regional Correctional Center and the Hector Garza Residential Treatment Center. We may be required to record an impairment charge in the future if we are unable to successfully negotiate a replacement contract on any of our facilities for which we currently have an operating contract. Given the nature of the evaluation of future cash flows and the application to specific assets and specific times, it is not possible to reasonably quantify the impact of changes in these assumptions.

In conjunction with our review of certain of our long-lived assets based on estimated market values associated with these assets, we determined that our carrying value for a currently vacant site of land was not fully recoverable and exceeded its fair value and, as a result, we recorded an impairment charge of \$0.3 million in the year ended December 31, 2008 (none in the year ended December 31, 2007). This charge is reflected in operating expenses in the accompanying financial statements. In conjunction with our review of our long-lived assets based on forecasted operating and cash flow losses associated with these assets at December 31, 2006, we determined that our carrying value for two of our adult community-based facilities was not fully recoverable and exceeded their fair value and, as a result, we recorded an impairment charge of \$0.4 million in the year ended December 31, 2006. This charge is reflected in operating expenses in the accompanying financial statements.

5. INTANGIBLE ASSETS

Intangible assets at December 31, 2008 and 2007 consisted of the following (in thousands):

	December 31,	
	2008	2007
Non-compete agreements	\$ 8,200	\$ 9,040
Accumulated amortization — non-compete agreements	(7,595)	(7,541)
Acquired contract value	6,240	6,442
Accumulated amortization — acquired contract value	(4,525)	(3,421)
Identified intangibles, net	2,320	4,520
Goodwill, net	13,308	13,355
Total intangibles, net	<u>\$ 15,628</u>	<u>\$ 17,875</u>

The changes in the carrying amount of goodwill for the year ended December 31, 2008 are as follows (in thousands):

	Adult Secure	Abraxas Youth and Family	Adult Community -Based	Total
Balance as of December 31, 2006.....	\$ 2,902	\$ 1,060	\$ 8,377	\$ 12,339
Reduction to goodwill.....	—	—	1,016	1,016
Balance as of December 31, 2007.....	2,902	1,060	9,393	13,355
Reduction to goodwill.....	—	—	(47)	(47)
Balance as of December 31, 2008.....	<u>\$ 2,902</u>	<u>\$ 1,060</u>	<u>\$ 9,346</u>	<u>\$ 13,308</u>

In 2008, we recorded a reduction to goodwill as a result of the final release of amounts previously placed in escrow related to the acquisition of Correctional Systems, Inc. (“CSI”) in April 2005. At December 31, 2008, we believe that there is no impairment to our existing goodwill.

Amortization expense for our acquired contract value was approximately \$1.1 million in each of the years ended December 31, 2008, 2007 and 2006. Amortization expense for our acquired contract value is expected to be approximately \$1.1 million for the year ended December 31, 2009 and approximately \$0.6 million for the year ended December 31, 2010.

Amortization expense for our non-compete agreements was approximately \$0.8 million, \$1.3 million and \$1.1 million for the years ended December 31, 2008, 2007 and 2006, respectively. Amortization expense for our non-compete agreements is expected to be approximately \$0.6 million in the year ended December 31, 2009.

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consisted of the following (in thousands):

	December 31,	
	2008	2007
Accounts payable.....	\$ 21,754	\$ 20,321
Accrued compensation.....	10,242	9,837
Accrued interest payable.....	11,329	5,707
Accrued taxes payable.....	6,680	3,926
Accrued insurance.....	8,003	7,779
Accrued legal.....	5,197	5,306
Resident funds.....	3,538	2,598
Other.....	2,350	2,028
Total accounts payable and accrued liabilities.....	<u>\$ 69,093</u>	<u>\$ 57,502</u>

7. INCOME TAXES

In July 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109” (“FIN 48”). FIN 48 established a single model to address the accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on the measurement, recognition, classification and disclosure of tax positions, as well as the accounting for the related interest and penalties, transition and accounting in interim periods.

The Company adopted the provisions of FIN 48 effective January 1, 2007. As a result of our adoption of FIN 48, we recorded a cumulative effect adjustment of approximately \$0.3 million which increased retained earnings at January 1, 2007. As of December 31, 2007 and December 31, 2008, we had unrecognized tax benefits in the amount of \$3.0 million and \$2.5 million, respectively. If these unrecognized tax benefits were recognized in future periods, approximately \$0.8 million and \$0.9 million would reduce our income tax expense and our effective tax rate for the years ended December 31, 2007 and 2008, respectively. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance at January 1, 2007	\$ 2,948
Additions based on tax positions related to current year ...	569
Additions for tax positions in prior year	4
Reductions for tax positions in prior year	—
Lapse in Statutes of Limitations	(503)
Balance at December 31, 2007	\$ 3,018
Additions based on tax positions related to current year ...	521
Additions for tax positions in prior year	23
Reductions for tax positions in prior year	—
Lapse in Statutes of Limitations	(1,094)
Balance at December 31, 2008	<u>\$ 2,468</u>

Estimated interest and penalties related to the underpayment of income taxes are classified as a component of income tax expense in the accompanying Consolidated Statements of Income and Comprehensive Income and totaled approximately \$0.1 million in the year ended December 31, 2007 and (\$0.1) million in the year ended December 31, 2008. Accrued interest and penalties were approximately \$0.3 million and \$0.2 million at December 31, 2007 and 2008, respectively.

We are subject to income tax in the United States and many of the individual states we operate in. We currently have significant operations in Texas, California and Pennsylvania. State income tax returns are generally subject to examination for a period of three to five years after filing. The state impact of any changes made to the federal return remains subject to examination by various states for a period up to one year after formal notification to the state. We are open to United States Federal Income Tax examinations for the tax years December 31, 2005 through December 2007. The 2006 federal income tax return is currently under audit by the Internal Revenue Service. We expect the audit to close within the next 12 months.

We do not anticipate a significant change in the balance of our unrecognized tax benefits within the next 12 months.

The following is an analysis of our deferred tax assets and liabilities (in thousands):

	December 31,	
	2008	2007
Deferred tax assets:		
Accrued liabilities and allowances	\$ 10,582	\$ 8,535
State operating loss carryforwards	3,005	2,088
Deferred compensation	2,276	1,176
Other	157	1,878
Total deferred tax assets	<u>16,020</u>	<u>13,677</u>
Deferred tax liabilities:		
Property and equipment	18,769	15,531
Prepaid expenses	917	832
Other	1,155	749
Total deferred tax liabilities	<u>20,841</u>	<u>17,112</u>
Valuation allowance	<u>(3,005)</u>	<u>(2,088)</u>
Net deferred tax liability	<u>\$ 7,826</u>	<u>\$ 5,523</u>

As of December 31, 2008, we have net operating losses for state income taxes of approximately \$34.4 million. Our tax returns are subject to periodic audit by the various jurisdictions in which we operate. These audits, including those currently underway, can result in adjustments of taxes due or adjustments of the NOLs which are available to offset future taxable income.

Valuation allowances of \$3.0 million have been established for uncertainties in realizing the benefit of certain state income tax loss carryforwards. For the years ended December 31, 2008, 2007 and 2006, changes in our state operating loss carryforwards (decreased)/increased our valuation allowance by \$0.9 million, (\$0.4) million and \$0.3 million, respectively. In assessing the realizability of carryforwards, we consider whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The valuation allowance will be adjusted in the periods that we determine it is more likely than not that deferred tax assets will or will not be realized.

The components of our income tax provision were as follows (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Federal current provision	\$ 11,200	\$ 6,213	\$ 4,332
State current provision	2,947	1,276	1,617
Total current provision	<u>14,147</u>	<u>7,489</u>	<u>5,949</u>
Federal deferred provision	1,250	1,034	3,114
State deferred provision	206	312	85
Total deferred provision	<u>1,456</u>	<u>1,346</u>	<u>3,199</u>
Total provision from continuing operations.....	<u>\$ 15,603</u>	<u>\$ 8,835</u>	<u>\$ 9,148</u>

Our tax returns are subject to periodic audits by the various jurisdictions in which we operate. These audits including those currently underway can result in adjustments of taxes due or adjustments of the NOLs which are available to offset future taxable income.

The following is a reconciliation of income taxes at the statutory federal income tax rate of 35% to the income tax provision recorded by us (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Computed taxes at statutory rate.....	\$ 13,384	\$ 7,263	\$ 7,602
State income taxes, net of federal benefit	2,046	1,109	1,042
Other	173	463	504
	<u>\$ 15,603</u>	<u>\$ 8,835</u>	<u>\$ 9,148</u>

8. CREDIT FACILITIES

Our long-term debt consisted of the following (in thousands):

	December 31,	
	2008	2007
Debt of Cornell Companies, Inc.:		
Senior Notes, unsecured, due July 2012 with an interest rate of 10.75%, net of discount	\$ 111,356	\$ 111,172
Revolving Line of Credit due December 2011 with an interest rate of LIBOR plus 1.50% to 2.25% or prime plus 0.00% to 0.75% (the "Amended Credit Facility").....	75,000	30,000
Capital lease obligations	26	37
Subtotal	<u>186,382</u>	<u>141,209</u>
Debt of Special Purpose Entities:		
8.47% Bonds due 2016	<u>134,100</u>	<u>145,500</u>
Total consolidated debt.....	320,482	286,709
Less: current maturities.....	<u>(12,412)</u>	<u>(11,411)</u>
Consolidated long-term debt.....	<u>\$ 308,070</u>	<u>\$ 275,298</u>

Long-Term Credit Facilities. Our Amended Credit Facility provides for borrowings up to \$100.0 million (including letters of credit), matures in December 2011 and bears interest, at our election depending on our total leverage ratio, at either the LIBOR rate plus a margin ranging from 1.50% to 2.25%, or a rate which ranges from 0.00% to 0.75% above the applicable prime rate. The available commitment under our Amended Credit Facility was approximately \$10.1 million at December 31, 2008. We had outstanding borrowings under our Amended Credit Facility of \$75.0 million and we had outstanding letters of credit of approximately \$14.9 million at December 31, 2008. Subject to certain requirements, we have the right to increase the commitments under our Amended Credit Facility up to \$150.0 million, although the indenture for our Senior Notes limits our ability, subject to certain conditions, to expand the Amended Credit Facility beyond \$100.0 million. We can provide no assurance that all of the banks that have made commitments to us under our Amended Credit Facility would be willing to participate in an expansion to the Amended Credit Facility should we desire to do so. The Amended Credit Facility is collateralized by substantially all of our assets, including the assets and stock of all of our subsidiaries. The Amended Credit Facility is not secured by the assets of MCF, a special purpose entity. Our Amended Credit Facility contains commonly used covenants including compliance with laws and limitations on certain financing transactions and mergers and also includes various financial covenants. We believe the most restrictive covenant under our Amended Credit Facility is the fixed charge coverage ratio. At December 31, 2008, we were in compliance with all of our debt financial covenants.

MCF is obligated for the outstanding balance of its 8.47% Taxable Revenue Bonds, Series 2001. The bonds bear interest at a rate of 8.47% per annum and are payable in semi-annual installments of interest and annual installments of principal. All unpaid principal and accrued interest on the bonds is due on the earlier of August 1, 2016 (maturity) or as noted under the bond documents.

The bonds are limited, nonrecourse obligations of MCF and secured by the property and equipment, bond reserves, assignment of subleases and substantially all assets related to the facilities included in the 2001 Sale and Leaseback Transaction (in which we sold eleven facilities to MCF). The bonds are not guaranteed by Cornell.

In June 2004, we issued \$112.0 million in principal of 10.75% Senior Notes (the “Senior Notes”) due July 1, 2012. The Senior Notes are unsecured senior indebtedness and are guaranteed by all of our existing and future subsidiaries (collectively, the “Guarantors”). The Senior Notes are not guaranteed by MCF (the “Non-Guarantor”). Interest on the Senior Notes is payable semi-annually on January 1 and July 1 of each year, commencing January 1, 2005. On or after July 1, 2008, we may redeem all or a portion of the Senior Notes at the redemption prices (expressed as a percentage of the principal amount) listed below, plus accrued and unpaid interest, if any, on the Senior Notes redeemed, to the applicable date of redemption, if redeemed during the 12-month period commencing on July 1 of each of the years indicated below:

<u>Year</u>	<u>Percentages</u>
2008	105.375 %
2009	102.688 %
2010 and thereafter	100.000 %

As the Senior Notes are now redeemable at our option (subject to the requirements noted) we anticipate we will monitor the capital markets and continue to assess our capital needs and our capital structure, including a potential refinancing of the Senior Notes.

Upon the occurrence of specified change of control events, unless we have exercised our option to redeem all the Senior Notes as described above, each holder will have the right to require us to repurchase all or a portion of such holder’s Senior Notes at a purchase price in cash equal to 101% of the aggregate principal amount of the notes repurchased plus accrued and unpaid interest, if any, on the Senior Notes repurchased, to the applicable date of purchase. The Senior Notes were issued under an indenture which limits our ability and the ability of our Guarantors to, among other things, incur additional indebtedness, pay dividends or make other distributions, make other restricted payments and investments, create liens, incur restrictions on the ability of the Guarantors to pay dividends or other payments to us, enter into transactions with affiliates, and engage in mergers, consolidations and certain sales of assets.

In conjunction with the issuance of the Senior Notes, we entered into an interest rate swap transaction with a financial institution to hedge our exposure to changes in the fair value on \$84.0 million of our Senior Notes. The purpose of this transaction was to convert future interest due on \$84.0 million of the Senior Notes to a variable rate. The terms of the interest rate swap contract and the underlying debt instrument were identical. The swap agreement was designated as a fair value hedge. The swap had a notional amount of \$84.0 million and matured in July 2012 to mirror the maturity of the Senior Notes. Under the agreement, we paid, on a semi-annual basis (each January 1 and July 1), a floating rate based on a six-month U.S. dollar LIBOR rate, plus a spread, and received a fixed-rate interest of 10.75%. For the three and nine months ended September 30, 2007, we recorded interest expense related to this interest rate swap of approximately \$0.1 million and \$0.2 million, respectively. The swap agreement was marked to market each quarter with a corresponding mark-to-market adjustment reflected as either a discount or premium on the Senior Notes. The carrying value of the Senior Notes as of this date was adjusted accordingly by the same amount. Because the swap agreement was an effective fair-value hedge, there was no effect on our results of operations from the mark-to-market adjustment as long as the swap was in effect. In October 2007, we terminated the swap agreement. We received approximately \$0.2 million in conjunction with the termination, which is being amortized over the remaining term of the Senior Notes.

Scheduled maturities of our consolidated long-term debt are as follows (in thousands):

	<u>Cornell Companies, Inc.</u>	<u>MCF</u>	<u>Consolidated</u>
For the year ending December 31,.....			
2009	\$ 12	\$ 12,400	\$ 12,412
2010	12	13,400	13,412
2011	75,002	14,600	89,602
2012	112,000	15,800	127,800
Thereafter.....	—	77,900	77,900
Total.....	<u>\$ 187,026</u>	<u>\$ 134,100</u>	<u>\$ 321,126</u>

9. COMMITMENTS AND CONTINGENCIES

Financial Guarantees

During the normal course of business, we enter into contracts that contain a variety of representations and warranties and provide general indemnifications. Our maximum exposure under these arrangements is unknown as this would involve future claims that may be made against us that have not yet occurred. However, based on experience, we believe the risk of loss to be remote.

Operating Leases

We lease office space, certain facilities and furniture and equipment under long-term operating leases. Rent expense for all operating leases for the years ended December 31, 2008, 2007 and 2006 was approximately \$10.2 million, \$10.4 million and \$11.5 million, respectively.

Landlord incentives or allowances under operating leases are recorded as deferred rent and amortized as a reduction of rent expense over the lease term. Those operating leases with step rent provisions or escalation clauses that are not considered contingent rent are recognized on a straight-line basis over the lease term. For those leases that include an existing index or rate, such as the consumer price index or the prime interest rate, the related minimum lease payments are recognized on a straight-line basis over the lease term and the amount of rent considered to be contingent is recorded as incurred and is not included in the straight-line basis rent expense. We do not receive significant sublease rentals under any of our existing operating leases.

Certain of our leases contain renewal options, which range from additional rental periods of one to five years. Escalation clauses are also included in certain of our leases. There are no significant restrictions imposed by our lease agreements concerning such issues as dividend payments, incurrence of additional debt or further leasing.

As of December 31, 2008, we had the following rental commitments under noncancelable operating leases (in thousands):

For the year ending December 31,		
2009	\$	7,598
2010		5,428
2011		11,234
2012		10,978
Thereafter		85,398
Total	\$	<u>120,636</u>

The following schedule shows the composition of total rental expense for all operating leases (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Minimum rentals	\$ 9,708	\$ 9,911	\$ 11,107
Contingent rentals	449	458	426
Less: sublease rentals	(221)	(246)	(232)
Total	<u>\$ 9,936</u>	<u>\$ 10,123</u>	<u>\$ 11,301</u>

401(k) Plan

We have a defined contribution 401(k) plan. Our matching contribution currently represents 50% of a participant's contribution, up to the first 6% of the participant's salary. We recorded contribution expense of approximately \$1.7 million, \$1.3 million and \$1.2 million for each of the years ended December 31, 2008, 2007 and 2006, respectively.

Legal Proceedings

We are party to various legal proceedings, including those noted below. While management presently believes that the ultimate outcome of these proceedings will not have a material adverse effect on our financial position, overall trends in results of operations or cash flows, litigation is subject to inherent uncertainties, and unfavorable rulings could occur. An unfavorable ruling could include monetary damages or equitable relief, and could have a material adverse impact on the net income of the period in which the ruling occurs or in future periods.

Valencia County Detention Center

In April 2007, a lawsuit was filed against the Company in the Federal District Court in Albuquerque, New Mexico, by Joe Torres and Eufasio Armijo, who each alleged that he was strip searched at the Valencia County Detention Center (“VCDC”) in New Mexico in violation of his federal rights under the Fourth, Fourteenth and Eighth amendments to the U.S. Constitution. The claimants also alleged violation of their rights under state law and sought to bring the case as a class action on behalf of themselves and all detainees at VCDC during the applicable statutes of limitation. The plaintiffs sought damages and declaratory and injunctive relief. Valencia County is also a named defendant in the case and operated the VCDC for a significantly greater portion of the period covered by the lawsuit.

In December 2008, the parties agreed to a proposed stipulation of settlement and the Court has preliminarily approved the settlement. The settlement amount under the terms of the agreement is \$3.3 million. Cornell’s portion of the stipulated settlement, based on the number of inmates housed at VCDC during the time Cornell operated the facility in comparison to the number of inmates housed at the facility during the time Valencia County operated the facility, is \$1.2 million and was funded principally through our general liability and professional liability coverage.

In the year ended December 31, 2007, we previously provided insurance reserves for this matter (as part of our regular review of reported and unreported claims) totaling approximately \$0.5 million. During the fourth quarter of 2008, we recorded an additional settlement charge of approximately \$0.7 million and the related reimbursement from our general liability and professional liability insurance. The charge and reimbursement were recognized in general and administrative expenses for the year ended December 31, 2008. The reimbursement was funded by the insurance carrier in the first quarter of 2009 into a settlement account, where it will remain until payments are made to the settlement class members. The Court granted preliminary approval of the settlement in the first quarter of 2009, and the claims administration process is underway. We expect the claims administration process to be completed and the final court approval of the settlement in the fourth quarter of 2009.

Shareholder Lawsuits

On October 19, 2006, a purported class action complaint was filed in the District Court of Harris County, Texas, 269th Judicial District (No. 2006-67413) by Ted Kinberg, an alleged stockholder of Cornell. The complaint names as defendants Cornell and each member of the board of directors at the time of the suit, as well as Veritas Capital Fund III, L.P. (“Veritas”). The complaint alleges, among other things, that (i) the defendants have breached fiduciary duties they assertedly owed to our stockholders in connection with our entering into the Agreement and Plan of Merger, dated as of October 6, 2006, with Veritas, Cornell Holding Corp., and CCI Acquisition Corp., and (ii) the merger consideration is unfair and inadequate. The plaintiffs sought, among other things, an injunction against the consummation of the merger. The proposed merger was rejected at a special meeting of our stockholders held on January 23, 2007. Consequently, we believe the case is moot and expect the plaintiffs to seek dismissal of their claims accompanied by a request for legal fees that may be owed. We do not expect the resolution of this matter to have a material adverse effect on our financial condition, results of operations or cash flows.

Settlement of Claim

On December 12, 2008, we settled a lawsuit the Company had filed in the United States District Court for the Eastern District of Pennsylvania against the Borough of New Morgan (the “Borough”), New Morgan Borough Council and certain individual council members. The lawsuit involved the operation of the Company’s Abraxas Academy in New Morgan, Pennsylvania and a sewage treatment facility that is owned by the Borough.

In connection with the settlement, all claims have been terminated and finally settled, including those concerning the operation and occupancy of the facility and the sewage treatment plant. Neither party has admitted liability for any claim or contention made by the other party. The Company received \$1.55 million from the Borough and agreed to pay the Borough unpaid sewage treatment bills in the amount of \$0.2 million through September 30, 2008. The \$1.55 million settlement is reflected in operating expenses in the accompanying financial statements.

Other

We hold insurance policies to cover potential director and officer liability, some of which may limit our cash outflows in the event of a decision adverse to us in the matters discussed above. However, if an adverse decision in these matters exceeds the insurance coverage or if the insurance coverage is deemed not to apply to these matters, it could have a material adverse effect on us, our financial condition, results of operations and future cash flows.

Additionally, we currently and from time to time are subject to claims and suits arising in the ordinary course of business, including claims for damages for personal injuries or for wrongful restriction of or interference with offender privileges and employment matters. If an adverse decision in these matters exceeds our insurance coverage, or if our coverage is deemed not to apply to these matters, or if the underlying insurance carrier was unable to fulfill its obligation under the insurance coverage provided, it could have a material adverse effect on our financial condition, results of operations or cash flows.

While the outcome of such other matters cannot be predicted with certainty, based on the information known to date, we believe that the ultimate resolution of these matters will not have a material adverse effect on our financial condition, but could be material to operating results or cash flows for a particular reporting period.

10. STOCKHOLDERS' EQUITY

Preferred Stock

Preferred stock may be issued from time to time by our Board of Directors, which is responsible for determining the voting, dividend, redemption, conversion and liquidation features of any preferred stock.

Options and Warrants

Under our 2000 Broad-Based Employee Plan (the "2000 Plan") we may grant non-qualified stock options to our employees, directors and eligible consultants for up to the greater of 400,000 shares or 4% of the aggregate number of shares of common stock issued and outstanding immediately after grant of any option under the 2000 Plan. The 2000 Plan options vest up to five years and expire ten years from the grant date. Under our 1996 Stock Option Plan, as amended and restated in April 1998 (the "1996 Plan") we may grant non-qualified and incentive stock options for up to the greater of 1,932,119 shares or 15.0% of the aggregate number of shares of common stock outstanding. The 1996 Plan options vest up to seven years and expire seven to ten years from the grant date. The Compensation Committee of the Board of Directors, which consists entirely of independent directors, is responsible for determining the exercise price and vesting terms for the granted options. The 1996 Plan and 2000 Plan option exercise prices can be no less than the market price of our common stock on the date of grant.

In conjunction with the issuance of subordinated notes in July 2000 (which are no longer outstanding), we issued warrants to purchase 290,370 shares of the common stock at an exercise price of \$6.70. We recognized the fair value of these warrants of \$1.1 million as additional paid-in capital. The warrants could only be exercised by payment of the exercise price in cash to us, by cancellation of an amount of warrants equal to the fair market value of the exercise price, or by the cancellation of our indebtedness owed to the warrant holder. During 2001, 168,292 shares of our common stock were issued in conjunction with the exercise and cancellation of 217,778 warrants. At December 31, 2006, 72,592 warrants were outstanding. During 2007, all 72,592 warrants were exercised and canceled.

For a summary of the status of our various option plans at December 31, 2007, see Note 2 to the consolidated financial statements.

Treasury Stock

We did not repurchase any of our common stock in the years ended December 31, 2008 and 2007. Under the terms of our Senior Notes and our Amended Credit Facility, we can purchase shares of our stock subject to certain cumulative restrictions.

Employee Stock Purchase Plan

We have an employee stock purchase plan under which employees can make contributions to purchase our common stock. Participation in the plan is elected annually by employees. The plan year begins each January 1st (the "Exercise Date")

and ends on December 31st (the “Ending Date”). For 2007, however, the plan year began April 1, 2007. Purchases of common stock are made at the end of the year using the lower of the fair market value on either the Beginning Date or Ending Date, less a 15.0% discount. For the years ended December 31, 2008, 2007 and 2006, employee contributions of approximately \$0.1 million, \$0.2 million and \$0.3 million were used to purchase 8,883, 25,348 and 22,593, respectively, of our common stock.

2006 Equity Incentive Plan

Our stockholders approved the establishment of the 2006 Equity Incentive Plan (the “2006 Plan”) at our June 29, 2006 annual meeting. The purpose of the 2006 Plan is to promote the interests of the Company and its stockholders by (i) attracting and retaining employees, directors, and consultants of the Company and its affiliates, (ii) motivating such individuals by means of performance-related incentives to achieve longer-range performance goals, and (iii) enabling such individuals to participate in the long-term growth and financial success of the Company. At the discretion of the Compensation Committee, any employee, director, or consultant of the Company or its affiliates may be granted an award under the 2006 Plan. The Compensation Committee administers the 2006 Plan.

A total of 1,400,000 shares of common stock are authorized for issuance under the 2006 Plan, all of which may be issued pursuant to incentive stock options. These shares of common stock will be in a “fungible pool” with shares subject to restricted stock, stock compensation and other stock-based awards counted against this limit as two (2) shares for every one (1) share granted and any shares subject to any other type of award to be counted against this limit as one (1) share for every one (1) share granted. Stock options (both non-qualified stock options and incentive stock options), stock appreciation rights, restricted stock, restricted stock units, performance awards, stock compensation and other stock-based awards may be granted under the 2006 Plan.

In the event of a Change of Control, as defined in the 2006 Plan, any outstanding stock option, stock appreciation right, non-performance based restricted stock or restricted stock unit award, and performance based restricted stock, restricted stock units, performance share or performance unit award (unless otherwise provided in the performance award agreement) will automatically vest. Upon a Change of Control, the Board of Directors may also take any one or more of the following actions: (i) provide for the purchase of any outstanding awards by the Company; (ii) make adjustments to any outstanding awards; or (iii) allow for the assumption or substitution of outstanding awards by the acquiring or surviving corporation. Grants of 287,000 shares of restricted stock were made under the 2006 Plan during the year ended December 31, 2007. No grants were made to any individual under the 2006 Plan during the year ended December 31, 2006.

11. DERIVATIVE FINANCIAL INSTRUMENTS AND GUARANTEES

Debt Service Reserve Fund and Debt Service Fund

In August 2001, MCF completed a bond offering to finance the 2001 Sale and Leaseback Transaction (in which we sold eleven facilities (as identified in Item 1 of this report) to MCF. In connection with this bond offering, two reserve fund accounts were established by MCF pursuant to the terms of the indenture: (1) MCF’s Debt Service Reserve Fund, aggregating \$23.8 million at December 31, 2008, was established to make payments on MCF’s outstanding bonds in the event we (as lessee) should fail to make the scheduled rental payments to MCF and (2) MCF’s Debt Service Fund, aggregating \$27.9 million at December 31, 2008, was established to accumulate the monthly lease payments that MCF receives from us until such funds are used to pay MCF’s semi-annual bond interest and annual bond principal payments. These reserve funds are typically invested in short-term money markets and commercial paper. Both reserve fund accounts are subject to the agreements with the MCF Equity Investors (Lehman Brothers, Inc. (“Lehman”)) whereby guaranteed rates of return of 3.0% and 5.08%, respectively, are provided for in the balance of the Debt Service Reserve Fund and the Debt Service Fund. The guaranteed rates of return are characterized as cash flow hedge derivative instruments. At inception, the derivatives had an aggregate fair value of \$4.0 million, which has been recorded as a decrease to the equity investment in MCF made by the MCF Equity Investors (MCF minority interest) and as a liability in our Consolidated Balance Sheets. Changes in the fair value of the derivative instruments were recorded as an adjustment to other long-term liabilities and reported as other comprehensive income (loss) in our Consolidated Statements of Operations and Comprehensive Income (Loss). Due to the bankruptcy of Lehman in 2008, the derivative instrument no longer qualified as a hedge and was de-designated. Amounts included in accumulated other comprehensive income are reclassified into earnings during the same periods in which interest is earned on the debt service funds. Changes in the fair value of this derivative after de-designation are recorded into earnings. At December 31, 2008, the fair value was deemed to be zero, and the change in fair value of \$1.2 million was credited to interest income.

In connection with MCF's bond offering, Lehman also provided a guarantee of the Debt Service Reserve Fund if a bankruptcy of the Company were to occur and a trustee for the estate of the Company were to include the Debt Service Reserve Fund as an asset of the Company's estate. This guarantee was characterized as an insurance contract and its fair value was being amortized to expense over the life of the debt. Due to the bankruptcy of Lehman in 2008, the full carrying value of the guarantee was determined to be unrecoverable. Accordingly, we recorded a charge of \$1.3 million in the year ended December 31, 2008. This charge is included in interest expense in the accompanying consolidated financial statements.

12. RELATED PARTY TRANSACTIONS

In September 1999, we entered into a consulting agreement with Cornell's founder, David Cornell, who was a director of Cornell through October 2003. Services rendered under the consulting agreement included serving as a director of Cornell over the initial four years of the term of the agreement and assisting in such areas as the development of new business, acquisitions, financings and executive management assimilation. As compensation for consulting services, we agreed to an annual payment of at least \$255,000 for each of the first four years of the seven-year initial term of the consulting agreement with an annual payment of at least \$180,000 for each of the last three years of the initial term. As additional compensation, we agreed to an annual bonus, subject to certain limitations, equal to \$75,000 during the first four years of the initial term and an annual bonus of \$60,000 during the last three years of the initial term. The initial term concluded in 2006 and the final bonus payment of \$60,000 was paid. The agreement was not renewed.

We also entered into a non-compete agreement with Mr. Cornell. The non-compete agreement has a term of 10 years and required us to pay a monthly fee of \$10,000 for the seven-year initial term of the consulting agreement. We capitalize the monthly payments and amortize the amounts over the 10-year term of the non-compete agreement. Due to his death in December 2008, the remaining unamortized balance was written-off. We recognized amortization expense related to this agreement of approximately \$84,000 for each of the years ended December 31, 2008, 2007 and 2006.

We maintained a life insurance policy for Mr. Cornell and made payments related to this policy of approximately \$0.2 million for each of the years ended December 31, 2008, 2007 and 2006. As a result of Mr. Cornell's death in December 2008, we received a return of cash premiums previously paid of approximately \$2.0 million in December 2008.

Total payments made for the above to Mr. Cornell were \$0.06 million and \$0.5 million for the years ended December 31, 2007 and 2006, respectively. No payments were made to Mr. Cornell in the year ended December 31, 2008.

We entered into a consulting agreement with a former director, Arlene Lissner, which expired in December 2008. Services rendered under this agreement include research and analysis for various topics including data collection, support and training for program development; performance-based contractual requirements and performance-improvement processes, accreditations and regulatory requirements. Payments under this agreement totaled \$0.3 million for each of the years ended December 31, 2008, 2007 and 2006. The agreement concluded in 2008 and was not renewed.

13. TERMINATED MERGER AGREEMENT

On October 6, 2006, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with The Veritas Capital Fund III, L.P., a Delaware limited partnership ("Veritas"), Cornell Holding Corp., a Delaware corporation ("Parent") and CCI Acquisition Corp., a Delaware corporation and wholly owned subsidiary of Parent ("Merger Sub"), pursuant to which the Merger Sub would be merged with and into us (the "Merger"), with Cornell surviving after the Merger as a wholly owned subsidiary of Parent.

Our Board of Directors unanimously approved the Merger Agreement. In connection with the Merger, the Parent and certain of our stockholders entered into a Voting Agreement dated on or about October 6, 2006, whereby such stockholders agreed, among other things, to vote their respective shares of our stock in favor of the Merger Agreement, the Merger and the transactions contemplated thereby. At a special meeting of our stockholders held on January 23, 2007, the proposed Merger Agreement was rejected.

Under the terms of the Merger Agreement, because the Merger was terminated, we reimbursed \$2.5 million of costs incurred by Veritas, Parent and Merger Sub in connection with the proposed merger in February 2007. Such costs for legal and external professional and consulting fees are reflected in general and administrative expenses for the year ended December 31, 2007.

14. DISCONTINUED OPERATIONS

We classify as discontinued operations those components of our business that we hold for sale or that have been disposed and have cash flows that are clearly distinguishable operationally and for financial reporting purposes from the rest of our operations. For those components, we have no significant continuing involvement after completion of disposal and their operations are eliminated from our ongoing operations. During the year ended December 31, 2005, we classified certain components as discontinued operations as the result of a management decision to close certain facilities. Notifications were made to the required contracting entities regarding the termination of the related programs. At December 31, 2008 and 2007, we did not have any significant net property and equipment balances pertaining to these former operations. There were no revenues generated by these discontinued operations in the years ended December 31, 2008, 2007 and 2006.

15. SEGMENT DISCLOSURE

Our three operating divisions are our reportable segments. The Adult Secure Services segment consists of the operations of secure adult incarceration facilities. The Abraxas Youth and Family Services segment consists of providing residential treatment and educational programs and non-residential community-based programs to juveniles between the ages of 10 and 18 who have either been adjudicated or suffer from behavioral problems. The Adult Community-Based Services segment consists of providing pre-release and halfway house programs for adult offenders who are either on probation or serving the last three to six-months of their sentences on parole and preparing for re-entry into society at large as well as community-based treatment and education programs as an alternative to incarceration. All of our customers and long-lived assets are located in the United States of America. The accounting policies of our reportable segments are the same as those described in the summary of significant accounting policies in Note 2 to the consolidated financial statements. Intangible assets are not included in each segment's reportable assets, and the amortization of intangible assets is not included in the determination of a segment's operating income. We evaluate performance based on income or loss from operations before general and administrative expenses, incentive bonuses, amortization of intangibles, interest and income taxes. Corporate and other assets are comprised primarily of cash, investment securities available for sale, accounts receivable, debt service fund, deposits, property and equipment, deferred taxes, deferred costs and other assets. Corporate and other expense from operations primarily consists of depreciation and amortization on the corporate office facilities and equipment and specific general and administrative charges pertaining to corporate personnel (including the \$1.85 million legal settlement received in the third quarter of 2007) and is presented separately as such charges cannot be readily identified for allocation to a particular segment.

The only significant non-cash items reported in the respective segments' income from operations is depreciation and amortization (excluding intangibles) and impairment of long-lived assets (in thousands).

	Year Ended December 31,		
	2008	2007	2006
Revenue:			
Adult secure services	\$ 209,283	\$ 183,199	\$ 178,795
Abraxas youth and family services	107,278	109,297	115,765
Adult community-based services	70,163	68,108	66,295
Total revenue	<u>\$ 386,724</u>	<u>\$ 360,604</u>	<u>\$ 360,855</u>
Pre-opening and start-up expenses:			
Adult secure services	\$ —	\$ —	\$ 2,657
Abraxas youth and family services	—	—	—
Adult community-based services	—	—	—
Total pre-opening and start-up expenses	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,657</u>
Depreciation and amortization:			
Adult secure services	\$ 10,504	\$ 8,570	\$ 8,008
Abraxas youth and family services	2,866	2,736	3,118
Adult community-based services	1,535	1,525	1,892
Amortization of intangibles	2,200	2,407	2,243
Corporate and other	838	748	1,024
Total depreciation and amortization	<u>\$ 17,943</u>	<u>\$ 15,986</u>	<u>\$ 16,285</u>
Income from operations:			
Adult secure services	\$ 63,170	\$ 44,096	\$ 44,849
Abraxas youth and family services	8,829	13,069	12,574
Adult community-based services	19,191	16,511	12,362
Subtotal	91,190	73,676	69,785
General and administrative expenses	(25,954)	(25,499)	(21,720)
Amortization of intangibles	(2,200)	(2,406)	(2,243)
Corporate and other	(839)	(762)	(1,024)
Total income from operations	<u>\$ 62,197</u>	<u>\$ 45,009</u>	<u>\$ 44,798</u>
Loss on discontinued operations, net of tax:			
Adult secure services	\$ —	\$ —	\$ —
Abraxas youth and family services	—	—	(706)
Adult community-based services	—	—	(1)
Total loss on discontinued operations, net of tax	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (707)</u>
Capital expenditures:			
Adult secure services	\$ 76,703	\$ 48,538	\$ 9,811
Abraxas youth and family services	1,808	1,351	1,182
Adult community-based services	956	310	749
Corporate and other	448	691	575
Total capital expenditures	<u>\$ 79,915</u>	<u>\$ 50,890</u>	<u>\$ 12,317</u>
Assets:			
Adult secure services	\$ 358,406	\$ 290,930	\$ 233,670
Abraxas youth and family services	105,991	109,478	100,366
Adult community-based services	60,170	63,008	63,105
Intangible assets, net	15,628	17,875	19,265
Corporate and other	96,726	81,496	107,127
Total assets	<u>\$ 636,921</u>	<u>\$ 562,287</u>	<u>\$ 523,533</u>

16. GUARANTOR DISCLOSURES

We completed an offering of \$112.0 million of Senior Notes in June 2004. The Senior Notes are guaranteed by each of our subsidiaries ("Guarantor Subsidiaries"). MCF does not guarantee the Senior Notes ("Non-Guarantor Subsidiary"). These guarantees are joint and several obligations of the Guarantor Subsidiaries. The following condensed consolidating financial information presents the financial condition, results of operations and cash flows of the Guarantor Subsidiaries and the Non-Guarantor Subsidiary, together with the consolidating adjustments necessary to present our results on a consolidated basis.

Condensed Consolidating Balance Sheet as of December 31, 2008 (in thousands)

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non- Guarantor Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
Assets					
Current assets:					
Cash and cash equivalents	\$ 14,291	\$ 265	\$ 57	\$ —	\$ 14,613
Accounts receivable	2,045	66,921	422	—	69,388
Restricted assets	—	3,432	27,938	—	31,370
Prepays and other	13,875	1,644	—	—	15,519
Total current assets	30,211	72,262	28,417	—	130,890
Property and equipment, net	101	312,446	141,975	(4,168)	450,354
Other assets:					
Debt service reserve fund	—	—	23,750	—	23,750
Deferred costs and other	60,322	23,267	5,367	(57,029)	31,927
Investment in subsidiaries	73,197	1,856	—	(75,053)	—
Total assets	<u>\$ 163,831</u>	<u>409,831</u>	<u>\$ 199,509</u>	<u>(136,250)</u>	<u>\$ 636,921</u>
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable and accrued liabilities	\$ 48,373	\$ 15,515	\$ 4,883	\$ 322	\$ 69,093
Current portion of long-term debt	—	12	12,400	—	12,412
Total current liabilities	48,373	15,527	17,283	322	81,505
Long-term debt, net of current portion	186,356	14	121,700	—	308,070
Deferred tax liabilities	16,246	94	—	1,151	17,491
Other long-term liabilities	5,851	113	56,733	(61,009)	1,688
Intercompany	(320,717)	320,722	—	(5)	—
Total liabilities	(63,891)	336,470	195,716	(59,541)	408,754
Minority interest	—	—	—	445	445
Stockholders' equity	227,722	73,361	3,793	(77,154)	227,722
Total liabilities and stockholders' equity	<u>\$ 163,831</u>	<u>\$ 409,831</u>	<u>\$ 199,509</u>	<u>\$ (136,250)</u>	<u>\$ 636,921</u>

Condensed Consolidating Balance Sheet as of December 31, 2007 (in thousands)

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non- Guarantor Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated</u>
Assets					
Current assets:					
Cash and cash equivalents	\$ 2,565	\$ 408	\$ 55	\$ —	\$ 3,028
Investment securities	250	—	—	—	250
Accounts receivable	1,814	70,495	679	—	72,988
Restricted assets	—	2,486	25,629	(592)	27,523
Prepays and other	11,362	1,519	—	—	12,881
Total current assets	15,991	74,908	26,363	(592)	116,670
Property and equipment, net	270	242,297	146,197	(4,812)	383,952
Other assets:					
Debt service reserve fund	—	—	23,638	—	23,638
Deferred costs and other	56,500	24,460	6,035	(48,968)	38,027
Investment in subsidiaries	41,445	1,856	—	(43,301)	—
Total assets	<u>\$ 114,206</u>	<u>\$ 343,521</u>	<u>\$ 202,233</u>	<u>\$ (97,673)</u>	<u>\$ 562,287</u>
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable and accrued liabilities	\$ 37,751	\$ 15,463	\$ 5,186	\$ (898)	\$ 57,502
Current portion of long-term debt	—	11	11,400	—	11,411
Total current liabilities	37,751	15,474	16,586	(898)	68,913
Long-term debt, net of current portion	141,172	26	134,100	—	275,298
Deferred tax liabilities	12,387	94	—	745	13,226
Other long-term liabilities	6,705	162	49,702	(52,168)	4,401
Intercompany	(284,258)	284,263	—	(5)	—
Total liabilities	(86,243)	300,019	200,388	(52,326)	361,838
Stockholders' equity	200,449	43,502	1,845	(45,347)	200,449
Total liabilities and stockholders' equity	<u>\$ 114,206</u>	<u>\$ 343,521</u>	<u>\$ 202,233</u>	<u>\$ (97,673)</u>	<u>\$ 562,287</u>

Condensed Consolidating Statement of Operations for the year ended December 31, 2008 (in thousands)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiary	Eliminations	Consolidated
Revenues.....	\$ 18,008	\$ 439,083	\$ 18,008	\$ (88,375)	\$ 386,724
Operating expenses.....	16,136	352,355	174	(88,035)	280,630
Depreciation and amortization.....	—	14,364	4,222	(643)	17,943
General and administrative expenses.....	25,879	—	75	—	25,954
Income (loss) from operations	(24,007)	72,364	13,537	303	62,197
Overhead allocations	(37,349)	37,349	—	—	—
Interest, net	8,000	5,093	10,997	(132)	23,958
Equity earnings in subsidiaries	31,233	—	—	(31,233)	—
Income before provision for income taxes.	36,575	29,922	2,540	(30,798)	38,239
Provision for income taxes	14,384	—	—	1,219	15,603
Minority interest in consolidated special purpose entity.....	—	—	—	445	445
Net income.....	<u>\$ 22,191</u>	<u>\$ 29,922</u>	<u>\$ 2,540</u>	<u>\$ (32,462)</u>	<u>\$ 22,191</u>

Condensed Consolidating Statement of Operations for the year ended December 31, 2007 (in thousands)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiary	Eliminations	Consolidated
Revenues.....	\$ 18,008	\$ 406,673	\$ 18,008	\$ (82,085)	\$ 360,604
Operating expenses.....	19,843	335,879	87	(81,699)	274,110
Pre-opening and start-up expenses.....	—	—	—	—	—
Depreciation and amortization.....	183	12,199	4,222	(618)	15,986
General and administrative expenses.....	25,424	—	75	—	25,499
Income (loss) from operations.....	(27,442)	58,595	13,624	232	45,009
Overhead allocations.....	(41,236)	41,236	—	—	—
Interest, net.....	6,972	5,094	11,889	309	24,264
Equity earnings in subsidiaries.....	13,244	—	—	(13,244)	0
Income before provision for income taxes.....	20,066	12,265	1,735	(13,321)	20,745
Provision for income taxes.....	8,156	—	—	679	8,835
Income from continuing operations.....	11,910	12,265	1,735	(14,000)	11,910
Discontinued operations.....	—	—	—	—	—
Net income.....	<u>\$ 11,910</u>	<u>\$ 12,265</u>	<u>\$ 1,735</u>	<u>\$ (14,000)</u>	<u>\$ 11,910</u>

Condensed Consolidating Statement of Operations for the year ended December 31, 2006 (in thousands)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiary	Eliminations	Consolidated
Revenues.....	\$ 18,008	\$ 408,832	\$ 18,008	\$ (83,993)	\$ 360,855
Operating expenses.....	23,498	335,515	33	(83,651)	275,395
Pre-opening and start-up expenses.....	—	2,657	—	—	2,657
Depreciation and amortization.....	—	12,499	4,222	(436)	16,285
General and administrative expenses.....	21,617	—	103	—	21,720
Income (loss) from operations.....	(27,107)	58,161	13,650	94	44,798
Overhead allocations.....	(40,432)	40,432	—	—	—
Interest, net.....	6,653	5,085	13,522	(2,190)	23,070
Equity earnings in subsidiaries.....	13,360	—	—	(13,360)	—
Income before provision for income taxes.....	20,032	12,644	128	(11,076)	21,728
Provision for income taxes.....	8,159	—	—	989	9,148
Income from continuing operations.....	11,873	12,644	128	(12,065)	12,580
Discontinued operations, net of income tax benefit of \$381.....	—	(707)	—	—	(707)
Net income.....	<u>\$ 11,873</u>	<u>\$ 11,937</u>	<u>\$ 128</u>	<u>\$ (12,065)</u>	<u>\$ 11,873</u>

Condensed Consolidating Statement of Cash Flows for the year ended December 31, 2008 (in thousands)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiary	Consolidated
Cash flows from operating activities:				
Net cash (used in) provided by operating activities	\$ (34,261)	\$ 78,937	\$ 14,303	\$ 58,979
Cash flows from investing activities:				
Capital expenditures	—	(79,915)	—	(79,915)
Sales of investment securities	250	—	—	250
Payments to restricted debt payment account, net	—	—	(2,901)	(2,901)
Proceeds from sale of fixed assets	—	846	—	846
Net cash provided by (used in) investing activities	250	(79,069)	(2,901)	(81,720)
Cash flows from financing activities:				
Payments of MCF bonds	—	—	(11,400)	(11,400)
Proceeds from line of credit	49,000	—	—	49,000
Payments on line of credit	(4,000)	—	—	(4,000)
Payments on capital lease obligations	—	(11)	—	(11)
Proceeds from exercise of stock options	737	—	—	737
Net cash (used in) provided by financing activities	45,737	(11)	(11,400)	34,326
Net increase (decrease) in cash and cash equivalents	11,726	(143)	2	11,585
Cash and cash equivalents at beginning of period	2,565	408	55	3,028
Cash and cash equivalents at end of period	\$ 14,291	\$ 265	\$ 57	\$ 14,613

Condensed Consolidating Statement of Cash Flows for the year ended December 31, 2007 (in thousands)

	<u>Parent</u>	<u>Guarantor Subsidiaries</u>	<u>Non- Guarantor Subsidiary</u>	<u>Consolidated</u>
Cash flows from operating activities:				
Net cash provided by (used in) operating activities	\$ (59,489)	\$ 74,169	\$ 12,564	\$ 27,244
Cash flows from investing activities:				
Capital expenditures	—	(50,890)	—	(50,890)
Purchase of investment securities	(241,425)	—	—	(241,425)
Sales of investment securities	253,100	—	—	253,100
Facility acquisitions	—	(18,554)	—	(18,554)
Site acquisition	—	(5,053)	—	(5,053)
Payments to restricted debt payment account, net	—	—	(2,084)	(2,084)
Proceeds from sale of fixed assets	—	375	—	375
Net cash provided by (used in) investing activities	11,675	(74,122)	(2,084)	(64,531)
Cash flows from financing activities:				
Proceeds from line of credit	30,000	—	—	30,000
Payments on MCF Bonds	—	—	(10,500)	(10,500)
Payments for debt issuance and other financing costs	(845)	—	—	(845)
Payments on capital lease obligations	—	(10)	—	(10)
Proceeds from exercise of stock options and warrants	2,786	—	—	2,786
Tax benefit of stock option exercises	355	—	—	355
Net cash provided by (used in) financing activities	32,296	(10)	(10,500)	21,786
Net (decrease) increase in cash and cash equivalents	(15,518)	37	(20)	(15,501)
Cash and cash equivalents at beginning of period	18,083	371	75	18,529
Cash and cash equivalents at end of period	\$ 2,565	\$ 408	\$ 55	\$ 3,028

Condensed Consolidating Statement of Cash Flows for the year ended December 31, 2006 (in thousands)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiary	Consolidated
Cash flows from operating activities:				
Net cash provided by operating activities	\$ 7,859	\$ 8,693	\$ 13,112	\$ 29,664
Cash flows from investing activities:				
Capital expenditures	—	(12,317)	—	(12,317)
Purchases of investment securities.....	(427,600)	—	—	(427,600)
Sales of investment securities	422,925	—	—	422,925
Payments to restricted debt payment account, net	—	—	(3,367)	(3,367)
Proceeds from sale of fixed assets	—	2,892	—	2,892
Net cash used in investing activities	(4,675)	(9,425)	(3,367)	(17,467)
Cash flows from financing activities:				
Payments of MCF bonds.....	—	—	(9,700)	(9,700)
Tax benefit of stock option exercises.....	224	—	—	224
Payments on capital lease obligations.....	—	(11)	—	(11)
Proceeds from exercise of stock options.....	2,096	—	—	2,096
Net cash (used in) provided by financing activities.....	2,320	(11)	(9,700)	(7,391)
Net increase (decrease) in cash and cash equivalents	5,504	(743)	45	4,806
Cash and cash equivalents at beginning of period	12,579	1,114	30	13,723
Cash and cash equivalents at end of period.....	\$ 18,083	\$ 371	\$ 75	\$ 18,529

17. SELECTED QUARTERLY FINANCIAL DATA (Unaudited)
(in thousands, except per share data)

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year
2008:					
Revenues.....	\$ 95,392	\$ 94,646	\$ 95,187	\$ 101,499	\$ 386,724
Income from operations.....	14,490	14,914	14,037	18,756	62,197
Net income.....	4,634	5,345	4,828	7,384	22,191
Earnings per share:					
Basic	\$.32	\$.37	\$.34	\$.52	\$ 1.55
Diluted	\$.32	\$.36	\$.33	\$.50	\$ 1.51
2007:					
Revenues.....	\$ 89,644	\$ 91,494	\$ 87,327	\$ 92,139	\$ 360,604
Income from operations.....	7,835	12,047	10,537	14,590	45,009
Net income.....	664	3,446	2,416	5,384	11,910
Earnings per share:					
Basic	\$.05	\$.24	\$.17	\$.38	\$.84
Diluted (a).....	\$.05	\$.24	\$.17	\$.37	\$.82
2008 Balance Sheet Data:					
Working capital	\$ 41,697	\$ 35,444	\$ 38,988	\$ 48,395	\$ 48,395
Total assets	578,530	602,787	628,107	636,921	636,921
Long-term debt, net of current portion.....	280,341	292,884	306,027	308,070	308,070
Stockholders' equity	206,877	212,711	219,179	227,722	227,722
2007 Balance Sheet Data:					
Working capital	\$ 75,749	\$ 59,080	\$ 22,827	\$ 47,757	\$ 47,757
Total assets	516,541	535,039	537,028	562,287	562,287
Long-term debt, net of current portion.....	256,085	254,463	245,083	275,298	275,298
Stockholders' equity	183,913	189,122	193,792	200,449	200,449

(a) The sum of quarters may not equal yearly amount as each quarter represents a discrete period and also due to rounding.

ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures designed to provide reasonable assurance that information disclosed in our annual and periodic reports is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. In addition, we designed these disclosure controls and procedures to ensure that this information is accumulated and communicated to management, including the chief executive officer ("CEO") and chief financial officer ("CFO"), to allow timely decisions regarding required disclosures. SEC rules require that we disclose the conclusions of our CEO and CFO about the effectiveness of our disclosure controls and procedures.

We do not expect that our disclosure controls and procedures will prevent all errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitation in a cost-effective control system, misstatements due to error or fraud could occur and not be detected.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, and as required by paragraph (b) of Rules 13a-15 and 15d-15 of the Exchange Act, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period required by this report. Based on that evaluation, our principal executive officer and principal financial officer have concluded that these controls and procedures are effective at a reasonable assurance level as of that date.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

In connection with the evaluation as required by paragraph (d) of Rules 13a-15 and 15d-15 of the Exchange Act, we have not identified any change in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our fiscal quarter ended December 31, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Cornell is responsible for establishing and maintaining adequate internal control over financial reporting for Cornell. Cornell's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Cornell's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and, (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We have assessed the effectiveness of our internal control over financial reporting as of December 31, 2008. To make this assessment we used the criteria for effective internal control over financial reporting described in *Internal Control — Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment, we have concluded that, as of December 31, 2008, the Company's internal control over financial reporting was effective.

Our management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2008 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

REPORT OF THE REGISTERED PUBLIC ACCOUNTING FIRM

See "Financial Statements and Supplementary Data — Report of Independent Registered Public Accounting Firm" in Item 8 of this report.

ITEM 9B. OTHER INFORMATION

None.

PART III

Items 10, 11, 12, 13 and 14 of Part III have been omitted from this report because we will file with the Securities and Exchange Commission, not later than 120 days after the close of our fiscal year, a definitive proxy statement or a Form 10-K/A. The information required by Items 10, 11, 12, 13 and 14 of this report, which will appear in the definitive proxy statement and/or the Form 10-K/A, is incorporated by reference into Part III of this report.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) **Financial Statements, Schedules and Exhibits**

1. Financial statements
 - Report of Independent Registered Public Accounting Firm
 - Consolidated Balance Sheets - December 31, 2008 and 2007
 - Consolidated Statements of Operations and Comprehensive Income/(Loss) for the years ended December 31, 2008, 2007 and 2006
 - Consolidated Statements of Stockholders' Equity for the years ended December 31, 2008, 2007 and 2006
 - Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006
 - Notes to consolidated financial statements
2. Financial statement schedules
 - All schedules are omitted because they are not applicable or because the required information is included in the financial statements or notes thereto.
3. Exhibits

Exhibit No.	Description
3.1	Restated Certificate of Incorporation of Cornell Companies, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996 filed on March 31, 1997).
3.2	Second Amended and Restated Bylaws of Cornell Companies, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on December 13, 2007).
3.3	Certificate of Amendment of Restated Certificate of Incorporation of Cornell Companies, Inc. (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 (Reg. No. 333-42444) filed on July 28, 2000).
4.1	Form of Certificate representing Common Stock (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Amendment 1 to Form S-1 (Reg. No. 333-08243) filed on August 26, 1996).
4.6	Indenture dated as of June 24, 2004 between Cornell Companies, Inc., the guarantors named therein and JPMorgan Chase Bank, as trustee (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on June 25, 2004).
4.7	Form of 10 3/4% Senior Note due 2012 (included in Exhibit 4.6).
4.8	Registration Rights Agreement dated March 31, 1994, as amended, among Cornell Corrections, Inc. and the stockholders listed on the signature pages thereto (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1 (Reg. No. 333-08243), filed on July 17, 1996, as amended).
4.9	Registration Rights Agreement, dated October 14, 1999 among Cornell Companies, Inc. and the investors party thereto (incorporated by reference to Exhibit 4.7 to the Company's Registration Statement on Form S-3 (Reg. No. 333-91211) filed on November 18, 1999).
10.1*	Cornell Corrections, Inc. Amended and Restated 1996 Stock Option Plan (incorporated by reference to Exhibit B to the Company's Schedule 14A filed on March 9, 1998).
10.2*	Form of Indemnification Agreement between Cornell Companies, Inc. and each of its directors and executive officers (incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Amendment 1 to Form S-1 (Reg. No. 333-08243) filed on August 26, 1996).
10.3*	Cornell Corrections, Inc. Employee Stock Purchase Plan (incorporated by reference to Exhibit 4.7 to the Company's Registration Statement on Form S-8 (Reg. No. 333-80187) filed on June 8, 1999).
10.4*	Cornell Corrections, Inc. Deferred Compensation Plan (incorporated by reference to Exhibit 4.8 to the Company's Registration Statement on Form S-8 (Reg. No. 333-80187) filed on June 8, 1999).
10.5*	Cornell Companies, Inc. 2000 Director Stock Plan (incorporated by reference to Exhibit 4.9 to the Company's Registration Statement on Form S-8 (Reg. No. 333-42444) filed on July 28, 2000).
10.6*	Cornell Companies, Inc. Deferred Bonus Plan (incorporated by reference to Exhibit 10.44a to the Company's Annual Report on Form 10-K for the year ended December 31, 2002 filed on March 31, 2003).
10.7	Premises Transfer Agreement, dated August 14, 2001, among Cornell Companies, Inc., Cornell Corrections of Georgia, L.P., Cornell Corrections of Oklahoma, Inc., Cornell Corrections of Texas, Inc., WBP Leasing, Inc., and Municipal Corrections Finance, L.P. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 28, 2001).
10.8	Master Lease Agreement (with addenda), dated August 14, 2001, between Municipal Corrections Finance, L.P. and Cornell Companies, Inc. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on August 28, 2001).
10.9	Master Lease Agreement dated December 3, 1998 between Atlantic Financial Group, Ltd. and WBP Leasing, Inc. and certain other subsidiaries of Cornell Corrections, Inc. (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 filed on October 30, 2001).

- 10.10 Amended and Restated Credit Agreement dated October 10, 2007 among Cornell Companies, Inc., its subsidiaries, JPMorgan Chase Bank N.A., as Administrative Agent, Bank of America, N.A., as Syndication Agent and the Lenders party thereto (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 12, 2007).
- 10.11* Amended and Restated Employment Agreement, dated August 2, 2007, between Cornell Companies, Inc. and James E. Hyman (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 6, 2007).
- 10.12* Restricted Stock Agreement, dated March 14, 2005, between Cornell Companies, Inc. and James E. Hyman (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on March 15, 2005).
- 10.13* Employment/Separation Agreement, dated March 9, 2005, between Cornell Companies, Inc. and John R. Nieser (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on March 15, 2005).
- 10.14* Amendment to Employment/Separation Agreement dated March 14, 2007 by and between Cornell Companies, Inc. and John R. Nieser (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on March 15, 2007).
- 10.15* Form of Severance Agreement (incorporated by reference to Exhibit 10.40 to the Company's Annual Report on Form 10-K for the year ended December 31, 1999 filed on March 30, 2000).
- Amendment to Severance Agreement dated March 14, 2007 by and between Cornell Companies, Inc. and Patrick N. Perrin (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on March 15, 2007).
- 10.16* Employment Agreement dated March 19, 2007 between Cornell Companies, Inc. and William E. Turcotte (incorporated by reference to Exhibit 10.16 to the Company's Annual Report on Form 10-K for the year ended December 31, 2007 filed on March 14, 2008).
- 10.17* Cornell Companies, Inc. 2006 Equity Incentive Plan (incorporated by reference to Appendix A to the Company's Schedule 14A filed on May 10, 2006).
- 10.18* Form of Cornell Companies, Inc. Restricted Stock Award — Performance Based (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 12, 2008).
- 10.19* Form of Cornell Companies, Inc. Restricted Stock Award — Time Based (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on March 12, 2008).
- 21.1† List of Subsidiaries.
- 23.1† Consent of PricewaterhouseCoopers LLP.
- 24.1† Power of Attorney (see signature page of this Annual Report on Form 10-K).
- 31.1† Section 302 Certification of Chief Executive Officer.
- 31.2† Section 302 Certification of Chief Financial Officer.
- 32.1† Section 906 Certification of Chief Executive Officer.
- 32.2† Section 906 Certification of Chief Financial Officer.
- 99.1 Letter Agreement, dated September 5, 2001, as amended, between Cornell Companies, Inc. and Lehman Brothers, Inc. (incorporated by reference to Exhibit 99.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2001 filed on April 16, 2002).

* Management compensatory plan or contract.

† Filed herewith

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

CORNELL COMPANIES, INC.

Dated: March 6, 2009

By: /s/ James E. Hyman
James E. Hyman
Chief Executive Officer, President and
Chairman of the Board

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints James E. Hyman, John R. Nieser and Patrick N. Perrin, and each of them, his true and lawful attorneys-in-fact, each with full power of substitution, for him or her in any and all capacities, to sign any amendments to this report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact or their substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities on March 6, 2009.

SIGNATURE	TITLE
<u>/s/ James E. Hyman</u> James E. Hyman	Chief Executive Officer, President and Chairman of the Board (Principal Executive Officer)
<u>/s/ John R. Nieser</u> John R. Nieser	Chief Financial Officer, Senior Vice President and Treasurer (Principal Financial Officer and Principal Accounting Officer)
<u>*</u> Max Batzer	Director
<u>*</u> Anthony R. Chase	Director
<u>*</u> Richard Crane	Director
<u>*</u> Zachary R. George	Director
<u>*</u> Todd Goodwin	Director
<u>*</u> Andrew R. Jones	Director
<u>*</u> Alfred Jay Moran, Jr.	Director
<u>*</u> D. Stephen Slack	Director
By: <u>/s/ Cathryn L. Porter</u> Cathryn L. Porter Attorney-in-Fact	

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Corporate Directory (As of April 15, 2009)

DIRECTORS

Max Batzer³
Portfolio Manager
Wynnefield Capital, Inc.

Anthony R. Chase¹
Chairman and Chief Executive Officer
ChaseSource

Richard Crane³
Attorney at Law

Zachary R. George²
Portfolio Manager and Managing Member
FrontFour Capital Group LLC

Todd Goodwin³
Retired Partner
Gibbons, Goodwin, van Amerongen

James E. Hyman
Chairman, President and Chief Executive Officer
Cornell Companies, Inc.

Andrew R. Jones²
Managing Member
NS Advisors, LLC

Alfred Jay Moran, Jr.¹
Director of Administration & Regulatory Affairs
City of Houston

D. Stephen Slack^{1,2}
President and Chief Executive Officer
South Bay Resources LLC

¹ Audit Committee member

² Compensation Committee member

³ Governance Committee member

EXECUTIVE OFFICERS

James E. Hyman
Chairman, President and Chief Executive Officer

John R. Nieser
Senior Vice President, Chief Financial Officer and Treasurer

Patrick N. Perrin
Senior Vice President and Chief Administrative Officer

Cathryn L. Porter
Senior Vice President, General Counsel and
Corporate Secretary

KEY MANAGEMENT PERSONNEL

Blake Barras
Vice President, Financial Planning and Analysis

Troy R. Berreth
Vice President, Information Technology

Michael L. Caltabiano
Senior Vice President, Adult Corrections

Benjamin E. Erwin
Senior Vice President, Corporate Development

Kathy Forsberg
Vice President and Corporate Controller

Peter Kiilu
Managing Director, Internal Audit

George Killinger
Vice President, Adult Secure

Jonathan P. Swatsburg
Senior Vice President, Abraxas Youth and Family Services

CORPORATE INFORMATION

Independent Accountants
PricewaterhouseCoopers LLP
1201 Louisiana, Suite 2900
Houston, Texas 77002

Stock Transfer Agent and Registrar
Computershare Investor Services
P.O. Box 43078
Providence, Rhode Island 02940-3078
1-800-962-4284

Corporate Headquarters
Cornell Companies, Inc.
1700 West Loop South, Suite 1500
Houston, Texas 77027
713-623-0790

Stock Listing

New York Stock Exchange Ticker Symbol: CRN

Certifications. Cornell submitted the annual CEO Certification to the New York Stock Exchange in 2008 and, separately, the Company filed Section 302 CEO and CFO certifications with the U.S. Securities and Exchange Commission as exhibits to its Annual Report on Form 10-K for the year ended December 31, 2008.

