

Funds: Doing time is money - prisons pay off for fund

Education, like jails, is a sure-shot pick

By **Danielle Kost**

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BOSTON: For managers of the RS Partners Fund, the second-best performing U.S. small-cap value mutual fund since 2001, only two things are certain this year: jails and education.

Andrew Pilara, who oversees the \$2.3 billion fund, is bullish on Corrections Corp. of America, the largest operator of jails and prisons in the United States, and Corinthian Colleges, which runs 130 colleges in the United States and Canada.

While most companies will post smaller earnings gains in 2006 as consumer spending weakens, businesses like Corrections and Corinthian Colleges will keep growing, said Pilara, who co-manages the fund with Joe Wolf and David Kelley. Demand for their services is not dependent on the economy, he said.

"Our caution led us to businesses that aren't economically sensitive," Pilara said in an interview by phone from his office at RS Investments in San Francisco.

Pilara said he expects rising commodities prices to hamper U.S. growth, while economists are forecasting that the first quarter will show the biggest gains in two years.

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The RS Partners Fund climbed 14 percent in the past year. Much of the gain came from energy-related companies like Compton Petroleum and Paramount Resources, which increased as oil and natural gas prices rose.

In the past five years, RS Partners advanced at an average annual rate of 22 percent, beating all 116 small-cap value funds tracked by Bloomberg except the Hotchkis & Wiley Small Cap Value Fund, which rose 23 percent. RS Partners

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matched the FBR Small Cap Fund's returns over five years. Small-cap value funds invest in small companies considered cheap relative to earnings.

Pilara, Kelley and Wolf invest in companies with market values of less than \$3 billion and typically hold stocks for two to three years. The fund had stakes in 52 companies at the end of last year, compared with 180 for the average small-cap value fund, according to data compiled by Morningstar, the Chicago-based industry research firm.

The RS Partners Fund looks for out-of-favor companies with growing cash flow. In marketing documents, the fund says it invests in companies that "manage capital, not earnings."

"We spend a lot of time on the balance sheet," said Pilara.

Pilara has worked at RS Investments, an employee-owned money management firm formerly controlled by Bank of America, since 1993 after running his own firm for 19 years. He has managed the RS Partners Fund since 1995.

The fund first invested in Corrections about a year ago, and the company's stock has gained 13 percent since then, three times that of the Standard & Poor's 500 index.

The company, based in Nashville, Tennessee, is seeking new government contracts to add to the 63 prisons with 71,000 beds that it currently manages. The number of prisoners held in U.S. jails increased at an average annual rate of 3.4 percent from 1995 to 2004, according to the U.S. Justice Department.

While the prison population has grown to 2.14 million, space has not increased apace, Pilara said. U.S. prisons are operating at 140 percent of capacity and state prisons at more than 100 percent, providing opportunities for private prison companies, he said.

Shares of Corinthian Colleges, based in Santa Ana, California, have not done as well. The company's fourth-quarter earnings slumped 47 percent to \$10.7 million after enrollment declined. Its shares dropped 25 percent in the past year.

Pilara, Wolf and Kelley bought the shares on the expectation that Jack Massimino, who took over as chief executive officer in November 2004, would revive profit growth by cutting costs. His predecessor, David Moore, acquired colleges and programs and ramped up spending to increase enrollment, hurting earnings.

The fund managers are sticking with Corinthian Colleges. The company is a "classic turnaround" story, Wolf said. "There's no question that more people are going back to school and enriching their skills."

The enrollment of students at least 25 years old at U.S. colleges will rise to 6.7 million in 2011, up 15 percent from 1999, according to the National Center for Education Statistics. In the 1990s, enrollment for that group fell.

Managers of the RS Partners Fund are concerned about the outlook for the U.S. economy after growth slowed to 1.6 percent in the fourth quarter from 4.1 percent in the prior three months.

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They said the rest of the decade may resemble the late 1970s, which were marred by rising energy prices and a sluggish economy.

"Global economic cycles will be dominated by China and India rather than by the developed countries' economic cycle," the managers said in a report sent to shareholders in December.

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