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Zacks Small-Cap Research

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CoreCivic, Inc. (CXW-NYSE)

CXW: 2Q21 Underscores Recent Balance Sheet Improvements & Strong FFO

CXW's 2Q21 adjusted EBITDA was up slightly to $101.7 million compared to $101.1 million in 2Q20, despite lower occupancy rates as a result of the COVID-19 pandemic and the absence of revenue from facilities that CXW sold recently. Although several one-time items impacted 2Q21 results, FFO was $0.46 compared to pro forma tax-adjusted 2Q20 of FFO per share of $0.47.

Current Price (08/24/21)	$9.60
Valuation	**$15.60**

OUTLOOK

CXS continues to strengthen its balance sheet, with proceeds raised from recent asset divestitures and a debt issuance / refinancing helping with this initiative by accelerating debt paydowns and extending debt maturities. Although reduced occupancy related to the pandemic negatively impacted the company's 2Q21 results, average occupancies improved sequentially, as rising vaccine rates ease this overhang. Moreover, with only one prison contract with the BOP, which accounts for only about 2% of total revenue, CXW has minimal exposure to the executive order to not renew DOJ contracts with private operators. Conversely, contracts with the U.S. Marshals Service (USMS) represent about 23% of CXW's annual revenue and CXW expects USMS need to remain relatively steady.

SUMMARY DATA

52-Week High	**$12.35**
52-Week Low	**$5.76**
One-Year Return (%)	**4.23**
Beta	**1.32**
Average Daily Volume (sh)	**1,378,823**
Shares Outstanding (mil)	**120**
Market Capitalization ($mil)	**$1,155**
Short Interest Ratio (days)	**5.1**
Institutional Ownership (%)	**71**
Insider Ownership (%)	**1**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**1.6**
Earnings Per Share (%)	**-3.0**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2021 Estimate	**N/A**
P/E using 2022 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**Above Avg.,**
Type of Stock	**Mid-Value**
Industry	**Reit-Eqty Trust**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2019	484 A	490 A	509 A	498 A	1,981 A
2020	491 A	473 A	468 A	473 A	1,905 A
2021	455 A	465 A	473 E	482 E	1,875 E

EPS / Loss per share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2019	$0.64 A	$0.69 A	$0.70 A	$0.59 A	$2.62 A
2020	$0.54 A	$0.56 A	$0.52 A	-$0.22 A	$0.45 A
2021	-$1.03 A	$0.13 A	$0.14 E	$0.15 E	-$0.60 E

4Q20 includes ~$0.35 noncash chg Qs might not sum from rounding

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KEY POINTS

- **CXW continues to strengthen its balance sheet**
- **Recent asset divestitures enabled acceleration of debt repayments**
- **Average occupancy declined y/y but was up sequentially from 1Q21 as vaccine rates increased**
- **CXW has minimal exposure to executive orders …**
- **… While several new contracts are expected to boost revenue**
- **CXW expects USMS needs to remain relatively steady; USMS accounts for ~23% of CXW revenue**

- CoreCivic's 2Q21 results mirror improving trends in its core operations, as occupancies rebound, although occupancies have still not recovered to pre-COVID levels. This reflects ongoing government and ICE measures to curb the spread of COVID-19 among prison and detainee populations. CXW's average compensated occupancy for the Safety and Community units was 71.6% compared to 74.9% in 2Q20 and up sequentially from 69.9% in 1Q21.

- Revenue of $464.6 million was down 1.7% year-over-year. This decline primarily reflected lower occupancy rates noted above, as well as the recent divestiture of assets. Revenue from recently signed contracts partially offset these factors. CXW reported adjusted EPS of $0.25 compared to $0.33. Adjusted EBITDA was $101.7 million, up from $101.1 million in 2Q20 and normalized FFO, excluding non-recurring items, was $0.46 per share compared with $0.56 in 2Q20.

- Recent asset sales helped accelerate debt repayments. Long-term debt declined to $1.48 billion from $1.75 billion at year-end 2020, through the combination of cash flow generation and proceeds from asset sales. The total leverage ratio was 3.3x TTM adjusted EBITDA, down from 4.3x at the end of 2Q20. CXW targets a leverage ratio of 2.25x to 2.75x. CXW had $162.9 million of cash at the end of 2Q21, plus an additional $8.9 million of restricted cash and about $688 million available under its $800 million revolver.

- Several recent contracts and potential new ones coming up are expected to help offset the decline in occupancies and revenue caused by the pandemic. Over the past decade or so, contract renewals have averaged over 90% per annum regardless of the administration in office.

2Q21 FINANCIAL REVIEW

COVID-19 Impact Lessens But Occupancies Still Below Pre-COVID Levels

CoreCivic's (NYSE: CXW) 2Q21 results mirror improving trends in its core operations as occupancies rebound. We note, however, that occupancies have still not recovered to pre-COVID levels. The lower occupancy rates reflect ongoing government measures to curb the spread of COVID-19 among the prison populations. Court delays as a result of the pandemic have also contributed to lower prison occupancy. At the same time, ICE has sought to contain the spread of COVID-19 through tighter control over the southern U.S. border, which has led to lower numbers of people housed under existing contracts with ICE. Moreover, this week the Supreme Court upheld Migrant Protection Protocols (MPP) mandating that many asylum-seekers wait outside the U.S. for their cases to be decided.

CXW's average compensated occupancy for the Safety and Community businesses in 2Q21 was 71.6% compared to 74.9% in 2Q20. Importantly however, average occupancy was up sequentially from 69.9% in 1Q21. CXW has been administering vaccine dosages and the number of inmates testing positive for the COVID-19 virus has declined. The quarter-to-quarter improvement notwithstanding, with cases on the rise in many areas of the country and emerging variants of the virus, the company expects the COVID-19 pandemic to continue to impact utilization levels of CXW's facilities in the near-term.

It is important to note that the company's exposure to reductions caused by the executive order implemented by the Biden administration to not renew Department of Justice contracts with privately operated criminal detention facilities is minimal. CXW has only one prison contract with the Federal Bureau of Prisons (BOP), which accounts for only about 2% of total revenue. Conversely, contracts with the U.S. Marshals Service (USMS) represent about 23% of CXW's annual revenue. USMS prison populations have remained relatively steady over

the past several years and CXW believes that the USMS does not have sufficient detention capacity to satisfy their current needs without leveraging the capacity that CXW and other private entities can provide. Of four USMS contracts set to expire in 2021, the company has already amended arrangements on two and is in discussions to amend / extend terms on the remaining two. Moreover, the company believes that need for states such as Alabama and Hawaii to replace old, outdated facilities with modern ones underscores the state of prison facilities throughout most of the country and the need for states and federal authorities to access privately run facilities.

Recent asset divestitures contributed to lower revenue, but accelerated debt reduction initiatives

Revenue of $464.6 million was down 1.7% year-over-year. This decline primarily reflected lower occupancy rates noted above, including within the company's Safety unit, lower occupancies reflect regulators actions to transition some residents to furloughs, home confinement or early releases due to COVID. Notably, however, the average occupancy for the Safety unit increased 120 basis points (bps) sequentially compared to 1Q21. The revenue decline also reflects CXW's decision to exit two managed-only contracts in Tennessee and the recent divestiture of assets.

CXW sold 42 GSA leased assets in the property segment in December of 2020. CXW subsequently completed the divestiture of other non-core assets, including the membership interests of SSA Baltimore Holdings, LLC, which owns a roughly 541,000 square-foot Social Security Administration (SSA) office building in Baltimore, Maryland. The company also completed the sale of two additional properties earlier in 2Q21, including Capital Commerce Center and a roughly 217,000 square-foot warehouse.

Revenue from recently signed contracts partially offset these factors. The impact of lower occupancy rates in 2Q21 was also partially offset by a 5.6% annual decline in operating expenses, despite several one-time charges, including a $52.2 million charge related to h debt repayments and refinancing. In addition, one-time items that impacted 2Q21 results include a $2.6 million charge related to settling shareholder litigation and $2.9 million asset impairment charge.

CXW reported EPS of $0.13 compared to $0.18 in 2Q20. However, adjusted for non-recurring items in both periods, adjusted EPS came in at $0.25 compared to $0.33. Adjusted EBITDA was $101.7 million, up from $101.1 million in 2Q20 and normalized FFO excluding the non-recurring items noted above was $0.46 per share compared with $0.56 in 2Q20. The decline in FFO primarily related to the tax impact from CXW's conversion to a taxable C Corporation from a REIT. On an apples-to-apples basis, normalized FFO of $0.46 per share was down only slightly from pro forma 2Q20 $0.47 per share, after applying a tax rate of 27.5% to last year's 2Q results.

STRENGTHENING THE BALANCE SHEET

Recent asset sales raise funds for debt repayments

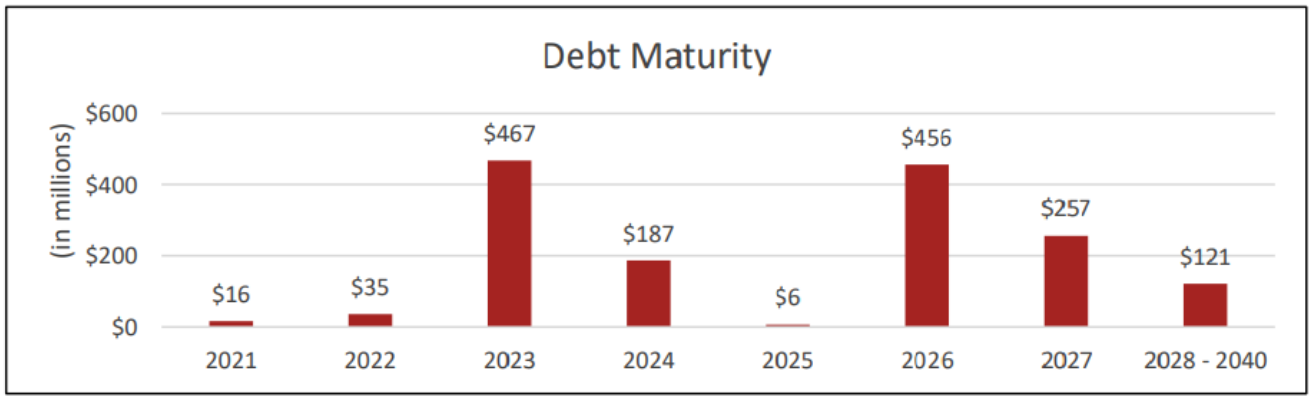
As noted, CXW closed on the sale of non-core assets in 1H21 and used much of the proceeds to pare debt. CXW reduced its net debt balance by almost $550.0 million over the last year. Long-term debt declined to $1.48 billion from $1.75 billion at year-end 2020, through the combination of cash flow generation and the above-noted asset sales. The total leverage ratio was 3.3x TTM adjusted EBITDA, down from 4.3x at the end of 2Q20. CXW targets a leverage ratio of 2.25x to 2.75x.

CXW expects to repay another roughly $100 million in 2H21 of debt using cash generated from operations. Since CXW is now structured as a C-Corp, CXW expects to retain and build cash at a faster pace going forward than it had over the past seven years as a REIT, despite the need to pay higher taxes. One key use of cash will be for debt repayments. CXW has generated cash flow from operations of more than $1.0 billion for the past three years.

CXW had $162.9 million of cash at the end of 2Q21, plus an additional $8.9 million of restricted cash. The company also has added liquidity $688 million available under its $800 million revolver. The revolver matures in 2023. CXW expects to continue to repay debt. By building internally generated cash under the C-Corp. structure, CXW expects to pay down a substantial amount of its overall debt before maturity and to refinance the remainder.

Debt Issuance

CXW accessed the capital markets in 2Q21 to raise $450 million of senior notes that mature in 2026 and used the roughly $435.1 million net proceeds to redeem all of its $250 million notes that were scheduled to mature in 2022. CXW also repaid $149 million of $350 million notes scheduled to mature in 2023 and pared its revolving credit facility by $80 million, using the combination of net proceeds from the issuance and cash from the balance sheet. These measures enabled CXW to extend the weighted average debt maturity from 5.3 years to 6.0 years. The company now has no major debt maturities coming due before 2023. The debt offering also enabled CXW to reduce its reliance on banks and other external source of cash and demonstrated ongoing investor interest in the company's securities.



Source: http://ir.corecivic.com/

The company also expects to allocate a substantial portion of its free cash flow to returning capital to shareholders through share buybacks and / or dividends. Management believes the shares are oversold at this level. The company has a history of buying its shares depending on market conditions. For instance, in 2009-2011, prior to the original conversion to a REIT structure, CXW repurchased about $500 million of its shares.

CONTRACT UPDATES

Alabama The Alabama Department of Corrections (ADOC) notified CXW of its decision to terminate two 30-year lease agreements effective August 6, 2021. As a result, CXW expects to incur an asset impairment charge of $4.0 million to $6.0 million for pre-development activities related to its early activities on developing correctional facilities in Alabama to satisfy the lease terms. The company is engaged in discussions with ADOC to evaluate potential alternative solutions.

Arizona The State of Arizona recently issued an RFP (request for proposal) for up to 2,706 beds, as Arizona plans to close its oldest facility, which the state feels is in dilapidated condition. The company intends to submit a proposal in response to the RFP.

Hawaii On July 1, 2021, CXW received notice from the State of Hawaii for the rebid of the company's contract at the 1,896-bed Saguaro Correctional Facility in Eloy, Arizona. CXW, which cares for about 1,100 inmates from Hawaii, as well as about 375 inmates from Idaho at this facility, expects to enter into a new three-year contract with Hawaii. In addition, The company is also in discussions with Hawaii regarding potential replacement solutions for the Oahu Community Correctional Center, which is the largest such facility in the state and needs to be replaced with a new, modern facility.

New Jersey ICE has notified CXW that it intends to exercise its renewal option to extend the contract at the 300-bed Elizabeth Detention Center through August 31, 2023. The contract had been set to expire in 3Q21.

Ohio Earlier in 2021, CXW signed a new contract with Mahoning County, Ohio to utilize up to 990 beds at the company's 2,016-bed Northeast Ohio Correctional Center. Mahoning County is responsible for county inmates and federal detainees. Mahoning County expects to use the Northeast Ohio facility to address its population needs, while other beds in the CXW facility will continue to be used by the state of Ohio. Specifically, in addition

to providing much needed capacity for Mahoning County, the Northeast Ohio Correctional Center also houses about 800 inmates under a management contract with the state of Ohio. CXW will continue to operate the correctional facility under both contracts.

ICE – NEED TO REPLACE CAPACITY

While the Biden administration remains committed to reducing the numbers of people entering the country illegally at the southern border and state governments propose measures to end ICE contracts, the administration nevertheless still faces the problem of housing people who have arrived. We believe this could, in turn, create an opportunity for CXW.

Separately, we also believe the recent closure of two ICE detention centers along the border imply opportunities for CXW, as the agency seeks alternative capacity. CoreCivic's 2020-21 results have been negatively impacted as ICE has sought to contain the spread of COVID-19 through tighter control over the southern U.S. border. In turn, this led to lower numbers of people housed under existing contracts with ICE. As the COVID-19 vaccine is administered and occupancy rates can return to pre-pandemic levels, the company's metrics are expected to improve. Moreover, while the Biden administration remains committed to reducing the numbers of people entering the country illegally at the southern border but still faces the problem of housing the immigrants who have arrived.

In addition, some state or government agencies that formerly provided capacity to ICE are now reluctant to do so, which also implies that ICE will have to seek other options, at least in the short-term. For example, earlier this year, New Jersey introduced Bill No. 3361, which seeks to prohibit "the State, local government agencies, and private detention facilities operating in this State from entering into, renewing, or extending immigration detention agreements."

The Illinois General Assembly passed SB 667, generally referred to as the Illinois Way Forward Act, which calls for local officials to end existing contracts to detain those in immigration custody by January 1, 2022, and also prohibits new ICE contracts going forward.

VALUATION

We think the current share price does not reflect the fundamental value of the company's steady cash flow generation and opportunities for new contracts to augment revenue. Pressure on CXW shares reflects concerns about government reform measures potentially overhanging sector prospects and negative publicity around ESG issues, among other factors. We note, however, that over the past 10+ years, contract renewals have averaged over 90% per annum regardless of the administration in office and we anticipate that will continue in the foreseeable future for the very reason that government entities need to house the prison population and also face budgetary issues that likely constrain construction of new facilities in the near-term.

Moreover, over the past several years, Core Civic has diversified into adjacent areas, growing its residential reentry centers, for example. The transition to the C-Corp. structure could open the door to CXW entering additional adjacent verticals. We are optimistic about CXW's opportunity to continue generating stable cash flow.

Historically, CXW shares have been valued on a price to forward FFO basis, commanding an average multiple of about 13-14x this metric. However, given the concerns outlined above, the multiple has contracted significantly. We would anticipate multiple expansion as CXW continues to generate stable cash flow. We also believe the company's ESG initiatives will contribute positively to anticipate multiple expansions.

We see upside to CXW share price from two sources in the near-term: 1) as the company continues its deleveraging measures, we expect the equity component of enterprise value will rise and 2) we anticipate multiple expansion as investors become more comfortable with the company's outlook.

Even if the shares attained only a 6x multiple of forward FFO in the near-term, which implies a significant discount from recent averages, that equates to a share price of $15.60, and considerable upside from current levels. We believe the risk / reward ratio could be attractive for investors who have a higher than average risk tolerance and longer time horizon.

RISKS

We believe risks to CXW achieving continued stable cash flow, and to our valuation, include the following.

- Lower occupancy levels as a result of COVID-19 could last longer than expected.
- Justice system reforms might result in lower aggregate prison populations. However, CXW's efforts at diversification in recent years have led to community operating unit and reentry houses.
- Negative publicity and/or increased activism regarding the private prison operators could further pressure the share price.
- The company could be subject to litigation risk.
- Competitive risk, as the company responds to requests for proposals or interest.

RECENT NEWS

- CXW reported 2Q21 results on August 9, 2021.
- CXW issued its ESG report on May 12, 2021.
- On January 19, 2021, CoreCivic established a new reentry-focused leadership role
- CXW announced the sale of 42 non-core government leased properties for $106.5 million on December 23, 2Q21.
- CXW announced its support for the restoration of Pell Grants and voting rights to people who had been incarcerated and the reform of licensure policies on October 21, 2Q21.
- On September 15, 2Q21, the company announced that it had entered into new management contract with the United States Marshals Service.
- CoreCivic entered into a new management contract with Idaho on August 17, 2020.

FINANCIAL MODEL

Core Civic

Core Civic Income Statement & Projections ($000s except per share data)

	2019	1Q20	2Q20	3Q20	4Q20	2020A	1Q21A	2Q21A	3Q21	4Q21	2021E
Revenue	$1,980,689	$491,101	$472,641	$468,266	$473,477	$1,905,485	$454,718	$464,571	$473,127	$482,117	$1,874,533
Y/Y % change	*7.9%*	*1.5%*	*-3.6%*	*-7.9%*	*-4.9%*	*-3.8%*	*-7.4%*	*-1.7%*	*1.0%*	*1.8%*	*-1.6%*
Operating expense	1,422,769	362,315	352,927	347,927	343,207	1,406,376	332,884	333,070	347,276	360,141	1,373,371
General and administrative	127,078	31,279	30,145	35,883	27,031	124,338	29,530	33,228	33,560	33,627	129,946
Depreciation and amortization	144,572	37,952	38,619	37,865	36,425	150,861	32,712	34,084	34,425	34,769	135,990
Shareholder litigation expense / other	-	-	-	620	-	620	51,745	2,550	-	-	54,295
Impairments / other	4,706	536	11,717	805	47,570	60,628	1,308	2,866	6,000	-	10,174
Total operating expense	1,699,125	432,082	433,408	423,100	454,233	1,742,823	448,179	405,798	421,261	428,538	1,703,775
Operating income	281,564	59,019	39,233	45,166	19,244	162,662	6,539	58,773	51,867	53,579	170,758
Operating margin	14.2%	12.0%	8.3%	9.6%	4.1%	8.5%	1.4%	12.7%	11.0%	11.1%	9.1%
Interest expense, net	84,401	22,538	20,996	20,193	19,572	83,299	18,428	23,222	22,167	22,145	85,963
Other (income) expense	438	(533)	(2,987)	(2,113)	25,272	19,639	148	13,409	4,949	4,900	23,406
	84,839	22,005	18,009	18,080	44,844	102,938	18,576	36,631	27,117	27,045	109,368
Pretax income	196,725	37,014	21,224	27,086	(25,600)	59,724	(12,037)	22,142	24,750	26,534	61,390
Taxes	(7,839)	(3,776)	962	(369)	(1,203)	(4,386)	(113,531)	(6,519)	(6,806)	(7,297)	(134,153)
Minority interest		(1,181)	-	-	-	(1,181)					
Net income	188,886	32,057	22,186	26,717	(26,803)	54,157	(125,568)	15,623	17,944	19,237	(72,764)
Per share data											
EPS	$1.59	$0.27	$0.18	$0.22	($0.22)	$0.45	($1.03)	$0.13	$0.14	$0.15	($0.60)
Dividends	$1.76					$0.88					
Average shares outstanding	119,164	120,725	120,974	120,980	121,034	120,928	121,366	122,059	122,759	123,259	122,361
Funds From Operation (FFO)											
Net income	$188,886	$33,238	$22,186	$26,717	($26,803)	$55,338	($125,568)	$15,623	$17,944	$19,237	($72,764)
+ D&A of real estate assets	107,402	28,106	28,244	28,249	27,447	112,046	23,759	24,926	23,712	23,688	96,084
+ Impairment of real estate assets	4,428	405	9,750	-	4,225	14,380	1,308	-	-	-	1,308
- Gain on sale of real estate assets	(287)	-	(2,818)	(1,570)	17,943	13,555		(38,766)	-	-	(38,766)
+ - Other	-	-	-	-	-	-	(350)	9,641	6,000	-	15,291
FFO	300,429	61,749	57,362	53,396	22,812	195,319	(100,851)	11,424	47,655	42,925	1,154
FFO/share	$2.52	$0.51	$0.47	$0.44	$0.19	$1.62	($0.83)	$0.09	$0.39	$0.35	$0.01
+ M&A expenses	1132	338		620							
+ COVID related expenses			8,165	2,820	2,792	13,777	1,598	836	1,550	1,535	5,519
+ - Other special items	10,360	3,216	2,314	5,503	50,681	61,714	152,284	43,757	1,000	2,500	199,541
Normalized FFO	311,921	65,303	67,841	62,339	76,285	271,768	53,031	56,017	50,206	46,960	206,214
Normalized FFO/share	$2.62	$0.54	$0.56	$0.52	$0.63	$2.25	$0.44	$0.46	$0.41	$0.39	$1.69

Source: Company reports, Zacks estimates

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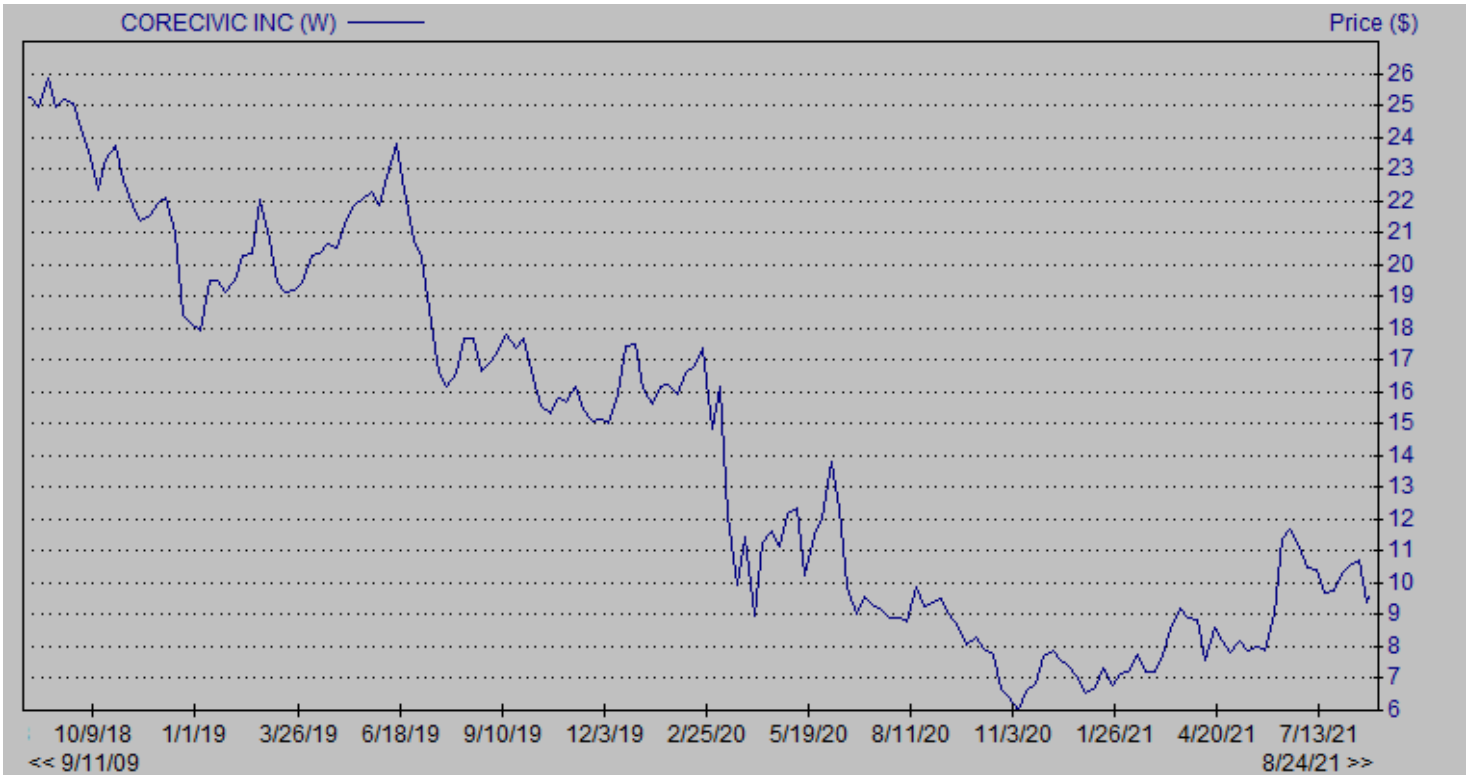

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