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Zacks Small-Cap Research

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CoreCivic, Inc. (CXW-NYSE)

CXW: Delays in La Palma Transition & Title 42 Reversal Mask Underlying Strength

CXW reported 2Q22 results that we believe reflect the underlying strength of the company's core business, although timing delays at the La Palma facility, which is taking longer than originally anticipated to transition to a new contract, and in reversing Title 42 led to a revenue shortfall. Divestitures of non-core assets are part of the strategy to strengthen the operating footprint and balance sheet and enhance shareholder value. CXW sold its McRae correctional facility in 2Q22 & expects a gain of about $75M+ in 3Q22.

OUTLOOK

CXW has executed on its strategy to deleverage via cash generated from operations, asset sales and opportunistic financings. Long-term debt was $1.148 billion at the end of 2Q22, down from $1.492 billion at yearend 2021. The company has no major debt maturities before 2023 and we believe the company is significantly better positioned to refinance and / or pare that currently than it was a few quarters back. We expect the company to continue balance sheet measures and CXW is also implementing additional steps to enhance shareholder value. The company's board recently increased the share buyback authorization to $225.0 million (from $150 million). Roughly $174.4 million remains under the plan. We anticipate further share buybacks, depending on market conditions.

Current Price (8/4/22)	$9.82
Valuation	**$18.00**

SUMMARY DATA

52-Week High	**$14.24**
52-Week Low	**$8.23**
One-Year Return (%)	**-6.57**
Beta	**0.91**
Average Daily Volume (sh)	**955,485**
Shares Outstanding (mil)	**118**
Market Capitalization ($mil)	**$1.148**
Short Interest Ratio (days)	**6.4**
Institutional Ownership (%)	**82**
Insider Ownership (%)	**2**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2022 Estimate	**16.0**
P/E using 2023 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	471 A	472 A	1,863 A
2022	453 A	457 A	459 E	462 E	1,831 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	$0.25 A	$0.23 A	-$0.43 A
2022	$0.16 A	$0.09 A	$0.62 E	$0.08 E	$0.94 E

incl~4Q20 $0.35 noncash chg 3Q22 asset sale gains Qs might not sum from rounding

Disclosures on page 9

KEY POINTS

- CXW reported 2Q22 results that we believe reflect the underlying strength of the company's core business, although timing delays at the La Palma facility, which is taking longer than originally anticipated to transition to a new contract with Arizona, and in reversing Title 42 led to a shortfall from our revenue expectations.

- The divestitures of non-core assets have been a consistent part of the company's strategy to strengthen its operating footprint and balance sheet and enhance shareholder value. CXW sold its McRae correctional facility in 2Q22 for $130.0 million. The sale is expected to produce a gain of about $75.0 million to $80.0 million in 3Q22.

- Subsequent to 2Q22, the company divested other noncore assets, resulting in aggregate net proceeds of $15.7 million. The proceeds will enhance the company's liquidity. CXW has earmarked a portion of its capital deployments to share repurchases, as well as debt reduction, and recently increased its share buyback authorization.

- As anticipated, the broader macroeconomic inflationary environment is impacting 2022 results, with pressure on operating margins. Management expects operating margins will trend up to more normalized levels once the La Palma transition is completed.

- The company lowered adjusted net income, adjusted EBITDA and FFO guidance reflecting the above-noted delays in the La Palma transition and the reversal of Title 42.

- CXW has executed on its strategy to pare debt and deleverage via cash generated from operations, asset sales and opportunistic financings. Long-term debt was $1.148 billion at the end of 2Q22, down from $1.492 billion and $1.748 billion at the end of 2021 and 2020, respectively. CXW had $115.6 million of cash at the end of 2Q22, plus an additional $11.8 million of restricted cash. Following recent measures, the company has no major debt maturities before 2023.

- We expect the company to continue balance sheet measures and CXW is also implementing additional steps to enhance shareholder value. The company's board recently increased the share buyback authorization to $225.0 million (from $150 million). Through August 1, 2022, the company had repurchased about $50.6 million of its shares, with roughly $174.4 million remaining under the repurchase plan. We anticipate further share buybacks, depending on market conditions.

- The sale price on the divestiture of the McRae facility represents a private market valuation of about $66,000 per bed, which would equate to a private market valuation of over $4 billion for CXW. We do not expect the shares to trade at a private market valuation but believe this metric underscores that CXW shares do not reflect the full value of the company's overall portfolio and its operating potential.

2Q22 HIGHLIGHTS: POSITIVE TRENDS MASKED BY TIMING DELAYS, INFLATION

Slower than expected population transition at La Palma facility constrains occupancy

CoreCivic (NYSE: CXW) reported 2Q22 results this week that we believe reflect the underlying strength of the company's core business, although timing delays at the company's La Palma facility and in reversing Title 42 (see below) led to a shortfall from our revenue expectations. Total revenue came in at $456.7 million compared to $464.6 million in 2Q21 and our estimate of $462.7 million. A key factor behind the lower than expected revenue was the reduction of ICE (Immigration and Customs Enforcement) populations at CXW's La Palma facility pending the facility's transition to state detainees under a new contract with the state of Arizona. The transition process is taking longer than the company originally anticipated. As CXW prepares to receive Arizona state inmates at this facility, the average daily population of ICE detainees at the facility is declining, which contributed to the above-noted revenue shortfall. Moreover, court action to stop the reversal of Title 42 also impacted revenue. Once Title 42 is lifted, we anticipate an increase in demand for occupancy at CXW facilities, as ICE apparently does not have sufficient supply to satisfy demand.

McRae divesture will generate 3Q22 gain, enhance CXW liquidity

CXW's sale of non-core real estate assets over the last several quarters also contributed to lower revenue compared to 2Q21. Divestitures of non-core assets have been a consistent part of the company's strategy to strengthen its operating footprint and balance sheet in order to enhance shareholder value. In line with these goals, CXW sold its 1,978-bed McRae correctional facility in 2Q22 for $130.0 million. The sale is expected to close in 3Q22 and produce a gain of about $75.0 million to $80.0 million. The company's existing contract with the Federal Bureau of Prisons (BOP) at the McRae Facility expires in November 2022 and CXW had not expected it to be renewed. The company entered into an agreement to lease the McRae facility from the Georgia Building Authority through November 30, 2022 to satisfy the contract with the BOP.

Subsequent to 2Q22, the company sold other noncore assets. CXW completed the sale of its Stockton Female Community Corrections facility, Long Beach Community Corrections center and an undeveloped California of land parcel. In the aggregate, these divestitures resulted in net proceeds of $15.7 million. The proceeds will enhance the company's liquidity. CXW has earmarked a portion of its capital deployment to share repurchases, as well as debt reduction.

Operating margins constrained by inflationary environment

As anticipated and as illustrated in the prior 2022 quarter, the broader macroeconomic inflationary environment is impacting 2022 results. The company realized an operating margin of 9.2%, down from 10.0% in the prior sequential quarter and 12.7% in the prior year quarter. In the near-term, management expects margins are likely to remain constrained by the La Palma transition, changes in staffing levels and wage inflation, among other factors. Labor shortages impacted margins last year, as staffing levels were lower than historical averages. Conversely, 2022 costs and operating margins are impacted by higher labor costs, particularly of registry nursing staff, as the company increases staffing levels and reflecting general wage inflation. In part, the company is adding staff in order to have adequate personnel once Title 42 ends and populations at its facilities increase (see below). Thus, there is likely to be a near-term increase in costs that precedes the expected incremental revenue when the number of ICE detainees housed in CXW facilities increases. However, as the transition at La Palma winds down and reflecting cost containment measures, the company is optimistic that operating margins will trend up to more normalized levels.

CXW reported 2Q22 net income of $10.6 million and EPS of $0.09. This compares to net income of $15.6 million and EPS of $0.13 in 2Q21. Adjusted EPS, excluding non-recurring items in both periods, was $0.13 per in 2Q22 compared to $0.25. Factors that explain the lower adjusted results include the above noted decline in population at La Palma and higher labor costs.

EBITDA & Adjusted EBITDA

EBITDA was $71.1 million compared with $82.1 million. Adjusted EBITDA, excluding shareholder litigation expense and other special items, was $78.8 million in 2Q22 compared to $101.7 million. The decline primarily reflects the sale of non-core properties that generated an aggregate $4.4 million in adjusted EBITDA in 2Q21, plus the above-noted lower populations at La Palma (about $10.8 million of the EBITDA variance) and the non-renewal of contracts at three facilities that collectively resulted in a reduction of $4.5 million.

FFO

FFO (Funds from operations) was $34.3 million ($0.28 per share) in 2Q22 versus $11.4 million ($0.09 per share) in 2Q21. Excluding special items, normalized FFO was $40.7 million, in-line with $41.5 million recorded in the prior 2022 quarter, but down compared to $56.0 million in 2Q21. FFO was hurt by the same factors that impacted adjusted EBITDA.

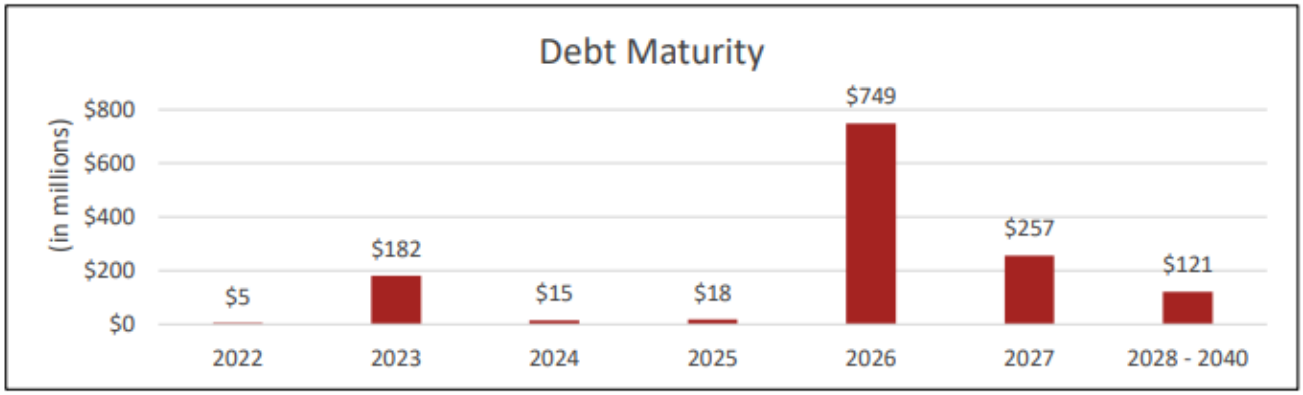
Lower Guidance Reflects Delays, Inflationary Pressures

The company lowered adjusted net income, adjusted EBITDA and FFO guidance reflecting the above-noted delays in the La Palma transition and the reversal of Title 42, as well as inflationary pressures. Prior guidance anticipated higher occupancy levels from ICE from the potential termination of Title 42. CXW expects the final ICE detainees to be transferred out of La Palma by the end of 3Q22. We have revised our model based on 2Q22 actual results and the company's updated guidance.

BALANCE SHEET STRENGTHENED; LIQUIDITY ENHANCED

Company better positioned with extended maturities, lower debt …

CXW has executed its strategy to pare debt and deleverage via cash generated from operations, asset sales (including recent divestitures) and opportunistic financings. The company's balance sheet is much stronger as of June 2022 than it was at the end of 2020. Over the past few quarters, CXW has reduced and refinanced debt substantially. In 2021, CXW accessed the capital markets to refinance debt and extend maturities. CXW raised $450 million of senior notes that mature in 2026 and added a tack-on offering of $225 million. The company put new credit facilities in place, comprised of a $100 million term loan and $250 million revolver that replace and extend CXW's prior credit facilities that were slated to mature in April 2023. CXW has extended this financing source by more than 3-years; the new facilities mature on May 12, 2026. The interest rate is linked to the BSBY (Bloomberg Short-Term Bank Yield) index. The initial applicable margin on is 3.25%, to be adjusted quarterly following CXW's quarterly filings. Notably, CXW had nothing drawn on its revolver at the end of 2Q22; by comparison, at the end of 1Q21, the company had about $112 million drawn against its revolver. The company also voluntarily repaid the remaining $124.1 million outstanding principal balance under its Term Loan B, with no prepayment penalties. The Term Loan B had a scheduled maturity of December 18, 2024. CXW also purchased another $3.6 million of 4.625% senior notes in 2Q22, thereby reducing the outstanding balance to $170.1 million.



…improving refinancing prospects

Long-term debt was $1.149 billion at the end of 2Q22, down from $1.492 billion at the end of 2021 and compared to $1.748 billion at the end of 2020. CXW had $115.6 million of cash at the end of 2Q22, compared to $299.6 million at year-end 2021, plus an additional $11.8 million of restricted cash. Following recent measures, the company has no major debt maturities coming due before 2023 and we believe the company is significantly better positioned to refinance and / or pare that currently than it was a few quarters back. The debt offerings and recent asset sales 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.

We expect the company to continue with balance sheet strengthening efforts, but at this point it is implementing additional steps to enhance shareholder value. Moreover, with no funds drawn against its revolver and above-noted cash balance, we believe the company has significant liquidity. The new credit facilities aggregate $350 million and CXW has an option to increase the availability under the revolver and to request term loans or up to $200 million or 50% of TTM consolidated EBITDA. With no near-term need to access the capital markets and minimal variable rate debt (less than 20% of total debt), the company believes it is better positioned than many others in a rising interest rate environment. We believe the new credit facilities reflect this, as well.

Enhancing shareholder value: new share buyback authorization

In terms of capital deployment, the company expects to invest about $79.5 million to $84.0 million in CapEx in 2022, with roughly 40% earmarked for maintenance CapEx on real estate assets, another roughly 40% for CapEx on other assets and IT and about 20% for facility renovations.

We also expect the company to prioritize actions to enhance shareholder value such as share buybacks. The company obtained board approval of a new share repurchase authorization of up to $150 million earlier this year and recently increased the authorization to $225.0 million. Through August 1, 2022, the company had repurchased 4.2 million shares for an aggregate gross $50.6 million, with roughly $174.4 million remaining under the repurchase plan. Depending on market conditions, we would anticipate further share buybacks. Down the road, we also believe the company could also enhance shareholder value via a dividend.

VALUATION

We maintain an $18 valuation on CXW shares and continue to believe that the current CXW share price does not fully reflect the expected stability and fundamental value of the company's steady cash flow generation, opportunities for new contracts to augment revenue and strengthening balance sheet. Pressure on CXW shares reflects concerns about government reform measures potentially overhanging sector prospects, although notably CXW's renewal rate on its owned facilities has averaged 95% over the previous five years, and negative publicity around ESG issues, among other factors. CXW released its fourth annual ESG Report recently. Among other measures, the company continues to provide vocational training to help prepare inmates for employment opportunities upon release and reduce recidivism. As the stability of the company's revenue streams and ESG measures continue, we anticipate further multiple expansion on CXW shares.

Strong contract renewal rates; revenue diversification efforts

We note 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, and it would not surprise us to see the company add other new revenue streams over time. 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 and with its ESG initiatives.

Anticipate further multiple expansion; FFO growth

Our $18 valuation implies a multiple of just under 12x one-year forward FFO, which remains below the recent average. Moreover, we would expect FFO per annum to grow in the high single digit range over the next year or so thereafter, as we believe likely in a more stable post-pandemic environment. We believe the risk / reward ratio could be attractive for investors who have a higher than average risk tolerance and longer time horizon.

Takeaways from McRae facility divestiture

The sale price CXW garnered from the divestiture of the McRae facility represents a private market valuation of about $66,000 per bed, as illustrated below. CXW has more than 70,000 owned and managed correctional beds. If the McRae price / bed were applied to CXW's portfolio, it would equate to a valuation above $4.0 billion. We do not expect the shares to trade at a private market valuation but note that it underscores, we believe, that CXW shares do not reflect the full value of the company's overall portfolio and its operating potential.

Takeaways From Divestiture of McRae Facility

McRae sales price ($M)	$130
McRae Facility beds*	1,978
Takeout price per McRae bed ($k)	$65.7
CXW's total beds* excluding idle facilities	63,897
Implied company private market value CXW ($M)	$4,199

Source: Company reports, Zacks estimates * As denoted by design capacity

RISKS

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

- As contracts come reach expirations, the company might not be able to renew existing contracts or secure alternative utilization.
- Title 42 could be extended.
- Occupancy levels as a result of COVID-19 or other factors could continue to fluctuate.
- 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.
- Inflation could pressure costs more than currently expected and CXW might not be able to obtain higher per diems from customers to help offset its impact.
- The company might not be able to fill hiring positions as quickly as it would like.

RECENT NEWS

- CXW reported 2Q22 results on August 2, 2022.
- CXW finalized new credit facilities and authorized a share buyback on May 12, 2022.
- CXW announced 1Q22 results on May 4, 2022.
- CXW provided an ESG update on April 11, 2022, with the release of its fourth annual ESG report.
- On February 9, 2022, CXW announced 4Q21 results.
- CoreCivic announced a new contract with the state of Arizona on January 10, 2022.
- On November 8, 2021, CXW announced 3Q21 results.
- On September 22, 2021, CXW announced the upsizing and pricing of its tack-on notes offering.
- CXW entered into a new lease agreement with the state of New Mexico at the Northwest New Mexico Correctional Center on September 21, 2021.
- CXW provided an update on the USMS contract for the West Tennessee Detention facility on September 17, 2021.
- CXW announced the sale of 42 non-core government leased properties for $106.5 million on December 23, 2Q20.

FINANCIAL MODEL

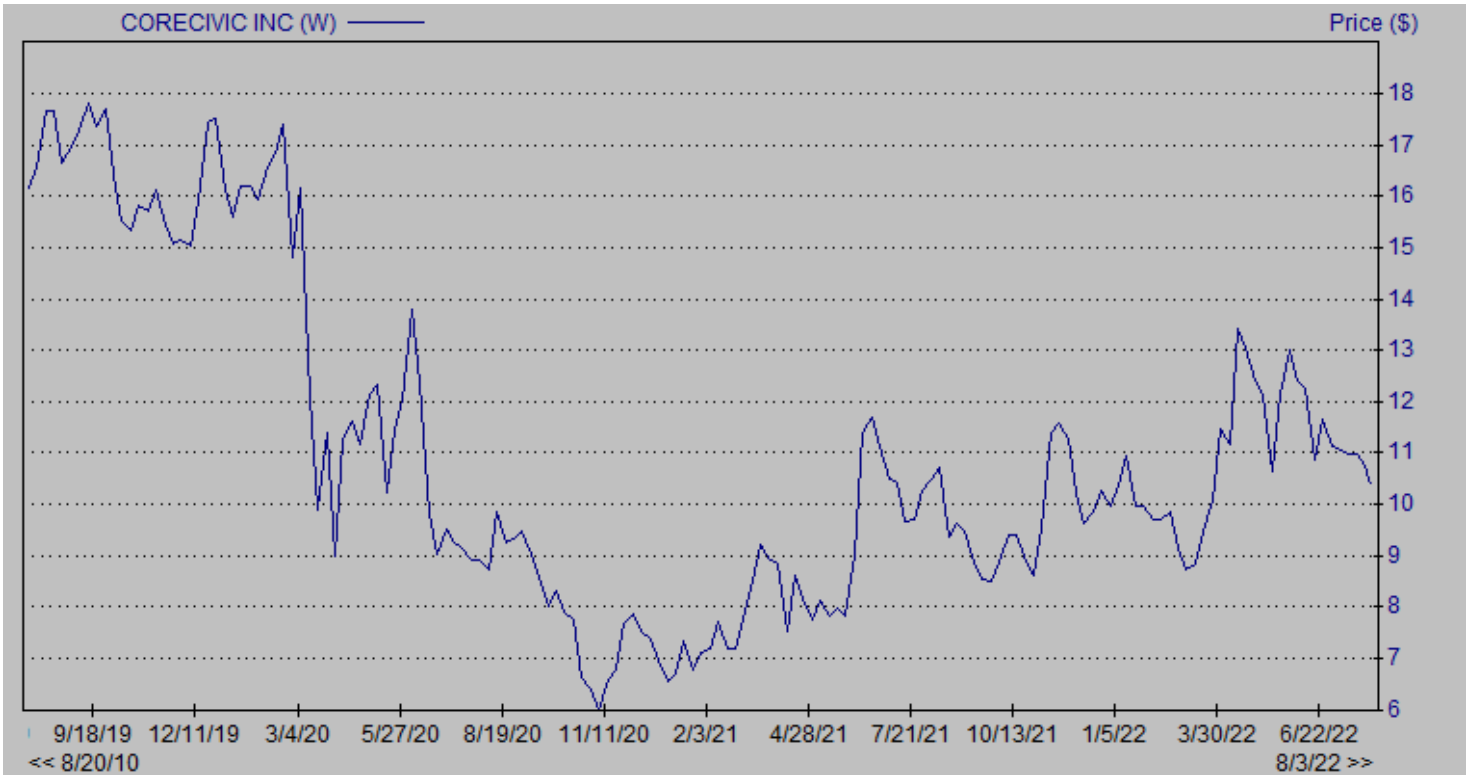
Core Civic

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

	2020A	1Q21A	2Q21A	3Q21A	4Q21A	2021A	1Q22A	2Q22A	3Q22E	4Q22E	2022E
Revenue	$1,905,485	$454,718	$464,571	$471,194	$472,133	$1,862,616	$452,988	$456,697	$459,437	$462,194	$1,831,316
Y/Y % change	*-3.8%*	*-7.4%*	*-1.7%*	*0.6%*	*-0.3%*	*-2.2%*	*-0.4%*	*-1.7%*	*-2.5%*	*-2.1%*	*-1.7%*
Operating expense	1,406,376	332,884	333,070	338,192	332,919	1,337,065	344,629	349,000	352,721	356,248	1,402,598
General and administrative	124,338	29,530	33,228	34,600	38,412	135,770	31,101	31,513	33,893	34,062	130,569
Depreciation and amortization	150,861	32,712	34,084	33,991	33,951	134,738	32,028	32,259	31,936	31,952	128,176
Shareholder litigation expense / other	620	51,745	2,550	-		54,295		1,900	-	-	1,900
Impairments / other	60,628	1,308	2,866	5,177	2,027	11,378	-	-	-	-	-
Total operating expense	1,742,823	448,179	405,798	411,960	407,309	1,673,246	407,758	414,672	418,550	422,263	1,663,243
Operating income	162,662	6,539	58,773	59,234	64,824	189,370	45,230	42,025	40,887	39,931	168,073
Operating margin	8.5%	1.4%	12.7%	12.6%	13.7%	10.2%	10.0%	9.2%	8.9%	8.6%	9.2%
Interest expense, net	83,299	18,428	23,222	20,653	23,239	85,542	22,920	21,668	25,845	26,362	96,795
Other (income) expense	19,639	148	13,409	(49)	4,217	17,725	(3,303)	5,782	(84,100)	125	(81,496)
	102,938	18,576	36,631	20,604	27,456	103,267	19,617	27,450	(58,255)	26,487	15,299
Pretax income	59,724	(12,037)	22,142	38,630	37,368	86,103	25,613	14,575	99,142	13,444	152,774
Taxes	(4,386)	(113,531)	(6,519)	(8,618)	(9,331)	(137,999)	(6,610)	(4,013)	(26,273)	(3,630)	(40,525)
						160.3%					
Minority interest	(1,181)										
Net income	54,157	(125,568)	15,623	30,012	28,037	(51,896)	19,003	10,562	72,869	9,814	112,248
Per share data											
EPS	$0.45	($1.05)	$0.13	$0.25	$0.23	($0.43)	$0.16	$0.09	$0.62	$0.08	$0.94
Dividends	$0.88										
Average shares outstanding	120,928	121,366	122,059	122,049	121,218	121,673	121,420	121,346	117,619	117,569	119,489
Funds From Operation (FFO)											
Net income	$55,338	($125,568)	$15,623	$30,012	$28,037	($51,896)	$19,003	$10,562	$72,869	$9,814	$112,248
+ D&A of real estate assets	112,046	23,759	24,926	24,877	25,176	98,738	24,166	24,501	24,272	24,284	97,222
+ Impairment of real estate assets	14,380	1,308			2,027	3,335	-	-	-	-	-
- Gain on sale of real estate assets	13,023		(38,766)	-	-	(38,766)	(2,261)	(1,060)	(82,046)	-	(85,367)
+ - Other	532	(350)	9,641	-	(506)	8,785	625	283	22,563	-	23,471
FFO	195,319	(100,851)	11,424	54,889	54,734	20,196	41,533	34,286	37,658	34,098	147,574
FFO/share	$1.62	($0.83)	$0.09	$0.45	$0.45	$0.17	$0.34	$0.28	$0.32	$0.29	$1.24
+ M&A expenses											-
+ COVID related expenses	13,777	1,598	836	-	-	2,434	-	-	-	-	-
+ - Other special items	61,714	152,284	43,757	3,728	3,085	202,854	-	6,381	-	-	6,381
Normalized FFO	271,768	53,031	56,017	58,617	57,819	225,484	41,533	40,667	37,658	34,098	153,955
Normalized FFO/share	$2.25	$0.44	$0.46	$0.48	$0.48	$1.85	$0.34	$0.34	$0.32	$0.29	$1.29

Source: Company reports, Zacks estimates

HISTORICAL STOCK PRICE



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