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CoreCivic, Inc. (CXW-NYSE)

CXW: Benefit of Strong Balance Sheet in Rising Interest Rate Environment

CXW's 1Q22 revenue performance illustrates the stability of the company's revenue streams, in our view, although the broader macroeconomic inflationary environment is impacting 2022 results. We note that 2022 results could be sensitive to exogenous factors including wage inflation and the status of Title 42 (which we believe represents possible revenue upside), as well as to how quickly the company can hire new personnel and occupancies increase.

OUTLOOK

The company has pursued its goal of lowering relative debt levels and strengthening its balance sheet. The TTM leverage ratio (net debt to adjusted EBITDA) was 2.7x at the end of 1Q22, down from 3.7x at the end of 2020 and within the targeted range of 2.25x to 2.75x. With cash of $378.2M at the end of 1Q22, no major debt maturities before 2023 and no funds drawn against its revolver, we believe the company has significant liquidity. CXW has no near-term need to access the capital markets and low levels of variable rate debt. The company therefore believes it is well-positioned in a rising interest rate environment. Management has also indicated that likely upcoming initiatives could include seeking authorization for a new stock repurchase program.

Current Price (5/5/22)	$11.99
Valuation	**$18.00**

SUMMARY DATA

52-Week High	**$14.24**
52-Week Low	**$7.37**
One-Year Return (%)	**47.30**
Beta	**1.05**
Average Daily Volume (sh)	**971,617**
Shares Outstanding (mil)	**122**
Market Capitalization ($mil)	**$1,458**
Short Interest Ratio (days)	**7.9**
Institutional Ownership (%)	**83**
Insider Ownership (%)	**2**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**1.4**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2022 Estimate	**16.8**
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	463 E	476 E	477 E	1,868 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	0.16 E	0.20 E	0.20 E	$0.71 E

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

Disclosures on page 10

KEY POINTS

- CXW reported 1Q22 revenue of $453.0 million compared to $454.7 million in 1Q21. Factors behind the slight revenue decline include the earlier than originally anticipated reduction of ICE populations at CXW's La Parma facility pending the facility's transition to state detainees under a new contract with the state of Arizona. CXW's recent sale of non-core revenue producing real estate assets also contributed to the lower revenue.

- Nevertheless, the relatively flat revenue performance illustrates the stability of company's contracted revenue streams, in our view. In the aggregate, the divested properties and managed contracts represented about $15 million of quarterly revenue that CXW has been able to offset with new contracts and other initiatives.

- As anticipated, the broader macroeconomic inflationary environment is impacting 2022 results, including boosting labor costs, particularly of registry nursing staff, as the company increases staffing levels. Although CXW is proactively managing G&A expenses where it can, the company now anticipates higher costs. This, combined with the earlier than anticipated reduction in ICE populations at La Parma, led the company to lower 2022 guidance.

- Our revised 2022 EPS forecast is $0.71, compared to $0.82 earlier. We note that 2022 results could be sensitive to exogenous factors including wage inflation and fluctuating COVID-19 cases, as well as to how quickly the company can hire new personnel. We believe the status of Title 42 represents possible revenue upside to our forecast.

- The company has pursued its stated goal of lowering relative debt levels and strengthening its balance sheet. The TTM leverage ratio (net debt to adjusted EBITDA) was 2.7x at the end of 1Q22, down from 3.7x at the end of 2020, and within CXW's targeted range of 2.25x to 2.75x.

- With cash of $378.2 million at the end of 1Q22, no major debt maturities before 2023 and no funds drawn against its revolver, we believe the company has significant liquidity. The company also expects to announce new credit facility in the near-term.

- Management has indicated that likely upcoming initiatives could include seeking authorization for a new stock repurchase program. With no near-term need to access the capital markets and minimal variable rate debt, the company believes it is better positioned than many others in a rising interest rate environment.

RECENT RESULTS; OUTLOOK

Recent trends illustrate stability of revenue streams

CoreCivic (NYSE: CXW) reported 1Q22 results this week. Total revenue came in at $453.0 million compared to $454.7 million in 1Q21. One factor behind the slight revenue decline was the reduction of ICE (Immigration and Customs Enforcement) populations at CXW's La Parma facility pending the facility's transition to state detainees under a new contract with the state of Arizona (see below). As the company prepares to receive Arizona state inmates at this facility, the average daily population of ICE detainees at CXW's La Parma facility is declining. This contributed to a revenue decline and roughly $2.4 million reduction in 1Q22 net operating income. Nevertheless, revenue declined only 0.4% year-over-year, despite lower ICE population at the facility and despite CXW's sale of 47 non-core real estate assets over the last several quarters and its 4Q20 exit of two managed-only contracts in Tennessee.

The relatively flat revenue performance illustrates the stability of company's contracted revenue streams, in our view. In the aggregate, the divested properties and managed contracts represented about $15 million of quarterly revenue that CXW has been able to offset with revenue from new contracts and the company's initiatives.

Operating margins expected to trend up

As anticipated, the broader macroeconomic inflationary environment is impacting 2022 results. The company realized an operating margin of 10%, down from 13.7% in the prior sequential quarter. However, CXW expects operating margins to trend up to more normalized levels over the next several quarters, as the transition at La Parma winds down and reflecting cost containment measures.

In the near-term, however, management expects margins are likely to be impacted by changes in staffing levels. 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.

CXW reported 1Q22 net income of $19.0 million and EPS of $0.16. This compares to a net loss of $125.6 million and net loss per share of $1.05 in 1Q21. Adjusted EPS, excluding non-recurring items in both periods, was $0.14 per in 1Q22 compared to $0.24. Factors that explain the lower adjusted results include the above noted decline in population at La Parma and higher labor (particularly registry nursing) costs.

EBITDA & Adjusted EBITDA

EBITDA was $83.0 million compared with $41.6 million. EBITDA was hurt in 1Q21 by shareholder litigation expense and asset impairment charges. Adjusted EBITDA, excluding shareholder litigation expense and other special items, was $80.8 million in 1Q22 compared to $96.3 million. The decline primarily reflects the sale of three non-core properties that generated an aggregate $4.9 million in adjusted EBITDA in 1Q21, plus the above-noted lower populations at La Palma and the non-renewal of contracts at three facilities that collectively resulted in a reduction of $9.0 million.

FFO

Funds from operations (FFO) was $41.5 million ($0.34 per share) in 1Q22 versus a loss of $100.9 million, or ($0.83) per share in 1Q21. Excluding the special items noted above and a gain on the sale of real estate assets in 1Q22, normalized FFO was $41.5 million or $0.34 per share compared to $53.0 million or $0.44. FFO was hurt by the same factors that impacted adjusted EBITDA, as well as by increased interest expense.

Guidance Reduced

Although CXW is proactively managing G&A expenses where it can, the company now anticipates higher labor costs, particularly related to hiring more registry nursing staff and general wage inflation. This, combined with the earlier than anticipated reduction in ICE populations at La Parma, led the company to lower 2022 guidance. CXW now expects 2022 EPS of $0.64 to $0.79, FFO per share of $1.45 to $1.60 and EBITDA of $336.1 million to $351.4 million. Prior guidance was for ranges of $0.72 to $0.86, $1.55 to $1.70 and $354.8 million to $370.0 million on these respective metrics.

We expect operating costs to rise over the next several quarters as the company continues to increase staffing levels. The challenges that many companies currently face regarding filling staffing positions are generally expected to persist. Although CXW has enacted several measures to mitigate their impact, including offering incentives to increase staffing levels, the company might not be able to fill hiring positions as quickly as it would like. The status of Title 42, fluctuation in COVID-19 cases and potential new contracts and / or renewals, among other factors, could impact 2022 results more than we currently anticipate. Our revised 2022 EPS forecast is $0.71, compared to $0.82 earlier. We note that 2022 results could be sensitive to exogenous factors including wage inflation and the status of Title 42, as well as to how quickly the company can hire new personnel.

STRENGTHENING BALANCE SHEET & REACHING TARGETS

TTM at targeted level; other initiatives to enhance shareholder value likely

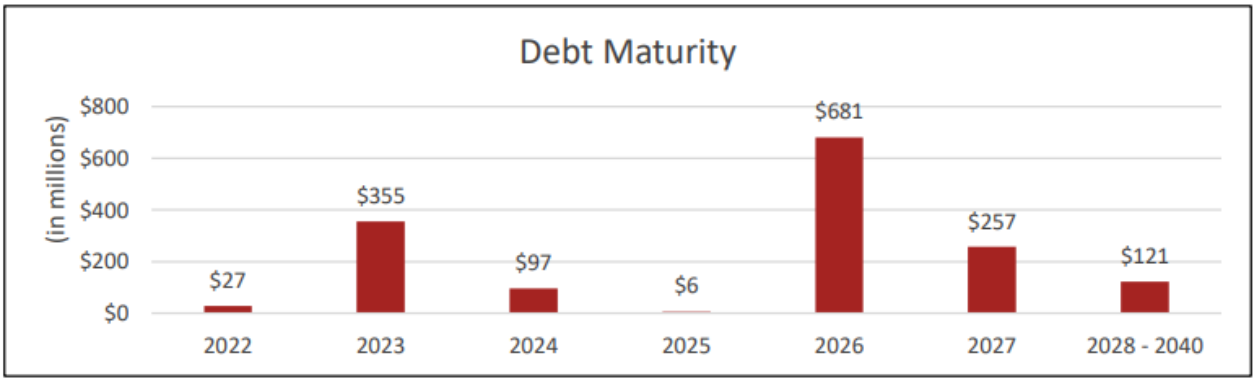
The company has pursued its stated goal of lowering relative debt levels and strengthening its balance sheet. CXW accessed the capital markets to refinance debt and extend maturities. In 2021, CXW raised $450 million of senior notes that mature in 2026 and added a tack-on offering of $225 million. The additional notes have an effective yield to maturity of 7.65%. Long-term debt was $1,483.9 billion at the end of 1Q22, down from $1.492 billion at the end of 2021 and compared to $1.747 billion at the end of 2020. We expect the company to

continue with balance sheet strengthening efforts, but at this point it can also begin to consider other initiatives to enhance shareholder value.

The TTM leverage ratio (net debt to adjusted EBITDA) was 2.7x at the end of 1Q22, down from 3.7x at the end of 2020. CXW's targeted leverage ratio is 2.25x to 2.75x; thus, the company is within its targeted range at this point.

CXW had $378.2 million of cash at the end of 1Q22, up from $299.6 million at 4Q21, plus an additional $12.3 million of restricted cash. With no funds drawn against its revolver, we believe the company has significant liquidity. The company has no major debt maturities coming due before 2023. 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.

The company also expects to announce new credit facility in the near-term. Following that, management has indicated that other likely initiatives could include seeking authorization for a new stock repurchase program. 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.



Source: Company presentation

HIGHLIGHT RECENT CONTRACT WINS

We highlight some key recent contract wins below. CXW remains in discussions with potential partners and continues to respond to RFPs for additional contracts. Given the older state of government owned detention infrastructure compared to CXW's newer facilities, the company expects its inmate and detainee populations to remain relatively stable, with potential increases expected from the reversal of Title 42, as discussed below.

Arizona contract largest private sector award in more than a decade

As noted, CXW has been awarded a new 5-year contract with the state of Arizona for up to 2,706 inmates at its 3,060-bed La Palma correctional center in Eloy, Arizona. The contract has an extension option for up to another 5-years. CXW expects to generate about $75 million to $85 million in annual revenue from the new Arizona contract.

Importantly, this represents the largest prison contract awarded to the private sector by any state in over a decade. Moreover, we also believe it validates the company's view that the relatively dilapidated state of many federal and state facilities could translate into opportunities for CXW to transfer populations to its more modern venues.

Northeast Ohio Correctional Center: state & county populations

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 uses the Northeast Ohio facility to address its population needs, while other beds in the CXW facility 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 continues to operate the correctional facility under both contracts.

New Mexico

CXW entered into a new three-year lease agreement for its Northwest New Mexico 596-bed facility in 2021. The new lease agreement commenced in 3Q21 (on November 1, 2021), at which time the company began transitioning the facility to the New Mexico Corrections Department. The agreement includes automatic extension options that could extend the lease through October 31, 2041.

Montana

CXW's USMS contract was set to expire in 2021; the contract was for 96 beds at the 664-bed Crossroads Correctional Center in Montana. In 3Q21, the company amended the contract with the state of Montana to fully utilize the capacity at Crossroads and extend the agreement through June of 2023. The two parties can extend the contract through August 2029 by mutual agreement.

EXPECTED IMPACT OF TITLE 42 REPEAL

Expect incremental revenue if detention capacity rises post-Title 42, as anticipated

In our view, the potential termination of Title 42 portends possible revenue upside for CXW. This, combined with improving operating trends over 2021 (see below) could translate into higher than currently anticipated 2022-23 revenue expectations, we believe. Title 42 was enacted during the pandemic under the Trump administration to deter immigration into the U.S., with a stated public health justification to deter the spread of COVID-19. It was based on legislation authorizing the government "power to prohibit, in whole or in part, the introduction of persons and property" to curb a contagious disease from spreading. Earlier this month, the Biden administration announced that Title 42 will cease by May 23, 2022, which has spurred concern that the administration might not be prepared for a potential increase in immigration along the southern border once Title 42 ends. In fact, several states have sued to block termination of the immigration measure.

According to CBS News citing government statistics as of the end February 2022, the U.S. has expelled more than 1.7 million migrants under Title 42 since March 2020. The majority of immigrants expelled under Title 42 are sent to Mexico, the Mexican government having agreed to accept expelled migrants who are Mexican, Guatemalan, Honduran or Salvadoran nationals. Originally authorized as a short-term stopgap measure, as the pandemic persisted, Title 42 was extended indefinitely. Now, citing increased vaccination rates in the U.S. and migrants' countries of origin, the CDC endorses the termination of Title 42, although the measure has been extended previously during the pandemic in the face of rising case numbers.

Government officials expect the flow of migrants at the southern border to increase once Title 42 ends. There is concern that ICE does not have adequate detention capacity if the flow of people seeking entry into the U.S. rises, as expected. The Washington Post cites preliminary U.S. Customs and Border Protection (CBP) data indicating that authorities were on-track to detain more than 200,000 people along the southern border last month, which would represent the highest monthly total since August of 2021. Concurrent with the expected rise in flows of people seeking asylum in the U.S., ICE has also recently closed older detention centers that were deemed inadequate. This is consistent with recent directives from the Homeland Security Secretary for an overall reform of detention facilities. While phasing out privately managed detention capacity is a stated goal for the current administration, in our view it is unlikely that ICE can move towards this target in the near- to mid-term.

We expect ICE demand for capacity will increase once Title 42 is lifted. Thus, we expect occupancy rates at several CXW facilities to increase. Many (an estimated roughly two-thirds) CXW centers are operated under occupancy guarantees that exceed current actual occupancy levels. Once actual occupancy reaches – and then passes – guaranteed levels, we expect CXW to garner incremental revenue.

VALUATION

We 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 improving balance sheet. Pressure on CXW shares reflects concerns about government reform measures potentially overhanging sector prospects and negative publicity around ESG issues, among other factors. CXW released its fourth annual ESG Report earlier this month. 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. 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 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.

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.

RECENT NEWS

- 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

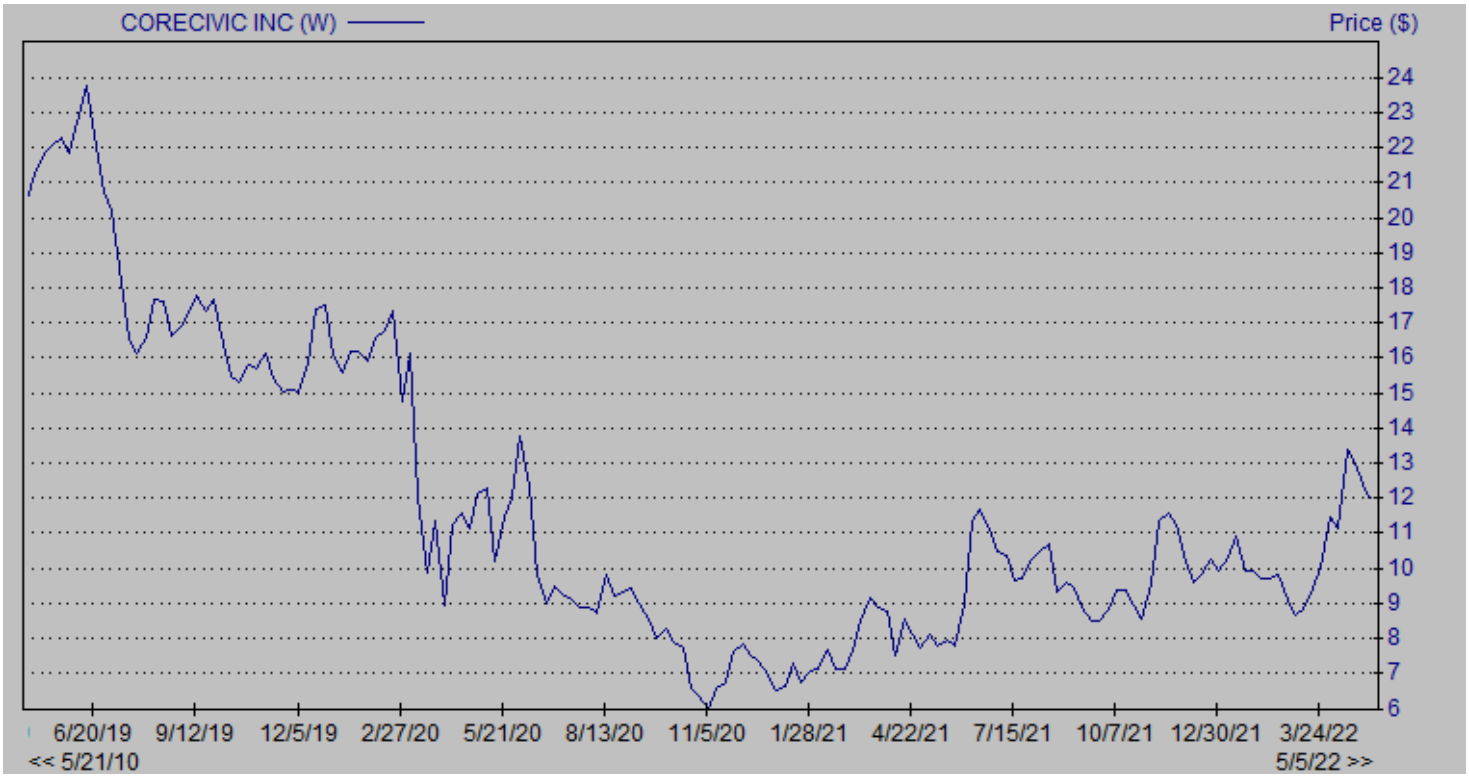
Core Civic

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

	2020A	1Q21A	2Q21A	3Q21A	4Q21A	2021A	1Q22A	2Q22E	3Q22E	4Q22E	2022E
Revenue	$1,905,485	$454,718	$464,571	$471,194	$472,133	$1,862,616	$452,988	$462,686	$475,906	$476,854	$1,868,434
Y/Y % change	*-3.8%*	*-7.4%*	*-1.7%*	*0.6%*	*-0.3%*	*-2.2%*	*-0.4%*	*-0.4%*	*1.0%*	*1.0%*	*0.3%*
Operating expense	1,406,376	332,884	333,070	338,192	332,919	1,337,065	344,629	348,075	351,389	351,740	1,395,833
General and administrative	124,338	29,530	33,228	34,600	38,412	135,770	31,101	31,199	33,893	34,062	130,254
Depreciation and amortization	150,861	32,712	34,084	33,991	33,951	134,738	32,028	33,204	33,573	33,400	132,205
Shareholder litigation expense / other	620	51,745	2,550	-		54,295		-	-	-	-
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	412,478	418,854	419,202	1,658,293
Operating income	162,662	6,539	58,773	59,234	64,824	189,370	45,230	50,208	57,052	57,652	210,142
Operating margin	8.5%	1.4%	12.7%	12.6%	13.7%	10.2%	10.0%	10.9%	12.0%	12.1%	11.2%
Interest expense, net	83,299	18,428	23,222	20,653	23,239	85,542	22,920	23,916	23,916	23,916	94,667
Other (income) expense	19,639	148	13,409	(49)	4,217	17,725	(3,303)	125	125	125	(2,928)
	102,938	18,576	36,631	20,604	27,456	103,267	19,617	24,041	24,041	24,041	91,739
Pretax income	59,724	(12,037)	22,142	38,630	37,368	86,103	25,613	26,167	33,011	33,612	118,403
Taxes	(4,386)	(113,531)	(6,519)	(8,618)	(9,331)	(137,999)	(6,610)	(7,196)	(9,078)	(9,243)	(32,127)
						160.3%					
Minority interest	(1,181)										
Net income	54,157	(125,568)	15,623	30,012	28,037	(51,896)	19,003	18,971	23,933	24,368	86,276
Per share data											
EPS	$0.45	($1.05)	$0.13	$0.25	$0.23	($0.43)	$0.16	$0.16	$0.20	$0.20	$0.71
Dividends	$0.88										
Average shares outstanding	120,928	121,366	122,059	122,049	121,218	121,673	121,420	121,118	121,068	121,018	121,156
Funds From Operation (FFO)											
Net income	$55,338	($125,568)	$15,623	$30,012	$28,037	($51,896)	$19,003	$18,971	$23,933	$24,368	$86,276
+ D&A of real estate assets	112,046	23,759	24,926	24,877	25,176	98,738	24,166	24,472	24,743	24,616	97,996
+ 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)	-	-	-	(2,261)
+ - Other	532	(350)	9,641	-	(506)	8,785	625	-	-	-	625
FFO	195,319	(100,851)	11,424	54,889	54,734	20,196	41,533	43,443	48,676	48,984	182,636
FFO/share	$1.62	($0.83)	$0.09	$0.45	$0.45	$0.17	$0.34	$0.36	$0.40	$0.40	$1.51
+ 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	-	-	-	-	-
Normalized FFO	271,768	53,031	56,017	58,617	57,819	225,484	41,533	43,443	48,676	48,984	182,636
Normalized FFO/share	$2.25	$0.44	$0.46	$0.48	$0.48	$1.85	$0.34	$0.36	$0.40	$0.40	$1.51

Source: Company reports, Zacks estimates

HISTORICAL STOCK PRICE



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