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Zacks Small-Cap Research

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CoreCivic, Inc. (CXW-NYSE)

CXW: Potential Upcoming Catalysts Include Pending Senior Note Redemption

We identify several upcoming potential catalysts for CoreCivic, including the transition at the La Palma facility, continued balance sheet measures such as the pending redemption of the company's 2023 notes and the expected termination of Title 42 at some point. We view these factors as likely catalysts for revenue growth, improving operating leverage and earnings advances over time.

OUTLOOK

CXW has executed on its strategy to deleverage via cash generated from operations, asset sales and opportunistic financings. CXW intends to redeem the $153.9 million outstanding of its 4.625% senior notes that mature in 2023 in full on February 1, 2023, using a combination of cash on hand and existing capacity under its revolving credit facility. CXW had $185.3 million of cash at the end of 3Q22 and its $250.0 million revolver was undrawn. Following upcoming redemption measures, the company will have no major debt maturities coming due before 2026.

Current Price (1/11/23)	$11.42
Valuation	**$18.20**

SUMMARY DATA

52-Week High	**$14.24**
52-Week Low	**$8.39**
One-Year Return (%)	**5.74**
Beta	**1.02**
Average Daily Volume (sh)	**1,037,637**
Shares Outstanding (mil)	**115**
Market Capitalization ($mil)	**$1,326**
Short Interest Ratio (days)	**2.4**
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	**11.0**
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)
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	464 A	465 E	1,839 E
2023	468 E	472 E	486 E	488 E	1,914 E

EPS / Loss per share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
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	$0.58 A	$0.12 E	$0.94 E
2023	$0.14 E	$0.16 E	$0.24 E	$0.25 E	$0.79 E

Qs might not sum reflecting rounding

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KEY POINTS

- We identify several upcoming potential catalysts for CoreCivic, including the transition at the La Palma facility, continued balance sheet measures such as the pending redemption of the company's 2023 notes and the expected termination of Title 42 at some point. We view these factors as likely catalysts for revenue growth, improving operating leverage and earnings advances over time.

- CXW intends to redeem the $153.9 million outstanding of its 4.625% senior notes that mature in 2023 in 1Q23, using cash on hand and existing capacity under its revolving credit facility. CXW had $185.3 million of cash at the end of 3Q22 and its $250.0 million revolver was undrawn. Following upcoming redemption, the company will have no major debt maturities before 2026.

- Title 42, enacted during the pandemic to deter immigration into the U.S. for public health reasons, has been slated to end and been extended several times, reflecting concern that the administration might not be prepared to handle the expected increase in immigration along the southern border.

- We expect ICE (Immigration and Customs Enforcement) demand for beds and detention capacity will increase once Title 42 is lifted, in turn spurring occupancy rates at several CXW facilities. We expect this expected trend to contribute to incremental revenue growth for CXW.

- The California Department of Corrections and Rehabilitation (CDCR) recently informed CXW that it intends to terminate the lease at a CXW California facility by March 31, 2024. CXW has significant lead time to enter into discussions with CDCR and potentially others to replace occupancy at that facility and is optimistic about this initiative. Moreover, the lease agreement at CCCC is fully funded through June 30, 2023.

- Over the past several quarters, the company has added staff in order to have adequate personnel in place once Title 42 ends. Thus, there has been a short-term increase in costs preceding incremental revenue. As occupancy at the company's La Palma facility increases and staffing costs normalize, we anticipate operating leverage for CXW; the company is optimistic that operating margins will then trend up to more normalized levels.

- Balance sheet and refinancing measures have led to substantially lower debt levels and are expected to yield lower interest expense going forward. CXW intends to redeem the remaining outstanding $153.9 million of its 4.625% senior notes that mature in 2023 in full in 1Q23, using a combination of cash on hand and its revolving credit facility.

POTENTIAL UPCOMING CATALYSTS

Expect positive revenue & operating leverage trends …

We identify several potential upcoming catalysts for CoreCivic (NYSE: CXW), including the expected termination of Title 42 at some point, the transition at the company's La Palma facility and continued balance sheet measures. We view the expected termination of Title 42 and La Palma transition as likely catalysts for revenue growth. This, combined with improving operating leverage as revenue increases and lower expected interest expense on balance sheet improvements, could translate into operating and profitability advances, we believe.

Uncertain when Title 42 ends but anticipate higher occupancies once it does …

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. Originally authorized as a short-term stopgap measure; as the pandemic persisted, Title 42 was extended. Reflecting concerns that the administration might not be prepared to handle the expected increase in immigration along the southern border, several states sued to block the termination of Title 42 and the initiative to end it stalled in the courts. Once measures to handle the expected increase in immigration are in place, the Biden administration appears intent to end Title 42.

We expect ICE demand for capacity will increase once Title 42 is lifted. There are concerns that ICE (Immigration and Customs Enforcement) does not have adequate detention capacity if the flow of people seeking entry into the U.S. rises, as expected. Moreover, ICE has also recently closed older detention centers that were deemed inadequate. In our view, this further challenges ICE's ability to handle a significant increase in people crossing the border in the near- to midterm.

Thus, we expect ICE demand for capacity will increase once Title 42 is lifted. Therefore, 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.

… and La Palma transitions fully …

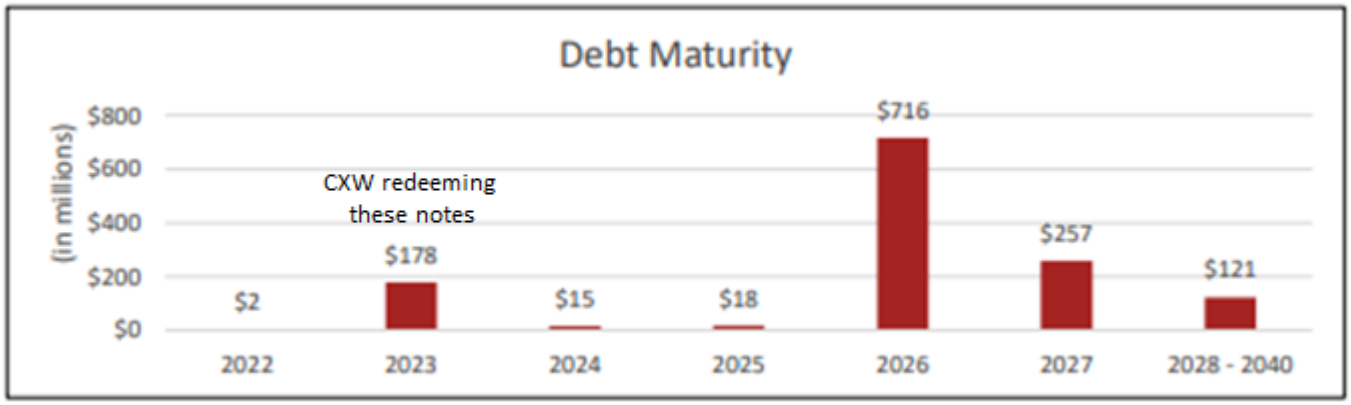
ICE populations at CXW's La Palma facility declined in 2H22, primarily reflecting the facility's transition to state detainees under a new contract with the state of Arizona. As CXW prepares to receive Arizona state inmates at La Palma, the average daily population of ICE detainees there declined, which contributed to the lower revenue. Management had indicated that the transition process was likely to be completed by the end of 2022 and populations at the facility are expected to return to more normalized levels.

The California Department of Corrections and Rehabilitation (CDCR) recently informed CXW that it intends to terminate the lease at CXW's 2,560-bed California City Correctional Center (CCCC) by March 31, 2024, citing declining inmate populations. CXW has significant lead time to enter into discussions with CDCR and potentially other entities to replace occupancy at that facility and is optimistic about this initiative, particularly reflecting what management notes is the advanced age of CDCR's facilities. Moreover, the lease agreement at CCCC is fully funded through June 30, 2023, after which time funding beginning July 1, 2023 will be determined during the California legislature's annual budget process. The CCCC facility generated rental revenue of $33.3 million from the CDCR for the full year of 2021.

Over the past several quarters, the company has added staff in order to have adequate personnel once Title 42 ends and populations at its facilities increase, including La Palma. Thus, there has been a short-term increase in costs preceding incremental revenue. As occupancy at the company's La Palma facility increases and staffing related costs normalize, we anticipate operating leverage for CXW with expected revenue increases. As the transition at La Palma winds down and reflecting CXW's cost containment measures, the company is optimistic that operating margins will trend up to more normalized levels.

… Debt reductions, maturities extensions - no major debt maturities before 2026 post upcoming redemption

At the same time, balance sheet and refinancing measures have led to substantially lower debt levels and are expected to yield lower interest expense going forward. CXW intends to redeem the $153.9 million outstanding of its $350 million 4.625% senior notes that mature in 2023 in full on February 1, 2023, using a combination of cash on hand and existing capacity under its revolving credit facility. CXW had $185.3 million of cash at the end of 3Q22 and its $250.0 million revolver was undrawn. Following upcoming redemption measures, the company will have no major debt maturities coming due before 2026.



Source: Quarterly supplement

In addition to internally generated cash, divestitures of non-core assets have also 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 3Q22 for $130.0 million. The sale closed in 3Q22 and produced the above-noted gain. 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. CXW reported a 3Q22 gain on the sale of real estate assets of $83.8 million. CXW's divestitures of non-core assets have been a consistent part of the company's strategy to strengthen its operating footprint and balance sheet.

In 2022, CXW completed the sale of other assets, as well, including its Stockton Female Community Corrections facility, Long Beach Community Corrections center and an undeveloped California of land parcel. The proceeds of these and other divestitures enhance the company's liquidity. CXW has earmarked a portion of its capital deployment to share repurchases, as well as debt reduction. The company's balance sheet is much stronger as of September 2022 than it was at the end of 2020, as CXW has reduced and refinanced debt substantially over the past few quarters. Recent debt offerings and 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.

In 3Q22, CXW reduced its debt balance by $109.1 million. CXW also purchased $33.5 million of its 8.25% senior notes that mature in April 2026, reducing the outstanding balance to $641.5 million. Other than the 4.625% notes maturing in May 2023, CXW has no other maturities before April 2026.

Long-term debt was $1.10 billion at the end of 3Q22, down from $1.492 billion at the end of 2021 and compared to $1.748 billion at the end of 2020. Following upcoming redemption measures, the company will have no major debt maturities coming due before 2026.

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.

OUTLOOK

Positive catalysts, with inflationary environment

The broader macroeconomic inflationary environment could continue to impact results in the near-term. For instance, reflecting wage inflation and revenue constraints, the company realized an operating margin of 6.5% in 3Q22, down from 9.2% in the prior sequential quarter and 12.6% in the prior year quarter. In the near-term, management expects margins are likely to remain constrained by several factors. These include the La Palma transition – even though the population transition is expected to be complete by yearend 2022, the company expects costs will still be higher than the historical normalized average through 1Q23. Some of the upward pressure on costs includes staffing of temporary workers and wage inflation, among other factors. For example, in 3Q22 CXW incurred $5.6 million more in temporary incentives compared to 3Q21 in order to attract and retain staff. The company expects staffing levels at La Palma to become more normalized over the next few months.

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. Conversely, 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. We introduce our initial 2023 estimates. We expect revenue to improve over 2023 as populations at La Palma increase. Given the uncertain timing of Title 42 ending, our preliminary forecasts might be adjusted depending on how long the measure remains in place. On a preliminary basis, our 2023 revenue forecast of $1.9 billion, compared to an estimated $1.8 billion in 2022 and $1.86 billion realized in 2021. We anticipate EPS of $0.80 compared to an estimated $0.94 in 2022 and ($0.43) in 2021. We note that the lower 2023 EPS forecast compared to 2022 reflects one-time gains on asset sales in 2022. Our normalized FFO (Funds from operations) per share forecast of $1.62 represents an anticipated 25.7% year-over-year improvement compared to our 2022 $1.29 estimate.

Anticipate further shareholder enhancing measures, including share repurchases

In terms of capital deployment, we expect the company to continue to prioritize actions such as debt reductions and 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 November 1, 2022, the company had repurchased 6.6 million shares for an aggregate gross $74.5 million, with roughly $150.5 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

Believe strong contract renewal rates not fully reflected in shares

As the stability of the company's revenue streams and ESG measures continue, we anticipate further multiple expansion on CXW shares. 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 strengthening 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 recently. Among other measures, the company continues to provide vocational training to help prepare inmates for employment opportunities upon release and reduce recidivism.

Notably, 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. Our $18.20 valuation implies a multiple of just about 11x one-year forward FFO, which remains below the recent average. 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. 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.

Valuation takeaway from McRae facility divestiture

The sale price CXW garnered from the recent divestiture of its 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 remain in place longer than expected.
- 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

- On December 22, 2022, CoreCivic announced its intention to redeem its 4.625% Senior Notes due 2023.
- CXW received lease termination notice for the California City Correctional Center from the State of California on December 6, 2022.
- CXW reported 3Q22 results on November 2, 2022.
- CXW finalized new credit facilities and authorized a share buyback on May 12, 2022.
- CXW provided an ESG update on April 11, 2022, with the release of its fourth annual ESG report.
- CoreCivic announced a new contract with the state of Arizona on January 10, 2022.
- 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, 2020.

FINANCIAL MODEL

Core Civic

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

	2020A	1Q21A	2Q21A	3Q21A	4Q21A	2021A	1Q22A	2Q22A	3Q22A	4Q22E	2022E	2023E
Revenue	$1,905,485	$454,718	$464,571	$471,194	$472,133	$1,862,616	$452,988	$456,697	$464,211	$465,364	$1,839,260	$1,914,135
Y/Y % change	*-3.8%*	*-7.4%*	*-1.7%*	*0.6%*	*-0.3%*	*-2.2%*	*-0.4%*	*-1.7%*	*-1.5%*	*-1.4%*	*-1.3%*	*4.1%*
Operating expense	1,406,376	332,884	333,070	338,192	332,919	1,337,065	344,629	349,000	368,194	366,830	1,428,653	1,462,451
General and administrative	124,338	29,530	33,228	34,600	38,412	135,770	31,101	31,513	30,194	31,113	123,921	123,951
Depreciation and amortization	150,861	32,712	34,084	33,991	33,951	134,738	32,028	32,259	31,931	31,952	128,170	128,076
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	-	-	3,513	-	3,513	-
Total operating expense	1,742,823	448,179	405,798	411,960	407,309	1,673,246	407,758	414,672	433,832	429,896	1,686,158	1,714,478
Operating income	162,662	6,539	58,773	59,234	64,824	189,370	45,230	42,025	30,379	35,468	153,102	199,657
Operating margin	8.5%	1.4%	12.7%	12.6%	13.7%	10.2%	10.0%	9.2%	6.5%	7.6%	8.3%	10.4%
Interest expense, net	83,299	18,428	23,222	20,653	23,239	85,542	22,920	21,668	20,793	20,044	85,425	75,000
Other (income) expense	19,639	148	13,409	(49)	4,217	17,725	(3,303)	5,782	(82,974)	(3,504)	(83,999)	-
	102,938	18,576	36,631	20,604	27,456	103,267	19,617	27,450	(62,181)	16,540	1,426	75,000
Pretax income	59,724	(12,037)	22,142	38,630	37,368	86,103	25,613	14,575	92,560	18,928	151,676	124,657
Taxes	(4,386)	(113,531)	(6,519)	(8,618)	(9,331)	(137,999)	(6,610)	(4,013)	(24,242)	(4,921)	(39,786)	(32,411)
						160.3%						
Minority interest	(1,181)											
Net income	54,157	(125,568)	15,623	30,012	28,037	(51,896)	19,003	10,562	68,318	14,007	111,890	92,246
Per share data												
EPS	$0.45	($1.05)	$0.13	$0.25	$0.23	($0.43)	$0.16	$0.09	$0.58	$0.12	$0.94	$0.79
Dividends	$0.88											
Average shares outstanding	120,928	121,366	122,059	122,049	121,218	121,673	121,420	121,346	116,569	116,519	118,964	116,093
Funds From Operation (FFO)												
Net income	$55,338	($125,568)	$15,623	$30,012	$28,037	($51,896)	$19,003	$10,562	$68,318	$14,007	$111,890	$92,246
+ D&A of real estate assets	112,046	23,759	24,926	24,877	25,176	98,738	24,166	24,501	24,158	24,284	97,109	95,801
+ Impairment of real estate assets	14,380	1,308			2,027	3,335	-	-	3,513	-	3,513	-
- Gain on sale of real estate assets	13,023		(38,766)	-	-	(38,766)	(2,261)	(1,060)	(83,828)	(1,450)	(88,599)	-
+ - Other	532	(350)	9,641	-	(506)	8,785	625	283	21,165	399	22,472	-
FFO	195,319	(100,851)	11,424	54,889	54,734	20,196	41,533	34,286	33,326	37,239	146,384	188,047
FFO/share	$1.62	($0.83)	$0.09	$0.45	$0.45	$0.17	$0.34	$0.28	$0.28	$0.32	$1.23	$1.62
+ 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	577	-	6,958	-
Normalized FFO	271,768	53,031	56,017	58,617	57,819	225,484	41,533	40,667	33,903	37,239	153,342	188,047
Normalized FFO/share	$2.25	$0.44	$0.46	$0.48	$0.48	$1.85	$0.34	$0.34	$0.29	$0.32	$1.29	$1.62

Source: Company reports, Zacks estimates

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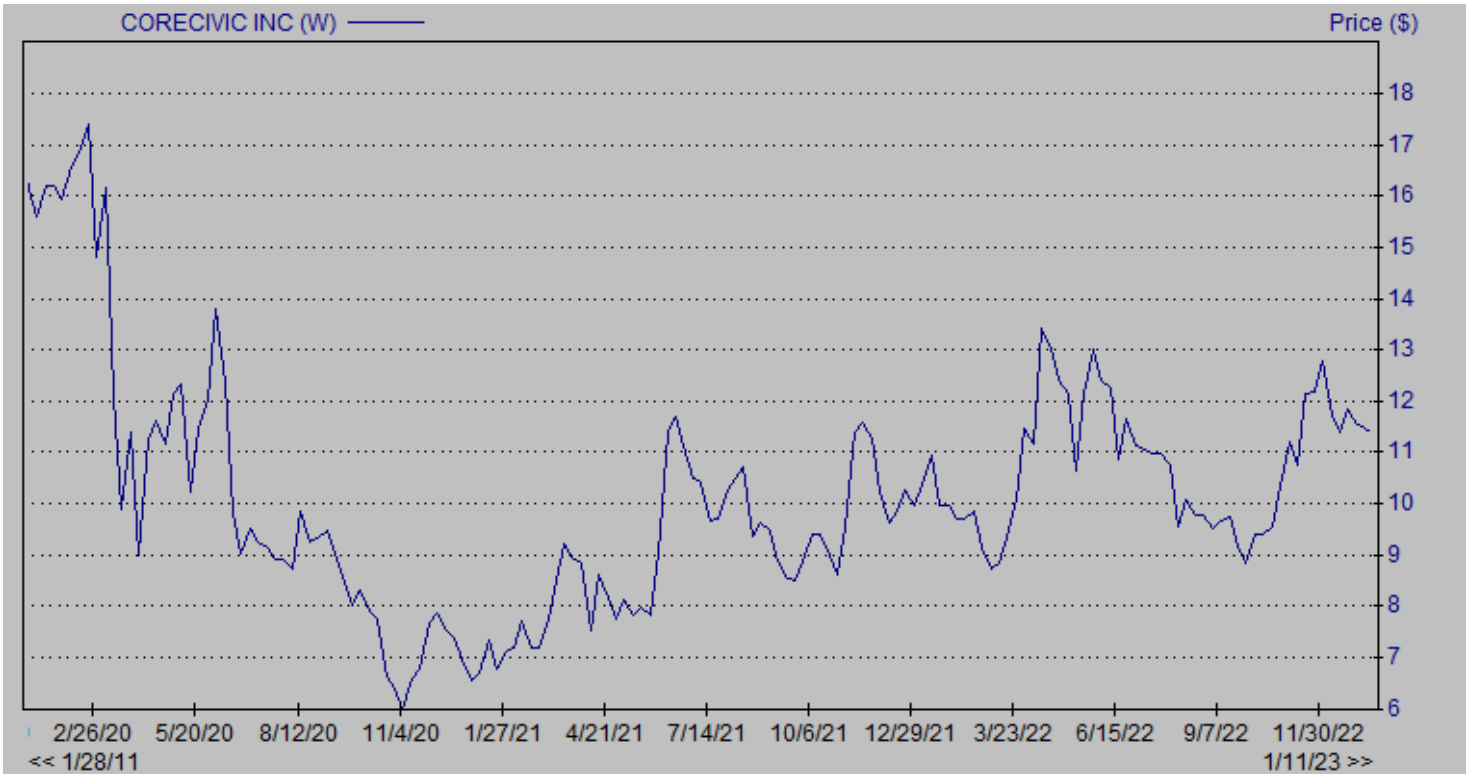

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