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Zacks Small-Cap Research

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Corecivic Inc (CXW-NYSE)

CXW: Asset Sales & Cash Generation Facilitate Deleveraging Measures

CXW sold 42 non-core properties in 4Q20 for net proceeds of $27.8M, with additional asset sales expected and the proceeds earmarked for debt repayment. Strengthening its balance sheet is a priority and the transition to a C-Corp. is expected to facilitate this initiative. CXW reduced total debt by more than $125M in 4Q20. The total leverage ratio was 3.5x, down from 4.0x in 4Q19. CXW targets a leverage ratio of 2.25x to 2.75x.

Current Price (02/16/21)	$7.62
Valuation	**$15.60**

OUTLOOK

The transition to a C-Corp. structure will facilitate the company's deleveraging initiatives. The ability to retain cash under the C-Corp. structure will also enable CXW to reduce its reliance on banks and other external source of cash, as CXW will be able to reinvest internally generated cash flow into paring debt, as noted, growing its business and returning capital to its shareholders.

In terms of the recent executive order regarding private prison operators, the initiative pertains primarily to the BOP, which accounted for only 2% of CXW's total 2020 revenue. Moreover, CXW has expanded into residential re-entry facilities and other adjacent verticals over the years, with opportunities for additional extensions, as well.

SUMMARY DATA

52-Week High	**$17.68**
52-Week Low	**$5.76**
One-Year Return (%)	**-53.34**
Beta	**1.36**
Average Daily Volume (sh)	**2,539,986**
Shares Outstanding (mil)	**121**
Market Capitalization ($mil)	**$922**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**73**
Insider Ownership (%)	**1**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**1.9**
Earnings Per Share (%)	**-1.7**
Dividend (%)	**-3.6**
P/E using TTM EPS	**3.4**
P/E using 2021 Estimate	**2.9**
P/E using 2022 Estimate	**N/A**
Zacks Rank	**3**

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	470 E	482 E	482 E	499 E	1,934 E

Price/Sales Ratio (Industry = 2.5x)

	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	$0.19 E	$0.20 E	$0.21 E	$0.20 E	$0.80 E

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

Disclosures on page 10

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KEY POINTS

- CoreCivic's 4Q20 results reflect the impact of lower occupancy rates as a result of the COVID-19 pandemic. Management believes, however, that the pandemic could also highlight the advantages of newer prison infrastructure such as CXW's in terms of inmate health. A recent study noted that relative numbers of inmate COVID-19 deaths reported by private facilities is "considerably lower" than at government-operated facilities.

- CXW sold 42 non-core properties in 4Q20 for net proceeds of $27.8M, with additional asset sales expected and the proceeds earmarked for debt repayment.

- CXW reduced total debt by more than $125 million in 4Q20. The total leverage ratio was 3.5x, down from 4.0x in 4Q19. CXW targets a leverage ratio of 2.25x to 2.75x. Strengthening its balance sheet is a priority and the transition to a C-Corp. is expected to facilitate this initiative.

- In terms of the recent executive order regarding private prisons, it is important to note that the order pertains primarily to BOP, which represented only 2% of the company's total 2020 revenue.

- Separately, reflecting its goal to provide services aimed at reducing recidivism, CXW recently created the role of VP Re-Entry Partnerships and Innovation. This is consistent with CXW's expanding the range of reentry and education programs it offers in recent years.

- The company has several new contracts that are expected to boost revenue and several potential opportunities, as states and government entities look to the private sector. For instance, CXW recently won a new Alabama contract to build two new facilities and a new BOP contract for residential re-entry and home confinement services. CXW also plans to respond to a request for interest from Hawaii.

2020 FINANCIAL REVIEW

COVID-19 Impact

CoreCivic (NYSE: CXW) reported 4Q20 results last week, with revenue coming in at $473.5 million. This represented a 4.9% year-over-year decline, which was consistent with prior quarters and expected. It stemmed primarily from lower occupancy rates as a result of COVID-19 with Immigration and Customs Enforcement (ICE) and at prison facilities. Government initiatives to curb the spread of COVID-19 among the prison populations have led to lower prison occupancy levels. In addition, ICE has sought to contain the spread of COVID-19 through tighter control over the southern U.S. border, which led to lower numbers of people housed under existing contracts with ICE. Court delays as a result of the pandemic have also contributed to lower prison occupancy. CXW's average compensated occupancy in 4Q20 was 72.7% compared to 79.8% in 4Q19. The impact of these factors was partially offset by the benefits of new contracts.

While the COVID-19 pandemic had a negative impact on occupancies and revenue in 2020, management believes that longer-term, it could serve to highlight the advantages of more modern prison infrastructure such as CXW's in protecting inmate's health. CXW facilities are, on average, 20 years old compared to 30 to 40 years old for the overall prison system, according to management. In fact, a recent report from the National Commission on COVID-19 and Criminal Justice noted that the "number of deaths per 100,000 reported by private facilities is considerably lower than the rate at prisons operated by state or federal governments."

Alabama governor Kay Ivey even noted the state's need to lease and operate new and modern correctional facilities and provide safe conditions for the inmate population. (The DOJ had sued the state over the conditions of its prison infrastructure.) CXW recently won a new contract from the state of Alabama (see below).

The impact of lower occupancy rates in 4Q20 was also partially offset by lower G&A expenses. Several of the company's facilities began receiving vaccine dosages, while simultaneously the number of inmates testing positive for the COVID-19 virus has declined.

CXW reported a loss per share of ($0.22). However, after adjusting for non-recurring items, including a non-cash asset impairment charge of $47.6 million and a $17.9 million loss on real estate assets, 4Q 2020 adjusted EPS came in at $0.40. Adjusted 4Q20 FFO per share was $0.63 compared with $0.59 in 4Q19. Adjustments include the 1-time items noted above.

We have revised our estimates as a result of 2020 actual results. We expect the COVID-19 pandemic to continue to impact utilization levels of CXW's facilities in the near-term. However, as access to vaccines improves, we believe occupancy levels could improve over the year, implying potential upside to our 1.5% 2021 revenue growth forecast, depending on the timing of the vaccine dissemination, among other factors.

STRENGTHENING THE BALANCE SHEET

Recent asset sales raise funds for debt repayments

CXW closed on the sale of 42 of its non-core government leased properties in 4Q20 for net proceeds of $27.8 million. The company has earmarked the proceeds primarily for debt repayment and also indicated that there are additional assets it is contemplating selling.

Total debt declined by more than $125 million in 4Q20, through the combination of cash flow generation and the above-noted asset sales. The total leverage ratio for the quarter was 3.5x, down from 4.0x in 4Q19. CXW targets a leverage ratio of 2.25x to 2.75x.

C-Corp Transition Facilitates Balance Sheet Goals

CXW had been structured as a REIT since 2013. Although the REIT structure provided certain tax benefits, it also meant that CXW was required to distribute at least 90% of its annual taxable income to shareholders every year. This mitigated the company's opportunity to build its cash position and to use cash for purposes other than dividend payments. On August 5, 2020, the company announced that its board of directors approved a plan to revoke its REIT election and become a taxable C Corporation, effective January 1, 2021.

Once the company completes the conversion to a C-Corp structure, CXW expects to retain and build cash at a faster pace than it has 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. Another source of funds will be the sale of non-core real estate assets such as the divestitures noted above. The company is among the largest private owners of real estate that is leased to various U.S. government agencies, with some of these assets potentially non-core.

CXW had $113.2 million of cash at the end of 4Q 2020, plus an additional $566.2 million available under its revolver. CXW expects to continue to repay debt. The company has about $250.0 million of debt that comes due by 3Q22. 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 reduction is the first prioritized use of cash. The company also expects to allocate a substantial portion of its free cash flow to returning capital to shareholders through share buybacks 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.

The ability to retain cash under the C-Corp. structure will also enable CXW to reduce its reliance on banks and other external source of cash, as it will be able to reinvest internally generated cash flow into growing its business and returning capital to its shareholders.

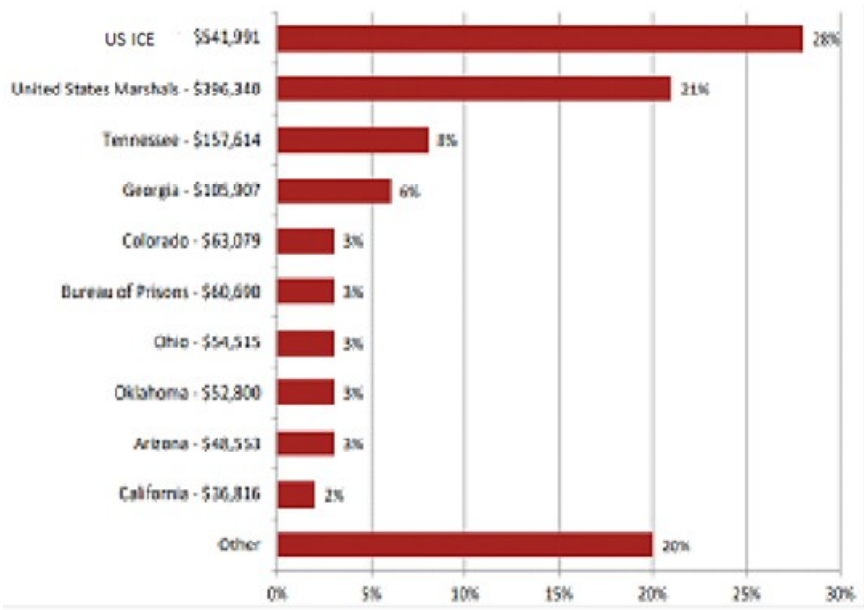
CONTRACT RETENTION AVERAGES >90% OVER THE DECADE

Recent executive order expected to have minimal impact on CXW

BOP

The industry faces the challenge of perceived political risk, particularly with the recent presidential election and subsequent executive order to not renew DOJ contracts with private prison operators if possible. This order is not expected to have a meaningful impact on CXW. Over the past few years, BOP's inmate populations have declined and, in turn, BOP's demand for private sector beds has also declined. The Department of Immigration and Customs Enforcement (ICE) represented the single largest source of 2020 revenue, followed by USMS and federal and state government agencies. BOP represented only 2% of the company's total 2020 revenue. At the end of 2020, CXW had only one prison contract with the BOP and recently renewed that contract through November 2022.

CXW Customer Breakdown, December 2020

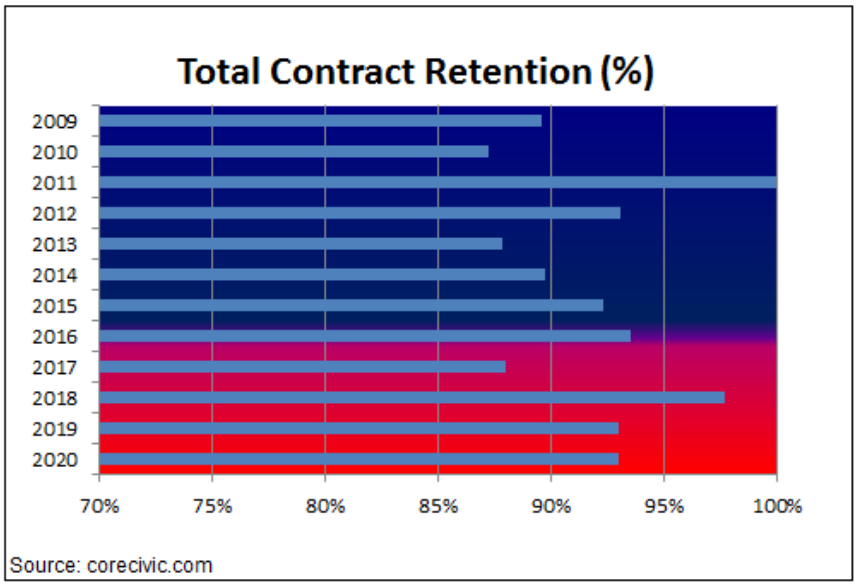


Source: www.corecivic.com

USMS

Demand from the USMS has been fairly steady over the past few years and the company expects this to continue in the near- to medium-term. One important advantage of out-sourcing to the private prison sector is the ability for USMS and other government agencies to manage costs. Another is that it relieves the government of having to fund the development and construction of prison facilities.

These are factors CXW cites when noting its consistently high contract retention rates. Since 2009, CXW has renewed, on average, over 90% of contracts up for renewal each year regardless of the administration in office (see below). Moreover, while sentencing reform might lead to lower numbers of people being sentenced, there is still a significant inmate population that needs to be housed and government agencies cannot house this population without using the private operators, according to management, without undertaking the construction of new and costly projects.



Separately, reflecting its goal to provide services aimed at reducing recidivism, CXW recently created the role of VP Re-Entry Partnerships and Innovation. This is consistent with CXW's initiatives in recent years expanding the range of reentry and education programs it offers inmates, including providing opportunities for inmates to earn a high school equivalency diploma or obtain vocational training and sometimes even higher education. One example of this is the creation of the above-noted role for an executive specifically tasked with overseeing this initiative. Another example is that CXW expanded its relationship with Ashland University in 2019 to offer some college courses. Research suggests that education and training can help lower recidivism, as inmates who obtain GEDs while in prison are 30% less likely to return to prison and those who complete vocational training are 28% more likely to find employment after their release.[1]. CXW's facilities are accredited by the American Correctional Association (ACA), an independent agency, with an average 99.6% score.

POTENTIAL GROWTH DRIVERS

New Contracts Expected to Create Growth Opportunities

Alabama
Alabama recently awarded CXW contracts for the development of two new correctional facilities that will contain a combined 7,000 beds. While financial terms have not been disclosed yet, the company has noted that they represent two of the largest development projects the company has ever won.

In addition to the recent Alabama contracts, CXW also plans to respond to a request for interest from Hawaii regarding the planned development of a new correctional facility in Oahu, which is contemplated to be the state's largest prison. Moreover, in 4Q20, the company won a new BOP contract for residential reentry and home confinement services at its 289-bed residential center in Tulsa, Oklahoma and 494-bed facility in Oklahoma City, Oklahoma. Thus, within the past few quarters, Oklahoma, Hawaii, Kansas and Alabama have each extended requests of interest of new contracts to private prison operators, which the company believes underscores the ongoing need for private facilities. The company believes that it has strong growth opportunities going forward as these states and others seek to increase and upgrade obsolete and often dangerously inadequate prison capacity. We highlight a few below.

Kentucky CXW entered into a 10-year lease with the Kentucky Department of Corrections in December 2019 for a 656-bed facility that previously had been idled since 2012. The lease commenced July 1, 2020.

[1] RAND Corporation, "Evaluating the Effectiveness of Correctional Education," 2013.

Mississippi In January 2020, CXW entered into an emergency contract with the state of Mississippi to care for up to 375 of Mississippi's inmates to be placed at the company's Tallahatchie, Mississippi facility for 90-days. The contract was expanded up to 1,000 beds and extended through October 4, 2020.

Idaho In August 2020, CXW entered into a new contract with the state of Idaho to care for up to 1,200 adult male offenders at the company's Saguaro facility in Arizona. Subject to availability, the company may also care for offenders at its Central Arizona Correctional Complex under terms of the contract, which commenced August 18, 2020, and has an initial term of five years, with unlimited extension options thereafter upon mutual agreement.

USMS In September 2020, CXW entered into a new three-year contract under an Intergovernmental Services Agreement between the city of Cushing, Oklahoma and the USMS to utilize the company's 1,692-bed Cimarron Correctional Facility The contract commenced on September 15, 2020, and includes unlimited 24-month extension options.

VALUATION

We think the current share price does not reflect the fundamental value of the company's real estate holdings 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 expansions that narrows – if not eliminates – the gap between the current multiple and historical averages 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 4Q20 results on February 10, 2021.
- On January 19, 2021, CoreCivic established a new reentry-focused leadership role
- On January 15, 2021, the company provided tax allocations of 2020 dividend distributions
- CXW announced the sale of 42 non-core government leased properties for $106.5 million on December 23, 2020.
- On November 4, 2020, CoreCivic reported 3Q 2020 operating and financial results.
- 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, 2020.
- On September 15, 2020, 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)

	2019	1Q20	2Q20	3Q20	4Q20	2020A	1Q21	2Q21	3Q21	4Q21	2021E
Revenue	$1,980,689	$491,101	$472,641	$468,266	$473,477	$1,905,485	$470,475	$482,094	$482,314	$499,185	$1,934,067
Y/Y % change	*7.9%*	*1.5%*	*-3.6%*	*-7.9%*	*-4.9%*	*-3.8%*	*-4.2%*	*2.0%*	*3.0%*	*5.4%*	*1.5%*
Operating expense	1,422,769	362,315	352,927	347,927	343,207	1,406,376	345,328	356,749	361,735	363,658	1,427,472
General and administrative	127,078	31,279	30,145	35,883	27,031	124,338	32,463	30,372	31,350	32,640	126,825
Depreciation and amortization	144,572	37,952	38,619	37,865	36,425	150,861	36,227	37,121	37,138	43,392	153,878
Related to business acquisitions	-	-	-	620	-	620	-	-	-	719	719
Impairments / other	4,706	536	11,717	805	47,570	60,628	-	-	-	-	-
Total operating expense	1,699,125	432,082	433,408	423,100	454,233	1,742,823	414,018	424,243	430,224	440,409	1,708,894
Operating income	281,564	59,019	39,233	45,166	19,244	162,662	56,457	57,851	52,090	58,775	225,173
Operating margin	14.2%	12.0%	8.3%	9.6%	4.1%	8.5%	12.0%	12.0%	10.8%	11.8%	11.6%
Interest expense, net	84,401	22,538	20,996	20,193	19,572	83,299	19,572	19,552	19,533	19,644	78,301
Other (income) expense	438	(533)	(2,987)	(2,113)	25,272	19,639	4,582	5,499	(2,100)	5,766	13,747
	84,839	22,005	18,009	18,080	44,844	102,938	24,154	25,051	17,433	25,410	92,048
Pretax income	196,725	37,014	21,224	27,086	(25,600)	59,724	32,303	32,800	34,657	33,365	133,125
Taxes	(7,839)	(3,776)	962	(369)	(1,203)	(4,386)	(8,883)	(9,020)	(9,531)	(9,175)	(36,609)
Minority interest		(1,181)	-	-	-	(1,181)					
Net income	188,886	32,057	22,186	26,717	(26,803)	54,157	23,419	23,780	25,126	24,190	96,516
Per share data											
EPS	$1.59	$0.27	$0.18	$0.22	($0.22)	$0.45	$0.19	$0.20	$0.21	$0.20	$0.80
Dividends	$1.76					$0.88					
Average shares outstanding	119,164	120,725	120,974	120,980	121,034	120,928	121,134	121,234	121,334	121,611	121,328

Source: Company reports, Zacks estimates

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