# The GEO Group (GEO)

*Updated June 9th, 2020 by Nikos Sismanis*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $14 | **5 Year CAGR Estimate:** | 10.1% | **Market Cap:** | $1.79B |
| **Fair Value Price:** | $12 | **5 Year Growth Estimate:** | 3.0% | **Ex-Dividend Date:** | 04/15/20 |
| **% Fair Value:** | 126% | **5 Year Valuation Multiple Estimate:** | -0.4% | **Dividend Payment Date:** | 03/23/20 |
| **Dividend Yield:** | 2.7% | **5 Year Price Target** | $13 | **Years Of Dividend Growth:** | 0 |
| **Dividend Risk Score:** | D | **Retirement Suitability Score:** | B | **Last Dividend Increase:** | 8.6% |

## Overview & Current Events

The GEO Group is a specialty REIT that owns, operates, and manages correctional, detention, and reentry facilities in the US, UK, South Africa, and Australia. The portfolio is made up of a total of 129 facilities, including 95,000 beds. Out of these, 80 are owned and operated by the company, 14 are leased, while 35 are managed only. More than 90% of the beds are located in the US. The company's operating income can be divided into three segments: US Secure Services, GEO Care, and International Services. They contribute 66%, 31%, and 3% of total operating income, respectively.

On April 30th, 2020, the company announced earnings for Q1 2020 for the period ending March 31st, 2020. For the quarter, revenues and normalized AFFO/share were $605.02 million, and $0.55, a decrease of 0.9%, and 17%, respectively. Reduced AFFO was attributed to additional costs related to COVID-19. The company is aware that should COVID-19 spread to a facility, many detainees will likely be affected, causing a disturbance in operations and the bottom line. Amid such uncertainties, the company has updated its guidance to reflect the risks. For FY2020, management expects full-year revenues of approximately $2.38B and AFFO to be in a range of $2.25 to $2.35 per diluted share.

## Growth on a Per-Share Basis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **AFFO[1]** | $ 1.00 | $ 1.41 | $ 1.66 | $ 1.91 | $ 2.14 | $ 2.24 | $ 2.50 | $ 2.55 | $ 2.47 | $ 2.75 | **$2.30** | **$2.67** |
| **DPS** | --- | --- | $0.27 | $1.37 | $1.55 | $1.67 | $1.73 | $1.88 | $1.88 | $1.92 | **$1.92** | **$2.07** |
| **Shares[2]** | 76 | 84 | 95.6 | 91.9 | 107.4 | 108.8 | 111 | 111.5 | 120.8 | 120.7 | **119.3** | **125** |

GEO has managed to consistently grow its AFFO as it expands its operations. The company has longstanding relationships in the justice system that has allowed it to essentially create a duopoly in the sector, along with its competitor CoreCivic (CXW). The company's cash flow is incredibly secured, as its tenants are state governments. Unlike commercial tenants, the government is very unlikely to miss payments, as it can always increase taxes, or even print money, to cover its costs. With such stability and tenant-credibility, GEO has a resilient business model. Its mission-critical facilities are recession-proof and not subject to the performance of the overall economy.

With growing AFFO, the company has also consistently increased its dividends. In 2020, management decided to suspend dividend growth as a prudent move towards capital preservation. Being a REIT, GEO has to finance future expansion through additional debt and equity. Because shares are currently yielding13.3% yield, it would be expensive for GEO to issue more equity, resulting in massively indebting its balance sheet over the past few years.

## Valuation Analysis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/FFO** | 16 | 9.92 | 10.56 | 12 | 10.7 | 11.1 | 9.2 | 11 | 8.9 | 7.2 | **5.1** | **5.0** |
| **Avg. Yld.** | --- | --- | 2.8% | 6.3% | 6.2% | 8.3% | 9.1% | 9.2% | 9.3% | 12.0% | **13.8%** | **15.5%** |

[1] In 2012-2013 GEO transitioned to being a REIT. Figures have been adjusted to reflect the corresponding AFFOs, per their annual reports. The 2010 figure represents EPS.

[2] Share count is in millions.

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GEO is currently trading at a low valuation of ~5x its FFOs. While the valuation may seem incredibly cheap there are several risks to take into account. In an effort to express their dislike of private prisons, all publicly traded banks decided to cut ties with the company last year. As a result, the company is left to borrow from lenders who now demand much higher rates, sometimes over 6%. Moreover, there has been speculation on whether regulation should ban private prisons, as profiting off of detainees is unethical. Such regulation would essentially kill the company's business model. Finally, the company has amassed a massive debt position of $2.65 billion, resulting in a concerning debt/equity ratio of nearly 300%. Considering that the future of private prisons is not a particularly exciting, combined with a much-indebted balance sheet and pressure towards unethical investing, we expect GEO's valuation multiples to remain depressed.

While the current yield of 13.3% may look incredibly attractive, risks shouldn't be ignored. Should some of GEO's risks materialize, shareholder value is likely to evaporate. For example, certain covenants with lenders forbid GEO to raise additional debt.  If the company is unable to pay lenders back, it is required to sell assets. Prisons, however, are incredibly illiquid with nearly 0 potential buyers, triggering further covenants down the road.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Payout | --- | --- | 16.2% | 71.7% | 72.4% | 74.5% | 69.2% | 73.7% | 76.1% | 69.8% | **83.4%** | **78%** |

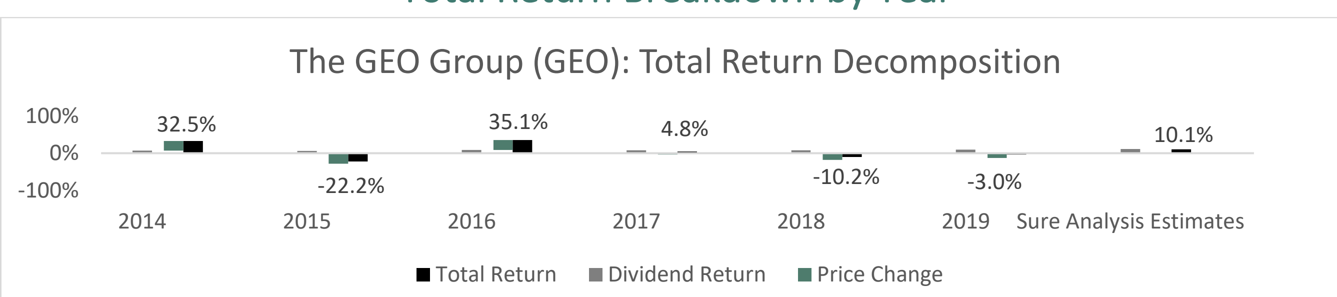
On the one hand, the company maintains a relatively healthy payout ratio, with incredibly reliable tenants. Under a potential recession, we expect the company's cash flows to be minimal if affected. Since February, chairman and CEO George Zoley has purchased more than $12 million in GEO shares to reassure shareholders. Moreover, as GEO operates essentially in a duopoly in a sector that is massively regulated, entry of new competitors is highly unlikely.

On the other hand, GEO's indebtedness and negative sentiment towards private prisons could considerably hurt the company going forward. Its interest coverage ratio is at all-time low of 1.66. With credible banks withdrawing their services, those who do lend to GEO rightfully require much higher returns, demanding above-average rates. The company is also unable to raise further equity, as its current yield would further burden the balance sheet. A dividend cut to pay down debt should not come as a surprise if it occurs.

## Final Thoughts & Recommendation

Despite the risks attached, we cannot ignore the stock's yield of 13.3%. While a dividend cut is not unlikely, the company's cash flows are resilient. Future regulation could hurt such stability, but the truth is a transition of operations of private prisons to public operators would be a very difficult and expensive process. If management starts paying down the existing debt and maintains a low payout ratio, investors could be well rewarded, for the risk taken with GEO. Assuming the company does not cut the dividend supported by steady cash flows, we expect annual returns of around 10% in the medium return. A potential multiple expansion amid a less dire outlook for the sector could potentially result further though capital gains.  With that said, there's just too much risk here to recommend this security as a buy.

## Total Return Breakdown by Year

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## Income Statement Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | $1,085 | $1,407 | $1,479 | $1,522 | $1,692 | $1,843 | $2,179 | $2,263 | $2,331 | $2,478 |
| Gross Profit | $273 | $371 | $390 | $397 | $446 | $480 | $529 | $563 | $576 | $617 |
| Gross Margin | 25.2% | 26.4% | 26.4% | 26.1% | 26.4% | 26.0% | 24.3% | 24.9% | 24.7% | 24.9% |
| SG&A Exp. | $102 | $110 | $114 | $117 | $115 | $137 | $149 | $190 | $185 | $186 |
| D&A Exp. | $44 | $82 | $92 | $95 | $96 | $107 | $115 | $124 | $126 | $131 |
| Operating Profit | $127 | $180 | $184 | $185 | $235 | $236 | $266 | $248 | $265 | $300 |
| Operating Margin | 11.7% | 12.8% | 12.5% | 12.2% | 13.9% | 12.8% | 12.2% | 11.0% | 11.4% | 12.1% |
| Net Profit | $63 | $79 | $135 | $115 | $144 | $139 | $149 | $146 | $145 | $167 |
| Net Margin | 5.9% | 5.6% | 9.1% | 7.6% | 8.5% | 7.6% | 6.8% | 6.5% | 6.2% | 6.7% |
| Free Cash Flow | $35 | -$33 | $157 | $75 | $88 | $25 | -$110 | $233 | $79 | $221 |
| Income Tax | $34 | $43 | -$41 | -$26 | $14 | $7 | $8 | $18 | $14 | $17 |

## Balance Sheet Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets | $2,412 | $3,050 | $2,839 | $2,889 | $3,002 | $3,462 | $3,749 | $4,227 | $4,258 | $4,318 |
| Cash & Equivalents | $40 | $43 | $32 | $52 | $41 | $60 | $68 | $81 | $31 | $32 |
| Accounts Receivable | $276 | $265 | $247 | $251 | $269 | $314 | $356 | $390 | $446 | $431 |
| Goodwill & Int. Ass. | $324 | $686 | $669 | $654 | $649 | $840 | $819 | $1,034 | $1,009 | $986 |
| Total Liabilities | $1,373 | $2,011 | $1,792 | $1,865 | $1,956 | $2,455 | $2,774 | $3,028 | $3,218 | $3,321 |
| Accounts Payable | $74 | $68 | $50 | $47 | $58 | $78 | $80 | $93 | $93 | $99 |
| Long-Term Debt | $1,031 | $1,581 | $1,476 | $1,574 | $1,612 | $2,086 | $2,412 | $2,576 | $2,744 | $2,742 |
| Shareholder's Equity | $1,019 | $1,023 | $1,047 | $1,024 | $1,046 | $1,007 | $975 | $1,199 | $1,041 | $997 |
| D/E Ratio | 1.01 | 1.55 | 1.41 | 1.54 | 1.54 | 2.07 | 2.47 | 2.15 | 2.64 | 2.75 |

## Profitability & Per Share Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets | 3.3% | 2.9% | 4.6% | 4.0% | 4.9% | 4.3% | 4.1% | 3.7% | 3.4% | 3.9% |
| Return on Equity | 7.5% | 7.7% | 13.0% | 11.1% | 13.9% | 13.6% | 15.0% | 13.5% | 13.0% | 16.4% |
| ROIC | 3.8% | 3.4% | 5.2% | 4.5% | 5.5% | 4.8% | 4.6% | 4.1% | 3.8% | 4.4% |
| Shares Out. | 84.0 | 95.6 | 91.9 | 107.4 | 108.8 | 111.0 | 111.5 | 120.8 | 120.7 | 119.3 |
| Revenue/Share | $12.91 | $14.72 | $16.09 | $14.17 | $15.55 | $16.61 | $19.55 | $18.73 | $19.31 | $20.77 |
| FCF/Share | $0.42 | -$0.34 | $1.71 | $0.69 | $0.81 | $0.22 | -$0.98 | $1.93 | $0.65 | $1.85 |

*Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.*