The GEO Group (GEO)

Updated August 8th, 2020 by Nikos Sismanis

Key Metrics

Current Price:	$10.67	**5 Year CAGR Estimate:**	14.5%	**Market Cap:**	$1.29B
Fair Value Price:	$12	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	10/24/20
% Fair Value:	93%	**5 Year Valuation Multiple Estimate:**	1.5%	**Dividend Payment Date:**	11/01/20
Dividend Yield:	12.7%	**5 Year Price Target**	$13	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	N/A

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 around 66%, 31%, and 3% of total operating income, respectively.

On August 6th, 2020, the company announced its Q2 2020 earnings for the period ending June 30th, 2020. For the quarter, revenues and normalized AFFO/share were $587 million, and $0.66, a decline of 4.2%, and 5.7%, respectively. Reduced AFFO was attributed to additional costs related to COVID-19, as well as some lag on contract renewals. For FY2020, management narrowed down its full-year guidance, anticipating AFFOs of $2.29-$2.33 per diluted share. Despite minor declines in its performance, management also decided to disproportionally cut the dividend by nearly 1/3 in efforts to pay down the company's unsustainable debt levels.

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	**$1.36**	**$1.65**
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 AFFOs as it expands its operations of building and managing prisons, and detention and reintegration facilities.

The company performed in line with our AFFO expectations, retaining its previous guidance levels. Still, the DPS was cut to $1.36 as its unsustainable long-term debt/equity ratio nearly touched 300%, requiring paying it down. We believe GEO can produce 3% annual AFFO-per-share growth, as contractual renewals have lagged amid COVID-19. We retain our DPS growth target at 4%, as the company will now have substantial wiggle room to raise its distributions in the medium term.

Note that little has changed in the company's underlying performance. The dividend cut is mostly due to balance sheet restructuring, as it would have remained relatively well-covered even under the current weaker AFFO performance.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/AFFO	16	9.9	10.6	12	10.7	11.1	9.2	11	8.9	7.2	**4.6**	**5.0**
Avg. Yld.	---	---	2.8%	6.3%	6.2%	8.3%	9.1%	9.2%	9.3%	12.0%	**12.7%**	**12.4%**

[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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Since our last report, GEO's valuation has contracted further, to new all-time lows at around 4.6 times its AFFO. The depressed valuation is partially attributed to institutional investors avoiding the company's shares, as profiting off of detainees is massively scrutinized. Despite the dividend cut, the stock yields a massive 12.7%, as shares have considerably declined as of lately. The company's yield, along with its dirt-cheap valuation, may seem quite compelling, but the risks are quite considerable.

Safety, Quality, Competitive Advantage, & Recession Resiliency

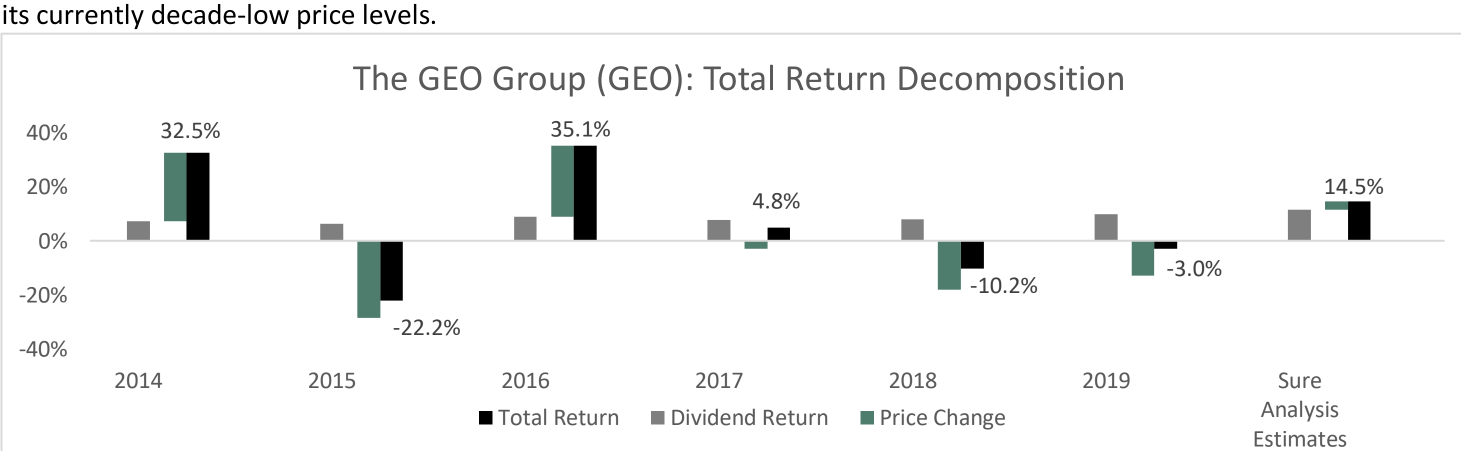
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	16.2%	71.7%	72.4%	74.5%	69.2%	73.7%	76.1%	69.8%	***59.1%***	***62.1%***

The company's payout ratio has approached quite healthy levels, as a result of the dividend cut. While we consider that distributions are safe, the market has priced in the stock's massive risks. If they materialize, shareholder value is likely to evaporate. For example, unlike other property trusts, which could easily sell their assets to pay down their debts, prison complexes are exceptionally illiquid. Since the company's covenants forbid it to raise additional debt, the company was forced to cut its distributions. The case remains, as the few lenders left providing GEO funding (all major banks have cut business ties with GEO), have been increasingly demanding. Moreover, there has been a lot of speculation on whether regulation should ban private prisons, as profiting off of detainees is unethical. Such regulation would permanently kill the company's business model, despite its current resilience.

Still, we can't ignore that GEO operates primarily in a duopoly, in a massively regulated sector; entry of new competitors is highly unlikely. 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 almost impossible to miss a payment, as it can always increase taxation, 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.

Final Thoughts & Recommendation

Despite the risks attached, income investors may find GEO's dividend yield of 12.7% very compelling, especially considering the company's cash flows are very resilient. Should the company's debt position decline, avoiding triggering the risks tied on its covenants, we can see the stock hugely rewarding shareholder in the medium term. Powered by its massive yield and the potential for a slight valuation expansion, we expect shares to deliver 14.5% annualized returns at its currently decade-low price levels.



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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.