The GEO Group (GEO)

Updated August 4th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	$7.16	**5 Year CAGR Estimate:**	12.5%	**Market Cap:**	$876.4 M
Fair Value Price:	$10.16	**5 Year Growth Estimate:**	-5.0%	**Ex-Dividend Date:**	N/A
% Fair Value:	70%	**5 Year Valuation Multiple Estimate:**	7.2%	**Dividend Payment Date:**	N/A
Dividend Yield:	N/A	**5 Year Price Target**	$7.90	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	N/A	**Retirement Suitability Score:**	N/A	**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 114 facilities, including 90,000 beds. Out of these, 70 are owned and operated by the company, 12 are leased, while 32 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 4th, 2021, The GEO Group announced its Q2 results for the period ended June 30th, 2021. For the quarter, revenues and AFFO/share were $565.42 million and $0.70, a decline of 3.8% and an increase of 6%, respectively. Revenues were mostly stable but still modestly affected by COVID-19 challenging GEO's business model as the Federal Bureau of Prisons' (BOP) operations remain relatively slowed down. However, due to continued favorable cost trends, higher occupancies at GEO's facilities for the U.S. Marshals Service, U.S. Immigration, and Customs Enforcement, and increased earnings from the company's electronic monitoring segment, AFFO/share growth came in positive.

Consequently, management raised its FY2021 guidance for AFFO/share of $2.51-$2.57 (previously $2.23-$2.31). This was due to GEO suspending the dividend entirely in April, which should help it deleverage faster. The company paid only one $0.25 dividend during FY2021 before the suspension. We have implemented a DPS of $0.75 in our calculations due to GEO's REIT status requiring it to resume the dividend from next year.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
AFFO[1]	$1.41	$1.66	$1.91	$2.14	$2.24	$2.50	$2.55	$2.47	$2.75	$2.51	***$2.54***	***$1.97***
DPS	---	$0.27	$1.37	$1.55	$1.67	$1.73	$1.88	$1.88	$1.92	$ 1.78	***$0.25***	***$1.21***
Shares[2]	84	95.6	91.9	107.4	108.8	111.0	111.5	120.8	120.7	120.0	***120.4***	***125.0***

While the company has been delivering a solid performance, enjoying contractually secured cash flows from governmental entities that are very unlikely to ever miss on their payments, shares have been struggling due to ethical concerns and the company's unsustainable debt levels.

On January 26th, President Biden signed an executive order directing the United States Attorney General not to renew U.S. Department of Justice contracts with privately operated criminal detention facilities, as consistent with applicable law. Two agencies of the DOJ, the Federal Bureau of Prisons ("BOP") and U.S. Marshals Service ("USMS",) utilize GEO's services. Also, by internally funding its future growth, its external financing issues can somewhat be dealt with. However, due to Mr. Biden's executive order, the USMS notified GEO that it would not renew the company's Queens Detention Facility contract. USMS accounts for 15% of GEO's revenues. To price in the four USMS contracts up for renewal in the short term, we estimate that AFFO/share will decline by around 5% annually in the medium term. This estimate is partially offset by interest expenses declining amid GEO prioritizing its debt pay downs.

[1] In 2012-2013, GEO transitioned to a REIT. Figures have been adjusted to reflect the corresponding AFFOs.

[2] Share count is in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

We have set the dividend at $0.75 post-2021, though this remains speculative. The board of directors is also evaluating whether GEO is worth keeping its REIT status, which further adds to the uncertainty in regards to future dividend rates.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Avg. P/AFFO	9.92	10.56	12.0	10.7	11.1	9.2	11.0	8.9	7.2	7.2	***2.8***	***4.0***
Avg. Yld.	---	2.8%	6.3%	6.2%	8.3%	9.1%	9.2%	9.3%	12.0%	12.0%	***---***	***15.4%***

Over the past year, GEO's valuation has contracted further, to as low as 2.8X its forward AFFO. The depressed valuation is partially attributed to institutional investors avoiding the company's shares, as profiting off detainees is massively scrutinized and partially to uncertainty regarding the sustainability of the business model. Despite the overall risks, however, we believe that the valuation is dirt-cheap and likely to expand to a more reasonable multiple of around 4.

Safety, Quality, Competitive Advantage, & Recession Resiliency

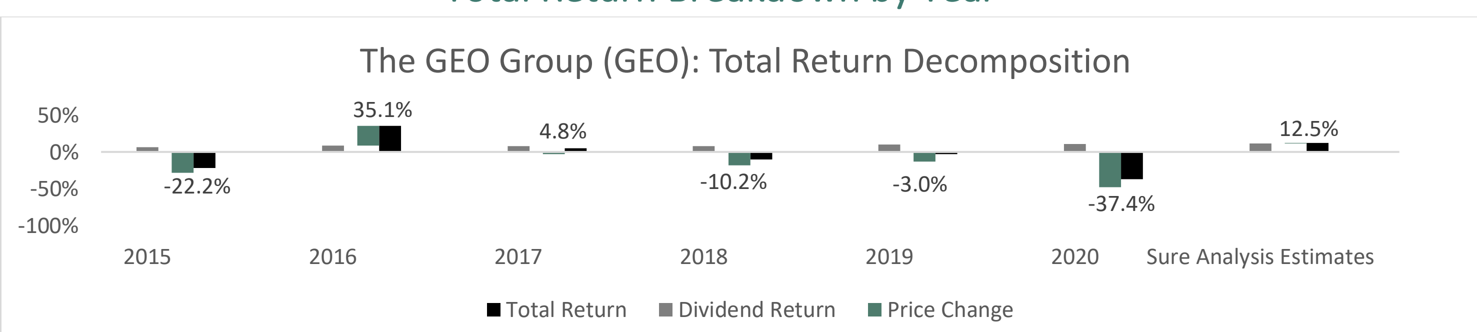
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	16%	72%	72%	75%	69%	74%	76%	70%	71%	***---***	***62%***

We had warned that if GEO's risks were to materialize, shareholder value would likely evaporate. The recent renewal failure with the USMS raised a great red flag. Unlike other property trusts, which could easily sell their assets to pay down their debts, prison complexes are exceptionally illiquid. Additionally, the company's covenants forbid it to raise additional debt, forcing GEO to self-fund its projects. All major banks have also cut business ties with GEO. Still, we can't ignore that GEO operates 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 flows are incredibly secured, as its tenants are state governments, though the recent executive order challenged this argument. Nonetheless, unlike commercial tenants, governments are extremely unlikely to miss a payment, as they 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

GEO's dividend suspension was a harsh but needed measure. The company will now have the opportunity to deleverage, reduce its financial expenses, and turn into a self-funded, sustainable business. We estimate annualized returns of around 12.5% in the medium term, powered by speculative dividend resumption and a valuation expansion towards a fairer multiple. While we rate GEO a buy due to its double-digit return potential, we highlight that its investment case is highly speculative and bears very high risks regarding its business model's longevity and its unpredictable variables.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	$1,479	$1,522	$1,692	$1,843	$2,179	$2,263	$2,331	$2,478	$2,350
Gross Profit	$390	$397	$446	$480	$529	$563	$576	$617	$572
Gross Margin	26.4%	26.1%	26.4%	26.0%	24.3%	24.9%	24.7%	24.9%	24.3%
SG&A Exp.	$114	$117	$115	$137	$149	$190	$185	$186	$193
D&A Exp.	$92	$95	$96	$107	$115	$124	$126	$131	$135
Operating Profit	$184	$185	$235	$236	$266	$248	$265	$300	$244
Operating Margin	12.5%	12.2%	13.9%	12.8%	12.2%	11.0%	11.4%	12.1%	10.4%
Net Profit	$135	$115	$144	$139	$149	$146	$145	$167	$113
Net Margin	9.1%	7.6%	8.5%	7.6%	6.8%	6.5%	6.2%	6.7%	4.8%
Free Cash Flow	$157	$75	$88	$25	-$110	$233	$79	$221	$333
Income Tax	-$41	-$26	$14	$7	$8	$18	$14	$17	$20

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	$2,839	$2,889	$3,002	$3,462	$3,749	$4,227	$4,258	$4,318	$4,460
Cash & Equivalents	$32	$52	$41	$60	$68	$81	$31	$32	$284
Accounts Receivable	$247	$251	$269	$314	$356	$390	$446	$431	$363
Goodwill & Int. Ass.	$669	$654	$649	$840	$819	$1,034	$1,009	$986	$943
Total Liabilities	$1,792	$1,865	$1,956	$2,455	$2,774	$3,028	$3,218	$3,321	$2,192
Accounts Payable	$50	$47	$58	$78	$80	$93	$93	$99	$86
Long-Term Debt	$1,476	$1,574	$1,612	$2,086	$2,412	$2,576	$2,744	$2,742	$2,912
Shareholder's Equity	$1,047	$1,024	$1,046	$1,007	$975	$1,199	$1,041	$997	$913
D/E Ratio	1.41	1.54	1.54	2.07	2.47	2.15	2.64	2.75	3.19

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	4.6%	4.0%	4.9%	4.3%	4.1%	3.7%	3.4%	3.9%	2.6%
Return on Equity	13.0%	11.1%	13.9%	13.6%	15.0%	13.5%	13.0%	16.4%	11.8%
ROIC	5.2%	4.5%	5.5%	4.8%	4.6%	4.1%	3.8%	4.4%	3.0%
Shares Out.	91.9	107.4	108.8	111.0	111.5	120.8	120.7	119.3	119.9
Revenue/Share	$16.09	$14.17	$15.55	$16.61	$19.55	$18.73	$19.31	$20.77	$19.59
FCF/Share	$1.71	$0.69	$0.81	$0.22	-$0.98	$1.93	$0.65	$1.85	$2.78

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