



Apr 05, 2022

## The GEO Group

General

### What Can End of Title 42 Mean?

**GEO**

NYSE

Rating

**Outperform**

Unchanged

**Title 42 to End?** The Biden Administration has stated the enforcement of Title 42 to expel immigrants will end May 23rd. First authorized in March 2020 during the COVID crisis, Title 42 continued to be enforced by the Biden Administration over the past year as a key tool to stop the spread of the virus in border facilities, but with the decline in COVID cases, the Administration will end the use of Title 42.

Current Price

**\$6.72**

Target Price

**\$15.00**

**Poised for a Surge?** In the first five months of the government fiscal year, monthly Southwest border encounters are averaging nearly 170,000 and are on pace to top two million for the year. Some reports suggest the number of people crossing once the restriction is lifted could triple to 18,000 per day, or more than double the current monthly encounter amount.

Market Capitalization

**824.97M**

**But Are We Ready?** Unfortunately, it appears the answer remains to be seen. While the Federal government suggests there will be a “comprehensive, whole-of-government” approach to lifting Title 42, many local elected and border officials have been quoted as saying they are in the dark about what to do, with some accusing the Biden administration of having “no plan.”

Shares Outstanding

**122.76M**

Float

**63.74M**

**What Can It Mean for GEO?** The ending of Title 42 should result in a significant need for detention facilities, especially if projections about a border surge prove accurate. With significant unused capacity, such a surge could result in a significant increase in revenue and EBITDA for GEO, although it remains to be seen if the Administration will employ the private sector solution to assist in managing this potential crisis.

Institutional Holdings

**75.3%**

12-Month Low/High

**\$4.96/\$11.00**

**Favorable Risk/Reward.** We continue to believe GEO shares represent a favorable risk/reward situation. We are maintaining our Outperform rating and a \$15 per share 12-month price target. While COVID and the political rhetoric remain headwinds, there are limited alternatives to GEO's services and we believe the Company's real estate assets and high quality contracts eventually will be properly valued.

Average 90-Day Volume

**2764778**

Fiscal Year End

**12/31/2021**

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#### Revenues (\$ MIL)

Period	2021A	2022E	2023E
Q1	576.4A	550E	
Q2	565.4A	545E	
Q3	557.2A	540E	
Q4	557.5A	530E	
	2,256.6A	2,165E	2,150.0E

#### EPS (\$)

Period	2021A	2022E	2023E
Q1	0.41A	0.20E	
Q2	0.35A	0.29E	
Q3	0.29A	0.28E	
Q4	(0.41)A	0.26E	
	0.58A	1.03E	1.14E

## So What Could Ending Title 42 Mean for The GEO Group?

In theory, the ending of Title 42 would result in an increased number of immigrants being processed through the system and through facilities, such as those owned and operated by GEO. In reality, it is unknown if the government will make use of the one significant option for processing the expected surge in immigrants or if the government will, instead, provide a cursory processing of immigrants and then send them on their way to await hearings.

What we can say is that GEO has the ability and capacity to support the government's efforts to manage any surge. At the end of December 2021, the Company had 10,222 beds at facilities that were currently vacant. GEO does not provide occupancy levels at specific facilities but we believe the Company would have additional available beds at existing facilities that currently serve ICE. Now, the Federal government continues to limit occupancy levels, so it is unlikely any facility would hit 100% occupancy. In addition, at existing facilities, at year-end GEO remained under the minimum guarantee for many facilities so adding more populations to these facilities would not necessarily result in an improvement in revenue.

If we just focused on the currently idled facilities and used 2021 secure owned and operated facilities average revenue per compensated man day, which was \$102.80, the 10,222 available beds could bring in approximately \$380 million of new revenue over the course of a year at 100% capacity. Applying the full year operating income percentage for the secure owned and operated segment of 30% to the \$380 million of revenue suggests an operating income contribution of \$114 million. As a reference point, we are projecting operating income for the entire Company for 2022 of \$271 million.

So, while it is too early to accurately state what the impact of ending Title 42 could have on GEO, the potential is there for a significant improvement in revenue and operating income for the Company.

## Company Profile

Founded in 1984, The GEO Group specializes in the ownership, leasing and management of secure facilities, processing centers, and reentry facilities and the provision of community-based services in the United States, Australia, South Africa and the United Kingdom. GEO owns, leases and operates a broad range of secure facilities including maximum, medium and minimum security facilities, processing centers, as well as community-based reentry facilities. As of December 31, 2020, the Company's worldwide operations included the management and/or ownership of approximately 93,000 beds at 118 secure and community-based facilities, including idle facilities and projects under development.

In addition to owning and operating secure and community facilities, GEO provides innovative compliance technologies, industry-leading monitoring services, and evidence-based supervision and treatment programs for community-based parolees, probationers and pretrial defendants. The Company's GEO Cares business also provides secure transportation services for offender and detainee populations as contracted domestically and in the United Kingdom through joint venture GEO Amey PECS Ltd. As of March 31, 2020, GEO oversees the provision of community supervision services for more than 210,000 offenders and pretrial defendants, including approximately 100,000 individuals through an array of technology products including radio frequency, GPS, and alcohol monitoring devices.

Finally, The GEO Group develops new facilities based on contract awards, using its project development expertise and experience to design, construct and finance what are state-of-the-art facilities that maximize security and efficiency.

For the year ended December 31, 2020, The GEO Group generated approximately 67% of revenues from its U.S. Secure Services business, 23% from its GEO Care segment, and 10% of revenue from its International Services segment.

## Fundamental Analysis: 3.5/5.0 checks

We give The GEO Group 3.5 checks out of 5.0, which falls within our "Above Average" range of 3.5 to 4.0 checks. We give the Company high marks for its Corporate Governance and Management. Officers and Directors, lead by CEO Zoley, hold a significant ownership position in the Company. The Company holds annual election of all directors. In addition, there are ownership guidelines for senior management and directors, many of whom have enjoyed long careers in the corrections industry. We view GEO's Competitive position favorably, as the Company holds a leading position in the private prison industry, is a leading company in residential reentry markets, and has a growing presence in the alternative incarceration market. We view the Company's Market Opportunity as mixed, with declining inmate populations and shifting political views as significant potential negatives, although aging government infrastructure could result in continued demand for the Company's services. And while we believe the Company will continue to generate sufficient cash flows to handle its debt load, the pullback by financial institutions to help finance the private prison industry is a negative. We view the Company's Operating Leverage as Average. While existing idled facilities could generate increases in operating income, government contracts can be cancelled or not renewed which could negatively impact operating leverage.

## Valuation Summary

We are maintaining our Outperform rating and a \$15 per share 12-month price target. At our \$15 price target, GEO shares would trade at 9.1x our projected 2022 FFO, 7.0x our 2022 AFFO estimate, and 9.1x on an EV/EBITDA basis. This compares to an overall REIT average of 25.3x 2022 FFO, according to NAREIT.

We also look at GEO stock from a property valuation perspective. The cost to build prison and detention facilities increases annually. Government at all levels face either a shortage of available facilities, old and outdated facilities, or a combination of both. One potential outcome of the private prison debate could be a government takeover of the existing private beds. In the table below, we provide a matrix of the valuation of GEO shares based on the cost of a bed, the current net value (after subtracting current outstanding debt) to GEO, and what the value per GEO share is if the government acquired the assets at either a 25% discount or 50% discount. For example, if the value of a prison bed was \$100,000, GEO's 47,000 owned beds would be worth some \$4.7 billion, or \$2.6 billion after subtracting outstanding debt. This equates to a value per GEO share of

\$21.28, well above the current market price of the common shares. If the government were to acquire the beds at 75% of fair value, then GEO's shares would be valued at approximately \$11.54, still above the current market price of the shares. If the government were to pay only 50% of value, then the per share value to GEO would be just \$1.68, below the current trading price. A key illustration in the table, in our view, is that at the vast majority of levels, The GEO Group's beds are worth more than the current trading level of the shares. And, not included in the valuation is the significant domestic managed only secure business, the Community segment, and the growing electronic monitoring business, nor the International segment.

### Safety Segment Property Valuation Matrix

(Value \$ in millions, except per share)

Owned Beds	Cost to Build/Bed	Gross Value	Net Value	Value/Share	Value at 25% Discount	Net Value	Value/Share	Value at 50% Discount	Net Value	Value/Share
47,000	\$50,000	\$2,350	\$201	\$1.68	\$1,763	-\$387	-\$3.24	\$1,175	-\$974	-\$8.12
47,000	\$75,000	\$3,525	\$1,376	<b>\$11.48</b>	\$2,644	\$495	\$4.15	\$1,763	-\$387	-\$3.22
47,000	\$100,000	\$4,700	\$2,551	<b>\$21.28</b>	\$3,525	\$1,376	<b>\$11.54</b>	\$2,350	\$201	\$1.68
47,000	\$125,000	\$5,875	\$3,726	<b>\$31.08</b>	\$4,406	\$2,257	<b>\$18.94</b>	\$2,938	\$789	\$6.58
47,000	\$150,000	\$7,050	\$4,901	<b>\$40.88</b>	\$5,288	\$3,139	<b>\$26.33</b>	\$3,525	\$1,376	<b>\$11.48</b>
47,000	\$200,000	\$9,400	\$7,251	<b>\$60.48</b>	\$7,050	\$4,901	<b>\$41.12</b>	\$4,700	\$2,551	<b>\$21.28</b>
47,000	\$250,000	\$11,750	\$9,601	<b>\$80.08</b>	\$8,813	\$6,664	<b>\$55.90</b>	\$5,875	\$3,726	<b>\$31.08</b>
47,000	\$300,000	\$14,100	\$11,951	<b>\$99.67</b>	\$10,575	\$8,426	<b>\$70.69</b>	\$7,050	\$4,901	<b>\$40.88</b>

Source: Company reports and Noble estimates

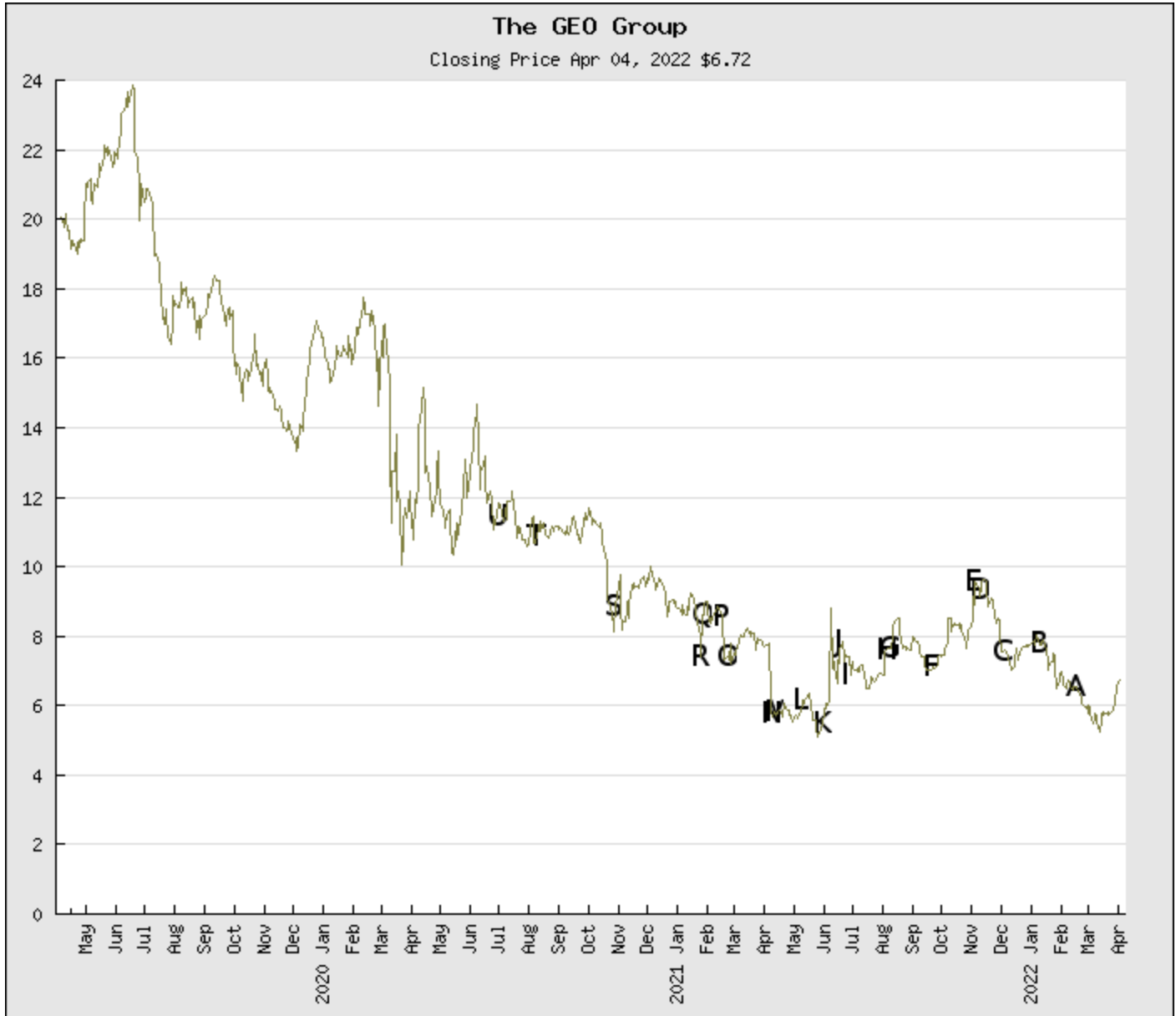
Gross Value = Number of beds multiplied by cost to build a bed

Net Value = Gross value minus net outstanding recourse debt at 6/30/2021

Value/GEO Share = Net Value divided by 119.9 million fully diluted shares

#### Investment Risks Include:

- Declining inmate populations. Since peaking in 2009, inmate populations have been declining due to changing laws. Continued declines in inmate populations could negatively impact GEO's operations.
- Political risk. The Biden Administration has taken steps to eliminate contracts with for profit prisons. GEO's business is dependent on government appropriations.
- Concentrated government customer base. In 2021, ICE, the USMS, and the BOP accounted for 49.5% of total revenues, with ICE accounting for 25.2% of total revenue. Any declines in these customers, could negatively impact financial results.
- More limited access to capital. Due to political pressure, certain banks have declined to do business with for profit prison operators which could make raising additional capital more difficult.
- Past and/or future acquisitions may not be successful.



A - 02/18/2022	Outperform	Target \$15.00	Current \$6.54	B - 01/11/2022	Outperform	Target \$15.00	Current \$7.79
C - 12/03/2021	Outperform	Target \$15.00	Current \$7.56	D - 11/09/2021	Outperform	Target \$15.00	Current \$9.35
E - 11/05/2021	Outperform	Target \$15.00	Current \$9.56	F - 09/23/2021	Outperform	Target \$15.00	Current \$7.11
G - 08/09/2021	Outperform	Target \$15.00	Current \$7.67	H - 08/05/2021	Outperform	Target \$15.00	Current \$7.62
I - 06/29/2021	Outperform	Target \$15.00	Current \$6.90	J - 06/21/2021	Outperform	Target \$15.00	Current \$7.82
K - 06/01/2021	Outperform	Target \$15.00	Current \$5.46	L - 05/11/2021	Outperform	Target \$15.00	Current \$6.16
M - 04/12/2021	Outperform	Target \$15.00	Current \$5.83	N - 04/08/2021	Outperform	Target \$15.00	Current \$5.77
O - 02/22/2021	Outperform	Target \$15.00	Current \$7.39	P - 02/17/2021	Outperform	Target \$15.00	Current \$8.58
Q - 01/27/2021	Outperform	Target \$15.00	Current \$8.62	R - 01/26/2021	Outperform	Target \$15.00	Current \$7.41
S - 10/30/2020	Outperform	Target \$15.00	Current \$8.86	T - 08/10/2020	Outperform	Target \$15.00	Current \$10.89
U - 06/29/2020	Outperform	Target \$15.00	Current \$11.45				

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Attribute	Weighting
Corporate Governance/Management	20%
Market Opportunity Analysis	20%
Competitive Position	20%
Operating Leverage	20%
Financial Leverage	20%

For each attribute, the analysts score the company from a low of zero to a high of ten based upon the analysis described below. The final rating and resulting check marks is a result of dividing the overall score (out of 100%) by ten.

Rating	Score	Checks
Superior	9.1 to 10	Five Checks
Superior	8.1 to 9	Four & A Half Checks
Above Average	7.1 to 8	Four Checks
Above Average	6.1 to 7	Three & A Half Checks
Average	5.1 to 6	Three Checks
Average	4 to 5	Two & A Half Checks
Below Average	3 to 3.9	Two Checks
Below Average	2 to 2.9	One & A Half Checks
Low Quality	0 to 1.9	One Check

While these are the attributes currently used for the analyst's fundamental analysis, the attributes and weighting may be reviewed, updated with additional attributes, and/or changed in the future based on discussions with the analysts and recommendations from the Director of Research.

Following is the description of each attribute in the fundamental analysis.

### Corporate Governance/Management

We believe that a review of corporate governance and assessment of the senior management are important tools to determine investment merit. Good corporate governance aligns management with the interests of stakeholders. As such, analysts are to rank the company on the basis of good corporate governance principles that may include rules and procedures, board composition and staggered term limits, rights and responsibilities, corporate objectives, monitoring of actions and policies, and accountability. In addition, analysts will assess issues with controlling shareholders and whether decisions have been made in the past that were in the interests of all shareholders. In addition, management will be assessed based on industry experience, expertise, and/or track record.

High ranking example: Board and management that is aligned with the interests of shareholders with incentives based on stock price appreciation and with an experienced management team known for exceptional shareholder returns.

Low ranking example: Concentrated ownership without independent directors that do not necessarily align with all shareholders' interests.

### The Market Opportunity Analysis

In this review, the analyst assesses the company's macro environment as a measure of understanding the industry. Factors considered include the size and growth potential of the industry under various economic conditions, the emerging demands in the market, technological benefits/disruptions, competition, geographical opportunities, and customer demands/needs, and an assessment of supply and distribution channels. In addition, the analyst will review legal and regulatory trends, as well as potential shifts in consumer or social behavior and natural environment changes.

High rank example: A company in an industry that is growing revenues well above GDP rates (which are on average 2% plus) and/or may have unmet or underserved needs in a rapidly growing market opportunity.

Low rank example: A mature industry that is in secular decline and likely to grow below GDP rates.

### Competitive Position

The evaluation of the company's competitive position is another macro environment attribute designed to measure the relevance, market share, position and value proposition, and sustainable differentiations of the company and its products/services within its industry. Ease of entry into the industry and the ability of other well-funded players to potentially enter the market would be determined. As such, the assessment would consider the company's strengths and advantages of its products/services against weaknesses and limitations. This may include the company's current brand awareness, pricing and cost structure, current market strategies and geographic penetration that may affect demand for its products/services. In addition, the company's competitors would be evaluated.

High rank example: An analyst would consider the company's product to be superior to its competitors and that should allow the company to gain market share.

Low rank example: A company with a "me-too" product that does not have any significant technology advantages in an industry that has low barriers to entry.

### Operating Leverage

Simplistically, operating leverage is determined by the operating income relative to changes in revenue. The analyst will calculate the impact on sensitivity on gross margins and variable costs to determine operating leverage. The analyst will take into account the ability of the company to cut fixed and variable costs in a challenged revenue environment and technological changes that may impact operating expenses. In addition, the analyst is to assess corporate strategies that include capital investment, which may be required for sustainable revenue growth, marketing expenses, and the company's ability to attract and retain talent and/or employees. The analyst should focus on the revenue opportunity and determine the price elasticity of demand for the company's products or services. In other words, the analyst is to rank the company based on improved operating margins going forward on an absolute and relative basis.

High rank example: A company that has improving margins for the foreseeable future, with significant price elasticity.

Low rank example: A company that is in a challenged revenue environment with a fixed cost structure and limited ability to cut costs, indicating an outlook for declining margins.

### Financial Leverage

A strict definition of financial leverage is total debt divided by total shareholder's equity. Financial leverage analysis is to determine the company's ability to improve shareholder value by means of utilizing its balance sheet to grow organically or to acquire assets. Analysts may look at the company's debt to cash flow leverage ratio, interest coverage ratios, or debt to equity ratios. In addition, the interest rate environment and the outlook for interest rates are a factor in determining the company's ability to manage financial leverage. Finally, the analyst is expected to determine the ability to service the debt given the industry and/or company profile, such as cyclical, barriers to entry, history of bankruptcy, consistency in revenue and profit growth, or predictability in sales and profits and large cash reserves. The analyst is expected to take into account capital intensity of the company and the anticipated of capital allocation decisions.

High rank example: A company with predictable and growing revenue and cash flow with modest debt levels. This may indicate that the company could improve shareholder value through growth investments, including acquisitions, using debt financing.

Low rank example: A company in a cyclical industry in a late stage economic cycle that has above average debt leverage and is in an industry that has a history of financial challenges, including bankruptcies.

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Outperform: potential return is >15% above the current price	95%	28%
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Underperform: potential return is >15% below the current price	1%	0%

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