GEO GROUP INC
Form 10-Q
November 12, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended October 3, 2010

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from to

Commission file number 1-14260

The GEO Group, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Florida (State or Other Jurisdiction of Incorporation or Organization)	65-0043078 (IRS Employer Identification No.)
One Park Place, 621 NW 53rd Street, Suite 700, Boca Raton, Florida (Address of Principal Executive Offices)	33487 (Zip Code)

(561) 893-0101
(Registrant s Telephone Number, Including Area Code)
(Former Name, Former Address and Former Fiscal Year if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

At November 5, 2010, 64,447,534 shares of the registrant s common stock were issued and outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE GEO GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME
FOR THE THIRTEEN AND THIRTY-NINE WEEKS ENDED OCTOBER 3, 2010 AND SEPTEMBER 27, 2009
(In thousands, except per share data)
(UNAUDITED)

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009
Revenues	$ 327,933	$ 294,865	$ 895,570	$ 830,305
Operating expenses	251,100	234,347	694,348	655,413
Depreciation and amortization	13,384	9,616	32,096	29,062
General and administrative expenses	33,925	15,685	72,028	49,936
Operating income	29,524	35,217	97,098	95,894
Interest income	1,734	1,224	4,448	3,520
Interest expense	(11,917)	(6,533)	(28,178)	(20,498)
Loss on extinguishment of debt	(7,933)		(7,933)	
Income before income taxes, equity in earnings of affiliate and discontinued operations	11,408	29,908	65,435	78,916
Provision for income taxes	7,547	11,510	28,560	30,374
Equity in earnings of affiliate, net of income tax provision of $449, $352, $1,672 and $936	1,149	904	2,868	2,407
Income from continuing operations	5,010	19,302	39,743	50,949
Loss from discontinued operations, net of tax benefit $216				(346)
Net income	$ 5,010	$ 19,302	$ 39,743	$ 50,603
Net (income) loss attributable to noncontrolling interests	271	(44)	227	(129)
Net income attributable to The GEO Group Inc.	$ 5,281	$ 19,258	$ 39,970	$ 50,474
Weighted-average common shares outstanding:				
Basic	57,799	50,900	52,428	50,800
Diluted	58,198	51,950	53,044	51,847
Income per common share attributable to The GEO Group Inc. (Note 3):				

Basic:								
Income from continuing operations	$	0.09	$	0.38	$	0.76	$	1.00
Income from discontinued operations								(0.01)
Net income per share-basic	$	0.09	$	0.38	$	0.76	$	0.99
Diluted:								
Income from continuing operations	$	0.09	$	0.37	$	0.75	$	0.98
Loss from discontinued operations								(0.01)
Net income per share-diluted	$	0.09	$	0.37	$	0.75	$	0.97
Comprehensive income:								
Net income	$	5,010	$	19,302	$	39,743	$	50,603
Total other comprehensive income, net of tax		5,208		1,858		2,308		8,657
Total comprehensive income		10,218		21,160		42,051		59,260
Comprehensive income (loss) attributable to noncontrolling interests		(214)		77		(185)		129
Comprehensive income attributable to The GEO Group Inc.	$	10,432	$	21,083	$	42,236	$	59,131

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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THE GEO GROUP, INC.
CONSOLIDATED BALANCE SHEETS
OCTOBER 3, 2010 AND JANUARY 3, 2010
(In thousands, except share data)

	October 3, 2010 (Unaudited)	January 3, 2010
ASSETS		
Current Assets		
Cash and cash equivalents	$ 53,766	$ 33,856
Restricted cash and investments (including VIEs[1] of $33,079 and $6,212, respectively)	40,180	13,313
Accounts receivable, less allowance for doubtful accounts of $622 and $429	261,683	200,756
Deferred income tax asset, net	31,195	17,020
Other current assets	21,443	14,689
Total current assets	408,267	279,634
Restricted Cash and Investments (including VIEs of $26,700 and $8,182, respectively)	39,766	20,755
Property and Equipment, Net (including VIEs of $170,986 and $28,282, respectively)	1,498,886	998,560
Assets Held for Sale	4,348	4,348
Direct Finance Lease Receivable	36,835	37,162
Goodwill	244,568	40,090
Intangible Assets, Net	92,342	17,579
Other Non-Current Assets	64,948	49,690
	$ 2,389,960	$ 1,447,818
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 66,799	$ 51,856
Accrued payroll and related taxes	43,690	25,209
Accrued expenses	119,323	80,759
Current portion of capital lease obligations, long-term debt and non-recourse debt (including VIEs of $19,365 and $4,575, respectively)	41,173	19,624
Total current liabilities	270,985	177,448
Deferred Income Tax Liability	51,069	7,060
Other Non-Current Liabilities	50,996	33,142
Capital Lease Obligations	13,888	14,419
Long-Term Debt	802,506	453,860
Non-Recourse Debt (including VIEs of $133,251 and $32,105, respectively)	191,603	96,791
Commitments and Contingencies (Note 12)		

Shareholders Equity				
Preferred stock, $0.01 par value, 30,000,000 shares authorized, none issued or outstanding				
Common stock, $0.01 par value, 90,000,000 shares authorized, 84,256,321 and 67,704,008 issued and 64,416,327 and 51,629,005 outstanding		644		516
Additional paid-in capital		713,296		351,550
Retained earnings		405,047		365,927
Accumulated other comprehensive income		7,762		5,496
Treasury stock 20,074,313 and 16,075,003 shares, at cost, at October 3, 2010 and January 3, 2010		(138,848)		(58,888)
Total shareholders equity attributable to The GEO Group, Inc.		987,901		664,601
Noncontrolling interests		21,012		497
Total shareholders equity		1,008,913		665,098
	$	2,389,960	$	1,447,818

[1] Variable interest entities or VIEs

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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THE GEO GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THIRTY-NINE WEEKS ENDED
OCTOBER 3, 2010 AND SEPTEMBER 27, 2009
(In thousands)
(UNAUDITED)

	Thirty-nine Weeks Ended	
	October 3, 2010	September 27, 2009
Cash Flow from Operating Activities:		
Net Income	$ 39,743	$ 50,603
Net (income) loss attributable to noncontrolling interests	227	(129)
Net income attributable to The Geo Group Inc.	39,970	50,474
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	32,096	29,062
Amortization of debt issuance costs	3,022	3,307
Restricted stock expense	2,529	2,652
Stock option plan expense	1,004	705
Provision for doubtful accounts	140	139
Equity in earnings of affiliates, net of tax	(2,868)	(2,407)
Income tax charge (benefit) of equity compensation	(786)	19
Loss on extinguishment of debt	7,933	
Changes in assets and liabilities, net of acquisition:		
Changes in accounts receivable and other assets	6,620	(21,552)
Changes in accounts payable, accrued expenses and other liabilities	13,944	11,084
Net cash provided by operating activities of continuing operations	103,604	73,483
Net cash provided by operating activities of discontinued operations		5,818
Net cash provided by operating activities	103,604	79,301
Cash Flow from Investing Activities:		
Acquisition, cash consideration	(260,239)	
Just Care purchase price adjustment	(41)	
Proceeds from sale of assets	334	
Increase in restricted cash	(2,070)	(1,426)
Capital expenditures	(68,284)	(113,714)
Net cash used in investing activities	(330,300)	(115,140)
Cash Flow from Financing Activities:		
Payments on long-term debt	(342,460)	(18,486)
Proceeds from long-term debt	673,000	41,000
Termination of interest rate swap agreement		1,719
Payments for purchase of treasury shares	(80,000)	
Payments for retirement of common stock	(7,078)	

Proceeds from the exercise of stock options		5,747		383
Income tax (charge) benefit of equity compensation		786		(19)
Debt issuance costs		(5,750)		(358)
Net cash provided by financing activities		244,245		24,239
Effect of Exchange Rate Changes on Cash and Cash Equivalents		2,361		4,244
Net Increase in Cash and Cash Equivalents		19,910		(7,356)
Cash and Cash Equivalents, beginning of period		33,856		31,655
Cash and Cash Equivalents, end of period	$	53,766	$	24,299
Supplemental Disclosures:				
Non-cash Investing and Financing activities:				
Capital expenditures in accounts payable and accrued expenses	$	8,565	$	20,362
Fair value of assets acquired, net of cash acquired	$	677,432	$	
Acquisition, equity consideration	$	358,076	$	
Total liabilities assumed	$	242,799	$	

The accompanying notes are an integral part of these unaudited consolidated financial statements.

THE GEO GROUP, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The unaudited consolidated financial statements of The GEO Group, Inc., a Florida corporation (the Company , or GEO), included in this Quarterly Report on Form 10-Q have been prepared in accordance with accounting principles generally accepted in the United States and the instructions to Form 10-Q and consequently do not include all disclosures required by Form 10-K. Additional information may be obtained by referring to the Company s Annual Report on Form 10-K for the year ended January 3, 2010. In the opinion of management, all adjustments (consisting only of normal recurring items) necessary for a fair presentation of the financial information for the interim periods reported in this Quarterly Report on Form 10-Q have been made. Results of operations for the thirty-nine weeks ended October 3, 2010 are not necessarily indicative of the results for the entire fiscal year ending January 2, 2011.

On April 18, 2010, the Company, the Company s wholly-owned subsidiary, GEO Acquisition III, Inc., and Cornell Companies Inc., (Cornell), entered into a definitive merger agreement, as amended on July 22, 2010, pursuant to which the Company acquired Cornell for stock and cash (the Merger). The Company completed the acquisition of Cornell, on August 12, 2010. Cornell is a Houston-based provider of correctional, detention, educational, rehabilitation and treatment services outsourced by federal, state, county and local government agencies for adults and juveniles. As a result of the Merger with Cornell, the Company s worldwide operations include the management and/or ownership of approximately 79,000 beds at 116 correctional, detention and residential treatment facilities including projects under development. Refer to Note 2.

Consolidation

The accompanying consolidated financial statements include the accounts of the Company, our wholly-owned subsidiaries, and the Company s activities relative to the financing of operating facilities (the Company s variable interest entities are discussed further in Note 10). All significant intercompany balances and transactions have been eliminated. Noncontrolling interests in consolidated entities represent equity that other investors have contributed to Municipal Corrections Finance L.P. (MCF) and the noncontrolling interest in South African Custodial Management Pty. Limited (SACM). Non-controlling interests are adjusted for income and losses allocable to the other shareholders in these entities.

Reclassifications

The Company s noncontrolling interest in SACM has been reclassified from operating expenses to noncontrolling interest in the consolidated statements of income as this item has become more significant due to the noncontrolling interest in MCF acquired from Cornell in the Merger. Also, as a result of the acquisition of Cornell, management s review of certain segment financial data was revised with regard to the Bronx Community Re-entry Center and Brooklyn Community Re-entry Center. These facilities now report within the GEO Care segment and are no longer included with U.S. corrections. The segment data has been revised for all periods presented. All prior year amounts have been conformed to the current year presentation.

Discontinued operations

The termination of any of the Company s management contracts, by expiration or otherwise, may result in the classification of the operating results of such management contract, net of taxes, as a discontinued operation. The Company reflects such events as discontinued operations so long as the financial results can be clearly identified, the operations and cash flows are completely eliminated from ongoing operations, and so long as the Company does not have any significant continuing involvement in the operations of the component after the disposal or termination transaction. The component unit for which cash flows are considered to be completely eliminated exists at the customer level. Historically, the Company has classified operations as discontinued in the period they are announced as normally all continuing cash flows cease within three to six months of that date. The Company has classified the results of operations of its terminated management contracts at certain domestic facilities as discontinued operations for the thirty-nine weeks ended September 27, 2009. There were no continuing cash flows from these operations in the thirteen weeks ended October 3, 2010 or September 27, 2009 or for the thirty-nine weeks ended October 3, 2010, and as such, there are no amounts reclassified to discontinued operations for those periods.

Changes in Estimates

The Company periodically performs assessments of the useful lives of its assets. In evaluating useful lives, the Company considers how long assets will remain functionally efficient and effective, given competitive factors, economic environment, technological

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advancements and quality of construction. If the assessment indicates that assets can and will be used for a longer or shorter period than previously anticipated, the useful lives of the assets are revised, resulting in a change in estimate. Changes in estimates are accounted for on a prospective basis by depreciating the assets current carrying values over their revised remaining useful lives.

During the first quarter of 2010, the Company completed a depreciation study on its owned correctional facilities. Based on the results of the depreciation study, the Company revised the estimated useful lives of certain buildings from its historical estimate of 40 years to a revised estimate of 50 years, effective January 4, 2010. The basis for the change in the useful life of the Company s owned correctional facilities is due to the expectation that these facilities are capable of being used for a longer period than previously anticipated based on quality of construction and effective building maintenance. The Company accounted for the change in the useful lives as a change in estimate which is accounted for prospectively beginning January 4, 2010. For the thirteen weeks ended October 3, 2010, the change resulted in a reduction in depreciation and amortization expense of $0.9 million, an increase to net income of $0.6 million and an increase in diluted earnings per share of $0.01. For the thirty-nine weeks ended October 3, 2010, the change resulted in a reduction in depreciation and amortization expense of $2.7 million, an increase to net income of $1.7 million and an increase in diluted earnings per share of $0.03.

Except as discussed above, the accounting policies followed for quarterly financial reporting are the same as those disclosed in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 22, 2010 for the fiscal year ended January 3, 2010.

2. BUSINESS COMBINATION

Purchase price allocation

Under the terms of the merger agreement, the Company acquired 100% of the outstanding common stock of Cornell for aggregate consideration of $618.3 million, excluding cash acquired of $12.9 million and including: (i) cash payments for Cornell s outstanding common stock of $84.9 million, (ii) payments made on behalf of Cornell related to Cornell s transaction costs accrued prior to the Merger of $6.4 million, (iii) cash payments for the settlement of certain of Cornell s debt plus accrued interest of $181.9 million using proceeds from the Company s Credit Agreement (Refer to Note 11), (iv) common stock consideration of $357.8 million, and (v) the fair value of replacement stock option replacement awards of $0.2 million. The value of the equity consideration was based on the closing price of the Company s stock on August 12, 2010 of $22.70.

GEO is identified as the acquiring company for US GAAP accounting purposes. Under the purchase method of accounting, the aggregate purchase price is allocated to Cornell s net tangible and intangible assets based on their estimated fair values as of August 12, 2010, the date of closing and the date that GEO obtained control over Cornell. In order to determine the fair values of a significant portion of the assets acquired and liabilities assumed, the Company engaged third party independent valuation specialists. The preliminary work performed by the third party independent valuation specialists has been considered in management s estimates of certain of the fair values reflected in the purchase price allocation below. For any other assets acquired and liabilities assumed for which the Company is not considering the work of third party independent valuation specialists, the fair value determined by the Company s management represents the price management believes would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. For long term assets, liabilities and the noncontrolling interest in MCF for which there was no active market price available for valuation, the Company used Level 3 inputs to estimate the fair market value.

The allocation of the purchase price for this transaction at August 12, 2010 is preliminary. The Company is in the process of obtaining the information necessary to complete its purchase price allocation. The Company has evaluated and continues to evaluate pre-acquisition contingencies related to Cornell that may have existed at the acquisition date of August 12, 2010. If these pre-acquisition contingencies become probable in nature and estimable before the end of the purchase price allocation period, amounts will be recorded to adjust the acquisition goodwill value for such matters as of the acquisition date of August 12, 2010. If these contingencies become probable in nature and estimable after the end of the purchase price allocation period, amounts will be recorded for such matters in the Company s results of operations. The purchase price was allocated to the fair value of the assets and liabilities as of August 12, 2010 as follows (in 000 s):

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		Purchase price allocation
Accounts receivable	$	57,761
Prepaid and other current assets		13,176
Deferred tax asset		10,934
Restricted assets		43,183
Property, plant and equipment		462,797
Intangible assets		77,600
Out of market lease assets		472
Other long-term assets		11,509
Total assets acquired	$	677,432
Accounts payable and accrued expenses		(53,646)
Fair value of non-recourse debt		(120,943)
Out of market lease liabilities		(24,071)
Deferred tax liability		(44,009)
Other long-term liabilities		(130)
Total liabilities assumed		(242,799)
Total identifiable net assets		434,633
Goodwill		204,382
Fair value of Cornell s net assets		639,015
Noncontrolling interest		(20,700)
Total consideration for Cornell, net of cash acquired	$	618,315

As shown above, the Company recorded $204.4 million of goodwill related to the purchase of Cornell. The strategic benefits of the Merger include the combined Company s increased scale and the diversification of service offerings. These factors contributed to the goodwill that was recorded upon consumation of the transaction. Of the goodwill recorded in relation to the Merger, only $1.5 million of goodwill resulting from a previous Cornell acquisition is deductible for federal income tax purposes; the remainder of goodwill is not deductible. Identifiable intangible assets purchased in the acquisition and their weighted average amortization periods in total and by major intangible asset class, as applicable, are included in the table below (in thousands):

	Weighted average amortization period		Fair value as of August 12, 2010
Goodwill	n/a		204,382
Identifiable intangible assets			
Facility Management contracts	12.5	$	70,100
Non compete agreements	1.7		5,700
Trade names	indefinite		1,800

Total identifiable intangible assets	$	77,600

As of October 3, 2010 the weighted average period before the next contract renewal for acquired contracts classified as U.S. corrections was 7.33 years and for GEO Care was 1.3 years.
The following table sets forth amortization expense for each of the five succeeding years related to the acquired facility management contracts:

Fiscal Year	**U.S corrections**	**GEO Care**	**Total**
2010	$ 738	$ 667	$ 1,405
2011	2,950	2,669	5,619
2012	2,950	2,669	5,619
2013	2,950	2,669	5,619
2014	2,950	2,669	5,619
2015	2,950	2,669	5,619
Thereafter	20,253	20,995	41,248
Net carrying value as of October 3, 2010	$ 35,003	$ 34,341	$ 69,344

Pro forma financial information
The results of operations of Cornell are included in the Company s results of operations beginning after August 12, 2010. The following unaudited pro forma information for 2010 combines the consolidated results of operations of the Company and Cornell as if the acquisition had occurred at the beginning of fiscal year 2010 and the unaudited pro forma information for 2009 combines the consolidated results of operations of the Company and Cornell as if the acquisition had occurred at the beginning of fiscal year 2009. The pro forma amounts are included for comparative purposes and may not necessarily reflect the results of operations that would have resulted had the acquisition been completed at the beginning of the applicable period and may not be indicative of the results that will be attained in the future (in thousands, except per share data):

	Thirteen weeks ended		Thirty-nine weeks ended	
	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009
Revenues	$373,001	$ 398,571	$1,145,511	$ 1,139,909
Net income (loss)	(8,143)	9,361	32,464	47,099
Net income (loss) attributable to The GEO Group Inc., shareholders	(8,352)	8,972	30,172	46,033
Net income (loss) per share basic	$ (0.14)	$ 0.13	$ 0.58	$ 0.69
Net income (loss) per share diluted	$ (0.14)	$ 0.13	$ 0.57	$ 0.68

The Company has included $53.6 million in revenue and $4.5 million in net income in its consolidated statement of income for the thirteen and thirty-nine weeks ended October 3, 2010 related to Cornell activity since August 12, 2010, the date of acquisition.

During the second and third fiscal quarters of 2010, the Company incurred $2.1 million and $13.5 million, respectively in non-recurring direct transaction related expenses which are recorded as operating expenses in the Company s consolidated statements of income. Also included in operating expenses is $0.5 million for retention bonuses paid to Cornell employees as compensation for services performed after the acquisition date.

3. SHAREHOLDERS EQUITY

Stock repurchases

On February 22, 2010, the Company announced that its Board of Directors approved a stock repurchase program for up to $80.0 million of the Company s common stock effective through March 31, 2011. The stock repurchase program is implemented through purchases made from time to time in the open market or in privately negotiated transactions, in accordance with applicable Securities and Exchange Commission requirements. The program may also include repurchases from time to time from executive officers or directors of vested restricted stock and/or vested stock options. During the thirteen and thirty-nine weeks ended October 3, 2010, the Company purchased 0.1 million and 4.0 million shares of its common stock, respectively, at an aggregate cost of $2.7 million and $80.0 million, respectively, using cash on hand and cash flow from operating activities. As a result, the Company has completed repurchases of shares of its common stock under the share repurchase program approved in February 2010. Included in the shares repurchased for the thirty-nine weeks ended October 3, 2010 were 1,055,180 shares repurchased from executive officers at an aggregate cost of $22.3 million.

Noncontrolling interests

Upon acquisition of Cornell, the Company assumed MCF as a variable interest entity and allocated a portion of the purchase price to the noncontrolling interest based on the estimated fair value of MCF as of August 12, 2010. The noncontrolling interest in MCF represents 100% of the equity in MCF which was contributed by its partners at inception in 2001. The Company includes the results of operations and financial position of MCF, its variable interest entity, in its consolidated financial statements. MCF owns eleven facilities which it leases to the Company.

The Company includes the results of operations and financial position of South African Custodial Management Pty. Limited (SACM or the joint venture), its majority-owned subsidiary, in its consolidated financial statements. SACM was established in 2001 to operate correctional centers in South Africa. The joint venture currently provides security and other management services for the Kutama Sinthumule Correctional Centre in the Republic of South Africa under a 25-year management contract which commenced in February 2002. The Company s and the second joint venture partner s shares in the profits of the joint venture are 88.75% and 11.75%, respectively. There were no changes in the Co