

WCN - Waste Connections, Inc. Q1 2019 Earnings Call
Thursday, April 25, 2019
8:30 a.m. EST

Officers and Speakers

Worthing Jackman; President

Mary Anne Whitney; Senior Vice President & Chief Financial Officer

Analysts

Michael Hoffman; Stifel, Nicolaus

Hamzah Mazari; Macquarie Capital

Brian Maguire; Goldman Sachs

Tyler Brown, Raymond James & Associates

Derek Spronck; RBC Capital Markets

Mark Neville; Scotiabank

Sean Eastman; KeyBanc Capital Markets

Chris Murray; AltaCorp Capital

Noah Kaye; Oppenheimer & Co

Presentation

Operator: Greetings, and welcome to the Waste Connections First Quarter 2019 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded Thursday, April 25, 2019.

I would now like to turn the conference over to Worthing Jackman, President. Please go ahead.

Worthing Jackman: Okay. Thank you, Melissa, and good morning, everyone.

I'd like to welcome everyone to this conference call to discuss our first quarter 2019 results and provide a detailed outlook for the second quarter. I'm joined this morning by Mary Anne Whitney, our CFO, and other members of our senior management team. Our CEO, Ron Mittelstaedt, remains on a leave of absence and is not able to join us today.

As noted in our earnings release, we are extremely pleased with the strong start to the year, which, along with the expected sequential improvement in volumes and recently completed acquisitions, positions us well for the remainder of 2019. Continuing strength in solid waste price growth once again drove underlying margin expansion and better-than-expected financial results in the quarter, enabling us to overcome weather-related impacts across multiple markets and further declines in recycled commodity values.

Adjusted free cash flow of almost 20% of revenue in the quarter puts us solidly on track to achieve our full year outlook of \$950 million. In addition, year-to-date we've signed or closed acquisitions with total annualized revenue of approximately \$100 million, putting us on pace to potentially deliver another outsized year of acquisition activity.

Before we get into much more detail, let me turn the call over to Mary Anne Whitney for our forward-looking disclaimer and other housekeeping items.

Mary Anne Whitney: Thank you, Worthing, and good morning.

The discussion during today's call includes forward-looking statements made pursuant to the Safe Harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995, including forward-looking information within the meaning of applicable Canadian securities laws.

Actual results could differ materially from those made in such forward-looking statements due to various risks and uncertainties. Factors that could cause actual results to differ are discussed both in the cautionary statement on Page 2 of our April 24 earnings release and in greater detail in Waste Connections' filings with the U.S. Securities and Exchange Commission and the securities commissions or similar regulatory authorities in Canada.

You should not place undue reliance on forward-looking statements and information as there may be additional risks to which we are not presently aware or that we currently believe are immaterial, which could have an adverse impact on our business. We make no commitment to revise or update any forward-looking statements and information in order to reflect events or circumstances that may change after today's date.

On the call, we will discuss non-GAAP measures such as adjusted EBITDA, adjusted net income attributable to Waste Connections on both a dollar basis and per diluted share, and adjusted free cash flow. Please refer to our earnings releases for a reconciliation of such non-GAAP measures to the most comparable GAAP measure. Management uses certain non-GAAP measures to evaluate and monitor the ongoing financial performance of our operations. Other companies may calculate these non-GAAP measures differently.

I will now turn the call back over to Worthing.

Worthing Jackman: Thank you, Mary Anne.

In the first quarter, solid waste price plus volume growth was 4%, in line with our guidance. That said, total price of 5.2% exceeded the high end of our outlook for the quarter and was our highest reported price in over 10 years, up 90 basis points year-over-year reflecting the impact of the additional price increases we implemented in mid-2018 in response to accelerating cost pressures and lower recycled commodity values.

Moreover, the total price was up 40 basis points sequentially from Q4 2018. As we've noted in our recent quarters, our pricing strength reflects the differentiation of our market model and intense focus on execution and accountability. In Q1, our pricing ranged from approximately 3 1/2% in our more exclusive markets in the Western region to an average of over 5 1/2% in our more competitive regions.

Reported volume growth in Q1 was negative 1.2%, slightly lower than expected due to an

estimated 50 basis points impact to volume growth from harsh winter weather conditions. Persistent and severe weather-related impacts in several markets resulted in facility closures and delayed special waste projects in certain markets, most notably in our Central region, which includes Minnesota, Illinois and Colorado, among the states hardest hit by prolonged, severe winter weather.

As expected, about 50 points of negative volume was due to purposeful shedding of poor quality revenue, primarily the impact of the New York City Department of Sanitation marine terminal operations contract for the third party. As noted on prior calls, we expect to fully anniversary the impact of shedding later this year.

As a result, we estimate that underlying volumes were about flat in the period, and the quarter ended with improving trends as special waste jobs and other activity picked up with improving weather in many markets. This sets us up for about 150 basis points sequential increase in volumes and positive volume growth on a reported basis in Q2, sooner than we had expected in the year.

Looking at year-over-year results in the first quarter by line of business on a same-store basis, commercial collection revenue increased approximately 5 1/2% mostly due to price increases. Roll-off revenue increased approximately 3% on higher pulls and revenue per day -- revenue per pull. In the U.S., pulls per day increased about 1%, and revenue per pull was up about 4%. In Canada, pulls per day were about flat, but an increase in revenue per pull of about 6 1/2%.

Solid waste landfill tonnage increased about 1% on increases in MSW tons, up about 4%, led by increases in the Northeast and California and C&D tons, up 7% on increases in several markets led by the mid-Atlantic and Colorado. Special waste tons were down about 9% in Q1 on tough comps and weather impacts in several markets as noted earlier, including Minnesota and Colorado.

Recycling revenue excluding acquisitions was about \$17 million in the first quarter, down \$5.5 million, or approximately 25%, which was worse than expected on continued deterioration in pricing for old corrugated containers, or OCC, and mixed paper. OCC prices in Q1 averaged about \$77 per ton, which was down 24% from the year ago period and down 17% from Q4 2018. OCC prices exited the quarter at their lowest levels during the period and have continued to weaken in Q2 as demand from China remains muted and domestic mills are mostly full.

Mixed paper revenue ex-acquisitions declined approximately 65% year-over-year, with values of less than \$0 in many markets, currently averaging around a negative \$7 per ton. We believe that the flow-through from changes in recycling revenue was similar to prior quarters, with decremental margins of approximately 95% due to the combination of lower fiber values and higher recycling processing costs resulting in an impact of over \$5 million in EBITDA and about \$0.015 per share of EPS in Q1.

OCC prices currently average between \$60 and \$65 per ton, down another 15% to 20% from Q1 and down about 30% to 35% from last year's average of \$95 in the second quarter. We see no impetus for improvement in recycled commodity values at this time, which reinforces our

conservative approach to full year guidance back in February.

Looking at E&P waste activity, we reported \$63.1 million of E&P waste revenue in the first quarter, up about 14% year-over-year. In addition to the Permian, which continues to be our largest basin, we are seeing a nice pickup in activity both on and offshore in Louisiana. And in Q1, we commenced operations at our new E&P waste landfill in Wyoming's Powder Basin where we expect that activity to begin to ramp during Q2.

Looking at acquisition activity, year-to-date we've signed or closed acquisitions with total annualized revenue of over \$100 million, including three new market entries in Colorado, Illinois and Iowa and tuck ins in Colorado, Montana, Nebraska, New York and Wyoming. The majority of this activity completed year-to-date closed in April, including Mountain Waste & Recycling, a leading independent provider of solid waste collection in Colorado, which serves over 100,000 customers in the north central mountains and Denver markets. And we also acquired Lewis Clark Recycling & Disposal, an integrated solid waste company with operations in Southern Illinois, Iowa and the greater Omaha area.

These acquisitions, along with a robust pipeline and active dialogue, put us on pace to deliver another outsized year of acquisition activity. Given the strength of our balance sheet and free cash flow generation, we remain well positioned for continued above-average acquisition activity.

Now I'd like to pass the call to Mary Anne to review more in depth the financial highlights of the first quarter and provide a detailed outlook for Q2. I will then wrap up before heading into the Q&A.

Mary Anne Whitney: Thank you, Worthing.

In the first quarter, revenue was \$1.245 billion, about \$5 million above our outlook and up \$104.5 million over the prior year period. Acquisitions completed since the year ago period contributed about \$75.4 million of revenue in the quarter, or about \$69 million net of divestitures.

Adjusted EBITDA for Q1, as reconciled in our earnings release, was \$385.7 million or almost \$3 million above our outlook for the period due to higher than expected revenue and margins. Adjusted EBITDA as a percentage of revenue was 31.0% in Q1, about 10 basis points above our margin outlook in spite of the headwinds of lower recycled commodity values and weather-related impacts as noted earlier and the margin dilutive impact of acquisitions completed since the prior year period.

Excluding the impact of acquisitions and the decline in recycled commodity values, adjusted EBITDA as a percentage of revenue was up approximately 45 basis points year-over-year. Moreover, underlying year-over-year margins increased 80 basis points when further adjusted for the incremental costs associated with our improved 401(k) match and stronger stock market performance in the quarter, which resulted in a 20 basis point increase to deferred compensation costs.

Fuel expense in Q1 was about 3.6% of revenue, and we averaged approximately \$2.66 per gallon for diesel in the quarter, which was down about \$0.02 from the year ago period and up \$0.01 sequentially from Q4 2018.

Depreciation and amortization expense for the first quarter was 14.3% of revenue, up 30 basis points year-over-year due to higher capital expenditures as well as increased amortization expenses associated with acquisitions completed since the year ago period.

Interest expense in the quarter increased \$4.9 million over the prior year period to \$37.3 million due to higher outstanding debt and increased interest rates as compared to the prior year period. Net of interest income from invested cash balances, interest expense increased \$2.8 million year-over-year. Debt outstanding at quarter end was about \$4.2 billion, about 21% of which was floating rate. And our leverage ratio as defined in our credit agreement was about 2.4x debt to EBITDA with cash balances of almost \$500 million.

Since quarter end, we have increased our fixed-to-floating debt ratio to approximately 90% as we completed a public offering of \$500 million of senior notes on April 16 with most of the proceeds directed to floating rate debt repayment. Our current weighted average cost of debt is approximately 3.6%.

Our effective tax rate for the first quarter was 18.2%. The Q1 rate, as expected, included a benefit to the provision related to excess tax benefits associated with equity-based compensation.

Regarding tax rates, we noted on our February call that late in December 2018, the IRS released proposed regulations associated with the Tax Act that we believe, if finalized as drafted, could impact our current effective tax rate of approximately 21.5%. We indicated at that time that, depending on the final form of any proposed regulations, our estimated resulting effective tax rate for 2019 could range between 21.5% and 26.5%. For the full year, our outlook assumed that some form of the proposed regs would be enacted and therefore reflected the midpoint of our expected range, or a 24% effective tax rate.

The proposed regulations are still anticipated to be finalized no earlier than June if they do indeed get approved as final, and that timing will impact our effective tax rate from quarter to quarter during the year. As we noted, our first quarter tax rate in 2019 was not impacted from these proposed regs. Similarly, our second quarter tax rate in 2019 is not expected at this time to be impacted, since the regulations remain in proposed form, and therefore should be about 22% in the period.

However, if the proposed regulations are enacted during Q2 as drafted, there would be a true up to our tax rate in the period, which we expect would increase the rate to approximately 26.5% in Q2 resulting in about a \$0.03 earnings per share impact for the period. We will provide a further update during our second quarter earnings call.

GAAP and adjusted net income per diluted share were \$0.48 and \$0.62 respectively in the first quarter. Adjusted net income in Q1 primarily excludes the impact of intangibles, amortization

and other acquisition-related items.

Adjusted free cash flow in Q1 was \$246.3 million, or 19.8% of revenue. Given our strong start to the year, adjusted free cash flow is solidly on track to achieve our original outlook of \$950 million for 2019.

I will now review our outlook for the second quarter of 2019. Before I do, we'd like to remind everyone once again that actual results may vary significantly based on risks and uncertainties outlined in our Safe Harbor statement and filings we've made with the SEC and the securities commissions or similar regulatory authorities in Canada. We encourage investors to review these factors carefully. Our outlook assumes no change in the current economic and operating environment. It also excludes any impact from additional acquisitions or divestitures that may close during the remainder of the year and expensing of transaction-related items during the period.

Turning now to our outlook for Q2 2019. Revenue in Q2 is estimated to be approximately \$1.360 billion. We expect price growth for solid waste to be in the range of 4.5% to 5% in Q2 with volume in the range of flat to up 50 basis points, a sequential increase of about 1.5% reflecting the pickup in special waste and other activity noted earlier. Adjusted EBITDA in Q2 is estimated to be approximately 31.9% of revenue, or about \$434 million, in spite of margin dilutive acquisitions completed since the year ago period and lower recycled commodity values.

Depreciation and amortization expense for the second quarter is estimated to be about 13.7% of revenue. Of that amount, amortization of intangibles in the quarter is estimated to be about \$32.5 million, or 9/10 per diluted share net of taxes.

Interest expense net of interest income in Q2 is estimated to be approximately \$36 million. Our effective tax rate in Q2, as noted earlier, is estimated to be about 22%, subject to change in the event that the proposed tax regulations as drafted are enacted during the quarter. As noted earlier, we estimate that the Q2 rate would increase to approximately 26.5% in the event that the proposed regulations as drafted are passed in June, which would result in an impact of approximately \$0.03 per share in the quarter. And finally, noncontrolling interest is expected to reduce net income by about \$200,000 in the second quarter.

And now let me turn the call back over to Worthing for some final remarks before Q&A.

Worthing Jackman: Thank you, Mary Anne.

Again, we are extremely pleased with our start to the year. Strength in solid waste pricing, improving solid waste volume trends and further growth in E&P waste activity position us well for the remainder of the year.

Year-to-date acquisition activity and ongoing dialogue are already indicative of another potential outsized year for acquisition activity. And as noted earlier, adjusted free cash flow is trending solidly on track to achieve our original \$950 million outlook for the full year. That all said, we believe it's appropriate, as in prior years, to wait until our Q2 earnings release to update our

outlook for the full year.

We appreciate your time today. I'll now turn this call over to the operator to open up the lines for your questions. Operator?

Questions & Answers

Operator: [Operator Instructions] Our first question comes from the line of Michael Hoffman with Stifel.

Michael Hoffman: When you look at the solid waste business, all the talking heads would go, we're 10 years into an economic recovery. How can this possibly continue? We've got to be into a recession eventually? What are you seeing that would tell us they're wrong, that things are stable, low-growth, healthy economy?

Worthing Jackman: Well, I think you just answered your own question because I agree with you. Kind of slow and steady seems to be kind of the path over the past decade versus a bubble that gets popped. Now they could still be proven right that slow and steady could come to an end, but we're not seeing any signs of that, Michael. In fact, we're pleasantly surprised at the earlier ramp in volume activity versus what we had expected in February. But clearly, it's been a longer road for recovery. It's been a slow and steady, but again, we're not seeing any signs of a slowdown at all.

Michael Hoffman: Okay. And then the ADSW transaction, presuming that they're going to have to sell stuff, is there anything from a Hart-Scott standpoint that would prevent you from being able to buy any or all of that based on what you know now?

Worthing Jackman: Not to our knowledge, Michael. Not to our knowledge.

Michael Hoffman: So that's an attractive future potential opportunity for you as well then?

Worthing Jackman: Absolutely.

Michael Hoffman: Okay. And then within the context of the recycling model itself, has the lower prices helped accelerate the pace to which the market model is changing? Or are we just still on a slow and steady, it's contract cycles and you've got to plow through it?

Worthing Jackman: You've got to plow through it. I mean, look, this has been an ongoing effort over the past year and a half to two in some cases. It's a market by market kind of Whac-A-Mole that you have out there depending upon what's happening unique in the market, including third-party or other facility closures that disrupt recycling. Obviously, you've got some independents that are in financial straits that might be shutting down. That disrupts the market further. You've got contracts that have different termination dates on it that give you different opportunities to renegotiate it. So clearly, it's -- I think the industry's made a lot of progress on this, a significant amount of progress over the past year and a half or two, but again it's not fully done.

Michael Hoffman: Okay. Thank you very much. Congratulations on a good quarter.

Operator: Our next question comes from Hamzah Mazari with Macquarie Capital.

Hamzah Mazari: My first question is on pricing. Worthing, you mentioned pricing of a little over 5%. This goes to the 6% that you saw mid-2008. I know you're giving quarterly guidance on price, but if you look over a multiyear timeframe, assuming the economy holds up, do you expect to surpass the 6% pricing level, just given that this sector is a lot more consolidated than we saw back in '08 and potentially a lot more disciplined? Any comments?

Worthing Jackman: No. Look, Hamzah, I know we've been fairly consistent. Pricing is linked to CPI and underlying cost escalators that we're seeing. On average, we're getting around 150 to 200 basis points right now over CPI in this environment. You tell me what CPI is, and we'll tell you where our pricing might end up. And so I wouldn't -- obviously, we're not saying 5.2% is going to 6%. We're saying 5.2% will go to probably 4 1/2% to 5%, likely the upper end of that range for Q2, but that's more just the fact that some price increases we put in place last year in response to inflation pressures we saw in the first 4 months of last year as well as the decline in recycling commodity values early last year that really started this trend, those interim price increases we put in place are anniversarying. So we'll stay, right now in this environment, we'll stay in that 4 1/2% to 5% for the full year unless we see something in the underlying cost side that causes us to need more.

Hamzah Mazari: Got it. And for my follow-up question, could you maybe frame for investors what the leadership team is doing to substitute in for Ron or how you're handling the burden of his leave of absence? Specifically, is it preventing you from doing much larger transactions? I know you've done some transactions that you highlighted, new market entries, etc. But curious, does his absence prevent you from doing multibillion-dollar deals in the near term? And then maybe for investors, what is the leadership doing to sort of step in for him?

Worthing Jackman: Well, I hope you see in the performance in Q1 at every level, whether it be top line growth, execution in the middle of the P&L, the underlying margin expansion that Mary Anne laid out for you that's seeded 80 basis points year-over-year reflective of strong price. I think you see, as we talked about, the execution and accountability that our culture -- is the foundation of our culture. So I think you've seen all of that and play in Q1. I think you see in our guidance it continuing. You see the acquisitions that we've gotten done year-to-date as well as what we'll continue to get done during this quarter shows you that we haven't skipped a beat. And really, that's a testament to the longevity of the management team and a team from top to bottom, really meaning throughout the organization, that's been together for a long period of time. It's a testament to the strength of the culture that's been purposeful that we've been driving through the organization for the past 12 to 14 years. So again, I don't think -- I wouldn't say anyone's skipped any beat. I would say our decentralized model, which puts a lot of decision-making at the front level in the local markets that's supported by an operating model that's a strong PVP and RVP model shows you that the execution doesn't slip. So I'd tell you that, from our seat right now, we're quite pleased with how things have stepped up. Obviously, Ron stays in our mind just from a care and concern for him and his family. But again, I think you see it's a testament to the organization that he has put together that you're seeing the results that we're

printing right now.

Operator: Our next question comes from the line of Brian Maguire with Goldman Sachs.

Brian Maguire: Yeah, I think Michael and Hamzah sort of danced around this question a little bit. I just wanted to ask it a little bit more directly. Given you can borrow at 3.6% sort of weighted average debt, what is it about the Advanced transaction that made you guys a little bit hesitant to pull the trigger on it or get involved? And any comments you could kind of have as to your activity in that asset as it came up for sale.

Worthing Jackman: Sure. Look, nothing prevents us from writing checks of that size. Nothing would prevent us from doing a large transaction, to Hamzah's question of writing a multibillion-dollar check. So there's nothing organizationally, balance sheet or any other constraints that prohibits us from doing that. Obviously, every acquirer sees something different in a target. We're no different. How Waste Management is looking at the Advanced acquisition is for the next call to be discussed, so I wouldn't want to weigh in on how they view Advanced. Obviously, we've had our own view of that acquisition over the years. We put it up and benchmarked it to the Progressive acquisition that we completed in 2016, and the metrics are different as we see them. But again, that's just from our perch. So I agree with you. I mean, there's nothing that prohibits us from doing it. Obviously, as we've always said, it's not just the markets you enter. It's the price you pay to get into them. And from our standpoint, we wish Waste the best. This is not something we believe we missed. Obviously, we hope to hang around the rim and pick up any divestitures potentially that come out of that transaction.

Brian Maguire: Okay. Yeah. That makes a lot of sense. Can you comment on the sort of related question on the \$100 million of acquisitions you've closed on, sort of how much of that was signed during the period? It does sound like most of it was in April, but just the cadence of when it'll come into the earnings and then sort of how the multiple you're paying on those compares to what you've been paying on transactions in the last year or two.

Mary Anne Whitney: Sure. Well, why don't I start with the first part of that and then turn it over to Worthing. So in terms of the \$100 million signed or closed, about \$10 million of that closed during Q1. About \$80 million in Q2, so that tells you in April the majority of its gotten done, and there's still about \$10 million left to close. So that's the breakdown. And then if you look -- if you're adding that into your model for subsequent quarters, it's about \$22 million per quarter is a way to think about the incremental contribution from acquisitions.

Worthing Jackman: And the cadence on activity here -- look, just because we're on this call today doesn't mean we're done with acquisitions for the period. Obviously, we've got a full quarter in front of us in Q2. I suspect you'll see a handful of additional transactions that sign or close in the period. That could, by midyear, take us up to what we call an average year of \$125 million to \$150 million of acquired revenue done by midyear, which leaves half the year left over for what we would call an above average amount of activity. And again, that would exclude any divestitures because we don't know the timing of the Waste and Advanced deal, and they've already highlighted that it's probably an early 2020 transaction. So as we've said before, the pipeline's robust, dialogue is active and the cadence of what we're doing has continued unabated.

With regards to multiples, again, as we've talked in the past, look, high-quality, larger, meaning 40, 50-plus million-type revenue acquisitions, attractive franchises, integrated models -- markets, things like that, those multiples have gone up about a turn to a turn and a half. Those are running anywhere from 9 1/2 to 10x EBITDA right now. Obviously, smaller market tuck ins are running right now still in that 4 to 6x, and kind of collection-only, smaller transactions could be running in that 6 to 8x depending upon the market. Everything we do is, again, cash on cash, so what I'm giving you is just the output of an NPV of what we're willing to pay divided by what the EBITDA is.

Brian Maguire: Yep. That makes sense. Just one last one from me. On the volume pick up you're seeing in 2Q, just wondering -- I know it's hard to quantify this, but is it possible that some of that is just the positive giveback of the 1Q weather-related issues, and then this bounce that we're seeing into 2Q may not be sustainable? Or do you feel like this is actually a good trend kind of heading into the back half of the year?

Worthing Jackman: I think it's a good trend because, again, in February, we had mentioned that we thought volumes would turn positive in the second half of the year, and that's not changed. The fact that we're turning positive in Q2 earlier than expected doesn't pull forward anything that we're seeing in the second half of the year into Q2. But to your point, wherever weather broke, whether it be the second, third or fourth week in March, volumes improved dramatically. Now the weather hasn't broken everywhere, but as that breaks in other markets, we expect to see it continue to increase. As you look at Q2, again, Central region which we noted before, which was negative in Q1 mostly due to weather, turns nicely positive in Q2, and obviously, so that's economic and weather. East region as well. I mean, East region, we also expect to be positive. And of course, the West has been the largest area for volume growth for the company as well. And again, as we continue to push through the purposeful shedding and get to the end of that, you're seeing the impact of that update in, what I would call, the legacy, more Progressive-type markets in Canada and the South region.

Operator: The next question comes from Tyler Brown with Raymond James.

Tyler Brown: Hey, congrats on the start to the year. Mary Anne, thanks so much for unpacking the margins, but I want to make sure that I've got it. So total margins were down, say, 30 basis points ex -- 30 down -- or down 30 basis points, but excluding M&A and recycling, they were up 45. Is that right?

Mary Anne Whitney: That's correct. So 50 basis points...

Tyler Brown: Okay. And then...

Mary Anne Whitney: Sorry. 50 and 25.

Tyler Brown: Okay. And -- okay. 50 and 25. Great. And then they were up 80 if you take out the 401(k) and stock comp?

Mary Anne Whitney: That's correct, yes.

Tyler Brown: Okay.

Worthing Jackman: Yes. That would've put reported margins -- that would've put consolidated margins, again, in excess of 32% in the period.

Tyler Brown: Okay. Now I know you play an outdoor sport, but any thoughts on what weather did on margins, maybe specifically at the leachate level?

Mary Anne Whitney: Well, we did note that leachate was up year-over-year and weather's part of that reason. I would say when we think about the weather impact and the incremental volume loss associated with weather, if you say that's 50 basis points, there's not a big margin impact from that because, of course, as Worthing noted in his remarks, in some cases it's actually facility closures that happen during weather impacts. And so it's really more about the volumes and not a big margin impact there. There are some costs that -- cost increases, and leachate was one of them and part of that is weather.

Tyler Brown: Okay.

Worthing Jackman: And Tyler, as you know, I mean -- Tyler, as you know, EBITDA before expenses is called revenue, right? And so if we're starting at 100% margin, there are ins and outs throughout the P&L. So if we start isolating all the bad things, we're not recognizing the good things as well. So our belief is that what we should really be focused on is simply just the impact of recycling because that episodically can move the needle. Obviously, recycling's been a topic du jour, and so we've highlighted that. The deferred comp -- well, the deferred comp is a -- as the market goes up is really a mark-to-market hit from a margin standpoint on EBITDA. It doesn't hit earnings per share because you see that impact come back in other income because we've invested in -- we've restricted cash to mirror the deferred comp liability, and so the income on that comes back in other income. Again, the 401(k) is just a one-year item for us because we'll anniversary that next year.

Tyler Brown: Right. Okay.

Worthing Jackman: Everything else -- to start highlighting one thing here, one thing there, one extra day, one less day, I mean, it just starts getting confusing.

Tyler Brown: Yeah. No, I hear you, but very strong. That's the key message there.

Worthing Jackman: Yes.

Tyler Brown: Okay. So Mary Anne, on the -- so I think going into the year, you were guiding to call it a 4% revenue contribution from M&A, so basically at this point, you're not going to get the full 100, but say you maybe add another 1% to 2% to that 4%. Is that the right way to think about it for the full year?

Mary Anne Whitney: Sure. As I said, there's about between \$65 million and \$70 million of what's closed to year-to-date that will contribute in 2019. And that's where the call it between \$20 million and \$25 million, 22, 23 per quarter incremental to what you already had rolling in.

Worthing Jackman: Put simply, I mean, Ron last year, when he talked about what could happen in 2019, we talked about 8% to 10% top line growth. We came into the year with 8% already in the bag. What you're hearing now is the march up towards 10% as transactions continue to close. Again, so I think what you're seeing is the execution that backs up what we had expected for the year last year.

Tyler Brown: Okay. And were -- you noted some new market entries, but were there some disposal assets in the mix in that \$100 million?

Mary Anne Whitney: Yeah. One of the markets is integrated, and in terms of your -- if you're thinking about the margin contribution -- excuse me, 2. There are 2 landfills come in the mix. And if you're thinking about the margin impact, I'd think about it the same way. For the full year guidance, the 30 basis point dilutive impact, it wouldn't be materially different with these incremental acquisitions.

Tyler Brown: Okay. Okay.

Worthing Jackman: And as we look at Q2, when we talk about the cadence of acquisitions, there could be another 1 or 2 landfills that we execute on in Q2.

Tyler Brown: Okay. Great. And then on the assets that are potentially coming to market, is it safe to assume that you would have interest in both call it selected small container and landfill? Or would you favor maybe one over the other? Or is everything at play?

Worthing Jackman: I'd tell you everything's in play.

Tyler Brown: Okay. And then maybe my last one here, Worthing. So you guys are putting up great pricing. Your large peers are putting up great pricing. And I'm curious about what's going on deeper in the industry, particularly at the mom-and-pop level. So what would you attribute this breakout in price to? Is it simply that everybody's full? Or do you think that the mom-and-pops who seem to set the marginal price in the industry are really getting crushed on recycling and other cost pressures, and it's just forcing them to make big price increases? And I'm curious if you're seeing that as you do diligence on those small guys.

Worthing Jackman: Absolutely. I think what you -- you just answered your question in that, look, if you came into '17 and '18 living on lower collection margins trying to subsidize it with recycling, well, again, you went from getting paid for the recyclables to getting charged \$120 to \$180 a ton, depends on where you are in the marketplace. That was a dramatic reversal for folks that were trying to give away recycling from a collection pricing standpoint and trying to avoid a landfill cost from a disposal standpoint. And so that alone was a major impact to those companies. And as well, they're seeing the same labor pressures, fuel pressures, third-party logistics pressures that we saw last year, and so just the combination of that forced everyone

really to go back in to get pricing.

And what you said is true on diligence. I mean, look, if -- the companies that we're looking at and the few that we have bought went in middle of last year and put incremental 6% and 7% price increases on top of their traditional 4% price increases and basically were putting 10% to 11% price increases in place last year to offset everything we just talked about. So without a doubt, it's a period of time, meaning last year and the rollover of that into this year, that folks have had to pursue price to offset what hit them, so it is a unique time with regards to both those things hitting simultaneously.

Operator: Our next question comes from Derek Spronck with RBC.

Derek Spronck: Just sticking with the pricing thematic, are you getting any pushback from customers around the absolute pricing level? And how are the customer churn levels?

Mary Anne Whitney: No. I would say coming into the quarter, we guided to 4 to 4 -- excuse me, 4 1/2% to 5%, and we delivered higher than that. So what that tells you is the retention rates were better than we expected coming into the quarter. And again, as Worthing said, some of what you're seeing on reported price is the rollover contribution from last year, so those were already in place. And actually, a disproportionate amount of PIs were in place coming into the year because of that. Our typical model, we'd put our prices in in Q1, and so you're seeing the benefit of the rollover and current retention rates being a little higher than expected.

Worthing Jackman: And we've seen no notable change in churn rates.

Derek Spronck: Okay. Great. Just on the E&P CapEx. I believe you indicated you were earmarking around \$15 million, but you had some optionality that you would decide whether to deploy the full \$15 million. Any update there?

Worthing Jackman: Yeah. I mean, we're still pursuing the same projects we've been talking about before. Obviously, the timing of those expenditures are really now in the hands of contractors and their ability to mobilize to work on our projects. It's -- these basins are labor constrained. They are contractor constrained. In some cases, most labor's been sucked into pipeline construction and other areas and diverted away from traditional earth movement and other construction. So we're at the mercy right now of contractors for the timing of what we get done in those areas. I'd say the good news is E&P is trending at or above where we expected for the year now with crude coming in at \$65 as we sit here today and M&A activity picking up in E&P land. We feel pretty good about where we sit with that the balance of the year.

Derek Spronck: Is a 50% EBITDA margin a good run rate margin? And would you still assume there's significant operating leverage if volumes were to pick up in E&P?

Worthing Jackman: Absolutely.

Derek Spronck: Okay. And then just one more for myself. SG&A expenses were down on a net basis nicely. I saw that there was around a \$6 million legal expense that rolled off, I believe.

Does that -- should we assume that is sustained, and therefore we should appropriately take down our SG&A expense over the next few quarters with roughly the same number?

Worthing Jackman: No. I mean, look, with 85% of our revenue sitting in the U.S. and 150% of our litigation sitting in the U.S., legal is not -- legal is a growth expense not something that's shrinking. So no, it's just -- it's timing of ins and outs based on what was in prior year. And to further my point before, if we start trying to add back every cost that went up, you're missing some costs that go down, right? And so it's like any portfolio of items. Some go up and some go down. But I wouldn't extrapolate Q1 into future periods.

Operator: Our next question comes from Mark Neville with Scotiabank.

Mark Neville: The \$5 million impact to recycling -- or from recycling in Q1, is that a similar-type hit in 2Q and through this back half? Or is it more nominal in the second half?

Mary Anne Whitney: No. As we described, what we've seen since Q1 is continued deterioration in recycled commodity prices, so even though last year the commodity prices stepped down a little between Q1 and Q2, I would say you'll see at least the same kind of impact in Q2 that the decrement will continue to be in that 95% range from the deterioration.

Worthing Jackman: But probably a little less punitive in the second half of the year just given the declines we saw throughout 2018.

Mary Anne Whitney: But Q2, I think similar is the right way to think about it.

Mark Neville: Okay. Okay. And you touched on this. The E&P is up nicely, and activity seems to be picking up. I guess, is the thought there are now that it's maybe a little better than flat? I think that was the previous expectation.

Worthing Jackman: Well, again, we'll give our thoughts on the full year in July. But obviously, we printed north of 60 in Q1. We're trending again north of 60 in Q2, so if you annualize just that first 6 months, you're getting to at least flat or better than flat year-over-year, but let's wait until Q2 is in the bank.

Mark Neville: Sure. And maybe just to clarify, Mary Anne, the \$22 million from M&A, that starts in Q2?

Mary Anne Whitney: That's correct.

Operator: Our next question comes from the line of Sean Eastman with KeyBanc Capital Markets.

Sean Eastman: I just wanted to go back to the volume outlook. Last quarter, you guys messaged kind of a flat underlying volume trajectory for the full year. Obviously, we started the quarter with some weather impacts, but it seems like sort of the earlier than expected ramp in 2Q is maybe a more meaningful data point there. So maybe -- I know we're waiting until next quarter,

but I'm just wondering if you could comment on the bias toward that flat underlying outlook based on what you've seen so far in this kind of initial 2Q ramp up.

Mary Anne Whitney: Sure. I would say we're certainly encouraged by what we've seen. I mean, some of it is -- it's a sharper increase, which you would expect with a prolonged winter and longer downs are going to make for a sharper ramp. But we're encouraged just looking at one-time jobs and the pace of those coming in, not just timing related, but bigger -- some incremental jobs there. We've had some nice wins, so there's a number of factors that are supporting not just a seasonal pickup, but some improving trends. So I would just say in general, we're encouraged. As Worthing said, we'll look in the middle of the year to communicate what we think the full year looks like, but we're certainly encouraged by what we've seen thus far in Q2.

Worthing Jackman: And even on more longer-term municipal contract wins, our win-to-loss ratio is up nicely relative to where it had been in the prior several quarters. So I -- to Mary Anne's point, we are encouraged.

Sean Eastman: Okay. That's great. Very helpful. And it's been asked a couple times on recycling, and I realize it's a small business, but I was wondering just if there's maybe a more concrete number around how we should think about the revenue, which translates into EBITDA essentially, sensitivity to, like, a \$10 change in that underlying basket. Just to the extent maybe we see further declines through the year, having a better idea of exactly what that means for you guys would be helpful.

Mary Anne Whitney: Well, sure. I mean, if you just look last year, we did around \$88 million in recycled commodities, and so a 10% move is about \$8 million, \$8.8 million, in that example, and we're telling you the decrementals. It would be almost that amount hit going to the EBITDA line, so you'd tax effect that and convert that and you get at least \$0.01 per share per quarter.

Worthing Jackman: And what we're talking about here is really how you'd see it come through the P&L on a consolidated basis, right? Obviously, to the extent that we're putting tip fees in, intercompany, to our own collection operations for the true processing cost of recycling that can do a left pocket to right pocket and make recycling look a lot better within our own P&Ls, but on a consolidated basis, moving tip fees from -- or costs from a recycling facility into your own collection operation doesn't move the consolidated needle. It just makes recycling look, in isolation, a little bit better year-over-year. But frankly, on a consolidated basis, you've got to think about it, and that's what Mary Anne's laying out for you.

Sean Eastman: Okay. That's helpful. And then just last one from me on recycling. You guys just seem a little less enthusiastic about sort of the pace at which this kind of challenged model is shifting towards something more sustainable. Just wondering kind of in longer-term, five-year outlook for recycling, how do you position around that sort of timeframe for recycling? How might that business look long-term for Connections? I'm just curious kind of higher-level, long-term view there for that business.

Worthing Jackman: Yeah. Look, we're making investments in recycling where it makes sense to make investments in recycling, make no mistake, in looking at other alternatives technologies to

further our sustainability initiatives as well. But I tell you, look, recycling is something that we're getting close to the washout, meaning, look, as soon you've washed out, right, it's easier to go up. And what I mean by that -- look, as additional mills start to open in North America that will accept recycling feedstock as the input, that will put a better bid to the underlying commodity, fiber in this case, which will help turn the tide for the commodity value. Obviously, last year, you saw about 4 mills get purchased for such repurposing. As those come online and if others come online, you will see the tide turn. Is that second half of 2020 or early 2021? Can't tell you. But if your question over the 5-year horizon, this will definitely become a better business as you play this thing out. Now again, what this is also suggesting is an understanding by regulators, which is difficult, and others that diversion is not recycling. Diversion, which people thought is diversion from landfills, really meant divert to Asia, and that game is over. And so we have to, as an industry and as the economy, be sustainable within our shores to handle the recycling feedstock and deal with the discards and the contamination coming out the backend within our own landfills. So on a 5-year horizon, obviously, it'll be better than it is today. Obviously, last week's data, we saw OCC just move up \$1, so maybe we've hit the bottom, not sure. But clearly at \$60 to \$65, it feels pretty close. But again, this is a domestic answer to the issue, not offshore.

Operator: Our next question comes from Chris Murray with AltaCorp Capital.

Chris Murray: Just looking longer-term, you've talked a little bit about your revenue numbers might be a bit better on some better-than-expected volume. But I'm just looking at your free cash flow conversion. So we're getting up to around 20%, and you're still talking about a \$950 million number, which at the rate you're really seeming to be running seems to be a bit light. Just wondering if there's something that we should be thinking about in terms of the free cash flow conversion rate that maybe is thinking that you're going to be a little more conservative? Is there something in this tax changes that could be hitting you or is there something that we may be missing? Or should we be thinking that maybe your free cash flow number might be moving a bit higher over time?

Worthing Jackman: Again, we've guided to 950. That's despite what we talked about in February, that \$20 million of cash flow we expected in this year just happened to clear the banks on December 31. We don't control that, so really 950 could've been 970. Look, I think we need to play the long game on cash flow generation, make sure we maintain cushion year in and year out for the things that could surprise us or market conditions that could materialize. So I wouldn't get over my skis on sitting here today trying to -- looking at promising more than 950. Obviously, if recycling turns and E&P takes off and acquisitions go well above what we're talking about, certainly I would expect 950 to go higher, but...

And with regards to taxes, obviously, we've always talked about with cash taxes that we expect over time to move up from that 60% or 65% range into that 80% to 90% range. Obviously, the way that U.S. tax law is structured right now, when bonus depreciation peels off in 2022, every company will see an increase in cash taxes in 2023 as a big spike that year. Then it'll start coming down again after you start putting that in the rearview mirror. But again, I'd own us for what we say we can do, and there's no impetus for us to just artificially try to deliver something above and beyond what is sustainable.

Mary Anne Whitney: The other thing that I would add, Chris, would just be a reminder that you can't generalize from Q1. It's always our strongest free cash flow quarter given the timing of tax payments and interest, and so important to recognize that it is a strong start, but keep that in mind.

Worthing Jackman: We always tell people, don't annualize Q1.

Chris Murray: Fair enough. But I guess what I'm trying to figure out though is that you've got -- you basically had a 30 basis point increase in EBITDA, 50 basis point increase in free cash flow margin. Just trying to think about whether or not there's something in the system that's letting you do that other than just the scale and growth that you're seeing.

Worthing Jackman: It's just timing. Again, I wouldn't -- let's get -- if you ask me that after us printing that 5 consecutive quarters, I'd give you a different answer. But as we're -- to make an extrapolation off one quarter, I think, would be premature.

Operator: [Operator Instructions] Our next question comes from the line of Noah Kaye with Oppenheimer.

Noah Kaye: I guess just on margins, kind of guiding flat for 2Q year-over-year and despite the headwinds, I just want to understand how we should think about cadence for the next couple of quarters. I mean, basically, does the incremental from recycling preclude you from getting that sort of 30 bips margin expansion for the full year or let's just say recycling plus a little bit more acquisition spend?

Worthing Jackman: Again, from a margin -- obviously, like I said, we'll update full year guidance in July. But obviously, if E&P comes in better, that's got nice incrementals. Recycling's a little worse. That's got high decrementals. Acquisitions can come in normally at a -- as we always caution you, on a margin-diluted basis. Depends on the type of deal we're doing, so let's see what we've done by July to give you a better insight on the impact of acquisitions for the full year. Obviously, the stock market is melting up. That could have some margin pressure based on deferred comp, but that's not earnings pressure, right, because it comes back in other income. So again, let's get to July to get a full picture on not only margin but more importantly dollar EBITDA and dollar revenue because, obviously, we're trending well in those areas.

Noah Kaye: Yep. Makes sense. And then just on your point around potential E&P outside -- I mean, not only getting to the higher oil prices, but even seeing consolidation or, shall we say, acquisitions by perhaps more disciplined operators into relevant basins. What are you seeing on pricing in the E&P space? And how does that play into potentially better leverage for your assets?

Worthing Jackman: I'd say that's a customer-by-customer, rig-by-rig discussion. Without a doubt, the trend in pricing in many cases is higher, but obviously, volume also plays a big role in that dialogue, obviously, capacity at each landfill. The water content within the solid waste stream can play a role in that discussion as well. We're not seeing pricing pressures. The overall or the underlying tone is flat to higher, and in most cases, it's higher.

Operator: There are no further questions at this time.

Worthing Jackman: Thank you, Melissa. Well, if there are no further questions, on behalf of our entire management team, we appreciate your listening to and interest in the call today. Mary Anne and I are available today to answer any direct questions that we did not cover that we're allowed to answer under Reg FD, Reg G and applicable securities laws in Canada.

Thank you again. We look forward to speaking with you at our upcoming investor conferences or on our next earnings call.

Operator: That does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.