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Q4 2018 Earnings Call
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Officers and Speakers
Worthing Jackman; Waste Connections, Inc.; President
Mary Anne Whitney; Waste Connections, Inc.; SVP & CFO

Analysts
Brian Maguire, Goldman Sachs
Hamzah Mazari, Macquarie Capital
Tyler Brown, Raymond James
Derek Spronck, RBC Dominion
Noah Kaye, Oppenheimer
Michael Hoffman, Stifel, Nicolaus
Chris Murray, AltaCorp Capital Inc.
Sean Eastman, KeyBanc Capital Markets

Presentation

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Waste Connections' Fourth Quarter 2018 Earnings Conference Call. (Operator Instructions). As a reminder, this conference is being recorded Thursday, February 14, 2019.

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

Worthing Jackman: Okay. Thank you, operator, and good morning. I'd like to welcome everyone to this conference call to discuss our fourth quarter 2018 results and provide a detailed outlook for both the first quarter and full year 2019. I'm joined this morning by Mary Anne Whitney, our CFO; and several other members of our senior management team.

Unfortunately, Ron Mittelstaedt, our CEO and Chairman of the Board, is unable to participate on this morning's call due to an immediate family member's medical matter. Ron appreciates everyone's concerns and sends his best.

As noted in our earnings release, 2018 finished on a high note, as financial results for the fourth quarter exceeded expectations on better-than-expected solid waste organic growth, E&P waste activity and acquisition contribution.

We're also extremely pleased with our results for the full year, as adjusted EBITDA as a percentage of revenue expanded 30 basis points, and adjusted free cash flow increased 15.2%. Increases in both solid waste pricing growth, which was up 130 basis points year-over-year to 4.5%, and E&P waste activity enabled us to overcome the precipitous decline in recycled commodity values and certain cost pressures during the year. The strength of these results continues to reflect the benefits of our purposeful culture, differentiated strategy, and disciplined execution.

2018 was also noteworthy for the continuing elevated pace of acquisition activity. Our acquisition of American Disposal in the fourth quarter brought total annualized acquired revenue to more than $360 million for the year, with rollover revenue contribution of approximately $200 million in 2019. Along with continued strong pricing growth, this already positions us for high-single-digit revenue growth and another 30 basis points adjusted EBITDA margin expansion in 2019, with any growth in solid waste volumes, E&P waste activity or additional acquisitions providing further upside.

We have increased adjusted free cash flow per share of the compounded rate of more than 15% per year over the past several years, and expect continuing double-digit adjusted free cash flow per share growth in the upcoming year. Our strong financial profile continues to afford the flexibility to fund outsize acquisition activity and increasing cash dividend and opportunistic share repurchases.

Before we get into much more detail, let me turn the call over to Mary Anne 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 3 of our February 13 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 of 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 fourth quarter, solid waste price less volume growth was 4.9%, exceeding the high end of our outlook for the period by almost 100 basis points. And volumes turned positive for the first time in 2018.

In the fourth quarter, solid waste pricing growth was our highest-reported price in a decade at 4.8%, up 30 basis points sequentially and up 120 basis points year-over-year. As noted in prior quarters, our pricing strength reflects the differentiation of our market model and intense focus on execution, as we implemented, and more importantly, retained additional price increases during 2018 to address recycling headwinds and certain cost pressures, including third-party logistics and fuel.

Once again in Q4, our pricing ranged from approximately 3% in our more exclusive markets in the Western region, to an average of about 5.5% in our more competitive regions.

Reported volume growth in Q4 turned positive for the first time since we began intentional shedding of lower-quality revenue and unsafe to service accounts acquired in the Progressive Waste transaction. Volumes were up 10 basis points and well above the high end of our expected range for the period. We continue to believe it prudent to be cautious on volume growth in this environment, with anything positive being upside.

Looking across our regions, volumes were driven most notably by our Western region, which was up over 3% in the quarter, while Canada and our Southern region, though showing some improvement sequentially, were both down year-over-year between 0.5% and 1.5% as we continue to anniversary the mostly-completed intentional shedding in those regions.

Looking at 2019, we expect pricing growth to continue to average about 4.5%, likely starting higher than that on a reported basis early in the year, and we expect reported volumes to be down about 50 basis points due to the remaining purposeful shedding of poor-quality revenue, with underlying volumes about flat year-over-year. We believe that our 2018 results are indicative of the effectiveness of a price-led organic growth strategy, and as noted earlier, we will continue to view any increases in underlying volumes as upside.

Looking at year-over-year results in the fourth quarter by line of business on a same-store basis, commercial collection revenue increased approximately 6.5%, mostly due to price increases. Roll-off revenue increased approximately 3.5% on higher revenue pull. For the U.S., pulls per day decreased about 1% and revenue per pull was up 3%. In Canada, pulls per day decreased about 1.5%, and revenue per pull increased about 7.5%.

Solid waste landfill tonnage increased about 1% on increases in MSW tons, up about 3%, led by increases in the Northeast and California, and C&D tons, up about 4% on increases across several markets, led by the Northeast and Texas. Special waste tons were down about 4% in Q4, a smaller year-over-year decrease than in prior quarters, as tough comps began to ease a bit.

Recycling revenue, excluding acquisitions, was about $20 million in the fourth quarter, down $8 million, or almost 30%, the smallest year-over-year decrease in 2018 due to easier comparisons on prices for OCC or old corrugated containers, and a slight increase sequentially. OCC prices in Q4 averaged about $93 per ton, which was down 23% from the year-ago period, and up 6% sequentially from Q3.

Mixed paper revenue, ex acquisitions, declined approximately 45% year-over-year as values remain between zero and $5 per ton. We believe that the flow-through from changes in recycling revenue was similar to prior quarters, with detrimental margins of approximately 95% due to the combination of lower fiber values and higher recycling processing costs, resulting in an impact of about $7.5 million in EBITDA and about $0.02 per share of EPS in Q4.

OCC prices currently average about $85 per ton, reflecting some recent weakness. This is down about 10% from Q4 and down about 15% from last year's average of $102 in the first quarter. We expect recycled commodity values to remain around these levels for the full year.

Looking at E&P waste activity, we reported $64 million of E&P waste revenue in the fourth quarter, up 20% year-over-year and down slightly sequentially from Q3, reflecting a lower seasonal decline than typically seen. We have not experienced a notable impact in activity levels resulting from weakening crude prices in late 2018. That said, we remain cautious in our outlook for E&P waste activity, and will let any increases in activity or ramping of newly constructed locations be upside in a year.

Looking at acquisition activity, as noted earlier, we closed the previously-announced acquisition of American Disposal in December, which along with other acquisitions completed earlier in 2018, provides rollover acquisition contribution of about $200 million in 2019.

Coming off of 2 years of outsize activity, during which we essentially completed 4 years' worth of acquisitions, we continue to believe that the factors that review favorably by sellers are still relevant. That is, sellers continue to note the strength of their underlying businesses, the clarity around taxes as a result of tax reform, and higher reinvestment rates as drivers for transactions. Dialogue remains active and the pipeline continues to be robust. In short, we believe 2019 could be another year with outsized acquisition activity.

In 2018, we deployed over $1 billion in acquisitions and returned over $210 million to shareholders, including opportunistically buying back stock during December's selloff. And we remain well positioned for potential continued outsized capital deployment in the upcoming year.

And now, I'd like to pass the call to Mary Anne to review more in depth the financial highlights of the fourth quarter, and provide a detailed outlook for Q1 and the full year 2019. I will then wrap up before heading into Q&A.

Mary Anne Whitney: Thank you, Worthing. In the fourth quarter, revenue was $1.26 billion, up $104.6 million over the prior-year period and about $37 million above our outlook, due to higher organic growth in solid waste and E&P waste, as well as contribution from closing the American Disposal acquisition in December.

In total, acquisitions completed since the year-ago period contributed about $66.5 million of revenue in the quarter, or about $61.4 million net of divestitures.

Adjusted EBITDA for Q4, as reconciled in our earnings release, was $397.2 million, about $11.2 million above our outlook for the period on higher-than-expected revenue, and up over $36 million year-over-year, despite an estimated hit to EBITDA from recycled commodities of approximately $7.5 million.

Adjusted EBITDA as a percentage of revenue was 31.5% in Q4, in line with our outlook, and up 30 basis points year-over-year. Excluding the margin-dilutive impact of acquisitions contributing in the period, adjusted EBITDA margins were up about 80 basis points in Q4, despite the impact of lower recycled commodity value.

Looking at the full year, EBITDA margins were up 30 basis points on the strength of price-led organic growth and E&P waste activity, in spite of the 70 basis point impact from recycling.

Fuel expense in Q4 was about 3.7% of revenue, up 10 points year-over-year. We averaged approximately $2.65 per gallon for diesel in the quarter, which was up about $0.04 from the year-ago period and down about $0.07 sequentially from Q3.

Depreciation and amortization expense for the fourth quarter was 14% of revenue, up 10 basis points year-over-year due to increased depreciation and amortization expense from acquisitions closed since the year-ago period.

Interest expense in the quarter increased by $2.7 million over the prior-year period, to $35.2 million, due primarily to higher total borrowings as compared to the prior-year period. However, this increase was partially offset by $1.5 million in higher interest earnings from invested cash balances. Net of interest earnings, interest expense in the period was $31.7 million, up $1.2 million year-over-year.

Debt outstanding at quarter-end was about $4.2 billion, approximately 23% of which was floating rate. And our leverage ratio, as defined in our credit agreement, ended the year at 2.45 times debt to EBITDA, with cash balances of almost $320 million.

Our effective tax rate for the fourth quarter was 20.3%, slightly lower than expected.

GAAP and adjusted net income per diluted share in Q4 were $0.50 and $0.63, respectively. Adjusted net income in Q4 primarily excludes the impact of intangibles, amortization and other acquisition-related items and impairments.

As noted earlier, the impact to our adjusted net income per diluted share from recycling was a drag of about $0.02 in Q4.

Adjusted free cash flow in 2018 was $879.9 million, or 17.9% of revenue and approximately $20 million higher than expected -- than anticipated due to better-than-expected collection activity on the final day of the year, essentially pulling some 2019 cash flow into 2018.

I will now review our outlook for the first quarter and full year 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.

Looking first at the full year of 2019, revenue in 2019 is estimated to be approximately $5.310 billion. For solid waste, we expect organic growth of approximately 4.0%. This includes price of about 4.5%, with volumes down about 50 basis points due to the remaining shedding of poor-quality revenue, primarily, the impact of the New York City Department of Sanitation's marine terminal operations contract with a third party. Underlying volumes are expected to be essentially flat.

Adjusted EBITDA in 2019, as reconciled in our earnings release, is estimated to be approximately $1.705 billion, or about 32.1% of revenue, up about 30 basis points year-over-year, in spite of over 30 basis points of dilutive margin impact from approximately $200 million in rollover acquisition contribution already in place for the year.

Regarding tax rate, we noted in our earnings release that late in December 2018, the IRS released proposed regulations associated with the Tax Act that we believe, if finalized, could impact our current effective tax rate of 21.5%. Depending on the final form of any proposed regulations, we estimate that our resulting effective tax rate for 2019 could range between 21.5% and 26.5%. The proposed regs are not anticipated to be finalized until June or thereabout, if they do indeed get approved as final.

And that timing will impact our effective tax rate from quarter-to-quarter during the year. For example, our first quarter tax rate in 2019 is not expected to be impacted from these proposed regs, and should be about 20% in the period. Excluding these proposed regs, our effective rate for Q2 through Q4 would average about 22% for a full year effective rate of 21.5%.

However, for the full year, our outlook assumes that some form of the proposed regs is enacted, and reflects the midpoint of our expected range, or a 24% effective tax rate.

Adjusted free cash flow in 2019, as reconciled in our earnings release, is expected to be approximately $950 million, or about 17.9% of revenue. To be clear, the potential tax rate impact from proposed regulations, as noted earlier, has already been considered in our guidance for adjusted free cash flow.

Turning now to our outlook for Q1 2019, revenue in Q1 is estimated to be approximately $1.24 billion. We expect price growth for solid waste to be in the range of 4.5% to 5% in Q1 with volume of approximately negative 1%, about half of which is due to the purposeful shedding, including the impact of the New York City Department of Sanitation's Marine Terminal operation contract; and additional impact from severe winter weather conditions.

Adjusted EBITDA in Q1 is estimated to be approximately 30.9% of revenue, or about $383 million, down 40 basis points year-over-year, but up 25 basis points when adjusted for the 65 basis point margin dilutive impact of acquisitions. This impact is most pronounced in Q1 due to the timing of deals in 2018.

Depreciation and amortization expense for the first quarter is estimated to be about 14.1% of revenue. Of that amount, amortization of intangibles in the quarter is estimated to be about $30.6 million or $0.08 per diluted share net of taxes.

Interest expense, net of interest income in Q1, is estimated to be approximately $35 million.

Our effective tax rate in Q1, as noted earlier, is estimated to be about 20% subject to some variability. The effective rate for the period includes about a $4 million benefit to the provision related to excess tax benefits associated with equity-based compensation.

And finally, non-controlling interest is expected to reduce net income by about $200,000 in the first quarter.

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

Worthing Jackman: Okay. Thank you, Mary Anne. 2018 was purely a remarkable year, considering the challenges that we overcame and the results we delivered to drive our 15th consecutive year of positive shareholder returns, completing another outsized year of acquisitions, overcoming the headwinds of recycling, certain cost pressures and lower margin acquisitions to drive reported margin expansion, and further reducing the frequency of safety-related incidents would be noteworthy in any environment, but even more so when facing the constraints of low unemployment in many markets.

These accomplishments would not have been possible without the tireless efforts of our over 16,000 dedicated employees. At Waste Connections, we believe that accountability is integral to everything we accomplish, and is ultimately what sets us apart. Given the headwinds that we were able to overcome in 2018, we appreciate the greater visibility we have coming into 2019, with high-single-digit revenue growth already in place, continued adjusted EBITDA margin expansion, and another year of targeted double-digit adjusted free cash flow per share growth. And again, any increases in solid waste volumes, E&P waste activity or additional acquisitions would provide further upside.

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

Questions & Answers

Operator: Thank you. (Operator Instructions). Brian Maguire with Goldman Sachs.

Brian Maguire: Ron, if you're listening, I hope all is well; hope to hear some good news. Guys, just trying to put aside the quarter and the outlook, just kind of a bigger-picture question for you to start off. It seems like consumer sentiment and mood around single-use plastic, single-use consumable items has been shifting a lot in the last year or so in Europe; it certainly has moved a lot of our packaging companies and the impact of that. And you guys seem to be sort of part of the solution. Potentially, with your recycling operations, there's been sort of a push to increase recyclability of single-use items, but obviously, the economics of that aren't really great especially these days. But potentially, this could morph into more than just a war on plastics; it could become more of a war on waste.

And just thinking about how do you guys really think about that impacting your business over the longer-term. Obviously, not something that probably is going to impact 2019 or maybe even 2020, but just do you expect that we'll see tighter regulation on landfill expansions, or could states and municipalities sort of view expansion of landfills as encouraging more waste? Any efforts you guys can do to increase the recyclability of items, or are we really just dependent on getting some government help for things like that?

Worthing Jackman: Well, Brian, you stopped your year count at 2020, and I suggest you probably have to go well beyond 2020 before you see any impact notable within our business. Clearly, bifurcation and separation of the waste stream at the source is a growing trend. Obviously, we applaud that because it helps the purity of what's going through our facilities. But obviously, what folks are also realizing, when you try to do to increased source separation to improve recycling and recovery, that costs more money. And so you do have this intersection of desires to recycle, maybe reuse, intersecting with the likely increase in cost to do so.

But I'd say in the near-term, which easily looking out over the next decade or more, I don't think you'd see a notable impact in anything within our business. Now, are we always looking at new technologies to improve our processing capabilities within our facilities? Absolutely, but that's evolutionary, it's not revolutionary.

Brian Maguire: Okay. I appreciate the color. Just switching gears, and Worthing, your comments on the M&A environment are certainly encouraging. I guess you obviously mentioned you've done a lot of deals over the last 2 years. Just wondering how you'd balance the need to integrate those deals effectively, and the risk involved with that, versus the opportunities that you've got in front of them; and if you think 2019 is going to be more of a year of just integrating what you've already done and digesting it, or could this be another front-forward year where we see something similar to what we saw in 2018?

Worthing Jackman: Well, obviously, it's hard to predict the ultimate amount we do in 2019, but I'd back up to your first question around integration. These are some gold-plated companies that were acquired in 2018 with fantastic management teams. In fact, if you start with the biggest transactions and work your way down from the bigger transactions, the existing teams that were running the businesses have stayed with the businesses. And so as you said, this required very few heads on our side to relocate into these operations, and so it's not stretched our bench at all.

What I'd say on how are they doing, I'd look no further than the initial company we purchased in 2018, Bay Disposal. And you look at the integration of Bay Disposal and the adoption of our culture, Bay Disposal led our company last year in incident reduction down almost 70% in exiting the year with a single [I-rate] moving forward.

And again, so I think we don't wait, sit around, and hope integration happens; I think the team hops on that early on. I think the support that we give acquired companies is second to none. It's not like we buy a business and all of a sudden, start believing that we can jam them with emails and jam them with requests. What we do is we flood them with people to support and grow and develop the business and integrate the business immediately, not the other way around.

So I'd say the success in 2018, and the amount of activity done in the past 2 years, is no way precluding us from what we could do in 2019. And again, we remain well-positioned should

2019 become another outsized year.

Brian Maguire: Okay, great to hear. I'll turn it over now. Thanks.

Operator: Hamzah Mazari with Macquarie Capital.

Hamzah Mazari: My question is on M&A as well. Could you maybe talk about how you're managing to keep returns on capital on these deals similar to what you've done historically, just given valuations have stepped up in the private market? So any thoughts on returns on deals?

Worthing Jackman: Sure. And as we've said before in prior calls, clearly, multiples have gone up a half a turn to a turn or so over the past couple of years, but that's a combination of things. Initially, it was a combination of very high-quality companies we're buying with high-quality assets; meaning companies that had over-invested probably in years up to sale.

And obviously, that means if you're looking at returns on a cash-on-cash basis, those returns benefit from lower CapEx required early on after acquiring the business. But the inverse happens too, and we take that out in evaluations if someone's under-invested, and we think we have to overinvest post-closing. So that's what initially drove it a couple of years ago.

Obviously, the change in tax law with regards to lower tax rates in the U.S., and immediate expensing of required capital based on how the deals are structured, that also accelerates obviously cash flow. And lower tax rate puts more cash flow in our pocket too. And so we haven't seen a major change in target IRRs. It's just a fact that the other changes that affect how we deduct our purchase price, how we can accelerate cash flow delivery, as well as the quality of assets also drives those returns.

Hamzah Mazari: Great. And just a follow-up question, on the volume side, is your commentary just incrementally more cautious or is it just conservatism? I guess underlying volumes are flat, but it feels like the U.S. consumer is still pretty strong; the job market is strong; GDP is up. So just any disconnect in sort of your volume commentary? Is it a comp issue or just any thoughts there?

Mary Anne Whitney: No, I wouldn't say any disconnect or change in what we're seeing. I would start by reminding that we always come into every year pretty cautious after coming off. We had 5 years in a row of very strong volumes. Last year, not on a reported basis because of the shedding, but continued strong underlying volumes, as we've discussed, in places like the West Coast which we highlighted in Q4.

The other thing I would note, Hamzah, in the last 2 quarters we've guided to volumes being down 50 basis points to 100 basis points, and we've beaten by on that by almost 100 basis points in both cases. So as we come into this year, and we saw the weather in January, and of course, we have already described the purposeful shedding that we already know about that's hitting 2019, we think it's prudent to guide to volumes being flat and letting volumes be upside, but to be clear, no change in what we're seeing out there.

Worthing Jackman: Yes, Hamzah, as we've been saying all along, we think the U.S. economy generally is in that 1% to 2% range, and the Canadian economy somewhere in that zero to 1%

change, the growth from an underlying basis. And I'd also point out you can slice and dice stuff as much as you want; you can say it tongue-in-cheek. If you exclude all the negatives, volume is nicely positive. So you've got to be careful about what you want to exclude in trying to lead a message, but we think it's always better to be cautious and let volumes be upside.

Hamzah Mazari: Got you. Just last question and I'll turn it over. The proposed regs that are impacting taxes for you, is that specific to you because of a tax inversion that you guys did, or is this sort of common for most companies? Thank you.

Mary Anne Whitney: So Hamzah, to answer your question about proposed regs, they do include some potential limits on the deductibility of interest in the United States, which could impact us if they get promulgated as proposed. And so that's why we mentioned them, and think it's prudent in our guidance to include that midpoint of the range of where they could end up. But again, to be clear, nothing's happened yet and they won't impact Q1.

Worthing Jackman: Yes, it affects all companies with cross-border inter-company financing. Obviously, with capital flowing across countries, this could get caught in, so it's any company with multinational operations.

Hamzah Mazari: Got you. Thank you.

Operator: Tyler Brown with Raymond James.

Tyler Brown: Hey, our thoughts go out to Ron. But hey, Mary Anne, I appreciate the Q1 guide. But could you guys put a finer point on the progression of the change in EBITDA margins as the year progresses? It sounds like you're going to be most burdened with the rollover of the M&A early in the year, and then that abates as the year progresses. Is that the right way to think about it?

Mary Anne Whitney: That is, Tyler, yes. As I said, it's over 30 basis points for the full year and the cadence would be as follows. It's about a 65 basis point margin dilutive impact in Q1, and that decreases to about 40 basis points in Q2; steps down to about 20 basis points in Q3; and mostly down by Q4, but about 10 basis points in Q4. So that overall, that works out to be between 30 basis points and 35 basis points for the year.

Tyler Brown: Okay, very helpful. And then Mary Anne, I know this is very fluid, but what is your expectation for cash taxes as a percent of that 24% book accrual?

Mary Anne Whitney: Yes, so the expectation for cash taxes as a percentage of book is about between 60% and 65%.

Tyler Brown: Okay. And does that change as time goes on? Will that go higher?

Mary Anne Whitney: As we said, to be clear, our $950,000 in free cash flow guidance already incorporates a consideration for our expectations around taxes.

Worthing Jackman: But obviously, if you go all the way out to 2023, when [loans] depreciation expires, obviously, you start at 60%, 65%; starts migrating above 85%, 90% especially when you intersect into 2023 when most of your CapEx outlays over the prior 5 years get fully expensed.

Tyler Brown: Okay. And then Worthing, this is a conceptual question, but you guys are guiding to, say, 60 basis points of core solid waste margins on a very healthy 4.5% price. Your larger competitors are guiding to, give or take, say, 30 basis points of margin expansion with 2 to high-2 pricing. So where do you think the disconnect is? Is it that you are being conservative, or do you have some sort of differing unit cost inflation set up? Am I reading too much into this, or just any thoughts broadly there?

Worthing Jackman: I don't know what's driving the outlook of other companies in the space. All we can address is how we look at things. Look, just look at our experience quarter-in and quarter-out, or year-in and year-out. We try to put numbers out there in February that provide enough cushion as we look at the entire year for the proverbial unknowns that can hit you.

And obviously, if we're able to dodge more of those unknowns, you'll see nice upside to our outlook. Putting numbers out there and then re-crafting the truth, as you move through the year to try to reinterpret people's perceptions, is not what we try to do during the year. We just lay it all out there and let our numbers speak for themselves.

Tyler Brown: Okay. That's helpful. And then just one last one. Mary, I think you mentioned 2.45 debt-to-EBITDA today. Curious, can you talk about what you view as your optimal capital structure? Where do you kind of want that leverage ratio long term? Thanks.

Mary Anne Whitney: Sure. We're certainly very comfortable being higher than that, and sort of in the 2.75 range, we think is a good place to be, because what we know is that we could then -- with the ability to take leverage up to 3.5 times or even higher for an outsized deal to the extent that opportunity were to present itself. But what we know is we'll de-lever dynamically about half a turn within a year and we like staying in that 2.75 to 3 times range.

Tyler Brown: All right, guys. Thank you very much.

Operator: Derek Spronck with RBC.

Derek Spronck: Just on the proposed changes, tax changes, should we assume that the cash flow impact would be the differential of the effective tax rate of 24% from 21.5%?

Mary Anne Whitney: Well, as I said, Derek, we think a bit more that this impacts GAAP, and really is less a matter of cash. And that's why we tried to give you free cash flow guidance that says, look, don't worry about that; we've already factored that in. It's really a GAAP issue.

Derek Spronck: So technically, there wouldn't be much of it? If the regulation didn't come through, there wouldn't be much of a free cash flow tailwind, is that correct?

Mary Anne Whitney: Yes. As you know, we try to come into the year with some visibility on what we think we can deliver, and that's how we factored in the $950,000. So at this point, we'd leave it at that. And I think what's helpful is we'll know more in April when we're on this call, and so we'll be able to give clearer guidance.

Derek Spronck: Okay, great.

Worthing Jackman: Remember, we apologize for over-delivering in 2018. So let's -- don't start raising the $950,000 on us right now.

Derek Spronck: Okay. It's the opposite of what I usually do is over-promise, under-deliver. But just moving on to some of the items in the 10-K, you have 14 landfills that you're seeking expansion. And it also indicated around 10% of your workforce is going through, or will be going through, a collective bargaining agreement in 2019. Is this just standard business for Waste Connections, or is there any risk that could be tied with those two developments?

Worthing Jackman: I'd say pull out all the prior Ks and you'll see similar ratios. This is just standard fare of the solid waste business. When you have a large portfolio of landfills, every company is going through episodic expansions, that's common. Obviously, when you have a large workforce and multiple underlying contracts with unions, we're negotiating those all the time. We just got a couple of finished earlier this year already, and that's just part of the day-to-day blocking and tackling.

Derek Spronck: Okay. Got it.

Mary Anne Whitney: And regarding that, I would just add, Derek, that a number of the landfills with the shorter lives are very small. And probably one of the largest is one that's been on there literally for years where we have another landfill right in the same market, which we've been anticipating the closure.

Derek Spronck: Okay. Got it. That's great. And then just one more for myself. Free cash flow, as a percent of revenue, originally, it was around 15%, but it was a sustainable run rate. 2017 it was 16.5%; 2018, 18%. It looks like 2019 is shaping up to be in and around 18%. Is that largely from the changes in the cash tax regime, or is it partly due to you leveraging economies of scale, or how should we think about that ratio on a sustainable basis here?

Worthing Jackman: Well, we've always said don't own us for 55% EBITDA to free cash flow conversion. That will be coming down over time. It will probably go into the low 50s, not the mid-50s. And so we fully expect that to come down over time, obviously, as we talked before, as cash taxes go up, as [loans] depreciation expires in 2022. And so that will always move down over the course of time, but as we sit here today, we don't see anything lowering that, bringing that below 50% anywhere anytime soon.

But again, as you know, as we've always said, as you look at EBITDA to free cash flow conversion, we always say that not only EBITDA creates the same amount of free cash flow; that's a combination of obviously, the financial profile and the performance we have on our collection side of the business, which again, is 60%-plus of revenue. It's a combination of -- and that's a lower asset-intensive business. It's a combination of how we structure acquisitions and looking for our basis in transactions, and that impacts cash taxes.

So there are a host of things that that drive comparisons against other companies. But again, for us, 55%, don't model that long term. We've been consistently saying that for some time now. We'll enjoy 55%, we can do it; but that's not a long-term number.

Derek Spronck: You have pretty good visibility though into 2020 though, that should be in and around that level, is that correct?

Worthing Jackman: Yes, we try to have visibility on that.

Derek Spronck: Yes, okay. Thank you very much. I'll leave it there.

Operator: Noah Kaye with Oppenheimer.

Noah Kaye: First, just a quick math question on the recycling. So assuming the [math] goes down 15% year-over-year, and that sort of decrementals continue, this is about a $10 million to $15 million EBITDA headwind for 2019, is that right?

Worthing Jackman: No, that's mostly a Q1 thing we're talking about here, because Q1 was the toughest comp year-over-year. Once you get past Q1, it's nominal.

Noah Kaye: Okay. So the full-year headwind, we're talking mid-single-digits?

Worthing Jackman: A couple of million [bucks], a couple of million [bucks].

Noah Kaye: Okay. Okay. And then just to piggy-back off of an earlier cash tax question, so essentially, you had a very low accrual in 2018. You go into 2019 and basically, you're looking at cash taxes at about a $70 million or so headwind year-over-year. So essentially, what I read into this is that underlying free cash flow growth is in the double-digits, is that a fair statement?

Mary Anne Whitney: Again, we did point out that we essentially over-delivered in 2018. So I do think if you back that out, you do see nice underlying growth beyond what we're showing here. So yes, you're right, we had the big over-accrual coming into 2018. And so on a reported basis, our cash taxes will be up about $75 million year-over-year, and we'll continue to deliver free cash flow. So that is fair.

Noah Kaye: Okay, great. And then maybe one last one. I walked past a Waste Connections hauling truck this morning in New York City. And after reading a lot of press around plans for New York City to move towards commercial-zone franchising, and the experience that LA has had so far. I guess generally, do you see this as a medium-term trend in more of your urban markets? And if so, how positive or negative do you think it is for Waste Connections?

Worthing Jackman: No, we don't see this as a trend. LA was late to the party relative to most markets on the West Coast. New York City, it's just something that makes sense in that tight operating environment. Dozens of trucks shouldn't be criss-crossing each other on crowded streets at all times of the day, and the risk profile was just too high for many operators.

The quality of the equipment that they can pick on the street is very low because of the [financial] positions they're in. And so it makes sense in New York to follow on the heels of LA. Now, how New York structures it in the end, it still remains to be seen, but we don't see this as a trend in other markets.

Noah Kaye: Okay. Thanks very much.

Operator: Michael Hoffman with Stifel.

Michael Hoffman: If you do no deals in 2019, can we continue to think about the structural organic growth in solid waste is in between 4% and 5%?

Worthing Jackman: Yes, we've been consistently saying it's between a 4% and 6% number, especially with this CPI in this pricing environment being 4.5%-plus.

Michael Hoffman: Okay. And then again, no deals in 2019. How long does it take to recover that 30 basis points, 35 basis points of 2019's dilution from deals?

Worthing Jackman: Recover -- again, what you have is the acquisitions would then be embedded in the base calculation. And so then you're looking at a jumping-off point again up 30 basis points year-over-year coming out of 2019. Then obviously, if you don't have the rollover of any dilutive transactions in the year, again you're looking at that typical 30 basis points to 40 basis point type margin expansion in 2020; albeit, let's wait and see how the economy is.

But no, again, when you've got the -- such a large denominator right now, it's rare that acquisitions move the needle on a notable basis. But when you have a deal as large as American at 3.5% of revenue coming in at comparative margins down 600 basis points because it's collection oriented, that's about a 20 basis point impact to consolidated margins. But again, if it's -- it depends on the size of the year for acquisitions. Obviously, if you do no deals, which we've never done, then you don't have that influence on reported margins going forward.

As Mary Anne said, as you begin to anniversary the deals we did last year, you see less and less of a drag in the reported numbers. And therefore, the printed margin expansion will be a lot higher as you move through the year relative to how we start the year.

Michael Hoffman: Right. I was just trying to draw that out. And then to be clear, you see no line of business weakness, no regional weakness? Prospects are probably flat. Housing, consumer, remains engaged?

Mary Anne Whitney: As I said earlier, there's nothing that's changed that would influence our volume outlook. We think it's pretty consistent with the way we've been communicating volumes for the last 2 quarters. And again, guiding down and then delivering better than that, and we'd prefer to start the year the same way.

Worthing Jackman: But as you know, Michael, this is such a fixed bill system business, that if you have a high-market-share model, generally, it's the tone of the underlying economy that's going to drive the volume growth and reported numbers. Our business is not about market share-grabbing; it's about servicing the underlying markets that we operate in.

Michael Hoffman: Yes, and my question wasn't specific about volume; it was about a macro view. You're not seeing line of business weakness; you're not seeing regional weakness. Housing, I'm assuming you're saying that --

Worthing Jackman: That's correct.

Michael Hoffman: -- you think it's going to be flattish. And you still see the consumer engaged, that's what I was asking.

Worthing Jackman: That's all a fair statement and we saw all that in January to confirm at least one month of 2019.

Michael Hoffman: Okay. And then just two more questions just to clarify something. If you're doing double-digit per share growth in free cash flow, obviously, you're going to be pretty active in the buyback because you've got to average at least 2%. That's the right way to think about that, right?

Worthing Jackman: Yes, as we've always said, if you look back for the past several years, the numerator has been what's been the key driver to the high-teens CAGR on free cash flow per share growth. But as the large numbers proceed, you've got a combination of higher numerator and lower denominator that eventually comes into play, because we're just spitting out more cash flow than we need to deploy in acquisitions, because again, we're cash funding all acquisitions, de-levering the balance sheet. We've got more than enough capacity and flexibility to affect the numerator and the denominator going forward.

Michael Hoffman: Right. And then last for me, just to be clear about an earlier question, Waste Connections is completely indifferent about what they would do with the trash once they collect it, as long as you generate a reasonable return on the capital you deployed. So whatever changes may come slowly, you'll be able to react to because you'll control it at the curve in the loading dock?

Worthing Jackman: No one around here is changing [S drives], Michael, that's right.

Michael Hoffman: Okay. All right, great. All right. Thanks.

Operator: Thank you. (Operator Instructions). Chris Murray with AltaCorp Capital.

Chris Murray: Just following on maybe on Michael's question a little bit around the free cash flow guidance, so the number year-over-year looks to start at around 8%. And so I guess a couple of pieces of this. First of all, expecting kind of high-single-digit revenue growth, you would have expected it would have been higher. What's the drag embedded in that number from the tax change, I guess is the first piece of that.

And then second, if I think about -- you think about your target leverage, you're sitting, call it, $300 million in cash. You're going to have the free cash flow generation. Should we start thinking about maybe a change in how you approach either the buyback, or something like that? Historically, 2% to 4% of shares bought back. But is there any opportunity to maybe step up that number as that free cash flow number expands?

Worthing Jackman: As you know, everything's possible. Again, that's the flexibility we have. Again, if you look at the free cash flow, we look at it as actually a double-digit growth because again, last year, we were talking about $860,000 and looking at it in 2019 of $950,000. That's little over 10% growth in free cash flow on a dollar basis. We've already apologized for giving $20 million more in 2018 and delivered $880 million instead of $860 million.

But again, it's too early to change the target of $950,000. Frankly, what that means is probably could have been $970,000 or more if that $20 million cleared the bank on January 2 instead of December 31. And so what the difference of a day make? That's the difference a day makes. So we're less focused on that; that's just a timing issue of when some checks cleared.

Mary Anne Whitney: And I guess the other piece of it regarding leverage and the ability to do more in terms of buybacks, as Worthing said, there are a number of things that are possible and we have so much flexibility. We continue to believe we're in a period of outsized M&A activity, as Worthing has said. And so that will continue to be our highest and best use of cash.

But again, we exited the year at sub-25 with over $300 million in cash on the balance sheet, and guided to $950,000 in free cash flow. So that's $800 million after the dividend; so we have ample firepower to do what we did last year.

Chris Murray: Okay.

Worthing Jackman: Yes, as you know also, Chris, look we are the ultimate owner of our stock. So we can be very patient when we pick the time to go to the market and buy. We bought it on February 5 last year; we bought in December [5] last year. And so I think our average repurchase price was around $71, and so it's that, in addition to deploying overbuilding and acquisitions, again, we spent over $1.02 billion on M&A. And we've returned the capital to shareholders and our leverage declined.

So again, we just feel fortunate to be in this position to, first and foremost, deploy our capital on strategically consistent and appropriately priced M&A opportunities. And then after the runway is so long for us on that opportunity, and then dabble in the stock market opportunistically.

Now, if for whatever reason, the seller expectations over-inflate, and deal activity slows down a little bit, and cash is building up, obviously, we don't sit on cash. We'll pick our spots in the market and step in a larger way.

Chris Murray: Okay, fair enough. And sorry, just the -- what was your expectation to tax change on the $950,000 guide?

Mary Anne Whitney: Again, what we tried to say is that we think this is a GAAP matter, and that on the free cash flow guide, we've already factored because the changes to taxes. So it's not a free cash flow impact.

Chris Murray: All right, great. Thanks. Just going back to some of the timing, as we think about the purposeful shedding, particularly in Canada, a 6.2% price number, you got to be thinking that that's got to step down a little bit as you anniversary the shedding; and maybe flatten out the volume number, even if you're going to go to a zero number. How should we think about the cadence as we move through 2019 in terms of, call it, the normalization of that price growth?

Mary Anne Whitney: Yes, you're right, Chris, and certainly, what you saw in Q4 on that continued high price in Canada, a lot of that is because of price increases that were put in in late 2017 and into 2018. And when, as you note, that was very purposeful, and as we said, really all of last year, that price stuck better than we expected and volumes took longer to go away than we would have expected when we really started that in earnest in 2017. What you should expect to see during 2019 is that price will start stepping down.

As Worthing said, even on a reported basis, when we guide to 4.5% for the full year, it will start higher than that. And then we exited Q4 2018 already higher than that. You should expect it to be higher than that in Q1 and step down over the course of the year. And I would expect Canada in particular to follow that same pattern over the course of 2019.

Chris Murray: Okay, fair enough. All right. And just one last one for me. Just kind of following-up, you had mentioned you're spending some CapEx on some E&P landfills. And I think they are supposed to be operational towards the middle of this year. I guess first of all I just want to confirm or update where we are with those projects.

And then anything we should think about -- and I know you had previously talked about some EBITDA margins -- but anything that's going to be odd in the start-up of those, or should we just assume that as they start taking volumes, that we should see fair -- call it, normalized margin profiles on the way in, or will there be some sort of dilution that we should expect in the back half of the year?

Worthing Jackman: It obviously depends, but the initial cost ramp, you won't notice in our overall consolidated business, because it's nominal compared to the size of our business. But obviously, the first revenue that comes in dollar-for-dollar, it will cover costs, right? And once we start exceeding that cost, because of the fixed-cost nature of that business, then you start seeing the incremental flow-through become a lot higher.

It really depends on the speed of the ramp with regards to timing One of our landfills will likely start doing its (inaudible) start during Q2 and so we're ahead of schedule on that one. Another project that we -- it's still under construction right now; that will probably start ramping early in the third quarter. And so that is on schedule with our original schedule because we're somewhat cautious on that.

So no, it's -- again, and what we've tried to say is that look, the ramping of that, of either of the new projects, and the other ones we're working on, we look at that as being just potential upside to the way we guide for the full year.

Chris Murray: All right. Thanks very much, folks.

Operator: Sean Eastman with KeyBanc Capital Markets.

Sean Eastman: I was hoping to get an update on the labor capacity and wage inflation challenges perhaps relative to when you guys reported in the fall. I was just hoping to get some context on things like turnover, safety incidents, and whether those things have stayed in check, or worsened, or maybe improved a little bit? And perhaps just what the main sort of goal and focus area is in terms of addressing these challenges in 2019?

Mary Anne Whitney: Sure. So I can start. Certainly first of all, with respect to safety, as Worthing noted, safety did continue to come down in 2018. You saw a high-single-digit decrease on our incident rate in 2018. We're in the dead of winter and had January with severe weather.

That certainly impacts safety and we're certainly mindful and paying close attention to it in Q1.

In terms of turnover, really remained in that, and we've been in that kind of 25% to 26% or 27% range on turnover. Haven't seen a market change there. What we really said all of last year is that we were pleased that it wasn't getting much worse, given the constraints on labor.

And what we saw with real wage increase in Q4, it was about where it was maybe a little higher than in Q3, high 4s, between 4.5% and 5%, would be the same employee wage increases. Of course, that's mitigated or muted in the P&L by the turnover, but that's what the wage increases are.

And as we think about 2019, as I think we've communicated, we've taken a look at things like our benefits and increased our 401k match, and done some things to make sure that we remain the employer of choice, and have the benefits that that we think are appropriate for our employees. And those costs are factored into our guidance for 2019.

Worthing Jackman: Yes, Sean, to Mary Anne's point about higher 401k contributions and the matching that we're doing, we anticipate that. And included in our outlook, that's about a 30 basis point headwind year-over-year. So while we guided a 30 basis point improvement in margins, obviously, if I adjust just for the anticipated increase of 401k contributions, that would have been a 60 basis point margin expansion for the full year. But we're anticipating again, increased participation and folks to be deferring more of their eligible compensation for that.

Sean Eastman: Really helpful. And my next question is just going back to the M&A. I was hoping to -- you guys are indicating an elevated environment continuing this year. I assume there's a pipeline of targets that are sort of in negotiations getting close. And out of those targets that are at -- in advance stages, I was hoping to get a sense for the mix of kind of collections-only versus integrated, or maybe non-solid waste to get a sense for what could be added this year?

Worthing Jackman: Again, like most years, we've got a couple of integrated, meaning collection and landfill. But then there's a large number that are collection-only that either tuck into our existing operations that could be internalized in our facilities, or new market entries as well. So it's just a standard mix, as we sit here right now, and it's all solid waste-oriented right now.

Sean Eastman: Okay. Got it. And just lastly for me, I'm just trying to get an idea for what the risk to this acquisition environment is. Is there potential for more private equity to swoop in? What could choke off some of this elevated deal activity?

Worthing Jackman: Well, obviously, as we talked about on last call, episodically, you've got, whether it be PE or PE-backed companies that come in and take a different look, and value things on EBITDA and not cash flow. Sometimes that's an interruption sometimes, and we don't get all the deals we think we might get. That's fine. Our view has always been you can never recover from overpaying. So that's obviously a potential interruption and we're fine with that.

Again, we're taking the long view here, as we know companies that pursue growth for growth sake don't end well. The debt could get paid off and the banks are safe, but the equity is always at risk. And so we've got to play the long game here and not be tempted into doing foolish things. And again, I think the track record you've seen over 21-plus-years validates that.

Sean Eastman: Excellent. Thanks so much for your time.

Operator: Thank you. (Operator Instructions).

Mr. Jackman, there are no further phone questions at this time.

Worthing Jackman: Well, great. Thank you. 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 the applicable securities laws in Canada.

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

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