Waste Connections, Inc. [WCN]
Q1 2023 Earnings Conference Call
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Company Participants:
Ron Mittelstaedt; President and Chief Executive Officer
Mary Anne Whitney; Executive Vice President and Chief Financial Officer

Analysts:
Tyler Brown; Raymond James
Kevin Chiang; CIBC World Markets
Sean Eastman; KeyBanc Capital Markets
Adam Bubes; Goldman Sachs
Michael E. Hoffman; Stifel
Noah Kaye; Oppenheimer & Co.
Jasper Bibb; Truist Securities
Hilary Lee; Morgan Stanley
Stephanie Moore; Jefferies
Walter Spracklin; RBC Capital
Stephanie Moore; Jefferies

Presentation:

Operator: Good day and welcome to the Waste Connections Q1 2023 Earnings Conference Call. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Ron Mittelstaedt, President and CEO. Please go ahead.

Ron Mittelstaedt: Okay. Thank you, Operator, and good morning. I would like to welcome everyone to this conference call to discuss our first-quarter results and to provide a detailed outlook for the second quarter.

As many of you know, I was reappointed recently to the role of CEO, which I had held from the Company's inception 25 years ago until July 2019, when I transitioned to Executive Chairman. I am pleased to have this opportunity to reconnect with so many of you that I have enjoyed working with over the years.

I am joined this morning by Mary Anne Whitney, our CFO, and several other members of our senior management team.

Looking at Q1, record solid waste pricing growth, strong operational execution and continuing acquisition activity provided a strong start to the year. While we recognized on our February earnings call that Q1 would be a difficult year-over-year comparison, given the precipitous decline in resource recovery values during the second half of '22, results in the period were further affected by extraordinary weather-related impacts to solid waste roll-off activity and land fill volumes, particularly on the West Coast. Underlying adjusted EBITDA margins were in line with our expectations, but acquisitions completed since the year-ago period were 30 points dilutive to reported margins, or more than 20 basis points higher than we had expected given the disproportionate weather-related impacts on the West Coast acquisitions.

Continued visibility on pricing, improving trends in labor availability and retention, and recent normalization of weather patterns position us to deliver the full-year outlook we provided in February. And, as we also noted then, any additional acquisitions, reduction of inflationary pressures or increases in values for recycled commodities or renewable fuel from the low levels we've seen since late last year would provide upside to this outlook. No improvement in those values was factored into our outlook.

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, Ron, 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 included in our April 26th 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, 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 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 measures. 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 Ron.

Ron Mittelstaedt: Thank you, Mary Anne.

In the first quarter we delivered solid waste price plus volume of 10.5%, total price of 11.8%, including about 80 basis points of fuel and material surcharges, range from about 8% in our mostly exclusive market Western Region, up to 13.5% in our competitive markets. Our pricing strength continues to reflect the resilience of our market model, our purposeful approach to addressing cost pressures and the advantages of local decision making driving operational execution and accountability in our decentralized organization.

Reported volume growth of negative 1.3% includes an estimated impact of about 50 basis points from the extreme weather events on the West Coast, including over a dozen atmospheric rivers, which impacted our operating locations, primarily in California, and resulted in a slowdown in roll off and landfill activity. The associated incremental volume [drag] is partially offset by increases in other markets, including in Florida on hurricane-related cleanup activity.

Beyond solid waste revenues played out largely as expected in Q1. Recycled commodities, landfill gas and renewable energy credit, or RINs, collectively were down about 40% year over year on commodity values that haven't moved materially off the bottom established in late 2022.

Similarly, E&P waste activity levels were as expected, at $48 million. E&P waste revenue in the first quarter was down about 8% sequentially, reflecting what we would consider typical seasonality. Trends showed some improvement during the quarter, which should bring the quarterly revenue run rate back to about $50 million.

Now, moving to acquisitions, we are encouraged by the cadence of activity as we continue to see high levels of interest from sellers, high-quality solid waste businesses, sustaining a robust pipeline and elevated levels of dialogue. We've closed approximately $45 million of annualized revenue year to date, most of which was included in our outlook and currently expect that pace of activity to continue throughout the year. There is no change to our capital allocation priorities, starting with strategically attractive, appropriately priced solid waste acquisitions. As always, we will remain selective about the markets we enter and the multiples we pay as we maintain our focus on long-term value creation.

To that end, we are also continuing the deployment of a number of sustainability-related projects outlined previously, including several renewable natural gas, or RNG, facilities, one of which is proceeding on schedule to be operational later this year. We look forward to the expansion of our RNG portfolio and continue to anticipate an incremental $200 million of EBITDA in 2026 in the projects in development on a commensurate outlay capital.

Given the strength of our balance sheet, with leverage below 2.9x, we retain tremendous flexibility as we continue to reinvest and grow the business. We have optionality around debt repayment, with over $1 billion in prepayable debt, along with the expanding return of capital to shareholders, including through opportunistic share repurchases and our established practice of increasing our annual per-share dividend when we undertake our typical review in October.

And 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 Q&A.

Mary Anne Whitney: Thank you, Ron.

In the first quarter, revenue of $1.901 billion was up $255 million, or 15.4%, year over year. Acquisitions completed since the year-ago period contributed about $133 million of revenue in the quarter, or about $132 million net of divestitures.

As Ron noted, we delivered total Q1 price of 11.8%, including core price of 11%. And we remain well positioned for full-year 2023 core pricing of about 9.5%. In fact, given the pricing acceleration in competitive [regions] during 2022, plus the rising benefit from higher CPI-linked market increases in '23, we now have over 85% of that 9.5% price either already in place at this time, or specified by contract. The expected sequential stepdown in reported price as we move through the year is the result of the combined impact of fuel surcharges turning negative, the anniversary-ing of outsize price increases in 2022 and the typical effect on seasonality on reported pricing.

Moving to solid waste volumes in Q1, adjusting for the weather-driven impact to our West Coast operations and the hurricane cleanup work in Florida, volumes were about as expected. Looking more broadly at trends and normalizing for these anomalies, we saw some moderation in activity levels over the course of Q1, most notably in March. And we're still waiting to see a meaningful seasonal ramp in activity. We have, however, seen improvement in the most affected West Coast markets, now that the sun is finally out.

Looking at year-over-year results in the first quarter on a same-store basis, commercial collection revenue was up 15% year over year due to price. Roll-off pulls per day were about flat on revenue per pull up 11%, and daily landfill tons were up nominally in Q1 on flat MSW tons. C&D tons were up 14%, offset by special waste, down 6%. The increase in C&D waste is due to activity in Florida and lower special waste activity reflects both a tough comparison to last year and weather-driven slowdowns, most notably in our Western Region. Prices for OCC, or old corrugated containers, averaged about $60 per ton in Q1, as expected, and RINs stayed mostly in the range of about $2.

Adjusted EBITDA for Q1, as reconciled in our earnings release, was $567 million and 29.8% of revenue, including about 30 basis points margin dilution from the impact of acquisitions completed since the year-ago period. This was about 20 basis points more diluted than expected, primarily due to the disproportionate impact from weather on acquisitions recently completed on the West Coast, including high-margin landfills. Otherwise, margins played out about as expected, as we overcame the weather impacts to deliver underlying solid waste margin expansion of 110 basis points.

Breaking the pieces down, excluding acquisitions, adjusted EBITDA was down 40 basis points year over year in the face of 160 basis points in commodity-related headwinds, including 120 basis points from lower recycled commodity values, 20 basis points from lower RINs, and 20 basis points from higher fuel costs. Partially offsetting that, increased E&P waste activity contributed about 10 basis points and, as noted, underlying solid waste margins expanded by 110 basis points on price-led growth, a reminder once again of the power and importance of anticipating, implementing and retaining price increases.

Interest expense in the quarter increased by $27 million over the prior-year period to $68.4 million, due primarily to higher total borrowings resulting from acquisition outlays as compared to the prior-year period. Including higher interest income from invested cash balances, net interest expense in Q1 increased by $24.5 million year over year to $65.6 million.

And, finally, adjusted free cash flow of $274 million was in line with our expectations and reflects the year-over-year increase in net capital expenditures of $32 million in the quarter, along with higher CapEx-related payables from year end and higher cash interest.

As Ron noted, we remain well positioned to deliver our full-year outlook as provided in February, including adjusted free cash flow of $1.225 billion.

I will now review our outlook for the second quarter of 2023. 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 Commission or similar regulatory authorities in Canada. We encourage investors to review these factors carefully.

Our outlook assumes no significant change in underlying economic trends. It also excludes any impact from additional acquisitions that may close during the remainder of the year, expensing of transaction-related items during the period and executive separation costs.

Revenue in Q2 is estimated to be approximately $2 billion. This includes solid waste price plus volume growth of about 8%, with core price of about 10%. E&P waste revenue is estimated at approximately $50 million and recovered commodity values are expected to remain largely in line with recent levels.

Adjusted EBITDA in Q2 is estimated at approximately $615 million, or 30.8%. This reflects continued headwinds from recovered commodity values in the year-ago period and some margin dilution from acquisitions completed since the year-ago period.

Depreciation and amortization expense for the second quarter is estimated at about 12.5% of revenue, including amortization of intangibles of about $39 million, or $0.11 per diluted share, net of taxes.

Interest expense net of interest income is estimated at approximately $60 million. And, finally, our effective tax rate in Q2 is estimated at about 22.5%, subject to some variability.

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

Ron Mittelstaedt: Thank you, Mary Anne.

Once again, I want to let all of you know how excited I am to reconnect with you and to reengage in those aspects of the day-to-day business that allow me to have greater impact on leadership at every level. It's an honor and a privilege to be back in this role and I appreciate the trust that the Board and our shareholders have placed in me and the Company as much today as I have over the last 25 years.

From our beginnings, Waste Connections has pursued a differentiated strategy focused on exclusive and secondary markets with a decentralized operating structure. Moreover, we have maintained that relationships drive results and as servant leaders we are field-focused and strive to set up for success those we have the privilege to lead. Nothing about that strategy or culture has changed in spite of the tremendous growth we have achieved. In fact, it's that growth that has magnified the importance of doubling down on human capital to focus on the development of our next generation of leaders. We are executing on a playbook that has served us well over the past quarter-century and looking ahead to the next 25 years. We want to [assure] you that the leadership team is in place to continue to drive the industry-leading results that are the hallmark of Waste Connections.

In the near term, as we've discussed, we are on track to deliver the full-year outlook we provided in February. Moreover, we are encouraged by several factors, including outsized visibility on our pricing for the full year, now at over 85%; improving trends in labor availability and retention; escalating dialogue on acquisitions; and, finally, the recent normalization of weather, most notably on the West Coast. We remain well positioned for upside from increased recovered commodity values or reduced inflationary pressures and we look forward to providing any updates to our full-year outlook as we typically do on our July call.

We appreciate your time today. I will now turn this call over to the Operator to opening up the lines for your questions about the quarter, our outlook, or whatever's on your mind. Operator?

Questions and Answers:

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Tyler Brown with Ray J.

Tyler Brown: So I just want to start with cost inflation. So I think last quarter you guys talked about unit cost inflation maybe of 6 to 7% embedded in the guidance. So first off, can you just talk about where maybe unit cost inflation is trending in Q1?

But, secondly, could you talk more about how that's trending in some of those major buckets? You talked a little bit about labor, but what about R [and] M, maybe subcontractor hauling? Because it just feels like there's some [dis-] inflation pressure building there. I'm just curious if you're starting to see that in any noticeable way.

Mary Anne Whitney: Sure, Tyler. So why don't I start and then Ron can add some color to this. So, as you pointed out, coming into the year we talked about the expectation of cost inflation in that 6 to 7% and specifically we talked about labor being a component of that and that we were in kind of a 6-to-8% increase environment, starting the year closer to 8%. And we thought those pressures would abate somewhat, moving down to 6% over the course of the year perhaps.

And the update to that is that I'd say we're still at the high end of the range and we're not surprised by that. The expectation would be that, as we anniversary the outsized increases we did last year, you'd see some of those pressures abate. And of course there's also the observation that some of those pressures more generally on labor. And as Ron mentioned in his remarks, we're seeing improving trends and so you would look forward to over the next couple of quarters seeing those benefits realized and the actual decrease in the pressures moving to the P&L.

With respect to third-party costs, we've talked about the fact that the really outsized ones in prior periods included things like third-party brokerage and disposal. And I can say we're seeing those pressures abate. They're still above headline inflation numbers, but they're stepping down and taking some of that pressure off. And when you look at our 110 basis points of underlying solid waste margin expansion, those line items are a big component of that, I would say.

Ron, did you want to add to that?

Ron Mittelstaedt: Yes. Tyler, agree with everything Mary Anne said. I mean, we are generally seeing some -- on at least a percentage basis, some slowing of cost inflation, as Mary Anne mentioned, but brokerage was up last year every quarter over the prior-year quarter in the teens to 20%-plus level. It dropped down to being up about 10% on the nose, so almost half of what it was. So, it's still up but it's dropped by almost 50%.

The other issue that's probably a little outsized right now, although supply chain is getting better without question, it's really still obviously not where it needs to be. So taking deliver of less trucks than is optimal at this point, but getting closer. Outside repairs is running probably 50 to 60% higher than we would expect. And that is indicative of major repairs on older equipment that's scheduled for replacement that you're sending out because it's a complicated component relative to typical in-house repairs. That will continue to get better as well.

And labor, although still elevated, is running in that 6 to 8% increased range. Some of that's [math comps], but that will continue to -- we believe continue to flatten out and decline as the year goes on.

Tyler Brown: Okay. Lots of good detail in there. So it does seem, though -- really trying to shift gears here. It does seem kind of clear from [my transports] and your commentary maybe about landfill tons and roll-off pulls that the economy feels to be slowing like, call it, real time. I mean, I know you don't have heroic assumptions in the guide, but the economy does feel shaky. Does it feel like the lower end is more at play at this point on the volume front?

Ron Mittelstaedt: Well, you know, Tyler, we've said that we expect this year to be -- back in February, to effectively be flattish. We defined that as between negative 1 and 1, so effectively flat. If you look at this quarter and you take out weather, it would have been about 0.8, so sort of near the lower end of that negative 1. If we look at -- give you some real-time numbers. If we look at, as an example, our landfill volumes, by month in the quarter, January was up 2%, February was up 3%. March was down 3%. That's how you get to what you got for the quarter, flat effectively. And April, through 26 days, we looked at this last night, is tracking to be 0 to 1% up. So was March an anomaly due to weather, particularly on the West Coast? We think it was. Do things feel like it's slowing a little? Maybe in certain markets, but nothing certainly extreme that we've seen. And, again, you look at roll-offs, January up 1%, February up 2%, March down 2, April through 26 days, back to approximately flat.

So everything we're seeing in real time -- gave you these numbers as backup -- tells us that we're in that sort of, I'd call it, flat to negative 1, maybe a little hair over with some special waste costs. And that's what we've guided.

Tyler Brown: Okay, perfect. And my last one here just real quickly, maybe this was from Monday's call. But clearly M&A is a really important aspect to your story. It always has been. But this year is kind of unique in the fact that your prior head of corporate development, he retired. I think he's going up into the Hall of Fame, which is great. You've moved into the CEO role. You had been very instrumental on the West Coast acquisition success the last couple of years. So can you just talk about that corporate development team, the bench there and your confidence on that front moving forward? Thanks.

Ron Mittelstaedt: Absolutely. Yes, so Rick Wojahn, long-term head of business development, did retire, is going into the Hall of Fame, as you noted, and well deserved. Rick was back-filled by a long-term internal executive of the Company for 24 years, who has most recently been a Regional Vice President, and prior to that, Divisional Vice President. But he started in the Company, when we founded it, in M&A. So he has an M&A background, knows the industry very, very intimately, private players, deal structure. Has a financial background as well. His name's Phil Rivard. And Worthing and I were in sync on asking him to step in and replace Rick.

Below Phil and below Rick, we've got a pretty robust, very seasoned M&A group in the field. We've actually made two additions to that team in the latter half of '22 to expand it. So I feel from a team standpoint we're as solid as we've been, if not greater, with greater coverage. It's tough to replace someone like Rick, with his relationships, but we have his relationships and Rick's still involved with us in assisting us with those larger deals where he has relationships. So we haven't lost that.

So, we feel real good about M&A. M&A ebbs and flows, as you know. Incredible year in '22. Incredibly strong year in the second half of '21, coming off the pandemic, sort of some pent-up demand coming out of the pandemic where things were slowed. But we're very confident in M&A. Nothing has changed in that arena.

Tyler Brown: Thanks, Ron. Thanks, guys.

Operator: Our next question comes from Kevin Chiang with CIBC.

Kevin Chiang: Maybe just turning to -- there seems to be a lot of legislation. I know the EPA has one on commercial fleet emissions, basically looking to accelerate the adoption of low- or zero-emission vehicles across the board here. Just wondering. I know a lot of this is in proposal stages and I know California is doing its own thing. But does this accelerate some of your fleet strategy in terms of pushing RNG or CNG or trying to electrify the fleet, just given some of the legislation you see coming through the pipeline here?

Ron Mittelstaedt: Well, Kevin, as you said, there's a lot of legislation being discussed. There's a lot of legislation currently being modified sort of a little back from where it originally was. Let me start with this. Generally speaking, legislation and regulation is good for the well capitalized public companies, including ourselves, and always has been for the last 20-plus years in this industry. While difficult to adopt, we've got the balance sheet to do it, to take advantage of it.

And it typically leads to improved pricing at a spread to the capital cost and expense of the legislation.

So legislation does not concern us. It levels the playing field with less low-capitalized companies and it makes it a tougher playing field for them. And it actually turns that into acquisition opportunity. So we like the regulation as long as it's uniform federally or within a existing state.

As you're seeing with a lot of legislation that comes out in a variety of areas related to the environment right now, the legislation is a bit ahead of the product development to comply with that legislation. And some of that is in its infancy. Some of that, even if it was adopted today, is decades from being able to get fleets fully converted, whether you're talking about illustratively electric or hydrogen.

But we are taking a close look at this. Obviously states where it is adopted already, like California, well, that's an easy decision. So we're keeping a close eye on it. We have a balance sheet to deal with it. And I would say on the margin it does move the needle in how fast you transition to some of these renewable-type products, both in our fleet as well as use at our landfill for certain treatment and other. But it's not going to be, in my mind, a needle mover either direction.

Kevin Chiang: Okay. That's very helpful. Maybe just a couple of, I guess maybe, nitpicky questions. If I look at the Q2 guide, Mary Anne, so I have kind of first half of the year. It implies first-half, second-half seasonality of kind of 47% of EBITDA in the first half. Historically you've been about a point higher than that. I know it's a small number. But is that just a function of, as you mentioned, some of the inflationary pressures decelerating as you get to the back half of the year, so you get a little bit more earnings in the back half? Or is there something else you'd call out here, just given your Q2 guide versus maybe historical trends?

Mary Anne Whitney: Sure. Fair question and happy to go through that. You're right. When we think about first half, second half, there's always the impact of seasonality. And certainly the way we guided for Q2, just an observation right up front is that as we mentioned in our remarks, we look forward to seeing that seasonal ramp. So arguably you could say maybe we guided to a little less than a fulsome seasonal ramp and I think that would be a fair observation.

But then more broadly, when I think about what happens in the course of the factor of seasonality. You typically see an increase sequentially of, call it, 00 to 150 basis points or more, just in a typical year. And then add on top of that the impact of recycled commodities which are another 150 basis points, the headwinds that starts in the first half of the year that abates by the second half of the year, which would explain why you would have a little more of an outsized increased back half of the year.

Kevin Chiang: Okay.

Ron Mittelstaedt: And, Kevin, this is Ron. The other thing I would say about that -- you noted the 1% differential between first and second. Remember, we just noted that there was about a 30 basis point drag, 20 basis points more than we thought, from acquisitions closed in the last quarter. As you know, we did a lot of M&A last year. M&A always, almost always, comes on at a dilutive margin or nominally dilutive. And it takes us 4, 6, 8 months to get that to where we think it's going to be. And that's going to be in the second half of this year.

Kevin Chiang: Right. That's very helpful and a great point there. Maybe just last one from me and maybe kind of a nitpicky question. I notice you're going to change your -- I guess some of your segments here, adding a new geographic region I guess starting here in the second quarter. Any [read to it]? Is it just maybe one of the regions got too big or is it reflection of maybe how you see some of the white space on the maps here in terms of where you'd like to grow, adding the mid-South as a new reporting segment?

Mary Anne Whitney: Sure. So I'd encourage you to think about it as a continuation of the strategy that's served us so well and that's our decentralized approach and the recognition that, given the amount of growth we've had and, to your point, the expectation of continued growth, that we want to have that same kind of visibility. And so it's an acknowledgement that you kind of -- you rerack and reshuffle the deck and distribute the regions accordingly. And so that's the way to think about it.

Kevin Chiang: Perfect. That's super helpful. Thank you very much and best of luck the rest of the year.

Operator: Our next question comes from Sean Eastman with KeyBank Capital Markets.

Sean Eastman: I just wanted to make sure I have the message on that elevated M&A dialogue, how you see that translating into closed deals maybe over the next 12 to 24 months, just considering obviously we're coming off a very big 2022.

Ron Mittelstaedt: Yes. Well, Sean, as I'm sure you know and I would tell you, elevated dialogue ultimately turns into increased closings. It takes some time. We've got a lot of LOIs in process right now. So I would tell you to think about these as sort of expecting things to more come through the late third, early fourth quarter, so second-half loaded, because you're talking about a three- to four-month process from when you start executing LOIs to when you actually close. Of course there's always risks that we don't get some of those. And that happens and we understand that. But we will have a successful hit rate and we expect this to be at or above an average year, as we've said. How much? Time will tell, because sellers have a decision in that process, obviously. But we feel good about where we're sitting with what we've got communicating out there right now.

Sean Eastman: Okay. Very helpful there. And then, great to hear that the labor availability, retention trends continue to improve. But I'm curious about the kind of operational leadership level. You know how the challenge of turnover and retention has been at that level, how that's trended. Would be really curious to hear your perspective on that, Ron.

Ron Mittelstaedt: Sure. Well, look, just to give you a couple data points, Q1 over Q4, turnover decreased by almost 10%, 10 percentage points, number one. And two -- or 10%, not 10 percentage points. Excuse me. And two, open job requisitions that we were searching for dropped by about 6%. So those are both heading in the right direction, still both well above historical and our expectations.

But how this works, when you are down frontline employees, be it drivers, landfill operators, maintenance personnel, what ends up happening to provide service quality is you are running routes longer at all locations. You are running supervisors in vehicles to complete routes, rather than being able to supervise. You're running operations managers and dispatch doing double duty on supervision. And everything struggles when you're doing that a little more than normal hours. Labor hours, safety reviews, more wear and tear on vehicles from longer routes being run than normal.

So it's sort of a spiral that's difficult. Well, as you unwind that spiral, those things get better. And so I would expect -- it doesn't happen overnight, but it will happen in time. I would expect each of those things to get better, our labor percentage, our safety results, our maintenance results and therefore our service quality and our sales and retention and ability to get new business. So we've got a ways to go, but it's better now in the first quarter than it was in the second, third or fourth of last year.

Sean Eastman: Interesting stuff. Thanks, Ron. I'll turn it over.

Operator: Our next question comes from Jerry Revich with Goldman Sachs.

Adam Bubes: This is Adam Bubes on for Jerry today. Thanks for taking my question. First-quarter margin just 29.8 and the second-quarter guide of 30.8% on a seasonally adjusted basis looks to be around 30.4% versus the outlook for the full year of 31.1%. So that implies a pretty sharp ramp sequentially in the second half of the year compared to normal seasonality to hit your guidance. Is the original margin guidance still on track? And can you just help frame that sequential acceleration in margins in the back half?

Mary Anne Whitney: Sure. Thanks, Adam. Yes. To address that question first, yes, the original guidance is intact. As we said, we've reaffirmed our full-year guidance and that included our margins. And the walk from the first half to the second half, just to reiterate, as I described earlier, it really is that two-pronged impact of, first of all, seasonality and the acknowledgement that the way we guided Q2 has a more muted seasonality than what we would typically see and we look forward to delivering Q2. And that's -- so there's 100 to 150 basis points or more just from seasonality alone as you think about margin. And then overlayed on top of that the easier comparison on recycled commodities which begin the year is a 150 basis points headwind. And that headwind fully abates, since recycled commodity values haven't really moved off of year-end numbers from last year. And, again, this is all before any upside from any of the factors we described like cost pressures abating to the extent those macro trends we're all observing as they make their way into the P&L, or any improvement in commodity values, incremental M&A, again as we've described.

Adam Bubes: Thanks. And you've laid out 10 landfill gas plants that are in development in the near term. Can you talk about the expected earnings ramp on those plants? And what's the pipeline beyond the 15 to 20 landfill gas projects that you've outlined in totality? Should we be thinking about further opportunities down the line? Or is 15 to 20 the end of what's economically feasible?

Mary Anne Whitney: Sure. So as you may recall, on our last call we described the portfolio project and we described an incremental $200 million in EBITDA in 2026. And although we didn't get specific about exactly how that layers in and exactly how the CapEx goes out to a comparable amount between 2022 and 2025, we said there's one project coming online this year that we own and of course that it's a portfolio of projects. About two-thirds of them we won't own. We'll be getting a royalty. And the other third we'll own.

And so you could layer them in, that you'll get a partial-year benefit from one this year, full-year benefit from next year, some incremental contributions from things coming on in '24. You might want to just stack them, sort of layer-cake them on, but [be a] $200 million in EBITDA. That's very high flow-through from the revenues, so not dissimilar by '26.

So beyond that, I'd say let's get to '26 and we'll certainly update you in the meantime. We're excited. As Ron said, we're committed to the development of this. We like our portfolio approach and we'll continue to explore opportunities going forward.

Adam Bubes: Thanks so much.

Operator: Our next question comes from Michael E. Hoffman at Stifel.

Michael E. Hoffman: Welcome back, Ron. Feels like a deja vu moment to hear your voice again.

Ron Mittelstaedt: Yours as well.

Michael E. Hoffman: The question I have about price is managing a spread. We all know that this is going to settle as inflation comes in and the rate of change settles. Talk to us about the strategy and the controls and the discipline through the model down to the decentralized that why we have confidence in holding onto the spread as we settle into a new run rate of rate of change.

Mary Anne Whitney: Well, let's start with what we've already committed to for the full year and the fact that we've guided to 9.5% core price and told you we have 85% visibility on it, meaning it's done or contractually stipulated. Probably 200 or 300 basis points higher than what other people are talking about, to my knowledge. And we've talked about the cost pressures in the business being in that 6 to 7%. So as you know, Michael, the reason we've pushed that much harder on pricing, part of it was the headwinds from recycled commodities and RINs. And that's just math that those pressures abate as we move through the year. And so, we focus on what is the underlying margin expansion in solid waste and we delivered the 110 basis points in Q1.

So, as we thought about the year coming into the year, we thought the greatest headwinds are earliest in the year, so it's most important to have the highest reported price then. And, as to the extent any of those pressures abate, and we've already talked about wages and the expectation that we go from the high end of the range of 8% down to more like 6%. So I think that's your math on how the spread is maintained as you move through the year.

Looking ahead, of course, it will be a function of what do inflationary pressures do as we move through the year and therefore how much pricing do we need in the competitive side of the business, knowing that the contractual side, the CPI-linked business, the PIs will be not dissimilar in '24 to what we've seen in '23, just based on the CPI that we've already reported.

Ron Mittelstaedt: And, Michael, I would add to the second part of your question, just on the field responsibility, our model, et cetera. Look, as you know, we believe this is truly a local business. And thus our decentralized model has a P&L-responsible manager in every market overlain by a divisional P&L manager, overlain by a regional P&L manager, because this business is so local. All of them are incentivized quite heavily in compensation on the performance of that local market against metrics for that local market, a large one being price and margin. So we drive this down to the local level, hold them accountable, allow them responsibility to make different judgements. It's very different by market. One size doesn't fit all.

And in addition to our, as Mary Anne outlined, high percentage of our business being franchise and they're very predictable, if you've got 42, 43% of your business that is contractually guaranteed, which we do, which is very different than anyone else out there, it allows us to heavily focus on that 56, 57% that's competitive. So I think it's a difference in strategy. It's a difference in structure. And that's what leads to quite a different spread relative to anyone else out there in price.

Michael E. Hoffman: Thank you. What is the right size of regional business to manage? And you've got a -- I'm not surprised you added a region, because you're growing and you grew pretty significantly over the last few years. But what's the right regional size of business? Now you're 4.1. You get to $10 billion we're probably going to have another region. Right? Nobody should be surprised.

Ron Mittelstaedt: Yes. Well, first off, I think the way we've thought through this and it's been in discussion for quite a period of time, Michael, over the last couple of years and thinking through where we want to be. We're trying to think 5, 7, 10 years out. What's the flow look like amongst regions and waste volumes? What's the regulatory environment within a geographic region? And then, what's the M&A opportunity within a geographic region so that we're not redoing these things every 2, 3, 4 years.

So we've taken a real hard look at that. And, look, the answer is it's a little different depending on how the geography is structured for waste. What do I mean by that? The franchise market takes probably less day-to-day oversight from a regional level than a highly competitive market on the East Coast or the Southeast, illustratively. So we think that a rounding $1.5 billion to maybe up to $2 billion in the competitive market piece is a fair number. We think that can be run higher than $2.5 billion in the franchise component. So it is a little bit different and that's a conscious decision. But if you want to use $1.5 billion to $2 billion as a fair number, that's probably a good barometer.

Michael E. Hoffman: Okay. Great. And then, the pace of M&A, I mean, if you take the $45 million and multiply by 4, you're about average, because the average is $150 million. So, I mean, if you're on a pace, you don't guide M&A until it happens. But we're kind of on a pace of $180 million. Right?

Ron Mittelstaedt: Yes. As you know, we would tell you, look, an average year is $150 million. I'm just using that because that's probably a fair number, 150, 175. So we're already above the average year pace of. And as I said in my comments, I think it is reasonable for us to expect an above average year, knowing what we know right now and who we're talking to and what LOIs we have out there. That's what should be expected. But having said that, if we didn't do more -- and that's not the case -- it would be because we're being very disciplined in our approach and in our market selection. And that should be what investors expect from us.

So that is not what I'm predicting, but that would be the only reason, is we're being disciplined on what we're doing. But, yes, to answer your question, we're above it and I think what it does is if we have that type of year we're talking about and it's a little more -- it is more second-half weighted, it sets us up incredibly well for '24 to start with another large year of rollover, just like this year did from the ending of '22.

Michael E. Hoffman: Okay. And then, I should have finished my question about price spread and margin and I didn't. I apologize. So, Mary Anne, you've laid this out, that the recycling offsets and when we start to anniversary. But you also have a really healthy index price that leverages second-half '23, first-half '24. So this momentum of margin carries right into '24 almost regardless of what else happens. And then there's your own discipline around managing open market spread than sustain it [assuming] the macro things all leveled out. I know that was a mouthful. But we should see [multiple speakers] a sustained period of margin improvement beginning in the second half for a while, all else being equal.

Mary Anne Whitney: So what we've said is it's a fair observation that pricing -- we continue to get the lagging benefit from PPI-linked markets. Because, remember, we absorbed all those costs when the spread went the other way in 2022. So we're benefiting from that in '23. And you're right; mathematically it says we'll get, as I mentioned before, a similar number and not dissimilar in '24. Then the question becomes what's the environment and how much pressure is still needed on the competitive book of business. Because as we've also said, we look forward to not needing to do the outsized increases. But, yes, to answer your question, we're very much focused on that and to the extent it takes longer for inflationary pressures to abate, that would suggest that the same dynamic that we saw coming into this year would persist into next year, meaning it should get easier over the course of the year.

Ron Mittelstaedt: Yes. And, Michael, one other thing on that. Again, I'm sure this is -- I know you're well aware of this. I say this more for people who might not be as familiar. Look, a lot of our CPI index business, particularly our franchise business, is set off a government calendar year, which means it is priced in July's CPI of each year. So for this year, '23, we're getting mostly last July and January 1 CPI. We will get for next year this July's CPI into next year. So it's still elevated even though the CPI, it's coming down throughout the course of '23 into '24. So, yes, it supports exactly what you just said.

Michael E. Hoffman: Got it. And then, everybody wants to talk about projects on RNG, but it's really about MMBtu. But one of the things they tend to forget to ask you -- and you all have the best-in-class conversion of your total captured MMBu into beneficially used in the group. You're at 60%. So it's not like there's a whole lot left to do other than upsell electricity into RNG. You've been doing this well.

Mary Anne Whitney: Well, I don't disagree with your characterization. I think everyone's portfolio of landfills and the age and life of their landfills is different. And we will continue to look forward to opportunities as we proceed. And we've described the ones that are at hand and how we've approached them.

Ron Mittelstaedt: And, Michael, I would say it a little bit differently. And I agree with your comment and what Mary Anne said. Look, we are very comfortable with the long-term, forward-looking performance of our core solid waste business standing up better than anything in the sector. Our RNG is an upside, not a bridge to get to a margin.

Michael E. Hoffman: Right. Got it. Thanks for taking the questions. Look forward to seeing you in New Orleans.

Ron Mittelstaedt: You as well.

Operator: Our next question comes from Noah Kaye with Oppenheimer & Company.

Noah Kaye: I'll just ask a couple of questions. First, a health check on the customer base. You had strong performance on DSOs, so customers were clearly paying their bills and you saw sticky price. Can you give us what the churn rate was in the quarter, what you've seen in April and where in the business there might be increasing price/volume trade-offs?

Mary Anne Whitney: So, fair observation. Yes, we have continued to see DSOs improve. And I'd say that's a combination of being proactive about it and that speaks to the power of a decentralized model where you've got local controllers taking responsibility for that. And, yes, we have not seen the kind of degradation which leads to increased issues on that front. And so we're encouraged by that. We're mindful of the fact that the overall economy is slowing down and it's something we pay close attention to.

So, to your point about churn, we would acknowledge that in our price that we've reported and the volumes we've reported, there is some price/volume tradeoff. There is some churn happening out there. And I think the important thing is that the way we view it is it's an acceptable tradeoff. And we're not surprised to see that tick up a little bit as we move through the quarter.

Noah Kaye: Okay. Thanks. Any way to quantify what that rate looks like currently and where a benchmark . . .

Mary Anne Whitney: Well -- sorry. So, as you know, in 40% of our business we don't have any churn. And in the other piece, it's typically running sort of in that mid- to high-single digits or it might tick up a little bit. So overall, if it says it's mid-single digits, that's probably a fair way to think about it.

Noah Kaye: Okay. So that's healthy. Last question just around truck deliveries. Obviously the quicker you can get those fresh trucks in the more it's helpful for your OpEx profile. What are you seeing on rate of truck deliveries and your confidence in being able to spend the full-year budget?

Mary Anne Whitney: So we're confident we can spend the full-year budget. I don't know that that's been an issue, Noah. And we also continue to see trucks -- and the reality is we sort of feel like the calendar has become somewhat arbitrary. We order trucks. Maybe we expect them in one year. A portion slips into the following year and some that we expect in that year slip into the subsequent year. And so, what are we seeing out there? We told you that there was a slug of trucks that we didn't get in '22. About half of those we took delivery of in the first quarter. And we also know and, as I think we mentioned last quarter that we'd already been told there are trucks, probably a like amount at least, that will slide from '23 into '24.

Noah Kaye: Okay, great. Thanks for the color.

Operator: Our next question comes from Tobey Sommer with Truist Securities.

Jasper Bibb: This is Jasper Bibb on for Tobey. I was just hoping you could give us some more color around what you're seeing on the industrial collection side. Still looked pretty strong in the quarter, but I guess I'm curious how much impact you might be seeing -- slower housing and construction leading indicators.

Mary Anne Whitney: Sure. As we said, as we think about the cadence through the quarter, month over month, March was really the first time we saw a little bit of a deviation, so mildly positive just shifting to negative. It's always a little lumpy on project-based business and, as we said, in light of C&D activity, but that was exclusively associated, or mostly associated, with hurricane cleanup. So I would say it's generally a little bit slower. No material change to the trends we've seen, but we are seeing signs of a slowdown.

Jasper Bibb: Thanks for that. And then maybe following up on the earlier comments about E&P waste for the first half. Any kind of comments around demand trends there or how that business is tracking relative to your initial expectations in 2023?

Mary Anne Whitney: Sure. I'd say it's tracking in line with our expectations. We always anticipate a bit of a seasonal adjustment in Q1. And we saw that. And then the question is how much does it snap back. As we said, we think it comes back to about that $50 million level. Rig count hasn't moved materially. And so activity levels haven't really changed dramatically. But we feel comfortable with communicating those sorts of levels, would be the expectation as we move through the year.

Ron Mittelstaedt: And, Jasper, this is Ron. Just one stat for you and for all listening. The statistic we track that most closely relates to industrial activity in one way or another is probably our special waste volumes into our landfills, because much of that comes from industrial cleanups and industrial waste streams. Just as a couple numbers, that was down 5% in '22. That's for the whole year. And it was down 6% in Q1. So, not really any material change in the first quarter relative to all of '22. So we're not seeing per se yet the industrial deteriorating by any meaningful measurement.

Jasper Bibb: That makes sense. Thank you for taking my questions.

Operator: Our next question comes from Toni Kaplan with Morgan Stanley.

Hilary Lee: This is Hilary Lee on for Toni Kaplan. Just wanted to ask about cash flows. So we saw in Q1 that it was down around 14% year over year. So it seems like it would be a decent ramp through the balance of the year, especially in Q2 to get to that 5% guidance number. Could you give more of a cadence for cash flows for the rest of the year?

Mary Anne Whitney: Sure. So we actually said -- observed last quarter when we gave our full-year guidance that we expected it to step up over the course of the quarter. And really there are a couple of factors driving that. And the most important one, I would say that's different in Q1 from the other quarters is really the hangover from all the CapEx we did late last year, some of which hit payables in Q1. And that's probably about $40 million. So if you think about bumping up from here, you could kind of step it up over the course of the year from the amount we did in Q1.

Hilary Lee: Got it. Thanks. And regarding pricing, obviously you guys have had strong pricing year to date. How have your conversations been with customers if you compared, like, this quarter to Q4 in last year? Has there been any more pushback given inflation is somewhat moderating?

Mary Anne Whitney: Well, the reality is that a lot of the price increases that you'd observe as hitting Q1 really were conversations that happened late last year, because that's the timing of billing cycles. And it was purposeful to get ahead of pricing because everyone had talked about the possibility, or the expectation, that inflationary pressures would abate and so it was better to get ahead of it. So I can't say that we've seen any material difference in them and I think that's reflected in the fact that pricing came in line with or better than what we'd talked about, which tells you that there wasn't a dramatic change in the rollbacks that we experienced. That being said, as I said earlier, we acknowledge that there is some price/volume tradeoff and we're not surprised by that.

Hilary Lee: Got it. Thank you. And just lastly for me, you talked about the 9.5% core price and 10% pricing. So does that include the surcharges, or is that just purely the core price?

Mary Anne Whitney: So as to what we said when we gave full-year guidance is that it would be essentially all core price, because the expectation was that fuel surcharges, while they're a small part of our overall mix, that they would be positive in Q1 and they would flip to negative in Q2 for the rest of the year. And so when we talk about 9.5, that is -- it's both things. It's total and all core.

Hilary Lee: Got it. Thank you so much.

Operator: Our next question comes from Stephanie Moore with Jefferies.

Stephanie Moore: Just one question from me and more so a follow-up from Michael's question earlier. I think you talked about the opportunity for potential upside just as cost pressures could abate. But from your lens, just looking at the first four months of the year, if these cost pressures do abate faster, do you think that would largely be due to potentially a macro slowdown or do you see the ability for pressure to come down faster and [yet] the economy still holds up?

And then maybe take another step further, if it is because the economy slows, how would you manage any potential impact to volumes while also benefiting from the fact that the cost pressures do come down? So I know that's a little longwinded, but just trying to think about those puts and takes. Thank you.

Mary Anne Whitney: Sure. It's the right way to think about it. And it's important to remember, this is -- the integrity of the model and that so much is fixed pay in the solid waste industry in our book of business that the exposure is pretty limited. But, yes, you'd see volumes slow down a little bit and what typically happens when you're in that environment, including in the extreme, in the Great Recession, is that margins on the collection side expand because of the nature of the fixed-pay system. So, that's a way to think about what the implications are of volumes going lower.

Stephanie Moore: Got it. I'll leave it at that. Thank you.

Operator: Our next question comes from Walter Spracklin with RBC Capital Markets.

Walter Spracklin: So just staying on the pricing, a little bit of a different tact on that, but just curious as to whether there's any real limit to your pricing. I know what the drivers are. You've got higher costs. You've got rational competitors. Waste pickup is a low-cost point. It makes it easier for you to put price increases through. But just curious if there's a limit there. Are customers at all pushing back on that limit?

And flipping the last question around, in the event that CPI comes down but, for whatever reason, your costs continue to stay elevated, either because of labor availability or what have you, are you worried at all about maintaining that spread that was discussed before if you've kind of hit the limit on price increases and then in the following year might see some difficulty passing on cost increases through and maintaining the spread.

Ron Mittelstaedt: Walter, look, again, we have always maintained 100 to 150 basis point spread minimum in 25 years of doing pricing. Part of that is the beauty of our model, where 40-plus percent is index and we get that plus in that piece.

The other is just the discipline of how we think about pricing and the spread necessary. Is there a limit? Well, number one, in 40-plus percent of the business there is a CPI limit or index. So in there there is. In the open market, the other 56%, there is in theory no limit, but the reality is what's the market and what are your peers doing as well. So, yes, there obviously is a limit.

We believe that we've pushed price as is necessary. We don't anticipate having to do that further unless something changes in the inflationary environment relative to the flattening and declining we're seeing right now. If, if, that was not the case, we absolutely can go back to our customer base. One, automatically we would get the indexed business. And the other, we've shown you the ability to get. But that's not what we're expecting, nor is it what the economy is expecting, nor is it what the economy is showing right now. So I mean it's I think a theoretical question more than what the expectations would be.

Walter Spracklin: Absolutely. I appreciate that, Ron. Second question here and last one for me is one of your smaller competitors have started the process of selling assets. And just curious if -- you've been very acquisitive over the last few years. Have any of your acquisitions kind of had a tag-on market attached to them that you're just not interested in being in or growing in? And if the sum total of those tag-on markets lead to -- it looks like these assets are selling at very attractive levels and I know you guys have been pretty good as stewards of capital. Just curious whether that's something that you would ever contemplate or not.

Ron Mittelstaedt: Well, first off, the only real asset that had, to use your word, a tag-on level of assets that really didn't fit our model and we didn't find attractive was after we did the large transaction with Progressive and we did sell down or swap out about 12 to 13% of the revenue that came along with that transaction. Most of our transactions, as you know, we hit singles and doubles. We are acquiring private businesses that are generally in one to two markets and they're very targeted and there's not something that we're expecting to divest there. We're always going to be looking at our book of business, examining the markets. Markets do change from time to time. And if we can't create a sustainable barrier to entry that allows us to run our model and improve price, we'll look at that.

But you've got to understand, the assets that are for sale predominantly through other companies that you're referring to, those companies were built with large buckets of divested and sort of stranded assets. And so you would expect there would be some that they would be looking to divest. It's also being driven by leverage issues and we don't have any of those issues. So, we looked at those assets and they were not assets that at that price or even a price substantially lower, we found attractive or fitting our model. So, we will look at it but it's not something any investor should think Waste Connections is out looking to do for any reasons relative to other companies in the industry.

Walter Spracklin: That's fantastic. Appreciate the time.

Operator: The next question comes from Stephanie Yee with JPMorgan.

Stephanie Yee: Good morning. I'll just ask one question here. Just wanted to come back to the discussion around labor and the improvement you're seeing. Can you talk about what you're doing to retain people on the front line? Is it just wage increases or are there other components? And how do you motivate people on the front line?

Ron Mittelstaedt: Well, Stephanie, is it not just wages, because good employees can go get wages anywhere. It's a very tight economy, labor market at least in the economy, and particularly for qualified and skilled individuals. Certainly wages and benefits matter and we've continued to focus on improving those as we always do, but particularly in '22 and as we head into '23.

Look, I think the beauty of our decentralized culture is that we put more leaders closer to the field than a more centralized model and those leaders are empowered to take care of their employees and retain those employees within reason on their own. They're not having to run that through a corporate program or a corporate structure that is more one size fits all. We have given them a lot more flexibility in what they're able to do to take care of people as individuals.

And quite honestly, that's the essence of what our servant leadership model is about, taking responsibility for the health and safety of our people at work and away from work. So you've got to be market competitive. You've got to make it a great place to work. You've got to give them an incentive to want to be there beyond the compensation and benefits. And that really comes down to the relationships that our leaders can build within as individuals on the front line. That's really the answer to that question and has been how we have focused on it for 18 years.

Stephanie Yee: Okay. Great. Appreciate it. Thank you.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Ron Mittelstaedt for any closing remarks.

Ron Mittelstaedt: Okay. Thank you, Operator. 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 Joe Box are available today to answer any direct question that we did not cover that we are allowed to answer under Regulation FD, Reg G and applicable securities laws in Canada.

Thank you again. We look forward to seeing you next week at WasteExpo and at upcoming investor conferences or on our next earnings call.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.