Waste Connections, Inc.
Q3 2022 Earnings Conference Call
November 3, 2022 8:30 AM ET

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Mary Anne Whitney, EVP & CFO

Analysts
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Presentation

Operator: Good morning, and welcome to the Waste Connections Q3 2022 Earnings Conference Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note, this event is being recorded.

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

Worthing Jackman: Thank you, operator, and good morning, and congrats to the Astros after a no-[no] last night. Yes, Jason Craft, you can pay me now.

I'd like to welcome everyone to this conference call to discuss our third quarter results, and to provide a detailed outlook for the fourth quarter and updated outlook for 2022, as well as some early thoughts about 2023. I'm joined this morning by Mary Anne Whitney, our CFO.

As noted in our earnings release, strong execution once again provided for better-than-expected results, driven in the third quarter by continued acceleration of solid waste pricing and higher E&P waste activity, along with acquisitions closed during the period.

Most notably, we overcame 50 basis points in incremental headwinds primarily from the precipitous decline in recycled commodity values in September to beat our outlook and expand adjusted EBITDA margin both sequentially and on a year-over-year basis, excluding the dilutive impact from acquisitions completed since the year-ago period.

Our outperformance through the third quarter and acquisitions closed year-to-date enhance our visibility for expected double-digit revenue and adjusted free cash flow growth in 2023, led by pricing expected to remain at elevated levels, plus contributions from acquisitions already signed or closed year-to-date. In addition, we expect underlying margin expansion to overcome headwinds from recent decreases in recycled commodity values.

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 discussed both in the cautionary statement included in our November 2 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 Worthing.

Worthing Jackman: Thank you, Mary Anne. We're extremely pleased by the strength of our results in Q3, as continued pricing acceleration and strong execution enabled us to overcome both the precipitous decline in recycled commodity values during the quarter and continued inflationary pressures.

We delivered total Q3 price of 10.1% led by core pricing of 8.3%, plus 180 basis points of fuel and material surcharges. Pricing ranged from 5.5% in our mostly exclusive market Western region, to between 10% and 13% in our competitive regions. The 130-basis point sequential increase in total pricing growth from Q2 was almost entirely attributable to core pricing, which is expected to increase further in Q4.

As noted last quarter, the continued acceleration of core pricing through the back half of 2022 positions us well for 2023, with visibility for continued elevated pricing, including in our exclusive markets where pricing is now expected to approach 7%.

Volumes in Q3 were down 70 basis points excluding the impact from the purposeful non-renewal of two municipal contracts noted in earlier periods, and continue to reflect tough comparisons following last year's reopening activity. More importantly, however, volumes reflect continued discipline around quality of revenue.

Looking year-over-year at Q3 by line of business, commercial collection revenue was up about 15% due mostly to price. Roll-off revenue was up about 11% on revenue per pull, up about 9% and daily pulls up about 2%.

Landfill rates per ton were also up over 9% on revenue up about 3% and tons down 6%, primarily due to continued tough comparisons for special waste. Special waste tons were down 16% in the period, but related revenue was up nominally year-over-year. MSW tons were down 4% and C&D tons were up 3%.

Moving next to revenues from recycled commodities, excluding acquisitions, recycled commodity revenues were down almost 35% year-over-year, reflecting a sequential decline from Q2 of 30% or about twice the magnitude anticipated, given the precipitous decline in recycled commodity values in September.

Looking at year-over-year landfill gas sales and renewable energy credits or RINs, landfill gas sales were up nominally in Q3 on slightly higher RIN values and higher volumes.

And finally, looking at E&P waste activity, we reported another sequential increase in E&P waste revenue to $53 million in the third quarter, up 52% year-over-year.

Moving to acquisition activity, as anticipated, acquisition activity continues to run well above historical levels, with $535 million in annualized revenue closed year-to-date, plus an additional $35 million under definitive agreement, expected to close by year-end or early in 2023. As such, we are already set up for over 4% in rollover acquisition contribution in 2023 from signed or closed deals.

Moreover, our pipeline remains quite robust for additional acquisitions expected to close later this year or early next, driven by continued above-average levels of interest from high-quality private company sellers, including some unique opportunities to expand our portfolio of West Coast exclusive markets.

We opportunistically prepositioned our balance sheet for expected continuing outlays by raising $1.55 billion in two recent debt offerings at favorable terms.

We continue to have capacity for outsized acquisition activity, while we fund our differentiated growth strategy, including our sustainability-related projects and expand our return of capital to shareholders. The strength of our operating performance, free cash flow generation and balance sheet positions us for another double-digit percentage annual increase in our quarterly cash dividend, as announced yesterday.

Our Board of Directors authorized a 10.9% increase to our regularly quarterly cash dividends, our 12th consecutive double-digit percentage increase since the initiation of our dividend in 2010. This followed our August announcement of the annual renewal of our normal course issuer bid authorizing the repurchase of up to 5% of our outstanding shares, which we will continue to approach opportunistically as we did earlier this year.

While executing our growth strategy, we maintain focus on our most important asset, our people, as highlighted in our recently released 2022 Sustainability Report, which details the efforts of over 20,000 employees who embody our values, culture, and shared view of sustainability as integral to our strategy for long-term value creation. Our updated report highlights significant advancement towards our aspirational ESG targets and the addition of a target for emissions reduction. It also provides expanded ESG-related disclosure with the introduction of Task Force on Climate-Related Financial Disclosures or TCFD.

Our continued progress, expanded targets, enhanced disclosure and ongoing investments in sustainability-related projects, are all emblematic of our commitment to the environment, and our employees and the communities we are privileged to serve.

Now, I'd like to pass the call to Mary Anne to review more in-depth the financial highlights of the third quarter and our increased outlook for 2022, and to provide a detailed outlook for Q4. I will then wrap up with some preliminary thoughts about 2023 before heading into Q&A.

Mary Anne Whitney: Thank you, Worthing. In the third quarter, revenue was $1.88 billion, up $283 million or 17.7% year-over-year, about $15 million above our outlook. Acquisitions completed since the year-ago period contributed about $154 million of revenue in the quarter or about $151 million net of divestitures.

Adjusted EBITDA for Q3 as reconciled in our earnings release was $588 million, up about $82 million or 16.3% year-over-year, and about $7 million above our outlook. This was in spite of an incremental $10 million drag from the precipitous drop in recycled commodity values, primarily in September, which essentially doubled the sequential decline as compared to our expectations in early August.

Looking at margins first on a sequential basis, at 31.3%, adjusted EBITDA margin was up 10 basis points as compared to Q2 in spite of a $20 million quarterly step-down in recycled commodity revenue.

Next, as compared to our expectations, we more than overcame 50 basis points in incremental headwinds during the quarter to beat our outlook by 30 basis points excluding acquisitions.

Incremental headwinds included 40 basis points from the further deterioration in commodity values and 10 basis points from impacts related to Hurricane Ian.

And finally, looking year-over-year, adjusted EBITDA margin was up 20 basis points year-over-year, excluding 60 basis points margin dilutive impact from acquisitions.

Other key margin drivers were as follows. Underlying solid waste margins expanded by 120 basis points, as leverage from double-digit price growth provided margin expansion to offset

continued cost pressures. In addition, increased E&P waste activity provided 40 basis points margin expansion and higher RIN values and gas generation added another 10 basis points. These increases were offset by 150 basis points combined margin drag from lower recycled commodity values of 90 basis points and an additional 60 basis points headwind from higher fuel costs, net of the CNG tax credit catch-up through Q3 of about $3 million.

Depreciation and amortization expense for the third quarter was 12.3% of revenue, down 70 basis points year-over-year.

Adjusted EBIT margin of 18.7% was 10 basis points above our outlook and up 20 basis points year-over-year, even including the margin dilutive impact of acquisitions.

Interest expense in the quarter increased by $10.7 million over the prior-year period to $51.2 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 Q3 increased by $9.5 million year-over-year to $49.4 million.

Debt outstanding at quarter-end was about $6.2 billion, over 90% of which was fixed rate. And our weighted average cost of debt was approximately 3.2%.

Our leverage ratio is defined in our credit agreement, net of cash balances, increased nominally in the quarter to about 2.7x net debt to EBITDA.

GAAP and adjusted net income per diluted share were $0.92 and $1.10 respectively in the third quarter, both of which include about a $0.06 after-tax benefit primarily resulting from the impact on certain debt from changes in foreign currency exchange rates in the period. That is the decline in the value of the Canadian dollar during the quarter. This unrealized benefit is reflected in both other income and in the tax provision.

While changes in foreign exchange rates and the corresponding translational impact operating results are not factors that we call out, the extreme currency volatility in recent months and the resulting outsized Q3 benefit, mostly related to unrealized gains on certain debt, warranted some additional commentary.

Moving on to free cash flow, year-to-date, we've delivered adjusted free cash flow of $929 million, or 17.4% of revenue, up 12.5% year-over-year in spite of capital expenditures up $139 million or 29% year-over-year. As such, we are well positioned to achieve our full year free cash flow outlook in spite of the incremental headwinds from lower recycled commodity values and the continued inflationary pressures impacting both operating expenses and CapEx.

I will now review our updated outlook for the full year and provide our outlook for the fourth quarter of 2022. 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 significant change in underlying economic trends. It also excludes any impact from additional acquisitions that may close during the remainder of the year and expensing of transaction-related items during the period.

Looking first at our updated outlook for the full year, as provided for and reconciled in our earnings release, revenue for 2022 is now estimated to be approximately $7.19 billion, or $65 million above our previously-updated outlook due primarily to the following. $85 million in contributions from acquisitions completed since our previous update in August, plus higher pricing, partially offset by lower recycled commodity values.

Adjusted EBITDA for the full year is estimated at approximately $2.21 billion, up $20 million from our previously updated outlook. At 30.7% of revenue, our adjusted EBITDA margin outlook is in line with our previous update, in spite of the high decrementals from lower recycled commodity values. Similarly, there's no change to our outlook for adjusted free cash flow or CapEx of $1.16 billion and $850 million respectively.

Turning next to our outlook for Q4, revenue in Q4 is estimated to be approximately $1.845 billion. We expect price plus volume growth for solid waste of 7.5% to 8%, led by total price remaining around 10% with core price expected to tick up sequentially from Q3. Reported volumes will continue to reflect the 80-basis point impact from expired contracts.

E&P waste revenue is expected at about $50 million and recovered commodity values are expected to remain largely in line with current levels.

RINs are in the 250 to 260 range and recycled commodities are down about 60% sequentially from Q3, with average prices for OCC or old corrugated containers at about $50 per ton.

Adjusted EBITDA in Q4 is estimated at approximately 30% of revenue or about $553 million, which includes an expected 30-basis point margin dilutive impact from acquisitions already completed.

Continued underlying margin expansion primarily from price-led organic growth is expected to mostly offset both inflationary pressures and assume outsized headwinds of over 150 basis points from recycled commodity values at current levels.

Upside would come from any improvements in commodity related revenues, higher E&P waste activity, acquisitions completed prior to quarter-end, clean-up activity related to Hurricane Ian, or easing of cost pressures given the magnitude of core-focused price increases already in place.

Depreciation and amortization expense for the fourth quarter is estimated at about 12.9% of revenue including amortization of intangibles of about $42 million, or about $0.12 per diluted share net of taxes.

Interest expense net of interest income is estimated at approximately $62 million, up from Q3 on higher outstanding balances, as acquisition outlays continue and assuming the recent and continued expected interest rate increases.

And finally, our effective tax rate in Q4 is estimated at about 21.5%, subject to some variability.

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

Worthing Jackman: Thank you, Mary Anne. Again, we are extremely pleased with our year-to-date performance and our positioning for both Q4 and 2023, particularly given inflationary pressures and ongoing labor constraints and the recent precipitous decline in recycled commodity values. During the space of these challenges, pricing growth and acquisition activity remain at elevated levels.

Put simply, we believe we're well positioned looking ahead, and although we will wait until February to provide our formal outlook for 2023, we can expand on the preliminary thoughts we shared in August based on the current economic environment.

We continue to have visibility for double-digit revenue and adjusted free cash flow growth in 2023, led by continued elevated solid waste pricing levels, plus over 4% from acquisition signed or closed thus far this year, with the potential for that amount to grow to more than 5% by early next year based on our current acquisition pipeline.

Moreover, we expect above-average underlying margin expansion to overcome headwinds from recent decrease in recycled commodity values. And to the extent that we see any improvement in recycled commodity values or easing of inflationary pressures during the year, those impacts, along with additional acquisitions completed throughout the upcoming year, will provide upside to these preliminary thoughts.

We look forward to having better visibility on the tone of the economy, the pace of acquisitions and expected commodity-driven activity when we provide our formal outlook in February.

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

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Toni Kaplan with Morgan Stanley.

Toni Kaplan: Congratulations on the quarter. I wanted to ask about you mentioned the double-digit free cash flow growth expectation into next year. Maybe help us with some of the potential pluses-and-minuses. I know you just talked about a few of them, but trying to think about interest and tax next year, working capital, incentive comp, things that we might not have all the answers for right now?

Mary Anne Whitney: Sure, happy to do so, Toni. So as Worthing described, expecting double-digit top line growth and overcoming the headwinds from recycled commodities at current levels. And so you start with that as your EBITDA expectation. And then, in terms of the puts and takes, I think of CapEx of about 10.5% kind of in line with what we're doing this year.

Interest expense, I think of it in terms of kind of book ending. You think of the rates from Q3 and Q4, I described the step-up sequentially from incremental outlays and higher rates. If that kind of goes into the range depending on our ability to pay down debt with the over $1 billion of free cash flow after the dividend that we'd be looking at, there would be some movement there.

And then finally, on cash taxes, as compared to book, I'd be thinking in a range of probably the 70% to 80% type of range.

Toni Kaplan: Terrific. And just as a follow-up, wanted to ask about pricing. I know you've mentioned a few times on the call, you're expecting the core price to increase further in 4Q, and there's sort of strength in the pricing line that we could still see. Just wanted to ask about when you think about the trajectory next year, would you think first half still has this momentum because of the restrictive pricing, but maybe weaker in second half or -- just wanted to understand anything around the timing of when we might see a pricing peak?

Worthing Jackman: Sure. Well, as we've said consistently, our pricing is merely a response to the environment we operate in. Obviously, exiting the second half of this year at 10% price means we'll be entering next year at those elevated levels.

A lot of economists predict that inflationary pressures will begin to abate and maybe peak early in the year, and move lower as we move to the latter part of the year. If that happens, I wouldn't be surprised if pricing, if it starts around 10%. In essence, as you say, peaks early in the year, but would still average 8% to 9% for the full year. Now if inflationary pressures remain elevated next year, pricing will remain at that 10% or more as we move through the year. And so again, it's in response to the environment.

But what we know is, when I say 8% to 9%, 8% to 9% is really the minimum I think companies need to deliver. When you look at the commodity pressures, when you look at inflationary pressures, wage pressures, we talked about higher interest rates, we talked about cash taxes. And you look at inflationary pressures on CapEx. So if you're going to run the gamut from top to bottom on what needs to be priced and recovered, 8% to 9% is the zip code that we're looking at for the full year assuming things abate a little bit next year. If they don't, we'll do better than that.

Toni Kaplan: Super. Congratulations again. Really good job.

Operator: Jerry Revich with Goldman Sachs.

Jerry Revich: Worthing, Mary Anne, I'm wondering if you could just expand on the levers that you folks were able to pull for the fourth quarter, given just the steep drop in recycled cardboard prices that you've been able to more than offset here with better core performance. Clearly, the pricing outlook for 2023 is clear. I was just impressed you were able to pull levers so quickly for the fourth quarter. So can you just give us a feel for the moving pieces that allowed you to offset that 1.5 headwind for 4Q?

Mary Anne Whitney: Sure. So I'd say it's a continuation of the execution and the initiative on the part of our field. As we've recognized consistently throughout the year, the need to continue to push on pricing and deliver on execution. So certainly managing the cost, but starting with the top line of continued pricing acceleration. And as we mentioned, the increase, the sequential

increase, in core pricing that you saw in Q3, that will continue into Q4. And so that's how we're addressing the continued need, as Worthing described, for pushing price.

And so I think that's fundamentally where it starts because to your observation, what the guidance implies for Q4 is -- we talked about 120 basis points underlying margin that the improvement in Q3, that has to expand, right? So it's even greater than that in Q4 to overcome mostly that incremental pressure from the additional sequential decline in commodity value.

Worthing Jackman: Yes, but levers got pulled earlier this year. We just don't wake up in September or October and say, hey, let's pull the lever and impact Q4. These things have to be predictive and they started in Q1.

Jerry Revich: So it wasn't incremental pricing actions since OCC prices dipped? This was just unfolding of existing pricing actions?

Worthing Jackman: The vast majority of it is based on what we began in Q1.

Jerry Revich: Super. And Worthing, just a moment ago, you mentioned the industry has put up 8% to 9% core price. And one of the items that you mentioned is higher interest cost, which is really interesting because that implies EBITDA margin expansion, right? So I'm wondering if you could just expand on that? And I know it's early relative to your 2023 framework, but are you saying that with the pricing actions, we could see a margin expansion even when accounting for the OCC headwind, as we think about the planning assumptions for 2023?

Worthing Jackman: Well, that's our belief right now. We used the word "overcome," not "offset." We used "overcome" for a reason. But no, it is our belief because, look, you can't stop again at EBITDA and try to compare it on a dollar basis because there's so many items hitting you below, which is why I mentioned interest, taxes and CapEx. And so our folks at a local level understand the challenges.

This only happens based on the success of our folks locally executing their playbook. This isn't corporate driven. Our folks know how to predict these challenges; we know how to communicate, discuss them. We know how to be accountable to overcome them. And again, pricing is only successful if it originates from a local level. So that's where it's got to be executed.

Jerry Revich: Super. Appreciate the discussion. Thanks.

Operator: Kyle White with Deutsche Bank.

Kyle White: I wanted to just follow up on the recycling and see if you keep current OCC prices where they are, what you expect the headwind would be for 2023? And then just longer term, curious how you're thinking about your exposure to those recycled commodities, and if there's anything that you could do to maybe better protect in case against the volatility there?

Mary Anne Whitney: Sure. So starting with the expected impact next year at current pricing, depending on the ultimate flow-through to the bottom line from these declines, you could see that it's anywhere from, call it, 70 or 80 basis points margin hit to 100 basis points. And that's

how we're thinking about what needs to be overcome, as Worthing described, when we think about overall reported margins.

With respect to derisking that aspect of the business, just a reminder that that's what we have been doing. And we think about that from, first of all, starting at the curb, pricing accordingly, as we have through these downturns in recycled commodity values, to make sure on the hauling side, we're getting compensated for that.

Secondly, the projects we have in development right now where we are internalizing more of our recycled commodities, meaning handling the processing ourselves, so that we're not exposed to paying processing fees to third-parties, which is where you can get hit incrementally in times like this when the values go down. And part of building those new facilities is also the updated technology, which provides for better quality coming out the back end, which is another way you derisk it. And you work to maximize the value by marketing your materials and taking advantage of your bulk, which is another thing we do.

So I'd say we're always thinking about that, Kyle. And we think our model, while we still have that piece that moves with commodity values, what we try to do mostly is communicate it to you, so you can understand those dynamics.

Kyle White: Got it. And yes, we really appreciate that. And then on the M&A front, I think you mentioned an increase from potential sellers coming to market. I was just wondering, is that a more one-off on some specific assets or broadly, are you seeing more sellers come to market? And what do you think is causing that? And as a result, are you seeing any fluctuation or decline in private valuation as a result?

Worthing Jackman: Yes, I'll tell you, the interest is still geographically broad. We mentioned that the West Coast remains quite strong. Canada, as we've said before, is active. And frankly, now the competitive areas have always remained active across the U.S. as well. And so what we say, it's a robust pipeline, it's not any one particular transaction. For us, we have a lot of what I would call $20 million to $40 million type revenue transactions in the pipeline, and that's our bread and butter, right? It's what we're known for. A couple of these are integrated, collection, transfer, recycling, and landfill companies, and again, those are quite attractive to us.

And from a seller standpoint, look, it's an interesting time to have a dialogue because the strong management teams that are at these companies, when they see a decline in commodities like this, we know they're out there putting out another 200 to 400 basis points of price because they're running their business, as you would hope they'd be running their business. That's why we call these gold-plated companies. And so it's an interesting time to have that dialogue.

Obviously, there's a lot of folks that are what I'll call more C&D oriented, that have come into market hoping for 21 valuations. That's not happening in this environment and this outlook for the economy and construction potentially. And so it's a mixed basket, but obviously, we remain vigilant on how we diligence them and how we value them. But again, I'd say it's coast-to-coast still in both U.S. and Canada.

Kyle White: Sounds good. Appreciate all the details.

Operator: Sean Eastman with KeyBanc Capital Markets.

Sean Eastman: Great quarter. So I just wanted to come back to the back-and-forth with Jerry on the potential for margin expansion next year. Just for clarity, I assume you guys are saying kind of underlying margins can see expansion year-on-year, and then we kind of walk back an M&A drag given that revenue growth is going to be outsized. Is that correct?

Worthing Jackman: Well, right now, what the M&A drag for next year is predicted to be, or estimated to be, about 20 basis points. It's not a material number. And if you think about our normal margin cadence, we talked about a 20 to 40 basis point margin expansion. Obviously, going into next year, we think it will be much higher than that to offset the commodities. But it also gives us a chance to offset what the current acquisition drag, 20 basis points.

Sean Eastman: Okay. That's very helpful. And then maybe just help us think about the different moving parts in the internal inflation. I think there was some kind of hope that we'd see a plateauing and some declining coming out of the second quarter. There was some encouraging signs on the labor front. It seems like the message now is more persistent, which is not particularly surprising. But just some color on those moving pieces would be great.

Worthing Jackman: We really haven't seen much change, what I'll call the pace of underlying inflation, as well as labor. As we look ahead, we see it on the horizon, that coming. But until that's there, we're still going to, as someone said before, pull the levers needed to address the realities of what we're in right now.

Where we are seeing some improvement obviously is on the hiring front. We continue to make progress month-to-month on hiring more people than new openings. And so that's maybe a sign that there's some light at the end of the tunnel on that side. Turnover has continued to remain stable and retention increase has been increasing a little bit on new hires. And so there are signs that the trends are starting to suggest that the break is coming, but we're not going to believe it's on us until we actually see it.

Sean Eastman: Okay, helpful. I'll turn it over. Thanks a lot.

Operator: Michael Hoffman with Stifel.

Michael Hoffman: So I want to know what the bet was for the second game?

Worthing Jackman: Oh, this could be a long call, Michael.

Michael Hoffman: Okay. I had to be rooting for the Phillies, that's where I went to college. So I want to move back into price real quick. Could you share with us what your restricted rate of change was versus your open market in 3Q and then the assumptions for that in 4Q?

Mary Anne Whitney: Sure. So in our exclusive markets, it was about 5.5%, and in our competitive regions, it ranged from about 10% to 13%. And again, what we described for Q4 is not materially different from Q3. So that's about the right way to think about it.

Worthing Jackman: Except that core might tick up a little bit.

Mary Anne Whitney: Yes, it might tick a little bit higher, yes.

Worthing Jackman: But yes.

Michael Hoffman: Say the last part again. What would tick up and tick down?

Mary Anne Whitney: The core is ticking up a little bit, as we described, so we said we'd stay around 10%, but more of it would come from core. We hope that people, that's what they appreciate, right? The core continues to accelerate, which is part of the setup for next year and the conviction that, as Worthing described, the continued elevated levels of pricing. We're not relying on fuel surcharges to get there. And then as we look ahead, as Worthing mentioned, in those restricted markets, it's closer to the 7% is how we're thinking about next year.

Michael Hoffman: Got it. That's very helpful then. Can you talk a little bit about what happens with price as a rate of change, as well as unit price, as we -- a couple of things. One, inflation does find a settling-down point; and two, we may slow down the economically. Help everybody understand the durability of this.

Worthing Jackman: Well, again, we'll do -- as you know, we already have a large percent of pricing rollover into 2023 based on the actions and the levers we pulled this year; just like we did in 2021, which gave us a lot of visibility of price into 2022 before the year even started. We'll do the vast majority of our price increases early in the year. And again, that ought to set us up for the type of pricing on a macro basis that I had suggested before, which is in that 8% to 9% at a minimum as we look at next year.

And again, if things remain elevated as we get into Q3 or Q4, we'll make another assessment. But I think the fed is doing a pretty good job of trying to tamp the brakes here. And again, once you start anniversarying the high rates of change you're seeing this year, a lot of the math should suggest that mid-single-digit inflation levels ought to be hit by middle of next year, and maybe come off that a little bit more as you exit 2023.

Michael Hoffman: Okay.

Worthing Jackman: But the important thing is getting the pricing done early, having strong rollover and doing the pricing early in Q1, much like we always do.

Mary Anne Whitney: And of course, the reminder that about 40% of the book of business is in those restricted markets. And so when we say we're expecting 7%, that number doesn't change based on what happens to inflation next year. That, of course, impacts 2024, not 2023, because it's a look-back.

Michael Hoffman: Right, right. And then from a volume standpoint, are you still seeing net positive service intervals and net new business formation versus losses?

Worthing Jackman: Yes, I'd say we track the sales results in these competitive markets where you can track that. Again, we're still running better than plan on net new business as well as on net new price.

Michael Hoffman: And then on the M&A side, are you seeing any easing evaluation, given the debt markets have kind of locked out the non-strategic buyer? Is that helping valuation? And second, do you think the above-average pace pauses if the sellers -- or if we're in a recession, sellers back off and wait?

Worthing Jackman: Well, again, Steve, this year, we'll get, what, 4 years of transactions done. We'll probably have next year baked by the time we get on our call in February with 10 more months left to go. But so no, look, the disconnect obviously is there was such a rush of folks and euphoria with free money and cheap money. And everyone was running around talking about high multiples without any regard to what type of business they have, what type of cash flow conversion they have. Those days are gone. I think there's a reality check of the ability for lower margin, low cash flow generators to think that they can just go get what they thought they could have gotten in 2020 or 2021. And so clearly, there's a reset on those types of businesses.

And look, our approach to valuation hasn't changed. We've always had above-market inputs on our return expectations. We've always viewed this on a cash-on-cash basis. In fact, some of the companies we're seeing now have 30%-plus margins. And so the cash-on-cash generation (inaudible) should warrant a higher valuation, as we said before, real estate in some of these markets is very expensive and that can move the multiple a little bit as well. And so nothing's changed on our view. But clearly, I think some sellers who are coming to the table with folks pitching them high multiples without the quality of assets or cash flow to support it, will create a disconnect for those sellers. And those folks might be starting a process that will disappoint them.

Michael Hoffman: Okay. And then Mary Anne, for capital spending next year, you said 10.5%, but that doesn't include any sustainability spending. So that would be on top of that?

Mary Anne Whitney: No, Michael. When we describe CapEx, we talk about the total CapEx; we don't divvy it up that way. And so at 10.5% of revenue, that would be everything.

Michael Hoffman: Okay. That's a pretty good dip from this year because you're running closer to 12% this year.

Worthing Jackman: But we've been very successful, and if you don't put it that way in spending money these past 2 years.

Michael Hoffman: (Laughter). All right. And then last one for me. Has the internal cost of inflation at least peaked? It's not rising still, or is it still rising? I just wasn't sure about that message.

Worthing Jackman: No, it's not rising. I'd say 4 or 5 months ago, it's just been remaining at these elevated -- and as I said, I was accused of being Donald Rumsfeld, I think last call. Again, the important things that -- the unknowns are known, and there have been no more unknowns that have surprised us. And so again, we've shaped the price, the required pricing, consistent with the environment and that environment's remained fairly stable now for the past 4 or 5 months.

Michael Hoffman: Okay. All right. Great, thanks.

Operator: Noah Kaye with Oppenheimer.

Noah Kaye: Interesting nugget from the Sustainability Report to see incident rates come down again in 2021. And that's really despite the increased activity, right, from reopening, the healthy amount of M&A that you did. And I'm just curious if you could talk a little bit about as you kind of rebuilt routes and activity from Covid, what you did and what you're doing to drive continued safety improvements in the business?

Worthing Jackman: Yes, well, obviously, those -- it's important to know when we say "an incident rate," it could be a bee sting, it could be hitting a mailbox. We try to track everything that's impacting our people or the community, right? And that includes non-preventables, meaning folks that hit us. And obviously, with proliferation of cellphones and distracted driving and other things, it always amazes me how many people hit garbage trucks. But there's a lot in that number that you referenced.

But look, from our standpoint, we always say, safety is behavioral based. It's not in a binder, it's not a department and each individual has to own it. Each individual has to come fit for duty; each individual has to remain aware and want to come home safe. And when you're putting over 10,000 routes on a street, or 11,000 routes on the street, we can have some incidents. But you got to remember, there's probably almost 11,000 that aren't having any incidents. Our southern region, which is a large slot in Texas across to Florida, had zero incidents yesterday. We celebrate those days; we should expect those days, but we still celebrate them.

And so, no, it's a relentless focus on a daily basis and our folks are willing to be held accountable. These are professional drivers, driving around in a dangerous environment. And hats off to them each and every day for the number of them that go through every day and years without any incidents.

Noah Kaye: Okay. Thanks. And then I think sticking with the theme of people and labor, to Michael's question earlier, about internal rate of cost inflation, can you characterize what you're seeing in the labor market now? Obviously, we're kind of heading into a seasonally softer period, but are we starting to see any easing in the labor market it? Does it remain tight broadly? Any sort of geographic easing that you might call out?

Worthing Jackman: Yes, it's always geographic-specific, right? You can have, in some cases, wage rates running in that 3% to 5% range; and in some areas, you might have market adjustments that push you higher than that. And so overall, I'd say, obviously, we're assuming kind of mid-single-digits or a little bit higher, but it varies by market and we try to be proactive and responsive to the vagaries in each market.

Noah Kaye: Yes, and I guess to tie that back to kind of the margin expectations, right? If you're overcoming [70 to 100] bps recycling headwind in 20 bps M&A dilution next year, and you're doing that with 8% to 9% price. What does that assume for internal cost inflation next year?

Worthing Jackman: Yes, obviously, we're working through budgets right now, but as I pencil it out, I wouldn't be surprised if it averages around 6%. And if I'm wrong, it may be at 7%, which is why you got to make sure you're covering it. Look, a lot of the comments out there, expect inflation to be abating on these on a reported basis as you move out of this year. And so maybe it

kind of starts oscillating that 8% to 8.5%. So those days of 9% or 10% hopefully are behind us, and again, most of the month-to-month trackers show our expectations of 4% to 6% by the time you hit midyear next year with a little softening in the latter part of the year.

Noah Kaye: Super-helpful, thank you.

Operator: Stephanie Moore with Jefferies.

Stephanie Moore: Continuing on the topic on price, but more so on the competitive landscape, I wanted to know if you were seeing any kind of changes in pricing activity more so on the local level from some of your smaller competitors, if they have kind of had their foot on the gas as much as the larger names in terms of just continuing to push price? Any color there would be helpful.

Worthing Jackman: Yes, it's a good question. They're being impacted by the same challenges that the rest of us are and so it's -- the pricing environment is no different on the smaller privates (inaudible) than on the public's. So I think you've seen folks march in lockstep. Especially if companies that have lower margins, you get this inflationary environment, 100% of your margin might get wiped out unless you're going to price, right? And so in some cases, pricing in that 8% to 12% is what we see on the Street.

And again now that the need to recover the commodity, as I said before, we know many privates that are putting 2% to 4% out there, higher than they expected probably back in the middle of this year, as we look at the upcoming year, again, it continues to show that the umbrella for pricing is there because it's needed to cover the costs and the impact on the commodity side.

Mary Anne Whitney: And just to add to that, Stephanie, we continue to see the reality of that in competitive bidding, for instance, on municipal contracts for small players, in many cases, can't even participate because they don't have the equipment or the people or such a large price increase as necessary to hold on to the business.

Stephanie Moore: Great, that's helpful. And then kind of switching gears, this year is shaping up to be another record M&A year after a robust last year. Can you talk about maybe, as you think about the last really 2 years of M&A activity and improvements to route density, and kind of building out some concentration in key markets, and how that's driving any margin improvement here this year?

Worthing Jackman: Yes, we don't look at it as driving margin improvement. Obviously, it helps on the fringes, but these aren't needle-movers. As we always say, acquisitions that come on board, we typically expect a modest amount of margin improvement. But again, many of these could be structurally lower than the base business because obviously, they may not have the full collection of assets, meaning might not have renewable fuels, might not have landfills, etc., some E&P waste, some of the higher-margin sides of the business. And so those are structurally dilutive. But it's little tuck-ins of $0.5 million here to $2 million or $3 million there, doing 15 or 20 those a year, that's not really going to move the needle for what you're asking about.

Stephanie Moore: Understood. Thanks so much.

Operator: Walter Spracklin with RBC Capital Markets.

Walter Spracklin: So Worthing, you called out West Coast exclusive markets as a particular opportunity on your M&A. Just curious what prompted you to flag that? Is it because there's larger deals that are coming up there, or is it because you're aligning a little bit more with that in focus? Just curious as to why you called out that particular area.

Worthing Jackman: Well, I think we've been calling it out throughout last year and this year. It seems like every decade or so, there's a wave of West Coast sellers. It's kind of generational shifts in whether to retain or sell a business and the dialogue is quite strong. You've seen us -- again, we talked about having closed many acquisitions in Oregon and California this year. When the year plays out, I wouldn't be surprised if over $200 million of acquired revenue just sits on the West Coast; that's a very active year, and there's dialogue that continues on the West Coast. And so again, we call it out in the periods when it's quite active because it's not always active, right? And I think West Coast activity is something that really leads to above-average amount of transactions and (inaudible) revenue in any one year.

Walter Spracklin: That's great. And then when you look at your pipeline, I know you've got a big number out there for the potential acquisition pipeline. But arguably, with the fast pace you're doing these, perhaps the most attractive go first. At what point do you think when you look at that annual guide you always give, and then you hit the number that you actually do, it's quite a disconnect. It sounds to me like you think 2023 is going to be another outsized year. How long do you think we're going to be in these outsized years before we see a kind of slowdown to what you've been typically flagging as a normal year for acquisitions?

Worthing Jackman: Well, as you know, we also remind people, don't own us for what we haven't done yet; so would love us even more in a year we don't do any transactions, right? That means we passed on a lot of things because we should. But no, look, there's still visibility on 2023. Obviously, as I said before, we may get an average amount of annual revenue completed by the time we're sitting on this call in February, right, with a lot of time left to go.

Look, we still easily turn down seven or eight transactions for every one or two that we actually do pursue. Many of the deals we're doing are based on relationship dialogue that's been going on for 20, 30-plus years, right? It's just -- the owners are finally saying "Now I'm ready." And so it's hard to predict when owners of quality companies will sell; they control the timing, not us. We just have to be ready to move when they say they're ready to go.

Walter Spracklin: Got it. And last question here is on your guide for next year in double-digit. At least one of your peers had that out there and backed off it. And not comparing you to that, or asking you to speak to that, but what do you think gives you the best support when you have OCC prices coming down? You used the word "overcome." What area would you say has been the most successful in overcoming that degradation? Is it higher than the acquisitions you mentioned? Is it your better markets? Are you achieving better pricing? What would you characterize in order of magnitude would be the most important offset to OCC price, declines in OCC pricing?

Worthing Jackman: Well, I think you're seeing -- you saw it in Q3 and you're seeing it in Q4, right? It's the fact that pricing is running around 10%. And if you're not able to get the price necessary, then I understand why some people may not want to give, I don't know, more insight into 2023 because they want to wait. Reality is that we're executing it, it's in place, and we know how to do it. And we'll do it again next year. But the good news is we only have, what, maybe 8 months of headwinds at this level and it's easier to calculate. The important thing also to know is it's one thing to know what the price is of OCC; it's another thing to move the product. And our folks have done a remarkable job still moving product in this environment versus just having it stacked up in our facilities.

Walter Spracklin: Great. I appreciate the time. And congrats on a great quarter.

Operator: (Operator Instructions). Stephanie Yee with JP Morgan.

Stephanie Yee: Very great quarter. I just want to ask about the volumes. I know you provided a lot details by different pieces earlier and I know a lot of those are facing tough year-over-year comps. But could you just comment on whether you're seeing any slowdown from your customers and maybe some projects, or what level of visibility you have for any signs of slowing, assuming we might go into an economic slowdown in the coming months?

Worthing Jackman: Sure. Without a doubt, we talked even last call, last two calls, on special waste. We noted that some special waste was sliding a little bit with regards to the timing of those projects, more because the budgets that were put in place by those developers did not incorporate the dramatic rise in logistics costs as you -- consumers' budgets put in place a while ago before they pull the trigger. And the escalation and logistics costs just wiped out the economics of those projects. And as more trucking capacity gets on the marketplace, as logistics costs are beginning to slip a little bit from those long haul providers, you're seeing those projects start coming back on.

As I look at Q4, at least so far in Q4, the C&D -- I mean, the special waste tons, while down just a little bit, they're nowhere near down as much as you saw in Q3. And so other than that, as you know, this is more of a fixed base system. It's [a lot of] the cans half full, a third full, three-quarters full or totally full. We know what we're charging when it comes to most of our customers. And so again on C&D, we're seeing continued strength. You saw that in the Q3 numbers, and revenue per pull up high-single-digits, bolster days still up. C&D volume in Q4 and our landfills remain nicely up. And so we're still seeing strong activity around that.

Mary Anne Whitney: What I'd add to that, Stephanie, is just that what I would note is just how remarkably steady the piece has been. I look at landfill volumes for instance, and so what you're seeing really are those comps and the lumpiness of special waste. When I looked geographically, actually our strongest region on volumes is our central region, and they were highly impacted on special waste. So that's just an interesting observation, a reminder of how lumpy it is. And where we saw weakness, or the lowest volumes, was Canada, which by the way, we had highlighted all throughout last year, the observation that their volume recovery had really outpaced the reopening activity. And while other people were saying, hey, there's a tail still to come, and we said, no, we think they're really back. And you're seeing that in the tougher comps this year.

Stephanie Yee: Okay, great. That was super-helpful color. Thank you. If I can just ask one more, I appreciate the color you provided on revenue growth kind of overcoming the margin headwinds, and then double-digit free cash flow in 2023, expected in 2023. I guess in regards to the free cash flow conversion, are you expecting it to be relatively steady versus 2022, even with kind of the bonus depreciation impact hitting, kind of stepping down in 2023?

Worthing Jackman: Yes, it should stay above 50%, whether that's 50.5% or 51% or 50.15%, too early to tell, but it will stay above 50%.

Stephanie Yee: Okay, great. Thank you.

Operator: This concludes our question-and-answer session. I'd like to turn the conference back over to Worthing Jackman for any closing remarks.

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

I'd be remiss to say that I've already been called out internally by the Philly fans that we have in Pennsylvania. And so hang in there, folks, it's the [best of three] now.

Thank you again. We look forward to seeing you at our upcoming investor conferences, or hearing from you on our next earnings call.

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