Waste Connections, Inc.
Q3 2023 Earnings Conference Call
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Mary Anne Whitney, EVP & Chief Financial Officer

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Kevin Chiang, CIBC World Markets
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Jerry Revich, Goldman Sachs
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Presentation

Operator: Good day, and welcome to the Waste Connections, Inc. Third Quarter 2023 Earnings Conference Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note, today's event is being recorded.

I'd 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 third quarter results, and to provide a detailed outlook for the fourth quarter as well as some early thoughts about 2024. I'm joined this morning by Mary Anne Whitney, our CFO, as well as other members of our leadership team.

As noted in our earnings release, we are extremely pleased by the durability of our financial and operating results in the quarter, with momentum for continued outsized margin expansion, solid operational execution drove adjusted EBITDA margin of 32.5% in the third quarter, as expected, up about 140 basis points sequentially and up 120 basis points year-over-year, in spite of over $15 million in unforeseen headwinds. Moreover, normalizing for recycled commodity values from just over a year ago, underlying adjusted EBITDA margin eclipsed 33% in the quarter. And this is total company EBITDA margin, not just solid waste.

During the quarter, we overcame elevated levels of risk-related expenses, and other lagging effects of higher employee turnover in prior periods, as well as site-specific incremental operating expenses at one of our landfills in California. The expected Q4 and ongoing impact of this evolving landfill situation are currently being evaluated, along with a recent shorter-term development at a landfill in Texas, and as such, weren't anticipated in the full year outlook we provided in August. We expect to get more clarity going forward, but currently, estimate the range of outcomes in Q4 to include impacts of up to $20 million to revenue, adjusted EBITDA, and adjusted free cash flow.

We remain encouraged by the pace of improvement in employee retention, which along with our differentiated strategy and execution, should provide for above-average underlying margin expansion in solid waste collection, transfer and disposal in 2024. On that basis, we should be positioned for high-single-digit adjusted EBITDA growth in 2024 on mid-to-high-single-digit revenue growth, including approximately $150 million of revenue carryover from acquisitions signed or closed year-to-date, with upside potential from additional acquisition activity and any further improvement in commodity-related activity.

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 October 25 earnings release, and in greater detail in Waste Connections filings with the U.S. Securities and Exchange Commission and the securities commissions or our 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. We are extremely pleased by our operational execution in Q3, driving results largely as expected in spite of the incremental headwinds described earlier, with an adjusted EBITDA margin accelerating to 32.5% on continued price-led organic growth in solid waste, reflecting a price cost spread of 250 basis points. As mentioned earlier, underlying adjusted EBITDA margin eclipsed 33% in the quarter at commodity values of just over a year ago.

As noted additionally, we overcame over $15 million in unforeseen headwinds during the quarter, primarily in two areas -- first, an increase of approximately $9 million to already-inflated risk related expenses. This development was associated with prior period activity and reflects the higher safety incident rates that accompanied the increased employee turnover in recent years, a reminder that risk is a lagging indicator as claims develop while turnover is a leading indicator. As we drive down turnover, risk expense will improve along with claim frequency and severity.

Next, we absorbed over $6 million in additional operating expenses at our Chiquita Canyon Landfill in Southern California, where we are managing and working to resolve what is characterized as an elevated temperature landfill or ETLF event. This refers to a reaction resulting in the rapid breakdown of waste at elevated temperatures -- in this case, occurring deep underground in an older portion of the landfill, involving non-hazardous waste that was accepted and handled prior to our ownership of the site.

While there are currently no impacts to ongoing waste acceptance at the site, the reaction has led to escalating amounts of leachate generation accompanied by odor impacts. Since communicating this occurrence to the appropriate governing and regulatory bodies, we have been coordinating our efforts to address the odors, handle the leachate and satisfy the concerns of various constituents.

The incremental costs in Q3 primarily included leachate treatment and disposal, along with engineering and monitoring costs. We expect these expenses to expand in Q4 to over $10 million, primarily as a result of increased leachate generation. Beyond that, we have determined that we are not yet currently in a position to estimate the ultimate impact or timing of resolution. We expect to have good clarity of timing and resolution by our February call.

The second landfill issue noted earlier is more clearly defined and more limited, but nonetheless, expected to impact Q4. At our Seabreeze Landfill in Texas, we experienced a slope failure at the end of the third quarter that has resulted in our shutting down the landfill, and redirecting tons to alternative disposal sites while we complete repairs and site work.

The impact of lost revenue and increased expenses at this site in Q4 are expected to be in the range of $5 million to $10 million. Depending on how quickly we are able to reopen the site, we currently expect to reopen the site in mid-December. We consider both of these landfill issues to be unusual, site-specific and non-recurring in nature, although differing in duration. While historically, many analysts and investors may have adjusted for similar types of non-recurring events by adding back the impacts, these are developing in real-time, and we are not currently in a position to make a final determination.

We have not included them in our outlook for Q4 or our preliminary thoughts for 2024, but in the interest of transparency, are providing the estimated range of potential outcomes in Q4 to include impacts of up to $20 million to revenue, adjusted EBITDA and adjusted free cash flow.

Returning to the strength of our operating and financial performance in Q3, we delivered core price of 8.8% and total price of 7.7%, including 110-basis point decline in fuel and material surcharges, primarily related to the decline in diesel prices.

Reported volume growth of negative 1.9% on a day-adjusted basis reflected the continued impact from intentional shedding as expected with recent acquisitions. As described last quarter, rightsizing markets and improving revenue quality should be considered integral to a disciplined approach to acquisitions, and therefore expected, especially given the magnitude of acquisition activity we have enjoyed over the past few years.

Moving on to the topic of acquisitions, we continue to see above-average levels of seller interest, and as typical, some activity getting pushed to year-end. To date, we have about $170 million in annualized revenue closed, with an additional $80 million already signed, and in some cases, awaiting regulatory consents, which are expected to close by year-end or very early in 2024. As such, we have visibility for almost 2% in acquisition rollover contribution in 2024, with the potential for that amount to grow from additional transactions anticipated to sign or close by early next year.

Our pipeline remains quite robust across our footprint, including some opportunities to further expand our portfolio of West Coast exclusive markets. 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 to capital to shareholders. To that end, our Board of Directors authorized an [11.8]% increase to our regular quarterly cash dividend, our 13th consecutive annual increase since the initiation of the dividend in 2012 -- 2010 -- excuse me.

While executing our growth strategy, we also demonstrated the ability to drive down emissions, and show significant progress towards achievement of our sustainability-related targets, as highlighted in our recently released 2023 Sustainability Report. In fact, as further outlined in that update, we saw a 14% reduction in Scope 1 and 2 emissions in 2022 in spite of outsized revenue growth, resulting in a 27% reduction in emissions intensity.

Moreover, we backed up that progress by doubling our targeted emissions reduction to 30%, and have initiated the process of aligning our emissions reduction targets with the Science Based Target initiative or SBTi. Our updated Sustainability Report also highlights our progress on the development of incremental capacity for recycling and renewable gas for RNG generation. We increased our operational offsets by 8% in 2022, driven primarily by an 18% increase in recycling tons, bringing our annual total to over 2 million recycled tons.

And looking ahead, we are positioned to significantly expand our biogas recovery through development of additional RNG facilities, including three new facilities expected to open in 2024.

Moreover, we continue to expect incremental annual EBITDA contribution of $200 million by 2026 from a comparable level of investment to that end, including approximately $125 million to $150 million of capital outlays on RNG facilities anticipated in 2024.

We continue to pursue the development of other RNG projects, including at our most recent acquisition, which we believe will be additive to these amounts as we look to 2026 and beyond. Continued investment in sustainability-related projects is consistent with our objective of value creation for our stakeholders, and along with enhanced disclosure and demonstrated progress, indicative of our commitment to the environment and the communities we are truly privileged to serve.

And additionally, we continue to invest in our most important asset, our people, and anticipate additional margin expansion opportunities from innovative approaches to further improve employee retention and engagement. We are encouraged by the progress we have made in employee retention efforts in Q3, with voluntary turnover stepping down sequentially for the fourth consecutive quarter. As compared to the peaks we saw in 2022, voluntary turnover is now down over 20% and open position requisitions are down over 30%. We look forward to seeing these trends continue and supporting the efforts of our local leaders with resources to facilitate that progress.

We characterize our efforts as doubling-down on human capital, as we renew our focus on empowering leaders for success in our decentralized operating model. Changes include revamping recruiting through upgraded technology offerings, and more than doubling training focused on frontline employees. We've initiated a pilot program for our own training academy for drivers, and are coordinating efforts for a diesel technician school offering. We're excited about our progress to date, and we look forward to seeing continued improvement as we enter 2024, when we should realize the lagging effects from improving retention rates during 2023 and into 2024.

As noted earlier, while we deliver industry-leading margins, we are still absorbing the residual effects of higher turnover in previous periods, which include elevated reliance on third-party services, as well as the increased overtime and associated equipment wear and tear, which ultimately, have an impact on safety incident rates and the associated costs of risks. The good news is that the progress and retention we're seeing today sets us up for future benefits from improving costs and risk, labor and maintenance, as the same cycle should play out in reverse when incident rates and severity decline along with turnover.

And now I'd like to pass the call to Mary Anne to review more in depth the financial highlights of the third quarter, and to provide a detailed outlook for Q4. I will then wrap up with some thoughts about 2024 before we head into Q&A.

Mary Anne Whitney: Thank you, Ron. In the third quarter, revenue of $2.065 billion was above our outlook and up $185 million or 9.8% year-over-year. Acquisitions completed since the year-ago period contributed about $103 million of revenue in the quarter net of divestitures. Core pricing of 8.8% ranged from about 6.5% in our primarily exclusive market western region to a range of approximately 8% to 10% in our competitive regions. As expected, core pricing stepped down sequentially from Q2 as a result of both the typical cadence of seasonality on reported price and the waning impact of outsized pricing activity from 2022 as compared to previous quarters.

The Q3 volume decline of 1.9% on a day-adjusted basis was in line with Q2, and similarly spread across residential collection with the non-renewal of certain municipal contracts. Commercial collection from opportunistic shedding of lower-quality accounts, and in post-collection in reduced transfer volumes directed to third-party disposal outlets. Our most impacted markets were in our eastern region, where we have had outsized acquisition activity over the past few years.

Looking year-over-year at other lines of business, roll-off pulls per day were up about 1% on revenue per pull, up about 6%, and landfill tons were up 5% year-over-year, largely driven by higher special waste tons up 17%, with C&D tons up 2% and MSW tons up 1%. The increase in special waste activity in Q3 followed two down quarters and was the result of a few jobs either getting delayed from Q2 or likely pulled forward from Q4, a reminder of the event-driven nature and inherent lumpiness of these projects. Through 9 months, special waste tons are up 1% year-over-year.

Moving next to revenues from recovered commodities, excluding acquisitions, recycled commodity revenues were down 27% year-over-year in Q3 and down 6% sequentially, about as expected, due to a sharp decline in the value of plastics during the quarter, partially offset by improvements in old corrugated containers or OCC, which averaged $88 per ton.

Landfill gas sales were up 7% year-over-year in Q3, due primarily to higher renewable energy credits or RINs, which averaged about $3.

And finally E&P waste activity. We reported another increase in E&P waste revenue to $59 million in the third quarter, up 6% sequentially from Q2 and up 10% year-over-year.

Adjusted EBITDA for Q3, as reconciled in our earnings release, increased by 14.1% year-over-year to $671.2 million, again, above our outlook. At 32.5% of revenue, our adjusted EBITDA margin was up 140 basis points sequentially from Q2, and up 120 basis points year-over-year, all from solid waste, as we delivered the outsized margin expansion that we projected in our updated outlook provided in August. And as Ron noted, that achievement was in spite of the $15 million in unforeseen cost headwinds overcome in Q3.

In fact, underlying solid waste margins arguably expanded by 150 basis points year-over-year on a normalized basis, as headwinds from the incremental landfill cost in Q3 accounted for about a 30-basis point drag to reported margins.

Within solid waste, price-led organic growth drove margin improvement across many areas, with outsized improvement in third-party logistics and disposal, and with offsets most notably from higher-risk costs.

Beyond solid waste, commodity impacts were a wash. 20 basis points benefit from higher E&P waste activity, plus another 20 basis points from lower fuel rates were offset by recycled commodity values, which although improving, were still a 40-basis point drag to margins.

Net interest expense of $66.2 million reflects a weighted average cost of about 4% on a mix of approximately 80% fixed and 20% variable rate debt, with an average [tenure] of over 10 years.

Leverage remained unchanged in the quarter at about 2.75x debt to EBITDA.

And our Q3 tax rate was slightly lower than expected at 21.6%, due primarily to the impact from lower foreign exchange rates for the Canadian dollar.

Year-to-date, we have delivered adjusted free cash flow of $969.3 million, or 16.2% of revenue, on track for our full year adjusted free cash flow outlook of $1.225 billion, excluding the ongoing landfill impacts Ron outlined earlier.

I will now provide our outlook for the fourth 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 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.

And finally, it did not reflect the two landfill situations described earlier, which could result in impacts in the quarter of up to $20 million in revenue, adjusted EBITDA and adjusted free cash flow.

Revenue in Q4 is estimated to be approximately $2.04 billion. We expect core price of about 8.5% and total price plus volume of 5.5% to 6%.

Recycled commodity values and RINs are projected in line with recent levels, and adjusted EBITDA in Q4 is estimated at approximately $658 million or 32.3% of revenue.

Depreciation and amortization expense for the fourth quarter is estimated at about 12.6% of revenue, including amortization of intangibles of about $39.5 million, or about $0.11 per diluted share net of taxes.

Interest expense, net of interest income in Q4, is estimated at approximately $68 million. And finally, our effective tax rate in Q4 is estimated at about 23%, 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. Again, we are extremely pleased with our year-to-date performance and our positioning for 2024, particularly given the strength of execution throughout 2023 and the improving dynamics in employee retention. Although, we won't provide our formal outlook for 2024 until February, we are able to expand on the early thoughts we provided in August, assuming no change in the current economic environment.

We continue to have visibility for outsized adjusted EBITDA margin expansion, resulting in expected high-single-digit adjusted EBITDA growth in 2024; unexpected mid-to-high-single-digit revenue growth, including price-led organic growth in solid waste, plus almost 2% from acquisitions signed or closed thus far in 2023, with the potential for that amount to grow by early next year based on our current pipeline.

To the extent that we see further improvement in recycled commodity values, or easing of inflationary pressures during the year, those impacts, along with additional acquisitions completed throughout the upcoming year, would provide upside to these preliminary thoughts, as would the benefit from RNG facilities coming online by 2024.

Adjusted free cash flow conversion would be expected to remain in the current range of 45% to 50% of adjusted EBITDA, excluding the outlays for RNG projects described earlier.

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

As we continue to grow towards revenue of $10 billion and more, we maintain that our decentralized operating philosophy, and therefore, our people are our greatest differentiator. Our results to date and our outlook for 2024 are a reflection of their commitments and accomplishments.

We recently celebrated our 26th anniversary as a company, and had the opportunity to be together as a team with our local leaders for the first time since the pandemic to renew the relationships that we know drive our results, and to reinforce the vision and values that have guided Waste Connections since its inception -- safety, integrity, accountability, customer service, servant leadership, and being a great place to work. In short, it's about both relationships and results.

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

Questions and Answers

Operator: Thank you. (Operator Instructions). Toni Kaplan with Morgan Stanley.

Toni Kaplan: A very strong pricing quarter once again. I was hoping you could maybe give some initial thoughts on pricing in 2024, maybe just kind of ballpark. How should we think about the trajectory? Would you expect sort of price to come down as inflation comes down, or are you not really expecting too much of a drop at all?

Mary Anne Whitney: Sure. Thanks, Toni. So in terms of pricing, I'd start with, you'll recall that about 40% of our pricing is CPI-linked, and therefore, there's that lagging impact. And so the CPI you see this year informs us about how to think about what that pricing looks like for next year. And then beyond that, we think in terms of that spread to drive margin expansion. And so as Ron described, the preliminary thoughts for 2024, saying mid-to-high-single-digits, including the 2% acquisition contribution, sort of informs you of how we're thinking about price plus volume making up the other piece to get you to that mid-to-high.

And then in terms of the cadence during the year, the typical cadence, Toni, is that pricing on a reported basis is typically highest in the first quarter, and steps down over the course of the year because of the denominator growing. But most of the pricing gets done early in the year, so we have good visibility by the time we report Q1.

Ron Mittelstaedt: And Toni, this is Ron. What we strive for continually is to be about 150 to 200-basis point spread to the CPI on an ongoing basis. So sort of whatever you would assume is the CPI for next year, if you're assuming that's 3.5% to 4%, I would add 150 to 200 basis points-plus to that assumption for the price, as this quarter, we did 250 basis points better than a cost spread, but we certainly strive to be in that 150 to 200 at least on a regular basis.

Toni Kaplan: Terrific, very helpful. I also wanted to ask -- you did a nice job describing the issues that you're seeing with the landfills in California and Texas. And you talked about it being not recurring and site-specific. I was just wondering, are there always issues like these, but these are bigger? So they have to be called out, or is there a reason why there are a couple of issues at the same time? Just trying to figure out, as we go forward, if we're going to see like some additional issues. I know these are supposed to be sort of one-time, but maybe just talk about if anything has changed.

Ron Mittelstaedt: Sure. So, first off, Toni, nothing whatsoever has changed. First off, we have well over 100 landfills in the company. And in 26 years, we've never once at any of our landfills had one of these elevated temperature events. So that tells you how rare and how unique they are. They definitely happen within the industry. At probably any given time, there's 5 or maybe 10 of these going on nationwide with various owners, but we have never had one before and so that is unique. It is also in Southern California and Los Angeles, which makes it a little bit more complicated because of the density of the population. So that's one.

The second one, the Texas issue -- and these are completely unrelated and coincidental in timing. The second one, the Texas issue, was a slope failure. That was actually our error caused by us. We could have prevented that, but we missed a few things. And we have only had two of those out of over 100 landfills in 26 years, one about 14 years ago and smaller, and we never needed to call it out or did call it out.

The other reason we've called out these two is because there has been press coverage of these in the media. And because of that, we felt it would be inappropriate not to communicate it to investors and other listeners, when it is in the press. So that's how I would characterize these two as to why they -- many would add these back is because of their non-recurring nature. And we've really never had either of these before.

Toni Kaplan: Super, thank you.

Operator: Kevin Chiang with CIBC.

Kevin Chiang: I appreciate, I guess, the uncertainty of how you're going to deal with some of these costs related to the landfill, both in, I guess, specifically in Q4. But if I look at Q3 and if I -

- and Mary Anne, I mentioned it, if you back that out, you saw solid waste margin expansion of about 150 basis points. Does that change how you think about the launching point for 2024? Excluding these issues, and if we treat them as one-time, it does feel like you're entering 2024 maybe a little bit higher than maybe what we would have thought a quarter ago. I'm not sure if you'd agree with that?

Ron Mittelstaedt: Yes, I think, Kevin, so number one, it does not change how we think about the launching point. Look -- and it has been raised by some of your peers in conversation. Look, we beat our guidance in Q3 and EBITDA and we overcame $15 million. So we really would have beat by $17 million. So some have said, hey, this is up to $20 million in Q4; why wouldn't you just not acknowledge that? And you could probably beat it. And what we would tell you is, look, we didn't expect to beat Q3 by $17 million in EBITDA. Good things happen, rough things happen sometimes. So we're being transparent on the rough things we know, and we do believe they're non-recurring completely. The [Texas] will be over in Q4; the California will not be over in Q4, but we believe it still will be non-recurring.

And so, no, we don't think of the launch-off point or the jump-off point as any different with these than we had, which is why in our comments, we've said we have outsized margin expansion. Look, we are now up 250 basis points between Q1 and Q3 in margin, okay? And we have just guided Q4 up substantially over last year's Q4. So the jump-off point is clearly higher than was anticipated earlier in the year.

Kevin Chiang: That's helpful. And then when I think back to the second quarter call, you gave a lot of color on some of the stuff you're doing on addressing labor turnover. And I think one of the comments you did make was, as you get turnover lower, that could yield about 100 basis points of margin improvement over the next, call it, 18 to 24 months. You called about $9 million of experience costs that weren't expected in the third quarter. Does that change how you think about the margin opportunity that you laid out back on the second quarter, whether it's the magnitude of the margin improvement or maybe the timing of realizing those?

Ron Mittelstaedt: No, it really doesn't, Toni -- excuse me -- Kevin, I apologize. It really doesn't, and here's why. Because in the $9 million of incremental risk expense, that's really a one-time issue on prior claims, okay? A part of it is forward-looking, but the smallest part of it is forward-looking. So the reduction in turnover and the improvements in labor and risk and other areas will offset that, will more than overcome that, and we stand by that margin impact.

One of the reasons we reiterated, hey, if you -- we just had a year-ago commodities, we're already north of 33%, is to show you that with that 100-basis point improvement over a few years, the 34% EBITDA margin visibility is really pretty clear right now.

Kevin Chiang: Okay. (Inaudible).

Mary Anne Whitney: The other thing I would add, Kevin, just to put some numbers around it, when we think about the cost of risk and coming -- how it was playing out in 2023 and specifically in Q3, our expectation was that it was a headwind; it was just a greater headwind. So it ended up being a 90-basis point headwind to reported margins. We had expected it to be a 40 to 50-basis point.

So my point is, that has been a factor throughout 2023, but it is one of those examples of as turnover goes down, the lagging benefits that should accrue to us over 2024 and 2025 potentially, that's one of the items that we'd expect to improve.

Kevin Chiang: Oh, that's great color. I'll leave it there. Thank you very much and best of luck as you close out the year here.

Operator: Tobey Sommer with Truist Securities.

Jasper Bibb: This is Jasper Bibb on for Tobey. Solid waste margins of the quarter, obviously, quite strong even with the unexpected costs. Also, seems like cost inflation, particularly on the labor side, is moderating a bit. But was hoping to get your preliminary expectations for how we should think about those main unit cost buckets tracking into 2024.

Mary Anne Whitney: Sure. So certainly, start and welcome Ron's input. We look at a couple of key areas, one being wages. And so wages in 2023 coming into the year, we expected to be in the range of 6% to 8%, the increases, same employee increases starting at 8%, and moderating maybe to that 6% or 6.5% over the course of the year. And the update is that's happening, and so we're seeing those improvements in wages particularly.

And then I'd say more broadly, the inflation we're seeing, and that we've referred to in that price cost spread, has stepped down over the course of the year from low-double-digits from over 10% to now more like 5.5%. So I'd say the trajectory, first of all, it's playing out as we expected because the expectation was that -- for instance, on the wage front, the outsized increases we put in during the course of 2022, we knew would anniversary over time, and not need to be put in at the same level in 2023. So as we continue, that trajectory should continue to moderate.

But I think what we have proven is that being in that 5% to 5.5% range, that should be -- we expected that's what we would see, and it's playing out largely as expected.

Ron Mittelstaedt: And I would say, Jasper, that for 2024, we're seeing CPI somewhere in that 3% to 4% range is what's being talked about, or actually what's coming in now, actually in the low 3% range. I would expect wage increases to be in that 3.5% to 4.5% range, so stepping down somewhat obviously, from the high level of CPI in 2023. But that would be sort of what I would expect from 2024 as we sit today.

Jasper Bibb: Thanks, that makes sense. And then some of your peers have discussed project delays on their landfill gas buildout. Just hoping you could give some color on your experience getting these early projects off the ground. And are you seeing any of the timelines move to the right at all there because of permitting or utility issues?

Ron Mittelstaedt: Yes, well, our peers are not alone. The reality is that the utility infrastructure, for the most part in the country, is not quite as ready as perhaps the producers like us are ready. There is significant delays in them getting transmission lines and interconnects ready, and that is pushing projects out sometimes 6 to 12 months from expectation. And we are also seeing some supply chain for transformers, generators, and other components that are needed, be delayed as well.

So still very good visibility on the projects, feel very comfortable with our 200 million by 2026. But can some projects move 3 to 9 months? Yes, they can, and yes, they are, and we are seeing that as well.

Mary Anne Whitney: And that's one of the reasons, as we think about our preliminary thoughts for 2024, the projects coming online, the three that we anticipate by early next year will be additive to anything we've talked about for 2024.

Jasper Bibb: Right. That's super-helpful. Thanks for taking the questions.

Operator: Michael Hoffman with Stifel.

Michael Hoffman: Just to touch on 2024, am I in the right neighborhood if I go price [6 to 8], volumes negative 2, and a fuel surcharge zero, M&A is 2, and that gets you to that sort of [6 to 8]. Is that mid-to-upper top line is the right way to think about it?

Mary Anne Whitney: Clearly, what we've said implies price plus volume probably mid-single-digits, right, to get to the mid-to-high. Now is it 6 minus 2, is it 5 and 0, is it 5.5? There's moving pieces in there, but we expect volumes to continue to be negative, and price needing to be more than that to get to that mid-single-digit range.

Ron Mittelstaedt: And Michael, the way -- I think you should think of it again, probably price in that 6 to 7 range, volume in that negative 1 range up to negative 2, probably starts a little higher, just as [comps], and then improves throughout the year. Again, we don't have quite as many acquisitions this year as we did coming out of 2022 into 2023, so there will be less shedding. So I think you get to the same math, but there's just a little nuance on it.

Michael Hoffman: Okay. That helps a lot. And then, Mary Anne, can you tell us what your year-to-date average commodity basket and year-to-date average RIN price is? And then what is the current number, so we can kind of figure out how to roll that into next year?

Mary Anne Whitney: Sure. So for OCC, we're trending for the full year to about $80 a ton. And that's using Q4 being at current rates, which are closer to $100. And then RINs for the full year are trending to about $2.60, assuming Q4 is closer to $3.

Michael Hoffman: Okay. All right. That's very helpful. And then, Ron, you've talked about 34% -- getting the whole company back to 34%. Everything I've heard so far, there's nothing that backs you off of that target and somewhere in the 2025 time zone (inaudible).

Ron Mittelstaedt: That's correct, yes, I think -- and Michael, I have said that we will get there, or believe we will get there again, depending -- I've also said that is with sort of 21-level commodities, okay? So with that caveat, but that is also without RNG.

Michael Hoffman: Right, which is all tailwind at this point, if we're staying in that $2 to $3 range. Can you remind us what your 2021 commodity basket was?

Ron Mittelstaedt: It was probably right at about -- give us one second, and we can. We're looking for that information. So we are going to be for the year -- Mary Anne just said we'll exit the year at a blended 80, Michael; we'll exit the year about -- yes?

Mary Anne Whitney: So OCC was 150 and (inaudible).

Ron Mittelstaedt: 150. So the basket was just a little lower.

Michael Hoffman: So 2021 was 150, is that what you said?

Mary Anne Whitney: That's right.

Ron Mittelstaedt: Yes.

Mary Anne Whitney: Average 150.

Michael Hoffman: Okay. All right. And then last one -- I get it, your experience on elevated temperatures, there is none because it hasn't happened to you. You did mention that this has been something in the modern era of landfill design we've been dealing with. What's the engineering department saying about the long-term outlook here? Do you actually reverse the temperature or you stabilize it, and therefore, that's what you're trying to get your hands around to talk to us about in February?

Ron Mittelstaedt: No, Michael, you actually reverse the temperature. As you reverse the temperature, which is what we are doing, we have added significant number of wells this -- late in the third quarter and so forth through the fourth quarter, we have add it over 50 new wells to pump out leachate and gas and reverse the temperature. As the temperature reverses and cools, the reaction stops and the generation of water stops, and that is the resolution.

Michael Hoffman: And when it comes down, the leachate management costs, which are running somewhere at $0.10, $0.15 a gallon, so it's a big number.

Ron Mittelstaedt: Yes, they're actually $0.38 a gallon in LA, because we're trucking it all off to POTW, because of the magnitude right now, we cannot recirculate when it comes down, there's a partial that we can recirculate during times of the year. But yes, it comes down dramatically, Michael.

Michael Hoffman: Okay. Thank you very much.

Operator: Bryan Burgmeier with Citi.

Bryan Burgmeier: Ron, you may have alluded to this earlier on, I think, in Kevin's question, sorry if I missed this. But 3Q EBITDA was essentially in line with your guidance, despite these kind of unexpected landfill costs. Is it possible to say what was maybe better-than-expected that allowed you to get back to your guidance?

Ron Mittelstaedt: Is it possible to say what would be better, is that what you said?

Bryan Burgmeier: Yes, you had $15 million in kind of unexpected landfill costs in the quarter. But you still kind of met your guide, what maybe came in above your expectations that netted out (inaudible) to your guide?

Mary Anne Whitney: Sure. So I'd say -- what we'd say is it's really the execution, the delivery in Q3, and as I described, the margin expansion comes from lots of small improvements within the P&L. And so within solid waste, we did a little better than expected. And then I'd say arguably, we had a little assist from E&P waste, which did step up sequentially in Q3. It was largely execution.

Ron Mittelstaedt: Yes, and generally, E&P does step down some in Q4, Bryan, so that might not be the same assist that it was in Q3. You had a little assist from RINs elevating at the end, so that right now appears to be holding, but we certainly can't project that to hold. And then you have, as we said, special waste was a little better than we had projected. It was up in the quarter. Whether or not that comes through in the fourth quarter, because you start to get into the winter weather, that is -- so those are things we're not projecting but -- and some are weather-dependent. Those are the kinds of things that could make that come through.

Bryan Burgmeier: Understood. Thanks for the detail. And last question for me. I was just wondering if you can provide an update on truck orders? The data, some of the comments from your peers seems pretty positive. Do you have a sense for maybe what percent of your 2023 orders are going to come in this year? And as you start to look out in 2024, does it seem like backlogs are maybe shrinking or expanding?

Ron Mittelstaedt: Yes, our experience is a little bit different than at least our large public peer; that may be due to their buying power because of their size. But we experience -- we are being told and we are planning that we'll get somewhere in the high-80s to almost 90% of our chassis and bodies; therefore, the full units delivered this year. We expect somewhere in that 10% to 12% to push or roll into 2024; by the way, that is a little less than what rolled into 2023 from 2022. So in that way it has improved.

But the manufacturers, particularly on the body side, not the chassis side -- the chassis side, we can get right now, which is opposite of last year. But the manufacturers on the body side are still saying there should be some delays through 2024 and it would be normalized in early-to-mid-2025. That is what we're hearing and experiencing.

Bryan Burgmeier: Got it. Thanks a lot. I'll turn it over.

Operator: Tyler Brown at Raymond James.

Tyler Brown: Hey, Ron, so I want to come back to turnover. So I think you guys gave some great statistics in the ESG Report. You talked about voluntary turnover. I think in 2022 -- correct me if I'm wrong -- but it was circa 21%. You mentioned that here in recent quarters, you have improved. But can you tell us where that number is today? I think you said it was down 20%. So is it basically already back down to that mid-to-high-teens, kind of where we were pre-Covid?

Ron Mittelstaedt: Yes, it's at 17.4 right now.

Tyler Brown: Okay. And so the whole idea here is that leads, but the benefits are a bit lagged. So that's what's really going to help us in 2024 and likely off into 2025?

Ron Mittelstaedt: Yes, that's right. Our objective is to continue to drive that voluntary down further. Our involuntary, meaning us making a proactive decision, will run higher for a little while, because we accepted employees that were probably a little more marginal than we would have otherwise, and maybe a little more risk. And so as voluntary comes down, we'll be more active on the involuntary, and then that will fall too as we re-staff with a little bit more of a higher-caliber employee in those. So that's how that will flow.

Tyler Brown: Okay, perfect. And I want to kind of come at the landfill developments here a little bit different way. So typically, how long would it take to rectify a slope failure? And typically, how long does it take to remediate one of these elevated temperature events? I appreciate maybe you're somewhat new to some of it. But I think I heard you say that the slope event maybe is a 1-to-2-quarter issue, but the temperature remediation could definitely take longer since it's in the landfill. Is that right?

Ron Mittelstaedt: Yes, so -- yes, we'll try to provide you as much clarity as we have and our experience. So the slope event, we will have remediated in the quarter, so that will be an under 90-day. And when I say "remediate and solved," we will have the landfill reopened and the slope stabilized and begin back-filling into a new area. So in that way, the event will be contained within the quarter. There will still be waste we have to relocate in the first quarter of next year. But that's not really anything you would see; that's just sort of using lateral airspace and then we will go up later. So that one's relatively simplistic to do.

And this was not a large failure; there was no equipment, no personnel, no anything involved. This was really a side slope failure with waste moving laterally some. It just happened to be near our road, which is one of the reasons we closed the site on a temporary basis.

Tyler Brown: Okay.

Ron Mittelstaedt: The elevated temperature event is a little bit harder to predict right now, Tyler, but here's what I will tell you. We've been monitoring this since March or April of this year, as temperatures were rising, we really didn't start seeing any significant generation of additional leachate or odors until really August is when that occurred. And so now, as we sit here at almost the end of October, we believe that we're just probably about a month away from being at the fulcrum point, and starting to come down in some of the -- I think certainly, at least, the odor component. The leachate generation will go on for a while, but I think we will have a lot better clarity in February.

These events -- these reactions can go on for some period of time, sort of think of it as it's going to go on, it takes time for the temperature to come down. As it comes down, the leachate generation comes down. As it comes down, the odor comes down, and it just sort of continues to diminish until it stops. So it's a matter of getting both the leachate and the methane out to slow the reaction fully because it's just -- it's an organic reaction so -- but it should sort of peak at some point, we believe here, in the first quarter or early next year.

Tyler Brown: Okay, perfect. And then Mary Anne, a couple of modeling questions. So I may have missed it, but what was the average commodity price in Q3?

Mary Anne Whitney: So Q3, OCC average was $88.

Tyler Brown: $88, perfect. And then I appreciate the margin walk, but was M&A dilutive? I would have thought that Arrowhead would be dilutive, just given all the transportation revenue flowing there.

Mary Anne Whitney: So M&A was not dilutive; it came in, in line in the aggregate.

Ron Mittelstaedt: In the aggregate, yes. There's a nominal dilution -- you are correct -- on the margin for Arrowhead because of the transportation. At this point, as we march forward, that will reverse.

Tyler Brown: Okay. So we should expect some dilution?

Ron Mittelstaedt: I would tell you de minimis.

Mary Anne Whitney: Yes.

Ron Mittelstaedt: If it's 10 bps, that's probably a fair number.

Mary Anne Whitney: Yes.

Tyler Brown: Okay, perfect. And then what is the revenue contribution in Q4 from M&A, if I could?

Mary Anne Whitney: $50 million.

Tyler Brown: Perfect, okay. Thank you guys so much.

Operator: Noah Kaye with Oppenheimer.

Noah Kaye: So I'm asking to help clarify this by investors, so I just want to make sure we're all clear. Can you clarify that the outlook for 2024 is based off of the current FY2023 guidance, which does not include the $20 million potential impact for 4Q?

Mary Anne Whitney: That's correct; that's consistent with the way we've approached it, yes.

Noah Kaye: All right. Appreciate that. Maybe if you can put some color around the RNG capital outlays, you said $125 million to $150 million for 2024. You had called out previously a total CapEx spend of $200 million through 2026. So, A, making sure there's no change there in the total expected spend. B, remind us what you're tracking to spend in 2023. And then maybe confirming the implication that you expect to be most of the way through that spending program exiting next year.

Mary Anne Whitney: Sure. So for 2023, maybe $35 million or $40 million is the way to think about the spend. And so that tells you the vast majority of it is next year in 2024.

Noah Kaye: All right, excellent. Last question -- we've gotten this from folks that the volumes associated with shedding seem higher relative to the level of M&A than perhaps, if you look back 4 or 5 years in the past. And wondering if that is a function of just a lot of the legacy contracts and these acquisitions you're doing recently being underpriced for the inflationary environment. Is there something else we should read into? And then really, I guess the question is at what point in the future would you expect the shedding associated with some of this M&A to start to abate?

Ron Mittelstaedt: Yes, well, first off, Noah, when you're doing M&A, there's always going to be some level of shedding because when you're acquiring a private company that -- I'm just going to use this -- that's got $40 million of revenue, they probably have somewhere between $4 million and $8 million that is going to come up in a 1-to-3-year period that you're probably going to bid to lose or keep at a margin that you want. So you start doing 200 million, 400 million, 500 million, as we've done per year over the last several years, 2021, 2022, especially; a fairly large year already this year, that's going to -- you're going to have some of that for a period of time.

We are still -- believe it or not, we are still rightsizing Progressive; we acquired that in 2016. Several of the larger contracts that we have lost in 2023 came out of Progressive in both Canada and Florida. And they were 10-year agreements that we lived with till expiration, and we bid them to either keep them and make money or happily walk away. And so obviously, we've only done one Progressive over time, and that is -- I would tell you that type of shedding is effectively probably done from that that footprint, but there's going to be some.

We think of the negative volume as probably roughly about 3 quarters to a point related to shedding, and about up to a point, maybe a little less, for a conscious price volume trade-off in competitive commercial markets. That's the way we think of that. And obviously, we have comfortably led the entire sector in 2022 in price, comfortably led it again in 2023 in price. And we are happy to take that price volume trade-off, as I think you're seeing it show up in the pace of the margin acceleration.

Mary Anne Whitney: The other observation I would make and offer is that if the observation is, hey, it looks like there's more shedding with these recent acquisitions, I'd say, no, we don't see a material difference. I think what's different is that the underlying economy isn't generating more volumes, and so it's more pronounced for ourselves and others in the industry. And so I think it's always going on, but there's generally a base of positive volume to offset it.

Noah Kaye: That's great context. Thank you both.

Operator: Jerry Revich with Goldman Sachs.

Jerry Revich: Ron, Mary Anne, I'm wondering if we could just talk about the margin trajectory in the core business. You folks sequentially posted margins that were a point better than normal seasonality. The guidance, excluding the noise, suggests another 60 basis points improvement versus normal in 4Q. Does that momentum continue into the first quarter? Are we getting caught up on price cost from here, or will you be at the appropriate run rate exiting 4Q?

Mary Anne Whitney: Sure. So I'll start with just keep in mind that Q3 is the seasonally strongest margin contributor across the industry for ourselves, and so that's important to put it in context. And remember, that's the starting point that you're going from right now. So I'd say there is normal seasonality, which impacts the degree to which that impacts reported margins.

We've also had the changing dynamics of recycled commodities and RINs, which of course, were the big headwind going into the year; that's waning and becomes a tailwind. So I'd say within that context, are we still encouraged by the trajectory of margins? Yes. And it's for the reasons that we've described. The opportunity for outsized price cost spread, we've pointed to that as a driver of the potential for outsized margin expansion in 2024, and then the follow-on benefits from the improving retention that we've described. So no change in the way we're thinking about those things. And yes, that is positive in terms of the trajectory.

Jerry Revich: And it sounds like the momentum is continuing into the first quarter just to be clear, Mary Anne, or at least expected to continue?

Mary Anne Whitney: Yes, nothing we've seen would depart from that. As I said, those tailwinds on the commodities, for instance are positive, and we haven't seen incremental cost pressures. So we're encouraged by the trends.

Jerry Revich: Okay, super. And in terms of you spoke to D3 RINs, just mathematically, given where pricing is now, that suggests 2024 versus 2023 will be about a $50 million tailwind if current spot prices hold, given the supply issues we've been talking about. Anything that would preclude you from realizing that benefit if the spot rate holds? Do you have any contracts in place? And I just want to confirm, if spot prices do hold, it would be additive to the guidance or preliminary outlook that you shared?

Mary Anne Whitney: So a couple of things. One, whenever -- the guidance we've given is basically marking to market commodity values. And so what we've said is continued movement in commodities would be upside along with the new projects coming online. So we've already factored in some tailwind from RINs, as well as recycled commodities. The other comment, Jerry, would be I never think in terms of that spot price because as you know, that's not indicative of where you actually sell RINs, even in the current environment. So rather than picking a point like 3.40, I'd say we're probably in that range of $3 to $3.25 is the way we've thought about it.

Jerry Revich: Got it. Thank you. And can you just update us on the timing of CapEx related to these projects? What are you expecting in 2024 and 2025 on the projects where you are putting capital to work?

Mary Anne Whitney: Right. So that would be that $125 million to $150 million in CapEx associated with the RNG projects that we said will impact 2024. That's the vast majority of the $200 million in outlays that we'd expect for all those projects to generate that $200 million in EBITDA by 2026.

Jerry Revich: Super. And then just a clarification. The $200 million, I believe when you had set that target, D3 RINs prices were in the low-2s, correct? Can I get you to fact-check that for me, please?

Mary Anne Whitney: I think what we talked about was a 5-year average, and so I think its north of that.

Ron Mittelstaedt: Yes, it's 250 million to 270 million.

Jerry Revich: Okay, super. Thank you.

Operator: Stephanie Moore with Jefferies.

Stephanie Moore: We talked a little bit about the volume environment and your own actions of shedding accounts, but could you maybe talk a little bit about the strength in the underlying environment, what you're seeing on both the commercial and residential side? I know you called out specialty being stronger, but that can be kind of volatile, but would love to just get your overall view.

Ron Mittelstaedt: Well, I would tell you overall, Stephanie, that the economy is okay. I wouldn't say it is by any way strong; I would say it's sort of a flattish environment from a growth standpoint. You have pockets of strength; I wouldn't really say there's too many pockets of weakness, just flatness. We looked at -- so year-to-date, our new business sales through our sales force activity is 102% of what it was year-to-date last year, so better than last year, but 2% in terms of new sales. So overall, I would say you've seen a little improvement over 2022, but really pretty flat.

And I think you saw that in our comments that in Q3, roll-off pulls were up 1%. Price on per pull was up quite strong, but roll-off pulls were up 1%. So I think that's indicative -- with our footprint being as large as it is, I think that's indicative of what's going on in the economy. And it sort of appears to be a soft landing scenario, but there's certainly no underlying real growth in the economy, not at this point. If some of the infrastructure spending occurs the way it is planned to occur in 2024 and 2025, then I think that could certainly accelerate development.

Mary Anne Whitney: What I'd add to that, Stephanie, is just that that's not a material change from what we've been saying really for the past 6 quarters or so. There's just not been a lot of movement.

Stephanie Moore: Thank you.

Operator: Stephanie Yee with JPMorgan.

Stephanie Yee: I was wondering if you can give us some color on what you're seeing in the M&A market? Just who you're coming up against, is it other strategic or financial players? And how are valuation levels trending? And just any color on where you're doing the acquisitions, maybe the geography or type of business that you've been acquiring?

Ron Mittelstaedt: Well, let's start with the last one, the easiest. The geography is throughout the U.S. and Canada. We've had a little more focus on the West Coast over the last 18 months or so. And of course, we're acquiring our typical solid waste disposal, collection, and transfer-type companies. Who do we compete with? We obviously compete with the other public companies, and we certainly compete with some regional private equity-backed companies, and then private mom-and-pop companies executing their own growth strategy.

So as far as valuations, we've seen valuations probably over the last 4 months or so probably pull back about a turn to maybe two turns of EBITDA from where they sort of peaked in, I'd say, late 2022. And we would probably expect that to continue to tighten a little bit as interest rates have continued to rise, and are expected to perhaps have another adjustment or so and being in a relatively flat economic environment. So that hopefully would be the answer to those questions you had, Stephanie.

Stephanie Yee: Yes, no, that is very helpful. Thank you.

Ron Mittelstaedt: You're welcome.

Stephanie Yee: And just one follow-up. Just on the intention for share repurchases, I know you renewed your issuer bid. But I guess just in terms of how you're thinking about M&A versus share repurchases, it sounds like M&A is still, in your view, the best use of capital, is that correct?

Ron Mittelstaedt: Well, that may be changing rapidly, but yes. Yes, no, clearly, M&A is still our best use of capital on any long-term basis and how we should create the most value. But we clearly are opportunistic in the share repurchase and will continue to stay opportunistic in that way.

Stephanie Yee: Okay. Sounds good. Thank you so much, Ron.

Operator: Thank you. And ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to the management team for any closing remarks.

Ron Mittelstaedt: Okay. Thank you, operator. 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 we did not cover that we are allowed to answer under Regulation FD, Regulation G and applicable securities laws in Canada.

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

Operator: Thank you. Ladies and gentlemen, this concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.