Waste Connections, Inc. [WCN]
Fourth Quarter 2020 Earnings Conference Call
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Company Representatives:
Worthing Jackman; President and Chief Executive Officer
Mary Anne Whitney; Senior Vice President and Chief Financial Officer

Analysts:
Walter Spracklin; RBC Capital
Tyler Brown; Raymond James & Associates
Jeff Goldstein; Morgan Stanley
Kyle White; Deutsche Bank
Hamzah Mazari; Jefferies
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Noah Kaye; Oppenheimer
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Stephanie Yee; J.P. Morgan
Sean Eastman; KeyBanc
Mark Neville; Scotiabank

Presentation:

Operator: Greetings, and welcome to the Waste Connections Fourth Quarter 2020 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded Thursday, February 18th, 2021.

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, everyone. I'd like to welcome everyone to this conference call to discuss our fourth quarter results and outlook for both the first quarter and full year 2021. I'm joined this morning by Mary Anne Whitney, our CFO.

As noted in our earnings release, Q4 capped off a remarkable year for Waste Connections, culminating in a solid beat [in the] period and providing higher entry point into 2021. A more than 250-basis points higher-than-expected improvement in solid waste volumes and increased values for recycled commodities and renewable fuels drove adjusted EBITDA margins 50 basis points above expectations for the quarter.

Moreover, we converted over 50% of adjusted EBITDA to adjusted free cash flow in the year while positioning ourselves for double-digit percentage growth and adjusted free cash flow to at least $950 million in 2021. With expected solid waste pricing plus volume growth of 5% and increasing recycling and renewable fuels values, 2021 is already positioned for continued topline growth and 50-basis points margin expansion, with additional upside from any further reopening activity, recovery in the economy or acquisitions completed during the year. Although our outlook for the year does not include any benefit from further reopening activity, we are pleased to note that last week was the first weekly increase in revenue we've seen from COVID impacted customers in several weeks.

Before we get into much more detail, I'm going to turn the call over to Mary Anne for our forward-looking disclaimer and other housekeeping items.

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

The discussion during today's call includes forward-looking statements made pursuant to the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995, including forward-looking information within the meaning of applicable Canadian securities laws. Actual results could differ materially from those made in such forward-looking statements due to various risks and uncertainties. Factors that could cause actual results to differ are discussed both in the cautionary statement included in our February 17th 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 are extremely pleased with our strong operating and financial performance in Q4 and throughout 2020, in spite of the impact from the COVID-19 pandemic. We often note our belief that culture, values and human capital are our greatest assets and instrumental in delivering differentiated results. This belief guided our response early on to the pandemic, which focused on reducing employee concerns regarding income, healthcare and family obligations in order to provide continuity of service and a bit of normalcy for our customers, reduce voluntary turnover and further improve safety performance.

We've spent over $35 million in 2020 for discretionary employee support, primarily for supplemental wages to all of our frontline employees, whether union or nonunion, remote or in person; and including temporary employees; as well as a thank-you bonus late in the year. Voluntary turnover ultimately declined 18% in 2020. Safety-related incident rates decreased 12%, with over 60% of our operating locations either posting zero safety related incidents or driving year-over-year improvements. And our total recordable injury rate ended at less than half the industry average.

Looking at solid waste organic growth. Price of 4.3% played out as expected in 2020, with combined price plus volume growth turning positive in Q4 for the first quarterly period since the onset of the pandemic on continued pricing strength plus a higher-than-expected 260 basis points of sequential volume improvement.

As a reminder, from the Q2 lows of about negative 10%, solid waste volumes recovered to about negative 6% in Q3 and further improved to about negative 3% in Q4. This progression reflected the continuous recovery in activity we have seen since the depths of the pandemic and sets us up for positive reported volumes in 2021 beginning in Q2, even without the benefit of any further economic recovery. Any continued reopening activity or improvements to the economy related to COVID-19 or other factors would be expected to drive higher-than-expected overall volumes in 2021.

Underlying solid waste margin performance in 2020 demonstrated the consistency of our focus on quality of revenue and managing costs. We exceeded each of our updated outlooks to deliver adjusted EBITDA margins of 30.5% in the year despite an 80-basis points drag from the high decrementals associated with lower E&P waste activity, plus an additional 70-basis points impact from the discretionary COVID-19-related employee support costs.

Not that we would adjust for such COVID-related costs, but it's worth noting that these discretionary costs alone accounted for more than the 60-basis points year-over-year margin decline in 2020, as underlying solid waste expansion more than overcame the drag from lower E&P waste activity. Moreover, we converted over 50% of adjusted EBITDA to adjusted free cash flow in 2020 and are positioned for an almost 53% conversion and double-digit dollar growth in 2021.

2020 was also noteworthy for the pace of acquisition activity, which accelerated at year-end to drive another outsized year. We acquired approximately $115 million in annualized revenue in Q4, including new market entries in Delaware and Minnesota and large tuck-ins in Colorado and Nebraska. Along with other acquisitions completed earlier in the year, this brings our total acquired annualized revenue in 2020 to approximately $180 million and provides rollover acquisition contribution of about $120 million or over 2% in 2021.

In spite of the limitations of the COVID-19 pandemic, we closed 21 transactions in 2020 and continue to be selective about the types of markets we pursue, the risk profiles we accept and the valuations we determine to be appropriate. Acquisition dialog remains elevated, with seller interest driven by many of the same factors as in recent years, including uncertainty regarding the outlook for taxes.

2020 marked our 17th consecutive year of positive total shareholder returns, up 13.9% in the year. We returned over $305 million to shareholders through dividends and opportunistic share repurchases in 2020, with our dividend increase in October marking a decade of continuous double-digit annual percentage increases since initiating the dividend.

Given the strength of our balance sheet and over $600 million in cash at year-end, we remain well positioned to fund additional acquisitions and increase our dividend and share repurchases. As we have consistently communicated, we prefer to maintain flexibility to capitalize on stock marked dislocations. This year, we've already repurchased over $65 million of shares year-to-date and expect such activity to continue throughout the year.

Now I'd like to pass the call to Mary Anne to review more in depth the financial highlights of the fourth quarter and provide a detailed outlook for Q1 and the full year 2021. I will then wrap up before heading into Q&A.

Mary Anne Whitney: Thank you, Worthing.

In the fourth quarter, revenue was $1.398 billion, about $63 million above our outlook due to higher-than-expected solid waste volumes and recycling and renewable fuel values; as well as about $12 million from acquisitions closed during the quarter. Revenue on a recorded basis was up $36 million or 2.7% year-over-year, in spite of E&P waste activity down $37 million year-over-year.

Acquisitions completed since the year-ago period contributed about $56.5 million of revenue in the quarter or about $52.7 million net of divestitures. Core price in Q4 of 4.3%, less about 50 basis points in fuel and material surcharges, was in line with our expectations. Pricing ranged from about 2.7% in our mostly exclusive market Western region to between 3.9% and 4.3% in our competitive markets.

As Worthing noted, solid waste volumes improved by 260 basis points sequentially in Q4 to negative 3.1%. Volumes improved in all of our regions, led by our mostly exclusive Western region, where volumes were positive 3.7% on strong underlying activity in many markets, improving landfill tons and roll-off activity.

Elsewhere in the U.S., volumes ranged from about negative 2% in our Southern region to down about 8% in our most impacted Northeast U.S. markets, which were hardest hit by the pandemic and remain slowest to reopen. As we have noted throughout the pandemic, our volumes largely reflect the pace and shape of shutdown and reopening activity across our markets. Relative weakness has generally persisted in those markets hardest hit by COVID-19 and related restrictions. That said, Canada's recovery has thus far outpaced its reopening activity, with volume losses cut from about 9% in Q3 to about 4.5% in Q4 on strong disposal volume.

Looking at year-over-year results in the fourth quarter on a same-store basis, we once again saw sequential improvements in all lines of business from the prior quarter. Commercial collection revenue improved by 150 basis points to down 1% year-over-year. Excluding the most impacted markets in the Northeast and Canada, commercial collection revenue was up 1.3%.

In the aggregate through Q4, about 65% of solid waste commercial customers and 56% of associated revenue in competitive markets we track that had suspended or reduced service had reached out for a resumption of service or increase in frequency. These levels are largely in line with the rates we saw through Q3 in spite of renewed COVID-driven restrictions in certain markets.

[Roll-off] pull per day increased sequentially by about 300 basis points to down 4% year-over-year, with the revenue per pull up 1%. Canada's recovery continued in Q4 to down less than 1% year-over-year. U.S. markets still lagged those levels but drove the sequential improvement in the quarter to down less than 5%, led by West Coast markets.

Landfill tons improved sequentially by 100 basis points to down about 5% year-over-year due to the strength of MSW tons, which were up 2% year-over-year, with price per ton up 3%. Widespread year-over-year increases in many markets were led by landfills in California and Oregon. Special waste and C&D tons were both down 14% to 15%.

Looking at Q4 revenues from recovered commodities; that is, recycled commodities, landfill gas and renewable energy credits or RINs. Excluding acquisitions, in the aggregate they were up about 50% year-over-year due to both higher RINs and higher recycle commodity revenues due to strong fiber value resulting in a margin tailwind in the period of about 70 basis points.

Prices for OCC, or old corrugated containers, averaged about $85 per ton in Q4, ended the year about $90 and have since been in the range of $100 to $105 per ton. Renewable fuels are also trading higher after averaging about $1.80 in Q4 and ending the year at $2.10. RINs have been in the range of $2.25 to $2.50, bolstered by a supportive political and regulatory environment.

Moving next to E&P waste activity. We reported $25.5 million of E&P waste revenue in the fourth quarter, up sequentially from Q3 as activity firmed up on higher rig counts and increased remediation work. Adjusted EBITDA for Q4 as reconciled in our earnings release was $426.6 million, about $27 million and 50 basis points above our outlook at 30.5% of revenue.

A 100-basis point year-over-year improvement in solid waste plus 70 basis points benefit from recycling and renewable fuels was more than offset by drags of 100 basis points from lower E&P waste activity and 50 basis points from the prior year C&G credit, along with another 50-basis point impact primarily from discretionary COVID-19-related and incentive comp costs and the margin dilutive impact of acquisitions completed since the year-ago period.

Full year adjusted free cash flow of $841.9 million or 15.5% of revenue exceeded the high end of our guidance and reflects the conversion of 50.7% of adjusted EBITDA in spite of capital expenditures about $25 million above expectations, as we capitalized on opportunities for fleet and equipment at year-end. Even more important is the free cash flow we didn't deliver in 2020, including from the deferral of payroll taxes as provided for the CARES Act and from the benefits of working capital, which provide a strong cushion going into 2021.

I will now review our outlook for the first quarter and full year 2021. 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 the full year 2021. Revenue in 2021 is estimated at $5.8 billion. For solid waste, we expect price plus volume growth of 5% with E&P waste revenue and the values for recycled commodities and renewable fuels assumed about in line with current levels. Adjusted EBITDA in 2021 as reconciled in our earnings release is expected to be approximately $1.8 billion or 31% of revenue, up 50 basis points year-over-year. Underlying margin expansion in the year for solid waste collection, transfer and disposal is estimated at approximately 60 basis points, with an additional 60-basis points benefit from higher values for recycled commodities and renewable fuels. This combined 120-basis points improvement is projected to be partially offset by an approximate 30-basis points margin dilutive impact from lower E&P waste activity at current rates, a projected 10-basis point drag from acquisitions already in place for the year and an additional 30-basis point drag from certain discretionary COVID-related cost, which we have assumed may continue in 2021.

To the extent that COVID infection rates and other related employee impacts abate during the year, such costs would be expected to abate as well. And as noted earlier, our initial 2021 outlook does not include any benefit from reopening activity or an improving economy driving higher solid waste volumes beyond the levels recovered through Q4, any pickup in E&P waste activity, or additional acquisitions closed during the year that would provide upside to our initial 2021 outlook.

Regarding tax rates. Our effective tax rate for 2021 is expected to be approximately 20% with some quarter-to-quarter variability. Adjusted free cash flow in 2021 as reconciled in our earnings release is expected to be at least $950 million, or approximately 16.4% of revenue on $625 million in capital expenditures.

Turning now to our outlook for Q1 2021. Revenue in Q1 is estimated to be approximately $1.37 billion. We expect price growth for solid waste of approximately 4% in Q1, with volume of about negative 4%. Excluding the impact of the severe winter weather we are experiencing across many states and provinces, volume trends remain consistent to slightly improving since Q4. Year-over-year comparisons for Q1 also reflect the estimated 50-basis point benefit in the 2020 period from the extra day due to leap year, as well as the strong start to last year that we observed prior to the onset of the COVID-19 pandemic.

E&P waste revenue and recovered commodity values are expected to remain in line with current levels. Adjusted EBITDA in Q1 is estimated to be approximately $415 million or 30.3% of revenue, up 10 basis points year-over-year, in spite of the continued margin headwinds expected from one final quarter of tough comparisons for solid waste volumes and E&P waste activity. Similar to the full year outlook, underlying margin expansion and solid waste hauling, transfer and disposal is projected at 60 basis points in Q1.

Depreciation and amortization expense for the first quarter is estimated to be about 13.8% of revenue, including amortization of intangibles of about $32.6 million or $0.09 per diluted share net of taxes. Interest expense net of interest income is estimated at approximately $42 million. And finally, our effective tax rate in Q1 is estimated to be about 19%, subject to some variability and below the expected full year rate due to tax benefits associated with vesting of equity-based compensation.

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

Worthing Jackman: Thank you, Mary Anne.

The strength of our results in 2020 and expectations for 2021 reflect our purposeful culture and differentiated strategy. Moreover, they are a testament to the tireless efforts of our dedicated essential workers. We are extremely grateful for our employees' efforts to drive not only outsized financial performance during this challenging period but operational excellence as well, as they honor commitments to our customers, communities and each other.

Operational excellence is also evident in our progress towards achieving our ESG targets, including, as noted earlier, further improvements in safety and employee retention. We also see it in employee engagement through improving servant leadership scores as we see it in the thousands of expressions of gratitude from our customers and the communities we have a privilege to serve.

I want to once again express my personal gratitude for the support of our customers, the partnerships we share with our communities, and especially for the commitment and vigilance of our 19,000 employees, who have made 2020 a success by any measure and positioned us for continued growth and success in 2021 and beyond.

We appreciate your time today. 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] Our first question comes from the line of Walter Spracklin, with RBC Capital Markets.

Walter Spracklin: I want to start with the volume guide here. Obviously, you're assuming the conditions stay in place. I hope that's conservative for all of us. But when you look at your first quarter here, I look at what you guided to for your fourth quarter when you were trending kind of 5.8%. You indicate negative 5.8%. You were indicating was improving, but you guided to 6% down. Here, if I hear you correctly, you're now guiding -- you did 3.1%. You say it's improving, but you're guiding to negative 4%. Just trying to get a sense of whether there's some inherent conservatism built in as early as the first quarter? I would have thought that your conservatism was mainly on the H2 expectations. But it does look like there's a little bit of an expectation built in to your guidance for perhaps a deterioration here in the first quarter? Just wanted to square that off.

Worthing Jackman: I'll start and hand it over to Mary Anne.

As we've pointed out in the script, and it may have been lost, when you look at just the impact of leap year last year compared to this year, we said that was also about a 50-basis point impact to volumes. The weather impact alone we've assumed is 50 to 70 basis points of impact to volumes in the period as well. And so if you just look at the weather impact and leap year, that's over 100-basis points impact to the 4%. Another way of saying we probably would have guided between 2.5% to 3% down had it not been for the weather this week, as well as obviously normalizing for the leap year.

Walter Spracklin: So it's really relating to those and nothing else? Okay. Moving on to the mix --

Worthing Jackman: [Inaudible] in the script that the trends continue to improve since year-end.

Walter Spracklin: Right. In terms of your guidance for full year revenue, I was wondering if you could give us a little bit of color, particularly around mix and how that's playing out for the year, and disaggregating between volume and price within that? Your core price and volume, but particularly around what you expect the magnitude of the mix impact for the year built into your guidance?

Mary Anne Whitney: Sure. So we said 5% price plus volume. But you've seen us delivering around 4% price, so you could easily break that down to be about 4% and about 1%. Could be a little more than that on price. Right out of the gate, what I can say is the stickiness has been good. We've been pleased with what we're seeing and feel, as with other years, we're set up to do a little -- to deliver a little better than what we expected or talked about. So I'd say that's a fair way to think about it, Walter, is 4% and 1%.

Walter Spracklin: So no impact from mix there that's imbedded in your 4% guide?

Mary Anne Whitney: Yes, that's correct.

Worthing Jackman: So obviously, Walter, the upside then, if you're trying to look for it, while it might be modest above the 4% in price, it's probably more so on the volume side, right? If more COVID impact of revenue comes back, if GDP really hits 5%, if Washington passes a $1.9 trillion stimulus package -- mean, there's so many variables that can drive the 1% notably higher. But let's see how this thing plays out before we all commit to that.

Operator: Our next question comes from the line of Tyler Brown, with Raymond James.

Tyler Brown: Hey, Worthing, so I want to come at the volume guide a little bit different. So I just want to make sure it's clear. So you're taking basically a snapshot of today and simply rolling that forward, right?

Worthing Jackman: That's correct.

Tyler Brown: So you talked about 40% of the commercial customers that have paused haven't returned. So if I just played around with the scenarios -- so we don't have all the numbers. But at a high level if, say, just half of those eventually came back, what would that maybe add to volume? Would that be something like 100 basis points just alone?

Worthing Jackman: It's absolutely right. I mean, it's about $100 million or so revenue in markets that we track that have not come back due to the COVID impact. And so if half of that came back, that's $50 million. Again, that's about 1% increase in volume activity. And the flow-through from that is somewhere in that 40% to 50% range, given the attractive incrementals as that comes back.

Tyler Brown: Right. And that doesn't even include if roll-off pulls or even new resi subscriptions, anything else, kind of comes back in?

Worthing Jackman: You have more of the explosive expectations around GDP for the year, or again whatever the stimulus might do, that's coming off the sideline, etcetera, from consumers. That's right.

Tyler Brown: So Mary Anne, thank you so much for unpacking the 50 basis points of overall expansion. But I've got to say, I'm a little unclear on COVID, cost specifically. So I think you said the COVID costs will be a 30-basis point headwind year-over-year in 2021? Did I hear that correctly?

Mary Anne Whitney: So what I mean -- the point we were trying to make, Tyler, was that there will be ongoing COVID costs which amount to about 30 basis points of an impact. So expenses that continue, while lower year-over-year as compared to what we put into the business in '20 -- the point is we're going to continue supporting our employees. And we've assumed that there's a 30-basis point impact related to that. And again, to the extent that that's not necessary because these other things happen -- the reopening, the reduction in cases -- then those costs would abate.

Tyler Brown: And then, just my last one here. So you talked a little bit about the weather in Q1. So maybe you've already answered this question a little bit, but you're expecting some volume. And you're kind of baking in the volume and the cost that could come from this kind of winter blast, if you will. That is basically into Q1?

Worthing Jackman: Absolutely.

Operator: Our next question comes from the line of Jeff Goldstein, with Morgan Stanley.

Jeff Goldstein: So it sounds like special waste and C&D is still providing meaningful drag. I think you mentioned down mid-teens on both in the quarter. So I'm just curious what you're hearing and seeing from customers in these markets and how you're thinking about growth there in '21?

Worthing Jackman: Well, right now it's just a question of anniversarying the depth of the pandemic. This will be the last quarter where we would see these kind of declines in those two streams. With some geographies, we still see quite a bit of strength in special waste. But in others it can be episodic. And so I think, again, getting through the Q1 print and anniversarying the pandemic will change those percents.

Mary Anne Whitney: Yes. To Worthing's point, I'd remind folks that if you look back to last year in Q1, in spite of the fact that the pandemic ultimately impacted numbers in March, special waste was up 17% year-over-year. So just the comp in and of itself was going to be difficult, and then layer a pandemic on top of it.

Jeff Goldstein: And then, I just wanted to ask an ESG question, specifically around the $500 million of investment you called out in your sustainability report towards meeting your 15-year target. Just how will this $500 million flow through the model over the long-term? Does it cap margins in any way? And how much is incremental to what you were investing prior to this announcement? Just overall, how should we think about the financial impact of the investment?

Worthing Jackman: Sure. If you take that $500 million, for instance, and just divide it by that 15-year period or so, obviously you get to a number of about $35 million or so a year, which -- on a $625 million spend right now, that's just part of our normal ongoing course of making prudent investments, driving the return. And everything we've always done has been consistent with these, with our ESG priorities and targets. It's just that we haven't really packaged it from a communication standpoint, which is what we're doing now. And if you look at it from a margin standpoint, what we will deploy over the next 3 to 5 years will likely have a $25 million or more incremental benefit to EBITDA alone.

And so again, these are the right investments. They're consistent with what we've done in the past. And again, everything we also do has an element of returns-based analysis with it.

Operator: Our next question comes from the line of Kyle White, with Deutsche Bank.

Kyle White: On service resumptions, or increases in frequency on commercial collection that had previously suspended or reduced service, can you give a bit more color as to why you think that didn't improve much from 3Q? And do you have a sense of how many commercial customers might be permanently closed?

Mary Anne Whitney: Sure. So, with respect to your observation that it didn't improve Q3 to Q4, what we would say is that we were kind of braced for the possibility that there would be deterioration. Because if you kind of wind back to October when we were looking at that, we are on the verge of some surges reemerging and some renewed lockdown activity, which of course we all saw in Q4. And so our observation is in spite of those renewed restrictions, particularly, interestingly, on the West Coast and Canada, you've seen the business hold up. So the recovery stayed basically in line with where it was in Q3.

And I would say the other thing to remember is I think that tells part of the story. And in addition to that, you have the markets which aren't competitive markets -- so the exclusive markets, as I mentioned, the West Coast -- but also you have the other lines of business like roll-off pulls and landfill tons. And we made the observation that you saw municipal solid waste tons, which as you know account for 55%, 60% of the landfill tons. That improved sequentially by 500 basis points Q3 to Q4. So I think you have these other drivers which show sequential volume improvement.

And then to your question regarding customers who are permanently out of the equation. As we've said in prior periods, what's interesting is, if I look at cancellation rates, there's no discernable difference this year versus prior years, which leads us to believe that that's not the full story, which is why we think it's appropriate to view things the way we have, which is to say, hey, we'll give you guidance that assumes it gets no better from here. And we'll communicate what those numbers are, as Worthing described, getting a point back from exiting the year down 3%. Some percentage will come back, and we're not in a position to guess what doesn't come back.

Worthing Jackman: I mean, you're talking restaurants, office buildings staffing up again; tourism increasing, schools reopening, arenas refilling. There's a whole element of revenue that's missing right now that will be dependent upon how the economy reopens and the timing of that.

Kyle White: And then, on return to shareholders, you seem to suggest that repurchases will be kind of a bigger portion this year, which makes sense considering your leverage. Do you have a target for how much in buybacks you want to complete this year, or maybe, perhaps, a minimum leverage target that you don't want to go below, that you view as kind of suboptimal from a capital structure standpoint?

Mary Anne Whitney: We're very comfortable where we sit. We like the flexibility, that leverage this 2.5 to 3x gives us. And we'd be less about having it being driven by that, but we just want to continue to be opportunistic, which is what we've demonstrated we've already done thus far this year. And again, we look for those opportunities to present themselves throughout the year. So there's not a specific target. But as we said, the expectation is, and the intent is, to increase that year-over-year.

Operator: Our next question comes from the line of Hamzah Mazari, with Jefferies.

Hamzah Mazari: My question is on M&A, both sort of short-term and long-term. Maybe 2021, do you sort of expect this year to be like last year? Are there any LOIs signed sort of so far? I know last year was sort of above average but below average relative to what you were doing in the sector. And then just long term, your overlap is pretty low with others. Do you foresee another mega-merger in the space as it relates to you? You've obviously integrated assets that are large, like Progressive Waste, pretty well. So just any color around short-term, and then much longer-term M&A, would be helpful.

Worthing Jackman: Sure. The short term, Hamzah, as we said, the dialogue continues to be elevated. If we think an average year is $125 million to $150 million in acquired revenue, we're positioned to meet or exceed that. The timing of that might be a little different, given some of the stuff that we thought may have closed in Q1 of this year, got done prior to the end of last year. And so you'd likely see more activity in the second half of this year versus the first half of this year with regards to that number.

But again, what's been driving sellers in the past continues to drive seller dialogue right now. I'd say the majority -- there are a couple of acquisitions that are above that $50 million or $75 million range that we're looking at. But the predominant of the deals we look at, as you know historically, is in kind of that $10 million to $30 million range with a few higher than that on average. So that pace of activity, that profile of what we find attractive and value creative, hasn't changed.

With regards to larger deals, never say never. But clearly, when you look at the experience that Waste Management and Advance had with DOJ and going through that protracted period, when you look at other companies that have been hung up in second reviews for what you would think would be yet even smaller transactions, never say never about large combinations. But we all recognize that you'd better be making prudent assumptions with regards to what you're going to get on the way out of those things. But again, there's nothing on the horizon right now as we look at it that's [in need] of moving like that.

Hamzah Mazari: And just my follow-up question. Just on Canada, the strong disposal activity that you saw, that you referenced sort of outpacing reopening activity there -- what's the sustainability of that disposal activity as you look into 2021?

Worthing Jackman: Well, we've seen that trend continue into '21, Hamzah. In fact, as Mary Anne talked about reopening activity in some of the COVID impacted markets, Calgary and Montreal were two of those top three, with New York City being number one in that recovery. And so despite the veracity of the lockdowns in Canada, we still see the business holding up very well. And as the lockdowns unwind, we'll see that rebound even further.

Operator: Our next question comes from the line of Kevin Chiang, with CIBC.

Kevin Chiang: Maybe if I can ask about how you think about the longer-term cost of risk for Waste Connections? You've always had a competitive advantage there. But when I look at your turnover this year -- a voluntary turnover that is -- you saw a pretty significant decline. You've done some stuff on the hourly wage rate, you're introducing new technology into the fleet. And I guess you have a longer-term target of a lower incident rate, I think, of 25% in your sustainability report. Just wondering, if I roll that all together, what does that mean for the cost of risk for you as you look out maybe 5 to 10 years from now?

Worthing Jackman: I'd be just crystal balling it and swagging it. And I say that because what you find is, when you get to as low a level as we are right now, meaning frequency of incidents and our TRIR -- look, some companies have long-term targets to get to a TRIR that's 35% higher than where we're at right now.

And so I say that because when you get to certain low levels of frequency -- by the way, that includes people hitting us too, right -- it gets harder and harder on a frequency standpoint to continue to move the needle as notably as we've done over the past 15=plus years. And so, yes, we would hold ourselves accountable to further improvement, in that we are making the investments on the capital side. Obviously, we've always said it's more about human behavior than it is about technology. It's how humans use that technology and coach for improvement, for instance.

So look, without a doubt, our jumping-off point now is probably around that 1.2% to 1.4% of costs right now from a risk standpoint. We'll drive frequency down lower. That'll help severity as well. But I think the cost push against that, to be honest with you, Kevin, is, as you may know, the insurance industry continues to drive up premiums for whatever risk you ask them to take above retention levels. And obviously, always the risk of one or two incidents over time that might be severe and expose yourself to litigation in the U.S.

But long way of saying look, we've got to continue to drive improvement. We're making the investments, holding ourselves accountable. If we just look at it alone, I think 5% of our locations last year had over 25% of the incidents, and so making a focused effort on those 5% of the locations that are that much above average. In risk, that's where we really see the greatest improvements on a year-over-year basis is getting everyone to where we want them to be, especially getting the outliers to show that kind of dramatic improvement that we expect.

Kevin Chiang: And maybe just a clarification question, maybe on the back of Hamzah's question on Canada. I was surprised to hear that the -- sounds like the recovery in Canada is outpacing maybe what you're seeing in the U.S. Northeast, when I think of both regions being kind of at the more severe end in terms of lockdown measures that governments have imposed. If I just compare those two markets, is there something happening in Canada specifically, or maybe something happening or not happening in the U.S. Northeast, that's resulting in outperformance in Canada, I guess, looking over the past quarter or two?

Worthing Jackman: Yes, it's likely just the lower jumping-off point on comparative cases, just lower denominators. But we look at the dollar improvement just last week for instance, a dollar basis on a weekly improvement with -- I think Calgary was probably 70% of what the dollar improvement was; up in New York and in Montreal was probably close to 50% of a dollar improvement up in New York. And so it's just comparative jumping-off points.

Mary Anne Whitney: The other observation I would make, Kevin, is that we saw the improvement in roll-off, which started in Q3. So there could be that construction-driven element. Pre-pandemic, there was strength in certain markets. Like in Quebec, for instance, we'd noted that. And we saw that kick right back in once restrictions were lifted. So I'd say the other aspect is maybe some of the restrictions are a little different market-to-market.

Operator: Our next question comes from the line of Noah Kaye, with Oppenheimer.

Noah Kaye: First question, just around the free cash flow trajectory. You outperformed the guide this year, and you did so despite building what appears to be a really outsized working capital cushion heading into 2021. You kind of left the $950 million free cash flow bogey unchanged for '21. So, can you call out any free cash flow headwinds or one-time items that we might want to think about in 2021? Anything that might lap or reset in 2022? I don't know if you want to touch on CARES Act, or any other considerations we should be thinking about?

Mary Anne Whitney: Sure. Thanks, Noah. And I can appreciate your observation that it feels like we left ourselves the opportunity to do better than $950 million. And of course, the guide is at least $950 million. And to your point, as we've communicated throughout 2020 and again today, we did position ourselves that way. You saw the reduction in payables, for instance, as we exited the year, and the fact that we said CapEx was about $25 million higher than we'd anticipated. And we still delivered the free cash flow better than the high end of our range.

To your point regarding things that are unique to '21 versus '20, you're right. The observation that the CARES Act benefits that we all enjoyed in '20, you then have payroll taxes kick back in '21, and you retake 50% of what you were able to defer. So the math for us, that was a little over $40 million is what the deferral was. And so that returns in '21 plus half of the repayment, so about $20 million. And of course, that's already factored into the at least $950 million that we've communicated.

Worthing Jackman: Yes. I know you're looking at the decline in payables. But look, we typically rolled in every year with a cushion. So if you just take Mary Anne's $60 million or $65 million of the reversal of CARES -- and of course the payroll taxes and paying it this year -- and net that against that $140 million or so, that gives you about net of $80 million of cushion. And it's not uncommon for us to have anywhere between $60 million and a $100 million of cushion going into any one year.

Operator: Our next question comes from the line of Michael Hoffman, with Stifel.

Michael Hoffman: I wanted to go back to service intervals for a second. So you clarified the progression 3Q into 4Q. How are you thinking about service intervals, when I look at the guidance? The assumption is just no headwind, neither good or bad, it's a net neutral? And therefore, that also offers an opportunity? So without answering your question for you -- go ahead?

Worthing Jackman: That's right.

Michael Hoffman: So therefore, housing has always helped create new business formation when it's above a certain level. And we're running at 300,000 starts above a 5-year average. So there's a potential for -- you build enough houses, you exhaust the infrastructure, I need another drugstore, things like that. It backfills the empty storefront. That's all upside potentially?

Worthing Jackman: That's right. Because what we said is that, look, we're not going to predict the timing or the magnitude of the improvement in the economy, or the timing or the inflection point of the recovery from COVID. And so when we communicate 5% combined price plus volume, what we're saying is that that's the business we know we have today.

Michael Hoffman: So, we have a backdrop of maybe this housing cycle could be a benefit into the year as well.

And then incremental margins -- so classically in my tenure, we've always talked about sort of 40%. And it's been just kind of a statement of 40%. Is it fair we're entering this year with a little bit of juice there, because you were able to use the pandemic as that laser focus to drive a little incremental productivity, the combination of time [wait], and come out of it with just a slightly better incremental? It feels like that in your solid waste margins when I look at what you did in 4Q, that the incremental was slightly better than a long-term trend.

Worthing Jackman: Yes, I mean, if it's primarily resulting from recovery in commercial, and recovery in disposal tons, you're absolutely right. Those are the two highest incrementals with regards to solid waste. And that's why you've seen above average incrementals on the returning revenue from COVID.

Michael Hoffman: And is some of it structural, too, because you've lowered the absolute cost [in] all of the model? [Inaudible]?

Worthing Jackman: Well, that's just reduced [inaudible], Michael, you know that. We start spending bar tabs again, we'll put that clause back in.

Michael Hoffman: Inflation -- can you remind us why garbage loves inflation?

Mary Anne Whitney: Sorry, we had trouble hearing the end of your question.

Michael Hoffman: So can you remind us why the garbage industry loves inflation?

Worthing Jackman: Well, as you know --

Michael Hoffman: I get questions about this all the time --

Worthing Jackman: -- [inaudible] market --

Michael Hoffman: -- and I just want them to hear it from you, why you love inflation?

Worthing Jackman: Well, look, we don't like runaway inflation, right? It's not good for anyone. But if you look over time, we'll typically average 150 basis points or more over CPI. And so as CPI comes back up, that'll help pricing. Obviously, you look at the cost structure, you got leverage going through the cost structure. It's not everything inflates at that rate within the P&L. Obviously, some things like labor have been moving higher than that recently, meaning recently over the past few years. And so that won't -- I don't see that stopping. But obviously, with labor being about 20% of cost as a percent of revenue, obviously getting that spread to CPI on the topline provides a lot more coverage of what moves through the middle and creates higher opportunities for margin expansion through the P&L.

Now what you also see, obviously, is the cost of CapEx goes up, too. Let's not lose sight of that. Just this year alone, you're seeing again cost of steel increases and the cost of kind of resin increases that are hitting [toner] prices. And so, yes, you get benefits in the P&L. But also understand that there's some unit cost inflation within CapEx as well. And so it doesn't all flow through the cash flow, but a good chunk of that does.

Mary Anne Whitney: And the one thing I would add to that, Michael, of course, is the reminder that inflation helps on pricing. What matters at the end of the day is if your pricing is fixed, right? And so you want a market model that allows you to retain the price and deliver that 150-basis points spread to CPI that Worthing described, which we demonstrated through the great recession, through expansion. We've demonstrated we've done that.

Operator: Our next question comes from the line of Stephanie Yee, with J.P. Morgan.

Stephanie Yee: I just want to ask about kind of your longer-term margins, whether you think there's room for it to step up to maybe like the mid-30s? I'm talking about EBITDA margins. Because we saw solid waste underlying margins expand 90 basis points in 2020, and then you're assuming 60 basis points in 2021. I guess, how much of that do you think is the lower cost structure that you're able to operate at because of some of the cost efficiencies that you gained during the pandemic? Or do you think we need some of those recycling prices or E&P to pick up, to really move towards kind of higher 30s type of margins?

Worthing Jackman: Sure. You've got a handful of things, as you know, that influence it. As Mary Anne pointed out already, just the 30.5% we reported in 2020 had a total of 150 basis points, just from the change in E&P waste activity and the discretionary costs we put in for COVID. Now assume the pandemic wanes, the quick march back up to recover that gets you back to the 32% as a jumping-off point for last year, and then you put the 50-basis point expansion on this year. Obviously, the march is already there to the mid-32s as you do the walk. Over time, we always talk about a 20- to 40-basis point assumed expansion of margins given that spread to CPI. And so you could see a multi-year walk, assuming E&P comes back to the levels we had last year. You got the year-to-year margin improvements. And obviously, to the extent that recovered commodity values move higher with any inflation expectation, that also has very high incrementals in the flow-through.

And so to get anywhere near like the 34% plus or minus range, everything's got to be working for you, both price, the tons in our landfills from E&P waste activity coming back, as well as recovery commodity values of moving it forward. What you don't see much anymore is that is the kind of margin dilutive impact from acquisitions. Because again the denominator so big for the base business that we have that even if we're doing $150 million to $200 million of acquired revenue per year, that has a very negligible impact on reported margin. So that drag is less notable.

Stephanie Yee: Thanks for painting that picture for us.

And also, this is kind of a bigger-picture question as well. If we were to get an infrastructure bill passed, can you just talk about qualitatively how that might impact your business?

Mary Anne Whitney: Sure. So to the extent there were to be an infrastructure bill, that would be expected to impact volumes, of course. So you'd see it in development projects, things like special waste and C&D activity. And you'd see it in overall economic growth that would be fueled by that infrastructure bill. And so we would benefit also on the hauling side. So certainly would be a boost for the industry and including ourselves on volumes.

Operator: [Operator Instructions] Our next question comes from the line of Sean Eastman, with KeyBanc.

Sean Eastman: Compliments on closing out the year strong.

I just wanted to dig in on the COVID-19-related costs. I mean, the magnitudes, both in 2020 and what you've included in the 2021 guidance, really stands out. And I guess the question is, one, does the nature of those costs change going into 2021? And, two, there has to be a payback around what you guys are spending there. So if you could just talk about how that percolates through and what that does for the business, that would be helpful.

Worthing Jackman: Sure. I mean, we don't do this because of a payback. We do it because it's the right thing to do, right, if you look at what we did last year early on in recognizing our folks as essential workers that have to show up every day versus stay secluded. And that warrants supplemental wages, right? That warranted basically unlimited wage support for folks that couldn't work because of -- if they had a loved one that was impacted, or if they contact traced, or they tested positive, that wasn't their fault. And so last year, we had people that got several weeks of pay based on just a sequencing of issues that befell them. And that was millions of dollars in just what I call waste support on top of it, just because of the impact of the pandemic.

Obviously, as the year wore on, we put a thank-you bonus in in the fall. Because once again, as they powered through it, we knew that the infection rates and the toughest time in the pandemic would be

December, January. And so we got ahead of that mentally with folks and put a thank-you bonus out there before Thanksgiving, heading into the holidays, really to steel them mentally to be prepared for what was about to hit them. And we were right. I mean, everyone knows that that third wave that hit over holiday season was unprecedented in the span of the pandemic, With many times the infection rates, five and six times. And our folks powered through it.

And so we look at again wage support, that continues. Obviously, you look in January, we're probably spending $250,000 a week on wage support for folks that were isolated for one reason or another. That's important. Again, most of our people have spouses that may have lost a job or had hours cut back. And so that incremental support is invaluable.

So obviously, we do a number of things like that in those support programs, the weekly wages we give for folks that are out. That continues to the extent needed, to Mary Anne's point. As infection rates come down, I think the need for that will abate. But nonetheless, the program, the policy is still there. Obviously, it's an easy reminder how hard our people work on a daily basis. And so we made sure that we put a $15 wage, $15 per hour minimum wage target, out there. We found we had about 4% of our employees below that amount. And I think it's -- look, our employees shouldn't have to go work two jobs to make ends meet. And so it was important to put that out there as well. Again, all of these things are just the right thing to do. The payback is not what we consider. Now we can look at the evidence and see what's happening out there. And I'm glad we did it. I mean, I think this whole industry can do better, as you look around this industry with how it pays its people, especially at the lower levels.

Operator: Our next question comes from the line of Mark Neville, with Scotiabank.

Mark Neville: Maybe just a couple points of clarification, first just on the recycled commodity values and the RINs, and what's baked into the guide. So when you say you assumed at current levels, is that Q4, or sort of where we're trending in Q1?

Mary Anne Whitney: No, it's the current levels. Basically where we've been trending in Q1, as we mentioned, we see some tick up. They ticked up over the course of the quarter and were around $100 or $105 per ton on OCC. And you've seen RINs in that $225 to $250 range.

Mark Neville: And then, I guess, on the E&P, the similar type question again. I assume it's sort of relative to Q4 maybe where we're at now. But I guess the increase in the commodity price, oil price, have your sort of thoughts around that business improved for the year?

Mary Anne Whitney: So our assumption at this point, and what's included in our guidance, is that we stay at essentially the current run rate. So that would imply it's around $25 million per quarter, a $100 million for the year, with no assumed pickup, as some other people have speculated that there will be a pickup in the back half of the year. That has not been factored into anything we've communicated.

Mark Neville: But I guess, with WTI north of 60, have you sort of any noticeable improvements, or is it just too soon?

Mary Anne Whitney: No, we really haven't. We'd say it's too soon. I mean, you've seen rig count up, you've seen WTI increasing. And as we said, it firmed up in Q4. But nothing material since then, no.

Mark Neville: And maybe just on the ESG front, again in Canada we have a carbon tax policy. And when you think about these things, is this something that's recoverable? Is it sort of a headwind to you? Would it require sort of a bigger investment across your network in bio gas, or does it create opportunities for M&A? Just sort of how you think about sort of these things, and just in general?

Worthing Jackman: Well, there's a lot of -- I'll start, and Mary Anne -- there's a lot to unpack in that question. Because there are many differences here. So with regards to carbon taxes that we may incur, those are pass-through. With regards to opportunities for us, obviously with regards to, for instance, the bio gas and renewable fuel side, clear opportunities. I mean, we're looking right now at building our second large gas plant in Canada. I would hope within -- we've worked on that for many years -- I would hope within 2 to 3 years, that's easily online. And you'll see the economic benefit of that flowing through the P&Ls.

So there's a lot of different things that we're doing, [but] in tax that's being imposed upon us, that's been passed through. Obviously, the investment opportunities that we laid out a part of our ESG and $500 million commitment over the span of those targets.

Mary Anne Whitney: And the one thing I would add to that, Mark, is that when we look at what's required in Canada, no change to our operations or anything we need to do. It could impact others and so could level the playing field in a way that helps us.

Operator: I'm showing no further questions at this time. I'll turn the call back over to the presenters.

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

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

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