**[ WCN ] - Waste Connections, Inc.**
**Q1 2022 Earnings Call**
**Wednesday, May 4, 2022, 8:30 AM ET**

*Officers*
Worthing Jackman; President, CEO & Director
Mary Anne Whitney; EVP & CFO

*Analysts*
Toni Kaplan; Morgan Stanley
Walter Spracklin; RBC Capital Markets
Jerry Revich; Goldman Sachs Group
Michael Hoffman; Stifel, Nicolaus & Company
Mario Cortellacci; Jefferies
Sean Eastman; KeyBanc Capital Markets
Kyle White; Deutsche Bank
Noah Kaye; Oppenheimer
Chris Murray; ATB Capital Markets
Kevin Chiang; CIBC Capital Markets
Stephanie Yee; JPMorgan Chase & Co.

**Presentation**

Operator: Greetings, and welcome to the Waste Connections First Quarter 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded today, Wednesday, May 4, 2022.

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

Worthing Jackman: Thank you, operator, and good morning.

I'd like to welcome everyone in this conference call to discuss first quarter results and to provide a detailed outlook for the second quarter. Joining me this morning is Mary Anne Whitney, our CFO.

As noted in our earnings release, we are extremely pleased by our strong start to the year with record solid waste pricing growth, driving underlying margin expansion in spite of inflationary pressures. Our 50 basis points year-over-year decline, and adjusted EBITDA margin in the quarter included 90 basis points combined margin impact, as expected, from $10 million of COVID-related frontline support in January and acquisitions completed since the prior year period. Looking ahead, further sequential improvement in solid waste pricing growth, increasing E&P waste activity and strong operational execution should continue to differentiate our performance.

We are on track to meet or exceed our full year adjusted free cash flow outlook of $1.15 billion, and the elevated cadence of solid waste acquisition activity has continued with approximately $175 million in annualized revenues closed year-to-date, confirming our expectations for another outsized year of such 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 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 May 3 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 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.

In the first quarter, we delivered solid waste price plus volume growth, totaling 7.6%. All-in price of 7.1%, including about 80 basis points in fuel and material surcharges, marks our highest reported price and range from about 4% in our mostly exclusive market Western region to between 7.5% and 8.5% in our competitive markets. Up 140 basis points sequentially from Q4, our Q1 pricing was 60 basis points above our outlook and ramped during the quarter as we continued to address the accelerating inflationary headwinds during the period.

Looking ahead to Q2. We expect another sequential increase in both core price and surcharges, with all-in price growth exceeding 8%. Our pricing strength continues to reflect our purposeful approach to addressing the headwinds of inflation and the resilience of our market model, both of which are hallmarks of our strategy. Moreover, the differentiated level of price is a testament to the execution and accountability of local leadership in our decentralized operating structure and the visibility on cost, which informs our approach to pricing.

Reported volume growth of positive 50 basis points also exceeded our outlook. As noted last quarter, reported volumes reflect about 80 basis points impact from the expiration of two poor quality municipal contracts, implying underlying volumes up about 1.3%. On a normalized basis, volumes were up in all regions and continue to be strongest in our Western region, which was up 2.6% in the period.

Looking at year-over-year results in the first quarter on a same-store basis, commercial collection revenue was up 12% year-over-year. Roll-off pulls per day were up 5%, on-revenue per pull up 7% and landfill tons were up 4%, led by a 12% increase in special waste with MSW tons up 2% and C&D tons up 1%.

Special waste activity was broad-based in both Canada and in several U.S. markets, including Colorado, Illinois and Minnesota, including some markets where favorable weather may have accelerated the timing of some jobs otherwise planned for Q2.

Looking at Q1 revenues from resource recovery, that is, recycled commodities, landfill gas and renewable energy credits, or RINs. Excluding acquisitions, collectively, they were up about 35% year-over-year due to higher values for both recycled commodities and RINs, resulting in a margin tailwind in the period of about 60 basis points. Prices for OCC, or old corrugated containers, averaged about $163 per ton in Q1 as expected, and RINs mostly stayed in the range of $3 to $3.25, slightly below the levels we were seeing earlier in the year.

And finally on E&P waste activity. We reported $40.8 million of E&P waste revenue in the first quarter, up 65% year-over-year and up 19% sequentially from Q4 on a pickup in activity during the quarter from increased drilling as well as remediation jobs primarily in the Permian Basin.

Given the backdrop of higher rig counts and elevated crude pricing levels, we are encouraged by the improving trends we saw during Q1 and which continued into April, bringing the quarterly run rate to about $45 million.

We are similarly encouraged by the cadence of acquisition activity. Year-to-date, we've closed approximately $175 million in annualized revenues, all in solid waste and in both the U.S. and Canada. Through four months, we've already completed what we would consider an above average year for us, and the pipeline remains robust.

As always, we remain selective about the markets we enter and the multiples we pay as we maintain our focus on long-term value creation. To that end, we continue to take an opportunistic approach to share repurchases. We repurchased $425 million of outstanding shares in early Q1.

We also accessed the capital markets early this year to lock in more long-term debt at an attractive rate and free up capacity on our bank facility.

Given the strength of our balance sheet, with leverage about 2.6x on a net debt-to-EBITDA basis, we remain well positioned to capitalize on this period of outsized acquisition activity with optionality around our continued return of capital to shareholders.

In addition to share repurchases, we would expect to maintain our established practice of increasing our annual per share dividend when we undertake our typical review in October.

Now I'd like to pass the call to Mary Anne to review more in depth the financial highlights of the first quarter and provide a detailed outlook for Q2. I will then wrap up before heading into Q&A.

Mary Whitney: Thank you, Worthing.

In the first quarter, revenue was $1.646 billion, about $36 million above our outlook and up $250 million, or 17.9% year-over-year. Organic growth was 10% in the quarter. And acquisitions completed since the year ago period contributed about $112 million of revenue, or about $110 million net of divestitures.

Adjusted EBITDA for Q1, as reconciled in our earnings release, was $502.1 million and 30.5% of revenue. As a reminder, this reflects 60 basis points impact from the $10 million in COVID-related support that we provided in January, plus 30 basis points drag from acquisitions. Normalizing for this unique supplemental expense and the margin dilutive impact of acquisitions, adjusted EBITDA margin would be 31.4%, up 40 basis points year-over-year.

Reported margins also reflect the impact of higher diesel costs during the quarter. Fuel expense in Q1 was about 4.0% of revenue, up about 70 basis points year-over-year, including the benefit from hedges on about half of our fuel purchases, mitigating the impact of higher prices.

We averaged approximately $3.30 per gallon for diesel in the quarter, up about 30% from the year ago period and up about 12% sequentially from Q4. Margin impacts reflect the quick run-up in fuel prices during late February and into March, which drove incremental costs of about $4 million for a drag of about 30 basis points beyond our expectations in February.

Looking on a reported basis at Q1 year-over-year margin drivers. The 60 basis point benefit from higher commodity-driven revenues described earlier was more than offset by the 70 basis point fuel headwinds also noted, resulting in a net drag of about 10 basis points. Higher E&P waste revenues accounted for about 40 basis points margin expansion.

As expected and noted, acquisitions resulted in a drag of about 30 basis points, and the $10 million in COVID support from January accounted for a 60 basis point drag. And underlying solid waste margins expanded by 10 basis points, demonstrating the power of price and the importance of a proactive approach. To reiterate, in the face of record levels of inflation, which not only persisted but accelerated during the quarter, we achieved underlying margin expansion in solid waste hauling, transfer and disposal.

Finally, we delivered adjusted free cash flow of approximately $320 million, or 19.5% of revenue in Q1, up 10.6% year-over-year in spite of capital expenditures up over 55%. As such, we are well positioned to meet or exceed our full year adjusted free cash flow outlook of $1.15 billion provided in February.

I will now review our outlook for the second quarter of 2022. Before I do, we'd like to remind everyone once again that actual results may vary significantly based on risks and uncertainties outlined in our safe harbor statement and filings we've made with the SEC and the Securities Commissions or similar regulatory authorities in Canada. We encourage investors to review these factors carefully.

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

Revenue in Q2 is estimated to be approximately $1.785 billion. This includes solid waste price plus volume growth of 7.5% to 8.5%. As Worthing noted, we expect pricing growth to increase sequentially to a range of 8% to 8.5% and reported volumes of flat to down 0.5 points. Similar to Q1, our reported volumes will reflect about 80 basis points drag from expired contracts, thus implying continued positive underlying volume trends.

E&P waste revenue is estimated at approximately $45 million, and recovered commodity values are expected to remain largely in line with current levels. Adjusted EBITDA in Q2 is estimated at 31.2% of revenue, or approximately $557 million. This reflects an expected 40 basis point margin dilutive impact from acquisitions completed since the prior year period, implying margins to be flat year-over-year, excluding such impact.

Depreciation and amortization expense for the second quarter is estimated at about 12.8% of revenue, including amortization of intangibles of about $37.5 million, or $0.11 per diluted share net of taxes. Interest expense net of interest income is estimated at approximately $45 million. And finally, our effective tax rate in Q2 is estimated at about 22.5%, subject to some variability.

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

Worthing Jackman: Thank you, Mary Anne.

We're extremely pleased with our start to the year, particularly given the challenges of record levels of inflation magnified by geopolitical events, ongoing supply chain disruptions and labor constraints as well as the overhang from COVID-related variant impacts.

As has been our focus throughout the pandemic, we have continued to provide outsized levels to support for health and welfare of our employees and their families. And to that end, we're also getting back to our regular cadence of in-person training and other opportunities to be together for shared celebrations, recognition and collaboration.

We believe we are well positioned for the remainder of 2022 with record solid waste pricing, underlying volume growth, further growth in E&P waste and easing cost comparisons. In addition, acquisitions completed year-to-date coupled with a robust pipeline suggests we are solidly on track to meet or exceed our full year 2022 outlook. That said, we'll stick to our typical approach and wait until our Q2 earnings release to update our outlook for the full year.

Q1 is a fitting start to our 25th anniversary year, a year in which we remind ourselves that our intentional culture, intentional strategy and intentional value creation have driven our success through the years.

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

**Questions and Answers**

Operator: (Operator Instructions) And we'll get to our first question on the line from Toni Kaplan with Morgan Stanley.

Toni Kaplan: I wanted to ask about -- if you could talk about attrition trends versus history. Obviously, you're in really exclusive secondary markets and attractive strategy for attrition. So just wanted to understand if pricing has had any impact on it or not really because of, basically, the strategy that you have.

Mary Whitney: Toni, with respect to attrition or pricing retention, said another way, as we've observed really for the past several quarters throughout last year and into this year, the retention rates have really been at historic highs. I think the fact that we keep continuing to deliver price in excess of the way we guide reflects that as well as the fact that we did incremental price increases.

And some people have asked if we see a difference across geographies in terms of the receptivity to price increases. And the short answer is no. We've seen a very broad-based, highly receptive environment for price increases.

Toni Kaplan: That's super. And separately, on recycling. I want to hear just long term, what do you see recycling growing to as a percent of revenue? What would be the main objective there that you have?

Worthing Jackman: It won't move too much as a percentage of revenue to what you see currently. Obviously, the commodity values drive a portion of that. But as you may know, we have two more facilities that are under construction now that should come online before the end of next year. That will add nominally to total recycling revenue. But again, the pace of acquisition activity will continue to keep that in check as a percent of the total.

Toni Kaplan: That's great. One last one for me. Just a broad question around volume. I know you've had more of a price-focused strategy. I know volumes are being impacted by the expiring contracts this year. But just long term, should we think about your volume growth in line with the market? Or is there something about the selectivity of your markets that should lead to a lower volume level than the market?

Worthing Jackman: Well, through the years, we've always said that we think of this industry as being a 1% to 2% volume growth industry. Obviously, there are periods where it exceeds 2% and some periods where it might be below 1%. But the thing you got to remember here is, especially in our model given the geographies we do cover, so much of our business is a fixed pay system. And so the actual calculation of volume growth is likely closer to being impacted by 15% to 20% of our revenue. But for new contracts, it might be 1% episodically.

And so to be reporting between 1% and 2% volume growth, you're reporting between a 10% and 15% growth on that 15% to 20% of revenue that's really impacting reported volumes. And that's really meaning roll-off activity and third-party tons across our scales.

Operator: We got our next question on the line. It's from Walter Spracklin with RBC Capital Markets.

Walter Spracklin: I want to turn to acquisitions here. And I know we've touched on this before, but I just wanted to double-check here that your competitors are starting to look into adjacent markets, highlighting the lower capital intensity, but the strong returns. It's a compelling case. It opens up and widens the purview of potential acquisitions in time when perhaps deals are getting either a little less attractive in terms of valuation or in terms of availability.

So just curious, Worthing, your view on the propensity to go into adjacent markets on the merits of that basis there that it is still high return and still consistent with -- somewhat consistent with what the markets you're in right now.

Worthing Jackman: Sure. Again, this will be the third call in the row, we get the question, and so will be the third call in a row that we're consistent with the answer. And that is, look, we have a long runway within the solid waste space. Many of the deals we're getting done are transactions that we've been chasing for a couple of decades.

And again, as you know, in our model, most of the deals we're getting done, it's sellers that are determining when it's right to sell. And the relationship creates a sold negotiated transaction. We can't pick the timing. It's a seller pick in the timing, so we need to be ready to execute on that.

And again, the pipeline that you see that's actionable is a multiple of the $175 million that has already been closed year-to-date. And so the runway is long for us. And obviously, many of our transactions that you see here, these new market entries, anything of size. And so there's less of an issue with regards to DOJ concerns that maybe some of the larger nationals might have.

As it relates to returns, the return profile is still very attractive. Again, you got to remember, we do cash-on-cash analysis here, and we're buying businesses with great cash flow and resilient cash flow. I mean, a lot of adjacencies to this industry are lower margin, lower barrier to entry businesses. And you've seen the volatility of those businesses through the ups and downs of economic cycles. And so we see no reason to our stripes and who we are on our march to $10 billion.

Walter Spracklin: That's great to hear. And the repeated question, I guess, always wanting to make sure that nothing's changed. And it's great to hear. Staying on that theme of acquisitions here. Obviously, when an acquisition opportunity comes about, it's there and then it's gone unless you transact on it. And therefore, does it ever look -- are you ever tempted to or would you consider in this environment where deals come up, and once they're gone, they're gone, that perhaps you look at being a little bit more aggressive?

I know there are peers out there, and at least one that's willing to redline in a little bit more to get those deals done. You've come through a pandemic, you've gone through recessions, you've proven your resiliency. Would you consider going above 3x, perhaps, for example, on leverage in order to take advantage of these unique and short-term opportunities or temporary opportunities that go away pretty quickly to be able to grow a little faster through the M&A front?

Worthing Jackman: Well, first off, again, with over $900 million of free cash flow after the dividend, the first $900 million we spend on delevering [ you have ], right, because that's adding EBITDA to the equation. And so it takes a lot of acquisition activity to move the needle to 3x or higher. And so when we're doing a lot of transactions, well, remember, $20 million to $40 million of revenue is considered still a big acquisition in our model. Now we've got a handful that are larger than that, but it's rare that you cross $100 million in revenue for a transaction within our model.

And so it takes a lot to move the needle. We've got to spend close to $2 billion to move the needle appreciably on leverage and even try to approach 3x. But what's important from a transacting standpoint is, look, we need to be -- we are very mindful. I can't speak about everyone else's approach, but I'm sure they are as well, in that when you see labor spiking in the last two years, as we've seen, when we now see fuel spike and third-party logistics cost spike, anyone that we're buying, we need to make sure that the plan is already executed or implemented to overcome the current realities of inflation or that the plan is actionable in the very near term to do it.

The last thing we want to be doing is valuing someone on 2021 results in the face of an underlying 8% to 10% cost pressure. And so the folks we're transacting on, we need to make sure we can check the box on that because to your point, we don't want to see multiples move up.

Walter Spracklin: Great. And just a final one for me here for Mary Anne. Margin expansion, a little more muted than what we had seen in the past. I know you flagged the employee comp on 60 basis points and the acquisitions on 30. Is that pretty much it? Would we see you get back to more of the 50 to, call it, 75, 80 basis points improvement that you would normally get now that you're passing some of -- at least the employee comp aspect? Or could we see that carry through to the year that may put a little bit more pressure on margins than what you would otherwise report in a normal period?

Mary Whitney: Sure. We'll certainly, I appreciate you acknowledging the 90 basis points, which as we've tried to make the point, think about our reported margins would have been 31.4%, but for those discretionary, those decisions to add those costs and then, of course, the opportunity to do deals.

Certainly, the other thing that stands out would be the impact of fuel and the 70 basis point headwind, and then the fact that we still drove underlying margin expansion in solid waste in spite of the fact that we had a headwind like that. So sure, if there weren't these kind of pressures, would margin expansion have been greater? Absolutely. That being said, we wouldn't have needed as much price. And I think as you look ahead to Q2, the observation could be that underlying margin expansion based on what we're seeing now should be greater in Q2 than it was in Q1.

Worthing Jackman: But also, you got to remember, looking in about 8% inflationary environment, if all a company does is recover the dollar impact of that, that's about 140 basis points dilutive to margins.

The fact that as we're guiding in Q2 net of acquisition activity that were flat year-over-year, to me, that's up 140 to get that back. And so the fact is that I'd say right now in this environment will do much better than the 30 to 50 basis point margin expansion just to be running flat year-over-year. And as inflationary pressures ease, the starting point of down 140 narrows and you start seeing reported margin expansion in future periods.

Operator: We'll get to our next question on the line. It's from Jerry Revich from Goldman Sachs.

Jerry Revich: I'm wondering if you could talk about the leading edge inflation indicators that you look for in your business. And how are they trending? We're going to be coming up on comps, where we started to see pretty high inflation in the back half of last year. And I'm just wondering, are those comps at a point where we might see the percent inflation slowing in the business, potentially, in the back half of the year? Can you just talk about what you're seeing since you folks were among the first to see inflation accelerating to the upside?

Worthing Jackman: Sure. That's a good question because, look, just like the use of the word transitory last year, that wasn't -- our view is inflation. You got to be prepared for inflation to be sticking around at these levels for a couple more quarters and run the business, assuming that now if we're wrong, because the -- we started anniversarying higher levels in the prior year and it does ease a little bit, as we've always said, that's upside for us.

Our expectation that it could be running at more elevated levels for longer, meaning through this year or most of this year, is that some people were late to the realizing inflationary pressures last year, believe it or not. I mean, look at vendors even this year that are trying to play catch up for what they didn't do last year. They're just waking up to the realities of, gee, higher labor and wages that they're paying wasn't transitory.

And so we're still seeing price increases, especially at certain vendors that even today are ranging upwards of low teens. And so we're going to run our business assuming that that is the environment until it's not. With regards to wages, our wages were up about 8% year-over-year in Q1. Q1 was our toughest comp because we really started pushing wages heavily in Q2 of last year. And so our wage pressures will start easing. But with regards to inflationary pressures from third-party vendors and stuff, we're still seeing that in the macro.

Look, fuel should be unknown right now. So when you say labor is mostly known and fuel is known, then it should start to ease. But we're going to, again, run our business assuming it's not until it does.

Jerry Revich: Super. And then can we just talk about in your recycling business, we're seeing strong interest from chemicals companies on procuring recycled plastics. I'm wondering if you can comment on what the pricing point is for recycled plastic for you versus virgin plastic. And what's the potential that we might see a meaningful premium development in that market over time?

Mary Whitney: Sure. So I would say, let's start with framing where the value of recycled commodities is. And it's really been primarily in the fiber. So when we talk about that basket, it's really been 50% to 70% of the value sits in fiber. It's moving up toward the higher end of that range as OCC has come back. And you're at this 160, 165 type of level for OCC.

I mentioned that because, yes, plastics are part of the equation, but they're a small piece of the equation. And the reality is that it's not as though there's a price point at which our interest changes. It's that this is this basket of commodities, and to the extent there's greater value in a piece of it, we'll do better.

Now have we seen some differentiation among different grades of plastic? Yes, there is greater demand for some than others. And so that's a good thing. It just increases the value of the basket. And frankly, if it increases the interest in doing more recycling, whether it's from a consumer standpoint or a manufacturing standpoint, that's all additive, and good timing since we're adding recycling capacity.

Worthing Jackman: And also, as you know, I mean, look if the refiners want to get in the plastic business, we applaud them. Just to be clear, we're not going to get in the refinery business.

Jerry Revich: And are you seeing an improvement in what you're selling the plastic at versus what virgin plastic would look like? Has that started to happen yet? Because obviously, in the past, it used to be a discount. I'm just wondering if you're starting to see that discount narrow at all? Is that something that [indiscernible]?

Mary Whitney: Certainly narrowing. Yes, certainly narrowing. And as I said, certain grades have outperformed. And there's a general lift in plastic values overall.

Operator: We'll get to our next question on the line. It's from Michael Hoffman with Stifel.

Michael Hoffman: I'd like to come back to the volume to ask it from a different perspective. Does the data that you're looking at support a thesis that new business formation, so that's small container, service interval trends are being positive, neither of those have peaked? That's one of the factors that you alluded to, that market growth one to two, but things that contribute to why it can be higher. What's your data telling you about the underlying business activity?

Worthing Jackman: Let's see. Q1 net new business for us doubled year-over-year. And that's measuring what's happening through our sales force, which obviously sits in competitive markets.

Michael Hoffman: Okay. So that's a good positive statement. And then we hear equipment is on allocation, or that we know labor is tight. So are you seeing potentially less competition for that piece of growth, somebody puts a store in and a new business and needs a garbage service? Because the competitors sitting there are going, where do I get the equipment, where do I get the labor?

Worthing Jackman: I don't think it's as much on that type of business. I think you're seeing some municipalities that maybe trying to rebid their contracts because they're end of term. And in the old days, they may have had six-month lead times or eight-month lead times on the bid. And if it's a large enough bid, they're finding it's tough for people to come compete because it's hard to go get 40 trucks to show up in six months. And so in those cases, you've seen some municipalities oftentimes just trying to extend the existing contract to the year and put more time on the RFP process.

Michael Hoffman: So if you have the business, renewal rates are up a little bit, and that's good for you?

Worthing Jackman: Renewal pricing is up dramatically as well.

Michael Hoffman: Oh, cool. And I know you were asked this inflation question from one perspective, I was going to answer it slightly differently. Do you think the components underlying inflation have peaked and leveled off, they're not continuing to rise? I get we have an anniversarying cycle, but with settled into where they are.

Worthing Jackman: Yes. I think they've -- it feels like they're peaking. We're getting fewer and fewer double-digit increases from vendors, I'd say that. So to that end, it seems like they are peaking. But obviously, we're going to be prepared for them to persist until they don't.

Michael Hoffman: Okay. And last one for me is the E&P improvement narrow? It's Texas and Gulf of Mexico. Or is that $100 -- are we starting to see other basins reactivate?

Worthing Jackman: I mean, it's most of the Permian where we're seeing things pick up. The Haynesville is up a little bit.

Mary Whitney: Eagle Ford --

Worthing Jackman: And the good news is we are finally seeing some rigs return to the Gulf. I mean, the Gulf has been impacted or was impacted heavily from the hurricane season last year. And we're probably seeing some of those negative impacts abate.

Operator: We'll get to our next question on the line. It's from Hamza Mazari with Jefferies.

Mario Cortellacci: This is Mario Cortellacci on for Hamza. Could you just comment on how you're thinking about your U.S. Northeast exposure, particularly in light of the larger deals you've done there in Massachusetts? Can you just remind us what your long-term strategy is there?

Worthing Jackman: Well again, it's just replicating what we've always done when going into such markets, which is -- and you've seen us do it in other markets in the Northeast. You've seen us do in the Midwest and other geographies as well. I mean, we had a strategy to go in and try to build a nice $200 million, $300 million business in New England. And obviously, you've seen us work on the integration and some internalization benefits that we have with some of our sites also in the Northeast, whether they be in New York and Pennsylvania.

And so it's just us executing our playbook. We entered Massachusetts last year, late last year. And we've done another handful of acquisitions, just given the fact that we had the beachhead of Harvey. And so it's just -- look, it's just the same playbook you've seen, again, in other markets. And New England is no different.

But look, we know there are certain areas of New England that make no sense for us, that do not fit our model. So it's -- we're not going to -- just because we're there doesn't mean we go everywhere.

Mario Cortellacci: Understood. And then just for my follow-up, it looks like the energy business is finally coming back a little more. Rig count's up. And I guess just could you give us a sense for whether the revenue base for that business can get back to its prior peak? And what would you need to see for that to happen? And also, could you just remind us of what your exposure is to various basins, and then what the margins are within the energy business?

Mary Whitney: So starting with the second piece. If you think of the -- when you say exposure in terms of the percentage of revenue that comes from each of these basins, the largest is the Permian, call that 50% to 60% of our revenue. Next is Louisiana onshore/offshore, which is 20% to 25% of revenue, pretty much evenly split onshore/offshore. After that, you then get -- it quickly jumps down to between 5% and 10% of revenue in a smattering of other basins, including the Eagle Ford, for instance.

In terms of getting back to prior peaks, I'd say the more recent peak of a run rate of about $65 million per quarter would be the right comparison because the prior peaks beyond that included the Bakken, which really is not a factor.

So here we sit at $45 million. You can do the math to see what it would take to get up there. I'd say the biggest change since prior peaks is although there's more activity in the Permian, there's more competition as well. So I'd factor that into any expectations about how quickly we grow and to what level.

Worthing Jackman: And as you know, the macro environment from the drilling standpoint is different now. You don't have -- you got, what, still about half the rigs from a rig count standpoint versus the peak eight, 10 years ago. And so the amount of drilling activity has changed dramatically. I mean, the propensity for a lot of drillers to spend like drunken sailors in the prior years, that's changed. There's different pressures, external pressures, on the drillers.

And so it's never say never on the prior peak, but it's hard to see us getting back to almost twice the amount of revenue that we're doing right now.

Mario Cortellacci: Got it. And then just on the margins?

Worthing Jackman: Overall, again, it's a landfill-based business. Again, this is a landfill-type margins, which is in that 50% to 60% range.

Mary Whitney: With the incremental higher than that.

Operator: The next question on the line from Kyle White with Deutsche Bank. We may have lost connection. We'll get to our next question on the line from Sean Eastman with KeyBanc Capital Markets.

Sean Eastman: Could we address the inflation topic from a capital spending perspective? I'm wondering how would you characterize where we're running versus budget on CapEx, just with maybe inflation potentially offset by delayed deliveries, et cetera. Could you walk us through that?

Worthing Jackman: Sure. I mean, you've got -- to your point, I think you spelled it out. I mean, in some cases, some pricing points for what would be construction or certain units that weren't already locked in from a pricing standpoint are up this year above original expectations. But also, you've got some delays likely in a number of units as you look back later on this year that will likely happen. So in some cases, you've got delays that basically create an air pocket to backfill inflation.

Now we're putting more capital in because, again, I think it's important to try to get our hands on as much fleet as possible in this environment and also to have surplus fleet that we can wield around for certain contracts as they come up. And so we're backfilling some of the delays with trying to access fleet earlier in the year.

But to your point, I mean, look, CapEx has inflation too. You just don't recover inflation within the P&L. As we've always said you got to focus on margins to make sure you're covering it on the capital side as well. And to that end, for us to be indicating that we're going to still plan on meeting or exceeding our cash flow guidance for the year, it means as we come around in July and update our guidance, there will be more revenue and more EBITDA to accomplish that.

Sean Eastman: Okay. Very helpful. And I'm just trying to think about fuel, the impact of fuel on margins over the balance of the year. I mean, it sounds like the whole 30 basis point shortfall versus the guidance and the first quarter was fuel. Part of that was maybe a catch-up dynamic. Part of that is a higher pass-through revenue dynamic. So if fuel just stayed here over the balance of the year, how much dilution would there be on the full year margin expectations?

Mary Whitney: Sure. Q1 is a pretty good indicator of what that full year would be, to your point, the incremental 30 basis points. Looking ahead to Q2, it's similar, a little worse in terms of what the headwind appears to be. And as Worthing said, until we see it otherwise, we're going to assume things stay the same. Comps get a little easier. But again, at a high level, I think that 30 basis point drag is a fair indication of what we're looking at right now.

Worthing Jackman: Yes. And the drag in Q1 was more about the timing, given the fact that the spike happened so late in February and throughout March, and the pricing was already on the street. So that's why you see some of the step up in Q2, is us recapturing that as well as adjusting for a full quarter impact of that.

Sean Eastman: Okay. Helpful. And then one last quick one. So the underlying core solid waste margins were essentially up 10 basis points in 1Q. What is that number in the 2Q margin guidance?

Mary Whitney: That number is north of that is. The way we think about it, maybe it's 20 or 30 basis points, something like that, but directionally higher.

Operator: We'll go to our next question on the line. It's from Kyle White from Deutsche Bank.

Kyle White: I actually wanted to follow up on the fuel question. I'm still a little confused. So 30 basis headwind relative to your expectation. Maybe can you just remind us your strategy on fuel relative to others using a full surcharge? How much was hedged going into this year? And then how are you recovering those costs given the acceleration we saw in diesel prices late in the quarter? I guess my confusion is is it a 30 basis headwind for the remainder of the year? Or is it going to be this 70 basis point headwind for the balance of the year and these quarters?

Mary Whitney: Sure. So I guess what we're talking about are two different things. One is relative to original expectations, right, because, of course, we gave guidance in February. And so what I was referring to is probably a fair way to think about the incremental headwind associated with what we've seen thus far and what we're expecting to see in Q2 and assuming that persists in terms of the levels of fuel costs that we're seeing.

With respect to our strategy, we have about 50% of our fuel hedged. And so the numbers we're giving you reflect the impact, the mitigating impact, of hedging below-market rates. So the 330 that you're saying in Q1, for instance, would have been about $1 higher, for instance, had we not put these hedges in place, so this fixed purchase contract.

With respect to how we recover it, it varies in our model. In some markets, we do get fuel surcharges, which is why you saw that step-up in fuel surcharges. And as we look ahead to Q2, the number steps up from the 80 basis points we got in Q1. It goes higher in addition to core going higher, which is the other part of the strategy since we've used higher core recover all different cost pressures, including fuel in some markets.

And then, of course, we have our CPI-linked markets, where we're not able to make additional adjustments. And so we would look to see some recovery next year in the form of higher CPI-linked price increases.

Kyle White: Got it. That's very helpful. And then I wanted to go back to inflation. Clearly, it's here in the OpEx side, but curious on the CapEx side what you're seeing on inflation and how you guys are managing this in order to maintain or increase your returns on invested capital, especially in the context of your more decentralized model.

Worthing Jackman: Sure. I mean, it starts with margins. I mean that's -- the margins are keeping up. So are the ROIs. It's when you see folks that are down on margins year-over-year on a same-store basis, that's where you start having the impact of higher CapEx diluting the year-over-year returns. And so we're not seeing that here.

Operator: On to our next question on the line from Noah Kaye from Oppenheimer.

Noah Kaye: So last year in 2Q, you started adding back discretionary and medical costs that were stripped out during 2020. Are those discretionary costs, would you say, fully back? Are they any incremental headwind this year?

Mary Whitney: Well, taking a step back, there certainly were different buckets of both discretionary costs. And as you said, there are things like medical costs, which I'd say were at a more normalized run rate, generally speaking. With respect to things like travel, meetings, that has stepped up. And as we said, we're -- as Worthing said in his prepared remarks, we're happy to be back together, and we are spending money on those things. We didn't call them out in Q1, but they're part of what we've already reported and what we will report the way we're guiding Q2.

Worthing Jackman: Yes. This is a year where we're all in on discretionary costs. So no, we're happy to be back. Obviously, there are a lot of celebrations going on throughout our company for our 25th. As Mary Anne said, there's a handful of training sessions throughout the company every week. And so no, it's great to be together again. And this is a year of -- it may be a tailwind for next year. Who knows?

Noah Kaye: Well, We'll see. We'll see. But that's good to hear. And then just on the labor situation, where is turnover retention at currently? Are you still, would you describe it, short staffed on any of your key regions or routes? Give us an update, if you can, on the retention rates.

Worthing Jackman: Sure. I mean, look, I think every company -- I don't care what industry you're in, you probably -- you wish you had more labor. And so I say that because we typically run about 4% to 5% in any environment, 4% to 5% down on what I would call full employment.

That's fairly common. In this environment, we're probably running 100 basis points higher than that, so 5% to 6%. And again, you distribute an extra 1% or so of employees throughout so many locations. If it's concentrated in one location, it's very impactful. But it was attributed across, obviously. We're getting by on that.

Look, we've had a huge focus on how we hire, how we onboard, retention, state interviews, how are we doing on 30, 60, 90, 120 days to get our newest employees over that hump. And so I'm pleased that we're seeing inroads in that and that turnover for newer employees is improving.

But from an overall turnover standpoint, we're back slightly above prepandemic levels. And I think to be to just be there in this environment of the great resignation or the society that we're living in right now, I can only imagine what it could have been how we've not been leaning into this these past three, four years.

Operator: We'll get our next question on the line. It's from Chris Murray from ATB Capital Markets.

Christopher Murray: Just maybe going back to free cash flow and your conversion in the quarter. Looked pretty strong. Just trying to think about all the moving parts as we go through the year when we're talking about hitting or exceeding guidance. I guess a few pieces of this. Anything to think about in terms of working capital?

And then the other piece is CapEx looks like it was a little bit lower than at least what you're run rating out of Q4. Should we be expecting that you'll probably have some catch up? I mean, I think you alluded to the fact that you're having some trouble maybe getting equipment. But if you can just give us an idea of some of the moving parts into your free cash flow thoughts right now, that would be great.

Worthing Jackman: Yes. Well, if I'll start, I mean, first off, CapEx. Obviously, we're up over 55% year-over-year. So Lord knows on having problem spending money. Look, we purposely front loaded a lot on the chassis side, both in Q4 and Q1 to stay ahead on the fleet deliveries. And so you've -- the biggest component of that increase year-over-year is the timing of chassis deliveries.

But I'd say we're at our expectation for the spend rate on CapEx. And obviously, working capital shifts, you got barely within working capital. We had an acquisition-related item that we had to settle. So that gives you the optics of a use of working capital, but it's just related to an acquisition right there. And so that's just ins and outs from a timing standpoint. And again, as you know, Q1 is typically the lowest tax payment quarter that we have in the year. And so that can influence the flow quarter-to-quarter as well.

Mary Whitney: Yes. And I would just echo that and add that, yes, so the conversion rate that you referred to in Q1, it's always a little outsized in Q1. That's pretty typical. And the other observation I'd make just with respect to working capital, it's a reminder that we'd like to come in with a cushion. We did this year as we had in the prior year, the outside cushion. So we like the optionality that gives us, but we certainly intend to end the year with some cushion as well.

So I'd say the comments Worthing made about having more revenue to drive more EBITDA dollars to then drive the free cash flow, certainly, when we update or consider updating in July, we'll address that.

Christopher Murray: Yes. Okay. But we shouldn't be just flatlining 20% across the board for the rest of the quarters, is, I guess, my question.

Mary Whitney: No. With respect to -- as a percentage of revenue?

Christopher Murray: Of revenue, yes.

Mary Whitney: No, it changes for those reasons that Worthing described, the timing of interest and taxes and other outlets.

Worthing Jackman: And construction projects could be heavier in the spring and summer seasons than you have in the winter season. So there are all sorts of ins and outs.

Christopher Murray: Okay. No, that's great. And then just thinking about your guidance for Q2. Can you just give us an idea of what you think the cadence of the contribution from acquisitions and divestitures might be over the remaining part of the year?

Mary Whitney: Sure. It was $110 million in Q1. I'd expect that to step up to about $140 million in Q2, back down to probably around $110 million in Q3 and then stepping down from there to maybe $65 million or $70 million in Q4.

Worthing Jackman: And with any deals we close between now and year-end to be additive to that.

Mary Whitney: Right, that's what is done today.

Operator: (Operator Instructions) And we'll get to our next question on the line from Kevin Chiang with CIBC.

Kevin Chiang: Maybe following up on an earlier question you got just on your M&A strategy and maybe what some of your peers are looking to do. Just wondering if you're seeing any impact on valuation multiples, if some of your larger competitors are looking outside of solid waste. And you mentioned DOJ concerns as well. And maybe smaller players are also facing a more challenging operating environment. Is that going to any deflation in the valuation multiples you're seeing out there?

Worthing Jackman: Yes. I'd say on an underlying standpoint, obviously, they're down from 2021 last year into this year. I'd say geography can influence that as well because in a handful of what I would call the larger acquisitions we've been doing both in the West Coast, the East Coast and in Canada, what's unique in some of these transactions is the underlying real estate value. The underlying real estate value, in many cases, can be north of 25% of the consideration. And that's unusual.

In some cases, sellers may want to hold on the real estate. And that's not in the deal, and so you've got a rent payment. And our view is in some of these geographies, owning the real estate is also a key component of our market presence. And so in those cases, while the underlying multiples may have come down a little bit, the step back, look at the multiples, they really haven't changed too much because, again, in those geographies, the real estate is worth so much.

Kevin Chiang: No, that's interesting color. And maybe just last one for me. Obviously, good pricing in the first quarter. Sequentially, you're going to continue to grind that higher here. You have this decentralized model. I suspect a lot of us haven't seen inflation at these levels for decades. I'm just wondering, has that changed the feedback loop between, I guess, corporate and the regions to make sure they stay ahead of inflation? Because I suspect the things they were tracking five years ago to figure out where costs were going is probably a little bit different today. Has that changed at all in terms of how you interact with the regions to make sure they're seeing the full inflationary picture? Or does the decentralized model -- they're staying on top of this pretty good here?

Worthing Jackman: Look, I think a hallmark of our strategy has been a decentralized model with the feedback loop we've always had. I mean, we were early last year in communicating this. We're early in moving wages up last year. You've seen us been moving price proactively throughout this period. And a lot of it is because of this decentralized nature and, again, the constant look at where we're at currently and the constant look ahead one, two, three months and beyond now, looking at continuing rolling updates on a full year basis to make sure the magnitude the weight of inflationary pressures is understood beyond just one day, one week, one month or three months.

And so that hasn't changed for who we are and what, again, how we've run the business over time. Financials are a commitment that our local folks are willing to be held accountable to, right. Recovering wage pressures, recovering cost pressures, et cetera, it's what we do. I mean, it's how you run a business. No one ever said this was easy. And our folks do a terrific job in how they price the business, how they recover the realities of cost, both in the P&L and capital and how we measure value creation.

And so again, we mentioned that because, again, we said it's been a hallmark of our strategy since day one. And that's proven to be effective in a pandemic, in high inflationary environments, in the Great Recession, really through good times and bad. So nothing's really changed our visibility on price.

Our visibility on price -- remember, we're still a company that gives quarterly guidance. We've done that since we went public at $30 million in revenue. And now here we are, run rate of $7 billion or more. So again, it's been a hallmark through the years. And again, it's -- pricing never surprises us when it comes to our ability to know what's on the horizon and what's happening in our business.

Operator: We'll proceed with the next question on the line from Stephanie Yee with JPMorgan.

Stephanie Yee: I just wanted to ask about pricing as we look beyond this year. I know this year, we're expecting inflation to probably stay elevated. Who knows what next year is going to bring? But let's assume some of the pressures ease a little. Should we see some of the pricing roll back either from -- there is the comp issue, the year-over-year comp is, but also just the prices that you've been pushing forward to customers. Would you, I guess, roll some of that back just to give the customers a break as well as we're seeing some of these pressures ease across the board?

Mary Whitney: Sure. So certainly, we think about the two different types of markets, Stephanie. And so first, in the exclusive markets where we're CPI-linked, you should expect that the 4% we're getting this year steps up next year as I mentioned earlier, since it's typically a look back to the midpoint of the prior year. So whether that number 5% or north of that next year remains to be seen, but it's certainly directionally higher and provides a boost to the overall reported pricing.

The other thing that we'll keep in mind is it depends on where we exit the year because the rollover impact, the price increases we do this year, will impact next year. And then we'll consider the environment as we make our plans for the balance of '23. And to your point, to the extent there's not as great a need to push us hard, we'd consider that as we make our plans.

Operator: And Mr. Jackman, we have no further questions on the line. I'll turn the call back to you.

Worthing Jackman: Perfect. 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 is available today to answer any direct questions that we did not cover that we're allowed to answer on the Reg FD, Reg G and applicable securities laws in Canada.

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

Operator: Thank you very much, and thank you, everyone. Thank you. And that does conclude the conference call for today. We thank you for your participation as you disconnect your lines. Have a great day, everyone.