Waste Connections, Inc. Q2 2022 Earnings Call
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Officers
Worthing Jackman; President, CEO & Director
Mary Anne Whitney; EVP & CFO

Analysts
Noah Kaye; Oppenheimer
Hamzah Mazari; Jefferies
Jerry Revich; Goldman Sachs
Michael Hoffman; Stifel
Sean Eastman; KeyBanc Capital Markets
Unknown Analyst; CIBC Capital Markets
Kyle White; Deutsche Bank
Unknown Analyst; Morgan Stanley

Presentation

Operator: Greetings, and welcome to the Waste Connections Second Quarter 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded Wednesday, August 3, 2022.

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

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

I'd like to welcome everyone to this conference call to discuss our second quarter results and increased outlook for 2022 and to provide a detailed outlook for the third quarter. I am joined this morning by Mary Anne Whitney, our CFO.

As noted in our earnings release, accelerating solid waste pricing and E&P waste activity drove a top to bottom leap in the second quarter. Solid waste pricing growth of 8.8% in Q2 enabled us to overcome increased inflationary pressures during the period and deliver adjusted EBITDA margin in line with our outlook and flat year-over-year, excluding the margin dilutive impact from acquisitions completed since the prior year period.

Our outperformance in the first half of 2022, expected further sequential increases within solid waste pricing growth, continuing strength in E&P waste activity and acquisitions closed year-to-date positioned us to increase our full year outlook for revenue, adjusted EBITDA and adjusted free cash flow and provide another reflection of our culture of accountability in a challenging operating environment.

As anticipated, acquisition activity is pacing well above average. We have signed to close approximately $470 million in annualized revenue so far this year, and our pipeline remains quite robust. As such, we believe we are well positioned for double-digit revenue growth in 2023 along with margin expansion from continuing solid waste pricing strength and rollover contribution from acquisitions already signed or closed year-to-date. Additional acquisitions expected to close later this year and early next will provide further growth.

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

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

The discussion during today's call includes forward-looking statements made pursuant to the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995, including forward-looking information within the meaning of applicable Canadian securities laws. Actual results could differ materially from those made in such forward-looking statements due to various risks and uncertainties.

Factors that could cause actual results to differ are discussed both in the cautionary statement included in our August 2 earnings release and in greater detail in Waste Connections' filings with the U.S. Securities and Exchange Commission and the Securities Commissions or similar regulatory authorities in Canada.

You should not place undue reliance on forward-looking statements as there may be additional risks of which we are not presently aware or that we currently believe are immaterial, which could have an adverse impact on our business. We make no commitment to revise or update any forward-looking statements in order to reflect events or circumstances that may change after today's date.

On the call, we will discuss non-GAAP measures such as adjusted EBITDA, adjusted net income attributable to Waste Connections on both the 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 performance in the first half of the year, led by strong execution and continued pricing implementation to address macro challenges. In the second quarter, as cost pressures persisted, we once again delivered pricing above our outlook, and we positioned ourselves for another sequential increase in Q3 to drive higher pricing in the second half of the year.

Total Q2 price of 8.8% from 7.2% in core price plus 160 basis points in fuel and material surcharges was 30 basis points above the high end of our outlook. Total pricing ranged from almost 5% in our mostly exclusive market Western region to between 9.5% and 10.5% in our competitive regions. Up 170 basis points sequentially from Q1, our Q2 pricing reflected a 90 basis point sequential increase in core pricing along with an 80 basis point uptick in fuel and material surcharges.

Moreover, we are set up for a 100 basis point sequential increase in pricing growth in Q3 to almost 10%, primarily from higher core pricing as we recognize the full quarterly impact of increases already put in place during Q2 and early Q3. The advantage of continued acceleration of core pricing through the back half of 2022 is not only the potential for margin improvement to the extent that cost pressures abate, but also the setup for 2023, given our higher focus on core pricing, which we retain versus surcharges.

Underlying volumes were up slightly in Q2, about as expected, while reported volume is down about 70 basis points, with the year-over-year decrease attributable to the expiration of two poor quality municipal contracts noted in earlier periods.

Looking at year-over-year results in the second quarter on a same-store basis. Commercial collection revenue was up about 14%, mostly due to price; roll-off revenue was up about 11% on revenue per pull, up about 8.5%; and daily pools up about 2.5% on increases in all regions, most notably our Central region, up about 5%.

The landfill revenue was up 2.5%, with average rates per ton up 6.5% and tons down about 3.8% on the toughest quarterly comparison from 2021. Year-to-date, tons are about flat year-over-year as we maintain our focus on quality of revenue across all lines of business.

Looking at Q2 revenues from recovered commodities, that is, recycled commodities, landfill gas or renewable energy credits, or RINs. Excluding acquisitions, collectively, they were up about 14% year-over-year, due to higher values for both recycled commodities and RINs, resulting in a margin tailwind in the period of about 20 basis points.

Commodity values were slightly below Q1, with average prices for OCC, or old corrugated containers, of about $158 per ton and RINs averaging about $320 in Q2. RINs and recycled commodity values showed some weakening late in the quarter and into July, with a drop in values taken the current overall commodity basket down about 20% compared sequentially to Q2. RINs have actually ticked up a bit from recent lows and are currently about $2.85.

Looking at a few of our sustainability-related projects under development. As noted last quarter, we have two greenfield recycling facilities and two renewable gas facilities under development, all of which are progressing and on track for completion by late 2023. The two recycling facilities will enable us to internalize the processing of recyclables that we are already collecting, thus having an attractive payback as we avoid third-party processing fees. And the RNG projects provide for beneficial reuse of landfill gas already being captured, also with compelling returns.

And finally, looking at E&P waste activity. We reported $50.4 million of E&P waste revenue in the second quarter, up 24% sequentially from Q1 and up 62% year-over-year, a margin tailwind of about 40 basis points in the quarter. Increases in drilling activity in multiple basins, led by the

Permian, have driven a step-up in quarterly E&P waste revenue of over 40% since year-end 2021 from about $35 million of revenue to our current quarterly run rate of about $50 million in revenue.

Moving to acquisition activity. As noted earlier, we've already closed 12 acquisitions year-to-date with annualized revenue of approximately $245 million, about 2x the level of what we would consider average for a full year. These transactions are all in solid waste and include West Coast franchises as well as new market entries and tuck-ins spread across competitive markets in the U.S. and in Canada.

With another $225 million in annualized revenues in both franchise and competitive markets expected to close during the third quarter, subject to customary closing conditions, our activity already exceeds last year's outsized levels and sets us up for over 3% in rollover acquisition contribution next year. And as we also noted, our pipeline remains quite robust for additional acquisitions, expected to close later this year or early next, driven by continued above-average levels of interest from high-quality private company sellers.

The strength of our balance sheet, with leverage of about 2.5x on a net debt to EBITDA basis, provides for continued flexibility during periods of outsized acquisition activity like the ones we've been experiencing, along with optionality around the return of capital to shareholders, which we've already demonstrated through share repurchases completed year-to-date along with another expected double-digit percentage annual increase in our cash dividend later this year.

Our focus remains as always on value creation and replicating the success achieved over 25 years through disciplined capital allocation, market selection and an intentional culture to drive differentiated, projectable results. We believe that the challenges of the current environment highlight the importance of this approach more than ever as we continue to execute through varying economic cycles.

Now I'd like to pass the call to Mary Anne to review more in depth the financial highlights of the second quarter and our increased outlook for 2022 and to provide a detailed outlook for Q3. I will then wrap up before heading into Q&A.

Mary Anne Whitney: Thank you, Worthing.

In the second quarter, revenue was $1.816 billion, about $30 million above our outlook, and up $282 million, or 18.4% year-over-year. Organic growth was over 9% in the quarter. And acquisitions completed since the year ago period contributed about $144 million of revenue in the quarter, or about $141 million net of divestitures.

Adjusted EBITDA for Q2 as reconciled in our earnings release was $567 million, about $10 million above our outlook and up about $82 million, or 16.9% year-over-year. Adjusted EBITDA margin of 31.2% of revenue was in line with the margin outlook we've provided for the period as we successfully overcame the continued escalation of cost pressures during the quarter. This included an incremental impact of 60 basis points from higher rates for fuel and third-party logistics as compared to our Q2 outlook, resulting in a year-over-year margin impact of 170 basis points combined from those two items.

Look at the other margin drivers in Q2. The strength of solid waste pricing, which exceeded the high end of the range we provided in May, drove underlying solid waste collection, transfer and disposal margin expansion of 110 basis points, excluding fuel and third-party logistics. This was bolstered by a 60 basis point combined margin benefit from higher E&P waste, recycled commodity values and RINs.

Excluding the margin dilutive impact from acquisitions completed since the year ago period, adjusted EBITDA margin was flat year-over-year as expected. To reiterate, normalizing for acquisitions, we delivered flat year-over-year margins in the face of inflationary pressures, which accelerated during the quarter to a 40-year high. Moreover, year-to-date, we've delivered adjusted free cash flow of over $638 million, or 18.4% of revenue, up 9% year-over-year in spite of capital expenditures up $100 million, or 36% year-over-year. As such, we are well positioned to increase our full year outlook for adjusted free cash flow to up almost 15% year-over-year.

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

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

Looking first at our updated outlook for the full year as provided for and reconciled in our earnings release. Revenue for 2022 is now estimated at approximately $7.125 billion, or $215 million above our initial outlook, with primary drivers including higher solid waste price-driven organic growth plus about $100 million from acquisitions completed since our initial outlook in February.

Adjusted EBITDA for the full year is now estimated at approximately $2.19 billion, or about 30.7% of revenue, down about 50 basis points from our initial outlook as follows. 40 basis points reflects the impact of incremental price increases to overcome higher inflationary pressures, including over 100 basis points from higher fuel and third-party logistics as compared to our original outlook; and 10 basis points is from the margin dilutive impact of acquisitions completed since February. We are increasing our outlook for adjusted free cash flow to $1.160 billion, with CapEx unchanged at $850 million.

Turning next to our outlook for Q3. Revenue in Q3 is estimated to be approximately $1.865 billion. We expect price plus volume growth for solid waste of about 9%, including total price of 9.5% to 10%, with core price of over 8%. Reported volumes will continue to reflect the 80 basis point impact from expired contracts.

E&P waste revenue is expected in line with Q2 levels, and recovered commodity values are expected to remain largely in line with current levels, which, as Worthing noted, are down 15% to 20% from Q2.

Adjusted EBITDA in Q3 is estimated at approximately $581 million, or 31.2% of revenue. This reflects an expected 40 basis point margin dilutive impact from acquisitions already completed, continued underlying solid waste margin expansion from price-led organic growth along with headwinds from fuel and third-party logistics, similar to Q2. Upside would come from any improvements in commodity-related revenues, higher E&P waste activity, acquisitions completed prior to quarter end or easing of cost pressures given the magnitude of core focused price increases already in place.

Depreciation and amortization expense for the third quarter is estimated at about 12.3% of revenue, including amortization of intangibles of about $38.5 million, or about $0.11 per diluted share net of tax. Interest expense net of interest income is estimated at approximately $47.5 million. And finally, our effective tax rate in Q3 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.

Again, we are extremely pleased to raise our outlook for the full year, particularly given the challenging macro environment and inflationary impacts that have continued to raise the bar on pricing and execution. We are set up for increasing underlying solid waste margin expansion through the second half of 2022 as escalating price increases offset inflationary pressures and are already well positioned for expected double-digit revenue growth in 2023 along with margin expansion from continuing solid waste pricing strength and rollover contribution from acquisitions already signed or closed year-to-date.

As noted earlier, additional acquisitions expected to close later this year and early next year will provide further growth when we provide our formal outlook in February. And given our focus on core pricing, the potential for outsized underlying margin expansion should cause pressures abate.

We are grateful for and especially proud of our over 20,000 employees as they effectively manage through the complexities of ongoing labor constraints, increased core pricing and supply chain challenges while delivering on commitments to our customers and the communities. We appreciate your time today.

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

Questions and Answers

Operator: (Operator Instructions) Our first question comes from Noah Kaye with Oppenheimer.

Noah Kaye: I think the story really has to start here with price. In terms of your commentary for next year, double-digit revenue growth. Obviously, that implies that core price will continue to be elevated into next year. So can you just help us get some confidence around that at this point? How much of that is really coming from the restricted side? How much of it from some of these incremental pricing initiatives? How do we unpack that?

Worthing Jackman: That's a great question because as you know, in restricted markets, there's a lag in the catch-up. And you'll see that next year. Look, as we already look at 2023, we're already positioned for at least 5% pricing without any other pricing actions to be taken. And that breaks down to at least 6% as we see it in our franchise markets. That along with the rollover pricing and competitive markets that's already been implemented, again, has us positioned for 5% price at a minimum next year before any other actions are taken in competitive markets.

So our expectations, as we look ahead, we do think that inflationary pressures have peaked, that they will moderate, may average closer to 5% or so next year. I don't think we'll know until another 12 months if it breaks below 5%. But again, even if the average is 5% next year without any other pricing actions, we're already set up to recover that. And obviously, I would expect us, if deflationary environment is 5%, that you'll see us do total pricing of at least 7% next year. And again, as you've seen this year, the vast majority of that will be core pricing.

Noah Kaye: Very helpful, Worthing. And then as you talk about potential for margin expansion next year, I'd just like to understand what you're seeing in terms of the trends right now in the cost structure. We can set fuel aside for a second and talk about some of the other components of solid waste. Where do you have a sense that those cost pressures may have been peak and starting to decelerate? How do we think about the real leverage potential in the business heading into next year?

Worthing Jackman: Well, what I think about -- I think cost pressure two ways. One is the actual cost pressure and the other one is when do you know it. And as we move through the first half of this year, obviously, anything fuel related, we've mentioned third-party logistics as other companies have as well. While companies like ours and others may have had those under contractual limitations on pricing from our vendors, the reality is in this environment, it was do you want the service or not.

And so I would say is, I hate to sound like Donald Rumsfeld, for those that remember who he is, but the unknowns are now known. And the peak of those and the pressures of those are behind us, and we've already implemented pricing to recover it. And so unless those gap up another 25%, which I highly doubt because you're seeing a rollover with the third-party logistics costs or other things, that again, having the cost structure known and having the pricing already implemented to address it, wow what we're looking at is primarily just the regular rate of inflation, whether it being wages -- again, which has already peaked back in Q1. And so we're on the other side of the curve as we see it, again, unless there is some exogenous shock to the system.

Mary Anne Whitney: And just to elaborate on that, Noah, just to add. So to Worthing's point, what have we seen peak? We've talked about that same employee increase that stepped up last year from 3.5% or 4% to end the year at 7%, started this year at 8%. It's moderated a little, come back to that 6% or 6.5% type of level. And so that's encouraging.

Of course, in the second quarter, what offset that was the increases in fuel and anything driven by fuel, which is why we highlighted the 60 basis point incremental drag from just fuel and third-party logistics that we saw in Q2.

So overall, when we think about inflationary pressures in the business, it's still that high single digits that we talked about in Q1, maybe moderating a little bit off those highs.

Worthing Jackman: You've seen other companies that are focused in this fuel environment on surcharges where almost half of their total price is surcharges. And so obviously, those have come on exponentially high as fuel increase, and there'll be -- the inverse will happen as fuel starts rolling over as we've seen currently.

Operator: Our next question comes from Hamzah Mazari with Jefferies.

Hamzah Mazari: I just wanted to follow up again just on pricing. And the question is more around your view when inflation moderates, what type of pricing is sustainable? And as part of that, maybe you can also just comment on when you're increasing price, how do you -- what's the internal thought process of do you put that in the surcharge bucket? Or do you put it in core price? I know you mentioned core price is stickier. So just anything you're doing internally to make pricing more sustainable as inflation moderates. And I realize part of your book of business is franchise, which has its own sort of reset where maybe you have less control.

Mary Anne Whitney: Sure. So to start with, to your question regarding how do we decide which buckets to put it in. We're a core price-focused company. Yes, we have some markets, which for legacy reasons used fuel surcharges, fuel and material surcharges, as part of the overall mix. But you see it in our numbers, Hamzah, where 85% of the price we're reporting is core. And yes, there is that small element that is fuel and material surcharges.

So the way we think about it is focusing on core, and we look to recover not just the fuel and logistics that we highlighted, but to use this as an example of what's been outsized. But we're looking to recover the cost pressures we're seeing in the business. And I think that's why when you look back over the 15 years -- last 15 years, you see that our pricing has generally averaged to spread the CPI of about 150 basis points.

So when you say where do you think ultimately pricing ends up, I think we would expect that over time, we get back to that normalized spread versus inflation. And that's certainly what we endeavor to do every year coming into the year. And this year we'd consider unique because you had that rapid escalation of cost pressures during the year. But again, what that does for us in that 40% of the business where you get the lagging CPI increase, we see that benefit in the subsequent year.

So just to be clear, we're still doing 4.5%, 5% price in, for instance, our West Coast region. And next year, to Worthing's point, part of what gives us visibility on our pricing is we already know that those increases will step up sequentially '23 over '22 because of the inflationary impacts over the prior year.

Hamzah Mazari: Got it. Very helpful. And just my follow-up question. Could you remind us how much unionized labor you have? And assuming you have less unionized labor than some of your larger peers. And is that kind of a headwind for you today? I guess is your -- it feels like your labor inflation is running higher than most. And is that because you just have less unionized labor? And does that reverse the other way when inflation does moderate? So just unionized labor exposure and whether that's a headwind for you.

Worthing Jackman: Well, I don't see it as a headwind for us because we have the lowest percent of unionized labor among the big three. I mean, we're about 20% overall, but in the U.S., we're much less than that because Canada has a much higher percentage of unionized labor just endemic to the market.

But no. I'd say, look, as the other companies face resets on their union contracts, their headwinds are in front of them, #1. #2, I'd say on the nonunion side and on the union side, put simply, our employees deserve pay raises. I mean, they're operating and living in a high inflationary environment. If we have very high expectations on their daily performance, especially around safety and risk, then they deserve to be paid and rewarded. And so it's not about let's just constrain what our people make. Our people should get paid a lot of money for doing a difficult job in this environment.

And again, we see savings. I mentioned risk, for example. I mean, we are 80 to 100 basis points below in total cost of risk. And so wages can be higher, but if you're getting quality people, you see the payback in other areas of the P&L. I don't begrudge anything our folks are getting from wage increase.

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

Jerry Revich: Mary Anne, I wonder if you could just expand on the third quarter margin outlook. So excellent operating momentum exiting the quarter. Normal seasonality is for margins to be up, call it, 40 basis points 3Q versus 2Q. And based on the outlook, we're looking for flat margins sequentially. Can you just expand on that? I think half of that headwind is the recycled price impact. But I'm wondering if you could just unpack the other moving pieces there sequentially.

Mary Anne Whitney: Sure. So great question, Jerry. And you're right, that does -- sequentially, it looks a little different, and that really is driven by the step down in recycled commodity values and RINs, first and foremost. The other aspect of it is that not only do we see them stepping down, but that exacerbates tougher comps in the prior year, which is why on a comparative basis -- and recall last year, we continued to deliver and had nice margin expansion in Q3 in spite of the cost pressures escalating. And so I think the comps have something to do with it, and the fact that recycled commodity value stepped up over the course of last year, which, as I said, exacerbates the step down in values in Q3 of this year.

Worthing Jackman: As we've noted, I mean, there are a handful of items that would be additive to that margin to the extent they play out. We're already starting to see fuel cracked a little bit as we move through Q3. We've seen RINs now click up a little bit over the last two weeks. So anyway, there's a basket of items that would be additive to that depending upon how the quarter plays out.

Mary Anne Whitney: But when I just think about it more broadly, second half of this year versus first half and similar year-over-year margin guidance implied in all those quarters, what's different is in the first half of the year, there was the assist from recycled commodities and RINs, and it tells you that we're getting better underlying solid waste margin expansion in the back half of the year. That's what we're guiding to. And you'd expect that as we've layered in more price.

Jerry Revich: Super. And then just to follow the breadcrumbs on 2023 that you folks have laid out, price cost tailwind of about 2 points versus 1.5 in a normal year. So just to tease that out, it sounds like that would suggest margin expansion opportunity of about 80 basis points versus the 40 or so that you have done historically. Is that how you folks are thinking about '23 from a planning standpoint as we sit here today?

Worthing Jackman: Yes. If that's how we think about it from a planning standpoint, we obviously wouldn't guide that high. So no, you should see -- obviously, the opportunity for margin expansion increases as inflationary pressures decrease, right? I mean, it's as you see, the greatest opportunity for margin expansion when inflation is running in that 2% to 3% range. And so let's see how inflation pressures abate. Let's see the impact on margins from acquisitions before we start assigning our leading margins to everything we acquire. Let's wait to see how much revenue gets contributed from that. But obviously, from an internal expectation, that's probably not too far off.

Jerry Revich: Super. And then lastly, utility deals for landfill gas have really accelerated since your last quarter's call. Kinder Morgan has acquired an asset. Longer-term offtake agreements are being struck. Can you just update us on how you're seeing the offtake market evolving as you get ready to bring online the two additional landfill gas plants? Are you seeing pricing in the, call it, mid-20s for longer-term agreements playing out at this point?

Mary Anne Whitney: Sure. So just to update more broadly on how active we are in RNG facilities. I think that's indicative of how encouraged we are about the underlying fundamentals of those projects. So to give you an update, in addition to the two that we've already talked about that Worthing said were on track, we have a total of four including those two, which are either under construction or equipment has been ordered; and then an additional six in development for a total of 10 projects at various stages of development, including under construction that we think will come online in the next two to five years.

And just from those projects alone, it really puts us on track to achieve the targets we laid out of increasing that beneficial reuse by about 40%. So those projects, as we've said, have strong fundamentals, really, over a broad range of outcomes on RINs. And we just think that longer term, it is a nice opportunity, and we'll continue to add those projects, and as opportunities present themselves.

Jerry Revich: And Mary Anne, can you comment on the uptake market? Is that developing?

Mary Anne Whitney: As I said, we're encouraged by the level of demand and interest out there. And I think that's what's driving so much -- so many projects across this space, is that the fundamentals are sound for that business.

Operator: Our next question is from Michael Hoffman with Stifel.

Michael Hoffman: Mary Anne, you came into the year with, if I remember correctly, nearly 50% of your fuel hedged. What's the plan at this point going into '23? And how have the hedges helped buffer some of this pressure?

Mary Anne Whitney: Sure. So you're right. We have about 50% hedged in '22, and we've got about 25% hedged in '23. And we certainly look for opportunities to increase that just to get better visibility, but also like to be opportunistic if/when opportunities present themselves. And again, as we think about the need for continuing to get price, part of it is the fact that fuel will be an incremental pressure as those hedges roll off, which benefited us this year.

Michael Hoffman: Okay. And then specifically to the timing of when your CPI resets, is there a mix issue around the calendar year? Or is it pretty much weighted July 1?

Mary Anne Whitney: Well, just to be clear, when we talk about those resets, it refers to the 12 months leading up to that date. So you've really got the impact at the midpoint of '22 from CPIs for the prior 12 months. And so is there some variability, if there's a reset, that's a slightly different metric? Sure. We try to give you overall type -- it's like when we say they're all CPI linked, and we know there's some actual differences on how price increases are calculated market by market. It's a good proxy for how to think about it. And I wouldn't try to get much more granular than that at this point.

Michael Hoffman: Yes. I asked the question poorly, clearly. The timing of when it happens. I get the lagging 12-month aspect and picking -- it's predominantly weighted to that portion of the revenues, the reset would be on July 1 predominantly?

Mary Anne Whitney: So no, the majority of our price increases actually get put in in January. Some are in July, and we have visibility on them. So that's why when we're communicating when -- as you'll recall, when we give our guidance in February, at that point, we've already done the largest bulk of the price increases. And by April, we have very good visibility. We typically have about 80% done or known at that point. I wouldn't expect next year to be any different.

Michael Hoffman: Okay. And then Worthing, on the pace of M&A, it's been exceptional, clearly. Is it holding up? Or is it -- are we starting to reach a peak? I mean, we've all been talking about that this would start settling into something back to a normal level, and it's kept going strong. What's the outlook as far as the pace, the pipeline, the conversations?

Worthing Jackman: Sure. I mean, every year, I prove myself wrong because the pace in the pipeline continues to be quite high as we pointed out on this call. We thought 400 last year would be a hard number to beat, and here we are already through that in seven months. So no, the dialogue remains quite robust, as we said. And I think the important thing is to note it's not one geography or another. It's still coast to coast, and it's across the U.S. and Canada. And so it's -- clearly, it's -- the pace remains elevated. And again, we're fortunate to have the balance sheet to take advantage of that.

Michael Hoffman: And expectation, whether it's 400 or 425 going into next year, it's not slowing down as far as the level of activity?

Worthing Jackman: So again, the pace remains the same. Now whether we transact on it all, whether they all survive diligence, it's a different issue. But no, it's again, we're still turning down probably seven or eight deals for every one or two that we're pursuing.

Michael Hoffman: And have valuations come in with some of the macro pressures that are happening in the market? Or are we still sort of at about the same valuation parameters?

Worthing Jackman: I'd say the valuations for gold-plated companies really hasn't changed much over the years, but maybe one or two turns over the years because, again, our assumed long-term cost of capital inputs haven't changed much over the past 25 years. I mean, we don't change our inputs just because money was free over the past three or four years. And so when you're looking at gold-plated companies with solid cash flows, that's driving the valuation.

Obviously, when you get to coastal deals, whether it be on the East Coast, the Northeast or whether it be in the West Coast, when real estate is involved, as I pointed out on a couple of other calls, the real estate component of it can be uniquely high and drive on appearances, the multiple a little bit higher because in some cases, real estate is 25% to 35% of the purchase price, almost. And that's unique to a couple of geographies.

Michael Hoffman: Okay. And then lastly, just to follow through on the underlying cost of inflation within the business. It's peaked and it's trending down gradually is the message, and we've come off the high in the first quarter. And it's slightly ebbing its way down.

Worthing Jackman: Yes. That's what it feels like. And again, we haven't baked that in to our outlook because I'd rather know it in the rearview mirror versus anticipating it continuing. But as you know, there are pundits on both sides of the argument on recession or not recession, et cetera. It's out there. And in my view is always wait 18 months and they can look back with better clarity.

Michael Hoffman: Right. Well, the fundamentals of your business would suggest that if there is one, your business is doing fine regardless.

Worthing Jackman: Oh, absolutely. Because, again, this is an industry that is very resilient, especially in difficult economies. And again, the fact is with the vast majority of our revenue under fixed pay systems, price is always more important than volume. And I think this industry has shown itself in the Great Recession and recession before that. And again, if there are some weak times on the horizon, this industry will do quite well.

Michael Hoffman: And then last one for me. The supply chain issues, have they started to ease at all? Or is it still just tight for trucks predominantly?

Worthing Jackman: We haven't seen an easing of them. I mean, we still expect a number of our units to get pushed into next year. Obviously, by keeping our CapEx the same, we found a way to backfill and source some other CapEx to replace it. Yellow iron, in some cases, we've already been put on notice. That could be 12 or 18-month lead times. And so we're well past when we've already placed our orders for yellow iron for next year because it's critical to get ahead of that.

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

Sean Eastman: As we look across the space here, everybody is getting outsized price. Most have great price visibility into 2023 as well. So just in light of that and in this unique operating environment, what would be the key points of differentiation you would highlight to investors here in the WCN model?

Worthing Jackman: Well, sure. First off, I think the model has remained unchanged, which is leading price, leading margin, leading free cash flow conversion. And so that's remained consistent throughout the years. But again, as we pointed out earlier in the call, I mean, what clearly differentiates us from the others is also our approach to price. I mean, to have 85% of our price this year core versus 50% as some others have, that makes a hell lot of difference as you play this out on a multiyear basis.

And again, as you see, cost pressures abate as we've talked about. There's core sticks. But that's not easy. I mean, this isn't a push-the-button-type business where we can sit here and essentially control price. Pricing is a local market-by-market implementation. It's not easy. It takes salespeople. It takes ops performing. It's an account-by-account analysis. And so that continues culturally to be a huge differentiation in how we approach price and where we think it's most important to drive it. And again, that's locally. It takes a lot of training and development to support and defend it. It takes a lot of investment in the business acumen to understand the need for price and why that's important.

And so again, I just think when you wrap up the overall market model that we approach, the financial results that go with the investment in human capital, and more importantly, a recognition of the importance of core price versus just letting a computer track the DOE index to put pricing on an invoice, that compounds itself on a year-over-year basis.

Sean Eastman: That's really helpful perspective, Worthing. I appreciate that. And maybe just one for Mary Anne, clarification on the updated guidance. So EBITDA guidance is up nicely. Free cash flow guidance is up, but maybe it feels like there's a cushion in there. And is the operating cash flow guidance actually a little bit lower? I just noticed that and wanted to get a little bit of clarity.

Mary Anne Whitney: Sure. So to your point, our free cash flow guidance is up about $10 million, and that represents a 15% increase year-over-year, which we think is a pretty remarkable outcome. With respect to CFFO, yes. As you point out, because of the adjustments, which impacted CFFO in the first half of the year that, of course, we disclosed as part of that reconciliation. GAAP measure for CFFO looks optically a little bit lower. But of course, the reason that there are those adjustments is because they've impacted what's reported in CFFO. And there are things like, for instance, the largest pieces related to an acquisition and an accrued liability that we discharge right after closing.

So impacted cash flow overall, but of course, shouldn't impact on an adjusted basis. That's CFFO. So the way I'd encourage you to think about it is both CFFO and free cash flow stepped up nominally from our original guidance with no change to CapEx.

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

Unknown Analyst: This is Jessica for Kevin. Just thee one question. So when we look back over the past 10 years, it does feel like the waste sector has come out of challenging periods in a stronger position. Exiting the financial crisis, we saw a greater focus on pricing discipline. And as you look at the impact of the pandemic and now headwinds from inflation, I was wondering if you're seeing any structural positive changes occurring within the broader waste sector. And I guess specifically what you guys are seeing.

Worthing Jackman: Well, I think the -- you broke up a little bit on the question. But look, I think you've seen the structural change in the waste industry. And it's really just more so the rest of the industry catching up. You really saw that in the -- heading into the Great Recession, where, again, the focus was on across the board on price retention with an acceptance that volumes may come and go based on the rise or fall of the economic tide, noting that by retaining price, as volumes come back, they'll intersect at higher pricing points and again, mean good things longer term.

We didn't see that going back 20 years ago in the minor recession we had in '03, '04. And so you look at how that's played out since the Great Recession, that pricing discipline across the industry has remained. It's been necessary because of added operating cost inputs and capital investments needed in post collection and rising CapEx costs. So it's not -- so the discipline has been needed, and pricing increases have been necessary. But again, I think the industry learned a broader lesson that was reaffirming in the Great Recession, and that discipline continues today. So again, as the sector sees cost pressures abate, again, the margin expansion opportunity for the sector expands as inflation comes down.

Operator: Our next question comes from Kyle White with Deutsche Bank.

Kyle White: I want to follow up a little bit on that and also on the pricing story. Obviously, that's the positive story across all the majors in waste. But curious if you're seeing any potential slippage on pricing at that local level from some of the smaller competitors just given the uncertainties or a potential slowdown in the economy going forward. Any kind of slippage there as maybe some of those smaller players look to ensure they keep volumes?

Worthing Jackman: Yes. Look, that's a market by market. Obviously, in some markets, there's always -- or there can be someone who's trying to play a low-price strategy. But understand, those that have played a low-price strategy, just as we saw those folks get burned when recycling rolled over five years ago and that whole impact reset private collar, low-price players to have to move pricing up to recover it, now you go into the COVID impacts, you go into high inflationary environment, you go into labor constraints, folks that have been caught with low pricing going into the last two years of this environment, they're getting gutted.

In some cases, they're just walking away from business and shutting their doors because you can't have low-priced work in an environment where wages need to be moving up the way they've been moving up over the past couple of years. You can't be in a low-price environment and suck down the cost of fuel increases because, again, if someone was trying to live on a high single-digit margin, they've already gone negative over the past two years, given all these pressures.

And so again, it's just another reminder of this can be an easier business to run, or it can be an extremely difficult and exhausting business to run. And I think this period of time right now makes it especially challenging for folks that want to be low-priced competitors, especially not knowing where the costs are. A lot of those folks might be down -- some of the folks are probably down 30% in drivers because they can't -- they haven't woken up to the realities of what it takes to pay to get drivers in the seats.

Kyle White: Right. And I assume that also leads into the M&A environment in terms of bringing more sellers to market just given the overall fatigue. But my other question, though, I wanted to focus on the E&P business. I guess you got -- you had another nice step-up year-over-year, why shouldn't we expect continued increases on a sequential basis here going into the back half, just given where oil is and rig count increasing?

Mary Anne Whitney: Sure. Well, what I would say, Kyle, is we're certainly encouraged by the cadence of activity, and we did see -- as you pointed out, we saw the sequential increase Q2 over Q1. And maybe that means that there's more to come in Q3. We'd rather let that be upside, so we guided to basically in line with Q2.

Worthing Jackman: But to your point, I mean, to the extent that the majors increase their CapEx budgets as they move into next year, and I think there's an expectation that they will. We ought to continue to see sequential movement in that as we move through '23.

Operator: (Operator Instructions) And our next question comes from Toni Kaplan with Morgan Stanley.

Unknown Analyst: This is Hillary for Tony. So we talked earlier about whether there's a debate of we're in a recession or not. So I guess have you seen any change in client behavior or activity? What kind of activity or behavior are you seeing the most from depending on the segment?

Worthing Jackman: Things have been, again, as I said before, fairly stable this year. I mean if you look at the commercial side, our numbers are up nicely year-over-year. Some of that might frankly just be market share taking from some folks that haven't been able to service their own commercial accounts, and we've been able to step in and do that. But nothing notable both up and down.

I would say on special waste, we talked about how that was down in Q2. Obviously, we had a nice strong start to the year in Q1. But we've seen some of those special waste jobs be pushed as logistics budgets and logistics costs have blown the budget that they originally had for those jobs. And so as those logistics costs come back down, we ought to see the special waste side of it start picking up again as it relates to jobs in our market areas. But no, it's been just fairly steady as you go.

Mary Anne Whitney: What I would add to that would just, that if you think about the most cyclical component of the business, we talked about roll offs hold, for instance, being pretty steadily, up a couple of points really across all of our regions. And so we really haven't seen a material change in that level of activity.

And to put it in perspective for you, that piece of the business, the construction-driven piece of the business between roll-off and construction demolition debris at our landfills represent less than 10% of the overall mix of revenue, just to give you some perspective. And again, we haven't seen any material change there.

Unknown Analyst: Got it. Thanks. And I guess just as a follow-up, could you guys talk anything about your M&A activity regarding -- is there any more targets or anything around recycling businesses?

Worthing Jackman: Obviously, with some companies that we buy, they may be collection and transfer and recycling. So recycling facilities may come with acquisitions. But when it comes to greenfield sites, obviously, we've talked about the two that we're constructing right now, one in Illinois and one in Colorado. And obviously, away from that, there are multiple upgrades happening from an automation standpoint and optical sorting standpoint across other facilities. But no, we're not looking at any particular single recycling focused type company. But again, recycling does come with the assets that we're buying.

Operator: Mr. Jackman, there are no further questions at this time. I'll turn the call back to you for closing remarks.

Worthing Jackman: Perfect. Well, if there are no further questions, on behalf of our entire management team and over 21,000 employees, we appreciate your listening to and interest in the call today. Mary Anne and Joe Box are available today to answer any direct questions that we did not cover that we're allowed to answer under Reg FD, Reg G and applicable securities laws in Canada. Thank you again. We look forward to seeing you at upcoming investor conferences or hearing from you on our next earnings call.

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