Waste Connections, Inc.
Q4 2022 Earnings Conference Call
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Mary Anne Whitney, EVP & CFO

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Toni Kaplan, Morgan Stanley
Kevin Chiang, CIBC World Markets
Walter Spracklin, RBC Capital
Noah Kaye, Oppenheimer
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Presentation

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

Now I'd like to turn the call over to Mr. Worthing Jackman. Please go ahead.

Worthing Jackman: Thank you, operator, and good morning, everyone. I'd like to welcome everyone to this conference call to discuss fourth quarter results and our outlook for both the first quarter and full year 2023. I'm joined this morning by Mary Anne Whitney, our CFO, and several other members of senior management.

As noted in our earning release, Q4 topped off an extraordinary year for Waste Connections, highlighted by continuing outperformance during the period, and providing a higher entry point and enhanced visibility for 2023. Strong operational execution and over 10% solid waste pricing, along with acquisitions closed during the period, once again provided for better-than-expected results. We more than offset inflationary pressures and commodity-related headwinds to expand adjusted EBITDA margin by 30 basis points, excluding the margin-dilutive impact of acquisitions completed since the year-ago period.

Looking at the full year, double-digit percentage growth in both revenue and adjusted EBITDA, along with adjusted EBITDA margin expansion, excluding the impact of acquisitions, continued to differentiate our results. We overcame elevated wage, fuel and inflationary pressures and a 70% drop in recycled commodity values in the second half of the year, with an acceleration in pricing during the year, providing momentum for higher core pricing in 2023.

Acquisition activity during the year also outpaced expectation for a total of approximately $640 million in acquired annualized revenues, which along with activity year-to-date, already provides acquisition contribution of 5% in 2023 with additional dialogue ongoing.

In short, tremendous operational execution in 2022 has provided outside visibility for double-digit top line growth along with adjusted EBITDA margin expansion in 2023, with upside from any improvement in recovery commodity values or inflationary pressures, as well as incremental acquisition activity during the year.

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

Mary Anne Whitney: Thank you, Worthing, and good morning. The discussion during today's call includes forward-looking statements made pursuant to the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995, including forward-looking information within the meaning of applicable Canadian securities laws. Actual results could differ materially from those made in such forward-looking statements, due to various risks and uncertainties. Factors that could cause actual results to differ are discussed both in the cautionary statement included in our February 15th earnings release and in greater detail in Waste Connections' filings with the U.S. Securities and Exchange Commission and the securities commissions or similar regulatory authorities in Canada.

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

On the call, we will discuss non-GAAP measures such as adjusted EBITDA, adjusted net income attributable to Waste Connections on both a dollar basis and per diluted share and adjusted free cash flow. Please refer to our earnings releases for a reconciliation of such non-GAAP measures to the most comparable GAAP measures. Management uses certain non-GAAP measures to evaluate and monitor the ongoing financial performance of our operations. Other companies may calculate these non-GAAP measures differently.

I will now turn the call back over to Worthing.

Worthing Jackman: Thank you, Mary Anne. First off, I'd like to recognize and applaud the efforts of our local teams, whose execution most notably over the past few years in the face of arguably the most challenging operating environment, has continued to drive differentiated results. In 2022, our 25th anniversary year, we once again demonstrated two hallmarks of Waste Connections, sustainability and sustaining ability. There should be no trade-off between the two.

As noted earlier, we're extremely pleased with our strong operating and financial performance in Q4 and throughout 2022, as we overcame elevated wage, fuel and inflationary pressures and a 70% drop in recycled commodity values to drive adjusted EBITDA margin expansion, excluding acquisitions in the year.

In 2022, we also delivered pricing of 9.2%, more than 200 basis points above our initial outlook and about 85% of which wasn't core price. Moreover, given the acceleration of pricing during the year, the lagging benefit of higher CPI resets and a strong start to the New Year, we're already set up for pricing to increase sequentially by about 100 basis points from the fourth quarter to 11.5% in Q1 and to average about 9.5% in 2023, essentially all in core price.

We delivered adjusted free cash flow of $1.165 billion in 2022, up over 15% year-over-year on CapEx of $913 million up 23% year-over-year, reflecting a purposeful step-up in CapEx during the year for opportunistic real estate purchases. Net of asset sales, CapEx was about $30 million above our outlook in spite of ongoing supply chain constraints for fleet and equipment.

As noted in our press release, we've been navigating the uncertainties in manufacturer delivery timing, and now expect to take delivery of an additional $50 million in fleet in 2023 that was originally expected in 2022.

Our 2022 CapEx also included about $75 million for sustainability-related projects, which was about $25 million less than we originally had expected, primarily for the two RNG facilities and two recycling facilities we've previously discussed, that will total about $150 million once completed.

Our 2023 sustainability CapEx is expected to be up from 2022 due to the timing of some of the expected 2022 outlays that drifted into this year, as well as the expected initiation of development of an additional large RNG project at a recently-completed acquisition.

As we have described previously, these RNG facilities are strategic investments with attractive paybacks at a range of values for recovered resources. With the additional project noted, our aggregate capital outlays for owned RNG projects are now approaching $200 million between 2022 and 2025. These projects, along with over a dozen others we've partnered on, are conservatively estimated to generate an incremental $200 million of EBITDA in 2026 or about $1 of EBITDA per dollar of CapEx.

Provisions in the recently-promulgated Inflation Recovery Act would further enhance expected returns, and could provide tax-related benefits as soon as 2023, as one of the new plants is scheduled to be online and start contributing in the second half of this year. As we have consistently emphasized in our approach to ESG, these projects are integral to our business, consistent with our focus on value creation and additive to our growth strategy, not something in lieu of acquisitions.

Looking next to acquisitions, in 2022, we closed approximately $640 million in annualized revenue. We completed 24 acquisitions, all in solid waste and spread across the U.S. and Canada, in both franchise and new competitive markets, including integrated markets, new market entries, and a number of tuck-ins to existing operations. This robust activity in 2022 capped 6 consecutive outsized years RAC-acquired annualized revenue, totaling over $2.1 billion since

2017. And we've had another strong start to the year in 2023. As always, we maintain a disciplined approach to market selection, the risk profiles we accept and evaluations we determine to be appropriate.

Since year-end, we've closed another integrated West Coast franchise with over $35 million in annualized revenue, which along with the rollover contribution from deals completed in 2022, already provides for 2023 acquisition contribution of over 5%. Continued dialogue sets up the potential for another outsized year of activity for which we remain well positioned, having entered 2023 with leverage below 3x in spite of acquisition outlays of over $2.3 billion during 2022.

Our balance sheet strength and free cash flow profile provide flexibility for continued elevated levels of investments in our organic solid waste growth strategy, along with renewable energy projects and solid waste acquisitions, while also increasing our return of capital to shareholders.

In 2022, we returned $668 million to shareholders through dividends and opportunistic share repurchases, up nearly 20% from the prior year. And we invested over $3.2 billion in CapEx and acquisitions for future growth.

Now I'd like to pass the call to Mary Anne to review more in depth the financial highlights of the fourth quarter, and provide a detailed outlook for Q1 and full year 2023. I'll then wrap up before heading in the Q&A.

Mary Anne Whitney: Thank you, Worthing. In the fourth quarter, revenue of $1.869 billion was $24 million above our outlook and up $245 million or 15.1% year-over-year.

Acquisitions completed since the year-ago period contributed about $153 million of revenue in the quarter or about $150 million net of divestitures.

Total Q4 price of 10.6% included 9% in core price, which stepped up sequentially by 70 basis points from Q3. Reflecting our highest levels in 2022, Q4 total price ranged from about 6% in our mostly-exclusive market Western region to between about 11% and over 13% in our competitive markets. The pricing acceleration in competitive regions during 2022, along with the lagging benefit from higher CPI linked-market increases in 2023, position us for about 9.5% total price in 2023, essentially all core with over 75% of that pricing already largely in place at this time [for now].

Solid waste volumes in Q4 were down 1.7%, excluding 80 basis points from the final quarterly impact from the purposeful non-renewal of two municipal contracts noted throughout 2022. Volumes were in line with our expectations in spite of the severe winter weather in late December.

Looking at year-over-year results in the fourth quarter on a same-store basis, commercial collection revenue was up 14%, mostly due to price. Rolloff pulls per day were about flat with revenue per pull up 9%; and landfill rates per ton were up about 7.5% on daily tons, down about 2% with MSW and special waste each down 3% to 4%, partially offset by higher C&D waste up 7%. And finally, E&P waste revenue of $53 million was in line with the prior quarter and up more than 50% year-over-year.

Looking at Q4 revenues from recycled commodities, excluding acquisitions, recycled commodity revenues were down about 70% year-over-year, about as expected, due to the precipitous decline in values since July, which continued through November.

Prices for OCC or old corrugated containers declined about 60% sequentially from Q3 to average about $56 per ton in Q4. OCC pricing has been relatively stable since November in the range of $55 to $60 per ton with some recent indications of improvement.

Finally, looking at year-over-year landfill gas sales and renewable energy credits for RINs, landfill gas revenues were up nominally in Q4 with lower RIN values offset by higher values. RIN values averaged about $2.65 in Q4 and have since declined to levels around $2.

Adjusted EBITDA for Q4 is reconciled in our earnings release with $564 million, up 13.8% year-over-year and about $11 million above our outlook, driving adjusted EBITDA margin of 30.2%, a 20-basis point beat to our outlook.

Margin in the quarter was up 30 basis points year-over-year, excluding the impact of acquisitions, as we more than overcame the toughest quarterly comparisons, including almost 150 basis points in headwinds from lower recycled commodity values.

Moving to full year adjusted free cash flow, we converted over 52% of adjusted EBITDA to adjusted free cash flow above our outlook at $1.165 billion or 16.2% of revenue. We over-delivered in spite of an incremental $30 million in CapEx, as we opportunistically made certain real estate purchases during the year.

As Worthing noted, our 2022 CapEx is also noteworthy for what it doesn't include. That is about $50 million in fleet due to manufacturer delivery delays, as well as about $25 million in sustainability-related outlays, all of which were expected in 2022 and are now included in our outlook for 2023 CapEx.

I will now review our outlook for the first quarter and full year 2023. Before I do, we'd like to remind everyone once again that actual results may vary significantly based on risks and uncertainties outlined in our safe harbor statement and filings we've made with the SEC and the Securities Commissions or similar regulatory authorities in Canada. We encourage investors to review these factors carefully.

Our outlook has assumes no change in the current economic environment. It also excludes any impact from additional acquisitions that may close during the remainder of the year and expense of transaction-related items during the period.

Looking first at the full year 2023, revenue in 2023 is estimated at $8.05 billion. For solid waste, we expect pricing of about 9.5%, essentially all core, and volumes in the range of flat to down 1%, plus about $360 million of estimated revenue in 2023 from acquisitions already completed and E&P waste activity and values for recovered commodities assumed in line with recent levels.

Adjusted EBITDA in 2023, as reconciled in our earnings release, is expected to be approximately $2.5 billion or about 31.1% of revenue, up 30 basis points year-over-year in the face of approximately 100 basis points in headwinds from recycled commodity and RIN values.

Said another way, adjusted EBITDA margin guidance is up 130 basis points year-over-year, excluding those two commodity drags.

Any moderation in inflationary trends, increases in the values for such recovered commodities or an E&P waste activity or additional acquisitions closed during the year, would provide upside to our 2023 outlook. To be clear, our outlook does not assume any improvement in recycled commodity values from earlier this year, which for instance, would add $10 million in annual revenue for every 10% move in price levels, or in RIN values, which would add approximately $5 million in annual revenue for every 10% move in price levels, both of which with very high flow-through.

We're encouraged by the improvement we're hearing about in February for recycled commodities, with prices in some markets reported to already be up more than 10% from recent lows. That said, we have not factored any such pickup into our outlook.

Interest expense is estimated at approximately $255 million, and our effective tax rate for 2023 is expected to be approximately 22% with some quarter-to-quarter variability.

Adjusted free cash flow in 2023, as reconciled in our earnings release, is expected at $1.225 billion on CapEx of $925 million, including $50 million in delayed fleet delivery from the prior year, as noted earlier. We also expect about $30 million in asset sale proceeds primarily associated with excess facilities we've either replaced or exited. Given the expected timing of CapEx and other outflows this year, adjusted free cash flow is expected to start the year relatively lower in Q1 and ramp higher in the subsequent quarters.

Turning now to our outlook for Q1 2023, revenue in Q1 is estimated at approximately $1.895 billion. We expect price plus volume growth for solid waste of 10.5% on pricing of about 11.5%, and E&P waste revenue of approximately $45 million, reflecting typical seasonality. Recovered commodity values are expected to remain in line with recent levels.

Adjusted EBITDA in Q1 is estimated at approximately 30% of revenue, or $568 million in what sets up as the toughest quarterly comparison in 2023 for recycled commodities and RINs.

Depreciation and amortization expense for the first quarter is estimated to be about 13.2% of revenue, including amortization of intangibles of about $38.5 million or $0.11 per diluted share net of taxes.

Interest expense, net of interest income, is estimated at approximately $67 million, and the tax rate is estimated at about 22%.

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

Worthing Jackman: Thank you, Mary Anne. Our results in 2022 and positioning into 2023 are a testament to the culture of accountability that has been the cornerstone of Waste Connections' 25-year history of outperformance and value creation. We are proud of our accomplishments in 2022, and grateful for the commitment of our over 22,000 employees whose tireless efforts positioned us not only to overcome the challenges of 40-year high inflation, compounded biodramatic drop-off in recycled commodity values during the year, but also to emerge a more cohesive and resilient team.

Moreover, their efforts have positioned us for double-digit revenue growth, along with the adjusted EBITDA margin expansion in 2023 with industry-leading free cash flow conversion. And to be clear, that's all without any assumed improvement from multiyear low recycled commodity and RIN values, causing an expected 100-basis point margin headwind. We're encouraged by indications that we may already be off those lows, and look forward to realizing upside from sustained improvement in these recovered commodities, as well as any moderation in inflationary pressures or additional M&A activity, again, sustainability and sustaining ability.

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

Questions and Answers

Operator: Thank you. We'll now begin the question-and-answer session. (Operator Instructions). Jerry Revich, Goldman Sachs.

Jerry Revich: I wonder if you folks can just expand on the margin cadence implied by guidance. So it just looks like with the first quarter outlook, you're setting up to be exiting the year with margins up, call it, 80 basis points year-over-year in the fourth quarter and a seasonally adjusted margin rate that's closer to 31.5%. And I'm wondering, as we think about what 2024 might look like, it looks like you've got some natural momentum even before thinking about what commodity prices do to drive a year of outsized margin improvement in 2024. I'm wondering if that cadence is consistent with how you're thinking about the flows?

Worthing Jackman: Well, I'll start with the 2024 observation, and hand it off to Mary Anne for the quarterly progression in the year. But I think you're right with regards to 2024. As much as we said this year is an outsized margin expansion year, excluding the headwinds from recovery commodities, obviously, they have a 100-basis point headwind and guide up 30, it means the underlying is up 130. And we typically talk about being up a targeted 20 basis points to 40 basis points, not 130.

If you move into next year, again, you've got the franchise markets printing pricing for next year off of CPIs we're seeing during the year this year by midyear. And so obviously, the pricing within the franchise markets should stay in that 6% plus or minus range. We're printing 7% this year. As inflation moderates into next year, if inflation does average like the pundits think, 3% to 4%, what you're seeing next year in the franchise markets is really more of the recapture of what we couldn't get in 2022, so that becomes an outsized year. And again, as you know, within our overall pricing structure, we typically exceed CPI by about 150 basis points or more. And so next year should stay, that combined with again, improving recycling values if it steps up during the year, should provide for another above-average margin expansion for the full year above the typical 20 basis points to 40 basis points.

Now with regards to the flow during the year --

Mary Anne Whitney: Sure. Thanks, Worthing. So Jerry, when you think about the flow during the year, I think the most instructive way to come about it is to look at what the headwinds do. And if you look at that 1000-basis point headwind over the course of the year from recycled commodities and RINs, it's heavily weighted to the first 2 quarters. So if you have about 150 basis points headwind in each of the first 2 quarters, that gets about cut in half in Q3 and essentially goes away by Q4.

If you just play that through, you can see how, to your point, you'd have the toughest comparison earliest in the year, and we've already guided to Q1, which by the way, pretty similar the way we guided Q4. And then you'd see the improvement, you'd see the ramp over the course of Q1 to Q4, of course, with the overlay of seasonality and your highest reported quarter still being Q3, would be the likelihood could be. The cadence there is 3, 2, 4, 1 in terms of seasonality. But the most important thing, I think about 2023, is the headwinds diminishing over the course of the year, even before we see any improvement.

Jerry Revich: Super, thank you. And can I just shift gears a little bit and talk about RNG? Since your last public comments, the EPA's rollout of eRINs and the overall framework really essentially blesses RNG as an effective biofuel. And with that context, I'm wondering if we could talk about what number of sites that you folks have that don't currently monetize gas in the plan, could ultimately over time, if you get permitting, etc., monetize gas at economically viable levels? And, separately, obviously, lots of details to be worked out on eRINs, but I'm wondering if you'd be willing to share how much e energy your gas to electric facilities are generating, adjusted for your ownership position?

Worthing Jackman: Well, I think you almost answered the question within how you asked it, which is there's still a lot of details to be worked out. And our view on eRINs right now is to wait till the final rules get promulgated this year before providing any hypothetical comment on it because anything again right now would just be hypothetical, right? Clearly, eRINs provides optionality for the projects we do have underway, as we compare one RNG versus eRIN approach. But I still think it remains to be seen who actually owns the eRIN with regards to the OEMs versus generators, etc. So our view is let's wait until the final rules get promulgated and then we'll make some comment comments on it.

Jerry Revich: Fair enough, Worthing. But I'm wondering if you'd just comment on the number of facilities part of the question? So what's not monetized yet within your footprint in terms of number of facilities that could get monetized?

Worthing Jackman: Well, we currently have electric generation facilities at 17 of our sites.

Jerry Revich: Perfect, thank you.

Operator: Toni Kaplan, Morgan Stanley.

Toni Kaplan: I wanted to ask about volume. You have the expiring contracts running through in 2022, so that was an impact there. But it did seem that volume is getting progressively softer. You did have some tough comps. But wanted to talk about sort of is it price discipline, or is it the special waste that you called out last quarter or something else? And it seems like you are implying a little bit of benefit -- or improvement, I should say in 2023. So just wanted to ask about it, and really just the normalized level. I know the expiring contracts are sort of rolling off, so that'll help.

Worthing Jackman: Yes, we think about this industry as more of a kind of a plus-one/minus-one type volume industry. Obviously, it's a bit more of a fixed price service-based business episodically, whether it be through special waste or new contract wins, that could push volume above the 1% episodically within gravitational pull kind of brings it back within that range. Obviously, last year, we talked about the purposeful shedding of two contracts that pushed reported volumes below the negative 1%, but we said, hey, adjusted for that, it was still staying nicely between net zero and negative one. And we look at this year as likely another year of zero to negative one, episodically, there may be a couple of things that do drive us above zero into the positive on any one quarter. But we'll wait to see how the year plays out on that. The important thing, obviously, in this environment, is price; the important thing is core price. And that's why we're pleased that the 9.5% in core price that we guided to for the year.

Mary Anne Whitney: And the only thing I'd add to that, Toni, would be that we'd say there's really been no change, no discernible change, in any of the trends we've seen. If you think about it, rolloff pulls have been in that flat to kind of up a point or two; landfill volumes have been flattish to down a little bit all year long. I look at January numbers, they're not materially different; maybe January's a little better than December was. There's always a little noise in the winter, but the key is that we haven't seen any market change really for the last year or so.

Toni Kaplan: Great. And I was hoping you could talk about your sustaining ability within sustainability. My question really is do you see sustainability as being a bigger part of your strategy in the future? I know you gave the EBITDA benefit and the CapEx. But just broadly, I guess, maybe just talk about your differentiators versus peers in the sustainability area.

Worthing Jackman: Well, first off, we've always noted that our discussion of sustainability efforts have been core to who we've been for 25 years. It's just we're speaking more about it these past few years and telling our story, right? So I think we are getting a little bit better at being more transparent about what's been going on through these years. Obviously, our take and view on investment in it is a balanced view of projects we own versus projects we partner on. And again, that approach, as we talked about, is the dollar-for-dollar return of EBITDA for CapEx dollar deployed in the aggregate, but it doesn't change who we are.

I think the discussion about sustaining ability really is one of reminding folks that sometimes, the pendulum swings from execution all the way over to from 5-year-out promises on sustainability and what it might deliver. I think we're proud to focus on both what we're doing quarter-in/quarter-out, year-in/year-out, how our folks step up to. We've talked about again, some of the most challenging operating environments we've seen these past few years, and we're proud to talk about the year now. And so I think over 25 years, if you want to define standing ability, I think it's that performance you've seen over 25 years and hopefully that pendulum that swings from execution to sustainability and really swung hard to the sustainability side from just a conversation in the market. Hopefully that's drifting back more to a more balanced view of both execution and sustainability.

Toni Kaplan: Makes a lot of sense, thank you.

Worthing Jackman: Next question, operator?

If people can hear us, we're calling the operator to check in on what's happened to the call. So I understand folks can hear us, but we can't hear anyone else. That's interesting. Well, I could ask myself questions and I could interview myself. Yes, we're trying to correct this. They can hear us, evidently; we can't hear them.

Mary Anne Whitney: (Inaudible) question.

Worthing Jackman: Not a bad idea. If you have a question, just email Mary Anne and myself, and we'll read the question and answer it.

(Cross-Talk)

Operator: Pardon me, this is the operator. Are you ready for your next question?

Worthing Jackman: Yes, Nick. Thank you. If you could let the next question come through?

Operator: Yes, that's Kevin Chiang with CIBC.

Kevin Chiang: Maybe if I could just talk about the M&A pipeline, if I look at maybe the average size of the deals, they've steadily increased the past few years, and really saw a marked jump in 2022. And I'm just wondering, it sounds like we should expect another outsized year in 2023, but has the composition of that pipeline changed at all, i.e., are you seeing larger companies for sale? Are you seeing maybe the pipeline getting bigger in terms of what you'd look at as a tuck-in acquisition? Be interesting. just given some of the trends we've seen in terms of kind of the average size per deal the past few years.

Worthing Jackman: Sure. And you're right, Kevin, there's some what I would call more outsized transactions, companies with $50 million, $60 million, $80 million or $100 million-type revenue profile. But look, an average year for us is 15 transactions to 18 transactions; that might be 2 to 4 new market entries between $20 million and $40 million of revenue. And it might be 10 or 12 tuck-in or kind of market expansion up acquisitions, that could be as low as $1 million or $2 million or as high as $5 million or $8 million. It's just that the combination of those 15 transactions to 20 transactions typically has gotten us to an average of about $150 million, right?

It's just when we do have a year of 24 acquisitions with a good handful of them being $50-plus-million in revenue, that's what really drives the number to $640 million. If you look at the pipeline right now, it's still what I would call middle of the fairway, where $20 million to $40 million, it's considered a large transaction and there's a lot of 5s and 10s in there as well. There's nothing that's what I would call outsized, but we never say never. It's early in the year, right?

But no, the average profile of what we're targeting is no different. It's just sellers of great businesses pick the time to sell, and it's just you've seen more people come to market or finally after 20 years or 30 years of dialogue decide to say, hey, it's time to sell. The transaction earlier this year again, $35 million fully-integrated franchise on the West Coast again, right in the sweet spot of that $20 million to $40 million.

Kevin Chiang: Perfect. That's super-helpful. And then just a second one for me, just a clarification. You talked about the potential upside with the IRA. Just confirming it doesn't sound like you're assuming any of that in your -- I guess in 2023 numbers or even your longer-term kind of return profile on these investments in RNG. It sounds like that would be upside to the numbers you provided in your prepared remarks.

Worthing Jackman: That's right. We've got again, investment tax credit that could apply to the plant we're bringing online in the second half of this year. Mary Anne noted it could be about $10 million of cash tax savings in the current year, and that it could be higher than that, but let's wait to see how this thing plays out. It's probably -- it might be the first ITC that's applied for. Clearly, it's the first one for us to see how that process moves through, but that's not in our number. Obviously, that would help on the free cash flow and obviously, reduce the net invest basis in that plant. And again, with regards to eRINs, we have not assumed anything in our outlook as we wait to get that rule finalized.

Kevin Chiang: Perfect. Congrats on a very strong 2022 there. Thank you very much.

Operator: Walter Spracklin, RBC.

Walter Spracklin: Thanks for the sensitivity on OCC. It's a big challenge for analysts that have varying conservatism in different management teams' estimates on some of these things to have that and normalize for it. And is it fair to say that although you said for every -- I think it was 10% and $10 million revenue, that's also EBITDA as well; presumably, that flows right to the bottom line, is that right?

Mary Anne Whitney: Yes, it's fair to say that. As we said in the prepared remarks, very high flow-through on both OCC and RINs, yes.

Walter Spracklin: Okay. So that's great. And then on acquisitions, when you're buying a lot of companies, it was indicated by one of your peers that sometimes, they come with some assets that are in areas that you may not necessarily want to be in, or is more difficult to operate in. And it's leading to some asset sales by one of your peers. Is that something that you're finding as well? Would you consider kind of pruning or swapping? Would you be buying assets that competitors are selling in markets where perhaps they're smaller and you're larger and vice versa? Is that something that you see a possibility as doing, or are most of your acquisitions in areas you want to be in, and kind of build up in that area?

Worthing Jackman: Yes, if you think about again, the profile of the companies we're buying, typically, they're in a singular market, right? So it's not like they're coming with multistate operations and we love two of the states, but not a third state, etc. So when you're the size companies that we're talking about and profiling, then there's really nothing to divest. Episodically, do they come with -- might they have a bad municipal contract that we need to play out and reprice and be agnostic whether we keep it or lose it? Sure, but it's not a wholesale geographic exit.

Walter Spracklin: Okay. That addresses my questions. Appreciate it, turn it back.

Operator: Noah Kaye of Oppenheimer.

Noah Kaye: Maybe give us a picture on the labor front. When we start to lap these high single-digit rates of labor pressure flowing through the P&L, how would that play into the margin outlook that you've outlined for the back half and some of the expectations that you outlined for 2024?

Worthing Jackman: Sure. Well, I would say, of course, wage rates stay in what I call the mid-to-high-single digits from the overall pressure standpoint, I think wages and wage pressures for the service economy generally, will be more persistent than software engineers and others that you've seen in the headlines getting laid off. Obviously, we price above wage pressures, and you've seen that consistently.

I'd say the good news on labor is that as we move through Q4, turnover improved sequentially as we moved through the year and entered this year. Our ability to hire has improved month-to-month as we move through the year, and Q4 was one of our highest periods for new hires. And I say that because the one pressure that's been on wages during the last 2 years when hiring was more difficult was the scale of the new employee coming in was intersecting somewhere within the current wage scale of existing operation, which put pressure on the wage for existing employees. That's abated.

And so now we're looking at more typical and normalized wages. Obviously, the wages we put in place for the year are mostly in place and so we'll live with that this year. But clearly, if inflation steps down as we move throughout the year and get into 2024, as turnover continues to improve and retention improve, I certainly expect the wage pressure to be mid-to-low-single-digits as we move into 2024.

Noah Kaye: That's great color, thanks. And I'm sure others will ask about some specific guidance items, but I just want to ask, what is the actual sustainability CapEx budget for 2023 since you mentioned some shift in the timing?

Mary Anne Whitney: Right. So as we mentioned, a little bit did shift from 2022 to 2023. We had originally contemplated the $150 million would get spent, $122 million and $50 million in 2023; and that shifted to more like 75 and 75 or a little more than that, given the new project. So 75, call it $75 million to $85 million in 2023.

Noah Kaye: Okay.

Worthing Jackman: So really, Noah --

Noah Kaye: Sorry, go ahead, Worthing.

Worthing Jackman: So as you see that play out with a total of $200 million that we've talked about for RNGs, and then you've got the 2 recycling facility plants, as that CapEx kind of burns off through 2025, then you see the CapEx as a percentage of revenue dip back down, that's when you see the conversion of free cash flow to revenue again start approaching 16.5% again. And that's when if you start layering on the contribution of the renewable fuel plants by 2026, that additional $200 million or so structurally moves to free cash flow generation to revenue by 2026 to about 17.5% of revenue.

Noah Kaye: Thanks for anticipating my question, Worthing. I'll leave it there.

Worthing Jackman: And by the way, your wife wants you to pick up eggs on the way home. (Laughter).

Noah Kaye: You got it.

Operator: Tyler Brown with Raymond James.

Tyler Brown: Mary Anne, did I hear you right, but at this point, 75% of your pricing is already set for 2023? And if that is right, doesn't that feel a bit more visible at this point in the year? Would that be fair?

Mary Anne Whitney: That is. It's a great point, Tyler. So typically coming into the year, by the time we report Q1, we're in the position to make a statement like that, that 75%-plus is either in place or is known because it's linked to a CPI adjustment, which has a look-back period. And this year, we're that much further ahead because of the nature of the price increases in 2022. So if you think about it, there are a few different buckets that contribute to the 75% that's known or in place.

One is the rollover contribution from PIs done last year, which of course, accelerated over the course of the year. And so it sets us up for having more rolling over. The next piece is the CPI-linked contracts, which as we've talked about, step up from 5% to 7% in 2023, so that piece is known. And then the final piece is what we've already put in place with our typical early approach to pricing, which was no different this year. We hit it hard doing the vast majority of our price increases in January this year. And so the combination of those three buckets really is what gets you to about 75%, as we described it already known or in place.

Tyler Brown: Yes, perfect. Okay. That's very helpful. And then can we quickly re-walk the Q4 margin? I think margins were down 30 basis points. I think you said 150-basis point headwind in commodities. But how much specifically from M&A and maybe some fuel-impacted margins, can you just go over those real quick?

Mary Anne Whitney: Sure. So the pieces are that there was a 60-basis point drag, 6-0, from acquisitions, which is why we made the point that it was up 30 basis points year-over-year, ex acquisitions. And that was in the face of fuel was about a 60-basis point headwind and recycled commodities were about 150 on their own.

Tyler Brown: Okay. And then if I'm not mistaken, you have a hedge position in your fuel. How does that play out for next year? I'm certainly assuming that's in the guide, but I just want to -- maybe when we think about this 2023 margin walk, you talked about the 100 basis points from commodities, but what about from fuel? And then specifically as well, what about from M&A? It just seems like you bought some very nice vertically-integrated companies in 2022. So is that maybe not as big of a drag?

Mary Anne Whitney: Yes, sure. The bridge is simpler this year, Tyler, because of a couple of reasons. So acquisitions in the aggregate, looking over the full year, there really is no discernible drag from acquisitions. And that's because, to your point, of the nature of the assets we acquired in 2022 and the concentration to disposal assets. Now as I look through the year, there's a little drag in Q1 and then that abates. So as I said, for the full year, I'd consider it about flat.

And fuel has a similar dynamic in that it is a headwind in Q1. It's about 30 basis points, and then that flips and by year -- for the full year, it's really not a headwind at all. And that's because, to your question about hedges, about 50% of our fuel is now hedged. And between the movement in what fuel prices have done and the incremental locks we advantageously put in place late last year, we basically derisk that. So at current levels, there's no impact from fuel.

Tyler Brown: Okay, perfect. And then I had a couple of questions. I just want to kind of go over the free cash flow guide and make sure I've got it all straight in my head. So last quarter, I think you said there was a line of sight to double-digit free cash flow growth. I'm going to say that was off of your one spot 1-6 guidance, which would have put you at, call it, just under $1.3 billion assuming, call it, low, low double-digit growth. But it sounds like there's about $50 million more in CapEx than was anticipated. So if I kind of take that off, that's what kind of gets me back to where the guide -- is that the right way to kind of square all that?

Mary Anne Whitney: Yes, I would agree with that. The number I would use is a 10% increase off of what we expected to deliver before we over-delivered in 2022 was $127.5 million. You back off $50 million, you're at the $122.5 million guide that we provided.

Tyler Brown: Yes, perfect. And then just my last one real quick. Worthing, you talked a little bit about this, but holistically, what is kind of the unit cost inflation assumption in 2023, including labor and subcontractor and everything kind of all-in?

Worthing Jackman: Yes, we're assuming a range between about 6% and 7% all-in.

Tyler Brown: Okay. All right. Thank you.

Operator: Michael Hoffman of Stifel.

Michael Hoffman: And I'm not buying eggs, they're $8 a dozen these days. (Laughter).

The free cash -- I wanted to ask free cash flow a different way. How should I think about a 2 or 3-year free cash flow growth stack, given there's lots of things in any given period these days? So what's the message about the growth stack, if you will, on free cash?

Worthing Jackman: Sure. You look at, first off, on the CapEx side again, you've got almost 100 basis points of revenue or 1% of revenue from sustainability projects in the current year and next year. Again, I'm rounding. It starts to moderate as you get into 2025, and so once we're through that, that puts -- this year, we're guiding, what, about 15.5% or more as a percentage of revenue. That puts us back to that 16.5% range as a percentage of revenue, and it puts it back above, comfortably above, the EBITDA, over 50% of EBITDA.

But again, as the RNG starts kicking in, as we're getting, as we said before, about $200 million of incremental EBITDA by 2026, the tax effect, that's putting another 1.4%, 1.5% by then cash flow generation as a percentage of revenue. And again, that's why I said as we get into 2026, we ought to be stacking up to about 17.5% or approaching 55% or so of EBITDA.

Michael Hoffman: Okay. And that's the important point is you've been living in a 50 million to 55 million, closer to low end, you're moving back towards the $55 million?

Worthing Jackman: Right, because what pushed us closer to $50 million here, obviously, is the additional sustainability CapEx, right, as well as higher interest rates, higher cash taxes, etc. But in October, we knew where interest rates were going, and we knew where cash taxes were going. And to Mary Anne's point, this isn't -- we don't sit here today surprised by the year-over-year changes. Yes, cash taxes are up $100 million, we knew that; we know cash interest is up.

It's more so for us for acquisition outlays. It's just that, as you know, the total debt outstanding grew by about $1.8 billion year-over-year. And you put any sort of floating rate of 5%, 5.5% on that, I'm not surprised that cash interest is up $65 million or something year-over-year. And so it's -- anyways, that's not a surprise. It's just the 50 million in fleet, as we move through the last 4 months, the numbers of delays went from less than 50 and maybe we'll still get them to 125 to 170 to 200 to 205 units as you exited the year.

We're sitting here waiting for a fleet we ordered 2 years ago that still hasn't been delivered, right? The 2022 CapEx was ordered in early 2021 and so it's that uncertainty. The good news is we held it to $50 million because we were able to pay for the chassis. And it's really just the bodies on 200-plus units that the cost of that, that's drifted into this year.

Michael Hoffman: Okay. And then can you share with us, as bonus depreciation unwinds, what's the total dollar amount that is going to walk back through?

Worthing Jackman: Yes, obviously, in this CapEx outlay, it's tough to -- on a dollar basis, it's going to merge. But because what happens is there's certain limitations of how much bonus appreciation we apply in any one year. Our cash taxes this year ought to be 65% to 70% of the GAAP accrual because of the amount of bonus depreciation carryover that we didn't use in prior years, right? And so it's not as a direct step-down that other companies might have been talking about because we have a little different book here.

Michael Hoffman: Okay. And then if I could shift gears to the RNG, if I include (indiscernible) plus the 4 that are being developed, how many MMBtu will you own when you're done in that $200 million of EBITDA?

Worthing Jackman: I don't have that number. That sounds more like an engineering question. But look, I think more about revenue and if we did, what, about $100 million or so of landfill gas and RINs revenue last year, and we stepped that up to $300 million or so by 2026, we're going -- and by the end, the company, obviously, will be bigger than the $8 billion we're guiding to now. And so overall, on a revenue basis, RINs could become -- and landfill gas could get to that 3% or so of revenue from the 1%, 1.5% it is right now.

Michael Hoffman: Okay. Sliced a different way, is your base assumption a $2 RIN and a $2.50 gas to get to that revenue number?

Worthing Jackman: Right.

Michael Hoffman: Okay. Everybody wants to ask about volume, and I've always heard you say you'll trade volume for price all day long. But another way to talk about volume is service intervals. Sort of what's the underlying trend in the small container business? How would you frame that, because I think that's the supply?

Worthing Jackman: Yes, as I look at just the last 6 months of last year to see that net new business remained positive through the year on a month-to-month basis. And so obviously, increases in new business are more than offsetting loss in any decreases.

Michael Hoffman: Okay. And then you always have a phrase for each year. So can you share with us what growth gratitude is -- what's the message?

Worthing Jackman: Sure. Obviously, last year was intentional, and we've talked a lot about what intentional meant to us through the years. Look, and I won't spend much time on this, but to me, growth is not about top line growth and growth in the business; it's more about the personal and professional development and growth of our leaders, right? Our leaders have spent exhausting amount of effort looking after their people through a very challenging time, pandemic, health, welfare issues, etc. And so our leaders just need to remember to invest in themselves and their own personal growth. And obviously, we will further that based on the amount of discretionary to -- I don't view training is almost discretionary, but we put a lot of effort and a lot of dollars into training and development. And so it's a reminder of our leaders to take care of themselves, don't forget to take care of themselves, and grow personally while they look after others as servant leaders.

And obviously, gratitude is shifting the DNA of any servant leader in recognizing and appreciating their employees and all the good benefits that come from that. And so it's just a -- it's a chance to reflect on individuals, and how grateful we all are to be part of this organization and keep that front and center as we move forward.

Michael Hoffman: Great, thank you very much.

Operator: Chris Murray, ATB Capital Markets.

Chris Murray: Maybe turning back to the CapEx question a little bit, I guess a couple of parts to this. First, if you look at this is the CapEx as a percentage of revenue, it's going to be a little bit higher this year with, I guess, the catch-ups. I guess a couple of things to think about. One, as we move into kind of later years and out of 2022 and things start to normalize, is there any reason to believe that CapEx doesn't step back to kind of historical levels kind of around 10% of revenue?

And then second, just looking at the cost line, you kind of mentioned labor and fuel a little bit. But does getting these additional vehicles or maybe some other things, is there anything that you can talk about in terms of cost reductions or cost improvements in the margin that look to maybe generate margins over and above what you can just do with price?

Worthing Jackman: Yes, I'll take a part of it. From how we run the business standpoint, there's not some great investment that's going to recklessly take out 7,000 heads and change the labor profile of this business. Are we -- do we automate and push the local communities to automate? Is that their decision? Yes. And so in some cases, it's a very long dialogue, but we have a couple of markets that we'll be automating that will help on the labor side.

Obviously, I think we've just celebrated our 50th robot to go into our recycling facilities, and obviously, each one theoretically should take up, if you double shifted 3 to 4 headcount in each per robot deployed. I'll be curious to see if looking at headcount, if that's actually happened or not. But obviously, we have gotten the benefit of much higher quality of product on the outbound, and the pricing we're getting above the high sheet -- high on the sheets has been a huge benefit for us and the ability to move our product given the quality of the product. So they're not just labor benefits sometimes or other benefits as well. And so we're constantly looking around the edges on that.

Obviously, with regards to AI and use of technology to -- we're not using that to try to replace heads with regards to customer service. We're trying to make the customer service experience improve and the pressures of responding to inbounds lighten up a little bit to improve retention around that, not to replace people, right? And so anyway, just our approaches and how we message is a little bit different, but suffice to say, there's a lot that goes on behind the scenes around this.

Mary Anne Whitney: And Chris, with respect to CapEx as a percentage of revenue, you're right to your observation that we have been in this period where, as we've described, whether it's sustainability-related investments, whether it's opportunistically making outlays for real estate as we look forward for future growth, various reasons, you've seen that running higher. And I think it's a reminder of why price has been so important, as we remind people, there's inflation not just in the P&L, but also on the CapEx side. You look at what the cost of construction projects has done and really, we're glad we've had the focus on price as we've had.

But all that being said, we do look forward as we move through this period to getting back to a more normalized rate. And I'd encourage you to think of that as more like 10.5% to 11% is how to think about kind of the base CapEx for a low amount of volume growth in kind of a typical year.

Chris Murray: Okay. That's helpful. Thanks, folks.

Operator: Stephanie Moore of Jefferies.

Stephanie Moore: I kind of wanted to put together, I think, a lot of the questions that have already been asked, but maybe asked a different way. I realize you're not accounting for much improvement in inflationary expectations. But I'm trying to think about it, if that's the case and inflationary pressures do stay elevated, does that mean you could see some upside even on the pricing side? I realize that there's pretty good visibility, 75% you called out, but is there still an opportunity for a bit more upside if inflation stays elevated? But then on the other side, if it does kind of abate from here, then clearly, would expect there'd be upside from the margin front as that improves, or is there a possibility to see a little bit of both? Just trying to kind of put all the pieces together.

Worthing Jackman: Sure. Good question. No, we've implemented pricing assuming it stays elevated and so it's not like staying elevated longer; it's going to be a surprise that we need to go back in again. We've anticipated that. So to the extent that it does start abating, as we noted, that is upside because pricing is done. And so no, we view that as more upside than trying to chase inflation like we've had to do these past 2 years, right? And so our folks are ahead of it.

We have not -- a lot of economists think inflation is going to be crossing 3%, 3.5% by the end of this year. We didn't price assuming the downward slope that most economists have from January to December because if you do that and they're wrong, and which they've been pretty consistently wrong, then we've mispriced our business, right? And so we've assumed elevated for longer, and to the extent it does abate, we'll get the upside from that.

Stephanie Moore: Understood. I'll leave it at that. Thank you, guys.

Operator: Kyle White, Deutsche Bank.

Kyle White: I know a lot has been talked about M&A, but I'm just curious, just given the fact that you spent quite a bit on acquisitions this last year, do you have the appetite and internal firepower to complete another outsized year of acquisitions in 2023, or should we expect it to be relatively subdued as you work to integrate some of those deals last year?

Worthing Jackman: Good question. Remember, after our dividend, we still have almost $1 billion of free cash flow to fund M&A. And so we were not constrained from a balance sheet standpoint to do another outsized year. If we just -- if an average year is $150 million and, let's say, we do $150 million or $200 million of acquired revenue this year, that's probably us spending about $0.5 billion. And so we still have another $0.5 billion left over for anything that might come along to put that number above 200 or to apply for other purposes. And so I think we're blessed to have the flexibility given the strength of the business and the cash flow generation and the growing denominator in EBITDA. That also brings leverage down to remain flexible for any opportunities that come.

Mary Anne Whitney: And to that point about balance sheet flexibility, we ended the year at a little over 2.9x debt to EBITDA. And if we're kind of in a normalized environment, we just do an average amount of year deals, then we'd expect that leverage to just dynamically delever, come down to about 2.5x over the course of the year.

Kyle White: Got it. That makes sense. And then on pricing, just what's been the reception, the customer reception, to kind of the pricing environment more recently, or compared to pre-pandemic levels? And then on that, it seems like the industry has been very disciplined on pricing front since the pandemic and over the past few years. Do you see any signs that this discipline will carry forward, maybe such that you could see a step-change in pricing behavior for the better over the longer term; or do you just view this all as a byproduct of the inflationary environment we're in?

Worthing Jackman: I think it's a byproduct of the inflationary environment; it's a byproduct of kind of some of the companies that live on lower margin, having much more pressure on wages, given the wage profile that they had going into the pandemic to support that kind of low pricing. Obviously, CapEx dollars are up, and so the pricing umbrella is there because of cost pressures, because of declining commodity values, wage pressures, etc.

To the extent that inflation does go down to 2%, 2.5%, 3% next year, I certainly expect that pricing should step down with it, right? Just because you can do 10% price doesn't mean you should be doing it in a 3% environment, right? And so I certainly expect that as we think about a longer-term spread to inflation, as inflation comes down, we'll maintain our spread and exceed that, but we'll step down as inflation steps down too.

Kyle White: Sounds good. Good luck in the year.

Operator: Stephanie Yee, JPMorgan.

Stephanie Yee: I wanted to ask at what point would you consider share repurchases as part of your capital allocation perhaps this year?

Worthing Jackman: Sure. Well, as you know, last year, we spent, what, about $425 million on share repurchases and so we're opportunistic. And so we maintain authorization to repurchase up to 5% of our shares annually. And to the extent we dip our toe in the market again, it remains to be seen. But look, acquisitions are always a higher and best use of our excess capital and so it's first and foremost, directed that way.

Mary Anne Whitney: And of course, in an environment like this, Stephanie, where incremental borrowing costs are over 5.5%, then debt repayment is another avenue that we'll consider.

Stephanie Yee: Okay. That makes sense. And can you just make a comment on your customer retention rates overall?

Worthing Jackman: Yes, retention is quite high. I think the other companies have talked about it as well. The reality is when we talk about labor constraints, it's across the industry. So it's the ability for competitors to poach is as constrained by their lack of excess capacity as others. I'd say that service in this environment matters a great deal. You can't put a price on the street and not service your customers, right? And so retention has been quite high, I'd say all-time high.

I'd say retention on pricing, even at these levels, is at its highest level as well. And so again, that just shows you the overall constraints that everyone is operating under, not just one company or another.

Stephanie Yee: Got it. Okay. Thank you very much.

Operator: (Operator Instructions). Sean Eastman, KeyBanc Capital Markets.

Unidentified Analyst: This is Nick on for Sean today. I just wanted to come back to sustainability. A lot of your competitors are talking about sort of increasing demand for plastic circularity. Is that consistent with maybe what you're seeing in the marketplace? And if so, would that be something you'd consider exploring further down the line?

Worthing Jackman: I think our view right now is we're happy to be a supplier of recovered plastics to some of these investments or others that are chasing this.

Unidentified Analyst: Thank you.

Operator: Thank you. This concludes our question-and-answer session. I'd like to turn the call back over to Mr. Worthing Jackman for closing remarks. Please go ahead.

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

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

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