



Waste Management Research (10/16/19)

Description: Waste Management provides waste management environmental services to residential, commercial, industrial, and municipal customers in North America. It provides collection services, including picking up and transporting waste and recyclable materials from where it was generated to a transfer station, material recovery facility (MRF), or disposal site; and owns, develops, and operates landfill gas-to-energy facilities in the United States, as well as owns and operates transfer stations. The company was formerly known as USA Waste Services, Inc. and changed its name to Waste Management, Inc. in 1998. WM was incorporated in 1987 and is headquartered in Houston, Texas.

Ticker: WM

Price: \$115.65

Market Cap: \$48.9B

Performance: +30.0% YTD

Dividend Yield: 1.80%

Analysis

Waste Management has been a solid company for investors' portfolio as the stock is up 30% YTD, 99% over the last 3 years, and up 427% over the last 10 years – outperforming the S&P500 by wide margins in each timeframe.

What has been the reason for such great performance? WM's ability to consistently grow their business even during difficult economic times. As we'll show shortly, it is WM's ability to be stable during the most difficult economic times that makes them such a solid hold with little volatility.

For example, in 2008-2009 the average S&P500 company saw their earnings fall 40% Y/Y and revenue fall about 13% Y/Y. As a result, the market fell 41% in 2008.

As for WM, well CUBE went back all the way to their 2009 10K. In the first screenshot, we see that revenues were consistently above \$13B but slipped to \$11.8B, a drop of 11.9% Y/Y, which is less than the S&P500. This isn't the bright spot though.

	Years Ended December 31,				
	2009(a)	2008(a)	2007(a)	2006	2005
	(In millions, except per share amounts)				
Statement of Operations Data:					
Operating revenues	\$11,791	\$13,388	\$13,310	\$13,363	\$13,074

If we look at cash flow from 2008 to 2009, WM only saw a 17% drop in free cash flow and could have actually been smaller but they held their capital expenditures fairly consistent. Nonetheless, the company maintained solid free cash flow and did not feel the need to slow down their CapEx.

	Years Ended December 31,	
	2009	2008
Net cash provided by operating activities	\$ 2,362	\$ 2,575
Capital expenditures	(1,179)	(1,221)
Proceeds from divestitures of businesses (net of cash divested) and other sales of assets	28	112
Free cash flow	\$ 1,211	\$ 1,466

As for EPS, in 2007 WM generated \$2.23, in 2008 they generated \$2.19, and in 2009 generated \$2.01 – only an 8.2% drop in EPS while the S&P500 witnessed a 40% drop in earnings.

	Years Ended December 31,		
	2009	2008	2007
Operating revenues	\$11,791	\$13,388	\$13,310
Costs and expenses:			
Operating	7,241	8,466	8,402
Selling, general and administrative	1,364	1,477	1,432
Depreciation and amortization	1,166	1,238	1,259
Restructuring	50	2	10
(Income) expense from divestitures, asset impairments and unusual items	83	(29)	(47)
	9,904	11,154	11,056
Income from operations	1,887	2,234	2,254
Other income (expense):			
Interest expense	(426)	(455)	(521)
Interest income	13	19	47
Equity in net losses of unconsolidated entities	(2)	(4)	(35)
Other, net	1	3	4
	(414)	(437)	(505)
Income before income taxes	1,473	1,797	1,749
Provision for income taxes	413	669	540
Consolidated net income	1,060	1,128	1,209
Less: Net income attributable to noncontrolling interests	66	41	46
Net income attributable to Waste Management, Inc.	\$ 994	\$ 1,087	\$ 1,163
Basic earnings per common share	\$ 2.02	\$ 2.21	\$ 2.25
Diluted earnings per common share	\$ 2.01	\$ 2.19	\$ 2.23
Cash dividends declared per common share	\$ 1.16	\$ 1.08	\$ 0.96

It gets even better, though. In 2017, WM issued \$0.96 per share in dividends, in 2008 they issued \$1.08 in dividends, and in 2009 they issued \$1.16! In other words, amongst one of the worst financial crisis our nation has witness, WM increased their dividend by almost 15%. How were they able to do this? By doing what CUBE's loves most.... Generating significant free cash flow.

As a result, here is the performance chart in 2008.



Waste Management was actually able to stay in positive territory for a majority of the year but only closed down 3.4% while the S&P500 tanked nearly 41%.

Fast forward to today, WM has only grown their business. In their most recent Q2 report in late July, the company reported:

Q2 Non-GAAP EPS of \$1.11 beating estimates by \$0.02 on revenue of \$3.95B (+5.6% Y/Y) beating by \$10M.

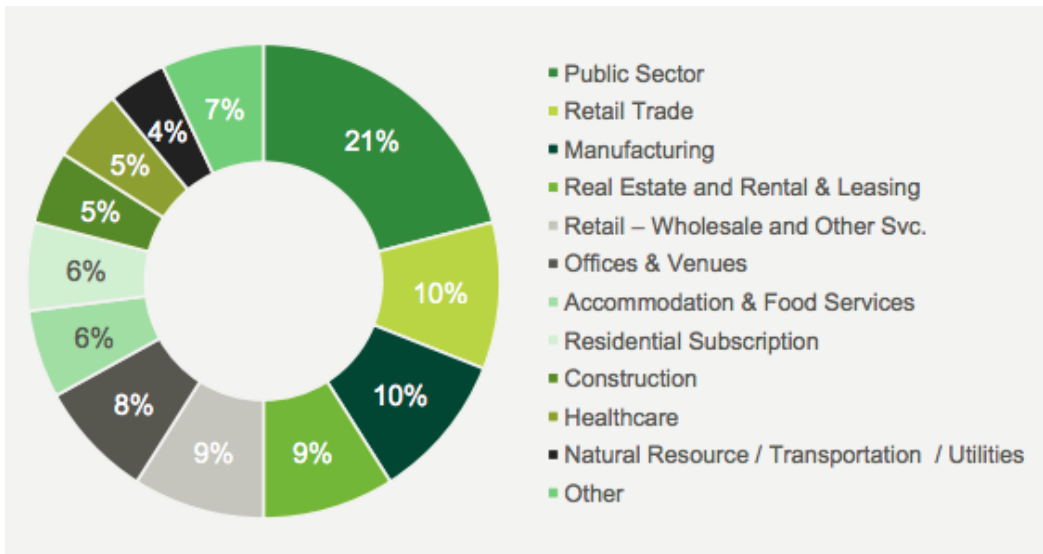
- On an adjusted basis, total operating EBITDA was \$1.13B for the second quarter of 2019, an increase of \$73 million, or 6.9%, from the second quarter of 2018.
- Net cash provided by operating activities was \$1.01B in the second quarter of 2019, an increase of \$35 million, or 3.6%, when compared to the second quarter of 2018. The growth in net cash provided by operating activities was driven by operating EBITDA growth and the Company's focus on improving working capital, partially offset by higher taxes and interest.
- Capital expenditures were \$578M in the second quarter of 2019, a \$142M increase from the second quarter of 2018, due to an intentional focus on accelerating certain

fleet and landfill spending to support the Company's strong collection and disposal growth.

- Free cash flow was \$440M in the second quarter of 2019 compared to \$621M in the second quarter of 2018. The decline in free cash flow was primarily driven by the increase in capital expenditures in the quarter attributable to Y/Y timing differences in fleet and landfill spending and a reduction in proceeds from divestitures.
- The Company paid \$217M of dividends to shareholders and repurchased \$180M of its shares in the second quarter of 2019.
- The Company spent \$48M on acquisitions of traditional solid waste businesses during the second quarter of 2019.
- Reaffirmed full year guidance:
 - Adjusted earnings per diluted share: \$4.28 - \$4.38
 - Adjusted operating EBITDA: \$4.40 - \$4.45B
 - Free cash flow: \$2.025 - \$2.075 billion

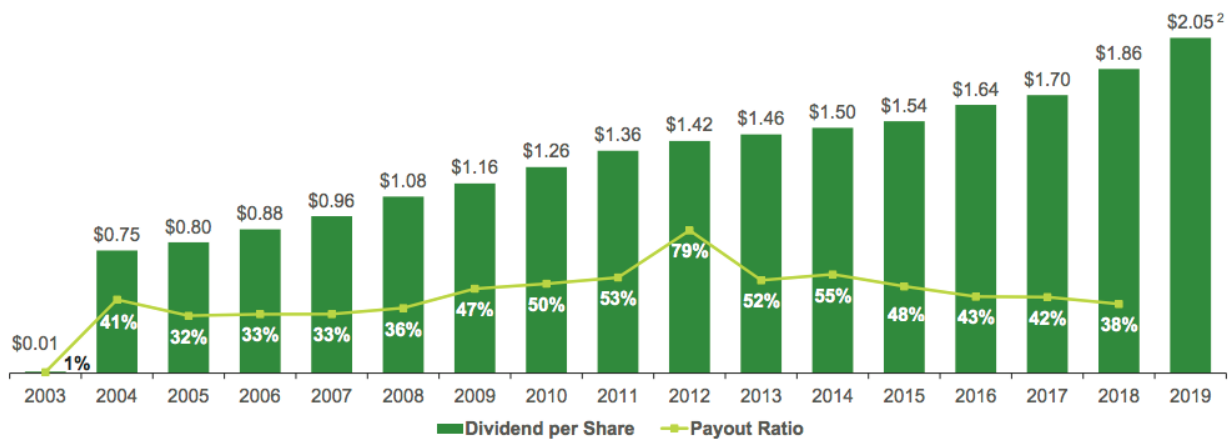
If we look across the board, WM is experiencing pretty solid growth from all of their business lines except for recycling which also happens to be their smallest segment revenue wise.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Commercial	\$ 1,052	\$ 986	\$ 2,078	\$ 1,941
Residential	655	632	1,295	1,246
Industrial	744	708	1,424	1,345
Other	122	115	231	216
Total collection	2,573	2,441	5,028	4,748
Landfill	1,023	915	1,887	1,720
Transfer	474	437	886	812
Recycling	264	305	555	617
Other (a)	445	439	876	866
Intercompany (b)	(833)	(798)	(1,590)	(1,513)
Total	\$ 3,946	\$ 3,739	\$ 7,642	\$ 7,250



Above is the breakdown of their revenues and below is WM's stellar dividend payout history. As of today's price, the dividend yield is around 1.8% but CUBE believes there is a lot of room for this to grow given the cash flow WM generates. In addition, the payout ratio has fallen below 40% and WM is guiding for 40-50% payout so we should continue to see this dividend rise for a 16th straight year.

DIVIDEND PER SHARE, PAYOUT RATIO¹ HISTORY



With the remaining cash flow that isn't getting paid out to shareholders, WM has been also buying back stock as seen by the \$180M worth they purchase in Q2 alone and also on acquisitions. In April, WM announced that they'd be acquiring the 4th largest waste management company in that of Advanced Disposal Services at a \$4.9B enterprise value.

WM sees this immediately adding value to shareholders via top-line growth, earnings, and cash flow. WM also expects more than \$100M of annual cost savings from the deal.

Wall Street was a pretty big fan of the deal because WM paid less than 11x estimated 2019 EBITDA which is less than its current 13x EBITDA valuation multiple.

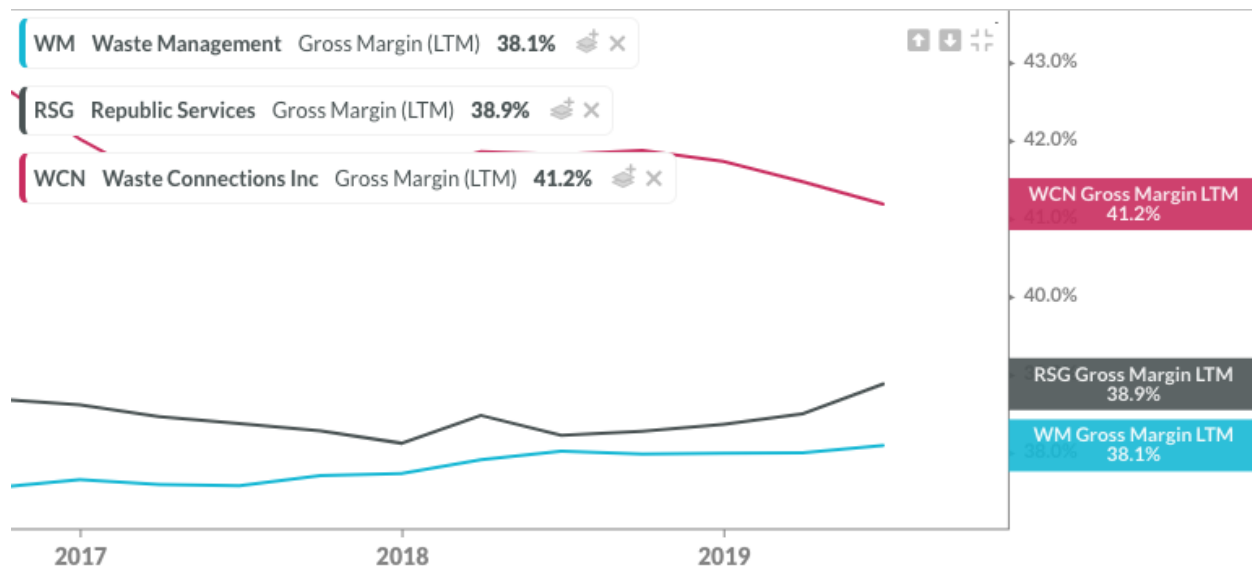
Speaking of valuations let's turn to the part that gets a little tricky for WM:

Peers:

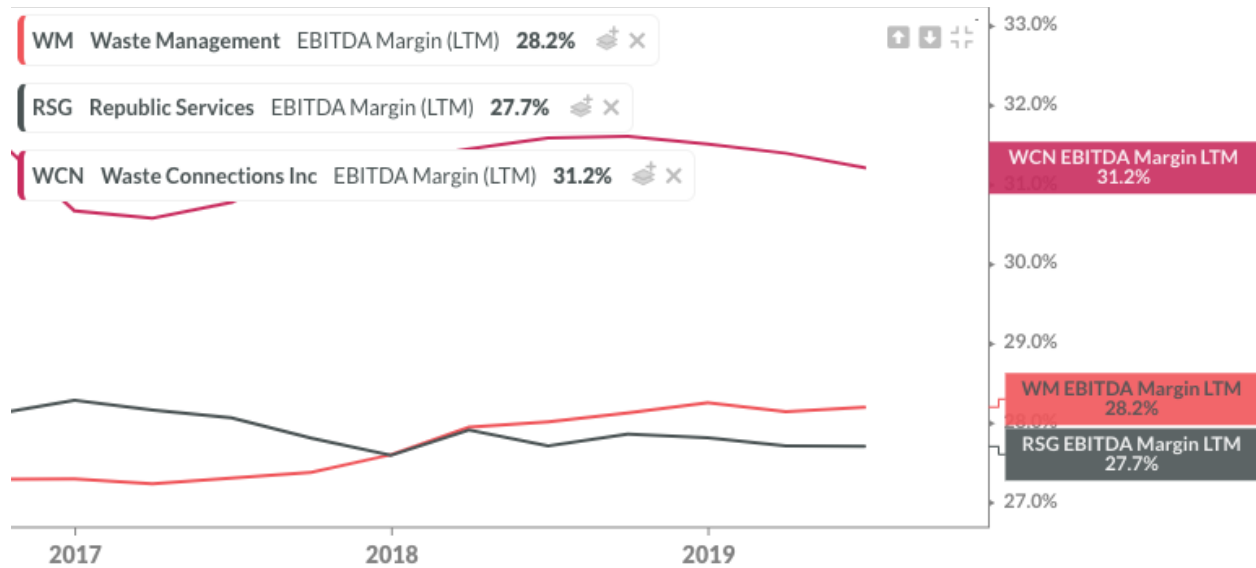
Republic Services, Inc. (RSG) engages in non-hazardous solid waste collection, transfer, recycling, and disposal services for municipal, residential, and energy services customers in the United States and Puerto Rico. The 23-year-old company operates roughly 195 active landfills and more than 200 transfer stations. Market Cap: \$27B

Waste Connections, Inc. (WCN) provides waste collection, transfer, disposal, and recycling services in the United States and Canada. It operates roughly 90 active landfills, more than 145 transfer stations, and about 66 recycling centers. Market Cap: \$24B

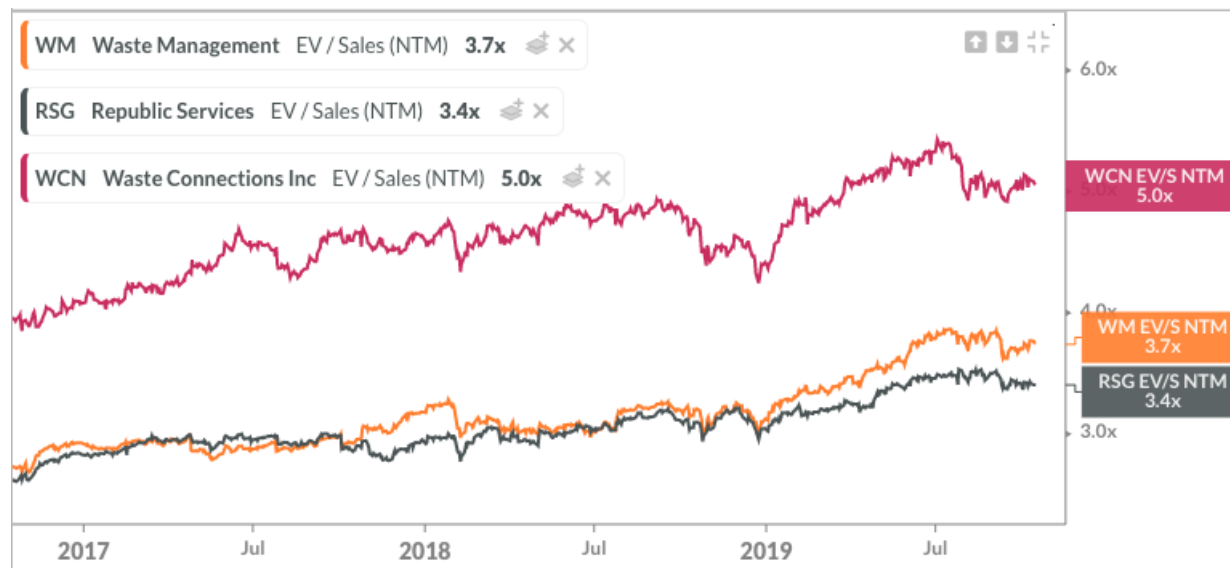
From a gross margins standpoint, WM trails its peers.



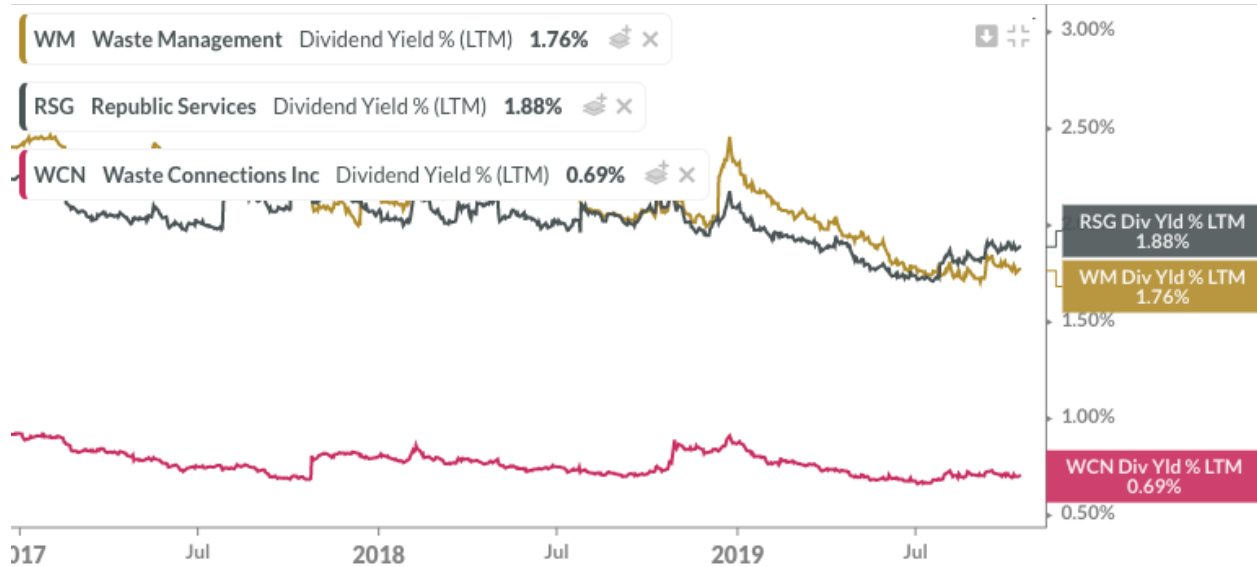
Moving down the income statement to EBITDA, WM falls in the middle of the pack.



On an enterprise value to sales basis, WM is in the middle of the pack and after the acquisition is fully taken into account will be a bit more expensive from this standpoint as EV takes into account net debt.



From a dividend standpoint, WM and RSG are neck and neck while WCN trails.



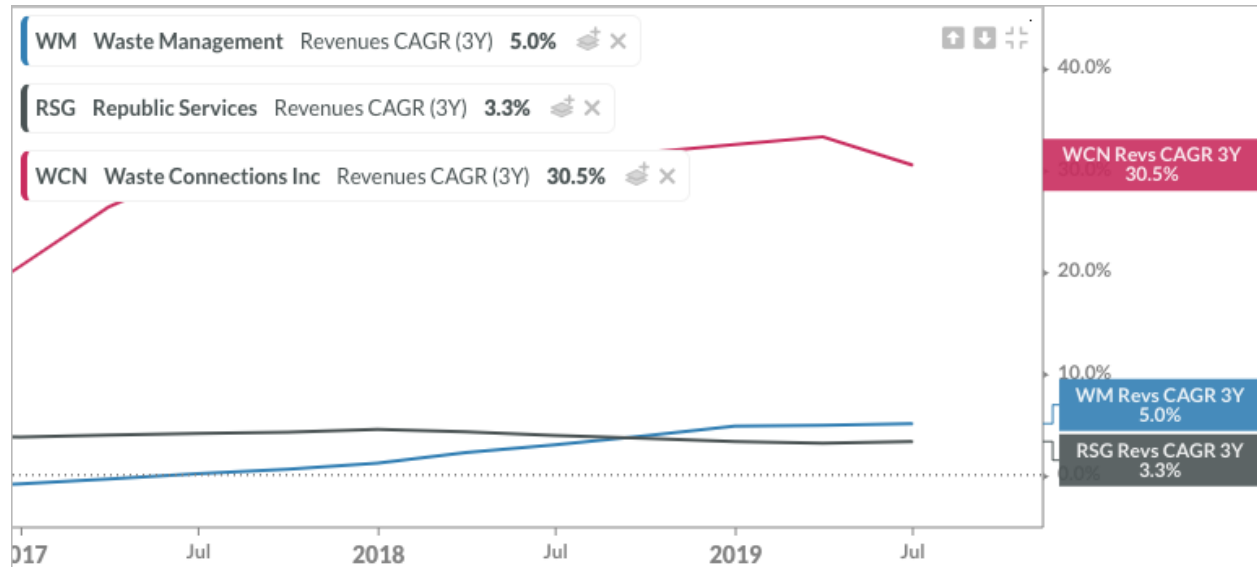
On a forward looking P/E basis, WM is right down the middle. WM and RSG are now testing their previous P/E highs here in the mid-20s range that we last saw in late 2017.



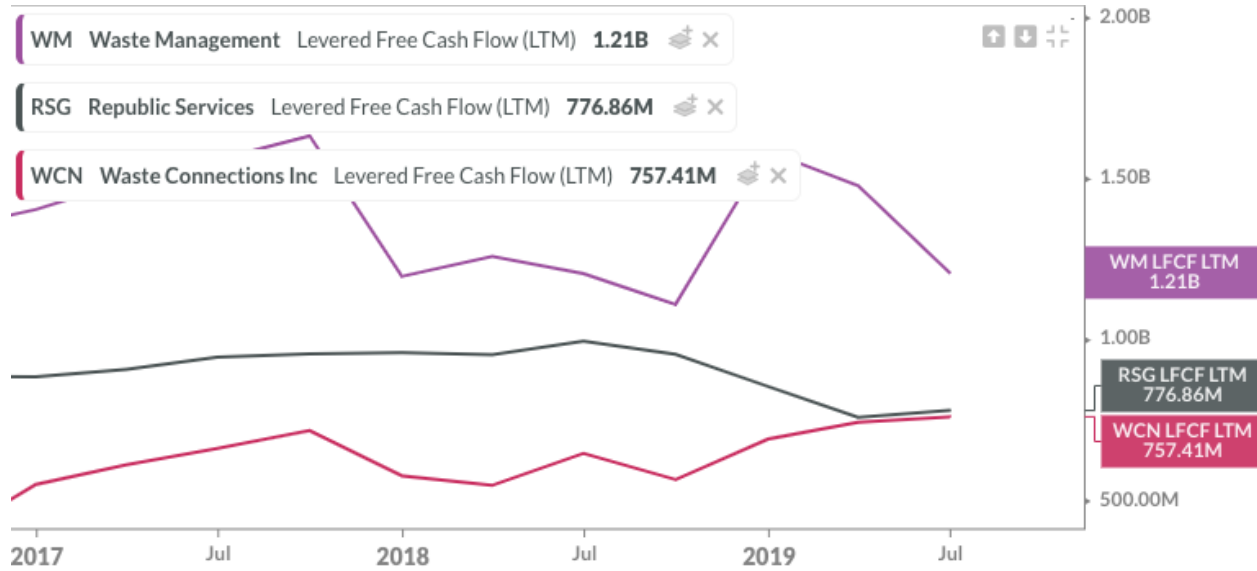
When we examine EV/EBITDA, WM is also middle of the road and also goes to show that they were able to grab Advanced Disposal Services at a pretty decent value of 11.0x EV/EBITDA which is the cheapest of the names.



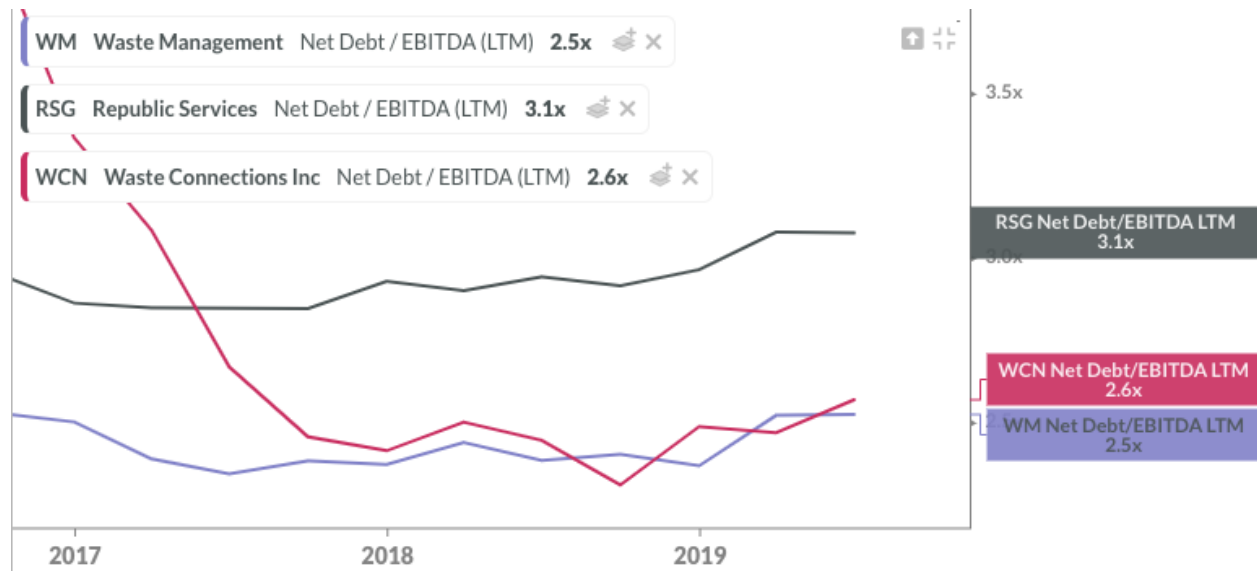
When looking at 3 YR revenue growth rates, WCN is a bit skewed as they experienced growth rates of 100% back in 2016. Since then, the company has consistently been growing revenues over in the high single digits which is above that of WM and RSG.



WM leads the pack in levered free cash flow which is why they are able to command the number one spot amongst their peers.



From a net debt to EBITDA look, WM is actually going to see a rise to about 2.8x-3.0x after the acquisition which is set to close in Q1 2020. This puts them toward the top with RSG.



Overall, these stocks deserve a premium valuation given how “recession proof” they are and it also helps that analysts predict the global waste management market size to grow from \$330.6B in 2017 to \$530.0B by 2025, growing at a CAGR of 6.0% from 2018 to 2025.

As countries move towards greener and cleaner initiatives, companies like WM will continue to thrive and grow. Seeing them generate such strong free cash flow and deploy it ways to optimize shareholder value is a great sight. The company could easily pump up their dividend payout ratio and return value that way but they see opportunities in the marketplace and that is why they use their free cash flow to also buyback stock but more importantly acquire companies. We believe there is still a huge market to tap into and as WM matures, they can increase their dividend without hesitation to retain and command a strong stock price.

As the global economy looks to be slowing down a bit, WM serves as a solid way to de-risk and diversify a portfolio as we've seen from how they performed during the 2008 financial crisis. We admit, WM's business is pretty boring if we're being blunt but the reason it garners such a P/E is because of how unappealing the fixed income market is and how appealing the free cash flow, dividend growth, and stability of revenues are at WM. These factors must be taken into consideration when looking at the fundamentals.

Let us now turn to the charts.

Technical Analysis



WM is at a crucial point right now. The stock is currently resting in-between the 50DMA of \$116.51 and 100DMA of \$115.36. This is a major crossroad for the stock. It is also sitting slightly below its pivot point of \$115.96. Earlier in September the stock cratered below its 50DMA and for a short while also fell below the 100DMA before recovering. Based on the MFI, RSI, and W%R, the stock is neither overbought nor oversold on the daily. This is a very tough chart to analyze so I also pulled up an hourly chart.



On the MFI, WM is oversold and the stock is holding the trend line. The stock literally needs to hold this exact spot otherwise the rebound uptrend is broken. If the stock is able to hold this level it will most likely continue its way back up the \$118-119 mark where it has seen some resistance in the past.

Short-term, you want to make sure it holds this exact level. If it is unable to, CUBE thinks it makes its way to the \$110 R1 support line and find support there. If \$115.50 is held, it should continue to crawl up the trend line.

As of right now, based on not just the charts but also the historical fundamental valuation metrics like that of a P/E, EV/Sales, and EV/EBITDA it does look like a small correction is warranted. Put simply, CUBE anticipates a short-term pullback but still feels WM is a great security for a diversified portfolio.