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WM - Q4 2017 Waste Management Inc Earnings Call

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OVERVIEW:

Co. reported 4Q17 revenues of $3.65b. Expects 2018 EPS to be $3.97-4.05.

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PRESENTATION

Operator

Good morning. My name is Theresa, and I will be your conference operator today. At this time, I would like to welcome everyone to the Waste Management Fourth Quarter and Full Year 2017 Financial Release Conference Call. (Operator Instructions)

I would now like to turn the call over to Ed Egl, Senior Director of Investor Relations. Thank you. Mr. Egl, you may begin your conference, sir.

Edward A. Egl - *Waste Management, Inc. - Director of IR*

Thank you, Theresa. Good morning, everyone, and thank you for joining us for our fourth quarter 2017 earnings call. With me this morning are Jim Fish, President and Chief Executive Officer; Jim Trevathan, Executive Vice President and Chief Operating Officer; and Devina Rankin, Senior Vice President and Chief Financial Officer. You will hear prepared comments from each of them today. Jim Fish will cover high-level financials and provide a strategic update. Jim Trevathan will cover price and volume details and provide an operating overview and related 2018 guidance, and Devina will cover the details of the financials, including additional guidance for 2018.

Before we get started, please note that we have filed a Form 8-K this morning that includes the earnings press release and is available on our website at www.wm.com. The Form 8-K, the press release and the schedules to the press release include important information.

During the call, you will hear forward-looking statements, which are based on current expectations, projections or opinions about future periods. Such statements are subject to risks and uncertainties that could cause actual results to differ materially. Some of these risks and uncertainties are discussed in today's press release and in our filings with the SEC, including our most recent Form 10-K.

Jim and Jim will discuss our results in the areas of yield and volume, which, unless otherwise stated, are more specifically references to internal revenue growth, or IRG, from yield or volume. All volume results discussed are on a workday-adjusted basis. During the call, Jim, Jim and Devina will discuss our earnings per diluted share, which they may refer to as EPS or earnings per share, and they also address operating EBITDA and operating EBITDA margin as defined in Footnote B to the earnings press release. Any comparisons, unless otherwise stated, will be with the fourth quarter of 2016. Net income, EPS, income from operations and operating EBITDA for the fourth quarter of 2017 and full year 2017 and 2016 have been adjusted to enhance comparability by excluding certain items that management believes do not reflect our fundamental business performance or results of operations. These adjusted measures, in addition to free cash flow, are non-GAAP measures. Please refer to the earnings press release footnote and schedules, which can be found on the company's website at www.wm.com, for reconciliations to the most comparable GAAP measures and additional information about our use of non-GAAP measures.

This call is being recorded and will be available 24 hours a day beginning approximately 1 p.m. Eastern Time today until 5 p.m. Eastern Time on March 1. To hear a replay of the call over the Internet, access the Waste Management website at www.wm.com. To hear a telephonic replay of the call, dial (855) 859-2056 and enter reservation code 8488065. Time-sensitive information provided during today's call, which is occurring on February 15, 2018, may no longer be accurate at the time of the replay. Any redistribution, retransmission or rebroadcast of this call in any form without the express written consent of Waste Management is prohibited.

Now I'll turn the call over to Waste Management's President and CEO, Jim Fish.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Thanks, Ed, and thank you all for joining us this morning. 2017 was arguably the best year we've seen as we exceeded expectations on all of our operational and financial metrics. About 1 year ago, I mentioned that each of our operating income, operating EBITDA and net cash provided by operating activities were at all-time highs. I'm very pleased to say that in 2017, we exceeded those highs and set new records in each of those metrics. Our continued focus on improving core price, adding profitable volume in a disciplined manner and controlling costs produced $3.22 of EPS, another year of double-digit improvement, with EPS improving more than 10%. In addition, operating income margin and operating EBITDA margin both achieved all-time highs. Our operating EBITDA exceeded $4 billion for the first time, and we achieved free cash flow conversion close to 45%. During 2017, we generated strong free cash flow that allowed us to return $1.5 billion to shareholders in dividends and share repurchases. We continued to see solid growth in the cash-generation capability of our business. The success that we achieved in 2017 sets the foundation for continued growth into 2018 and beyond. For the full year, our strong growth in EPS, operating EBITDA and free cash flow was driven by solid growth in revenue. Revenues increased $876 million or 6.4%. This is the best revenue dollar increase that we've seen since 1998, and more importantly, the majority of the increase is organic price and volume. For the full year, our collection and disposal core price was 4.8% with yield of 2%. In 2017, total company volume for the year was 2.3%, marking the first time in this cycle that we've exceeded 2% volume for the full year. In 2017, we continued to focus on improving price and growing high-margin volumes, all while delivering exceptional customer service. Our strong results reinforce our conviction that these are the right areas to focus on, and we look forward to continued progress into 2018. For 2018, we expect EPS to be between $3.97 and $4.05 and free cash flow to be between $1.95 billion and $2.05 billion.

Before turning the call over to Jim and Devina, I want to point out our recent 8-K filing for those of you who may not have seen it. Jim Trevathan, our Executive Vice President and Chief Operating Officer; and Jeff Harris, our Senior Vice President of our Northern Tier Operations, both announced their plans to retire at the end of this year. Both Jim and Jeff have made tremendous contributions to the success of Waste Management throughout their distinguished careers, and we have an excellent succession planning process which has produced a very solid group of internal succession candidates. The strength of that group was demonstrated by our recent promotion of Tara Hemmer to Senior Vice President of Operations, Safety and Environmental Compliance. As we approach Jim and Jeff's retirement date, we will provide additional details on our succession plans. But suffice it to say, our operations are in excellent leadership hands today and will continue to be in the future.

I will now turn the call over to Jim and Devina to further discuss our fourth quarter results and our 2018 guidance in more detail, and I will conclude with a brief strategic commentary on 2018 and beyond following their comments.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Thanks, Jim, and good morning. In the fourth quarter, our business continued to drive income from operations and operating EBITDA growth. We saw both price and volume in our traditional solid waste business exceed 2% for the third consecutive quarter. As a result, total company income from operations grew $61 million, an increase of almost 10%. And income from operations margin expanded 80 basis points to 18.6% when compared to last year. Our operating EBITDA grew $90 million, an increase of 9.7% when compared to the fourth quarter of 2016. And our operating

EBITDA margin expanded 100 basis points to 27.9% when compared to last year. Revenues in the fourth quarter were $3.65 billion, an increase of $192 million or 5.5% when compared to the fourth quarter of 2016. The growth in revenues was predominantly driven by our collection and disposal business from the combined impact of price and volume of $172 million. Fourth quarter revenues were negatively impacted by lower recycling commodity prices and lower volumes, which drove a $25 million decline in recycling revenues. In the fourth quarter, our collection and disposal core price was 4.8% and yield was 2.2%. On the volume front, total volume was 3.4%, and traditional solid waste volume was up 5%. Volumes in the fourth quarter benefited by about 140 basis points from hurricane cleanup in Texas and Florida and 60 basis points from increased volumes from the new Los Angeles franchise collection and the new New York City disposal contracts.

Looking at other revenue metrics. Service increases exceeded service decreases for the 16th consecutive quarter, and new business continued to exceed lost business for the 11th consecutive quarter. Our churn increased in the recent quarter due to the transitioning of accounts related to the new City of Los Angeles franchise contract, but remember that the contract results in a net gain of customers with this new franchise. Excluding the expected churn from these customers, our churn rate was 9.7% in the fourth quarter, a 30 basis point sequential improvement. For a density-based business like ours, we have historically measured churn based upon the number of customer locations, and we will continue to do so. However, if you look at churn on a revenue basis, it was 7.7%, excluding the churn from the New York City -- I'm sorry, from the City of Los Angeles contract. With strong improvements in our quality of service metrics and our focus on providing customers with a differentiated offering, we expect continued improvement in all these metrics.

Our collection lines of business continued to perform exceptionally well. In the fourth quarter, commercial core price was 6.5%, with volume up 2.5%. Industrial core price was 9.4% with volume up 5.9% in the fourth quarter.

In the residential line of business, core price was 3.2%, while residential volume was down 2.1% in the fourth quarter, similar to the third quarter. The combined price and volume increase in our collection line of business led to income from operations growing $39 million.

In the landfill line of business, total volume increased 18.7%, aided by increased volumes from the hurricane cleanup in Florida and Texas. More specifically, MSW volume grew 12%, C&D volume grew 23.6% and combined special waste and revenue-generating cover volume grew 4.5%. On the MSW front, we saw strong volumes in our base volumes, which were up 10.4%. We continued to benefit from an outage at our Virginia waste-to-energy plant, which added another 160 basis points to our MSW volumes. Our C&D volume increase included the impact of the California wildfire cleanup. Excluding that cleanup, our C&D volume was still a robust 10.7% in the fourth quarter.

Regarding pricing, we achieved core price of 2.5% in the landfill line of business, and MSW yield was 2%. The combined positive price and volume led to total income from operations growing $49 million or more than 16%, and operating EBITDA growing $74 million or more than 18% when compared to the fourth quarter of 2016. We also saw income-from-operations margin in the landfill line increase 110 basis points and operating EBITDA margin increase 230 basis points, including 100 basis points from hurricane cleanup. For the full year 2018, we expect to see the same strong price and volume results that we saw in 2017, with core price projected to be 4% or greater and yield of 2% or greater. In addition, we expect total company volumes to grow in the range of between 2% and 2.2% for the full year in 2018, consistent with the volume results that we achieved in 2017.

Looking at our recycling business. In the fourth quarter, average recycling commodity prices declined 8.1%, and volume declined 2.9% as we saw the impact of China canceling import licenses or delaying the renewal of import licenses to their mills. As we anticipated in October, the decline in price and volume and the cost impact of meeting the new quality control standards impacted EPS by a negative $0.03 in the fourth quarter when compared to the fourth quarter of 2016. When we gave preliminary guidance for the recycling business in October, we expected recycling to have a negative $0.04 per share impact in 2018. Since then, China did not grant any import licenses until the end of December, and those they did grant were fewer in number with lower volumes than expected. The contamination limit that China proposed of 0.5% is now expected to be strictly enforced, which will result in continued increased cost. OCC remains under continued pricing pressure, as we currently see in the first quarter. Based upon these factors, we now expect our recycling operations to have a negative $0.08 to $0.10 per share impact on 2018 EPS, weighted to the first half of 2018.

Moving now to operating expenses. In the fourth quarter, total operating cost increased $116 million when compared with the fourth quarter of 2017. The cost increases were largely due to increased volumes, leading to higher collection, repair and maintenance costs and fuel expenses. Our operating expenses as a percentage of revenue improved 10 basis points, from 62.1% in the fourth quarter of 2016 to 62% in the fourth quarter of 2017. Efficiency gains and other cost-control effort, particularly in the labor and transfer and disposal cost lines, more than offset increased cost at our recycling facilities and the higher fuel expenses of 75 basis points as a percent of revenue. So in summary, our traditional solid waste business improved operating expenses as a percent of revenue by 120 basis points during the quarter, thanks to the strong execution of our field and corporate team.

Finally, on a personal note and as Jim mentioned, I am retiring at the end of 2018. I believe our company is in great hands moving forward. Our senior leaders, corporate and field, are as aligned on our strategy as we have ever been in my tenure with the company. I'm proud to say that we've worked diligently at developing and aligning our field and corporate leadership teams, and I believe we have the best group of field leaders in our history. As you all know, I've had the privilege of working with Jim Fish, both at corporate and in the field, and I know him well. When our board chose Jim as CEO over a year ago, from my perspective as a member of the senior team and as the largest internal shareholder in our company, I was very pleased. Jim and the board asked me to stay for a couple of years after that transition, and I welcomed that opportunity and I appreciated their confidence. Jeff Harris and I have been a part of this business for a long time. He and I both believe that, after we retire, the superb leadership here at corporate and in the field are more than ready to move Waste Management to the next level of success. Along with Jim's extensive experience in the field and in corporate, we have leaders like John Morris and Tara Hemmer with decades of operations experience. And of course, with people like Devina and Chuck, who are here in the room today, and my other colleagues on the senior leadership team, including our corporate department heads, the company is in excellent hands today and in the future. My decision regarding the timing is based solely on 2 beliefs. First, the future leadership is in place and will succeed. Second, after 39 years with the company, it's time to move to spend more time with my wonderful wife of almost 46 years. She deserves it and I desire it. And also, more time with our 10 grandkids. Well, I desire that and I trust they will as well. [Renée] and I have many goals otherwise that we want to accomplish outside of family and our company as we transition to what's next for us. But please remember, as I've reminded members of our WM family, I have 10.5 months remaining to create value for our customers, our people and our shareholders, and I plan to sprint to the finish line.

I'll now turn the call over to Devina to further discuss our financial results and guidance.

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

Thanks, Jim, and good morning, everyone. In 2017, our strong operating results helped us to achieve our financial priority of converting more of each revenue dollar to cash from operations, growing free cash flow and then allocating that cash flow to grow our business and provide value to our shareholders. In the fourth quarter of 2017, we generated $790 million of cash from operations. That's an increase of almost 5% from the prior year period. Full year cash from operations was $3.18 billion in 2017, an increase of over 8% if we adjust 2016 for the $67 million swap termination benefit. Our cash flow from operations as a percentage of revenue grew 40 basis points from the prior year to 22%. But more importantly, we demonstrated that the 360 basis point increase in this metric, when compared to our long-term average, is sustainable. We're going to continue to focus on operating efficiencies, cost control and working capital management efforts to not just maintain but grow this metric in the years ahead.

We generated $342 million of free cash flow in the fourth quarter of 2017. That's a $46 million decline from the fourth quarter of 2016. We again saw strong growth in our operating EBITDA, and so the year-over-year decrease was due entirely to a $151 million increase in our capital spending in the fourth quarter. This increase was planned, allowing us to realize permanent tax benefits from assets placed in service in 2017, but more importantly, to support the business growth that we've been experiencing. For the full year, we generated $1.77 billion of free cash flow, an increase of $60 million from 2016 and above the high end of our revised guidance for the year. The strong and consistent free cash flow we generate supports our focus on returning value to our shareholders through dividends and share repurchases and also growing the business by funding acquisitions.

In the fourth quarter, we paid $184 million in dividends and spent $120 million on tuck-in acquisitions. As Jim mentioned, for the full year, we returned $1.5 billion to our shareholders, growing our dividend for the 14th consecutive year and spending the full $750 million of share repurchase authorization to buy back over 9.7 million shares of our stock. We also spent $200 million on acquisitions, which was at the high end of our plan for the year.

Turning to SG&A. For the fourth quarter of 2017, SG&A was $369 million, a $9 million decrease from the prior year period. As a percent of revenue, SG&A costs were 10.1% for both the fourth quarter of 2017 and the full year. When looking at the full year, this is the best SG&A margin we have seen since 2005 and a 30 basis point improvement from 2016. In 2018, we expect SG&A expenses to be approximately $1.5 billion, and we continue to target SG&A as a percent of revenue of about 10%.

Before turning to our guidance for 2018, I want to spend some time talking about tax reform, which will certainly benefit our earnings and cash flows in future years. It also had about a $530 million net positive impact on our 2017 earnings and balance sheet as we remeasured our deferred tax liabilities and estimated the cost of a onetime deemed repatriation of our accumulated Canadian earnings. We exploited this net benefit of $1.21 per share from our as-adjusted earnings for the fourth quarter and full year. After this adjustment, our recurring effective tax rate for 2017 was about 36%, which was slightly below our expected rate. With tax reform, we expect our recurring effective rate to decline by 10 to 11 percentage points in the year ahead to about 26%, making this a clear benefit to the future earnings and cash flows of our business. The reduction in our effective rate is less than the 14% decrease in the corporate rate due primarily to a decrease in the benefit of the deduction of state taxes, a modest increase in state rates and then the non-deductibility of certain costs. We estimate that the lower rate will reduce our cash taxes by about $275 million from what we would have otherwise expected to pay in 2018. We see corporate tax reform as a positive step for the U.S. economy for the long term and an opportunity to continue to invest in our employees and our operations. The reduction in cash taxes will certainly bolster the company's free cash flow growth immediately, but we will also focus on investing a portion of these tax savings to grow our business in the long run as the economy continues to grow.

So as we think about our guidance for 2018, we project that our operating EBITDA will increase to $4.2 billion to $4.25 billion. This guidance includes the impact of our previously announced plan to pay approximately $65 million in bonuses at the end of 2018 to our hard-working employees who do not get the opportunity to participate in our salary and incentive plan, as well as a $55 million to $65 million headwind we currently expect in our recycling line of business. We expect that this strong operating EBITDA growth will, in turn, drive free cash flow of between $1.95 billion and $2.05 billion. That's an increase of about 10% to 15% compared with 2017. We expect our capital expenditures to increase by $100 million to $200 million in 2018 as we make incremental investments to support business growth and invest in our fleet. This will put us temporarily above our long-term stated range for capital expenditures of 9% to 10% of revenue. But as we demonstrated in 2017, we are making this incremental investment in a disciplined way to provide accretive returns and drive long-term EBITDA and cash flow growth. With this strong growth in free cash flow, we expect to again increase the cash allocated to shareholders in 2018. Our board continues to demonstrate conviction in the cash generation of our business as evidenced by the intended 9.4% increase in our per-share dividend for 2018 and then the authorization to repurchase up to $1.25 billion of our shares. This is the largest increase in our per-share dividend in a decade and a $500 million increase in the share repurchase authorization from the prior year. We remain committed to returning value directly to our shareholders through dividends and share repurchases, but we also see value in complementing our organic growth with tuck-in acquisitions. We continue to have the strongest balance sheet in the industry, finishing 2017 with a debt-to-EBITDA ratio of 2.4, positioning us well to make strategic acquisitions at the right price.

I will now turn the call back over to Jim.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Thanks, Devina. Devina discussed the impact of corporate tax reform on our 2018 cash taxes and the use of a portion of those dollars for the $2,000 bonus to 34,000 of our employees and some incremental capital spending on the fleet in 2018. Long term, however, our strategic focus will include: our people; our technology, including our fleet; recycling for the future; and growth of the business, both organically and through acquisition. In a company where a large percentage of our 42,000 jobs are hourly skilled positions with a manual component to them, our people must be given the lead position in our strategic objectives list for the long term. It's no secret that the millennial generation is not gravitating towards the skilled trade careers the way the Baby Boomers and the Gen Xers did. With that in mind, a big part of our people strategy is designed -- is to design a 21st-century approach to hiring, training, leadership development and retention. An important component of our strategic approach to our people is to encourage our employees to stay and make a full career with Waste Management. Our $2,000 bonus was a first step in that process, and we will continue to analyze the impact of turnover on our operations and our financials to be able to evaluate the merits of a retention program beyond 2018.

On the fleet and technology fronts, we're driving our strategic fleet replacement program more quickly as we standardize the fleet across the company to reduce maintenance and operating costs and improve our service offering to our customers. In addition, our new digital team is hard at work, building a comprehensive digital strategy that includes projects that greatly improve our customers' digital experience. The ultimate outcome of our fleet and our digital strategies is the creation and a combination of top line and bottom line growth through continuous improvement within our fleet operations and differentiation of our overall customer experience through technology.

As a management team, we've been giving much thought to our recycling business in the future. Our customers expect us to provide recycling services to help them meet their sustainability goals, and we believe our management team, our network of recycling plants and our valuable brokerage business distinguish Waste Management from all others. Over the last several years, we've proactively retooled our contracts by removing floor pricing, adding contamination and processing fees and streamlining processing operations. Now with the recent the steps taken by China to strictly enforce its new quality control standards for recycled commodities, which we believe are here to stay, we have an opportunity to build a recycle plant of the future that will provide solid, less volatile returns for our shareholders, meet the quality control requirements of our mill customers and continue to provide a sustainable recycling outlet for our customers. Building that plant of the future will involve, among many things, partnering with our OEMs to innovate on next-generation equipment that can improve processing times, throughput and ultimately produce a higher-quality product. We're currently piloting a fully robotic sort line. Depending upon the outcome of our pilot, our plan would be to move from test to production in the next few years.

And lastly, as part of our strategic growth plan, we will continue to invest in acquisition opportunities that surpass our return criteria and create value for our shareholders. With more companies now meeting our hurdle rate of return due to the lower corporate tax rate, the primary determining factor as to whether we add to our normal annual acquisition guidance of $100 million to $200 million will be the extent to which sellers' expectations may have changed. Rest assured though, what won't change is our financial discipline with those acquisitions.

In summary, 2017 was a very successful year for Waste Management, and we expect that 2018 will be just as successful as we stay focused on our strategy. Our employees are hard at work on executing our 2018 plans, which should position us to continue to grow our earnings and cash flow in 2018 and beyond. We have the best employees in the industry, and I want to thank each member of the Waste Management team for our success.

And with that, Theresa, let's open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Tyler Brown with Raymond James.

Patrick Tyler Brown - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Jim, so really strong on the guide on the volume side, but I think you mentioned L.A. and New York were additive in Q4. But can you talk about how much in the '18 guide both of those contracts will add?

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Yes, Tyler. Jim Trevathan. They will add some volume. They obviously will roll forward, but it's -- I don't know, 10-or-so basis points, in that vicinity, 20. It's not huge. Our base core business is doing very well, Tyler, and we expect that to continue into '18. But they're there, and they're helping. But their -- the New York City, for example, will not be up at full speed until the fourth quarter of 2018 as they continue to move volume from current locations through those MTSs. So that won't hit until late in the year, the full strength of the New York City volume.

Patrick Tyler Brown - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Okay, perfect. And then how much do you expect Fairfax to be a drag as that plant comes back online?

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

I'd say about 10, 20 basis points. We'll get you more firm numbers, but that -- it's in that vicinity.

Patrick Tyler Brown - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Okay, okay. That's okay. And then on the $200 million in tuck-ins, pretty strong this year, really strong number in Q4. But any way you guys could talk about kind of what may be the internal hurdle rates are or maybe EBITDA multiple on the capital that was deployed this year?

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Yes. I mean, we don't know normally talk about our hurdle rate. I mean, I think, though, as I said in my remarks, that we do think that more companies will now hit that hurdle rate because when you think about NOPATs, I mean, the T portion of that has obviously changed. So I think the big question in our mind as we think about our normal kind of $100 million to $200 million, Tyler, is what happens to seller expectations because I think the pool is a bit broader now. We will have more candidates out there that meet our return requirements, and so then the question becomes what happens to sellers' expectations with things like individual income tax reform.

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

But I think you can look -- Tyler, I would just add that I think you look at our return on invested capital as a good indication of how we think of hurdle rates. As we talked about for many years, we intend to invest the capital that we have available to us through our free cash flow in a way that's accretive. And so our return on invested capital growth over the last few years is because we're acquiring business and investing capital in a way that will continue to create growth for the return on invested capital over the years ahead.

Patrick Tyler Brown - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Right. Okay. And then to be clear, though, there's about $100 million to $200 million of M&A assumed in the guide. Is that correct?

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

So we've talked about $100 million to $200 million as our annual target. As Jim mentioned, we're -- we've got the balance sheet. We are well positioned in order to allocate that and then some in the year ahead, but it's going to be largely dependent upon whether we can get transactions done in a disciplined way and whether seller expectations will align with our own view of value in this new environment.

Patrick Tyler Brown - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Okay. And then just my last one. Jim Trevathan, this is a question for you. It's on the transportation side. So there's a lot of talk about rising truckload rates here in '18. I'm just curious if you can talk about how subcontractor hauling contracts really are structured? Do you guys buy on the spot? Do you buy it annually? Or is it usually under some sort of like multiyear contract? Just curious on how some of the subcontractor expenses work.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Yes, Tyler. They're primarily at least annual, in most cases multiple-year contracts when we commit, for example, moving volume from transfer stations into our landfills, so no immediate impact. There may be, in many cases, fuel surcharges like we charge our customers that are impacted as fuel rates change. But overall, it's not a huge impact on a 1-year basis. Over time, if we see the same trend happen, that will occur, but we'll get that price back from our customers as we move. As our cost goes up for transportation, we're going to raise the pricing on disposal.

Operator

And your next question comes from the line of Hamzah Mazari with Macquarie Capital.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

The first question, maybe for Jim Fish. If you could maybe -- actually for Jim and Jim. Maybe if you could just frame for us how much self-help is there in your portfolio? I know you mentioned churn and you can measure that in a few different ways. But how much room is there to improve churn going forward? And then specifically also on working capital. It feels like the industry turns cash a lot faster than you guys. Is there any self-help in the portfolio going forward?

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Yes. Hamzah, I'll start with your churn question. As we've said on almost every one of these calls, we don't see an end to improving churn. It's one of the reasons that, as Jim mentioned, we're looking from a digital standpoint at improving our offering to customers to create more stickiness. It's the reason that we focus so heavily on a quality-of-service metric on the collection lines of business. We see opportunity in churn, whether it's on a revenue basis, as I mentioned, or on a number of customer locations like we've historically measured churn. There's continued opportunity. We haven't put a number to it, and it's not a guidance topic that we're going to give you a guidance number on. But we're going to seek improvement every year in that metric.

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

And then, Hamzah, I would say the same is true on the working capital front. You speak to the cash churn rates for our business as it compares to the rest of the industry, and that's certainly something that we pay attention to. And you'll see in our 2017 results that we made good strides with regard to working capital, and we expect that those strides will continue to bear fruit in the year ahead. It's difficult to predict how quickly we can make changes. As an example, we got an additional 1.5-day extension on our DPO in 2017. It'd be great to see that same result in the year ahead, but it's difficult to say that that's going to be what we target because, as you know, when you focus on continuous improvement, you tend to address the easier parts of change first and the parts that will provide the most value the quickest first. And that's certainly the approach that we've been using. We're going to continue to move the needle, both on our DSO and our DPO, in the year ahead. And that continuous improvement mind-set is something that applies to all parts of our business. So I guess that sums it up with regard to your view of self-help that's in the guidance.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

Sure. And then just on the free cash flow guidance of $1.95 billion to $2.05 billion, how much of the tax reform savings is flowing through into that number on sort of a bottom line basis? Any color there?

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

Sure. So as I mentioned, we expect about $275 million of a reduction on a pre-tax-reform basis versus tax-reform basis. That $275 million is inclusive of both the reduction in the rate, the corporate rate and then also moving from bonus depreciation to full expensing of capital. And so that $275 million is offset then by $50 million to $75 million of an increase that we can expect as our pretax earnings grow. And then when we look at 2017, we did have some tax planning benefits that won't repeat. We talked about pulling forward some of our capital spend into the fourth quarter. We also accomplished a number of other tax planning initiatives in the fourth quarter that provided us some benefit. So all in all, I think you focus on that $275 million and the $50 million to $75 million of increase, and that says what kind of flow through that we would expect in free cash flow in the year ahead.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

Got you. And just on capital allocation. Jim, how are you thinking about M&A? I know there's antitrust issues in the solid waste business. Maybe there are some tuck-ins. Seller expectations are higher, as we heard from one of your peers earlier. What's your priority in terms of M&A as you look at the business on a go-forward basis, whether it's industrial waste or other avenues, energy? I know you want to be investment grade, so that maybe limits sort of the sizing of M&A. But just any color on capital allocation, specifically M&A?

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Yes. Specific to M&A, Hamzah, I think we've said many times on calls that right down the middle of the fairway seems to be working pretty well for us. So solid waste, if I had to kind of order these, I would say solid waste would be first. But there are some tangential businesses that may not be straight down the middle but are very good businesses that we like. Certainly, energy services is a business that's shown some real nice growth, particularly in the latter half of 2017, and we expect that going forward into '18. So that's a business that we like. The haz waste business we like as well, and anything related to the industrial services business because it does appear that the economy is growing and will grow in '18 and '19 in those areas. And then recycling, even though recycling is down, it's a business that we still are committed to. So those are probably the key areas.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

Great. Congratulations, Jim, on your retirement and 10 grandkids.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

I'm still here, Hamzah. No more grandkids.

Operator

And your next question comes from the line of Michael Hoffman with Stifel.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Devina, can we start -- or Devina and Jim, can we start with the CapEx? The incremental $100 million, just to understand that, that's replacing vehicles faster. It's not necessarily adding trucks faster is the way to think about that. Plus growth would be -- you had a really good volume year, so you got some incremental cell development you need to deal with. That's the way to think about that?

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

So I think with regard to the fleet part of the answer, Michael, I would actually revise that to say it is both. So it's replacing some of our existing fleet faster, and it's investing in trucks -- incremental trucks as we see core commercial and industrial collection growth. And then you're right, we've seen accelerated landfill volume increases, and so we'll build out more on the cell development side as well.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. So following on through the route additions, this is being driven by true underlying volume growth. I mean, in my 30 years of covering this, there was a time where a garbage company would add a truck at 45 hours' worth of utilization and hope it grew into 50 hours' worth of utilization. And now my sense is that collection is fundamentally full, and you're starting to find yourself at 55 hours on average. So let's add the 11th truck on a 10-truck route to get back to 50. Is that the way to think about it?

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Yes. Michael, the way I look at it, we grew commercial and industrial volume, as I stated in the script, I mean, at very healthy numbers, yet our routes grew about 1%. So we're -- at a local district level, we'd probably -- we look it your way. But across the company, we're looking at it on a gross metric standpoint and then seeing where the biggest growth opportunity is as we look forward. Now we look very closely at -- each fall, when we do strategic planning with our areas at what MSAs are growing? What's our GDP? And what do we expect from them? And that also affects the truck side of the house.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

And I -- Jim. And Michael, I would say that, that speaks to the success which we've talked about for a couple of years, the success of our service delivery optimization program. I mean, when you're only growing your routes by 1% and you're growing your volume by 2.3%, that tells you that you're doing something right on the efficiency side through John and Jeff Harris.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Yes. We, for example, Michael, own the SDO, our efficiency and -- process that we rolled out several years ago. We've got 98% of our districts that are up, about 98% of our routes are certified, so we're really pushing to continue to get that efficiency. And your overall concept is right, but we may look at it metric-wise a little differently.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay, fair enough. And if I follow through then on the CapEx, is this in '18 running at a higher rate of normalized pace and therefore I can think of your free cash flow as actually having -- there's another $100 million play there to the upside? That's the way to think of -- because the other way to put it -- look at this and I would pursue it further with Devina is, if you finish the year at $1.77 billion but you're going to a midpoint of $2 billion and I got something in the $200 million is tax related, then it doesn't look like there's a lot of operating growth there when, in reality, there is.

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

We've got a great deal of operating growth in the free cash flow line. So I would say, first, with regard to capital and how we think about it over the long term, we've talked for a long time about 9% to 10% being our target capital expenditures as a percentage of revenue. And certainly, our pricing focus and growing our revenue through price is one of the tools that helped for us to maintain that discipline in capital expenditures. But when you look over the long term, in years where volume growth is lower, we didn't just trend toward the bottom of that range, we often broke through and were in the 8% range. So when we're looking at capital expenditures as a percentage of revenue over the long term in the future, if we continue to see the level of volume growth that we saw in 2017 and expect in 2018, you can expect our capital expenditures to be above the high end of that typical range because we're going to be really focused on making sure that we deploy assets in a way to participate in growth. And so we finished 2017 at about 10.5% of revenue. And if you look at 2018 and the plan, it will take us to about 10.7% to 11% of revenue in capital in the year ahead. And so it's too early for us to start to give guidance on 2019 or 2020. But I can tell you that if we see the economy respond the way we expect it to with tax reform and potentially infrastructure spending ahead, then you can see us continue to spend a higher level of capital.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Michael, I would add one thing to what Devina said. And that is that, in my mind, the best indicator of how the business is doing is the single-biggest component of free cash flow, which is EBITDA. And if you look at our EBITDA guidance that we gave, I mean -- and you factor in that we've got $65 million in there that we -- that was for the $2,000 bonus, you've got somewhere between $55 million and $65 million in headwind on recycling and still providing growth of kind of $200 million to $225 million, which is kind of 4.8% to 6%, something like that, in a 2.5% to 3.5% economy, whatever it is, that's pretty darn strong. I think it tells you that the core business is really performing well. We're pleased with the business. We're pleased with the economy that we're handed here. And so that free cash flow number, Devina went through it well, but I think the number -- the underlying number that is most impressive is that EBITDA number.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Fair enough. And to that end, Devina, in 3Q, you reset the baseline free cash flow to $1.6 billion. What's that number look like now post tax reform?

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

So I think at this point, with the higher CapEx we're seeing and somewhat of a position that the American economy is not really used to -- corporate America is not used to, which is lower corporate taxes and what to do with those, I mean, that really honestly, Michael, has been a central question around corporate tax reform is, will companies return it directly to shareholders? Or will they inject it in the economy and see it come out the other side in the form of higher economic growth? I think before we give a number that is a higher baseline -- by the way, it is going to be higher. I mean, just to be clear here. Our free cash flow baseline is going up, but we need the next few months to figure out by how much. And some of that is because the way we handle taxes or these tax reform dollars is a little different than just simply tacking them on to free cash flow.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay, fair enough. In your guidance, the 2% for price, if I look at your summary data sheet, the way you disaggregate it for collection, disposal, recycling, fees and fuel, that 2% would imply about a $290 million growth in dollars. How do I break that up in -- at least what's the recycling headwind of that when I think about that to get to the $290 million on the revenue line?

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

When we look at revenue, you're speaking about our 2018 guidance?

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Yes, yes, yes.

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

So when we look at the expected headwinds from recycling to revenue, we think it's about $100 million in the year ahead.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay, okay. That's very helpful. And then retention, where do you stand at this juncture in your retention within the 20,000 employees that are drivers, mechanics? And what is the opportunity there? And at what pace do you think you can improve it?

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Yes. I mean, we're probably close to 20% when we think about turnover. And -- so what's interesting about that, Michael, is that in our first 2 years, our -- half of our turnover takes place with employees, and I'm really talking about those 2 job groups that you mentioned. But half of that turnover takes place in the first 2 years. So if we can get them to that, whatever the magic is, to that date, if we can get them to year -- the end of year 2, then we hang on to them. They choose to really make a career with Waste Management. That was part of our objective with the $2,000, was, first of all, we buy ourselves a year. And so somebody that is at -- currently at 14 months with the company, now we get them past that 2-year point, to the extent that there's some magic to that. And then we'll also have the next 11 months, 10 months to really analyze and see is there merit to some type of longer-term retention program?

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

And Michael, we've spent a lot of time looking at this issue of driver and technician retention. And the other thing that I'd add, just a little bit of color to Jim's point that was right on target, was that if you look at efficiency or our risk cost or our customer scores from drivers, those longer-tenured drivers just kill it compared to that first year or 2 new driver. So not only do you get the value -- the obvious value from retention, you get it on the true core business side as well that we think will add real value long term as we get that number down as low as we can.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

And by the way, we haven't baked any improvement in that number that I gave you, Michael, into any plan. And we've got some numbers to show that the cash cost of a turnover employee can be as -- in the range of $12,000 to a higher number. I mean, I've seen some numbers that are higher than that, quite a bit higher than that. So -- and none of that's baked in. So to the extent that we actually improve our turnover in 2018 with the $2,000, that ends up being just gravy for us.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Very good. And then on the volume side. Is Fairfax out now in '18, it's out of the number?

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Yes, it's back up.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay, it's back up. And then on deals, I just want to make sure -- I get the $100 million to $200 million. But you're referring to what you're spending, not dollars or revenues. Or is it dollar or revenues? I just want to make sure I was...

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

That's what we're spending, right.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

You're spending, okay. And you're -- so you're staying with the $100 million to $200 million for now, and we'll see what the pace of activity and people's expectation...

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Yes. Look, I mean, that number is kind of a squishy number because last year it was $200 million and the year before was $100 million, but then there's been years where we've -- all of a sudden, a deal has come across the table that looked really good to us and we spent -- Deffenbaugh or -- and we spent $500 million or $450 million or whatever. So that number is kind of a guidance number, but that number can change. And particularly this year, as we think about corporate and individual tax reform, we're giving a number of $100 million to $200 million, but that could very easily change.

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

We didn't build in anything above that $100 million to $200 million in our guidance.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Fair enough. And then lastly, on the recycling. The $0.04 in 3Q goes to $0.08 to $0.10. Some of that has to be taxes, but the rest of it is there's more expense. There was less -- lower price, and I was curious to mix. And then -- and the other is just you were pretty big exporter to China. I'm assuming you have found alternatives, and so you found places for the volume to go. Now we have to wait and see how the market pricing behaves once the Chinese New Year is over.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Yes. I'll share this with Trevathan on the first part. Really, it is -- this is the low -- this is slow time of year for China. So they're not buying a lot of cardboard at this point. So this is the right time of year for them to do it, not a coincidence that they did this with Green Fence a few years ago during the same time of year. And how that kind of plays out for us is that we're seeing -- because of the lower demand, you're seeing prices drop off. So we've seen, I think, Jim, a 24% decrease in price in the fourth quarter. And we're projecting something in that neighborhood, maybe even a little more in Q1, and then starting to normalize in terms of commodity prices in Q2 but particularly in Q3 and Q4. And then the other side is cost. And because of these contamination limits of 0.5%, we are seeing our processing cost go up. And so we're -- that's something that we have some control over, and we're in the process of addressing that going forward.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

And, Michael, to the -- your first part, yes. We have outlets for our materials. We talked about it quite a bit on the last couple of calls. We've spent a lot of time. Our team at corporate, we think, are the best in the industry at finding outlets for materials, and we've done that aggressively. It doesn't affect cost. Cost is still down, but we absolutely have outlets for our materials. But Jim mentioned contamination. I also want to mention, we're looking to reclaim part of that contamination cost over time. We did a lot of work, as we've talked about the last 3 or 4 years, around the business model itself, and contracts are part of that. And we've gotten real value. This is still a really valuable business to our shareholder but to our customers, and we've gotten value out of those contract changes that got rid of floor pricing. Most of them added contamination charges. We -- for third-party volumes, we're charging contamination charges, and it started to get more aggressive in that regard. For the public sector contracts, most of them have the clauses in place. But getting it from those residential customers is a little different task, and we're aggressively ramping up that effort as well to try to reclaim that cost and, again, improve the business model itself so that long term, these kinds of changes are managed properly. But without a doubt, we're getting rid of our materials, have no issues there. But it is affecting price and cost because of the transportation.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

I don't think it's overstating it, Michael, to say we're going to go to battle against contamination here. And I think that's better for us economically. It's also better for the environment. So it's the right thing to do on all fronts, but we are definitely going to go to battle against contamination.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

This is a fascinating -- I realize this isn't the forum to continue that part of the conversation, but it is a fascinating part of the conversation because it means getting back to the municipality and everybody having an honest conversation about how this has been approached from the start, that the point of collection...

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

You're exactly right, and it's about creating a sustainable business model as well as sustainable benefit to the environment.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

We better let Corey talk or he's going to hang up. Corey is next.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

So one last thing. Jim Trevathan, I've known you for most of that 39 years, and I can say that you're leaving this better than you found it, both your business and the community you're serving. It's been a pleasure.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Thank you, Michael.

Operator

And your next question comes from the line of Corey Greendale with First Analyst (sic) [Analysis].

Corey Adam Greendale - *First Analysis Securities Corporation, Research Division - MD*

I love that previewing that I'm next. I can like prepare. Jim Trevathan, congratulations on sprinting into the sunset and hope it's a good final year. So just a couple of questions. So first of all, actually maybe hitting on a couple of things you've been talking about. On the cost side, so as you mentioned, Jim Fish, the EBITDA improvement includes that $65 million in bonuses. Can you just talk a little bit -- I'm looking for more about how you're thinking about this, not like a definitive answer but kind of the philosophy. Why did you decide a onetime bonus was kind of the right thing to do? And how you're thinking about -- like if we're modeling out '19, should we say that, well, that $65 million goes away? Or are you thinking about ways you're going to reinvest, maybe not with another bonus, but other things you're going to do along similar lines for retention purposes?

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Yes, Corey. I mean, look, there was -- there were a couple of objectives, and we've talked about them on the call and in other forums. But beyond just injecting dollars into the economy and giving something, as Devina mentioned, to those employees that don't participate in salary and incentive plans, we've talked a lot today about the fact that we -- that part of the objective was to encourage our folks to make careers at Waste Management. Keep in mind, this is somewhat of kind of uncharted water for us because we haven't -- I would argue that nobody on the call or at this table has been through something where we've seen a big tax reduction like this and how that is best returned to shareholders. I mean, is it best returned to shareholders just through a straight share repurchase? Or is it best returned to shareholders through injecting it back to the economy and then seeing that growth? And so as we thought about what to do with some of those dollars as it relates to our employees, we felt we don't really know the answer. And so a piece of those -- of that objective was to buy ourselves a little bit of time, hence the payout at the end of the year, and help us by doing that in designing programs for the future, potentially, that help us with retention. So I don't know if that answers your question, but that was really our thinking.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Just one more piece of color there. I'd like to stress that, that $2,000 per employee was not in place to combat wage inflation in any sense. We've got a process in place. We work really closely with our HR teams. We look at the demand, the competitive wages by MSA, and we adjust accordingly. We found a few that we think needed change, and then we changed them, and we'll continue to look at that. This has nothing to do with just normal wage inflation. It's to look strategically at our employees and how do we improve that retention issue.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

That's absolutely right. It wasn't crumbs, by the way, either, Corey.

Corey Adam Greendale - *First Analysis Securities Corporation, Research Division - MD*

No. I appreciate that answer. And then on the volume front, and maybe this is another slightly hard question to answer. But Jim Fish, in the past, you've talked about focusing somewhat, I think, disproportionately on opportunities for growth in parts of either the economy or the country that are growing as opposed to looking for volume kind of everywhere. Is that still the case? And part of what I'm looking for is kind of an addressable market opportunity number. Like how much of the country do you put in that bucket now? And how much of the country would you say is not in that kind of growth, so we're not -- so you're not going to go after volumes as much?

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

I think the good news here, Corey, is -- and you're right. That's how we used to talk about it was that, hey, it looks pretty good in Texas, but the rest of the country doesn't look very good; or it looks good in Florida, but not so good in the Northeast. I would tell you right now, as we go through our monthly financial reviews and talk to our area vice presidents, boy, it's hard to find an area that doesn't have some strength. Now there are some areas that are stronger than others. California, for example, is absolutely fantastic for us right now, as is Florida. Texas has been -- excluding the hurricane cleanup, has been a little slower because of the energy business, but that's starting to come back. But even places that historically have been slow for 3 decades, that kind of Rust Belt area, have started to show some real promise in terms of growth, Michigan and Ohio and Pennsylvania. New England's been good for us as well. So I've named just about every area for us. Canada is doing well for us as well. Western Canada is a little bit more like Texas because it's more energy driven, but I would expect that Western Canada will start to pick up just like Texas is. So hard to come up with one that's not doing pretty well right now.

Corey Adam Greendale - *First Analysis Securities Corporation, Research Division - MD*

Great. And just one last quick one. As we're modeling out the quarters of the year, is there anything you'd point out to us as far as like particularly difficult comps or event-driven work, or I don't know if the hurricanes make a big difference, but where you see kind of meaningful changes in volume relative to the full year number as you look quarter-to-quarter?

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

I think the -- really we've talked about this a lot as we prepared for this call, and the only business that gives us pause right now is recycling. We obviously increased the -- from $0.04 to kind of an $0.08 to $0.10, so it's basically a $0.09 number in terms of headwind for 2018. If something unexpected were to happen, if something crazy were to happen in China, if they just simply decided not to buy OCC, which I don't know how they could do that as a huge exporter, but if they decide they're going to stay at the same level of purchase for the remainder of the year that they are today, yes, that would throw a wrench into our operation a bit. But keep in mind that that's still -- on a revenue basis, recycling is still 10% of our -- or less of our overall revenue base. So the only thing that causes me to say, "Okay. This one could be -- this one could impact us," would be recycling. The rest of our guidance, including our traditional solid waste, looks very, very strong right now.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

And, Corey, the only other one is on the landfill side. All that storm debris happened in the second half of the year, so just landfill comps will get more difficult in that regard. But the core MSW shouldn't be affected, should be still strong regardless of the quarter.

Operator

And your next question comes from Noah Kaye with Oppenheimer.

Noah Duke Kaye - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

And just to pick up right there, amplifying Corey's question. It looks like the volume comps were actually stronger in the first half of the year, all in for '17. So I mean, just thinking a little bit more precisely about the cadence of volume for '18, that 2%. I mean, should it be a little bit lower in the first half of the year and gathering strength maybe in the third quarter? Is that right way to think about it?

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

Well, actually, Noah, in 2017, those volume comps, the way they trended, had a lot to do with the anniversary of some national account business. And so that's what you saw impact 2017, particularly in the commercial line of business. So we don't have that same kind of large contracts that we'll be anniversarying in the year ahead. So other than what Jim mentioned with regard to the landfill volumes and the storm debris, there's not anything that would dramatically influence the quarter-by-quarter volume trends in 2018.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

I will say, Noah, what is encouraging to us as we look into '18 is that we're through the month of January, obviously. And when we look at January's volume with slow volume on recycling, we still had a very good month. So we're encouraged with what we saw in the month of January. It's a small sample. It's 1 out of 12. But January looked encouraging.

Noah Duke Kaye - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

Great. And then I think -- just thinking about price, volume, mix. For many years, I think, at least going back 5 years, average yield on collection disposal was always higher than volume. I mean, certainly we're shedding some unwanted or low-margin business strategically. Now in '17, we've seen volume actually outstrip yield, and it looks like they're kind of on par for '18. So can you just comment to how the strategy is playing out? I mean, is this basically the result of many years of kind of leading with price? Because now the way it looks, it looks like it's not necessarily price-led growth.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

I think, Noah, we're -- we have not changed our strategy regarding price at all. We will go get our core price guidance numbers, and we'll execute that. Those processes are in place, and we're pretty good at it at the area level, with corporate leading the way. The volume change, the economy has helped some, obviously. We think we've gotten better. We know we have on the defection side. We've gotten some -- again, the storm debris kind of things that helped that volume-to-price relationship improved the volume side of the house. The outage that we've talked about in Virginia did. Special waste was strong last year, especially in the second half of the year and should move forward. But most of that has come from economic change, from our focus on defection and from our attempt to go put the right resources in the right cities and MSAs to take advantage of the volume that's occurring per GDP, and that's what Jim talked about. So as the opportunity is there, we've gotten better at getting that volume.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

One question, though, that hasn't been asked, which has direct bearing on your question, is CPI. I mean, we typically don't talk about CPI because, for the last few years, it's worked against us, and we've just said we'll get our price numbers irrespective of what CPI does. But CPI does impact about -- we have kind of indexed base pricing on about 35% of our total business, and we've always said that about a 10 basis point increase in CPI equates to $0.01 per share. We've built in some increase, call it, 20 basis points, into our pricing for 2018. But we all saw the CPI numbers that came out yesterday that were higher than most people expected. So there could be some upside there, albeit kind of on a half year basis because we've already taken -- we tend to take our index-type price increases in January and July, with a few of them lingering into October. So on a full year basis, once we get a full year of this CPI, I would expect that there will be some tailwind for us from CPI. And then -- but we won't get the full tailwind in 2018.

Operator

And your next question comes from the line of Jeff Silber with BMO.

Sou Chien - *BMO Capital Markets Equity Research - Associate*

It's Henry Chien calling for Jeff. Thanks for going into the pricing. I was going to ask how much of that is embedded in the core price. But I was just curious to hear thoughts on how sustainable achieving that kind of 4% core price growth and are you seeing any competition in getting the new contracts? And then just trying to understand how much of this kind of seems like above-market pricing growth that you're able to achieve over the next few years.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Henry, I don't see any different competitive landscape than we've had for the last couple of years. This is a very competitive business, and I think it always will be. It has been and will be. Volume, obviously, helps in that from -- that comes from the economy. There are more startups that give all of us a better opportunity to get some volume growth, but our core price strategy isn't going to change for our core collection customers. We're still -- the marketplace allows it. We go get that core price increase, and we will in '18. And I think that the team are set up and ready to do it again in '19 and '20 and on. I just don't see that changing, and I don't see a competitive difference today than 2 or 5 years ago.

Sou Chien - *BMO Capital Markets Equity Research - Associate*

Got it. Okay, great. That's good to hear. And in terms of -- just wanted to switch back to M&A and your acquisition strategy. With growth kind of accelerating all throughout the U.S., do you imagine any shift? Or are you thinking of any shift in the types of acquisitions you're looking at, whether it's expanding your routes or putting more of a focus on that and in the collection business? Or -- I know you mentioned industrial is the kind of potential opportunity, but just curious on your thoughts there.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

The only thing, Henry, that could come to mind that might be a little different, and we certainly haven't identified anything down this path, but would be something technology-related. I think other than that, you won't see us stray too far outside of kind of our norm in terms of M&A.

Operator

And your next question comes from the line of Michael Feniger with Bank of America.

Michael J. Feniger - *BofA Merrill Lynch, Research Division - VP*

I'm just curious, though, like what is your view on the optimal leverage ratio for this company? Clearly, free cash flow is going up. You have a higher baseline of free cash flow. I guess I'm just trying to think what should we be thinking about the leverage at this part of the waste cycle? I mean, surely, we're below that right now.

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

So are you speaking to debt to EBITDA? Is that what you're thinking of with regard to leverage?

Michael J. Feniger - *BofA Merrill Lynch, Research Division - VP*

Yes.

Devina A. Rankin - *Waste Management, Inc. - Senior VP & CFO*

Yes. We're certainly below our long-term averages. We're at the best level, I think, that the company has ever been, certainly in my tenure. And we've talked for a long time about the fact that our goal is a solid investment-grade rating, and so we'll continue to prioritize that when we think about leverage. We don't chase leverage up as our business grows and as EBITDA grows by allocating more cash to things that aren't accretive to the business for the long term. That's our first priority is ensuring that we continue to invest dollars to grow that return on invested capital and grow our business over the long term. So we don't want to make short-term decisions that would affect the leverage. We certainly are comfortable with where we are today, and we're comfortable up to around 3.25x because we think that, that is what is needed to maintain our investment-grade rating.

Michael J. Feniger - *BofA Merrill Lynch, Research Division - VP*

Okay. That's helpful. And just lastly, you guys are clearly investing in the business, investing in your fleet and using tax reform as a benefit. You mentioned how routes are, for you guys, are up 1%. Is there any concern that you're seeing smaller players maybe adding routes or adding trucks ahead of the underlying volume growth? I know you guys are being disciplined. I'm just trying to get a sense of what you're seeing, the tightness of the market and out of the smaller players.

James E. Trevathan - *Waste Management, Inc. - COO and EVP*

Yes. Michael, I haven't seen any change in '17 -- '16 or '17 versus the historical view that -- all of our competitors, whether they're small third parties or the majors. I think, in general, this is a disciplined business that rewards those who act in a disciplined manner. And I think the industry is, for the most part. And there are always one-offs but not that would affect any of us over the long haul.

Michael J. Feniger - *BofA Merrill Lynch, Research Division - VP*

Okay. And just -- if I could just, lastly. I mean, you mentioned recycling is part of core. You're exploring that. That's part of the pillars of what you're looking at with M&A. Just to push you a little bit on that, is that more looking at trying to have more scale? Or is it more looking at a certain technology? And what would you actually be kind of focusing on if -- with M&A when it comes to recycling?

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

You're right. It's -- I answered maybe an earlier question about technology, and that might be a place where we would look at technology. As I mentioned in my prepared remarks, we're already looking at and testing, piloting some technology in the recycling line of business. We're always looking for where there's kind of innovation within our business, so -- but recycling might be an area where we would find some. It would be nice to smooth out the volatility of that business.

Operator

And there are no further questions.

James C. Fish - *Waste Management, Inc. - President, CEO & Director*

Okay. In closing, first and foremost, our sincere thoughts and prayers go out to the community of Parkland, Florida. Look, no one should have to go through what they faced yesterday with such a horrific act. And I would tell you, this has become all too common in today's society. So Parkland, you're in our prayers for sure.

Secondly, and on a far more positive note, I'd like to say a few words about 2 really great friends and great executives, Jeff Harris and Jim Trevathan. Their retirement date is still 11 months away. But at that date, Jim and Jeff will have dedicated 59 years between the 2 of them to Waste Management. And really, a lot of where we are today, the heights that we've achieved of late, are due to those 2 guys, to Jeff Harris and Jim Trevathan. So we'll obviously talk more about them as we get closer to their retirement dates. But over the next 10 months, I plan to try and absorb a lot of the knowledge and wisdom and expertise that they have and that they've developed over those 59 years. And I'm sure that the rest of our senior leadership team will be doing the same thing.

Thanks for your time today, and we'll talk to you next quarter.

Operator

Thank you for participating in today's Waste Management conference call. This call will be available for replay beginning at 1:30 p.m. Eastern Standard Time today through 11:59 p.m. Eastern Standard Time on March 1, 2018. The conference ID number for the replay is 8488065. The number to dial for the replay is (855) 859-2056.

This concludes today's Waste Management conference call. You may now disconnect.
