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Fireside Chat with Waste Management CFO Devina Rankin

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Michael Feniger: Devina, thank you for joining us by the way.

Devina Rankin: Glad to be here.

Michael Feniger: Just to start it off, I think it would be helpful for us to take a step back maybe to understand how Waste Management became the company it is today. So we'll get into the conversation about the waste industry and some of the dynamics at play, but Waste Management has been around for decades, yet it feels like over the last few years it kind of underwent a transformation with you and Jim at the top. Just to put some numbers around that, in 2019 your revenue finished at $15 billion. That's about 10% above where it was 4 or 5 years ago, yet your EBITDA is up 30% and your EPS has nearly doubled. So maybe you can walk through how Waste Management has really outperformed itself through this waste recovery we've seen over the last few years.

Devina Rankin: I really can't think of a better way to start the conversation, because in so many ways, that tells our story for us. And I think there's more room for us to grow. I think while Jim and I would like to say that we've had an impact, and leadership certainly does help us to define accountability and discipline and focus on collaboration and communication and all of those things, I think fundamentally it's the assets that we have the luxury of being given in order to approach the marketplace and the people at Waste Management who are driving this engine. And there's so much more that we can do from here.

I think -- you pointed to the revenue growth being relatively muted when you compare it to the EPS and the EBITDA growth, and I think in so many ways that's how we're growing. So where some of that revenue growth is coming from. And we've talked about landfill pricing and landfill volumes, those being things that really have shown through in terms of topline growth the last several years. And we expect that to continue because our landfills are so well positioned. We talk about population growth and urbanization as trends, we don't see anything that's telling us those trends slow down or revert. So that certainly will be a factor.

This team is committed to continuous improvement. We've talked about continuous improvement and differentiation truly being kind of the 2 things that should be central to how we execute. And if you think about a continuous improvement mindset in a mature industry with assets that are well placed, that means we're just never going to settle, that we've achieved a level of execution that we can't continue to see some growth and opportunity for better leverage.

And then on the differentiation side, I think Waste Management really has fundamentally changed the conversation about sustainability and I think that there's room there as well. I think sustainability for us isn't a new thing or kind of a flavor of the month that's happening because of Larry Fink's letter. It's the way we do business and it has been the way we do business. I've been with the company for 17 years and sustainability is just at the center of what we do and how we execute with the investment in recycling, with investments that we've made in looking for next generation technologies.

I think the piece of the sustainability message for Waste Management that has been underappreciated in years past that we're really focusing on now is people. So we talk a lot at Waste Management about people and planet and the focus on putting our people first is another piece of that sustainability message that really does fuel that earnings growth.

Michael Feniger: That's helpful. You were talking about how the revenue growth maybe looks muted compared to the EBITDA or the EPS growth. What's interesting is I think on the volume side, Waste Management is expecting and guided to 1.5% volume growth in 2020. This is actually above some of your peers. We have some of the peers coming here tomorrow, just a quick shout out, and what's interesting is, with this 1.5% volume growth, Waste Management actually volumes inflected a little late. It was in 2016. And now all of a sudden, your volumes are actually growing faster than your peers. That's kind of weird to see such a big company, the leader by wide margin, actually growing faster than its peers. So maybe you could touch on that dynamic. Is it the geographical mix? Is it some initiatives of focusing in certain areas where you think you can capture more growth?

Devina Rankin: I think there are 3 things. First is that well-placed asset network. So in the landfill part of the business, I think having assets that are close to city centers where waste is created is fundamental. And while our competitors certainly have well placed assets as well, I think there are just some fundamental differences in terms of where some of those assets are. And therefore, the type of growth that is organically being created there. I think we'll continue to see strength because of those well-placed assets.

The second I think is more that differentiation focus that I mentioned, and we're particularly seeing that in the national accounts part of the business. And that's taking hold in a way that it really has changed the conversation on how national accounts business can be viewed. Our national accounts partners are looking for a service provider who is as committed to sustainability as they are. And so with data and reporting that we're able to deliver to our customers, we've actually seen our customers migrate to Waste Management and do so in a way that allows us to price that business more appropriately and see what would have been considered nonstandard price increases in that part of the Waste Management customer profile.

I think the third one really comes down to commercial collection and what we are doing to know our customers better. Not just than our competitors, but better than we did yesterday. So what can we do in the way of using technology that we have on all of our routed vehicles to understand our customer needs and how those customer needs are evolving. And that means that we're seeing service increase opportunities because our customers can (inaudible). And so tomorrow, they might need to be serviced twice a week instead of the one time a week that they've been accustomed to. Or they might have an opportunity to have a larger container. And all of that comes with a different volume model.

So I think those are the types of things that are fueling the volume and none of them necessarily -- I think the leadership position in the industry is the catalyst to the well placed asset network, but I think our commitment to sustainability and knowing our customer is what's fueling everything else and I think that that will be sustainable.

Michael Feniger: Can I piggyback off that? Because investors used to view that national accounts as being a very price competitive type business, that they were very fickle with pricing. Are you sensing though that things have changed in terms of how maybe these customers view your offering and sustainability, that maybe prior cycles they were much more price conscious and now sustainability is much more in the forefront for investors? But even national accounts at corporate, is that changing that dynamic a little bit more?

Devina Rankin: I think it has been a significant change in the dynamic and one that we expect to continue to be important. While large companies, I mean I lead our supply chain organization at Waste Management and I will tell you, I know that the charge to that team is to always look for the low-cost service provider. But it doesn't mean that we compromise on the level of service that we're willing to assess. And so we look for differentiated service offerings in our own supply chain and I know that other large companies are doing the same. And with Waste Management's steps toward providing a level of reporting and visibility on waste streams for our customers, that actually is something that they see real value in. Because they have their own sustainability goals and objectives. And so by being able to deliver something to them that others are not able to deliver, the pricing piece of the discussion is not necessarily going away, but it's becoming secondary.

Michael Feniger: That makes sense. You discussed landfills and your assets there. It's kind of interesting because I've been covering the waste sector for a few years now and landfill pricing has always been the holy grail. It kind of drove investors nuts because it's a scarce asset, very capital intensive, yet pricing was always muted. This changed in 2019. I believe Waste Management reported its highest pricing at the landfill in over a decade. So I guess my question to you is, why was pricing muted before? What kind of changed in 2019? And is that type of pricing sustainable do you feel like in 2020 and going forward?

Devina Rankin: Is it sustainable? Yes. And to comment on the investors' frustration, I would say that those frustrations were shared by a lot of the leaders who get to sit back in judgment from a corporate office and say, why can't we execute here? I think what's fundamentally changed is we're giving tools to our leaders who are boots on the ground with the landfill assets that they manage that they didn't have before. So they have visibility into how the cost of operating our landfills, constructing our landfills have changed, and now our responsibility to keep up with that cost increase, cost inflation. But more importantly, they're given insight into how well positioned our landfill assets are and understanding that our customers have choices. And they certainly have a choice to go to an alternative site, but we have to understand that their decision will be dependent upon things like transportation costs. So if Waste Management's landfill asset is positioned such that the next best alternative requires an incremental X dollars in transportation costs in order to reach that site, we need to take that into account in how we're going to market with the price of that scarce asset that we have in the marketplace.

I think all of that insight is something that creates a level of credence and clarity for local operators that they didn't have in the past. And so we're executing well on giving them the tools that they need in order to sustain their business models in the field.

Michael Feniger: That's helpful. We're hearing, even though landfill pricing is going up, cost of running the landfills has been rising too. Can you help bucket what is driving the cost at the landfill? And is the price/cost dynamic at the landfill at least starting to improve with these increases you're putting in? Or is it just kind of offsetting the higher costs you're observing?

Devina Rankin: I think we have an opportunity for it to keep pace with and hopefully eclipse the higher costs. Right now, it truly is about ensuring that we're keeping pace. I think that the cost increases have been most significant in 2 areas. One is the construction cost. So whether it be the labor costs for the construction processes, or just the extensive infrastructure required as landfills become larger and more complex, and therefore, more complex. So I think you've seen landfill cost per ton from a construction perspective increase effectively kind of that 3% to 5% annually range. A lot of it is based on level dynamics, right, so it can vary across the network.

On the operating cost side, leachate is far and away the factor that has increased our operating costs. Because of the nature of the landfill line of business, we are lucky enough to see that our variable costs are relatively low as a percentage of the total cost of doing business. And I think that continues to provide some strength in terms of ensuring that landfill pricing is providing appropriate leverage to earnings and cash flow. And we'll keep our eye on that, but that cost category is one that's increasing.

Michael Feniger: That's helpful, and I believe landfill and disposal pricing has an impact on the collection side and we're seeing high collection pricing, strong pricing in the collection market. Can you help us understand what is driving that higher pricing? And more importantly, we've always been nervous that if Waste Management prices too high, you'll see the mom & pops, the small haulers out there, coming in to undercut you. It doesn't feel like that's happening right now. Do you foresee that happening? Do you understand why maybe these dynamics are happening where in prior cycles, if Waste Management ever tried to raise a price, you would get a call and the mom & pop would try to undercut it?

Devina Rankin: You know, I really do think differentiated service has been something that's been important. And while I'm really proud of what Waste Management is doing, I do think the large-scale providers have all made a concerted effort to just meaningfully differentiate how we serve our customers on the collection side of business. And I think that's providing a lot of strength in terms of our ability to price. I think the other thing that's interesting here is labor dynamics. I think the last few years you've seen labor dynamics in the space change because of the backdrop of the US economy and the strength of the US economy and the fact that employees have choices. And I know that Waste Management's focus on people first and thinking about what we can do to differentiate ourselves as a great place to work has been important. And we know that we've seen stories, they're anecdotes, but stories of smaller competitors who have a hard time identifying talent in a scarce environment. And so that's a factor. And I think all of that really comes back to, if Waste Management focuses on customer service and employee engagement and providing our employees an employer of choice, I think that those 2 things will allow for differentiated pricing in the marketplace.

Michael Feniger: And you discussed the labor pool right now. I mean I believe -- what is Waste management's turnover right now? Because if I speak to subindustry players, the private guys are seeing turnover 30%, 40%. It's very difficult for them to run day to day operations when you're seeing that level of turnover. So I'm curious to hear what you guys are seeing on the turnover side. And are you seeing the elevated wage pressure, is that starting to abate or is that just kind of steady where it was the last few quarters?

Devina Rankin: We have seen our driver turnover improve over 150 basis points in the last year. And I don't think it's one thing, I think it's a lot of things together. We've talked about it in terms of the investment that we've made in training. And that's important to our employees because it means that we care about them and that we're onboarding them in a way that shows that we want them to be best positioned for success in their job. So we've built 2 training centers and are really making a concerted effort to have all of our drivers go through this training center and learn best practices and executing on their day to day jobs.

I think in terms of the other things that we're doing, I think investing in healthcare is an example. Healthcare, we're all watching TV every day and we know that in the national dialogue, healthcare is always central. And Waste Management has kept our employees' healthcare costs flat for the last 4 years. And that really is setting us apart. So all of that comes together to help us achieve that 150 basis points reduction in turnover in an environment where we see a really healthy labor market for employees. And we think that that helps on our risk management costs, it helps on customer service. But it just helps in the overall culture of Waste Management. And all of these things are working together in order to make the investment really worthwhile.

In terms of labor pressure, we have seen some slight abatement in terms of the level of impact that that was having. I would say it reached a peak in 2018 and we saw a slight decline in 2019. And the level that we expect in 2020 is effectively a continuation of what we saw in 2019.

Michael Feniger: That's helpful. I know we were talking before about the transformation that has kind of played out with Waste Management. This is a big year for you guys. This year, I think around the end of the first quarter hopefully, you'll be closing the acquisition of Advanced Disposal which was the 4th largest nonhazardous waste operator. Can you just help us understand maybe what you can share? What was the logic behind this acquisition? What made you feel ready that the balance sheet of the company was ready to do this acquisition? And why not just continue doing your pace of tuck-ins and buying back your stock. What made this acquisition attractive for you guys at this point in time?

Devina Rankin: The balance sheet I think without question, it was in the best shape of the company's history. So we knew that we had balance sheet strength to do a strategic transaction. And I think there was a lot of dialogue as people saw that strength persist and then maybe get to a point where it didn't feel like it was at a sustainable level. Ask us why and what is this for, and I think there was a level of hesitation about what type of transaction they could see us do. I think that the shareholder response to the Advance Disposal acquisition has shown you that we didn't just think that this was a good transaction, we think that our investors see it as a good transaction as well.

I think in a lot of ways, it was timed exceptionally well because Waste Management, as we started the conversation about being able to take good, solid revenue performance and translate that into a multiple of earnings expansion and cash flow expansion, I really do think speaks to the value creation that we expect to see from this deal. It's about a $1.6 billion per year revenue company and they have quality customers who are looking for continued good service and we think that we can provide that in a way that we do it at Waste Management's margins rather than Advanced Disposal margins. And whether it be SG&A discipline, capital discipline, ensuring efficiency in our driver workdays, which all of those things we've been making investments in. And not just investing in, but seeing real traction and making strides in our ability to convert more of every revenue dollar into earnings and cash flow. That's why this transaction made a lot of sense.

On top of that, I think it was right to look at the cultures of the 2 organizations and say, these 2 cultures make sense together and we're starting from a position of strength. When you look at the Advanced Disposal business, they really seem to focus on 2 things, and that's safety and customer. And when you have a team of people who are thinking about safety and customer every day, that's a great place for us to start from, because those 2 things are important, they're part of the core commitments and values of Waste Management. So we know that we're starting from a place where these 2 organizations are going to mesh well and that's important too.

Michael Feniger: Two things you brought up before the acquisition, how strong your business was and still is, but it was a concern that it felt like it was borderline too strong. Was Waste Management indicating something about the cycle that they were seeing because they were being so conservative? I'm just curious where you feel we are in the overall waste cycle. Waste cycle, the waste industry is always viewed as a later cycle industry. I'm curious to hear, where are we with landfill tons below peak? What are you seeing with service increases and decreasing? Jim brought up a quarter ago that he was seeing some delay with special waste projects, but now feels like the pipeline is filling up again. So I'm curious where you feel like we are in the overall cycle right now.

Devina Rankin: We have a lot of optimism that this strength and momentum is going to continue. And so while I can't speak specifically to where we are in the longest growth cycle that we've seen in our country's history, I would tell you we have a lot of optimism that the fundamentals of the US economy continue to position Waste Management, the waste industry, for strength. We always look at things like population growth, GDP growth, certainly CPI. Although I think you've heard from all of us that we're going to focus less and less on CPI and more and more on ensuring that we're pricing our service appropriately. And that's more indicative of the cost structure of the organization than how we're seeing those changes impact the way we do business.

All of those things point to continued growth for us. We're seeing housing starts, the momentum there. And when you look at landfill tons at Waste Management specifically, our peak I think, I went back and our peak was in 2006, and it was 126 million tons. And we are currently at about 120 million tons. Now, that's actually an apples to oranges comparison, because at the time, we owned Wheelabrator and Wheelabrator had monofill sites. So we have less landfills than we did then in the network. So on an apples to apples basis, I think we've now gotten to peak levels of landfill volumes. For context purposes only, landfill volumes are up about 25% in the last 5 years, which is really incredible. The drivers for those landfill volume increases aren't that we have more landfills, because I just mentioned we have less of them today than we did before, but it's those well positioned assets and it's the growth in consumption that we're all creating. And so I think that the fundamentals that positioned us for that type of growth in the last 5 years are still there, and we would expect that to continue into the next 5 years.

Michael Feniger: We haven't even talked about coronavirus being part of the play. So what I'm curious to hear is, obviously you guys are 100% North America in terms of your direct sales. I'm just curious if the China outlook does severely weaken, that does have a knock-on effect on the US industrial economy. Can you help size up how much of your exposure, because you guys have exposure kind of to the broad-based economy, how much do you feel is exposed to manufacturing, industrial, those type of areas?

Devina Rankin: We talked about it being probably in the 7% to 9% range and we pulled that back to industrial and manufacturing temporary roll-off type businesses and looking at that specific impact. If you then include follow-on impacts of special waste contracts and C&D type contracts or work at the landfill, then there may be some incremental impact as well. But I do think that the type of investment that we've seen, the supply chain risks for coronavirus is the piece that's really a big unknown for us. Not in terms of how we do our business, but in terms of how the rest of the US economy is able to sustain and continue to perform with this backdrop. So for us, I think it's really too early to tell, but I think it's a small enough part of the overall business, there's enough fundamental strength that we think the rest of the business will continue to prevail.

Michael Feniger: Fair enough. Speaking about the rest of the business, we got more than halfway through before talking about recycling. And many in the audience may not realize that the US is right now in a recycling crisis to say the least. Landfills is doing phenomenally well right now with pricing, but recycling is not a lucrative business despite the strength you're seeing and generations wanting to be more sustainable. I mean I think recycling was basically breakeven for you guys last year, which is actually kind of impressive considered that the commodity prices were down 35%, 40%. So maybe can you help us frame how was the recycling industry kind of built in the last few years and what is going on now between you and municipalities to kind of change that discussion around recycling to make it a more sustainable economic model going forward?

Devina Rankin: There's a lot there. So first, I'll start with, while recycling is not performing at peak levels and we're meaningfully off of peak levels, it is still above a breakeven business. So it is a profitable business for us, but it's not something that we see as a kind of mic drop for us. There's still some execution that's needed. And the execution that's needed starts with informing and educating all of us on what is recyclable and what is not. It requires a level of investment in the infrastructure of our recycling facilities. It requires those conversations with municipalities. It also requires that we all do our part to create demand for the recycled content. There has to be demand for the product that we manufacture in our facilities. And so Waste Management is looking to make an impact in all of those parts of the value chain and we think we've made really good process changes in terms of how we will go to market. The conversations we will have with municipalities, we're about halfway through those contracts and the halfway through point is because a lot of those contracts are long term. So as we re-approach municipalities and have the conversations, they're not surprised. They've been hearing from us. They hear things in the media. And so all of the things are holding together to make them make well informed decisions about what the recycling business will cost in order to be sustainable.

I think it's really interesting, I recognize I'm not necessarily the average consumer, but I would tell you that there is very little that I spend money on that I would be willing to spend double in order to have that service maintained. And when we all step back and think about what we have been paying for recycling, some of us may not even know what we've been paying. And municipalities in a lot of ways have viewed it as garbage plus recycling and recycling has been effectively thrown in for free. So doubling zero isn't going to get us there, but making us accountable and responsible for looking at the service that's being provided and the fact that in order to provide that service we have to make the same investment in the driver and the same investment in a truck. Then we are also making investments in state of the art equipment at our recycling facilities. Those investments need to have returns. And if we had to pay double for the waste service that we provide, I don't think any of us would say that that's too much of a cost to bear in order to continue to protect our planet and the natural resources that we are all preserving by doing the right thing and recycling.

Michael Feniger: Well, I think you mentioned the demand aspect which is a challenge, to find demand for these sources of recycled materials. I think there's a stat that 60% to 65% of the recycled materials at your, at some of the MRFs, have zero to no economic value. So some of that --

Devina Rankin: Hard to believe.

Michael Feniger: That's hard to believe. But some of that is outside your control. You do have the MRF of the future. You guys are investing in a new MRF. Can you talk about the things that are inside your control? So what are some of the investments you're making to hopefully lower that cost and processing cost that isn't so dependent on an elevated commodity price to be able to see margins in recycling go back to mid-teens which is where they were a couple of years ago.

Devina Rankin: You know, technology within the facilities is a big piece of that. And the MRF of the future that you mentioned is one investment. We're also piloting some robotics across the network that we think will be another incremental component. Our gross operating expense per ton for recycling has increased at least 10% over the last 2 years. And so when you look at an increase in operating expense per ton, at the same time being compounded by a 40% decline in the commodity value on the backend, that's not a winning equation. And so it's something that we've got to work through.

One of the ways that we can improve our operating expense per ton is by making us all more accountable for contamination. So if you're going to contaminate the stream, you're going to have to pay an incremental cost for that. And hopefully, we actually see improved behavior. That's one of the impacts that we see really take hold. And if it doesn't, the fee structure will kick in and do what it needs to in order to keep us all responsible for the incremental costs that we incur in order to manage that additional contamination.

But the technology should also do its part because the sorting process should be more efficient. When contamination levels are higher, the manufacturing process has to be slowed down. Because you have to allow for more processing of the material. If equipment allows for more of the contamination to be pulled out in a quicker and more easily, repeatable way, then there's value there that can increase the throughput cycle and not have us slow down that manufacturing process to a point where the incremental labor that we're having to incur becomes an additional burden. So all of those things working together really should help us to revert that operating expense trend and get it back to where it needs to be.

Michael Feniger: Can you give us a flavor of contamination rates? You guys have been talking about ugly contamination rates. What are we actually seeing here that is causing such a spike?

Devina Rankin: It's been around 20%. In early days of recycling, it was more like 10%. And aspirational for Waste Management, we would like to see contamination levels get back to 10% over the long term. That's certainly more manageable and brings that zero value/negative value part of the equation down meaningfully.

Michael Feniger: Just bringing it back to the transformation of Waste Management, some of the capital allocation decisions you guys have made, the big one we just discussed, Advanced Disposal, which made a lot of sense in your wheelhouse. What's kind of interesting is, last year I believe it was, you did Petro Waste which was much smaller, but I think it was in the energy space. So are there other areas of environmental services that Waste Management is starting to explore where they see some adjacencies and some growth opportunities with this movement of sustainability?

Devina Rankin: On the energy and environmental services side, I think it's good to put that into context. In spite of that acquisition, it's still about 1% of the company's total revenue. So it does put it into perspective. I think when you talk about where our top line growth is going to come from, I continue to see us executing well in that core collection and disposal business and that really being the fuel of long-term revenue growth.

In terms of adjacencies, we do look at them. And we actually have a very disciplined process to say, how does this fit? We look for extensions that are based on what we do well and where we are positioned. So those 2 things really together need to be a part of the equation. So what we do well, we're a great transportation company, so therefore a logistics company in a lot of ways. We also are really fundamentally committed to environmental sustainability. And so if we think about those 2 core competencies, what does that mean about the service offerings that we can provide that aren't part of the core Waste Management portfolio today? There are other places. There's not anything specifically in the pipeline though that we're looking at that we think makes the fundamental shift in kind of the mix of business that you see today.

Michael Feniger: Fair enough. Just wanted to see if there's any questions in the audience. If not, I might just keep going with one or two. I'm curious to know about you guys do a lot about the environment, environmental concerns. PFAS is an emerging concern now. There was a movie out early this year, Dark Waters. We see what's going on with 3M and their PFAS liabilities. I'm just curious how Waste Management is handling this new emerging forever chemical that's potentially in the waste stream -- well, it's in the waste stream, but how you guys are monitoring it at the landfills. And also, you guys have a big engineering team, but a lot of landfills run by municipalities might not have that. So I'm just curious how we see this forever chemical kind of evolving and its impact potentially at the landfill.

Devina Rankin: The evolution is something that we absolutely have our eye on. I think it's very difficult for us to predict the scale of either the risk or the opportunity. And I think what's important for Waste Management and how we're stepping back from the complexity of this issue is thinking about it both as a risk and an opportunity. Because I think that engineering and science-oriented focus on environmental stewardship is something that we know we do well, possibly better than anyone in our space. And as a result, it's something that will continue to be a commitment of ours and something that we will lead and partner on where we see an ability to have impact.

I can't predict, none of us can predict how this will manifest itself in terms of how waste gets managed in the future. What we do is every single day monitor our waste water. Every single day monitor our sites and ensure that we're mindful of the waste that we're taking in and the impact that that's having on the communities that we serve. And we retain that commitment and we'll continue to be steadfast in doing so and then look to be a community partner or a business partner as this evolves and we look to see what the impacts could be to other parts of the economy.

Michael Feniger: That's great. I just saw we're out of time, so I just want to thank Devina and Waste Management for coming today and entertaining my questions. Appreciate it. Thank you.