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WM - Q3 2018 Waste Management Inc Earnings Call

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OVERVIEW:

Co. reported 3Q18 diluted EPS of $1.15. Expects 2018 adjusted EPS to be $4.13-4.15.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Waste Management Third Quarter 2018 Earnings Release Conference Call. (Operator Instructions) And as a reminder, this conference is being recorded. I would now like to introduce your host for today's conference, Mr. Ed Egl, Director of Investor Relations. Sir, you may begin.

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

Thank you, Amanda. Good morning, everyone, and thank you for joining us for our Third Quarter 2018 Earnings Conference 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 Devina will cover the details of the financials. 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 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 stated otherwise, are more specifically references to internal revenue growth or IRG from yield or volume.

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'll also address operating EBITDA, which is income from operations before depreciation and amortization, and operating EBITDA margin. Any comparisons, unless otherwise stated, will be with the third quarter of 2017. Net income, effective tax rate, EPS, operating cost, income from operations and operating EBITDA for both the third quarter of 2018 and 2017 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 notes 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 at 1:00 p.m. Eastern Time today until 5:00 p.m. Eastern Time on November 15. 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 6079618. Time-sensitive information provided during today's call, which is occurring on October 25, 2018, may no longer be accurate at the time of a 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. The recurring theme for the first 2 quarters of 2018 was one of historically strong solid waste, more than overcoming a weak recycling market. In the third quarter, we generated strong operating EBITDA growth, and we expect that growth to continue and accelerate into the fourth quarter and into 2019. We executed very well on our plans to refine our recycling pricing model and pass on the higher cost of contamination to customers, and we saw tangible benefits from the investments we're making in our employees. Our collection and disposal business generated strong organic revenue growth of 6.4% in the quarter. With the exception of last year's fourth quarter, which had significant hurricane-related volumes, this quarter was the strongest core price and volume quarter in our company's history, and our commercial and industrial volumes continue to show steady growth trends, which we view as clear indicators that the overall economy remains on solid footing.

Our operating EBITDA margin was 29% for the third quarter, and our collection and disposal operating margins improved by 40 basis points from the same quarter of prior year. When you combine this with our disciplined cost control on the SG&A line, we delivered solid growth in our income from operations and operating EBITDA, despite $22 million of continued recycling headwinds, about $17 million of unexpected third-party transportation and disposal costs, along with other inflationary cost pressures. We fully expect to pass those cost increases through to our customers, with price increases in late Q4 and early Q1. Our current quarter operating EBITDA growth of 3.4% outpaced our second quarter growth of 3.1%, leaving us confident that we will deliver full year operating EBITDA growth of approximately 5% in 2018.

Overall, in the third quarter, we generated EPS of $1.15. Given the outstanding performance in the solid waste business and a lower-than-anticipated tax rate, we're once again increasing our 2018 adjusted EPS guidance. Our new EPS range is $4.13 to $4.15.

With respect to our full year operating EBITDA guidance, we expect to meet or exceed analysts' current 2018 consensus of $4.204 billion, and we're narrowing our range to $4.2 billion to $4.22 billion. Similarly, we expect to meet or exceed analysts' current 2018 free cash flow consensus of $1.95 billion, as we narrow our free cash flow guidance to $1.95 billion to $2 billion for the year.

In the first quarter, we talked a lot about investing a significant portion of our tax reform proceeds into our people. We know that our people are the key to our success, and that's why we're focused on developing and retaining the best workforce in the industry. We're investing heavily in our employees and identifying future leaders of the company through succession planning and leadership development. In 2018, we will have invested over $135 million of compensation benefits in our employees over and above our ordinary merit increase. That $135 million has come in the form of a $2,000 hourly bonus, which is unique in our industry, market-driven wage adjustments and full absorption by the company of health care increases in 2018. Additionally, we have spent significant dollars in training, equipment and facilities upgrades this year, all aimed at providing our employees a safe and effective work environment, so that they can deliver top-quality service to our customers.

There are a number of benefits to our customers, communities and shareholders from the investments we're making in our employees. One measure we use to assess the effectiveness of these efforts is employee turnover, and I'm proud to say that in the third quarter, we saw this metric improve. This is an impressive result, considering we're in essentially a full employment economy and would normally expect our turnover to increase in such a strong job market.

We also see the value of these investments in our quality of service, efficiency metrics and the overall profitability of our business. There's not a single-solution approach to improving retention and employee satisfaction, but we're committed to making investments in our employees and driving a people-first culture at Waste Management. This focus on investing in our employees will continue into Q4 and 2019 as we further upgrade our fleet, facilities and technology, and as we look to build a world-class people organization.

Lastly, regarding succession planning. As you know, this is Jim Trevathan's final earnings call, and as recently announced, we've promoted John Morris, from our Senior Vice President of the Southern tier operations, to be Jim's successor in the Chief Operating Officer role. John is a long-tenured industry and Waste Management veteran, with significant operating experience, and most of you have met him during investor meetings. I have no doubt he will be successful in this role. With Jeff Harris, our Northern tier -- from our Northern tier also retiring this year, we need to fill the operations Senior Vice President positions for both tiers. We're pleased to announce the promotion of Tara Hemmer to the position of Senior Vice President of Southern tier operations, and Steve Batchelor to Senior Vice President of Northern tier operations. Tara and Steve both have extensive field operations experience and have both also led corporate operational functions. The success that they've demonstrated in their current roles gives us confidence in their ability to drive continued operating improvements in their respective tiers.

Also with Jim's retirement, we're losing an important role within our company as Head of Sales, Marketing and Customer Experience. Through our succession planning process, we've identified Mike Watson to be our Chief Customer Officer. Mike will be responsible for all sales, marketing, pricing and customer experience centers. Mike has both sales and operational experience, and we're excited to have Mike leading the customer organization and continuing to drive exceptional customer service.

In summary, we feel good about our organic revenue growth and the earnings growth the business is generating. In 2018, we expect to deliver approximately 5% growth in our operating EBITDA, in spite of the challenges we're overcoming in recycling, the investments we're making in our people and inflationary cost pressures, particularly in third-party transportation. As a result, we're optimistic when looking out to 2019, as our internal indicators point towards sustained strength in the overall economy.

We'll give our detailed guidance in February, but suffice it to say that our base case for operating EBITDA growth in the year ahead is a repeat of the strong 5% growth we've seen in 2018, with real potential for an acceleration of that growth in 2019. I'm very enthusiastic about the direction of the company. We continue to deliver strong financial and operating performance, and have promoted strong leaders to continue our high standard of operational excellence. With the hard work our employees have demonstrated so far, I'm confident that we can achieve our goals for the remainder of this year and set the stage for an even better 2019. I will now turn the call over one last time to Jim to cover our third quarter operating results in more detail.

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

Thank you, Jim, and good morning. 2018 has been a great year. So in this case, we don't mind sounding like a broken record when we say that our traditional solid waste business is firing on all cylinders. For the sixth quarter in a row, revenue growth from both price and volume exceeded 2%. We continue to see strong organic revenue growth this quarter from the collection and disposal business, driving $200 million of incremental revenue or a 6.4% increase compared to the third quarter of 2017. Jim's earlier statement about the historic significance of this quarter as our company's best-ever core price and volume result in a quarter without storm volume is worth repeating. Our laser focus on customer service is showing up in our results. Churn was 8.9% in the third quarter, a 110 basis point year-over-year improvement. Rollbacks improved 210 basis points year-over-year, and 410 basis points sequentially to 21.1%. Service increases exceeded service decreases for the 19th consecutive quarter, and new business exceeded lost business for the 14th consecutive quarter, reflecting both our continued focus on our customers and the strength of the economy.

Turning to internal revenue growth, our collection and disposal core price was 5.4% in the third quarter, a 70 basis point improvement from last year, and yield was 2.5%, up 50 basis points. Traditional solid waste volumes grew 3.4%, while total company volumes improved 4.4%. The strong growth was driven by our most profitable lines of business: Commercial, industrial and landfill. We also saw transfer station volumes increase 5.4%, primarily due to the New York City disposal contract. Strong volume growth was achieved, despite the additional volumes we received from hurricane cleanup and a competitor outage in the third quarter of 2017. As a reminder, our volume comparisons in the fourth quarter will be tougher due to the significant volume increases we saw from those 2 storms last year.

So let's walk through the results by line of business, beginning with the tremendous growth in collection. Commercial core price was 6.7% for the quarter, with volumes up 3%. Industrial core price was 10.7%, with volumes up 3.3%. In the residential line of business, core price was 3.6%, and volumes increased 0.7%. The combined price and volume increases led to collection income from operations growing $42 million or 6.8%, and operating EBITDA growing $54 million or 7%.

In the landfill line of business, total volumes increased 5.1%. MSW volumes grew 2.2%, C&D volume grew 10.5% and combined special waste and revenue-generating cover volumes grew 7.2%. We achieved core price of 2.9%. And in the third quarter, our landfill line of business grew income from operations by $7 million, and operating EBITDA by $26 million.

In recycling, our field and corporate teams are working together to execute the initiatives we outlined to you earlier this year to improve the business model, including the contamination issues we face. While we're transitioning our contracts as they renew to ensure that we always recover processing cost before paying any rebates, we are currently passing back the cost of excess contamination to customers. In the quarter, we saw a larger year-over-year commodity price decline than we saw in the second quarter. Yet due to our efforts to address contamination, the EPS recycling impact improved $0.03 per share sequentially, even with no improvement in commodity prices, to about a negative $0.04 per share. Year-to-date, the impact is a negative $0.18 per share.

As we expect pricing comparisons to ease in the fourth quarter and continued success on our approach to address contamination, we expect the year-over-year EPS recycling headwind to remain in the negative $0.17 to $0.20 per share range that we laid out last quarter.

Total operating expenses as a percentage of revenue were 62% in the third quarter. Total operating expenses increased $79 million over the third quarter of 2017. The drivers of the $79 million increase were core solid waste volume growth, acquisitions, inflationary cost pressures and investment in our employees. One of the investments we made in our employees, the hourly employee bonus, added about $16 million to our third quarter cost of operations. With pressures on labor, you might expect to see an increase in turnover, but as Jim mentioned, we've actually seen an improvement in turnover. We have also seen a 14% increase in our subcontractor expenses, as our vendors face labor and fuel cost pressures. Generally, we're able to pass all these higher costs in our prices for third-party volumes received at our transfer stations.

While the cost pressures are real and we are managing them, we also are experiencing strong revenue growth to cover higher cost. We're working hard every day to make sure that our pricing programs are outpacing our costs, and with improving technology and process changes, we are improving our collection efficiency. These positive results are reflected in the strong operating EBITDA growth that Jim discussed.

And after 39 years with our company, 19 years on the senior team and 25 quarters helping report our results as Chief Operating Officer, I'm pleased to end on a quarter with such strong results. Waste Management has great assets. Our greatest asset is our people, including our frontline team members, their local and area leadership teams and our corporate departments. We are better aligned on executing our strategy consistently across North America than at any time in my tenure. We have an excellent senior team, and it's been an honor and a privilege to be on this team with leaders who have vision and have proven that they can execute on that vision. And more importantly, they're just excellent people who I call friends. I'm confident that when I retire as an employee at the end of the year, and yet remain a shareholder, Waste Management will continue to be in excellent hands, working hard to create more value for all of us. And I will now turn the call over to Devina, for my last time, to discuss our financial results.

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

Thanks, Jim, and good morning, everyone. Our third quarter operating and financial results were solid, positioning us well to finish 2018 strong and start the new year with momentum for continued growth. As Jim mentioned, we are going into the fourth quarter confident that we will deliver on our 2018 guidance for EPS, operating EBITDA and free cash flow. As has been the case throughout 2018, our third quarter results were driven by strong organic revenue growth in our traditional solid waste business, as well as our focus on controlling costs through operating efficiencies and our efforts to manage discretionary spending and SG&A to respond to other cost pressures. Together, these things positioned us to deliver another quarter of increased cash from operations.

In the third quarter of 2018, cash from operations was $874 million, compared to $853 million in the same period last year. The growth in cash from operations was primarily driven by the strong operating EBITDA performance that Jim discussed. The current quarter growth was less significant than our operating EBITDA would imply, due to some timing differences in cash taxes and other components of our working capital. But we remain focused on improving working capital to provide even better cash flow conversion in the year ahead. When you look at the year-to-date results, the combined benefits of our earnings growth and working capital discipline are clear. Year-to-date, our operating cash flow as a percentage of revenue is an impressive 24%, which is a 200 basis point improvement over full year 2017.

When we think about allocating our cash from operations, a critical piece is capital investment in the core business to support the strong organic growth we are seeing. This quarter, we spent $404 million on capital expenditures, and our year-to-date capital investment is $1.24 billion, keeping us on pace to spend the high end of our full year capital expenditure guidance of $1.6 billion to $1.7 billion.

We are seeing very strong organic growth in our highest-return businesses, and we expect that to continue, so we are making valuable investments in our fleet and landfills to position us well to continue to respond to growth. When we evaluate these investment opportunities, we're applying the same discipline and rigor that has made us the clear industry leader in return on invested capital.

We generated $480 million of free cash flow in the third quarter, bringing our year-to-date free cash flow to $1.52 billion, almost a 7% increase from the same period in 2017, and in line with our long-term growth expectations. We paid about $200 million in dividends and bought back $200 million in shares in the third quarter. So far this year, we've paid $605 million in dividends and repurchased $750 million of our shares.

We also completed another $79 million in core solid waste tuck-in acquisitions this quarter, bringing the year-to-date total to nearly $350 million. Our balanced allocation of free cash flow to shareholder returns and acquisitions in 2018 reflects our commitment to a disciplined and consistent capital allocation plan.

While we do not formally review our long-term cash flow outlook until later in the fourth quarter, we are pleased with the growth that we are seeing in our cash conversion and baseline free cash flow. We are using almost all of the lower taxes from tax reform on employee investments and increased capital expenditures in 2018, and we expect that these investments will continue to be valuable in the years ahead. In spite of a more muted lift in free cash flow from tax reform, we are pleased with the increased profitability and cash flow conversion of the business, and expect that we will continue to provide a healthy increase in shareholder dividends as a result.

Turning now to SG&A. These costs were 9% of revenue in the third quarter, a 60 basis point improvement over last year. On a dollar basis, SG&A decreased $11 million from the same period last year to $345 million. As we've seen upward pressure on our operating cost, we've worked hard to rationalize discretionary SG&A spending. For the first time, we expect to finish the year with SG&A as a percentage of revenue under 10%.

Our effective tax rate for the third quarter of 2018 was 16.6%, and on as-adjusted basis, it was 21.3%. Our adjusted tax rate for the quarter was slightly lower than we expected due to favorable return to accrual adjustments that are typical of our third quarter. We now expect our adjusted full year tax rate to be about 23%.

Turning to our financial metrics. Our debt-to-EBITDA ratio, measured based on our bank covenants, remained at 2.4x at the end of the third quarter. About 17% of our total debt portfolio is at variable rate, and our weighted average cost of debt for the quarter was about 4%.

We're pleased with our results so far in 2018, and I know that as I speak, the Waste Management team is working diligently to deliver a strong finish to the year.

With that, Amanda, let's open the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Corey Greendale of First Analysis.

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

Jim Trevathan, congratulations, way to go out on top. So just a couple questions. In terms of the narrowing of the guidance and taking down the high end, I think you're saying primarily that's because of kind of labor cost pressures that you expect to recover with pricing going into 2019, but can you just elaborate on that?

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

Yes, I mean, look, I think, here's the point, Corey, and I want to make sure this comes across clearly. When we sat in this conference room a year ago and were building our 2018 plan, that plan did not contemplate $135 million that I mentioned. It didn't contemplate a $2,000 bonus that was $70 million, it didn't contemplate the labor cost increases. And it did not contemplate a -- it certainly expected a downturn in recycling, but it was kind of in the $0.10 range, $0.08 to $0.12. It did not expect recycling to be $60 million worse than that. So all of that is kind of about $200 million in EBITDA, and I think that's the point that I really want to make, which is yes, we're down kind of in the lower end of our original range. And so call it $4.210 billion. The original range would have had us at $4.225 billion, right? So call it a $15 million difference between the original range and where we are today. And consider that's -- that we've got an awful lot in there that, that solid waste has overcome. So while we, as Jim said, we sound like a broken record, I think that needs to be reiterated. The solid waste market for the industry, and specifically for WM, and I say specifically for us because we have the $70 million that nobody else has in our cost structure, is incredibly good. It's making up for all of this other stuff that's touching us. We can talk a little bit about inflationary cost or whatever, but I just want to make sure that we understand that yes, we are coming off a little bit from that very original guidance. But when we sat here a year ago, there was a bunch of stuff that did not get baked into that plan that is hitting us today. But most importantly, solid waste is overcoming all of it.

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

Yes, understood. And just trying to understand the moving pieces. So since you're talking about 2019, without giving guidance, I'm assuming it's somewhat fair game, so I know you said you think you're positioned to accelerate bottom line growth in 2019. So 2 questions about that. Have you already thought about what -- and you're probably not going to announce anything now, but what you're going to do as far as like the bonus in 2018, are you going to do something like that in 2019? Or how are you going to address that? And secondly, do you expect that, if you just look at the solid waste business, could bottom line growth, would you expect it would accelerate in 2019?

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

Yes, so a couple things in 2019. First of all, it was, we haven't made a decision on the $2,000 at this point. I wouldn't expect to make this $2,000 a recurring payment over a period of years, but we have not made a specific decision around the $2,000. I do think that when you look at the -- when you look at solid waste and you look at the operating cost piece, that $135 million over and above our annual merit increase, we will look at that bucket and say how much of that are we going to spend? How much do we need to spend to remain competitive in the marketplace from a labor standpoint? Don't know the answer to that yet, and we'll scrub that as we get closer to February, when we actually give guidance. But we think that there's a number of things that look like they may be tailwinds for us. Of course, we've talked a lot about the fact that we think recycling is going to be a tailwind for us, and that tailwind could be kind of somewhere in the $40 million to $50 million range. And that assumes commodity prices hold flat where they are today. I tend to think they're kind of closer to the bottom than they are to the top. So if they show any improvement, then that number could be better, but the $40 million to $50 million basically is the carryover effect of these fees that we've put into place throughout the year. But more of those fees have been hitting us in Q3 and Q4 than in Q1 and Q2 last year. So without saying where we think we're going to come in, because we just haven't scrubbed all those numbers yet, it's why I said in my prepared remarks that I think EBITDA growth can, at least at a baseline, be as good as this year, which is 5%. And there's a real possibility that we could exceed it in 2019.

Operator

And our next question is from the line of Hamzah Mazari of Macquarie.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

The first question is just around the impact, potential impact of a U.S. housing slowdown on your business. I know you're not seeing it right now, but maybe if you could talk about past cycles when housing has slowed, how has your business reacted? And maybe what you're seeing currently as it relates to business, indirectly or directly impacted by U.S. housing potentially continuing to slow?

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

Yes, Hamzah, good question. Look, let me say this about housing. First of all, our business is quite a bit different than it was in 20 -- or in 2008, 2009. We had, 10 years ago, a lot more exposure to the residential housing market. Today, our exposure to the residential housing market we think is kind of in the $150 million to -- $100 million to $150 million per year in revenue range. And so let's say housing -- let's say it dropped off the table and was down by 20%, which by the way, is actually -- it's still growing today. It's just growing at a slowing rate. So this certainly doesn't feel like an '08, '09, but let's say it was. Let's say it dropped off by 20%. Our exposure there, because we're a small participant in the residential housing market, is probably $20 million a year, so it's pretty small. We're much bigger when it comes to construction and demolition in the commercial and industrial sector. And I would tell you from that standpoint, and Jim can probably talk about our volume numbers specifically there, but those 2 segments look increasingly strong for us. So I would tell you that we're not really seeing this kind of -- the big macro number that's getting talked about a lot is housing starts, and we're not really seeing it for, primarily because it's being overcome by bigger pieces of business for us. And secondarily, it's just much, much smaller than it was 10 years ago.

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

Jim, to that point, the commercial business has always been a really good indicator of what's going on in that sector, because as you build out houses in new neighborhoods, you get that commercial growth that surrounds those new neighborhoods. And Hamzah, if you look back, I mean, we were positive in commercial volume through every quarter of '16. Since the first quarter of 2017, it's been over 2.5%, and we're past 3% right now in the commercial line of business. This is our most profitable line of business from a margin view and from a return on invested capital view. This looks like a really strong economy. And I think the commercial line of business is an excellent indicator of that. It's hitting on all cylinders, as we talked about, and it's supported by both our people, our folks are doing an excellent job. We've added volume on the national account front. In the commercial line of business, our inside sales center had their best year. Our area teams have had their best year that I can find on the commercial side. Our operating guys are really focused on service and they have helped us reduce defection. It's a real success story from a commercial standpoint, and I think that connects to your question about housing and just the general economy.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

Very helpful. And just second question, we talked about labor cost pressures, the subcontractor expense, amongst some discretionary labor costs. Do you expect operating leverage on the gross margin line to improve in '19? Is that the takeaway that we should take, because you're going to do essentially be able to pass on some of these labor inflationary costs? So I'm specifically just talking about op leverage on the gross margin line, not EBITDA growth.

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

Yes, and it kind of goes to Corey's earlier question. I mean, if you -- we really have some kind of inflationary pressures in -- but they're limited to kind of 3 cost categories. We talked about labor, which is up 4%-ish and that excludes the $2,000. I mean, repairs and maintenance are up about 4.5% and the third-party transportation is up 9.5%. I mentioned that the third-party transportation, we look to pass that through. There really are 2 anecdotes to inflation. One's pricing, and one's efficiency gains. So we'll use pricing to pass through the third-party transportation increase. It takes us a little while to get to it, so it'll be kind of end of Q4 and into Q1 of next year to offset the 9.5% increase that was pretty unexpected that hit us in Q3 this year. Repairs and maintenance up 4.5%, but that should really start to come down considerably next year because a lot of that is driven by an old fleet. And we have bought more trucks this year than at any year in our history, and a lot of that was back-end loaded. So those back-end loaded fleet purchases in 2018 will start to positively impact repairs and maintenance as we get into 2019. So I wouldn't expect to see the 4.5% in repairs and maintenance going forward. And then the 4%, look, I think it's -- that one is where you use efficiency gains. And 2019, as with 2018, we will spend a lot of time focused on how do we become more efficient. We're looking to roll out a routing optimization software that we think will really help us with operating efficiencies. So we think there's some real opportunity, and it goes a bit to Corey's question about kind of that 5% EBITDA growth next year.

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

And Hamzah, I would just add on that the other 2 things that should provide lift to that gross margin you're speaking of in 2019 are disposal pricing focuses that Jim spoke about last quarter, that we're going to continue to execute upon in the year ahead. And also as we integrate these businesses, and optimize them, that we've acquired in 2018, we expect those to provide some lift for us in 2019.

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

Yes, Jim and Devina, one specific that shows the margin opportunity is that we've all seen the investment in our fleet this year. And if you look at most of -- a big portion of those trucks were in the commercial line of business to support that volume growth. And if you compare September as well as Q3 maintenance cost for that line of business, it was roughly flat with prior year, where maintenance costs for the other 2 lines of business that have had not a significant new truck influx, were what created the operating cost increase. So as we move forward and in Q3 and 4, we're seeing more trucks, of the new trucks on the industrial and residential line, I expect the same maintenance cost margin opportunity, as we get those trucks there routed and servicing customers better.

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

Yes, good point.

Operator

And your next question comes from the line of Noah Kaye of Oppenheimer.

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

There seems to be a very common theme already emerging from some of the questions, really around price and cost, and in your comments as well. And I just want to make sure we're all thinking about this right. You're on track to deliver kind of 2% and 2% yield plus volume, or frankly, well above that in volume this year. But as you look at what you talked about with disposal pricing, getting better pricing to account for rising third-party costs. As we look to next year, are we headed towards something more like a 3% and 1% environment? And what does that imply potentially about your ability to really make these core price increases stick at a higher level?

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

Noah, let me jump in, and I know Jim will have something to add to this, but you heard it a lot, my previous boss talked a lot about 2% and 2%. We've done that now for 6 consecutive quarters. As that retiring employee of the company and a big shareholder, I really like the idea of my current boss talking about 3% and 3%. But 2% and 2% is good as well. So not a forecast, that's an existing executive, but a shareholder, loving 3% and 3%.

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

So here's what I would add to that. Look, I think we're going to finish the year around a yield number of, maybe not for the whole year, but certainly in Q3, Q4, of around 2.5%. And so Devina talked about disposal pricing and getting more aggressive with that. We've talked about taking some cost pass-through price increases for things like third-party transportation. So Jim, I don't think it's unrealistic to expect that we couldn't finish 2019 for the entire year at a 3% yield. You did say 3% and 1% and...

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

I didn't.

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

Well, no, you didn't, but...

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

If I did -- I only said 3%.

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

But Noah said 3% and 1%. So I think you're a little pessimistic on the 1% there. Unless the economy does something different than what our internal indicators are portending, then I would tell you that we're kind of more where Jim Trevathan is, 3% and 3%.

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

Yes, let's not build that into models yet. I would tell you we're still looking at it, but to Jim's point, we are more optimistic than that 1% would imply.

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

I appreciate that. And then, Devina, maybe one for you as well. The improvement in OCF conversion this year, well noted. Obviously, there was some working capital drag in the quarter. Just want to talk about kind of your -- first, any kind of areas of concern within the customers in terms of accounts receivable billed, not being able to get that back? And then kind of more looking at '19, any reason why you can't get, say, another 100 to 200 bps improvement in that conversion rate?

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

So I'll start with the first question with respect to receivables. And I can tell you we did have a drag in the current quarter on the receivable front. But I would attribute that more to business mix and revenue growth. Both things are good for us. On the business mix side, it's the revenue growth that we're seeing in the industrial line of business in particular. Those customers tend to be a little slower pay, and some of the national accounts business as well. So we see pressure on the DSO line, but no pressure on bad debt expense or collectability that causes us any pause, and as a result, the revenue growth side of the equation is really what we focus on there. And it's okay to us that we see a small drag on DSO, because for us, it's the long-term EBITDA growth that we're going to focus on. And I really think that, that leads to your second question, and really circles back to what we talked about already with regard to the leverage that we see in the operating expense line in the year ahead to provide incremental growth in cash flow conversion for 2019. It's difficult to say if we'll get incremental cash flow conversion at the level that we saw in 2018, because a piece of that is tax reform-related, and you have the 1-year lift that will come from tax reform and some of the proactive tax planning that we did at the end of 2017, that left us in an overpaid position at the end of the year and allowed us to capture some of that benefit in 2018.

Operator

And our next question is from the line of Tyler Brown from Raymond James.

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

Devina, back to that point. So can you update us on where cash tax as a percent of the book taxes will end up this year? Obviously, I'm assuming it's less than 100%, again, given some of those tax planning strategies, but how should we think about that maybe in '19 and '20? Will it move up?

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

So in 2018, we think that's going to be around 65%. So we're still scrubbing that number, because as you saw in the current quarter release, we had some tax benefits from return to accrual, and that will impact that relationship. And I haven't quite gotten through that impact yet, because we finalized the tax return so late in the quarter. So I'll get you more color on that as we get it. But with regard to how we think about it looking long term, we expect it to tick up to more like a 75% to 80% ratio on a long-term basis.

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

I think, Tyler, the big question about '19 is with respect to cash from operations and ultimately, free cash flow, I mean, taxes are going to be what they're going to be. I mean, we're managing them a little bit. As Devina said, I mean, we had related tax reform, some prepayment, and then recapture of that. So but the big question is going to be around working capital management, which was asked of her, and then also around CapEx. And I would tell you, and that may be your follow-on question, so I'll go ahead and preempt you. But I think CapEx, when you -- we've talked in years past about it being kind of 10%-ish of overall revenue. And this year is a much bigger number than that, some of it is just, is kind of recovering some of the old fleet and replacing some of that old fleet. But as we think about 2019, 2020 and beyond, it's really a matter of looking at kind of growth capital versus replacement capital. And there was a, as you have heard from Trevathan, there's a fair amount of growth in the system. So we've invested fairly heavily in growth capital this year. But I think scrubbing that CapEx number to come up with a number that's acceptable to us, acceptable to shareholders, is going to be important, an important aspect of our free cash guidance that we give in February.

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

Right. Yes, no, that was definitely what I was looking for. But to wrap it up, so you're on track for, let's call it around $2 billion this year, maybe you're hot on CapEx, maybe you're a little cool on cash taxes, but you -- and you presumably have, I think, a $70 million cash bonus payment. But also, recycling prices are close to a decade low. I know you really haven't talked about baseline free cash flow recently, but does there really -- is there any reason to believe that this $2 billion is not a very good jumping-off point when you kind of think about the next couple years forward?

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

Like Jim said, we'll definitely scrub some of the details, particularly on the capital side of the equation, as we get closer to providing guidance for 2019. I think the most important piece in the baseline free cash flow assumption comes down to EBITDA growth. And the long-term EBITDA growth rate that Jim mentioned of 5% and being confident in that, we're going to peg our expectations for long-term free cash flow growth at that level. And so if we look at 2018 guidance of $1.95 billion to $2 billion, our expectation at this point would be that the EBITDA growth will translate into free cash flow growth.

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

Right, right. And maybe just one quick last one for Jim Trevathan, this kind of goes back to Hamzah's question. But I know you mentioned that industrial volumes were up 3.3%. Can you bifurcate that between temporary and permanent pulls? Do you have that data?

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

Yes, no, I don't have it here, Tyler. I can get -- we can get you something, though. But it was -- I mean, I think it's roughly the same. I don't think you're going to see a wide disparity between that temporary growth and our base business, that those permanent customers. The economy is sound and doing very well and that's where that -- that's where you see the permanent business doing exceptionally well. And we focus more there because we can expect that to continue long term.

Operator

Our next question is from the line of Jeff Silber of BMO Capital Markets.

Jeffrey Marc Silber - *BMO Capital Markets Equity Research - MD & Senior Equity Analyst*

Sorry to circle back to recycling, I know it was an issue in prior quarters and becoming less of an issue now, but can you just give us a little bit more color in terms of how the restructuring of your contracts are going so far?

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

Yes, I would tell you this, there's kind of a question of short-term receptivity of these fees and long-term. Short-term receptivity has, I think, been pretty good. And we've got 2 different types of fees here. So we're talking about a recycled materials offset fee, which is really more driven by commodity prices. And then we have a contamination fee that's really not driven by commodity prices, it's driven by the amount of contamination that comes in the front door, which we've talked about in the past, has increased a fair amount over the last 5 to 10 years. So we're charging both. We're -- as we broke it out, I think last quarter, into phases, and I won't go into that level of detail. But we are -- it's still getting customers onto those fees, so that continues and that will continue into 2019. We really had very few customers on those fees in the first quarter of 2018. A few more in second quarter, and then they really started to ramp up into third quarter and fourth quarter. So that's why we think we have kind of a, assuming commodity prices are flat, a $40 million to $50 million tailwind potentially in 2019. The other side of that is kind of the long-term receptivity, and that one's hard to gauge. I don't know how receptive customers will be over the long term, which means that we have to take a more strategic view of recycling. And what I would tell you is that we're looking to fundamentally change our processing plants, where we're actually looking at building a recycle plant of the future. And that recycle plant of the future, which could open as soon as kind of Q4 of '19, would fundamentally change our processing cost, it would fundamentally change the quality of the recycled product coming out of the back end of the plant. And that's more of the long-term solution in our minds. Doesn't mean, by the way, that we would stop charging fees. It's just we've got to change the way we process materials.

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

Jim, I might add that those first 2 phases that you mentioned that are more temporary are the initial -- they are going very well, every month, every week. Yesterday's report showed an improvement versus the prior week. So we're moving those 2 categories forward much quicker. That third is that long-term residential contract change. And that, although we have some contracts that we've gotten agreement from cities to change in the middle of the contract, most of them are going to go to the end. So every month, every quarter, as they expire, we're changing the fee. That receptivity is different than the first 2, but still positive.

Jeffrey Marc Silber - *BMO Capital Markets Equity Research - MD & Senior Equity Analyst*

Okay, that's helpful. And then just circling back to some of the, I guess, unexpected third-party costs that you had mentioned. Is there anything that you can do different fundamentally in your business to reduce that from happening in future quarters?

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

Look, most of that third-party -- I mean, I would tell you that, that third-party cost increase that hit us in the third quarter was largely from our transportation providers seeing the same type of labor inflation and fuel cost increases, and then also some DOT hour limitations recently imposed. So I think that's what is the cause of that. And so is there a way to mitigate that? I think the best answer to that is through price increase of our customers. I mean, we can always go back, and we do go back to our procurement group and try to make sure that we have fair rates with our providers, and we think we do. So when they pass through their own cost increases, we just have to make sure that we turn around and pass them back through to our customers as well.

Operator

Our next question is from the line of Michael Feniger of Bank of America Merrill Lynch.

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

I'm just trying to square something away. I mean, you're seeing the momentum on your business, you're kind of optimistic. The message is clear. Like how should I square that away with your balance sheet? I think your leverage is just the lowest we've seen in a decade. We're talking about closer to a 3% and 3% type scenario rather than a 3% and 1%. So how should I square that away with kind of where your leverage is now and how you're thinking about that?

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

You're right. Our balance sheet is in the best shape that it's been, not just in a decade, but really, probably in our history. And from our perspective, we are going to focus on long-term return of value to the shareholder in a combination of dividends, share repurchases and then strategic M&A. And what I think the balance sheet tells you is that we believe that we're really well-positioned for future strategic M&A decisions that we could make at a different point in the cycle. I think if you look at where we are, we all talk about the fact that the economy is probably at a peak. And there's definitely some room to go from here. But we've talked about the length of growth in this economy and the expectation that it could turn from here. And we like the fact that we're as well-positioned today as we are to be able to act in a different economic environment, should opportunities present themselves. We have also proactively done tuck-in M&A in this environment. And so when you look at 2018 free cash flow, we expect to allocate more than 100% of free cash flow through a combination of those shareholder returns and M&A in 2018. And so we won't see a tick down in leverage from here, because the health of the balance sheet gives us that strategic flexibility that we think is important from this point forward.

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

That makes -- and just for my follow-up, you guys invested in growth CapEx. The market is strong, I totally get that. I'm just wondering if you can maybe comment on the industry. So we know demand is strong, I'm just trying to gauge the supply side of that. Are you seeing the smaller and medium-sized companies also really reinvesting in their fleet or adding a lot of trucks to their routes as well?

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

I don't know. I mean, obviously, the big integrated guys are, just like we are. I don't know about the smaller guys. I guess I don't follow them closely enough. I can tell you the guy that picks up mine hasn't reinvested in his fleet recently, but so I don't know. It's -- I will tell you one last thing, and then Devina had something. I think a lot of our CapEx in '18, I mentioned fleet, but a lot of it is this transition to CNG and automation. So it's not just replacing older trucks, it's transitioning to natural gas and automation.

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

Yes, the one piece of color on the smaller provider that I think is important is they're going to have a different capital structure than we are and they're going to be very sensitive to the rising interest rate environment. And so that actually should speak well to the larger providers who are going to be able to continue to fund their capital with free cash flow in this rising interest rate climate.

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

And if I could just squeeze one in. When you were talking about the capital allocation, like can you just remind us how you think about, with what you were commenting before about the baseline free cash flow, how do we think about that in terms of your dividend policy?

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

So over the long term, we just look to increase the dividend annually in a way that's consistent with our long-term growth expectations in free cash flow. We're currently at about 45% of free cash flow on the dividend. Because of the nice healthy growth in free cash flow over the last several years, we expect that you'll see another healthy increase in the 2019 dividend in the year ahead. Last year was about 9.5% of an increase on a year-over-year basis. I would expect that we're going to be in a position to consider an increase that's along those same lines, although it's too early for us to say. And we'll be reviewing that more specifically as we review that baseline free cash flow assumption that we talked about.

Operator

Our next question comes from the line of Brian Maguire of Goldman Sachs.

Derrick Laton - *Goldman Sachs Group Inc., Research Division - Associate*

It's Derrick Laton filling in for Brian. If we could circle back to M&A for a second. I appreciate you guys aren't looking to maybe do any large strategic acquisition in, given this point in the cycle, but maybe if you could comment a little bit on your -- the environment for tuck-in acquisitions? You guys, I think you mentioned, already spent about $350 million so far this year on those. Just kind of the pipeline that you have for acquisitions, and then the opportunities as you look ahead to 2019?

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

Yes, so I would tell you that there are still some good companies out there with reasonable expectations, as evidenced by the -- by our increase in M&A in 2018. It also feels a little bit like there's some elevated expectations. I think that was kind of Devina's point, with the economy being hot right now, there are some companies that have pretty elevated expectations. And we have said since the beginning of time, that we're going to be disciplined about how we look at acquisitions from a pre-synergy multiple standpoint, and we're just not interested in paying 13x or whatever for some of these folks. I -- so but to reiterate the first point, there are some good companies out there with very reasonable expectations that are very attractive to us.

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

And I would add to that, if you look at the third quarter, we spent $79 million. And so I think that's a good indication of the fact that we still have a healthy pipeline and we're going to continue to execute deals where we can integrate them well into our existing business and get good operating leverage in the years ahead. The revenue that we've acquired in 2018 is around $215 million. And so while that might get muted on our internal revenue growth pace that you guys look at, because we had some offsets from divestitures, the acquisition piece is healthier from an EBITDA contribution perspective. And we're really optimistic that you'll see a nice lift in 2019 from that M&A activity.

Operator

Our next question is from the line of Michael Hoffman of Stifel.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Jim Trevathan, it's been a pleasure. So Devina, I can't help but ask you about working capital, specifically around payables. You and I have talked about this, 6 days that's in your hand, and I'm curious what it takes to pay your bills slower, to get some help there?

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

Yes, so what I would say is, if you look at our days payable over time, we're really satisfied with the work that we've been doing and that we continue to do to move this metric in the right direction. In 2017, we got a 2-day lift. In 2018, it's been more like a 1/2 a day over the course of the year, so certainly a slowdown, but I would attribute that to the fact that when you implement continuous improvement-type initiatives, you focus on the biggest levers first, and that's what you see in these results. When you look at the benefits that we've gotten so far, it's in the spend categories where we had spend concentrated with few vendors. As we continue to move this initiative forward, it's harder to move the needle, because you're looking at spend in the hands of many, many more vendors, so that takes time to roll out. We, though, are not taking our foot off that pedal. We continue to move it in the right direction. The headwind that we saw in the current quarter really was on the DSO side of the equation. And as you know, DSO has a far greater impact on the dollar impact to cash from operations than the DPO part of the equation does. So when you see that kind of impact to the DSO calc, you end up with a headwind, even though you're making progress on the other side.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Okay, but do you still think if I looked out 3 to 4 years, you're going to get that 6 days up?

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

It's certainly an aspirational goal. I kind of would equate it to the aspirational goal that we have in SG&A, to get SG&A as a percentage of revenue below 10%. And I can tell you we had that goal when I started with the company 16 years ago and we're getting there for the first time this year. So I can't tell you how quickly we'll get those 6 days. When I look at working capital, I do think that there's about $300 million of lifetime enterprise value to free cash flow. But I would remind everyone that when you get that lift, it's a onetime lift. It's not something that you then see in recurring free cash flow going forward.

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

But it's not going to take us 16 years.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Well, yes, and it's -- and you were asked about that baseline. It resets the baseline, and that's where I was really getting, as I think there's more baseline upside than $2 billion. But shifting gears -- go ahead, sorry.

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

So Michael, I would just like to clarify that working capital really can't reset the baseline, because similar to if we went back and looked at 2017, and as I mentioned, we got a 2-day lift in DPO, in the aggregate, working capital benefited us about $100 million last year. We have to get that same kind of lift in 2018 in order to just replicate that in the baseline. And so we actually are behind the curve because we're not getting the same year-over-year lift. And that shows up as a decrease on a year-over-year basis. So it's not lifting the baseline when we get this free cash flow contribution from DPO extensions.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Okay. Maybe we're talking about that philosophically differently, but I'll push that to a different time. Given the commentary, humorous or not, about a 3% and 3%, let's temper it and just say it's still a 2% and 2%, but you don't have a headwind from recycling. In fact, we have to sort of ask where does the process fee show up now as a revenue number? Is it a price issue? You are probably going into next year with a 4% or 5% starting number, if not better, which means 5% in EBITDA is flat margins. And yet I would assume you're expecting to improve margins in '19.

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

Well, yes, and that's why, I mean, look, when I say 5%, that's why we're not giving guidance. We're still in the middle of our planning process for next year. But just more of an indication of our view of the overall economy and our view of our business, less specifically. I would tell you that I think that 2% and 2% is, and assuming the economy stays strong, that 2% and 2% is probably conservative. I think we can do better than 2% and 2%. There is a bear case out there for volumes within the industry. We are much closer to the bull case, and it's not just kind of an aspiration. We look at the bull case, and we look at the impact of tax reform that is still being felt, we look at reduced government regulation beginning to positively impact the special waste market. We look at the construction business continuing to grow. Cranes in just about every city and even housing starts, which I mentioned earlier doesn't have as big an impact for us, but housing starts potentially kind of bottoming. All of that is just kind of a bullish case that would tell you that volumes have more upside than downside in this type of economy. And look, I don't want to be blindly optimistic here, but it sure feels like when I look at some of our advance indicators, that we're closer to the bull case than the bear case, which kind of leads me to believe that 2.5% is more doable than 2%.

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

And I would certainly say that there is an expectation for margin expansion in the year ahead. So the revenue side of the equation, we're very optimistic about. But we also, as we mentioned earlier, have a great deal of optimism on the cost and efficiency side.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Okay. And then to that end, if we stripped away the recycling headwind this quarter and the rev rec headwind, can you, in fact, articulate margin expansion in solid waste?

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

Yes, we had 40 basis points of margin expansion in solid waste in the quarter. And then your comment about rev rec, rev rec and the hourly bonus that Jim mentioned actually offset one another. And so when we look at the recycling line of business, that was a 20 basis point headwind. And so that gets you to the 20 basis points of EBITDA margin that we saw in the quarter.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Okay. And then if you took the things you've done this year in recycling, if you hadn't done them, what would the $0.17 to $0.20 been? Maybe that's another way for us to understand the power of this going into '19.

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

So in the current quarter, we think it was about $0.03 of benefit and you can see that most easily if you look at the first and second quarter impact were a total of $0.15. And in Q4, we only had a $0.04 impact. So if you take...

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

With lower prices, with lower commodity prices.

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

Absolutely. And so that shows you the value of those fee programs that we've put in place. There's more work that we can do on the cost part of the recycling line of business, and Jim mentioned the automation and recycling plan of the future. But we're also optimistic that as we really start to see contamination efforts take hold, we can do a better job of managing the gross operating expense of the plants going forward.

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

And Michael, we've seen about 3% improvement in the operating cost sequentially, as we've tackled this since the Q1 high number. So we're better in Q2 and Q3 sequentially on the operating side. By just without the fee impact, just the operating cost side. So we're making those improvements.

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

I think, Michael, actually, the answer to your question might be that $40 million to $50 million number that I gave you for next year, because the assumption there is that we hold flat on commodity prices. So if we hold flat on commodity prices from this year, that $40 million to $50 million is really the effect of those fees on a year-over-year basis.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

In both revs and EBITDA?

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

Yes, so that's EBITDA. So call it -- yes, let's call it $0.07.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Okay. Okay, that helps. And then you all have talked in the past about $1.5 billion of direct labor cost and you think you could take that down by 10%. Where are we in that in the context of helping manage some of this inflation that's going on?

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

Well, so I think that's an important question, because as we think about 2019, we talked a lot internally about the fact that this 2019, that there's really going to be a focus on operating costs in 2019. John Morris is sitting here at the table, so I'm looking right at him. But I think, seriously, 2019 we have a real opportunity with some of the technology that we're looking to roll out. And the continuation of improving that middle of the route that we've talked about, we've gotten really good at managing the ends of the route, being pre-trip and post-trip. The middle of the route is an area where we think we still have real opportunity. So I think you'll see, specific to labor, improvement in 2019. And then as we think about other things like repairs and maintenance, we talked about that, and how that, of course, has been an operating cost headwind for us this year, and we expect that not only with new trucks, but also with process improvement, we can begin to whittle away at that.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

So 10% is still realistic and maybe you can keep most of it, not all of it, in terms of inflation?

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

Yes, I don't -- it kind of goes to Devina's comment about the working capital. It's -- 10%, I think, is realistic. I'm not sure I can give you a time frame on that.

Operator

And with that, this does conclude our Q&A session for today. I'd like to turn the conference over to Mr. Jim Fish for the closing remarks.

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

Well, thank you, everyone. Lastly today, I'd like to say a few words about Jim Trevathan and Jeff Harris. As Jim said, he's been on the senior leadership team for almost 20 years and has been with Waste Management for almost 40 years. And I've spent every quarter preparing for these calls since I took the CFO role and he took the COO role in 2012. And I have to tell you, there's many times that I've looked across the table in amazement at Jim and how well thought out his answers were, how well articulated his answers were, to difficult questions. Jim has been a confidant, a strategic partner, a voice of reason and most importantly, a friend to me for many years. And now I'll look forward to spending some time with Jim outside of the office at their cabin and steamboats and on a golf course somewhere. Jeff Harris, our Senior Vice President of Northern tier operations, as we said, is also retiring at the end of the year, and has dedicated almost 25 years of his distinguished career to Waste Management. He's been a very important sounding board for me as a senior leader and Jeff's leadership in the Northern tier is going to be a tough act to follow. I think Jeff's probably going to spend some of his retirement making more trips to Columbus to see his Buckeyes, although after last weekend, he might just watch them on TV. But look, I really want to express my sincere thanks to Jim and Jeff for their many years of valuable service to Waste Management and for their invaluable contribution to our continued success. We wish you both the very best in your coming retirements and we expect to see you guys at our Phoenix Open in February.

James E. Trevathan - *Waste Management, Inc. - Executive VP & COO*

On behalf of Jeff and myself, Jim, it's been a pleasure and a privilege. Thank you.

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

Well, thanks very much. We'll sign off with that. Thanks for joining us today. We'll talk to you next quarter.

Operator

Ladies and gentlemen, this conference will be available for replay after 1:00 p.m. Eastern Time today through November 8, 2018, at 11:59 p.m. Eastern Time. You may access the replay system at any time by dialing (855) 859-2056 and entering the access code 6079618. This does conclude your conference call for today. Thank you for your participation in the conference. You may now disconnect. Have a great day.