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PRESENTATION

Operator

Good afternoon. Thank you for standing by. Welcome to the Waste Management, Inc. Second Quarter 2021 Earnings Conference Call. (Operator Instructions) Please be advised today's conference is being recorded. (Operator Instructions) Now I would like to turn the call over to Director of Investor Relations, Ed Egl. Please go ahead, sir.

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

Thank you, Holly. Good morning, everyone, and thank you for joining us for our second quarter 2021 earnings conference call. With me this morning are Jim Fish, President and Chief Executive Officer; John Morris, Executive Vice President and Chief Operating Officer; and Devina Rankin, Executive Vice President and Chief Financial Officer. You'll hear prepared comments from each of them today. Jim will cover high-level financials and provide a strategic update. John will cover 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 of 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. All forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially. Some of these risks and uncertainties are discussed in today's press release and in our filings with the SEC, including our most recent Form 10-K.

John will discuss our results in the areas of yield and volume, which unless otherwise stated, are more specifically references to internal revenue growth or IRG from yield or volume. During the call, Jim, John and Devina will discuss operating EBITDA, which is income from operations before depreciation and amortization. Any comparisons, unless otherwise stated, will be with the second quarter of 2020.

Net income, EPS, operating EBITDA margin and SG&A expense results 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 and tables, 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 and non-GAAP projections.

This call is being recorded and will be available 24 hours a day beginning approximately 1 p.m. Eastern Time today until 5 p.m. Eastern Time on August 11. 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 6965743. Time-sensitive information provided during today's call, which is occurring on July 27, 2021, 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. Last quarter, we were feeling very good about the prospects for the year when we announced our Q1 results and raised our full year guidance. Now more than halfway through the year, all parts of our business have performed well above those revised expectations.

In the second quarter, we achieved operating EBITDA of $1.31 billion, which we converted into strong cash from operations of more than $1 billion. First and foremost, this superb performance is a result of our outstanding core business model. In addition, this performance was driven by our continued focus on providing our customers with exceptional service, offering our employees a great place to work and driving sustainability through our business model. Our very strong results, in addition to our confidence in the transformative changes we're making to our business model, led us to increase our full year guidance once again. The size of our revisions in each of these first 2 quarters clearly demonstrates the earnings-producing potential of our strategy. In the back half of the year, we expect continued strong volume, pricing that offsets inflationary pressures and record results from our commodity-based businesses.

With all of this powerful momentum, we now expect to generate 2021 operating -- adjusted operating EBITDA of at least $5 billion with free cash flow of at least $2.5 billion, all while continuing to make growth investments in our sustainable solutions and technology platforms. At the core of these strong results is our recycling business, which is central to our sustainability and business strategy. Our efforts to improve the recycling business, combined with robust demand for recycled commodities, led to second quarter delivering the recycling business' best ever financial performance by a considerable margin.

We've made substantial progress in derisking our recycling business by shifting to a fee-for-service contract structure, which has lifted the floor for recycled returns and created an economically sustainable business model. We've also made significant technology investments to improve the cost structure and grow the business. At our automated facilities, labor costs were 35% lower in the second quarter compared to our other single-stream MRFs. These investments not only lower operating costs and improve plant efficiency but also allow us to adjust our equipment to respond to evolving end market demands.

For example, we're now segregating out specific plastics that in the past were sold as a bundled lower-priced bale, reacting quickly as markets evolve for new recycled commodity types. The capability to efficiently sort these materials allows us to extract more value for these commodities as demand increases for recycled material. Overall, our investment in recycling technology -- our investments in recycling technology are generating solid returns, and we are accelerating our plans to roll out this new operating model across our MRF network.

Sustainability has been a central part of our strategy for many years, so I want to take some time to highlight how we're advancing our sustainability journey. At the beginning of the month, Tara Hemmer transitioned into her new role as Senior Vice President and Chief Sustainability Officer, bringing together our sustainable solutions and ESG efforts under one umbrella. We believe this strong focus is critical to continuing to integrate environmental sustainability and social responsibility into a strategic business framework.

Our supply chain goals, which include increasing our spending, both with sustainable and diverse suppliers, are examples of how this focus is integrated in our day-to-day operations. Next month, we're hosting a supplier diversity initiative called Share the Green, which will give women-owned businesses the opportunity to become a supplier for 1 or more of the 45 companies participating in the event. This 3-day nationwide event will provide great opportunities for diverse businesses and help participating companies to secure excellent suppliers.

And finally, we continue to make real progress on our digital transformation to differentiate our customers' experience. In the past, I've mentioned our automated setup process that streamlines customers' orders and reduces our cost to serve. Through our advanced technology, we're eliminating nearly all manual steps in setting up a customer account, allowing setup to occur almost instantaneously after an order is processed. This will save us several million dollars annually, improve setup accuracy and increase customer satisfaction.

This more accurate setup of customers also helps us to auto-route these customers, which increases operational efficiency and will optimize routes without manual processing. We are now connecting our advanced technologies to automatically insert 90% of our new commercial customers into existing routes, reducing our cost to serve and improving our speed to service. Our customer and digital teams continue to enhance the capabilities of our digital tools to provide a unique and engaging experience for our customers while, at the same time, connecting this front-end experience to our operational systems to allow for improved efficiency and lower costs. We expect that these investments in technology will continue to benefit us for many years to come.

In conclusion, strong performance across all of our businesses, collection and disposal, recycling and renewable energy generated outstanding results so far this year. Our focus on disciplined pricing and cost management helped to offset the inflationary cost pressures that we've seen. And we expect to continue this focus into the second half of the year to help us deliver on our newly revised outlook. I will now turn the call over to John to discuss our operational results for the quarter.

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Thanks, Jim. Good morning, everyone. We're pleased with the excellent second quarter results we achieved across our business. We produced exceptional EBITDA growth of almost 24% in the collection and disposal business as the economy continues to recover from the pandemic's steepest impacts in the second quarter of 2020. Collection and disposal volume climbed 9.6% in the quarter, which exceeded our expectations. And our focus on disciplined pricing programs produced a substantive second quarter collection and disposal yield of 3%.

Turning more specifically to our volume results. Robust recovery in our highest-margin businesses, commercial, industrial and landfill, drove our very strong performance. In the second quarter, commercial and MSW volume reached pre-pandemic levels, and industrial volumes recovered to levels just shy of those before the pandemic. While we're very pleased with the pace of volume recovery thus far, there remains opportunity for further volume improvement in the second half of the year from key areas of our business, including industrial, special waste and certain geographies such as Canada.

Additionally, pockets of our commercial business, such as education and offices, have yet to fully recover. For the full year, we now expect organic volume in the collection and disposal business to grow 2.5% or more. Pivoting to price, our second quarter results further demonstrate the focus the entire team has on overcoming our cost headwinds as well as improvements following the intentional customer-focused steps we took in the second quarter of 2020. This focus is particularly evident in our residential core price of 5.4%, landfill core price of 4.7% and transfer core price of 3.4%. We continue to be committed to pricing programs that are aligned with our cost structure, which is even more important as we see pressure on labor, transportation, supplies and capital costs. Our new full year outlook for collection and disposal yield is 3.7% or greater.

Our strong revenue growth was also supported by great results in our customer metrics. Churn was 8% in the quarter, and service increases outpaced service decreases by more than twofold. Additionally, we increased our net customer growth rate, driven by optimization of our sales force and investments in technology.

Looking at operating costs. Second quarter operating expenses as a percentage of revenue improved 10 basis points to 61.1%, demonstrating that we are continuing to manage our cost as volumes recover even in the face of inflationary cost pressures. It's no surprise to anyone who follows economic indicators that most businesses are experiencing inflation in their costs throughout 2021, and our business is no exception, particularly with regard to labor. We expect to overcome these pressures by increasing operating efficiencies and executing on our disciplined pricing programs.

There's no silver bullet when it comes to attracting and retaining talent, and we are using a multifaceted approach that includes addressing wages, offering flexible schedules and broadening benefits. Our long-term focus is on keeping our people first so that we are the employer of choice. Overall, inflation trends are something we are watching very closely and managing very proactively with our area, supply chain and revenue management teams.

We continue to make progress on the integration of the Advanced Disposal operations. To date, we've combined around 45% of the ADS operations into our billing and operational systems, which has allowed us to capture synergies and provide additional services to those customers. We are on track to migrate virtually all the ADS customers by the end of the year. Year-to-date, we have achieved more than $30 million of annual run rate synergies, and we expect cost synergies of between $80 million and $85 million in 2021. This will bring the annual run rate synergies to around $100 million at the end of 2021, and we continue to forecast another $50 million to be captured in 2022 and 2023 from a combination of cost and capital savings.

And finally, as Jim mentioned, our recycling team set new highs in the second quarter with record contributions to earnings and margins. We also achieved strong growth in our renewable energy business as we generated and sold more RINs and sold them at higher prices. We've made significant investments in these businesses in recent years, and we're pleased with the strong returns they're generating.

Before I turn the call over to Devina, I want to thank the entire WM team for the remarkable job they have done in managing our operations and providing safe and reliable service to our customers. Our people really are the foundation of our success. And with that, I'll hand off to Devina to discuss our financial results in further detail.

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Thanks, John, and good morning. Our team once again delivered strong performance in the second quarter. Robust volume growth since last year's peak pandemic impact, dynamic pricing efforts, record recycling results, disciplined integration of the ADS business and our continued focus on cost management combined to deliver 28% operating EBITDA growth and 50 basis points of operating EBITDA margin expansion. As Jim mentioned, these outstanding results and our confidence in the continued strength of our business model have led us to raise our 2021 financial guidance yet again.

Full year revenue growth is now expected to be 15.5% to 16%, with organic growth in the collection and disposal business of 5.5% or greater. For adjusted operating EBITDA, we expect to generate between $5 billion and $5.1 billion, an increase of $225 million at the midpoint from the original guidance we provided in February. Our business is exceeding the strong outlook we established at the beginning of the year on a number of fronts. Volume has recovered, particularly in the commercial collection business at a faster rate than we expected. Market values for recycled commodities and RINs have increased. Our integration of the ADS business has generated more synergy value. And certain of our technology investments focused on reducing our cost to serve have delivered more savings than planned.

While the bridge from our initial guidance to the current guidance has a number of puts and takes, the most significant drivers are accelerated price and volume recoveries in the collection and disposal business of about $135 million; improved recycling profitability of another $135 million; renewable energy increases of about $55 million; and additional ADS synergies of around $25 million. These increases are partially offset by elevated cost inflation and incentive compensation costs that we currently estimate to be about $125 million. The increase in adjusted operating EBITDA guidance is expected to translate directly into incremental free cash flow, and we now expect that we will generate between $2.5 billion and $2.6 billion of free cash flow for the year.

Turning to our second quarter results. SG&A was 9.6% of revenue in the second quarter, a 30 basis point improvement over 2020. This result demonstrates our success-making incremental technology investments that will benefit our customer engagement and cost to serve over the long term. At the same time, we're realizing benefits from the integration of ADS and returns on certain of our new technology solutions. We also continue to focus on managing our discretionary spending to optimize our costs.

Second quarter net cash provided by operating activities grew more than 20%. This increase was driven by our extremely strong operating EBITDA growth. There was an unfavorable working capital comparison in the second quarter, but we attribute that to timing differences in tax payments and cash received from CNG credits. We are encouraged to see continued progress on our DSO and DPO measures.

In the second quarter, capital spending was $396 million, bringing capital expenditures in the first half of 2021 to just over $665 million. While capital spending in the first half of the year was expected to be less than prior year due to timing differences in truck delivery schedules, our 2021 pace of capital expenditures has been slower than we planned. The slower pace is due to supply chain and labor constraints impacting some of our vendors, and we've made deliberate decisions to defer spending in some categories as we observe what we expect to be temporary dislocation in certain markets. To offset these delays, we're proactively pulling forward capital investments in areas we can and also where we know the returns will be strong.

As Jim mentioned, we're in the process of accelerating recycling investments as we have strong proof points of technology and equipment upgrades, reducing the cost structure of the business and improving delivered quality of processed materials. We continue to target full year capital spending within our $1.78 billion to $1.88 billion guidance range.

In the first half of 2021, our business generated free cash flow of $1.5 billion, a conversion from operating EBITDA of 61%. This very strong result positions us well to achieve our new higher free cash flow outlook even as we target capital spending increases in the second half of the year. Our capital allocation priorities continue to be a strong balance sheet, prudent investment in the growth of our business and strong and consistent shareholder returns. In the second quarter, we paid $242 million in dividends and allocated $250 million to share repurchases. Our leverage ratio of 2.84x has improved even more quickly than expected due to our strong operating EBITDA growth, and it's tracking well toward our target leverage of 2.7x -- 2.75x by the end of the year. At the same time, our robust cash generation in the first half of the year positions us to increase our full year share repurchase expectation up to our full $1.35 billion authorization. With this increase, we expect our weighted average share count for the full year to be approximately 422 million shares.

Thanks to the hard work of every member of the WM team, we delivered another quarter of strong operational and financial results. The successes of the first half of 2021 position WM to deliver on our commitments to our people, our customers, the communities we serve and our shareholders. With that, Holly, let's open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is going to come from the line of Tyler Brown with Raymond James.

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

Jim, obviously, a great quarter. I know there's been a lot of talk about labor of late. You touched on it in your prepared remarks, but can you just talk about labor availability, how it's impacting the business? Is this more of a cost issue or is it actually precluding revenue opportunities? And then are there any indications that it's easing or is it actually getting worse?

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

We're seeing it easing at this point because we're hiring. And as Devina went through the numbers and John as well, we have had to hire at a higher rate. I think Devina mentioned $125 million as kind of a combination of incentive compensation and higher costs. And so those higher costs, in large part, are due to some of these inflationary pressures that we're seeing on the labor line.

And so if I use June as an example, I think the number is -- we hired 685 mostly drivers and technicians in the month of June. And it wasn't just churning people because we had 125 who left. So the net addition was pretty significant to replace some of these folks that have decided to sit on the sidelines because of the government programs that are out there. I would tell you those government programs are affecting not just us, they're affecting big and small businesses. And right now, at least in the United States, the federal benefits are scheduled to roll off on the sixth of September. It's not a stretch to say that there isn't a business out there that isn't looking forward to the sixth of September.

To your first question about whether it is precluding growth or just creating some difficulties on it with existing customers, I think it's much more of the latter. I don't see it keeping us from growing and that's reflected mostly in our volume figures.

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

Okay, okay. That's very helpful. And then, Devina, do you specifically have what the average commodity value was for Q2? And then where is that commodity value today and basically, what is in the back half guide?

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Yes. So in the second quarter, it was just above $100 per ton on a mix basis. Our second half guide is a little over $117 a ton, bringing the full year outlook to an average of $104. July did see some really nice uptick from June levels. And for context purposes, June was at about $114 a ton. So that gives you an indication that we're on the right track for our outlook for the remainder of the year.

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

And Tyler, real quick. One kind of indication as we think about recycled commodity prices is that we do believe we're on a longer-term bullish trend here, and there's a couple of reasons for that. One is we think there's a permanent shift that's taken place, particularly as you think about OCC but also plastics. Just to give you one other data point here. When we think about OCC pricing and how much room it has to go, we're 17% above historical averages at the end of the second quarter but we're still 40% below all-time highs. So we think there still is room to go.

And as we and other companies are kind of moving forward, this ESG movement is really gaining traction. We think that commodities like plastics will continue to increase in price. So we're encouraged by the pricing trends. And we don't think they're the same kind of ebbs and flows that were short-lived in the past. We think these are longer term.

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

Okay, great. I know it will probably be a long call so I'll turn it over.

Operator

And our next question will come from the line of Jerry Revich with Goldman Sachs.

Jerry David Revich - *Goldman Sachs Group, Inc., Research Division - VP*

Jim, Devina, can you talk about how much CapEx opportunities you have over the next couple of years to deploy towards recycling to landfill gas development? What's the opportunity set because the payback periods look pretty attractive across those investment sets? And so I'm just curious if you could quantify the pipeline for us and maybe provide the context on the opportunity set between the 2.

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Yes. So over the last few years, we had invested about $100 million annually in the recycling line of business and we had plans to continue at that pace. But as we mentioned in our prepared remarks, we're looking to accelerate that pace. And in the back half of the year, we're targeting somewhere upwards of $65 million or more in incremental capital spend in the recycling line of business relative to what our plans were because that is one of the places we see some opportunity to pull things forward both from a return profile and not an area where we've seen a significant impact from supply chain constraints.

In the renewable energy business, I would say it's been a little more peaks and valleys with regard to our investment trend historically. But when we look forward, the pipeline for continued investment is very strong. We have one additional project that will complete in 2021, and we're already looking at somewhere around 5 or more for the years to come. We're still in the process of considering whether or not that's something that we do ourselves or that we look to do in partnership with others because this is a place where not only is there reason for us to consider preserving our capital for high-growth opportunities in the traditional collection and disposal business, but there's also tremendous interest in this type of investment in the space of sustainability and projects like this that are so unique in terms of opportunity can create incremental value. But your point about the returns on them is spot on, really good payback periods on both recycling and renewable energy.

Jerry David Revich - *Goldman Sachs Group, Inc., Research Division - VP*

And in terms of just to shift gears, the collection yield was obviously impressive this quarter and it sounds like that surprised to the upside as well. Can you just talk about what aspects relative to your plan have surprised to the upside? Would it be geographic or what line of business? And do you view the 4%-plus yield in collection as sustainable into the back half of the year when the comps look a little tougher?

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Yes. So I think what's important here is that when we look at our pricing performance in the first half of 2021, it really did impress us to the upside on just about every line of business. John talked a great deal about the residential line of business and our intentional efforts there to improve profitability. But most importantly, I think you saw really strong pricing in industrial and commercial collection and then also the steps that we're taking to continue to drive price in the landfill line of business.

Our outlook for second half because of the year-over-year comp is that we'll have yield in the range of 2.75% to 3% in the back half of the year, and that's just representative of a more normalized pricing range that we had in the second half of 2020 relative to the second quarter of last year when we took those proactive steps that were really focused on customer retention and taking care of our customers in a desperate time of need. So really strong outlook for the second half. I would tell you that I'm optimistic that there could be strength over and above even what our outlook presents currently.

Operator

Our next question will come from the line of Michael Hoffman with Stifel.

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

So if we start with the capital spending, can you get the midpoint spent that's left, which is about $1.2 billion, given the supply disruptions even if you pull forward?

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Our current outlook says we can get there. I'm less optimistic today than I was when we gave our guidance at the end of the first quarter, which is why we came off at the high end of the range that we had previously spoken to. I would tell you, there's no shortage of opportunity for us to invest in the business, and we're going after that opportunity in a very targeted way. And as I mentioned, the recycling line of business, in particular, is a place that we're accelerating.

It's good for us to try and pull some of what we can forward so that we don't create too much of a headwind in 2022 for capital because there are things that we see pushing into that year that we would have expected to spend currently such as landfill airspace capacity where we've seen liner costs and availability be slower than what we would have expected.

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

And just to tease that out a little bit, most of you on the bigger companies locked in slots in pricing in '21. Are they going to honor the price if it gets...

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Sorry. I lost you there, Michael.

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

Yes. Sorry, there was a call waiting. Just beeped into me. The -- you locked in your slots in 2021 for your trucks at a good price. You're not bearing some of that inflation yet? Are they going to honor those prices going into '22 if the supply issues delay deliveries?

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Absolutely, and it's a great point. So on the truck side, in particular, it's all about making sure that we are positioned well for deliveries on a ready schedule. John will give a little more color on that, but we do have strong commitments both for the remainder of 2021 and early into 2022.

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Yes, Michael, I think where we're seeing some pressure is on the container side with steel prices. So some -- we're making some decisions on fixed versus buy there but that would be normal. And to Devina's earlier point, we are seeing stress on the supply chain with some other commodity-based materials. We are pushing some of it out. Think about landfill liner and those kind of things, not going to affect the business, but whether we buy now or push off are decisions we're making with the supply chain team day in and day out.

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

Okay. And then Devina, you're on -- your guidance puts you at a 50% free cash flow conversion rate on the low end at $5 billion at $2.5 billion. Is that a new baseline, 50%? Is that the way to think about the business going into the next year and beyond?

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

So I think the baseline conversation is one we really want to more fully discuss as we get later into the year. But we're really excited about the baseline that we've established. We're making progress on the working capital front, and we've certainly also made progress in terms of the investments that we're making in capital expenditures paying strong returns.

The place I would give a little bit of caution with respect to that being the right number is the recycling and renewable energy business is providing a lift from a flow-through perspective, and you're not having to make an incremental capital investment to get that dollar. We did have a low bonus payment in 2021 as a result of the poor performance in 2020, and that will have an opposite impact in the year ahead.

And then there's also some uncertainty in what corporate taxes look like in 2022. But I will tell you that the returns that we're seeing on our technology investments, the reduced interest run rate that we've established, given the recent debt transaction, having ADS fully integrated in the year ahead and just the general strong performance of the collection and disposal business, all of those things do provide upside. And so we're optimistic that we can maintain that 50%, but there is a little bit of caution that's prudent.

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

Okay, fair enough. And last one for me, Jim. I appreciate the demand side of sustainability, lifting commodity values structurally and this is the hard part of modeling. There's also a supply issue going on and disruption. So at some level, even if the next low is a much higher low, this is a tough question because it's -- what are we at risk at? And then I'm comparing it to your last peak, which is 2017. And yet the business model is different because in 2017, it was commodity-based. Today, it's 60% fee-based. So how do we, as modelers, think about managing risk around that recycling revenue line?

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

I think we've done a good job over the last couple of years since the last peak of really derisking the recycling business overall, so that when we do have these kind of high highs or low lows, we tend to smooth those out. And then really, it's more smoothing out the low lows than smoothing out the high highs. We'd like to take advantage of these very high prices when they get there but not taking on the chin when we have the very low prices.

And so some of that derisking is moving to a fee-based model. Some of it has -- and that has really proven to be successful for us. Some of it is the new technology that John and I mentioned, putting that into our network so that we operate those at a lower cost structure. I mentioned 35% difference between the kind of the next-gen plants versus current plants. And Devina mentioned an acceleration of CapEx there pulling that forward. So that's a way that I think we mitigate some of this.

And then I do believe that it probably was -- while it didn't feel like that at the time, it was probably a good thing that we ultimately lost our biggest customer in recycling, which was China a couple of years ago because now it's all moved -- a lot of that's moved back state-side and is more predictable. And so I think the recycling business has changed a lot from when we had our last peak, which was, as you said, 2017. And it's changed for the better and I think it's changed permanently.

Operator

Our next question will come from the line of Jeff Goldstein with Morgan Stanley.

Jeffrey Daniel Goldstein - *Morgan Stanley, Research Division - Equity Analyst*

Just on the volumes first, are you able to add some color to the volume growth by geography? And I think you mentioned continued Canada softness in your prepared remarks. But are the best performing volumes at this point now just the places that shut down the hardest and now have the easiest comps or is it more nuanced than that? And then just in terms of volume trends, are you able to talk to the month-over-month trends and if that continued to get better throughout the quarter and now that July is almost done here?

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

Sure, Jeff. Really, the only kind of persistent slowness that we're seeing right now is in Canada. And I looked at July's numbers again this morning and that's still there. The encouraging part about Canada is it looks like it's going to reopen fully sometime in the next 2 to 3 weeks so that is encouraging for us. But it hasn't been great, and it has been kind of 3 to 6 months behind the United States. So July's numbers still look soft in Canada. That's really the biggest geographic difference for us.

I think when you -- John mentioned that commercial has fully recovered when you really compare to 2019 -- 2020 comparisons, for obvious reasons, are not really meaningful. But when you start comparing to 2019, commercial has fully recovered. But it's only about 0.5% above 2019. We really haven't seen kind of the growth aspect of the economy hit that commercial line of business.

And then maybe most encouraging of all for us individually and then also on a more macro basis for the overall economy are our C&D and special waste streams. And when we look sequentially at how they did, I mean, those 2 waste streams took the biggest hit of anything last year during COVID. And so they have seen the biggest sequential improvement, so they are on a great upward track. And I think those 2 by themselves, which tend to be kind of the most forward-looking indicators for us, are the best barometer overall of not only our business going forward but maybe even the North American economies, a good macro sign for the economy.

Jeffrey Daniel Goldstein - *Morgan Stanley, Research Division - Equity Analyst*

Great, that was all very helpful color. And then just a question on the 2- to 3-year pricing outlook as we sit here today. Maybe just some broad strokes because I'm just thinking with your index contracts repricing on a lag and that figure looking like it should accelerate next year, is it safe to say your pricing in '22 should be above whatever you print this year? Just how should we think about the potential for price to continue to improve into next year and beyond that, really.

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

Yes. So let me -- I'm going to let John chime in on the resi piece real quick. I'll just give you a little bit of my kind of overview on pricing. First of all, we were -- when we looked at our pricing numbers, again, another metric that's not overly meaningful year-over-year because, as you recall, last year, we really put the brakes on with respect to some of our pricing actions. But when you look sequentially at what we did in terms of collection price and in terms of landfill price, that's what gives us -- that's what makes us feel most encouraged about the potential going forward.

And to Devina's point, that is an area of confidence for us. The team understands that pricing is critical to cost recovery but that it's also critical to margin expansion. So we're not just looking at this as a cost recovery mechanism. Part of the success for the quarter was that we did use pricing to recover some of those cost pressures that we've discussed. But it also helped us expand margins. And that really is the plan going into 2022, that we'll continue to use price to offset what we expect will be some continued inflation, not as aggressive of inflation figures we're seeing now because some of this, we believe, is temporary, as I mentioned earlier, caused by some of the current government's benefits. But there is some -- feels like some structural inflation in the system. Pricing will help us more than recover that and will be a good thing for us going forward. And John, maybe you can talk about resi pricing a bit.

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Yes, Jeff, and I think on resi, you heard that in some of our prepared comments, strong yield at 4.7% for the quarter, up from year-to-date. Same thing with core price. We did shed a little bit of volume, but I happen to know that, in fact, one big franchise we had in the Southeast which was underperforming and we made a decision to move it up and instead, it went out. And I think what you're seeing though is continued and increasing benefit from our focus on moving the residential number and not to be -- and part of that, you heard a lot of conversation about recycling. Part of fixing residential, I've said this on a few calls, is fixing recycling because about 2/3 of what we process comes from a residential stream that either we collect or another vendor collects. So long story short, we feel good overall about our pricing strategy, the consistency and the upward trend. And specifically on residential, we expect to continue on a trend as well.

Jeffrey Daniel Goldstein - *Morgan Stanley, Research Division - Equity Analyst*

All right. That was all very helpful, and congrats again on the quarter.

Operator

Our next question will come from the line of Hamzah Mazari with Jefferies.

Hamzah Mazari - *Jefferies LLC, Research Division - Equity Analyst*

Could you maybe talk about what you're expecting in terms of pace of labor hiring, just specifically headcount? I know, Jim, you talked about a June number. Could you talk about -- is that the pace we should expect for the second half? I know stimulus comes off so maybe labor shortages kind of go away, but any thoughts there?

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

What I would tell you is that Jim pointed to June as being a particularly strong month. But really, our progress on the hiring front really started 4 or 5 months ago. As we started to get more confidence in what was coming back in terms of post-COVID recovery, we tried to get out in front of it. So we have been making steady progress really for the last 4 or 5 months. It really flipped in June and we really saw the fruits of our labor take hold.

I would expect that going forward for the next handful of months, we're going to continue at a similar pace. Keep in mind though, to the extent we talked about volume recovery and what lines of business it's coming from, coupled with, as an example, in residential, where we may shed a little bit of volume going forward to get the right margins, we have to balance all those things out. But I think Jim's commentary around what we did in June is something you can expect for at least the next handful of months.

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

Well, Hamzah, I've also said a number of times that we're looking at this somewhat opportunistically. If the pie of kind of available folks who would work for this company is shrinking -- and look, I've heard that from my 18-year-old daughter that people aren't interested in her high school -- senior high school class in driving trucks, then that actually is okay for us as long as we get ours. And that's what I've said is, if we get ours and the pie is shrinking, I don't care about the rest of the pie. All I care about is ours. And so there is kind of an opportunistic approach to this.

But to John's point, I mean, I think we are getting ours. It hasn't been a completely smooth road for us, to be honest. But I think we're getting to a point. And certainly, September 6 will be helpful for everyone when these benefits roll off.

Hamzah Mazari - *Jefferies LLC, Research Division - Equity Analyst*

Good, very helpful. And then just my second question just is around M&A. And the question really is your leverage will be 2.75x, I think you said, by the end of the year. You're clearly generating a lot of cash flow, free cash. Could you talk about M&A in terms of outside the solid waste business? Particularly, you mentioned recycling investments and you mentioned plastics. Are there technologies that can scale in plastics? Or I know you're using maybe venture capital and investing in those funds versus actually buying technology. But just broad thoughts on M&A outside the core solid waste business longer term.

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

Sure. So by the way, to your point about our balance sheet, I mean, it's a compliment to Devina and John and the whole team for really getting our balance sheet back down to where we said it would be by the end of the year, and that's -- it's pretty impressive that through this acquisition, we're already down below 3x against down, I think, 2.85x.

So regarding M&A, Hamzah, outside of core, the -- and you mentioned specifically plastics, I think you're aware of the ownership position we have in the company called Continuous Materials, and that company does turn plastics and paper -- low-value plastics and mixed papers into a roofing material. And we have a 33-ish percent investment in them at this point. So that -- we're excited about the potential for that. And it helps us take some of that material that might otherwise find its way to a landfill, pull it out of the landfill because it doesn't do anything in terms of creating any gas or anything usable coming out of the landfill and doing something that's preferable in terms of kind of ESG but also preferable financially for us.

So we will look for those types of investments. We're cautious about big acquisitions regardless but particularly cautious about big noncore acquisitions. I just don't want to step on a landmine here as we're walking down a pretty nice path and that could be a landmine if we were to do something like that. So we're not opposed to doing noncore acquisitions. We want to make sure that we have a lot of intelligence in those before we do anything. And I would be surprised, very surprised, if you would see us do anything large in the noncore space.

Hamzah Mazari - *Jefferies LLC, Research Division - Equity Analyst*

Got it. But just lastly, I'll turn it over, it's just a clarification or just an update. Could you update us how much of your book of business is CPI indexed? And is it just a straight LTM CPI it adjusts to? Or are there other indexes? And what is that running today?

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Yes. We're at about 40%, Hamzah, and there's a mix there in terms of whether it's CPI flat or the Waste Sewer Trash index. We continue to prioritize a push toward WST, though I would tell you that we see strength in the CPI numbers and therefore view that as something that provides some incremental value, particularly in the second half of the year but then looking forward into 2022 as well.

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Yes. I think Hamzah, whether CPI has been up or down, we've always -- we've been demonstrating for the last more than a handful of years that regardless of what's going on with CPI, we're going to make sure we price the business to at least cover our costs and expand margin.

Operator

And our next question is going to come from the line of Sean Eastman with KeyBanc Capital Markets.

Sean D. Eastman - *KeyBanc Capital Markets Inc., Research Division - Senior Equity Research Analyst*

It looks like this recycling commodity rebates is a new disclosure unless I'm mistaken. It would be great to just quickly walk through the mechanics of that. I guess those kick in at a certain basket value in recycling. Any help just understanding that number and the mechanics would be helpful, especially maybe in reference to how it's built in, in the second half would be great.

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Sure, Sean. So this is a new disclosure that we're making, and as the leading commentary on the table suggests, what we are attempting to do here is just provide clarity where there is a bit of inconsistency across the industry. And one of the things in particular that's really important in this business is conversation about operating EBITDA margin. And for WM in Q2 of 2021, on an apples-to-apples basis as best we can when we compare across the business, our operating EBITDA results were 31.2% for the quarter when you compare with this approach more similarly aligned with one of our competitors in particular.

And all we're doing here, you can look at the operating expense table that's in the 10-Q and what you see there is the cost of goods sold line, and that includes rebates that we pay in the recycling line of business. That's the driver of that cost category. And what we're doing here is reflecting that if you were to net that against the associated revenues rather than grossing it up between revenue and operating expenses, the impact to our margin is 130 basis points in the quarter.

The increase on a year-over-year basis reflects the strength of commodity prices, which we've talked about. And so naturally, with the continued strength and outlook for even better year-over-year comps in the second half of the year than we had in the first half of the year, you would expect that to expand further from the 130 basis points that we measured in the second quarter. But really, for us, this is about comparability and trying to enhance that across the space.

Sean D. Eastman - *KeyBanc Capital Markets Inc., Research Division - Senior Equity Research Analyst*

Okay, got it. I think I'm going to have to spend some time with that on that one. Secondly, we haven't talked too much about ADS. It seems like the integration is going quite smoothly. Any color on the strength in the ADS book of business from a pricing program perspective and whether, even just anecdotally, you've uncovered some of the cross-sell opportunities that aren't fully reflected in that synergy target?

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Sean, yes, I would say the integration continues to go really well. You heard in my prepared remarks about our confidence around overall cost, SG&A synergies and reiterating that we still think when it's all said and done, we'll have $150 million of total synergies by 2023. And you also heard from me that we're just about 45% of the way through taking that data from ADS' databases and moving that over to WM. So that's allowing us to -- when you think about routing efficiencies and the other logistical benefits from combining the customer base, you heard that as well in my prepared comments. And I think from a revenue standpoint, as we're moving that business in and it becomes WM business and it goes into portfolio, we're going to manage it in a similar fashion we manage the rest of our business.

Operator

And our next question will come from the line of Walter Spracklin with RBC Capital Markets.

Walter Noel Spracklin - *RBC Capital Markets, Research Division - MD & Analyst*

I guess my first question here is back on M&A, and obviously, we've heard an executive order from President Biden that seems to be singling out larger companies in respective industries that are exercising some pricing power. And while Waste doesn't necessarily get flagged in that, do you see any increased scrutiny by the DOJ, any increased pressure, any change in approach that they might take toward looking at deals that you might do in the future that would put at risk any of your ability to grow by acquisition at a pace that you otherwise would have if this order hadn't come through?

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Yes. I mean, look, to be honest, we haven't seen anything. I mean, we all read the news and we read comments and so you can kind of take those for whatever they're worth. But when we really look at some of the tuck-ins that we've done post-ADS, I mean, we haven't seen anything at this point. What we are hearing that's not related in really any way to your question but is more about M&A is that it's somewhat related, I guess, to the new administration because if there is a tax change, we are seeing that there are some companies out there that are becoming sellers because of this prospective change in tax law.

Similarly, we're seeing some folks that are saying, "You know what, I don't like the labor environment right now." And they're looking at selling for that reason. And then the third thing we're hearing is that in our industry, with some of these small businesses, there just isn't, in many cases, a robust succession plan for some of these companies. So I think it's not directly related to your question about DOJ, but it is related to some of the things that are happening within the current administration, whether it's the subsidies for unemployed or whether it is related to tax law changes. But DOJ, we're not seeing anything at this point.

Walter Noel Spracklin - *RBC Capital Markets, Research Division - MD & Analyst*

Okay, that's helpful. And then turning to residential volumes, obviously coming up against tougher comps here. And I'm curious whether we are seeing, and it would make sense to see, just want to confirm residential volumes now coming down as people get back to work. But the key question here is that is there structurally anything -- any changes that you've made during COVID-19 that would -- with your contract on the residential side, that would change what otherwise would be what we would expect with a slowdown in -- or a decline in residential volumes so that the impact would be less onerous or perhaps would be complemented here based on the mix as we see residential volumes come off on a year-over-year basis.

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Yes. Well, there are a few things. We are -- we have seen a little bit of moderation as folks have returned back to their place of work. But there is going to be a little bit of a lingering effect because I think the workforce is going to change a little bit. You're going to see some more folks work remotely or from home. But that doesn't look meaningful. We have seen a little bit, Jim commented on this earlier, we have seen a little bit of a shift in the residential recycling stream. Obviously, Amazon is doing well. We're seeing it show up in the percentage of cardboard that's coming out or fiber that's coming out of a lot of our residential contracts, which is honestly a good thing, especially in this environment.

We're seeing some improvement, although not as significant by weight, if you will, in terms of the quality and quantity of some of the higher-margin streams. We talked specifically about plastics and the kind of mixed plastic we use to make versus the specific plastic products that we're producing for customers. So we view that all as positive. I think overall in general volume in terms of units, I don't think our message has changed. We're going to continue to make sure that we move residential from a margin perspective up to where it competes with every other line of business. And we're really making good progress there.

And if you look at our price versus volume in the last handful of quarters, it has been slightly negative. But if you look at the core price and yield compared to that, that's certainly a trade-off we're willing to make. As I've said before, we don't want to -- we're not trying to push the volume out, but we're going to make sure that the investments we're making in that line of business align with our overall long-term strategy from a profit and return standpoint.

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Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

So John really covered the substance and the business drivers very well. Walter, one kind of clarifying facts that I just want to be sure is clear for us is that the volume decline that you're seeing is different from container weight. And so the shift that we're seeing as people return to their workplaces and less people are working from home is more about the container weight, the volume measure that you're seeing in those intentional steps that we've taken that John has spoken about to be very prudent in terms of making incremental investments in the residential line of business with our capital and with our workforce where we are seeing constraints. And that's business that we knew that we would be shedding and shedding with purpose.

Operator

Our next question will come from the line of Noah Kaye with Oppenheimer.

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

I'd like to pick up on Michael's earlier observation about sustainability fueling the higher demand for recycling to really try to understand how you see this opportunity for the company. Just given the acceleration in corporate commitments to recycle and use recycled content, I think the U.S. Plastics Pact, which has 100 corporate signatories, they just unveiled their road map to 2025. And at the same time, it really seems like there's still a pretty big infrastructure gap around recycling these materials and getting them back to those producers. You just look at the difference between the co-mingled bales and the individual grades of plastics.

So would just love to understand kind of your road map for how this is a growth opportunity for the company, both in terms of putting in more infrastructure in terms of helping to close the loop and getting some of these materials back to the manufacturers and then being able to potentially capture organic share gains with those types of manufacturers as a result.

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

Well, no, I think you've hit on kind of the key microeconomic piece here, which is that finally, it looks like demand is catching up with supply. We've always had the supply, but we haven't, until fairly recently, had as much demand as we would like. We've had demand but maybe not as much as we would like. And I think what we're seeing is that companies are now, with this real focus on virtually every company, ESG focus, are inclined to use recycled material, recycled -- improve the recycled content percentages. So that's been a benefit for us.

There is still, to your point, there still is opportunity, I think, to expand infrastructure, particularly here in the U.S., but we are seeing it -- we're seeing encouraging signs there. And we have outlets through our brokerage group outside of the United States, which has been one of the real benefits there. When China went away literally overnight, our brokerage team was able to move commodities pretty quickly to other spots, other places around the world. And we still have those and we'll continue to move commodities there.

But I do like the long-term trends not only for our recycling business but as someone who's very focused on the environment. I like the fact that we're moving to becoming more ESG-focused and that we're -- the companies that are using and producing materials are looking to use recycled content as opposed to just using virgin content.

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

Great. And I guess the follow-up to that would be, you mentioned some of the significant savings around automation in the MRFs, labor and otherwise. Have you really seen a lot of innovation in the last few years, I guess, following China National sort around those pieces of equipment, those technologies that are driving these returns? Is there more innovation coming down the pike? I guess what I'm basically asking is, is the rate of technology innovation in and around recycling improving at a rate that supports some of these demand and commitments from the eventual buyers of the content?

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Yes. No, I think that's a great question. I think what you see in the numbers that we referenced around how we're -- how pleased we are with the investments we made in this advanced and advancing technology, I think that supports the model. We are very pleased with the plants that we're -- we've invested in thus far. Jim mentioned the labor arbitrage and we're benefiting from that. And by the way, that's not just labor for labor's sake, those are positions that are certainly been and continue to be hard to fill so it's solving a few problems there.

I think around the demand of the customer, we all mentioned that, that side of the equation is as strong now as it's ever been. And for all the comments made around ESG, we feel confident that, that's going to continue to grow. And I think plastics is one example. I mean, we've got the material stream either through our plants or through in other parts of the waste stream. And what you're seeing is some migration from what was in the waste stream obviously now to higher-value commodities.

And Devina said this not today but on other calls, when you look at it from a return -- a return on invested capital standpoint, our recycle plants are at the top of the heap. So to the extent we keep investing more CapEx there, we're going to be very pleased with that. And we think that the technology is advancing in a form and fashion that's going to allow us to continue to meet the customers' demands.

Operator

Our next question will come from the line of Kevin Chiang with CIBC.

Kevin Chiang - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Analyst*

Maybe just one for me and maybe on the ESG angle as well. Can you just give us an update on your EV strategy here? I think you're evaluating a couple of trucks. I'm trying to get a sense of, when do you think you need to make a larger order to kind of hit some of your emission reduction targets? And I guess, how do you balance the technology you're seeing now versus maybe what's in the development pipeline, whether it's solid state or fuel cell, when you think of making this fleet transition?

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

No, good question. One we get often and what I said on the last call and publicly in other venues is we are working with a number of vendors to watch to see how the battery technology is advancing. As I said before, I think naturally, we're going to -- we were seeing it in the passenger vehicles, and we'll probably see it in light-duty vehicles. In some cases, we're seeing it already. So we've got a number of vendors we're working with to watch the way the different technologies advance.

I would tell you in terms of our strategy on fleet, we've said before, we've pivoted from the traditional diesel fleet that we had to CNG. I wouldn't say it was seamlessly but the way our fleet plan works is we have some flexibility to be able to move from diesel to CNG, and we view it as CNG to battery electric vehicles the same way.

I would tell you what I think will happen is, and I talked about this at the conference Devina and I were at a few weeks ago at WasteExpo, I am confident that over time, they're going to solve the weight issue, the range issue, the parasitic load of a refuse vehicle, all those things, I think, will get solved. I think the bigger question is the infrastructure piece. And we're also watching them through to see what kind of infrastructure we would need in our distributed environment to be able to service a fleet of 20,000 vehicles.

Kevin Chiang - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Analyst*

That's helpful. Just as a clarification, when you think of that problem being solved, is it within kind of the construct of a lithium-ion battery? Or do you think it's an evolution from this, either using fuel cell extenders or even moving to a different propulsion system?

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Kevin, I would -- that's something I think is a little bit still a little murky at this point. That's the reason why we're working with a handful of different vendors just to make sure we've got our eye on all the different potential solutions to your good question.

Operator

Our next question will come from Jeff Silber with BMO Capital Markets.

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

Wanted to move over to the legislative and regulatory side. I believe earlier this week, the House pushed through a potential bill on PFAS to require the EPA to establish national drinking water standards. Can you give us an update on what you think is going on there and how long the time line is going to be for this?

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

I don't know that we know exactly what the time line is. We saw that as well. Maybe a bit more of a kind of a macro answer to that is that we do look at PFAS as being a cost impact to us, but we look at it as a much bigger opportunity for us than a cost impact. We know there may be some added costs, albeit something we have had our eye on for quite some time and have been honestly working with EPA on it for quite some time.

But we also really are looking at this with a pretty interested eye because once we do know those details that you referenced there, I think it really opens up a big opportunity for us. And so we're -- I'm not sure, I might be overstating to say we're excited about it, but we do -- we are encouraged that this could be a big stream, revenue stream for us. But at this point, it still is -- I'll use John's words, it still is a little bit murky. And we don't know exactly what the details are going to be on how they -- what they say about PFAS. But for example, we're -- it feels a little bit like it's coal combustion residual part 2.

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

Okay, interesting. And then continuing this theme, we're also hearing and reading a lot more on the EPR side. I know it's big in Canada and we're seeing some things going on in specific states in the U.S. Again, if you can give us an update there from your perspective, what you think the impact might be on your business.

John J. Morris - *Waste Management, Inc. - Executive VP & COO*

Yes, Jeff, our entire team is following what's going on with EPR. And I think our position is still the same, which is we feel like we have the assets, the infrastructure, the network to solve for a lot of the challenges that come out of EPR. So to the extent we can continue to maximize use of our assets, I think we're -- we understand that. But that, too, is a little bit -- there's still some wood to chop on that front as well. I know there's some things that are unique going up in Canada, but I think we're well positioned there as well with -- in terms of assets to help solve for that challenge.

Operator

Our next question will come from the line of David Manthey with Baird.

David John Manthey - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Last quarter, you mentioned that you expected landfill yield in particular to be strong. I'm wondering this quarter, was it up to your expectations? And just could you give us a bit of an outlook on that business, in particular, landfill yield?

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

The landfill yield was slightly above our expectations in the second quarter, I would say not as much above expectations as, say, C&I was. And we do expect it to moderate somewhat from the second quarter levels, that we're still encouraged that with our focus on MSW pricing in particular and then the strong pipeline that we have from a volume perspective in C&D and special waste, that, that will give some natural lift to yields in the back half of the year as those streams tend to have strong pricing that's more difficult to predict specifically because it can vary by geography and where the streams come in. But all in all, our outlook is very strong at -- from a core price perspective, I really think that, that tells the story. And we're driving core price above 4% in the landfill line of business, which is the result we want to see.

David John Manthey - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. And Devina, you also mentioned something about incentive comp being higher in the future. I wasn't sure if that was a comment regarding the second quarter -- I'm sorry, the second half of 2021 or if that was 2022 or both. Could you clarify?

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

Sure. So it really is a difference between whether you're looking at EBITDA or free cash flow. So I'll start with EBITDA. It's something that's impacted us in the first half of the year. The total impact for the full year, we now expect to be in the ballpark of around $60 million, could be a little north of that from an EBITDA cost perspective. And so you are seeing some margin pressure from that.

When we look at the collection and disposal business, in particular, when we disclosed in the press release that, that business was backwards 10 basis points relative to prior year, 50 basis points of that was actually incentive compensation. So when you adjust for that, that shows that the traditional solid waste business actually made really strong progress in margin expansion.

Our cash flow impact on a year-over-year basis will show up in 2022. And so that's where I made the 2022 comment earlier because this year in 2021, when we paid last year's bonus, we had a little bit of a benefit to cash flow relative to what we would expect in the year ahead just because 2020's payout was around 70% for the total company, and we expect this year to be meaningfully higher than that.

Operator

And our last question will come from the line of Michael Feniger with Bank of America Merrill Lynch.

Michael J. Feniger - *BofA Securities, Research Division - VP*

Great quarter. Just a question just for Devina. I mean, you guys raised the outlook, which is great. Just to check my math, is the margin range still the same with the April guide? And in the first half, you guys expanded margins of 80 basis points, 50 bps in Q2, which is impressive with the volume recovery. So I'm just trying to get a sense of what you're implying in the second half. And is that what you were referring to earlier in the call, Devina, when you said you feel like there is some conservatism still in this guide?

Devina A. Rankin - *Waste Management, Inc. - Senior VP of Field Operations, Executive VP & CFO*

It's a great question, Michael. And what I would say is the implied guide on margin is that we're basically flat to positive 50 basis points for the full year. And what that implies about the second half is that we will have a chance for a little bit of margin degradation from the year prior. The what behind that really comes down to the inflationary cost pressures that we've talked a great deal about, incentive compensation but also the conversation about the strength in hiring. We're going to have additional training hours in the back half of the year as we get those new drivers on board.

All of those things put slight downward pressure on the margin outlook. But there are a lot of positives and we're focused on those positives and think that they could outperform what we're currently projecting, though too early to say. The first is definitely the strength of the traditional solid waste business. And we always have to lead with that. Certainly, recycling commodity price and RIN values provide additional benefit from a margin perspective.

Then the ADS integration, the strength of that in the back half of the year and John's comments earlier about where we are year-to-date on synergies but where we expect to end the year. The ADS business, we estimate, could have provided as much as a 75 basis point headwind to our margins in the second quarter. And we expect that, that moderates in the back half of the year as we do things like moderate the level of incremental investment that's needed in the fleet to get it to WM standards, and we realize that synergy potential that we've outlined for everyone.

So as much as there are some things that are working against us, we do think that there are some tailwinds. Just a little difficult for us to predict, particularly given the inflationary cost environment that we're all talking about.

Michael J. Feniger - *BofA Securities, Research Division - VP*

Understandable, Devina, that makes sense. And with that slight margin degradation that you're kind of expecting in the second half, and you laid out some of the positives. I mean, I guess, to Devina or Jim, I mean, this is a weird year obviously with comps from COVID. When all this gets normalized and when we think about 2022, just to set the stage here, are we thinking like 2%-plus volumes with this economic recovery, yields shifting higher because of pricing? Is it in the 3% range? And what you're seeing on the pricing front, and Devina, like what you suggested with some of these moderating investments, I mean, are we thinking about margin expansion above 50% in 2022 with what you guys are seeing right now and the yield you guys are expecting in the second half of this year as some of these costs that kind of fade out next year? Maybe just help set that stage if 50 bps of margin expansion kind of makes sense next year.

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

So Michael, we're really just kind of entering into our 2022 budgeting process here, so I would say we don't have a lot of detail on it yet. But on kind of a bigger scale here, I do think we're feeling encouraged about the volume and the price forecast as we think about 2022 and even beyond 2022. Pricing, in particular, feels like we're encouraged that we're able to not only cover inflationary cost increases but also add to margin. And we're very encouraged by the sequential signs we've seen both in collection and in landfill pricing. So that gives us quite a bit of confidence on the price front.

Volumes, the volumes have been good. And to your point, 2020 comparisons were not meaningful. But look, volume hasn't totally returned. I talked about Canada being soft. And we think Canada obviously will come back when we get to 2022, so that would be a tailwind for us on the volume side. Landfill volumes have not fully returned. MSW is the one that may be the exception there, but I mentioned special waste and C&D that have not fully returned. Those appear, though, to be very strong right now, and the pipeline appears very good with special waste.

So we'll obviously give you more color as we get to our guidance session, but we feel encouraged about what we're doing on OpEx, what we're seeing on volume and price, and we feel encouraged about the longer-term trends for recycling. All of that would bode well for the -- at the out years.

Operator

Thank you. I'll now turn the call over to President and CEO, Jim Fish.

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

All right, thank you. A bit of a long call today but we're particularly proud of the results for the quarter, so we want to make sure we took all your questions. Thank you for your questions. Very good questions today. And thanks for your time. I look forward to talking to you next quarter.

Operator

Thank you for participating in today's Waste Management, Inc. Second Quarter Earnings Conference Call. This call will be available for replay beginning at 1:30 p.m. Eastern Time through midnight on Sunday, August 10, 2021. The conference ID for the replay is 6965743. The number to dial in for the replay is (855) 859-2056 or (404) 537-3406. Again, thank you for participating. You may now disconnect.
