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WM.N - Q3 2020 Waste Management Inc Earnings Call

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OVERVIEW:

WM reported that 3Q20 revenues were down about 2.7% from 3Q19. Co. expects 2020 organic revenue decrease of 3.25-3.75%.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Waste Management Third Quarter 2020 Earnings Release Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Ed Egl, Director of Investor Relations. Thank you. Please go ahead, sir.

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

Thank you, Lindsay. Good morning, everyone, and thank you for joining us for our third quarter 2020 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 will 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 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. 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 and subsequent Form 10-Qs.

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 third quarter of 2019.

Net income, EPS, operating EBITDA and 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, including costs incurred in connection with the recently closed acquisition of ADS. 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 November 16. 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 9177824. Time-sensitive information provided during today's call, which is occurring on November 2, 2020, may no longer be accurate at the time of a replay. Any redistribution, retransmission or rebroadcast of this call in any form without the expressed 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. I'd like to open the call by welcoming the employees and customers of Advanced Disposal to the Waste Management family. We closed the acquisition last week, and we're excited about the opportunity ahead to create value from this deal. We're also pleased with the concurrent close with GFL Environmental on the divestiture package. I'd like to give it to Richard Burke and the Advanced Disposal team for the great job they did staying focused on operating their business safely and efficiently during the extended close period. The next phase of our journey, the hard work of combining these 2 great companies, has now begun. John will speak a bit more on this topic, but suffice to say, we're very confident in the long-term value of the acquisition, and the integration is off to a great start.

We're extremely pleased with our third quarter results, which were a testament both to our team's ability to optimize our business in a new environment as well as the progress of the economic recovery in North America. We've consistently pointed to operating EBITDA as the best measure of the health of our business. And despite the challenging backdrop, we delivered third quarter operating EBITDA results in line with last year's record performance and expanded operating EBITDA margin by 70 basis points.

It's been said many times that great companies are able to emerge from tough times stronger than they were going in. In that vein, WM has learned this year that we can permanently operate our business with a lower cost structure. Despite a 2.7% decline in our third quarter revenues, the team was able to improve operating expense as a percent of revenue by 110 basis points and hold SG&A expenses as a percent of revenue relatively flat. This is the second consecutive quarter where we've demonstrated this flexibility in a difficult operating environment, and we're committed to holding on to operating efficiencies and cost savings as our volumes turn positive again.

In addition to proactively changing the cost structure of our business, we're taking steps that propel us forward as a stronger, more differentiated company in the eyes of our customers. As I discussed last quarter, our investments in customer service digitalization, or CSD, are unquestionably the right approach, and we've accelerated these investments to reap the benefits sooner. So far this year, we've made considerable progress on this effort that will fundamentally transform our business model by offering our customers greater choice in how to interact with us and by seamlessly connecting the front-end customer experience to our back-end processes. And we've started to see the benefits.

Our online sales channel is our fastest-growing sales channel, and we've seen an increase in our conversion rates for customers signing up for new service when visiting our e-commerce site. We've also made progress in automating a variety of operational back-office and customer communication processes, which are paving the way for efficiency gains, improved customer experience and further cost reduction.

To support our CSD journey, we've modified our field sales structure to expand online and inside sales functions while reducing and optimizing outside sales coverage. These adjustments are part of our long-term vision to position our team to engage with customers on the customers' terms, improving customer satisfaction and engagement. It also enables us to reduce our cost of new customer acquisition and improved sales performance at a more efficient cost. We're confident that these strategic sales coverage adjustments, coupled with our digital growth strategy, better support our customers as well as the long-term growth of the business.

Recycling continues to show the improved results that we expected when we started to change the business model, providing stronger financial results in the third quarter. In addition to our new highly automated MRF in Chicago, we've opened a similar facility in Salt Lake City with another to open soon in Raleigh. Using advanced technology in our recycling facilities is the blueprint for improving our cost structure, producing a higher-quality material and being flexible to changing recycling end-market demands.

Recycling is only the beginning of our commitment to sustainability. Last month, we published our 2020 Sustainability Report: Building Value Together. The report describes how we are addressing challenges and opportunities related to ESG and doing so in close partnership with our customers, suppliers and communities. Through the crisis of 2020, we've remained steadfast in our commitments to protecting the environment and contributing to a circular economy.

WM is a leading voice in the call to create domestic end-market demand for recycled content. One of the ways we're walking the talk is our collaboration with Cascade Cart Solutions to develop and purchase residential carts made with post-consumer resin. Another way is our investment in Continuous Materials, a company which develops building materials from hard-to-recycle paper and plastics. Increasing the value of the material that we process increases the economic benefits from recycling, which drives volumes and benefits the environment.

The shift in our operating model, along with benefits from the acquisition of ADS and our progress in transforming the recycling business, position us for a strong finish to the year with positive momentum heading into 2021. We performed exceptionally well despite the difficulties presented with COVID-19. Our results in the first 9 months of the year give us confidence we can generate free cash flow in excess of $2 billion, exclusive of ADS transaction costs. As we also achieved the highest operating EBITDA margin in the company's history in the third quarter, we're confident we can exceed the high end of our guidance for full year operating EBITDA margin of 28% to 28.5%.

After all we've been through this year, what's most impressive is we expect to finish 2020 within a stone's throw of our all-time high 2019 operating EBITDA. For that, I'm internally grateful to our teammates who have made it happen this year in the face of difficult circumstances.

I'll 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, and good morning. Our third quarter results showcased the strong execution of our frontline team members who are safely and efficiently servicing our customers each day as well as the resilience of our business model as we manage costs and capital expenditures in this dynamic environment. The team's hard work paid off with tremendous results as we improved operating expense as a percentage of revenue 110 basis points and expanded operating EBITDA margins 70 basis points.

We saw steady volume recovery across the collection and disposal business during the third quarter, improving volumes, coupled with collection and disposal yield, returning to a healthy 2.6%, generated revenue above our expectations. We were anticipating a revenue decline of 3.5% to 5.5% in the second half of the year with the majority of that decline weighted toward the third quarter, yet third quarter revenue only declined 2.7%. Of the commercial volume suspended due to the pandemic, almost 70% have resumed service, and there's further cause for optimism in the C&I business as net new business and service increases versus service decreases were both positive and showed significant sequential improvement in the third quarter.

Residential container waste continue to be elevated mid- to high single digits compared to last year. Recovering the cost of increased waste is part of our conversation with municipalities as we work to improve the profitability of our residential business and change the structure of residential contracts. In the residential line of business, our yield improved to 3.5% as we make progress on this effort.

External volumes for the third quarter were down -- external landfill volumes for the third quarter were down just over 8% with special waste volumes down about 12% and C&D volumes down about 19% on a tough comparison, in part, due to the wildfire cleanup last year. Without the cleanup from last year, C&D volumes declined about 7%. Landfill volumes improved sequentially each month in the quarter with total landfill volumes in September down less than 4% and C&D and special waste each down about 8%. Notably, MSW volume was flat for the quarter, and September volumes increased nearly 2% year-over-year, a powerful indicator of the progress of economic recovery.

Moving to pricing. Third quarter core price was 3.2%. Adjusted for the impact of lower volume, core price would be 4.1%. As expected, pricing metrics are trending back toward pre-pandemic levels following the intentional customer focus steps we took to support our small business customers during spring shutdowns. We're confident that helping our customers during a difficult economic climate was the right step, and we continue to see increased loyalty from our customers.

Third quarter churn improved 100 basis points year-over-year to 8.8%, and we saw another boost in our Net Promoter Scores for all business lines we measure. In particular, our commercial business score more than doubled driven by higher scores for reliability, flexibility and improved online resources. Our pricing results reflect 3.3% core price in both landfill and transfer businesses as we continue the positive momentum with post-collection pricing initiatives. We've been disciplined with our post-collection pricing, and we remain committed to staying the course.

Turning to ADS. No one has been more eager than me to welcome the ADS team to Waste Management. And with the closing behind us, we're extremely confident in the value this deal will deliver. We've gotten significant clarity on the ADS business and are pleased with the recovery the business has shown as the economy has reopened. We work closely with the ADS team for many months and are hard at work on integration, giving us confidence that we will exceed the $100 million synergy target despite higher-than-originally-expected divestitures.

As Jim mentioned, 2020 has taught us we can operate our business with a much lower cost structure than we have historically, and we're holding on to operating efficiencies and cost savings as volumes return. The 110 basis point improvement in operating expense as a percentage of revenue in the third quarter is evidence of our success. When volumes began to decline in March, we aggressively flexed our routes and trucks, parking more than 800 vehicles at peak declines. This lowered maintenance costs and allowed us to optimize volumes across the younger, lower-cost portion of the fleet. Throughout the pandemic, route reductions have outpaced volume declines in the commercial and industrial lines of business. As volumes have returned, we have been extremely disciplined in bringing back trucks into service, driving improved asset utilization and helping keep maintenance costs low.

In the third quarter, lower maintenance spending resulted in a 70 basis point improvement in operating expense as a percentage of revenue. We've also been successful in improving efficiency as each week since February we service more yards, homes and hauls per hour than in the same period in 2019.

Increased efficiency was a key driver of less overtime in the quarter while volume decreases across the collection and disposal business were in the mid-single digits over time was down 21% in the commercial and industrial lines of business and over time was down 27% in the disposal business.

The team is doing an exceptional job of managing expenses, and I'm confident we are carrying forward the lessons we've learned on safely operating our business at a lower cost structure.

In closing, I want to thank the entire waste management team, including our new Advanced Disposal team members, for their hard work and dedication during trying times. Third quarter results exceeded our expectations on virtually all measures as we continue to demonstrate our ability to manage our operations in an uncertain environment.

I will now turn the call over to Devina to discuss our financial results in further detail.

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

Thanks, John, and good morning, everyone. As Jim and John have discussed, our third quarter 2020 results have demonstrated both the strong foundation provided by our essential services and resilient business model and the value created from the hard work of our team who are delivering each day in an increasingly cost-effective way.

When we look at our third quarter operating and financial results, as John just said, virtually every metric exceeded the expectations we set just 3 months ago. Volumes have come back stronger than expected. We have flexed operating costs to drive improved margins, and that's far better than our targeted efforts to keep them flat, and we have seen improved customer account collection trends take hold. All of this positions us to finish the year strong with organic revenue down in the range of 3.25% to 3.75% versus the 4% to 5% we projected in July, targeted operating EBITDA margin of more than 28.5% and free cash flow in excess of $2 billion. With revenues down about 2.7% from the prior year quarter, our operating EBITDA was essentially flat on a year-over-year basis. This strong result underpinned net cash flow from operations, which was $1.029 billion, an increase of 8% compared to the same quarter last year.

Over the course of the third quarter, we saw strong recovery in our customer collections and days sales outstanding, lessening the expected headwind from working capital. Additionally, our operating cash flow for the quarter includes the deferral of payroll tax payments under the CARES Act, which provided a benefit of about $40 million. We continue to expect the full year benefit of payroll tax deferral to be $120 million.

Third quarter capital spending was $343 million, a $140 million decrease from the same quarter in 2019. While we continue to prioritize investments in the long-term growth of our business, we took prudent steps to reduce and defer certain aspects of our capital spending until we had better visibility into the pace of volume recovery. The majority of the targeted reductions were the result of adjustments in landfill cell construction schedules and a decrease in the purchase of steel containers. We expect full year capital expenditures to be between $1.6 billion and $1.65 billion.

Our business generated free cash flow of $691 million in the third quarter. Through the first 9 months of the year, free cash flow was $1.432 billion, a conversion of cash from operating EBITDA of (inaudible). And as I just mentioned, for the full year, we expect our strong operating performance, effective management of working capital and disciplined capital spending to yield free cash flow in excess of $2 billion, excluding the impact of ADS. Our strong free cash flow positions us to invest in our business and return cash to our shareholders. In the third quarter, we paid $230 million in dividends. We remain fully committed to our dividend program, solid balance sheet and balanced allocation of remaining available cash to strategic acquisitions and share repurchases.

With the recent closing and funding of the ADS acquisition, our balance sheet and liquidity remained strong, and we are well positioned to continue our practices of sound investment and strong shareholder returns. We financed the $4.6 billion acquisition of ADS, net of the $856 million in proceeds from the divestiture to GFL Environmental, with a combination of our credit facilities and commercial paper. We continue to look for the right window to access the capital markets for long-term financing alternatives.

Current and forecasted leverage ratios are well within the financial covenant of our revolving credit facilities, and we expect to quickly return to our targeted total debt to EBITDA of 2.5 to 3x.

Turning to SG&A costs. There's no doubt that the lessons we're taking to heart from the pandemic have extended to SG&A as well. While third quarter SG&A was slightly above prior year at $389 million, that increase is due to an accrual for long-term incentive compensation as well as an intentional acceleration in technology and investments that Jim mentioned earlier. Absent these 2 items, our SG&A would have been down nearly $30 million from the third quarter of 2019, demonstrating our collective commitment to reduce discretionary spending. SG&A as a percentage of revenue was 10.1% despite the revenue decline in the quarter, and we continue to target SG&A as a percentage of revenue of about 10%.

Before turning the call over for questions, I want to provide an overview of our planned approach to updating financial guidance post ADS. With the close of the acquisition just behind us, the entire team is focused on welcoming ADS employees and serving our new customers. Each company produced outstanding third quarter results, and we are confident that we will finish 2020 strong as a collective team. Our integration plans are robust. And as John just mentioned, we're confident that we can achieve planned synergies. This is an integrated business model. And for that reason, developing estimates for the costs associated with routes from a partially divested hauling district can be difficult. We are well underway in analyzing and evaluating our financial plans for the year ahead, and we will clearly delineate a plan with our fourth quarter 2020 results that speaks to the top strategic priorities of Waste Management and the integrated value of ADS. Suffice it to say, we closed 2020 excited about the road ahead and prepared to make the value of the whole greater than the sum of its parts.

In closing, I want to thank our team for all they have accomplished. Our strong results are a testament to the resilience of both our people and our business model.

With that, Lindsay, let's open the line for questions.

QUESTIONS AND ANSWERS

Operator

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

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

Devina, so I appreciate that you'll give some more details in January. But just at a high level, when we think about the moving pieces for '21 cash flow, is it basically that we take your kind of jumping-off point, maybe layer in some EBITDA growth, add in ADS? But then should we also take away for some CARES repayments and maybe a step-up in legacy CapEx? Are those kind of the big buckets, not necessarily numbers, but just the puts and takes?

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

Yes. You absolutely have those buckets right.

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

So on CARES, is it half of it will come back next year and then another half in '22?

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

Yes. That's correct. So the $120 million that we have reduced our 2020 cash outlay will repay all of -- or we'll have a full year in the year ahead for normal course of business and then 50% of this year's outlay.

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

Right. Okay, okay. Good. That's very helpful. And then, John, so at the Investor Day, I think you talked about $100 million in savings over the next few years from productivity, but you guys have noted that COVID has driven you guys to structurally rethink a lot of things. And it seems like this productivity is not necessarily going to go away. So I guess my question is have those savings that you talked about at Investor Day basically been captured? Or are those in $100 million savings still on the come?

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

No. I think, Tyler, I mean, listen, we're very, very pleased with what the teams have been able to do to control cost, and a lot of that's been done through efficiency over time, better maintenance and repair results, et cetera. So we've taken full advantage of it, but that's not to suggest that we don't have some more opportunity within the operating expense categories.

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

Okay. Great. And so maybe just my last question, again, kind of a bigger question here. But I mean I think if you guys crest 28.5% margins, I think it's maybe the best margins you've ever posted. I'd have to go back and maybe look at one of Bill's old models. But over the next few years, do you feel that 30% margins are achievable? And if so, maybe what might be some of the drivers to get you there?

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

Sure. Well, I think what John just mentioned should give everyone confidence that the 28.5% year-to-date EBITDA margin that we have produced through really tough circumstances, this isn't kind of indication of what we can achieve. It's an indication of what's yet to come in terms of additional incremental value that can be created from here. While we look at EBITDA margin for the year, there are always puts and takes. I think what's important to know is that in the current year we look at those puts and takes and say, "Sure. Something like health and welfare expenses that were lower in the second quarter may work against us in the year ahead," but what's more important is that the operating performance and the ability to lever down on discretionary spending. Those things are indicative of long-term value creation on the margin front, and those will far outpace that health and welfare headwind that we have in 2021.

Operator

Our next question comes from Jeff Goldstein with Morgan Stanley.

Jeffrey Daniel Goldstein - *Morgan Stanley, Research Division - Research Associate*

I want to ask on the core price is going up to 3.2% from 1.3% last quarter, at this point, are you fairly confident that you can get back to the pre-COVID core price levels of about 4% sooner rather than later as you're now just waiting to remove the last set of price concessions? Or you think that last amount of the recovery will be harder to come by and maybe a certain amount of customers will continue to be under pressure? Just how should we be thinking about that?

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

No. It's a good question because there was -- there were a lot of moving parts in the second quarter, and we talked about the fact that we were supporting our small business customers in the second quarter. And that would all be reflected in price, whether it was the free month of service or whether it was deferred price increases. All that would show up on the price line, so we knew that Q2 was going to be artificially low. And Q3 has had a piece of that in there as well, so we're confident that the pricing will remain a core strength for us in Q4 and beyond, whether it is commercial or roll-off. Or more recently, John's focus and our focus as a team on residential pricing and landfill pricing, those are all going to be strengths of ours.

It's a little bit of -- the last question about margin. In addition to cost controls that we're confident in, we're also equally confident in our price capabilities.

Jeffrey Daniel Goldstein - *Morgan Stanley, Research Division - Research Associate*

Okay. That's helpful. And then I figured I'd ask with election tomorrow, just curious how you're thinking about the range of outcomes here. And while tax, I'm sure, is probably the most obvious variable, is there anything else we should -- related to regulation that you're keeping an eye on that we should be aware of as well?

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

I'll speak quickly to the tax impacts. When we look at a Biden win, the thing that is most apparent there is federal tax rates could increase from 21% currently to 28%. That's about a 6.5% increase in our effective tax rate based on our current modeling, and that would be about $150 million increase in the provision and about $125 million in cash taxes. Really hard to predict further than that. We know that bonus depreciation is something that seems to have bipartisan support. And so therefore, we expect 100% expensing to continue through 2022 and then the phaseout to continue thereafter. Aside from that, I'll let Jim speak to the impacts to the rest of the business.

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

Yes. I would just change one word in Devina's sentence, if we look at a Biden win.

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

Yes, exactly.

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

We will -- regarding environmental regulation, it is interesting for us that -- first off, all of our focus is not necessarily on the federal elections. We tend to focus on state elections, too, because the state has such an important place. That's an important role for us, and that carries over to environmental regulation.

But as it relates to the federal elections tomorrow, we've said that regulation is actually, in a strange way, a good thing for WM because we hold ourselves to a very high regulatory standard, environmental standard. And so any additional regulation actually tends to work in our favor. So to the extent that, that comes out of tomorrow's election, that could be a good thing for us.

Operator

Our next question comes from Hamzah Mazari with Jefferies.

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

Maybe for Jim. You've talked about technology for a few years now, and we see in your prepared comments some of the accelerated tax spend that you flagged. Could you maybe at a high level just talk about where you are in your tech journey? Sort of what's behind you and what's yet to come, both from a spend perspective and sort of the benefits? Do the benefits come right away? Or is there a little bit of a lag?

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

I think there's a bit of a lag here, Hamzah. We have accelerated the spend. As we mentioned, Devina mentioned it, and it's impacting SG&A cost. And we felt like this was the right year to do it. This -- I think I read somewhere that 77% of companies have done the same thing, have accelerated their digital spend.

Just to kind of put it in -- to be specific about what it's impacting, though, and what it's impacted so far, things like customer setup is being impacted, routing and dispatch, service confirmation, billing inquiries. All of those make up the pie of calls that come into our call centers, and the idea is that we'll give that option, at least, to our customers to be able to self-service. And then behind the scenes, there will be a real significant streamlining of really all of those processes.

Today, there's a lot of steps involved. There's a lot of data entry involved. Ideally, we get to a point where you greatly reduce the amount of data entry, which reduces the amount of potential for error and then, in turn, reduces the confusion sometimes it results from those errors when a customer calls in.

I would tell you that we're -- if I use kind of a baseball analogy here that we're probably in inning 3 here as it relates to this full customer service digitalization, and that will take us all the way through 2021 to fully develop, but we are moving quickly on it. And we're encouraged by what we're seeing, not just on those process changes, but also on the front end of that, which is where the customer sees it.

As I mentioned in my script, we're seeing our biggest increases are coming in, in that e-commerce channel. So we're excited about this, and we think this is a -- has the real potential to separate us from the pack even more significantly going forward.

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

Got it. Very helpful. And then just on the volume side, anything you're seeing sort of regionally relative to your expectations that, that was a bit different? And then maybe just frame for us what does October look like I know you gave some detail on September. Just curious if the sort of the recovery that we've seen during the quarter is similar to October or if there's differences we should be aware of when looking at the commercial business.

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

It's interesting, Hamzah. We've -- I've read a couple of reports that have talked about volume being different in the urban settings versus rural. I would tell you this is not an urban versus a rural. The impact of COVID has not been urban versus rural. What it's really been is almost state by state and province by province, so the states that seem to be doing the best and are closest to full recovery happen to be those states that opened up most quickly. So those are states like Texas, like Florida, like Arizona, Georgia. Those states are doing best when we look at our own data. And the states that are lagging are states like Pennsylvania, Michigan, New York and then provinces like Ontario and Québec. Those have been most stringent on reopening and are the furthest behind. I would tell you, here in Texas, it's full steam ahead. We've been going out to restaurants for a number of months now, at least in our family. And we're out both nights this weekend. And it is full steam ahead here. The businesses that tend to be lagging, the sectors are still hospitality, still sports, entertainment, schools, to some degree, and then the related small businesses there that touch those sectors.

But overall, I would tell you that I think we are seeing a full reopening. I think what we're seeing is that people are just saying they can't be shut down forever. They have to -- their businesses, particularly small businesses, that is their -- that's the way they put food on the table. And so I don't expect those small businesses to continue to be shut down forever. And when will these states fully reopen? I don't know. Some of that depends on the extent of COVID and the pursuit of a vaccine. But if I had to guess, if you press me on it, I would say mid- to late 2021 you'll see most of these states and provinces be reopened.

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

Got you. And just last question, I'll turn it over. Is the ADSW -- I know we'll get more detail, and I know you have to look at the divestitures and et cetera. But is that free cash flow accretive next year to you guys? Or do we just wait for more details at Q4? Just any high-level thoughts.

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

Yes. Hamzah, I would say we absolutely expect the acquisition to be free cash flow accretive in the year ahead. The free cash flow impacts to the fourth quarter, we're expecting that to be more like a push, even potentially a little bit on the downside because of some of the cost to achieve and starting to make investments on the capital investment side as we integrate some of our sites. So I would say fourth quarter impacts is either flat to down on the free cash flow front. And then we really start to see the benefits of full run rate of the ADS EBITDA, combined with early indications of our synergy capture and a lower capital cost as well, as we refinance the required indebtedness.

Operator

Our next question comes from Kevin Chiang with CIBC.

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

Maybe just following up on Hamzah's question there. I think you mentioned in your prepared remarks about 70% of commercial had seen some sort of resumption. To the extent you start seeing some sort of softness, especially in provinces and states that are -- that may be more likely to lock things down again, just wondering if the lessons you've learned from the lockdowns you saw in March and April, would you approach these differently with your commercial customers? Or is the game plan you saw 6 months ago the same game plan you'd implement in another re-lockdown in some of these markets?

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

Yes. I don't think we would approach things differently. That doesn't mean we're going to come back out with another free month of service for small customers. And to the extent that states lock down, I mean, there has been a bit of an ebb and flow there with some states. But again, the states that have -- at least from an economic standpoint have done the best in this recovery are those states that have been pretty consistent about staying open and trying to put protocols in place to protect against spikes in COVID. And those are states like Texas and like Arizona and Florida and Georgia, So I think we would handle it the same way. And -- but going forward, I don't anticipate offering another deferral of price increases or another free month of service to small businesses.

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

I think it's equally important to think about how we responded with our employees. And it goes without saying that when you look at turnover as well as employee morale and safety results that our response on the employee front, we think, was exactly what it needed to be, and we would repeat those steps. Some of the costs, though, that we incurred, particularly for the back office as we moved folks into a work-from-home mode, those were onetime, and we wouldn't look to see those repeat.

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

Okay. That's helpful. And maybe just a second one for me. I just want to go to your sustainability report. You highlighted the progress you've made and some of the targets you have over the next few years here. At a high level, to get to some of those targets, do you see the need to maybe in the near term here see some level of capital intensity creep as you invest in some of these technologies? Or with the integration of ADS, is there any catch-up CapEx there to bring ADS up to the targets that you want to achieve as a company as a whole?

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

Well, 2 questions there, and I'm going to let John take the second one about ADS. The first one related to sustainability, it's a fair question. We don't necessarily see any capital creep related to our focus on sustainability. Look, we've been focused on sustainability. It's not something we've been focused on for 2 quarters. It's something we've been focused on for probably 10 years but more specifically for the last 5 years, and we managed through that. And to the extent that there's any capital needs, that just gets built into our budget.

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

I think the second part of the question with regard to ADS, I mean we've obviously had a good bit of time to study their capital structure in the business, and the short answer is we don't see that as a capital drag. They've been very deliberate and intentional on how they've capitalized the business, and we feel comfortable that they're in a good spot as we start the integration.

Operator

Our next question comes from Kyle White with Deutsche Bank.

Kyle White - *Deutsche Bank AG, Research Division - Research Associate*

Congrats on closing the ADS deal.

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

Thanks, Kyle.

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

Thank you.

Kyle White - *Deutsche Bank AG, Research Division - Research Associate*

I just want to focus a little bit -- focus on some contracts. And as you renegotiate contracts, especially on the residential side, are there any key differences that you've been able to implement into the contract structure as a result of the pandemic? Any kind of real examples of change here?

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

Yes. I mean, listen, Kyle, we've been talking about residential long before COVID. And I think if you look at the results, and Jim commented on what we've done on the core price and yield side with regard to residential, I think I said this on the last call. The additional pressure, if you will, that the volumes, because of people working from home, it does present another challenge. And we're having those conversations with municipalities and with the franchises.

What I'm really happy about is if you look at even the margins in residential now, even with what's going on in recycling, and to some extent, what's gone on with this pandemic and the additional waste, we're still showing margin progress there. I think the conversation around the pandemic and the waits and whatnot, it seems to have leveled out, and as we said, in kind of the mid- to high single digits, depending on where you are in the country. And that's a conversation we're going to continue to have.

Listen, it's a challenging conversation. A lot of these municipalities are facing budget constraints or whatnot, but I would tell you where we're having success is getting the price up being paid adequately for the service we're providing. Our public sector team has really done a nice job of really partnering with these municipalities and working with them on ways where they can streamline maybe some of the service offerings, still achieve what they need for their residents and still allow us to be compensated at an appropriate level.

Kyle White - *Deutsche Bank AG, Research Division - Research Associate*

That's helpful. And then going back to sustainability, you have been one of the more aggressive companies to shift to CNG fleets with I believe around 60% of your collection fleet using CNG with a target of around 70% by 2025. How should we think about this target in regards to some of the innovation that's been happening on the battery electric side? Are you considering potentially slowing down your CNG purchases to kind of wait and see how electric performs?

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

No. Kyle, I would tell you, we're very happy with where we are on our CNG conversion. We're running right now -- because we've taken some trucks off the street, we're actually running close to 70% right now of our routed vehicles. And I think part of what you're seeing in our improved maintenance and repair numbers and whatnot is due to us running a younger, more efficient fleet that's -- the majority of which is CNG.

I will tell you, on the other alternatives, electric vehicles, in particular, we've got a number of pilots going on with different vendors. I mean that's still a developing technology. I think for the heavy-duty vehicle class, that was really a focus for us, there's still a little bit of wood to chop there. And I think when we get to the point where it's advanced, we're going to have to be very careful with who we pick as in terms of the technology leader.

Operator

Our next question comes from Walter Spracklin with RBC Capital Markets.

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

Yes. I'd like to come back to volume and the discussion around the potential risk that we do see some jurisdictions go back into a tighter COVID-19 lockdown while others were opening quicker and just really kind of put it all together in your jurisdictions, adding it all together. Jim, just a simple question. I mean,do you see the volume that you saw in the third quarter -- or the fourth quarter going to be better or worse than what you saw in the third quarter? I know one of your peers has kind of, I think, conservatively guided to a flat to technically, I guess, slightly worse volume performance in the fourth quarter. But given the cadence and seeing where your jurisdictions are, what would be your best guess in terms of fourth quarter, better or worse?

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

Yes. We think it will be relatively flat. I think it's such a difficult question because of how states manage their reaction to some of these spikes in COVID. We're sitting here in Texas, and I think Texas, whether you talk about the mayor here in Houston or the governor, I think Texas, actually, we went through our own spike back in July and part of August, and the state managed its way. The city of Houston managed its way through that quite well, so we didn't re-shut down as we were in April and May. We just put stronger protocols in place, and we're more -- we were tougher on those who were offending, but we did not go back and shut down businesses.

Now that's not my decision. That's the decision of the Governor of Texas and the mayors of these cities. But I think Texas is a pretty good indicator of how to handle it without crushing businesses but also making sure that we're keenly aware of the danger of a spike in COVID. I don't know whether some of these other states will handle it the same way. So as a consequence, we're projecting relatively flat volume in Q4.

I think Hamzah asked earlier, and I didn't really answer the question, how we're looking in October. And just as I said, with the quarter, October is looking pretty similar to what September looked like, so relatively flat. A few things are lower. A few things are higher. But overall, we expect that the volume will be flat from Q3 to Q4.

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

I appreciate that. Following up on the margin question, I know operating margin has been a key focus for a lot of investors across a lot of different industries as volumes come back here. And in some sectors, it's pretty obvious where operating leverage exists and how it's going to come together. When I look at Waste, I do hear you on items such as lower SG&A, lower corporate travel and so on. But I just think about what a higher volume would mean in terms of increased congestion that would come with it -- traffic congestion that would hamper fluidity in your pickup operations. I think about overtime that you had before and whether in a normal volume environment, to what extent you can manage that down, manage that better than pre-COVID and then some of the health and welfare costs that are coming in.

When I put all that together, the line of sight toward clear operating leverage in the waste sector isn't as obvious. And perhaps, Jim, you can correct me there or give me a little bit of insight as to where operating leverage might come in for your business.

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

Well, look, we've said it. John said it in his script, and he can add color here. But what we really are -- the big takeaway for us in -- particularly in Q3, but also, to a lesser extent, in Q2 was that we now believe we can truly operate this business at a lower operating cost structure. Devina also talked about SG&A. And so in all the obvious areas, things like travel and some of the discretionary spend, we know that we can run at SG&A that's lower than previously thought.

But most importantly, when we look at what John discussed in his prepared remarks, we absolutely believe that, as we climb back to volume breakeven and then start to accelerate again, that we've learned that we can operate at a lower operating cost structure. There are -- as you mentioned, there are some things that will impact our operation such as traffic.

But when I look at -- I use Houston a lot because I sit here. But I look at charts for Houston traffic every week put out by a group here of the Greater Houston Partnership, and Houston traffic is almost back to pre-COVID levels. Yet, when you look at the city of Houston for us, we are still looking similar to the rest of our business in terms of overtime.

So it gives me confidence that while traffic will certainly create some snarls in our operations that we'll be able to hang on to these efficiency gains that we're picking up. And then add to that what we're doing with digitalization, and I believe that these -- that's why we firmly believe that this is a long-term, sustainable approach to -- a new approach to our operations. John, anything to add?

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

The only thing, I'll use coverage. And the only thing I'd add, Walter, is we do have a lot of granular data on the density of volumes we're picking up and how that's been eroded and now come back. And to Jim's point, we're talking about 70%, give or take, of our C&I business coming back that was eroded, yet you still see a very wide gap in the efficiency and the overtime ratio. So we're almost back to kind of a normal traffic pattern in a lot of places and that some of that friction has return yet, the operating folks are doing a great job of hanging on to the savings.

Operator

Our next question comes from Sean Eastman with KeyBanc Capital Markets.

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

With the Advanced Disposal deal having closed, I wanted to ask about this for a while. We haven't been able to talk to the Advanced team for some time. It's just interesting the timing of the acquisition around this pretty nice inflection they saw in average yields in 2018, then it seems like they've held on to really well through the first half of '20. So I'm just hoping you guys could sort of refresh us on that dynamic over there sort of what's driven that inflection. And then is it fair to say that once that gets folded into the WM footprint, there's potential for some additional momentum on that line as a combined company?

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

Yes, Sean. It's a good question. A couple of questions in there. One is if you -- obviously, in our prepared remarks, we reiterated again how confident we feel about exceeding the $100 million synergy target, and that's obviously in a sort of post-COVID environment. I think Richard and the team have done a really nice job in the first half of the year as evidenced by their results and their recovery, especially in the geographies that they were in, the 16 states that Advanced was in. And as Jim mentioned in his comments, we've been comparing those recovery rates in those geographies, and the Advanced portfolio came back nicely. And as Devina mentioned in her comments, the third quarter, both companies performed really well. So if you think about -- even though we're in a COVID environment, even though the divestitures were higher, we're still very confident in our synergy number as we roll into Q4 and into 2021.

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

Got you. That's helpful. And one for Devina, just a refresh on the financing of the transaction. Just trying to understand what happened with -- what happens with ADSW's debt. I guess basically, what is WM's combined company cost of debt at close? And are there any interest savings there built into the synergy target? Or is that separate?

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

Sure. So I'll start with just where we were from a leverage perspective immediately following the close, and that's about 3.15x, including pro forma EBITDA. So it really does speak to the solid financial position of Waste Management. And so when we look at that number, we think that both -- when you combine synergy capture as well as growth in both businesses, we'll be quickly to our targeted leverage ratios over the course of 2021.

As it relates to ADS' debt, that was immediately repaid upon close. And simply by taking that indebtedness and replacing it with WM's debt, we see an immediate synergy value from that in the ballpark of $40 million on a gross basis. So after tax, clearly, a lower number than that. That is not something that was specifically contemplated in the $100 million of synergies. That relates to operating performance and SG&A rationalization, and we'll be executing upon those strategies over the course of the next year.

Operator

Our next question comes from David Manthey with Baird.

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

I'm sure it's hard to see through the seasonal factors of the business, but are you seeing any actual and C&D waste is seeing a surge maybe from projects that were delayed from the second quarter as those are wrapped up? And what I'm asking is, is there any chance in your mind that we could see a double dip in that part of the business?

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

So I think your question was largely around special waste and projects there. And so what we're seeing with special waste, and to some degree, C&D, although C&D is a bit cloudy. The picture is cloudy because of last year and the fire volume from last year. And as John mentioned, if you normalize for that, it's maybe 7% down year-over-year as opposed to 19% down. But primarily with special waste, what we're seeing is that these large companies that own these special waste projects that there's some discretion in the timing of the initiation of those projects, so our pipeline looks quite good at this point. And the big question is when will they initiate those projects. Many of them, as you might expect, have been delayed in 2020, and we expect that they will build those projects into their budgets for 2021 after this unpredictability goes away from 2020.

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

And second, have you discussed thoughts on when you might reinstate share repurchase? Or not yet?

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

As I just mentioned, when we look at 2021 and see a clear path to leverage in our targeted range of 2.5 to 3x, we're really optimistic that we'll be able to resume share repurchases at some point in 2021. We always revisit our capital allocation plans in the fourth quarter, and we'll do that again this year with expectations for clarity on the dividend and the extent of 2021 share buyback at that time. But we will remain focused on balanced allocation to a combination of M&A and share buyback with excess free cash flow.

Operator

Our next question comes from Noah Kaye with Oppenheimer.

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

I'd like to start with a follow-up question on pricing and would note, by the way, the 2.6% collection disposal yield is a very strong result, even pre-pandemic. But you said, I think John earlier, that core price would have been 4.1% if not for volume. Can you just disambiguate that a little bit for folks, explain that? And then really, the corollary question is, as we move into the fourth quarter here and we'll be on some of the concessions, do we see price continuing to improve sequentially?

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

So the short answer to the second part is yes. I think what we've talked about as we went through Q2 and into Q3 is that those delivery concessions were going to have an impact, but we thought making a 1-quarter concession to those customers was the right thing to do. And honestly, from everything we've seen, from the feedback from our customers around Net Promoter Score I commented on,that it's absolutely been the right move. I think what you're seeing from Q2 to Q3, in particular, in commercial and industrial, where most of those concessions were made is you saw a nice recovery. We're not all the way back up to where we were, but what we've all said throughout this pandemic when we've been chatting with you folks is that it's not a change in our strategy or our philosophy, but it was a short-term decision made to ease some of the -- what was going on with our customers. So I think when you look at the bridge between Q2 and Q3, we'll see continued momentum as we go into the fourth quarter and into next year.

Operator

Our next question comes from Jeff Silber with BMO Capital Markets.

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

You talked a little bit about this in the earlier remarks, but we've been seeing a lot of headlines of state and local governments under pressure. And the thought is that the pressure might get worse because tax revenues lag. Can you just remind us what your exposure is to municipalities and what you think? Do you think the environment will get worse over the next year or 2?

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

I'll just quickly speak to the impact of CPI, which is usually one of those pieces that can have some pressure, and that's about 35% to 40% of the revenue line. And so that is a place where we have our eye on, what we're going to do in pricing execution over the course of 2021 to overcome what may be mild pressure on that side.

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

I would add to that. Thanks, Devina. I would add to that, too. If you go back the last handful of years, which I've done over and over again, and look at CPI and our core price performance, you can see that they're not -- there's a disaggregation there, and that's been strategic. We've talked about moving away from a traditional CPI to other rate-setting mechanisms, and I think that's what you see. And as evidenced by what we're doing in residential and with some of the municipal customers in our landfills, that core price performance shows that we're moving further and further away from CPI because it's frankly not a rate-setting mechanism that aligns as well as some others when it comes to the cost of our business.

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

Okay. That's helpful. And then just one quick follow-up. You mentioned the synergy targets with ADS in excess of $100 million. Can you just remind us the timing on that? Is that something you think you'll have fully done by the end of next year? Or is it going to take a little bit of time?

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

No. Well, clearly, originally, we talked about it going through '21 and into '22, and that was before maybe the delay. So the short answer is we won't get it all in '21. We feel like we've got great integration plans. The teams hit the ground running on Friday. Things are going exceptionally smooth. I looked at our -- talked to our team this morning, and customers are getting serviced. So we feel very pleased about where we sit, and I think we're going to make a lot of ground up in '21. We won't get it all, though.

Operator

Our next question comes from Michael Hoffman with Stifel.

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

Playing a little bit of cleanup here near the end. So I got a few questions just to clarify, some things we've been hearing. Devina, I get that we can't get a profit guidance yet because of the integration challenges. Can you tell us what the 2 months of revenue would be in the fourth quarter for ADS and then what the rollover is into '21? Hello?

Operator

Ladies and gentlemen, this is the operator. Please stand by. We are experiencing some technical issues. Again, please hold. (technical difficulty)

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

Michael, we're back. Can you hear us? Sorry. We figured that most of your questions have been asked, so we went ahead and...

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

Yes. Well, I'm playing cleanup, so I've got to come back to some of the stuff that's been discussed and get some clarity. Devina, on Advanced, I get we don't have EBITDA. You need to get through some budgeting and what have you. But can you tell us what 2 months of revenues would be in 4Q and what the rollover would be into '21?

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

So the rollover is an interesting question. 2 months, we're looking at about $275 million of revenue on a gross basis. On a divested basis, we're in the ballpark of $225 million, but it's really hard for us to know for sure. On a rollover basis, you would just extend that off of the 10 months, but we're not yet speaking to expectations for yield and volume for their business because we're still in the planning processes.

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

Okay. So if I just took -- it's $225 million divided 2 and then multiply it by 10, that's what I should roll over?

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

Yes. But we have yet to assess the intercompany impact. So if you think about the integration of the sites that are in markets where we will now take ADS volume into a Waste Management landfill, we don't know those impacts to the net revenue of the business.

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

Fair enough. Fair enough. Do you still spend -- plan on spending $40 million on the ERP this year?

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

So we have -- to date, that number is in the ballpark of $25 million, I believe, and we are on pace. The reason the number is lower than we had initially expected, it's not because we slowed anything down. It's actually because we saw some ability to reduce our costs with T&E on the third-party support that we had, and so we have a lower cost in the current year. We do, at this point, expect to spend more in the coming year on acceleration of our work efforts, both on the HR side and the finance side.

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

Perfect. And then cash flow from ops is going to be about $100 million better than your 2Q revision of the numbers. How much of that's working capital versus you're running the business better, it's profit? So...

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

When we look at it, the cash flow from ops piece is -- I would say you kind of split it down the middle. You've got lift in operating EBITDA above expected levels, and that's both on the revenue side and the margin side. And then the remainder of it has to do with the cash collections taking hold that I mentioned earlier. We had projected an $80 million to $100 million headwind from DSO in the year, and we now have worked pretty hard to offset almost all of that. Though at this point, we're projecting that we get that to a moderated level of, say, a headwind of $20 million to $40 million.

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

Okay. That's great. And then just to be clear, your incremental margins before we entered this were kind of like 40% around collection and in the 60s in disposal. And what your message is, is you've proved that you can permanently lift the incremental margin.

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

That's right. I think that when we look at the incremental margin of the business, while the traditional returns from a margin perspective on an LOB perspective are important, but what's equally important is our ability to get leverage on the cost side. And what you've seen strong execution on in 2020 is that getting the most expensive work hour out of the day and getting the most expensive mile off the road. And so both on the labor and maintenance front, we've seen really strong leverage, and that really does benefit us both on collection and disposal. John mentioned in his prepared remarks disposal overtime hours being down, approaching 30%. So really strong results on the cost side give us really a lot of confidence that we're going to have better incremental margins on the volume return.

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

Okay. And then, Jim, you shared that you thought if the states get to full reopening by the middle of the year a trend. Is this an appropriate way to think about cadence without getting into numbers? First quarter's negative volume, 2Q is positive. They even each other out. Second half is positive. The year is positive.

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

I'm not sure I'd say they even each other. I mean, look, you remember that a little bit of the first quarter of '20 was impacted, not a lot. But certainly, 2 or 3 weeks of the first quarter was impacted. And then obviously, second quarter was a huge impact. So I wouldn't say they would even each other out. We haven't fully determined what our volume is going to look like for 2021 yet. But just based on what you were saying there, I think first quarter is going to be -- certainly going to be less impacted than second quarter. So the year-over-year comp might be difficult in Q1, but we do have that second half of March that is an easy comp. And then obviously, you have a very easy comp when you get to Q2 and Q3.

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

Okay. And then if you added back in your environmental fee number, the $42 million, the right way -- and that's because you gave back these and did things like that, I think, if I understand correctly, then your yield would have been like 3.4% in the quarter. Have I interpreted that correctly?

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

I'm not sure we've done the math there. But look, there was -- there were a lot of gives to our customers for all the right reasons in Q2 and Q3. And that's why we have said we are confident in our ability to capture price going forward.

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

Great. Last one for me. You talk about people first. Talk about the COVID fatigue and how that sort of is managed through as a business given the essential service aspect of this and the day-to-day sort of presence of this?

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

So Michael, I would tell you, listen, the vast majority -- you mentioned essential workers. The vast majority of our folks have never gone home, and we have -- are certainly following all of the safety protocols as they ebbed and flowed. And I think the proof is, is that when you look at where some of our employees have been affected, by and large, it's not been from inside the workplace. It's been from outside the workplace. So the protocols we've put in place have clearly been helped to prevent any spread within our districts.

I would say, in terms of fatigue, I certainly think in the beginning there was a lot more unknown than there is today. I think with all the assistance we've provided to the field, I think the field would tell you now that we're operating a little bit of a new normal. But as evidenced by turnover, Devina mentioned morale, operating -- I mean, when you look at all this, it would suggest that our teams continues to perform really well and not really be fatigued, if you will. I know it is certainly a stress on everybody, but I think our team has done an excellent job of managing through it. The leadership has done a great job at the field level and here in Houston of managing through it. So I would tell you it's the new normal for now until we get a solution for this.

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

Well, we've provide, Michael, a lot -- in addition to financial support for all of our teammates, we provide a lot -- through our HR group, we've provided emotional support for employees. And certainly, we're seeing an increased demand for that year-over-year. I think it's -- though it's been amazing how our teams performed under these circumstances. And I do believe that by taking that financial -- that big financial worry off the table for them, that has helped them emotionally as well. So -- but yes, you're right. I mean we talk about the term people first all the time, and it is at the top of our list.

Operator

Our next question comes from Michael Feniger with Bank of America.

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

Devina, you mentioned how CPI 30%, 35% of your business could be mild pressure in 2021. The good news is you guys are talking about the momentum really in commercial and industrial. Do you usually implement like 50%, 67% of that book of PIs for 2021? Does it usually happen in Q4 and early 2021? And as Jim mentioned, some pockets of weakness, like education, entertainment, hospitality. How do we think about the ability to implement some PIs with some of your fragile customers? Is it more of -- I'm sure it's not a one size fits all. So is there a percentage of your book that you guys are looking at, and that's more of a wait and see as the recovery broadens out?

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

I'll speak to the first part. So our annual PIs for that part of our business are typically in July and October and so really wasn't much of an impact in 2020 in terms of our deferred price increases because we deferred those beginning in April and continued that through June. So our PI activity was normal course of business beginning in July with the exception of the items that Jim has mentioned. So when we think about the year ahead, that's when you can start to see those pressures take hold. And then with that, I'll turn the rest over to John.

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

Yes. Michael, I would say, I think you said it well, is we've got some pockets that Jim referenced, lodging, some parts of education, travel, et cetera, restaurants that are still in some form of a business slowdown, if you will, and I think that's right. I mean, Jim said, what we did in Q2 is not necessarily what we're going to repeat. But I think going forward, that is a case-by-case basis on understanding what's going on with each of those customers in those segments and making the appropriate long-term decision.

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

That's really helpful. Have you guys -- is there a rough estimate of how we should think about that base? You guys have such a diverse customer base. But like you just said, lodging, travel, education, maybe restaurants. Is there kind of a percentage that we can say this is kind of the pockets of risk while the other businesses are obviously moving in the right direction?

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

I think it's -- Michael, part of why this industry is such a great investment for shareholders is because we are so diversified that one sector going down doesn't really have a dramatic impact on us. So now obviously, in April and May, when you had multiple -- the entire economy going down, it was going to have an impact on us. But even then, you're still talking about a certain percentage of the economy being essential services, and we provide service to them.

So I think when we look at that piece that has lagged, it's probably -- I mean we talked about schools being 8% to 10% of our commercial business, and those have come back in many cases, in most cases, maybe not fully. Some have come back fully. Some are coming back on a hybrid basis. The sports teams are trying. As we saw last night on the football game, the Pennsylvania teams have been at 0 fans. Looked like last night, they had -- 7,500 fans was probably good for that game, but it's coming back slowly. But the beauty of this industry is that we represent all sectors of the economy. And many of those sectors are deemed essential and they have been there since March. And those that are not essential are recovering reasonably quickly, some less than others. But we feel confident that, as we showed in our volume numbers, that 2021 will be the eventual emergence of all of these businesses.

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

That makes sense. And I might have missed this. You guys clearly performed very well in the third quarter, and I think you said ADS did, too. Are there going to be financials on ADSW since they were a stand-alone entity for the months of Q3? And how should we think about -- you guys went through this very lengthy, long DOJ process, some commercial customers a bit -- are a little fragile right now. Can you go out and reprice the ADSW book right away? Or is it kind of have to be a wait and see and take it quarter by quarter?

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

So with respect to whether or not you'll see a full set of ADS financials for the third quarter, the quick answer to that is no. What I would say is that when we give guidance in 2021 related to the combined business, we'll give a lot of transparency and color about the pieces of the puzzle that get to the combined outlook.

Operator

Our next question comes from Mark Neville with Scotiabank.

Mark Neville - *Scotiabank Global Banking and Markets, Research Division - Analyst*

First, great quarter, and congrats on getting ADS done.

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

Thank you.

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

Thank you.

Mark Neville - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Just perhaps my first question, just around the cost conversation and the structural improvement. I'm just curious. As long as you come back -- again, presumably some costs come back. But the steps that you've taken through the pandemic and sort of what you've done, has all that been sort of fully optimized? Or is there still sort of cost improvement to come in the coming quarters from the actions that you've taken to maybe partially offset some of that cost come back?

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

Yes. I mean certainly, when -- as volumes continue to return, there's some incremental cost. But I think is what you've seen from us through Q2 and then in Q3, we've been able to certainly overcome that. And we've expanded margins the way we have, and that's in light of us losing volume in our highest-margin business. So the natural thought would be as that business starts to come back, we continue to keep a close eye on cost control, both on the operating side and on the SG&A side, that we've got some more runway there.

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

I think the additional leverage that you see is the continued execution on optimal work week, continued execution on maintenance service delivery, optimization and then the cost reductions that we should get in the overall structure, whether it be back office or front line, as a result of the technology investments that we're making taking hold.

Now Jim spoke fully to the fact that those will take some time, but we do expect to see those begin to take hold in 2021. And there's additional leverage from all of those initiatives combined.

Mark Neville - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Okay. Maybe just a question on price. Again, I appreciate there's parts of the business that are still feeling some pressure. But again, there's other parts of your business where you're taking some sort of structural actions around municipal landfill price. I guess my question just would be -- maybe not the quantum, but more in terms of the length of time or the visibility that you have around price or the strength in price, just from some of the structural actions that you're taking.

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

I think your question might be related to -- and in some ways related to what we're doing with our differentiation efforts. And so we believe that there's -- not only is there this price strength that we've shown, which is, in large part, intended to recover cost increases and at the same time expand margin. But there's also a piece of that now going forward, which we really haven't tapped into yet, that's really related to a differentiated service offering. And when you're differentiated, you can charge more for your services, and your customers are willing to accept that because they truly view you as being differentiated. That's really what we hope to get out of customer service digitalization, and we are very much in the early innings there.

Mark Neville - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Okay, okay. Maybe just one last one then on the synergy, the $100 million target. Devina, you mentioned, I think, $40 million of savings is from refinancing the debt. When you talk about confidence in exceeding the $100 million, is that sort of driven by that? Or is it, again, I guess, the $100 million on the operations?

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

Yes. No. Just to clarify, if I misspoke, the $40 million is incremental to the $100 million. The $100 million is from operating and SG&A as well as CapEx execution.

Mark Neville - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Right. So when you talk about exceeding the $100 million, that's, again, aside from the $40 million?

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

That's correct.

Operator

There are no further questions in queue at this time. I'll turn the call back over to our presenters.

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

Well, thank you. In closing today, I'd like to recognize 3 of our areas that have had to contend with natural disaster after natural disaster. And in doing so, they've done it with amazing patience and professionalism. First off, our Gulf Coast area took a direct hit from 3 separate hurricanes this year. And many of our teammates were displaced from their homes, and several of our facilities incurred pretty significant damage. But through all of that, they've persevered and they've gotten the job done, which was amazing in and of itself.

And similarly, our Northern and Southern California areas have really almost had to come to accept that wildfires are just a devastating normal these days. We've had wildfires the last several years and certainly including last year and then again this year, but the team hasn't wavered. They've provided outstanding service and really demonstrated love for their customers and their communities. In fact, you may have heard about the story of one of our drivers who literally saved the life of an elderly woman in Paradise, California last year.

So to those 3 areas, Northern California, Southern California and Gulf Coast, they should be commended for the job that they've done through this really unfortunate series of natural disasters.

Thank you to all of you. God bless you, and thank you to all of you for joining us this morning, and we will talk to you next quarter.

Operator

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