Participants

Devina Rankin, CFO and SVP of Waste Management (WM)

Nate Abercrombie, The Stock Podcast

Interview Transcript

Nate: [00:00] Devina Rankin with Waste Management, thank you so very much for joining the IWTB podcast. It's going to be a pleasure talking to you about your company.

Devina: [00:08] Happy to be here.

Nate: [00:09] Could we start off just talking about your background; your history at Waste Management and just how you came up through the industry and then eventually achieved the role of Chief Financial Officer?

Devina: [00:23] Yeah, sure. So I've actually been at Waste Management a little over sixteen years now. I started with the company as an employee after having seen the company from the seat of the audit firm Arthur Andersen and most people know the story of how Arthur Andersen ended up no longer being in existence. When the firm went under, I found myself looking for a new home and a new career and I knew the business somewhat well because of the time that I had spent here and I had actually been really impressed by the resilience of the business at that point in time because here the company was going through merger integration challenges after the USA Waste-Waste Management integration. And while that presented a lot of significant challenges, the business just did phenomenally well and was showing a level of strength in those circumstances that impressed me. And so I came on board as an Analyst in the financial reporting team doing SEC reporting and I think what was great about that experience and where I started is that it required that I understand the company from a pretty broad perspective and ultimately that perspective is of the shareholder and telling the company's story in the 10Q's and 10K's in a way that resonates with shareholders.

[02:02] And I did that for about eight years and then had an opportunity to move into treasury and that was a really important step in my career; both for Waste Management specifically, but then also as I think about broadening my expertise as a finance professional because as an accountant, you tend to have more of a historical perspective. What the move to treasury did for me is give me more of a forward-looking perspective. And from a career perspective, I think what was so important for me, Sheryl Sandberg’s book, Lean In, says it very well, with respect to your career being a jungle gym and not a ladder, and I can tell you at the benefit of hindsight that if I hadn't taken that move into treasury, I would have never been a good candidate for CFO of Waste Management. And so I think it positioned me very well to continue to grow professionally and at this great company.

Nate: [03:11] Yeah, that is interesting. What is the role of a treasury analyst? I mean, what were your responsibilities there?

Devina: [03:21] Yeah. So I was the assistant treasurer. I was responsible for all elements of cash management, debt capital markets work; so understanding the company from a debt investor perspective. While our debt doesn't have to be marketed because it tends to fly off the shelf anytime that we have an issuance, which is a really good thing, I was participating in connecting the equity investor story with a debt investor story and bringing all of that together, thinking about our financial position. And that was a point in time that Jim really came on board in finance at Waste Management and we started to see pressure to our leverage and the balance sheet quality that made the job really exciting. I was in a great place at the time because we had an opportunity to really take a hard look at where we were and where we wanted to be. And so I participated in some recapitalization of some of our debt balances and very strategic and intentional steps to reduce indebtedness in the right ways and balance that with still a very good focus on shareholder return.

Nate: [04:43] So could you just provide maybe a brief history of Waste Management and the industry?

Devina: [04:49] Sure. So Waste Management was established as a public company in 1971. So you can see that the company's history goes pretty far back. And if you actually look at the companies that were brought together to form that initial public company, those roots are even deeper. And we've had some counting that go back as far as the late 1800's. So it's a business with very long history, very deep history, but what really happened in the time since Waste Management became a public company is early on it was about recognizing that there was value to the roll up type model for this business. And this is a local business in a lot of ways but our founders recognized that there was tremendous value in finding a way to scale the business across a larger footprint. And so that model resulted in, I remember stories of more than an acquisition a day being done in the late 90's as an example.

Nate: [06:04] Wow.

Devina: [06:04] And so there was just tremendous focus on building the scale of the enterprise over that time period that ended up resulting in the merger of USA Waste and Waste Management in 1998. And that was actually around the time of my introduction to the company because as I mentioned before, I was part of the post-integration team with Arthur Andersen. And what had happened there was really about a weak moment in Waste Management history because of some accounting issues that they'd encountered. And as a result, one of the smaller regional players saw an opportunity to merge with Waste Management and at that time they were the largest player in the industry and USA Waste was relatively small. Basically, consolidation has continued to be a theme in the industry and we think that that consolidation has provided a great deal of value, not just to the shareholder but also to the customer. And we think of it in terms of the fact that this business, like I said, is a very local business and so having better safety standards, consistency across the industry when it's held by those larger enterprises really is for the benefit of just about every constituent.

Nate: [07:37] Has Waste Management and the industry always been a roll up story?

Devina: [07:46] I think the roll up story started in the 1990's, but I think the roll up story has continued. I think you continue to see consolidation in the waste industry and that created a changing dynamic. There used to be more fragmentation even in the large public company than there is today and we're seeing less and less fragmentation in the space. And I think, ultimately, that's a good thing. I think it's a good thing for discipline and safety, discipline and pricing, discipline and cost control and efficiency and competition from a customer service differentiation perspective. I think all of those things really ultimately drive value to the shareholder and to the customer.

Nate: [08:37] Could you describe Waste Management's asset portfolio and what do you think is the most important or critical component to that portfolio?

Devina: [08:47] So I'll start with our people. Waste Management has over forty-three thousand employees across North America and those employees serve over twenty-one million customers. So when we think about the portfolio of assets, it really does start with the Waste Management employee. Beyond that, it becomes about the physical assets and we really are unrivaled in scale and scope. We have close to two hundred and fifty landfills, over three hundred transfer stations, over a hundred recycling facilities and forty of those are single streams. We have over fourteen thousand routed vehicles serving the collection lines of business with about 50% of those routed vehicles now being natural gas. We focus a lot on renewable energy and believe that that is a fundamental sustainability oriented building block for this organization so that we think about the environmental impact of our business over the long term. And that became a much more significant focus of the enterprise probably about ten years ago, but it's central to the way that we think about things now and how we expect to build over the long term.

[10:13] And so like I said, getting to a point where we have the largest natural gas fleet in the industry is very impressive and something that we're very proud of. We've built out a significant fueling infrastructure. We have over a hundred fueling stations across the country, so very impressive. And then on top of that, we also have about a hundred and twenty-five landfill gas-to-energy facility that take the gas that's naturally created in the landfills and convert that to a renewable energy source. So again, focusing on creating environmental utility from the service that we provide every day.

Nate: [10:52] Yeah. And I'm going to ask this question and you may not have the data point right in front of you so no big deal if you can't answer it. But I'm kind of curious, how much natural gas does a landfill produce? Like an average-sized landfill, how much natural gas are you getting out of that?

Devina: [11:14] That's a good question. I don't have the answer to that. I certainly can find out and let you know. What's important to keep in mind there is it's going to vary dramatically from one site to the next. So what I mentioned before about the fact that we have about two hundred and fifty landfills but we only have about a hundred and twenty-five landfill gas-to-energy plants, you might ask yourself why it's not two hundred and fifty. And the answer to that is because, as an example, a C&D landfill, construction and demolition waste, that won't create the same methane that an MSW landfill creates. And so you need the right composition of waste in order for the landfill gas to be something that can be captured and then converted into energy.

Nate: [12:04] Yeah. You mentioned landfills. I am very curious how many landfills are there in the United States?

Devina: [12:14] So we don't know the count of landfills but when we think about the capacity, the landfill airspace capacity that exists in the marketplace, we think that the large three public company currently holds somewhere in the 40-50% range of airspace capacity in the market. So that shows you, from a scale perspective, how significant that two hundred and fifty landfill count is.

Nate: [12:47] Yeah. And I think landfills, maybe talking about landfills just a little bit more is important because I think one of the pushbacks, at least one of the pushbacks that I remember hearing about the waste industry was just that the barriers to entry are very low. So if somebody wants to go out and buy a truck, a garbage truck, and then go out and contract with people, it's not that difficult to do. But the landfill component to the investment story for Waste Management is a really important one because the barriers to build a new landfill are quite high, aren't they?

Devina: [13:32] So, yes. And it's not necessarily that the barrier to build a landfill is high. It's that the expertise required in order to permit and construct a landfill requires a lot of -- there's a lot of complexity to the business that really is good for all of us because it means that the landfill is not a large hole in the ground. It's a constructed assets and the barrier to entry really is associated with the sophistication that exists in constructing, permitting and then, over the long term, operating and capping and closing that landfill. And there really is a concentration of, I would say the respect and trust that is placed in different people's hands in order to do that as a business because it's not something where you can just show that you have capital. You really have to have that human capital that is that expertise.

Nate: [14:43] Yeah, that makes sense. So you mentioned some different waste streams. You mentioned C&D, construction and demolition, and you mentioned MSW. Could you just describe the different waste streams that Waste Management touches?

Devina: [14:58] Sure. So about 50% of our business is collection and within collection, we break that down even further between different types of customers, starting with our residential customers and that's about 25% of the collection business. Then we have our small container of small and medium business type commercial customer and so that's often referred to in terms of the type of truck that services it and as the front-end loader. And then you've got -- that represents about 40% of the collection business. And then you've got industrial haulers, industrial collection business, and that's about 30% of the mix. In the industrial, you can think of in terms of being split between temporary and permanent business and the temporary business is the large open-top containers that get placed at a construction site and then the permanent business is more in the back of a large, say, grocery store or other sort of large business that has significant waste needs.

[16:19] Then if you turn from collection to the other lines of business, you have the transfer business, which is basically, if you think of it in terms of consolidating the waste at a closer in facility and from a logistics perspective, optimizing the transportation of that waste to the ultimate disposal facility. Our transfer business is about 10% of our revenue, and then our landfill business is about 20%, and the recycling line of business - so I'm sure we'll talk a great deal about recycling - but recycling's a little less than 10% of our business today. We do have some other parts of the business, the ancillary businesses that are in the mix. You can think of the renewable energy sales, those aren't captured in the landfill line of business as an example. So when we sell that electricity, we consider that kind of an other non-core type business.

Nate: [17:22] I see. Okay. Now, that's very helpful. I have this question in here about margins and how much of an uplift you get from owning the landfill. I'm not sure if for competitive reasons, if that's something that you'd like to talk about. But I think it's also important just to highlight, I guess how critical, again, how critical landfills are to the business and how owning a landfill improves your margins.

Devina: [17:54] Actuarially, we don't talk about the results and the returns of each line of business specifically but you're absolutely right that there is certainly an expectation for higher margins in the landfill line of business and that's because of the capital intensity of the landfill line of business. So when we think about the specific margins of the business, we really turn that into a return on invested capital consideration. And so our collection line of business, the best margins and returns are in our commercial and industrial lines of business. The residential line of business actually has pretty thin margin. It's highly competitive. The barriers to entry are lower in the residential line of business than they are in commercial because it's easier to get route density right away. But over the long term, we think of ensuring that the margins in the landfill space are elevated relative to that collection line of business that is very, very attractive because, ultimately, to cover the long-term capital investment that you have to make in a landfill and the long-term closure and post-closure of that site, you have to ensure that the margins on that business provide the right level of return for the total cost of that side over its entire life.

Nate: [19:25] Yeah. And achieving those returns has a lot to do with price and I think the pricing dynamics in the waste space are really interesting because my -- so when I first started covering the space, my mentor in the Industrial Group that post a part of, he described the pricing dynamics, or at least the history of the pricing dynamics in the waste space, in such a way that there was enormous competition and people were competing on price. And I think it had a lot to do with maybe it was a private equity firm that bought a waste business and was just trying to grow the business really rapidly. And from what I understand, the pricing dynamics, well, they were nothing like they are today because fundamentals in the business, in the waste business, are - they still look to be really, really strong. But the history behind the pricing dynamics is something that was interesting to me. Would you be willing to provide just a little background on price and the history of it and then just the dynamics that you think are important for investors to understand?

Devina: [20:38] Certainly. So from my perspective, in the time that I've been at Waste Management, I can tell you that the evolution and how the business thinks about pricing dynamic has been remarkable and I really think it comes back to one word and that's "discipline." And in the past, I would say that this industry was one of putting garbage on sale to create benefits and market share. Right? So I think you had a realization that in order to get more of the pie as a company, the best way to do that was to competitively price the business. And instead of recognizing that that would just shrink the size of the pie, that would sometimes result in a downward spiral to a point where return dynamics in the business weren't what they should be. And there was a real recognition by our last CEO and I really do think that David Steiner deserves a lot of credit for having the insight about our business, about our dynamics, to understand that really no one is winning by putting garbage on sale because no one's going to create more garbage just because we put garbage on sale.

[22:08] And so a recognition that in this industry to lead on price didn't do anyone any favors because it just reduced the size of the overall marketplace, was a real turning point. And I think the level of discipline that we created and then we believe that we continue to see the benefits of, as we think about the consolidation that's happened in the marketplace, but also just as different things like workforce dynamics have changed and you have different pressures by the smaller haulers, as an example, on their cost structure, has really changed the way that the industry thinks about price over the long term. And there's enough fragmentation in this marketplace that you're really going to have a good, strong competitive dynamic in a strong pricing environment.

Nate: [23:13] Yeah. Absolutely. It's just interesting. Electricity, oftentimes you don't really care; you are buying a commodity. With waste, it's another kind of like a utility bill. I live in Denver. The city picks up my garbage. But in other markets where you are out there competing for business, I guess I'm just trying to understand how it works from -- do you talk to cities and you sign agreements with them to pick up trash or are you going out door-to-door in certain markets trying to get more people to use your service as opposed to one of your competitors, I mean, for it. And I guess I'm really thinking about it more on the residential side, but how does that work in terms of growing the business and the arrangements that you have with your customers? I mean, you don't want five different garbage trucks going down one alley every other Thursday. You'd prefer to have just one garbage truck going down that alley and that garbage truck being your garbage truck. But how do you maintain those relationships with your customers, or is it cities on the residential side, and then maybe we could talk about commercial and industrial after that.

Devina: [24:35] Sure. So I think what's helpful is to think about it in terms of the different structures that can define how a marketplace is defined in terms of waste service provider. And in some markets, you'll have a single municipal contract, whether it be a homeowners' association or a city has decided that they will contract on each resident's behalf and pick a service provider for a number of different reasons. In some cases, we have some municipalities that are very focused on sustainability and the fleet that is driving around in their communities and, for that reason, they want to see a company like Waste Management because we are prioritizing the CNG fleet. But then you have, alternatively, an open market model and that open market model is one where each resident makes their own decision about service provider. So your ability to create customer relationship in those two different models is very, very different.

[25:49] Differentiation of service in the residential line of business can be challenging because ultimately you do have a part of the customer base that's going to look for the best price for the service that's going to be provided, but there are differentiations that matter and, like I said, in some markets it's going to be about the company that will make a commitment to the community in natural gas. The company that is willing to have an integrated service offering that pulls together waste management as a top collector of municipal solid waste, but also a leader in the recycling space. Or in the West Coast, as an example, or Canada, where organic waste has become increasingly important. So there are types of service that can be differentiated and where there's differentiation, that's where establishing that deeply rooted customer relationship is so important and key. You're going to have other parts of the business where you still want to have a top quality customer service focus, but on top of that, your focus has to be on continuous improvement and efficiency because the customer's going to be much more price sensitive.

Nate: [27:17] I see. Okay. And for commercial and industrial customers, are you out there marketing to them and you're competing maybe a little bit more acutely with, well, for commercial customers. Just to understand how you grow the commercial and industrial businesses, what are you doing to gain new customers?

Devina: [27:45] From the commercial line of business, that really is understanding the marketplace that you operate within and enhancing your route structure and the service offering that you have within that community in order to make the business as efficient as possible. Those customers, we talk a lot about churns in this business and those customers tend to stay with Waste Management for about ten years, which is really impressive. And so a lot of times just the greenfield opportunities and looking for new business growth and ensuring that we are participating in that market expansion that exists in growth markets and so for us it's about allocating sales resources and capital dollars and people resources to the markets that are growing more significantly than the rest of the US and Canadian economy. So it's a really disciplined focus on the market dynamics and thinking about how we are positioned in a market today and how you bring those two things together to create the most value. And then it's retaining that customer and ensuring that that customer is going to stay with Waste Management for at least ten years.

Nate: [29:06] I'm glad that you mentioned churn because I wanted to talk about core price and yield because when I first started learning about your industry, I really struggled with core price and yield because I kind of felt like they were maybe used interchangeably and how on the SEC filings Waste Management, Waste Connections and Republic show the numbers that result in the core pricing and yield, maybe are a little bit different, I'm sorry, different. And so as an analyst trying to understand what those two things are was really, it was critical, but it's also kind of hard for me to wrap my head around at first. So could you just describe what core price is, what yield is and what are the different numbers that go into core price and yield?

Devina: [30:01] So the biggest difference between core price and yield is that the core price measure is how we think about pricing activities on existing business and yield represent changes in price for all business, including changes in the average unit rate for new business. So there really is a difference in the two measures. One is focused on our ability to roll through price increases to existing customers and the other represents both that and the impact of the change in new and lost business pricing on the total mix of the revenue that the business provides.

Nate: [30:48] Now, that's super helpful. So could you talk about recycling a little bit. Waste Management is, I believe you guys are the biggest recyclers in the United States and I think there's kind of a storied history there just in terms of how profitable that business was for Waste Management early on and then commodity prices went down. Maybe there was an oversupply of recycled waste, but I think Waste Management's role and history in recycling is really interesting. So if you had to frame it up for somebody, how would you describe it?

Devina: [31:25] Sure. So I think the role of leadership in the recycling business is one that we've held for decades and Waste Management started to have a significant role in recycling in about the 1980s and there was a point in time where we realized that ultimately the demand for recycling, so to speak, or the number of tons that would get recycled would actually increase pretty dramatically because customers felt like it was more convenient. Because in the early days, we probably can all remember where we had to put our materials in three different containers and early on you probably had your newspaper in one bin and then your other paper be it magazines or the glossies that you get in your junk mail on Tuesday, is in another container. And then you would have your plastics and glass in a third container and metal. And there was a realization that the burden for the consumer was probably reducing the amount of material that was taken out of the waste bin and put into the recycling stream.

[32:43] And technology was brought to play, called single stream recycling, around the 2000s. And there was a realization that you could see a dramatic step change in the amount of material recycled and that change is about 40% more recycled materials, which is quite remarkable. And so we made significant investments in building out a network of facilities and then we made additional acquisitions in that line of business as well and really have seen the amount of recycled materials improved over the years quite nicely. Now, that has leveled off a bit and the leveling off probably comes from the fact that we're seeing some of the diversion goals associated with diverting waste away from the landfill being less about the environmental utility of what actually is ultimately recyclable and just taking waste out of the stream that is landfill bound. And so we're trying to consider, because right now today we're at about 35% on average recycled across the entire stream of waste and to see another step change in that, it's difficult to know what can create that. But what has gotten in the way of any additional progress there, I think in large part, is the volatility that you spoke of in recycle commodity prices because ultimately the market for the material created out of the recycling process has dramatically changed, particularly in the last year or so.

Nate: [34:37] So going from multiple streams, meaning like the different bins, to single stream, increased recycling by 40%. Did I hear that statistic right?

Devina: [34:51] That's correct.

Nate: [34:52] Wow. That is pretty phenomenal. Other parts of the world recycle quite a bit. Now, there are some parts in the world, I think Europe, recycles a lot more than people do in the United States. Why is that? What is it? Just consumer behavior or is it the packaging; is a lot more of the packaging recyclable? Why is there such a big difference in the amount that we recycle here in the United States versus other parts of the world?

Devina: [35:20] I really do think that it's two things. I think the first is the economics and when you look at Europe and the model that they've created for disposal alternative, they've really shift the economic realities of landfill as a viable business through taxation. And so there's a clear difference in land availability between Europe and the US. There's a lot more land available in the US and so because of that, I think that when you look at the economic difference between processing a ton of waste through a recycling facility, and in today's dollars that's around $65 a ton, versus putting a ton of waste into a fully constructed landfill at, say, on average, $25 a ton, there's just a dramatic difference in those two options. And in Europe, the taxation on the landfill has taken away that economic difference.

[36:35] And then the other I think is the consumer. Ultimately, there has to be a consumer demand for recycling as a business model. And I think because in the US we started with something that really was add on service, it wasn't priced specifically and separately as as a compliment to the waste service, it was really shown as just an extension of the service that was already being provided, I think we've had a hard time having the consumer buy in to the incremental costs that they will bear in order to create the environmental and sustainability focus utility that the service provides. I think you see that in different markets in different ways. So on the West Coast, as an example, you've seen a lot more legislated participation in recycling as a business and when we have that kind of government support and buy in, we've certainly seen the ability for those businesses to create the environmental utility at the same time in an economically viable way.

Nate: [37:51] I appreciate the insight into your recycling business. Another industry, or I guess an industry that you guys touch is energy, and I know that this was kind of a hot topic, call it five years ago, when the growth in oil and gas drilling was really booming and there's a lot of waste. I didn't realize this but there's an enormous amount of waste associated with drilling a well and so the waste companies started growing their energy business or at least their exposure to energy waste and I'd love to get your perspective on the background there.

Devina: [38:31] Yeah. So we certainly participated in that upswing that we saw several years ago. We did so a little differently than our largest competitors. We did that organically and where we already had well-placed disposal assets and collection operations so that we could use those existing assets to better leverage the overall service that we provided to those customers in those markets. While we did see our competitors go out and make very intentional investments through acquisition in that space, and it's been a good market for all of us, I believe, and you certainly do see some volatility in that business. I think that's typical when you have anything that's commodity-oriented. The upswing that we're seeing in that business today is nice and that's good. It's less significant for us than it is for our larger competitors but we continue to look for opportunities to grow the business over the long term because this upswing is certainly something where we see long term growth potential and we're going to continue to look for ways to optimize that for our business.

Nate: [39:46] Yeah. Could you talk about technology? Just to transition a little bit to one of the things, one of the concepts that I remember having a couple of conversations with Jim Fish about what you guys are doing in the technology space and how important technology is for waste management?

Nate: [40:00] What you guys are doing in the technology space and how important technology is for Waste Management?

Devina: [40:06] Technology is actually really exciting and I think it's exciting in a way that most investors or customers would never think about. Our business is one that's not necessarily been a fast adopter of technology, but technology certainly played a role in the way that we do business. If you look at what we've already accomplished, things like using an automated side loader in our residential collection business so that it changes the job or the employee, it changes the efficiency so that no longer do you need a driver to have a helper on the truck that's getting up and down off of the truck at each and every stop in order to sling the waste into the back of the vehicle. Now you have one driver and they're able to navigate the route very efficiently and very safely. So, technology's certainly been something that we've leveraged in the business.

[41:08] It's not necessarily been in the same way that I think we all think about technology that we have put onboard computer units in each and every one of our trucks and that's improving our routing capabilities, it's improving our efficiency in the business. It's also improving our knowledge of the customer need because if we see customers that have a different service level that they require in order to meet their business needs, we have better information about that customer today as a result of those onboard units. As far as where technology is going, I would say that's even more exciting. I think it's not going to surprise anyone that technology will play a greater role in where we go from here. It's been what it has played in getting us to where we are today. And as we think about technology that's on the horizon, there's anything from customer facing to back office to the way that we operate and some of the best examples, if you look at what we're doing in the recycling line of business, like we were just talking about, we're building the recycling facility of the future where robotics can be used to separate the materials in a more efficient way and to reduce the impacts of contamination on that strain. Then, if we think about the landfill line of business, we are piloting currently a piece of Caterpillar equipment on one of our facilities, on one of our landfills where the heavy equipment will be remote operated. instead of having an employee that has to be in the elements and on the working face of the landfill, they're going to be able to remote operate the equipment and those changes are really, really exciting.

Nate: [43:06] You mentioned recycling and an automated separation piece of machinery. Today is recycling separated by hand?

Devina: [43:16] Equipment is used today, but there's a lot of human capital that is used to supplement what the equipment can achieve on its own.

Nate: [43:27] I did get the chance to visit a local recycling facility. Did they call them Mirvs? Is that what--?

Devina: [43:36] MRF, M-R-F.

Nate: [43:39] M-R-F, MRF. I got to visit one here locally and I did see what you're describing, just the human capital component, but then also the machines that they have to bounce around paper versus plastics. Based on the shape or the slant of the conveyor belt, maybe plastics will go one way and paper will go another way. It was really fascinating to watch. I could have sat there and just watch that piece of machinery work for at least at least five minutes.

Devina: [44:13] It's quite remarkable. The machinery can do so much more than it could ten years ago, but there are continued advancements in the capabilities of the machinery for source separation, and we're going to be sure that we bring those into play.

Nate: [44:29] Yes. Well, since we're still on recycling, this is one thing that I think every listener should understand or know, and that's pizza delivery boxes. Do we recycle them?

Devina: [44:43] We don't. You can recycle the part that's not greasy. If you really want to do the right thing, you would rip off the part that has the cheese and the grease and you would throw that in your trash, and if the rest of it is clean, you can put that in your recycle.

Nate: [45:00] That was probably the most interesting thing for me to learn when I started learning about the waste space. Anyway, could you describe what you think are the most important financial metrics for Waste

Management's management team and operations team? What are they focused on? Is it sales growth? Is it free cash flow? Is it EBITDA?

Devina: [45:21] The answer to your question is yes, yes and yes. We think the three most important metrics for us to pay attention to are organic revenue growth, our ability to grow revenue in an efficient way by growing EBITDA dollars and margin, and then converting that into free cash flow dollars. Those are the primary financial objectives that we look at. In terms of how we ensure that those priorities are connected with the way that our regional managers drive their business decisions, we have two components, and one is the annual incentive compensation plan and the other is the longer term stock incentive plan and the annual incentive plan. They are measured on a combination of EBITDA dollar growth and our operating expenses as a percentage of revenue. Then, the long term incentive plan is based on two things. One is free cash flow dollars and the other is total shareholder return for the Waste Management stock holder.

Nate: [46:41] I see. There's a lot of interesting components to the Waste Management investment story and one of them is clearly been your ability to grow your EBITDA margins. You've grown them. They were 25% in 2011 and since then, they've gradually climbed up to, at least last year, 28%.

Devina: [47:03] We closed last year at 27.7% percent. I would tell you we'll finish this year closer to a twenty eight and a half, I would guess.

Nate: [47:11] Yes. I was hoping that you could share with the listeners what have been the big drivers in growing your EBITDA margins and your profitability.

Devina: [47:21] When you start with the top line, I do think it's the combination of pricing-discipline and then discipline-volume growth, and ensuring that we're attracting the right volume and that's in those growth markets that are going to provide the best return. on the operating costs line, it's about route optimization and cost control, operating efficiencies, really driving that cost control and then, I think, SCNA is become a good part of the story, too. We've done a lot to ensure that we better align our back offices to support ultimately the customer, but really doing that by enabling the front line employees that serve the customer every day and just doing so in a really efficient way.

Nate: [48:14] What types of cost pressures are you seeing right now? I mean, obviously they're not as significant as your ability to drive price and profitable volumes because your margins keep going up, but I recall some cost inflation in certain areas of the business. I'd just be curious to know what you're keeping your eyes on right now that could push margins lower and even what could push margins higher.

Devina: [48:40] I don't think it would surprise anyone to know that the piece of our business, the most cost inflation is on the people side. With unemployment at historical lows, it really is an environment where you're seeing cost pressure both for Waste Management and personal direct labor, but also in third party sub-contracted labor as well. That's been the part of the cost structure that’s seen the most pressure, but we've really seen some of it as an investment opportunity to ensure that if we can win on the people side of the equation, we ultimately think we went over the long term because when you invest in your people, they're going to do everything they can to serve the customer, and serving the customer then benefits the shareholders. We think that some of the cost pressure that you're seeing is from just the general market dynamics, but then the rest of it, some of the intentional investment that we're making in our people as well.

Nate: [49:53] I remember when Tax Reform was announced last year. You guys were one of, I don't think, a very large number of companies that gave some of that back to your employees through raises, which I thought was really great. My company didn't do that.

Devina: [50:10] We're very proud of that. We think it's really important to know that the company is making investments in the people that do the hard work to serve our customers every day.

Nate: [50:22] That's great. You, Jim and the new guys coming in, do you guys have a target for what you think steady state normalized EBITDA margins are based on what you're seeing longer term in terms of cost pressures and then technology improvements, efficiency gains, route density, etcetera. What do you think the long term EBITDA margin profile for Waste Management is?

Devina: [50:50] Others in the industry have talked about 30% aspirationally for a while. There are certainly going to be ebbs and flows in the EBITDA margin of the business as long as there's volatility from recycling commodity prices, so it's hard to target a specific margin over the long term. For us, I think it's about continuous improvement and ensuring that the growth that we've created, that you've commented on from 2011 to 2018, it's something that we continue to look for progress in order to improve both the EBITDA margin and then the conversion of those EBITDA dollar to free cash flow dollars.

Nate: [51:39] Do you have a targeted free cash flow conversion rate from EBITDA? Is there something that you think about is being steady state on that side of the equation?

Devina: [51:49] We're really happy to see the business up and around stay in the 45 to 47.5% range today. If you compare that to where we were in 2011, I think that's really impressive as well because we were closer to the mid thirty at that time, so we've seen a lot of good growth in the cash generation of the business. I would love to see us over the long term stay in the 45 to 50% range.

Nate: [52:20] What are you spending money on that reduces cash flow from your EBITDA numbers? Is it trucks? Is it investing in landfills? What are the types of maintenance capital expenditures that waste management has to deal with year in and year out?

Devina: [52:39] In 2018, we've made an intentional increased investment in the fleet part of our asset base. We invest consistently in both trucks and landfill airspace construction, so those are going to continue to be the most significant requirements for capital investment over the long term. The increase that you're seeing in the current year is really directly connected with the strong organic revenue growth that we've been creating in the business. We’ve seen increased route, which is quite phenomenal when you look at the fact that that's not coming from acquisition funds. That’s coming from organic revenue growth. We’re doing all of that and at the same time increasing margin, which we think is a great story.

Nate: [53:35] You mentioned fourteen thousand vehicles in your fleet. Is there a useful life that you guys think about when you invest in when you buy a new truck? What is that number? Then also, how many are you replacing on an annual basis?

Devina: [53:56] Our useful life varies significantly by line of business, but our weighted average is around eight and a half today. We really, in a very healthy way, increased the number of trucks that we buy each year over the last several years. It's been in the thirteen hundred to fifteen hundred range per year.

Nate: [54:19] That's good to know. Just sticking with capital expenditures, are the things that you're thinking about over the midterm that don't involve trucks or the fleet? Is there something else that maybe over the next few years that you're going to have to invest in and then just how do you plan on funding those types of investments?

Devina: [54:44] I would say that there are probably three categories. First is the landfill gas to energy part of our infrastructure. That's something that we're looking at potentially increasing investments in over the medium term that you haven't necessarily seen over the last five to ten years. That's still something that we're thinking through, but I think you could see an increase in investment in that part of the business in the not too distant future. I've also mentioned the investment in the merge of the future. That's not maintenance capital for us. that's a little more R&D oriented, and it's ensuring that we are evolving the business and so if we see those investments really take hold and provide real value, I think you could see in the medium term and increase in the level of capital spending required for the recycling part of the business because the payback on that investment is going to be so significant.

[55:44] Then, third is in technology and it's not necessarily the technology of the robotics and the recycling line of business. It's other forms of technology, whether it be building out customer facing technology capabilities. Right now we don't know whether that becomes a P&L item because it's expense associated with the development or whether the development is capitalizable. We're still assessing that, but it's cash either way. We think those investments are going to make sense, too. I think those are the broad categories as far as how they would get funded. The lovely thing about this business, I think, for the shareholder and then also as leaders thinking about innovation where we're headed over the long term, is that we generate a great amount of free cash flow every year, so we have a great deal of flexibility to be able to fund these incremental investment for the cash that the business generates.

Nate: [56:49] That's really helpful. I appreciate the explanation and you categorizing the three different buckets. Just talking about the balance sheet, is there anything about the balance sheet that you would like to highlight or discuss? I mean, you've got an extremely strong balance sheet. You've got lower leverage than any other waste company, I believe. It's almost like you're poised to make a big acquisition or are you just preparing for maybe some volatility in the marketplace over the next few years and you just want to have enough cushion? I would just be very curious to hear you expound upon why the balance sheet looks so good and if there are other motivations for that.

Devina: [57:35] I mentioned earlier that I came to the CFO role from treasury. Jim and I both took our last positions at a time when the balance sheet did not look so good. There were actually discussions about whether our leverage with constraining and whether our long term shareholder distribution policies were sustainable. So, he and I both came into our roles with an objective of getting the balance sheet in order so that we had better strategic flexibility to make decisions about how to grow long term in good times or in bad. We set out with an objective of cleaning up our balance sheet and I think we did a great job of it quite frankly the EBITDA growth that we have seen in the base business outpaced what we would have expected at the time that we took on that objective.

[58:38] What we reflected on as we were seeing that momentum, that really strong growth in the EBITDA part of the equation, was whether or not we should increase the debt balances to reflect the growth that we were seeing. What we decided upon, and I think makes a lot of sense, is that when you have a healthy balance sheet, you have strategic flexibility and that gives you a position of power and thinking about how you grow the business over the long term. I would say we don't expect for the balance sheet to improve from here. I think that we would see value in having, potentially, a higher leverage ratio over the long term, but we're certainly not going to chase that up given where we are in the economic cycle and an expectation that some dry powder if we see maybe some of the lofty expectations for valuation in M&A that exists today retreat a little, is a good thing to have. I think, ultimately, it's ensuring that Waste Management is well positioned for long term growth, whether it be organic or inorganic through cycle.

Nate: [59:57] Makes perfect sense. The waste industry is well known to be a pretty defensive industry from a market perspective. Everybody always produces waste, I guess is the point I'm trying to make. But I am curious just how defensive from your perspective, an investment in Waste Management is given the prospects of people are talking about a recession today? I'm just curious what you think is a reasonable expectation for pricing may actually hold up given how disciplined the industry is today, but on the volume side, volumes could come down a little bit. What is a reasonable expectation for just swings in Waste Management's volumes given the event of a recession or just an economic downturn?

Devina: [01:00:53] We've certainly spent a lot of time looking at that. We're in the middle of our long term financial plan right now. What I would tell you is what I'm most comfortable about is that we don't think that the sharp decline that we saw with the last recession it's something that we need to be thinking about or preparing for. We think that this growth cycle has looked different and it's been a slow growth economy for the last several years, and we think that that probably is a good indicator of what we should think about in terms of the risk to volume that would exist in any recessionary environment. The last decline was led by housing and our business was much more extensively dependent upon those volumes, than we are in this environment. We think that there's a lot of reasons to be bullish on waste volumes over the long term because if you think about factors, such as population growth, housing expansion that's happening with where we are with millennials and the time in life for them to start to form new households, we think that there are a lot of signs, but the next change in volume won't be as dramatic as the change in volume will be. you're spot on that the pricing discipline in this industry really gives us a lot of confidence that we would be able to continue to retain pricing in this different or more challenging economic environment next time around. The other thing I think that we've learned and we've shown that we can flex on the way up in this economic environment, but that gives us confidence that we would also be able to flex our costs down if our volumes changed in a way that that was appropriate.

Nate: [01:03:00] That's very helpful. Could you talk about your philosophy as it pertains to shareholder returns? actually, I think it might even be really helpful just to hear you describe the investment proposition to potential shareholders who aren't familiar with the waste space, don't understand exactly what's been going on in the industry and for specific companies like yours, where you're buying back shares, you're paying a dividend and you're rolling up the industry. Could you just maybe frame it up for investors to understand exactly what the shareholder returns story is as well and how that fits in?

Devina: [01:03:37] From a shareholder perspective, I think that there are a number of things that make Waste Management a really good investment. I think if you think about the industry dynamics to start with, the fact that it's a disciplined business, it's a utility-like business in a lot of ways in that it's an essential service, and that service as needed in any economic environment, the stability associated with that business coupled with long term growth that we are creating, both from operating efficiency and from additional consolidation in the industry, and thinking about extending the service offerings to the customers to ensure that we're thinking about recycling and organics and things that customers are looking for from their waste services provider. When it comes to Waste Management specifically, I would tell you that I compare Waste Management to the other publicly traded companies in the industry. I think it doesn't really matter if you look at us on an enterprise value to EBITDA basis or a free cash flow yield basis, we're on sale right now relative to our competitors and I think that that provides a great buying opportunity for a shareholder.

Nate: [01:04:59] Could you also highlight what the shareholder return story is? You consistently buy back shares and you also pay a dividend, correct?

Devina: [01:05:10] We do. Each year I would tell you that it's our goal to take the free cash flow that the business generates and that's after we've spent all of the money we need to spend on the trucks and the landfills. Those free cash flow dollars are allocated to some combination of dividends, share repurchases and acquisition. in 2018, we expect to allocate over 90% of our free cash flow through a combination of dividends and buybacks. Over the long term, I would tell you my expectation is that the dividend growth story will be one of being very directly correlated with the long term growth that we see in free cash flow. We're creating better leverage in free cash flow each and every year, so that provides some upside potential there. But at the same time, we've been growing the business at a rate that's more quick and more steady than the economy would indicate you should otherwise expect. Those things together mean that I think the shareholder investment story is a good one.

Nate: [01:06:24] I appreciate that. What are some of the key metrics that you think are important from the perspective of valuing the business? I mean, is it P/E multiples, EBITDA multiples, some form of yield whether it's dividend or free cash flow yield? What do you think is most important for investors to focus on, especially whenever they compare you with the other waste companies in the industry?

Devina: [01:06:52] We look at all of them. I would tell you that don't think it really matters which one you look at. We think that, relative to our peers, Waste Management is currently at a discount and therefore this is a buying opportunity. I would tell you, I look at P/E, I look at enterprise value to EBITDA. I look at free cash flow yield. I pay a little less attention to the dividend yield because I think that's something that can vary over time. I think paying more attention to that long term commitment to shareholder allocations is what's important there rather than a point in time dividend yield measure.

Nate: [01:07:37] What do you think the market's missing within the context of your evaluation versus your peers? What do you think is misunderstood?

Devina: [01:07:47] I think that ultimately when you look at Waste Management and you look at the organic growth, both in top line and bottom line dollars that we've been able to create, I don't think that the shareholder, the stock price currently reflects the real work that is being done to create growth organically. I tend to think that somehow that organic growth is being inappropriately discounted.

Nate: [01:08:16] If you had to estimate replacement value for Waste Management's business, what do you think that value would be?

Devina: [01:08:25] Ultimately, I would tell you I think it's immeasurable. I think our scale is not something that you can replicate. The people and the assets that we have placed across the country to serve our customers is unique and it's provided us a really strong hold on the leadership position in the industry for a long time. It's a healthy market and a healthy industry and we've got really well performing competitors. At the end of the day, it's a great business for all of us, but for someone to come in and throw dollars at it and try to replicate it, it really is close to impossible.

Nate: [01:09:07] Yes, I imagine it's hard to put a price tag on a landfill as well.

Devina: [01:09:11] Absolutely.

Nate: [01:09:12] We talked about some really great tailwinds for your company and your industry. Could you talk about what headwinds that you're thinking about or you're keeping an eye on or just something that keeps you up at night relative to either growth or margins or the industry? Is there anything there with respect to market discipline that you're concerned about? Any bad actors, bad players, anything that you'd like or that you could highlight?

Devina: [01:09:43] I would tell you there's not really anything that keeps me up at night, but I think the biggest challenge for Waste Management going forward is on the labor and talent side. This isn't a business where just having the best assets is what will help you win. Having the best people and putting them in a position to succeed is what will really make the difference, and in a really tight labor market that can be a challenge, so ensuring that waste management continues to be a best place to work is a priority.

Nate: [01:10:20] For lots of companies, but I can see it specially for yours because you have a lot of people, forty-three thousand people that work for your company. It's a large number and I'm sure it's hard to manage that many people. Last question is, I'm just curious whether or not you have a funny or interesting story from an investor conference or an investor meeting that you'd be willing to share.

Devina: [01:10:47] The thing that is most intriguing, and I think is for the average audience participants, is how significantly different those interactions are than what you would expect coming in. I was lucky enough to go on some of the investor roadshows before I took the CFO role, so I didn't have this sprung on me when I when I took the job. but getting to see the workings of it up close and personal changes the dynamics of it in a really good way because coming into it you have this perception of the analyst, or the shareholder or the investor as almost an OZ like character great, powerful and having all of this knowledge and information, and so it can be threatening and intimidating.

[01:11:45] I think what's funny about it is going and sitting down one-on-one with folks. You really get to see behind the curtain and to see that there are people. sometimes they're right out of school and don't know anything about your business and you have to be able shift from having a conversation with someone who's just learning the industry and just learning their own job to having a conversation with someone like Michael Hoffman, who you referenced earlier, who's been around this business far longer than I have. I think that's been the most interesting thing about those investor meetings for me, is being able to pivot and respond to either one of those extremes.

Nate: [01:12:28] That's a really interesting perspective and I can tell you that, you mentioned OZ like characters, maybe they have a loud voice, especially when they're calling you on the phone if the quarter didn't go very well. But it's funny even for me, when I think back to some of the meetings that I went to and you're in a room with a CEO or a CFO, I felt that way. I felt intimidated, like senior management, "Why am I even here? What right do I have to sit here in front of this person and ask them questions?" I sincerely appreciate your time, Devina. It’s been a pleasure talking to you and having you on the program.

Devina: [01:13:04] Thank you. We’ll, talk to you soon.

Nate: [01:13:06] Okay, you take care.

Devina: [01:13:08] You too. Bye-bye.