

Waste Management

Margin break out arrives

Reiterate Rating: NEUTRAL | PO: 203.00 USD | Price: 188.26 USD

Strong Q4 results: margin break out arrives

In our view, WM ended 2023 on a high note with a strong Q4 after underwhelming Q2-Q3 (Q2 – miss and cut, Q3 – capex push out). Adj EBITDA of \$1.56bn, up 15% YoY on a 5.7% revenue gain. EBITDA beat BofA by 3%, due to (much) stronger operating leverage (i.e., 70% flow through). Margin of 29.9% expanded 240bps YoY (vs BofA 29.1%). Why is this impressive? i) collection & disposal margin up 260bps YoY (i.e., core solid waste – not purely commodity driven, ii) FY23 margin of 28.9% - finally a 'break out' from a tight seven year range (27.5-28.5%), suggesting margin can climb to new peak levels. Other bright spots: i) core price 7.3% re-accelerated (Q3 6.6%, 2Q 6.9%), ii) volume was firmly positive (+1.9% on a workday adjusted basis), iii) SG&A cost control with 9.8% of sales.

2024: only 30bps of margin growth? Feels conservative

2024 guide includes sales growth 6-7% (volume 1%, yield 5%), EBITDA \$6.275-6.425bn, up 8% YoY at midpoint and in line with consensus (\$6318mn). While the range is in line with consensus, we are surprised by the margin range (29-29.4%) – expanding 30bps YoY (at midpoint) – given strong finish in Q4, positive price vs cost, and recovery of commodity values (recycling, RIN credits). WM expects incremental \$115mn of EBITDA from sustainability investments yet we look for the split as renewables is more margin accretive (40-50% margin) vs recycling side (~15%). Based on commodity assumptions, recycling appears conservative vs renewables a tad aggressive (i.e., more so nat gas).

FCF weighed down by green capex – yet end in sight

FCF is projected to be \$1.9-2.05bn, flat to up vs 2023 (\$1.9bn), & below FCF in 2020/21 (\$2.5-2.65bn) due to elevated 'green capex' for sustainability projects. FCF yield of 2.6% is rather low, yet investors are looking to the outer years as bulk of capex is starting to wind down as \$2.2bn of the \$2.8-2.9bn spend by end of 2024. See page 2 for details.

Neutral: positive micro, macro rotation weighs valuation

We raise estimates post a strong Q4. We raise our PO to \$203 (\$185) based on 15x 2024 EV/EBITDA as we believe a higher multiple is warranted given the strong margin profile (vs 14x prior). Reiterate Neutral – we see a positive margin story, yet valuation near the high end of range (low FCF yield, rotation risk) keeps risk/reward balanced.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	5.59	6.19	6.80	7.51	8.05
GAAP EPS	5.39	5.66	6.80	7.51	8.05
EPS Change (YoY)	15.5%	10.7%	9.9%	10.4%	7.2%
Consensus EPS (Bloomberg)			6.76	7.64	8.71
DPS	2.60	2.80	3.00	3.22	3.45
Valuation (Dec)					
P/E	33.7x	30.4x	27.7x	25.1x	23.4x
GAAP P/E	34.9x	33.3x	27.7x	25.1x	23.4x
Dividend Yield	1.4%	1.5%	1.6%	1.7%	1.8%
EV / EBITDA*	16.4x	15.4x	14.2x	13.2x	12.4x
Free Cash Flow Yield*	2.6%	2.4%	2.5%	3.2%	4.4%

* For full definitions of *IQmethod*SM measures, see page 5.

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Timestamp: 13 February 2024 05:00AM EST

13 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	185.00	203.00
2024E Rev (m)	21,768.9	21,749.6
2025E Rev (m)	23,082.1	23,056.7
2026E Rev (m)	NA	24,319.2
2024E EPS	6.77	6.80
2025E EPS	7.52	7.51
2026E EPS	NA	8.05

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Stock Data

Price	188.26 USD
Price Objective	203.00 USD
Date Established	13-Feb-2024
Investment Opinion	A-2-7
52-Week Range	148.31 USD - 190.44 USD
Mkt Val (mn) / Shares Out (mn)	75,827 USD / 402.8
Free Float	99.8%
Average Daily Value (mn)	291.20 USD
BofA Ticker / Exchange	WM / NYS
Bloomberg / Reuters	WM US / WM.N
ROE (2024E)	35.5%
Net Dbt to Eqty (Dec-2023A)	208.5%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

Nat gas = natural gas, RIN = Renewable Identification Number, ISM = institute supply management

iQprofileSM Waste Management

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	10.0%	10.6%	10.9%	11.3%	11.5%
Return on Equity	33.2%	35.9%	35.5%	33.6%	31.3%
Operating Margin	17.6%	18.7%	19.2%	19.6%	19.9%
Free Cash Flow	1,949	1,825	1,872	2,396	3,346

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	2.0x	1.9x	1.8x	1.7x	1.8x
Asset Replacement Ratio	1.3x	1.4x	1.4x	1.1x	1.1x
Tax Rate	23.3%	22.9%	24.0%	24.0%	24.0%
Net Debt-to-Equity Ratio	213.2%	208.5%	177.8%	144.4%	110.4%
Interest Cover	9.2x	7.7x	8.3x	9.0x	9.7x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	19,698	20,426	21,750	23,057	24,319
% Change	9.9%	3.7%	6.5%	6.0%	5.5%
Gross Profit	7,404	7,820	8,387	9,015	9,567
% Change	8.6%	5.6%	7.2%	7.5%	6.1%
EBITDA	5,512	5,899	6,386	6,875	7,330
% Change	9.5%	7.0%	8.3%	7.7%	6.6%
Net Interest & Other Income	(447)	(554)	(560)	(560)	(560)
Net Income (Adjusted)	2,321	2,519	2,741	3,012	3,260
% Change	13.4%	8.5%	8.8%	9.9%	8.2%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	2,240	2,475	2,631	3,012	3,260
Depreciation & Amortization	2,038	2,083	2,175	2,306	2,432
Change in Working Capital	(145)	(14)	(153)	(667)	(91)
Deferred Taxation Charge	49	0	0	0	0
Other Adjustments, Net	354	175	345	345	345
Capital Expenditure	(2,587)	(2,895)	(3,125)	(2,600)	(2,600)
Free Cash Flow	1,949	1,825	1,872	2,396	3,346
% Change	-19.9%	-6.4%	2.6%	28.0%	39.7%
Share / Issue Repurchase	(1,500)	(990)	(330)	(330)	(330)
Cost of Dividends Paid	(1,077)	(1,150)	(1,224)	(1,290)	(1,397)
Change in Debt	1,360	500	0	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	351	476	770	1,522	3,117
Trade Receivables	2,461	2,518	2,473	3,222	3,398
Other Current Assets	739	739	739	739	739
Property, Plant & Equipment	15,719	16,623	17,597	17,915	18,107
Other Non-Current Assets	12,097	12,032	11,882	11,732	11,582
Total Assets	31,367	32,388	33,461	35,129	36,943
Short-Term Debt	414	414	414	414	414
Other Current Liabilities	3,980	4,024	3,825	3,907	3,992
Long-Term Debt	14,570	15,070	15,070	15,070	15,070
Other Non-Current Liabilities	5,539	5,657	5,852	6,047	6,242
Total Liabilities	24,503	25,165	25,161	25,438	25,718
Total Equity	6,864	7,199	8,276	9,668	11,200
Total Equity & Liabilities	31,367	32,364	33,437	35,105	36,919

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Industrial Machinery

Company Description

Waste Management (WM) is the largest non-hazardous waste operator, servicing 21mn customers across 48 states and Canada. The company is vertically integrated, owning nearly 400 collection operations, 249 active solid waste landfills, 297 transfer stations, and 104 recycling centers. The company has significant economies of scale, with 66% of waste it collects disposed at its own landfill.

Investment Rationale

We expect Waste Management (WM) to benefit from long-term tailwinds for the industry - rising barriers to entry, consolidation, repricing landfills, deploying technology initiatives, etc. That said, we believe that the company is contending in the near-term with higher than expected inflationary pressure that weighs on profitability.

Stock Data

Average Daily Volume 1,546,796

Quarterly Earnings Estimates

	2023	2024
Q1	1.31A	1.61E
Q2	1.51A	1.72E
Q3	1.64A	1.75E
Q4	1.74A	1.48E

Sustainability investments update

WM plans to spend an incremental \$850-\$900mn on recycling and RNG projects in FY24. The company added that it plans to invest \$2.8-\$2.9bn on these 'green' projects from 2022-2026 (which includes \$1.325bn already spent through 2022-2023). These projects are expected to contribute an incremental EBITDA run-rate of ~\$800 million by the end of 2026 (i.e., \$510mn in RNG and \$290-\$310 from recycling). We would note that this is a step higher than WM's targets outlined during its Sustainability Day early last year (i.e., \$2.2bn+ in incremental capex to generate \$740mn in incremental EBITDA through 2022-2026).

Price objective basis & risk

Waste Management (WM)

Our \$203 price objective is based on 15x EV/EBITDA for 2024E, at the high end of the company's historical range (8-14x) and in-line with peer Republic Services. We believe the high end of the range is appropriate given margins are expected to break out to the upside this year and likely next year (following the tight range over the last seven years), waste offers more visibility than other sectors, and better price vs cost discipline. That said, FCF visibility is limited as WM pushed out growth capex on project timing, creating an element of volatility around FCF profile.

Upside risks to our PO are 1) higher-than-expected contribution from renewable natural gas, 2) faster-than-expected volume and price recovery, 3) more aggressive cash return to shareholders than we currently envision. Downside risks to our PO are 1) Higher than expected labor costs, 2) execution issues on growth capex initiatives, 3) lower than expected pricing in the open market.

Analyst Certification

I, Michael Feniger, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AECOM	ACM	ACM US	Michael Feniger
	Blue Bird Corp	BLBD	BLBD US	Sherif El-Sabbahy
	Caterpillar Inc	CAT	CAT US	Michael Feniger
	CNH Industrial NV	CNHI	CNHI US	Michael Feniger
	Construction Partners Inc.	ROAD	ROAD US	Michael Feniger
	ESAB Corp	ESAB	ESAB US	Sherif El-Sabbahy
	Finning International Inc.	YFTT	FTT CN	Sherif El-Sabbahy
	H&E Equipment Services Inc	HEES	HEES US	Sherif El-Sabbahy
	Knife River Corp	KNF	KNF US	Sherif El-Sabbahy
	Republic Services	RSG	RSG US	Michael Feniger
	Techtronic Industries Co Ltd	TTNDF	669 HK	Michael Feniger
	Techtronic Industries Co Ltd	TTNDY	TTNDY US	Michael Feniger
	United Rentals Inc	URI	URI US	Michael Feniger
	Vulcan Materials	VMC	VMC US	Michael Feniger
	Waste Connections Inc	WCN	WCN US	Michael Feniger
	WillScot Mobile Mini	WSC	WSC US	Sherif El-Sabbahy
NEUTRAL				
	AGCO Corp	AGCO	AGCO US	Michael Feniger
	Deere & Co	DE	DE US	Michael Feniger
	Fluor	FLR	FLR US	Michael Feniger
	GFL Environmental Inc	GFL	GFL US	Michael Feniger
	GFL Environmental Inc	YGFL	GFL CN	Michael Feniger
	Jacobs Eng.	J	J US	Michael Feniger
	Kennametal Inc.	KMT	KMT US	Michael Feniger
	Martin Marietta Materials	MLM	MLM US	Michael Feniger
	NV5 Global Inc.	NVEE	NVEE US	Michael Feniger
	PACCAR Inc	PCAR	PCAR US	Michael Feniger
	RB Global, Inc	RBA	RBA US	Michael Feniger
	Waste Management	WM	WM US	Michael Feniger
UNDERPERFORM				
	Allison Transmission Holdings Inc.	ALSN	ALSN US	Sherif El-Sabbahy
	Casella	CWST	CWST US	Michael Feniger
	Cummins Inc	CMI	CMI US	Michael Feniger
	Herc Holdings Inc	HRI	HRI US	Sherif El-Sabbahy

US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	IPG Photonics	IPGP	IPGP US	Michael Feniger
	Oshkosh Corp.	OSK	OSK US	Michael Feniger
	Terex Corp.	TEX	TEX US	Michael Feniger
	Timken Company	TKR	TKR US	Michael Feniger

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales
Basic EBIT + Depreciation + Amortization

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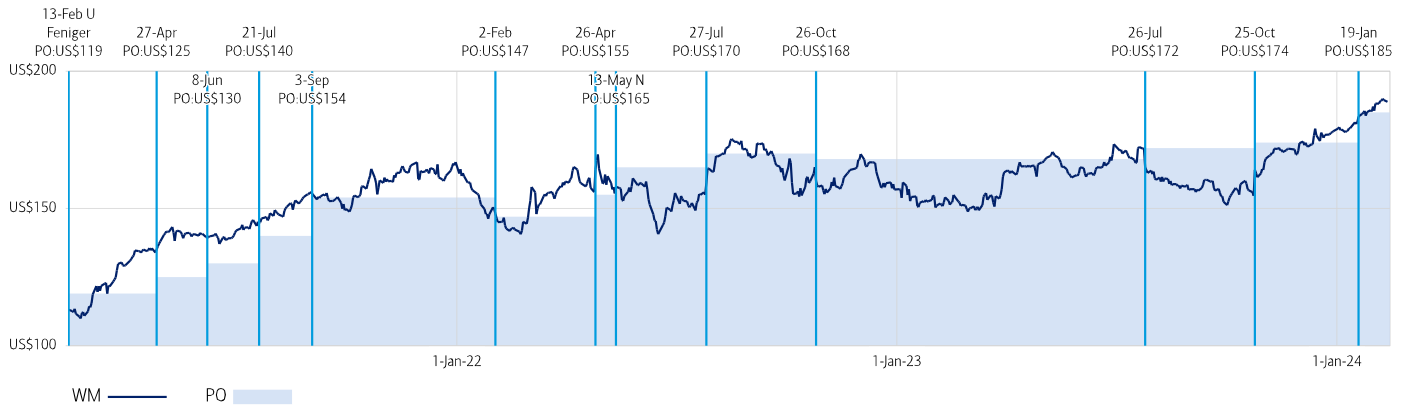
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Waste Management (WM) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Machinery/Diversified Manufacturing Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	27	42.19%	Buy	8	29.63%
Hold	17	26.56%	Hold	8	47.06%
Sell	20	31.25%	Sell	8	40.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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