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WCN.TO - Q1 2018 Waste Connections Inc Earnings Call

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OVERVIEW:

Co. reported 1Q18 revenues of $1.14b and GAAP diluted EPS of $0.47. Expects 2Q18 revenues to be approx. $1.225b.

CORPORATE PARTICIPANTS

Ronald J. Mittelstaedt *Waste Connections, Inc. - Chairman & CEO*

Worthing F. Jackman *Waste Connections, Inc. - CFO & Executive VP*

CONFERENCE CALL PARTICIPANTS

Brian P. Maguire *Goldman Sachs Group Inc., Research Division - Equity Analyst*

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

Derek Spronck *RBC Capital Markets, LLC, Research Division - Analyst*

Hamzah Mazari *Macquarie Research - Senior Analyst*

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

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

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

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Waste Connections First Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded, Thursday, May 3, 2018.

I would now like to turn the conference over to Mr. Ronald Mittelstaedt, Chairman of the Board and CEO. Please go ahead, sir.

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Okay. Thank you, operator, and good morning. I'd like to welcome everyone to this conference call to discuss our first quarter 2018 results and provide our financial outlook for the second quarter. I'm joined this morning by Steve Bouck, our President; Worthing Jackman, our CFO; and several members of our senior management team.

As noted in our earnings release, better-than-expected solid waste price growth and E&P waste activity drove strong performance in the period and position us well for the remainder of 2018.

Adjusted EBITDA margins in the first quarter increased 80 basis points year-over-year in spite of above the precipitous decline in recycled fiber values and weather-related impacts across the majority of our operational footprint. Given our strong start to the year and recent acquisitions, we believe adjusted free cash flow is tracking to exceed our original outlook of $850 million for 2018.

Regarding acquisition activity, we've signed or completed acquisitions with total annualized revenue of approximately $165 million year-to-date, including 3 new market entries and the pipeline for potential additional acquisitions, exceeds what's been completed so far in 2018.

Finally, as anticipated, we resumed our share repurchase program, opportunistically buying back approximately $42 million of shares in the first quarter.

Before we get into much more detail, let me turn the call over to Worthing for our forward-looking disclaimer and other housekeeping items.

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

Thank you, Ron, and good morning. The discussion during today's call includes forward-looking statements made pursuant to the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995, including forward-looking information within the meaning of applicable Canadian security laws.

Actual results could differ materially from those made in such forward-looking statements due to various risks and uncertainties. Factors that could cause actual results to differ are discussed both in the cautionary statement on Page 2 of our May 2 earnings release and in greater detail on Waste Connections' filings with the U.S. Securities and Exchange Commission and the Securities Commission or similar regulatory authorities in Canada.

You should not place undue reliance on forward-looking statements and information, as there may be additional risks of which we are not presently aware or that we currently believe are immaterial, which could have an adverse impact on our business. We make no commitment to revise or update any forward-looking statements and information in order to reflect the events or circumstances that may change after today's date.

On the call, we will discuss non-GAAP measures, such as adjusted EBITDA, adjusted net income attributable to Waste Connections on both a dollar basis and per diluted share and adjusted free cash flow. Please refer to our earnings releases for a reconciliation of such non-GAAP measures to the most comparable GAAP measure. Management uses certain non-GAAP measures to evaluate and monitor the ongoing financial performance of our operations. Other companies may calculate these non-GAAP measures differently.

I'll now turn the call back over to Ron.

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Okay. Thank you, Worthing. In the first quarter, solid waste price plus volume growth was 3.2%, in line with our overall expectations. Total price of 4.3% exceeded our outlook for the quarter and increased 60 basis points sequentially from Q4. This sequential increase was due to both an approximate 150 basis point improvement in our mostly exclusive market Western Region, where price increases approached 3.5%. And we achieved high price retention rate across our secondary markets.

Reported volume growth in Q1 was negative 1.1%. Purposeful shedding of less attractive revenue across the former Progressive Waste footprint, particularly in Canada and the Northeast, accounted for an estimated 80 basis points of reported negative volume growth in the period, most of which should abate by the end of Q3. An additional estimated 40 basis points impact to volume growth can be attributed to tougher weather conditions and special waste timing.

And lastly, the permitted volume change at our Chiquita Canyon landfill in Q3 of last year reduced reported volumes by almost 30 basis points. Net of these items, overall volumes were up about 0.5 percentage point in the period, while delivering price growth of 4.3%.

On a same-store basis in Q1, commercial collection revenue increased about 5% and roll-up revenue increased 4% from the prior year period. In the U.S., roll-up pulls per day increased 2% and revenue per pull rose about 3.5%. In Canada, a 7% decrease in pulls per day, primarily related to the purposeful shedding of lower quality revenue and some severe weather conditions, was more than offset by an 8% increase in revenue per pull.

Solid waste landfill tonnage in Q1 on a same-store basis was slightly up over the prior year period. MSW tons rose approximately 0.005%, special waste tons increased 3.5% and C&D tons decreased 7.5%. The decrease in C&D tons was primarily due to a difficult weather conditions relative to the year-ago period across most of our footprint.

Top year-over-year comparisons at several of our landfills and limitations in pulls by the new conditional use permit at our Chiquita Canyon landfill in Southern California. New limitations at the Chiquita Canyon landfill resulted in a 60% reduction in special waste tonnage and a 54% reduction in C&D tons at this site. Excluding these reductions, which anniversary in August, special waste tonnages were up 10% in the first quarter and C&D tons were effectively flat.

Recycling revenue, excluding acquisitions, was about $22 million in the first quarter, down more than $18 million or 45% year-over-year due to the precipitous drop in recycled fiber values, especially prices for recovered mixed paper. Prices for OCC, or Old Corrugated Containers, in Q1 averaged about $102 per ton, which was down 38% from a year-ago period and down 16% sequentially from Q4. Mixed paper values declined an estimated 80% year-over-year. We estimate these declines in fiber values, along with increased recycling processing cost, impacted EBITDA by approximately $14 million and earnings per share by $0.04 in Q1 compared to the year-ago period.

OCC prices have since recovered almost 10% of recent lows and currently average around $90 per ton or down about 12% compared sequentially to Q1's average and down 48% from the level we averaged in last year's second quarter.

At current OCC in mixed paper values, we estimate this sequential decline from Q1 together with incremental processing cost will add an additional 20 basis points margin headwind and around $0.01 earnings per share drive per quarter for the remainder of the year relative to our original outlook provided in February. This additional drag could be overcome though, if the recent recovery trend in OCC prices continues.

Looking at E&P waste activity. We reported $55.6 million of E&P waste revenue in the first quarter, up to 51% year-over-year and up 4% sequentially from Q4. Activity ramped a little faster than we had expected in the period, providing a higher run rate into the remainder of the year. In addition, we've recently received 3 new permits to expand our asset positioning within the West Texas Permian. We'll likely commence construction on at least 2 of these permits later this year, providing additional growth opportunities beginning in the second half of 2019.

Looking at acquisition activities since our update in February. In March, we acquired Right Away Disposal, an integrated provider of solid waste collection, recycling, transfer and disposal services in Arizona's fast-growing Pima, Pinal and Maricopa Counties, consisting of 3 collection operations, 1 recycling facility, 2 transfer stations and a large municipal solid waste landfill. This is basically the market area in the valley between Phoenix and Tucson.

In early April, we acquired the Heart of Florida Landfill in Central Florida, a municipal solid waste landfill that complements our existing operations. And on May 1, we signed an affinitive agreement for a new market entry to provide -- to acquire a provider of collection, processing and transfer services with approximately $55 million of annualized revenue. This is expected to close in June.

These acquisitions together with the previously discussed Bay Disposal transactions and smaller tuck-ins completed in Idaho, Nebraska, North Carolina and Texas aggregate to a total of approximately $165 million of annualized revenue we've signed or closed year-to-date, including 3 new market entries for future growth opportunities. At this level, we've already completed what we will consider an above average amount of acquisitions for the year and, as mentioned earlier, a pipeline for potential additional acquisitions exceeds what's been completed year-to-date. We clearly have visibility on 4% to 5% or greater acquisition growth for 2018.

As noted earlier, we resumed our share repurchase program, opportunistically buying back approximately $42 million of shares in the first quarter. This is a good start to our full year repurchase target of between $250 million and $400 million. We are fortunate that the strength of our financial profile and free cash flow generation provides us with the flexibility to increase the return of capital to shareholders, while funding an above average amount of acquisition activity.

And now I'd like to pass the call to Worthing to review more in depth our financial highlights for the first quarter and to provide a detailed outlook for Q2. I will then wrap up before heading into Q&A.

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

Thank you, Ron. In the first quarter, revenue was $1.14 billion, up $48.9 million over the prior year period. Acquisitions completed since the year-ago period contributed about $38.7 million of revenue in the quarter and about $10.8 million net of divestitures.

Adjusted EBITDA for Q1, as reconciled in our earnings release, was $356.9 million or almost $4 million above our outlook for the period due to higher-than-expected revenue and margins. In spite of the high margin negative flow-through impact from the precipitous decline in recycled commodity values, adjusted EBITDA in the period increased more than $24 million year-over-year or about a 50% flow-through on the incremental change in revenue. Adjusted EBITDA, as a percentage of revenue, was 31.6% in Q1, up 80 basis points year-over-year and 20 basis points above our margin outlook.

The majority of the margin improvement in the period was attributed to a year-over-year increase in E&P waste activity within solid waste. Margin expansion in Q1 was driven by strong pricing growth, which enabled us to overcome an estimated 155 basis point margin drag from recycling and 25 basis points from limitations imposed by the new conditional use permit at our Chiquita Canyon landfill, plus additional weather-related impacts.

Fuel expense in Q1 was about 3.7% of revenue. And we averaged approximately $2.68 per gallon for diesel in the quarter, which was up about $0.20 and $0.07 per gallon, respectively, from the year-ago period and sequentially from Q4.

Depreciation and amortization expense for the first quarter was 14% of revenue, up 20 basis points year-over-year due to increased depreciation expense from capital expenditure outlays since the year-ago period. Interest expense in the quarter increased $3.2 million over the prior year period to $32.4 million, due to higher interest rates as compared to the prior year period.

Net of interest income from invested cash balances, interest expense increased $2.5 million year-over-year. Debt outstanding at quarter end was about $3.9 billion, about 27% of which was floating rate. And our leverage ratio, as defined in our credit agreement, was about 2.4x debt-to-EBITDA. Our effective tax rate for the first quarter was 20.3% or 30 basis points higher than our outlook for the period. The effective tax rate for the period included a $4.6 million benefit to the provision related to excess tax benefits associated with equity-based compensation, which is down about $2.4 million from the prior year period or $0.01 impact to EPS. Looking at the remainder of 2018, we now expect our effective tax rate to be approximately 23% subject to some variability quarter-to-quarter.

GAAP and adjusted net income per diluted share were $0.47 and $0.56, respectively in the first quarter. Adjusted net income in Q1 primarily excludes the impact of intangible amortization and acquisition-related items. Adjusted free cash flow in Q1 was $220.2 million or 19.3% of revenue. Given our strong start to the year and recent acquisitions, adjusted free cash flow is tracking to exceed our original outlook of $850 million for 2018.

I'll now review our outlook for the second quarter. Before I do, we'd like to remind everyone once again that actual results may differ significantly based on risks and uncertainties outlined in our safe harbor statement and filings we've made with the SEC and the Securities Commissions or similar regulatory authorities in Canada. We encourage investors to review these factors carefully.

Our outlook assumes no change in the current economic and operating environment. It also excludes any remaining rebranding costs resulting from the Progressive Waste acquisition and any cost related to additional acquisitions that may close during the period.

Revenue in Q2 is estimated to be approximately $1.225 billion. We expect pricing growth for solid waste to be about 4% in Q2, with volume losses similar to Q1, given lingering weather -- winter weather impacts in many markets throughout April that have delayed the typical seasonal ramp in those geographies.

Adjusted EBITDA in Q2 is estimated to be approximately $395 million or about 32.2% of revenue. This reflects an expected 40 basis point year-over-year margin expansion in the upcoming quarter, in spite of expected margin headwinds similar to those we experienced in the first quarter, predominantly from recycled commodity declines year-over-year.

Depreciation and amortization expense for the second quarter is estimated to be about 13.9% of revenue. Of that amount, amortization of intangibles in the quarter is estimated to be about $26.5 million or $0.07 per diluted share net of taxes.

Interest expense, net of interest income in Q2 is estimated to be approximately $32.5 million. Finally, our effective rate -- tax rate in Q2, as noted earlier, is estimated to be about 23% subject to some variability.

And now let me turn the call back over to Ron for some final remarks before Q&A.

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Okay. Thank you, Worthing. Again, we are extremely pleased with our start to the year. Near record solid waste pricing growth and increased E&P waste activity have enabled us to overcome significant recycling headwinds and position us well for the remainder of the year.

Acquisition activity is an another bright spot with an above average amount of transactions already signed or closed and an even bigger pipeline under active dialogue.

Finally, our return of capital is ratcheting up with the resumption of our share repurchase program. We are pleased to note that adjusted free cash flow is trending above our original $850 million outlook for the year. But with recycling prices beginning to rise again and acquisition activity set to close, we believe it's prudent to wait until our Q2 earnings release to formally update our outlook for the full year.

We appreciate your time today. I will now turn this call over to the operator to open up the lines for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Tyler Brown with Raymond James.

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

Worthing, I just want to make sure I have it right, but of the $165 million of acquired revenue year-to-date, should we think about 70% of that is effectively being in that $850 million guidance, the other pro rata share, call, the $100 million is basically incremental to the guide. Is that right?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

With regards to the -- for the cash flow guide, that's correct. And if you look at the timing of that incremental $100 million or so, as you say, that would likely contribute around $65 million plus or minus to the revenue guide, assuming the -- this next transaction that was signed yesterday closes in June. I think, you'll get some, obviously, EBITDA flow-through and incremental free cash flow to the $850 million on top of that.

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

Okay. And then any color on maybe a blended basis what EBITDA margins could be there, I think, maybe high 20s?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

On a blended basis, that's right. Because the first $110 million or so came in at about the corporate average, given the landfill mix with that because we got 3 landfills in those transactions. The next one set to close is -- that's not on a landfill, it's in a disposal neutral market, that comes in at -- in the low to mid-20s from a margin standpoint. So when you blend those together, you're right, you're getting to the kind of 28% plus or minus blend.

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

Okay. Perfect. And then Ron, I know north of 4% pricing here, I guess, as you look at the first half is obviously quite good. It's well ahead of the 3.5% guidance. But how should we think about pricing for the remainder of the year? I mean, it feels like CPI is improving, churns low, small haulers are full, any reason to think that the back half can't see the same as what we're seeing here in the first half?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

No, I mean no real reason to think that. Again, Tyler, remember, I'm going to estimate, but between 70% and 75% of our price increase for the year is completed by April 1. So unless there is a material change in churn, your denominator that you're working off of it is effectively fixed. So there's not a reason to think it would change materially.

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

It moves down a little bit as the seasonal denominator increases.

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

That's right. If seasonal revenue come in particularly in Q3, but you're not talking about material changes.

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

Right, right. Okay, perfect. And then maybe just the last one, was there anything in there from a CNG tax credit, I'm guessing it would be de minimis?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

It's de minimis. It's a couple of million. It's de minimis. You're right.

Operator

Our next question comes from the line of Hamzah Mazari with Macquarie Bank.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

The first question is just on M&A as well. You're starting up the buyback. You've done a record number of deals this year. Is there anything to read into that maybe the deal activity going forward is not as strong, because you're ratcheting up the buyback? Or maybe just frame for us, are there still chunkier deals in the pipeline or maybe this is just a timing thing?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. No, Hamzah, I mean, number one, nothing to read into it. As you know, we were always very active in our buyback, very consistent, leading up to the Progressive transaction that we would've completed 2 years ago come within the next couple of weeks here. And we -- because with that deal, we took leverage up significantly and have worked it from the low 3s down into the low 2s now. We really resumed it because we're very comfortable with where our leverage is. As we're continuing to add deals, we're bringing EBITDA in. Leverages continuing to drop. We've been only utilizing cash on the balance sheet. We haven't even used all the cash on the balance sheet. And so again, we're seeing leverage to come down by more than 0.1 turns of EBITDA per quarter, just based on the EBITDA and cash flow. And so we are very comfortable that with everything we see out there, we're still going to be below our leverages target. So it's really a very good problem to have. I mean, again, we haven't even got to the $850 million of free cash that we're guiding already for the year. So nothing to read into that. Deals can be chunkier, you are correct. But as we've said, the pipeline is strong as I've seen it. An 18-plus years, probably going back to the late '90s in terms of opportunities, that doesn't mean they're going to translate, but as far as opportunities. So no correlation between the 2 there.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

Yes. And just a follow-up to that. As you're bidding on these deals, maybe if you could give some color as to -- has the competition on these deals changed against you when you're bidding? Or is there really no competition? I know there's new PE money that's been raised, that's chasing the space now. One of the largest competitors spent a lot on acquisitions this quarter. And so just curious, if there is any change in how you're going up against as sort of valuations are relatively high in the sector?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. I mean, no real material change, Hamzah. Obviously, as our footprint has increased due to the transaction we did almost 2 years ago with Progressive. Certainly, that puts us in some areas where the -- there is more competition for deals. Generally, Hamzah, and I say generally, 8 to 8.5 out of every 10 deals we're really not bidding. We don't really do auctions. If it's an auction, we're going to probably lose, probably a P is going to win, because they're not going to know what they're doing, and they're going to overpay. So we just really don't participate in those much. Most of the deals we do are, I would say, somewhat sole source. We're sort of a logical buyer. And -- while sellers are obviously going to shop, we're going to pay what we're going to pay. So I haven't -- we haven't seen that competition is materially different for transaction in what we do than say 3 years ago.

Hamzah Mazari - *Macquarie Research - Senior Analyst*

Okay, great. I have a follow-up question, I'll turn it over. It's pretty well understood waste fundamentals are pretty strong for the group. But maybe if you could just frame how investors should think about risks to the waste cycle going forward? I realize the business lacks by a year going into a recession as well as coming out. But just any sense of how you're thinking about risks on a slowdown? Is it higher inflation, higher interest rates, any view there?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. Well, I mean, number one, we are not seeing any signs anywhere that would indicate to us that a contraction is around the corner. I mean, GDP is rising, certainly relative to the last 8 years. GDP is rising. Interest rates are moving up very slowly. We just saw Fed pause this week on what was expected to be another increase. The volume environment is solid. As you've seen the pricing environment is solid. We've been benefited, I think, disproportionally because of our large franchise presence in the Western U.S. and you've seen the CPI move up over 100 basis points. We're approaching that over the last year or so in the West Coast. It continues to be higher. So that bodes well for '19, because we'll be getting our '19 prices based of the July CPI of '18. So we can look out and see in the 2020 that pricing should remain strong, unless something collapses between now and July, which is 60 days away. So I mean, quite a bit of visibility on price in the space. Acquisition environment is strong as we talked about. A lot of reasons for that. I think, sellers of all types view that there was a window that tax change has benefited buyers, tax changes benefited sellers. Rising interest rates help resellers to reinvest after-tax proceeds and fixed income. The economy is strong. And they feared that there could be a political change perhaps in 2020 that could change things. So there is a window. And we heard that repeatedly at WasteExpo from sellers of all types last week. So I think, other than commodities, which are obviously very negative relative to a year ago, the space is extremely strong, and we're not seeing any signs of weakness in it. Obviously, a tough -- a strong economy leads to a tight labor market. You're seeing wage pressure, but they are manageable, I would say, at this point in time. And we are exceeding our wage with our price. So if we're cycling there, I'd really say the industry would be firing on all 8 cylinders in an 8-cylinder engine. So right now, it's probably at least 6 or 7 of 8.

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

But even this year, you're seeing all the companies overcome the impact of recycling. And you fast forward to '19, it's anniversary.

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. And if you are on the Republic call yesterday, I listened briefly, I could not agree more with what their executive team said. I mean, I actually think this recycling thing is a good thing. It's a chance potentially. If the price stays low enough long enough, it's a chance to fix a very broken economic model and address it. But otherwise, the industry will probably won't address. So I actually view that as a positive thing. And I'm thankful it's happening now under what's very strong umbrella.

Operator

Our next question comes from the line of Derek Spronck with RBC Capital Markets.

Derek Spronck - *RBC Capital Markets, LLC, Research Division - Analyst*

The pricing environment seems pretty strong. How much revenue do you have tied to CPI? And is the pricing increased broad-based? Or are you being a little bit more purposeful towards pricing versus volume? Or is just generally a better pricing environment right now?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Well, there's a tacky to those. First off, I would say that the pricing is broad-based. The first part of your question was how much do we have tied to the CPI. I would say we have -- I mean, around -- between 40% and 45% of revenue, particularly collection revenue tied to a CPI or some sort of CPI-based index. So it's a pretty large number, and we like that. And as we said, that, that number on the West Coast is pushing towards 3.5% and appears already locked in to be somewhat similar to that 4.19%. Again, because we will be basing it mostly on the July CPI. Pricing is broad-based. We got very strong pricing across our Canadian footprint. In fact, our Canadian footprint probably has the highest pricing that we achieved, albeit with some volume trade-off. And all of our regions geographically exceeded 3.5%. So there wasn't one that was below it. So I would tell you, broad-based, due to a good economic environment, good GDP environment. I would also tell you that if you are not getting 3% price in this environment, you're probably have a margin compression. I think you're seeing that at other company. Despite strong price, if you exclude accounting changes in CNG credits with this recycling, you are still getting margin compression. So you're really need to be north of 3% or so in this environment -- this cost environment that we believe to get margin expansion, and we pushed it hard. I mean, we will be the first to say we pushed it hard.

Derek Spronck - *RBC Capital Markets, LLC, Research Division - Analyst*

Is there any concern that from an absolute level pricing or your contract rates are reaching a point where there will be customer push back? Or would you say that your services that you're providing are still -- you're still providing some pretty good value on an absolute price level?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Well, I would say that's a market-by-market issue. Derek, pricing is a -- again, it is not a science. Pricing is an art. I mean, we look at pricing on a local market basis through 517 P&L amongst 7 million customers. And we don't just -- there's not a broad-brush. You see it amalgamated as a broad-brush for the company and by region, but it's very different. There are a number of markets where we are not doing price increases. There are a number of customers where we are not doing price increases. So obviously, that tells you that are markets that we're well north of 5% to get to where we are, and that's because it's a market-centric issue. It's based on your asset positioning. It's based on your cost structure. It's based on your competitive positioning. And so look, the reality is, whether you raise price 2% or you raise to 10%, the same customer is going to cry, right? That has never changed in this business. So we might as well do at 5% to 8%, make it worth a while. But -- so yes, I think, whether we are all providing what we believe is a quality service, but there is a percentage of those customers that no matter what service level we're providing, price adjustments are difficult. And so that's just something we have to battle through.

Derek Spronck - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay, that's great color. And just quickly, could you talk a little bit about the assets that you bought, in particular the Heart of Florida Landfill, what sort of capacity and/or do you see the ability to implement some pricing increases in the landfill? And how it relates to your jet landfill and some of your collection assets in the area?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. Well, I mean, the Heart of Florida Landfill, basically, serves the Ocala market area predominantly, where the jet landfill sort of serves a market, south of that which is more the Orlando and south market area. So there is really not pricing opportunities per se. And we didn't buy it for a pricing opportunity in the market, we bought it for the opportunity to internalize some of our other volumes that came through the Progressive transaction that we couldn't internalize to our jet landfill. The Heart of Florida is a very large, very new MSW landfill. I'll go out and really not that say, I believe one of the only, if not the only remaining privately owned MSW landfill in the state of Florida, there are several C&D landfills, there are several municipal MSW, but privately owned MSW landfill, I believe this was the last one. And so we view it as a very strategic asset, both in the short and the long term. There is a number of opportunities around it, we believe, over time to consolidate. So again, that's what I would tell you. We think it's a very strategic asset for our footprint.

Operator

Our next question comes from Brian Maguire with Goldman Sachs.

Brian P. Maguire - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Ron, just following on your comments earlier about the recycling and how this could potentially be a good thing for the industry longer term. We've heard from Republic, as you mentioned and Waste Management talk about efforts to try and change how the payment structure is done and maybe derisk the business going forward. Is that your sense as well that we're going to have -- maybe have some tough conversations with customers about getting paid for the value that you guys provide there and kind of remove some of the -- maybe upside and downside risk from the business? And to the extent, you've already started to have those types of conversations. Any comments you can make on how those are going? And any expectations about success that you might have with that?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. Well, number one, Brian, and yes, the answer to your question is yes to all the above. I mean, I think that we -- I can't speak for anyone else. But look, we view -- if you think about this on the solid waste side, we don't go to customers and price their collection of garbage based on what we might make at the landfill. We price the garbage based on the return that we need to account for the capital and the cost structure for collection for the containers we put out there, the trucks we send to them, our hauling infrastructure on a local market basis and we expect to return. The landfill should be, if we own it, an upside opportunity because that also has the capital base associated with it. That's not how the industry has done recycling for a host of reasons. The industry has said, "Well, let's sort of just forget about our cost of collection and recycling. Let's just call that $2 a home or we send the same trucks that we send to collect garbage and get $20. We get $2 or $3 for recycling. And let's use our landfill, called Processing, that has a commodity, let's use that as our payment. Well, that all works when the payments are $150 to $200 a ton. And when it's like it is today, it doesn't work. And so I don't think that we, I don't think our investors want us allocating capital to something that there is a return in 1 year and no return maybe for the next year or 2 and then there is a return. So we've got to take the volatility out of this business, that means giving up some of the upside when communities are very high and taking out some of the downside. So much like you heard Republic say, I mean, we are working on similar things. I would tell you we are behind them in that. I view that is not a good thing, but an opportunity for us. Our margins where they are despite being behind in that opportunity. Remember, for us, it's 2% of revenue, not 5.5% to 6%. So it's a much smaller problem on a percentage basis to deal with. But these -- this is a long-term issue to correct. It will not be corrected in 1 or 2 years. We can make good headway as a company and an industry, but you're talking about many contracts that are 3, 5, 7, 10 years long. So it involves substantive renegotiation. But I think we can make quite a bit of progress over the next few years at the areas where we have the biggest exposure. And effectively, look, we want to be paid a processing fee per ton for a customer. That gives us a return on our cost structure for the capital outlay. And whatever that commodity is, it's the customers' commodity, it's not ours. I mean, we're willing to let them have the benefit and the detriment of it. And we're willing to do some risk sharing because the customers going to want to do that. But to take 100% of it, which is really what many customers would prefer that we and our industry do and the industry has made a practice of, that's not something I see us continuing indefinitely.

Brian P. Maguire - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. Just switching gears a bit, I think I heard you say weather more than you typically do. Just -- and I think you mentioned a couple of stats, but it was pretty quick there in the prepared remarks. So I wonder if you could kind of summarize what do you think the overall weather impact might have been in 1Q? And it sounds like in 2Q, you're expecting some of that to carry over. Any kind of rough rule of thumb on how much we can expect weather to impact in 2Q as well?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

Sure. What we mentioned in Q1 was about a 40 basis point estimated impact on volumes in the period because you remember last year, in many parts of the U.S. and Canada, the winter was not as harsh, in fact it was a very mild winter. This year, you saw winter -- very tough winters throughout the first 4 months of the year in Canada. You saw a dip into the Upper Midwest. You saw it go down to East Coast. You saw 4 nor'easters hit various parts of the country. So anyway, you've got -- the majority of that impact of 40 was in Q1 because now you just have the month of April in certain parts of the geographies. I can only estimate, but it's probably going to be 10 to 20 basis point volume impact in Q2. And that's baked into the numbers that we guided to for Q2. From a margin standpoint, obviously we didn't quantify the margin impact, but there was additional margin impact in the period that we overcame in our margin piece.

Brian P. Maguire - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. Just one last one from me. On Chiquita Canyon, it's -- you obviously drag on volumes quite a bit. And I think over time, I'd expect it could be offset by some increase in pricing and tipping fees. Just wondering how -- what sort of the pricing environment in that region, given people have to be put in their stuff somewhere or may be paying more for the limited capacity that's available, and any opportunity that are you're going to -- timing on when some of those price increases potentially could reopen, anything that contractually would keep you from doing it. But just on any kind of color on timing for potentially being able to recover some of the loss volumes through pricing?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. Well, first off, Brian, the vast majority of the loss volumes have been -- let me back up. I'm going to round. We went from a taking approximately 3 million tons annually at Chiquita Canyon under our old permit to take -- to being allowed to take 2 million. So it's about 1 million ton a year differential that started abating in the late third quarter, early fourth quarter last year. That's why you're seeing it fully in Q1. So it was about -- I'm going round 200,000 tons in Q1 of this year less than Q1 of last year. The -- now the vast majority of that 1 million ton was special waste in C&D that was lower priced, lower margin business that we pushed out purposely, so that we wanted the higher price MSW. In addition, we have been steadily raising both the gate rates and where we did not have contracts the rates for that MSW. So you are correct, on a revenue and on an EBITDA basis, we are not fully offsetting by any means, but we are making a material impact to where we were on a revenue basis.

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

Yes, Brian, you might recall when we first talked about Chiquita last year, we estimated about a 40 basis point margin impact. And to Ron's point, the higher price points that we've been working hard to get was just a 25 basis point margin headwind in the current quarter.

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. And so, I mean that is happening on a realtime basis and has been happening really since Q4 of last year on the price basis, Brian. As far as where that volume has gone, well, I mean, that volume has gone to a variety of locations. There's only a couple of landfill owners within the county. And most of them were at their cap. So they've seen some benefit, but most of it has gone outside the county. Most of it is traveling further differences into facilities in the Inland Empire and to the desert towards Arizona. And so it's traveling further distances is the short answer to your question.

Operator

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

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

E&P kind of continually getting a little bit stronger it seems like every quarter. But we're still, I think, about 30% on a run-rate basis below where this, kind of, was at the peak, maybe even a little bit more. And it seems like there's still a number of plays left to really kind of come back here, lots of positive commentary from a number of industrials so far this period around continued growth in the E&P. So just wondering, what are your expectations now, you talk about double-digit growth last time. Does that still feel right? Do you think there maybe some upside potential to that? And what are you seeing on the ground?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

When we laid out our outlook for E&P back in February, we were at about $190 million, $195 million of revenue run rate entering this year. We talked in terms of about a $30 million increase baked into our outlook, meaning getting to about $220 million or so, $225 million. The kind of the higher exit speed from Q1 into Q2 probably puts us at that $230 million to $235 million type run rate clip right now. We'll see how the balance of the year plays out. So we're probably running about $10 million plus or minus above our prior assumption. So obviously, that's being utilized to offset some increased weakness in recycling. But you're right about -- from the prior peak -- I mean, in the prior peak, we reported about $300 million of revenue in 2014. And so we're running about 25% or so -- 20%, 25% below that. And your point is dead on. I mean, back then, the Bakken was our largest play. And obviously, the Bakken is still yet to wake up. So the Bakken is probably running 80% below its prior peak right now. Obviously, Gulf of Mexico, Eagle Ford, some other parts of Louisiana and the Gulf Coast are still yet to fully show up like we saw in 2014. So if you strip away on a basin basis, we're actually running ahead of where we were in '14 for those basins that are active right now.

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

Okay, that's a great color. And then just so we all have our cadence of volume, right? I mean, a lot of focus on price rightfully so and pricing is stronger than what we perhaps thought. But with your comments on little bit of incremental weather headwinds getting close to kind of a negative 1% headline in 2Q. Should we think about kind of that 0 to 0.5% headline volume for the year, maybe being at a little lower end now? Or do you think sort of there's some timing here that could be maybe push some volume growth a little bit stronger in the back half?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

Well, I think, that's one of the reasons why we still wait for July, because when you've seen such a prolonged winter, the question really is what's the season -- how high is the seasonal snap back, because in those markets that we're heavily impacted by winter, yet saw spring come in late March, early April, we saw tremendous seasonal pop -- above average seasonal increase. And so we got -- let's see how May plays out to see what the seasonal increase is, April to May, now that, that April winter is really exited most of those affected markets.

Operator

Our next question comes from the line of Corey Greendale with First Analysis.

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

I just had a couple of quick ones. First of all the -- Ron, you've touched a couple times on the 3.5% price in the Western region, which in terms of both the sequential pickup and the absolute number, that seems like a higher number than I would have expected given the exclusive nature of those markets. And CPI said -- I think you said, you're pushing hard on price, but how did you -- could you comment on how you achieved such a strong result in the exclusive market?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

Yes. Corey, it's Worthing. I'll start that one. I mean, it's not just CPIs, but obviously in certain rate of return markets, the CapEx investment has driven some of the trajectory on pricing in those markets. And also, our folks have been very proactive with municipalities around the impact of recycling. And in some cases, we're getting increased core price to help offset some of the impact of the declines in recycling.

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

Okay, great. And then, Worthing, I'll ask you a question and if Ron wants to answer, that's fine. On the free cash flow side, I understand you're ahead of pace. If you look at the cadence in 2017 and take the same percentage, it's not sort of -- it doesn't necessarily look that way, so -- but I mean, I think you're obviously on top of it. But can you just give us a sense of the quarterly cadence of free cash flow to set expectations?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

Sure. I mean, what you had last year is, we had a lot of CapEx that we pulled in the last year. But the overhang of the bills, the cash outflow hit us earlier this year. And so, number one, you'll see that repeat itself again as we exit this year, now that our CapEx clip is running $0.5 billion or more, so that's number one. Number two, you see it's the question of timing. If you note accrued liabilities and payables are down dramatically, and that's where you see the majority of that reflected. Our -- if you annualize Q1, we're running comfortably ahead of $850 million. And if you look at the timing of the cash tax payments, those mostly are in Q2, 3, 4. You'll see a dramatic shift in that. You'll see the working capital come back from that reductions in payables and liabilities during the course of the year. And as we've said all along, I mean, there is a good $75 million or $80 million of tax prepay, that's not in our $850 million guidance, and we're not pulling on that to suggest. But that's why we're going to be exceeding the $850 million. So you'll see a different quarter-to-quarter variability this year relative to what you saw last year. But again, most of that you'll see that came out of Q1 will come back into Q4.

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

Got it. And then I just had one last quick one for Ron. And if this is not -- feel free to give a really quick answer if you prefer, but your comment about price being more of an art than a science. I know there -- some others in the industry that are looking at data and trying to apply more science to it and that's true across number of industries. But just what's your view of sort of applying technology to that problem? And over time, can it be -- should it become more of a science than an art?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Well, look, I think, Corey, I would agree with the greater utilization of data. I mean, I still think it's an art. The greater utilization of data just makes you a better painter, I mean -- and to know what to do where. And we use a lot of data to determine how we should paint that picture as well. So the -- we should be more pinpoint, therefore more scientific in that way as we go forward, as our data improves. But at the end of the day, it still gets down to, in our opinion, your ability to push price is really determined by your market model and your positioning within each market. And that's what we spent a lot of our time and have since the inception of the company. And again, I would point to all 4% price up against -- I think the next highest is about 2.5% to 2.7%. So with that, I would say that the market model is outperforming the data model.

Operator

(Operator Instructions) And our next question comes from the line of Michael Hoffman with Stifel.

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

Worthing, on the guidance for 2Q and the $1.225 billion, if you -- what's the sort of the deal number like you gave for how it played out for 1Q where you went $39 million to gross $11 million net, what's that assumption in the $1.225 billion?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

Ask your next question, and I'll get the answer to that.

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

Okay. And then on E&P, I just follow-on very quickly, you're trending at a $55 million plus at this pace. So we shouldn't be surprised if we'd hit $60 million or approach $60 million in any given quarter and then maybe seasonal dip, but that's the trend, right? $55 million plus?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

That's correct. I mean, we are -- that suggesting it's going to hit $60 million, but it could be down close to $60 million. We'll see how it plays out.

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

And then Ron, safety is clearly a big focus. You spend a lot of efforts to fix the -- culture had been about this. Can you update us on the trend?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Sure. I mean, yes, Michael, it is a huge focus for us, as you know. We believe that safety is and the reduction of incidents is a -- an excellent indicator of health of the culture of the company. Because we believe it's heavily tied to turnover, who we are hiring and how they are treated as they are employed. So a better more empowered employee tends to be safer no matter what. So we look at it because they are our employees. And we look at it because it's an indicator of how the health of the company is in our opinion. Things continue to improve, albeit at a lower clip. We're -- I don't want to say we're getting to a point of no return, but we're certainly getting to a point of diminishing return. To give you a perspective, Michael, when we closed the progressive transaction, not quite 24 months ago, their incident rate was approaching 60 at it's peak, that for -- those that aren't aware, that means 6 out of every 10 employees will have a recordable accident or injury every 12 months. Waste Connections at the time that we close, was out at about 0.14, so 14 out of 100 would have an accident or an injury every 12 months. We have decreased the progressive side to approximately 0.21 or so, right in the range. So we've reduced it about almost 70%, a little less than 70%, bringing our blended performance up to about 0.18 or there about, because Waste Connections is basically stayed flat at where we were premerger. So it has been a reduction of the peak of over 4,000 incidents a year of the rolling average of over 2,000 incidents a year. So there's been substantive improvement.

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

And how is that levered into labor turnover, given labor has been in this ongoing challenge of finding people?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. I mean, our labor turnover has been running pretty flat now for about 4 quarters, within a 1% variability. On -- and again, on the former Progressive side to provide a number, at close turnover was running around 43% to 44%, and 90-plus percent of that was voluntary. We have got the turnover in that footprint down to about 26% to 27%, and about 60% of that is voluntary. Our goal is to get to at least under 50% voluntary. And our target is to get that down into the low 20s to the high-teens. We think that's a healthy way, particularly if half of that is on a voluntary basis, then we're getting down to single -- high single digits of people that are leaving voluntarily versus involuntary and that's very manageable. So we have some room to go there. But despite tougher and tougher labor -- tightening of the labor market, we continue to be flat to nominal improvements.

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

And I think all of that ultimately leads into defection-related issues around price. So can you talk about in the quarter, what your retention rate look like on price? It feels like you've retained more of what you entered the market with, not only did you go with a bigger number, you had retained more of it too.

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes, yes. And certainly, to your first comment, Michael, certainly service quality has probably as much or more to do with retention as anything. But the other thing that has a lot to do with retention is the health of the economy, right? I mean, again in 40% to 43% of our business, there is no worry about retention. You get a 100% retention of what's put out, because of the franchise nature of the business. So that allows us to focus on the other 57% of the business, where you don't have guaranteed retention. There, our service quality is extremely important. And I think we continue to work on improving that, but, again, so is the health of the economy. Because when the economy is healthy, the private haulers who tend to live at a lower margin, they're getting their growth through the growth in the market, which provides a better pricing umbrella for all of the players in the market and allows for higher retention. So to answer your question, the retention was north of 90%.

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

Okay. And when -- a takeaway we saw from Expo, I was talking to the private, they fundamentally said they were full in commercial collection that at this juncture they'd have to either add a route or displace the lower margin customer to add a customer. Would you buy into that statement?

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Yes. I think that's why so many of them were in line at Expo. I mean, there are at a capital inflection point, right? And so one of the things that drives, whether small, medium or large drive their consideration to sell of those catalysts. I mean, taxes, interest rates, the strength of the business and where they had a capital inflection point in their business. So I can't make that statement for every company, but certainly a lot of them are now well ahead of where they were pre-Great Recession, coming out of that in '12 or '13.

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

Okay. All right. Worthing, did we buy you enough time?

Worthing F. Jackman - *Waste Connections, Inc. - CFO & Executive VP*

Yes. You could have asked me to follow up about 10 minutes ago, on your first question. We've assumed the acquisition -- new acquisition contribution is about $54 million in the period and divestiture impact is about $28 million, and so the net of that is $26 million. Now that does not include any contribution potentially from the transaction we signed yesterday that could contribute during the month of June depending on when we close it.

Operator

And there are presently no further questions on the phone lines at this time.

Ronald J. Mittelstaedt - *Waste Connections, Inc. - Chairman & CEO*

Okay. Well, if there are no further questions, on behalf of our entire management team, we appreciate you listening to and interest in the call today. Both Mary Anne and Worthing are available today to answer any direct questions that we did not cover that we are allowed to answer under Regulation FD, Regulation G and applicable securities laws in Canada. We thank you, again, and we look forward to speaking with you at our coming investor conferences or on our next earnings call.

Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation, and ask that you please disconnect your lines.
