Industry Update

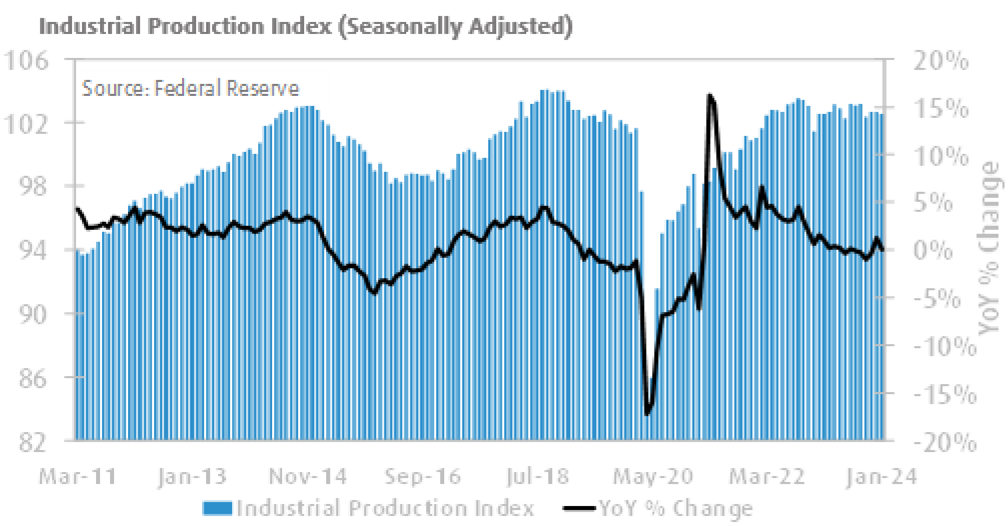
Refuse and Recycling

Key Developments

- According to the **Bureau of Labor Statistics**, the fatality rate for refuse and recyclable material collectors fell significantly from 27.9 per 100,000 full-time equivalents (FTE) in 2021 to 22.6 per 100,000 FTE in 2022, while the national rate for all industries increased.
- The **BLS** also said the Waste Management and Remediation Services industry was near record-high employment (production and non-supervisory) at the end of 2023, while average hourly wages grew 8.2% year-over-year, also reaching a record high.
- The January **Producer Price Index** for recyclable corrugated paper has been on a steady uptrend, increasing 159% since bottoming in November 2022 and 119% over the past year. Conversely, the PPI for recyclable plastics was down 22% from a post-Covid peak in June 2022.
- According to the **Census Bureau**, household formation, a leading indicator for solid waste volumes, accelerated from 286,000 during the 3rd quarter to 820,000 (+0.6%) units during the 4th quarter and also grew by 1.5 million units (+1.1%) from the year-earlier quarter.
- Be sure to check out the latest perspectives from BMO economists on the macro outlook (page 4).

Industry Fundamentals

The robust industry conditions of last year, highlighted by exceptional pricing strength within a backdrop of multi-decade high inflation, are a tough act to follow and not likely to be repeated. Still, the industry margin and cash flow setup for 2024 remains positive, with moderating internal cost inflation helping to offset a less robust CPI-based pricing environment. Incremental operating synergies from vigorous acquisition activity over the past few years and the potential for elevated recycling commodity prices should also support margin expansion. Additionally, the anticipated start of government-sponsored infrastructure projects and the Fed loosening by mid-year should result in volume tailwinds from increased C&D and industrial activity and a more robust M&A environment.



In January, **U.S. industrial production** unexpectedly fell 0.1%, while December was revised lower to a flat reading. Manufacturing output (the biggest share of industrial production) dropped for the first time in three months, down 0.5%, amid a sag in nondurable goods production. In the meantime, durable goods manufacturing held up, with computer and electronic products extending record highs, even as motor vehicles & parts and machinery fell.

The decrease in manufacturing output pushed **capacity utilization** lower by 0.5 percentage points to 76.6%, 1.7 percentage points below a year earlier, and 1.6 percentage points lower than the long-run average.

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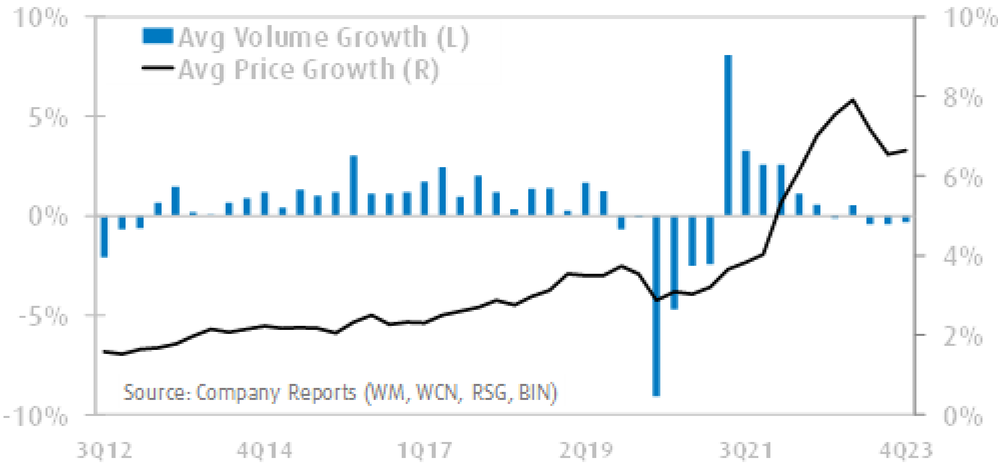
Business Indicators

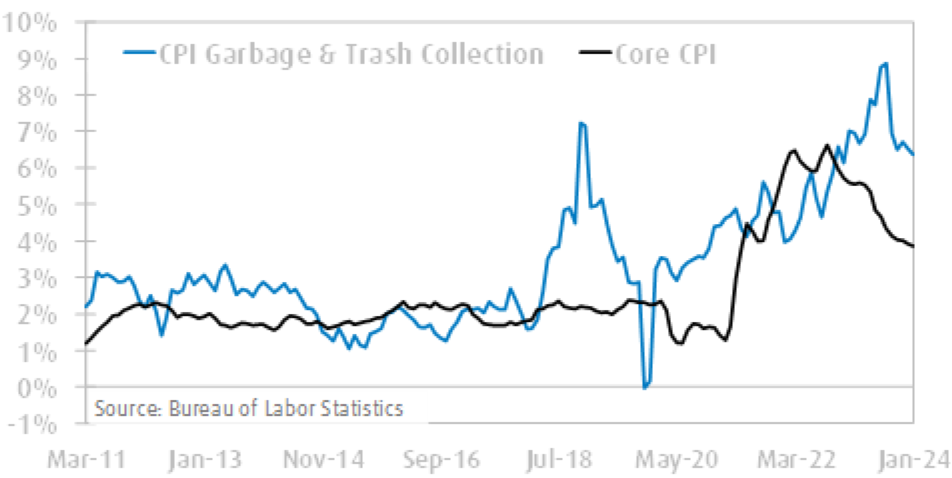
Public Company Average Reported Volume and Pricing Growth Y/Y % Change



A sample group of public refuse haulers realized average year-over-year **pricing growth** of 6.6% during the 4th quarter, up ten basis points from the 3rd quarter but down 90 basis points from a year earlier yet still well above the trailing 5-year and 10-year averages of 4.7% and 3.6%, respectively. Although clearly past peak, the most recent pricing metrics reflect advantageous negotiating leverage within the cooling but still elevated inflationary backdrop.

Solid waste volumes have shown a dramatic deceleration from post-pandemic boom times and, during the 4th quarter, were down 0.3% compared to a year earlier and slightly negative for the fourth quarter out of the most recent five. Yearly comparisons remain challenging while inflation and higher interest rates continue to take their toll on the industrial sector and C&D activity.

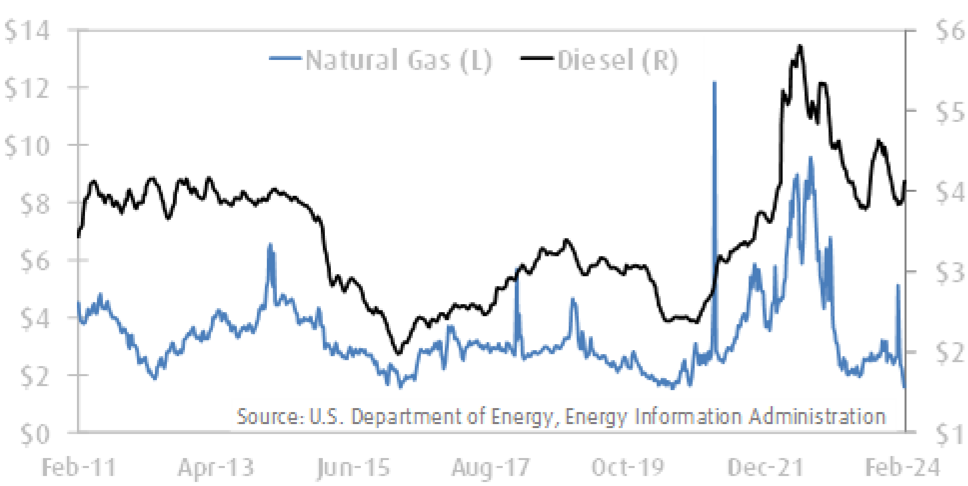
Core CPI (All Items Excl. Food & Energy) vs. CPI Garbage & Trash Collection Y/Y % Change



Headline CPI increased 0.3% in January, above the consensus forecast of 0.2% and notably above the downwardly revised December reading of 0.2%. The "hotter" than expected reading was again driven by the usual suspects - substantial price increases in food, services, and housing components, despite the anticipated decline in gasoline prices. **Core CPI** during January jumped 0.4% versus 0.3% in December, higher than the 0.3% forecast by the consensus, with the year-on-year rate holding at an elevated 3.9% compared to a 3.7% consensus forecast.

The CPI index explicitly related to garbage and trash collection, frequently used as a benchmark for contract service pricing, continues to be extraordinarily "sticky." Although well off its peak, the index remains well above historical averages.

Natural Gas Spot and On Highway Diesel Weekly Prices



Since the invasion of Ukraine and, more recently, the conflict in the Middle East, Diesel fuel prices have been on a high-altitude roller-coaster. However, over the past six months, mirroring a slump in WTI prices before a recent bump higher in February, the national monthly average Diesel price of $4/gallon in mid-February had decreased $0.56 (-12%) from a September peak.

According to the most recent forecast from the U.S. Energy Information Administration (EIA), WTI crude and Diesel prices are expected to peak during the 2nd quarter, followed by gradual price declines through the fall. However, the EIA also acknowledges the risk of further upside to their forecasts depending on the persistence and effectiveness of the Houthi Red Sea attacks.

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"Voice of the BMO Economics Team"

With macro conditions outperforming most economists' expectations, services inflation proving sticky, and market expectations for the Fed to start cutting rates pushed out to later in the year, we thought checking in on the BMO Economics Team's latest perspective on the Fed and the outlook for the U.S. economy would be helpful.

For more: https://economics.bmo.com/en/

U.S. PCE Inflation and Income Growth Run "Hot" in January
Scott Anderson, Chief U.S. Economist – February 29th, 2024

As advertised, we received more unwelcome news on the consumer inflation front for January. **PCE prices accelerated 0.3% in the month, in-line with our forecasts**, and up from a downwardly revised 0.1% increase in December. This was the highest monthly inflation reading on this measure since September. Driving the price increases last month, services increased 0.6% and food prices jumped 0.5%, even as energy and goods prices declined 1.4% and 0.2%, respectively. Core PCE prices, excluding food and energy, accelerated even more than the headline reading, by 0.4% after a modest 0.1% increase in December. This was the highest reading on monthly core PCE inflation since January of last year. From a year ago, PCE inflation slipped to a more tolerable 2.4% from 2.6% in December due to favorable base effects. Core PCE inflation also moderated in-line with consensus expectations to 2.8% from 2.9%.

Personal income growth increased to a sizzling 1.0% in January from 0.3% in December as social security benefits rose on a one-time 3.2% cost-of-living adjustment, and as other government social benefits increased due to Affordable Care Act enrollments. This is a similar increase in personal income that we saw in January of last year that helped fuel a consumer spending surge in the first quarter. However, disposable personal income, income less personal current taxes, increased a somewhat tamer 0.3% in January in-line with December's increase. Moreover, because of the jump in inflation last month, real disposable personal income growth was unchanged last month, continuing a slowdown pattern we have seen since November. The lack of real disposable income growth in January should weigh on real consumer spending growth in Q1, despite the eye-popping headline increase in nominal income growth.

Personal spending growth was subdued, slipping to 0.2% in January from December's stellar 0.7% gain. Real personal spending fell 0.1%, reflecting a 1.1% decline in goods spending, as demand for motor vehicles and parts plunged. Real services spending continued to advance at a 0.4% pace, led by increases in housing and utilities. The personal saving rate increased modestly to 3.8% in January from 3.7% in December.

Bottom line: The "hot" PCE inflation and personal income growth in January will keep the FOMC firmly on inflation watch, but the drop in the year-on-year PCE measures of inflation will give the Fed some additional breathing room to remain data dependent and patient as they consider the timing of their first interest rate cut.

Nvigorating

Douglas Porter, Chief Economist and Managing Director - February 23rd, 2024

Stocks rolled to new highs this week, perhaps best highlighted by Japan’s Nikkei finally surpassing its end-1989 peak. Putting those 34+ years into perspective, Britain has had eight different Prime Ministers, Canada six, the U.S. has also had six Presidents, and we’ve lost count of Japan’s leaders over that spell. Spurred on by Nvidia’s blowout earnings, the S&P 500 and Dow also reached new milestones, albeit with no change in world leaders since the prior records (hit last Thursday). The S&P is now up a cool 27% from a year ago, while the Nasdaq’s yearly rise is fast approaching 40%, and the Nikkei has even topped that mighty gain.

The furious rally in equities **makes the Fed’s job even more complicated**. Already frustrated by sticky services inflation, and a surprisingly healthy job market early in 2024, the heavy-duty loosening of financial conditions hardly calls out for the need for rate relief—on the contrary. This week’s FOMC Minutes noted the “risks of easing too quickly”, with some concerned that “progress on inflation could stall”. Fixed-income markets have absorbed the message, with Treasury yields backing up even further this week, rising to levels last seen nearly three months ago—or before the Powell Pivot. Market pricing of Fed rate cuts is leaning to fewer and further out, with even the June meeting now in some doubt, and little more than three cuts in total seen for the full year (**we’re calling for four cuts, starting in July**).

Aside from the Minutes, it was a particularly uneventful week on the U.S. economic data front. However, the light fare was still generally solid, with jobless claims falling anew to just 201,000—zero sign of stress there—and the S&P PMI showing a pick-up in manufacturing this month to its best reading since the fall of 2022 at 51.5. True, the leading indicator fell for the 23rd month in a row (basically since Fed hikes began), but the Conference Board opined that the index is out of recession range because more than half its underlying components have been on a rising trend over the past six months. We do expect growth to cool this year, and are holding at 2% GDP for Q1, but that’s from the piping hot pace of 4% average growth in the second half of 2023.

The stock market sprint may revive broader **consumer confidence**, and could further support growth, in part through the **wealth effect**. **Business capital spending** may also be revved up by the equity rally, with machinery and equipment spending potentially following the strength already seen in factory construction over the past year. Note though that so far, the AI boom has mostly been reflected in stock prices and only a narrow sliver of business outlays; over the past four years, overall business investment is up at a leisurely 2.7% annualized pace, a shadow of the double-digit gains seen in the late 1990s during the internet boom. Still, capital spending is supporting overall activity, and helping steer the economy away from a downturn. And GDP growth of around 2% is hardly cool enough to seriously weigh on underlying inflation, thus keeping Fed officials cautious.

January FOMC Minutes… Fear of Cutting Too Quickly
Scott Anderson, Chief U.S. Economist – February 23rd, 2024

The Minutes from the January FOMC meeting were **closely aligned with our pre-conceived expectations, and reinforce our baseline forecast for a mid-year start to the rate cutting cycle at the earliest this year.** Right now, the June or July FOMC meetings appear to be the most likely candidates for the first quarter-point rate cut. The minutes clearly illustrate that **most Fed officials remain concerned about moving too quickly to cut interest rates:** it was noted that the **risks of moving too quickly to cut outweigh the risks of keeping borrowing costs elevated for too long.** Some officials noted progress on inflation could stall. In contrast, only a couple of officials pointed to risks to the economy from waiting too long. The economic forecast prepared by the staff for the January meeting was slightly stronger than the December projections. In general, officials said they remained "highly attentive" to inflation risks and noted they did not see it as appropriate to lower rates until gaining "greater confidence" inflation is moving sustainably toward 2%. Officials highlighted the uncertainty in the economic and inflation outlook, as well as uncertainty over how long a restrictive policy stance would be needed.

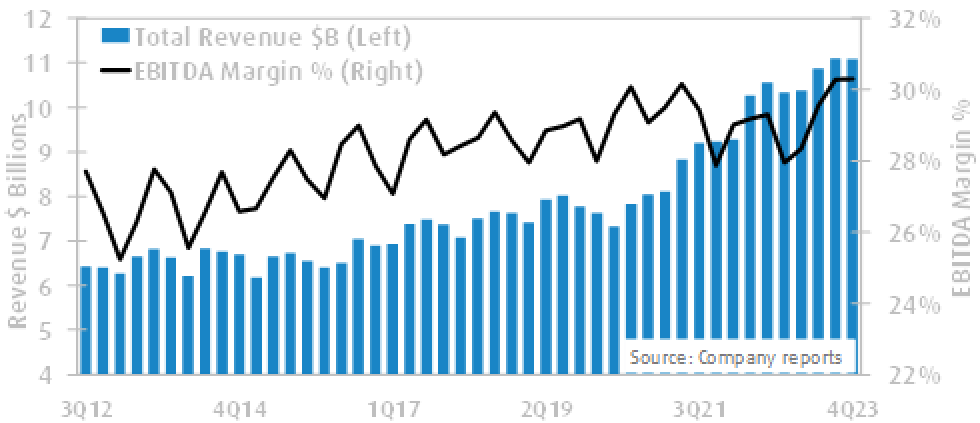
No detailed plans were mentioned for the winding down of the Fed's quantitative tightening program. However, acknowledging reductions in the overnight reverse repo usage, many officials said it would be appropriate to start in depth balance sheet discussions at the next meeting. A few officials noted balance sheet runoff could continue after rate cuts begin, while some policymakers said a slowing pace of runoff could help smooth the transition to an ample level of reserves and allow the runoff to continue for longer. The staff noted that once the ON RRP facility is either depleted or stabilized at a low level, reserves will decline at a pace comparable with the runoff of the Fed's securities portfolio.

In terms of risks around the outlook, Fed staff placed "some weight" on the chance that further progress on inflation could take longer than expected, while characterizing U.S. financial system vulnerabilities as notable, and saw risks on the economic forecast skewed to the downside.

Bottom Line: The minutes were not much of a market mover today with probabilities of a March or May rate cut holding near recently low levels, and bets still being placed on June or July for the first reduction. The market is pricing in about 3 and a half quarter-point rate cuts before the end of this year. U.S. stocks were trading modestly lower in the wake of the minutes release. Treasury yields rose, mostly holding onto increases seen earlier in the day.

Business Indicators

Waste Management Public Company Total Revenue and EBITDA Margin



Composite includes: WM, WCN, RSG, BIN

2024 Outlook for Waste Management Public Companies

Company	Revenue Y/Y %	Adj. EPS Y/Y %	EBITDA Y/Y %
Waste Management	+6.5%	+9.9%	+8.7%
Republic Services	+8.5%	+6.8%	+10.1%
Waste Connections	+9.2%	+12.3%	+13.8%

Source: BMO Equity Research as of 2/28/24

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Total revenue for a sample group of public waste management companies during the 4th quarter was flat with the seasonally strong 3rd quarter and slightly better than the average 1% seasonal downtick over the past dozen years. Further, despite pressure on volumes due to slowing manufacturing and construction activity, sticky pricing strength combined with contributions from M&A resulted in the 2nd highest quarterly revenue total on record and year-over-year growth of 7.3%.

EBITDA margin typically follows the direction of revenue due to increasing or decreasing asset utilization and operating leverage. However, in the abnormal climate of the past couple of years and despite solid revenue growth, the industry's profit margin has been diluted by unusually high and sticky internal cost inflation (labor, insurance, maintenance, etc.), acquisition integration inefficiencies, and deflationary recycling commodity prices. That said, in a gradual return to normalcy as internal cost inflation subsides, EBITDA margin of 30.3% during the 4th quarter tied the record high set in the preceding 3rd quarter on essentially the same revenue base. Still, margins during the quarter were only 20 basis points better than the previous record high 2nd quarter of 2021 despite 26% higher revenue.

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