

Industry Update

Refuse and Recycling



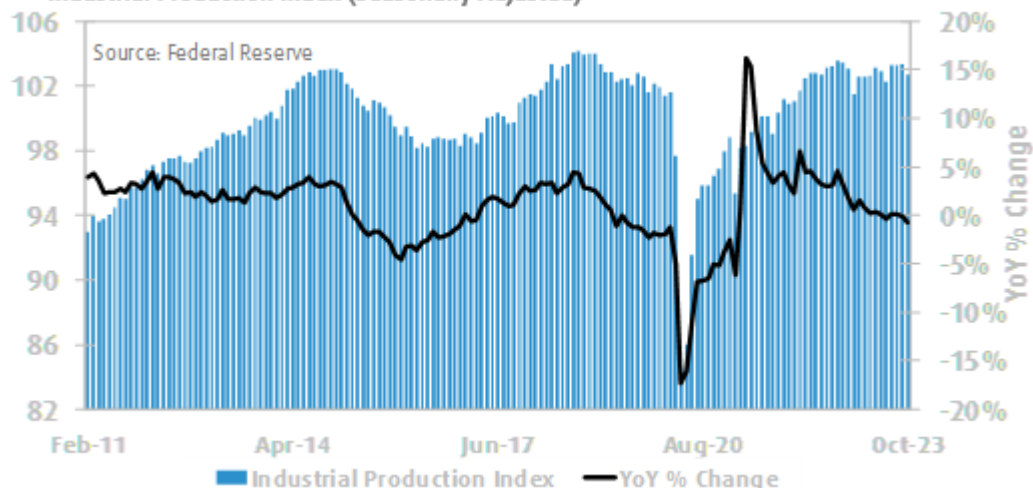
Key Developments

- Acquisitions by public solid waste companies have cooled considerably year-to-date. According to **Wastedive**, the largest players spent \$3 billion on acquisitions through the 3rd quarter, down from nearly \$5 billion during the same period last year.
- The **BLS Producer Price Index** for recyclable corrugated paper has been on a steady uptrend while increasing 89% year-to-date through October. Conversely, the PPI for recyclable plastics was down 8% year-to-date through September.
- According to the **Bureau of Labor Statistics**, the Waste Management and Remediation Services industry was near record-high employment in September, although flat since June. Wages are also stagnating at a high level, with average hourly wages during the 3rd quarter declining 0.6% from the 2nd quarter but still up 7.4% from a year earlier.
- According to the **Census Bureau**, household formation, a leading indicator for solid waste volumes, decelerated from 866,000 during the 2nd quarter to 286,000 (+0.2%) units during the 3rd quarter but still grew by 1.8 million units (+1.4%) 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 margin and cash flow benefits of internal cost inflation falling faster than CPI-influenced pricing coupled with incremental operating synergies from robust acquisition activity over the past few years continue to outpace macro and industry-specific challenges to growth and profitability. Volumes are mixed at best, with the renewed traction of return-to-office creating a tailwind for the commercial sector, albeit at the expense of lost momentum in the residential sector. Meanwhile, the C&D and manufacturing sectors continue to struggle with elevated borrowing costs that undercut consumer demand and business investment. If conditions continue to stiffen, the industry maintains proven cash flow preservation levers, including discretionary expense discipline, automation efficiencies, and the postponement of capital outlays.

Industrial Production Index (Seasonally Adjusted)

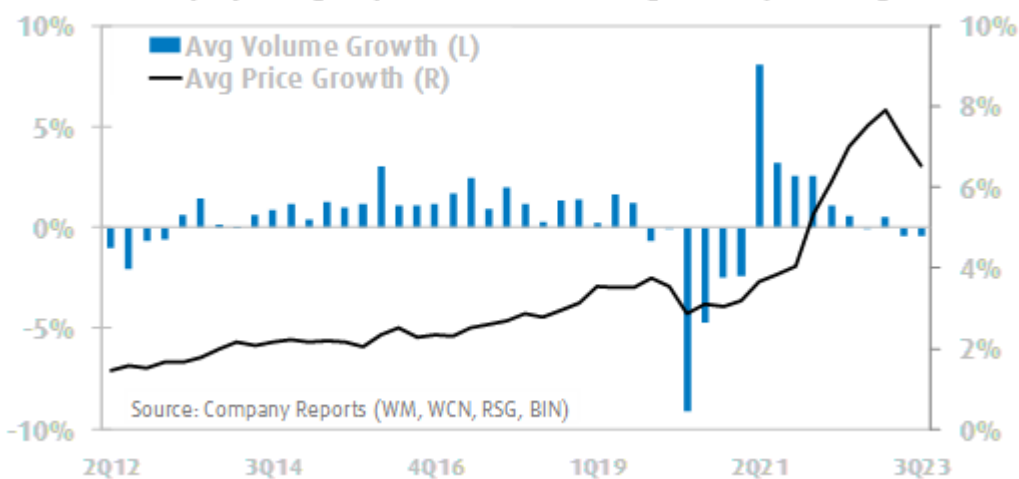


U.S. industrial production fell 0.6% in October, marking the first decline in four months. Manufacturing output (the biggest share of industrial production) dropped 0.7% amid a 10% plunge in motor vehicles and parts. The autoworkers strike disrupted production in October, but with workers back on the line to start November, a rebound is likely in the making. Business equipment (-0.5%) and consumer goods (-1.2%) fell for a second straight month.

Not surprisingly, **manufacturing capacity utilization** dipped to a ten-month low and well below the long-term average, which should keep downward pressure on goods prices.

Business Indicators

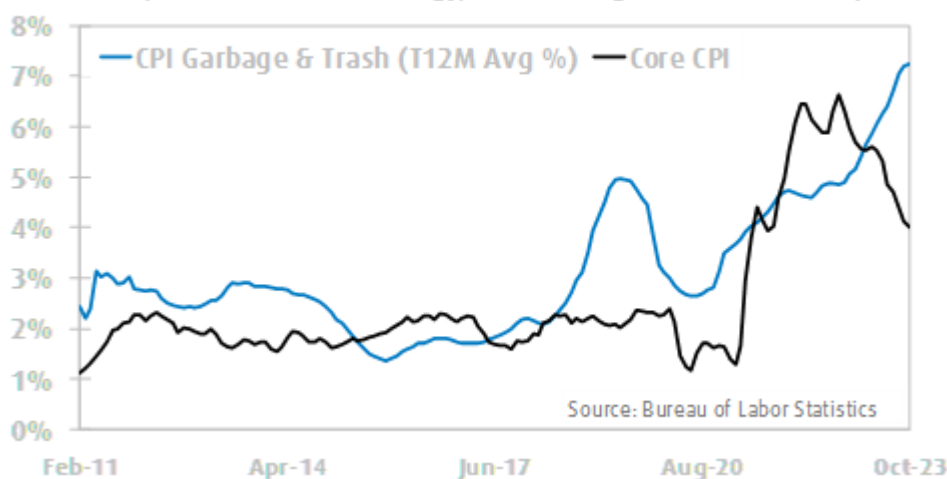
Public Company Average Reported Volume and Pricing Growth Y/Y % Change



A sample group of public refuse haulers realized average year-over-year **pricing growth** of 6.5% during the 3rd quarter, down 70 basis points from the 2nd quarter and 140 basis points below the record high reached during the 1st quarter but still well above the 5-year and 10-year averages of 4.5% and 3.4%, 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 and, during the 3rd quarter, were down 0.4% compared to a year earlier for the second consecutive quarter. Yearly comparisons remain challenging while inflation and higher interest rates continue to take their toll on the industrial sector and C&D activity.

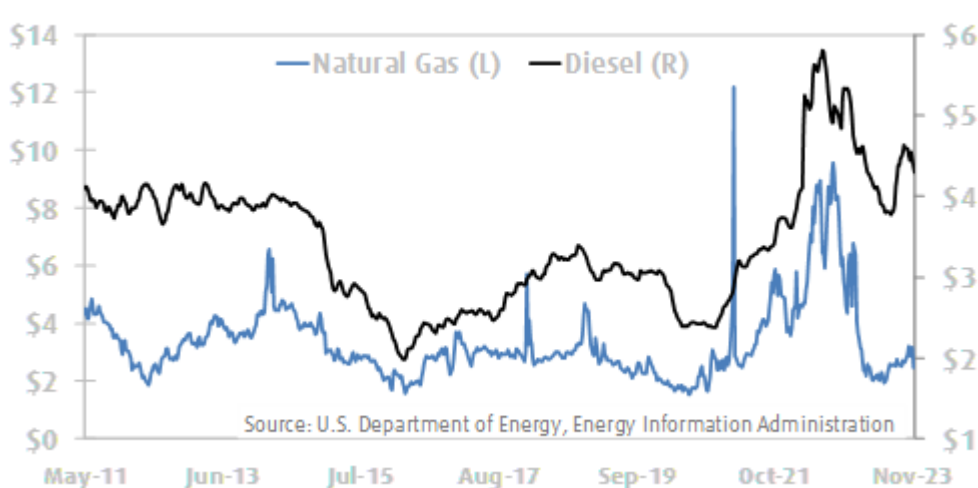
Core CPI (All Items Excl. Food & Energy) vs. CPI Garbage & Trash Collection Y/Y % Change



Headline CPI during October was flat month-over-month as energy prices declined 2.5%, offsetting a 0.3% increase in the food index. The flat reading was the lowest since July 2022, while the 3.2% year-over-year increase was the 2nd lowest since March 2021. Core CPI during October was also up by a less-than-expected 0.2% month-over-month and “only” 4.0% year-over-year, the smallest increase in more than two years.

The **CPI index explicitly related to garbage and trash collection**, which is used frequently as a benchmark for contract service pricing, for the time being, continues to be extraordinarily “sticky” despite negative volume growth.

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. Over the past few months, mirroring a runup in WTI crude prices since mid-summer, the national weekly average Diesel price of \$4.29 per gallon in mid-November had increased \$0.53 (+14%) from a recent low in July but was still down 19% from a year earlier.

The crude price increase since summer reflects increasing odds of avoiding a hard landing, increased geopolitical threats, and OPEC+ production cuts. The current BMO outlook for WTI suggests that crude prices will continue to drift higher toward an average of \$82.50 per barrel in 2024, up from an average of \$79 in 2023.



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“Voice of the BMO Economics Team”

With U.S. macroeconomic conditions outperforming most economists' expectations but with the lag of financial tightening not yet fully reckoned with, we thought checking in on the latest views from the BMO Economics Team would be helpful. For more: <https://economics.bmo.com/en/>

US Retail Sales Slip In October – Jay Hawkins, Senior Economist, November 15th, 2023

Much as BMO Economics anticipated, consumer spending growth is poised to cool in the fourth quarter. **U.S. retail sales declined 0.1% month-on-month in October**, a significant deterioration from the upwardly revised surge of 0.9% in September. Weaker job and wage growth, falling excess savings and the bite of higher interest rates are the primary reasons for the decline and are now headwinds to consumer spending in the all-important holiday season. Receipts in seven of 13 major categories declined with the biggest drops in furniture stores (-2.0%), motor vehicles and parts (-1.0%) and sporting goods stores (-0.8%). These are all considered discretionary categories and the declines suggest consumers might be shifting their spending to essentials amid still-high inflation. The largest gains were in grocery stores (+0.6%), electronics (+0.6%) and restaurants and bars (+0.3% but down from a robust 1.6% in September). The monthly declines pushed the year-on-year growth rate down to 2.5% from 4.1% in September. So-called **control retail sales** – which exclude restaurants, motor vehicles, gas stations and building materials stores and is used to calculate consumer spending in the GDP report – **rose 0.2%** in October, a significant moderation from the 0.7% gain in September.

Bottom Line: The decline in retail sales in October following strong growth in September suggests the U.S consumer might finally be buckling amid higher borrowing costs, elevated prices and slowing job and wage growth. We expect real consumer spending to moderate to a seasonally adjusted annual rate of 1.9% in the fourth quarter following a solid-but-unsustainable 4.0% pace in the third quarter.

US Inflation Cools Sharply In October – Scott Anderson, Chief US Economist, November 14th, 2023

U.S. **CPI inflation was flat in October**, below expectations and marking a sharp slowdown from the 0.4% gain in September. The “stagnant” October inflation report breaks a string of outsized gains over the previous two months and re-establishes the decelerating inflation trend in the United States. The big driver of the slowdown, as expected, was the 5.0% drop in gasoline prices, and the 2.5% drop in overall energy prices last month. Still, several other important categories also saw price declines, including airline fares (-0.9%), used car prices (-0.8%), new vehicle prices (-0.1%), commodities (-0.4%), and education (-0.2%). The year-on-year inflation rate decelerated to 3.2% from 3.7% in September and the slowest pace since July.

Core CPI inflation also came in below consensus expectations, increasing just 0.2% in October. (Consensus was looking for a somewhat firmer 0.3% increase.) That's the best reading on this inflation measure since July and helped bring the year-on-year core inflation rate down to 4.0% from 4.1% in September. The supercore measure of CPI inflation (excluding energy and rents) also came in on the low side at 0.22%, down from 0.61% in September. Shelter inflation eased to a more comfortable 0.3% from a sizzling 0.6% in September, while overall services inflation moderated to 0.3% from 0.6% in September. **The Fed is likely to welcome the sharp cooldown in overall and core consumer inflation in October. It will keep the FOMC firmly on the sidelines and in wait-and-see mode as the December meeting approaches.**

Bottom Line: The sharp moderation in both headline and core CPI inflation in October is an important step in the Fed's goal of returning inflation to its 2.0% target on a sustainable basis. But, the heavy reliance on volatile gasoline and energy price declines for much of last month's improvement will still keep the Fed from declaring total victory. We are encouraged to see the moderation in the core and super-core measures of inflation in October as well, but we will need to see further improvement in the months ahead for the U.S. inflation slowdown story to remain intact and keep the Fed on the sidelines for good.

United States

The U.S. **economy just had its strongest quarter in nearly two years**. Led by consumer and government spending, real GDP growth **accelerated to 4.9% annualized in Q3**, more than double the prior quarter's rate. That's not the speed one would expect after the most aggressive Fed policy in four decades. Growth of 2.9% in the past year is the most since rates started rising in early 2022. A pickup in hiring and real wages pumped consumer spending 4.0% annualized in the quarter. A mid-year bounce in confidence, partly due to lower gas prices, also padded the spending spree. Meantime, fiscal policy remains stimulative, with government spending jumping 4.6% last quarter. In contrast, growth was tempered by some cooling in business spending on equipment and commercial structures. The latter had been juiced by fiscal incentives aimed at refurbishing the nation's physical and electrical infrastructure and reshoring microchip and electric vehicle battery production.

However, **growth is expected to decelerate sharply to around 1% annualized in Q4 and stall early next year**. For all of 2024, real GDP looks to **expand just 1.3%**, down from an estimated 2.4% in 2023. Demand will succumb to the over 500 bps of Fed rate hikes and resulting tighter financial conditions, as well as stricter lending standards. The rate-sensitive housing market is sagging anew, with existing home sales testing 13-year lows as 30-year mortgage rates approach 8%. The latter is also to blame for lean resale listings, as over half of mortgaged households are paying a rate of less than 4% and, so, are reluctant to move. The tight supply, in turn, has sent prices to record highs and affordability to the worst level in nearly four decades.

Meantime, households have lost their appetite for dining and travel, likely due to **diminished excess savings**. A sharp drop in the saving rate supported spending in Q3, but that's unlikely to persist as many lower and middle income households appear to have depleted pandemic stockpiles, according to two Fed studies. In addition, **consumer confidence has dipped** amid a pullback in equity markets and with the Middle East conflict threatening to fuel another rise in energy prices. While improved inventories are supporting auto sales, high borrowing costs and prices will keep them in the center lane.

The economy still faces the threat of a **government shutdown** after November 17. A five-week closure could carve more than half a percentage point from Q4 annualized growth. But the economy appears to have dodged two other bullets. The recently-settled **strike between the UAW and Detroit automakers** now looks to clip just two tenths of a percentage point from Q4 annualized growth, a far cry from the nearly 3-ppt hit that was feared had the strike escalated to include all workers and lasted through year-end. In addition, the **resumption of student loan payments** might now have a much more modest impact of, say, one-quarter percentage point instead of more than one percentage point, as the Administration's Saving on a Valuable Education plan gives many lower-income borrowers the opportunity to reduce or even defer payments.

A soft economic landing is likely the minimum needed to restore price stability. Consumer price growth has fallen from a four-decade peak of 9.1% y/y in mid-2022 to 3.7% in September, while the core rate has eased more gradually from 6.6% to a two-year low of 4.1% y/y. Smoother-running global supply chains and some moderation in wage growth have helped. However, **services inflation remains sticky** due to robust demand and ongoing tightness in labor markets, suggesting a full retreat to the 2% target is unlikely before 2025.

Turning Point? (Cont.)

Despite peppy growth, the **Fed held its fire at the last two policy meetings** amid tighter financial conditions stemming from the sharp rise in bond yields. With the full effect of past rate hikes still to come, Powell said the Fed will "proceed carefully", though some further loosening in labor markets and easing in inflation will likely be needed to forgo future rate hikes. The modest upturn in the unemployment rate to 3.9% in October should keep the Fed on hold in December. As well, a timely pickup in labor productivity has held back unit labor costs, a key inflation driver. Assuming the jobless rate rises to around 4-1/2% by next summer, the Fed could be done raising rates. Still, given stubborn services inflation, rate cuts are likely off the table until September 2024.

After punching through 5% for the first time in 16 years, 10-year **Treasury yields** have slipped back to around 4.6% amid speculation the federal funds rate has peaked. We expect the benchmark yield to decline almost half a percentage point by late next year.

Canada

Unlike the U.S., **Canada's economy has stalled, at best**. Real GDP contracted slightly in Q2 and Statistics Canada's initial read is for a slight decline in Q3, meeting one (though not the most accurate) definition of recession. Special factors such as wildfires and strikes by public sector and port workers haven't helped, but there is more behind Canada's underperformance. Households are struggling with larger debts and shorter-term mortgages than U.S. consumers. Past rate hikes will increasingly bear down on spending, as less than half of mortgages have reset at higher rates since early 2022, according to the central bank's Financial System Review. While Canadian households still appear to have substantial excess savings, they are likely to use them to pay down debt and ease the burden of rising loan payments. The divergence with the U.S. also reflects less heated fiscal spending, greater exposure to the weak global economy, and sagging labour productivity. The latter partly explains why the economy isn't growing despite 3% annual population growth, causing living standards to shrink.

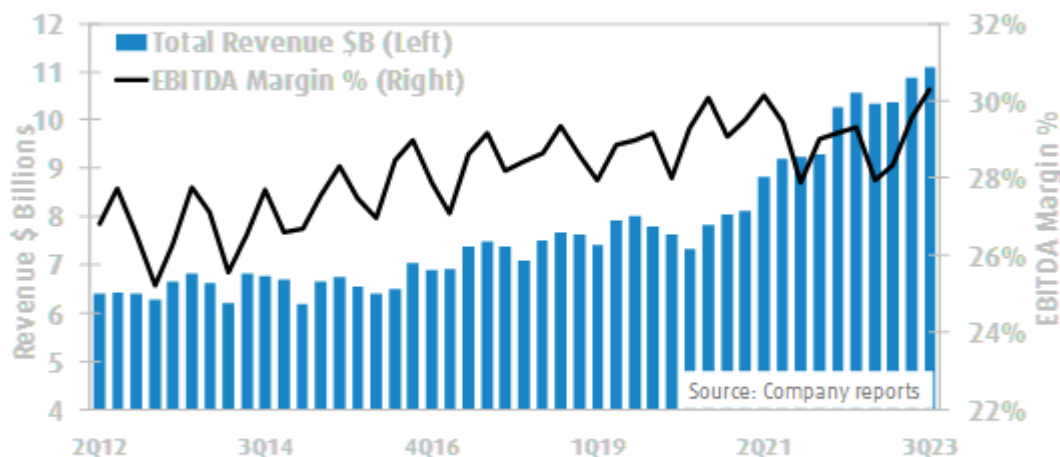
We expect **real GDP to contract 1.0% annualized in Q4** and remain flat early next year. Not helping is a **housing market heading south once again** as a result of high mortgage rates and the worst affordability in over three decades. Benchmark prices could sag about 5% by next summer, taking total losses to around 15% since early 2022. Apart from a still-rapidly expanding public sector, Canada's economy is also getting some lift from auto sales, which zoomed 20% y/y in October amid more ample supplies and pent-up demand. Still, **real GDP is expected to grow just 0.5% in 2024** after an estimated 1.0% rate in 2023, a far cry from 3.4% in 2022. At 5.7% in October, the unemployment rate is up 0.8 ppts from its half-century low of mid-2022, and will likely reach 6.5% by next summer. Although employment has risen by one-half million in the past year, with nearly a quarter of the gains landing in the past three months, it can't keep up with torrid labour force growth. And, with job vacancies sliding 26% y/y in August, hiring could weaken soon.

A looser labour market will ease pressure on unit labour costs, which are still running hot due to fast-rising wages and declining productivity. It should also support a **further slowing in consumer inflation**, which has fallen from 8.1% in mid-2022 to 3.8% in September. Most core CPI metrics are now below 4%, though sticky services prices (notably rents) suggest that inflation could still take until late next year to return to the 2% target.

With the economy on the cusp of recession, the **Bank of Canada is likely done raising rates**. It kept the policy rate unchanged at 5.0% in the latest two meetings, but retains a tightening bias given elevated inflation. We suspect the next move in policy rates is a cut, likely beginning in July 2024, and eventually settling at a more neutral level of around 2.75% in 2026. A friendlier rate environment should see 10-year Canada yields ease modestly from current levels of around 3.8%.

Business Indicators

Waste Management Public Company Total Revenue and EBITDA Margin



Composite includes: WM, WCN, RSG, BIN

Total revenue for a sample group of public waste management companies saw a typical uptick during the usually seasonally strong 3rd quarter. Still, the 2.1% sequential increase from the 2nd quarter was slightly below the average 2.9% seasonal uptick over the past dozen years. Nonetheless, despite pressure on volumes due to slowing manufacturing and construction activity, sticky pricing strength combined with contributions from M&A still resulted in the highest quarterly revenue total on record and year-over-year growth of 5.1%.

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 strong 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 3rd quarter was a record high. Still, margins during the quarter were only 20 basis points better than the previous record high 2nd quarter of 2021 despite 26% higher revenue.

2024 Outlook for Waste Management Public Companies

Company	Revenue Y/Y %	Adj. EPS Y/Y %	EBITDA Y/Y %
Waste Management	+7.0%	+11.5%	+8.5%
Republic Services	+6.7%	+10.5%	+8.4%
Waste Connections	+7.5%	+16.2%	+10.8%

Source: BMO Equity Research as of 11/15/23

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