Industry Update

Refuse and Recycling

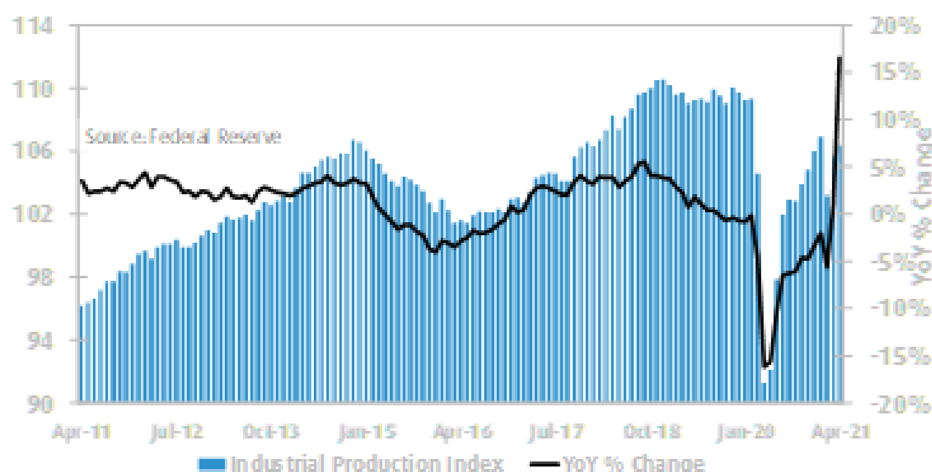
Key Developments

- The **American Forest & Paper Association (AF&PA)** announced that 65.7% of paper and 88.8% of OCC (Old Corrugated Containers) consumed in the United States was recycled in 2020. By comparison, the three-year average recycling rate for OCC is 92.4%, while paper recycling has met or exceeded 63% since 2009.
- According to the **Bureau of Labor Statistics**, total employment in the Waste Management and Remediation Services industry has been stagnant since November. Still, as of April, industry employment had regained a total of 14,800 jobs (+3.4%) since the pandemic low but remained 9,400 (-2.1%) below the pre-pandemic high.
- According to the **Census Bureau**, household formation, a leading indicator for solid waste volumes, increased modestly by 139k (+0.1%) units during the 1st quarter but still increased nearly 1.6 million units (+1.2%) compared to a year earlier.
- Be sure to check out the latest opinions from **BMO economists** on the macro outlook (starting on page 4).

Industry Fundamentals

The industry setup remains optimistic for the remainder of the year as the tailwinds of reopening are likely to outweigh any headwinds. Increasing volume from the hospitality, commercial, construction, and manufacturing sectors will likely more than offset possible slowing in the residential sector. Upward pressure in prices for recycling commodities and later contract re-pricing will balance against upward pressure on wages and fuel costs. Meanwhile, industry operating leverage and free cash flow generation through the economic upcycle will benefit from Covid-era efficiencies that extend beyond the pandemic. Additionally, potential changes to capital gains tax policy could accelerate consolidation before year-end. Lastly, BMO Economists continue to forecast strong GDP growth, now pegged at 6.5% for 2021 and a still robust 4.3% for 2022.

Industrial Production Index (Seasonally Adjusted)



U.S. industrial production rose 0.7% in April, missing expectations but still robust considering a tough comparison to an upwardly revised reading for March. The critical manufacturing sector (76% of total output) rose 0.4%, which was a satisfactory result given ongoing supply chain component shortages, particularly in the motor vehicles and parts subsector, which fell 4.3%.

Mining activity, which includes the vital oil-producing sector, increased 0.7% in April and has mostly recovered from the bad weather of February but is still down 2.7% year-over-year.

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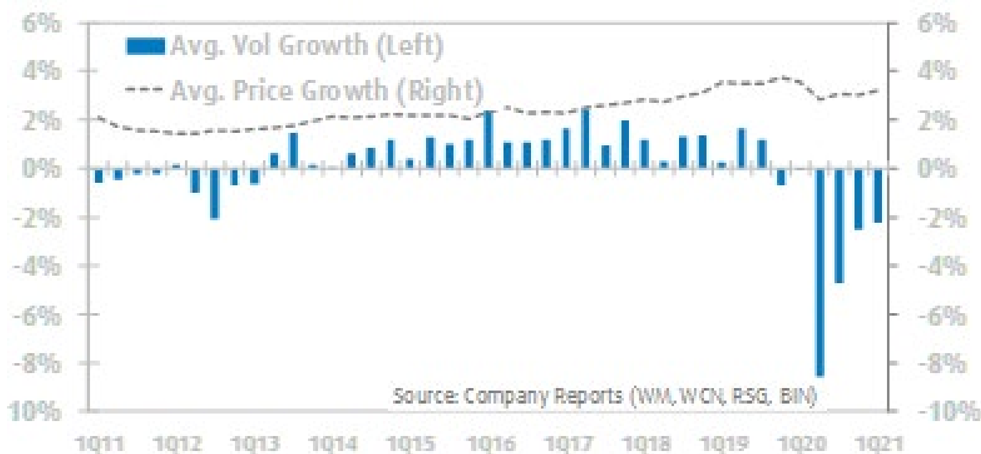
Business Indicators

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 3.2% during the 1st quarter, which was up 20bp from the 4th quarter and above the 5-year and 10-year averages of 2.9% and 2.4%, respectively. Pricing continues to be assisted by a recovery of Covid-related concessions, strength in the residential sector, and the ongoing migration toward industry-specific CPI-based contract pricing.

Given a combination of industrial sector supply chain constraints coupled with a slower than expected vaccine rollout early in the year, **solid waste volumes** improved only modestly during the 1st quarter. Overall volumes were below year-earlier levels by an average of 2.2%, which was still a modest improvement from the 2.5% average decline during the 4th quarter.

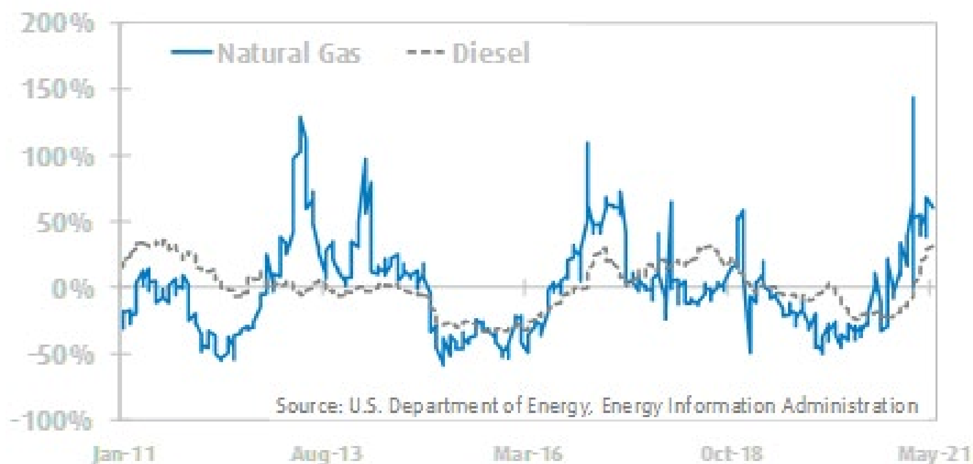
Core CPI (All Items Excl. Food & Energy) vs. CPI Garbage & Trash Collection Y/Y % Change

U.S. consumer prices surged 0.8% in April, which was well ahead of the consensus expectation and the biggest monthly gain since June 2008. Compared to a year ago, total CPI increased 4.2% (highest since September 2008), and core CPI rose 3.0%, which was the highest since December 1995.

The increase in prices was broad-based and reflected a perfect storm of component and labor scarcity combined with accelerating demand and easy year-over-year comparisons.

Similarly, the **CPI index explicitly related to garbage and trash collection**, which is used increasingly as a benchmark for contract service pricing, reached a two-year high in April.

Natural Gas Spot and On Highway Diesel Weekly Prices (Y/Y % Change)



As of mid-May, the average weekly **retail Diesel** price of $3.18 per gallon was up 55 cents (+21%) since the beginning of the year and up more than 34% since the bottom last year.

That said, the current outlook suggests that crude and similarly diesel prices are nearing a peak as the Colonial Pipeline issues clear, OPEC+ gradually lifts capacity constraints, and new supply creeps into the market. As of early May, the EIA forecasted that diesel prices would trend modestly lower through the remainder of the year and exit 2021 near $2.95 per gallon.

The spot price for **natural gas** has demonstrated a bias to the upside as heating demand remained strong in the Midwest and Northeast as temperatures remained cooler than usual through early May.

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"Voice of the BMO Economics Team"

With issues relating to the economic re-opening taking center stage, including accelerating inflation, the employment situation, and supply chain constraints, we thought it would be helpful to check in on the BMO Economics Team's current outlook for the U.S. economy. For more: https://economics.bmo.com/en/

US Economy – That Very Bad 70's Show
Doug Porter, BMO Senior Economist and Managing Director Economics May14th, 2021

Warning: *Inflation risks in the rear-view mirror may be closer than they appear.*

Every once in a while, an economic statistic comes along that truly changes the prevailing narrative in one fell swoop, suddenly shifting the landscape on the outlook. The U.S. April CPI may just be one of those rare beasts. As staggering as the 4.2% pop in the headline inflation rate was, the true shock was the 0.9% m/m rise in the core, which lifted its annual pace to a tidy 3.0%. To put that monthly jump in perspective, the largest previous rise in the past 30 years was 0.5%. True, outsized spikes in used cars, airfares, and hotel rates alone accounted for more than half of the move; but, even extracting these mammoth gains still leaves us with a meaty rise of more than 0.4% on the core-core. And, commodity prices and wage pressures have only strengthened since April, further fueling inflation fears, even prompting some talk of stagflation. As if on cue, the long gas lines in the southeast U.S. evoked bad memories of the 1970s, minus only the Buick Skylarks, Ford Pintos and AMC Gremlins.

However, **before breaking into a panic at the inflation disco, consider a few mitigating points.** And this may sound a bit odd, coming from someone who was just warning two weeks ago about serious upside inflation risks. But besides the well known base effects in play, the meaty monthly rises were also driven by some clearly **temporary** factors. Some reflected (presumably) short-lived supply bottlenecks (the 10% spike in used vehicles), and some a catch-up in prices in reopening sectors (a 10% pop in airfares). One way to at least partially control for these factors is to look at the two-year compounded inflation rate; in the past 24 months, both headline and core CPI have risen at a 2.2% annual rate, almost exactly back to the pre-pandemic pace. In other words, **prices are mostly returning to "normal"—**albeit in double-time.

For this surge to really stick and lead to lasting inflation, there would have to be a shift in expectations and much firmer wage gains. On the former, the **University of Michigan's** May survey of consumer sentiment found that inflation expectations have indeed taken a big step up. Consumers believe that inflation for the next five years will be 3.1%, up from 2.7% last month. That's the highest in more than a decade. Curiously, the implied five-year inflation rate from TIPS is now 2.7%, up from just 2.0% at the start of the year. While an imperfect measure of expectations, it's notable that the markets and households are largely in sync on which way the inflation winds are blowing. Meanwhile, building wage pressures are quite apparent, as Sal digs into below in more detail. So, overall, the main point is that **while the April spike in prices is mostly an aberration, it's the medium-term upside risks for inflation that we regard as much more important.**

Financial markets calmed considerably after the initial shock of the outsized CPI print. Bond yields did finish the week slightly higher, but the slim 5 basis point rise in 10-year Treasuries overall hardly qualifies as a seismic shift. Still, it is telling that **after two big downside surprises on two key economic indicators** for April—jobs and retail sales—**and the CPI/PPI pop, that yields are higher, not lower versus pre-payrolls levels.** While bonds mostly kept their cool, stocks were roiled by the inflation scare, with the highest fliers especially feeling the stress. Even with a late-week recovery, the Nasdaq still peeled off more than 3%, while the S&P 500 slipped about 2%.

"Voice of the BMO Economics Team"

US Economy – That Very Bad 70's Show (cont.)
Doug Porter, BMO Senior Economist May14th, 2021

The flip side of the price spike is the **impact on growth** from both the cause—the multi-faceted supply disruptions—and the effect. That is, consumer sentiment looks to have been blunted by the price surge, with the U of M's survey weakening notably in early May, and retail sales flattening last month. Even so, the economy has plenty of underlying momentum rolling into Q2, supported by further re-openings in many states. Note that even with no gain in retail sales, the April level still stands at a massive 25% annualized rate above the Q1 level. As a result, we remain entirely comfortable with our call of 8.5% GDP growth in the current quarter and 6.5% for all of 2021, followed by 4.3% in 2022. It just so happens that both of these annual estimates are now within one tick of the latest consensus calls (6.6% and 4.2%). With the average outlook for 2021 GDP sprinting almost 3 full percentage points since last October, consensus has caught up with our call.

US Economy – Workers Wanted
Sal Guatieri, BMO Senior Economist May14th, 2021

With a 6.1% unemployment rate, **U.S. companies shouldn't be having so much trouble filling positions, but each week the anecdotes and data suggest they are.** The NFIB survey found that a record 44% of small firms were unable to fill positions in April, which is even higher than the 38% that claimed difficulty when the jobless rate was at a half-century low of 3.5%. A near-record number of firms said they couldn't fill positions due to a lack of qualified applicants. Meantime, the BLS reported a record (back to 2001) 8.1 million job openings in March, up 8% from the prior month and 15% above pre-virus levels. Amazingly, the previously hard-hit (but now rapidly re-opening) leisure and hospitality sector has 25% more job openings than before the pandemic.

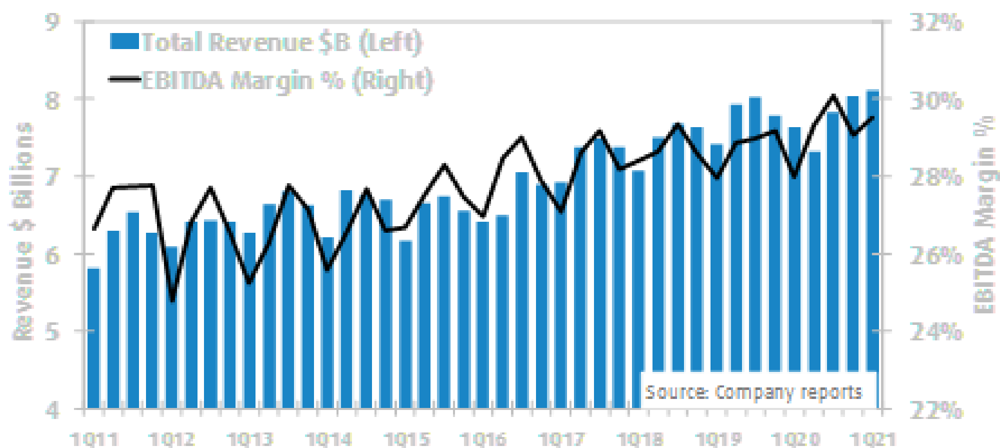
Timelier data on job postings suggest the number of positions across the nation rose further in April. The issue now isn't so much a lack of demand for workers (witness the steady sag in weekly new jobless claims to a pandemic low), **it's more a lack of available, qualified help.** Hiring isn't keeping pace with the rapid increase in openings, with the latter now a record 35% above the former in March. Layoffs also sagged to an all-time low. At the same time, more workers are feeling emboldened to leave their current job for a new one—2.4% of employees jumped ship in March, tying a record. If they could be filled, current job openings would cover a good portion of the 9.8 million unemployed and the 2.8 million persons claiming they are prevented from seeking work due to the pandemic.

Some of the labor shortages will ease as more people get vaccinated and become less worried about their health, and as more schools reopen, easing childcare duties. As well, the supplemental $300 per week UI benefit is set to end in September; in fact, some states have already stopped the extra payout, citing a disincentive to work. For now, companies are extending work hours and ramping up the use of automation to help meet demand. The latter will only widen the skills gap.

More workers are moving into the driver's seat on wage demands (especially truck drivers amid an acute shortage). **This is translating in textbook fashion into higher wages.** Along with several states raising minimum wages earlier this year, more companies (including heavy-weights McDonald's and Amazon) are hiking pay. And, along with surging prices for materials and supplies, more firms are trying to pass the cost increases along to customers. The NFIB survey found that the largest number of firms since April 1981 is raising their selling price, a period when hourly compensation was running 10% y/y. We're not going back to the 10% CPI rate of that time, but we could be in the early days of a classic wage-price spiral that sustains inflation at ever higher levels.

Business Indicators

Waste Management Public Company Total Revenue and EBITDA Margin



With the tailwinds of accelerating vaccinations and a rollback of Covid-related restrictions, **total revenue** for a sample group of public waste management companies saw a seasonally atypical uptick and reached a new quarterly high. Revenue during the 1st quarter increased 0.8% from the 4th quarter and a robust 6.1% compared to a year earlier.

Historically, **EBITDA margin** follows revenue trends and experiences a sequential decrease during the 1st quarter. But this year was an exception to both and the year-over-year adjusted EBITDA increase of 11.9% during the 1st quarter easily outpaced the revenue increase. As a result, EBITDA margin of 29.5% represented a 40 basis point increase from the 4th quarter and a 150 basis point increase from the year-earlier 1st quarter.

2021 Outlook for Waste Management Public Companies

Company	Revenue Y/Y %	Adj. EPS Y/Y %	EBITDA Y/Y %
Waste Management	+12.9%	+20.7%	+14.7%
Republic Services	+7.1%	+7.8%	+9.0%
Waste Connections	+9.6%	+19.1%	+12.9%

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