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Spring 2024

Industry Update

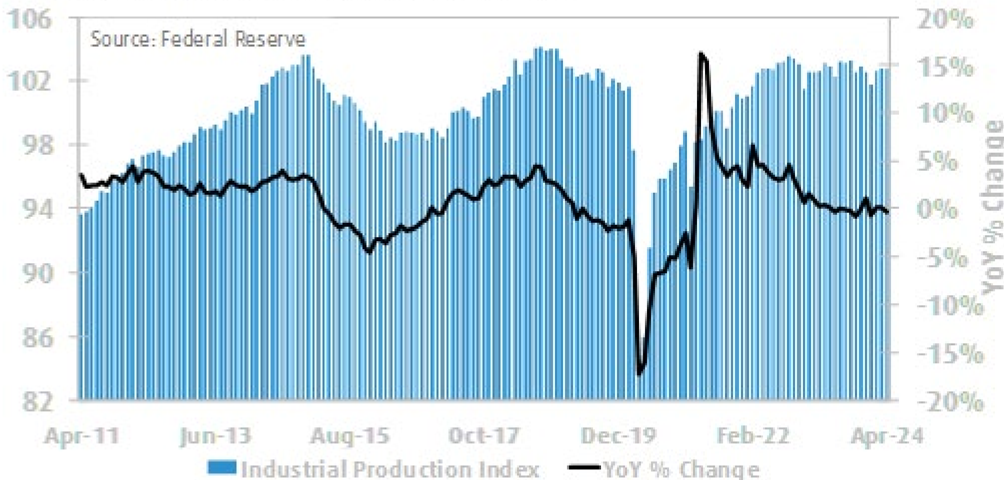
Refuse and Recycling

Key Developments

- Following the finalization of EPA national drinking water standards for per- and poly-fluoroalkyl substances (PFAS), the waste management industry is pursuing federal legislative clarity via the **Resource Management PFAS Liability Protection Act**, which would specifically exempt privately owned landfills as passive receivers of PFAS-containing material, from CERCLA (Superfund) and other legal liability.
- According to Wastedive, **M&A spending** by publicly traded solid waste and recycling operators amounted to $1.29 billion during the 1st quarter, primarily driven by one large acquisition by Waste Connections valued at $1.1 billion. This compares to full-year totals of $4.2 billion in 2023 and $6.3 billion in 2022.
- The April **Producer Price Index** for recyclable corrugated paper has been on a steady uptrend, increasing 214% since bottoming in November 2022 and 90% over the past year. Conversely, the PPI for recyclable plastics was down 25% from a post-COVID peak in June 2022.
- Be sure to check out the latest perspectives from BMO economists on the macro outlook (page 4).

Industry Fundamentals

Following the release of 1st quarter earnings results from the public operators, the industry margin and cash flow setup for the balance of 2024 remains positive, with moderating internal cost inflation counterbalancing a less robust but still above-historic average CPI-based pricing environment. Subsiding wage inflation and improvements in new equipment deliveries are helping to control maintenance/repair and other operating costs. However, most solid waste volume signals remain lackluster, particularly concerning C&D and industrial. Any sustainable turnaround in organic volume growth will hinge on the timing and pace of a Fed easing cycle. In this regard, BMO economists have trimmed their forecast from cuts totaling 75 basis points this year to 50 basis points, starting with 25 in September and another 25 penciled in for December.



Industrial production was flat in April after March's reported sharp gain (0.4%) was revised to virtually nothing (0.1%). Manufacturing (the largest share of industrial production) tumbled 0.3% in the month after a downwardly revised 0.2% advance and is also below year-ago levels (-0.5%). Across major sectors, consumer goods production rose only slightly, business equipment and construction supplies fell materially, and all three were down year over year.

The decrease in manufacturing output pushed **capacity utilization** lower by 0.3 percentage points to 76.9%, 1.5 percentage points below a year earlier, and 1.3 percentage points lower than the long-run average.

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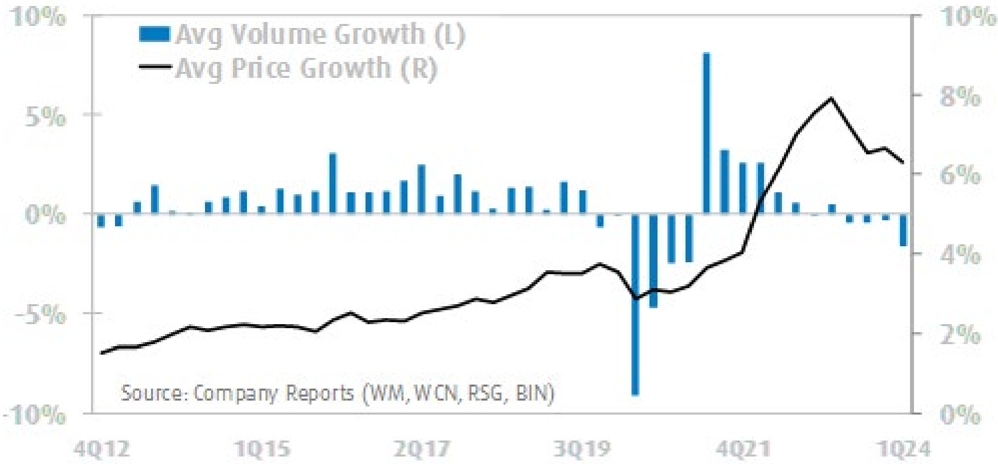
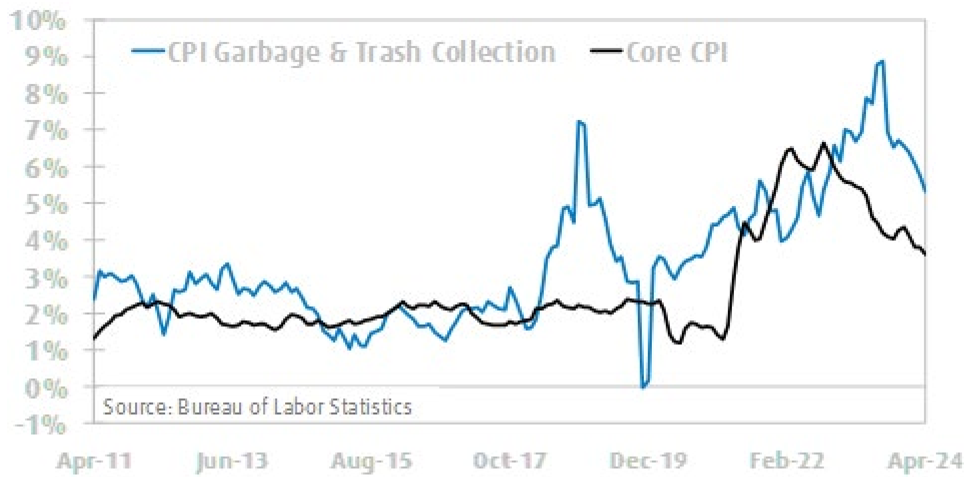
Business Indicators



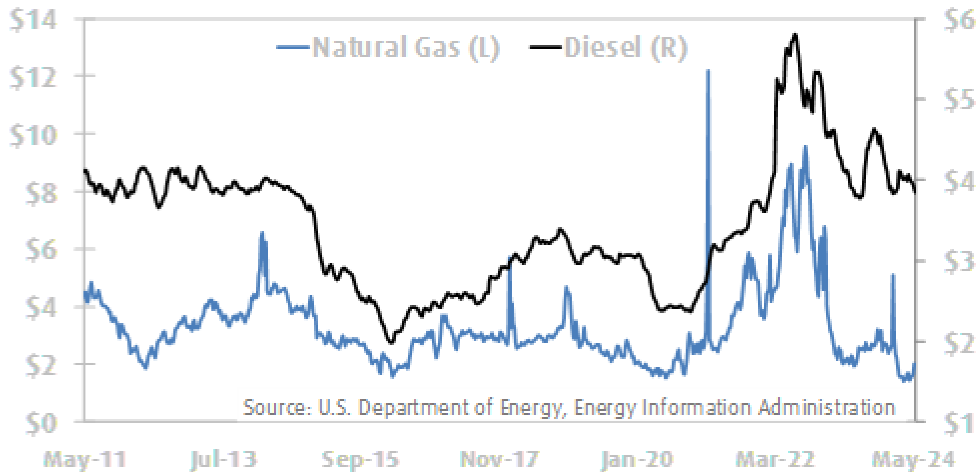
A sample group of public refuse haulers realized average year-over-year **pricing growth** of 6.3% during the 1st quarter, down from 6.6% in the 4th quarter and 7.9% a year earlier yet still well above the trailing 5-year and 10-year averages of 4.9% and 3.7%, respectively. Although well past peak, the most recent pricing metrics reflect advantageous negotiating leverage within the cooling but still elevated inflationary backdrop.

Solid waste volumes continue to decelerate from post-pandemic boom times. During the first quarter, volumes were down an average of 1.6% compared to a year earlier and have been negative for five of the last six quarters. Yearly comparisons remain challenging while inflation and higher interest rates continue to take their toll on the industrial sector and C&D activity.



Headline CPI moderated to 0.3% in April from 0.4% in March and February. On a year-over-year basis, CPI increased 3.4% vs 3.5% in March. This was somewhat below consensus forecasts, and, on the margin, there was a softer pattern to the individual price categories. The BLS noted that over seventy percent of the increase in inflation last month came from just two components: gasoline (+2.8%) and shelter (+0.4%). **Core CPI** increased 0.3% last month while slipping year-over-year to 3.4% from 3.6%, both in line with expectations.

The CPI index explicitly related to garbage and trash collection, which peaked later and is moderating more rapidly than the broader CPI, nonetheless remains well above historical levels.



Mirroring a relatively tight range in crude prices, the national average **Diesel price** of $3.85/gal in mid-May was flat year-to-date. That said, diesel prices were still down 17% from the previous high in September.

Given record North American production and a still pending replenishment of the U.S. strategic petroleum reserve, and despite better-than-expected global growth, increased geopolitical threats, disrupted Suez access, and a cap on OPEC+ production, crude prices have been confined to a relatively narrow two-year range. As such, the current BMO outlook for WTI suggests that oil prices will remain relatively stable, with an average of $80 per barrel in 2024 and 2025, up from an average of $77.6 in 2023.

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"Voice of the BMO Economics Team"

With macro conditions starting to show signs of fatigue, services inflation proving sticky, and market expectations for the Fed to begin 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/

Sticky Inflation, Sticky Rates
Sal Guatieri, Senior Economist – May 17th, 2024

Inflation was doing so well, until this year. After rising 2.0% annualized in the second half of 2023, and thus meeting the Fed's definition of price stability, the core PCE deflator bolted 3.7% higher in the first quarter of 2024. The culprit was a 5.4% pop in services prices, in sharp contrast with deflating goods prices. Sturdy gains in necessities such as auto insurance, electricity and natural gas piled onto strength in discretionary items such as recreational services and hotel fees. Rent is also proving a stubborn beast to tame, though recent market measures flag a deceleration. One can draw a straight line all the way from strong wage growth to sturdy services demand and inflation.

This means labor markets likely need to loosen to bring inflation to target. And they have, but only a little. Fewer businesses have job openings, fewer workers are quitting, and fewer consumers think jobs are plentiful. After a blowout quarter, payroll gains decelerated to a normal 175,000 in April. At 3.9%, the unemployment rate is half a percentage point above the cycle low. But it may need to rise further to take the edge off wage gains as employment costs and hourly compensation are still running north of 4% on a yearly basis. It's only because of faster productivity (2.9%) that unit labor costs are held in check (1.8%). But productivity slowed in the first quarter, suggesting this well might be running dry.

For labor markets to loosen further, the economy will need to land at least softly; that is, grow at a sub-potential rate of under 2%. It did take a run at the tarmac in Q1, as real GDP slowed to a 1.6% annualized rate. Faster imports, slower inventory building, and a rare downshift in government spending led to a sharp drop in altitude from 3.4% in Q4 and 4.9% in Q3. However, private domestic demand stayed aloft, cruising at a 3%-plus rate for a third straight quarter. The resiliency of consumer and business spending—85% of the economy—warranted a modest upgrade to our economic outlook. Still, more recent data suggest growth likely stayed below 2% in Q2. Along with slower payrolls, the ISM metrics slipped into contraction territory in April, retail sales and industrial production both stalled in the month, and consumer confidence soured on weaker job prospects and lower equity values. **For all of 2024, GDP growth looks to decelerate to 1.6%** on a Q4/Q4 basis, about half of last year's rate, as elevated interest rates bear down on demand. A moderate pickup to 2.0% is expected in 2025 if the Fed reverses course.

Inflation's wrong turn is likely a speed bump for rate cuts rather than a roadblock. Citing a "lack of further progress" on inflation, the FOMC provided no guidance on rate-cut timing after its May 1 policy meeting. Chair Powell said the committee will need some combination of calmer core prints and weaker labor markets to gain confidence in the inflation outlook. Throwing markets a bone, he at least said increases were "unlikely" as policy is already "sufficiently restrictive". **We pushed out our call for the first reduction to September** (from July) and expect just one follow-up move this year in December. If inflation behaves, though, an additional 175 bps of rate relief could flow by early 2027.

At least the FOMC will be relaxing quantitative tightening soon. Starting June 1, it will reinvest all but $25 billion of maturing Treasury notes per month, down from the current cap of $60 billion. The slower-than-expected run-off of its bond portfolio could ease pressure on Treasury yields, though what's really needed is much calmer inflation data.

“Voice of the BMO Economics Team”

The Path Forward Remains as Clear as Mud
Scott Anderson, Chief U.S. Economist - May 17th, 2024

Economic data, as it has for much of the pandemic and post-pandemic periods, continue to surprise the consensus forecast. This week, the **surprises were resoundingly to the downside**. Meanwhile, sizable data revisions continue to cloud the outlook for economic forecasters and Fed policy makers, making the path forward about as clear as mud. As Chair Jerome Powell is fond of saying at his FOMC press conferences these days, inflation is still too high, further progress in bringing it down is not assured, and the path forward is uncertain. Last week I posed the question: is the second quarter going to show strong real U.S. GDP growth or be more of an inflationary mirage? Our forecast has been closer to the latter than the former, expecting below-consensus real GDP and consumer spending growth of around 1.7% and 2.0%, respectively, with stubbornly resilient CPI inflation of around 3.7% annualized in the second quarter. The median forecast from the Survey of Professional Forecasters published by the Philadelphia Fed on May 10th is looking for second quarter GDP growth of 2.1%. I was hoping this week’s data on April retail sales, industrial production, housing starts, and consumer and producer inflation would shed some important light on the question, as the Atlanta Fed and New York Fed GDP trackers for Q2 GDP growth have also been holding well above our estimates in recent weeks.

Well, the April data are in and there was a unanimous miss on all U.S. growth fronts, including retail sales, industrial production, housing starts, and initial jobless claims, so it seems **our somewhat below consensus forecast for Q2 remains just about in the right place for now.** Maybe the mud isn’t quite as cloudy for us. In fact, the economic surprises around the U.S. economic data haven’t been this consistently negative since 2019 before the pandemic began. Let’s start with the retail sales report for April. Not only did headline sales remain unchanged from March, and well below the consensus estimate of 0.4%, but retail sales excluding food service, gasoline, building materials and auto dealers, often referred to as the retail sales control group and used as an input for estimating real consumer spending in the quarterly GDP report, actually declined 3.1% at an annualized pace last month. After subtracting out April’s 3.8% annualized CPI inflation rate, core real retail sales dropped at a hefty 6.9% annualized pace to kick-off the second quarter.

In response to the weaker growth to start the second quarter, the GDP tracker from the Atlanta Fed dropped to 3.6% from a peak of 4.2% the week before, while the New York Fed’s version slipped to a lower 1.9% this week. Yes, these tracking forecasts remain somewhat above our Q2 growth forecast, but it will only take a few more disappointing reports or downward revisions to past data to move these tracking forecasts down to our level.

Speaking of downward revisions, we are expecting a pretty big one on May 30th with the release of the second estimate of first quarter GDP. Growth was already a bit of a disappointment when it came in well below forecasts at 1.6%. But along with this week’s April retail sales report, core retail sales for prior months were revised substantially lower through March, shaving half a percentage point off the initial first quarter BEA estimates for consumer spending and GDP growth. **We expect the latter will get revised down to a measly 1.1%** from the 1.6% initial estimate. The analysts still talking about a strong and resilient consumer and labor market to justify current equity market valuations may soon need to start changing their tune to Fed rate cuts are coming to the rescue. Over the last two weeks, more elevated initial jobless claims also point to a recent softening in the U.S. labor market that merits some closer attention.

Turning to this week’s inflation data, we have seen an impressive round of applause in the financial markets with U.S. equity markets surging to new record highs and Treasury bond yields generally dropping as traders solidify around the view that the Fed will be able to start cutting interest rates by our forecasted September date. While the headline and core CPI measures of inflation year-on-year moderated in-line with our and the consensus forecasts, the details looked a bit softer than the past three months and generally moved in the right direction, **keeping the door open for a couple Fed rate cuts this year**. So yes, still sticky inflation, but a bit of light at the end of the tunnel. If only we can get there through all this mud.

Small Business Not Yet Seasick

Sal Guatieri, Senior Economist – May 17th, 2024

A resilient economy is lifting all ships, but some higher than others. In particular, while large firms appear to be taking the waves in stride, **smaller shops are taking on some water**. Although confidence among corporate executives is healthy and normal, that's not the case for small business owners. The NFIB small business optimism index, though ticking up last month, is little changed in the past year and about 10% below normal. Plans to increase staff and capital expenditures have ebbed as the same low number of respondents as in the Great Recession think now is a good time to expand. Many small firms are hiking pay to retain workers, but more are getting squeezed when passing the bill to customers.

The divergence in confidence between large and small businesses is reflected in recent hiring. While large and mid-size firms expanded staff by 1.6% and 1.0%, respectively, in the six months to April, **smaller stores (with fewer than 50 employees) have largely held the line** (0.1%), according to ADP. A large percentage of small companies can't find qualified help to fill positions, as bigger firms usually offer better pay and benefits. Labor quality ranks second only to inflation as their most pressing problem.

Compared with bigger firms, **small shops are struggling more with rising wages** as they have less ability to adopt labor-saving technologies to address worker shortages. They also have less leverage in controlling supply costs. Small firms are especially **challenged with high borrowing costs and access to credit**, as most rely on banks rather than investors for financing, and the former have tightened loan standards in the past year. Many small stores need to repay loans from the Small Business Administration, which provided nearly $400 billion of credit to almost four million businesses during the pandemic. Many have little choice but to pass higher credit, wage and other costs to customers, yet risk losing market share. Small businesses that rely on lower-income households are at greatest risk, as their spending power and savings have been disproportionately impacted by inflation.

To be sure, **most small businesses are making a go of it**, with many even thriving thanks to the robust economy. Business bankruptcies, though turning up, are only at pre-pandemic levels. American households have increased spending at twice the rate of their Canadian peers in the past year, as the latter are much more affected by mortgage resets. But the longer that interest rates stay aloft, the more consumers will feel the need to retrench. While Wall Street is pining for lower rates to keep cruising, it's Main Street that truly needs relief to avoid going under.

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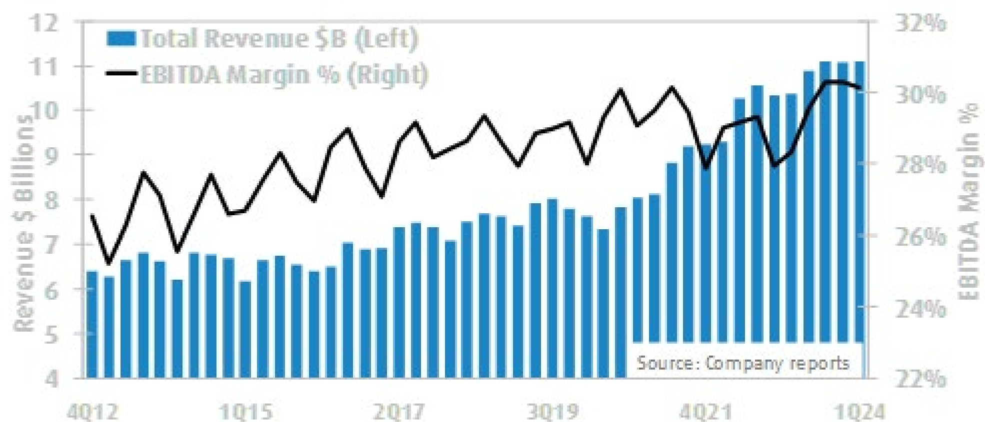
Business Indicators

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 during the first quarter was a smidge better than flat compared to the seasonally strong third and fourth quarters and slightly better than the average 2% seasonal downtick over the past dozen years. Further, despite pressure on volumes due to sluggish manufacturing and residential construction activity, pricing strength combined with contributions from M&A resulted in year-over-year growth of 6.9% and the highest quarterly revenue total on record.

EBITDA margin typically follows the direction of revenue due to increasing or decreasing asset utilization and operating leverage. However, in the abnormal post-COVID 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.) and acquisition integration inefficiencies. That said, in a gradual return to normalcy as internal cost inflation subsides, the average EBITDA margin of 30.1% during the 1st quarter was 20 basis points lower than the record high set in the preceding two quarters but an impressive 180 basis points better than a year earlier.

2024 Outlook for Waste Management Public Companies

Company	Revenue Y/Y %	Adj. EPS Y/Y %	EBITDA Y/Y %
Waste Management	+5.4%	+20.4%	+10.2%
Republic Services	+7.5%	+10.3%	+10.8%
Waste Connections	+10.5%	+15.0%	+15.6%

Source: BMO Equity Research as of 5/15/24

Refuse Financing Inquiries

Travis Ward
(214) 492-4554
travis.e.ward@bmo.com

Industry Research Contact

Michael Zimm, CFA
Michael.zimm@bmo.com

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