

Waste Management, Inc (NYSE: WM)

Sector: Industrials



Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap.	Dividend Yield	Beta
\$96.91	\$81.73	\$89.73	\$69.55	30.87	\$35.49.3 B	2.08%	0.67

Business Description

Waste Management is the largest non-hazardous waste operator, servicing 21 million customers across 48 states and Canada. The company owns nearly 400 collection operations, 249 active solid waste landfills, 297 transfer stations, and 104 recycling centers. The company is vertically integrated and has significant economies of scale – 66% of waste it collects disposed at its own landfill. In the Collection business, they generally set up long term service contracts with clients. For the residential market, contracts are generally 3-7 years and the fees are paid by either municipalities or the actual individual homeowner. Commercial and industrial contracts are typically 3 years, with fees depending on the type and scope of service. Generally, WM supplies a large dumpster for businesses to use, which enables them to collect trash with one truck and operator. The Landfill business is the most profitable, and is a source of competitive moat due to the environmental and regulatory barriers in place to operation of landfills. The Transfer business is also an important part of the business because haulers will stop there when a disposal site is not nearby. This is where the garbage is sorted. Third party haulers also use these stations to dump waste, and WM charges a “tipping fee” for this. The last part of their business is Recycling, which is currently only 8% of revenue, but is the first to introduce residential single-stream recycling, which has resulted in a dramatic increase in the volumes collected.

Industry Trends

The waste management industry is a very competitive market with a few key drivers. The largest driver is population, because as the population grows, the volume of trash increases. Another important driver is manufacturing and construction, which is most notably seen in the way revenue decreases in the winter months as construction slows. This results in some slight seasonality in earnings. Severe storms also have an impact on the business, as post storm clean up generates additional volumes.

Investment Thesis

Our investment thesis centers around three pillars: cash is king, expert capital allocators, and internalization. First, WM has demonstrated a capability to generate steady and robust free cash flows, all while maintaining a best in class credit rating. Having this access to cash provides strategic flexibility to the business. Secondly, management has proven themselves to be expert capital allocators. This is seen in their nearly 12% ROIC, and strategic acquisitions (supporting their roll-up strategy) and divestitures. Thirdly, they have the largest and most diverse asset and customer base, which begets a symbiotic relationship between business segments that leads to lower operating leverage.

Valuation Assumptions

WACC: 7.1%
Terminal FCF Growth Rate: 2.5%
Upside: 18.6%
Sources: Bloomberg, Annual reports

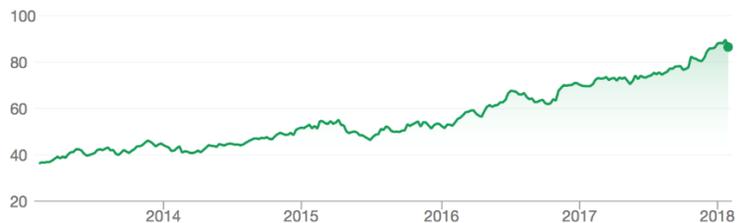
Key Financials

Current stock price: \$81.73
Intrinsic Value: \$96.91

Corporate Social Responsibility

Waste Management is a leader in corporate social responsibility. This is highlighted by their leadership in their green initiatives for wildlife preservation, green energy, and recycling. As part of their methane to energy business, they create enough energy to power more than 500,000 homes every year. Their ESG Disclosure Score is 27.3, which compares to an industry average of 19.9. They also have better scores in % Independent Directors and % Women on Board, with 81.8 vs 79.0 and 18.2 vs 14.8, respectively.

5-Year Stock Performance



Competitive Analysis

Waste Management is the leader in the waste management industry, with the highest ROIC. In the US, there are three top tier firms which are, WM, RSG, and WCM. These three firms have the largest market shares, totaling nearly 48% of the market. The remaining players consist of governmental players (think municipal garbage pick-up) and many small local and regional players. These players are all subject to the same high levels of regulation, which creates high barriers to entry in this industry. It is also difficult to leave the industry, particularly if you own landfills, because the government requires that you manage those landfills into perpetuity to prevent environmental damage.

Competitive Advantages

Waste Management has a lot of competitive advantages over other firms, the biggest being its economies of scale. Since the business is already so large, and integrated (note 66% top to bottom) it means that they can leverage a multitude of cost savings up and down the value chain, which puts them way ahead of the competition. Something interesting to note is their balance sheet strength. They are under-levered compared to their competitors, and now with tax reform, they will have the ability to go on a spending spree and accelerate their roll up strategy. They also have strong management, that has a proven history of good strategic decision making.

Risks

The main risks we foresee impacting WM, include threats from competitors in their highly competitive industry. They also face risks of increasing regulation and exposure to commodity prices in their recycling business.

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