



# **Stock Spotlight: Waste Management**

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# Turning Trash Into Opportunity

Waste Management is part of the Industrials sector of the stock market. Industrials are typically a good indicator of how an economy is doing overall. With a slowed economy in recent years, it is not surprising that industrials have lagged the market, as illustrated over the past 30-month performance below—the S&P500 in **green**, Industrials Sector in **blue**, and Waste Management in **gold**.

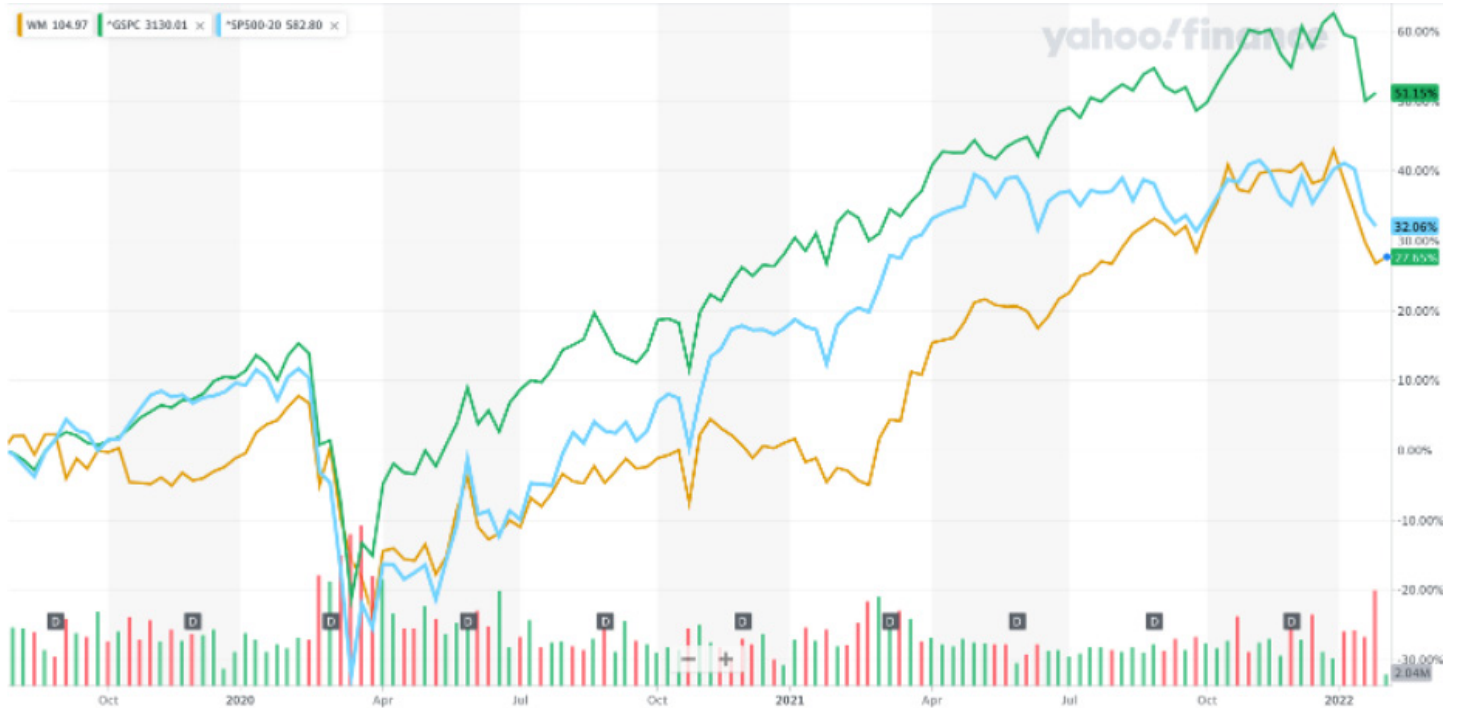


Figure 1: S&P 500 vs. Industrial Sector vs. Waste Management August 1, 2019 - January 31, 2022 Source: Yahoo! Finance

Industrial companies are the backbone of economic growth. Steel mills create supplies for infrastructure, or—in Waste Management’s (WM) case—hauling and recycling the waste from development. COVID has been difficult for industrials. When the world locked down in March 2020, industrials was one of the most impacted sectors. Then, over 2021 and into 2022, growth was further inhibited by international supply chain disruptions.

It is not surprising that industrials and WM have lagged the broader market. However, Qube believes that WM is a diamond in the rough: a company that was mispriced and underappreciated by the market. We think it is more than just trash and, in fact, a hidden treasure!

From the initial research report in August 2019, our team determined the intrinsic value of WM as \$134.97. On August 7, 2019, when we purchased WM for Qube clients, the price was \$116.83, representing a 15.53% upside. As of January 31, 2022, WM closed at \$150.44 for a total current gain of 28.77%. **We exceeded our initial intrinsic value far quicker than our expected 3-5 year time horizon.**

Since our initial purchase of WM, the company has continued to evolve. Read on to discover why Qube is still holding WM, our current valuation, and why our diamond continues to shine.

## Who is Waste Management?

Their bins are everywhere. Walk behind any commercial building and look. The odds are good the bin will have the green W and yellow M. WM is North America's leading comprehensive waste management services provider. They operate in the Environmental & Facility Services sub-sector of the Commercial Services & Supplies sector. Due to the high costs of developing the infrastructure to run a waste company, **there are not many competitors.**



To better grasp the size of WM, in 2019, they operated 249 landfills, 305 transfer stations, and had a vehicle fleet of over 32,000 trucks. For perspective, in 2018, Canada Post had a fleet of almost 13,000 vehicles<sup>1</sup>. Waste Management's fleet is almost 3 times that!

The market concentration is high by the leading firms. It would be a stretch to say WM is in an oligopoly, but there are limited options when choosing a company for waste collections. Their largest competitor in the United States is Republic Services, which, as of 2021, has two-thirds as many landfills. Due to the barriers to entry in the industry, the larger waste collection companies acquire smaller operators to spur growth. In 2020, WM acquired Advanced Disposal Services, which added 3 million customers to WM, a 15% increase from their 2018 figures.

	Solid Waste Landfills 2018	Solid Waste Landfills 2021
Waste Management	249	293
Republic Services	190	195
Waste Connections	56	82
Advanced Disposal Services	41	Acquired by WM in 2020
Casella Waste Systems	8	45

Source: *Wastedive.com 10 insights from public waste company 10-Ks* By: Cole Rosengren & Rina Li.

WM does more than just garbage. Their operations are split between **five revenue streams**. Each segment of their revenue stream is a part of the total collection and disposal system. They have control over all the factors in the waste ecosystem. The five segments are collection (54%), landfill (20%), recycling (7%), transfer (10%), and other (9%).

The segment you may not be familiar with is transfers. But it is a **crucial competitive advantage** with WM. They have 346 transfer stations that consolidate and compact waste collected in rural areas. The waste is then loaded into long-haul trailers or rail cars to be transported to landfills.

<sup>1</sup> Source: Canada Post 2018 Annual Report

The transfer stations are used by WM but can also be used by competitors. If competitors use the transfer network, they pay a fee to WM. So, even if a customer doesn't choose WM, the odds are good for rural customers WM still received a piece of the pie.

## Hidden Treasures: Why Waste Management is a Gem

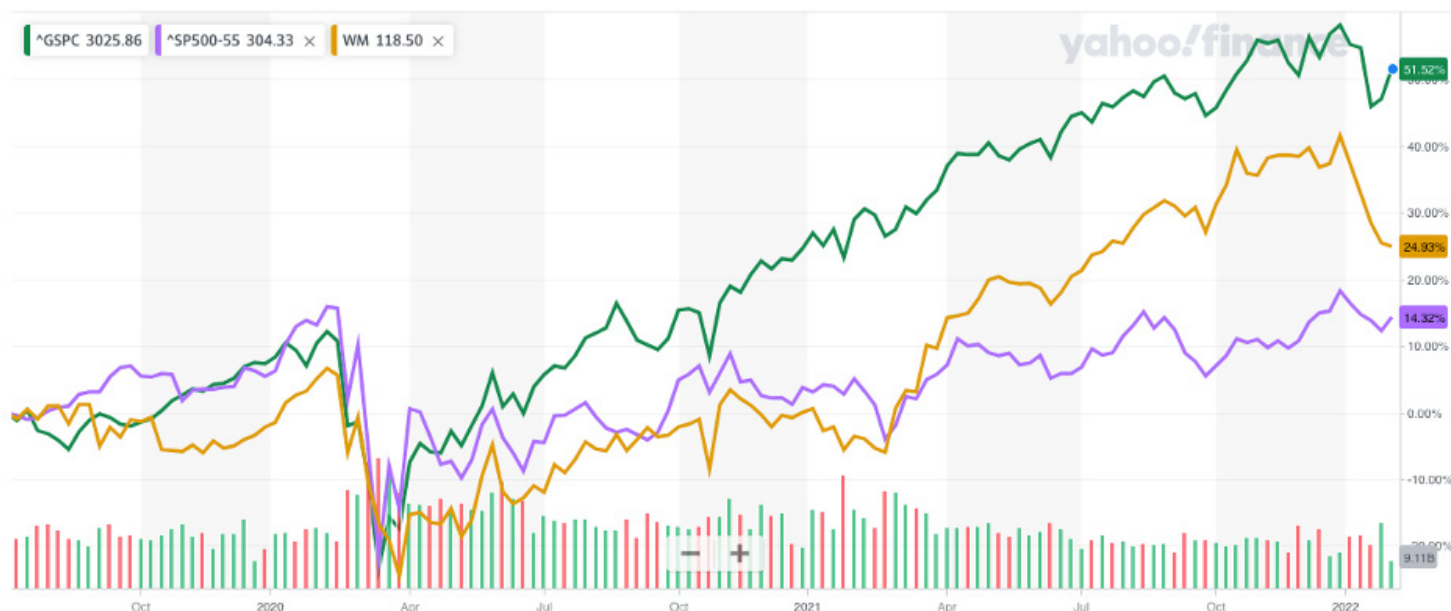
In business strategy, there is a common model called Porter's 5 Forces. A company positions itself based on competition in the industry, potential of new entrants into the industry, power of suppliers, power of customers, and the threat of substitute products.

### Companies that are well-positioned to succeed have:

1. Low competition = More pricing power
2. Low threat of new entrants = Hard for competitors to enter the industry
3. Low power of suppliers = Many suppliers for only a few buyers
4. Low power of customers = Customers have limited choices and need to pick a company to use
5. Low threat of substitutes = Customers need to use your product and cannot substitute it

When one thinks of an industry that comprises the five forces for success, utilities leaps to mind. Because utilities can be so competitively powerful, they are usually regulated. For investors, utility companies offer consistent returns with little volatility. **The sector is historically much less volatile than the market.**

As a proxy, the Spider S&P500 Utilities Sector ETF has a 5-year beta of 0.37. With the market having a beta of 1.0, 0.37 means over the past 5-years, utilities have been 63% less volatile than the market—less volatility, less expected return. Lower returns have been the trend for the past few years. Since we purchased WM, the Utilities Sector (**purple**) has returned 14.33%—compared to the S&P500s 51.6%.





The first hidden gem of WM is the value they bring because they operate similar to a utility company. WM contracts are structured like a utility agreement. Customers can lock in a flat rate, which increases with market prices incrementally. Or choose a contract that fluctuates with an index.

When a customer hires WM, the average commercial contract is 3-10 years. As costs of collection rise for WM, they are not left with a deteriorating profit margin for the length of a contract. **Instead, their revenues are more consistent due to the dynamic pricing.** Like a utility provider, costs go up for them, and prices go up for the end customers and vice versa.

The consistency in their operating margin can be seen from their financials over 2015-2021<sup>2</sup>.

	2015	2016	2017	2018	2019	2020	Trailing 12 Months
Operating Margin	15.8%	16.9%	18.2%	18.7%	17.5%	16.0%	16.8%
Gross Margin	36.5%	37.6%	37.7%	38.0%	38.6%	38.6%	39.0%
Operating Exp. % of Sales	20.7%	20.8%	19.5%	19.3%	21.0%	22.6%	22.2%

Their trait as a utility company does not end with contract pricing. WM also has moats to prevent competition. Utility companies have moats in the time and costs required to build a power plant. Once a power plant is up and running, it has a long operating life. WM had to jump through the regulatory hurdles to open their landfills.

Now that they are open, their active landfills have an average remaining life of **50 years**. Each landfill will continue to drive profits over the useful life. It is difficult and cost-prohibitive for competitors to try and duplicate their offerings. With a utility company, there is only one power grid supplying power. Landfills are comparable, where there may be only one or two in a service area.

With long contracts, stable revenues, and infrastructure to last for decades, WM will be a gem that we expect will continue to shine—providing returns for our investors.

### Value of a Jeweller: Leader in Innovation

Much of the value of a gem comes from the jeweller’s ability to cut the stone and bring out the beauty held within. Since 2016, James Fish has been running WM, making them into the gem we are proud to own. His strategy has been focused on innovation.

<sup>2</sup> Source: WM financial data provided by Bloomberg

WM is leading the way with recycling technology. They continue to invest in autonomous technologies that will enable the company to bolster its top-line. In their recycling facilities, machines can now segregate specific plastics that, in the past, were sold as lower-priced bundled recyclables. With improved sorting, WM can react as markets evolve for new recycled commodity types and extract more value for these commodities as demand increases.

They have also invested in converting more solid waste into recycled products. Between 2000 and 2015, the percentage of waste that was recycled grew from 28.5% to 34.7%. Although 6% may not seem like a lot, in 2015 the US generated 262.4 million tons of municipal waste. If the waste were spread out, it would go to the moon and back 25 times!

Saving 6% from ending up in landfills saves 1.5 trips to the moon and back. More waste being recycled is also a revenue driver as recycled materials are sold off to third parties, who then create new products.



Another innovation is WM's ability to harvest methane gas produced from the decomposition of waste. The methane is collected and sold as medium BTU gas. WM supplies methane to 72 gas-to-energy projects in over 22 states in just the US. Their waste is a treasure for the energy companies and continues to provide revenue after collection.

Another innovation is the use of single-driver trucks. WM was at the forefront of using bins that could be emptied by forks attached to their vehicles. Rather than having a driver and a picker, WM just employs a driver. The truck does all the heavy lifting and emptying of bins. The system saves on labour and avoids workplace-related injuries caused by heavy lifting.

### How Long Will Our Gem Stay Hidden?

As of the end of January 2022, WM has provided a 29% return since our initial purchase. What was once a hidden treasure is starting to become recognized for its value.

The price run-up in the past year and a half has been attributable to WM's revenues through the pandemic outpacing previous growth. We projected a long-term revenue growth rate of 3% in our initial valuation. Growth has been **over 13%** through the pandemic, causing a much faster appreciation in share price as investors flock to the security.



## **In Conclusion...**

For now, we are finding WM to be fair-valued. Our intrinsic valuation is currently \$154.56, with the share price as of April 8 at \$165.15. We expect WM to continue to grow but provide less share appreciation as their operating segments grow. Their dividends and share buybacks represent a 3% return on current share value. We will continue holding it as an alternative to cash in the portfolio. However, we are on the lookout for new diamonds in the rough. Should a new jewel present itself, WM could find itself out on the curb for collection.

At Qube, we are passionate about financial literacy. To discuss how our comprehensive valuation approach can make your wealth matter, reach out to us by [email](#) or call [\(780\) 463-2688](tel:7804632688).



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