Waste Connections

Industrials
NYSE: WCN | TSX: WCN
Market Perform | Hold

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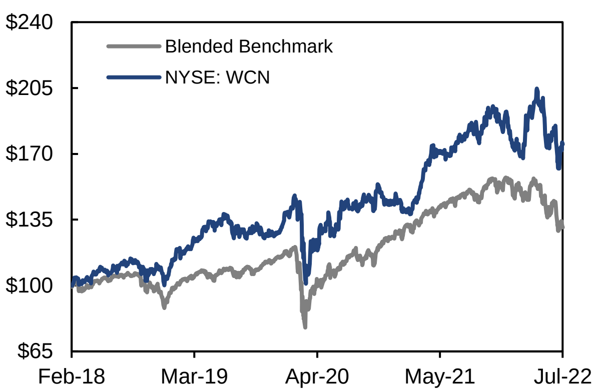
Return on Investment	
Current Share Price	$123.96
Target Price	$124.00
Dividend Yield	0.7%
Implied Return	1%
Conviction Rating	2

Market Profile	
52-Week Range	$113.50 - $145.62
Market Capitalization (US$mm)	$32,175
Net Debt (US$mm)	$5,650
Minority Interest (US$mm)	$5
Enterprise Value (US$mm)	$37,829
Beta (5-Year Monthly)	0.71

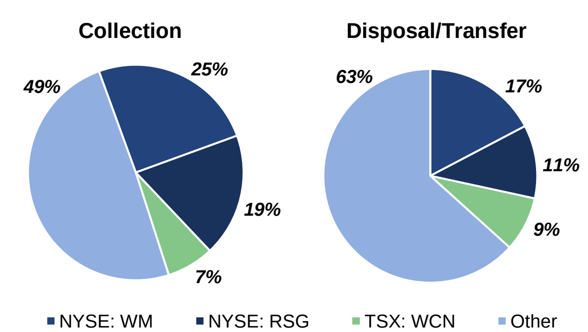
Metrics	2021A	2022E	2023E
Revenue (US$mm)	$6,151	$6,951	$7,368
EBITDA (US$mm)	$1,744	$2,103	$2,229
EPS	$2.40	$3.22	$3.46
NTM EV/EBITDA	19.2x	18.1x	18.2x

Holding Period Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: Waste Services Industry Market Share (2022)



Source: IBISWorld

Business Description

Waste Connections (TSX: WCN) is the third-largest non-hazardous solid waste services company in North America. The Company provides waste collection, transfer, disposal, and recycling services in both exclusive and competitive markets in the U.S. and Canada. Through its R360 Environmental Solutions subsidiary, WCN is a leading provider of non-hazardous exploration & production (E&P) waste treatment, recovery, and disposal services in the most active natural resource producing areas in the U.S. The Company's merger with Progressive Waste in 2016 enabled WCN to expand its services throughout Canada as one of the largest full-service providers of waste collection in the country. Currently operating in 44 U.S. states and six Canadian provinces, WCN is committed to providing superior services to residential, commercial, industrial, and E&P customers.

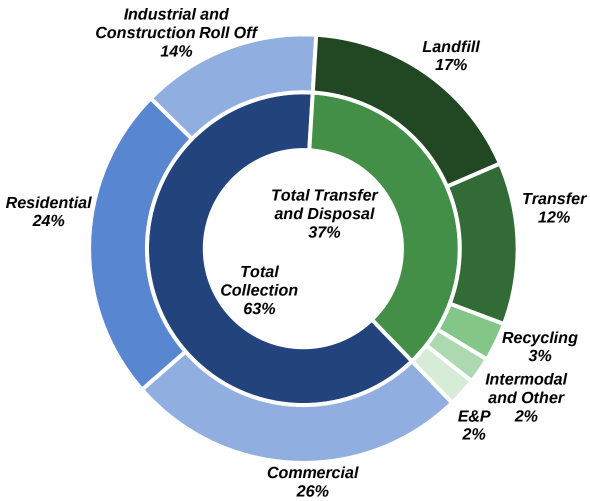
Industry Overview

The waste collection, waste disposal, and transfer service industries were negatively impacted by reduced business activity during the COVID-19 pandemic, suffering from declining industrial manufacturing and construction output. In contrast, residential waste serves as a source of stability, and coupled with the essentiality of waste services, the industry delivers consistent growth, despite cyclical influences. As such, it has been dubbed "first derivative cyclical," with growth rates moving with the ebbs and flows of the economy, but rarely moving negative. As pandemic restrictions subside, population growth, business creation, residential and non-residential construction, and increased consumer spending are expected to boost demand for waste services. Additionally, government legislation surrounding environmentally safe practices and increased recycling efforts are expected to drive demand for waste transfer and disposal services.

Landfill revenues primarily come from tipping fees, which dramatically change throughout North America, and while there are several factors that decide this fee, the ultimate driver is population density in the area. For environmental protection and safety reasons, average distances between landfills and population centres have increased, resulting in larger, well-engineered landfills and the introduction of the transfer station as an intermediary. Not only does this introduce another cost markup along the waste stream, but environmental protection regulations make transfer centres and landfills increasingly costly to maintain. With a high capital input requirement and high fees collected along the waste stream, the waste services industry has seen the emergence of larger, vertically integrated operators. By controlling the waste stream from start to finish, these operators can optimize volume sourcing and routing to its network of disposal centres, which drastically increases margins. This enables the operators to offer lower prices at the collection level, so they can consistently outbid smaller operators for contracts (residential or industrial) and grow the top-line. The result is a virtuous flywheel that rewards internalization and access to capital; accordingly, the industry continually sees increasing consolidation.

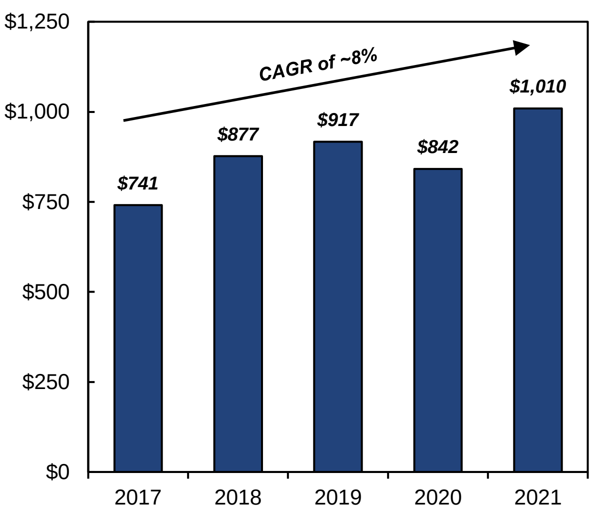
Government legislation encourages waste transfer and disposal companies to utilize waste-to-energy services to capture (cont.)

Figure 2: FY2021 Revenue Segmentation



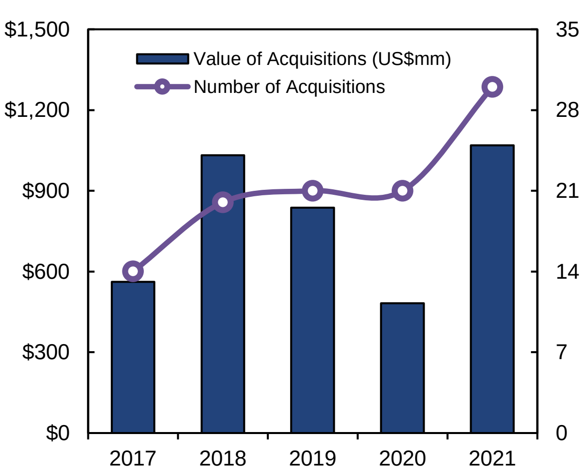
Source: Company Filings

Figure 3: Adjusted Free Cash Flow (US$mm)



Source: Company Filings

Figure 4: LHS Acquisitions Value vs RHS Number



Source: Company Filings

methane gas from landfills to produce energy. To become more closely affiliated with recycling and renewable energy activities, companies will be required to continue implementing environmentally friendly practices. In turn, this may increase operating costs and capex and potentially lower the incredibly high barriers to entry.

Mandate Fit

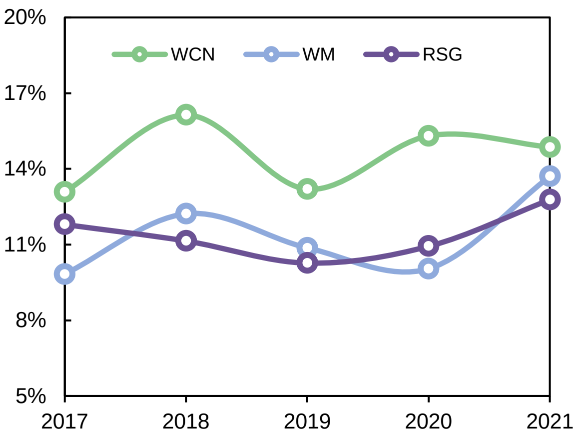
Quality Management: WCN's management team is led by President and CEO Worthing F. Jackman, who has served in the role since July 2019. Jackman took over the role after having held various positions since joining the Company in 2003, including CFO. In 2021, the Company doubled its return of capital to shareholders through US$560mm of dividends and share repurchases. Management continues to emphasize strong capital discipline by focusing on return of capital to shareholders, strategic acquisitions, and further capex to sustain long-term business growth. Moving forward, management has guided a robust M&A pipeline for 2022 that may result in yet another year of US$1B acquisition spending.

Competitive Advantage: WCN currently operates in a mix of competitive urban markets (~60% of contracts) and exclusive markets (~40%). In smaller markets with less competition, WCN holds a high market share through exclusive contracts, vertical integration, and asset positioning. The last of these is where WCN differentiates itself among the other large operators; for municipal solid waste (MSW) and E&P waste services, WCN only purchases assets that fit well within its existing network and avoids competing in areas saturated by major competitors Waste Management (NYSE: WM) and Republic Services (NYSE: RSG). Exclusive and franchise contracts in Western America are the most coveted, which is WCN's highest EBITDA geographical subsidiary at ~22%. However, by competing in secondary/rural markets, WCN can effectively replicate the franchise model anywhere and achieve ~90% internalization rates. Additionally, WCN gains a high market share in disposal-neutral regions, in which disposals are a pass-through cost. Since there is no advantage to owning the landfill, the Company only collects and halves the capex requirement. Although non-integrated operations in competitive markets typically produce the lowest FCF margins, WCN can turn these into FCF margins of greater than 15%, comparable with integrated operations in exclusive markets. Though this strategy is easily replicable, the number of disposal-neutral regions is limited, and WCN benefits from a first-mover advantage.

Strong Balance Sheet: WCN continues to hold a strong balance sheet position as the economy recovers from the COVID-19 pandemic. WCN maintained a Net Debt/EBITDA ratio of 2.4x throughout 2021. Additionally, the Company reduced its Total Debt/EBITDA ratio to 2.7x from 3.0x in 2021, which is consistent with its target leverage ratio, and WCN boasts a BBB+ credit rating from S&P. The Company demonstrated an excellent ability to preserve balance sheet health during the pandemic, and with its debt issuance of US$500mm in Q1 2022, it has more than doubled its cash on hand. The CPMT believes this debt issuance is the ideal method to fuel its future growth while maintaining its desired capital structure of a Total Debt/EBITDA ratio between 2.5x and 3.0x.

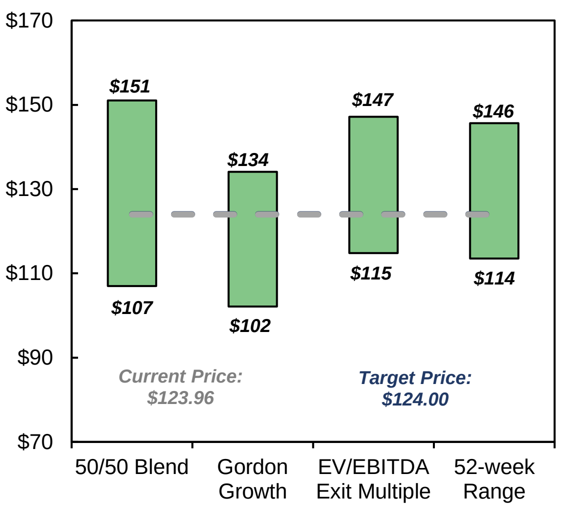
Growing Free Cash Flow: WCN has grown FCF at a 17% five-year CAGR and adjusted FCF at an 8% CAGR. The Company's industry-leading FCF growth is driven by its competitive advantage and management's discipline in expanding into areas with the highest potential ROIC. By growing volume through acquisitions and (cont.)

Figure 5: FCF Margin vs Peers



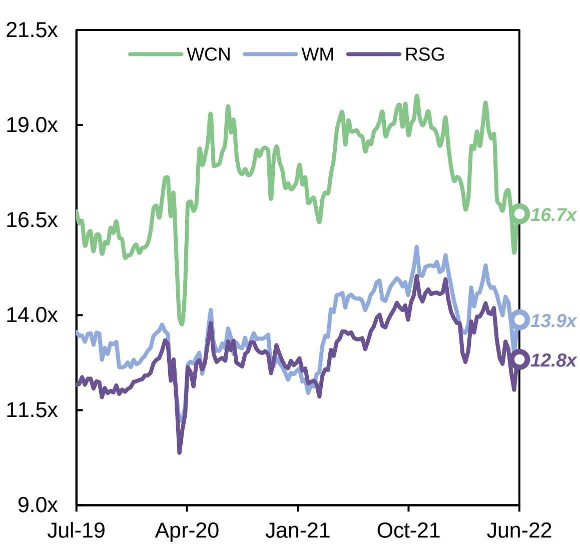
Source: S&P Capital IQ

Figure 6: Valuation Football Field



Source: CPMT Analysis

Figure 7: NTM EV/EBITDA vs Peers



Source: S&P Capital IQ

new biddings, as well as increased fees per contract (up 5.7% in Q4) and lower capex, WCN has maintained a stable free cash flow margin (between 13% and 20%) for the last ten years.

ESG Initiatives

Key ESG considerations impacting WCN include environmental stewardship, health and safety, and employee and community engagement. Currently, the Company has committed US$500mm towards renewable gas and resource recovery projects. The construction of two recycling plants will commence in 2022 and two renewable natural gas facilities will be constructed in 2023. Additionally, WCN has set goals of increasing offsets to emissions by at least 50%, increasing resources recovered by at least 50%, increasing biogas recovery by at least 40%, and processing at least 50% of leachate on site. As well, WCN continues to invest in landfill gas recovery systems and will begin evaluating implementation of electric vehicles into its fleets. The Company set a long-term goal of reducing employee incident rates by 25%. WCN has taken strides to improve employee safety by implementing AI-drive truck camera systems and advanced safety features in fleets, as well as revised employee training and development opportunities. WCN has also implemented a formal diversity policy for board and senior management to improve gender and minority representation.

During the COVID-19 pandemic, WCN spent US$50mm providing its frontline employees with bonus payments and supplemental wages, covering COVID-19 testing and related medical costs, and expanded access to its Employee Relief Fund.

Risks

Though WCN has strong pricing power, labour and capex costs are sensitive to inflation, which could erode the Company's strong FCF margins. Changes in regulations in the U.S. and Canada could influence landfill capping (the covering of contaminated material in a landfill) and the hazardous classification of waste. This has the potential to make it more difficult for WCN to engage in its landfill services, which comprises approximately 20% of its total revenue. Lastly, a decline in commodity prices negatively impacts the demand for recycling and E&P services, which WCN provides.

Investment Thesis and Valuation

WCN was valued at $124 using a five-year DCF with a WACC of 6.79%. The terminal value was a 50/50 blend of (1) the Gordon Growth method, using a 3% terminal growth rate, and (2) an EV/EBITDA exit multiple of 16x. WCN has historically traded at a premium to WM and RSG, which the CPMT believes to be justified given its best-in-class EBITDA growth and FCF generation. The CPMT believes that the Company lies in the sweet spot of size, as it is sufficiently large to be vertically integrated and handle the industry's capital intensiveness, while remaining small enough to not be burdened with low profitability operations. Management has exhibited an incredible ability to grow where the highest NPV opportunities lie. Indeed, whereas the original investment thesis was predicated around growth through internalization, on which management delivered, the new thesis focuses on growth through acquisitions, with 2021 and 2022 shaping up to be historic years in acquisition spending. However, the Fund believes that the market understands and appreciates the features that make WCN such a strong company, which is reflected in the target price being negligibly different from the current price. Thus, while the CPMT maintains conviction that WCN will return its cost of equity, we recognize this to be an opportunity to search for new names with higher alpha.