

Waste Connections Inc. Makes Money out of Garbage

Description

Back in May 2016, **Waste Connections Inc.** ([TSX:WCN](#))([NYSE:WCN](#)) bought Toronto's Progressive Waste Solutions in an all-stock deal, thus creating the new Waste Connections Inc.; Progressive Waste Solutions shareholders own approximately 30% of the new company, and the old Waste Connections shareholders own the remaining 70%. The new combined company is the third-largest solid waste company in North America. Year-to-date, the stock has a return of 10.6%.

Here's why I think it will continue to do well.

Fragmented industry

The solid waste industry is a fragmented one, and Waste Connections is in a prime position to take be a consolidator given the company's strong cash flow generation.

Beating/meeting expectations

The company has handily beat expectations in two of the last three quarters. In the fourth quarter of 2016, EPS came in at \$0.68 versus expectations of \$0.64. In the second quarter of 2016, EPS came in at \$0.66 versus expectations of \$0.52.

Similarly, the company gave 2017 guidance that was above consensus estimates. This is always a good thing. And although the valuation on this stock is not cheap, the fact that the company is beating expectations is key in making me comfortable with it.

Strong free cash flows

The company has a history of strong cash flow generation, and the acquisition has stepped this up dramatically.

In the fourth quarter of 2016, cash from operating activities almost doubled to \$795 million and free cash flow increased 61% to \$450 million. Even after paying for capital expenditures, acquisitions, some debt repayment, and dividend payments, the company still had cash left over; we can see the cash balance increasing, and it now stands at \$154 million. Free cash flow as a percent of revenue in the latest quarter was a very impressive 13.3% of revenue.

Balance sheet improvement

With the acquisition of Progressive Waste Solutions, Waste Connections assumed plenty of debt, and as of December 2016, it had a debt/EBITDA ratio of three times. While this is not ideal, it doesn't worry me because the company's cash flow generation is strong and can be used to pay this down, and because the acquisition will give rise to synergies for the combined company that will further drive the company's cash flow generation.

As of the second quarter of 2016, the debt balance was \$3.8 billion, and this has been brought down slightly to \$3.6 billion as of the fourth quarter of 2016. So, the company is already putting its cash flow to use to improve the balance sheet.

In summary, Waste Connections Inc. is a solid, well-run company that is poised to continue to do well, even in a weak economy due to the defensive nature of its business.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:WCN (Waste Connections)

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