Why Waste Connections Is a Buy at These Levels

Description

So far this year, **Waste Connections** (TSX:WCN)(NYSE:WCN) have outperformed the broader equity markets. The North American solid waste services company has returned 5.1% against the decline of 11% in the S&P/TSX Composite index. Notably, during the global meltdown in financial markets in March, the company had declined by 27.8% from its peak compared to a fall of 37.8% in the S&P/TSX Composite index. Given the defensive nature of the stock, its aggressive expansion strategy, and consistently strong performance, I believe the company's stock could rise further.

The performance in the last five years looks impressive

Waste Connections is involved in the collection, transfer, and disposal of non-hazardous waste. It also provides waste treatment and disposal services for niche markets, such as exploration and production companies.

Waste Connections has grown its revenue from US$2.12 billion in 2015 to US$5.39 billion in 2019 at a CAGR (compounded annual growth rate) of 26.3%. Both organic growth and acquisitions drove the company's revenue during the period.

Last year, the company completed 21 acquisitions, while in 2018 and 2017, it acquired 20 and 14 business, respectively. These acquisitions are accretive to Waste Connections's margins, as they have increased the company's market share and route density. It has maintained its EBITDA margins over 31% from 2015 to 2019.

Despite the impact of the COVID-19 outbreak, Waste Connections reported revenue growth of 8.7% in the first quarter. The slowdown in economic activities due to the implementation of shelter-in-place restrictions lowered the company's revenue growth during the quarter. The company's EBITDA margins declined to 30.2% from 31% in the corresponding quarter of the previous year.

In April, which represented the full impact of the lockdown, Waste Connections's revenue fell 6% year over year. Its EBITDA margin contracted by 2%. Compared to other businesses, the company has braced well during the period.

Growth drivers

Waste Connections targets secondary and rural markets, which aid the company in acquiring significant market share and maintaining its higher margins. Also, the pandemic has impacted economic activities more in urban areas than the rural markets. So, I believe Waste Connections will be less impacted compared to its peers from the pandemic-infused lockdown.

Waste Connections focuses on having disposal sites within the markets it tends to operate to reduce transportation costs and to has a competitive advantage over its peers. By the end of the first quarter, the company owned 82 landfills and operated six on life-of-site agreements and four on limited-term agreements. Meanwhile, one site is still in the development stage.

The average remaining landfill life for these sites stands at 28 years. However, with necessary permissions, it could be extended to 31 years. So, the company is well positioned to maintain or expand its share in the markets it operates.

Waste Connections's liquidity and dividends

Despite the slowdown, Waste Connections generated US$369.6 million from its operations in the first quarter. At the end of the first quarter, the company's cash and cash equivalents stood at US$1.2 billion. It could also avail another US$762.6 million of credit, raising its liquidity to approximately US$2 billion.

The dividend yield of this lesser-known TSX stock stands at 0.8%, which is on the lower side. However, the company has raised its dividends at a CAGR of close to 16% from 2014 to 2019. Meanwhile, its strong liquidity position supports the company to maintain its dividend payouts.

Bottom line

As of June 26, Waste Connections was trading a forward P/E (price-to-earnings) multiple of 32.5. It looks expensive compared to its average forward P/E multiple of 30.5 over the last three years. Despite the expensive valuation and near-term weakness, I am bullish on the stock, given its strong growth prospects, high liquidity position, and consistent dividend growth.

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