



Why Waste Connections (TSX:WCN) Is a Buy After its Impressive 3rd-Quarter Earnings

Description

On October 28, **Waste Connections** ([TSX:WCN](#))([NYSE:WCN](#)) reported an impressive [third-quarter performance](#), beating both analysts' top- and bottom-line expectations. Its revenue came in at \$1.39 billion against analysts' expectation of \$1.38 billion, while its adjusted EPS stood at \$0.72, well above the expected \$0.66. Meanwhile, let's look at the company's third-quarter performance in more detail.

A sequential improvement in revenue

Waste Connections's third-quarter revenue showed significant improvement from its second quarter, as the economic activities began to improve after the lockdown. The improvement in the solid waste volumes and higher recovered commodity values drove the company's top line.

However, year over year, the company's revenue was still down 1.6% due to lower solid waste volumes and weaker E&P (exploration and production) activities. Year over year, the solid waste volumes declined by 5.7%, which was partially offset by favourable pricing of 3.7%. The company's revenue collection from E&P activities fell 64% year over year due to lower drilling activity.

Better-than-expected EBITDA margin

Waste Connections has reported an adjusted EBITDA of 432.6 million for the quarter, which represented an EBITDA margin of 31.1%, which was 0.4% higher than the company's guidance. Better-than-expected revenue and higher recovered commodity values drove the company's EBITDA margin.

Meanwhile, year over year, the company's adjusted EBITDA margin was down 0.3%, as lower E&P waste activities and pandemic-related expenses more than offset an improvement in the solid waste segment.

For the quarter, the company has posted an EPS of \$0.60. However, removing special items, its adjusted EPS came in at \$0.72, which was marginally lower than its previous year's quarter of \$0.73.

Liquidity and dividends

For the first nine months, the company has generated free cash flows of \$778 million, representing 19.2% of its total revenue. It is also an improvement of \$15.5 million from its previous year. Meanwhile, the company's liquidity at the end of the quarter stood at \$2 billion, with \$859 million of cash and cash equivalents. So, the company has ample liquidity to pay out its dividends and also fund its acquisitions.

On Wednesday, the company's board had declared a 10.8% increase in its quarterly dividend to US\$0.205 per share, which represented a 10th consecutive year of double-digit growth. The strong cash flows have allowed the company to raise its dividends. Waste Connections's dividend yield currently stands at 0.8%, which is on the lower side. However, the company's dividends are still lower than 25% of its adjusted free cash flow. So, the company has room to increase its dividends.

Outlook

The company's fourth-quarter guidance was a letdown. The management expects its revenue for the fourth quarter to be at \$1.335 billion, representing a year-over-year fall of 2%. The decline of 6% in its solid waste's volumes could more than offset favourable pricing of 4% to lower its revenue.

Although the company's volumes have not witnessed any decline, the management was cautious in its guidance, given the concerns over additional shutdowns or restrictions amid the rising COVID-19 infections. The company's adjusted EBITDA could come in at \$400 million compared to \$419 million in the previous year's quarter.

However, Waste Connections's long-term growth prospects remain intact. Since the beginning of this year, Waste Connections has signed or closed 16 acquisitions, which will add \$135 million in annualized revenue. The company also has ample liquidity to fund future acquisitions.

Bottom line

Amid the broader equity markets' weakness, Waste Connections's stock has declined by close to 5% this month. Given the company's growth prospects, higher margins, and strong liquidity, I believe investors with a long-term horizon [should buy the stock for superior returns](#).

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rnanjapla

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