RESEARCH REPORT

January 29, 2018

Stock Rating	BUY
Price Target	CAD $99.89
Current Price	CAD $90.27

Bear Case	Price Target	Bull Case
$87.59	$99.89	$102.35

Ticker	WCN
Market Cap (MM)	$19,304
P/E NTM	32.7x
EV/EBITDA NTM	14.9x

52 Week Performance

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Waste Connections Inc. (TSX:WCN)

Not a Garbage Company

Introduction

Waste Connections Inc. (TSX: WCN) is the third largest solid waste company in North America. Their success in the solid waste industry is largely attributed to their commitment to market selection, asset & contractual positioning, and execution at the local level.

Investment Thesis

(1) Well-Positioned Against Economic Downturn

(2) Unmatched Pricing Power in Strategic Markets

(3) Strong Execution Unlocking Inorganic Potential

Valuation

The discounted cash flow analysis reaches a targeted share price of $102.35, implying a one-year return of ~14%. Using a terminal growth rate of 3.0% and a WACC of 6.0%, the implied exit multiple is 15.2x. The target price is calculated using the Canadian exchange rate on January 26, 2018 of 1.23 USD/CAD, as the company reports in USD and is dual-listed on the NYSE and TSX.

Conclusion

Industrials will be entering a position in WCN as it transitions to underweight Rail relative to our index. Industrials is proposing the purchase of roughly 171 shares of TSX:WCN at a price of $90.27, representing 30% of the pro-forma portfolio.

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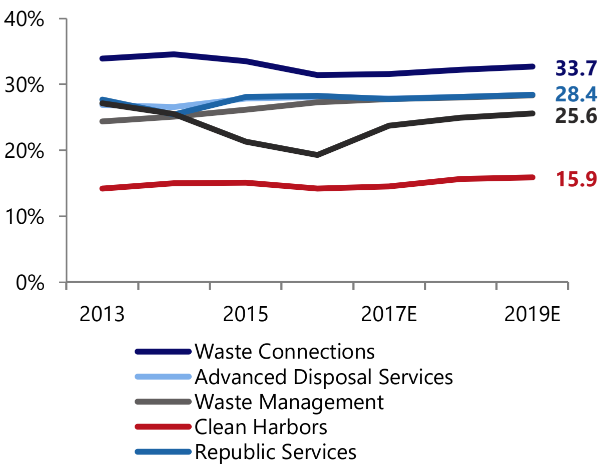
Company Overview

Waste Connections Inc. (WCN) is a provider of solid waste collection, transfer, recycling, and disposal services. WCN also provides intermodal services for transport of cargo and solid waste containers in the Pacific Northwest. WCN's revenue is generated from selling these services to residential, commercial, and industrial customers. Generally, the services are provided under one of the following arrangements: governmental certificates, exclusive franchise agreements, exclusive municipal contracts, and residential subscriptions. Through their subsidiary R360, WCN offers environmentally-conscious, non-hazardous, waste treatment, recovery, and disposal services to Exploration and Production companies in the U.S.. The company's revenue is segmented into six groups: Southern (U.S.), Western (U.S.), Eastern (U.S.), Canada, Central (U.S.), and Exploration and Production. WCN operates both in Canada and in the U.S., with separate headquarters in the two countries. WCN's Canadian operations are a product of a 2016 merger between WCN and Progressive Waste Solutions. The merger was an all stock deal which cost WCN approximately $5.2 billion. Analysts now see the merger favourably, as the company appears to be realizing more synergies than originally expected. For example, SG&A expense savings estimates at the time of the merger were in the $50 million range. Now, however, analysts expect these cost synergies to reach between $110-120 million. The reason for the new, more favourable, estimate is that WCN has been able to extensively capitalize on expense reductions from merging overlapping sales, general, and administrative expenses and on long-term savings from safety and operational improvements. The deal was also projected to result in over $625 million of adjusted free cash flow generation from tax-effected synergies, capital expenditure disciple, and other cash flow benefits. As well, WCN has been able to sustain its industry-leading EBITDA margins despite the merger, by divesting out of some of Progressive Waste Solutions low margin businesses. WCN focuses on implementing both cost efficient and environmentally sustainable practices. The company is also committed to safety in the workplace. In fact, WCN's strict safety measures led to a decrease in the number of injured employees who were hurt in Progressive Waste Solutions' facilities. This then led to a lower employee turnover rate. The current CEO of WCN is Ronald Mittelstaedt, who has held the position since the company's formation in 1997. Mittelstaedt boasts more than 27 years of experience in the solid waste industry.

Exhibit I

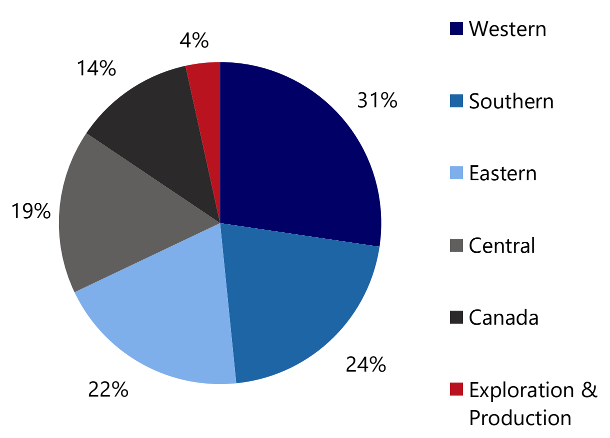
EBITDA Margin Peer Comparison



Source: Capital IQ

Exhibit II

Geographical Revenue Segmentation



Source: Capital IQ

Investment Thesis I: Well-Positioned Against Economic Downturn

Driven by population growth and building activities, the North American waste industry generally grows at low-single digit figures. Relative to other industries, the essential nature of the solid waste service space creates extremely defensive market characteristics. A historical analysis of the prior cycle, demonstrates that waste volumes and prices maintain strong momentum through the later phases of the cycle. As we move into the later stages of economic growth, waste companies are positioned to significantly outperform the market.

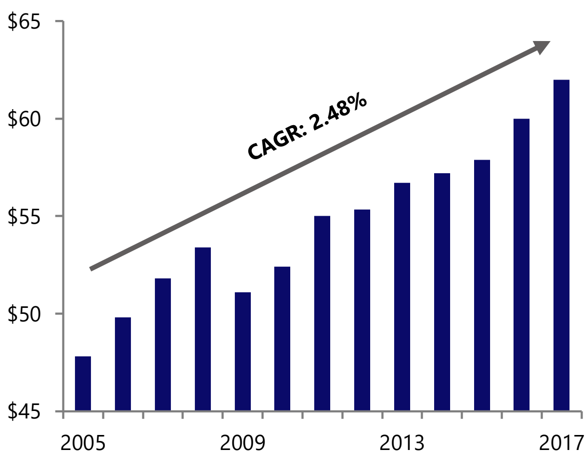
Within this stable industry, WCN builds in an additional element of downside risk protection through a unique market selection strategy. Unlike its peers, WCN is the only company focused on exclusive and secondary markets. Currently, roughly 45% of WCN's revenues are generated from exclusive waste service arrangements. The collection deals that the company receives are awarded on a district basis. These contracts effectively allocate all activities associated with waste collection, both commercial and residential, to WCN in any given region for an extended period of time.

The agreements range from government certificates, which are perpetual contracts that are unique to the State of Washington, to municipal contracts, which typically cover a period of three to six years. With the structural integration of price escalators based on various measures of inflation, these contracts allow WCN to benefit from increased cash flow visibility and sticky streams of revenue. Sitting on top of a positive underlying volume outlook, including GDP growth, housing starts, and industrial construction all projected to grind higher, these long-term deals create an attractive combination of stability and growth.

As WCN continues to build relationships with different municipalities and further develops its diverse geographic operational network, the company will become even less dependent on individual customer groups and even more protected from isolated economic downturns. Ultimately, we believe that the reliability of WCN's business model paired with the overall security of the industry, presents a solid opportunity to de-risk our portfolio, especially as we look to minimize our exposure to NAFTA headwinds which we view could harm other parts of our portfolio.

Exhibit III

U.S. Solid Waste Industry Revenue Growth (B)



Source: Environmental Business International

Exhibit IV

Diverse Geographic Footprint

Source: RBC Capital Markets

Investment Thesis II: Unmatched Pricing Power in Strategic Markets

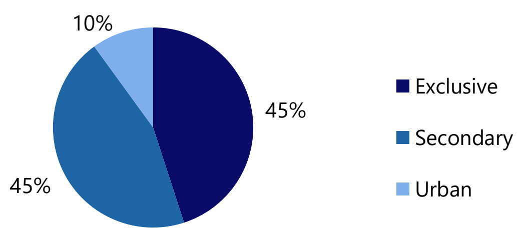
In recent years, WCN's entrenched presence within attractive exclusive and secondary markets has allowed the company to generate superior pricing growth relative to its largest rivals. The key implication of the company's differentiated market selection strategy involves lower customer churn rates and consequently, comparably better pricing dynamics. The company's captive pricing power can be illustrated by average pricing improvements of approximately 2.8% per year, or more than 100 bps above Waste Management and Republic Services, since 2010.

Relative to its major rivals in the waste service sector, WCN derives the largest proportion of its revenues from exclusive and secondary markets with limited exposure to large urban centers. With the exclusive and secondary segments accounting for close to 90% of WCN's sales, the company faces relatively minimal competitive pressures in the markets it participates in.

For WCN, exclusive markets refers to operations in which the company owns either franchise agreements, municipal contracts, or government certificates, and is the single supplier of waste collection services. On the other hand, secondary markets describe operations in rural and suburban geographies in which the company captures a high collection markets share, and is either vertically integrated, WCN owns the proximal landfill, or disposal neutral, a municipality owns the proximal landfill.

Exhibit V

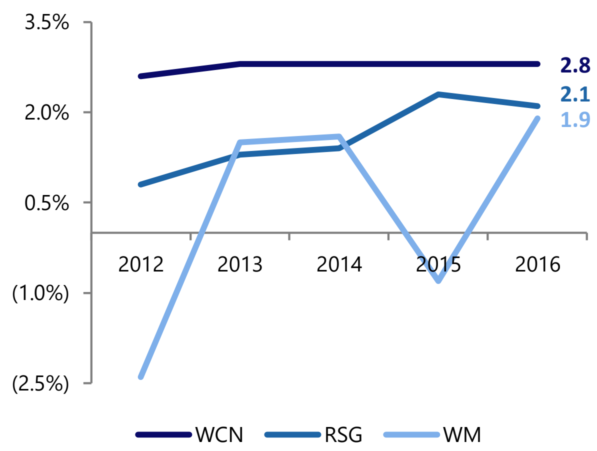
Market Segment Revenue Breakdown



Source: Raymond James

Exhibit V1

Relative Core Price Growth



Source: Company Reports

By avoiding the large, densely populated cities within urban markets, WCN can focus on less competitive segments that facilitate sustainable core price growth. Over the short-term, WCN's pricing power within these segments will likely be protected as regional contracts and asset rights act as barriers to entry for competing waste service companies. In the long-term, customers within key exclusive and secondary markets will likely continue to choose WCN over major competitors as the company continues to realize efficiencies through network breadth and depth enhancements.

Overall, we believe that WCN's rooted position within the differentiated exclusive and secondary segments offers a distinct investment opportunity within a near oligopolistic waste industry. Looking ahead, as the company is able to leverage its unmatched pricing power in these strategic markets, consistent organic growth will be fueled.

Investment Thesis III: Strong Execution Unlocking Inorganic Potential

At the company's recently held Investor Day in June 2017, management estimated that 75% of the margin gap with peers is structural (i.e. market selection, asset positioning). Meanwhile, it was approximated that the remaining 25% reflects the company's focus on solid execution. With best-in-class adjusted EBITDA margins and FCF conversion levels, WCN boasts an impressive track record of building route density and driving operational efficiencies within the company's vertically integrated system.

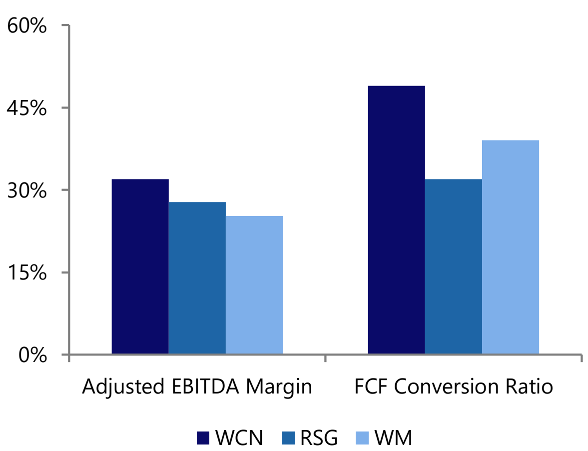
Since the waste solutions market is highly regionalized and has very low barriers to entry, the fragmented market currently includes over 5,000 small private waste companies, with the majority of those names recording less than $20 million in annual sales. Moving forward, we expect the trend of industry consolidation to persist as large, well-capitalized public companies continue small, tuck-in acquisitions. With an adjusted EBITDA margin of 32.0% and FCF conversion at 50% of EBITDA, WCN's balance sheet effectively positions the business to continue to grow by acquisition.

Since 2010, the company has purchased more than 100 disposal businesses for a total consideration of around $8.5 billion, with the largest acquisition being the recent integration of Progressive Waste of $5.2 billion. With close to $500 million of cash currently on WCN's balance sheet coupled with strong cash flow generation, the company's yearly M&A growth target of 3% - 4% will likely be exceeded in the coming years.

While inorganic growth will allow the company to gain local knowledge, capitalize on multiple accretion, and expand operating leverage, in many cases we think of WCN to be the acquirer of choice. Specifically, WCN's decentralized operating structure can be attractive for sellers that want to continue to lead these businesses after the transaction. A long track record of effective execution and strong culture increases the probability of a successful integration. After accounting for nearly 75% of the company's revenue growth over the past decade, we believe a history of strong execution has positioned the company financially to benefit from additional M&A upside potential.

Exhibit VII

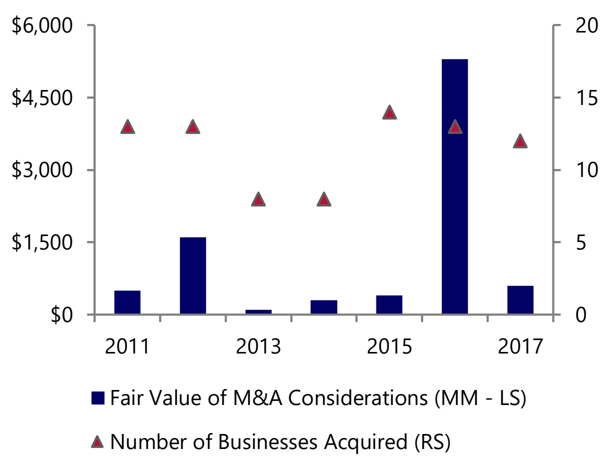
Five-Year Average Financial Comparison



Source: BMO Capital Markets

Exhibit VIII

Integration Track Record



Source: Capital IQ

Catalysts & Risks

Catalyst - Economic & Population Growth

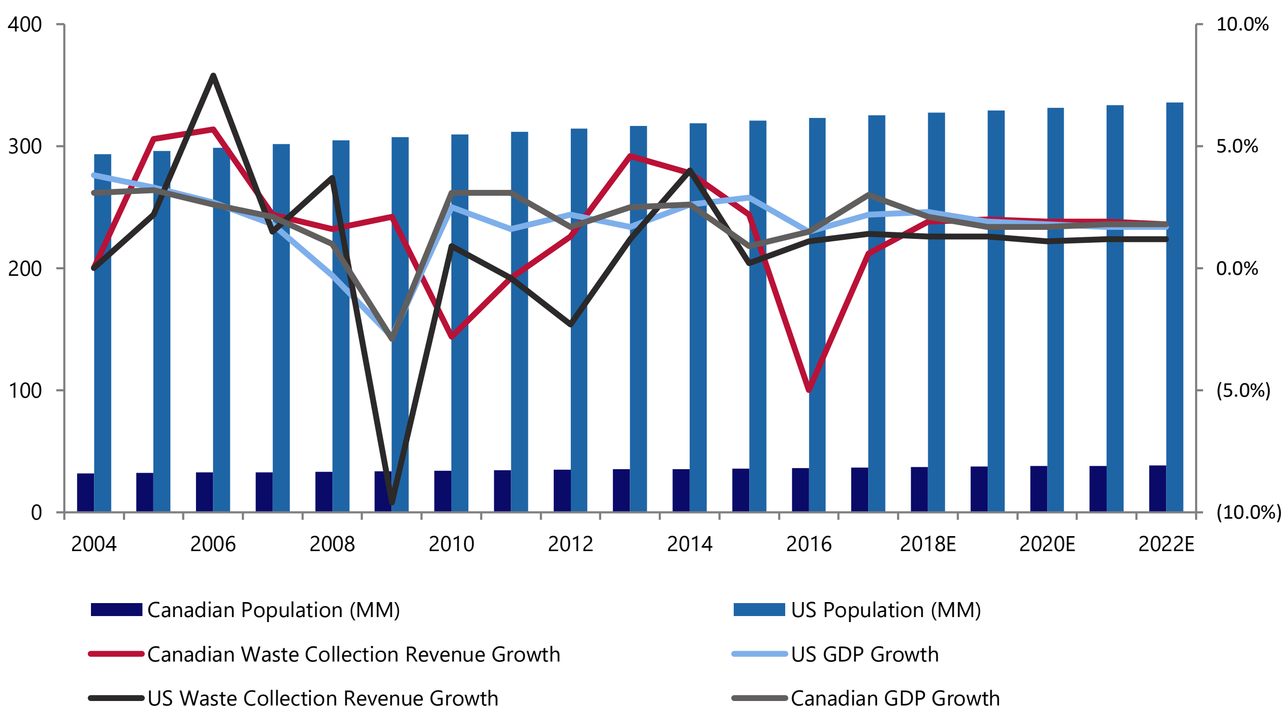
The growth of the waste collection industry is closely tied to both overall population and economic growth.

Population growth results in an increase in demand for waste collection services, primarily from the residential market. Canada's population has been growing in recent years. Between the 2011 and 2016 censuses, Canada saw an approximate population increase of 5%. This growth rate is the highest of all of the G7 countries. Population is anticipated to continue to grow at a similar pace over the coming years, primarily due to immigration. The U.S. population is also expected to grow in the near future. It is projected that the U,S. population will grow at an annualized rate of 0.8% from the period spanning 2017 to 2022. This steady increase in population in both the U.S. and in Canada will lead to an increase in demand for waste collection services.

In a similar manner, waste collection industry growth is closely tied to overall economic growth. Both the Canadian and to a larger extent the American, economies are expected to grow steadily over the coming years.

Exhibit IX

GDP, Population, & Industry Growth in the U.S. & Canada



Source: IMF

Catalysts & Risks

Economic growth will boost consumer and business spending. This will result in an increase in both consumer and residential waste generation and therefore, demand for waste collection. Another significant element of overall economic growth, is that it is expected to stimulate the growth of both non-residential and residential U.S. construction, to the degree of 4.6% and 3.4%, respectively, from the period spanning 2017 to 2022. Since construction sites often generate a plethora of waste, this should have positive implications for the waste collection industry.

Catalyst – U.S. Recycling Growth

U.S. recycling rates have risen consistently over the past 30 years. The coming years are not expected to be an exception to this rule. The anticipated growth of U.S. recycling is primarily due to rising pressure from governments, at both the state and federal levels, on individuals and businesses, to increase their recycling. For example, the Californian Government set a target in August, 2017 to achieve 75% recycling, composting, or source reduction of solid waste by 2020. While recycling has historically been a low margin, volatile industry, technological improvements have helped improve profitability over the past few years.

Increased demand for recycling would result in increased revenues for waste collection companies in general. This is because, waste collection companies derive part of their revenue from recycling services and the sale of recyclable scrap material to processing firms. As well, it is possible that environmentally conscious waste collection businesses, like WCN, could benefit from this trend disproportionately, when compared to the average waste collection company.

Catalyst – Canadian Privatization of Municipality Waste Collection

As Canadian municipal governments continue to combat budgetary pressure, it is likely they will look to privatize certain services, including waste collection. For example, Toronto, has already privatized waste collection west of Yonge Street, a decision which saved the municipality an approximate $11.9 million. In January, Toronto deferred a decision to further privatize this service. This decision serves as proof that the privatization of waste collection is a relevant, albeit contentious, issue in significant municipalities. If more districts are privatized, industry operators will have access to more residential consumers. It is likely that large and mid-sized waste collectors who have the capacity to expand their services, would benefit most from privatization. As well, Canadians are becoming increasingly environmentally-conscious. Meaning that, municipalities may be more likely to award waste collection contracts to environmentally conscious companies.

Risk – Environmental Regulation

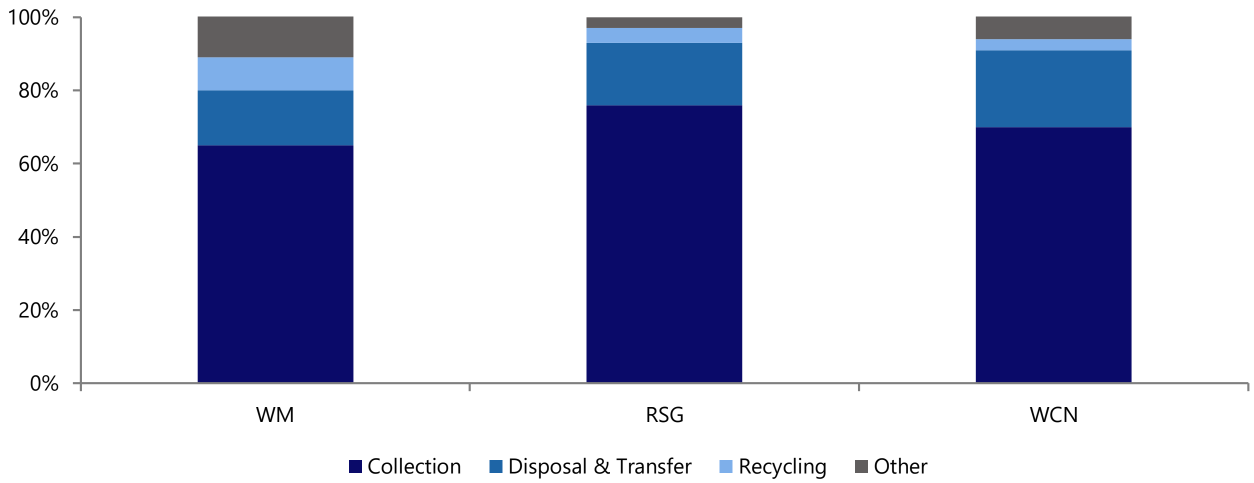
While increased public concern about the environment will have positive effects in the form of increased demand for recycling, it could also hinder industry growth in the form of regulation. While the Trump Administration is repealing environmental regulatory policies, states have not followed suit. For example, the New York State Department of Environmental Conservation implemented Part 360, Solid Waste Management Facilities Regulation in September, 2017. This new policy highlights changes in landfills, waste transport, as well as other restrictions. This trend of regulation could disrupt WCN's business and make it less profitable. However WCN's environmental focus could mitigate the risk of further state regulations. Nonetheless, these regulations tend to be rather unpredictable and could affect WCN if they concern a part of the company's business that is not entirely environmentally friendly. As well, unforeseen environmental problems could result in site remediation costs or potential litigation.

Risk – China Limiting Waste Imports

Historically, China has been a keen importer of waste from North America. In late 2017, China announced that it would be reducing its importation of this commodity and shutting mills that process scrap into reusable materials, in an effort to reduce pollution.

Exhibit X

Revenue Segmentation Competitor Analysis



Source: BMO Capital Markets

Catalysts & Risks

In 2016, the U.S. shipped more than $5.6 billion of recyclable commodities to China. China's decision, which took affect January 1st, could have significant negative implications on waste management companies like WCN, as demand, alongside price, will likely decrease dramatically for scrap commodities.

As well, for the reduced amount that China does import, they have introduced higher purity standards that could be difficult and costly to comply with. Ron Mittelstaedt, CEO of WCN, announced that WCN could lose "several million dollars a year" in revenue as a result of the changes that China has made. It is expected that this change in Chinese policy will reduce US recycled commodities exports to China by 18%. Purity specifications will likely drive this number even higher. However of its largest competitors, WCN is the least reliant on its recycling revenue. Meaning that, if these predicted outcomes come to fruition, WCN will face the least negative implications among its largest competitors.

Growing Competition from Niche Player Rubicon

Rubicon is a U.S. based asset-light competitor which prioritizes waste diversion and low cost collection services. Rubicon offers customers a service in which they will analyze their waste streams and identify ways that the customer could increase the proportion of their waste that could be recycled. The company has integrated advanced technology, offers low costs services, and has proven to be a fierce competitor. Rubicon has been actively seeking market share in the industry. It has been reported that, Rubicon has paid customers of other waste collection companies the cancellation fees associated with their transitioning to Rubicon. Rubicon has been engaged in a series of litigation between themselves and the three major waste collection companies. While rulings in these cases have often been unfavourable to Rubicon, analysts suspect that the legal proceedings act as publicity for the company and incite customers against the oligopolistic nature of the waste collection industry.

QUIC

January 29, 2018
Not a Garbage Company

Discounted Cash Flow Analysis

	2013	2014	2015	2016	2017 YTD	2017 Q4	2018E	2019E	2020E	2021E	2022E
Revenue	1,929	2,079	2,117	3,376	3,473	1,133	4,836	5,078	5,281	5,440	5,603
Year over Year Growth %	*16.1%*	*7.8%*	*1.8%*	*59.4%*			*5.0%*	*5.0%*	*4.0%*	*3.0%*	*3.0%*
Cost of Goods Sold	1,065	1,138	1,177	1,958	2,024	651	2,781	2,920	3,010	3,101	3,194
% of Revenue	*55.2%*	*54.8%*	*55.6%*	*58.0%*	*58.3%*	*57.5%*	*57.5%*	*57.5%*	*57.0%*	*57.0%*	*57.0%*
Gross Profit	864	941	940	1,418	1,449	481	2,055	2,158	2,271	2,339	2,409
Year over Year Growth %	*22.5%*	*8.9%*	*-0.1%*	*50.9%*			*6.5%*	*5.0%*	*5.2%*	*3.0%*	*3.0%*
Operating Expenses	454	481	500	821	845	227	1112	1117	1109	1142	1177
% of Revenue	*23.5%*	*23.1%*	*23.6%*	*24.3%*	*24.3%*	*23.3%*	*23.0%*	*22.0%*	*21.0%*	*21.0%*	*21.0%*
EBITDA	654	718	710	1,061	1,076	402	1,523	1,650	1,690	1,741	1,793
% of Revenue	*33.9%*	*34.5%*	*33.5%*	*31.4%*	*31.0%*	*35.5%*	*31.5%*	*32.5%*	*32.0%*	*32.0%*	*32.0%*
Year over Year Growth %	*25.6%*	*9.7%*	*(1.1%)*	*47.8%*			*3.1%*	*8.3%*	*2.4%*	*3.0%*	*3.0%*
Less: Depreciation and Amortization	244	258	270	464	472	147	580	609	528	544	560
% of Revenue	*12.6%*	*12.4%*	*12.7%*	*13.7%*	*13.6%*	*13.0%*	*12.0%*	*12.0%*	*10.0%*	*10.0%*	*10.0%*
EBIT	410	460	440	597	604	255	943	1,041	1,162	1,197	1,233
% of Revenue	*21.3%*	*22.1%*	*20.8%*	*17.7%*	*17.4%*	*22.5%*	*19.5%*	*20.5%*	*22.0%*	*22.0%*	*22.0%*
Year over Year Growth %	*25.4%*	*12.1%*	*(4.3%)*	*29.9%*			*9.8%*	*10.4%*	*11.6%*	*3.0%*	*3.0%*
Less: Income Taxes	125	152	(32)	114	286	68	253	279	311	321	330
Net Operating Profit After Taxes	285	308	472	483	318	186	690	762	850	876	902
Year over Year Growth %	*28.6%*	*7.8%*	*53.4%*	*2.5%*			*9.8%*	*10.4%*	*11.6%*	*3.0%*	*3.0%*
Plus: Depreciation and Amortization	244	258	270	464	472	147	580	609	528	544	560
Less Capital Expenditures	210	241	239	345	317	103	484	508	528	544	560
% of Revenue	*10.9%*	*11.6%*	*11.3%*	*10.2%*	*9.1%*	*9.1%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*
Less: Change in Net Working Capital	18	21	(19)	9	(88)	(11)	24	25	26	27	28
% of Revenue	*0.9%*	*1.0%*	*(0.9%)*	*0.3%*	*(2.5%)*	*(1.0%)*	*0.5%*	*0.5%*	*0.5%*	*0.5%*	*0.5%*
Unlevered Free Cash Flow	335	342	523	647	473	240	834	912	899	924	951
Discount Period						0.125	1.125	2.125	3.125	4.125	5.125
Discount Factor						99.3%	93.7%	88.3%	83.3%	78.6%	74.2%
Present Value of Unlevered Cash Flows						**238**	**781**	**805**	**749**	**727**	**706**

Share Price Calculation

Share Price Calculation	
PV of UFCF	4,006
Terminal Year Growth Rate	3.00%
Discount Rate	6.00%
PV of Terminal Value	17,943
Enterprise Value	**25,410**
Enterprise Value	25,410
Less: Total Debt	3,931
Plus: Cash and Cash Equivalents	495
Implied Equity Value	**21,974**
Shares Outstanding	264.3
Implied Share Price ($USD)	**83.14**
USD/CAD Exchange Rate	1.23
Implied Share Price ($CAD)	**102.35**

Sensitivity Analysis

Implied Exit Multiple

		Terminal Growth Rate				
		2.50%	**2.75%**	**3.00%**	**3.25%**	**3.50%**
WACC	**5.60%**	14.6x	16.0x	17.5x	19.4x	21.8x
	5.80%	13.7x	14.9x	16.3x	17.9x	19.9x
	6.00%	13.0x	14.0x	15.2x	16.6x	18.3x
	6.20%	12.3x	13.2x	14.2x	15.5x	17.0x
	6.40%	11.6x	12.5x	13.4x	14.5x	15.8x

Implied Share Price

		Terminal Growth Rate				
		2.50%	**2.75%**	**3.00%**	**3.25%**	**3.50%**
WACC	**5.60%**	$ 98.67	$ 107.33	$ 117.66	$ 130.18	$ 145.68
	5.80%	$ 92.86	$ 100.48	$ 109.46	$ 120.20	$ 133.27
	6.00%	$ 87.71	$ 94.47	$ 102.35	$ 111.66	$ 122.83
	6.20%	$ 83.12	$ 89.15	$ 96.13	$ 104.28	$ 113.95
	6.40%	$ 78.99	$ 84.42	$ 90.63	$ 97.84	$ 106.28

Discounted Cash Flow Analysis

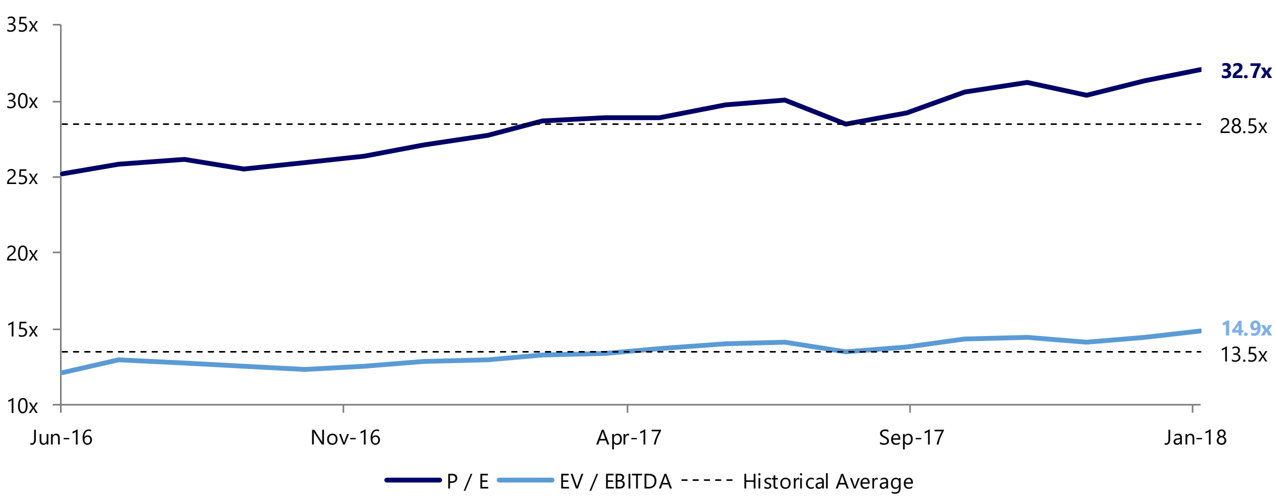
The Discounted Cash Flow Analysis reaches a targeted share price of $102.35, implying a one-year return of ~14%. Using a terminal growth rate of 3.0% and a WACC of 6.0%, the implied exit multiple is 15.2x. The terminal growth rate is reasonable in our view as historically, WCN has grown through pricing contracts 2.8% higher each year for the past ten years, coupled with industry growth of ~2.4%. The target price is calculated using the Canadian exchange rate on January 26, 2018 of 1.23 USD/CAD, as the company reports in USD and dual-listed on the NYSE and TSX.

Valuation	Weighting	Target Price
DCF	75%	102.35
Historic Multiple Average	25%	92.53
Target Price		**99.89**
Current Price		**90.27**
Capital Return		10.66%
Dividend Yield		0.67%
All-in Return		**11.33%**

WACC Calculation	
Risk-Free Rate[1]	2.69%
Market Risk Premium[2]	5.08%
Levered Beta	0.67
CAPM - Cost of Equity	6.09%
Historical ROE (10-Year Annual)	8.24%
Cost of Equity (Blended)	**7.17%**
Cost of Debt	4.50%
Effective Tax Rate	26.8%
After Tax Cost of Debt	**3.29%**
Capital Structure	
Debt	30.0%
Equity	70.0%
Total:	**100.0%**
WACC	**6.00%**

Exhibit XI

Historical Forward Multiples Analysis



Source: Capital IQ

Historical Multiples – Bear, Base, Bull Cases & Target Price

Bear Case Share Price Calculation	
2019 Est. EBITDA	1,650
Historical Average NTM EV/EBITDA	13.5x
Estimated Enterprise Value	22,241
Less: Total Debt	3,931
Plus: Cash and Cash Equivalents	495
Implied Equity Value	**18,805**
Shares Outstanding	264.3
Implied Share Price ($USD)	**71.15**
USD/CAD Exchange Rate	1.23
Implied Share Price ($CAD)	**87.59**

Base Case Share Price Calculation	
2019 Est. EBITDA	1,650
Sell-Side Analyst NTM EV/EBITDA	14.0x
Estimated Enterprise Value	23,105
Less: Total Debt	3,931
Plus: Cash and Cash Equivalents	495
Implied Equity Value	**19,670**
Shares Outstanding	264.3
Implied Share Price ($USD)	**74.42**
USD/CAD Exchange Rate	1.23
Implied Share Price ($CAD)	**91.61**

Bull Case Share Price Calculation	
2019 Est. EBITDA	1,650
Current NTM EV/EBITDA	14.9x
Estimated Enterprise Value	24,559
Less: Total Debt	3,931
Plus: Cash and Cash Equivalents	495
Implied Equity Value	**21,123**
Shares Outstanding	264.3
Implied Share Price ($USD)	**79.92**
USD/CAD Exchange Rate	1.23
Implied Share Price ($CAD)	**98.38**

Valuation Commentary

The valuation was completed using a blend of Discounted Cash Flow Analysis and Historical Multiple Analysis (75%-25%). It was more heavily weighted on the DCF as the cash flows are consistent and the business is reaching steady state. The model is conservative in our opinion as it fails to take into account accretive future M&A growth that management has historically done successfully.

The multiples analysis was very conservative since there is an opportunity for multiple expansion over the next five years if management can successfully continue to acquire businesses and integrate them into WCN's platform. Furthermore, there are positive tailwinds impacting the industry leading to stable growth, limited downside risk for a reasonable price. The Industrials team believes that investors will look to this sector if there is a downturn in the economy.

Overall, the limited downside risk is very attractive to this business and will likely continue to outperform other subsectors in our coverage universe late into the economic cycle. Industrials will be entering a position in WCN as it transitions to underweight Rail relative to our index.

References

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