



Stock Pick of the Week: Republic Services (RSG)

Our stock pick this week comes from an unglamorous industry, but one that can produce attractive profits. Services that make lives easier and that people begin to take for granted — insurance, for example — can often be extremely profitable while fly under the radar. Our stock pick of the week is waste collection and recycling services provider Republic Services (RSG). Republic Services receives our Attractive rating.

What is Republic Services?

Republic Services provides waste collection, recycling, and disposal services for commercial, industrial, and residential customers across the United States. From curbside residential waste collection to supplying commercial waste containers and compactors to landfill transportation, Republic Services covers the entire spectrum of waste collection. As noted above, this often-overlooked business has become very profitable for Republic Services, and has allowed them to operate in 39 states as well as Puerto Rico. The company is also involved in recycling and renewable energy projects apart from standard waste collection.

Impressive 2014 So Far

Republic Services had an outstanding 2014, with year-end results to be reported soon. Through the end of the third quarter, revenues were up 5% over 2013 and better yet, operating income was up 32%. The company's Commercial and Industrial segment revenues, which combined make up 50% of total revenue, were up 4% and 9% respectively while Residential revenues remained flat. These increases were attributed to due to price increases all lines of business.

The recent growth of the top and bottom line are a positive signal that Republic Services is continuing to build on its already strong history of growth. Over the past five years, Republic Services has grown after-tax operating profit ([NOPAT](#)) by 6% compounded annually and increased its return on invested capital ([ROIC](#)) to 7%. While a 7% ROIC is not overly impressive when viewed against other industries, it ranks fifth out of the 19 Environmental & Facilities Services companies we cover.

Republic Services has generated \$1 billion in [free cash flow](#) on a trailing 12-month basis. As an added bonus, Republic Services pays out dividends that provide a 2.8% yield. With strong positive free cash flow, Republic Services should have no problem continuing this cash distribution of just over \$400 million. If the company can continue growing revenues, keeping costs in line, and increasing profitability, Republic Services has great upside.

New Growth Going Forward

The waste collection industry is not experiencing what you would call “rapid” growth. Republic Services is the second-largest waste hauling company, behind Waste Management (WM) and the industry is filled with many smaller operations. Republic Services has a history of acquiring these smaller competitors as a way to quickly enter a market, as well as avoid regulatory complications. The existing company already meets the regulations of an area, allowing Republic Services to quickly enter and save time and money when opposed to entering new markets on their own. On top of its organic revenue growth, Republic Services expects the most recent acquisitions to attribute 1 percentage point to revenue growth in 2014. As with all acquisitions, purchasing the wrong company or paying too much can drastically impact Republic Services' shareholder value. Management must not fall into the trap of acquiring companies just to spend money, but do their diligence and ensure the acquisition will be accretive to revenues, and more importantly, profits.

An Undervalued Find

At its current price of ~\$40/share, Republic Services has a price to economic book value ([PEBV](#)) ratio of 1.1. This ratio implies the market expects Republic Services NOPAT to only grow by 10% from current levels over the life of the company.

If Republic Services can [continue to grow NOPAT by 6% compounded annually for the next 10 years, the stock is worth \\$53/share today](#) — a 33% upside. Add in the dividend yield and it's worth even more in your portfolio long-term.



Disclosure: David Trainer and Kyle Guske II receive no compensation to write about any specific stock, style, or theme.



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