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Why recycling business is feeling so discarded these days

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A City Of San Diego's Environmental Services Department truck empties recycling bins.

The recycling business stinks these days with the price of commodities, such as plastics, metal and paper, all in the dumps.

Paper, which represents a good chunk of the recycling market for the major waste haulers, is in a downturn that began almost five years ago. Aluminum, a raw material used in producing beverage cans, is at depressed prices and feeling the effects of a supply glut and slowing demand from China. And the decline in plastic scrap is due to oil prices and overcapacity in the polyethylene terephthalate, or PET, resin manufacturing industry.

The severity of the commodities downturn is apparent when looking at the number of recycling facilities that have closed nationwide in recent years. There have been reported closings in California, Colorado, Florida, Illinois and Missouri, just to name a few. Falling prices for scrap

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are also impacting the nation's three biggest publicly held waste haulers, all of which have recycling market exposure.



Waste Management, the nation’s largest garbage company, sold or jettisoned 30 recycling facilities over the past few years and about 900 employees were affected. KeyBanc analyst Joe Box said in a note last week that the Dallas-based waste management behemoth “could shutter more in 2016 as low commodity prices are pressuring recycling profitability.”

The recycling downturn is particularly dire in California, where falling commodity prices along with cuts to the state-subsidized recycling program have resulted in hundreds of redemption centers closing in the past year. Last month, rePlanet, one of the state’s largest recyclers, announced it closed 191 centers across California. On its website, rePlanet blamed the cuts on a reduction in state fees, higher labor costs and “12 months of unprecedented declines in commodities pricing of aluminum and PET plastic.”

“Recyclables as commodities fluctuate in value more than any other commodity out there,” said Chaz Miller, director of policy and advocacy for the National Waste and Recycling Association, a trade group that represents private sector waste and recycling companies. “It’s partially just the nature of them. They are sort of the tail end of the raw material chain.”

Observers say the California situation was complicated by the recycling industry’s reliance on processing plastics such as PET under the state’s bottle law; they get a processing fee set by the state.

Last year, PET scrap exports sank 25 percent from a year earlier, with China — the biggest buyer in 2014 — reducing volumes by about 40 percent. The broader decline in recycled commodities also reflects the strengthening of the U.S. dollar.

PET scrap prices topped out around \$500 per ton in 2011, and recently were around \$200, or a decline of 60 percent, according to CalRecycle. Aluminum is down about 40 percent from its peak, while aggregated blend paper is still around 50 percent below its highest price.

Waste Management chief David Steiner told analysts last month during the company’s fourth-quarter earnings conference call that average commodity recycling prices fell by 17.5 percent in 2015.

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"On the recycling commodity price front, 2016 has seen a continuation of the downward slide, and current prices are down \$20 per ton, or 23 percent from January of 2015," he said. "These are levels that we have not seen in nearly seven years, since the 2009 recession."

Added Steiner, "We are committed to recycling and we will continue to work to change the business model to generate revenue that covers our processing costs and drive out operating expenses so that the business is sustainable over the long term."

Republic Services, another major trash hauler with recycling operations, said on its fourth-quarter call last month that average commodity prices for all materials it handled at recycling facilities fell by 16 percent in the December quarter from the prior year. When excluding glass and organics, however, the average decline for commodities was 14 percent. As a commodity, glass has held up better but some trash haulers consider it a burden, or what Republic Services termed part of the "low value waste streams."

"Nobody wants the glass," said Michael Hoffman, a Stifel analyst covering environmental services. "I don't care if you're little or big."



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Glass may be one of the worst things to recycle from the big garbage companies' perspective because of breakage at material recycling facilities where shards of glass can get into machines, cause breakdowns and raise processing costs. Also, there's other unwanted items such as dry cleaner bags and plastic shopping bags that get thrown into the curbside containers that can cause sorting equipment to jam and contribute to the overall residual waste problem.

Some of the big haulers are going back into their contracts with municipalities and starting to enforce the residual content clauses. Contracts typically contain clauses allowing no more than 15 percent residual content, or "non-program materials" (i.e., unrecoverable recyclables). Residual material exceeding contract terms can result in the companies billing back municipalities to recover some of the extra processing costs.

Analysts look for contracts with municipalities and terms of the contracts to be changing in the years to come.

Historically, municipalities have set a price for picking up garbage waste from homes, and the big haulers tended to do recycling essentially for little or nothing on top of the basic collection services. The haulers were able to resell the commodity materials from the items they collected and it served as a cash cow. Given the decline in commodity prices, though, the playing field changed and companies want to charge for the actual cost of picking up the trash.

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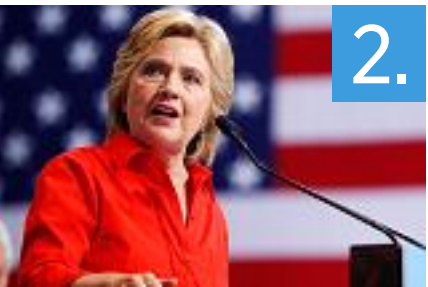
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"On the margin, what will happen with lower commodity [prices] is good long term for these companies," said Barclays analyst Jon Windham. "They will renegotiate the contracts and get a higher price on the municipal solid-waste pickup."

Windham believes the solid waste management industry is attractive despite headwinds from recycling. He said recycling revenue for the big players tends to be a small percentage of total revenues, adding that several trends are working in favor of the industry's long-term growth.

"These are safe-haven stocks. The vast majority of the revenue and the vast majority of the profit comes from picking up your trash and putting it in a landfill. And the only impact there on commodities is lower fuel costs. These names tend to outperform in a time of commodities decline."

Shares of the major trash haulers are trading at or near all-time highs and crushing the broader market averages. Year to date, industry leader Waste Management is up 7 percent through Tuesday's close and No. 2 Republic Services is ahead by 6 percent. [Waste Connections](#), the industry's no. 3 hauler which in January agreed to merge with Progressive Waste, has seen its stock jump up 13 percent this year.



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