

WASTE MANAGEMENT INC
Form 10-Q
July 29, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended June 30, 2014

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____
Commission file number 1-12154

Waste Management, Inc.

(Exact name of registrant as specified in its charter)

Delaware
*(State or other jurisdiction of
incorporation or organization)*

73-1309529
*(I.R.S. Employer
Identification No.)*

1001 Fannin

Suite 4000

Houston, Texas 77002

(Address of principal executive offices)

(713) 512-6200

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The number of shares of Common Stock, \$0.01 par value, of the registrant outstanding at July 22, 2014 was 466,401,578 (excluding treasury shares of 163,880,883).

PART I.

Item 1. *Financial Statements.*

WASTE MANAGEMENT, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Millions, Except Share and Par Value Amounts)

	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 137	\$ 58
Accounts receivable, net of allowance for doubtful accounts of \$32 and \$33, respectively	1,710	1,699
Other receivables	87	111
Investment in unconsolidated entity		177
Parts and supplies	166	178
Deferred income taxes	106	113
Other assets	149	163
Total current assets	2,355	2,499
Property and equipment, net of accumulated depreciation and amortization of \$16,998 and \$16,723, respectively	12,031	12,344
Goodwill	6,094	6,070
Other intangible assets, net	493	529
Investments in unconsolidated entities	419	414
Other assets	787	747
Total assets	\$ 22,179	\$ 22,603
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$ 692	\$ 744
Accrued liabilities	1,031	1,069
Deferred revenues	471	475
Current portion of long-term debt	786	726
Total current liabilities	2,980	3,014
Long-term debt, less current portion	9,011	9,500
Deferred income taxes	1,796	1,842
Landfill and environmental remediation liabilities	1,540	1,518
Other liabilities	705	727
Total liabilities	16,032	16,601
Commitments and contingencies		
Equity:		
Waste Management, Inc. stockholders' equity:		
Common stock, \$0.01 par value; 1,500,000,000 shares authorized; 630,282,461 shares issued	6	6
Additional paid-in capital	4,624	4,596
Retained earnings	6,376	6,289
Accumulated other comprehensive income	135	154
Treasury stock at cost, 164,396,943 and 165,961,646 shares, respectively	(5,288)	(5,338)
Total Waste Management, Inc. stockholders' equity	5,853	5,707

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Noncontrolling interests	294	295
Total equity	6,147	6,002
Total liabilities and equity	\$ 22,179	\$ 22,603

See notes to Condensed Consolidated Financial Statements.

WASTE MANAGEMENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Millions, Except per Share Amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Operating revenues	\$ 3,561	\$ 3,526	\$ 6,957	\$ 6,862
Costs and expenses:				
Operating	2,301	2,311	4,533	4,520
Selling, general and administrative	353	353	728	743
Depreciation and amortization	339	339	656	662
Restructuring	1	2	2	10
(Income) expense from divestitures, asset impairments and unusual items	35	11	37	15
	3,029	3,016	5,956	5,950
Income from operations	532	510	1,001	912
Other income (expense):				
Interest expense, net	(115)	(121)	(236)	(242)
Equity in net losses of unconsolidated entities	(13)	(8)	(22)	(16)
Other, net	(2)	2	(5)	(9)
	(130)	(127)	(263)	(267)
Income before income taxes	402	383	738	645
Provision for income taxes	180	127	279	213
Consolidated net income	222	256	459	432
Less: Net income attributable to noncontrolling interests	12	12	21	20
Net income attributable to Waste Management, Inc.	\$ 210	\$ 244	\$ 438	\$ 412
Basic earnings per common share	\$ 0.45	\$ 0.52	\$ 0.94	\$ 0.88
Diluted earnings per common share	\$ 0.45	\$ 0.52	\$ 0.94	\$ 0.88
Cash dividends declared per common share	\$ 0.375	\$ 0.365	\$ 0.75	\$ 0.73

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Millions)

(Unaudited)

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Consolidated net income	\$ 222	\$ 256	\$ 459	\$ 432
Other comprehensive income (loss), net of taxes:				
Derivative instruments, net	4	12	(2)	10
Available-for-sale securities, net	2	(1)	2	
Foreign currency translation adjustments	40	(37)	(19)	(69)
Post-retirement benefit obligation, net				
Other comprehensive income (loss), net of taxes	46	(26)	(19)	(59)
Comprehensive income	268	230	440	373
Less: Comprehensive income attributable to noncontrolling interests	12	12	21	20
Comprehensive income attributable to Waste Management, Inc.	\$ 256	\$ 218	\$ 419	\$ 353

See notes to Condensed Consolidated Financial Statements.

WASTE MANAGEMENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Millions)

(Unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Consolidated net income	\$ 459	\$ 432
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	656	662
Deferred income tax benefit	(48)	(29)
Interest accretion on landfill liabilities	43	43
Interest accretion on and discount rate adjustments to environmental remediation liabilities and recovery assets	2	(7)
Provision for bad debts	19	25
Equity-based compensation expense	29	34
Excess tax benefits associated with equity-based transactions	(1)	(7)
Net gain from disposal of assets	(25)	(10)
Effect of (income) expense from divestitures, asset impairments and unusual items and other	37	26
Equity in net losses of unconsolidated entities, net of dividends	22	16
Change in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Receivables	(8)	(4)
Other current assets	11	3
Other assets	13	(5)
Accounts payable and accrued liabilities	(16)	(32)
Deferred revenues and other liabilities	(54)	(25)
Net cash provided by operating activities	1,139	1,122
Cash flows from investing activities:		
Acquisitions of businesses, net of cash acquired	(26)	(210)
Capital expenditures	(474)	(501)
Proceeds from divestitures of businesses and other assets (net of cash divested)	266	74
Net receipts from (deposits to) restricted trust and escrow accounts	11	(2)
Investments in unconsolidated entities	(11)	(24)
Other	(60)	(30)
Net cash used in investing activities	(294)	(693)
Cash flows from financing activities:		
New borrowings	1,500	461
Debt repayments	(1,925)	(658)
Cash dividends	(349)	(341)
Exercise of common stock options	31	98
Excess tax benefits associated with equity-based transactions	1	7
Distributions paid to noncontrolling interests	(22)	(32)
Other	(2)	
Net cash used in financing activities	(766)	(465)
Effect of exchange rate changes on cash and cash equivalents		(4)
Increase (decrease) in cash and cash equivalents	79	(40)
Cash and cash equivalents at beginning of period	58	194
Cash and cash equivalents at end of period	\$ 137	\$ 154

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See notes to Condensed Consolidated Financial Statements.

WASTE MANAGEMENT, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(In Millions, Except Shares in Thousands)

(Unaudited)

	Waste Management, Inc. Stockholders' Equity										
	Total	Common Stock		Additional Paid-In Capital			Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Noncontrolling Interests
		Shares	Amounts	Capital			Shares	Amounts			
Balance, December 31, 2013	\$ 6,002	630,282	\$ 6	\$ 4,596	\$ 6,289	\$ 154	(165,962)	\$ (5,338)	\$ 295		
Consolidated net income	459				438				21		
Other comprehensive income (loss), net of taxes	(19)					(19)					
Cash dividends	(349)				(349)						
Equity-based compensation transactions, including dividend equivalents, net of taxes	76			28	(2)		1,562	50			
Distributions paid to noncontrolling interests	(22)								(22)		
Other							3				
Balance, June 30, 2014	\$ 6,147	630,282	\$ 6	\$ 4,624	\$ 6,376	\$ 135	(164,397)	\$ (5,288)	\$ 294		

See notes to Condensed Consolidated Financial Statements.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The financial statements presented in this report represent the consolidation of Waste Management, Inc., a Delaware corporation; Waste Management's wholly-owned and majority-owned subsidiaries; and certain variable interest entities for which Waste Management or its subsidiaries are the primary beneficiaries as described in Note 13. Waste Management is a holding company and all operations are conducted by its subsidiaries. When the terms the Company, we, us or our are used in this document, those terms refer to Waste Management, Inc., its consolidated subsidiaries and consolidated variable interest entities. When we use the term WM, we are referring only to Waste Management, Inc., the parent holding company.

We are North America's leading provider of comprehensive waste management environmental services. We partner with our residential, commercial, industrial and municipal customers and the communities we serve to manage and reduce waste at each stage from collection to disposal, while recovering valuable resources and creating clean, renewable energy. Our Solid Waste business is operated and managed locally by our subsidiaries that focus on distinct geographic areas and provides collection, transfer, recycling and resource recovery, and disposal services. Through our subsidiaries, we are also a leading developer, operator and owner of waste-to-energy and landfill gas-to-energy facilities in the United States.

We evaluate, oversee and manage the financial performance of our Solid Waste business subsidiaries through our 17 geographic Areas. Our Wheelabrator business provides waste-to-energy services and manages waste-to-energy facilities and independent power production plants. We also provide additional services that are not managed through our Solid Waste or Wheelabrator businesses, which are presented in this report as Other. Additional information related to our segments can be found in Note 8.

The Condensed Consolidated Financial Statements as of June 30, 2014 and for the three and six months ended June 30, 2014 and 2013 are unaudited. In the opinion of management, these financial statements include all adjustments, which, unless otherwise disclosed, are of a normal recurring nature, necessary for a fair presentation of the financial position, results of operations, comprehensive income, cash flows, and changes in equity for the periods presented. The results for interim periods are not necessarily indicative of results for the entire year. The financial statements presented herein should be read in connection with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2013.

In preparing our financial statements, we make numerous estimates and assumptions that affect the accounting for and recognition and disclosure of assets, liabilities, equity, revenues and expenses. We must make these estimates and assumptions because certain information that we use is dependent on future events, cannot be calculated with precision from available data or simply cannot be calculated. In some cases, these estimates are difficult to determine, and we must exercise significant judgment. In preparing our financial statements, the most difficult, subjective and complex estimates and the assumptions that present the greatest amount of uncertainty relate to our accounting for landfills, environmental remediation liabilities, asset impairments, deferred income taxes and reserves associated with our insured and self-insured claims. Actual results could differ materially from the estimates and assumptions that we use in the preparation of our financial statements.

Reclassifications

When necessary, reclassifications have been made to our prior period consolidated financial information in order to conform to the current year presentation.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Landfill and Environmental Remediation Liabilities

Liabilities for landfill and environmental remediation costs are presented in the table below (in millions):

	June 30, 2014			December 31, 2013		
	Landfill	Environmental Remediation	Total	Landfill	Environmental Remediation	Total
Current (in accrued liabilities)	\$ 92	\$ 35	\$ 127	\$ 95	\$ 35	\$ 130
Long-term	1,352	188	1,540	1,326	192	1,518
	\$ 1,444	\$ 223	\$ 1,667	\$ 1,421	\$ 227	\$ 1,648

The changes to landfill and environmental remediation liabilities are reflected in the table below (in millions):

	Landfill	Environmental Remediation
December 31, 2012	\$ 1,338	\$ 253
Obligations incurred and capitalized	59	
Obligations settled	(71)	(20)
Interest accretion	87	4
Revisions in estimates and interest rate assumptions	6	(6)
Acquisitions, divestitures and other adjustments	2	(4)
December 31, 2013	1,421	227
Obligations incurred and capitalized	26	
Obligations settled	(23)	(9)
Interest accretion	43	3
Revisions in estimates and interest rate assumptions	(6)	2
Acquisitions, divestitures and other adjustments	(17)	
June 30, 2014	\$ 1,444	\$ 223

At several of our landfills, we provide financial assurance by depositing cash into restricted trust funds or escrow accounts for purposes of settling final capping, closure, post-closure and environmental remediation obligations. Generally, these trust funds are established to comply with statutory requirements and operating agreements. See Note 13 for additional information related to these trusts.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Debt

The following table summarizes the major components of debt at each balance sheet date (in millions) and provides the maturities and interest rate ranges of each major category as of June 30, 2014:

	June 30, 2014	December 31, 2013
U.S. revolving credit facility, maturing July 2018 (weighted average interest rate of 1.2% at June 30, 2014 and December 31, 2013)	\$ 105	\$ 420
Letter of credit facilities, maturing through December 2016		
Canadian credit facility and term loan, maturing November 2017 (weighted average effective interest rate of 2.6% at June 30, 2014 and 2.7% at December 31, 2013)	351	414
Senior notes maturing through 2039, interest rates ranging from 2.60% to 7.75% (weighted average interest rate of 5.7% at June 30, 2014 and December 31, 2013)	6,279	6,287
Tax-exempt bonds, maturing through 2045, fixed and variable interest rates ranging from 0.04% to 5.7% (weighted average interest rate of 2.2% at June 30, 2014 and 2.3% at December 31, 2013)	2,649	2,664
Capital leases and other, maturing through 2055, interest rates up to 12%	413	441
	9,797	10,226
Current portion of long-term debt	786	726
	\$ 9,011	\$ 9,500

Debt Classification

As of June 30, 2014, we had (i) \$517 million of debt maturing within the next 12 months, including \$350 million of 6.375% senior notes that mature in March 2015 and \$102 million of tax-exempt bonds; (ii) \$105 million of short-term borrowings outstanding under the U.S. revolving credit facility (\$2.25 billion revolving credit facility) and (iii) \$905 million of tax-exempt borrowings subject to repricing within the next 12 months. Based on our intent and ability to refinance portions of our current obligations on a long-term basis as of June 30, 2014, including through use of forecasted available capacity under our \$2.25 billion revolving credit facility, we have classified \$741 million of this debt as long-term and the remaining \$786 million as current obligations. The \$741 million classified as long-term is less than our unused and available capacity under our \$2.25 billion revolving credit facility of \$1.3 billion discussed below due to expected decreases in such available capacity within the next 12 months.

Revolving Credit and Letter of Credit Facilities

As of June 30, 2014, we had an aggregate committed capacity of \$2.65 billion for letters of credit under various U.S. credit facilities. Our \$2.25 billion revolving credit facility expires in July 2018 and is our primary source of letter of credit capacity. Our remaining committed letter of credit capacity is provided under facilities with terms ending through December 2016. As of June 30, 2014, we had an aggregate of \$1.3 billion of letters of credit outstanding under various credit facilities. Approximately \$874 million of these letters of credit have been issued under our \$2.25 billion revolving credit facility. As of June 30, 2014, we had outstanding borrowings under our \$2.25 billion revolving credit facility of \$105 million, leaving \$1.3 billion of unused and available capacity.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We also have a Canadian credit agreement that matures in November 2017 and provides for C\$150 million of revolving credit capacity. We have the ability to issue up to C\$50 million of letters of credit under the Canadian revolving credit facility, which if utilized, reduces the amount of credit capacity available for borrowings. As of June 30, 2014, we had no letters of credit or borrowings outstanding under the credit facility.

Debt Borrowings and Repayments

\$2.25 Billion Revolving Credit Facility During the first half of 2014, we made net repayments of \$315 million under our \$2.25 billion revolving credit facility with available cash.

Canadian Credit Facility and Term Loan We repaid C\$65 million, or \$60 million, of net advances under our Canadian credit facility and term loan during the six months ended June 30, 2014 with available cash.

Senior Notes In March 2014, we repaid \$350 million of 5.0% senior notes that matured in March 2014 with borrowings under our \$2.25 billion revolving credit facility. In May 2014, we issued \$350 million of 3.5% senior notes due May 15, 2024. The net proceeds from the debt issuance were \$347 million, all of which were used to repay borrowings under our \$2.25 billion revolving credit facility.

Tax-Exempt Bonds During the six months ended June 30, 2014, we repaid \$15 million of tax-exempt bonds with available cash.

4. Derivative Instruments and Hedging Activities

The following table summarizes the fair values of derivative instruments recorded in our Condensed Consolidated Balance Sheet (in millions):

Derivatives Designated as Hedging Instruments	Balance Sheet Location	June 30, 2014	December 31, 2013
Foreign currency derivatives	Long-term other assets	\$ 1	\$ 2
Total derivative assets		\$ 1	\$ 2
Electricity commodity derivatives	Current accrued liabilities	\$ 1	\$ 3
Foreign currency derivatives	Current accrued liabilities	2	
Interest rate derivatives	Current accrued liabilities		28
Total derivative liabilities		\$ 3	\$ 31

We have not offset fair value amounts recognized for our derivative instruments. For information related to the inputs used to measure our derivative assets and liabilities at fair value, refer to Note 12.

Fair Value Hedges**Interest Rate Swaps**

In prior years, we entered into interest rate swaps to maintain a portion of our debt obligations at variable market interest rates. We designated these interest rate swaps as fair value hedges of our fixed-rate senior notes. Fair value hedge accounting for interest rate swap contracts increased the carrying value of our debt instruments by \$51 million as of June 30, 2014 and \$59 million as of December 31, 2013. These fair value adjustments to long-term debt are being amortized as a reduction to interest expense using the effective interest method over the remaining term of the related senior notes, which extend through 2028. We recognized benefits to interest expense associated with the amortization of our terminated interest rate swaps of \$3 million and \$5 million for the three-month periods ended June 30, 2014 and 2013, respectively, and \$8

million and \$10 million for the six-month periods ended June 30, 2014 and 2013, respectively.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash Flow Hedges

Forward-Starting Interest Rate Swaps

During the first quarter of 2014, forward-starting interest rate swaps with a notional value of \$175 million matured and we paid cash of \$36 million to settle the associated liabilities. These swaps were designated as cash flow hedges and had been executed in prior years to hedge the risk of changes in semi-annual interest payments due to fluctuations in the forward ten-year LIBOR swap rate for an anticipated fixed-rate debt issuance that occurred in May 2014. Accordingly, the effective portion of the loss associated with the matured forward-starting swaps has been deferred as a component of Accumulated other comprehensive income and is being amortized to interest expense over the ten-year term of the related senior notes. The ineffectiveness realized during the second quarter of 2014 was not material.

At June 30, 2014 and December 31, 2013, our Accumulated other comprehensive income included \$53 million and \$34 million, respectively, of after-tax deferred losses related to all terminated swaps. These losses are being amortized as an increase to interest expense using the effective interest method over the ten-year term of the related senior notes, which extend through 2024. As of June 30, 2014, \$11 million (on a pre-tax basis) is scheduled to be reclassified as an increase to interest expense over the next 12 months for these previously terminated swaps.

Foreign Currency Derivatives

We use foreign currency exchange rate derivatives to hedge our exposure to fluctuations in exchange rates for anticipated intercompany cash transactions between WM Holdings and its Canadian subsidiaries. As of June 30, 2014, we had foreign exchange cross currency swaps outstanding for all of the anticipated cash flows associated with intercompany loans from WM Holdings to the wholly-owned Canadian subsidiaries. The hedged cash flows as of June 30, 2014 include C\$370 million of total notional value. The scheduled principal payments of the loan and the related swaps are as follows: C\$70 million due on October 31, 2016, C\$150 million due on October 31, 2017 and C\$150 million due on October 31, 2018. We designated these cross currency swaps as cash flow hedges. Gains or losses resulting from the remeasurement of the underlying non-functional currency intercompany loan are recognized in current earnings in the same financial statement line item as offsetting gains or losses on the related cross currency swaps.

Electricity Commodity Derivatives

We use short-term receive fixed, pay variable electricity commodity swaps to reduce the variability in our revenues and cash flows caused by fluctuations in the market prices for electricity. We hedged 1.73 million megawatt hours, or approximately 56%, of Wheelabrator's full year 2013 merchant electricity sales and the swaps executed through June 30, 2014 are expected to hedge approximately 482,000 megawatt hours, or approximately 16%, of Wheelabrator's full year 2014 merchant electricity sales. For each of the three- and six-month periods ended June 30, 2014, we hedged 17% of Wheelabrator's merchant electricity sales. For the three- and six-month periods ended June 30, 2013, we hedged 56% and 54%, respectively, of Wheelabrator's merchant electricity sales.

There was no significant ineffectiveness associated with our cash flow hedges during the three and six months ended June 30, 2014 or 2013. Refer to Note 11 for information regarding the impacts of our cash flow derivatives on our comprehensive income and results of operations.

Credit-Risk-Related Contingent Features

Our interest rate derivative instruments have in the past, and may in the future, contain provisions related to the Company's credit rating. These provisions generally provide that if the Company's credit rating were to fall to specified levels below investment grade, the counterparties have the ability to terminate the derivative agreements, resulting in settlement of all affected transactions. As of June 30, 2014 and December 31, 2013, we did not have any interest rate derivatives outstanding that contained these credit-risk-related features.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Income Taxes

Our effective income tax rate for the three and six months ended June 30, 2014 was 44.7% and 37.8%, respectively, compared with 33.2% and 33.0%, for the comparable prior year periods. We evaluate our effective income tax rate at each interim period and adjust it as facts and circumstances warrant. The difference between federal income taxes computed at the federal statutory rate and reported income taxes for the three and six months ended June 30, 2014 was primarily due to the divestiture of our Puerto Rico operations and certain other collection and landfill assets. We recognized a \$25 million loss on the divestment as discussed in Notes 9 and 10. No tax benefit was recorded in connection with the loss. In addition, we incurred \$32 million of tax charges to repatriate accumulated cash prior to the divestment. Also contributing to the difference for the three and six months ended June 30, 2014 was the unfavorable impact of state and local income taxes offset, in part, by the favorable impact of federal tax credits and the utilization of capital loss carryovers. The six month period also benefited from the revaluation of our deferred taxes and utilization of state net operating losses resulting from a change in state law. The difference between federal income taxes computed at the federal statutory rate and reported income taxes for the three and six months ended June 30, 2013 was primarily due to the favorable impact of federal tax credits and tax audit settlements offset, in part, by the unfavorable impact of state and local income taxes and tax implications related to impairments.

Investment in Refined Coal Facility In January 2011, we acquired a noncontrolling interest in a limited liability company, which was established to invest in and manage a refined coal facility in North Dakota. The facility's refinement processes qualify for federal tax credits that are expected to be realized through 2019 in accordance with Section 45 of the Internal Revenue Code.

We account for our investment in this entity using the equity method of accounting, recognizing our share of the entity's results of operations and other reductions in the value of our investment in Equity in net losses of unconsolidated entities, within our Condensed Consolidated Statement of Operations. We recognized \$2 million of net losses resulting from our share of the entity's operating losses during both the three and six months ended June 30, 2014, and \$2 million and \$3 million during the three and six months ended June 30, 2013, respectively. Our tax provision was reduced by \$5 million and \$8 million for the three and six months ended June 30, 2014, respectively, and by \$6 million and \$9 million for the three and six months ended June 30, 2013, respectively, primarily as a result of tax credits realized from this investment. See Note 13 for additional information related to this investment.

Investment in Low-Income Housing Properties In April 2010, we acquired a noncontrolling interest in a limited liability company established to invest in and manage low-income housing properties. The entity's low-income housing investments qualify for federal tax credits that are expected to be realized through 2020 in accordance with Section 42 of the Internal Revenue Code.

We account for our investment in this entity using the equity method of accounting, recognizing our share of the entity's results of operations and other reductions in the value of our investment in Equity in net losses of unconsolidated entities, within our Condensed Consolidated Statement of Operations. The value of our investment decreases as the tax credits are generated and utilized. During the three and six months ended June 30, 2014, we recognized \$6 million and \$12 million of losses relating to our equity investment in this entity, \$2 million and \$3 million of interest expense, and a reduction in our tax provision of \$9 million (including \$6 million of tax credits) and \$17 million (including \$11 million of tax credits), respectively. During the three and six months ended June 30, 2013, we recognized \$6 million and \$12 million of losses relating to our equity investment in this entity, \$2 million and \$3 million of interest expense, and a reduction in our tax provision of \$10 million (including \$7 million of tax credits) and \$17 million (including \$11 million of tax credits), respectively. See Note 13 for additional information related to this investment.

Bonus Depreciation The American Taxpayer Relief Act of 2012 was signed into law on January 2, 2013 and included an extension for one year of the bonus depreciation allowance. As a result, 50% of qualifying

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

capital expenditures on property placed in service before January 1, 2014 were depreciated immediately. The acceleration of deductions on 2013 qualifying capital expenditures resulting from the bonus depreciation provisions had no impact on our effective income tax rate for 2013 although it reduced our cash taxes.

6. Earnings Per Share

Basic and diluted earnings per share were computed using the following common share data (shares in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Number of common shares outstanding at end of period	465.9	468.1	465.9	468.1
Effect of using weighted average common shares outstanding		(0.2)	(0.3)	(1.3)
Weighted average basic common shares outstanding	465.9	467.9	465.6	466.8
Dilutive effect of equity-based compensation awards and other contingently issuable shares	2.1	1.5	1.9	1.3
Weighted average diluted common shares outstanding	468.0	469.4	467.5	468.1
Potentially issuable shares	13.8	13.6	13.8	13.6
Number of anti-dilutive potentially issuable shares excluded from diluted common shares outstanding	0.8	1.2	2.8	3.2

7. Commitments and Contingencies

Financial Instruments We have obtained letters of credit, surety bonds and insurance policies and have established trust funds and issued financial guarantees to support tax-exempt bonds, contracts, performance of landfill final capping, closure and post-closure requirements, environmental remediation, and other obligations. Letters of credit generally are supported by our \$2.25 billion revolving credit facility and other credit facilities established for that purpose. These facilities are discussed further in Note 3. Surety bonds and insurance policies are supported by (i) a diverse group of third-party surety and insurance companies; (ii) an entity in which we have a noncontrolling financial interest or (iii) wholly-owned insurance companies, the sole business of which is to issue surety bonds and/or insurance policies on our behalf.

Management does not expect that any claims against or draws on these instruments would have a material adverse effect on our consolidated financial statements. We have not experienced any unmanageable difficulty in obtaining the required financial assurance instruments for our current operations. In an ongoing effort to mitigate risks of future cost increases and reductions in available capacity, we continue to evaluate various options to access cost-effective sources of financial assurance.

Insurance We carry insurance coverage for protection of our assets and operations from certain risks including automobile liability, general liability, real and personal property, workers compensation, directors and officers liability, pollution legal liability and other coverages we believe are customary to the industry. Our exposure to loss for insurance claims is generally limited to the per incident deductible under the related insurance policy. Our exposure, however, could increase if our insurers are unable to meet their commitments on a timely basis.

We have retained a significant portion of the risks related to our automobile, general liability and workers compensation claims programs. General liability refers to the self-insured portion of specific third party claims made against us that may be covered under our commercial General Liability Insurance Policy. For our

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

self-insured retentions, the exposure for unpaid claims and associated expenses, including incurred but not reported losses, is based on an actuarial valuation and internal estimates. The accruals for these liabilities could be revised if future occurrences or loss development significantly differ from our assumptions. We do not expect the impact of any known casualty, property, environmental or other contingency to have a material impact on our financial condition, results of operations or cash flows.

Guarantees In the ordinary course of our business, WM and WM Holdings enter into guarantee agreements associated with their subsidiaries operations. Additionally, WM and WM Holdings have each guaranteed all of the senior debt of the other entity. No additional liabilities have been recorded for these intercompany guarantees because all of the underlying obligations are reflected in our Condensed Consolidated Balance Sheets.

We also have guaranteed the obligations and certain performance requirements of, and provided indemnification to, third parties in connection with both consolidated and unconsolidated entities. Guarantee agreements outstanding as of June 30, 2014 include (i) guarantees of unconsolidated entities' financial obligations maturing through 2020 for maximum future payments of \$9 million and (ii) agreements guaranteeing certain market value losses for approximately 825 homeowners' properties adjacent to or near 20 of our landfills. Our indemnification obligations generally arise from divestitures and provide that we will be responsible for liabilities associated with our operations for events that occurred prior to the sale of the operations. Additionally, under certain of our acquisition agreements, we have provided for additional consideration to be paid to the sellers if established financial targets or other market conditions are achieved post-closing and we have recognized liabilities for these contingent obligations based on an estimate of the fair value of these contingencies at the time of acquisition. We do not currently believe that contingent obligations to provide indemnification or pay additional post-closing consideration in connection with our divestitures or acquisitions will have a material adverse effect on the Company's business, financial condition, results of operations or cash flows.

Environmental Matters A significant portion of our operating costs and capital expenditures could be characterized as costs of environmental protection as we are subject to an array of laws and regulations relating to the protection of the environment. Under current laws and regulations, we may have liabilities for environmental damage caused by our operations, or for damage caused by conditions that existed before we acquired a site. In addition to remediation activity required by state or local authorities, such liabilities include potentially responsible party, or PRP, investigations. The costs associated with these liabilities can include settlements, certain legal and consultant fees, as well as incremental internal and external costs directly associated with site investigation and clean-up.

Estimating our degree of responsibility for remediation is inherently difficult. We recognize and accrue for an estimated remediation liability when we determine that such liability is both probable and reasonably estimable. Determining the method and ultimate cost of remediation requires that a number of assumptions be made. There can sometimes be a range of reasonable estimates of the costs associated with the likely site remediation alternatives identified in the investigation of the extent of environmental impact. In these cases, we use the amount within the range that constitutes our best estimate. If no amount within a range appears to be a better estimate than any other, we use the amount that is the low end of such range. If we used the high ends of such ranges, our aggregate potential liability would be approximately \$190 million higher than the \$223 million recorded in the Condensed Consolidated Financial Statements as of June 30, 2014. Our ultimate responsibility may differ materially from current estimates. It is possible that technological, regulatory or enforcement developments, the results of environmental studies, the inability to identify other PRPs, the inability of other PRPs to contribute to the settlements of such liabilities, or other factors could require us to record additional liabilities. Our ongoing review of our remediation liabilities, in light of relevant internal and external facts and circumstances, could result in revisions to our accruals that could cause upward or downward adjustments to income from operations. These adjustments could be material in any given period.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of June 30, 2014, we had been notified by the government that we are a PRP in connection with 75 locations listed on the EPA's Superfund National Priorities List, or NPL. Of the 75 sites at which claims have been made against us, 14 are sites we own. Each of the NPL sites we own was initially developed by others as a landfill disposal facility. At each of these facilities, we are working in conjunction with the government to evaluate or remediate identified site problems, and we have either agreed with other legally liable parties on an arrangement for sharing the costs of remediation or are working toward a cost-sharing agreement. We generally expect to receive any amounts due from other participating parties at or near the time that we make the remedial expenditures. The other 61 NPL sites, which we do not own, are at various procedural stages under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, known as CERCLA or Superfund.

The majority of these proceedings involving NPL sites that we do not own are based on allegations that certain of our subsidiaries (or their predecessors) transported hazardous substances to the sites, often prior to our acquisition of these subsidiaries. CERCLA generally provides for liability for those parties owning, operating, transporting to or disposing at the sites. Proceedings arising under Superfund typically involve numerous waste generators and other waste transportation and disposal companies and seek to allocate or recover costs associated with site investigation and remediation, which costs could be substantial and could have a material adverse effect on our consolidated financial statements. At some of the sites at which we have been identified as a PRP, our liability is well defined as a consequence of a governmental decision and an agreement among liable parties as to the share each will pay for implementing that remedy. At other sites, where no remedy has been selected or the liable parties have been unable to agree on an appropriate allocation, our future costs are uncertain.

Item 103 of the SEC's Regulation S-K requires disclosure of certain environmental matters when a governmental authority is a party to the proceedings, or such proceedings are known to be contemplated, unless we reasonably believe that the matter will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than \$100,000. The following matter is disclosed in accordance with that requirement. We do not currently believe that the eventual outcome of such matter could have a material adverse effect on the Company's business, financial condition, results of operations or cash flows.

On December 22, 2011, the Harris County Attorney in Houston, Texas filed suit against McGinnes Industrial Maintenance Corporation (MIMC), WM and Waste Management of Texas, Inc., et. al, seeking civil penalties and attorneys' fees for alleged violations of the Texas Water Code and the Texas Health and Safety Code. The County's Original Petition pending in the District Court of Harris County, Texas alleges the mismanagement of certain waste pits that were operated from 1965 to 1966 by MIMC. In 1998, a predecessor of WM acquired the stock of the parent entity of MIMC.

Additionally, on April 30, 2014, the United States District Court for the District of Hawaii issued an indictment against Waste Management of Hawaii, Inc. (WMHI) and two employees of WMHI. The United States Attorney's Office for the District of Hawaii had been investigating water discharges at the Waimanalo Gulch Sanitary Landfill, which WMHI operates for the city and county of Honolulu, in connection with three major rainstorms in December 2010 and January 2011. The indictment alleges violations of the federal Clean Water Act, conspiracy and making false statements to the Hawaii Department of Health and the EPA. We are vigorously defending against this action. Given the early stage of this case and significant issues in dispute, we cannot currently predict an outcome or estimate a range of loss, but we could potentially be subject to sanctions, including requirements to pay monetary penalties.

Litigation In October 2011 and January 2012, we were named as a defendant in a purported class action in the Circuit Court of Sarasota County, Florida and the Circuit Court of Lawrence County, Alabama, respectively. These cases primarily pertain to our fuel and environmental charges included on our invoices, generally alleging that such charges were not properly disclosed, were unfair and were contrary to the customer service contracts. The law firm that filed these lawsuits had filed a purported class action in 2008 against subsidiaries of WM in Bullock County, Alabama, making similar allegations. The prior Alabama suit was removed to federal court, where the federal court ultimately dismissed the plaintiffs' national class action claims.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The plaintiffs then elected to dismiss the case without prejudice. We will vigorously defend against these pending lawsuits. Given the inherent uncertainties of litigation, including the early stage of these cases, the unknown size of any potential class, and legal and factual issues in dispute, the outcome of these cases cannot be predicted and a range of loss cannot currently be estimated.

From time to time, we are also named as defendants in personal injury and property damage lawsuits, including purported class actions, on the basis of having owned, operated or transported waste to a disposal facility that is alleged to have contaminated the environment or, in certain cases, on the basis of having conducted environmental remediation activities at sites. Some of the lawsuits may seek to have us pay the costs of monitoring of allegedly affected sites and health care examinations of allegedly affected persons for a substantial period of time even where no actual damage is proven. While we believe we have meritorious defenses to these lawsuits, the ultimate resolution is often substantially uncertain due to the difficulty of determining the cause, extent and impact of alleged contamination (which may have occurred over a long period of time), the potential for successive groups of complainants to emerge, the diversity of the individual plaintiffs' circumstances, and the potential contribution or indemnification obligations of co-defendants or other third parties, among other factors. Additionally, we often enter into agreements with landowners imposing obligations on us to meet certain regulatory or contractual conditions upon site closure or upon termination of the agreements. Compliance with these agreements inherently involves subjective determinations and may result in disputes, including litigation.

As a large company with operations across the United States and Canada, we are subject to various proceedings, lawsuits, disputes and claims arising in the ordinary course of our business. Many of these actions raise complex factual and legal issues and are subject to uncertainties. Actions filed against us include commercial, customer, and employment-related claims, including purported class action lawsuits related to our sales and marketing practices and our customer service agreements and purported class actions involving federal and state wage and hour and other laws. The plaintiffs in some actions seek unspecified damages or injunctive relief, or both. These actions are in various procedural stages, and some are covered in part by insurance. We currently do not believe that the eventual outcome of any such actions could have a material adverse effect on the Company's business, financial condition, results of operations or cash flows.

WM's charter and bylaws provide that WM shall indemnify any person against all liabilities and expenses, and upon request shall advance expenses to any person, who is subject to a pending or threatened proceeding because such person is a director or officer of the Company. Such indemnification is required to the maximum extent permitted under Delaware law. Accordingly, the director or officer must execute an undertaking to reimburse the Company for any fees advanced if it is later determined that the director or officer was not entitled to have such fees advanced under Delaware law. Additionally, WM has entered into separate indemnification agreements with each of the members of its Board of Directors, its Chief Executive Officer and each of its executive vice presidents. The employment agreements between WM and its Chief Executive Officer and other executive and senior vice presidents contain a direct contractual obligation of the Company to provide indemnification to the executive. The Company may incur substantial expenses in connection with the fulfillment of its advancement of costs and indemnification obligations in connection with actions or proceedings that may be brought against its former or current officers, directors and employees.

Multiemployer Defined Benefit Pension Plans About 20% of our workforce is covered by collective bargaining agreements with various union locals across the United States and Canada. As a result of some of these agreements, certain of our subsidiaries are participating employers in a number of trustee-managed multiemployer defined benefit pension plans for the covered employees. In connection with our ongoing renegotiation of various collective bargaining agreements, we may discuss and negotiate for the complete or partial withdrawal from one or more of these pension plans. A complete or partial withdrawal from a multiemployer pension plan may also occur if employees covered by a collective bargaining agreement vote to decertify a union from continuing to represent them. Any other circumstance resulting in a decline in Company

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

contributions to a multiemployer defined benefit pension plan through a reduction in the labor force, whether through attrition over time or through a business event (such as the discontinuation or nonrenewal of a customer contract, the decertification of a union, or relocation, reduction or discontinuance of certain operations) may also trigger a complete or partial withdrawal from one or more of these pension plans.

One of the most significant multiemployer pension plans in which we have participated is the Central States, Southeast and Southwest Areas Pension Plan (Central States Pension Plan). The Central States Pension Plan is in critical status, as defined by the Pension Protection Act of 2006. Since 2008, certain of our affiliates have bargained to remove covered employees from the Central States Pension Plan, resulting in a series of withdrawals, and we have recognized charges to Operating expense associated with the withdrawal of certain bargaining units from the Central States Pension Plan and other underfunded multiemployer pension plans. In October 2011, employees at the last of our affiliates with active participants in the Central States Pension Plan voted to decertify the union that represented them, withdrawing themselves from the Central States Pension Plan. The Company believes there are no collective bargaining agreements remaining that require continuing contributions to this plan; however, this point is the subject of pending litigation with the trustees for the Central States Pension Plan.

We are still negotiating and litigating final resolutions of our withdrawal liability for certain previous withdrawals. Except in the case of our withdrawals from the Central States Pension Plan, we do not believe any additional liability above the charges we have already recognized for such previous withdrawals could be material to the Company's business, financial condition, liquidity, results of operations or cash flows. In addition to charges recognized in prior years, we currently estimate that we could incur up to approximately \$40 million in future charges based on demands from representatives of the Central States Pension Plan. As a result, we do not anticipate that the final resolution of the Central States Pension Plan matter could be material to the Company's business, financial condition or liquidity; however, such loss could have a material adverse effect on our cash flows and, to a lesser extent, our results of operations, for a particular reporting period. Similarly, we also do not believe that any future withdrawals, individually or in the aggregate, from the multiemployer pension plans to which we contribute, could have a material adverse effect on our business, financial condition or liquidity. However, such withdrawals could have a material adverse effect on our results of operations or cash flows for a particular reporting period, depending on the number of employees withdrawn in any future period and the financial condition of the multiemployer pension plan(s) at the time of such withdrawal(s).

Tax Matters We are currently in the examination phase of IRS audits for the tax years 2013 and 2014 and expect these audits to be completed within the next nine and 21 months, respectively. We participate in the IRS's Compliance Assurance Process, which means we work with the IRS throughout the year in order to resolve any material issues prior to the filing of our annual tax return. We are also currently undergoing audits by various state and local jurisdictions for tax years that date back to 2005, with the exception of affirmative claims in one jurisdiction that date back to 2000. We are not currently under audit in Canada and all tax years prior to 2009 are closed. In July 2011, we acquired Oakleaf Global Holdings (Oakleaf), which is subject to potential IRS examinations for the years 2010 and 2011. Pursuant to the terms of our acquisition of Oakleaf, we are entitled to indemnification for Oakleaf's pre-acquisition period tax liabilities. We maintain a liability for uncertain tax positions, the balance of which management believes is adequate. Results of audit assessments by taxing authorities are not currently expected to have a material adverse impact on our results of operations or cash flows.

8. Segment and Related Information

Our senior management evaluates, oversees and manages the financial performance of our Solid Waste subsidiaries through our 17 geographic Areas. These 17 Areas constitute our operating segments and none of the Areas individually meet the quantitative criteria to be a separate reportable segment. We have evaluated the aggregation criteria and concluded that, based on the similarities between our Areas, including the fact that our Solid Waste business is homogenous across geography with the same services offered across the Areas,

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

aggregation of our Areas is appropriate for purposes of presenting our reportable segments. Accordingly, we have aggregated our 17 Areas into three tiers that we believe have similar economic characteristics and future prospects based in large part on a review of the Areas' income from operations margins. The economic variations experienced by our Areas is attributable to a variety of factors, including regulatory environment of the Area; economic environment of the Area, including level of commercial and industrial activity; population density; service offering mix and disposal logistics, with no one factor being singularly determinative of an Area's current or future economic performance. As a result of our consideration of economic and other similarities, we have established the following three reportable segments for our Solid Waste business: Tier 1, which is comprised almost exclusively of Areas in the Southern United States; Tier 2, which is comprised predominately of Areas located in the Midwest and Northeast United States; and Tier 3, which encompasses all remaining Areas, including the Northwest and Mid-Atlantic regions of the United States and Eastern Canada. Our Wheelabrator business, which manages waste-to-energy facilities and independent power production plants, continues to be a separate reportable segment as it meets one of the quantitative disclosure thresholds. The operating segments not evaluated and overseen through the 17 Areas and Wheelabrator are presented herein as Other as these operating segments do not meet the criteria to be aggregated with other operating segments and do not meet the quantitative criteria to be separately reported.

Summarized financial information concerning our reportable segments is shown in the following table (in millions):

	Gross Operating Revenues	Intercompany Operating Revenues	Net Operating Revenues	Income from Operations
Three Months Ended:				
June 30, 2014				
Solid Waste:				
Tier 1	\$ 885	\$ (138)	\$ 747	\$ 223
Tier 2	1,650	(310)	1,340	335
Tier 3	911	(151)	760	149
Solid Waste	3,446	(599)	2,847	707
Wheelabrator	206	(25)	181	20
Other	551	(18)	533	(29)
	4,203	(642)	3,561	698
Corporate and Other				(166)
Total	\$ 4,203	\$ (642)	\$ 3,561	\$ 532
June 30, 2013				
Solid Waste:				
Tier 1	\$ 891	\$ (144)	\$ 747	\$ 221
Tier 2	1,641	(313)	1,328	325
Tier 3	871	(139)	732	131
Solid Waste	3,403	(596)	2,807	677
Wheelabrator	215	(27)	188	4
Other	554	(23)	531	(27)
	4,172	(646)	3,526	654
Corporate and Other				(144)
Total	\$ 4,172	\$ (646)	\$ 3,526	\$ 510

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Gross Operating Revenues	Intercompany Operating Revenues	Net Operating Revenues	Income from Operations
Six Months Ended:				
June 30, 2014				
Solid Waste:				
Tier 1	\$ 1,735	\$ (267)	\$ 1,468	\$ 441
Tier 2	3,152	(578)	2,574	619
Tier 3	1,758	(286)	1,472	273
Solid Waste	6,645	(1,131)	5,514	1,333
Wheelabrator	436	(52)	384	54
Other	1,098	(39)	1,059	(47)
	8,179	(1,222)	6,957	1,340
Corporate and Other				(339)
Total	\$ 8,179	\$ (1,222)	\$ 6,957	\$ 1,001
June 30, 2013				
Solid Waste:		&n		