Stericycle (SRCL) Earnings Report: Q2 2015 Conference Call Transcript

The following Stericycle conference call took place on July 23, 2015, 05:00 PM ET. This is a transcript of that earnings call:

Company Participants

- Sean McMillan; Stericycle, Inc.; VP Corporate Finance
- Charlie Alutto; Stericycle, Inc.; President, CEO
- Dan Ginnetti; Stericycle, Inc.; EVP, CFO
- Brent Arnold; Stericycle, Inc.; EVP, COO

Other Participants

- Ryan Daniels; William Blair & Company; Analyst
- David Manthey; Robert W. Baird & Company, Inc.; Analyst
- Al Kaschalk; Wedbush Securities; Analyst
- Brian Butler; Stifel Nicolaus; Analyst
- Scott Schneeberger; Oppenheimer & Co.; Analyst
- Jay Hanna; RBC Capital Markets; Analyst
- Sean Dodge; Jefferies LLC; Analyst
- Adam Baumgarten; Macquarie Research; Analyst
- Barbara Noverini; Morningstar; Analyst
- Isaac Ro; Goldman Sachs; Analyst
- Jason Rodgers; Great Lakes Review; Analyst
- Kevin Steinke; Barrington Research Associates, Inc.; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Good afternoon, my name is (Blair) and I will be your conference operator today. At this time, I would like to welcome everyone to Stericycle's second quarter earnings conference call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions). Thank you.

Sean McMillan, VP of Corporate Finance, you may begin your conference.

Sean McMillan (VP Corporate Finance):

Welcome to Stericycle's second quarter 2015 conference call. I will now read the Safe Harbor statement. This conference call may contain forward-looking statements that involve risks and uncertainties, some of which are beyond our control, for example general economic and market conditions.

Our actual results could differ significantly from the results described in the forward-looking statements. Factors that could cause such differences include changes in governmental regulation of the collection, transportation, treatment, and disposal of regulated waste; increases in transportation and other operating costs; the level of governmental enforcement of regulations governing regulated waste collection and treatment; our ability to execute our acquisition strategy and integrate acquired businesses; competition and demand for services in the regulated waste industry; political, economic, and currency risks related to our foreign operations; impairments of goodwill or other indefinite lived intangibles; exposure to environmental liabilities; and compliance with existing and future legal and regulatory requirements; as well as other factors described in our filings with the US Securities and Exchange Commission, including our most recently filed annual report on Form 10-K.

As a result, past financial performance should not be considered a reliable indicator of future performance and investors should not use historical trends to anticipate future results or trends. We make no commitment to disclose any subsequent revisions to forward-looking statements.

I will now turn it over to Charlie Alutto, CEO.

Charlie Alutto (President, CEO):

Thank you Sean. We are pleased to report our second quarter results. As expected, our business rebounded from the severe weather and seasonality we experienced in Q1. In addition, our recall and returns business had a very strong Q2, which included a record number of recalls handled in the quarter. All of our lines of business continued to perform well.

Joining me on today's call to review our second quarter results will be

Dan Ginnetti, CFO, and Brent Arnold, COO. I will now turn it over to Dan.

Dan Ginnetti (EVP, CFO):

Thank you Charlie. The results for the second quarter are as follows. Revenues were $715.7 million, up 11.7% from $640.8 million in Q2 2014. Internal growth, excluding returns and recall revenues, was up 7.7%. Domestic revenues were $518.2 million, of which $489.9 million was domestic regulated waste and client services, and $28.3 million was recalls and returns. Domestic internal growth, excluding recalls and returns revenues, was up 6.6%, consisting of SQ up 8% and LQ up 5%.

International revenues were $197.5 million and internal growth adjusted for unfavorable foreign exchange impact of $27.3 million was up 10%. Acquisitions contributed $58.9 million to growth in the quarter. Gross profit was $305.3 million, or 42.7% of revenues. SG&A expense, including amortization, was $135.7 million, or 19% of revenues. Net interest expense was $16.4 million. Net income attributable to Stericycle was $60.5 million or $0.70 per share on an as-reported basis and $1.14 adjusted for acquisition-related expenses and other adjusted items.

Now for the balance sheet. Our covenant debt to EBITDA ratio was 2.32 at the end of the quarter. The unused portion of the revolver at the end of the quarter was approximately $685 million. In the quarter, we repurchased 574,807 shares of common stock on the open market in an amount of $77.4 million. At the end of the quarter, we have authorization to purchase 4.1 million shares. Our CapEx was $25.4 million. Our DSO was 66 days. Year-to-date as reported cash from operations was $178.7 million. When adjusted for recall reimbursement and one-timers, cash from operations was $203.7 million.

I will now turn it over to Brent.

Brent Arnold (EVP, COO):

Thanks Dan. Worldwide, we continue to use our strong free cash flow to drive our growth through acquisitions. In the quarter, we closed eight acquisitions, six domestic and two international. The international acquisitions were in the Netherlands, which represents a new country for us, and Canada. Revenues from the eight acquisitions were $10.1 million in the quarter and annualized are approximately

$48.3 million. Our worldwide acquisition pool remains robust with well over $100 million in annualized revenues in multiple geographies and lines of business.

Last year, we expanded our recall business with the acquisition of a company specializing in the automotive industry. Our combined capabilities allow us to offer our unique recall solutions to the automotive sector. As a result, this contributed to a nice rebound in our recalls and returns business in the quarter.

On the international front, our success in selling multiple services resulted in strong organic growth in the quarter. We have now fully launched the Sharps Management service in both Brazil and Chile. Now that this solution is available in these markets, our customers can begin to enjoy the safety, compliance and sustainability benefits provided by this service offering.

Looking ahead, we continue to see expanding growth opportunities as Stericycle provides multiple services to help our customers improve their operations and achieve their goals. As we execute on this strategy, we can more than triple our customer revenues.

As you all know, last week, Stericycle announced the acquisition of Shred-It International. This exciting new platform provides us an excellent opportunity to continue our organic growth, acquisitions, and international expansion for many years to come. We would like to thank all of the Shred-It and Stericycle team members for all of their hard work and dedication they've demonstrated in making this acquisition possible.

I will now turn it over to Charlie.

Charlie Alutto (President, CEO):

Thank you Brent. I would now like to provide insight on our current guidance for 2015. Please keep in mind that these are forward-looking statements and our guidance does not include future acquisitions, divestitures, integration, acquisition related and other adjusting items.

For 2015, we believe analyst EPS estimates will be in the range of $4.64 to $4.69. We believe analyst revenue estimates for 2015 will be in the range of $2.84 billion to $2.88 billion, depending on assumptions for growth and impact from foreign exchange rates. We anticipate 2015 internal growth rates to be SQ 8% to 10%, LQ 5% to 8%, international 6% to 9%, and recall and returns revenues between $100 million to $115 million. We believe analysts will have estimates for 2015 free cash flow between $445 million to $456 million. 2015 CapEx is anticipated to be between $96 million to $100 million. We expect the full-year as reported tax rate to be in the range of 34% to 34.5%.

In closing, we are very pleased with our second quarter 2015 results and remain excited about our multiple growth opportunities for 2015 and beyond.

Thank you for your time today. We will now answer any questions. As a reminder, please limit yourself to one question and one follow-up question as necessary. (Blair), you can now open the Q&A line.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions). Ryan Daniels, William Blair.

Ryan Daniels (Analyst - William Blair & Company):

Thanks for taking my question. Maybe I'll start with one on the LQ growth. I know it's been 5% or at the low end of guidance for a couple of quarters. And I'm curious if we should be thinking of that as kind of a more sustainable growth rate throughout the year or if there's any initiatives you have on cross-selling or any new product launches that might skew that upwards a little bit as we start looking forward.

Charlie Alutto (President, CEO):

No, really no change to the guidance. Obviously overall I think growth engines performed well in line, both LQ and SQ. Keep in mind, though, as we continue to have a headwind on fuel surcharges, that does bring down the growth rate again this quarter roughly about 1% in both LQ and SQ. So it's really more of a factor of the headwind associated with fuel surcharges. We don't protect what fuel will do for the third and fourth quarters, so that's why the growth rates will remain the same for the rest of the year.

Ryan Daniels (Analyst - William Blair & Company):

Okay. That's helpful color. And then I guess Dan, my thought would be for you, just on gross margins, can you talk a little bit about the bridge you sometimes provide and then any color on the absolute level? I think it might be just a touch below what we were modeling. Thanks.

Dan Ginnetti (EVP, CFO):

Yes. I'll first give you the bridge to Q to Q. So we are very pleased with our third straight quarter-over-quarter increase in gross margin. Our increase over Q1 was 25 basis points. So, if you start with a Q1 gross margin of 42.4%, the returns on the recall business rebounded from the weather and seasonality, and that increased our margin by about 55 basis points. Those more than offset the unfavorable impact of about 15 basis points from acquisition, and about 30 basis points due to our benefits related to healthcare claims. Our core business improved by about 16 basis points from efficiencies and slightly lower fuel expense. So our Q2 gross margin was 42.6%.

And I think you asked to compare that to your expectation. And I think if we looked at the Street models, they were about 43.3%. And if you bridged it at acquisitions in the quarter were about a 30 basis point headwind. Customer mix, both in our recall and our international business, unfavorably impacted us slightly by about 16 basis points. And then, as I mentioned before, increases in our benefits related to healthcare claims were unfavorable by about 30 basis points. And then we saw some great improvements in the business of about 12 basis points over the expectations set in our prior guidance.

Ryan Daniels (Analyst - William Blair & Company):

Okay. Perfect. Very helpful. Thanks guys. I'll hop in the queue.

Operator:

David Manthey, Robert W. Baird.

David Manthey (Analyst - Robert W. Baird & Company, Inc.):

Thank you. On the change in the revenue outlook, I assume that's pretty standard acquisitions being offset by worsening FX. Can you put any numbers around the FX piece?

Dan Ginnetti (EVP, CFO):

Yes. I think you're looking at the bridge to our revenue and the change in guidance there. Our previous guidance was about 2.81 to 2.86. But we had a really nice quarter. We beat the Street estimate by about $7 million, so we raised it by about $7 million there. The acquisitions that we completed in Q2 will contribute about $24 million to the year. And then we slightly narrowed the recall guidance by raising up the bottom end, and then we lowered the top end each at about $5 million. So new guidance is $100 million to $115 million, and that gives you the $2.84 billion to $2.88 billion guidance.

Charlie Alutto (President, CEO):

So there really was no impact from foreign exchange on the guidance going from this point forward, David.

David Manthey (Analyst - Robert W. Baird & Company, Inc.):

Okay. And then second, it's I guess a little over a year since the acquisition of PSC with synergies and accretion up to your expectations. Could you talk at all about the year-to-year growth rate that you saw in the combined PSC-StrongPak LTE has waste business this quarter?

Brent Arnold (EVP, COO):

Yes. I think, as you said, we came across the one-year mark on the last quarter. The integrations went really well. From a growth rate perspective, they are really in line with the overall growth rates of the business. Certainly it's additional service that adds to both LQ and SQ, so it's a contributor to both the LQ growth, that 6% to 8% -- 8% to 10% growth and the LQ of the 5% to 8% growth. So it's growing nicely. It's a lot of SQ work that we get. We do have some project work that's included in there. And I think overall, though, the good news there is we saw a lot of seasonality and weather impacting that business in Q1, and it came back like we thought in Q2. So they performed really well in the quarter.

David Manthey (Analyst - Robert W. Baird & Company, Inc.):

Great, thank you.

Operator:

Al Kaschalk, Wedbush Securities.

Al Kaschalk (Analyst - Wedbush Securities):

Good afternoon everybody. Just a question here, more maybe philosophical. The recalls and returns business is actually increasingly becoming a small piece. I was wondering why, or perhaps are we going to see some additional disclosure or guidance on some of the other service lines, particularly what we just talked about on the industrial side business?

Charlie Alutto (President, CEO):

Yes, I think when you think about our other businesses, it gets hard to break those out because we share so many of the resources in that business. So we have operational synergies, back-office synergies that we use and that support that business, a lot of shared services. Where the recall business kind of from an operational perspective does operate independently, Al, and that's why that's always been reported out, one of the reasons why that's been reported out separately. So right now there is no plan to report out other segments of the business. We do get some recall outside of the US but it's not material and those numbers get reported into the specific countries and our international results.

Al Kaschalk (Analyst - Wedbush Securities):

Okay. My follow-up then, the automotive has actually been a good market. I noticed that the number of recalls you had was a record number, but the dollar level still is pretty low. So how should we be thinking about your direction on this particular segment, and then both domestically or North America. And then obviously there's a fairly growing market opportunity in places outside of North America.

Charlie Alutto (President, CEO):

Yes, I think the revenue number actually was really good. It was $28.3 million for the quarter. That's the highest it's been in the previous -- for the six quarters. So certainly that is a good number, a nice rebound over Q1, which was at $20 million.

As far as the auto sector, as Brent mention in his comments, we did a small acquisition in 2014. That gave us exposure to that sector, matching and leveraging those relationships with our call center capabilities. It obviously provides our customers now with a unique solution and we believe the sector is an opportunity for both our customers and Stericycle .

If you think about our capabilities, we used to serve -- we were serving the pharmaceutical industry, the medical device industry, consumer products and the food and beverage industry. We really weren't exposed to the automotive sector. Now, by having that exposure to that sector, if you think about a recall event now in the US or really for that matter in any part of the world, we have that experience and the exposure now to all of those sectors. It really rounded out our service offering and the team put up a great number in Q2 at the $28.3 million level, which was a nice improvement over Q1, and like I said, the biggest number we put up in that space since beyond 2014 -- before 2014.

Al Kaschalk (Analyst - Wedbush Securities):

Thank you.

Operator:

Michael Hoffman, Stifel.

Brian Butler (Analyst - Stifel Nicolaus):

This is Brian Butler in for Michael. I just wanted to ask one on the working capital side. Can you talk about that in the quarter? It looked like DSOs were up a little bit and working capital was fairly high. And how to think about that in the second half and where you end the year.

Dan Ginnetti (EVP, CFO):

Yes. As we mentioned before, we had an incredibly strong revenue period. In fact, our growth quarter-over-quarter was up $52.3 million. And so when you look at our DSO, about two days of it went up, which was attributed to the growth in the quarter that really came in the latter half of the quarter and in areas that do have slightly higher DSO. We had a one-day impact, which is really a timing of adding acquisition to the balance sheet.

They don't always coincide with the new revenue coming in. But we remain focused on this area. We really believe it will come back by the end of the year. And we maintained our free cash flow guidance as a result of that. So I think what you're going to see is the working capital that's been a strength of this company, no change to the guidance, and we will continue to put it to work whether it be acquisition share repos or maintaining our debt levels.

Brian Butler (Analyst - Stifel Nicolaus):

Okay. And then a quick follow-up on growth, just domestically on the SQ. Can you give any color on the breakdown kind of between what is the incremental services you are selling to current customers versus kind of new customers?

Charlie Alutto (President, CEO):

Sure. This is Charlie. SQ growth, as we have stated in our guidance, is 8% to 10% growth. There really hasn't been a significant change to the contribution to those growth rates. Again, about 40% to 50% of that organic growth is related to price and volume, and then 50% to 60% of that, so the remainder of that growth, is in the additional services, whether that's Steri-Safe hazardous-waste disposal, Communications Solutions, they all contribute to the SQ growth.

Brian Butler (Analyst - Stifel Nicolaus):

Great. Thank you.

Operator:

Scott Schneeberger, Oppenheimer.

Scott Schneeberger (Analyst - Oppenheimer & Co.):

Thanks. Good afternoon. Going back to RMS, could you speak a little bit more about the auto acquisition and what actually are the -- is the auto activity recall activity you're seeing? And then is that passing through and active here at the end of the quarter and end of July? And beyond that, what else in RMS is -- is it still active? Is the trend strong into the third quarter? Thanks.

Charlie Alutto (President, CEO):

Sure. This was a small acquisition in 2014. They had some capabilities in items related to recalls in the auto. They did not have a call center capability. So really when you say where are we taking it now, we are taking it more -- as you know, Scott, we've got great capabilities in call center not only in our communication solutions, but also in our recall and returns division. So it's taking that and leveraging those relationships over those capabilities that we have. It's certainly contributed to the growth in Q2. I wouldn't say that we had other contributors as well. We had a record number of recalls for the quarter. We are building momentum in the auto sector, and we do anticipate that that momentum will continue for the remainder of the year. Obviously, we brought up the low end of the guidance. We are still missing some of those multiple blockbuster acquisitions and that's why we brought the top end down a bit. But we think the momentum, especially in the auto sector, will continue for the rest of 2015.

Scott Schneeberger (Analyst - Oppenheimer & Co.):

Thanks. A couple more. Still on the acquisition topic, you had eight total, six US, two international, Dutch, Canada. Could you talk about what they were, LQ, SQ, other, in US and international please?

Dan Ginnetti (EVP, CFO):

Yes. As you mentioned, there were six domestic, two international. There were six in the compliance services, two in ComSol. The split of the rest, SQ LQ, is about 35% SQ, 65% LQ.

Scott Schneeberger (Analyst - Oppenheimer & Co.):

The comps saw both in the US, I assume?

Dan Ginnetti (EVP, CFO):

No. There was one in US, one in international.

Scott Schneeberger (Analyst - Oppenheimer & Co.):

Okay, thanks. And lastly, if I could sneak one in on tax rate, it was a little lower than we had anticipated in the quarter. The guide, 34% to 34.5%. Just I guess we can back into what second half looks like now, but just thoughts on bumping this in tax rate.

Dan Ginnetti (EVP, CFO):

Yes. It's a great question there, Scott. The guided tax rate for the quarter was in fact 35.5% to 36%. And while you did see an as-reported tax rate of 33.64%, this was primarily a result of the large settlement that we had discussed and done an 8-K earlier on in the quarter. When you adjust for this settlement, the tax rate in the quarter is actually 35.5%, right in line with guidance. So as a result, we got no EPS benefit on our adjusted EPS that we reported. Going forward, in Q3, I think still the 35.5% to 36% rate is a good rate to hold. And based off the benefit that we saw in Q1, that would give you an annual tax rate of about 34% to 34.5%.

Operator:

Gary Bisbee, RBC Capital Markets.

Jay Hanna (Analyst - RBC Capital Markets):

This is Jay Hanna in for Gary. What do you guys expect to be the real driver to increase your cash EPS from 2016 to 2018? Is it going to include debt reduction and lock on M&A?

Dan Ginnetti (EVP, CFO):

Yes. I'm glad you brought up the cash EPS. And obviously we talked about that on the PSC -- or on the Shred-It call that we had and the acquisition coming up. And really by eliminating that deal related amortization, we think it better represents our operating performance. Really all that we are doing is we are taking out the amortization in that. And so the growth in our EPS really goes back to the core fundamentals of our business, continuing to be able to have strong revenue growth, sell across multiple lines of service, execute on synergies and efficiencies. And that will really drive the accretion you're looking for.

I want to make sure that's the question that you were asking, because we talk about cash EPS. Some people believe it's -- our cash flow per share, and that's not the cash EPS that we are referring to. More often, you are seeing cash EPS is nothing different than the adjusted EPS that we report, and then removing the deal related amortization.

Jay Hanna (Analyst - RBC Capital Markets):

Right, no, we understand that. How do you feel about synergies driving that going forward as well?

Brent Arnold (EVP, COO):

This is Brent. There's really two categories of synergies that we are looking at. First, there's the Cintas synergies, as Shred-It acquired Cintas back in 2014. They're doing really well with regard to achieving those. Through Q1, they are 29% of the way home. Keep in mind too they had two different operating systems and whenever you have that, it makes it hard to accomplish certain synergies until you get on the same platform. I'm happy to report that all of their locations now are on SAP. So things like route density, moving customers from on-site shredding to off-site shredding to their facilities, which are actually under capacity which will be a nice pickup for us as we use that available capacity, all those things will contribute to growing our overall EBITDA.

Jay Hanna (Analyst - RBC Capital Markets):

Okay. Thank you. One more quick question. How much of the revenue loss last quarter from bad weather did you guys get back in Q2?

Charlie Alutto (President, CEO):

Yes, I would say we got back everything. We talked about weather and then weather-related seasonality, again, a new phenomenon with us with the PSC acquisition. We feel like we've made up both the weather and the seasonality in this quarter.

Jay Hanna (Analyst - RBC Capital Markets):

Thank you.

Operator:

Sean Dodge, Jefferies.

Sean Dodge (Analyst - Jefferies LLC):

Good afternoon. Thanks. The returns and recall business, can you give us a sense of the size of the fixed cost space there? And how quickly can you flex that up and down as you go through periods where you have a few events and then quarters like this where you have many?

Charlie Alutto (President, CEO):

I think we talked about it before, the fixed costs. I think the team is done a really good job. The fixed cost is more involved in the facilities, the call center facility that we have, also the warehouse space that we have when we take product back. You know, when we start to get to the low $20s million or high teens [million], it's hard to make up that fixed cost. So you saw that was a driver of margins down in Q3, Q4 and a little bit in Q1 of this year.

Then once we get past those low $20s millions that is in revenue, those fixed costs now are coming in, and obviously earning additional margins on that. So when you talk about a lot of other costs going in there, the variable costs, it's more labor. It's the retrievable labor that we have with independent contractors that go out and grab the product or the nonperforming assets. If the call center agents, that we have a large influx of call center work. But I would tell you that high -- when you get below the low $20s million, it's tough to cover that, those fixed costs. And then the customer mix obviously would also impact the gross margin as well.

Sean Dodge (Analyst - Jefferies LLC):

Okay. And then your international segment is comprised of multiple countries that are all in various stages of being built out. What is roughly the difference in margins between the most mature markets and some of your newer ones? And are any of the margins in your foreign markets approaching that of the United States?

Brent Arnold (EVP, COO):

This is Brent. Overall, from an international margin perspective, as you know, it's greater LQ than SQ. So the good news is is their LQ margins are higher in international than our share domestically, but overall that provides a challenge for them. We are always working to improve that SQ-LQ mix, and one of the main ways we do that is through our clinical services.

This quarter, we actually had a really good clinical services performance. That helps bring more margin to our business and helps to grow that. And we are always focused on different types of acquisitions, new services that will continue to drive our margin. Another good example of that would be our dosimetry business that we got in in Spain and Portugal. So again, they may be a little lower than we'd like, but I think we are focused on raising them and a lot of that will come from SQ business.

Operator:

Adam Baumgarten, Macquarie.

Adam Baumgarten (Analyst - Macquarie Research):

Can you just give an update on the ComSol platform and how that's going? And should we expect, as that rolls out, you guys accelerate acquisitions on that front?

Charlie Alutto (President, CEO):

Yes, it's Charlie. Steri-Connect is our new operating platform for our communications solution business. It's on track and will be completed at the end of the year. We now have production clients on Steri-Connect today and we are adding new clients every week. We are also ramping up to have all of our call answering services clients on the new platform by the end of 2016.

We've said this previously, this new platform obviously provides better quality calls and will also come with operational efficiencies that are not available with the current legacy systems we are operating. I think the team -- kudos to the team of doing a really great job. They're really focused on -- they were focused on the development. They're now focused on the deployment. And we are really excited about that platform. And that will help us obviously integrate faster. So once we have the platform set, we have all the customers on it, that really gives us the confidence from a sales perspective, but also from an acquisition and integration standpoint as well.

Adam Baumgarten (Analyst - Macquarie Research):

Great. Thanks.

Operator:

Barbara Noverini, Morningstar .

Barbara Noverini (Analyst - Morningstar):

Good afternoon everybody. Can you comment on whether there are any operational synergies between recall and returns and PSC Environmental? Specifically I'm thinking about retail pharmacy, perhaps pharmaceutical returns. Have those entities been able to share resources or access or are their operations still really mutually exclusive?

Charlie Alutto (President, CEO):

Actually, that's how we got into the business. We were in recalls and returns, as you know, since 2005. And what really spearheaded us into it is that team had done an acquisition of a company called Strong Environmental. It gave us additional capabilities for some hazardous waste offerings, also gave us some capabilities on the LQ side. But they had a business called StrongPak.

We had the relationships. We meaning recalls and returns had the relationships with retailers and that's really the team that built that business up for us, which led us to the PSC acquisition. We had done a really good job on the sales and marketing side of that business but we were lacking in the operational infrastructure. And as you know, one of the main attractions of Stericycle to PSC was that operational infrastructure that they brought to us. So there were synergies there. There were opportunities to leverage relationships, and we continue to leverage those types of relationships really across all of our businesses today.

Barbara Noverini (Analyst - Morningstar):

Got it. So if that's the case, why do you actually break out recall and returns? Why is that not just assumed one into the other?

Charlie Alutto (President, CEO):

Because operationally they are separate. We do leverage the relationships there, but we do run that separately. There's not a lot of operational synergy. When you go and pick up a retail pharmacy for whether it be medical waste or whether it's recurring hazardous waste or former StrongPak which is now part of environmental solutions, we leverage that operational infrastructure. And recall tends to be a lumpy and uneven business. That's one of the good reasons why we've always kind of called it out from a shareholder perspective, so they get clarity over that number. But we don't share an operational infrastructure. They are two separate businesses.

Barbara Noverini (Analyst - Morningstar):

Okay, thanks a lot.

Operator:

Isaac Ro, Goldman Sachs .

Isaac Ro (Analyst - Goldman Sachs):

Good afternoon. I just wanted to start off with one more on recall and returns. I'm just trying to figure out if there would be any sort of follow through from the current upside this quarter that you got into 3Q and 4Q. I kind of looked at sort of the range by which you raise your guidance for that business versus kind where your numbers came out on total topline versus consensus. And it seemed like there might be a couple of million dollars of wiggle room. So, I'm just trying to figure out what to assume for 3Q and if there's anything in 4Q as well.

Charlie Alutto (President, CEO):

Yes. It's always a lumpy business. The team will tell you they get frustrated because it's really hard to predict quarter to quarter. We do think, though, we feel good about the second half of the year. I think it's more related to the auto sector where we continue to gain momentum, and that's why we feel good about the second half of the year, and really the record number of events in Q2.

We've always said some of the things we look at as signs of are we on the right track. We continue to have record number of events. Some of them are small, but we know that the large blockbuster events will eventually come, and if we continue to gain market share and get people to rather than do it themselves but to outsource it to Stericycle , that we really have a good chance to build momentum in that space. So it's, again, very tough to predict, but we do feel good about the second half of the year.

Isaac Ro (Analyst - Goldman Sachs):

Got it. So, it sounds like it's sort of the lumpiness, not any one contract or a couple of big ones there (multiple speakers)

Charlie Alutto (President, CEO):

No, very lumpy, not related to one contract.

Isaac Ro (Analyst - Goldman Sachs):

Okay, helpful. Then just one follow-up on the tax rate. It looked like your guidance came down a little bit for the year. I wasn't sure why that was and if you could put any color on that. Thank you.

Dan Ginnetti (EVP, CFO):

Actually, the tax rate guidance is, for Q3, it remains the same. The annual number is really an impact of the lower tax rate that we experienced in Q1 which was a result of some consolidation of entities and some one-time tax benefits. So the tax rate, as I mentioned, this quarter, when you normalize it for the litigation settlement, came in exactly where we estimated it to be. And we think Q3 we will be about the same. And the reason also it is slightly higher has to do with the foreign exchange impact, and some of the lower revenues internationally, which is our lower tax rate countries. And so that's why we've kind of pushed up both in Q2 and then subsequently in Q3 and into the rest of the year at the higher end of 35.5% to 36%.

Operator:

Jason Rodgers, Great Lakes Review.

Jason Rodgers (Analyst - Great Lakes Review):

Good afternoon. I apologize if I missed this, but did you give the total number of accounts, large Q and small Q?

Brent Arnold (EVP, COO):

This is Brent. The total overall accounts are 610,000. And from an SQ perspective, 588,000 were SQ; the remainder were large.

Jason Rodgers (Analyst - Great Lakes Review):

And you talked about Shred-It being on an SAP system. It Stericycle on the same system, and what's the process of combining the two?

Charlie Alutto (President, CEO):

Right now, Stericycle is not on that operating system. It is too early to tell what system we ultimately go to to run the combined business. Obviously, we have a lot on the line with the Cintas /Shred-It synergy, so we want the team to focus on that. No decision has been made on the ultimate system. We're going to learn over the next coming months more about that SAP system. As Brent kind of said in his comments, that was critical for a lot of those synergies, was to get the former Cintas business on the Shred-It SAP platform.

Jason Rodgers (Analyst - Great Lakes Review):

Thank you.

Operator:

Kevin Steinke, Barrington Research.

Kevin Steinke (Analyst - Barrington Research Associates, Inc.):

Good afternoon. I just want to make sure I understood the EPS guidance bridge here, $4.64 to $4.69, in line with previous guidance. And the revenue guidance came up a little bit. Just if you could give that bridge.

Dan Ginnetti (EVP, CFO):

Yes, sure, happy to do that. So the prior guidance, as you know, was $4.64 to $4.69. We had $0.03 of improvements that we expect to happen in the back half of the year in EPS from acquisitions, and the interest that you will see, the reduced rate for the rest of the year. But those will be offset by some of the increases that we talked about in healthcare benefits. And then remember we did lower the top-end guidance on recall. So as a result, the guidance remains unchanged at $4.64 to $4.69.

And just for those of you that are kind of anticipating the change to a cash EPS, the equivalent will be $4.90 to $4.95. And I think as you're kind of building this out, ramping up from $1.18 in Q3 and then so on out of your models is probably the best approach.

Kevin Steinke (Analyst - Barrington Research Associates, Inc.):

Okay, great. Thank you. And then when you announced the Shred-It acquisition, you talked about $52 million of remaining synergies from the combination primarily with the Cintas business. Now that they're both on the same SAP platform, do you see them working down a meaningful chunk of that $52 million of synergies within the next three to four months before you close the deal? And then post-close, what's the time frame for getting whatever is remaining?

Dan Ginnetti (EVP, CFO):

Overall, our plan is to have, by the end of this year, we hope to have 50% of the synergies realized of that remaining $52 million. And then over the course of the next year, we hope to get all the projects completed to get to 100%. But realize some of that will bleed into 2017, so while the projects will wrap up in 2016, the financial impact will bleed over into 2017.

Charlie Alutto (President, CEO):

Yes. Just to clarify a little bit, the total synergy between Cintas and Shred-It was in the low $70s million, $72 million, and by the end of the year, it will be 50% of that $72 million, and the remainder will be realized into 2016.

Dan Ginnetti (EVP, CFO):

Just for clarity, the total overall was $73 million. They had $21 million realized already. The $52 million is remaining through 2017.

Operator:

There are no further audio questions at this time. I will turn the call back over to the presenters.

Charlie Alutto (President, CEO):

Great. Thanks, (Blair). We appreciate everyone taking time to participate on today's call and the continued support of our longtime shareholders. Enjoy the rest of the summer. We will see everybody on the road later this quarter. Have a great evening. Thanks everybody.

Operator:

This concludes today's conference call. You may now disconnect.