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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 March 31, 2004

or

o	**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	**73-1309529**
(State or other jurisdiction of incorporation or organization)	*(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 o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934.) Yes ☑ No o

The number of shares of Common Stock, $0.01 par value, of the registrant outstanding at April 26, 2004 was 580,529,906 (excluding treasury shares of 49,752,555).

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PART I.

Item 1. ***Financial Statements.***

WASTE MANAGEMENT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Millions, Except Share and Par Value Amounts)

ASSETS

	March 31, 2004	December 31, 2003
	(Unaudited)	
Current assets:		
Cash and cash equivalents	$ 689	$ 135
Accounts receivable, net of allowance for doubtful accounts of $58	1,454	1,494
Notes and other receivables	300	317
Parts and supplies	79	82
Deferred income taxes	419	421
Prepaid expenses and other assets	195	139
Total current assets	3,136	2,588
Property and equipment, net of accumulated depreciation and amortization of $9,804 and $9,553, respectively	11,287	11,411
Goodwill	5,299	5,266
Other intangible assets, net	160	156
Other assets	1,319	1,235
Total assets	$21,201	$20,656

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 31, 2004	December 31, 2003
Current liabilities:		
Accounts payable	$ 590	$ 639
Accrued liabilities	1,711	1,750
Deferred revenues	427	429
Current portion of long-term debt	575	514
Total current liabilities	3,303	3,332
Long-term debt, less current portion	8,445	7,997
Deferred income taxes	1,682	1,663
Landfill and environmental remediation liabilities	1,147	1,124
Other liabilities	684	727
Total liabilities	15,261	14,843
Minority interest in subsidiaries and variable interest entities	265	250
Commitments and contingencies		
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	4,493	4,501
Retained earnings	2,540	2,497
Accumulated other comprehensive loss	(65)	(53)
Restricted stock unearned compensation	(4)	—
Treasury stock at cost, 50,536,575 and 54,164,336 shares, respectively	(1,295)	(1,388)
Total stockholders' equity	5,675	5,563
Total liabilities and stockholders' equity	$21,201	$20,656

See notes to condensed consolidated financial statements.

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WASTE MANAGEMENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Millions, Except Per Share Amounts)
(Unaudited)

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Operating revenues	$2,896	$2,732
Costs and expenses:		
Operating (exclusive of depreciation and amortization shown below)	1,920	1,809
Selling, general and administrative	316	323
Depreciation and amortization	325	302
Restructuring	—	20
Asset impairments and unusual items	(9)	(1)
	2,552	2,453
Income from operations	344	279
Other income (expense):		
Interest expense	(113)	(109)
Interest income	3	2
Equity in earnings (losses) of unconsolidated entities	(19)	1
Minority interest	(7)	(1)
Other, net	(2)	3
	(138)	(104)
Income before cumulative effect of changes in accounting principles and income taxes	206	175
Provision for income taxes	62	68
Income before cumulative effect of changes in accounting principles	144	107
Cumulative effect of changes in accounting principles, net of income tax expense of $5 for 2004 and income tax benefit of $31 for 2003	8	(46)
Net income	$ 152	$ 61
Basic earnings per common share:		
Income before cumulative effect of changes in accounting principles	$ 0.25	$ 0.18
Cumulative effect of changes in accounting principles	0.01	(0.08)
Net income	$ 0.26	$ 0.10
Diluted earnings per common share:		
Income before cumulative effect of changes in accounting principles	$ 0.25	$ 0.18
Cumulative effect of changes in accounting principles	0.01	(0.08)
Net income	$ 0.26	$ 0.10
Cash dividends per common share	$ 0.19	$ —

See notes to condensed consolidated financial statements.

WASTE MANAGEMENT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Millions)
(Unaudited)

	Three Months Ended March 31,	
	2004	**2003**
Cash flows from operating activities:		
Net income	$ 152	$ 61
Adjustments to reconcile net income to net cash provided by operating activities:		
Cumulative effect of changes in accounting principles	(8)	46
Provision for bad debts	13	12
Depreciation and amortization	325	302
Deferred income tax provision	39	43
Minority interest	7	1
Equity in losses (earnings) of unconsolidated entities, net of distributions	15	(1)
Net gain on disposal of assets	(6)	(2)
Effect of asset impairments and unusual items	(9)	(1)
Change in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Receivables	51	45
Prepaid expenses and other current assets	(30)	(38)
Other assets	(6)	31
Accounts payable and accrued liabilities	(78)	(86)
Deferred revenues and other liabilities	5	16
Net cash provided by operating activities	470	429
Cash flows from investing activities:		
Acquisitions of businesses, net of cash acquired	(73)	(85)
Capital expenditures	(181)	(212)
Proceeds from divestitures of businesses, net of cash divested, and other sales of assets	22	16
Net receipts from restricted funds	78	54
Net cash used in investing activities	(154)	(227)
Cash flows from financing activities:		
New borrowings	347	6
Debt repayments	(9)	(21)
Minority interest distributions paid	(14)	—
Common stock repurchases	(24)	(68)
Cash dividends	(109)	—
Exercise of common stock options and warrants	48	2
Other	(1)	(4)
Net cash provided by (used in) financing activities	238	(85)
Effect of exchange rate changes on cash and cash equivalents	—	—
Increase in cash and cash equivalents	554	117
Cash and cash equivalents at beginning of period	135	264
Cash and cash equivalents at end of period	$ 689	$ 381

See notes to condensed consolidated financial statements.

WASTE MANAGEMENT, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(In Millions, Except Shares in Thousands)
(Unaudited)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Restricted Stock Unearned Compensation	Treasury Stock	
	Shares	Amount					Shares	Amount
Balance, December 31, 2003	630,282	$ 6	$4,501	$2,497	$(53)	$—	(54,164)	$(1,388)
Net income	—	—	—	152	—	—	—	—
Cash dividends	—	—	—	(109)	—	—	—	—
Common stock issued upon exercise of stock options and warrants and grants of restricted stock, including tax benefit of $13	—	—	(8)	—	—	(4)	3,599	92
Unrealized loss resulting from changes in fair values of derivative instruments, net of tax benefit of $5	—	—	—	—	(7)	—	—	—
Realized losses on derivative instruments reclassified into earnings, net of tax benefit of $2	—	—	—	—	2	—	—	—
Unrealized gain on marketable securities, net of taxes of $1	—	—	—	—	2	—	—	—
Translation adjustment of foreign currency statements	—	—	—	—	(9)	—	—	—
Other	—	—	—	—	—	—	28	1
Balance, March 31, 2004	630,282	$ 6	$4,493	$2,540	$(65)	$ (4)	(50,537)	$(1,295)

See notes to condensed consolidated financial statements.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The condensed financial statements presented herein represent the consolidation of Waste Management, Inc., a Delaware corporation, its majority-owned subsidiaries and entities required to be consolidated pursuant to the Financial Accounting Standards Board ("FASB") Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46") (See Note 9). Waste Management, Inc. is a holding company that conducts all of its operations through its subsidiaries. When the terms "the Company," "we," "us" or "our" are used in this document, those terms refer to Waste Management, Inc. and all of its consolidated subsidiaries. When we use the term "WMI," we are referring only to the parent holding company, and are not including any of the subsidiaries.

The condensed consolidated financial statements as of and for the three months ended March 31, 2004 are unaudited. In the opinion of management, these financial statements include all adjustments, which, except as described elsewhere herein, are of a normal recurring nature, necessary for a fair presentation of the financial position, results of operations, and cash flows 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, 2003.

In preparing our financial statements, we make several estimates and assumptions that affect the accounting for and recognition of assets, liabilities, stockholders' equity, revenues and expenses. We must make these estimates and assumptions because certain of the information that we use is dependent on future events, cannot be calculated with a high degree of precision from data available or simply cannot be readily calculated based on generally accepted methodologies. In some cases, these estimates are particularly difficult to determine and we must exercise significant judgment. Actual results could differ materially from the estimates and assumptions that we use in the preparation of our financial statements.

Accounting change — The FASB's December 2003 revision to FIN 46 deferred until March 31, 2004 our application of the Interpretation to non-special purpose type variable interest entities created on or before January 31, 2003. Our application of FIN 46 to this type of entity resulted in the consolidation of certain trusts established to support the performance of closure, post-closure and environmental remediation activities. On March 31, 2004, we recorded an increase in our net assets and a credit to cumulative effect of changes in accounting principles of approximately $8 million, net of taxes, to consolidate these variable interest entities. The consolidation of these trusts has not had, nor is it expected to have, a material effect on our financial position, results of operations or cash flows. The impact of our implementation of FIN 46 is discussed further in Note 9.

Reclassifications — As a result of internal review processes, we identified certain mandatory fees and taxes that have historically been treated as pass through costs that actually represent direct obligations of the Company. Effective January 1, 2004, we began recording all mandatory fees and taxes that create direct obligations for us as operating expenses and recording revenue when the fees and taxes are billed to our customers. We have conformed the prior year's presentation of our revenues and expenses with the current year's presentation by increasing both our revenue and our operating expenses for the quarter ended March 31, 2003 by approximately $16 million.

Certain reclassifications have also been made in the 2003 consolidated statement of cash flows in order to conform to the current period presentation.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

2. Landfill and Environmental Remediation Liabilities

Landfill

We have material financial commitments for final capping, closure and post-closure obligations with respect to our landfills. The activities for which these asset retirement obligations were established include the following:

- *Final capping* — Involves the installation of flexible membrane and geosynthetic clay liners, drainage equipment and compacted soil layers and topsoil over areas of a landfill where total airspace capacity has been consumed. Final capping asset retirement obligations are recorded on a units-of-consumption basis as airspace is consumed within each discrete capping event with a corresponding increase in the landfill asset, until all airspace related to each discrete capping event has been consumed.

- *Closure* — Includes the construction of the final portion of methane gas collection systems (when required), demobilization and routine maintenance costs. These are costs incurred after the site ceases to accept waste, but before the landfill is certified as closed by the applicable state regulatory agency. These costs are accrued as an asset retirement obligation as airspace is consumed over the life of the landfill with a corresponding increase in the landfill asset.

- *Post-closure* — Once a landfill is certified closed by the applicable state regulatory agency, we are required to maintain and monitor the site for a period that is generally 30 years. These maintenance and monitoring costs are accrued as an asset retirement obligation as airspace is consumed over the life of the landfill with a corresponding increase in the landfill asset.

We develop our estimates of these obligations using input from our operations personnel, engineers and accountants. Our estimates are based on our interpretation of legal and regulatory requirements and are intended to approximate fair value under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 143, *Accounting for Asset Retirement Obligations.* An estimate of fair value under SFAS No. 143 should include the premium that a third party would receive for bearing the uncertainty in cash outflows. However, when using discounted cash flow techniques, reliable estimates of market premiums are not available because there is no market for selling the responsibility for final capping, closure and post-closure obligations independent of selling the landfill in its entirety. Accordingly, we do not believe that it is possible to develop a methodology to estimate reliably a market risk premium and therefore no market risk premium is included in our determination of expected cash outflows for landfill asset retirement obligations. The specific methods used to calculate the fair value for final capping, closure and post-closure and the method of accruing for these balances are explained in detail in our Annual Report on Form 10-K for the year ended December 31, 2003.

We inflate estimated final capping, closure and post-closure costs to the expected time of payment using an inflation rate of 2.5% and discount those expected future costs back to present value using a credit-adjusted, risk-free discount rate, which was 6.25% for liabilities incurred in 2004. Our credit-adjusted, risk-free discount rate is based on the risk-free interest rate on obligations of similar maturity adjusted for our own credit rating. Changes in our credit-adjusted, risk-free discount rate do not change recorded liabilities, but subsequently recognized obligations are measured using the revised credit-adjusted, risk-free discount rate. We determine the inflation rate and our credit-adjusted, risk-free discount rate on an annual basis unless interim changes would significantly impact our results of operations.

Environmental Remediation

We routinely review and evaluate sites that require remediation and determine our estimated cost for the likely remedy based on several estimates and assumptions. These estimates are sometimes a range of "reasonably possible" outcomes. "Reasonably possible" outcomes are those outcomes that are considered more than remote and less than likely. In cases where our estimates are a range, we use the amount within the range that constitutes our best estimate. If no amount within the range appears to be a better estimate than any other, we use the low end of each range in accordance with SFAS No. 5 and its interpretations. If we used the high ends of such ranges, our aggregate potential liability would be approximately $175 million higher on a discounted basis than the estimate recorded in our condensed consolidated financial statements as of March 31, 2004.

As of March 31, 2004, we had been notified that we are a potentially responsible party in connection with 71 locations listed on the NPL, which is the EPA's National Priorities List. Through various acquisitions, we own 16 of these sites that were initially developed by others. We are working with the government to characterize or remediate identified site problems and have either agreed with other parties on an arrangement for sharing the costs of remediation or are pursuing resolution of an allocation formula. We generally expect to receive any amounts due from these parties at, or near, the time that we make environmental remediation expenditures. Claims have been made against us at another 55 sites we do not own where we have been an operator, transporter or generator of waste. These claims are at different procedural stages under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, which is also known as Superfund. At some of these sites, our liability is well defined as a consequence of a governmental decision and an agreement among the parties involved as to the allocation of costs. At others where no remedy has been selected or the liable parties have been unable to agree on an appropriate allocation, our future costs are uncertain. Any of these matters could have a material adverse effect on our condensed consolidated financial statements.

Where we believe that both the amount of a particular environmental remediation liability and the timing of the payments are reliably determinable, we inflate the cost in current dollars until the expected time of payment using an inflation rate of 2.5% and discount the cost to present value using a risk-free discount rate with a term approximating the weighted average period until settlement of the underlying obligation, or 4.25%. We determine the inflation rate and the risk-free discount rate, which is based on the rates for United States Treasury bonds with similar maturities, on an annual basis unless interim changes would significantly impact our results of operations.

Financial Statement Impact of Landfill and Environmental Remediation Obligations

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

	March 31, 2004			December 31, 2003		
	Landfill	Environmental Remediation	Total	Landfill	Environmental Remediation	Total
Current (in accrued liabilities)	$109	$ 56	$ 165	$109	$ 57	$ 166
Long-term	876	271	1,147	849	275	1,124
	$985	$327	$1,312	$958	$332	$1,290

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The changes to landfill and environmental remediation liabilities for the three months ended March 31, 2004 and 2003 are reflected in the tables below (in millions):

	Landfill	Environmental Remediation
December 31, 2003	$958	$332
Obligations incurred and capitalized	18	—
Obligations settled	(8)	(8)
Interest accretion	15	2
Revisions in estimates	1	—
Acquisitions, divestitures and other adjustments	1	1
March 31, 2004	$985	$327
December 31, 2002	$655	$343
Cumulative effect of change in accounting principle	266	—
Obligations incurred and capitalized	12	—
Obligations settled	(7)	(8)
Interest accretion	15	2
Revisions in estimates	1	9
Acquisitions, divestitures and other adjustments	12	7
March 31, 2003	$954	$353

At several of our landfills, we provide financial assurance by depositing cash into escrow accounts or trust funds that are legally restricted for purposes of settling closure, post-closure and environmental remediation obligations. The fair value of these escrow accounts and trust funds was approximately $210 million at March 31, 2004, and is primarily included as other long-term assets in our condensed consolidated balance sheet. Balances maintained in these trust funds and escrow accounts will fluctuate based on (i) changes in statutory requirements; (ii) the ongoing use of funds for qualifying closure, post-closure and environmental remediation activities; (iii) acquisitions or divestitures of landfills; and (iv) changes in the fair value of the underlying financial instruments.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

3. Debt and Interest Rate Derivatives

Debt

Debt consisted of the following (in millions):

	March 31, 2004	December 31, 2003
Revolving credit facilities(a)	$ —	$ —
Senior notes and debentures, maturing through 2032, interest rates ranging from 5.00% to 8.75%	6,062 (b)	5,662
Tax-exempt bonds maturing through 2038, fixed and variable interest rates ranging from 1.0% to 10.0% (weighted average interest rate of 2.7% at March 31, 2004)	1,801 (c)	1,762 (c)
Tax-exempt project bonds, principal payable in periodic installments, maturing through 2027, fixed and variable interest rates ranging from 1.1% to 9.3% (weighted average interest rate of 5.1% at March 31, 2004)	566 (d)	566 (d)
5.75% convertible subordinated notes due 2005	33	33
Capital leases and other, maturing through 2022, interest rates up to 12%	558	488
	9,020	8,511
Less current portion	575 (e), (f)	514
	$ 8,445	$ 7,997

a) We are required to maintain the following financial covenants under our revolving credit facilities: (i) an interest coverage ratio in excess of 3 to 1; (ii) total debt to EBITDA ratio of less than 3.25 to 1; and (iii) minimum net worth of at least $3.5 billion plus 75% of cumulative consolidated net income beginning with the quarter ended March 31, 2001, all as defined in the credit facilities for the purpose of determining compliance with the covenants. The credit facilities requiring compliance with these financial covenants state that the calculations must be based on generally accepted accounting principles promulgated by the FASB that were in effect as of the last fiscal year before the date we entered into these facilities. We therefore calculate our covenants based on GAAP as of December 31, 2000 and 2001 for the five-year revolver and the three-year revolver, respectively. Therefore, our adoption or implementation of accounting pronouncements or interpretations effective on or after those dates does not impact the calculation of the financial covenants defined above. As of March 31, 2004 and December 31, 2003, we were in compliance with all covenants under our revolving credit facilities and all other debt instruments.

b) During March 2004 we issued $350 million of 5.0% senior notes due March 15, 2014. Interest on the notes is payable on March 15 and September 15 of each year. The net proceeds of the offering were approximately $346 million after deducting underwriters' discounts and expenses. We have invested these proceeds in cash equivalent investments pending repayment of $150 million of 8.0% senior notes due April 30, 2004 and $200 million of 6.5% senior notes due May 15, 2004.

c) We actively issue tax-exempt bonds as a means of accessing low-cost financing. These bonds are used to finance expenditures for landfill construction and development, equipment, vehicles and facilities in support of our operations. We have increased our utilization of tax-exempt financing and plan to continue this trend due to the attractive rate offered for these instruments. Proceeds from bond issues are held in trust until we incur qualified expenditures, at which time we are reimbursed from the trust funds. Proceeds from these financing arrangements are treated as non-cash financing activities and are excluded from cash provided by financing activities in our cash flows as the proceeds are deposited directly into trust funds and we do not have the ability to use the funds in regular operating activities. Accordingly, our 2004 issuances of approximately $75 million of tax-exempt bonds maturing through 2029 were treated as non-cash financing activities. We issue both fixed and floating rate obligations. Interest rates on floating rate bonds are re-set on a weekly basis and the underlying bonds are supported by letters of credit.

d) Tax-exempt project bonds have been used by our Wheelabrator Group to finance the development of waste-to-energy facilities. These facilities are supported by long-term contracts with multiple municipalities. The bonds generally have periodic amortizations that are supported by the cash flow of each specific facility being financed.

e) Our debt obligations as of March 31, 2004 include $294 million of 7.0% senior notes due October 1, 2004, which have been classified as long-term. Additionally, we have $257 million of fixed rate tax-exempt bonds subject to repricing within the next twelve months, which is prior to their scheduled maturities. If the reoffering of the bonds is unsuccessful, then the bonds can be put to us. These bonds are not backed by letters of credit that would serve to guarantee repayment in the event of a failed reoffering and are therefore considered a current obligation. However, these bonds have been classified as long-term in our condensed consolidated balance sheet as of March 31, 2004. The classification of these obligations as long-term was based upon our current and forecasted available capacity under our two long-term revolving credit facilities and our intent to refinance the borrowings with other long-term financings. In the event other sources of long-term financing are not available, we intend to use our revolving credit facilities.

f) We have $934 million of tax-exempt bonds at March 31, 2004 that mature through 2038 and are remarketed weekly by a remarketing agent to effectively maintain a variable yield. If the remarketing agent is unable to remarket the bonds, then the remarketing agent can put the bonds to us. We have obtained letters of credit, issued under our revolving credit facilities, to guarantee repayment of the bonds in this event. We classified these borrowings as long-term at March 31, 2004 because the borrowings are supported by letters of credit issued under our two revolving credit facilities, which are both long-term.

As of March 31, 2004, we had a three-year, $650 million syndicated revolving credit facility and a five-year, $1.75 billion syndicated revolving credit facility. The three-year revolver matures in June 2005 and the five-year revolver matures in June 2006. At March 31, 2004, no borrowings were outstanding under our revolving credit facilities, and we had unused and available credit capacity under the facilities of $725 million.

As part of our operations, and in connection with issuances of tax-exempt bonds, we use letters of credit to support our bonding and financial assurance needs. The following table summarizes our outstanding letters of credit (in millions):

	March 31, 2004	December 31, 2003
Revolving credit facilities	$ 1,675	$ 1,608
Letter of credit and term loan agreements(a)	295	284
Letter of credit facility(b)	350	349
Other lines of credit	102	146
	$ 2,422	$ 2,387

a) In June 2003 we entered into a five-year, $15 million letter of credit and term loan agreement, a seven-year, $175 million letter of credit and term loan agreement, and a ten-year, $105 million letter of credit and term loan agreement, which expire in June 2008, 2010, and 2013, respectively.

b) In December 2003 we entered into a five-year, $350 million letter of credit facility.

Our letters of credit generally have terms allowing for automatic renewal after one year. In the event of an unreimbursed draw on a letter of credit, the unreimbursed amount generally converts into a term loan for the remaining term under the respective agreement or facility. Through March 31, 2004, we had not experienced any unreimbursed draws on letters of credit.

Our debt balances are generally unsecured, except for approximately $474 million of the tax-exempt project bonds outstanding at March 31, 2004 that are issued by certain of our subsidiaries within our Wheelabrator Group and secured by the related subsidiaries' assets, with a carrying value of approximately $670 million, and by the related subsidiaries' future revenue. Additionally, our consolidated variable interest entities have approximately $171 million of outstanding borrowings that are collateralized by assets of those entities. These assets have a carrying value of approximately $398 million as of March 31, 2004.

Interest rate swaps

We manage the interest rate risk of our debt portfolio principally by using interest rate derivatives to achieve a desired position of fixed and floating rate debt, which was approximately 64% fixed and 36% floating at March 31, 2004. Interest rate swap agreements outstanding as of December 31, 2003 and March 31, 2004 are set forth in the table below (dollars in millions):

As of	Notional Amount	Receive		Pay		Maturity Date	Fair Value Liability(a)
December 31, 2003	$ 17	Floating	1.15%	Fixed	7.27%	Through December 31, 2012	$ (3) (b)
December 31, 2003	$2,250	Fixed	6.38%-7.65%	Floating	3.74%-5.54%	Through December 15, 2017	$(99) (c),(d)
March 31, 2004	$ 17	Floating	1.11%	Fixed	7.27%	Through December 31, 2012	$ (3) (b)
March 31, 2004	$2,250	Fixed	6.38%-7.65%	Floating	3.70%-5.50%	Through December 15, 2017	$(35) (c),(d)

a) The fair value of interest rate derivatives is included in our balance sheets as components of other long-term assets and other long-term liabilities. Fair values of these interest rate derivatives are based on third party pricing models.

b) The interest rate derivative contract's terms do not qualify for hedge accounting. Therefore, the contract is accounted for at fair value with changes in fair value recognized immediately in interest expense.

c) These interest rate derivatives qualify for hedge accounting. Therefore, changes in fair value of these interest rate swap contracts are deferred and recognized as an adjustment to interest expense over the remaining life of the hedged instrument.

d) The fair value of these interest rate derivatives at December 31, 2003 is a net fair value liability of $99 million that is comprised of $2 million of other long-term assets and $101 million of other long-term liabilities. The fair value of these interest rate derivatives at March 31, 2004 is a net fair value liability of $35 million that is comprised of $7 million of other long-term assets and $42 million of other long-term liabilities.

Fair value hedge accounting for interest rate swap contracts increased the carrying value of debt instruments by approximately $219 million as of March 31, 2004 and $168 million as of December 31, 2003. The following table summarizes the accumulated fair value adjustments from interest rate swap agreements by underlying debt instrument category (in millions):

Increase (decrease) in carrying value of debt due to hedge accounting for interest rate swaps	March 31, 2004	December 31, 2003
Senior notes and debentures:		
Active swap agreements	$ (35)	$ (99)
Terminated swap agreements	253 (a)	266
	218	167
Tax-exempt and project bonds:		
Terminated swap agreements	1 (a)	1
	$ 219	$ 168

a) Of these amounts, $46 million (on a pre-tax basis) is scheduled to be reclassified as a credit to interest expense over the next twelve months.

Interest rate swap agreements reduced net interest expense by $24 million for both the three months ended March 31, 2004 and 2003. The significant terms of the interest rate contracts and the underlying debt instruments are identical and therefore no ineffectiveness has been realized.

Interest rate locks

We have entered into cash flow hedges to secure the underlying interest rates in anticipation of various senior note issuances. Upon issuing the related senior notes, the hedge agreements were terminated resulting in a deferred loss, net of taxes, of approximately $38 million at March 31, 2004, which is included in accumulated other comprehensive loss. Of this amount, $6 million (on a pre-tax basis) is scheduled to be reclassified into interest expense over the next twelve months.

4. Income Taxes

The current tax obligations associated with the provision for income taxes recorded in the statements of operations are reflected in the accompanying condensed consolidated balance sheets as a component of accrued liabilities, and the deferred tax obligations are reflected in deferred income taxes. The difference in federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended March 31, 2004 is primarily due to the favorable impact of non-conventional fuel tax credits and a favorable audit settlement, offset in part by state and local income taxes. The difference in federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended March 31, 2003 is primarily due to state and local income taxes, offset in part by non-conventional fuel tax credits. We continue to evaluate our effective tax rate at each interim period and adjust it accordingly as facts and circumstances warrant.

In January 2004, we acquired a minority ownership interest in a coal-based synthetic fuel production facility (the “Facility”) in exchange for consideration of $83.3 million, which is primarily comprised of a note payable for $82.5 million, as well as a commitment to fund our pro-rata share of the operations of the Facility. We have also agreed to make additional payments to the seller based on our pro-rata allocation of the tax credits generated by the Facility. The synthetic fuel produced at the Facility through 2007 qualifies for tax credits pursuant to Section 29 of the Internal Revenue Code (currently credits are not available for fuel produced after 2007).

We have been granted a private letter ruling from the U.S. Internal Revenue Service (“IRS”) confirming that the synthetic fuel produced by the Facility is a “qualified fuel” under Section 29 of the Internal Revenue Code and that the resulting tax credits may be allocated among the owners of the interests in the Facility.

We account for our investment in this entity using the equity method of accounting, which results in the recognition of our pro-rata share of the entity’s losses, the amortization of our initial investment and other estimated obligations being recorded as equity in losses of unconsolidated entities within our statement of operations. The total loss recognized during the three months ended March 31, 2004 was approximately $19 million. We also recognized approximately $2 million of interest expense related to this investment during the current period. The tax benefits that we will realize as a result of our investment in this entity have been reflected as a reduction to our provision for income taxes. This resulted in a decrease in our tax provision of approximately $19 million and a 5.2% reduction in our effective tax rate for the three months ended March 31, 2004, substantially offsetting the equity losses and interest expense realized during the period.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

5. Comprehensive Income

Comprehensive income represents all changes in our equity except for changes resulting from investments by, and distributions to, stockholders. Comprehensive income for the three months ended March 31, 2004 and March 31, 2003 was as follows (in millions):

	Three Months Ended March 31,	
	2004	2003
Net income	$ 152	$ 61
Other comprehensive income (loss):		
Unrealized loss resulting from changes in fair values of derivative instruments, net of tax benefit	(7)	(3)
Realized losses on derivative instruments reclassified into earnings, net of taxes	2	—
Minimum pension liability adjustment, net of taxes	—	1
Unrealized gain on marketable securities, net of taxes	2	—
Translation adjustment of foreign currency statements	(9)	40
Other comprehensive income (loss)	(12)	38
Comprehensive income	$ 140	$ 99

The components of accumulated other comprehensive loss were as follows:

	March 31, 2004	December 31, 2003
Accumulated unrealized loss on derivative instruments, net of tax benefit	$(47)	$(42)
Accumulated unrealized gain on marketable securities, net of taxes	3	1
Cumulative translation adjustment of foreign currency statements	(21)	(12)
	$(65)	$(53)

6. Earnings Per Share

The following reconciles the number of common shares outstanding at March 31 of each year to the weighted average number of common shares outstanding and the weighted average number of common and dilutive potential common shares outstanding for the purpose of calculating basic and diluted earnings per common share (shares in millions):

	Three Months Ended March 31,	
	2004	2003
Number of common shares outstanding at end of period	579.7	591.4
Effect of using weighted average common shares outstanding	(2.4)	2.3
Weighted average basic common shares outstanding	577.3	593.7
Dilutive effect of common stock options and warrants and other contingently issuable shares	5.5	2.1
Weighted average diluted common shares outstanding	582.8	595.8

7. Stock Based Compensation, Common Stock Dividends and Common Stock Repurchases

Stock Based Compensation

We account for our stock-based compensation using the intrinsic value method prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees,* as amended. Pursuant to APB Opinion No. 25, we do not recognize compensation cost for our stock options because the number of shares potentially issuable and the exercise price, which is equal to the fair market value of the underlying stock on the date of grant, are fixed.

The following schedule reflects the pro forma impact on net income and earnings per common share of accounting for our stock options using SFAS No. 123, *Accounting for Stock-Based Compensation,* which would result in the recognition of compensation expense for the fair value of stock options as computed using the Black-Scholes option-pricing model (in millions, except per share amounts):

	Three Months Ended March 31,	
	2004	**2003**
Reported net income	$ 152	$ 61
Less: compensation expense per SFAS No. 123, net of tax benefit	13	15
Pro forma net income	$ 139	$ 46
Basic earnings per common share:		
Reported net income	$ 0.26	$ 0.10
Less: compensation expense per SFAS No. 123, net of tax benefit	0.02	0.02
Pro forma net income	$ 0.24	$ 0.08
Diluted earnings per common share:		
Reported net income	$ 0.26	$ 0.10
Less: compensation expense per SFAS No. 123, net of tax benefit	0.02	0.02
Pro forma net income	$ 0.24	$ 0.08

Common Stock Dividends and Repurchases

In August 2003, we announced that the Board of Directors approved a quarterly dividend program. In January 2004, we declared our first quarter dividend of $0.1875 per share of common stock, which was paid on March 25, 2004 to stockholders of record as of March 1, 2004.

In February 2002 we announced that our Board of Directors had approved a stock repurchase program for up to $1 billion in annual repurchases each year through 2004, to be implemented at management's discretion. We have repurchased over 60 million shares of our common stock at a cost of approximately $1.6 billion under this program. We have not repurchased any of our common stock in 2004, although we did make a payment of approximately $24 million in January 2004 to settle repurchases made in December 2003.

As of March 31, 2004, we have the ability, under our most restrictive financial covenants, to make dividend payments and share repurchases in the aggregate amount of approximately $595 million, plus 25% of future net income.

8. Commitments and Contingencies

Financial instruments — We have obtained letters of credit, performance bonds and insurance policies, and have established trust funds and issued financial guarantees to support tax-exempt bonds, contracts, performance of landfill closure and post-closure requirements, environmental remediation and other obligations. We obtain surety bonds and insurance policies from an affiliated entity that we have an investment in and account for under the equity method. We also use insurance policies issued by our wholly-owned insurance company, the sole business of which is to issue policies for the parent holding company and its other subsidiaries, to secure such performance obligations. In those instances where our use of captive insurance is not allowed, we generally have available alternative bonding mechanisms. Because virtually no claims have been made against these financial instruments in the past, and considering our current financial position, we do not expect that these instruments will 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.

During 2003, we entered into three letter of credit and term loan agreements and a letter of credit facility to provide us with additional sources of letter of credit capacity. See Note 3 for information related to the letter of credit capacity provided by these agreements. Additionally in 2003, we guaranteed the debt of a newly-formed surety company in order to assist in the establishment of that entity. 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 — For the 14 months ended January 1, 2000, we insured certain risks, including auto, general liability and workers' compensation, with Reliance National Insurance Company, whose parent filed for bankruptcy in June 2001. In October 2001, the parent and certain of its subsidiaries, including Reliance National Insurance Company, were placed in liquidation. We believe that because of various state insurance guarantee funds and potential recoveries from the liquidation, it is unlikely that events relating to Reliance will have a material adverse impact on our financial statements.

Guarantees — We have entered into the following guarantee agreements associated with our operations.

- Waste Management Holdings, Inc. ("WM Holdings"), one of WMI's wholly-owned subsidiaries, has fully and unconditionally guaranteed WMI's senior indebtedness that matures through 2032. WMI has fully and unconditionally guaranteed the senior indebtedness of WM Holdings that matures through 2026 and WM Holdings' 5.75% convertible subordinated notes due 2005. Performance under these guarantee agreements would be required if either party defaulted on its respective obligations. No additional liability has been recorded for these guarantees because the underlying obligations are reflected in our consolidated balance sheets. See Note 11 for further information.

- WMI has guaranteed the tax-exempt bonds of its subsidiaries. If a subsidiary fails to meet its obligations associated with tax-exempt bonds as they come due, WMI will be required to perform under the related guarantee agreement. No additional liability has been recorded for these guarantees because the underlying obligations are reflected in our consolidated balance sheets. See Note 3 for information related to the balances and maturities of our tax-exempt bonds.

- We have guaranteed certain financial obligations of unconsolidated entities. The guarantees are primarily for the benefit of entities that we account for under the equity method of accounting. The related obligations, which mature through 2020, are not recorded on our consolidated balance sheets, and we have not recorded any liability for these guarantees. As of March 31, 2004, our maximum future payments associated with these guarantees is approximately $35 million. However, we have ongoing projects with the entities and believe that our performance under these guarantees is not likely.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- During 2003, we issued a $25.6 million letter of credit to support the debt of a surety bonding company. The guaranteed obligation is included as a component of long-term debt in our condensed consolidated balance sheet.

- WM Holdings has guaranteed all reimbursement obligations of WMI under its $350 million letter of credit facility and $295 million letter of credit and term loan agreements. Under those facilities, any draw on a letter of credit supported by facilities will be reimbursed by WMI to the entities funding the facilities. See Note 3 for disclosure related to our outstanding letters of credit under these facilities at March 31, 2004.

- In connection with the $350 million letter of credit facility, WMI and WM Holdings entered into a guarantee pursuant to which they guaranteed interest rate swap payments made by the entity funding the letter of credit facility. The probability of loss for the guarantees was determined to be remote and the fair value of the guarantees is immaterial to our financial position and results of operations.

- Certain of our subsidiaries have guaranteed the market value of certain homeowners' properties that are adjacent to our landfills. These guarantee agreements extend over the life of the landfill. Under these agreements, we would be responsible for the difference between the sale value and the market value of the homeowners' properties, if any. We do not believe it is possible to determine the contingent obligations associated with these guarantees, but we do not believe it would have a material effect on our financial position or results of operations.

- We have indemnified the purchasers of businesses or divested assets for the occurrence of specified events under certain of our divestiture agreements. We do not believe it is possible to determine the contingent obligations associated with these indemnities.

- WMI guarantees the service and lease obligations of certain of its subsidiaries. If a subsidiary fails to meet its contractual service or lease obligations as they come due, WMI has an unconditional obligation to perform on its behalf. No additional liability has been recorded for service guarantees because the subsidiaries' obligations are properly accounted for as costs of operations as services are provided. No additional liability has been recorded for the lease guarantees because the subsidiaries' obligations are properly accounted for as operating or capital leases, as appropriate.

We currently believe that it is not reasonably likely that we will be required to perform under these guarantee agreements or that any performance requirement would have a material impact on our consolidated financial statements.

Environmental matters — Our business is intrinsically connected with the protection of the environment. As such, a significant portion of our operating costs and capital expenditures could be characterized as costs of environmental protection. Such costs may increase in the future as a result of legislation or regulation. However, we believe that we generally tend to benefit when environmental regulation increases, because such regulations increase the demand for our services, and we have the resources and experience to manage environmental risk. For more information regarding environmental matters, see Note 2.

Litigation — In December 1999, an individual brought an action against the Company, five former officers of WM Holdings, and WM Holdings' former independent auditor, Arthur Andersen LLP, in Illinois state court on behalf of a proposed class of individuals who purchased WM Holdings common stock before November 3, 1994, and who held that stock through February 24, 1998. The action is for alleged acts of common law fraud, negligence and breach of fiduciary duty. In May 2001, the court granted in part and denied in part the defendants' motion to dismiss and in August 2003 denied defendants' motion for summary judgment. The extent of possible damages, if any, in this action cannot yet be determined.

In April 2002, a former participant in WM Holdings' ERISA plans and another individual filed a lawsuit in Washington, D.C. against us and others, attempting to increase the recovery of a class of ERISA plan participants based on allegations related to both the events alleged in, and the settlements relating to, the class action against WM Holdings that was settled in 1998 and the class action against us that was settled in November 2001 and paid in September 2003. Subsequently, the issues related to the latter class action have been dropped as to the Company, its officers and directors. Additionally, a single group of stockholders opted not to participate in the settlement of the class action lawsuit against us related to 1998 and 1999 activity and filed an individual lawsuit against us. The Company intends to defend itself vigorously in all of these proceedings.

Three groups of stockholders have filed separate lawsuits in state courts in Texas and federal court in Illinois against us and certain of our former officers. The lawsuit filed in Illinois was subsequently transferred to federal court in Texas. The petitions allege that the plaintiffs are substantial holders of the Company's common stock who intended to sell their stock in 1999, or to otherwise protect themselves against loss, but that the public statements we made regarding our prospects, and in some instances statements made by the individual defendants, were false and misleading and induced the plaintiffs to retain their stock or not to take other measures. The plaintiffs assert that the value of their retained stock declined dramatically and that they incurred significant losses. The plaintiffs assert claims for fraud, negligent misrepresentation, and conspiracy. The first of these cases was dismissed by summary judgment by a Texas state court in March 2002. That dismissal was reversed in the first quarter of 2004 by an intermediate appellate court, and we are appealing that decision. The second case also filed in state court is stayed pending resolution of the first case, and we intend to continue to vigorously defend these claims. In March 2004, the court granted our motion to dismiss in the third case, which was pending in federal court, and the plaintiffs have appealed that dismissal.

From time to time, we pay fines or penalties in environmental proceedings relating primarily to waste treatment, storage or disposal facilities. As of March 31, 2004, there were nine proceedings involving our subsidiaries where the sanctions involved in each could potentially exceed $100,000. The matters involve allegations that subsidiaries (i) operated a waste-to-energy facility that, as a result of intermittent and isolated equipment malfunctions, exceeded emission limits and failed to meet monitoring requirements, (ii) are responsible for remediation of landfill gas and chemical compounds required pursuant to a Unilateral Administrative Order associated with an NPL site, (iii) are responsible for late performance of work required under a Unilateral Administrative Order, (iv) improperly operated a solid waste landfill and caused excess odors, (v) improperly operated a solid waste landfill by failing to maintain required records, properly place and cover waste and adhere to proper leachate levels, (vi) did not comply with air regulations requiring control of emissions at a closed landfill, (vii) improperly operated a solid waste landfill by failing to maintain required leachate levels and erosion control and failing to properly operate and monitor gas wells and adequately control odors and stormwater, (viii) failed to comply with an operating permit for a solid waste incineration unit by exceeding permit limits for capacity, temperature and waste charging rates and record keeping and notifications associated with those permit violations, and (ix) discharged wastewater from a cogeneration facility in noncompliance with waste discharge requirements issued pursuant to a state water code. We do not believe that the fines or other penalties in any of these matters will, individually or in the aggregate, have a material adverse effect on our financial condition or results of operations.

It is not always possible to predict the impact that lawsuits, proceedings, investigations and inquiries may have on us, nor is it possible to predict whether additional suits or claims may arise out of the matters described above in the future. We intend to defend ourselves vigorously in all the above matters. However, it is possible that the outcome of any of the matters described, or others, may ultimately have a material adverse impact on our financial condition or results of operations in one or more future periods.

We are also currently involved in other routine civil litigation and governmental proceedings relating to the conduct of our business. We do not believe that any of these routine matters will have a material adverse impact on our consolidated financial statements.

Tax matters — We are currently under audit by the IRS and from time to time are audited by other taxing authorities. We fully cooperate with all audits, but defend our positions vigorously. Our audits are in various stages of completion. Specifically, we are in the process of concluding the appeals phase of IRS audits for the years 1989 to 1996. The audits for these years should be completed within the next 15 months. In addition, we are in the examination phase of an IRS audit for the years 1997 to 2000. This audit should also be completed within the next 15 months. To provide for potential tax exposures, we maintain an allowance for tax contingencies, the balance of which management believes is adequate. Results of audit assessments by taxing authorities could have a material effect on our quarterly or annual cash flows over the next 15 months as these audits are completed. However, we do not believe that any of these matters will have a material adverse impact on our results of operations.

9. Variable Interest Entities

In January 2003, the FASB issued FIN 46, which requires variable interest entities to be consolidated by their primary beneficiaries. A primary beneficiary is the party that absorbs a majority of the entity's expected losses or receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. In December 2003, the FASB revised FIN 46 to clarify key terms, additional exemptions for application and an extended initial application period.

As it applies to us, the effective dates for FIN 46 are as follows:

Entity Characteristics		
Creation or Modification	**Entity Type**	**Effective Dates**
After January 31, 2003	All variable interest entities (a),(b)	February 1, 2003
On or before January 31, 2003	Special purpose variable interest entities(c)	December 31, 2003
On or before January 31, 2003	All other variable interest entities(d)	March 31, 2004

a) We began consolidating a surety bonding company that was formed July 1, 2003 during the third quarter of 2003 due to our financial interest in that company, as described in our annual report on Form 10-K for the year ended December 31, 2003. The consolidation of this variable interest entity has not had a material impact on our financial position or results of operations as of and for the three months ended March 31, 2004.

b) As discussed in Note 4, we acquired an ownership interest in a coal-based synthetic fuel production facility during the first quarter of 2004. We invested in this variable interest entity because the synthetic fuel that it produces qualifies for Section 29 tax credits. Along with the other equity investors, we will support the operations of the entity in exchange for a pro-rata share of the tax credits generated. Our obligation to support the entity's future operations is, therefore, limited to the tax benefit we expect to receive. We are not the primary beneficiary of this entity, and we do not believe that we have any FIN 46 exposure to loss as a result of this investment.

c) We began consolidating two limited liability companies, from which we lease three waste-to-energy facilities, on December 31, 2003, as described in our Annual Report on Form 10-K for the year ended December 31, 2003. The consolidation of these entities decreased our operating expenses by approximately $10 million for the three months ended March 31, 2004. However, substantially all of this decrease was offset by increases in interest expense and minority interest expense resulting in an immaterial impact on our net income for the period.

d) We have determined that we are the primary beneficiary of trust funds that are legally restricted for purposes of settling certain of our closure, post-closure or environmental remediation obligations. Therefore, on March 31, 2004, we recorded a credit of approximately $8 million, net of tax, or $0.01 per diluted share, as a cumulative effect of change in accounting principle to consolidate these trust funds. The consolidation of these variable interest entities also resulted in an increase in other long-term assets of approximately $36 million, an increase in minority interest liabilities of approximately $22 million and an increase in deferred tax liabilities of approximately $6 million at March 31, 2004. Trust funds are established to meet our statutory financial assurance requirements and future financial obligations and variability in the fair value of trust assets is generally for our benefit or detriment. Our exposure to loss associated with these entities is, therefore, a function of the adequacy of the funds to meet our statutory requirements and closure, post-closure and environmental remediation obligations as they come due. As the trust funds are generally invested in high quality, low risk financial instruments and are expected to continue to meet the statutory requirements for which they were established, we do not believe that there is any material exposure to loss associated with the trusts. We do not expect this change in accounting to materially affect our financial position or results of operations.

10. Segment and Related Information

We manage and evaluate our operations primarily through our Eastern, Midwest, Southern, Western, Canadian, Wheelabrator and Recycling Groups. These seven operating Groups are presented below as our reportable segments. These reportable segments, when combined with certain other operations not managed through the seven operating Groups, comprise our North American Solid Waste, or NASW, operations. NASW, our core business, provides integrated waste management services consisting of collection, disposal (solid waste and hazardous waste landfills), transfer, waste-to-energy facilities and independent power production plants that are managed by Wheelabrator, recycling and other miscellaneous services to commercial, industrial, municipal and residential customers throughout the United States, Puerto Rico and Canada. The operations not managed through our seven operating Groups are presented herein as “Other NASW.”

Summarized financial information concerning our reportable segments for the three months ended March 31 is shown in the following table (in millions). For comparability purposes, prior period information has been restated to conform to the current year presentation.

Three Months Ended:	Gross Operating Revenues	Intercompany Operating Revenues(d)	Net Operating Revenues(e)	Income from Operations(f)
March 31, 2004				
Canadian	$ 141	$ (14)	$ 127	$ 11
Eastern	921	(189)	732	68
Midwest	527	(95)	432	64
Southern	791	(123)	668	159
Western	639	(86)	553	92
Wheelabrator	196	(14)	182	45
Recycling	172	(5)	167	5
Other NASW(a)	55	(20)	35	(5)
Total NASW	3,442	(546)	2,896	439
Other(b)	—	—	—	—
Corporate(c)	—	—	—	(95)
Total	$3,442	$(546)	$2,896	$ 344
March 31, 2003				
Canadian	$ 117	$ (12)	$ 105	$ 7
Eastern	882	(178)	704	58
Midwest	506	(86)	420	58
Southern	742	(113)	629	140
Western	615	(85)	530	84
Wheelabrator	199	(16)	183	42
Recycling	133	(3)	130	—
Other NASW(a)	46	(15)	31	3
Total NASW	3,240	(508)	2,732	392
Other(b)	—	—	—	(2)
Corporate(c)	—	—	—	(111)
Total	$3,240	$(508)	$2,732	$ 279

a) Other NASW includes operations provided throughout our operating Groups for methane gas recovery and certain third party sub- contract and administration revenues managed by our national accounts department. Also included are certain quarter-end adjustments related to the reportable segments but not included in the measure of segment profit or loss used to assess their performance for the periods disclosed.

b) All of our international waste management services and non-solid waste services were divested by March 31, 2002. However, we continue to incur minimal administrative expenses in connection with these divestitures.

c) Corporate functions include the treasury, legal, information technology, tax, insurance, management of closed landfills and related insurance recoveries, centralized service center and other typical administrative functions. Certain of the associated costs for support services are allocated to the seven operating Groups.

d) Intercompany operating revenues reflect each segment's total intercompany sales including intercompany sales within a segment and between segments. Transactions within and between segments are generally made on a basis intended to reflect the market value of the service.

e) Our operating revenues tend to be somewhat lower in the winter months, primarily due to the lower volume of construction and demolition waste. The volumes of industrial and residential waste in certain regions also tend to decrease during the winter months. Our first and fourth quarter results of operations typically reflect these seasonal trends. In addition, particularly harsh weather conditions may result in the temporary suspension of certain of our operations.

f) For those items included in the determination of income from operations, the accounting policies of our segments are generally the same as those described in the summary of significant accounting policies included in our December 31, 2003 Form 10-K, except as discussed in Note 1 included herein.

The table below shows the total revenues contributed by our principal lines of business (in millions):

	Three Months Ended March 31,	
	2004	2003
Collection	$ 1,964	$ 1,867
Landfill	664	628
Transfer	369	342
Wheelabrator	196	199
Recycling and other(a)	249	204
Intercompany(b)	(546)	(508)
Operating revenues	$ 2,896	$ 2,732

a) In addition to the revenue generated by our Recycling Group, we have included revenues generated within our five geographic operating Groups derived from recycling, methane gas operations, sweeping services and Port-O-Let® services in the "recycling and other" line of business.

b) Intercompany revenues between lines of business are eliminated within the condensed consolidated financial statements included herein.

11. Condensed Consolidating Financial Statements

WM Holdings has fully and unconditionally guaranteed WMI's senior indebtedness. WMI has fully and unconditionally guaranteed all of WM Holdings' senior indebtedness and its 5.75% convertible subordinated notes due 2005. None of WMI's other subsidiaries have guaranteed any of WMI's or WM Holdings' debt. As a result of these guarantee arrangements, we are required to present the following condensed consolidating financial information (in millions).

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WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

CONDENSED CONSOLIDATING BALANCE SHEETS

March 31, 2004

(Unaudited)

ASSETS

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Current assets:					
Cash and cash equivalents	$ 684	$ —	$ 5	$ —	$ 689
Other current assets	—	—	2,447	—	2,447
	684	—	2,452	—	3,136
Property and equipment, net	—	—	11,287	—	11,287
Investments in and advances to affiliates	9,931	6,211	—	(16,142)	—
Other assets	34	106	6,638	—	6,778
Total assets	$10,649	$6,317	$20,377	$(16,142)	$21,201

LIABILITIES AND STOCKHOLDERS' EQUITY

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Current liabilities:					
Current portion of long-term debt	$ 223	$ 184	$ 168	$ —	$ 575
Accounts payable and other accrued liabilities	94	55	2,579	—	2,728
	317	239	2,747	—	3,303
Long-term debt, less current portion	4,618	1,314	2,513	—	8,445
Due to affiliates	—	—	6,106	(6,106)	—
Other liabilities	39	3	3,471	—	3,513
Total liabilities	4,974	1,556	14,837	(6,106)	15,261
Minority interest in subsidiaries and variable interest entities	—	—	265	—	265
Stockholders' equity	5,675	4,761	5,275	(10,036)	5,675
Total liabilities and stockholders' equity	$10,649	$6,317	$20,377	$(16,142)	$21,201

December 31, 2003

ASSETS

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Current assets:					
Cash and cash equivalents	$ 224	$ —	$ (89)	$ —	$ 135
Other current assets	—	—	2,453	—	2,453
	224	—	2,364	—	2,588
Property and equipment, net	—	—	11,411	—	11,411
Investments in and advances to affiliates	9,936	6,065	—	(16,001)	—
Other assets	29	106	6,522	—	6,657
Total assets	$10,189	$6,171	$20,297	$(16,001)	$20,656

LIABILITIES AND STOCKHOLDERS' EQUITY

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Current liabilities:					
Current portion of long-term debt	$ 118	$ —	$ 396	$ —	$ 514
Accounts payable and other accrued liabilities	88	43	2,687	—	2,818

	206	43	3,083	—	3,332
Long-term debt, less current portion	4,325	1,531	2,141	—	7,997
Due to affiliates	—	—	6,327	(6,327)	—
Other liabilities	95	6	3,413	—	3,514
Total liabilities	4,626	1,580	14,964	(6,327)	14,843
Minority interest in subsidiaries and variable interest entities	—	—	250	—	250
Stockholders' equity	5,563	4,591	5,083	(9,674)	5,563
Total liabilities and stockholders' equity	$10,189	$6,171	$20,297	$(16,001)	$20,656

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

Three Months Ended March 31, 2004

(Unaudited)

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues	$ —	$ —	$2,896	$ —	$2,896
Costs and expenses	—	—	2,552	—	2,552
Income from operations	—	—	344	—	344
Other income (expense):					
Interest expense, net	(55)	(20)	(35)	—	(110)
Equity in subsidiaries, net of taxes	187	200	—	(387)	—
Minority interest	—	—	(7)	—	(7)
Equity in losses of unconsolidated entities and other, net	—	—	(21)	—	(21)
	132	180	(63)	(387)	(138)
Income before cumulative effect of changes in accounting principles and income taxes	132	180	281	(387)	206
Provision for (benefit from) income taxes	(20)	(7)	89	—	62
Income before cumulative effect of changes in accounting principles	152	187	192	(387)	144
Cumulative effect of changes in accounting principles	—	—	8	—	8
Net income	$152	$187	$ 200	$(387)	$ 152

Three Months Ended March 31, 2003

(Unaudited)

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues	$ —	$ —	$2,732	$ —	$2,732
Costs and expenses	—	—	2,453	—	2,453
Income from operations	—	—	279	—	279
Other income (expense):					
Interest expense, net	(60)	(33)	(14)	—	(107)
Equity in subsidiaries, net of taxes	99	119	—	(218)	—
Minority interest	—	—	(1)	—	(1)
Equity in losses of unconsolidated entities and other, net	—	1	3	—	4
	39	87	(12)	(218)	(104)
Income before cumulative effect of changes in accounting principles and income taxes	39	87	267	(218)	175
Provision for (benefit from) income taxes	(22)	(12)	102	—	68
Income before cumulative effect of changes in accounting principles	61	99	165	(218)	107
Cumulative effect of changes in accounting principles	—	—	(46)	—	(46)
Net income	$ 61	$ 99	$ 119	$(218)	$ 61

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WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

Three Months Ended March 31, 2004

(Unaudited)

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	$ 152	$ 187	$ 200	$(387)	$ 152
Equity in earnings of subsidiaries, net of taxes	(187)	(200)	—	387	—
Other adjustments and charges	9	(2)	311	—	318
Net cash provided by (used in) operating activities	(26)	(15)	511	—	470
Cash flows from investing activities:					
Acquisitions of businesses, net of cash acquired	—	—	(73)	—	(73)
Capital expenditures	—	—	(181)	—	(181)
Proceeds from divestitures of businesses, net of cash divested, and other sales of assets	—	—	22	—	22
Net receipts from restricted funds	—	—	78	—	78
Net cash used in investing activities	—	—	(154)	—	(154)
Cash flows from financing activities:					
New borrowings	346	—	1	—	347
Debt repayments	—	—	(9)	—	(9)
Common stock repurchases	(24)	—	—	—	(24)
Cash dividends	(109)	—	—	—	(109)
Exercise of common stock options and warrants	48	—	—	—	48
Other	(1)	—	(14)	—	(15)
(Increase) decrease in intercompany and investments, net	226	15	(241)	—	—
Net cash provided by (used in) financing activities	486	15	(263)	—	238
Effect of exchange rate changes on cash and cash equivalents	—	—	—	—	—
Increase in cash and cash equivalents	460	—	94	—	554
Cash and cash equivalents at beginning of period	224	—	(89)	—	135
Cash and cash equivalents at end of period	$ 684	$ —	$ 5	$ —	$ 689

Three Months Ended March 31, 2003

(Unaudited)

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	$ 61	$ 99	$ 119	$(218)	$ 61
Equity in earnings of subsidiaries, net of taxes	(99)	(119)	—	218	—
Other adjustments and charges	41	15	312	—	368
Net cash provided by (used in) operating activities	3	(5)	431	—	429
Cash flows from investing activities:					
Acquisitions of businesses, net of cash acquired	—	—	(85)	—	(85)
Capital expenditures	—	—	(212)	—	(212)
Proceeds from divestitures of businesses, net of cash divested, and other sales of assets	—	—	16	—	16
Net receipts from restricted funds	—	—	54	—	54
Net cash used in investing activities	—	—	(227)	—	(227)
Cash flows from financing activities:					
New borrowings	—	—	6	—	6

Debt repayments	—	—	(21)	—	(21)
Common stock repurchases	(68)	—	—	—	(68)
Exercise of common stock options and warrants	2	—	—	—	2
Other	(3)	—	(1)	—	(4)
(Increase) decrease in intercompany and investments, net	187	5	(192)	—	—
Net cash provided by (used in) financing activities	118	5	(208)	—	(85)
Effect of exchange rate changes on cash and cash equivalents	—	—	—	—	—
Increase (decrease) in cash and cash equivalents	121	—	(4)	—	117
Cash and cash equivalents at beginning of period	316	—	(52)	—	264
Cash and cash equivalents at end of period	$437	$ —	$ (56)	$ —	$ 381

Item 2. ***Management's Discussion and Analysis of Financial Condition and Results of Operations.***

When we make statements containing projections about our accounting and finances, plans and objectives for the future, future economic performance or when we make statements containing any other projections or estimates about our assumptions relating to these types of statements, we are making forward-looking statements. These statements usually relate to future events and anticipated revenues, earnings, cash flows or other aspects of our operations or operating results. We make these statements in an effort to keep stockholders and the public informed about our business, and have based them on our current expectations about future events. You should view such statements with caution. These statements are not guarantees of future performance or events. All phases of our business are subject to uncertainties, risks and other influences, many of which we have no control over. Any of these factors, either alone or taken together, could have a material adverse effect on us and could change whether any forward-looking statement ultimately turns out to be true. Additionally, we assume no obligation to update any forward-looking statement as a result of future events or developments. The following discussion should be read together with the condensed consolidated financial statements and the notes to the condensed consolidated financial statements.

Some of the risks that we face and that could affect our business and financial statements for the remainder of 2004 and beyond include:

- possible changes in our estimates of site remediation requirements, final capping, closure and post-closure obligations, or compliance and regulatory developments;
- the possible impact of regulations on our business, including the cost to comply with regulatory requirements and the potential liabilities associated with disposal operations, as well as our ability to obtain and maintain permits needed to operate our facilities;
- the effect of limitations or bans on disposal or transportation of out-of-state waste or certain categories of waste;
- possible charges against earnings as a result of shut-down operations, uncompleted development or expansion projects or other events;
- the effects that trends toward requiring recycling, waste reduction at the source and prohibiting the disposal of certain types of wastes could have on volumes of waste going to landfills and waste-to-energy facilities;
- the effect the weather has on our quarter to quarter results, as well as the effect of extremely harsh weather on our operations;
- the effect that price fluctuations on commodity prices may have on our operating revenues;
- the outcome of litigation or threatened litigation;
- the effect competition in our industry could have on our profitability or cash flows;
- possible diversions of management's attention and increases in operating expenses due to efforts by labor unions to organize our employees;
- possible increases in operating expenses due to fuel price increases or fuel supply shortages;
- the effects of general economic conditions, including the ability of insurers to fully or timely meet their contractual commitments and of surety companies to continue to issue surety bonds;
- the need for additional capital if cash flows are less than we expect or capital expenditures are more than we expect, and the possibility that we cannot obtain additional capital on acceptable terms if needed;
- possible errors or problems upon implementation of new information technology systems; and
- possible fluctuations in quarterly results of operations or adverse impacts on our results of operations as a result of the adoption of new accounting standards or interpretations.

These are not the only risks that we face. There may be additional risks that we do not presently know of or that we currently believe are immaterial which could also impair our business and financial position.

General

Our principal executive offices are located at 1001 Fannin Street, Suite 4000, Houston, Texas 77002. Our telephone number at that address is (713) 512-6200. Our website address is http://www.wm.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K are all available, free of charge, on our website as soon as practicable after we file the reports with the SEC. Our stock is traded on the New York Stock Exchange under the symbol “WMI.”

We are the leading provider of integrated waste services in North America. Through our subsidiaries we provide collection, transfer, recycling and resource recovery, and disposal services. We are also a leading developer, operator and owner of waste-to-energy facilities in the United States. Our customers include commercial, industrial, municipal and residential customers, other waste management companies, electric utilities and governmental entities.

Overview

The first quarter of 2004 was positive for the Company. Before cumulative effects of changes in accounting principles, net income for the quarter was $144 million, or $0.25 per diluted share, as compared to $107 million, or $0.18 per diluted share in the first quarter of 2003. The increase in net income was primarily due to progress we have made in growing our customer base and revenues, reducing certain of our costs and leveraging our infrastructure.

Revenues for the quarter were up 6.0%, from $2.73 billion in the first quarter 2003 to $2.90 billion in the current quarter. Half of the increase was due to average yield and volume increases, whereas most of the remainder was due to our acquisition program.

Our increase in revenue due to average yield increases came mostly from collection customers that have been with us for a year or longer. We were not able to sustain the same yield improvement throughout all of our lines of business mostly because we strategically lowered some prices to avoid losing customers to competitors and because of customer churn. Increases in commodity prices for recyclable materials was a significant component in our increased revenue, although much of that increase is rebated back to our suppliers, reducing the impact on income.

Revenue growth from volumes in the quarter was the strongest we have seen in the past few years. The increase in volumes as compared to last year’s quarter can be attributed primarily to the additional day in February 2004 and the harsh winter in the first quarter of 2003 that was not experienced in 2004, although the increases were partially offset by the loss of the Chicago Blue Bag contract in 2003. Although volumes in the current quarter were actually down slightly after considering these factors, we believe that the trends late in the quarter and early in the second quarter are positive, and therefore remain optimistic that the recent positive trends will continue. Additionally, volumes in certain lines of business have been very encouraging, such as in our roll-off business, where we have begun initiating price increases in many of our markets.

We have paid approximately $325 million, net, for acquisitions since the first quarter of 2003. The effect of these acquisitions was an approximately 2.6% increase in revenues in the first quarter of 2004 as compared to the prior year’s quarter. We will continue to focus on acquisitions that improve our collection route density and internalize waste volumes into our disposal facilities as they become available.

We continue our efforts to control costs. Our total operating expenses increased from the first quarter of last year, but as a percentage of revenue they remained constant between the first quarter of 2003 and the current quarter. Increased operating expenses in the first quarter of 2004 as compared to the first quarter of 2003 were generally due to increased volumes, including from acquisitions. Adversely affecting our effort to lower operating costs as a percentage of revenue were increased third-party transportation costs due to higher volumes, the redirection of waste to more distant landfills, primarily in the Eastern United States, and higher third party transportation rates, again primarily in the East. Additionally, while increased market prices for recyclable materials favorably affected revenue, our costs of good sold increased as a percentage of revenue because a majority of this price increase is rebated to our recycling suppliers. However, we continue to actively search for cost cutting opportunities. In our selling, general and administrative expenses, which decreased overall and as a percentage of revenues as compared to the prior year quarter, the majority of the decrease resulted from lower labor costs, driven primarily by the decline in our use of contract labor. This and other cost reductions were partially offset by increases in selling costs, but we believe that these costs, many of which are a function of operating revenues, are important in growing our business.

Finally, our free cash flow for the quarter was approximately $311 million. Our net cash provided by operating activities in the first quarter of 2004 was approximately $470 million. Free cash flow was calculated by subtracting from net cash provided by operating activities our capital expenditures of approximately $181 million and adding to that the proceeds from our divestitures, net of cash divested, and other sales of assets of approximately $22 million. We expect that our free cash flows will be lower in certain future quarters in 2004 due principally to higher capital expenditures. We are still projecting free cash flow for the year to be in line with the outlook we provided previously of $900 million to $1 billion, based on estimated projections of net cash provided by operating activities of over $2.1 billion, capital expenditures of $1.15 billion to $1.25 billion and proceeds from divestitures, net of cash divested, and other sales of assets of over $50 million for the year.

Critical Accounting Estimates and Assumptions

In preparing our financial statements, we make several estimates and assumptions that affect the accounting for and recognition of our assets and liabilities and revenues and expenses. We must make these estimates and assumptions because certain of the information that we use is dependent on future events, cannot be calculated with a high degree of precision from available data or is simply not capable of being readily calculated based on generally accepted methodologies. In some cases, these estimates are particularly difficult to determine and we must exercise significant judgment. The most difficult, subjective and complex estimates and the assumptions that deal with the greatest amount of uncertainty relate to our accounting for landfills, environmental remediation liabilities and asset impairments, as described in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2003.

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Results of Operations for the Three Months Ended March 31, 2004

The following table presents, for the periods indicated, the period to period change in dollars (in millions) and percentages for the respective consolidated statement of operations line items.

	Period to Period Change For the Three Months Ended March 31, 2004 and 2003	
Statement of Operations:		
Operating revenues	$164	6.0 %
Costs and expenses:		
Operating (exclusive of depreciation and amortization shown below)	111	6.1
Selling, general and administrative	(7)	(2.2)
Depreciation and amortization	23	7.6
Restructuring	(20)	*
Asset impairments and unusual items	(8)	*
	99	4.0
Income from operations	65	23.3
Other income (expense):		
Interest expense, net	(3)	(2.8)
Equity in earnings (losses) of unconsolidated entities	(20)	*
Minority interest	(6)	*
Other, net	(5)	(166.7)
	(34)	(32.7)
Income before cumulative effect of changes in accounting principles and income taxes	31	17.7
Provision for income taxes	6	8.8
Income before cumulative effect of changes in accounting principles	$ 37	34.6 %

* Percentage change is not meaningful. Please refer to the explanation of these items included herein for a discussion of the relationship between current year and prior year activity.

The following table presents, for the periods indicated, the percentage relationship that the respective consolidated statement of operations line items bear to operating revenues:

	Three Months Ended March 31,	
	2004	2003
Statement of Operations:		
Operating revenues	100.0 %	100.0 %
Costs and expenses:		
Operating (exclusive of depreciation and amortization shown below)	66.3	66.2
Selling, general and administrative	10.9	11.8
Depreciation and amortization	11.2	11.1
Restructuring	—	0.7
Asset impairments and unusual items	(0.3)	—
	88.1	89.8
Income from operations	11.9	10.2
Other income (expense):		
Interest expense, net	(3.8)	(3.9)
Equity in earnings (losses) of unconsolidated entities	(0.7)	—
Minority interest	(0.3)	—

Other, net	—	0.1
	(4.8)	(3.8)
Income before cumulative effect of changes in accounting principles and income taxes	7.1 %	6.4 %

Operating Revenues

Our operating revenues for the three months ended March 31, 2004, were $2.9 billion, compared with $2.7 billion in 2003. Shown below (in millions)is the contribution to revenues during each period provided by our seven operating Groups and our Other North American Solid Waste, or NASW, services.

	Three Months Ended March 31,	
	2004	**2003**
Canadian	$ 141	$ 117
Eastern	921	882
Midwest	527	506
Southern	791	742
Western	639	615
Wheelabrator	196	199
Recycling	172	133
Other NASW	55	46
Intercompany	(546)	(508)
	$2,896	$2,732

Our operating revenues generally come from fees charged for our collection, landfill, transfer, Wheelabrator (waste-to-energy) and recycling services. The mix of operating revenues from our different services is reflected in the table below (in millions):

	Three Months Ended March 31,	
	2004	**2003**
Collection	$1,964	$1,867
Landfill	664	628
Transfer	369	342
Wheelabrator	196	199
Recycling and other	249	204
Intercompany	(546)	(508)
	$2,896	$2,732

The following table provides details associated with the period-to-period change in NASW revenues (dollars in millions) along with an explanation of the significant components of the current period changes:

	Period to Period Change for the Three Months Ended March 31, 2004 and 2003	
Average yield:		
Base business	$ 15	0.6%(a)
Commodity	31	1.1 (b)
Electricity	—	—
Fuel surcharge and fees	1	—
Total	47	1.7
Volume	36	1.3 (c)
Internal growth	83	3.0
Acquisitions	70	2.6 (d)
Divestitures	(5)	(0.2)
Foreign currency translation	16	0.6
	$164	6.0%

a) Average yield from our commercial and residential collection operations, transfer operations and municipal solid waste landfill operations were the primary drivers of the increase in base business revenue. The increases in these areas were partially offset by average yield declines in our industrial collection operations, particularly in the Midwestern portion of the United States, and our special waste landfill operations, where we continued to be affected by lower prices in the Southern United States.

b) Revenue was positively affected by price increases in all of the recycling commodities that we process. However, a significant portion of increases from commodity prices are rebated to our suppliers, increasing our cost of goods sold. The majority of the current quarter improvement in commodity pricing was attributable to increases in the prices of old corrugated cardboard, plastics, high-grade paper and mix-grade paper.

c) Volume-related revenue increases were primarily attributable to our collection, landfill and transfer lines of business. These volume increases were driven by the negative impact that the harsh winter weather in the Eastern United States had on our volumes in the first quarter of 2003 and the additional workday in the first quarter of 2004 due to the leap year. These revenue improvements were offset by volume declines experienced by (i) our residential collection operations in the Eastern United States; (ii) our waste-to-energy facilities; and (iii) our transfer and recycling operations in the Midwest because of the loss of a contract with the City of Chicago in February 2003. Excluding the impact of weather, the additional workday and the loss of the contract with the City of Chicago, volumes for the first quarter of 2004 are slightly down.

d) This increase is primarily related to our acquisition of collection assets from Allied Waste Industries, Inc. in the third and fourth quarters of 2003. Other acquisitions of recycling, transfer and waste-to-energy assets made after the first quarter of 2003 also provided notable increases in revenues during the current period.

Operating Expenses (Exclusive of Depreciation and Amortization Shown Below)

Operating expenses are (i) labor and related benefits, which include salaries and wages, related payroll taxes, insurance and benefits costs and the costs associated with contract labor; (ii) disposal costs, which include tipping fees paid to third party disposal facilities and transfer stations; (iii) maintenance and repairs relating to both equipment and facilities; (iv) subcontractor costs, which include the costs of independent haulers who transport our waste to disposal facilities; (v) costs of goods sold, which are primarily the rebates paid to suppliers associated with recycling commodities; (vi) fuel costs, which represent the costs of fuel and oils to operate our truck fleet and landfill operating equipment; (vii) disposal and franchise fees and taxes, which include landfill taxes, host community fees and royalties; and (viii) other operating costs, which include equipment and facility rent, property taxes, insurance and claims costs, and landfill operating costs.

The following table summarizes the major components of our operating expenses, including the impact of foreign currency translation, for the three months ended March 31, 2004 and 2003 (in millions):

	Three Months Ended March 31,		
	2004	2003	Change
Labor and related benefits	$ 707	$ 658	$ 49 (a)
Disposal costs	313	293	20 (b)
Maintenance and repairs	184	176	8
Subcontractor costs	178	155	23 (c)
Cost of goods sold	140	114	26 (d)
Fuel	88	85	3
Disposal and franchise fees and taxes	119	112	7
Other	191	216	(25)(e)
	$1,920	$1,809	$111

a) This increase is primarily related to (i) increases in salaries and wages as a result of acquisition activity in the last three quarters of 2003; (ii) increases in employee benefit costs; (iii) increased overtime costs due in part to increased volumes; and (iv) merit raises implemented during the second quarter of 2003 and the first quarter of 2004. These increases have been partially offset by savings realized as a result of our February 2003 restructuring and June 2003 workforce reduction.

b) Increases in disposal costs during the current period are due principally to volume increases from both general operating activities and acquisitions. The current period also benefitted from reduced disposal costs as a result of reduced activity because of the harsh winter weather in the Eastern United States during the first quarter of 2003.

c) Increased subcontractor costs were largely attributable to (i) 2003 acquisition activity; (ii) increased volumes; and (iii) additional transportation costs associated with the redirection of waste in the Eastern portion of the United States due to capacity constraints at some of our landfills.

d) These costs are generally related to rebates provided to our recycling suppliers and are, therefore, driven by market prices of recyclable commodities. The majority of the current quarter increase was attributable to changes in the market prices of old corrugated cardboard, plastics, high-grade paper and mix-grade paper. These increases also affected our current quarter operating revenues, resulting in a relatively insignificant net impact on our operating results.

e) On December 31, 2003 we consolidated two special purpose type variable interest entities from which we lease three waste-to-energy facilities. Prior to the consolidation of these entities, we accounted for the underlying lease agreements as operating leases. The consolidation of these entities has, therefore, resulted in a decline in rental expense for the three months ended March 31, 2004, partially offset by increases in depreciation, interest expense and minority interest expense. Decreased landfill site maintenance costs also resulted in a decrease in our other operating expenses during the quarter ended March 31, 2004.

Selling, General and Administrative

Selling, general and administrative expenses are (i) labor costs, which include salaries, related insurance and benefits, contract labor, and payroll taxes; (ii) professional fees, which include fees for consulting, legal, audit, and tax services; (iii) provision for bad debts, which includes allowances for uncollectible customer accounts and collection fees; and (iv) other general and administrative expenses, which include voice and data telecommunications, advertising, travel and entertainment, rentals, postage, and printing.

The following table summarizes the major components of our selling, general and administrative costs for the three months ended March 31, 2004 and 2003 (in millions):

	Three Months Ended March 31,		
	2004	2003	Change
Labor and related benefits	$187	$194	$ (7)(a)
Professional fees	32	32	—
Provision for bad debts	13	12	1
Other	84	85	(1)
	$316	$323	$ (7)

a) The most significant decrease in labor-related costs during the current period is related to the decline in the use of contract labor. We also benefited from salary and wage decreases due to our 2003 workforce reductions, which offset the impact of annual merit increases. Lower insurance costs and bonus accruals also contributed to the current period decline. Partially offsetting these cost decreases is the impact of increased commissions as a result of comparatively higher operating revenues.

Other Components of Income From Operations

The following table summarizes the remaining components of income from operations for the three months ended March 31, 2004 and 2003 (in millions):

	Three Months Ended March 31,		
	2004	2003	Change
Depreciation and amortization	$325	$302	$ 23 (a)
Restructuring	—	20	(20)(b)
Asset impairments and unusual items	(9)	(1)	(8)(c)

a) This increase is primarily related to (i) an increase in landfill airspace amortization due to higher volumes at our landfills; (ii) increased information technology depreciation expense recognized as a result of placing additional enterprise-wide software systems into service during the latter half of 2003; and (iii) increased depreciation expense for our Wheelabrator Group as a result of consolidating two variable interest entities, from which we lease three waste-to-energy facilities, increasing our depreciation and interest expense, but decreasing operating expenses.

b) In February 2003 we reduced the number of market areas that make up our geographic operating Groups and reduced certain overhead positions to streamline our organization. As a result, we incurred approximately $20 million in one-time employee severance and benefit costs.

c) We recognized approximately $8 million in net gains during the first quarter of 2004 primarily as a result of divestitures of certain Port-O-Let® operations.

Income From Operations by Reportable Segment

The following table summarizes income from operations by reportable segment for the three months ended March 31, 2004 and 2003 and provides explanations of significant factors contributing to the identified variances (in millions):

	Three Months Ended March 31,		
	2004	2003	Change
Canadian	$ 11	$ 7	$ 4
Eastern	68	58	10 (a)
Midwest	64	58	6
Southern	159	140	19 (b)
Western	92	84	8
Wheelabrator	45	42	3
Recycling	5	—	5
Other NASW	(5)	3	(8)
Total NASW	$439	$392	$47

a) The Eastern Group's 2004 operating revenues were favorably affected by quarter-over-quarter improvements in average yield, a measure of the impact of pricing on revenues. The current period yield improvement was partially offset by volume declines, particularly in landfill operations, experienced in spite of the harsh winter weather during the first quarter of 2003 and the additional workday in 2004. The net impact of these revenue changes was positive internal revenue growth of 1.6% for the first quarter of 2004, which is one of the primary reasons for the current period increase in the Group's income from operations. The absence of one-time employee severance and benefit costs incurred as part of the February 2003 restructuring and higher operating expenses incurred because of the 2003 harsh weather conditions also positively affected the Eastern Group's 2004 operating income. These earnings improvements were partially offset by increased costs for the transportation of waste, labor and other items.

b) The Southern Group's 2004 operating income was favorably affected by (i) positive internal revenue growth of 2.7% largely due to volume increases in higher margin landfill operations; (ii) acquisitions; (iii) the 2003 impact of one-time employee severance and benefit costs incurred as part of the February 2003 restructuring; and (iv) various operating cost reductions.

Other Components of Income Before Cumulative Effect of Changes in Accounting Principles

The following summarizes the other major components of our income before cumulative effect of changes in accounting principles for the three months ended March 31, 2004 and 2003 (in millions):

	Three Months Ended March 31,		
	2004	2003	Change
Interest expense, net	$110	$107	$ 3
Equity in (earnings) losses of unconsolidated entities	19	(1)	20 (a)
Minority interest	7	1	6 (b)
Other, net	2	(3)	5
Provision for income taxes	62	68	(6)(a)

a) In January 2004, we acquired an equity interest in a coal-based synthetic fuel production facility. We account for our investment in this entity using the equity method of accounting, which resulted in the recognition of approximately $19 million in losses during the first quarter of 2004. The tax benefits, including tax credits, that we will realize as a result of our investment in this entity have been reflected as a reduction in our provision for income taxes of approximately $19 million and a 5.2% reduction in our effective tax rate for the three months ended March 31, 2004. This decrease has been partially offset by an increase in our overall provision for income taxes as a result of the increase in our consolidated pre-tax income.

b) The increase of approximately $6 million in minority interest expense is primarily attributable to the consolidation of two special purpose type variable interest entities on December 31, 2003 as a result of our implementation of FIN 46.

Cumulative Effect of Changes in Accounting Principles

On March 31, 2004, we recorded a credit of approximately $8 million, net of tax, or $0.01 per diluted share, as a cumulative effect of change in accounting principle as a result of the consolidation of previously unrecorded trusts as required by Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities.* See Note 9 to the condensed consolidated financial statements.

In the first quarter of 2003, we recorded a charge of $46 million, net of taxes, to cumulative effect of changes in accounting principles for the adoption of certain accounting changes described below.

- Through December 31, 2002, we accrued in advance for major repairs and maintenance expenditures and deferred costs associated with annual plant outages at our waste-to-energy facilities and independent power production plants. Effective January 1, 2003, we changed our policy from that method to one that expenses such costs as they are incurred. We recorded approximately $25 million, net of taxes, or $0.04 per diluted share, as a credit to cumulative effect of changes in accounting principles.

- Through December 31, 2002, we accrued for future losses under customer contracts that over the contract life were projected to have direct costs greater than revenues. Effective January 1, 2003, we changed our policy from that method to one that expenses such losses as they are incurred. We recorded approximately $30 million, net of taxes, or $0.05 per diluted share, as a credit to cumulative effect of changes in accounting principles.

- In connection with the adoption of SFAS No. 143, we recorded approximately $101 million, including tax benefit, or $0.17 per diluted share, in the first quarter of 2003 as a charge to cumulative effect of changes in accounting principles. Substantially all of this charge was related to the impact of changes in accounting for landfill final capping, closure and post-closure costs.

Liquidity and Capital Resources

The following is a summary of our cash balances and cash flows for the three months ended March 31, 2004 and 2003 (in millions):

	Three Months Ended March 31,	
	2004	2003
Cash and cash equivalents at the end of the period	$ 689	$ 381
Net cash provided by operating activities	$ 470	$ 429
Net cash used in investing activities	$(154)	$(227)
Net cash provided by (used in) financing activities	$ 238	$ (85)

Net Cash Provided by Operating Activities — We generated approximately $470 million in cash flows from our operating activities during the three months ended March 31, 2004 compared with $429 million provided in the comparable prior year period, an increase of $41 million. Current period operating cash flows were favorably affected by improved profitability due in part to the harsh winter weather experienced during the first quarter of 2003. However, we experienced fluctuations in each of the components of working capital, resulting in a net unfavorable change. This decline was largely due to the favorable impact of the termination of interest rate swap agreements before their scheduled maturities in 2003.

Net Cash Used in Investing Activities — We used approximately $154 million of our cash resources for investing activities during the first quarter of 2004, a decrease of approximately $73 million as compared to the first quarter of 2003. This decrease is primarily due to a $43 million decline in acquisition spending and capital expenditures, from $297 million in 2003 to $254 million in 2004. Also contributing to the current period decrease was a $6 million increase in proceeds from divestitures and other sales of assets and a $24 million increase in net receipts from restricted funds.

Net Cash Provided by and Used in Financing Activities — During the first quarter of 2004 we issued $350 million of 5.0% senior notes, which was the primary driver of the $238 million increase in cash as a result of our financing activities during the three months ended March 31, 2004. We also received approximately

$48 million for common stock option and warrant exercises during the current period, which is a significant increase in the cash generated by this activity as compared with the comparable prior year period. Partially offsetting these inflows was the payment of our first quarter dividend of $0.1875 per share of common stock, or approximately $109 million, and the cash settlement of 2003 share repurchases for $24 million. During the first quarter of 2003, we used approximately $85 million for financing activities, primarily as a result of the repurchase of our common stock for approximately $68 million. Although cash used for share repurchases was relatively insignificant during the first quarter of 2004, we intend to complete between $400 million and $500 million in share repurchases during the remainder of the year.

We operate in a capital intensive business and continuing access to various financing sources is vital to our operations. In the past, we have been successful in obtaining financing from a variety of sources on terms we consider attractive. Based on several key factors we believe are considered by credit rating agencies and financial markets to be important in determining our future access to financing, we expect to continue to maintain access to capital sources in the future. These factors include:

• the essential nature of the services we provide and our large and diverse customer base;

• our ability to generate strong and consistent cash flows despite the economic environment;

• our liquidity profile;

• our asset base; and

• our commitment to maintaining a moderate financial profile and disciplined capital allocation.

In addition to our working capital needs for ongoing operations, we have capital requirements for (i) capital expenditures for construction and expansion of landfill sites, as well as new trucks and equipment for collection and other operations, (ii) refurbishments and improvements at waste-to-energy facilities and (iii) business acquisitions. We currently expect to spend approximately $1 billion for capital expenditures and approximately $175 million for acquisitions during the remainder of 2004.

Our Board of Directors has approved a quarterly dividend program that is expected to result in an annual payment of $0.75 per share. The program was initiated in the first quarter of 2004 when we declared our first quarter dividend of $0.1875 per share of common stock, or approximately $109 million, which was paid on March 25, 2004 to stockholders of record as of March 1, 2004. We currently expect to make dividend payments of approximately $325 million for remaining 2004 quarterly dividends.

Our share repurchase program, which was approved by our Board of Directors in 2002, is in its final year. Under this program, we have repurchased over 60 million shares of our common stock at a cost of approximately $1.6 billion. We have not purchased any of our common stock in 2004, although we did make a payment of approximately $24 million in January 2004 to settle repurchases made in December 2003. We believe that the program has been an important source of shareholder value and we intend to continue to use cash flows from operations for share repurchases in either open market or privately negotiated transactions during the remainder of 2004.

Our strategy is to primarily utilize cash flows from operations to meet our capital needs and contractual obligations. However, we also have bank borrowings available to meet these capital requirements and, when appropriate, will obtain financing by issuing debt or common stock.

As of March 31, 2004, we had a three-year, $650 million syndicated revolving credit facility and a five-year, $1.75 billion syndicated revolving credit facility. The three-year revolver matures in June 2005 and the five-year revolver matures in June 2006. We have generally used each of these facilities to issue letters of credit that support our tax-exempt bond issuances, municipal and governmental waste management contracts, closure and post-closure obligations and disposal site or transfer station operating permits. We expect that similar facilities will continue to serve as a cost efficient source of this form of financial assurance in the future, and we continue to assess our financial assurance requirements to ensure that we have adequate letter of credit and surety bond capacity in advance of our business needs. Because letters of credit generally have a one-year term, the three-year $650 million syndicated revolving credit facility will no longer be a viable source of new letters of credit beginning in June 2004. Therefore, we are currently evaluating our credit capacity needs and considering alternatives for refinancing or extending the maturities of both our three and five-year revolving credit facilities. At March 31, 2004, no borrowings were outstanding under our revolving credit facilities and we had unused and available credit capacity under these facilities of approximately $725 million.

During March 2004 we issued $350 million of 5.0% senior notes due March 15, 2014. The net proceeds of the offering were approximately $346 million after deducting underwriters' discounts and expenses. We have invested these proceeds in cash equivalent investments pending repayment of $150 million of 8.0% senior notes due April 30, 2004 and $200 million of 6.5% senior notes due May 15, 2004. Our debt obligations as of March 31, 2004 also include $294 million of 7.0% senior notes due October 1, 2004, which have been classified as long-term debt in the accompanying condensed consolidated balance sheet. The classification of these obligations as long-term was based upon our current and forecasted available capacity under our two long-term revolving credit facilities and our intent to refinance the borrowings with other long-term financings. In the event other sources of long-term financing are not available, we intend to use our revolving credit facilities.

We also issued approximately $75 million of tax-exempt bonds during the first quarter of 2004, $35 million of which was issued to refinance higher rate tax-exempt bonds. Proceeds from these financing arrangements are primarily used for the construction of collection and disposal facilities and are deposited directly into trust funds because we do not have the ability to use the funds in our regular operating activities. Accordingly, we report these amounts as an investing activity when the cash is released from the trust funds and a financing activity when the industrial revenue bonds are repaid out of our cash balances. At March 31, 2004, approximately $424 million of funds were held in trust to meet future capital expenditures at various facilities. These fund balances are included as other long-term assets in the accompanying condensed consolidated balance sheets. We continue to increase our use of tax-exempt financing due to the attractive rates offered for these instruments.

Off-Balance Sheet Arrangements

We are party to (i) lease agreements with unconsolidated variable interest entities and (ii) guarantee arrangements with unconsolidated entities as discussed in the *Guarantees* section of Note 8 to the condensed consolidated financial statements. These lease agreements are established in the ordinary course of our business and are designed to provide us with access to facilities at competitive, market-driven prices. Our third-party guarantee arrangements are generally established to support our financial assurance needs and landfill operations. These arrangements have not materially affected our financial position, results of operations or liquidity during the period ended March 31, 2004 nor are they expected to have a material impact on our future financial position, results of operations or liquidity.

Seasonal Trends and Inflation

Our operating revenues tend to be somewhat lower in the winter months, primarily due to the lower volume of construction and demolition waste. The volumes of industrial and residential waste in certain regions where we operate also tend to decrease during the winter months. Our first and fourth quarter results of operations typically reflect these seasonal trends. We also use the slower winter months for scheduled maintenance at our waste-to-energy facilities, so repair and maintenance expense is generally higher in our first quarter than in other quarters during the year. In addition, particularly harsh weather conditions may result in the temporary suspension of certain of our operations.

We believe that inflation has not had, and in the near future is not expected to have, any material adverse effect on our results of operations. However, management's estimates associated with inflation have had, and will continue to have, an impact on our accounting for landfill and environmental remediation liabilities.

Item 4. ***Controls and Procedures.***

Disclosure Controls and Procedures

We maintain a set of disclosure controls and procedures designed to ensure that information we are required to disclose in reports that we file or submit with the SEC is recorded, processed, summarized and reported within the time periods specified by the SEC. An evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures are effective to ensure that we are able to collect, process and disclose the information we are required to disclose in the reports we file with the SEC within required time periods.

PART II.

Item 1. ***Legal Proceedings.***

Information regarding our legal proceedings can be found under the "Litigation" section of Note 8, *Commitments and Contingencies,* to the condensed consolidated financial statements.

Item 6. ***Exhibits and Reports on Form 8-K.***

(a) *Exhibits:*

Exhibit No.		Description
10.1	—	Employment Agreement between the Company and Lynn M. Caddell dated as of March 12, 2004.
12	—	Computation of Ratio of Earnings to Fixed Charges.
31.1	—	Certification Pursuant to Rule 15d — 14(a) under the Securities Exchange Act of 1934, as amended, of David P. Steiner, Chief Executive Officer.
31.2	—	Certification Pursuant to Rule 15d — 14(a) under the Securities Exchange Act of 1934, as amended, of Robert G. Simpson, Senior Vice President and Chief Financial Officer.
32.1	—	Certification Pursuant to 18 U.S.C. § 1350 of David P. Steiner, Chief Executive Officer.
32.2	—	Certification Pursuant to 18 U.S.C. § 1350 of Robert G. Simpson, Senior Vice President and Chief Financial Officer.

(b) *Reports on Form 8-K:*

In the first quarter of 2004, we filed Current Reports on Form 8-K dated March 3rd and March 5th to announce we had entered into an underwriting agreement for the public offering of $350 million of our 5.0% senior notes due March 15, 2014 and to file a legal opinion and an accountant's consent related to that offering. On March 3rd, 9th and 19th, we also filed Current Reports on Form 8-K in order to file legal opinions in connection with certain offerings of common stock under our universal shelf registration statement.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WASTE MANAGEMENT, INC.

By: /s/ ROBERT G. SIMPSON

Robert G. Simpson
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

WASTE MANAGEMENT, INC.

By: /s/ GREG A. ROBERTSON

Greg A. Robertson
Vice President and
Chief Accounting Officer
(Principal Accounting Officer)

Date: April 30, 2004

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INDEX TO EXHIBITS

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Exhibit 10.1

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT (the “Agreement”) is made and entered into on this 12 day of March, 2004 by and between Waste Management, Inc. (the “Company”), and Lynn M. Caddell (the “Executive”).

1. Employment.

The Company shall employ Executive, and Executive shall be employed by the Company upon the terms and subject to the conditions set forth in this Agreement. Employment with the Company and the effectiveness of this Agreement are subject to Executive’s successful completion of the Company’s pre-employment background check and pre-employment drug screen.

2. Term of Employment.

The period of Executive’s employment under this Agreement shall commence on March 22, 2004 (“Employment Date”), and shall continue for a period of two (2) years, and shall automatically be renewed for successive one (1) year periods on each anniversary of the Employment Date thereafter, unless Executive’s employment is terminated in accordance with Section 5 below. The period during which Executive is employed hereunder shall be referred to as the “Employment Period.”

3. Duties and Responsibilities.

(a) Executive shall serve as the Senior Vice President – Information Technology and Chief Information Officer. In such capacity, Executive shall perform such duties and have the power, authority, and functions commensurate with such position in similarly-sized public companies, and have and possess such other authority and functions consistent with such position as may be assigned to Executive from time to time by the Chief Executive Officer, President, or the Board.

(b) Executive shall devote substantially all of her working time, attention and energies to the business of the Company, and its affiliated entities. Executive may make and manage her personal investments (provided such investments in other activities do not violate, in any material respect, the provisions of Section 10 of this Agreement), be involved in charitable and professional activities, and, with the prior written consent of the Board, serve on boards of other for profit entities, provided such activities do not materially interfere with the performance of her duties hereunder (however, the Board does not typically allow officers to serve on more than one public company board at a time).

4. Compensation and Benefits.

(a) Base Salary. During the Employment Period, the Company shall pay Executive a base salary at the annual rate of THREE HUNDRED THOUSAND DOLLARS ($300,00.00) per year, or such higher rate as may be determined from time to time by the Company (“Base Salary”). Such Base Salary shall be paid in accordance with the Company’s standard payroll practice for its executive officers. Once increased, Base Salary shall not be reduced.

(b) Annual Bonus. During the Employment Period, Executive will be entitled to participate in an annual incentive compensation plan of the Company, as established by the Compensation Committee of the Board from time to time. The Executive's target annual bonus will be Seventy-Five percent (75%) of her Base Salary in effect for such year (the "Target Bonus"), and her actual annual bonus may range from 0% to 150% of Base Salary (*i.e*., a maximum possible bonus of two times the Target Bonus), and will be determined based upon (i) the achievement of certain corporate performance goals, as may be established and approved by from time to time by the Compensation Committee of the Board, and (ii) the achievement of personal performance goals as may be established by Executive's immediate supervisor. The annual bonus for calendar year 2004 will be paid in 2005, if earned, at the same time as similarly situated executive employees receive or would otherwise receive their bonuses, and will be prorated based upon the number of days Executive was employed by the Company during calendar year 2004, provided that Executive remains employed through the end of the 2004 calendar year.

(c) Stock Based Incentives. Effective on or about the Employment Date, the Company will grant Executive an award of 4,800 restricted shares of the common stock of the company and will grant Executive a stock option for 50,000 shares of common stock of the Company with one-fourth (1/4) of such options vesting on each of the next four (4) anniversaries of the Grant Date, subject to the approval of the Compensation Committee of the Board of Directors. The exercise price shall be the fair market value on the date of grant of the option, as determined in accordance with the applicable stock incentive plan. The award, vesting, and exercise of all stock incentive awards will be subject to and governed by the provisions of the applicable stock incentive plan and the applicable award agreement, if any, issued to Executive thereunder. Executive is eligible to be considered for additional stock incentive awards under the Company's stock incentive plan as administered by, and at the sole discretion of, the Compensation Committee of the Board.

(d) Benefit Plans and Vacation. Subject to the terms of such plans, Executive shall be eligible to participate in or receive benefits under any pension plan, profit sharing plan, salary deferral plan, medical and dental benefits plan, life insurance plan, short-term and long-term disability plans, or any other health, welfare or fringe benefit plan, generally made available by the Company to similarly-situated executive employees. The Company shall not be obligated to institute, maintain, or refrain from changing, amending, or discontinuing any benefit plan, or perquisite, so long as such changes are similarly applicable to similarly situated employees generally.

During the Employment Period, Executive shall be entitled to vacation each year in accordance with the Company's policies in effect from time to time, but in no event less than four (4) weeks paid vacation per calendar year.

(e) Expense Reimbursement. The Company shall promptly reimburse Executive for the ordinary and necessary business expenses incurred by Executive in the performance of the duties hereunder in accordance with the Company's customary practices applicable to its executive officers.

(f) Other Perquisites. Executive shall be entitled to all perquisites provided to Senior Vice Presidents of the Company as approved by the Compensation Committee of the Board, and as they may exist from time to time, including the following:

(i) Automobile allowance at the annual rate of Twelve Thousand Dollars ($12,000.00), payable in accordance with the Company's standard payroll practice for its executive officers and prorated in any year that Executive does not work a full calendar year;

(ii) Financial planning services at actual cost, and not to exceed Fifteen Thousand Dollars ($15,000.00) annually;

(iii) Additional one-time financial planning services at actual cost, not to exceed $20,000, for services in preparation for voluntary retirement (for such purposes voluntary retirement means retirement from the Company after attainment of (x) the age of 55, or (y) a sum of years of services with the Company plus age equal to 65 or greater);

(iv) Social organization initiation fees and dues with a benefit of a one-time initiation fee at actual cost (not to exceed ten percent (10%) of Executive's Base Salary), and monthly dues at actual cost (not to exceed $500 per month); and

(v) An annual physical examination on a program designated by the Company.

5. Termination of Employment.

Executive's employment hereunder may be terminated during the Employment Period under the following circumstances:

(a) Death. Executive's employment hereunder shall terminate upon Executive's death.

(b) Total Disability. The Company may terminate Executive's employment hereunder upon Executive becoming "Totally Disabled." For purposes of this Agreement, Executive shall be considered "Totally Disabled" if Executive has been physically or mentally incapacitated so as to render Executive incapable of performing the essential functions of Executive's position with or without reasonable accommodation. Executive's receipt of disability benefits under the Company's long-term disability plan or receipt of Social Security disability benefits shall be deemed conclusive evidence of Total Disability for purpose of this Agreement; provided, however, that in the absence of Executive's receipt of such long-term disability benefits or Social Security benefits, the Company's Board may, in their reasonable discretion (but based upon appropriate medical evidence), determine that Executive is Totally

Disabled.

(c) Termination by the Company for Cause. The Company may terminate Executive's employment hereunder for "Cause" at any time after providing a Notice of Termination for Cause to Executive.

(i) For purposes of this Agreement, the term "Cause" means any of the following: (A) willful or deliberate and continual refusal to perform Executive's employment duties reasonably requested by the Company after receipt of written notice to Executive of such failure to perform, specifying such failure (other than as a result of Executive's sickness, illness or injury) and Executive fails to cure such nonperformance within ten (10) days of receipt of said written notice; (B) breach of any statutory or common law duty of loyalty to the Company; (C) has been convicted of, or pleaded *nolo contendre* to, any felony; (D) willfully or intentionally caused material injury to the Company, its property, or its assets; (E) disclosed to unauthorized person(s) proprietary or confidential information of the Company; (F) any material violation or a repeated and willful violation of Company policies or procedures, including but not limited to, the Company's Code of Business Conduct and Ethics (or any successor policy) then in effect; or (G) breach of any of the covenants set forth in Section 10 hereof.

(ii) For purposes of this Agreement, the phrase "Notice of Termination for Cause" shall mean a written notice that shall indicate the specific termination provision in Section 5(c)(i) relied upon, and shall set forth in reasonable detail the facts and circumstances which provide the basis for termination for Cause. Further, a Notification of Termination for Cause shall be required to include a copy of a resolution duly adopted by at least two-thirds (2/3) of the entire membership of the Board of Directors at a meeting of the Board which was called for the purpose of considering such employment termination, and at which Executive and her representative had the right to attend and address the Board, finding that, in the good faith belief of the Board, Executive engaged in conduct set forth in Section 5(c)(i) herein and specifying the particulars thereof in reasonable detail. The date of termination for Cause shall be the date indicated in the Notice of Termination for Cause. Any purported termination for Cause which is held by an arbitrator not to have been based on the grounds set forth in this Agreement or not to have followed the procedures set forth in this Agreement shall be deemed a termination by the Company without Cause.

(d) Voluntary Termination by Executive. Executive may terminate her employment hereunder with or without Good Reason at any time upon written notice to the Company.

(i) A termination for "Good Reason" means a resignation of employment by Executive by written notice ("Notice of Termination for Good Reason") given to the Company's Chief Executive Officer or President within ninety (90) days after the occurrence of the Good Reason event, unless such circumstances are substantially corrected prior to the date of termination specified in the Notice of

Termination for Good Reason. For purposes of this Agreement, “Good Reason” shall mean the occurrence or failure to cause the occurrence, as the case may be, without Executive’s express written consent, of any of the following circumstances: (A) the Company substantially changes Executive’s core duties or removes Executive’s responsibility for those core duties, so as to effectively cause Executive to no longer be performing the duties of her position (except in each case in connection with the termination of Executive’s employment for Death, Total Disability, or Cause, or temporarily as a result of Executive’s illness or other absence); provided that if the Company becomes a fifty percent or more subsidiary of any other entity, Executive shall be deemed to have a substantial change in the core duties of her position unless she is also Senior Vice-President of the ultimate parent entity; (B) removal or the non-reelection of the Executive from the officer position with the Company specified herein, or removal of the Executive from any of her then officer positions; (C) any material breach by the Company of any provision of this Agreement, including without limitation Section 10 hereof; or (D) failure of any successor to the Company (whether direct or indirect and whether by merger, acquisition, consolidation or otherwise) to assume in a writing delivered to Executive upon the assignee becoming such, the obligations of the Company hereunder; or (E) the reassignment of Executive to a geographic location more than fifty (50) miles from her then business office location.

(ii) A “Notice of Termination for Good Reason” shall mean a notice that shall indicate the specific termination provision relied upon and shall set forth in reasonable detail the facts and circumstances claimed to provide a basis for Termination for Good Reason. The failure by Executive to set forth in the Notice of Termination for Good Reason any facts or circumstances which contribute to the showing of Good Reason shall not waive any right of Executive hereunder or preclude Executive from asserting such fact or circumstance in enforcing her rights hereunder. The Notice of Termination for Good Reason shall provide for a date of termination not less than ten (10) nor more than sixty (60) days after the date such Notice of Termination for Good Reason is given, provided that in the case of the events set forth in Sections 5(d)(i)(A) or (B), the date may be five (5) business days after the giving of such notice. The Company, at its sole discretion, may waive this requirement.

(e) Termination by the Company without Cause. The Company may terminate Executive’s employment hereunder without Cause at any time upon written notice to Executive.

(f) Effect of Termination. Upon any termination of employment for any reason, Executive shall immediately resign from all Board memberships and other positions with the Company or any of its subsidiaries held by her at such time.

6. Compensation Following Termination of Employment.

In the event that Executive’s employment hereunder is terminated in a manner as set forth in Section 5 above, Executive shall be entitled to the compensation and benefits provided under this Section 6, as applicable to the form of termination:

(a) Termination by Reason of Death. In the event that Executive's employment is terminated by reason of Executive's death, the Company shall pay the following amounts to Executive's beneficiary or estate:

(i) Any accrued but unpaid Base Salary for services rendered to the date of death, any accrued but unpaid expenses required to be reimbursed under this Agreement, any vacation accrued to the date of termination, any earned but unpaid bonuses for any prior calendar year, and, to the extent not otherwise paid, a pro-rata bonus or incentive compensation payment for the current calendar year to the extent payments are awarded to senior executives of the Company and paid at the same time as senior executives are paid.

(ii) Any benefits to which Executive may be entitled pursuant to the plans, policies and arrangements (including those referred to in Section 4(d) hereof), as determined and paid in accordance with the terms of such plans, policies and arrangements.

(b) Termination by Reason of Total Disability. In the event that Executive's employment is terminated by the Company by reason of Executive's Total Disability (as determined in accordance with Section 5(b)), the Company shall pay the following amounts to Executive:

(i) Any accrued but unpaid Base Salary for services rendered to the date of termination, any accrued but unpaid expenses required to be reimbursed under this Agreement, any vacation accrued to the date of termination, and any earned but unpaid bonuses for any prior calendar year. Executive shall also be eligible for a pro-rata bonus or incentive compensation payment for the current calendar year to the extent such awards are made to senior executives of the Company for the year in which Executive is terminated, and to the extent not otherwise paid to the Executive.

(ii) Any benefits to which Executive may be entitled pursuant to the plans, policies and arrangements (including those referred to in Section 4(d) hereof) shall be determined and paid in accordance with the terms of such plans, policies and arrangements.

(c) Termination for Cause. In the event that Executive's employment is terminated by the Company for Cause, the Company shall pay the following amounts to Executive:

(i) Any accrued but unpaid Base Salary for services rendered to the date of termination, any accrued but unpaid expenses required to be reimbursed under this Agreement, any vacation accrued to the date of termination, and any earned but unpaid bonuses for any prior calendar year.

(ii) Any benefits to which Executive may be entitled pursuant to the plans, policies and arrangements (including those referred to in Section 4(d) hereof up to the date of termination) shall be determined and paid in accordance with the terms of such plans, policies and arrangements.

(d) Voluntary Termination by Executive. In the event that Executive voluntarily terminates employment other than for Good Reason, the Company shall pay the following amounts to Executive:

(i) Any accrued but unpaid Base Salary for services rendered to the date of termination, any accrued but unpaid expenses required to be reimbursed under this Agreement, any vacation accrued to the date of termination, and any earned but unpaid bonuses for any prior calendar year.

(ii) Any benefits to which Executive may be entitled pursuant to the plans, policies and arrangements (including those referred to in Section 4(d) hereof up to the date of termination) shall be determined and paid in accordance with the terms of such plans, policies and arrangements.

(e) Termination by the Company Without Cause Outside Window Period; Termination by Executive for Good Reason Outside Window Period. In the event that Executive's employment is terminated by the Company outside a Window Period (as defined in Section 7) for reasons other than death, Total Disability or Cause, or Executive terminates her employment for Good Reason outside of a Window Period, the Company shall pay the following amounts to Executive:

(i) Any accrued but unpaid Base Salary for services rendered to the date of termination, any accrued but unpaid expenses required to be reimbursed under this Agreement, any vacation accrued to the date of termination, and any earned but unpaid bonuses for any prior calendar year.

(ii) Any benefits to which Executive may be entitled pursuant to the plans, policies and arrangements referred to in Section 4(d) hereof shall be determined and paid in accordance with the terms of such plans, policies and arrangements.

(iii) Subject to Executive's execution of the Release (as defined in Section 7), an amount equal to two times the sum of Executive's Base Salary plus her Target Annual Bonus (in each case, as then in effect), of which one-half shall be paid in a lump sum within ten (10) days after such termination and one-half shall be paid during the two (2) year period beginning on the date of Executive's termination and shall be paid at the same time and in the same manner as Base Salary would have been paid if Executive had remained in active employment until the end of such period.

(iv) Subject to Executive's execution of the Release (as defined in Section 7), the

Company at its expense will continue for Executive and Executive's spouse and dependents, all health benefit plans, programs or arrangements, whether group or individual, disability, and other benefit plans, in which Executive was entitled to participate at any time during the twelve-month period prior to the date of termination, until the earliest to occur of (A) two years after the date of termination; (B) Executive's death (provided that benefits provided to Executive's spouse and dependents shall not terminate upon Executive's death); or (C) with respect to any particular plan, program or arrangement, the date Executive becomes eligible to participate in a comparable benefit provided by a subsequent employer. In the event that Executive's continued participation in any such Company plan, program, or arrangement is prohibited, the Company will arrange to provide Executive with benefits substantially similar to those which Executive would have been entitled to receive under such plan, program, or arrangement, for such period on a basis which provides Executive with no additional after tax cost.

(v) Subject to Executive's execution of the Release (as defined in Section 7), Executive shall be eligible for a bonus or incentive compensation payment, at the same time, on the same basis, and to the same extent payments are made to senior executives of the Company, pro-rated for the fiscal year in which the Executive is terminated.

(f) Suspension and Refund of Termination Benefits for Subsequently Discovered Cause. Notwithstanding any provision of this Agreement to the contrary, if within one (1) year of termination of employment of Executive by the Company for any reason other than for Cause, it is determined by Company that Executive could have been terminated for Cause then, to the extent permitted by law:

(i) the Company may elect to cancel any and all payments of any benefits otherwise due Executive, but not yet paid, under this Agreement or otherwise; and

(ii) Executive will refund to the Company any amounts, plus interest, previously paid by Company to Executive pursuant to Subsections 6(e)(iii), 6(e)(iv) or 6(e)(v).

7. Resignation by Executive for Good Reason or Termination by Company Without Cause During A Window Period.

(a) Certain Terminations During a Window Period. In the event a Change in Control occurs and (x) Executive terminates her employment for Good Reason during the Window Period , or (y) the Company terminates Executive's employment without Cause (and for reason other than Death of Total Disability) during the Window Period, the Company shall, subject to Executive's execution of the Release (as defined in this Section 7), pay the following amounts to Executive:

(i) The payments and benefits provided for in Section 6(e), except that (A) the amount and period with respect to which severance is calculated pursuant to

Section 6(e)(iii) will be three (3) years and the amount shall be paid in a lump-sum and (B) the benefit continuation period in Section 6(e)(iv) shall be for three (3) years.

(ii) Executive shall also receive a bonus or incentive compensation payment for the calendar year of the termination, payable at 100% of the maximum bonus available to Executive, pro-rated as of the effective date of the termination. Such bonus payment shall be payable within five (5) days after the effective date of Executive's termination. Except as may be provided under this Section 7 or under the terms of any incentive compensation, employee benefit, or fringe benefit plan applicable to Executive at the time of Executive's termination of employment, Executive shall have no right to receive any other compensation, or to participate in any other plan, arrangement or benefit, with respect to future periods after such resignation or termination.

(b) Certain Additional Payments by the Company.

(i) In the event that the Executive shall become entitled to payments and/or benefits provided by this Agreement or any other amounts in the "nature of compensation" (whether pursuant to the terms of this Agreement or any other plan, arrangement or agreement with the Company, any person whose actions result in a change of ownership or effective control covered by Section 280G(b)(2) of the Code or any person affiliated with the Company or such person) as a result of such change in ownership or effective control (collectively the "Company Payments"), and such Company Payments will be subject to the tax (the "Excise Tax") imposed by Section 4999 of the Code (and any similar tax that may hereafter be imposed by any taxing authority) the Company shall pay to the Executive at the time specified in subsection (iv) below an additional amount (the "Gross-up Payment") such that the net amount retained by the Executive, after deduction of any Excise Tax on the Company Payments and any U.S. federal, state, and for local income or payroll tax upon the Gross-up Payment provided for by this Section 7(b), but before deduction for any U.S. federal, state, and local income or payroll tax on the Company Payments, shall be equal to the Company Payments.

(ii) For purposes of determining whether any of the Company Payments and Gross-up Payments (collectively the "Total Payments") will be subject to the Excise Tax and the amount of such Excise Tax, (x) the Total Payments shall be treated as "parachute payments" within the meaning of Section 280G(b)(2) of the Code, and all "parachute payments" in excess of the "base amount" (as defined under Code Section 280G(b)(3) of the Code) shall be treated as subject to the Excise Tax, unless and except to the extent that, in the opinion of the Company's independent certified public accountants appointed prior to any change in ownership (as defined under Code Section 280G(b)(2) or tax counsel selected by such accountants (the "Accountants") such Total Payments (in whole or in part) either do not constitute "parachute payments," represent reasonable compensation for services actually rendered within the meaning of Section 280G(b)(4) of the Code in excess of the "base amount" or are otherwise not subject to the Excise Tax, and

(y) the value of any non-cash benefits or any deferred payment or benefit shall be determined by the Accountants in accordance with the principles of Section 280G of the Code.

(iii) For purposes of determining the amount of the Gross-up Payment, the Executive shall be deemed to pay U.S. federal income taxes at the highest marginal rate of U.S. federal income taxation in the calendar year in which the Gross-up Payment is to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of the Executive's residence for the calendar year in which the Company Payment is to be made, net of the maximum reduction in U.S. federal income taxes which could be obtained from deduction of such state and local taxes if paid in such year. In the event that the Excise Tax is subsequently determined by the Accountants to be less than the amount taken into account hereunder at the time the Gross-up Payment is made, the Executive shall repay to the Company, at the time that the amount of such reduction in Excise Tax is finally determined, the portion of the prior Gross-up Payment attributable to such reduction (plus the portion of the Gross-up Payment attributable to the Excise Tax and U.S. federal, state and local income tax imposed on the portion of the Gross-up Payment being repaid by the Executive if such repayment results in a reduction in Excise Tax or a U.S. federal, state and local income tax deduction), plus interest on the amount of such repayment at the rate provided in Section 1274(b)(2)(B) of the Code. Notwithstanding the foregoing, in the event any portion of the Gross-up Payment to be refunded to the Company has been paid to any U.S. federal, state and local tax authority, repayment thereof (and related amounts) shall not be required until actual refund or credit of such portion has been made to the Executive, and interest payable to the Company shall not exceed the interest received or credited to the Executive by such tax authority for the period it held such portion. The Executive and the Company shall mutually agree upon the course of action to be pursued (and the method of allocating the expense thereof) if the Executive's claim for refund or credit is denied.

In the event that the Excise Tax is later determined by the Accountant or the Internal Revenue Service to exceed the amount taken into account hereunder at the time the Gross-up Payment is made (including by reason of any payment the existence or amount of which cannot be determined at the time of the Gross-up Payment), the Company shall make an additional Gross-up Payment in respect of such excess (plus any interest or penalties payable with respect to such excess) at the time that the amount of such excess is finally determined.

(iv) The Gross-up Payment or portion thereof provided for in subsection (iii) above shall be paid not later than the thirtieth (30th) day following an event occurring which subjects the Executive to the Excise Tax; provided, however, that if the amount of such Gross-up Payment or portion thereof cannot be finally determined on or before such day, the Company shall pay to the Executive on such day an estimate, as determined in good faith by the Accountant, of the minimum amount of such payments and shall pay the remainder of such payments (together with interest at the rate provided in Section 1274(b)(2)(B) of the Code), subject to further payments pursuant to subsection (iii) hereof, as soon as the amount thereof can reasonably be determined, but in no event later than the ninetieth day after the occurrence of the event subjecting the Executive to the Excise Tax. In the event that the amount of the estimated payments exceeds the amount subsequently determined to have been due, such excess shall constitute a loan by the Company to the Executive, payable on the fifth day after demand by the Company (together with interest at the rate provided in Section 1274(b)(2)(B) of the Code).

(v) In the event of any controversy with the Internal Revenue Service (or other taxing authority) with regard to the Excise Tax, the Executive shall permit the Company to control issues related to the Excise Tax (at its expense), provided that such issues do not potentially materially adversely affect the Executive, but the Executive shall control any other issues. In the event the issues are interrelated, the Executive and the Company shall in good faith cooperate so as not to jeopardize resolution of either issue, but if the parties cannot agree the Executive shall make the final determination with regard to the issues. In the event of any conference with any taxing authority as to the Excise Tax or associated income taxes, the Executive shall permit the representative of the Company to accompany the Executive, and the Executive and the Executive's representative shall cooperate with the Company and its representative.

(vi) The Company shall be responsible for all charges of the Accountant.

(vii) The Company and the Executive shall promptly deliver to each other copies of any written communications, and summaries of any verbal communications, with any taxing authority regarding the Excise Tax covered by this Section 7(b).

(c) Certain Definitions.

(i) For purposes of this Agreement, "Change in Control" means the occurrence of any of the following events:

(a) any Person is or becomes the Beneficial Owner, directly or indirectly, of securities of the Company (for this purpose, securities beneficially owned by such person will not include any securities acquired directly from the Company or its Affiliates) representing twenty-five percent (25%) or more of the combined voting power of the Company's then outstanding voting securities other than in a transaction approved by a majority of the members of the Incumbent Board;

(b) individuals who, on the Employment Date, constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to the Employment Date whose election, or nomination for election by the Company's stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, except that any such individual will not be considered a member of the Incumbent Board if his or her initial assumption of office occurs as a result of either an actual or threatened election contest (as such term is used in Rule 14a-11 of Regulation 14A promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board;

(c) there is a consummated merger or consolidation of the Company with any other corporation, other than (A) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving or parent entity) more than fifty percent (50%) of the combined voting power of the voting securities of the Company or such surviving or parent entity outstanding immediately after such merger or consolidation or (B) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no Person, directly or indirectly, acquired twenty-five percent (25%) or more of the combined voting power of the Company's then outstanding securities (not including in the securities beneficially owned by such person any securities acquired directly from the Company or its Affiliates); or

(d) the stockholders of the Company approve a plan of complete liquidation of the Company or there is consummated an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets (or any transaction having a similar effect), other than a sale or disposition by the Company of all or substantially all of the Company's assets to an entity, at least fifty percent (50%) of the combined voting power of the voting securities of which are owned by stockholders of the Company in substantially the same proportions as their ownership of the Company immediately prior to such sale.

(ii) For purposes of this Section 7, "Affiliate" shall mean an affiliate of the Company, as defined in Rule 12b-2 promulgated under Section 12 of the Exchange Act.

(iii) For purposes of this Section 7, "Beneficial Owner" shall have the meaning set forth in Rule 13d-3 under the Exchange Act;

(iv) For purposes of this Agreement, "Exchange Act' means the Securities and Exchange Act of 1934, as amended from time to time;

(v) For purposes of this Section 7, "Person" shall have the meaning set forth in Section 3(a)(9) of the Exchange Act, as modified and used in Sections 13(d) and 14(d) thereof, except that such term shall not include (1) the Company, (2) a trustee or other fiduciary holding securities under an employee benefit plan of the Company, (3) an employee benefit plan of the Company, (4) an underwriter temporarily holding securities pursuant to an offering of such securities or (5) a corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their ownership of shares of Common Stock of the Company.

(vi) For purposes of this Agreement, "Window Period" means the period commencing

6-months immediately prior to the date on which a Change in Control occurs and ending the second anniversary of the date on which a Change in Control occurs.

(vii) For purposes of this Agreement, "Release" means that specific document which the Company shall present to Executive for consideration and execution after any termination of employment pursuant to Section 5(e) and Section 6(e), wherein if she agrees to such, she will irrevocably and unconditionally release and forever discharge the Company, it subsidiaries, affiliates and related parties from any and all causes of action which Executive at that time had or may have had against the Company (excluding any claim for indemnity under this Agreement, any claim under state workers' compensation or unemployment laws, or any claim under COBRA).

8. No Other Benefits or Compensation. Except as may be provided under this Agreement, or under the terms of any incentive compensation, employee benefit, or fringe benefit plan applicable to Executive at the time of Executive's termination or resignation, Executive shall have no right to receive any other compensation, or to participate in any other plan, arrangement or benefit, with respect to future periods after such termination or resignation.

9. No Mitigation; No Set-Off. In the event of any termination of employment hereunder, Executive shall be under no obligation to seek other employment, and there shall be no offset against any amounts due Executive under this Agreement on account of any remuneration attributable to any subsequent employment that Executive may obtain. The amounts payable hereunder shall not be subject to setoff, counterclaim, recoupment, defense or other right which the Company may have against the Executive or others, except upon obtaining by the Company of a final non-appealable judgment against Executive.

10. Covenants

(a) Company Property. All written materials, records, data, and other documents prepared or possessed by Executive during Executive's employment with the Company are the Company's property. All information, ideas, concepts, improvements, discoveries, and inventions that are conceived, made, developed, or acquired by Executive individually or in conjunction with others during Executive's employment (whether during business hours and whether on the Company's premises or otherwise) which relate to the Company's business, products, or services are the Company's sole and exclusive property. All memoranda, notes, records, files, correspondence, drawings, manuals, models, specifications, computer programs, maps, and all other documents, data, or materials of any type embodying such information, ideas, concepts, improvements, discoveries, and inventions are the Company's property. At the termination of Executive's employment with the Company for any reason, Executive shall return all of the Company's documents, data, or other Company property to the Company.

(b) Confidential Information; Non-Disclosure. Executive acknowledges that the business of the Company is highly competitive and that the Company has agreed to provide and immediately will provide Executive with access to "Confidential Information" relating to the business of the Company and its affiliates.

For purposes of this Agreement, “Confidential Information” means and includes the Company’s confidential and/or proprietary information and/or trade secrets that have been developed or used and/or will be developed and that cannot be obtained readily by third parties from outside sources. Confidential Information includes, by way of example and without limitation, the following information regarding customers, employees, contractors, and the industry not generally known to the public; strategies, methods, books, records, and documents; technical information concerning products, equipment, services, and processes; procurement procedures and pricing techniques; the names of and other information concerning customers, investors, and business affiliates (such as contact name, service provided, pricing for that customer, type and amount of services used, credit and financial data, and/or other information relating to the Company’s relationship with that customer); pricing strategies and price curves; positions, plans, and strategies for expansion or acquisitions; budgets; customer lists; research; weather data; financial and sales data; trading methodologies and terms; evaluations, opinions, and interpretations of information and data; marketing and merchandising techniques; prospective customers’ names and marks; grids and maps; electronic databases; models; specifications; computer programs; internal business records; contracts benefiting or obligating the Company; bids or proposals submitted to any third party; technologies and methods; training methods and training processes; organizational structure; personnel information, including salaries of personnel; payment amounts or rates paid to consultants or other service providers; and other such confidential or proprietary information. Information need not qualify as a trade secret to be protected as Confidential Information under this Agreement, and the authorized and controlled disclosure of Confidential Information to authorized parties by Company in the pursuit of its business will not cause the information to lose its protected status under this Agreement. Executive acknowledges that this Confidential Information constitutes a valuable, special, and unique asset used by the Company or its affiliates in their businesses to obtain a competitive advantage over their competitors. Executive further acknowledges that protection of such Confidential Information against unauthorized disclosure and use is of critical importance to the Company and its affiliates in maintaining their competitive position.

Executive also will have access to, or knowledge of, Confidential Information of third parties, such as actual and potential customers, suppliers, partners, joint venturers, investors, financing sources, and the like, of the Company and its affiliates.

The Company also agrees to provide Executive with one or more of the following: access to Confidential Information; specialized training regarding the Company’s methodologies and business strategies, and/or support in the development of goodwill such as introductions, information and reimbursement of customer development expenses consistent with Company policy. The foregoing is not contingent on continued employment, but is contingent upon Executive’s use of the Confidential Information access, specialized training, and goodwill support provided by Company for the exclusive benefit of the Company and upon Executive’s full compliance with the restrictions on Executive’s conduct provided for in this Agreement.

In addition to the requirements set forth in Section 5(c)(i), Executive agrees that Executive will not after Executive’s employment with the Company, make any unauthorized disclosure of any then Confidential Information or specialized training of the Company or its affiliates, or make any use thereof, except in the carrying out of her employment responsibilities hereunder. Executive also agrees to preserve and protect the confidentiality of third party

Confidential Information to the same extent, and on the same basis, as the Company's Confidential Information.

(c) Unfair Competition Restrictions. Upon Executive's Employment Date, the Company agrees to and shall provide Executive with immediate access to Confidential Information. Ancillary to the rights provided to Executive following employment termination, the Company's provision of Confidential Information, specialized training, and/or goodwill support to Executive, and Executive's agreements, regarding the use of same, and in order to protect the value of the above-referenced stock options, any restricted stock, training, goodwill support and/or the Confidential Information described above, the Company and Executive agree to the following provisions against unfair competition. Executive agrees that for a period of two (2) years following the termination of employment for any reason ("Restricted Term"), Executive will not, directly or indirectly, for Executive or for others, anywhere in the United States (including all parishes in Louisiana, and Puerto Rico) (the "Restricted Area") do the following, unless expressly authorized to do so in writing by the Chief Executive Officer of the Company:

Engage in, or assist any person, entity, or business engaged in, the selling or providing of products or services that would displace the products or services that (i) the Company is currently in the business of providing and was in the business of providing, or was planning to be in the business of providing, at the time Executive was employed with the Company, and (ii) that Executive had involvement in or received Confidential Information about in the course of employment; the foregoing is expressly understood to include, without limitation, the business of the collection, transfer, recycling and resource recovery, or disposal of solid waste, hazardous or other waste, including the operation of waste-to-energy facilities.

It is further agreed that during the Restricted Term, Executive cannot engage in any of the enumerated prohibited activities in the Restricted Area by means of telephone, telecommunications, satellite communications, correspondence, or other contact from outside the Restricted Area. Executive further understands that the foregoing restrictions may limit her ability to engage in certain businesses during the Restricted Term, but acknowledges that these restrictions are necessary to protect the Confidential Information the Company has provided to Executive.

A failure to comply with the foregoing restrictions will create a presumption that Executive is engaging in unfair competition. Executive agrees that this Section defining unfair competition with the Company does not prevent Executive from using and offering the skills that Executive possessed prior to receiving access to Confidential Information, confidential training, and knowledge from the Company. This Agreement creates an advance approval process, and nothing herein is intended, or will be construed as, a general restriction against the pursuit of lawful employment in violation of any controlling state or federal laws. Executive shall be permitted to engage in activities that would otherwise be prohibited by this covenant if such activities are determined in the sole discretion of the Chief Executive Officer of the Company to be no material threat to the legitimate business interests of the Company.

(d) Non-Solicitation of Customers. For a period of two (2) years following the termination of employment for any reason, Executive will not call on, service, or solicit competing business from customers of the Company or its affiliates whom Executive, within the previous twelve (12) months, (i) had or made contact with, or (ii) had access to information and files about, or induce or encourage any such customer or other source of ongoing business to stop doing business with Company.

(e) Non-Solicitation of Employees. During Executive's employment, and for a period of two (2) years following the termination of employment for any reason, Executive will not, either directly or indirectly, call on, solicit, encourage, or induce any other employee or officer of the Company or its affiliates whom Executive had contact with, knowledge of, or association within the course of employment with the Company to terminate his or her employment, and will not assist any other person or entity in such a solicitation.

(f) Non-Disparagement. Executive covenants and agrees that Executive shall not engage in any pattern of conduct that involves the making or publishing of written or oral statements or remarks (including, without limitation, the repetition or distribution of derogatory rumors, allegations, negative reports or comments) which are disparaging, deleterious or damaging to the integrity, reputation or good will of the Company, its management, or of management of corporations affiliated with the Company.

11. Enforcement of Covenants.

(a) Termination of Employment and Forfeiture of Compensation. Executive agrees that any breach by Executive of any of the covenants set forth in Section 10 hereof during Executive's employment by the Company, shall be grounds for immediate dismissal of Executive for Cause pursuant to Section 5(c)(i), which shall be in addition to and not exclusive of any and all other rights and remedies the Company may have against Executive.

(b) Right to Injunction. Executive acknowledges that a breach of the covenants set forth in Section 10 hereof will cause irreparable damage to the Company with respect to which the Company's remedy at law for damages will be inadequate. Therefore, in the event of breach or anticipatory breach of the covenants set forth in this section by Executive, Executive and the Company agree that the Company shall be entitled to seek the following particular forms of relief, in addition to remedies otherwise available to it at law or equity: (A) injunctions, both preliminary and permanent, enjoining or restraining such breach or anticipatory breach and Executive hereby consents to the issuance thereof forthwith and without bond by any court of competent jurisdiction; and (B) recovery of all reasonable sums as determined by a court of competent jurisdiction expended and costs, including reasonable attorney's fees, incurred by the Company to enforce the covenants set forth in this section.

(c) Separability of Covenants. The covenants contained in Section 10 hereof constitute a series of separate but ancillary covenants, one for each applicable State in the United States and the District of Columbia, and one for each applicable foreign country. If in any judicial proceeding, a court shall hold that any of the covenants set forth in Section 10 exceed the time, geographic, or occupational limitations permitted by applicable laws, Executive and the Company agree that such provisions shall and are hereby reformed to the maximum time, geographic, or occupational limitations permitted by such laws. Further, in the event a court shall hold unenforceable any of the separate covenants deemed included herein, then such unenforceable covenant or covenants shall be deemed eliminated from the provisions of this Agreement for the purpose of such proceeding to the extent necessary to permit the remaining separate covenants to be enforced in such proceeding. Executive and the Company further agree that the covenants in Section 10 shall each be construed as a separate agreement independent of any other provisions of this Agreement, and the existence of any claim or cause of action by Executive against the Company whether predicated on this Agreement or otherwise, shall not constitute a defense to the enforcement by the Company of any of the covenants of Section 10.

12. Indemnification.

The Company shall indemnify and hold harmless Executive to the fullest extent permitted by Delaware law for any action or inaction of Executive while serving as an officer and director of the Company or, at the Company's request, as an officer or director of any other entity or as a fiduciary of any benefit plan. This provision includes the obligation and undertaking of the Executive to reimburse the Company for any fees advanced by the Company on behalf of the Executive should it later be determined that Executive was not entitled to have such fees advanced by the Company under Delaware law. The Company shall cover the Executive under directors and officers liability insurance both during and, while potential liability exists, after the Employment Period in the same amount and to the same extent as the Company covers its other officers and directors.

13. Arbitration.

Except with respect to enforcement of the covenants contained in Section 11 herein, the parties agree that any dispute relating to this Agreement, or to the breach of this Agreement, arising between Executive and the Company shall be settled by arbitration in accordance with the Federal Arbitration Act and the commercial arbitration rules of the American Arbitration Association ("AAA"), or any other mutually agreed upon arbitration service. The arbitration proceeding, including the rendering of an award, shall take place in Houston, Texas, and shall be administered by the AAA (or any other mutually agreed upon arbitration service). The arbitrator shall be jointly selected by the Company and Executive within thirty (30) days of the notice of dispute, or if the parties cannot agree, in accordance with the commercial arbitration rules of the AAA (or any other mutually agreed upon arbitration service). All fees and expenses associated with the arbitration shall be borne equally by Executive and the Company during the arbitration, pending final decision by the arbitrator as to who should bear fees, unless otherwise ordered by the arbitrator. The arbitrator shall not be authorized to create a cause of action or remedy not recognized by applicable state or federal law. The award of the arbitrator shall be final and binding upon the parties without appeal or review, except as permitted by the arbitration laws of the State of Texas. The award shall be enforceable through a court of law upon motion of either party.

14. Disputes and Payment of Attorney's Fees.

If at any time during the term of this Agreement or afterwards there should arise any dispute as to the validity, interpretation or application of any term or condition of this Agreement, the Company agrees, upon written demand by Executive (and Executive shall be entitled upon application to any court of competent jurisdiction, to the entry of a mandatory injunction, without the necessity of posting any bond with respect thereto, compelling the Company) to promptly provide sums sufficient to pay on a current basis (either directly or by reimbursing Executive) Executive's costs and reasonable attorney's fees (including expenses of investigation and disbursements for the fees and expenses of experts, etc.) incurred by Executive in connection with any such dispute or any litigation, provided that Executive shall repay any such amounts paid or advanced if Executive is not the prevailing party with respect to at least one material claim or issue in such dispute or litigation. The provisions of this Section 11, without implication as to any other section hereof, shall survive the expiration or termination of this Agreement and of Executive's employment hereunder.

15. Requirement of Timely Payments.

If any amounts which are required, or determined to be paid or payable, or reimbursed or reimbursable, to Executive under this Agreement (or any other plan, agreement, policy or arrangement with the Company) are not so paid promptly at the times provided herein or therein, such amounts shall accrue interest, compounded daily, at an 8% annual percentage rate, from the date such amounts were required or determined to have been paid or payable, reimbursed or reimbursable to Executive, until such amounts and any interest accrued thereon are finally and fully paid, provided, however, that in no event shall the amount of interest contracted for, charged or received hereunder, exceed the maximum non-usurious amount of interest allowed by applicable law.

16. Withholding of Taxes.

The Company may withhold from any compensation and benefits payable under this Agreement all applicable federal, state, local, or other taxes.

17. Source of Payments.

All payments provided under this Agreement, other than payments made pursuant to a plan which provides otherwise, shall be paid from the general funds of the Company, and no special or separate fund shall be established, and no other segregation of assets made, to assure payment. Executive shall have no right, title or interest whatever in or to any investments which the Company may make to aid the Company in meeting its obligations hereunder. To the extent that any person acquires a right to receive payments from the Company hereunder, such right shall be no greater than the right of an unsecured creditor of the Company.

18. Assignment.

Except as otherwise provided in this Agreement, this Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective heirs, representatives, successors and assigns. This Agreement shall not be assignable by Executive (but any payments due hereunder which would be payable at a time after Executive's death shall be paid to Executive's designated beneficiary or, if none, his estate) and shall be assignable by the Company only to any financially solvent corporation or other entity resulting from the reorganization, merger or consolidation of the Company with any other corporation or entity or any corporation or entity to or with which the Company's business or substantially all of its business or assets may be sold, exchanged or transferred, and it must be so assigned by the Company to, and accepted as binding upon it by, such other corporation or entity in connection with any such reorganization, merger, consolidation, sale, exchange or transfer in a writing delivered to Executive in a form reasonably acceptable to Executive (the provisions of this sentence also being applicable to any successive such transaction).

19. Entire Agreement; Amendment.

This Agreement shall supersede any and all existing oral or written agreements, representations, or warranties between Executive and the Company or any of its subsidiaries or affiliated entities relating to the terms of Executive's employment by the Company. It may not be amended except by a written agreement signed by both parties.

20. Governing Law.

This Agreement shall be governed by and construed in accordance with the laws of the State of Texas applicable to agreements made and to be performed in that State, without regard to its conflict of laws provisions.

21. Notices.

Any notice, consent, request or other communication made or given in connection with this Agreement shall be in writing and shall be deemed to have been duly given when delivered or mailed by registered or certified mail, return receipt requested, or by facsimile or by hand delivery, to those listed below at their following respective addresses or at such other address as each may specify by notice to the others:

To the Company:	Waste Management , Inc. 1001 Fannin, Suite 4000 Houston, Texas 77002 Attention: Corporate Secretary
To Executive:	At the address for Executive set forth below.

22. Miscellaneous.

(a) Waiver. The failure of a party to insist upon strict adherence to any term of this Agreement on any occasion shall not be considered a waiver thereof or deprive that party of the right thereafter to insist upon strict adherence to that term or any other term of this Agreement.

(b) Separability. Subject to Section 11 hereof, if any term or provision of this Agreement is declared illegal or unenforceable by any court of competent jurisdiction and cannot be modified to be enforceable, such term or provision shall immediately become null and void, leaving the remainder of this Agreement in full force and effect.

(c) Headings. Section headings are used herein for convenience of reference only and shall not affect the meaning of any provision of this Agreement.

(d) Rules of Construction. Whenever the context so requires, the use of the singular shall be deemed to include the plural and vice versa.

(e) Counterparts. This Agreement may be executed in any number of counterparts, each of which so executed shall be deemed to be an original, and such counterparts will together constitute but one Agreement.

IN WITNESS WHEREOF, this Agreement is EXECUTED and EFFECTIVE as of the day set forth above.

/s/ Lynn M. Caddell
Lynn M. Caddell
("Executive")

WASTE MANAGEMENT, INC.
(The "Company")

By: /s/ Lawrence O'Donnell, III
Lawrence O'Donnell, III
President & Chief Operating Officer

EXHIBIT 12

WASTE MANAGEMENT, INC.

COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES
(In Millions, Except Ratios)
(Unaudited)

	Three Months Ended March 31,	
	2004	**2003**
Income before income taxes, cumulative effect of changes in accounting principles, net losses in equity investments and minority interests	$ 232	$ 176
Fixed charges deducted from income:		
Interest expense	113	109
Implicit interest in rents	12	17
	125	126
Earnings available for fixed charges	$ 357	$ 302
Interest expense	$ 113	$ 109
Capitalized interest	4	5
Implicit interest in rents	12	17
Total fixed charges	$ 129	$ 131
Ratio of earnings to fixed charges	2.8x	2.3x

EXHIBIT 31.1

SECTION 302 CERTIFICATION

I, David P. Steiner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Waste Management, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a –(15e) and 15d – (15e)) for the registrant and have:

   a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a. all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 30, 2004

By: /s/ David P. Steiner
David P. Steiner
Chief Executive Officer

EXHIBIT 31.2

SECTION 302 CERTIFICATION

I, Robert G. Simpson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Waste Management, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a –(15e) and 15d – (15e)) for the registrant and have:

    a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

    b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

    a. all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 30, 2004

By: /s/ Robert G. Simpson
Robert G. Simpson
Senior Vice President and
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Waste Management, Inc. (the “Company”) on Form 10-Q for the period ended March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, David P. Steiner, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ David P. Steiner
David P. Steiner
Chief Executive Officer

April 30, 2004

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Waste Management, Inc. (the “Company”) on Form 10-Q for the period ended March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Robert G. Simpson, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Robert G. Simpson
Robert G. Simpson
Senior Vice President and
Chief Financial Officer

April 30, 2004