

S&P Global
Market Intelligence

Waste Connections, Inc.

NYSE:WCN

Earnings Call

Thursday, April 23, 2026 1:30 PM GMT

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Call Participants

EXECUTIVES

Mary Anne Whitney

Executive VP & CFO

Ronald J. Mittelstaedt

Founder, CEO, President & Director

ANALYSTS

Adam Samuel Bubes

*Goldman Sachs Group, Inc.,
Research Division*

Bryan Nicholas Burgmeier

Citigroup Inc., Research Division

Faiza Alwy

*Deutsche Bank AG, Research
Division*

Jerry David Revich

*Wells Fargo Securities, LLC,
Research Division*

John Trevor Romeo

*William Blair & Company L.L.C.,
Research Division*

Kevin Chiang

*CIBC Capital Markets, Research
Division*

Konark Gupta

*Scotiabank Global Banking and
Markets, Research Division*

Noah Duke Kaye

*Oppenheimer & Co. Inc., Research
Division*

Patrick Tyler Brown

*Raymond James & Associates,
Inc., Research Division*

Seth Robert Weber

BNP Paribas, Research Division

Shlomo H. Rosenbaum

*Stifel, Nicolaus & Company,
Incorporated, Research Division*

Tobey O'Brien Sommer

*Truist Securities, Inc., Research
Division*

Toni Michele Kaplan

Morgan Stanley, Research Division

Presentation

Operator

Hello, everyone. Thank you for joining us, and welcome to the Waste Connections, Inc. Q1 2026 Earnings Call. [Operator Instructions]. I will now hand the conference over to Ron Mittelstaedt, President and CEO. Please go ahead.

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Thank you, operator, and good morning. I'd like to welcome everyone to this conference call to discuss our first quarter results. I'm joined this morning by Mary Anne Whitney, our CFO; as well as several other members of our senior management.

As noted in our earnings release, we are well positioned for 2026 following a strong start with upside potential from recent trends. We do not -- we not only exceeded expectations for revenue and EBITDA, but delivered EBITDA margin of 32.5%, up 90 basis points year-over-year, excluding commodity impacts in spite of outsized weather impacts and in advance of recovering higher fuel costs. Against a volatile macroeconomic and geopolitical backdrop, our results reflect the durability of our model and consistency of execution as we continue to benefit from improved operating trends, along with recent increase in commodities and special waste activity.

Before we get into much more detail, let me turn the call over to Mary Anne for our forward-looking disclaimer and other housekeeping items.

Mary Anne Whitney

Executive VP & CFO

Thank you, Ron, and good morning. The discussion during today's call includes forward-looking statements made pursuant to the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995, including forward-looking information within the meaning of applicable Canadian securities laws. Actual results could differ materially from those made in such forward-looking statements due to various risks and uncertainties. Factors that could cause actual results to differ are discussed in the cautionary statement included in our April 22 earnings release and in greater detail in Waste Connections' filings with the U.S. Securities and Exchange Commission and the Securities Commissions or similar regulatory authorities in Canada.

You should not place undue reliance on forward-looking statements as there may be additional risks of which we are not presently aware or that we currently believe are immaterial, which could have an adverse impact on our business. We make no commitment to revise or update any forward-looking statements in order to reflect events or circumstances that may change after today's date.

On the call, we will discuss non-GAAP measures such as adjusted EBITDA, adjusted net income on both a dollar basis and per diluted share and adjusted free cash flow. Please refer to our earnings releases for a reconciliation of such non-GAAP measures to the most comparable GAAP measures. Management uses certain non-GAAP measures to evaluate and monitor the ongoing financial performance of our operations. Other companies may calculate these non-GAAP measures differently.

I will now turn the call back over to Ron.

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Thank you, Mary Anne. On the strength of our business and consistent execution, 2026 is off to a great start with results exceeding expectations. Despite the volatility of the broader macro environment, we haven't seen anything to date that doesn't support our full year outlook as provided in February. In fact, we believe we should be well positioned for incremental benefits, both from external factors driving higher

fuel and other commodities and also as a result of our ongoing investments in human capital and AI, which have broad implications for our operations, along with continued M&A.

In Q1, we saw improving dynamics across our business, starting with better-than-expected solid waste pricing retention, resulting in core price of 6%, providing visibility for the high end of our full year 2026 outlook of 5% to 5.5%.

Next, our landfill tons were slightly stronger than expected, offsetting the volume impacts from slowdowns and closures related to severe winter weather, which persisted in several markets, most notably in the Northeast. Landfill activity was led by higher special waste tons, up 8% year-over-year in Q1, the sixth consecutive quarter of improving special waste.

Looking next at the aspects of our results related to crude oil prices and related volatility, which are twofold. First, our E&P waste business, where revenues increased sequentially and were up about 4% year-over-year on a like-for-like basis. We saw increases both in Canada on greater production-oriented activity and higher pricing and in the U.S. on drilling-oriented activity, most notably in the Gulf. To date, we haven't seen a meaningful increase in rig count or pickup in drilling activity, which may be driven by sustained higher crude prices or long-term supply disruptions and would be additive to the levels we are currently experiencing.

Next, fuel and related costs. Spot diesel in the U.S. was up 12% year-over-year, including an increase of over 35% in March. That surge drove our internal fuel costs about \$5 million above our expectations for Q1. Our exposure to the cost impacted is limited due to the hedges we proactively put in place for over 45% of our expected diesel requirements for 2026. Additionally, in certain markets, our pricing mechanisms allow for recovery of a portion of higher fuel-related costs over time through surcharges, which will step up in Q2 as a result of the incremental costs we have already absorbed.

Based on what we have seen to date, we would expect to be largely insulated on an EBITDA basis over time from most of the effects of higher fuel costs between the benefit from any pickup in the E&P waste activity, the impact of hedges and the recovery of higher diesel costs through surcharges, albeit with some lag in timing.

Looking next at trends for other commodities. Recycled commodity values stepped up sequentially in Q1 for the first time in 7 quarters, led by improving values for fiber during the quarter. Although nominal, the increase is a positive indicator. And landfill gas sales also stepped up sequentially, in this case, due to increased volumes on stable values for renewable energy credits or RINs.

Moving next to operating trends. Q1 marked our 14th consecutive quarter of improvement in employee retention and the achievement of another milestone as voluntary turnover dropped to below 10%. We can't overstate the value of human capital as a differentiator and continue to see the benefits of lower turnover throughout our operations from our record safety levels to increased employee engagement and ultimately, customer retention.

Shifting to the subject of technology. Our continued investment and focus on AI and our overall digital platform are showing promising results within pricing effectiveness, customer engagement and asset optimization. Specifically, our AI-driven pricing tool has yielded approximately 20% improvement in customer retention and pricing effectiveness while maintaining our core pricing strength. We are encouraged by early results knowing our analytics and capabilities will only get better as our technology advances.

Further, for the balance of '26 and into 2027, we are excited about our continued involvement with the field to expand our AI-powered tools, reinforcing our commitment to our decentralized-first model and value-based approach to the business. These current and future tools will continue to expand our customer engagement and routing productivity with early indications suggesting strong returns on investment.

Moving next to M&A. We continue to anticipate another outsized year of activity based on a robust and building pipeline with high visibility on a handful of deals with aggregate annualized revenue of approximately \$100 million expected to close by the end of Q2 or early Q3. We are on track for another

above-average M&A year. Most importantly, we remain disciplined in our approach to acquisitions and well positioned for implementing our growth strategy, while also increasing return of capital to shareholders.

To that end, on a year-to-date outlays of approximately 365 million, we've repurchased about 1% of shares outstanding. And finally, an update on our management of the ongoing elevated temperature landfill or ETLF event at Chiquita Canyon, our closed landfill in Southern California. We continue to make progress on mitigating the reaction, which based on objective data collected to date is stable, controlled and decelerating.

As noted previously, we have sought out the increased involvement and oversight of the U.S. EPA in an effort to streamline the process. Over the past several weeks, the EPA has expanded its involvement at the facility, which we welcome. To date, the EPA has weighed in and provided direction on 2 critical issues, and we respect their expertise and experience, which have facilitated the development of plans to resolve these matters consistent with our expectations.

We continue to work with the EPA on a long-term agreement, which should provide even greater clarity once consummated. There is no change in our 2026 outlook for Chiquita, which reflects free cash flow impacts of \$100 million to \$150 million. That said, we did adjust our accrual in Q1 to reflect the higher spending we saw in 2025, which was incorporated into our 2026 outlook. We look forward to being in a position to more formally reforecast the outlays for subsequent periods once we have a road map for moving forward, still anticipated this year.

Additionally, we continue to expect free cash flow impacts in 2027 will decline as compared to 2026, as previously communicated and continue to step down in each year going forward.

And now I'd like to pass the call to Mary Anne to review more in-depth financial highlights of the first quarter. I will then wrap up before heading into Q&A.

Mary Anne Whitney
Executive VP & CFO

Thank you, Ron. In the first quarter, revenue of \$2.371 billion exceeded our expectations and was up \$143 million or 6.4% year-over-year. Contributions from acquisitions net of divestitures totaled \$55 million in the quarter. Organic growth in solid waste collection transfer and disposal of 3.1% was led by 6% core price, which ranged from about 4% in our mostly exclusive market Western region to over 7% in our competitive markets. Total price of 5.9% included a reduction of about 10 basis points in fuel and material surcharges given the lag in recovery of higher costs.

With over 75% of our price increases already in place or contractually provided for, we have high visibility for full year 2026 core pricing at the high end of the range we provided or about 5.5%. And given the recent step-up in diesel costs, we would expect surcharges to increase accordingly, albeit with a lag, driven not only by the mechanics of the surcharges, but also due to advanced monthly or quarterly billing for some of our customers.

As Ron noted, we had hedges in place for almost half of our diesel requirements and utilized surcharges in a portion of our markets. Yield of 4.7% reflects ongoing reductions in customer churn and implies solid waste volumes down about 1.5%, including up to about 0.5 point attributable to outsized weather events that contributed to Q1 volume losses to varying degrees across all of our regions, except the Western region, where volumes were up about 1.5%.

Looking at year-over-year results in the first quarter on a same-store basis. Roll-off pulls were down 1% on rates per pull up 3%. And with the exception of our Western region, pulls were down in all regions. That said, we are encouraged by improving roll-off trends, especially given weather impacts. As compared to Q4 year-over-year results, pulls were less negative by almost 0.5 point and year-over-year rates per pull stepped up by 120 basis points.

Landfill trends, while still mixed, are also encouraging. Total tons were up 4% on MSW up 5% and special waste up 8%, partially offset by ongoing weakness in C&D down 5%. Increases in MSW tons were spread across our Western Canadian and Central regions, while special waste activity was broad-based, driving

increases in 5 of 6 of our geographic regions. Most noteworthy, though, was a 20% increase in special waste activity in our Central region, where the pickup in activity we noted in recent quarters had been lagging other markets.

And following up on Ron's comments about improving commodity-driven activity. Recycled commodity revenues improved during Q1, led by an increase in old corrugated cardboard or OCC, which averaged \$89 per ton in Q1 and exited the quarter in line with the 2025 full year average price of \$94 per ton. Additionally, our landfill gas sales increased sequentially as a result of contributions from one of our new RNG facilities currently in startup and also from higher natural gas prices, which spiked in Q1, similar to last year.

Values for renewable energy credits, or RINs, remained stable at about \$2.40 following the EPA's updates for renewable volume obligations. Adjusted EBITDA for Q1, as reconciled in our earnings release, was \$769.5 million, up 8% year-over-year. At 32.5% of revenue, our adjusted EBITDA margin exceeded our expectations and was up 50 basis points year-over-year, driven by 90 basis points underlying margin expansion offset by about 40 basis point drag from commodities. Outsized solid waste margin expansion reflected improvement in several cost items, reflecting favorable price/cost spread dynamics led by strong pricing retention and magnified by benefits from employee retention and safety. These benefits were partially offset by higher fuel and related costs.

And finally, adjusted free cash flow of \$246 million was in line with our expectations and consistent with our full year outlook as provided in February of \$1.4 billion to \$1.45 billion. We were pleased to see Q1 CapEx outlays outpaced last year's slow start, largely as a result of more expeditious deliveries of fleet and equipment and faster progress on projects, including our RNG facilities in development.

Moving next to our balance sheet. We opportunistically accessed the public debt market with a \$600 million note offering in early March to further diversify funding sources. Following that highly successful offering and activities during the quarter, including share repurchases, as noted by Ron, our debt outstanding of about \$9.1 billion had a tenure of over 8 years at an average interest rate of about 4%, with about 80% of our debt fixed. With liquidity of approximately \$1 billion and quarter end net debt-to-EBITDA leverage of about 2.75x, we retain flexibility for acquisitions as well as returning capital to shareholders through additional repurchases and dividends.

And now let me turn the call back over to Ron for some final remarks before Q&A.

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Okay. Thank you, Mary Anne. As we've said, 2026 is off to a great start, and there are a number of factors working in our favor for the rest of the year. The strength of our results is a reflection of the projectability and consistency that sets us apart regardless of the macroeconomic environment. Our industry-leading results are also a reminder of the importance we place on asset positioning and market selection, both of which are fundamental to our strategy and which we believe drive differentiation.

Our results highlight the importance of discipline around capital allocation as well as the value of human capital and culture in driving results. These are the tenets that have guided Waste Connections' approach since our founding over 28 years ago and which remain fundamental as we approach \$10 billion in revenue very soon. To that end, we're most grateful for the commitment of our 25,000-plus employees who live our values every day, putting safety first and making Waste Connections such a great place to work.

We appreciate your time today. I will now turn this call over to the operator to open up the lines for your questions. Operator?

Question and Answer

Operator

[Operator Instructions]. Your first question comes from the line of Tyler Brown with Raymond James.

Patrick Tyler Brown

Raymond James & Associates, Inc., Research Division

Mary Anne, so I appreciate some of the comments on fuel, but I just want to make sure that I've got it. So sorry for this, it's kind of a multipart question. But number one, I just want to make sure that it's clear that kind of over the course of the year, you would expect fuel to be effectively a push from an EBITDA dollar perspective. But then two, if we assume where fuel is and it stays where it is, we clearly need to contemplate higher surcharges, and that will be dilutive on margins. So I assume that needs to be considered. Can you maybe size some of the dilution there?

And then three, for my garbage bill, I believe I paid 2 months in advance. So we also need to consider that there is a lag on fuel recovery. So can you help us think about fuel dilution specifically in Q2? So I know there's a lot there. I'm sorry about that, but just some more color on fuel.

Mary Anne Whitney

Executive VP & CFO

Sure. Happy to address that. And there are a lot of moving parts. And so here's how I'd approach it. First of all, you have fuel impacts that are direct and indirect. And what we know is that the direct impacts are mitigated or impacted by, first of all, the hedges we have in place. So we've got hedged almost 50% of our fuel requirements and then we get fuel surcharges in certain of our markets. And as you said and as we said in the script, largely in terms of the dollar amounts of the impact from fuel, we can recover that over time through fuel surcharges.

You used the term during the year. I'd just remind that since the spike started in March, it goes into next year in terms of the recovery. To your point, there is a lag. The lag is driven by -- it's twofold. One is the mechanism specified by whatever the -- what limits it provides for the surcharge. And then secondly, as you also pointed out, we advance bill customers on a quarterly or monthly basis. And so you can appreciate that when fuel ran in March, customers who we had billed in January, of course, we couldn't have recovered that. We hadn't anticipated it, so it could take, by example, up until May to get that.

So then that brings you to the question of how quickly we recover and to think about it quarter-by-quarter, Q2 would be the toughest, right, because it's the slowest recovery because we're late to the game. By Q3, you're more at that 100% level, and then that continues through the year. So of course, again, as you pointed out, there's a margin impact there when you recover the dollars. And so you get the revenue and EBITDA, but the margin changes. And obviously, that's a function of how big the number is.

Illustratively, if we've got about 50 million gallons that aren't hedged, you then rate that over the course of 3 quarters of the year, you could see how with a couple of dollars higher fuel, this could be as much as \$60 million or \$70 million in incremental fuel surcharges that would run through the P&L, and that would create that margin differential.

So then I think about the other bucket, which is indirect impacts. So moving to indirect impacts, it then says there's an opportunity to have incremental benefits associated with the higher fuel to the extent that there is an increase, for instance, in E&P waste activity. And that, again, we would expect to take longer. We haven't seen it yet as strong as our E&P results were in Q1 that really didn't reflect the pickup in drilling activity. We did see an improvement in commodities. You've already seen a little bit of an offset of those margin drags. And then you would look to continue to see that as we move through the year.

Patrick Tyler Brown

Raymond James & Associates, Inc., Research Division

Okay. Perfect. And then I know I'm sometimes a bit spacey, but maybe I missed it, but did you give any color specifically on Q2 around revenue or EBITDA? And is that a change? Should we think about not getting that forward quarter look? Or how should we think about that?

Mary Anne Whitney
Executive VP & CFO

No. Actually, it's consistent with the way we've been doing it really since last year. And we certainly give guardrails around the movement throughout the year, and I think we did that in Q1 when people laid out their framework for the year. And so I now think about directionally to provide what's changed since our guidance in February.

And of course, as I mentioned, when I look overall at the commodity impact, that's probably improved just based on where the pricing has gone to date, it's probably a 10 basis point benefit versus where we expected things to be in February, and you'd start seeing that in Q2 to the extent it doesn't change from here. And we just talked about the incremental margin headwinds associated with fuel, which would be most felt in Q2 versus the other quarters.

Operator

Your next question comes from the line of Konark Gupta with Scotiabank.

Konark Gupta
Scotiabank Global Banking and Markets, Research Division

The first one, Mary Anne, the underlying margins in Q1, if you strip out the fuel impact, I think they were up 110 basis points, excluding commodities as well. I think in February, you guys were looking at 50 to 70 basis points for the full year. I'm just trying to understand like with the pricing moving to the high end of the range, do you think the underlying margin expansion has potential upside to the 50 to 70 bps you said for the full year?

Mary Anne Whitney
Executive VP & CFO

Obviously, we're excluding fuel in this conversation. But yes, with respect to the fact that we just said we had a nice strong start to the year, that could be arguably another indication of maybe a nice tailwind as we move through the year. We'd always be cautious because you have to have a lot of things go right, and we described all the things that went right in Q1 and acknowledging that those benefits we've seen, for instance, from the human capital-driven benefits as we described with respect to retention and the improvement we've seen there, we've gotten most of those benefits. So I wouldn't think that they continue at the same extent as we move through the year. So you might have a little better improvement in Q1 versus the other quarters and the underlying margin expansion.

Konark Gupta
Scotiabank Global Banking and Markets, Research Division

Okay. That makes sense. And on the M&A side, I think, Ron, you were mentioning about another \$100 million acquisition worth in the coming few months. I just wanted to understand the nature of these transactions. What kind of areas are you targeting? And what kind of assets are these mostly post collection or collection?

Ronald J. Mittelstaedt
Founder, CEO, President & Director

Yes, sure. Well, first, and I was a little -- you broke up just a little, but didn't -- we didn't mean to imply that there was a \$100 million transaction. There's a series of transactions that equate to \$100 million or more, just to clarify. These are all consistent with our traditional, what I'd call singles and doubles, core solid waste transactions both franchise and competitive, both -- we have some integrated transactions in that, meaning collection through disposal and a few smaller E&P tuck-in transactions as well. So everything that's consistent with our existing platform.

Operator

Your next question comes from the line of Toni Kaplan with Morgan Stanley.

Toni Michele Kaplan

Morgan Stanley, Research Division

I wanted to talk about volume. I think last quarter, you had talked about for the year an expectation of down 50 to flattish. This quarter, we did see some nice improvement versus last year, and it was impacted by weather, so even better than the 150. And so my question is, does anything need to happen specifically to get to -- are you still expecting a flat to down 50 for volume for the year? And does anything sort of special need to happen? Or are you running at that sort of pace to get to that level and how much visibility you have in that?

Mary Anne Whitney

Executive VP & CFO

Sure. So I guess a couple of observations. We did see improvement in underlying volumes, as you point out, in Q1, and we're still able to deliver the volumes in line with our expectations in spite of, call it, 25 to 50 basis points of weather impact. Some of that, we'd attribute to that improvement in special waste, which you never -- you try to hesitate to generalize from that because it can be lumpy, and we've had multiple quarters of improvement in special waste. So I'd be cautiously optimistic there.

And then, Toni, the final piece of the puzzle is really that construction-driven activity, which we haven't seen accelerate yet. And so there was some improvement in the underlying dynamics factored into our expectations for the full year that got you closer to that flat or even positive as you exit the year to deliver those numbers as you described. But the good news is that we are seeing that reduction in the shedding or lost contracts. And so that is directionally getting us in the right -- we're moving in the right direction.

Ronald J. Mittelstaedt

Founder, CEO, President & Director

The last thing I'd comment on that, Toni, is -- and I think we commented on this in our remarks was that we -- with our AI pricing tool, we've seen perhaps up to almost a 20% improvement in retention/churn on the same type of price, which led us to a little bit higher performance on price than our 5% to 5.5% guidance. And so that has a component to volume as well.

Toni Michele Kaplan

Morgan Stanley, Research Division

Terrific. And then I wanted to ask about E&P, strong in the quarter, I think up sort of modestly organically, but a nice quarter there. And also, you had sort of mentioned if the fuel prices continue to be high, that could be even more of a tailwind for you. Just wanted to understand, has your pipeline changed? Has it gotten better? Or is this sort of you need a little bit more time for prices to be at a higher level in order to see any sort of impact to the pipeline and future deals?

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Yes. I mean, as you know, Toni, the crude ran with the Iran crisis so precipitously within a matter of days to let alone a week. We have not yet seen any increase in rig count in the U.S., which is what would be needed to drive incremental drilling activity to affect our volumes in the U.S. Now if you have a sustained higher price in crude, you will absolutely see -- there is a mobilization period that takes place that takes time and it takes several months. And producers aren't just going to react on a 4- to 6-week price increase in crude.

But if you have a sustained increase in crude price, they will react, and then you'll see a mobilization of rigs, and we will see greater drilling activity and then that will have an impact. And then, of course, in our Canadian E&P business, that is 80% to 85% production linked. And we have seen some nominal increase in their production because of what's going on with the price of crude in Canada as well, as well as their

ability to export or their desire to. So certainly, if this is sustained, we will see it. But I'd say it's too early to say that producers are reacting to a 4- to 6-week crisis and not knowing if that's -- how long that is going to go on.

Operator

Your next question comes from the line of Faiza Alwy with Deutsche Bank.

Faiza Alwy

Deutsche Bank AG, Research Division

Yes. I wanted to ask about yield. And you've been -- we've been talking about fuel surcharges, but I'm curious if there is sort of this potential for underlying benefit that we could see on yield alone as you look at your contracts where you may not have fuel surcharges, for example. Just curious how we should think about yield going forward from here and if there's room for potential upside.

Mary Anne Whitney

Executive VP & CFO

Sure. So most of our price increases, as we described, are in place or known. And so when I think about the benefit in yield, that could be in '27 more so than in '26. That doesn't mean that there haven't been situations in the past when there's been outsized cost pressures or inflation later in the year, and we've revisited our price increases. But at this time, we think in terms of the recovery through the fuel surcharges that we know we're entitled to and then incremental pricing benefits lagging and into next year.

Faiza Alwy

Deutsche Bank AG, Research Division

Okay. Understood. And some of the benefits that you've been talking about as it relates to retention, just because this is a relatively newer metric you've historically given us core price. Just help us think through like does that show up more now in volume or in yield? And sort of how should we think about that? Does yield still sort of decelerate through the course of the year mechanically? Or should we see, again, like a slight improvement as maybe you lean into some of your technology initiatives a little bit more?

Mary Anne Whitney

Executive VP & CFO

So yield, you should expect yields to follow the similar cadence to what price did because really, what we're talking about is always the dollars associated with the price increases that we've retained and the denominator gets bigger, right? So most of the price increases are done early in the year. So that's a consistent numerator on a denominator that's getting bigger.

What's changed in the way we're communicating it is that arguably before our volume was reflecting any difference in mix and the price volume trade-off, the customer churn that was inherent in delivering the price increase. And so now we've just really shifted it to the yields bucket. So it's a function of those 2 pieces. So of course, as customer churn improves, the yield should reflect some of that. So you will see a little bit, but I would still expect the number, the absolute value to decrease over the course of the year.

Operator

Your next question comes from the line of Adam Bubes with Goldman Sachs.

Adam Samuel Bubes

Goldman Sachs Group, Inc., Research Division

I have a follow-up on E&P. I think on the last call, you talked about expectations for E&P waste revenues flattish for the full year. And in the quarter, I think it was up over 20%. It sounds like that was largely acquisition contribution, but are you seeing outperformance on the acquired revenues? And is the right way to still think about E&P revenues for the full year as flattish because the run rate looks much better right now?

Mary Anne Whitney*Executive VP & CFO*

Sure. So I think the commentary about E&P expectations is that really not much margin contribution was expected. And on an organic growth basis, it was expected to be pretty minimal. And so this is really consistent with what we expected given the fact that we had rollover contribution from acquisitions, but also have the benefit of projects we've done, including at bolt-on acquisitions recently, but also, for instance, reopening one of the facilities we've talked about reopenings. That's why we tried to communicate like-for-like basis to normalize for those benefits.

So I'd say, overall, I still think the margin impact, again, unless we -- or until we get that pickup that Ron was just talking about in terms of drilling activity where it could be more meaningful, I think that would be pretty limited. But yes, the dollar amount would go up because of those incremental projects on the rollover.

Adam Samuel Bubes*Goldman Sachs Group, Inc., Research Division*

Got it. And then I think you're targeting 7 AI initiatives through 2027. It sounds like some of those are already having a real impact. I understand you're going to lap some of the strong margin tailwinds from voluntary turnover, but between continued price cost, the AI initiatives, landfill gas ramping, just at a high level, how are you thinking about potential for continuation of outsized underlying margin expansion beyond 2026?

Ronald J. Mittelstaedt*Founder, CEO, President & Director*

Yes, Adam, I mean, you're correct. We've targeted 7 initial AI initiatives between 2025 and '27. We implemented 3 of those in 2025. We're implementing 2 in '26 and 2 more in '27. We are spending roughly \$25 million to \$30 million a year right now in each year on those initiatives. If you put them all together, the returns have been quite staggering, to be honest. Most of them much quicker than a 1-year payback. As we roll out our routing and other broader digital tools, it really suggests that the returns will meet or exceed the pricing tool return.

I know others in our space have talked about fairly significant margin contribution, and we have no reason to believe it looks any different. We haven't laid out a formal number. But look, we believe as we come out of '27 and head into '28, it is reasonable that through all 7 of those initiatives to expect somewhere approaching about 100 basis points of margin appreciation as we head into '28. So this doesn't just come linearly. Obviously, you load the costs up initially in terms of the capital and the infrastructure. We're in that phase and still delivering what we're delivering and then you see those improvements as things get fully implemented in the field and deployed, which takes time.

It takes time to reroute 570 locations with 15,000 trucks. That's going to take all the way through the majority of '27 as an example. So we feel extremely confident and are very excited about what we're seeing from AI. It has outpaced our expectations in virtually every manner, but it is a complex implementation. But those 7 initiatives are all on pace. If anything, we think we're a little bit ahead. But I think that 100 basis points is a fair expectation as we come through getting all 7 implemented.

Operator

Your next question comes from the line of Bryan Burgmeier with Citi.

Bryan Nicholas Burgmeier*Citigroup Inc., Research Division*

Maybe just following up on E&P. Just curious if you think the kind of 4% growth rate that you flagged in 1Q is an appropriate number for 2Q or 3Q. I'm not sure if maybe that 1% number only captured 1 month of improvement, so maybe 2Q could be even better. Also, I don't want to kind of get ahead of ourselves. So any detail on that would be great.

Mary Anne Whitney

Executive VP & CFO

Well, I think the key thing is that we haven't seen a pickup in the drilling activity, frankly. So really, that would be the determinant. So I would say watch the rig count, and that will be the leading indicator that, that could improve. I wouldn't encourage you to think that there's been a recent run-up and that you should then increase that for a full quarter. As we've said, we really haven't seen it yet. Underlying activity is up nominally is the way we described it. And so I'd say it'd be a little premature to go that far.

Bryan Nicholas Burgmeier

Citigroup Inc., Research Division

Okay. That makes sense. And last question, and I can turn it over. I think we're targeting like \$30 million of EBITDA from natural gas this year. I guess, a, is that still accurate? And then, b, did any of that sort of come online in 1Q? Or do we think about that being mostly kind of back half weighted?

Mary Anne Whitney

Executive VP & CFO

Yes. So I think you're referring to the RNG or landfill gas sales where nat gas is a tiny piece of it, and we talked about that spiking in Q1 as it did last year. But what I'd say is it's always good news when you get a contribution from a facility in start-up. A reminder that start-up comes up -- comes with a lot of expenses. So you're working through that as you start these facilities. But we look forward to having more visibility. And certainly, we'd expect in July when we revisit all of our expectations, we'll have a little better visibility on our RNG projects.

But we still are on track to have those facilities come online as we have described, so that our or a dozen-or-so, about half of them were still to come that we'd expect that by year-end. And so maybe some are a little early and some are a little later, but it's right in line with our expectations.

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Yes, Bryan, just to reiterate on Mary Anne, we originally outlined 12 RNG projects, 5 were online by the end of '25. One came online in the first quarter -- the end of the first quarter of '26. So really no contribution or very de minimis. And we plan to bring another 6 online by year-end, most likely most of those coming online in the fourth quarter to give us all 12 online for next year. We remain confident in that. And so the CapEx on RNG will come to effectively an end for these first 12 and then the EBITDA contribution from those will come in '27 and beyond. So you will sort of have a double impact to free cash flow starting in '27 from the RNG.

Operator

Your next question comes from the line of Trevor Romeo with William Blair.

John Trevor Romeo

William Blair & Company L.L.C., Research Division

I had one more follow-up on the E&P business. I think, Mary Anne, you talked about one of the previously mothballed facilities coming back online. So can you just remind us, do you have more of those mothballed facilities kind of still off-line at this point? Or just sort of any other organic project growth opportunities or anything like that, that could still happen in the future and what the decision would look like on those?

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Sure. Trevor, this is Ron. So when we acquired in February of '24, 30 facilities from Secure that were disposal, landfill and processing facilities, 25 of those were operational. There were 5 smaller facilities that were mothballed. To date, we have brought online 2 of those 5 facilities. So there's 3 that we will

continue to make market dynamic decisions on whether we will reopen those or not. These tend to be smaller facilities, but contributing \$2 million to \$5 million in EBITDA per facility sort of as we open them. So collectively, they're meaningful.

And as I said, we've opened 2. We are evaluating. And of course, demand will depend on whether we open one in the latter part of this year or not. I wouldn't expect it to be meaningfully contributive. But as I said, the aggregate and the rollover is meaningful as we go forward.

John Trevor Romeo

William Blair & Company L.L.C., Research Division

Okay. That's really helpful. And then maybe just switching over to the New York City market. I think there was some reporting recently about time lines on some of the waste zones and the rollout kind of shifting around a bit. I know you've also kind of added to your presence there with acquisitions in the market or in the region kind of the last several quarters, let's say. So all that said, could you maybe just give us an update on how the city rollout and your kind of positioning and strategy is going there?

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Sure. Happy to. So the New York City market is going through the implementation of a nonexclusive franchise system from an openly competitive system where there were hundreds of smaller in this term called carters or haulers in the city for the commercial waste. They have divided the city into 30 commercial zones amongst the 5 boroughs. And they have awarded 3 franchise haulers per zone. No hauler is allowed to have more than 15 zones.

We have the maximum at 15. We have -- most of our zones are in Manhattan and Queens and The Bronx. We have a fully integrated position. We have multiple transfer stations in our zones. And we also have 5 MSW and C&D landfills that we are feeding that volume to or can feed it to over the coming years. I think it's safe to say we're really the only fully integrated company in New York City in those zones.

So it is an opportunity that we are very excited about. It is coming along. But the city is going through some changes, as you know, in leadership, et cetera. No impact to the franchise system other than they are slowing the implementation a bit in some of the zones just because it is such a change. And so it's pushing back between 6 and 12 months, the implementation of their original zone scheduling. So it's sort of -- they hope to have everything implemented sort of by the end of '27. And now we're hearing that plan is sort of the middle of '28 to the end of '28 by the time everything is implemented. So no other change than a 6- to 12-month delay on the full implementation of the zones.

Operator

Your next question comes from the line of Jerry Revich with Wells Fargo.

Jerry David Revich

Wells Fargo Securities, LLC, Research Division

Ron, I just wanted to circle back to the performance at Arrowhead. So you folks have ramped that operation up really nicely over the course of this year. Last quarter, we spoke about internalization rate approaching 60% for the company. That's one of the contributing factors. What can that look like on a multiyear basis now as you folks have delivered on the higher capacity? How much higher could you take volumes at the landfill over the next couple of years? And where could internalization rate for the company go as you continue to ramp that up?

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Sure. Well, I appreciate the kind words about the achievement of that, Jerry. It's been a lot of work by our team to get there. Look, we are right now or this year running between 7,500 and 8,000-plus tons a day at our peak when we add Arrowhead. We have a plan to get that to 8,500 to 9,000 as we roll into 2027

for the year, then this takes a number of incremental step changes in trackage, both in Arrowhead, at the landfill as well as at the intermodal facilities along the East Coast.

And so that is in the process of being implemented and laid by Norfolk Southern. So we have a cap, if you want to use that word, of 15,000 tons a day is what the facility is permitted for and that's on a 7-day, 365-day year, 24-hour a day permit cap. So there's still obviously a lot of room. So I'm not going to sit here and tell you that in 5 years, we're going to get to that. But I do believe that we will get north of 10,000 tons a day, it's somewhere in the 2- to 3-year mark from now as we sit here.

As we continue to grow, that will move the internalization on that objective into the low to mid-60% level, which, as you know, and those that follow us know, it means we're really actually more than 80% internalized in our competitive market footprint, which is where it really matters. And when you compare it against competitive market models, that's very, very high. So it is something we're focused on, but it is playing out about as we had hoped.

Jerry David Revich

Wells Fargo Securities, LLC, Research Division

Super. And then just a shorter-term question. Impressive pricing in the quarter and so you folks were able to put up really good margins even with the diesel headwind. Can you just talk about how pricing cadence played out over the course of the quarter? To what extent did that reflect you folks managing the business for these pockets of inflation? Or any other comments that you would make on the outperformance in the quarter?

Mary Anne Whitney

Executive VP & CFO

Sure. Well, what I'd say about the outperformance in the quarter is that what's really great about it is it came from so many different places. And I will say that pricing retention was a little stronger than expected, and we'd attribute some of that to the success of rolling out that AI price optimization tool that we've talked about. So we've continued to see benefits there. We'd also say that our human capital-driven initiatives and being fully staffed and providing the level of service that allows us to defend those price increases has continued to be additive.

And then again, as we've said, all these initiatives have driven small improvements in a number of areas. And so when I look through what drove the 110 basis points of underlying margin expansion, it's pretty much every line item with the exception of fuel and related costs there, which was about a 20 basis point drag that as we've described. So I would say, Jerry, that's how we think about the outperformance.

Now that was augmented by the fact that we had strong special waste volumes. And so landfill volumes were a little better than expected. So that's a good guy. Commodities improved over the course of the quarter. So that's a little good guy. So all those pieces working together helped to drive the margin expansion.

Operator

Your next question comes from the line of Seth Weber with BNP Paribas.

Seth Robert Weber

BNP Paribas, Research Division

Just another margin question. Your SG&A was basically flat year-over-year with higher revenue. I just -- was there anything unusual in that number in either number year-over-year? Or is there any reason to think why you can't kind of continue to keep SG&A flattish year-over-year going forward with all these initiatives you're talking about?

Mary Anne Whitney

Executive VP & CFO

Yes. There can always be some noisy things, whether it's incentive comp or other pieces. We certainly -- and that always hits in Q1. We certainly have talked about the fact that for our AI initiatives, we've hired, we've incurred some upfront costs in order to drive those benefits we're seeing. So that would be a contributor. But really nothing to call out there. Just a reminder that there's always a lot of moving pieces quarter-to-quarter.

Seth Robert Weber

BNP Paribas, Research Division

Okay. And then just in your prepared remarks, you talked about strength in the volumes in the Western region. Can you just put any more color behind that? What's driving that? Which areas, in particular, which markets?

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Sure. Seth, this is Ron. Yes, I think one of the reasons we point this out, and again, for those that have followed us for quite some time, the West region is what we call our exclusive region and our franchise region. And the benefit of that is that we get 100% of all volumes wherever they're generated, and we get them at a guaranteed price of the franchise. So I think it just shows that, that model derives a very strong volume and stability benefit, which is why we like it.

We had strong landfill and special waste growth in our Eastern Oregon landfills as well as in some of our Northern California landfills, as an example. So -- and we saw consistency and as Mary Anne noted, improvement in roll-off volumes in our West, again, because we get everything. So not only was our price per pull up there, but if our pulls actually per day were up there as well.

So you do not have that price/volume competitive trade-off in the West, and I think that was what we were trying to note more than anything. And so that probably more reflects the underlying economy at -- maybe a 0% to 1% type real GDP going on right now. So that was really what the commentary was about.

Operator

Your next question comes from the line of Shlomo Rosenbaum with Stifel.

Shlomo H. Rosenbaum

Stifel, Nicolaus & Company, Incorporated, Research Division

Ron, I just wanted to ask you a little bit more about what it looks like in terms of the cyclical parts of the business? It seems like special waste continues to be strong. C&D was down 5%. I think last quarter, it was down 4%. Maybe it's bouncing around a little bit. You noticed the pulls getting less negative. Are we -- are you seeing this as an improvement? Are you seeing this as kind of a flattening out? Like where do you see that we are? And where do you think that we're going to end the year in terms of overall economic activity? And where do you see the trajectory of the business in that way?

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Well, obviously, if I understood that, we'd be in a different business. But I'll give you what we believe, how is that? Look, special waste being up for the sixth consecutive quarter. In our industry, special waste is traditionally a leading indicator. So -- and the reason is it is predominantly speculative cleanup for development of commercial or residential real estate. That is predominantly what special waste is. So that usually precedes infrastructure and construction development of some point -- at some point. So that's a positive.

Now C&D being down 4% to 5%, that's a real-time indicator of what activity is predominantly in construction, okay? Now you don't do a lot of construction in Q1 because of the winter weather. So that's a little hard to say, is that an indicator of the economy or not. I would tell you it's probably not. I think we feel like there's pent-up demand starting to come. We're not seeing any negative indicators in our business.

Obviously, if the Iran situation drags on and fuel remains elevated for consumers and businesses, that could be a pinch point in the economy. But assuming, hopefully, that this is a relatively short-lived situation and fuel retreats by the second half of the year, we think there's a lot of positive momentum in the underlying economy that should start to come through. So I would tell you to your comment, we would say flat to improving was how you asked the question, and that's where we would say it is.

Mary Anne Whitney

Executive VP & CFO

The other observation from it would be that, that was our 10th consecutive quarter of negative C&D volumes, right? So clearly, this has been around for a while, roll-off pulls similarly. At some point, the comps get that much easier, and so you should see it get better. And so that was kind of the expectation going into the year that maybe things became less negative. As Ron said, Q1 is probably not the right time to look for it, but that's how we're thinking about the business trajectory.

Shlomo H. Rosenbaum

Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. And then just shifting back to a question you touched on in rail and how you're continuing to internalize more over there. I just wanted to ask, is there -- in terms of what's going on to the rail as you're ramping up the tons, is it primarily internalization? Or are you seeing some also at the landfill third-party contributing to some of the growth in the tons there as well? I'm asking that both kind of strategically and then also just in terms of where the pricing is for rail versus kind of the stuff that is landfilled more locally?

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Sure. So at this point, Shlomo, most of what is going on the rail, our rail, at least in our situation, is a greater amount of internalized tons. Now that has been very purposeful. We've taken tons over the last 1.5 years that were going into third-party sites on the Eastern Seaboard. Some of those our sites, some of those third parties, and we've internalized some of that volume. We have not yet pursued aggressively third-party volumes into our intermodal transfers on the Eastern Seaboard because we have had some capacity constraints at some of our Northeastern landfills.

So we have pulled down some of our volume there and internalized it on the rail so that we could take customer volumes into those landfills. And so as that alleviates itself here over the next year to 2 years at a couple of our sites, we will be able to pursue more third-party volume onto our rails, and that will be incremental to us. But we have not yet done that. So this has been mostly internalized volume at this point in time.

Look, as far as the competitiveness of the rails, look, the longer you go, the farther you go, in our case now, rail is going 1,500 to 1,800 miles from the Eastern Seaboard to Alabama. So it's quite some distance, you start becoming more competitive with an increasing fuel surcharge than you do on over the road. If you were going a shorter distance, trucking would be more cost effective. But when you start talking longer distances, rail is more cost-effective than trucking.

Operator

Your next question comes from the line of Noah Kaye with Oppenheimer & Co.

Noah Duke Kaye

Oppenheimer & Co. Inc., Research Division

Great. The first one is on yield and price. I would just observe that this 130 bps spread between core price and yield is already quite tight in a positive way for this industry. And so I'd guess that spread probably tightened year-over-year given the intentional shedding moderating and some of the AI and turnover and safety initiatives. But is there any way to dimension or confirm what kind of improvement in the spread might have been year-over-year? And how should we be thinking about that sort of spread for '26 as a whole? How should we be modeling that?

Mary Anne Whitney

Executive VP & CFO

Sure. So when I look back and try to do apples-for-apples in prior periods, I'd say I agree with you overall that, that churn was probably running more in that 150 to 200 basis points for several quarters. And so some of what we've seen is a tightening there. What gets a little trickier, as you can appreciate, Noah, is that mix factors into this and so does seasonality, therefore.

And it's a reminder that when we look at, for instance, selling in the Northeast and that rates per yard can be twice as much as they are in, say, our Mid-South or Southeast region, that is another factor that's influencing what that amount is, which is frankly why we thought it was good to get it out of volume because it was overstating the negative volumes in a way that felt punitive.

So what we're really trying to do is achieve some parity with our peers or comparability with our peers, and we're going to acknowledge that it's still imperfect, but I think that's another consideration to have, which could cause a little variability.

Noah Duke Kaye

Oppenheimer & Co. Inc., Research Division

Okay. And then related, it looks like risk management as a percentage of COGS improved 30 bps year-over-year in the quarter. You've talked in the past about risk management as a lagging benefit of improved safety rates. Was that in any way a positive surprise? And how are you thinking about in the guide risk management as a benefit to margins for '26?

Mary Anne Whitney

Executive VP & CFO

Yes. As you'll recall, we called it out in Q4 that, that was the first time we'd really seen it flip from being a headwind to a tailwind. And so was it a surprise? Look, it's always encouraging when you see the trends that you've expected to see in the business materialize in the numbers, you're always cautious because you can't generalize. But 2 quarters is certainly good to see.

And yes, we came into the year, Noah, as you'll recall, we've talked about the fact those drivers for outsized margin expansion, we said this was really the final piece of those human capital-driven benefits, the lagging benefit of risk. So is it generally in line with what we were hoping for this year? Yes. It will vary quarter-to-quarter, but this is the right way to think about it. It's a good guy that was factored into our expectations.

Operator

Your next question comes from the line of Kevin Chiang with CIBC.

Kevin Chiang

CIBC Capital Markets, Research Division

Congrats on a strong start to the year here. Maybe just a follow-on on, I guess, a number of questions that were asked along the same vein. Just on the special waste, I appreciate a lot of the moving parts in Q1 can be a little bit noisy with weather. But I guess when you look back historically, what type of lead indicator is special waste to total volumes? Like does it typically lead total volume inflection by like a year, 6 months, 18 months? Is there any like rule of thumb that we can point to when you see this type of special waste improvement over such a long period of time?

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Yes. I mean I think, Kevin, it's a little anecdotal, but I would tell you that generally, it's certainly in that next 6 to 12 months. I mean, look, this is property being cleared by developers who have pulled permits to do speculative construction or development. So that's shopping centers, infrastructure, apartments,

homes, et cetera. So you're probably talking that, that goes on for that lot clearing and cleanup goes on for 3 to 9 months and then construction begins.

So we've talked about it, it's improving for 6 consecutive quarters now. So I think it's reasonable to expect that by this summer, as we go into the summer and through it, you should see some pickup in C&D and flow through into the solid waste business. I mean that would be a traditional pattern.

Kevin Chiang

CIBC Capital Markets, Research Division

That's helpful. And maybe if I can ask the yield and core price question over a longer period of time. You're definitely gaining traction with some of your AI revenue management strategies here. Like when you look at -- whether it's a ratio or a spread, does that change over time as you look at some of the benefits from this AI tool? Like do you reduce churn and so it helps the yield or maybe the rollbacks also improve, so maybe the net impact on the numerator and denominator are kind of equal? Just wondering how that ratio may or may not be impacted as you gain momentum on some of these revenue management initiatives driven by AI.

Mary Anne Whitney

Executive VP & CFO

Sure. So as you know, Kevin, first of all, of course, the absolute value of whatever this number is, is a function of what our costs are doing. So to the extent that we're seeing benefits in costs that say we need less price, that will factor into what you see, whether it's price or yield. Now specific to yield as compared to core price, I would expect, and we look forward to, needing to put less price on the street, but to retain more because of these tools.

And as we've said, that's one of the benefits we're already seeing. And ultimately, as we've described, it's really keeping the customer longer that's the greatest benefit. And so I would expect there to be some improvement in yields, but that would be tempered by the need for less price overall. So I'm not -- we'll take both of those things into consideration in terms of expectations for what those numbers look like.

Operator

Your next question comes from the line of Tobey Sommer with Truist.

Tobey O'Brien Sommer

Truist Securities, Inc., Research Division

If I could ask a follow-up question on the rail point. As you look at the business and the industry over a long stretch of time, how do you see the volumes shifting towards rail? And how -- what are your plans to help drive that change beyond Arrowhead? I imagine with the success you've experienced, you're looking at other ways to drive that change.

Ronald J. Mittelstaedt

Founder, CEO, President & Director

Yes. Tobey, I mean, obviously, look, today, rail is predominantly or almost exclusively a Northeastern Seaboard modality for waste because of very high tip fees in the Northeast because of landfill scarcity. You're not building new landfills in the Northeast, and it's obviously difficult to expand landfills in the upper Northeast. So the combination of all of that is ripe for rail to take waste out of the geography. As landfill airspace scarcity gets tighter in other parts of the country, such as along the lower East Coast Seaboard, as an example, down in through Florida and the Carolinas, I think you will begin to see similar things happen at smaller levels there next.

You still have a very -- a large amount of airspace available in the Southeast and in the Midwest and in the Rocky Mountains at relatively inexpensive cost relative to the Northeast. So it's not as conducive in that geography for rail. And then on the West Coast, in the Pacific Northwest, you do have rail as a very large modality that has been in place for quite some years in Washington and Oregon. You do not have it really in California, and I would not expect it there anytime soon. So look, you really need to be moving

the volumes somewhere probably north of 300 to 400 miles for rail to make sense in most -- or tip fee environment.

So as you go forward 5, 10 years and you continue to see consolidation of landfills and increasing airspace rates or tip fee rates, you will see more and more rail as waste moves economically farther. So look, without divulging to the last part of your question, let me just say, stay tuned. And I think with -- for us, you will see an incremental rail opportunity that will happen in 2026, and I'm quite confident in that. So it will continue to develop throughout the industry. It will be slower, but follow landfill tip fees and the price of crude because those are the 2 things that as they move up, rail becomes more and more economical.

Operator

We have reached the end of the Q&A session. I will now turn the call back to Ron Mittelstaedt for closing remarks.

Ronald J. Mittelstaedt

Founder, CEO, President & Director

If there are no further questions, on behalf of the entire management team, we appreciate your listening to and interest in the call today. Mary Anne and Joe Box are available today to answer any direct questions we did not cover that we are allowed to answer under Regulation FD, Reg G and applicable securities laws in Canada. Thank you again, and we look forward to connecting with you at upcoming investor conferences or on our next earnings call.

Operator

This concludes today's call. Thank you for attending. You may now disconnect.

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