26-Apr-2017

Covanta Holding Corp. (CVA)

Q1 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to the Covanta Holding Corporation's First Quarter 2017 Financial Results Conference Call and Webcast. An archived webcast will be available two hours after the end of the conference call and can be accessed through the Investor Relations section of the Covanta website at www.covanta.com. The transcript will also be archived on the company's website.

At this time, for opening remarks and introductions, I'd like to turn the call over to Dan Mannes, Covanta's Vice President of Investor Relations. Please go ahead.

Daniel Mannes
Vice President-Investor Relations, Covanta Holding Corp.

Thank you, and good morning. Welcome to Covanta's first quarter 2017 conference call. Joining me on the call today will be Steve Jones, our President and CEO; and Brad Helgeson, our CFO. We will provide an operational and business update, review our financial results and then take your questions.

During their prepared remarks, Steve and Brad will be referencing certain slides that we prepared to supplement the audio portion of this call. Those slides can be accessed now or after the call on the Investor Relations section of our website, www.covanta.com. These prepared remarks should be listened to in conjunction with these slides.

Now, on to the Safe Harbor and other preliminary notes. The following discussion may contain forward-looking statements and our actual results may differ materially from those expectations. Information regarding factors that could cause such differences can be found in the company's reports and registration statements filed with the SEC.

The content of this conference call contains time-sensitive information that is only accurate as of the date of this live broadcast, April 26, 2017. We do not assume any obligation to update our forward-looking information unless required by law. Any redistribution, retransmission or rebroadcast of this call in any form without the expressed written consent of Covanta is prohibited.

The information presented includes non-GAAP financial measures. Because these measures are not calculated in accordance with U.S. GAAP, they should not be considered in isolation from our financial statements, which have been prepared in accordance with GAAP. For more information regarding definitions of our non-GAAP measures and how we use them as well as the limitations as to their usefulness for comparative purposes, please see our press release which was issued last night and was furnished to the SEC on Form 8-K.

With that, I'd like now to turn the call over to our President and CEO, Steve Jones. Steve?

Stephen J. Jones

President, Chief Executive Officer & Director, Covanta Holding Corp.

Thanks, Dan and good morning, everyone. For those of you using the web deck, please turn to slide 3. I'll start off with a quick overview of our financial results and the key drivers impacting the quarter.

Adjusted EBITDA was $51 million and free cash flow was negative $17 million. These results were in line with our expectations and we are affirming our full year 2017 guidance. As you know, as we mentioned on our last earnings call, our first quarter results typically reflect our heaviest maintenance spend for the year and our planned maintenance schedule in 2017 was more front-end loaded than in prior years.

In addition, we ended up moving even more maintenance activity into the first quarter to get some of the work done while a few of our plants had unplanned downtime, most notably our Fairfax facility, which is recovering from the fire in February. While this, of course, had a dampening effect on Q1 results, it should lead to higher revenues and lower costs through the balance of the year.

At Fairfax, we're making good progress towards returning the facility to operations later in Q2. The primary effort is around repairing and reinstalling the refuse cranes and we're working closely with Fairfax County to ensure that we have joint agreement on any required fire safety enhancement.

The fire damage and resulting downtime are covered under our insurance programs, so bear in mind that recoveries for property damage, lost revenue and incremental cost will be received later in the year. The overall impact of Fairfax to our full year 2017 results will be relatively small and was already factored into our guidance.

Before I go into detailed operating review, I want to update our progress on some key initiatives during the first quarter. Our state-of-the-art Dublin facility is nearing completion as well into commissioning. We began receiving waste deliveries earlier this week and plan to begin processing waste in the next few weeks.

We will then begin the work through performance testing and all other related start-up activities. We remain on track for commercial operations by the beginning of the fourth quarter. We're excited to start delivering world-class service to Dublin and to surrounding communities.

During the quarter, we saw strong performance in our waste business as pricing continues to firm amid better industry-wide volumes. Our Covanta Environmental Solutions platform again was a key contributor to performance at our EfW plants through sourcing more profiled waste while also organically expanding Environmental Services revenue.

After a long period of weak commodity prices, metals prices rebounded nicely in Q1, particularly for ferrous. While we anticipate some pullback in the HMS Index over the remainder of 2017, we expect metals prices to be a meaningful driver year-over-year.

Lastly, we opportunistically executed a $400 million debt refinancing in order to both extend the term and lower the coupon. Brad will provide more on the benefits of this transaction in his comments.

Now, get into detail on our markets and operations. I'll start with the waste business, please turn to slide 4.

In our waste contract portfolio, we reached an agreement to extend our long-term client relationship at the SECONN facility under a new four-year tip fee contract, transitioning from its previous service for fee structure. We're happy to continue to provide sustainable waste disposal services to these client communities.

During the quarter, our EfW processing revenue grew $4 million or 1.7% on a same-store basis. Overall, average waste revenue per ton increased by about 3% organically, driven by contractual escalation, higher spot market prices and growth in profiled waste. Volume was lower year-over-year due to the facility downtime previously noted, which impacted revenue by $3 million in the quarter.

The first quarter showed solid growth across our Covanta Environmental Solutions platform. We closed on two small acquisitions in the quarter that further expanded both our geographic footprint and service offerings.

Our sales team drove 12% year-over-year growth in internalized profiled waste, benefiting overall EfW waste pricing as I just mentioned. In addition, we grew Environmental Services revenue at our existing material processing facilities by 26% on an organic basis through stronger sales performance and continued integration of the platform.

Now, let's move on to energy. Please turn to slide 5. For the second year in a row, winter weather was quite mild, but importantly, our highly hedged book helped mitigate the weakness in market prices. Total revenue declined 2.5% in the quarter on a same-store basis. So the majority of the reduction was due to lower volume given plant downtime.

Separately, the transition of legacy long-term power contracts to market prices net of improved revenue sharing following service to tip fee transition unfavorably impacted energy revenue by $4 million.

In line with our disciplined hedging strategy, full year 2017 exposure is now only 1.3 million megawatt hours. Looking ahead to 2018, we've already hedged 1.7 million megawatt hours, increasing our contract in hedged positions to 55% of total megawatt hours on a production basis. We will continue hedging our 2018 exposure as we move through this year.

From a market perspective, while we've seen improvement in natural gas prices given improving demand and lower production, the outlook for power remains muted.

Let's move on to the metals business on slide 6. Ferrous revenue increased by $2 million versus the first quarter of 2016. Realized prices nearly doubled amid higher HMS prices and our expanded processing efforts. Recovered volumes were up slightly year-over-year, though sales were lower due to the timing of product shipments.

The ferrous market showed meaningful strength year-over-year with the HMS #1 Index averaging $272 per ton, a 72% improvement over the first quarter of 2016; the HMS Index price for April at $258 per ton. Year-to-date prices are well ahead of our full year guidance of $200 to $250 per ton on HMS. However, we remain cautious regarding the potential impact of weakening iron ore prices on scrap metal as the year progresses.

On the non-ferrous side, revenue increases by $1 million or 14% on a same-store basis as increased recovery drove higher volumes while realized pricing was roughly flat year-over-year.

We're now in the start-up of our non-ferrous processing facility in Eastern Pennsylvania. As this facility moves into full operation and processes the majority of our recovered non-ferrous, we expect realized sales prices to materially improve. This will be partially offset by modest declines in sales volumes on a year-over-year basis as the material is cleaned.

The cover photo of this presentation shows the processing unit as well as the sample of the coin that we can now – that this process can now separate.

Let's move on to operating expense and CapEx. Please turn to slide 7. Total EfW maintenance spend in the quarter, including both expense and CapEx, was $122 million versus $120 million in Q1 2016. This modest increase was driven primarily by scheduled maintenance and the acceleration of planned work at certain facilities, including Fairfax, during unplanned downtime in the quarter.

Looking at the full year, our outlook for EfW maintenance expense between $275 million and $285 million is unchanged. First quarter EfW maintenance expense of $97 million represented nearly 35% of the full year forecast as a midpoint of our guidance, which is a greater percentage than we've seen in the last two years. This is simply a timing issue given our schedule as well as the tactical decision to accelerate some maintenance into Q1 as I mentioned. This implies that the balance of our maintenance spend for the remainder of the year should be roughly flat year-over-year on a dollar basis.

Other plant operating expenses increased 8% on a same-store basis compared with Q1 2016, driven by some higher cost related to plant downtime, including hauling and disposal and purchased power costs as well as expenses related to the organic growth of Covanta Environmental Solutions that I mentioned earlier.

I'll quickly wrap up with a note on our progress on a couple of key strategic initiatives. No big news yet, but we're moving the ball forward. We continue advancing our project development pipeline in the UK and we're excited about the opportunities we see in that market. We look forward to discussing these with you in greater detail when the time is right.

Similarly, with respect to our total ash processing initiative, we're now in the permitting process on our first facility and we'll provide a more detailed update when permitting is in place and we move into construction.

To conclude, while the year is still young, I'm very pleased with the progress we've made to-date, and we're well-positioned to begin to show meaningful growth over the coming quarters and beyond.

With that, I'll turn the call over to Brad to discuss the first quarter financial results in more detail.

Bradford J. Helgeson

Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

Thanks, Steve. Good morning, everyone. I'll begin my review of our first quarter 2017 financial performance with revenue on slide 9.

Total revenue was $404 million in the quarter, up $1 million over Q1 2016. Revenue increased $14 million on an organic same-store basis. Within that amount, our core business activities, excluding commodity price changes, generated $7 million year-over-year. Steve reviewed the key drivers of this growth in the quarter, most notably higher EfW waste prices and growth in the Environmental Solutions business, partially offset by the impact of plant downtime.

Recycled metal prices represented a $6 million tailwind as we saw improved markets for both ferrous and non-ferrous material. Transactions and contract transitions together were a net headwind of $12 million year-over-year, driven primarily by the sale of our China operations in 2016 and the impact of long-term power contracts rolling off.

Moving on to slide 10. Adjusted EBITDA was $51 million in Q1 2017 compared to $76 million in Q1 2016. On a same-store basis, adjusted EBITDA was $19 million lower year-on-year. Excluding the benefit from higher commodity prices, adjusted EBITDA related to core business activities was lower by $26 million in the quarter, primarily due to increased downtime, including at Fairfax.

Let me take a minute to review the impact of plant downtime in the quarter in more detail and explain why the effect on our full-year outlook is far less significant. In aggregate, unplanned downtime at three facilities reduced adjusted EBITDA by approximately $23 million in the quarter. These were Fairfax and extended outage to enhance boiler performance at Durham York and an extended turbine outage at another facility. I'll note that the latter two facilities came back online within the quarter and are running well.

In the P&L, the $23 million impact in the quarter was roughly split between revenue, which was visible on the previous slide as an offset to an otherwise strong quarter across the board on the top line and plant's operating costs, which again were roughly split between the maintenance and other plant operating expense lines.

On the cost side, higher maintenance related to downtime resulted from accelerating planned activity into the quarter in order to optimize plant operations for the remainder of the year as Steve described. Within other plant operating expenses, higher cost related to downtime included hauling and disposal for bypassing waste and the cost of purchasing power to run facility systems while turbines were down.

Looking ahead to the full year, while these events clearly dampened the results for Q1, we expect a very limited year-over-year impact when accounting for improved output during the balance of the year after having completed some maintenance early as well as the recovery of insurance at Fairfax, which will be realized over the remainder of the year. Again, this was all contemplated already in our full year guidance.

Moving on, commodity prices were net benefit to adjusted EBITDA with metal prices contributing $6 million on a year-over-year basis and energy capacity prices higher by $1 million. Transactions, mainly the sale of our China operations in the first half of 2016, reduced adjusted EBITDA in aggregate by $3 million on a year-over-year comparable basis in the quarter.

Contract transitions also represented a $3 million net decline as a $7 million negative impact from the expiration of above-market long-term power contract was partially offset by the benefit from waste and service contract transitions.

There's no change to our full-year guidance on adjusted EBITDA, nor to our expectation for 3% to 5% organic adjusted EBITDA growth excluding commodity prices.

With the Fairfax insurance recoveries, a flat level of maintenance year-over-year as Steve mentioned, improved production volumes and continued strong performance in our EfW Waste and Environmental Solutions businesses, we expect organic growth to be more visible in the coming quarters.

Turning to slide 11, free cash flow was negative $17 million in the first quarter compared to negative $1 million in the prior year. Excluding changes in working capital, free cash flow was down $15 million year-over-year. This change is broadly explained by the lower adjusted EBITDA, partially offset by lower maintenance CapEx relative to the same period last year.

Turning to slide 12, our growth investment outlook reflects a modestly higher expectation for organic growth projects relative to our commentary on the fourth quarter call. The estimated total is now approximately $30 million for 2017, which is $5 million higher than our previous outlook with the increase related to metal recovery and processing systems and new equipment for growth in the Environmental Solutions business.

We also completed two small acquisitions in our Environmental Solutions platform in the quarter, only one of which was included in our previous forecast. So we've updated the outlook for that activity as well.

Construction of the Dublin facility remains on track, as Steve discussed earlier, but our outlook for spend this year to complete the project, unchanged.

Turning to slide 13, I'll conclude with an overview of our balance sheet and leverage ratios. Net debt increased by $115 million in Q1 to $2.66 billion. This was on plan given the continued drawdown of project debt to fund the construction of the Dublin facility as well as our seasonally negative free cash flow in the first quarter.

During the quarter, we exercised our call option on $400 million of 7.25% high yield notes due 2020 and issued $400 million of new unsecured notes maturing in 2025 at a coupon of 5.875%. This opportunistic refinancing added five years of term consistent with our strategy of maintaining balance sheet stability by proactively extending maturities and reduced the annual coupon by $5.5 million. This very strong execution represents a clear signal of the debt market's view of our credit quality.

As a housekeeping note, we had completed the bond issue in March, but the call of the existing notes occurred in early April. So as a result, the quarter-end balance sheet temporarily included both sets of notes as well as the cash from the offering.

The net debt-to-adjusted EBITDA ratio at the end of Q1 was 6.9 times. We expect leverage to peak in Q2 and Q3 before beginning to track down after Dublin comes online. With a full year of contribution from Dublin, we expect leverage to quickly return below 6 times on a net debt-to-adjusted EBITDA basis, all else being equal, as the next step on our long-term deleveraging trajectory.

The leverage ratio covenant under our senior secured credit facility was 3.4 times at March 31 versus the covenant limit of 4 times. This covenant excludes the unsecured holding company debt as well as the project debt at Dublin, with the latter to be included in the ratio once the facility has been operational for a year. Additionally, we continue to maintain substantial liquidity with $458 million in available capacity under our revolving credit facility.

Before we conclude, I want to repeat that Q1 is traditionally our weakest quarter from an adjusted EBITDA perspective and that certainly was the case this year as the typical seasonality was magnified given plant outages and accelerated maintenance activities. We expect significantly improved results in the second half of 2017, with an even more pronounced upward trend from first half to second half in our results exhibited last year.

With that, operator, we'd like to transition to Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operating Instructions] Your first question comes from Noah Kaye from Oppenheimer & Company. Your line is open.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Thanks very much. Maybe we could start with just a couple of housekeeping things. I wanted to clarify, you mentioned 55% of your energy output for next year is either contracted or hedged. Does that include – does 55% include the output from Dublin? Because I understand that a significant portion of that would command a very high premium tariff.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Yeah, it does. And that percentage of the Dublin output would be sold down as a tariff and effectively the fixed price is about 50% of the output.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

That's great.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

But, yeah, that does reflect that.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

And then just respect to metals, I noticed that you – the gap between recovered and sold metals quantity in the quarter was fairly large. Is that really a timing issue? Should we see a catch-up on metals quantity sold in the second quarter?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Yeah. It is a timing issue that clouds that a little bit, where we exited the year 2016 with essentially all of our inventories sold and we ended up building up a little bit of inventory in the quarter.

So it's not 12,000 tons that went into inventory, rather than out the door. So, if you adjust for that, the difference will reflect the difference between what comes out of the back of the plants and then the volume that's reduced by the processing.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Okay. And then in terms of strategic initiatives, you ended up putting more capital already this year into CES. Maybe kind of help us understand how to think about the ability to grow that business. Is the gating factor here – as you think about higher value waste streams like pharmaceutical waste, is the gating factor channel and access to the waste? Is it capacity, free capacity at the facility? And how should you be able to grow that business over time as you start to see more free cash flow cushion from contributions at Dublin and elsewhere?

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Yeah, sure. I mean, so there's a couple of things that come into play. We think we have plenty of access to the Energy-from-Waste facility, so the disposal capacity is there. The reason we've been doing some of these small bolt-on acquisitions is to get access to the waste.

So if you look at one of the deals we did this quarter and they're both small, but with a company up in Canada and they primarily do product destruction in the pharmaceutical area and home goods. But the pharmaceutical area is an area that we want to get more access to. It's a growth area. The tipping fees are much higher than the tipping fees in municipal solid waste. So, when we start to look out at these various opportunities, we're going to migrate to opportunities that get us access to the type of waste that we want.

We continue to see this business being able to grow at double digits through 2017, and we grew it roughly 15% last year and in that same range the year before. So, this is a good growth business and we'll continue to do the activities around this that allow us to migrate this waste into our Energy-from-Waste facilities.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Okay. Great. Thank you very much. I will jump back in queue.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Thanks, Noah.

Operator: Your next question comes from Tyler Brown from Raymond James. Your line is open.

Patrick Tyler Brown
Analyst, Raymond James & Associates, Inc.

Q

Hey. Good morning, guys.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Good morning.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp. A

Good morning.

Patrick Tyler Brown
Analyst, Raymond James & Associates, Inc. Q

Hey. Just a couple questions on the waste side. Just to start, so congrats on the momentum on spot waste pricing. But I am curious, where are most of your non-profiled uncontracted tons? I guess the spot MSW, where is that geographically generated?

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp. A

So generally – so you're talking about profile? So profile was generally…

Patrick Tyler Brown
Analyst, Raymond James & Associates, Inc. Q

Non-profile.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp. A

Non-profile.

Patrick Tyler Brown
Analyst, Raymond James & Associates, Inc. Q

Yeah, your non-profiled spot.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp. A

Well, it's in and around where our plants are. So, depending on what plants have – where our contract obligations are on different plants.

Patrick Tyler Brown
Analyst, Raymond James & Associates, Inc. Q

Okay. Well, let me ask it this way. So, how do you think about your New England capacity moving forward? I know your Massachusetts plants are merchant in nature, but given the dynamics up there, are you inclined to maybe sign fewer contacts later or maybe shorter duration contracts just to let you participate in any disposal tightening up there?

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp. A

Yeah. So I understand what you're getting at now. Sorry about that.

So if you look at, for example, our SECONN, we just signed a SECONN extension. It was four years. They tend to generally be longer-term contracts that we signed. But in a market like that, we thought it was best to go with a shorter term. It made sense for both our client community and ourselves, but we start to look at the marketplace.

And particularly, in New England market, we think the market's going to tighten. And so, we want to make sure that we give ourselves a chance to participate in these markets that are getting a little bit tighter.

Patrick Tyler Brown Q
Analyst, Raymond James & Associates, Inc.

Okay. And then maybe a bigger...

Stephen J. Jones A
President, Chief Executive Officer & Director, Covanta Holding Corp.

A classic example of what we're doing.

Patrick Tyler Brown Q
Analyst, Raymond James & Associates, Inc.

Right, right. Okay. And then maybe a bigger picture question. But as we think about the uncontracted pricing moving into the future, I mean where do you guys see that number going relative to the $72 you just reported? I mean, is there a natural asymptote that it will converge to or is that asymptote really dependent on the quality of profiled waste that's coming in?

Bradford J. Helgeson A
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

I think will largely be – really there are two drivers as you know. One is the mix issue and continuing to bring in profiled waste – I mean the profiled waste a ton now on average, and there's a wide dispersion within this average. But those tons average over $100 a ton and we see a pretty long runway to continue to grow that business. So that'll certainly be a driver. And then you have the underlying uplift of MSW prices, of course, primarily in the Northeast where, kind of getting back a little bit to your questions to lead off, most of our merchant capacity exists in the New England area.

So, is there a number to which that'll approach asymptotically? It's hard to put a number on that. I guess theoretically, you could kind of pencil out if you were to transition more of the capacity to profiled waste to what that would look like and ultimately, that does have a limit. But certainly, we think there's runway to grow that overall average pretty meaningfully for a number of years, frankly.

Patrick Tyler Brown Q
Analyst, Raymond James & Associates, Inc.

Okay. Good deal. And then, Brad, just one quick housekeeping, but on the business interruption recovery, where will that be booked? Is that going to be a contra-expense? And if so, where will it be in the P&L?

Bradford J. Helgeson A
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

It will. Yeah, it'll be a contra-expense and it'll hit the other operating expense line. So, historically, as you know, there are some other small things that hit that line, but generally speaking, if you look at our other revenue and our other expense line that, for all intents and purposes, represents construction activity.

So, this will cloud that a little bit and will point out what the impact is as we move through the years so you know what's what. But it'll flow through as a contra-expense, hitting that line that otherwise would really just represent construction expense.

Patrick Tyler Brown
Analyst, Raymond James & Associates, Inc.

Q

Okay. Perfect. Thanks, guys.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Thanks.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Thanks.

Operator: Your next question comes from Michael Hoffman from Stifel. Your line is open.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you for taking my questions. Good morning...

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Good morning, Michael.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

...Brad, Dan. Thanks for your note over the weekend, Steve. I appreciate it.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

That was great.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

So 1Q 2017, the hit to EBITDA, how do take that $23 million – how do I think about the split that's covered by insurance versus made out through improved operating leverage?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

So, I guess I'll say for both of those combined, so between insurance and, as you say, improved operating leverage by basically having the plants come back online and having gotten the maintenance out of the way in the first quarter, that will reduce the $23 million to – I mean, it's probably about a $5 million overall impact, so not something that's clearly a significant for the full year. And again, repeating ourselves over and over, but that was assumed when we laid out the guidance in February.

I don't really want to get into further than that, the specific split of what's behind and what's maintenance within that, but that's the overall impact.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Well, if you could help a little bit just so we understand, if I make this up that the contract revenue is $100 million, the contract expense is $90 million but now, I've got an offset to that $90 million. What should I – what's the scope of that offset because of the insurance recovery so we get the location of this right?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Yeah. I mean, that's a level of detail on the specific P&L line items that we haven't put out. But as I mentioned a minute ago, I think as the proceeds come in and as they're impacting the specific line items on the P&L on a quarterly basis, we'll point out what those impacts are.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. So you want us to guess. On the unplanned downtime, Steve, can you help us a little bit? Why is what's happening happening? You had the post-mortem in Fairfax with the challenges in Durham York for the turbine issues, what's the underlying why at this point? And I'm curious, if you're Lean Six Sigma initiative has got enough of a cultural challenge that that's part of it and that's the struggle with Lean Six Sigma, you got to fight through the culture issues and when you get to the other side, there's a lot of reward.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Well, let me answer the first part of that. I mean, we've got a fleet of 42 plants and we have issues that occur all the time. And one of the jobs of the management team is to deal with those issues, right?

So, for example, a good example, last year, we had outage at one of – our turbine in Plymouth. You guys don't even know about that because we controlled the work around that and we're able to get it fixed. And so, whenever you have a fleet of 42 plants, you're going to have some amount of activity that's going on. So I don't find anything unusual about that. This is consistent with other operating plants that I've been involved in over my career.

When you start to think about continuous improvement, continuous improvement really falls into three areas: there's continuous improvement activities around revenue side, there's continuous improvement around the cost side and that's where kind of outage optimization falls, and there's a continuous improvement around the balance sheet. And we're undertaking projects in all those areas.

And as you know, we had a growth productivity or continuous improvement target last year of about $10 million. We hit that. What we tried to do this year was to put out there publicly a net organic growth target that took into account continuous improvement, the profiled waste activities and CES activities that we're involved in, the metals activities, the ash processing. So, you will be able to get a sense as you move through 2017 on that organic target and how we're doing on continuous improvement and some of those other things on a net basis, right?

So I don't think there's a cultural issue or another issue. It's just a factor of having a large fleet of plants and how you operate these plants in order to hit our targets. And like I said, things happen every year. It's our job as the management team to figure out how to fill in the holes and the kind of negative productivity that occurs from time to time.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Switching gears to total ash, you've told us this, I just can't remember, what plant is this happening on?

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Total ash processing is going to be at the – we're looking at a number of places, but where the permitting now is looking in Pennsylvania. So we're looking at the facility at – it's not at a plant; it's at the processing facility in Pennsylvania.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

The Fairless Hills plant? Okay, Fairless Hills location. Okay. And then...

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

That's our current location.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

And then, Brad, on Dublin, when that goes commercial, what's the impact to interest expense reported once you start capitalizing interest?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Yeah. It's about $20 million on a full-year basis, so $5 million a quarter on the senior debt and the junior debt.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

So we should see that showing up in 4Q. Whatever our run rate was, [ph] if we have $35 million, it goes to $40 million (33:39) kind of thing?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Exactly, yeah. I will point out, though, that we also have the preferred stock investment into the project. And so the dividend on that preferred stock would add about another $10 million, if that doesn't hit the interest expense line, but just so you have everything from a cash flow standpoint.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. And that's – so $10 million a year, $2 million a quarter?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.
A

Correct. $10 million a year divided by four, correct.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Yeah, $2 million – or $2.5 million, whatever. Yeah. Okay.

And then on the profiled waste side, that growth that you reported, is that all volume or were you getting an ASP walk-up as well?

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Yeah. I think it's both. I've missed the last part. AS – what did he say?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.
A

Average sale price.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Oh, average sale price. I'm sorry. Yeah, it was both.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

It's both. Okay. Is it more volume than price, though, because that's – the opportunity was a pretty healthy volume – the non-contracted volume?

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Yeah. Volume was a little heavier than price.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay. And then, just to be clear, the questioner asked earlier about – I mean you have about 15% to 20% of your capacity is not under contract at the moment. That's what you're playing with on the profiled side.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Right. That's correct.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Right?

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Yeah. So, I mean, so we have contracts that our capacity at our plants have already spoken for. And then we look at the uncontracted part and we're trying to do that. The pocket switch effectively are bringing in profiled waste and less MSW because the tipping fees are higher.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Right. And it happens to be that more of your East Coast, Mid-Atlantic, Northeast plants have...

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

That's correct.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

... availability of uncontracted than anywhere else in the country because of the nature of those markets. Okay. So...

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

That's correct.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Yeah.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

And to follow through the line of thinking, you're building in some optionality by shortening contract cycles on contracted that one capture rising tip fees, but also you could make the decision – you could shift to 25% uncontracted at some future day, if you wanted to.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Right.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

That's exactly right. You've captured that very correctly.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

All right. And then the last question from me, Dominion Electric in Virginia has got a big transmission maintenance they need to do, but it's scheduled for the second half. Are you going to have any luck in moving that to the first half so you don't have to take Fairfax down again?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Yeah. I think at this point, Michael, that's still pretty speculative and preliminary at least from the information that we have, so we don't have a specific plan with regard to that. I think in any event, it wouldn't be a material impact on us.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

So it doesn't change your guidance issue if they push you out of service again for two weeks?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

No, no.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

No, it doesn't.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

No.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. All right, great. Thank you.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Thanks, Michael.

Operator: Your next question comes from Al Kaschalk from Wedbush Securities. Your line is open.

Al Kaschalk
Analyst, Wedbush Securities, Inc.

Q

Hey. Good morning, guys.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Good morning, Al.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Good morning, Al.

Al Kaschalk
Analyst, Wedbush Securities, Inc.

Q

A lot of questions there. Maybe they can find one here that's different.

On the free cash flow, given the comments about interest expense and the preferred stock fourth quarter, I guess will you need to remind folks that the free cash flow calculation and the guidance you're providing is before those items, isn't that correct? Could you just clarify that?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Yeah. So, as a matter of definition, the free cash flow reflects all the interest expense and actually will also reflect the dividends that we're going to pay on the preferred stock.

Al Kaschalk
Analyst, Wedbush Securities, Inc.

Q

So that's included that $100 million to $150 million you're affirming. And just so we know everyone's on the same page, the planned operation of the company, where this was going to occur, has been incorporated into those numbers.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Yeah. Yeah, exactly.

Al Kaschalk
Analyst, Wedbush Securities, Inc.

Q

Okay. Great. Second, I hear you on the $23 million and the revenue and the operating expense. I think it would be great if you could just help us understand, on the $51 million that you did in the first quarter on EBITDA, how much of that was negatively impacted by Fairfax or what you're able to at least chew up for us because, obviously, there are a lot of different components in the consensus numbers. But just to get a little bit more confident level that that $51 million was negatively impacted by a fire, which arguably isn't recurring.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Yeah. Let me take the first part of this and I'll ask Brad to jump in.

So if you think about the gap, it – the year-on-year decline on adjusted EBITDA, it's really – it falls into three buckets. Roughly half of it is due to lower revenue due to plant downtime, a quarter of it is rather scope on maintenance, and the remaining quarter is due to downtime related to operating expenses.

As we move into second quarter and more so in the second half of the year, we expect recovery of most of the lost revenue and downtime costs through insurance, plus we expect better year-over-year production and lower maintenance costs. So that kind of frames out a little bit of the difference between the adjusted EBITDA numbers.

I don't know, Brad, if you want to...

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Yeah. So within the $23 million, as I mentioned in the prepared remarks, the $23 million was actually in three plants, one of which was Fairfax. Fairfax represented about half of that, maybe a little less. And then, of course, the other two ended up really just as outage work that we did in the first quarter that we had planned to do later in the year anyway, so it really was entirely a quarterly issue.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

You're right, too. I think from a management team standpoint, we had these outages. They were unscheduled. It made a lot of sense to move up scheduled outages that we had later in the year.

I mean, it didn't make any sense to do those scheduled outages later in the year. We could amass resources, get parts, get folks out there and get that work done during a period of time when we're already down. So it was tactical or opportunistic. I mean, pick your word, but we thought that made good sense from a management and P&L standpoint.

Al Kaschalk
Analyst, Wedbush Securities, Inc.

Q

Yeah. No, I agree. And I think just quantify or help the investors in terms of where it is relative to the $400 million...

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Yeah.

Al Kaschalk
Analyst, Wedbush Securities, Inc.

Q

...$440 million that you guided, it sounds to me like you really have maybe just a $5 million shortfall after insurance in terms of where things were, given everything else equal, which I know is not, unchanged isn't fair necessarily. But relative to this event, it seems like it's a $5 million event.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Yeah. That's right, Al. You're in the right part there.

Al Kaschalk
Analyst, Wedbush Securities, Inc. Q

All right. That's all I have. Thank you and we'll be in touch.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp. A

Thanks, Al. Thank you.

Operator: Your next question comes from Andrew Buscaglia from Credit Suisse. Your line is open.

Andrew E. Buscaglia
Analyst, Credit Suisse Securities (USA) LLC Q

Hey, guys. Just a quick one on your maintenance spend. So you did $97 million in the quarter, so this is to hit your guide. You're really implying it's about flat or moderate, may even modest year-over-year decline on that spend line. Is that correct? And then, what gives you confidence you can do that or is there anything that we should know that – in our model in terms of the cadence of the spend?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp. A

Yeah. That is correct. If you look at our full-year guide and kind of back into what that implies for the rest of the year, we'll be basically flat on a dollar basis. There's obviously a bit of range on our guidance, but you take the midpoint, that's what it implies.

We have a – I mean I'll recognize what Steve had said earlier about the inherent uncertainty about what may happen at one plant or another. But across a portfolio of over 40 plants, it really smoothes out over a longer period of time and adds a lot of stability to the overall company. So, as a result, I mean we have a high degree of confidence in our maintenance plan.

And I think what you've seen here over the last several years, including last year, is we put a range out. In the scheme of things, it's actually not a very wide range on what our maintenance spend is going to be for the year and then we hit it. And of course, things can happen, but given our team and our track record, we feel really good about what our plan is for the rest of the year.

Andrew E. Buscaglia
Analyst, Credit Suisse Securities (USA) LLC Q

Okay. So exiting the year, it's possible we could see year-over-year – you could see that spend negative or down year-over-year.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp. A

If you look at the range, it's possible. But yeah, it's possible.

Andrew E. Buscaglia
Analyst, Credit Suisse Securities (USA) LLC Q

Okay. Okay. And then, just another high-level one. I mean, I know your debt-to-EBITDA ticked up a little bit. What's going on with M&A? I know in the profiled waste that you had some activity last year. Are you guys still looking at stuff now or is it really just focusing on your debt and the dividend?

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Yeah. We're being as – we're always stewards of the capital, but we're being even more particular now.

Andrew E. Buscaglia
Analyst, Credit Suisse Securities (USA) LLC
Q

Yeah.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

The acquisitions that we mentioned, the two are very small. And so, we're going to be – we're going to continue being careful on how we spend our money right now. I'd really like to get our leverage ratios back in line with more of our long-term goal. So, you're not going to see us doing a lot of acquisitions in the CES space for that reason.

Andrew E. Buscaglia
Analyst, Credit Suisse Securities (USA) LLC
Q

All right, makes sense. All right. That's it for me. Thanks, guys.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Thanks, Andrew.

Operator: [Operator Instructions] Your next question comes from Brian Lee from Goldman Sachs. Your line is open.

Brian Lee
Analyst, Goldman Sachs & Co.
Q

Hey, guys. Thanks for squeezing me in here. Had a few...

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.
A

Good morning, Brian.

Brian Lee
Analyst, Goldman Sachs & Co.
Q

Hi. On the hedges in the energy segment for 2018, clearly, you've extended those a bit since the last update. Do you anticipate we'll get up to the sort of 2.5 million megawatt hour level that you're tracking at for 2017 or maybe even higher as you think about the hedging strategy from here? And then, can you provide any sense for what type of pricing level you're seeing these hedges relative to the $36 per megawatt hour you're guiding to for this year?

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Yeah. Certainly, Brian. It's Brad. I think that the number to look at is we've got the other side of that equation, so the amount of exposure that we're going to look to have going into the year.

And so what you should expect is that – and there are other factors around this, but as a rule of thumb, you should expect that we're going to go into next year with about the same open position that we entered this year with. And so we'll be heading to get down to that number. And yeah, we are seeing lower prices for 2018 that we're hedging this year than what we have hedged historically and are realizing here as we move to 2017.

Brian Lee
Analyst, Goldman Sachs & Co.

Q

Okay. Fair enough. I know this one might be a little bit early to comment on, but I saw some press recently on the proposed the Manila waste energy facility. So just wondering if you can provide any color on where you are in that process, what the expected participation role is for Covanta and then maybe how it compares to some other opportunities internationally you're sizing up in. Steve mentioned the UK pipeline. I know you've been active in Australia and other places in Asia. So, we'll be curious how the Manila facility stacks up against some of those.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Yeah. So we're involved as a partner and this is kind of an early-stage project at this point, Brian. We see opportunities in Island Nations. I talk about this a lot. Island Nations are more likely to realize or quickly to the point of time where they don't want to use their land for landfills and rather use – utilize energy from waste. And this particular project would handle waste from the largest city in the Philippines.

We're not the primary developer on this project, but we've been brought in for our operational expertise. So a lot of times, we'll get calls on projects. A lot of them we'll pass on, but we'll get calls on projects because of the – we run a number of different technologies.

I mentioned we have 40-plus plants. There's different technologies in those plants. So we're viewed as the best operator in Energy-from-Waste space. So, we'll get calls into these projects because of our operational expertise. So this project is still in the early days.

If I look around the world where you're going to see more activity from us closer in is in the UK. And so, we've talked about our project in South Rookery, which is further along in development process. We've got the planning permit. We're in the process to get the environmental permit.

And I mentioned in my prepared remarks, we'll have some more color on that as we get a little further into the process here, but that's much further along. And there are some other opportunities in the UK that we're exploring. UK, again in Island Nation, is moving pretty quickly into the Energy-from-Waste space.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Brian, I'll just jump in for a second here. As a rule of thumb, for financial impact, any investments that we're looking at in Asia will tend to be less significant from a financial impact than the projects we would look at in, say, the UK or Dublin.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Yeah. Good point.

Bradford J. Helgeson
Executive Vice President & Chief Financial Officer, Covanta Holding Corp.

A

Just in nominal terms, the construction costs are lower, tip fees are lower, power prices are lower. So the facilities just represent a smaller investment. And as Steve mentioned, we'll tend to be a minority partner in those projects as well. That will further reduce the impact on us.

From a financial standpoint, having a plant like Dublin coming online and then executing on a pipeline in the UK will be a much, much bigger driver from a financial standpoint.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Yeah. Good build.

Brian Lee
Analyst, Goldman Sachs & Co.

Q

Okay. Appreciate that color.

Maybe last housekeeping one from me and I'll pass it on. Can you guys provide any update on the Harrisburg, Lancaster and Delaware Valley contract negotiations and then anything beyond those? Are there any other near-term contracts you're looking to extend? Thanks, guys.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Yeah. We're in discussions right now with Delaware County related to Delaware Valley facility, and then Lancaster and Harrisburg. We're well on our way through the discussion, so we're hoping we'll get something wrapped up here shortly. So I don't want to say too much at this point because we're in negotiations, but we're actively dialoguing with those folks as we speak.

Brian Lee
Analyst, Goldman Sachs & Co.

Q

All right. Thanks, guys.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Thanks, Brian.

Operator: [Operator Instructions] You next question comes from Michael Hoffman with Stifel. Your line is open.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

So the follow-up. ECP is selling Wheelabrator again. I am assuming you won't comment about whether you're participating, but I'm interested in that. If it ends up sold again, does it have any risks to you all from a behavior standpoint or are there any behavior things going on as they try and prop up the EBITDA to sell the business?

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

We're aware they have a process going on, but as a matter of policy, I don't like to comment on other people's acquisition processes. So, I really can't say much about...

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

...what they're up to at this point.

Michael E. Hoffman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

All right. Thanks.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Sure.

Operator: [Operator Instructions] We do not have any questions over the phone at this time. I will turn the call over to the presenters.

Stephen J. Jones
President, Chief Executive Officer & Director, Covanta Holding Corp.

So this is Steve again. Thanks for taking the time out to talk to us about our business. As you can tell, we're – we continue to be excited about our prospects and we, like I said, we appreciate taking the time to walk through all this with us. So I wish everybody a good day, and we'll talk to you again as we get into next quarter. Thanks.

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