30-Apr-2021

Covanta Holding Corp. (CVA)

Q1 2021 Earnings Call

Copyright © 2001-2021 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

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

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

Derek W. Veenhof
Executive Vice President-Sustainable Solutions, Covanta Holding Corp.

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

OTHER PARTICIPANTS

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Michael E. Hoffman
Analyst, Stifel Financial Corp.

Mario Cortellacci
Analyst, Jefferies LLC

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Scott Justin Levine
Analyst, Bloomberg Intelligence

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to the Covanta Holding Corporation's First Quarter 2021 Financial Results Conference Call and Webcast. And our current 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, Jason, and good morning, everyone. Welcome to Covanta's first quarter 2021 conference call. Joining me on the call today will be Mike Ranger, our President and CEO; Derek Veenhof, our COO; and Brad Helgeson, our CFO. On today's call, Mike will provide an update on the strategic review, Derek will discuss our operating performance, and Brad will provide a more detailed financial update. Afterwards, we will take your questions.

During their prepared remarks, Mike, Derek, and Brad will be referencing certain slides 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, onto the Safe Harbor and other preliminary notes. The following discussion may contain forward-looking statements and our actual results may differ materially from these expectations. Information regarding factors that

Copyright © 2001-2021 FactSet CallStreet, LLC

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 30, 2021. 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 the US 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, and as well as 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, Mike Ranger. Mike?

Michael W. Ranger

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

Thanks, Dan, and good morning, everyone. Let me start with a strategic review. I know it is on your minds and it has certainly been a major focus within the company in recent months. When we talked in February, I described the scope of our initial review, which aimed to identify each of the fundamental elements of our business and assess how we could unlock value. We have now completed that initial review and I am even more confident that the underlying value is there and it is substantial. Our plan is now in motion. While this strategic review has moved at full speed, our operating businesses have performed exceptionally well, as you can see from our first quarter results. And this highlights another observation that I have that the business platform is very solid, which allows our strategic work to proceed with a full focus and with confidence that our operations will continue to form – perform at high levels.

In the past, we have provided a fair amount of information regarding matters that affect our results on the margins each reporting period, specifically movements in energy and metals pricing. These factors are important to your understanding of business result but are commodity market-driven.

Our strategic review is focused more on the core of our businesses and what we can control to increase our profitability and enhance shareholder value.

At a macro level, the strategic review has clarified that our business has four principal components, each with different characteristics and value and each representing a different business model. Our review has identified opportunities in cost control, capital allocation, asset rationalization, and medium- to long-term cash flow generation. The steps we will take will be different for each component, and I wanted to spell these out so you can understand our framework for approaching the strategic review.

So, let me address these components one at a time. First, our 21 North American Waste-to-Energy plants, we own 100% of these plants and benefit from long-term contracted waste supply and strong local waste markets. And as a group, they represent the vast majority of the value of our business as configured today. Second, our Irish and UK Waste-to-Energy business. As you know, we own these plants in partnership with financial and waste industry participants. Both the Irish and UK markets are much more favorable than North America in terms of waste and energy pricing and policy support. When the UK plants go into operation, we will have a new fleet of Waste-to-Energy plants in these markets. And as a group, they will make a meaningful contribution to both our near-term results and growing future equity value.

Copyright © 2001-2021 FactSet CallStreet, LLC

Third, our Environmental Solutions business, which is in adjacency to our Waste-to-Energy business, sources high-value, nonhazardous waste from commercial and industrial customers. It has more of a sales and logistics focus and is less capital intensive than our core Waste-to-Energy business. Fourth, the 18 sites in North America where we operate Waste-to-Energy plants owned by the public sector, while some of these operations are profitable as, a group, they are contractually and financially challenged. And we are developing plans to improve the value they represent through renegotiations and expirations.

As we think about each of these components of our business in the context of our strategic review, we have engaged with third parties to obtain focused value discovery for each of these business lines. These are presently ongoing, and we will highlight whether opportunities – and they will highlight whether opportunities exist relative to certain of our discrete assets when measured against our consolidated valuation. The outcome of this exercise will, of course, help us shape our path forward.

Another area of focus in the strategic review has been our overhead structure and our resource and capital allocation decision-making. As I mentioned in February, this work is focused primarily on the overhead resource that support our North American business. Given the very different business models in each component of the business, it makes sense to adjust the resource support to serve each appropriately. We have developed a detailed plan to streamline overhead cost, and our work so far is expected to result in about $15 million to $20 million of run rate savings as we enter next year and about $30 million as we enter 2023. We have already taken certain actions including a voluntary early retirement program and expect to recognize approximately $5 million in savings in 2021. We will continue this work to yield additional savings. I consider what we've done so far as a first step.

Another area of our strategic focus, as we discussed in February, is to improve the cash flow contribution of each financially challenged operation and, if we see no clear path to doing so, close it down. We have now identified a number of sites where we intend to shut our operations over the next several years, including several public sector operating contracts where we have already notified our clients that we do not intend to extend contracts when they expire.

And, at the same time, we are in active negotiations with other public sector clients to negotiate contract extensions on improved terms. But, again, if we are unable to do so, we will extend the operating – we will extend operating agreements at these sites if, in fact, we can make them more profitable. However, if we cannot, we will close those plants as well. We estimate that the incremental overhead savings resulting from the planned shutdown of underperforming sites will yield $10 million to $15 million in reductions, which will offset related near-term reductions in reported adjusted EBITDA and cash flow. More fundamentally, though, these efforts will resize and reshape our asset portfolio in ways that will make us leaner and better able to grow shareholder value.

Lastly, as part of our strategic review, we have taken a comprehensive look at our long-term financial outlook with a focus on the impact of factors within our control, specifically added contributions from the UK activity as it moves to an operating business, overhead expense reductions, prioritizing capital spending, and organic growth plans we intend to implement. What has become clear from this exercise is that the business is capable of generating increasingly meaningful profits and cash flow over the medium- to long-term.

Through 2024, we expect cumulative free cash flow will exceed $800 million, which would be available for the payment of dividends, share repurchases, debt repayment, or reinvesting in the base business or in new opportunities. And we expect that, by 2022, adjusted EBITDA will be well in excess of $500 million. And by 2024, it will exceed $600 million, with the free cash flow exceeding $250 million. This is the base case against we will – against which we will compare future strategic actions.

 Copyright © 2001-2021 FactSet CallStreet, LLC

Regarding our balance sheet leverage, in the near to medium term, we are targeting to reduce our ratio of debt to adjusted EBITDA to less than 5 times by the end of 2022 with capacity for further reductions over the following several years towards 4 times in area, we believe reflects a sensible target – capital structure target to support the business over the long term. The pace at which we approach these longer term reductions will be a function of capital allocation decisions to maximize shareholder value.

A long-term financial outlook is largely driven by factors within our control and that we have already set in motion. And as I noted at the outset of my remarks, our review has been singularly focused on steps we can take with the core of our business to improve profitability and enhance shareholder value. Of course, our results may be affected by factors not within our control, but that is not our focus. And as I look forward, there's no question that we are solidly positioned for predictable increases in profitability and cash flow. We see a clear path to meaningful enhanced equity value.

Let me shift to an update on the UK. Clearly, the transition of our UK portfolio from construction activity to an operating business is in – is an important aspect of our profitability improvements in the near and medium term. And critical to our strategic review is ensuring that the full long-term value of our UK projects alongside Dublin is recognized in our share price.

Through our partnership with the Green Investment Group, we have moved our four projects into construction totaling 1.5 million metric tonnes of waste processing capability. Construction has proceeded remarkably well across this portfolio, especially considering the challenges presented by both Brexit and the pandemic. This achievement now positions us to transition to a valuable operating business in the UK generating significant financial contribution from these four projects. Where we're getting that transition and by early 2024 we will have, when coupled with our Dublin project, five new assets operating in one of the best markets in the world in terms of waste pricing and policy support.

Our Rookery project will be the first to move into operations. We expect it will begin receiving waste within weeks. And we are commissioning the plant now with full commercial operations early in 2022. We expect Rookery's 2022 contribution to our adjusted EBITDA will be $25 million and an annual run rate thereafter exceeding $30 million. Beyond Rookery, our other projects now under construction will enter operations sequentially through early 2024. Specifically, we expect that Earls Gate will begin operations in Q1 2023 with an annual run rate of $8 million in adjusted EBITDA. Newhurst will begin operations in Q2 2023 with an annual run rate of $15 million. Protos will begin operations in Q1 2024 with an annual run rate of $20 million.

To highlight the sizable contributions we expect from these projects, this UK portfolio, together with planned improvements to our Dublin operation will add at least $85 million in annual adjusted EBITDA by 2024, resulting in an annual run rate for this group of assets between of $105 million and $115 million in adjusted EBITDA. And we are very confident this will be realized. Owen Michaelson, our new President in the UK and Ireland is laser-focused on driving the successful completion of the four construction projects, building out the operating and management team, and creating additional value through development of more projects in our UK pipeline.

And even beyond our pipeline, our strategic work has identified several areas where we can enhance value from this portfolio reinforcing our belief that the Ireland and UK remain a primary growth avenue and a source of tremendous potential value for shareholders.

Turning to the first quarter. We had very strong operating and financial performance achieving adjusted EBITDA of $106 million. These results, which Derek and Brad will discuss in more detail were possible only with the

Copyright © 2001-2021 FactSet CallStreet, LLC

impressive effort of our teams and conditions that remain challenging. It is a credit to the resiliency of our people in business and to the essential nature of our services. As we look ahead, several factors positioned us well for strong operational performance across our North American business through the end of 2021.

Notably our really solid Q1 results from the Waste-to-Energy fleet even with an aggressive program of planned maintenance, very good performance from our Environmental Solutions business with a strong pipeline of new volume. Our increased focused on cost control, and strengthening waste in commodity markets as conditions improve across the broader economy. As we announced last night with these factors and trends, we are increasing our 2021 adjusted EBITDA guidance to $460 million to $480 million and increasing our free cash flow guidance to $125 million to $155 million.

To conclude my remarks, we are committed to creating value through the strategic review process. As we execute on that commitment I am confident that this team will remain focused on the core business and on driving improved financial results.

With that, I'd like to turn it over to Derek to discuss our operational and business highlights. Derek?

Derek W. Veenhof

Executive Vice President-Sustainable Solutions, Covanta Holding Corp.

Thank you, Mike, and good morning, everyone. I'll be referring to our Investor Presentation and we'll begin my comments on slide 4. We are off to an exceptional start in 2021. Despite the obvious obstacle of navigating an ongoing pandemic, our employees performed at the highest level in the first quarter, operating efficiently and providing superior service to our customers and our communities.

From a waste market perspective, we achieved solid growth with same-store tip fees increasing by 4% on average across the fleet. Notwithstanding adverse winter weather conditions, residential waste volumes remained robust, and our pricing continues to reflect the strength in our core disposal markets where our position allows us to be very disciplined around re-contracting activity. Our contracting and portfolio mix, which is weighted to residential, has helped support prices during the quarter and will pay further dividends throughout the year. As commercial volumes, including profiled waste, continue to build and normalize, we'll have very good opportunities to realize further price growth despite our highly contracted profile.

We are operating against the backdrop of limited and declining landfill capacity in our core market, as well as a growing demand for zero landfill options. At a macro level, we do not see these trends changing. And we view capacity scarcity as a long-term tailwind to our business that will support tip fee growth above inflation across the fleet for some time.

Our Environmental Solutions business continues to generate pricing improvements into our Waste-to-Energy assets as the team continues to focus on improving our mix of customers and products. While first quarter profiled waste revenue was lower year-over-year against 2020, this was a result of challenging weather and residual COVID impacts as compared to a record first quarter in 2020 that also benefited from event work. However, we were able to increase realized profiled waste prices during the quarter and March represented both a record month of profiled waste revenue and the first month with positive volume trends in a year. With strong economic growth predicted for the US, our profiled waste business should be a very positive contributor to our overall tip fee mix.

Copyright © 2001-2021 FactSet CallStreet, LLC

Moving on to the commodity markets, one of the biggest stories of the quarter has been the strength in metals prices. With continued economic recovery and a very tight supply chain for industrial metals, prices for the scrap products we produce have strengthened.

When combined with our upgrading and processing capabilities, we were able to nearly double our realized pricing. During the quarter, metal sales volumes rose by 14% which was a function of improved recovery and some timing benefits realized from record ferrous processing volume at our SEMASS plant in March. Recovered metals are global commodities, and while we can't control the market clearing prices, we believe that our strategy of increasing metals recovery and upgrading non-ferrous material are adding meaningful value. The investments we have made over time in these areas provide leverage to pricing upside and more optionality and sales. Further, we see solid market fundamentals and we are well-positioned to continue to capture value in what is looking like an improved market going forward.

On the energy side, we saw year-over-year improvement in the first quarter given the colder weather in the Northeast. From a historical perspective, our real-life energy prices remain low in absolute terms, but stable much like natural gas prices. We remain highly hedged in the near and intermediate term, and we continue to seek opportunities to manage and mitigate our risk while capturing upside. I'm extremely proud of the accomplishments of our operations team and successfully executing an ambitious first quarter maintenance program. During the quarter, we executed on a 16% increase in planned boiler outage days compared to last year in order to put us back on our preferred schedule of focusing a good quantity of major outages in Q1. This timing works well in conjunction with a seasonally lower waste volume generation and enables us to effectively coordinate our outages with the needs of our customers.

One obvious result of the amount of planned maintenance was that waste intake and energy generation was lower by about 5% versus the same quarter last year. This was to be expected, and we will make up all this ground in the coming quarters. Given the substantial amount of work accomplished thus far, we have a high-degree of confidence and visibility to strong plant production for the balance of the year. As you heard Mike say, we plan to continue to keep a tight rein on costs. This cost focus was visible in the quarter as strong waste and metal revenue generated significant operating leverage.

Before we move on to the financial discussion, I wanted to remind everyone of the positive environmental aspects of Covanta's business and our commitment to sustainability. This quarter, we were able to reduce life-cycle Greenhouse Gas emissions by 4.2 million metric tonnes through our operations. This is a function of the avoidance of methane emissions, the generation of renewable electricity, and the benefits of metal recovery and recycling. We expect to report our progress on this every quarter as these savings are fundamental to our value proposition.

A key component of our business relates to our locations in and amongst the communities and customers that we serve as a primary means of local waste treatment. We are highly attuned to the communities and our clients and believe we can engage with them and help mitigate impacts on the environment. We initiated our own Environmental Justice Policy a decade ago and most recently supported landmark Environmental Justice legislation in New Jersey in 2020. This area of work and involvement is never complete, and we continue to have a number of environmental improvement initiatives across the fleet. Be assured, we will always strive to be a leader in environmental performance.

With that, I'll turn it over to Brad to discuss the financial results.

Copyright © 2001-2021 FactSet CallStreet, LLC

Bradford J. Helgeson

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

Thanks, Derek. I'll begin my review of our financial results on slide 5. Total revenue for the quarter was $498 million up $30 million from prior year, driven primarily by a 4% increase in Waste-to-Energy tip fees; a $10 million increase in market index prices for ferrous and non-ferrous metals; a $5 million increase in energy prices, including electricity capacity and RECs; and $7 million from new wholesale load serving contracts that we won last year.

Other contributors to higher revenue included service fee escalation, sales growth in the Environmental Solutions business, and higher realized metals prices relative to the underlying indices due to improved processing. These were partially offset by the greater amount of scheduled plant downtime in the quarter, which impacted waste, energy, and metals production by $8 million compared to last year.

Now, moving on to slide 6. Adjusted EBITDA was $106 million in the quarter, up $9 million over Q1 2020. The $15 million increase in revenue from higher commodity market prices fell directly to the EBITDA line. In addition, we saw strong net organic growth in adjusted EBITDA across most of the business as revenue growth in tip fees, service fees, Environmental Solutions, and metals processing generated substantial operating leverage.

To the negative, the higher planned maintenance scheduled in the quarter resulted in a $14 million increase in maintenance expenses and a $6 million net impact from related plant outage downtime. As Mike discussed, we are revising our full year 2021 adjusted EBITDA guidance range to $460 million to $480 million, representing a $20 million increase at the midpoint and tightening of the range. Building from strong Q1 results, our outlook has improved significantly relative to our original range. Execution of the Q1 and early Q2 outage plan has positioned the fleet for strong production for the balance of the year with increased visibility to plant uptime as much of the year's planned maintenance scope is now behind us. Metals prices and to a lesser extent energy prices, have improved further from original guidance.

I'll note that our forecast assumes a degree of mean reversion in metals prices over the coming months, so our outlook would continue moving higher to the extent that the current market holds, all else being equal. We also expect to begin to realize some benefit from our announced overhead cost plan as we move through the year.

Looking out over the next few years, there are two key drivers that bridge to our outlook for 2024 that are under our control. As our UK projects come online and we execute on growth opportunities in Dublin, the UK and Ireland business will contribute $80 million to $90 million of new proportional adjusted EBITDA and approximately $50 million of incremental free cash flow. This will begin with the Rookery projects transitioning to full-time commercial operations in less than a year contributing approximately $25 million to adjusted EBITDA in 2022.

The second driver for which we have clear visibility and control is our overhead rationalization plan, which will target $30 million in run rate cost reductions as we exit 2022 with $15 million to $20 million to be implemented as we exit this year. As Mike described, we've developed a detailed plan to achieve these reductions. Our plan is broad-based and will address all areas of our overhead spend to varying degrees with specific opportunities including reorganizing and consolidating certain corporate functions, improving business processes, better leveraging technology, and reducing spend as we refocus priorities.

From a cash perspective, there will be costs to implement the plan over the next two years, including severance and outside expertise. We'll get more specific on these onetime costs as we move forward. But in any event, they'll be excluded from adjusted EBITDA. Between the UK and Ireland and the cost plan, these two items

Copyright © 2001-2021 FactSet CallStreet, LLC

comprise the substantial majority of the bridge. Beyond that, we will continue to grow our core business organically, most notably through waste prices and expanding sales and Environmental Solutions.

In addition, as cash flow grows and we delever the balance sheet, the cumulative effect of capital allocated to reinvest in growth and/or reduce interest expense will increasingly become a driver as well. Commodities will remain a variable around our underlying growth trajectory. The 2024 outlook assumes energy prices at today's market forward curves and metals prices at approximately 10-year averages which would effectively represent a modest pullback from where we are this year. None of this reflects any potential transactions coming out of the strategic review. If, for example, we choose to sell a particular part of the business, it would obviously impact this outlook. But we would do so in order to advance our overall objective of fully recognizing the component values of the company and growing shareholder value. The key takeaway here is that the baseline outlook for the company as currently constituted is already highly compelling.

Now please turn to slide 7. Free cash flow is $19 million in the quarter, essentially flat compared to the first quarter of 2020. However, excluding movements in working capital where we saw a strong inflow last year, free cash increased by $14 million driven by higher adjusted EBITDA and lower maintenance CapEx. We are also revising our full year 2021 guidance for free cash flow to $125 million to $155 million, representing a $20 million increase at the midpoint and tightening of the range in line with the increase in adjusted EBITDA guidance as the drivers of both metrics are largely the same.

Now, please turn to slide 8 where I'll touch on capital allocation. As I discussed last quarter, we remain well positioned to generate free cash flow in excess of our planned growth capital spend and dividend with the excess available to reduce debt. As our outlook for growth investment this year remains unchanged, our revised expectation for free cash generation will increase the amount of excess cash available to allocate to debt reduction this year all else being equal.

Now, please turn to slide 9 where I'll conclude our prepared remarks with a brief update on the balance sheet. At March 31, net debt was approximately $2.5 billion, a $21 million increase from year-end 2020. Our total leverage ratio was 6.1 times and the senior credit facility covenant ratio was 2 times. Available liquidity under our revolving credit facility was $422 million at quarter end. As Mike noted, we expect our leverage ratio to fall below 6 times this year and below 5 times by year-end 2022, both without any potential further actions in connection with the strategic review that might accelerate this improvement.

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

Copyright © 2001-2021 FactSet CallStreet, LLC

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Noah Kaye from Oppenheimer. Please go ahead.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Good morning. Thanks for taking the questions and, for all the color on the strategic review and the very helpful walk on the UK projects. You know, Mike, the 18 waste energy operated sites, the ones you're operating for the public, sounds like that's going to go down. But I wonder if we could sort of level set here, it would be helpful to have some color, can you help us understand what the actual contribution of that line of business is to the profitability of the company today? And then, as you think about some of the actions that could be taken over the next couple of years, what can be done to increase that profitability and by how much?

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Sure. So, on baseline basis, if you think about it, there's $110 million of plant level gross profit from the 18 plants in North America. If you took a pro rata share of overhead against that, there's about $50 million of overhead expense. And then, there's about $35 million to $40 million of plant-level CapEx that is recorded. So, just – those are all within $5 million or so of refinement. So, you can see that there's probably $40 million of reported EBITDA and there's probably $15 million of free cash flow on a net basis. So, if you just – if you put that through a filter, that's what would come out. And what would improve that would be, reduce our obligations or responsibility for actual CapEx at facilities. That would be a first line of improvement that we are negotiating, for which Derek and his team is on point. The other would be the change base fees for the services that we provide. Our – we've been negatively impacted by low inflation, which are the basis for our escalators over time, which may not be in line with what our increased costs have been.

So, it really comes down to we want each individual facilities to be able to stand on its own two feet from a contractual perspective so that each is positively contributing incrementally to the overall value of the company. We have, as you know, expiration dates coming up now over the next five to seven years that affect about 35% of our portfolio to 40%. And we're going to make sure that each plant, in our determination about whether or not to let the contract expire or extend would be based upon that level set of profitability from both an EBITDA fully loaded basis with overhead included plus contribution to free cash flow. And if those hurdles are not met then expiration would be the logical conclusion. So, that's the framework in which we're operating as Derek is negotiating with those public sector clients.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

That's extremely helpful. Next question, again, appreciate if you walk on the growth in the EU portfolio. Can you just give us a little bit of color on how you plan to boost the profitability of Dublin because I see that taking a step-up in the coming years?

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Copyright © 2001-2021 FactSet CallStreet, LLC

So, let me just – there is a permitting process that's presently going on right now to expand the throughput of that plant. It was designed to handle about 10% to 15% more throughput than what the original permit calls for. And so we're going to try to capture that because it should logically be that for very little increased incremental costs that the throughput, which there is demand for in that marketplace, could be pushed through with the permit increase without any other meaningful expenses associated with it. So that's in the process of working its way through that – the legal requirements to expand that permit.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.
Q

Okay. Thanks. And I guess the last...

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

60 million tonnes a year.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.
Q

Okay. That's very helpful. And I guess just the last one. And I think, just kind of echoing a little bit what Brad said at the end here. But – if you executed this outlook from a deleveraging perspective, but you don't necessarily really need do anything in terms of asset divestitures, so. And obviously, this cost reduction program is helping enable that. I just wonder, if, you kind of benchmark your thinking now to where you were at when you started this review, Mike, do you feel any sort of less urgency now to divest certain assets just given the improved outlook? And can you talk a little bit about, I would say, the interest levels that you're seeing for some of the assets out there in the market at this point?

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

Yeah. That's a pretty clear question. So I'll answer the first part and let Brad address the leverage question. Our view has always been that the hurdle for an asset sale determination had to be based upon that – the execution of that would result in an uplift in the overall consolidated value of the remaining company. And so, a near-term objective of reducing leverage is one component in that mix, right, because you'd be eliminating certain interest expense and you'd be gaining greater flexibility.

But if in the end, you weren't able to capture the uplift in the contribution from the value of the sale and the reduction of the cost of the leverage in the overall valuation of that sale relative to the overall company then you wouldn't do it, right? That's not – that objective isn't worth – I mean, the way I think about it is you don't take the shingles off the house and burn them in the fireplace to keep the house warm, right? So, that can't be shortsighted and it can't solve a near-term problem. And I don't think that the problem of our leverage is acute enough to have to take actions like that. So, that's how we've approached this. And there's a fair amount of interest in the discrete assets of the company. And we need to fashion that against what the value indications are and what the contribution then is to the resultant overall consolidated remaining entity.

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

Yeah. And in terms [ph] of – its Brad (00:36:42) – in terms of the leverage, following on Mike's comment and we've always said this that, we have a view on what is, all things considered, probably the right level of leverage for us to work towards over time. And that's never been a function of any immediate discrete pressure from a

Copyright © 2001-2021 FactSet CallStreet, LLC

covenant perspective or ratings or any other, near-term driver. I think the takeaway and it sounds like you're taking the right message away is the underlying business plan is going to give us some really nice optionality over the next few years.

I think we have pretty clear visibility to, at least through 2022, getting leverage down below 5 times. That's sort of step one. And then as we continue to move it lower over time, the speed at which we do it will be a function of what the other alternatives are in front of us at the time for allocating capital. But the takeaway is, and Mike mentioned in his prepared remarks, our outlook has us generating cumulatively about $800 million of free cash.

If you take away the dividend at its current rate and our planned investments in the UK that's $400 million to $500 million of excess cash that we can either deploy to accelerate deleveraging or potentially deploy in another way to generate a higher return on capital, all of which would be along that long-term path towards 4 times.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Great. Thank you so much.

Operator: The next question comes from Michael Hoffman from Stifel. Please go ahead.

Michael E. Hoffman
Analyst, Stifel Financial Corp.

Thank you for taking my question. There's two points I want to sort of get at. The long-term view, are you've shared some insights on incremental EBITDA contributions, so I'd like to come back to that. But if I take the $600 million and the $250 million, can you give us some high-level basic assumptions that are there? Like are you – is it the existing business and anything you do around improvements or is it shrunk? What are the pieces?

Because let me give you some math I've done quickly. Midpoint in your guidance is at $470 million this year. If I pulled out $20 million from metals upsides because they normalized, so call it $450 million, I get a $105 million between cost savings in the UK/Ireland, that puts me in a – call it a $545 million and then I just need organic growth off the domestic portfolio to make up the difference, but that's a path. And you do the similar thing to the cash. So, what's in your assumptions?

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

Yeah. So, Michael, it's Brad. Let me kind of walk through the same bridge and maybe adjust the numbers a little bit and kind of get to it a different way. So, midpoint of guidance for this year is – on EBITDA is $470 million. We talked about UK and Dublin, obviously primarily UK projects moving into operations. That's $80 million to $90 million, and then $30 million from the cost plan. And then, what that then leaves us with, just to get to $600 million, and certainly, our plan and our expectation, all else being equal, would be that we would exceed $600 million is $15 million of organic growth.

What's implied in this is, at least for metals prices, a bit of a headwind from a mean reversion to a 10-year average on metals prices. So, that's another, I think you said $20 million. By my math, it's $10 million to $15 million of EBITDA. So, that would then imply an organic growth piece just to get to $600 million of about $25 million – $25 million, $30 million, which is a 2% CAGR. So, in my mind, that's kind of the high level of the bridge component. And then the bridge for free cash essentially works the same way with the added kicker that as we delever the balance sheet, we're going to reduce our interest expense.

Copyright © 2001-2021 FactSet CallStreet, LLC

Michael E. Hoffman
Analyst, Stifel Financial Corp.

Q

And underlying all that is the existing portfolios that is currently here. So you haven't walked away from any of the 18 or sold anything. It's everything you own today is all part of that assumption?

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

A

Generally, yeah. So, to put a finer point on that and without getting into specifics because it's not appropriate at this point for us to do so, there is an implicit assumption in there that we will be exiting certain of our operations over this timeframe. But as you can probably tell, because I didn't note it in the bridge, we don't expect that to frankly have a material impact on EBITDA and cash flow particularly when you factor in additional overhead reductions that would come in connection with that. But it certainly doesn't assume anything materially from a transaction standpoint, from the strategic review, whether it be a sale or an acquisition.

Michael E. Hoffman
Analyst, Stifel Financial Corp.

Q

Terrific. So, my second question, I have to ask it since you cracked the door open. If we have $40 million of EBITDA from the 18 service fee would you share what the EBITDA breakdown is for the 21 own electricity and metals to get to the $470 million?

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Well, it's everything other than...

Michael E. Hoffman
Analyst, Stifel Financial Corp.

Q

Well, [indiscernible] (00:42:35)...

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

... [ph] whether (00:42:36) $20 million in EBITDA is from Environmental Solutions and then the contribution from Dublin presently. Otherwise, it's everything. Everything else comes directly from those 21 plants.

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

A

Yeah. Net of the remaining overhead.

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Net of the remaining overhead.

Michael E. Hoffman
Analyst, Stifel Financial Corp.

Q

Okay. All right. So...

Copyright © 2001-2021 FactSet CallStreet, LLC

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Yeah. I mean, just to put a pin on it, it's – that's $400 million of generation of net EBITDA from that portfolio.

Michael E. Hoffman
Analyst, Stifel Financial Corp.

Q

From the 21, just that's the way to think about it. And it's the right way to – sometimes people try to desegregate electricity and metals but, they all – they're all interrelated because the plants have to be operating, period. So you got to generate [indiscernible] (00:43:23) you get electricity from [ph] it to produce metals that's all integrated. And that's $400 million on 21 (00:43:28).

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

A

That's right. Correct.

Michael E. Hoffman
Analyst, Stifel Financial Corp.

Q

All right. Terrific. Thank you for a lot of clarity. The transparency helps, so appreciate that you gave it.

Operator: The next question comes from Mario Cortellacci from Jefferies. Please go ahead.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Hi. Thanks for the time. I just want to touch on the negotiation process that you guys have underway. And just, I guess, I wanted to understand how those conversations are going. And I think is there any potential or how much potential is there for some of those contract negotiations to be expedited? I feel like, obviously, you already have a few in mind for something that you're already going to close. And then the ones that you still have hope for you have to wait for those contracts to come up for expiration or be closer. Can you go to them today? And how much leverage do you have over them to be able to get what you want in a good timeline?

Derek W. Veenhof
Executive Vice President-Sustainable Solutions, Covanta Holding Corp.

A

Hi, Mario. This is Derek. I'll attempt to answer your question as best as I can. So in terms of where are we in negotiation, we are in negotiation with several of these clients today. We have been in dialogue with all of them obviously through this strategic review process and keeping them abreast as appropriate. So we are in dialogue. We feel pretty good about the clients we are in dialogue with at this point in time in terms of their understanding of where we need to go as a company and why we need to change these service agreements. So, I think, generally speaking, there can be a pretty good outcome for both our client or our clients and Covanta. There are win-wins within that negotiation.

So – and then on the other side, there are going to be some that may not be successful. And as already pointed out by Brad and Mike that the contribution around some of those contracts hasn't been great, and we're just going to exit at that point in time, so be it. In terms of leverage, don't really look at it that way. I suppose that's appropriate. But these clients have been with us a long time. We respect that. And this has always been about trying to formulate win-wins and move the business forward. So productive conversations, each side has its own

Copyright © 2001-2021 FactSet CallStreet, LLC

degree of leverage. Each side uses that as we go about. So I expect over the next few years, we're going to have a very clear picture of what remains in terms of our client business.

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.
A

And just to follow up on that, one thing – one question you did ask that Derek didn't address.

But is part of the overall thought process is one of the levers is in exchange for extending the contract into a timeframe where this doesn't have to be front of mind constantly for the client is to address ones that are not at their expiration yet. But you can find a longer-dated relationship that works for both sides. So, Derek has already started down that path. There's the near term and the midterm at this juncture, and then some longer-term ones that he's also looking at. But it's clearly to come up with a more sustainable relationship with the clients for longest period of time possible.

Mario Cortellacci
Analyst, Jefferies LLC
Q

Great. Thank you. And then just one follow-up. And I think you've already talked about this in the past, and I think you've kind of made it clear that you're not really interested in collections and doing deals. And I know you have a strategic review going on, and that's not really in the cards right now. But maybe you can help us understand why buying collection businesses even longer term just doesn't make sense for Covanta? Or in the coming years, as you delever, could there be a philosophy change in maybe you go and do deal like that?

Derek W. Veenhof
Executive Vice President-Sustainable Solutions, Covanta Holding Corp.
A

Mario, you're back to Derek again. So, historically, we've not been in that space. And with the distribution of our assets and their locations, we've never really had a fundamental problem of sourcing waste into the plants. And I suppose if we did have a problem that would be a route that we would – that we could revisit and look at and see if it was accretive to our model. That hasn't been the case to-date. We focused on the intermediate hubs, transfer stations, and the security of long-term deals with large municipalities, and it's provided us plenty of coverage. The second aspect to that is there are other people in the collections business, and that's quite obvious, and they're quite skilled at what they do. We respect that. We view ourselves as an independent player in the marketplace for disposal. And it would be very difficult for us to catch up to their levels of sophistication on collection. Let's, put your money where you're really good at.

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

Yeah. And just adding on to that – it's Brad, I mean, there are two reasons – sort of stepping back, there are two reasons why we would consider vertically integrating. One would be to address an issue around waste supply. And that's an issue we don't have and I've never seen the need – given our infrastructure and our contractual profile and market position, we've never seen the need to go down that road in order to address an issue on waste supply. The other reason would be is there an opportunity to leverage our disposal assets in certain markets to grow the company in that direction.

As Derek said, that is a very competitive market with competitors who already do a very good job. That would be an entirely new business for us. And then also it's been a matter of capital allocation. Certainly, we've had other priorities, including most notably building the business in the UK and Ireland. And then the Environmental

Copyright © 2001-2021 FactSet CallStreet, LLC

Solutions business as well, we've had other priorities for our capital beyond getting into what is a competitive business.

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

And just one last piece on that is when you think about – the question was asked by another analyst is when you think about the value of the company-owned plants and their locations to have a mix of – and the plants are always full and they're always managed for profitability on the margins in terms of finding the highest value waste available beyond the long-term contractual ones. Being agnostic in a market like that has got to be helpful, right, because then municipalities and then vertically integrated waste companies view you as a partner and a resource as opposed to a competitor. And I think we do benefit from that.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Thank you so much.

Operator: The next question comes from Brian Lee from Goldman Sachs. Please go ahead.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Good morning. Thanks for taking the questions. So, I think you kind of answered this, but just to be specific on the asset sales and shutting down of select assets and some of the renegotiations. Are these actions we should see more clarity around moving through the next several quarters in 2021? I know it sounds like it's going to be a multiyear effort, but just how are you thinking about the timeline?

Are we going to see some updates around that? And then, if you kind of force rank the priority and timing potential of each set of these actions, I suppose it's going to be asset specific. But just, in general, what's easier to get done? Is it the contract renegotiations? Is it just waiting for certain contracts to expire, and then moving away from those assets? What's – how should we be thinking about that?

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

A

Yeah. Hey, Brian. It's Brad. So, I would divide potential changes to the portfolio into two categories. The one category is where we're working through underperforming operations. And the next steps for those will be specific to the situation. Some of those are assets that we own where we would shut it down. Some of them are operating contracts where, upon expiration, potentially, we no longer operate that asset for the client.

As far as timeline, I would say that's going to play out over a number of years as opposed to quarters. I probably wouldn't put it in terms of quarters. It's a focus area. We're having conversations today for contracts that have expirations over the next several years. So, there's a long lead time there. But I wouldn't expect – you shouldn't expect a flurry of announcements in that area in the coming quarters. I draw a distinction between those and other transactions that might potentially come out of the strategic review that I would characterize as transactions to better realize value of discrete assets. Those are potential transactions that we're focused on right now. And we would anticipate having more announcements in that area over the balance of the year.

Copyright © 2001-2021 FactSet CallStreet, LLC

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Okay. Fair enough. That's helpful. And then, I don't know if you covered this. I might have missed it, but the – I think you mentioned $15 million to $20 million of savings here on some of the cost actions through this year and then getting to the full $30 million in 2023. It sounds like the $30 million is going to flow dollar-for-dollar through to EBITDA. Are there any offsets in the near-to-medium term on the sort of $15 million to $20 million, or are we going to see that also just flow through to the EBITDA line?

And then, specific to the kind of modeling, I suppose, it sounds like it's a lot of different items, but where specifically should we be expecting to see those cost savings materialize when we think about the modeling of it?

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

Yeah. Hey, Brian. It's Brad. So, the $15 million to $20 million and then ultimately the $30 million, the right way to think about that is that it will flow directly to the adjusted EBITDA line. We would – as necessary in the period we would adjust for any onetime cost to implement. I mentioned this in the prepared remarks to that come to mind would be potential severance costs and to the extent that we are engaging with third-party expertise to help execute certain aspects of the plan. So, those are things that would be cash in the period and so therefore would be reflected in our free cash flow because we don't adjust free cash flow, but we would adjust them for adjusted EBITDA.

So, just to make sure there's total clarity, the $15 million to $20 million, as we exit this year on a run rate basis – another way to say that is we would expect a $15 million to $20 million reduction to overhead, and I'll get back to what exactly that means in a second in 2022. And the $30 million of run rate as we exit 2022 would be seen on a full-year calendar basis in 2023. So, you've heard us talk about overhead, the addressable – just to put a little more detail on this. The addressable overhead that we're focused on primarily supports the North American business is approximately $190 million.

Last year, we reported $120 million of SG&A, so the balance of that overhead actually flows through the operating expense line. And the way – just for financial statement presentation purposes, the way we allocate that is based on the nature of the function. So, for example, Derek's team flows through cost of operations. My team flows through SG&A. It's kind of a simple way to think about it. So, in terms of the income statement, you'll see the impact in those two lines as the plan is implemented.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

All right. Thanks a lot. Appreciate the color. I'll pass it on.

Operator: The next question comes from Scott Levine from Bloomberg. Please go ahead.

Scott Justin Levine
Analyst, Bloomberg Intelligence

Hi. Good morning, guys. Can you hear me?

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

Copyright © 2001-2021 FactSet CallStreet, LLC

Yeah, we can hear you.

Scott Justin Levine
Analyst, Bloomberg Intelligence

Q

Great. I'm not sure, if you mentioned this, I don't know if it's a question for Brad. But I know you guys have talked in the past about 4 times kind of being a target range for leverage, and I'm guessing that's under review as part of this broader strategic review. But I was just wondering if you can comment on your thoughts on what you see as a comfortable or a target leverage range for the company?

And if so, elaborate maybe a little bit more on when you reach that, is the philosophy at this point maybe more growth-oriented or capital returns oriented and – or are we getting ahead of ourselves there given the fact that I think you're saying you expect to be below 5 times by the end of next year. Just trying to get a sense of whether growth and capital returns maybe reenter the picture in a more meaningful way in 2023 or whether it takes 4 times leverage to kind of get to that level?

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

A

Yeah. Hey, Scott. It's Brad. Long time, no speak. So, nothing has come out of the strategic review that has changed our view on 4 times, plus or minus, as an appropriate level of leverage for the business. That doesn't mean that we're not comfortable if the opportunity warrants it to run the business at a higher level, and it doesn't mean that once we get to 4 times, we won't continue to delever. But I think in terms of a North Star for where we're going to be heading over time, 4 times is still the number.

I think what we might do and how we might prioritize capital return versus investing, whether it be, you know, in the existing business or inorganic growth, I think it is a little too early to start to handicap those. We'll see what the opportunity set is in front of us where we are as a company, and make those decisions as appropriate at the time. I think compared to where we've been in the past – because 4 times is not a new number, we've talked about 4 times for a long period of time now. I think the real difference now is we see a clear path over a relatively short timeframe, so between now and 2024, to where the business with the UK projects coming online primarily, will begin to generate cash at a level that makes that, a very real option and reality for us as opposed to something that's a little further out over the horizon, which is really how we – more how we've talked about it in the past.

Scott Justin Levine
Analyst, Bloomberg Intelligence

Q

Got you. Thank you. One quick follow-up, I guess maybe you want to know this question at the outset, I guess I'd ask you, if have any options – I know at the beginning of the strategic review, the mantra is always everything is on the table. Have any options been taken off the table as you guys have progressed through this review? Or maybe any changes in philosophy regarding the business since you initiated this process I think last October.

Michael W. Ranger
President, Chief Executive Officer & Director, Covanta Holding Corp.

A

Scott, the answer is no. Nothing's been eliminated at this point. And we're in the phase of having more facts in front of us to evaluate, whereas before, in our discussion at the end of October, it was more instinctual. And yet, we've gotten lots of confirmation on some of our original thoughts and some other eye-opening alternatives. So, in that regard, we're going to work through that once again. Everything that you do is a lost opportunity. But it also is a big gain if you do it the right way. So, that's how we're looking at it. Everything's got to be measured against what the current expectations are in this current valuation of the company is. And if we can enhance that and

Copyright © 2001-2021 FactSet CallStreet, LLC

change that trajectory then those alternatives are still available to us, and we will act on them accordingly at the right time. And as Brad mentioned, just to underscore, that category was the second that he talked about. And we would see actions taking place through the remainder of this calendar year.

Scott Justin Levine
Analyst, Bloomberg Intelligence

Got it. Understood. Thanks, guys.

Operator: This concludes the question-and-answer session. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2021 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.