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Covanta Holding Corp. (CVA)

Q1 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to Covanta Holding Corporation's First Quarter 2019 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 introduction, 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, Melissa, and good morning, everyone. Welcome to Covanta's first quarter 2019 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 in the Investor Relations Section of our website, www.covanta.com. These prepared remarks should be listened to in conjunction with the call – with the 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

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this live broadcast, April 26, 2019. 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 express 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 to now 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, our quarterly results are summarized on slide 3. I'll begin my discussion on slide 4.

We're executing well on our 2019 plan, as we generated $84 million of adjusted EBITDA and $6 million of free cash flow during the first quarter, and our financial outlook for the year remains unchanged. We are affirming our previous expectations of adjusted EBITDA range in the range of $440 million to $465 million and free cash flow of $120 million to $145 million.

We processed 5.2 million tons in the first quarter, a 7% increase over last year, as a result of strong plant operations and the expansion of our portfolio. We expect to set another full year production record in 2019.

As you all know, the first quarter normally represents a heavy period of plant maintenance and this year was no different. In the first quarter, we completed almost 30% of our expected maintenance for the year. Overall maintenance spend in the quarter was lower than last year, with the mix slightly more to expense and CapEx. This was consistent with our plan for the quarter, and our full year expectations for maintenance expense and CapEx are unchanged.

As we sit here today, market prices for energy and metals are in line with our previous comments, and in aggregate, the business is right on track.

From an end-market perspective, our number one focus remains the waste market, and we continue to benefit from a strong disposal price environment. Waste flows remain robust, transportation infrastructure stretched and our attractively located assets have flexibility to capture price increases. In the past, we've discussed New England as a particular source of strength, but the pricing improvement is fairly broad-based throughout our footprint of merchant plants.

For the quarter, tip fees were up over 5% overall on a same-store basis. Recall that this growth rate is occurring even as nearly 80% of our tip fee waste is under contract with contractual escalators running closer to 2%. Our ability to see these types of increases is a function of stronger spot markets, improved pricing as we re-contract and the continued benefits of growing volumes of profiled waste from a price mix perspective. While we do not expect to be at 5% every quarter, we still expect to see full-year same-store tip fee price improvement of over 3%.

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On top of the strength in the municipal solid waste, we continue to increase integration of profiled waste into our Energy-from-Waste plants, with revenue up 9% in the quarter. This growth is a product of expanding market demand for sustainable non-landfill solutions, effective sales execution and the increased internalization of volumes through our network of material processing facilities. I anticipate that we'll continue to grow profiled waste revenue at our Energy-from-Waste plants at around this rate for the full year.

In March, we hit an important milestone as we began operations at the East 91st Street Marine Transfer Station or MTS in Manhattan. The facility is currently ramping volume and is ultimately expected to deliver 170,000 tons annually for processing at our Delaware Valley and Niagara sites under a 20-year contract. Including the new MTS, Covanta will sustainably process roughly one-third of all the residential waste collected by New York City.

We extended another long-term client partnership in the quarter, signing a new 15-year waste disposal agreement with the town of Babylon, New York. Long Island remains short of waste disposal options, and we continue to work closely with our clients to provide solutions to this growing issue. The historical arrangement with Babylon was under a service fee contract structure, while the new agreement transitions to a tip fee structure, where we will benefit from a greater share of the energy revenue under our long-term power contract, as well as opportunities with ash and metals management and merchant disposal capacity.

As I've discussed in recent quarters, we're focused on optimizing our fleet by exploring alternative options for some of our less-profitable plants. The desired outcome in these situations is to make meaningfully – meaningful changes to improve profitability or unlock upside opportunities. We've announced some of these in recent quarters. However, in some cases, the right answer is to redeploy our resources and capital elsewhere.

This quarter, we closed the Warren County, New Jersey facility, as previously announced, and reached an agreement to divest the Springfield and Pittsfield assets. While all three plants were well-run, they suffered from relatively small sizes, and we saw limited opportunities for improved economics under our ownership. We're pleased to have found a new owner for Springfield and Pittsfield, who will focus solely on their operations and will continue to support the local communities. We expect this transaction to close in the second quarter.

Given the small size and financial contribution of these three facilities, this will not have a material impact on our overall expectations for the year. But going forward, we believe that this will reduce the risk in our portfolio and allow management to sharpen its focus on more profitable opportunities.

A few underperforming plants remained in our fleet, and we'll continue to look at all options either to improve their performance or exit operations.

Last but certainly not least, I'm very pleased to note that alongside our partners, Green Investment Group and Veolia, we reached financial close on the Rookery project late last month. It is the biggest of the four projects we've announced so far and we expect it to process around 545,000 metric tons of waste annually.

I appreciate the hard work of our development team and our partners, as well as the support of the project lenders to help us reach this critical milestone. With financial close behind us, we're in full-scale construction. Our primary EPC contractor is Hitachi Zosen Inova who very successfully built our Dublin project. As is typical for these projects, construction is anticipated to take about three years, which puts commercial operations in 2022.

Once operational, Covanta will be the operator of the plant under a long-term arrangement, while Veolia will supply the majority of the waste. The ownership split is as previously discussed with Covanta and GIG, each owning 40% of the project, and Veolia owning the remaining 20%.

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One of the many benefits of our partnership with GIG is the ability for the original developer to partially monetize their investment at financial close. For Rookery, Covanta received $44 million of consideration at financial close, highlighting the value of the project. In addition, as Brad will discuss in more detail, this is part of an overall strategy that is highly efficient for funding our equity stakes in these projects.

As I step back and look at our UK development more holistically, things are moving along very well. We now have two of the four projects that we've announced in construction. And on a combined basis, they will account for roughly half of the targeted annual free cash flow of $40 million to $50 million from this pipeline. We're now focused on bringing the next two projects, Protos and Newhurst, to financial close and into construction.

With that, I'll hand the call over to Brad to discuss our financial results in greater 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 financial performance with revenue on slide 6. Total revenue for the quarter was $453 million, down $5 million from the first quarter of 2018. Organic growth, excluding the impact of commodity prices, was effectively flat year-over-year as waste price growth was offset by lower construction revenue in the quarter.

Commodity prices had a modestly negative impact as we saw a $4 million decline related to lower market prices for energy and metals. Transactions were net positive to revenue, as the September 2018 acquisition of the Palm Beach operations added $15 million during the quarter, while the deconsolidation of Dublin during the middle of the first quarter of 2018 reduced revenue by $10 million year-over-year.

Long-term contract transitions reduced revenue by $4 million in the quarter, specifically the previously discussed transition of a client-owned facility to another operator early last year, and the end of project debt service payments received from our Babylon client under the service fee contract for that facility.

Moving on to slide 7, adjusted EBITDA was $84 million in the first quarter, a $16 million decline compared to the first quarter of 2018, which was expected given the known year-over-year headwinds for the quarter that I discussed on our last earnings call in February. Excluding commodity prices, adjusted EBITDA declined by $7 million organically as the benefit of higher waste prices was offset by the unfavorable year-over-year comparison against $7 million of business interruption insurance proceeds received last year, as well as a slightly higher mix of expense versus CapEx within our maintenance spend this quarter.

Looking ahead to the balance of the year, the unfavorable comps will abate and we continue to expect organic growth and adjusted EBITDA to be in our target range of 3% to 5 % for the full year.

The modest headwind from commodity prices as I just discussed translated directly from revenue to the adjusted EBITDA line. The net impact of transactions was immaterial in the quarter, as the benefit of the Palm Beach acquisition was largely offset by the deconsolidation of Dublin.

Long-term contract transitions represented a $4 million headwind in the quarter, in-line with the impact on revenue. At the midpoint of our full year adjusted EBITDA guidance range, we would come in roughly flat year-over-year. So it's fair to assume that for the balance of the year, and more specifically the second half, we'll begin to see year-over-year improvement.

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I'd like to take a moment here to explain a few items in the quarter that did not impact adjusted EBITDA, but created some noise in our income statement. First, we booked a $50 million net gain on sales in the quarter. This reflects a $57 million gain related to the Rookery project, partially offset by writedowns associated with the planned divestiture of the Springfield and Pittsfield facilities. In addition, we accrued $4 million in other operating expenses related to the closure of the Warren facility. Again, these items are excluded from adjusted EBITDA.

Turning to slide 8, free cash flow was $6 million for the quarter, a $58 million improvement compared to the first quarter of 2018. The primary driver as compared to last year was the normalization of working capital. Recall that we saw a significant outflow related to the adjustment of accounts payable last year that did not reoccur this quarter, as we're now managing payables at a more consistent level. At the same time, we continue to drive improved AR performance which was $15 million better this quarter from a cash flow standpoint as compared to last year, and follow the benefit of over $20 million from a five-day reduction in DSO over the course of 2018.

Among other drivers, maintenance CapEx was lower by $14 million on a comparable year-over-year basis.

As Steve noted earlier, both our overall maintenance spend and our relative mix of CapEx were lower in this year's first quarter. While we do expect modestly lower capital spend – maintenance capital spend for the full year as discussed on our last earnings call, much of the favorability in Q1 related to the timing of projects within our 2019 maintenance plan.

Q1 free cash flow was much stronger than in recent years. However, I would not extrapolate that to your outlook for the full year. Our guidance remains $120 million to $145 million, and we are confident in that range.

Now, please turn to slide 9, where I'll review our growth investment activity. During the first quarter, we invested $3 million in organic growth projects, primarily for increased metal recovery and opportunities in our Covanta Environmental Solutions business, and $11 million for transportation equipment required for commencing service at the Manhattan Marine Transfer Station.

Of course, the big news on the topic of growth investment this quarter was our progress at Rookery. I'll walk through the financing structure for the project as a whole in pound sterling terms with Covanta's anticipated cash flows in U.S. dollar terms at current exchange rates. The total capital cost of Rookery is expected to be £460 million, with approximately 70% funded by attractive long-term non-recourse project financing at a rate of under 5%. The remainder of the capital, approximately £145 million, will be funded by the partners, ourselves, GIG and Veolia, as equity in the project subsidiary. Covanta's share of funding for our 40% stake will be approximately £60 million or $80 million.

The partners put project level bridge financing in place for the equity funding, which will defer the funding requirement until commercial operations in 2022. In our case, we collateralize this bridge financing for our equity commitment with a letter of credit under our corporate credit facility, without impacting our balance sheet or credit ratios.

Under our partnership with GIG, we received $44 million in consideration at closing as the primary developer of the Rookery project. This represents recovery of development costs incurred with a premium, plus a further premium that GIG paid us for the right to invest in the project based on anticipated project returns.

Stepping back, looking at the amount that we monetized upfront versus the anticipated equity investment of approximately $80 million, we expect our net funding requirement in the Rookery project to be only about $40

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million or less than three times anticipated free cash flow from the project. And again, with no investment outflow required for another three years.

This is a very efficient funding mechanism and demonstrates how we're looking to fund these very attractive investments without significantly impacting our balance sheet deleveraging goals. Our overall 2019 outlook for growth investments is unchanged. However, as a reminder, the amounts shown here for UK spend of $10 million represents only the remaining investment in Earls Gate, and does not yet reflect commencement of full construction at Protos or Newhurst.

Depending on the timing of those projects and the level of near-term funding requirements, this 2019 outlook may change as we move through the year.

Looking at the UK pipeline as a whole over the next several years, our total planned investment across all four announced facilities remains $150 million to $200 million, which we expect will end up entirely funded by the proceeds from the sale of the 50% stake in Dublin to GIG last year, and the premiums that we're earning from the UK projects that we developed as they reach financial close.

Please turn to slide 10, where I'll provide a brief update on our balance sheet. At March 31, net debt was a $2.47 billion, up $32 million from December 31, 2018. At quarter end, our consolidated leverage ratio was 5.9 times, up slightly from 5.6 times at the end of 2018, and the senior credit facility ratio was 2.4 times. Our available liquidity under our revolver was about $350 million.

As discussed on our last earnings call, given our current outlook for adjusted EBITDA, free cash flow, and capital spend in 2019, it's likely that our year-end credit ratios will be similar to where we exited 2018 if not a touch higher. However, our longer term path for continued deleveraging in 2020 and beyond remains firmly intact.

Before we turn it over to Q&A, I'd like to head it back to Steve for some concluding comments.

Stephen J. Jones

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

Thanks, Brad. I want to take a moment and reiterate a few things. Our business is centered around providing sustainable waste disposal solutions, and the tightening disposal capacity many of our key markets combined with contracts coming up for renewal, the market has moved in our favor. This trend is not likely to abate anytime soon, and we see positive pricing momentum continuing well into the future.

In light of this and coupled with positive macroeconomic factors such as stable GDP, strong population growth and upper trending housing starts, we're beginning to see early signs of interest by a few of our clients in adding new domestic EfW capacity.

We know the development cycles are long, but we see these early discussions as encouraging and we're uniquely positioned to participate in these opportunities. At the same time, we'll continue to execute on our domestic organic growth opportunities, continuous improvement initiatives and UK development. We're focused on growing the business and operational excellence with respect to our overall fleet of plants, this is an exciting time for Covanta, and I'm proud of the team's accomplishments and look forward to the opportunities in front of us.

With that, let's move on to Q&A. Operator?

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QUESTION AND ANSWER SECTION

Operator: Great. Thank you. [Operator Instructions] Your first question comes from the line of Tyler Brown from Raymond James. Your line is open.

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

Hey. Good morning, guys.

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

Good morning.

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

Good morning.

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

Hey. Nice start to the year. Real quick on Pittsfield and Springfield. So, it seems that you sold to a strategic buyer who presumably will continue to run those plants, but I also get the sense you didn't get much for them or won't get much for them. So, how do you weigh sell versus shutter, as presumably shuttering the facility would kind of permanently tighten the entire waste market driving lasting value to your other plants? Or is my geography completely off, it's just not going to be a big deal from a size perspective?

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

It's not a big deal from a size perspective. These are relatively small plants. If you look at Pittsfield, it processes 80,000 tons a year, Springfield, 130,000 tons or so. So these are small plants. They're actually Central to Western Massachusetts, so not a big impact on the tighter market in Eastern Massachusetts.

And then, if you look overall, I mean the way we look at this, and it's similar to Warren where we did a similar analysis. We kind of looked at the keep case versus the sell or shutdown case. In this particular divestment case, we're not getting a material amount of proceeds. So, we really looked at what it would cost us to keep and continue to run these plants versus exiting or divesting the plants.

Now, it's interesting, the adjusted EBITDA from these facilities is less than 2%, so you're not going to see a big impact from an adjusted EBITDA standpoint. And at the end of the day, it allows us, from a management standpoint, the focus on our bigger, more profitable plants. Because an issue at one of these smaller plants – and these quickly go from free cash flow positive to free cash flow negative depending on if you have an issue at one of these plants, we have to go respond for these smaller plants too. So, this is an opportunity to really focus. And one of the things I've been pushing is focusing on our bigger more profitable plants with our management talent.

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

Okay. Okay. No, that's helpful. But Brad, I do want to come back to the mechanics of Rookery. So, I just want to make sure I've got this. So, your total equity investment in the project is maybe $80 million, but you're getting some $40 million of premium and cost recovery considerations upfront. So all said, your net equity investment, it's a $40 million for a 40% stake. Is that right?

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

That's correct. Yeah.

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

Okay. And then the international pipeline is expected to yield $40 million to $50 million of free cash. You mentioned that the first two facilities are half of that. But I thought Rookery is the largest of the four. So, is the expected free cash flow contribution from Rookery, call it, $15 million, $20 million, or is that too high?

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

Well, I mean, I won't comment on a specific number, but you're thinking about it the right way based on the numbers we've put out for the pipeline as a whole. And you're right, Rookery is the largest contributor to that $40 million to $50 million.

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

Okay. But to be clear, your cash-on-cash payback on Rookery is something like maybe three years. Is that right?

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

Yeah, I mean I alluded to that in the prepared remarks where effectively it's less than 3 times free cash.

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

Wow. Okay. All right. That's fantastic. And then, just my last one here, quick shout out to your waste team, obviously, great pricing there. The 5% is on the whole book, right? So, the contract piece was up maybe 1% or 2%. But any color on how much spot tons were up, or was all of the contracted benefit largely mix?

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

Yeah, the contracted piece – you're right, the contracted piece, I mean, we're running around 2% as a broad average at this point. To answer the first part of your question, it does apply to everything. Contracted piece at 2%. So, really anything that's not tied down is growing by double digits at this point.

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

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Okay. All right. Great. Thank you very much.

Operator: Your next question comes from the line of Noah Kaye from Oppenheimer. Your line is open.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Thanks for taking the questions. And to add to Tyler, that return on Rookery cash return is really compelling. You mentioned that you would have – you would expect similar kind of mechanics in place for the other two projects. Would we be expecting to see, I presume, a lower cash return because of your role as a developer in those projects, or would it be comparable? How do we think about that?

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

A

Hey, Noah, it's Brad. It'll be comparable structurally in terms of the arrangement we have with GIG. I'd tell you that Rookery is the largest of the four projects. And given that size has very attractive returns on equity which then translates into how the premium is calculated under our agreement with GIG. So, you'll expect something similar, but the dollars are not going to be at the same level.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Yeah. That's fair. And then, I believe we should be reaching pretty soon the end of the review of the operating permit at Protos kind of nary a peep there, anything that would lead you to anticipate that you wouldn't be able to kind of get past that and get a financial close fairly soon?

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

A

Well, we're optimistic on Protos. It doesn't – it didn't have – it doesn't have the noise around that a Rookery had. And yeah, we're within a week or so of getting through that 90-day judicial review period. And then we'll move fairly quickly to close. We're in discussions with the EPC provider, we're in discussions with the banks, so we expect as we get through the second quarter here, we'll get through closing. June-July timeframe is my guess.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Excellent. And then just turn to a different subject, TAPS, I see the investment in there. Can you give us an update on where you're at with setting up that facility?

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

A

Sure. The equipment is under construction and we're testing it offsite, and expected to be delivered and installed at the Fairless Hills facility around mid-year. So basically, we decided at the technology provider's site to do some testing and then we'll move it by – on a modular basis to Fairless Hills. And then after that, we'll move into commissioning. So we use a good part of the second half of the year for commissioning and ensure that the operations are consistent and we're getting the throughput out of the facility that we expected.

I mean, we're pretty excited about this. You've heard us talk about it for a while, this has been something in the industry that's been kind of talked about over many years. We're also in early-stage discussions for developments

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at some of our other sites. And so – and I think I've talked about this before. I want get the Fairless Hills facility fairly well along, and then we'll look at deploying this technology at other sites. And we have talked to some of our clients and looked at some of our sites on what the next set of investments will be.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Okay. Great. Thank you very much.

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

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

Q

Hey, gang, thanks for taking the questions. Housekeeping and I'm sorry if you said it on the call and I missed it. Are the asset sales being treated as disc ops or is it just all done already and it disappears?

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

A

Hey, Michael, it's Brad. Not disc ops, we moved them to assets held for sale at quarter end technically.

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

Q

Okay. So in 2Q, if they close in that timeframe, we'll see – that's what we'll see in the balance sheet.

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

A

Yeah. Exactly.

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

Q

Okay. Cool. And then in your contracted volume, could you help us with what that bell curve looks like from, if today was zero and you went out five years, what's the bell curve of the renewals, so we can understand some of the cadence of taking advantage of this improving to the marketplace?

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

A

About 20% of our portfolio turns over every year, right, in that...

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

Q

It's pretty tight ball curve.

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

A

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...yeah. Yeah, because of the average tenure, if you look at the average tenure of our contracts, it's about 20% turnover in the base every year. And what you're getting at is that gives us the opportunity to kind of re-price at the higher pricing that we're seeing and we'll continue to – and we believe continue to see in the future.

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

There is some lumpiness to that as you look out over a five-, six-year period. But just as a rule of thumb, it's an average of 20% probably.

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

Well and – so, some of this pricing that's happening is very concentrated geographically. So, is it reasonable assuming that 20% that the geographic mix is balanced enough that I'm not going have – we're not going to see weird dips versus weird spikes either?

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

I don't think you'll see and, correct me if this isn't your question, but I don't think you're going to see spikes and dips or certainly not dips with regard to waste pricing. I think the trajectory is clearly up as we see it...

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

Yeah, more rate of change.

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

Yeah. Rate of change is going to be...

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

...yeah more of rate of change is what I was thinking. I mean one year it might be an 8%, and next year it's a 3%, because there's an odd mix issue of faster-changing markets versus slower-changing markets. That's what I was really trying to get at.

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

Exactly.

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

Yeah, you're right about that. The other thing too, and we were a little surprised by this, is that, as you mentioned New England markets been quite robust. But we're seeing pricing power kind of across the Eastern seaboard, which is where our fleet is primarily based. So, we've been pleased by that. It's been more broad-based than we originally anticipated.

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

So to that end, I realize you wouldn't normally talk about a specific contract. But I think Boston has some unique aspects to it. So five years ago the disposal award came out at about $72 with approximately about a 2% escalator. So you finished the five years at $78. Is it true that the pricing is coming in at a $90 handle, and so that's a pretty steep step up, and it's mostly about that's what I'm trying to get at as opposed to getting down to the roots of a single contract?

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

Yeah. Well, it's hard to comment. We're right in the middle of that RFP process. So it's hard to comment on that. We'll provide some additional color at some point in the future potentially.

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

But are we directionally, the scale of this is kind of what that's like without getting around a hard number?

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

Sure. Yes.

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

It's a much bigger increase than people were expecting.

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

Yeah. It's a healthy market. I'll put it that way.

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

Okay. And then, on the – you made an interesting comment, maybe once again there will be U.S. development, Steve, which I have to admit, it would have been a hard bet to make.

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

Great.

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

Is there a geographic part of the country that's more likely than that? Like is it going to be the East Coast, Mid-Atlantic, that kind of thing, or is it coming from – interest coming from multiple places?

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

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No. We're seeing it in multiple places, primarily on the East Coast. There are population centers on the East Coast. And I think what's happening is people are looking – municipalities are looking at their 10-year solid waste plan, and starting to think about what they're going to do over the next 10 years. And, in some places, and we talked about this, you look at the Northeast area in particular, it's getting pretty tight for disposal capacity, and you're well aware of that.

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

Q

Yes. Yes. And then, lastly, just so I understand, the UK opportunity, I know there's been a lot of oohing and aahing about rates of return, and none of that's new. The only thing that's new is you've got the financial closed, right? I mean the structure of this has always been the structure. You just – we've got the financial close, so now we're triggering more visibility?

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

A

Yeah, but it is a unique – the premium part of it is unique. I'm not sure we explained it in a level of detail that we explained it today, because we effectively are able to monetize some of the hard work that we did. If you think about it in stages, you get through the business development into construction stage. Usually, you wouldn't monetize at that point, but we're able to monetize with this premium payment arrangement that we set up with the partners.

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

A

Yeah. Michael, your comment is correct. Nothing change. I mean this is the structure that we had described. I think what's new here is now that we have a powerful example of how those numbers actually add up.

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

A

Yeah. We'll put numbers on it now.

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

Q

Got it. And then just for my benefit, $150 million to $200 million, how would I split it between approximately what the premiums will be out of that versus Dublin? I can't – just so I have a sense of how I'm thinking of that?

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

A

Yeah. Well, Dublin, if you recall, that sales price was a little over $130 million. So, that's in U.S. dollar terms and that's the bulk of it. We took another $44 million out of Rookery as we just announced today. So between those two, you're pretty close to covering up to $200 million...

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

Q

Got it.

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

A

...for the pipeline, so.

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

Q

And then the next two would have some contribution as well and that gets you close enough, and anything that's left over, you just pull it off the credit line?

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

A

Correct.

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

A

That's correct.

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

Q

Got it. Okay. Cool. Thank you very much.

Operator: Your next question comes from the line of Brian Lee from Goldman Sachs. Your line is open.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Thanks for the questions. Maybe just a few housekeeping ones here. The gain on Rookery, can you elaborate, is that upfront monetization something you'll see also on Protos or Newhurst? So, just if you could remind us if you're the original developer on those facilities as well?

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

A

Yeah, it will be similar. As I mentioned a few minutes ago, the magnitude will be smaller, we expect. But those are the same as Rookery. With respect to our agreement with GIG, of course, we're partnering with Biffa on Protos and Newhurst. We, Covanta, we're the original developer on Protos. Biffa is the original developer on Newhurst. But in the context of our partnership with GIG, we're bringing the both projects to our combined partnerships, so that work the same way as Rookery, again, structurally, but not necessarily in terms of the magnitude that Rookery represented.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Fair enough. And then, I guess, structurally, on Rookery, you're talking about the roughly $40 million net investment through 2022. But really, if everything is according to the targeted timeline, your only outlay happens in 2022, and it's fairly de minimis, if not zero, in terms of outlays until that timeframe. Is that correct?

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

A

Yeah, that's correct. As I mentioned in my prepared remarks, the partners decided to bridge finance at the project level, the equity funding. So, what you would typically see on a project like this is the equity would go in upfront or pro rata. So, for example, we expect for Protos, as an example, to be investing equity pro rata over the construction period.

When I say pro rata, I mean, along with the debt being drawn down. But we bridge financed – for various reasons, we bridge financed the equity so that really – the only cash going in is effectively the repayment of the bridge loan at the conclusion of construction.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Great. No, that's helpful. And then, maybe last one from me, I'll pass it on here is, on the pricing strength in the tip fee uncontracted volumes, specifically I know, just looking historically, Q1 tends to be, from an absolute dollar perspective, the weakest quarter of the year historically. But the mid-teens increase year-on-year pretty robust here. So, just wondering anything unique in Q1 mix wise or is it something from the comp from last year. Just any color there. And then how we should be thinking about pricing trends for that specific stream for your mix for the rest of the year? Thanks, guys.

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

A

Yeah. There – a few drivers there. So, of course, the market overall is very strong. And as I mentioned, anything that's not under contract, we're seeing very healthy double-digit-type growth rates as an average across the portfolio. That's also the line where the mix shift to profiled waste is benefiting us. You see that trend going back over a long period of time. So, we grew profiled waste revenue by 9% year-over-year in the quarter, so that's contributing to it.

Also on the margin, just based on where we had outages, as we're working through the outage schedule in the first quarter, we did have some mix benefits in terms of the impact on some of the prices. Just based on where some of the outages were. We look at – we've talked about this on the earnings call in February when we set guidance, our expectation is still that the overall tip fee will be growing 3% at a minimum. And so, maybe the way to think about this is, the contractual piece, we'll get bumps as we recontract, but for existing contracts, those are growing at inflation-type levels. So then what then that implies, what the uncontracted growth would be to end up with an overall 3% growth rate.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Makes sense. Thanks guys.

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

A

Sure.

Operator: Your next question comes from the line of Jeff Silber from BMO. Your line is open.

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Henry Sou Chien
Analyst, BMO Capital Markets (United States)

Q

Hey. Good morning, guys. It's Henry Chien calling for Jeff.

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

A

Good morning.

Henry Sou Chien
Analyst, BMO Capital Markets (United States)

Q

I just wanted to ask – hey, I just wanted to ask if you have any update on the balance sheet, and in terms of debt paid down and given, I guess, the future equity needs or equity funding that you expect to have...

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

A

Yeah, Hey, Henry, it's Brad. As I mentioned, from a leverage ratio standpoint, we don't plan on any improvement in 2019. In fact, if anything, it may tick up slightly, that's just based on the fact that we expect – from a ratio standpoint, we expect EBITDA to be at the midpoint of our guidance range, roughly flat year-over-year. And we are investing in the business.

Notwithstanding the cash that we pulled out of the Rookery project upfront, we are investing in some other areas. Of course, the organic growth initiatives that we continue to invest in, we have to prepare for the New York City MTS startup in terms of buying some additional transportation equipment that we needed. And then, of course, TAPS, which we expect in total to represent an investment of about $25 million.

So this is not a debt pay-down year for us, these are investments that we think are going to bear a lot of fruit for us going forward. What we would expect is to pivot back towards the trajectory of deleveraging starting in 2020.

Henry Sou Chien
Analyst, BMO Capital Markets (United States)

Q

Got it. Okay. Great. Thanks so much.

Operator: There are no further questions at this time. Mr. Jones, I turn the call back over to you.

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

Thank you, all, again for your interest in participation. We've made a lot of progress already this year and look forward to more positives over the coming months. In addition, we have an active IR calendar this spring and we look forward to seeing many of you on the road in May and June. Have a great day and thanks for participating.

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

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