

COVANTA HOLDING CORP
Form 10-Q
October 29, 2015
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended September 30, 2015

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from _____ to _____

Commission file number 1-06732

COVANTA HOLDING CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or Other Jurisdiction of
Incorporation or Organization)

95-6021257

(I.R.S. Employer
Identification Number)

445 South Street, Morristown, NJ
(Address of Principal Executive Office)
(862) 345-5000

07960
(Zip Code)

(Registrant's telephone number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Applicable Only to Corporate Issuers:

Indicate the number of shares of the registrant's Common Stock outstanding as of the latest practicable date.

Class
Common Stock, \$0.10 par value

Outstanding at October 23, 2015
133,169,737

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES
 FORM 10-Q QUARTERLY REPORT
 For the Quarter Ended September 30, 2015

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-Q may constitute “forward-looking” statements as defined in Section 27A of the Securities Act of 1933 (the “Securities Act”), Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”), the Private Securities Litigation Reform Act of 1995 (the “PSLRA”) or in releases made by the Securities and Exchange Commission (“SEC”), all as may be amended from time to time. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of Covanta Holding Corporation and its subsidiaries (“Covanta”) or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Statements that are not historical fact are forward-looking statements. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as the words “plan,” “believe,” “expect,” “anticipate,” “intend,” “estimate,” “project,” “may,” “will,” “would,” “could,” “should,” “seeks,” or “schedule,” or similar words, or the negative of these terms or other variations of these terms or comparable language, or by discussion of strategy or intentions. These cautionary statements are being made pursuant to the Securities Act, the Exchange Act and the PSLRA with the intention of obtaining the benefits of the “safe harbor” provisions of such laws. Covanta cautions investors that any forward-looking statements made by us are not guarantees or indicative of future performance. Important factors, risks and uncertainties that could cause actual results to differ materially from those forward-looking statements include, but are not limited to:

- seasonal or long-term fluctuations in the prices of energy, waste disposal, scrap metal and commodities;
- our ability to renew or replace expiring contracts at comparable prices and with other acceptable terms;
- adoption of new laws and regulations in the United States and abroad, including energy laws, environmental laws, labor laws and healthcare laws;
- our ability to utilize net operating loss carryforwards;
- failure to maintain historical performance levels at our facilities and our ability to retain the rights to operate facilities we do not own;
- our ability to avoid adverse publicity relating to our business;
- advances in technology;
- difficulties in the operation of our facilities, including fuel supply and energy delivery interruptions, failure to obtain regulatory approvals, equipment failures, labor disputes and work stoppages, and weather interference and catastrophic events;
- difficulties in the financing, development and construction of new projects and expansions, including increased construction costs and delays;
- limits of insurance coverage;
- our ability to avoid defaults under our long-term contracts;
- performance of third parties under our contracts and such third parties' observance of laws and regulations;
- concentration of suppliers and customers;
- geographic concentration of facilities;
- increased competitiveness in the energy and waste industries;
- changes in foreign currency exchange rates;
- limitations imposed by our existing indebtedness and our ability to perform our financial obligations and guarantees and to refinance our existing indebtedness;
- exposure to counterparty credit risk and instability of financial institutions in connection with financing transactions;
- the scalability of our business;
- restrictions in our certificate of incorporation and debt documents regarding strategic alternatives;
- failures of disclosure controls and procedures and internal controls over financial reporting;
- our ability to attract and retain talented people;
- general economic conditions in the United States and abroad, including the availability of credit and debt financing; and
- other risks and uncertainties affecting our businesses described in Item 1A. Risk Factors of Covanta's Annual Report on Form 10-K for the year ended December 31, 2014 and in other filings by Covanta with the SEC.

Although we believe that our plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, actual results could differ materially from a projection or assumption in any of our forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to change and inherent risks and uncertainties. The forward-looking statements contained in this Quarterly Report on Form 10-Q are made only as of the date hereof and we do not have, or undertake, any obligation to update or revise any forward-looking statements whether as a result of new information, subsequent events or otherwise, unless otherwise required by law.

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

COVANTA HOLDING CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	2014	2015	2014	2015
	(Unaudited)			
	(In millions, except per share amounts)			
OPERATING REVENUE:				
Waste and service revenue	\$283	\$252	\$805	\$760
Recycled metals revenue	16	26	49	72
Energy revenue	108	120	319	350
Other operating revenue	15	16	40	65
Total operating revenue	422	414	1,213	1,247
OPERATING EXPENSES:				
Plant operating expenses	260	248	849	798
Other operating expenses	18	19	55	66
General and administrative expenses	20	26	71	73
Depreciation and amortization expense	50	51	148	157
Net interest expense on project debt	3	3	10	8
Net write-offs	—	48	24	64
Total operating expenses	351	395	1,157	1,166
Operating income	71	19	56	81
Other expenses:				
Interest expense	(31	) (30	) (92	) (92
Non-cash convertible debt related expense	—	—	—	(13
Loss on extinguishment of debt	—	—	(2	) (2
Other expense, net	—	—	(1) —
Total other expenses	(31	) (30	) (95	) (107
Income (loss) before income tax benefit (expense) and equity in net income from unconsolidated investments	40	(11	) (39	) (26
Income tax (expense) benefit	(11	) 16	19	24
Equity in net income from unconsolidated investments	5	2	11	5
NET INCOME (LOSS) ATTRIBUTABLE TO COVANTA HOLDING CORPORATION	\$34	\$7	\$(9	) \$3
Weighted Average Common Shares Outstanding:				
Basic	132	130	132	130
Diluted	134	131	132	131
Earnings (Loss) Per Share Attributable to Covanta Holding Corporation Stockholders:				
Basic	\$0.26	\$0.05	\$(0.07) \$0.02
Diluted	\$0.25	\$0.05	\$(0.07) \$0.02

Cash Dividend Declared Per Share:	\$0.25	\$0.25	\$0.75	\$0.61
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The accompanying notes are an integral part of the condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended September 30, 2015		2014		Nine Months Ended September 30, 2015		2014	
	(Unaudited)		(Unaudited)		(Unaudited)		(Unaudited)	
	(In millions)							
Net income (loss) attributable to Covanta Holding Corporation	\$34		\$7		\$(9	)	\$3)
Foreign currency translation	(5	)	(5	)	(14	)	(7)
Net unrealized (loss) gain on derivative instruments, net of tax expense (benefit) of \$1, \$(1), 3 and \$(4), respectively	—		(6	)	6	)	(11)
Net unrealized loss on available for sale securities, net of tax expense of \$0 for all periods presented	—		(1)	—)	—)
Other comprehensive loss attributable to Covanta Holding Corporation	(5	)	(12	)	(8	)	(18)
Comprehensive income (loss) attributable to Covanta Holding Corporation	\$29		\$(5	)	\$(17	)	\$(15)

The accompanying notes are an integral part of the condensed consolidated financial statements.

Table of ContentsCOVANTA HOLDING CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	As of September 30, 2015 (Unaudited) (In millions, except per share amounts)	December 31, 2014
ASSETS		
Current:		
Cash and cash equivalents	\$69	\$84
Restricted funds held in trust	108	105
Receivables (less allowances of \$7 and \$6, respectively)	300	299
Deferred income taxes	45	29
Prepaid expenses and other current assets	105	102
Assets held for sale	101	94
Total Current Assets	728	713
Property, plant and equipment, net	2,632	2,608
Restricted funds held in trust	133	91
Waste, service and energy contracts, net	291	314
Other intangible assets, net	39	17
Goodwill	301	274
Investments in investees and joint ventures	11	13
Other assets	181	176
Total Assets	\$4,316	\$4,206
LIABILITIES AND EQUITY		
Current:		
Current portion of long-term debt	\$5	\$5
Current portion of project debt	35	35
Accounts payable	55	33
Accrued expenses and other current liabilities	249	306
Liabilities held for sale	23	26
Total Current Liabilities	367	405
Long-term debt	2,223	1,968
Project debt	187	190
Deferred income taxes	719	743
Waste and service contracts, net	15	19
Other liabilities	177	97
Total Liabilities	3,688	3,422
Commitments and Contingencies (Note 13)		
Equity:		
Covanta Holding Corporation stockholders equity:		
Preferred stock (\$0.10 par value; authorized 10 shares; none issued and outstanding)	—	—
Common stock (\$0.10 par value; authorized 250 shares; issued 136 and 136 shares, respectively; outstanding 133 and 133 shares, respectively)	14	14
Additional paid-in capital	811	805
Accumulated other comprehensive loss	(30) (22
Accumulated deficit	(169) (15

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Total Covanta Holding Corporation stockholders equity	626	782
Noncontrolling interests in subsidiaries	2	2
Total Equity	628	784
Total Liabilities and Equity	\$4,316	\$4,206

The accompanying notes are an integral part of the condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Nine Months Ended September 30,		
	2015	2014	
	(Unaudited, in millions)		
OPERATING ACTIVITIES:			
Net (loss) income	\$ (9	) \$ 3
Adjustments to reconcile net loss to net cash provided by operating activities from continuing operations:			
Depreciation and amortization expense	148	157	
Amortization of long-term debt deferred financing costs	6	5	
Amortization of debt premium and discount	—	(1)
Net write-offs	24	64	
Loss on extinguishment of debt	2	2	
Non-cash convertible debt related expense	—	13	
Stock-based compensation expense	15	15	
Equity in net income from unconsolidated investments	(11) (5)
Dividends from unconsolidated investments	3	10	
Deferred income taxes	(22) (17)
Other, net	—	3	
Change in restricted funds held in trust	14	14	
Change in working capital	(16	) 1
Total adjustments for continuing operations	163	261	
Net cash provided by operating activities from continuing operations	154	264	
Net cash provided by operating activities from discontinued operations	—	1	
Net cash provided by operating activities	154	265	
INVESTING ACTIVITIES:			
Proceeds from the sale of investment securities	—	6	
Purchase of investment securities	—	(4)
Purchase of property, plant and equipment	(267) (152)
Change in restricted funds held in trust	(64) (20)
Acquisition of business, net of cash acquired	(70) (13)
Acquisition of noncontrolling interest in subsidiary	—	(12)
Other, net	—	(6)
Net cash used in investing activities from continuing operations	(401) (201)
Net cash provided by investing activities from discontinued operations	—	—	
Net cash used in investing activities	(401) (201)
FINANCING ACTIVITIES:			
Proceeds from borrowings on long-term debt	294	412	
Proceeds from borrowings on revolving credit facility	655	431	
Proceeds from equipment financing capital lease	15	47	
Proceeds from borrowings on project debt	59	63	
Proceeds from borrowings on Dublin Convertible Preferred	85	—	
Proceeds from settlement of Note Hedge	—	83	
Payments related to Cash Conversion Option	—	(83)
Principal payments on long-term debt	(196) (557)
Payments of borrowings on revolving credit facility	(509) (361)
Payment of equipment financing capital lease	(3) —	

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Principal payments on project debt	(63) (33)
Payment of deferred financing costs	(8) (36)
Cash dividends paid to stockholders	(100	) (69)
Change in restricted funds held in trust	2	(57)
Other, net	—	(7)
Net cash provided by (used in) financing activities from continuing operations	231	(167)
Net cash used in financing activities from discontinued operations	—	(2)
Net cash provided by financing activities	231	(169)
Effect of exchange rate changes on cash and cash equivalents	(4	) (3)
Net increase (decrease) in cash and cash equivalents	(20	) (108)
Cash and cash equivalents at beginning of period	91	200	
Cash and cash equivalents at end of period	71	92	
Less: Cash and cash equivalents of discontinued operations and assets held for sale at end of period	2	12	
Cash and cash equivalents of continuing operations at end of period	\$69	\$80	

The accompanying notes are an integral part of the condensed consolidated financial statements.

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

The terms “we,” “our,” “ours,” “us” and “Company” refer to Covanta Holding Corporation and its subsidiaries; the term “Covanta Energy” refers to our subsidiary Covanta Energy LLC and its subsidiaries.

Organization

Covanta is one of the world’s largest owners and operators of infrastructure for the conversion of waste to energy (known as “energy-from-waste” or “EfW”), and also owns and operates related waste transport and disposal and other renewable energy production businesses. EfW serves two key markets as both a sustainable waste management solution that is environmentally superior to landfilling and as a source of clean energy that reduces overall greenhouse gas emissions and is considered renewable under the laws of many states and under federal law. Our facilities are critical infrastructure assets that allow our customers, which are principally municipal entities, to provide an essential public service.

Our EfW facilities earn revenue from both the disposal of waste and the generation of electricity and/or steam, generally under contracts, as well as from the sale of metal recovered during the EfW process. We process approximately 20 million tons of solid waste annually. We operate and/or have ownership positions in 45 energy-from-waste facilities, which are primarily located in North America, and 11 other energy generation facilities, primarily consisting of renewable energy production facilities in North America (wood biomass and hydroelectric). In total, these assets produce approximately 10 million megawatt hours (“MWh”) of baseload electricity annually. We also operate a waste management infrastructure that is complementary to our core EfW business.

We have one reportable segment, North America, which is comprised of waste and energy services operations located primarily in the United States and Canada. We are currently constructing an energy-from-waste facility in Dublin, Ireland, which we own and will operate upon completion. We hold equity interests in EfW facilities in China and Italy. For additional information, see Note 6. Financial Information by Business Segments.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with United States Generally Accepted Accounting Principles (“GAAP”) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for fair presentation have been included in our condensed consolidated financial statements. All intra-entity accounts and transactions have been eliminated. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2015. This Form 10-Q should be read in conjunction with the Audited Consolidated Financial Statements and accompanying Notes in our Annual Report on Form 10-K for the year ended December 31, 2014 (“Form 10-K”).

We use the equity method to account for our investments for which we have the ability to exercise significant influence over the operating and financial policies of the investee. Consolidated net income includes our proportionate share of the net income or loss of these companies. Such amounts are classified as “equity in net income from unconsolidated investments” in our condensed consolidated financial statements. Investments in companies in which we do not have the ability to exercise significant influence are carried at the lower of cost or estimated realizable value. We monitor investments for other-than-temporary declines in value and make reductions when appropriate.

Reclassification

During the quarter ended September 30, 2015, certain amounts have been reclassified in our prior period condensed consolidated statement of operations to conform to current year presentation and such amounts were not material to current and prior periods.

During the nine months ended September 30, 2015, we determined that the assets and liabilities associated with our investments in China met the criteria for classification as Assets Held for Sale. The assets and liabilities associated with these assets are presented in our condensed consolidated balance sheets as current “Assets held for sale” and Current “Liabilities held for sale.” For additional information, see Note 4. Assets Held for Sale.

Correction of an Error

During the year ended December 31, 2014, we identified errors associated with partnership tax basis accounting from acquisitions completed in prior periods. The impact of the errors in prior periods financial statements was not material to any of those periods. Consequently, we have corrected the aforementioned errors and other insignificant tax related errors for the prior periods presented by restating the condensed consolidated financial statements and other information included herein. As disclosed in our Form 10-K, we have restated our quarterly unaudited financial data. Provided below is a reconciliation of the previously reported amounts to the adjusted amounts for the three and nine months ended September 30, 2014 (in millions, except per share amounts):

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) - (Continued)

Consolidated Statement of Operations

	Three Months Ended September 30, 2014		
	As Reported	Adjustment	As Adjusted
Depreciation and amortization expense	\$52	\$(1)	\$51
Net income attributable to Covanta Holding Corporation	\$6	\$1	\$7
Basic and diluted earnings per share	\$0.05	\$—	\$0.05

	Nine Months Ended September 30, 2014		
	As Reported	Adjustment	As Adjusted
Depreciation and amortization expense	\$158	\$(1)	\$157
Income tax benefit	\$20	\$4	\$24
Net (loss) income attributable to Covanta Holding Corporation	\$(2)	\$5	\$3
Basic and diluted (loss) earnings per share	\$(0.02)	\$0.04	\$0.02

Change in Estimate

Revenue under our Durham York construction contract is recognized using the percentage-of-completion method, measured by the cost-to-cost method. We evaluate the estimate of our total construction costs for the contract throughout the life of the project and make revisions to our estimated costs as necessary. During the nine months ended September 30, 2015, we reduced our overall profit estimate related to this construction project by approximately \$20 million and we now expect an overall loss on the construction project.

Change in Accounting Principle

Effective January 1, 2015, we were required to adopt guidance concerning service concession arrangements. The amendment applies to an operating entity of a service concession arrangement entered into with a public-sector entity grantor when the arrangement meets certain conditions. The amendments specify that such an arrangement may not be accounted for as a lease nor should the infrastructure used in a service concession arrangement be recognized as property, plant and equipment by the operating entity. Instead, the operating entity should refer to other guidance to account for the arrangement, such as Topic 605 of the Accounting Standard Codification - Revenue Recognition. We adopted this guidance using a modified retrospective approach which requires the cumulative effect of applying this guidance to arrangements existing at the beginning of the period of adoption be recognized as an adjustment to retained earnings. As a result, accumulated deficit as of January 1, 2015 as originally reported of \$15 million increased by \$45 million (\$75 million reduction of property, plant and equipment, net of tax of \$30 million) to \$60 million.

The adoption of this guidance had the following effect on our condensed consolidated statement of operations (in millions, except per share amounts):

	Three Months Ended September 30, 2015 Increase (Decrease)	Nine Months Ended September 30, 2015
Plant operating expenses	\$3	\$25
Depreciation and amortization	\$	