

COVANTA HOLDING CORP

Form 10-Q

April 22, 2009

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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 March 31, 2009**

**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 1-6732**

**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)*

**40 Lane Road, Fairfield, NJ**

*(Address of Principal Executive Office)*

**07004**

*(Zip Code)*

**(973) 882-9000**

**(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 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:**

The number of shares of the registrant's Common Stock outstanding as of the last practicable date.

| <b>Class</b>                   | <b>Outstanding at April 16, 2009</b> |
|--------------------------------|--------------------------------------|
| Common Stock, \$0.10 par value | 154,840,440 shares                   |

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**FORM 10-Q QUARTERLY REPORT**  
**For the Quarter Ended March 31, 2009**

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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, 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 Covanta are not guarantees or indicative of future performance. Important assumptions and other important factors that could cause actual results to differ materially from those forward-looking statements with respect to Covanta include, but are not limited to, the risks and uncertainties affecting their businesses described in Item 1A. Risk Factors of Covanta s Annual Report on Form 10-K for the year ended December 31, 2008 and in other filings by Covanta with the SEC.

Although Covanta believes that its 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 its forward-looking statements. Covanta s 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 Covanta does 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.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

|  | <b>For the Three Months Ended<br/>March 31,</b>     |               |
|--|---|---------------|
|  | <b>2009</b>   | <b>2008</b>   |
|  | <b>(As Adjusted)</b>                                |               |
|  | <b>(Unaudited)</b>                                  |               |
|  | <b>(In thousands, except per share<br/>amounts)</b> |               |
| <b>OPERATING REVENUES:</b>   |   |               |
| Waste and service revenues   | \$ 206,269  | \$ 217,623    |
| Electricity and steam sales  | 141,869   | 153,065       |
| Other operating revenues   | 10,622  | 18,078        |
| Total operating revenues   | 358,760   | 388,766       |
| <b>OPERATING EXPENSES:</b>   |   |               |
| Plant operating expenses   | 256,042   | 259,011       |
| Depreciation and amortization expense  | 51,498  | 48,574        |
| Net interest expense on project debt   | 12,769  | 13,761        |
| General and administrative expenses  | 25,515  | 24,154        |
| Other operating expenses   | 9,744   | 12,501        |
| Total operating expenses   | 355,568   | 358,001       |
| Operating income   | 3,192   | 30,765        |
| <b>Other income (expense):</b>   |   |               |
| Investment income  | 1,028   | 1,640         |
| Interest expense   | (9,506)   | (15,199)      |
| Total other expenses   | (8,478)   | (13,559)      |
| (Loss) income before income tax benefit (expense), equity in net income<br>from unconsolidated investments and noncontrolling interests in<br>subsidiaries | (5,286)   | 17,206        |
| Income tax benefit (expense)   | 1,992   | (6,905)       |
| Equity in net income from unconsolidated investments   | 5,809   | 5,492         |
| <b>NET INCOME</b>  | <b>2,515</b>  | <b>15,793</b> |

|   |                 |                  |
|---|-----------------|------------------|
| Less: Net income attributable to noncontrolling interests in subsidiaries | (1,380)         | (1,869)          |
| <b>NET INCOME ATTRIBUTABLE TO COVANTA HOLDING CORPORATION</b>             | <b>\$ 1,135</b> | <b>\$ 13,924</b> |
| <b>Weighted Average Common Shares Outstanding:</b>                        |                 |                  |
| Basic   | 153,467         | 153,165          |
| Diluted   | 154,737         | 154,572          |
| <b>Earnings Per Share:</b>  |                 |                  |
| Basic   | \$ 0.01         | \$ 0.09          |
| Diluted   | \$ 0.01         | \$ 0.09          |

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



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

|   | As of   |                                       |
|---|---|---------------------------------------|
|   | March 31,<br>2009<br>(Unaudited)<br>(In thousands, except per<br>share amounts) | December 31,<br>2008<br>(As Adjusted) |
| <b>ASSETS</b>   |   |                                       |
| <b>Current:</b>   |   |                                       |
| Cash and cash equivalents   | \$ 159,472  | \$ 192,393                            |
| Marketable securities available for sale  | 300   | 300                                   |
| Restricted funds held in trust  | 186,202   | 175,093                               |
| Receivables (less allowances of \$3,404 and \$3,437)                                  | 225,689   | 243,791                               |
| Unbilled service receivables  | 52,062  | 49,468                                |
| Deferred income taxes   | 39,219  |                                       |
| Prepaid expenses and other current assets   | 115,913   | 123,214                               |
| <b>Total Current Assets</b>   | <b>778,857</b>  | <b>784,259</b>                        |
| Property, plant and equipment, net  | 2,511,601   | 2,530,035                             |
| Investments in fixed maturities at market (cost: \$27,090 and \$26,620, respectively) | 27,111  | 26,737                                |
| Restricted funds held in trust  | 142,603   | 149,818                               |
| Unbilled service receivables  | 36,939  | 44,298                                |
| Waste, service and energy contracts, net  | 211,938   | 223,397                               |
| Other intangible assets, net  | 82,020  | 83,331                                |
| Goodwill  | 195,617   | 195,617                               |
| Investments in investees and joint ventures   | 108,783   | 102,953                               |
| Other assets  | 154,322   | 139,544                               |
| <b>Total Assets</b>   | <b>\$ 4,249,791</b>   | <b>\$ 4,279,989</b>                   |
| <b>LIABILITIES AND EQUITY</b>   |   |                                       |
| <b>Current:</b>   |   |                                       |
| Current portion of long-term debt   | \$ 6,657  | \$ 6,922                              |
| Current portion of project debt   | 195,997   | 198,034                               |
| Accounts payable  | 35,986  | 24,470                                |
| Deferred revenue  | 16,163  | 15,202                                |
| Accrued expenses and other current liabilities  | 174,170   | 215,046                               |
| <b>Total Current Liabilities</b>  | <b>428,973</b>  | <b>459,674</b>                        |
| Long-term debt  | 771,129   | 770,949                               |
| Project debt  | 834,496   | 880,336                               |

|                             |                  |                  |
|-----------------------------|------------------|------------------|
| Deferred income taxes       | 619,078          | 566,687          |
| Waste and service contracts | 111,251          | 114,532          |
| Other liabilities           | 165,624          | 165,881          |
| <b>Total Liabilities</b>    | <b>2,930,551</b> | <b>2,958,059</b> |

**Commitments and Contingencies (Note 14)****Equity:**

Covanta Holding Corporation stockholders' equity:

Preferred stock (\$0.10 par value; authorized 10,000 shares; none issued and outstanding)

Common stock (\$0.10 par value; authorized 250,000 shares; issued 155,506 and 154,797 shares; outstanding 154,841 and 154,280 shares)

|                                      |          |         |
|--------------------------------------|----------|---------|
| Additional paid-in capital           | 15,551   | 15,480  |
| Accumulated other comprehensive loss | 919,883  | 917,810 |
| Accumulated earnings                 | (10,332) | (8,205) |
| Treasury stock, at par               | 363,018  | 361,883 |
|                                      | (67)     | (52)    |

|  |           |           |
|--|-----------|-----------|
| Total Covanta Holding Corporation stockholders' equity | 1,288,053 | 1,286,916 |
|--|-----------|-----------|

|  |        |        |
|--|--------|--------|
| Noncontrolling interests in subsidiaries | 31,187 | 35,014 |
|--|--------|--------|

|                     |                  |                  |
|---------------------|------------------|------------------|
| <b>Total Equity</b> | <b>1,319,240</b> | <b>1,321,930</b> |
|---------------------|------------------|------------------|

|                                     |                     |                     |
|-------------------------------------|---------------------|---------------------|
| <b>Total Liabilities and Equity</b> | <b>\$ 4,249,791</b> | <b>\$ 4,279,989</b> |
|-------------------------------------|---------------------|---------------------|

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

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | <b>For the Three Months Ended</b> |              |
|---|-----------------------------------|--------------|
|   | <b>March 31,</b>                  |              |
|   | <b>2009</b>                       | <b>2008</b>  |
|   | <b>(As Adjusted)</b>              |              |
|   | <b>(Unaudited)</b>                |              |
|   | <b>(In thousands)</b>             |              |
| <b>OPERATING ACTIVITIES:</b>  |                                   |              |
| Net income  | \$ 2,515                          | \$ 15,793    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |              |
| Depreciation and amortization expense   | 51,498                            | 48,574       |
| Amortization of long-term debt deferred financing costs                           | 904                               | 931          |
| Amortization of debt premium and discount   | (2,082)                           | (2,770)      |
| Non-cash convertible debt interest expense  | 1,590                             | 1,479        |
| Stock-based compensation expense  | 3,907                             | 3,651        |
| Equity in net income from unconsolidated investments                              | (5,809)                           | (5,492)      |
| Dividends from unconsolidated investments   | 266                               | 9,122        |
| Deferred income taxes   | (4,317)                           | 172          |
| Other, net  | 462                               | (595)        |
| Increase in restricted funds held in trust  | (9,413)                           | (25,629)     |
| Change in working capital, net of effects of acquisitions                         | 11,874                            | 4,470        |
| <br>Net cash provided by operating activities                                     | <br>51,395                        | <br>49,706   |
| <b>INVESTING ACTIVITIES:</b>  |                                   |              |
| Proceeds from the sale of investment securities                                   | 3,405                             | 13,401       |
| Purchase of investment securities   | (3,779)                           | (9,137)      |
| Purchase of property, plant and equipment   | (26,833)                          | (38,990)     |
| Purchase of equity interest   | (1,083)                           |              |
| Loan issued to client community to fund certain facility improvements             | (6,192)                           |              |
| Property insurance proceeds   |                                   | 3,500        |
| Other, net  | (238)                             | (1,524)      |
| <br>Net cash used in investing activities   | <br>(34,720)                      | <br>(32,750) |
| <b>FINANCING ACTIVITIES:</b>  |                                   |              |
| Proceeds from the exercise of options for common stock, net                       | 147                               | 221          |
| Financings of insurance premiums, net   | (3,112)                           | (3,455)      |
| Proceeds from borrowings on project debt  |                                   | 4,076        |
| Principal payments on long-term debt  | (1,675)                           | (1,691)      |
| Principal payments on project debt  | (45,268)                          | (55,119)     |
| Decrease in restricted funds held in trust  | 4,321                             | 16,077       |

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|   |            |            |
|---|------------|------------|
| Distributions to partners of noncontrolling interests in subsidiaries | (3,716)    | (2,346)    |
| Net cash used in financing activities                                 | (49,303)   | (42,237)   |
| Effect of exchange rate changes on cash and cash equivalents          | (293)      | 269        |
| Net decrease in cash and cash equivalents                             | (32,921)   | (25,012)   |
| Cash and cash equivalents at beginning of period                      | 192,393    | 149,406    |
| Cash and cash equivalents at end of period                            | \$ 159,472 | \$ 124,394 |

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

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**COVANTA HOLDING CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF EQUITY**  
**For the Three Months Ended March 31, 2009**

|   | Covanta Holding Corporation Stockholders' Equity |                        |                                  |   |                         |                             |                             |   |                 |
|---|--|------------------------|----------------------------------|---|-------------------------|-----------------------------|-----------------------------|---|-----------------|
|   | Common Stock<br>Shares                           | Common Stock<br>Amount | Additional<br>Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Loss | Accumulated<br>Earnings | Treasury<br>Stock<br>Shares | Treasury<br>Stock<br>Amount | Noncontrolling<br>Interests<br>in<br>Subsidiaries | Total           |
| Balance as of<br>December 31,<br>2008 (As<br>Adjusted)                            | 154,797  | \$ 15,480              | \$ 917,810                       | \$ (8,205)                                    | \$ 361,883              | 517                         | \$ (52)                     | \$ 35,014   | \$ 1,321,930    |
| Stock-based<br>compensation<br>expense  |  |                        | 3,907                            |   |                         |                             |                             |   | 3,907           |
| Shares forfeited<br>or terminated<br>employees                                    |  |                        | 1                                |   |                         | 8                           | (1)                         |   |                 |
| Shares<br>repurchased for<br>tax withholdings<br>or vested stock<br>wards         |  |                        | (1,911)                          |   |                         | 140                         | (14)                        |   | (1,925)         |
| Exercise of<br>options to<br>purchase<br>common stock                             | 25   | 3                      | 144                              |   |                         |                             |                             |   | 147             |
| Shares issued in<br>connection with<br>non-vested stock<br>ward                   | 684  | 68                     | (68)                             |   |                         |                             |                             |   |                 |
| Distributions to<br>partners of<br>noncontrolling<br>interests in<br>subsidiaries |  |                        |                                  |   |                         |                             |                             | (4,677)   | (4,677)         |
| Comprehensive<br>income, net of<br>income taxes:                                  |  |                        |                                  |   |                         |                             |                             |   |                 |
| Net income  |  |                        |                                  |   | 1,135                   |                             |                             | 1,380   | 2,515           |
| Foreign currency<br>translation   |  |                        |                                  | (1,801)<br>(42)                               |                         |                             |                             | (530)   | (2,331)<br>(42) |

|                    |         |           |            |             |            |     |         |           |              |       |
|--------------------|---------|-----------|------------|-------------|------------|-----|---------|-----------|--------------|-------|
| FAS 158            |         |           |            |             |            |     |         |           |              |       |
| Unrecognized net   |         |           |            |             |            |     |         |           |              |       |
| loss               |         |           |            |             |            |     |         |           |              |       |
| Net unrealized     |         |           |            |             |            |     |         |           |              |       |
| loss on            |         |           |            |             |            |     |         |           |              |       |
| available-for-sale |         |           |            |             |            |     |         |           |              |       |
| securities         |         |           |            | (284)       |            |     |         |           |              | (284) |
| Total              |         |           |            |             |            |     |         |           |              |       |
| comprehensive      |         |           |            | (2,127)     | 1,135      |     |         | 850       |              | (142) |
| loss               |         |           |            |             |            |     |         |           |              |       |
| Balance as of      |         |           |            |             |            |     |         |           |              |       |
| March 31, 2009     | 155,506 | \$ 15,551 | \$ 919,883 | \$ (10,332) | \$ 363,018 | 665 | \$ (67) | \$ 31,187 | \$ 1,319,240 |       |

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 *Company* refers to our subsidiary Covanta Energy Corporation and its subsidiaries.

**Organization**

We are a leading developer, owner and operator of infrastructure for the conversion of waste to energy (known as *energy-from-waste* ), as well as other waste disposal and renewable energy production businesses in the Americas, Europe and Asia. We conduct all of our operations through subsidiaries which are engaged predominantly in the businesses of waste and energy services. We also engage in the independent power production business outside the Americas.

We own, have equity investments in, and/or operate 60 energy generation facilities, 50 of which are in the United States and 10 of which are located outside the United States. Our energy generation facilities use a variety of fuels, including municipal solid waste, wood waste (biomass), landfill gas, water (hydroelectric), natural gas, coal, and heavy fuel-oil. We also own or operate several businesses that are associated with our energy-from-waste business, including a waste procurement business, a biomass procurement business, four landfills, which we use primarily for ash disposal, and several waste transfer stations. We have two reportable segments, Domestic and International, which are comprised of our domestic and international waste and energy services operations, respectively.

**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 financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for fair presentation have been included in our financial statements. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ended December 31, 2009. 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, 2008 ( *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.

All intercompany accounts and transactions have been eliminated.

Effective January 1, 2009, we adopted the following pronouncements which require us to retrospectively restate previously disclosed condensed consolidated financial statements. As such, certain prior period amounts have been reclassified in the unaudited condensed consolidated financial statements to conform to the current period presentation.

We adopted Statement of Financial Accounting Standards ( SFAS ) No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin (ARB) No. 51 ( SFAS 160 ). SFAS 160 amends the accounting and reporting for noncontrolling interests in a consolidated subsidiary and the deconsolidation of a subsidiary. Under SFAS 160, we now report minority interests in subsidiaries as a separate component of equity in the condensed consolidated financial statements and show both net income attributable to the noncontrolling interest and net income attributable to the controlling



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

interest on the face of the condensed consolidated income statement. SFAS 160 applies prospectively, except for presentation and disclosure requirements, which are applied retrospectively.

We adopted Financial Accounting Standards Board ( FASB ) Staff Position ( FSP ) No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) ( FSP APB 14-1 ). FSP APB 14-1 is effective for our \$373.8 million aggregate principal amount of 1.00% Senior Convertible Debentures ( Debentures ) and requires retrospective application for all periods presented. The FSP requires the issuer of convertible debt instruments with cash settlement features to separately account for the liability (\$127.5 million as of the date of the issuance of the Debentures) and equity components (\$246.3 million as of the date of the issuance of the Debentures) of the instrument. The debt component was recognized at the present value of its cash flows discounted using a 7.25% discount rate, our borrowing rate at the date of the issuance of the Debentures for a similar debt instrument without the conversion feature. The equity component, recorded as additional paid-in capital, was \$141.3 million, which represents the difference between the proceeds from the issuance of the Debentures and the fair value of the liability, net of deferred taxes of \$105 million as of the date of the issuance of the Debentures. For additional information, see Note 6. Changes in Capitalization.

FSP APB 14-1 also requires an accretion of the resultant debt discount over the expected life of the Debentures, which is February 1, 2007 to February 1, 2027. The condensed consolidated income statements were retroactively modified compared to previously reported amounts as follows (in millions, except per share amounts):

|  | <b>Twelve Months Ended<br/>December 31,</b> |             | <b>Three Months<br/>Ended<br/>March 31,</b> |
|--|---|-------------|---|
|  | <b>2007</b>                                 | <b>2008</b> | <b>2008</b>                                 |
| Additional pre-tax non-cash interest expense           | \$ (5.2)                                    | \$ (6.1)    | \$ (1.5)                                    |
| Additional deferred tax benefit                        | 2.2   | 2.6         | 0.6   |
| Retroactive change in net income and retained earnings | \$ (3.0)                                    | \$ (3.5)    | \$ (0.9)                                    |
| Change to basic earnings per share                     | \$ (0.01)                                   | \$ (0.02)   | \$ (0.01)                                   |
| Change to diluted earnings per share                   | \$ (0.02)                                   | \$ (0.02)   | \$ (0.01)                                   |

For the three months ended March 31, 2009, the additional pre-tax non-cash interest expense recognized in the condensed consolidated income statement was \$1.6 million. Accumulated amortization related to the debt discount was \$12.9 million and \$11.3 million as of March 31, 2009 and December 31, 2008, respectively. The pre-tax increase in non-cash interest expense on our condensed consolidated statements of income to be recognized until 2027, the maturity date of the Debentures, is as follows (in millions):

|             |             |             |             |             |                  |
|-------------|-------------|-------------|-------------|-------------|------------------|
| <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>2012</b> | <b>2013</b> | <b>2014-2027</b> |
|-------------|-------------|-------------|-------------|-------------|------------------|

|   |        |        |        |        |        |          |
|---|--------|--------|--------|--------|--------|----------|
| Pre-tax increase in non-cash interest expense | \$ 6.5 | \$ 7.0 | \$ 7.6 | \$ 8.1 | \$ 8.7 | \$ 197.1 |
|---|--------|--------|--------|--------|--------|----------|

**Note 2. Recent Accounting Pronouncements**

On April 9, 2009, the FASB issued three FSPs intended to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities. FSP SFAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides guidelines for making fair value measurements more consistent with the principles presented in SFAS No. 157, *Fair Value Measurements*. FSP SFAS No. 107-1 and APB No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, enhances consistency in financial reporting by increasing the frequency of fair value disclosures. FSP SFAS No. 115-2 and SFAS No. 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, provides additional guidance designed to

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

create greater clarity and consistency in accounting for and presenting impairment losses on securities. These FSPs are effective for us for reporting periods ending after June 30, 2009. We are continuing to assess the potential disclosure effects of these pronouncements.

In December 2008, the FASB issued FSP SFAS No. 132R-1, *Employers' Disclosures about Postretirement Benefit Plan Assets* ( FSP SFAS 132R-1 ) which significantly expands the disclosures required by employers for postretirement plan assets. The FSP requires plan sponsors to provide extensive new disclosures about assets in defined benefit postretirement benefit plans as well as any concentrations of associated risks. In addition, the FSP requires new disclosures similar to those in SFAS No. 157, *Fair Value Measurements* , in terms of the three-level fair value hierarchy. The disclosure requirements are annual and do not apply to interim financial statements and are required by us in disclosures related to the year ended December 31, 2009. We do expect the adoption of FSP SFAS 132R-1 to result in additional annual financial reporting disclosures and we are continuing to assess the potential effects of this pronouncement.

**Note 3. Acquisitions and Business Development**

Acquisitions made prior to December 31, 2008 were accounted for in accordance with SFAS No. 141, *Business Combinations* ( SFAS 141 ). Effective January 1, 2009, all business combinations will be accounted for in accordance with SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS 141R ).

Our growth strategy includes the acquisition of waste and energy related businesses located in markets with significant growth opportunities and the development of new projects and expansion of existing projects. We will also consider acquiring or developing new technologies and businesses that are complementary with our existing renewable energy and waste services business. Acquisitions are accounted for under the purchase method of accounting. The results of operations reflect the period of ownership of the acquired businesses, business development projects and dispositions. The acquisitions in the section below are not material to our condensed consolidated financial statements individually or in the aggregate and therefore, disclosures of pro forma financial information have not been presented.

***Acquisitions and Business Development***

***Domestic***

***Maine Biomass Energy Facilities***

On December 22, 2008, we acquired Indeck Maine Energy, LLC which owned and operated two biomass energy facilities. The two nearly identical facilities, located in West Enfield and Jonesboro, Maine, added a total of 49 gross megawatts ( MW ) to our renewable energy portfolio. We sell the electric output and renewable energy credits from these facilities into the New England market. We acquired these two facilities for cash consideration of approximately \$53.4 million, net of cash acquired, inclusive of final working capital adjustments. There were no amounts allocated to goodwill or other intangible assets in the final purchase price allocation.

***Kent County, Michigan Energy-from-Waste Facility***

On December 4, 2008, we entered into a new tip fee contract with Kent County in Michigan which commenced on January 1, 2009 and extended the existing contract from 2010 to 2023. This contract is expected to supply waste utilizing most or all of the facility's capacity. Previously this was a service fee contract.

*Pasco County, Florida Energy-from-Waste Facility*

On September 23, 2008, we entered into a new service fee contract with the Pasco County Commission in Florida which commenced on January 1, 2009 and extended the existing contract from 2011 to 2016.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Indianapolis Energy-from-Waste Facility*

On July 25, 2008, we entered into a new tip fee contract with the City of Indianapolis for a term of 10 years which commenced upon expiration of the existing service fee contract in December 2008. This contract represents approximately 50% of the facility's capacity.

*Tulsa Energy-from-Waste Facility*

On June 2, 2008, we acquired an energy-from-waste facility in Tulsa, Oklahoma for cash consideration of approximately \$12.7 million. The design capacity of the facility is 1,125 tons per day ( tpd ) of waste and gross electric capacity of 16.5 MW. This facility was shut down by the prior owner in the summer of 2007 and we returned two of the facility's three boilers to service in November 2008. During the year ended December 31, 2008 and quarter ended March 31, 2009, we have invested approximately \$4.9 million and \$0.4 million, respectively, in capital improvements to restore the operational performance of the facility.

*Alternative Energy Technology Development*

We have entered into various agreements with multiple partners to invest in the development, testing or licensing of new technologies related to the transformation of waste materials into renewable fuels or the generation of energy. Initial licensing fees and demonstration unit purchases approximated \$6.5 million and \$0.2 million during the year ended December 31, 2008 and quarter ended March 31, 2009, respectively.

*Harrisburg Energy-from-Waste Facility*

In February 2008, we entered into a ten year agreement to maintain and operate an 800 tpd energy-from-waste facility located in Harrisburg, Pennsylvania. Under the agreement, we have a right of first refusal to purchase the facility. We also have agreed to provide construction management services and to advance up to \$25.5 million in funding for certain facility improvements required to enhance facility performance, the repayment of which is guaranteed by the City of Harrisburg. We have advanced \$8.2 million and \$14.4 million as of December 31, 2008 and March 31, 2009, respectively, under this funding arrangement. The facility improvements are expected to be completed by mid 2009.

*Hillsborough County Energy-from-Waste Facility*

We designed, constructed, and now operate and maintain the 1,200 tpd mass-burn energy-from-waste facility located in and owned by Hillsborough County in Florida. Due to the growth in the amount of municipal solid waste generated in Hillsborough County, Hillsborough County informed us of its desire to expand the facility's waste processing and electricity generation capacities. In August 2005, we entered into agreements with Hillsborough County to implement this expansion, and to extend the agreement under which we operate the facility through 2027. Environmental and other project related permits have been secured and the expansion construction commenced on December 29, 2006. Completion of the expansion, and commencement of the operation of the expanded project, is expected in the second half of 2009.

***International***

*China Joint Ventures and Energy-from-Waste Facilities*

On April 2, 2008, our project joint venture with Chongqing Iron & Steel Company (Group) Limited received an award to build, own, and operate an 1,800 tpd energy-from-waste facility for Chengdu Municipality, in Sichuan Province, People's Republic of China. On June 25, 2008, the project's 25 year waste concession agreement was executed. In connection with this project, we invested \$17.1 million for a 49% equity interest in the project joint venture company. The Chengdu project is expected to commence construction in mid 2009.

In December 2008, we entered into an agreement to purchase a direct 58% equity interest in the Fuzhou project, a 1,200 metric tpd 24 MW mass-burn energy-from-waste project in China, for approximately \$14 million.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

We currently hold a noncontrolling interest in this project. This purchase is conditional upon various regulatory and other conditions precedent and is expected to close in the second quarter of 2009.

On March 24, 2009, we entered into a 25 year concession agreement and waste supply agreements to build, own and operate a 350 metric tpd energy-from-waste facility for Taixing Municipality, in Jiangsu Province, People's Republic of China. The project, which will be built on the site of our existing coal-fired facility in Taixing, will supply steam to an adjacent industrial park under short-term arrangements. The Taixing project is expected to commence construction later this year.

*Dublin Joint Venture*

On September 6, 2007, we entered into definitive agreements to build, own, and operate a 1,700 metric tpd energy-from-waste project serving the City of Dublin, Ireland and surrounding communities. The Dublin project is being developed and will be owned by Dublin Waste to Energy Limited, which we control and co-own with DONG Energy Generation A/S. Project construction, which is expected to start in mid 2009, is estimated to cost approximately 350 million and is expected to require 36 months to complete, once full construction commences. Dublin Waste to Energy Limited has a 25-year tip fee type contract to provide disposal service for approximately 320,000 metric tons of waste annually. The project is expected to sell electricity into the local electricity grid under short-term arrangements. We and DONG Energy Generation A/S have committed to provide financing for all phases of the project, and we expect to utilize debt financing for the project. The primary approvals and licenses for the project have been obtained, and any remaining consents and approvals necessary to begin full construction are expected to be obtained in due course. We have begun to perform preliminary on-site work and expect to commence full construction in mid 2009.

**Note 4. Earnings Per Share**

Per share data is based on the weighted average number of outstanding shares of our common stock, par value \$0.10 per share, during the relevant period. Basic earnings per share are calculated using only the weighted average number of outstanding shares of common stock. Diluted earnings per share computations, as calculated under the treasury stock method, include the weighted average number of shares of additional outstanding common stock issuable for stock options, restricted stock, and rights whether or not currently exercisable. Diluted earnings per share for all the periods presented does not include securities if their effect was anti-dilutive (in thousands, except per share amounts).

|  | <b>For the Three Months<br/>Ended March 31,<br/>2009                      2008</b> |           |
|--|--|-----------|
| Net income attributable to Covanta Holding Corporation | \$ 1,135   | \$ 13,924 |
| <b>Basic earnings per share:</b>                       |  |           |
| Weighted average basic common shares outstanding       | 153,467  | 153,165   |
| Basic earnings per share                               | \$ 0.01  | \$ 0.09   |

**Diluted earnings per share:**

|  |         |         |
|--|---------|---------|
| Weighted average basic common shares outstanding   | 153,467 | 153,165 |
| Dilutive effect of stock options   | 454     | 619     |
| Dilutive effect of restricted stock  | 816     | 788     |
| Dilutive effect of convertible debentures  |         |         |
| Weighted average diluted common shares outstanding   | 154,737 | 154,572 |
| Diluted earnings per share   | \$ 0.01 | \$ 0.09 |
| Stock options excluded from the weighted average dilutive common shares outstanding because their inclusion would have been antidilutive           | 2,026   | 1,938   |
| Restricted stock awards excluded from the weighted average dilutive common shares outstanding because their inclusion would have been antidilutive |         |         |



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

See Note 1. Organization and Basis of Presentation for a discussion of the retrospective accounting change resulting from the adoption of FSP APB 14-1 effective January 1, 2009.

On January 31, 2007, we issued 1.00% Senior Convertible Debentures due 2027 (the "Debentures"). The Debentures are convertible under certain circumstances if the closing sale price of our common stock exceeds a specified conversion price before February 1, 2025. As of March 31, 2009, the Debentures did not have a dilutive effect on earnings per share.

**Note 5. Financial Information by Business Segments**

We have two reportable segments, Domestic and International, which are comprised of our domestic and international waste and energy services operations, respectively. The results of our reportable segments are as follows (in thousands):

|   | Reportable Segments |               | All<br>Other(1) | Total      |
|---|---------------------|---------------|-----------------|------------|
|   | Domestic            | International |                 |            |
| <b>Three Months Ended March 31, 2009:</b> |                     |               |                 |            |
| Operating revenues                        | \$ 313,173          | \$ 41,537     | \$ 4,050        | \$ 358,760 |
| Operating income (loss)                   | 4,435               | (859)         | (384)           | 3,192      |
| <b>Three Months Ended March 31, 2008:</b> |                     |               |                 |            |
| Operating revenues                        | \$ 323,284          | \$ 62,779     | \$ 2,703        | \$ 388,766 |
| Operating income (loss)                   | 25,354              | 5,838         | (427)           | 30,765     |

(1) All other is comprised of our insurance subsidiaries' operations.

**Note 6. Changes in Capitalization****Long-Term Debt**

Long-term debt is as follows (in thousands):

|   | March 31,<br>2009 | As of<br>December 31,<br>2008 |
|---|-------------------|-------------------------------|
| 1.00% Senior Convertible Debentures due 2027    | \$ 373,750        | \$ 373,750                    |
| Debt discount related to Convertible Debentures | (233,426)         | (235,016)                     |
| Senior Convertible Debentures, net              | 140,324           | 138,734                       |

|                       |            |            |
|-----------------------|------------|------------|
| Term loan due 2014    | 637,000    | 638,625    |
| Other long-term debt  | 462        | 512        |
| Total                 | 777,786    | 777,871    |
| Less: current portion | (6,657)    | (6,922)    |
| Total long-term debt  | \$ 771,129 | \$ 770,949 |

See Note 1. Organization and Basis of Presentation for a discussion of the liability component associated with the Debentures and the retrospective accounting change resulting from the adoption of FSP APB 14-1 effective January 1, 2009.

Under limited circumstances, prior to February 1, 2025, the Debentures are convertible by the holders into cash and shares of our common stock, if any, initially based on a conversion rate of 35.4610 shares of our common stock per \$1,000 principal amount of Debentures, (which represents an initial conversion price of approximately \$28.20 per share) or 13,253,867 issuable. The value of the issuable shares, if the Debentures were converted at March 31, 2009, exceeds the principal value of the Debentures by \$200.3 million.

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 6 of the Notes to Consolidated Financial Statements in our Form 10-K.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Short-Term Liquidity**

As of March 31, 2009, we had available credit for liquidity as follows (in thousands):

|                            | <b>Total<br/>Available<br/>Under<br/>Facility</b> | <b>Maturing</b> | <b>Outstanding<br/>Letters<br/>of Credit as of<br/>March 31, 2009</b> | <b>Available as of<br/>March 31,<br/>2009</b> |
|----------------------------|---|-----------------|---|---|
| Revolving Loan Facility(1) | \$ 300,000  | 2013            | \$  | \$ 300,000                                    |
| Funded L/C Facility        | \$ 320,000  | 2014            | \$ 285,361  | \$ 34,639                                     |

(1) Up to \$200 million of which may be utilized for letters of credit.

Under our Revolving Loan Facility, we have pro rata funding commitments from a large consortium of banks, including a 6.8% pro rata commitment from Lehman Brothers Commercial Bank. Lehman Brothers Commercial Bank is a subsidiary of Lehman Brothers Holdings, Inc., which filed for bankruptcy protection in September 2008. We believe that neither the Lehman Brothers Holdings, Inc. bankruptcy, nor the ability of Lehman Brothers Commercial Bank (which is not currently part of such bankruptcy proceeding) to fund its pro rata share of any draw request we may make, will have a material affect on our liquidity.

**Credit Facilities**

The loan documentation under the credit facilities, comprised of a \$300 million revolving credit facility (the Revolving Loan Facility), a \$320 million funded letter of credit facility (the Funded L/C Facility), and a \$650 million term loan (the Term Loan Facility) contains customary affirmative and negative covenants and financial covenants. We were in compliance with all required covenants as of March 31, 2009.

**Equity**

During the three months ended March 31, 2009, we awarded grants for 684,231 shares of restricted stock awards. See Note 11. Stock-Based Compensation.

During the three months ended March 31, 2009, we did not repurchase shares of our common stock under the repurchase program authorized in September 2008.

See Note 1. Organization and Basis of Presentation for a discussion of the equity component associated with the Debentures and the retrospective accounting change resulting from the adoption of FSP APB 14-1 effective January 1, 2009.

**Note 7. Comprehensive (Loss) Income**

The components of comprehensive (loss) income are as follows (in thousands):

|   | <b>Three Months Ended<br/>March 31,</b> |             |
|---|---|-------------|
|   | <b>2009</b>                             | <b>2008</b> |
| Comprehensive (loss) income, net of income taxes:                             |   |             |
| Net income attributable to Covanta Holding Corporation                        | \$ 1,135                                | \$ 13,924   |
| Foreign currency translation  | (1,801)                                 | 1,027       |
| SFAS 158 unrecognized net loss  | (42)                                    | (169)       |
| Net unrealized loss on available-for-sale securities                          | (284)                                   | (70)        |
| Other comprehensive (loss) income attributable to Covanta Holding Corporation | (2,127)                                 | 788         |
| Comprehensive (loss) income attributable to Covanta Holding Corporation       | \$ (992)                                | \$ 14,712   |
| Net income attributable to noncontrolling interests in subsidiaries           | \$ 1,380                                | \$ 1,869    |
| Other comprehensive loss Foreign currency translation                         | (530)                                   | (34)        |
| Comprehensive income attributable to noncontrolling interests in subsidiaries | \$ 850                                  | \$ 1,835    |

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

See Note 1. Organization and Basis of Presentation for a discussion of the retrospective accounting change resulting from the adoption of FSP APB 14-1 and SFAS 160 effective January 1, 2009.

**Note 8. Income Taxes**

We record our interim tax provision based upon our estimated annual effective tax rate and account for the tax effects of discrete events in the period in which they occur. We file a federal consolidated income tax return with our eligible subsidiaries. Our federal consolidated income tax return also includes the taxable results of certain grantor trusts described below.

We currently estimate our annual effective tax rate, including discrete items, for the year ended December 31, 2009 to be approximately 37.0%. We review the annual effective tax rate on a quarterly basis as projections are revised. The effective income tax rate was 37.7% and 40.1% for the three months ended March 31, 2009 and 2008, respectively. The liability for uncertain tax positions, exclusive of interest and penalties, was \$132.5 million as of both March 31, 2009 and December 31, 2008. No additional liabilities were recorded for uncertain tax positions during the three months ended March 31, 2009. Included in the balance of unrecognized tax benefits as of March 31, 2009 are potential benefits of \$114.9 million that, if recognized, would impact the effective tax rate.

We continue to reflect interest accrued on uncertain tax positions and penalties as part of the tax provision under FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, ( FIN 48 ). For the three months ended March 31, 2009 and 2008, we recognized \$0.03 million and \$0.4 million, respectively of interest and penalties on uncertain tax positions. As of both March 31, 2009 and December 31, 2008, we had accrued interest and penalties associated with unrecognized tax benefits of \$8.1 million.

We will continue to monitor issues as they are examined by auditors representing tax authorities to determine whether an adjustment to existing FIN 48 liabilities is required or whether a FIN 48 liability should be provided for a new issue. As issues are examined by the Internal Revenue Service ( IRS ) and state auditors, we may decide to adjust the existing FIN 48 liability for issues that were not deemed an exposure at the time we adopted FIN 48. Accordingly, we will continue to monitor the results of audits and adjust the liability as needed. Federal income tax returns for Covanta Energy are closed for the years through 2003. However, to the extent NOLs are utilized from earlier years, federal income tax returns for Covanta Holding Corporation, formerly known as Danielson Holding Corporation, are still open. The tax returns of our subsidiary ARC Holdings are open for federal audit for the tax return years of 2004 and forward, and are currently the subject of an IRS examination. This examination is related to ARC Holdings refund requests related to NOL carryback claims from tax years prior to our acquisition of ARC Holdings in 2005 that require Joint Committee approval. State income tax returns are generally subject to examination for a period of three to five years after the filing of the respective return. The state impact of any federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states. We have various state income tax returns in the process of examination, administrative appeals or litigation.

Our NOLs predominantly arose from our predecessor insurance entities (which were subsidiaries of our predecessor, which was formerly named Mission Insurance Group, Inc., Mission ). These Mission insurance entities have been in state insolvency proceedings in California and Missouri since the late 1980 s. The amount of NOLs available to us will be reduced by any taxable income or increased by any taxable losses generated by current members of our consolidated tax group, which include grantor trusts associated with the Mission insurance entities.

While we cannot predict with certainty what amounts, if any, may be includable in taxable income as a result of the final administration of these grantor trusts, substantial actions toward such final administration have been taken and we believe that neither arrangements with the California Commissioner nor the final administration by the Missouri Director will result in a material reduction in available NOLs.

We had consolidated federal NOLs estimated to be approximately \$591 million for federal income tax purposes as of December 31, 2008, based on the tax returns as filed. The NOLs will expire in various amounts from

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

December 31, 2009 through December 31, 2028, if not used. Current forecasts indicate we will utilize consolidated federal NOLs in 2009 which will otherwise expire in 2009. In addition to the consolidated federal NOLs, as of December 31, 2008, we had state NOL carryforwards of \$119.7 million, which expire between 2012 and 2027, capital loss carryforwards of \$69.0 million expiring in 2009, additional federal credit carryforwards of \$32.7 million, and state credit carryforwards of \$0.8 million. These deferred tax assets are offset by a valuation allowance of \$34.3 million.

For further information, refer to Note 9. Income Taxes of the Notes to the Consolidated Financial Statements included in our Form 10-K.

**Note 9. Supplementary Information****Operating Revenues**

The components of waste and service revenues are as follows (in thousands):

|   | <b>For the Three Months<br/>Ended March 31,</b> |             |
|---|---|-------------|
|   | <b>2009</b>                                     | <b>2008</b> |
| Waste and service revenues unrelated to project debt        | \$ 186,680                                      | \$ 193,864  |
| Revenue earned explicitly to service project debt-principal | 13,719  | 17,197      |
| Revenue earned explicitly to service project debt-interest  | 5,870   | 6,562       |
| Total waste and service revenues                            | \$ 206,269                                      | \$ 217,623  |

Under some of our service agreements, we bill municipalities fees to service project debt (principal and interest). The amounts billed are based on the actual principal amortization schedule for the project bonds. Regardless of the amounts billed to client communities relating to project debt principal, we recognize revenue earned explicitly to service project debt principal on a levelized basis over the term of the applicable agreement. In the beginning of the agreement, principal billed is less than the amount of levelized revenue recognized related to principal and we record an unbilled service receivable asset. At some point during the agreement, the amount we bill will exceed the levelized revenue and the unbilled service receivable begins to reduce, and ultimately becomes nil at the end of the contract.

In the final year(s) of a contract, cash is utilized from debt service reserve accounts to pay remaining principal amounts due to project bondholders and such amounts are no longer billed to or paid by municipalities. Generally, therefore, in the last year of the applicable agreement, little or no cash is received from municipalities relating to project debt, while our levelized service revenue continues to be recognized until the expiration date of the term of the agreement.

Our independent power production facilities in India generate electricity and steam explicitly for specific purchasers and as such, these agreements are considered lease arrangements. Electricity and steam sales included lease income from our international business of \$32.3 million and \$54.1 million for the three months ended March 31, 2009 and

2008, respectively.

### **Operating Costs**

#### *Pass through costs*

Pass through costs are costs for which we receive a direct contractually committed reimbursement from the municipal client which sponsors an energy-from-waste project. These costs generally include utility charges, insurance premiums, ash residue transportation and disposal and certain chemical costs. These costs are recorded net of municipal client reimbursements in our condensed consolidated financial statements. Total pass through costs were \$14.8 million and \$16.0 million for the three months ended March 31, 2009 and 2008, respectively.



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Amortization of waste, service and energy contracts*

The vast majority of our waste, service and energy contracts were valued in March 2004 and June 2005 related to the acquisitions of Covanta Energy and ARC Holdings, respectively. These intangible assets and liabilities were recorded using then-available information at their estimated fair market values based upon discounted cash flows. The following table details the amount of the actual/estimated amortization expense and contra-expense associated with these intangible assets and liabilities as of March 31, 2009 included or expected to be included in our statement of income for each of the years indicated (in thousands):

|                                   | <b>Waste, Service<br/>and<br/>Energy Contracts<br/>(Amortization<br/>Expense)</b> | <b>Waste and Service<br/>Contracts<br/>(Contra-Expense)</b> |
|-----------------------------------|---|---|
| Three Months ended March 31, 2009 | \$ 11,458   | \$ (3,281)  |
| Remainder of 2009                 | \$ 30,843   | \$ (9,897)  |
| 2010                              | 29,864  | (12,721)  |
| 2011                              | 26,740  | (12,408)  |
| 2012                              | 24,647  | (12,412)  |
| 2013                              | 21,037  | (12,390)  |
| 2014                              | 20,319  | (12,390)  |
| Thereafter                        | 58,488  | (39,033)  |
| Total                             | \$ 211,938  | \$ (111,251)  |

*Other operating expenses*

The components of other operating expenses are as follows (in thousands):

|   | <b>For the Three Months<br/>Ended March 31,<br/>2009      2008</b> |           |
|---|--|-----------|
| Construction costs                      | \$ 5,346   | \$ 13,157 |
| Insurance subsidiary operating expenses | 3,813  | 2,371     |
| Insurance recoveries                    |  | (3,748)   |
| Foreign exchange loss (gain)            | 505  | (497)     |
| Other                                   | 80   | 1,218     |
| Total other operating expenses          | \$ 9,744   | \$ 12,501 |

**Note 10. Benefit Obligations*****Pension and Other Benefit Obligations***

The components of net periodic benefit costs are as follows (in thousands):

|  | <b>Pension Benefits</b>                     |             | <b>Other Post-Retirement Benefits</b> |             |
|--|---|-------------|---------------------------------------|-------------|
|  | <b>For the Three Months Ended March 31,</b> |             |                                       |             |
|  | <b>2009</b>                                 | <b>2008</b> | <b>2009</b>                           | <b>2008</b> |
| Service cost                           | \$  | \$          | \$                                    | \$          |
| Interest cost                          | 1,197                                       | 1,176       | 122                                   | 137         |
| Expected return on plan assets         | (975)                                       | (1,182)     |                                       |             |
| Amortization of net prior service cost | 19  |             |                                       |             |
| Amortization of actuarial gain         | (46)  | (131)       | (37)                                  | (38)        |
| Net periodic benefit cost              | \$ 195                                      | \$ (137)    | \$ 85                                 | \$ 99       |

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Defined Contribution Plans***

Substantially all of our domestic employees are eligible to participate in defined contribution plans we sponsor. Our costs related to defined contribution plans were \$4.4 million and \$4.2 million for the three months ended March 31, 2009 and 2008, respectively.

**Note 11. Stock-Based Compensation**

Compensation expense related to our stock-based awards totaled \$3.9 million and \$3.7 million during the three months ended March 31, 2009 and 2008, respectively.

On February 2, 2009, February 26, 2009, and March 9, 2009, we awarded certain employees 1,627 shares, 677,960 shares and 4,644 shares of restricted stock awards, respectively. The restricted stock awards will be expensed over the requisite service period. The February 26, 2009 grant is subject to an assumed ten percent forfeiture rate. The terms of the restricted stock awards include two vesting provisions; one based on a performance factor and continued service (applicable to 66% of the award) and one based solely on continued service (applicable to 34% of the award). If all performance and service criteria are satisfied, the awards vest during March of 2009, 2010 and 2011 for the February 2, 2009 award and the awards vest during March of 2010, 2011 and 2012 for the February 26, 2009 and March 9, 2009 awards.

As of March 31, 2009, we had approximately \$18.1 million and \$5.3 million of unrecognized compensation expense related to our unvested restricted stock awards and unvested stock options, respectively. We expect this compensation expense to be recognized over a weighted average period of 2.3 years for our unvested restricted stock awards and 3.1 years for our unvested stock options.

**Note 12. Financial Instruments**

Our investment securities that are traded on a national securities exchange are stated at the last reported sales price on the day of valuation.

|  | As of             | Fair Value Measurements at Reporting Date Using                                  |   |  |
|--|-------------------|--|---|--|
|  |                   | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|  | March 31,<br>2009 |  |   |  |
|  |                   | (In thousands)   |   |  |
| Marketable securities available for sale   | \$ 300            | \$ 300   | \$  | \$   |
| Investments in fixed maturities at market  | 27,111            | 27,111   |   |  |
| Derivatives – Contingent interest feature of the Convertible Debentures (See Note 6) | 0                 |  | 0   |  |

|       |    |        |    |        |    |   |    |
|-------|----|--------|----|--------|----|---|----|
| Total | \$ | 27,411 | \$ | 27,411 | \$ | 0 | \$ |
|-------|----|--------|----|--------|----|---|----|

***Contingent Interest***

On January 31, 2007, we completed an underwritten public offering of \$373.8 million aggregate principal amount of Senior Convertible Debentures. The Debentures bear interest at a rate of 1.00% per year, payable semi-annually in arrears, on February 1 and August 1 of each year, commencing on August 1, 2007, and will mature on February 1, 2027. Beginning with the six-month interest period commencing February 1, 2012, we will pay contingent interest on the Debentures during any six-month interest period in which the trading price of the Debentures measured over a specified number of trading days is 120% or more of the principal amount of the Debentures. When applicable, the contingent interest payable per \$1,000 principal amount of Debentures will equal 0.25% of the average trading price of \$1,000 principal amount of Debentures during the five trading days ending on the second trading day immediately preceding the first day of the applicable six-month interest period. The contingent interest feature in the Debentures is an embedded derivative instrument. The first contingent cash

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

interest payment period does not commence until February 1, 2012, and the fair market value for the embedded derivative was zero as of March 31, 2009.

**Note 13. Related-Party Transactions**

We hold a 26% investment in Quezon Power, Inc. ( Quezon ). We are party to an agreement with Quezon in which we assumed responsibility for the operation and maintenance of Quezon s coal-fired electricity generation facility. Accordingly, 26% of the net income of Quezon is reflected in our statements of income and as such, 26% of the revenue earned under the terms of the operation and maintenance agreement is eliminated against Equity in Net Income from Unconsolidated Investments. For the three months ended March 31, 2009 and 2008, we collected \$5.2 million and \$9.0 million, respectively, for the operation and maintenance of the facility. As of March 31, 2009 and December 31, 2008, the net amount due to Quezon was \$0.1 million and \$3.2 million, respectively, which represents advance payments received from Quezon for operation and maintenance costs.

**Note 14. Commitments and Contingencies**

We and/or our subsidiaries are party to a number of claims, lawsuits and pending actions, most of which are routine and all of which are incidental to our business. We assess the likelihood of potential losses on an ongoing basis and when losses are considered probable and reasonably estimable, record as a loss an estimate of the ultimate outcome. If we can only estimate the range of a possible loss, an amount representing the low end of the range of possible outcomes is recorded. The final consequences of these proceedings are not presently determinable with certainty.

***Environmental Matters***

Our operations are subject to environmental regulatory laws and environmental remediation laws. Although our operations are occasionally subject to proceedings and orders pertaining to emissions into the environment and other environmental violations, which may result in fines, penalties, damages or other sanctions, we believe that we are in substantial compliance with existing environmental laws and regulations.

We may be identified, along with other entities, as being among parties potentially responsible for contribution to costs associated with the correction and remediation of environmental conditions at disposal sites subject to federal and/or analogous state laws. In certain instances, we may be exposed to joint and several liabilities for remedial action or damages. Our ultimate liability in connection with such environmental claims will depend on many factors, including our volumetric share of waste, the total cost of remediation, and the financial viability of other companies that also sent waste to a given site and, in the case of divested operations, its contractual arrangement with the purchaser of such operations.

The potential costs related to the matters described below and the possible impact on future operations are uncertain due in part to the complexity of governmental laws and regulations and their interpretations, the varying costs and effectiveness of cleanup technologies, the uncertain level of insurance or other types of recovery and the questionable level of our responsibility. Although the ultimate outcome and expense of any litigation, including environmental remediation, is uncertain, we believe that the following proceedings will not have a material adverse effect on our consolidated financial position or results of operations.

In August 2004, the United States Environmental Protection Agency ( EPA ) notified Covanta Essex Company ( Essex ) that it was a potentially responsible party ( PRP ) for Superfund response actions in the Lower Passaic River Study Area, referred to as LPRSA, a 17 mile stretch of river in northern New Jersey. Essex is one of at least 73 PRPs named thus far that have joined the LPRSA PRP group. On May 8, 2007, EPA and the PRP group entered into an Administrative Order on Consent by which the PRP group is undertaking a Remedial Investigation/Feasibility Study ( Study ) of the LPRSA under EPA oversight. The cost to complete the Study is estimated at \$54 million, in addition to EPA oversight costs. Essex s share of the Study costs to date are not material to its financial position and results of operations; however, the Study costs are exclusive of any costs that may be required of PRPs to remediate the LPRSA or costs associated with natural resource damages to the LPRSA that may

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

be assessed against PRPs. On February 4, 2009, Essex and over 300 other PRPs were named as third-party defendants in a suit brought by the State of New Jersey Department of Environmental Protection ( NJDEP ) against Occidental Chemical Corporation and certain related entities ( Occidental ) with respect to alleged contamination of the LPRSA by Occidental. The Occidental third party complaint seeks contribution from the third-party defendants with respect to any award to NJDEP of damages against Occidental in the matter. Considering the history of industrial and other discharges into the LPRSA from other sources, including named PRPs, Essex believes any releases to the LPRSA from its facility to be de minimis in comparison; however, it is not possible at this time to predict that outcome with certainty or to estimate Essex s ultimate liability in the matter, including for LPRSA remedial costs and/or natural resource damages and/or contribution claims made by Occidental and/or other PRPs.

***Other Matters***

Other commitments as of March 31, 2009 were as follows (in thousands):

|                             | <b>Commitments Expiring by Period</b> |                               |                               |
|-----------------------------|---------------------------------------|-------------------------------|-------------------------------|
|                             | <b>Total</b>                          | <b>Less Than<br/>One Year</b> | <b>More Than<br/>One Year</b> |
| Letters of credit           | \$ 291,733                            | \$ 38,582                     | \$ 253,151                    |
| Surety bonds                | 64,086                                |                               | 64,086                        |
| Total other commitments net | \$ 355,819                            | \$ 38,582                     | \$ 317,237                    |

The letters of credit were issued under various credit facilities (primarily the Funded L/C Facility) to secure our performance under various contractual undertakings related to our domestic and international projects or to secure obligations under our insurance program. Each letter of credit relating to a project is required to be maintained in effect for the period specified in related project contracts, and generally may be drawn if it is not renewed prior to expiration of that period.

We believe that we will be able to fully perform under our contracts to which these existing letters of credit relate, and that it is unlikely that letters of credit would be drawn because of a default of our performance obligations. If any of these letters of credit were to be drawn by the beneficiary, the amount drawn would be immediately repayable by us to the issuing bank. If we do not immediately repay such amounts drawn under these letters of credit, unreimbursed amounts would be treated under the Credit Facilities as additional term loans in the case of letters of credit issued under the Funded L/C Facility, or as revolving loans in the case of letters of credit issued under the Revolving Loan Facility.

The surety bonds listed on the table above relate primarily to performance obligations (\$55.1 million) and support for closure obligations of various energy projects when such projects cease operating (\$9.0 million). Were these bonds to be drawn upon, we would have a contractual obligation to indemnify the surety company.

We have certain contingent obligations related to the Debentures. These are:

holders may require us to repurchase their Debentures on February 1, 2012, February 1, 2017 and February 1, 2022;

holders may require us to repurchase their Debentures, if a fundamental change occurs; and

holders may exercise their conversion rights upon the occurrence of certain events, which would require us to pay the conversion settlement amount in cash and/or our common stock.

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 6 of the Notes to Consolidated Financial Statements in our Form 10-K.

We have issued or are party to performance guarantees and related contractual support obligations undertaken pursuant to agreements to construct and operate domestic and international waste and energy facilities. For some projects, such performance guarantees include obligations to repay certain financial obligations if the project revenues are insufficient to do so, or to obtain financing for a project. With respect to our domestic and international



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Concluded)**

businesses, we have issued guarantees to municipal clients and other parties that our subsidiaries will perform in accordance with contractual terms, including, where required, the payment of damages or other obligations. Additionally, damages payable under such guarantees on our energy-from-waste facilities could expose us to recourse liability on project debt. If we must perform under one or more of such guarantees, our liability for damages upon contract termination would be reduced by funds held in trust and proceeds from sales of the facilities securing the project debt and is presently not estimable. Depending upon the circumstances giving rise to such domestic and international damages, the contractual terms of the applicable contracts, and the contract counterparty's choice of remedy at the time a claim against a guarantee is made, the amounts owed pursuant to one or more of such guarantees could be greater than our then-available sources of funds. To date, we have not incurred material liabilities under such guarantees, either on domestic or international projects.

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**Item 2. *MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS***

The terms we, our, ours, us, Covanta and Company refer to Covanta Holding Corporation and its subsidiaries. The following discussion addresses our financial condition as of March 31, 2009 and our results of operations for the three months ended March 31, 2009, compared with the same periods last year. It should be read in conjunction with our Audited Consolidated Financial Statements and Notes thereto for the year ended December 31, 2008 and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2008 to which the reader is directed for additional information.

The preparation of interim financial statements necessarily relies heavily on estimates. Due to the use of estimates and certain other factors, such as the seasonal nature of our waste and energy services business, as well as competitive and other market conditions, we do not believe that interim results of operations are indicative of full year results of operations. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts and classification of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

**OVERVIEW**

We are a leading developer, owner and operator of infrastructure for the conversion of waste to energy (known as energy-from-waste), as well as other waste disposal and renewable energy production businesses in the Americas, Europe and Asia. We are organized as a holding company and conduct all of our operations through subsidiaries which are engaged predominantly in the businesses of waste and energy services. We also engage in the independent power production business outside the United States.

We own, have equity investments in, and/or operate 60 energy generation facilities, 50 of which are in the United States and 10 of which are located outside the United States. Our energy generation facilities use a variety of fuels, including municipal solid waste, wood waste (biomass), landfill gas, water (hydroelectric), natural gas, coal, and heavy fuel-oil. We also own or operate several businesses that are associated with our energy-from-waste business, including a waste procurement business, a biomass procurement business, four landfills, which we use primarily for ash disposal, and several waste transfer stations.

Our mission is to be the world's leading energy-from-waste company, with a complementary network of renewable energy generation and waste disposal assets. We expect to build value for our stockholders by satisfying our clients' waste disposal and energy generation needs with safe, reliable and environmentally superior solutions. In order to accomplish this mission and create additional value for our stockholders, we are focused on:

- providing customers with superior service and effectively managing our existing businesses;
- generating sufficient cash to meet our liquidity needs and invest in the business; and
- developing new projects and making acquisitions to grow our business in the Americas, Europe and Asia.

We believe that our business offers solutions to public sector leaders around the world in two related elements of critical infrastructure: waste disposal and renewable energy generation. We believe that the environmental benefits of energy-from-waste, as an alternative to landfilling, are clear and compelling: utilizing energy-from-waste reduces greenhouse gas (GHG) emissions, lowers the risk of groundwater contamination, and conserves land. At the same time, energy-from-waste generates clean, reliable energy from a renewable fuel source, thus reducing dependence on fossil fuels, the combustion of which is itself a major contributor to GHG emissions. As public planners in the Americas, Europe and Asia address their needs for more environmentally sustainable waste disposal and energy

generation in the years ahead, we believe that energy-from-waste will be an increasingly attractive alternative. We will also consider, for application in domestic and international markets, acquiring or developing new technologies that complement our existing renewable energy and waste services businesses.

Our business offers sustainable solutions to energy and environmental problems, and our corporate culture is increasingly focused on themes of sustainability in all of its forms. We aspire to continuous improvement in

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environmental performance, beyond mere compliance with legally required standards. This ethos is embodied in our Clean World Initiative , an umbrella program under which we are:

- investing in research and development of new technologies to enhance existing operations and create new business opportunities in renewable energy and waste management;
- exploring and implementing processes and technologies at our facilities to improve energy efficiency and lessen environmental impacts; and
- partnering with governments and non-governmental organizations to pursue sustainable programs, reduce the use of environmentally harmful materials in commerce and communicate the benefits of energy-from-waste.

Our Clean World Initiative is designed to be consistent with our mission to be the world's leading energy-from-waste company by providing environmentally superior solutions, advancing our technical expertise and creating new business opportunities. It represents an investment in our future that we believe will enhance stockholder value.

Also in order to create new business opportunities and benefits and enhance stockholder value, we are actively engaged in the current discussion among policy makers in the United States regarding the benefits of energy-from-waste and the reduction of our dependence on landfilling for waste disposal and fossil fuels for energy. Given the current economic dislocations and related unemployment, the Obama administration is also expected to focus on economic stimulus and job creation. We believe that the construction and permanent jobs created by additional energy-from-waste development represents the type of "green jobs", on critical infrastructure, that will be consistent with the administration's focus. The extent to which we are successful in growing our business will depend in part on our ability to effectively communicate the benefits of energy-from-waste to public planners seeking waste disposal solutions, and to policy makers seeking to encourage renewable energy technologies (and the associated "green jobs") as viable alternatives to reliance on fossil fuels as a source of energy.

Our senior management team has extensive experience in developing, constructing, operating, acquiring and integrating waste and energy services businesses. We intend to continue to focus our efforts on pursuing development and acquisition-based growth. We anticipate that a part of our future growth will come from acquiring or investing in additional energy-from-waste, waste disposal and renewable energy production businesses in the Americas, Europe and Asia. Our business is capital intensive because it is based upon building and operating municipal solid waste processing and energy generating projects. In order to provide meaningful growth through development, we must be able to invest our funds, obtain equity and/or debt financing, and provide support to our operating subsidiaries.

***Economic Factors Affecting Business Conditions***

The recent economic slowdown, both in the United States and internationally, has reduced demand for goods and services generally, which tends to reduce overall volumes of waste requiring disposal, and the pricing at which we can attract waste to fill available capacity. At the same time, the sharp declines in global natural gas and oil prices have pushed energy pricing lower generally, and may reduce the prices for the portion of the energy we sell which is not under fixed price contracts. Lastly, the downturn in economic activity tends to reduce global demand for and pricing of certain commodities, such as the scrap metals we recycle from our energy-from-waste facilities. The combination of these factors could reduce our revenue and cash flow.

The same economic slowdown may reduce the demand for the waste disposal services and the energy that our facilities offer. Many of our customers are municipalities and public authorities, which are generally experiencing fiscal pressure as local and central governments seek to reduce expenses in order to address declining tax revenues which may result from the recent economic dislocations and increases in unemployment. At the same time, dislocations in the financial sector may make it more difficult, and more costly, to finance new projects. These factors, particularly in the absence of energy policies which encourage renewable technologies such as energy-from-waste,

may make it more difficult for us to sell waste disposal services or energy at prices sufficient to allow us to grow our business through developing and building new projects.

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***Acquisitions and Business Development***

In our domestic business, we are pursuing additional growth opportunities through project expansions, new energy-from-waste and other renewable energy projects, contract extensions, acquisitions, and businesses ancillary to our existing business, such as additional waste transfer, transportation, processing and disposal.

We are also pursuing international waste and/or renewable energy business opportunities, particularly in locations where the market demand, regulatory environment or other factors encourage technologies such as energy-from-waste to reduce dependence on landfilling for waste disposal and fossil fuels for energy production in order to reduce GHG emissions. In particular, we are focusing on the United Kingdom, Ireland and China, and are also pursuing opportunities in certain markets in Europe and in Canada and other markets in the Americas.

**2009 acquisitions and business development**

We entered into an agreement to acquire two waste transfer stations near the Philadelphia, Pennsylvania metro area. We expect to close on this acquisition in the second quarter 2009.

**2008 acquisitions and business development**

*Domestic Business:*

We acquired Indeck Maine Energy, LLC which owned and operated two biomass energy facilities. The two nearly identical facilities, located in West Enfield and Jonesboro, Maine, added a total of 49 gross megawatts ( MW ) to our renewable energy portfolio. We sell the electric output and renewable energy credits from these facilities into the New England market. We acquired these two facilities for cash consideration of approximately \$53.4 million, net of cash acquired, inclusive of final working capital adjustments.

We acquired an energy-from-waste facility in Tulsa, Oklahoma for cash consideration of approximately \$12.7 million. The design capacity of the facility is 1,125 tons per day ( tpd ) of waste and gross electric capacity of 16.5 MW. This facility was shut down by the prior owner in the summer of 2007 and we returned two of the facility's three boilers to service in November 2008, and plan to return its third boiler to service during 2009. During the year ended December 31, 2008 and quarter ended March 31, 2009, we invested approximately \$4.9 million and \$0.4 million, respectively, in capital improvements to restore the operational performance of the facility.

We entered into new tip fee contracts which will supply waste to the Wallingford, Connecticut facility, following the expiration of the existing service fee contract in 2010. These contracts in total are expected to supply waste utilizing most or all of the facility's capacity through 2020.

We entered into a new tip fee contract with Kent County in Michigan which commenced on January 1, 2009 and extended the existing contract from 2010 to 2023. This contract is expected to supply waste utilizing most or all of the facility's capacity. Previously this was a service fee contract.

We entered into a new service fee contract with the Pasco County Commission in Florida which commenced on January 1, 2009 and extended the existing contract from 2011 to 2016.

We entered into a new tip fee contract with the City of Indianapolis for a term of 10 years which commenced upon expiration of the existing service fee contract in December 2008. This contract represents approximately 50% of the facility's capacity.

We entered into various agreements with multiple partners to invest in the development, testing or licensing of new technologies related to the transformation of waste materials into renewable fuels or the generation of energy. Initial licensing fees and demonstration unit purchases approximated \$6.5 million and \$0.2 million during the year ended December 31, 2008 and quarter ended March 31, 2009, respectively.

*International Business:*

We entered into an agreement to purchase a direct 58% equity interest in the Fuzhou project, a 1,200 metric tpd 24 MW mass-burn energy-from-waste project in China, for approximately \$14 million. We currently

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hold a noncontrolling interest in this project. This purchase is conditional upon various regulatory and other conditions precedent and is expected to close in the second quarter of 2009.

**Under Advanced Development/Construction**

*Domestic Business:*

We entered into a ten year agreement to maintain and operate an 800 tpd energy-from-waste facility located in Harrisburg, Pennsylvania and obtained a right of first refusal to purchase the facility. Under the agreement, the term of which commenced February 1, 2008 following satisfaction of certain conditions precedent, we will earn a base annual service fee of approximately \$10.5 million, which is subject to annual escalation and certain performance-based adjustments. We have also agreed to provide construction management services and to advance up to \$25.5 million in funding for certain facility improvements required to enhance facility performance, the repayment of which is guaranteed by the City of Harrisburg. As of December 31, 2008 and March 31, 2009, we advanced \$8.2 million and \$14.4 million, respectively, under this funding arrangement. The facility improvements are expected to be completed by mid 2009.

We designed, constructed, operate and maintain the 1,200 tpd mass-burn energy-from-waste facility located in and owned by Hillsborough County in Florida. In August 2005, we entered into agreements with Hillsborough County to implement an expansion, and to extend the agreement under which we operate the facility to 2027. During 2006, environmental and other project related permits were secured and the expansion construction commenced on December 29, 2006. Completion of the expansion, and commencement of the operation of the expanded project, is expected in the second half of 2009.

*International Business:*

We entered into a 25 year concession agreement and waste supply agreements to build, own and operate a 350 metric tpd energy-from-waste facility for Taixing Municipality, in Jiangsu Province, People's Republic of China. The project, which will be built on the site of our existing coal-fired facility in Taixing, will supply steam to an adjacent industrial park under short-term arrangements. The Taixing project is expected to commence construction later this year.

We and Chongqing Iron & Steel Company (Group) Limited have entered into a 25 year contract to build, own, and operate an 1,800 tpd energy-from-waste facility for Chengdu Municipality in Sichuan Province, People's Republic of China. In connection with this award, we invested \$17.1 million for a 49% equity interest in the project joint venture company. The Chengdu project is expected to commence construction in mid 2009.

We have entered into definitive agreements for the development of a 1,700 metric tpd energy-from-waste project serving the City of Dublin, Ireland and surrounding communities. The Dublin project, which marks our most significant entry to date into the European waste and renewable energy markets, is being developed and will be owned by Dublin Waste to Energy Limited, which we control and co-own with DONG Energy Generation A/S.

We are responsible for the design and construction of the project, which is estimated to cost approximately 350 million and will require 36 months to complete, once full construction commences. We will operate and maintain the project for Dublin Waste to Energy Limited, which has a 25-year tip fee type contract with Dublin to provide disposal service for approximately 320,000 metric tons of waste annually. The project is structured on a build-own-operate-transfer model, where ownership will transfer to Dublin after the 25-year term, unless extended. The project is expected to sell electricity into the local grid under short-term arrangements. We and DONG Energy



Generation A/S have committed to provide financing for all phases of the project, and we expect to utilize debt financing for the project. The primary approvals and licenses for the project have been obtained, and any remaining consents and approvals necessary to begin full construction are expected to be obtained in due course. We have begun to perform preliminary on-site work and expect to commence full construction in mid 2009.

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### **Business Segments**

Our reportable segments are Domestic and International, which are comprised of our domestic and international waste and energy services operations, respectively.

#### *Domestic*

For all energy-from-waste projects, we receive revenue from two primary sources: fees charged for operating projects or processing waste received and payments for electricity and steam sales. We also operate, and in some cases have ownership interests in, transfer stations and landfills which generate revenue from waste and ash disposal fees or operating fees. In addition, we own and in some cases operate, other renewable energy projects in the United States which generate electricity from wood waste (biomass), landfill gas, and hydroelectric resources. The electricity from these other renewable energy projects is sold to utilities. For these projects, we receive revenue from electricity sales, and in some cases cash from equity distributions.

#### *International*

We have ownership interests in and/or operate facilities internationally, including independent power production facilities in the Philippines, Bangladesh and India where we generate electricity by combusting coal, natural gas and heavy fuel-oil, and energy-from-waste facilities in China and Italy. We receive revenue from operating fees, electricity and steam sales, and in some cases cash from equity distributions.

### **Contract Structures**

Most of our energy-from-waste projects were developed and structured contractually as part of competitive procurement processes conducted by municipal entities. As a result, many of these projects have common features. However, each service agreement is different reflecting the specific needs and concerns of a client community, applicable regulatory requirements and other factors. Often, we design the facility, help to arrange for financing and then we either construct and equip the facility on a fixed price and schedule basis, or we undertake an alternative role, such as construction management, if that better meets the goals of our municipal client. Following construction and during operations, we receive revenue from two primary sources: fees we receive for operating projects or for processing waste received, and payments we receive for electricity and/or steam we sell.

We have 22 domestic energy-from-waste projects where we charge a fixed fee (which escalates over time pursuant to contractual indices that we believe are appropriate to reflect price inflation) for operation and maintenance services. We refer to these projects as having a *Service Fee* structure. Our contracts at *Service Fee* projects provide revenue that does not materially vary based on the amount of waste processed or energy generated and as such is relatively stable for the contract term. In addition, at most of our *Service Fee* projects, the operating subsidiary retains only a fraction of the energy revenues generated, with the balance used to provide a credit to the municipal client against its disposal costs. Therefore, in these projects, the municipal client derives most of the benefit and risk of energy production and changing energy prices.

We also have 16 energy-from-waste projects (13 domestic and 3 international) at which we receive a per-ton fee under contracts for processing waste. We refer to these projects as having a *Tip Fee* structure. At *Tip Fee* projects, we generally enter into long-term waste disposal contracts for a substantial portion of project disposal capacity and retain all of the energy revenue generated. These *Tip Fee* service agreements include stated fixed fees earned by us for processing waste up to certain base contractual amounts during specified periods. These *Tip Fee* service agreements also set forth the per-ton fees that are payable if we accept waste in excess of the base contractual amounts. The waste disposal and energy revenue from these projects is more dependent upon operating performance and, as such, is

subject to greater revenue fluctuation to the extent performance levels fluctuate.

Under both structures, our returns are expected to be stable if we do not incur material unexpected operation and maintenance costs or other expenses. In addition, most of our energy-from-waste project contracts are structured so that contract counterparties generally bear, or share in, the costs associated with events or circumstances not within our control, such as uninsured force majeure events and changes in legal requirements. The stability of our revenues and returns could be affected by our ability to continue to enforce these obligations. Also, at some of our energy-from-waste facilities, commodity price risk is mitigated by passing through commodity costs to contract counterparties. With respect to our other domestic renewable energy projects

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and international independent power projects, such structural features generally do not exist because either we operate and maintain such facilities for our own account or we do so on a cost-plus basis rather than a fixed-fee basis.

We generally sell the energy output from our projects to local utilities pursuant to long-term contracts. Where a Service Fee structure exists, our client community usually retains most (generally 90%) of the energy revenues generated and pays the balance to us. Where Tip Fee structures exist, we generally retain 100% of the energy revenues. At several of our energy-from-waste projects, we sell energy output under short-term contracts or on a spot-basis to our customers. At our Tip Fee projects, we generally have a greater exposure to energy market price fluctuation, as well as a greater exposure to variability in project operating performance.

We receive the majority of our revenue under short and long term contracts, with little or no exposure to price volatility, but with adjustments intended to reflect changes in our costs. Where our revenue is received under other arrangements and depending upon the revenue source, we have varying amounts of exposure to price volatility. The largest component of this revenue is comprised of waste revenue, which has generally not been subject to material price volatility. Energy and metal pricing tends to be more volatile. During the second and third quarters of 2008, pricing for energy and recycled metals reached historically high levels and has subsequently declined materially.

At some of our domestic renewable energy and international independent power projects, our operating subsidiaries purchase fuel in the open markets which exposes us to fuel price risk. At other plants, fuel costs are contractually included in our electricity revenues, or fuel is provided by our customers. In some of our international projects, the project entity (which in some cases is not our subsidiary) has entered into long-term fuel purchase contracts that protect the project from fuel shortages, provided counterparties to such contracts perform their commitments.

## **Seasonal Effects**

Our quarterly operating income from domestic and international operations within the same fiscal year typically differs substantially due to seasonal factors, primarily as a result of the timing of scheduled plant maintenance. We typically conduct scheduled maintenance periodically each year, which requires that individual boiler units temporarily cease operations. During these scheduled maintenance periods, we incur material repair and maintenance expenses and receive less revenue until the boiler units resume operations. This scheduled maintenance typically occurs during periods of off-peak electric demand in the spring and fall. The spring scheduled maintenance period is typically more extensive than scheduled maintenance conducted during the fall. As a result, we typically incur the highest maintenance expense in the first half of the year. Given these factors, we typically experience lower operating income from our projects during the first six months of each year and higher operating income during the second six months of each year.

## **Contract Duration**

We operate energy-from-waste projects under long-term agreements. For those projects we own, our contract to sell the project's energy output (either electricity or steam) generally expires at or after the date when the initial term of our contract to operate or receive waste also expires. Expiration of these contracts will subject us to greater market risk in maintaining and enhancing revenues as we enter into new contracts. Following the expiration of the initial contracts, we intend to enter into replacement or additional contracts for waste supplies and will sell our energy output either into the regional electricity grid or pursuant to new contracts. Because project debt on these facilities will be paid off at such time, we believe that we will be able to offer disposal services at rates that will attract sufficient quantities of waste and provide acceptable revenues. For those projects we operate but do not own, prior to the expiration of the initial term of our operating contract, we will seek to enter into renewal or replacement contracts to continue operating such projects. We will seek to bid competitively in the market for additional contracts to operate other facilities as similar contracts of other vendors expire.

## RESULTS OF OPERATIONS

The comparability of the information provided below with respect to our revenues, expenses and certain other items was affected by several factors. As outlined above under *Acquisitions and Business Development*, our acquisition and business development initiatives resulted in various additional projects which increased

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comparative 2009 revenues and expenses. These factors must be taken into account in developing meaningful comparisons between the periods compared below. The following general discussions should be read in conjunction with the condensed consolidated financial statements and the Notes thereto and other financial information appearing and referred to elsewhere in this report.

Effective January 1, 2009, we adopted the following pronouncements which required us to retrospectively restate previously disclosed condensed consolidated financial statements. As such, certain prior period amounts have been reclassified in the unaudited condensed consolidated financial statements to conform to the current period presentation.

We adopted Statement of Financial Accounting Standards ( SFAS ) No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin (ARB) No. 51 ( SFAS 160 ). SFAS 160 amends the accounting and reporting for noncontrolling interests in a consolidated subsidiary and the deconsolidation of a subsidiary. Under SFAS 160, we now report minority interests in subsidiaries as a separate component of equity in the condensed consolidated financial statements and show both net income attributable to the noncontrolling interest and net income attributable to the controlling interest on the face of the condensed consolidated income statement. SFAS 160 applies prospectively, except for presentation and disclosure requirements, which are applied retrospectively.

We adopted Financial Accounting Standards Board ( FASB ) Staff Position ( FSP ) No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) ( FSP APB 14-1 ). FSP APB 14-1 is effective for our 1.00% Senior Convertible Debentures ( Debentures ) and requires retrospective application for all periods presented. The FSP requires the issuer of convertible debt instruments with cash settlement features to separately account for the liability and equity components of the instrument. FSP APB 14-1 also requires an accretion of the resultant debt discount over the expected life of the Debentures, which is February 1, 2007 to February 1, 2027. The condensed consolidated income statements were retroactively modified compared to previously reported amounts as follows (in millions, except per share amounts):

|  | <b>Twelve Months Ended<br/>December 31,</b> |             | <b>Three Months<br/>Ended</b> |
|--|---|-------------|-------------------------------|
|  | <b>2007</b>                                 | <b>2008</b> | <b>March 31,<br/>2008</b>     |
| Additional pre-tax non-cash interest expense           | \$ (5.2)                                    | \$ (6.1)    | \$ (1.5)                      |
| Additional deferred tax benefit                        | 2.2   | 2.6         | 0.6                           |
| Retroactive change in net income and retained earnings | \$ (3.0)                                    | \$ (3.5)    | \$ (0.9)                      |
| Change to basic earnings per share                     | \$ (0.01)                                   | \$ (0.02)   | \$ (0.01)                     |
| Change to diluted earnings per share                   | \$ (0.02)                                   | \$ (0.02)   | \$ (0.01)                     |

For the three months ended March 31, 2009, the additional pre-tax non-cash interest expense recognized in the condensed consolidated income statement was \$1.6 million.



**Table of Contents****Consolidated Results of Operations Comparison of Results for the Three Months Ended March 31, 2009 vs. Results for the Three Months Ended March 31, 2008**

|  | <b>For the Three Months<br/>Ended<br/>March 31,</b> |                  | <b>Increase<br/>(Decrease)</b> |
|--|---|------------------|--------------------------------|
|  | <b>2009</b>   | <b>2008</b>      | <b>2009 vs 2008</b>            |
|  | <b>(Unaudited, in thousands)</b>                    |                  |                                |
| <b>CONSOLIDATED RESULTS OF OPERATIONS:</b>   |   |                  |                                |
| Total operating revenues   | \$ 358,760  | \$ 388,766       | \$ (30,006)                    |
| Total operating expenses   | 355,568   | 358,001          | (2,433)                        |
| Operating income   | 3,192   | 30,765           | (27,573)                       |
| Other income (expense):  |   |                  |                                |
| Investment income  | 1,028   | 1,640            | (612)                          |
| Interest expense   | (9,506)   | (15,199)         | (5,693)                        |
| Total other expenses   | (8,478)   | (13,559)         | (5,081)                        |
| (Loss) income before income tax benefit (expense), equity in net income from unconsolidated investments and noncontrolling interests in subsidiaries | (5,286)   | 17,206           | (22,492)                       |
| Income tax benefit (expense)   | 1,992   | (6,905)          | (8,897)                        |
| Equity in net income from unconsolidated investments   | 5,809   | 5,492            | 317                            |
| <b>NET INCOME</b>  | <b>2,515</b>  | <b>15,793</b>    | <b>(13,278)</b>                |
| Less: Net income attributable to noncontrolling interests in subsidiaries  | (1,380)   | (1,869)          | (489)                          |
| <b>NET INCOME ATTRIBUTABLE TO COVANTA HOLDING CORPORATION</b>  | <b>\$ 1,135</b>                                     | <b>\$ 13,924</b> | <b>(12,789)</b>                |
| Weighted Average Common Shares Outstanding:  |   |                  |                                |
| Basic  | 153,467   | 153,165          | 302                            |
| Diluted  | 154,737   | 154,572          | 165                            |
| Earnings Per Share:  |   |                  |                                |
| Basic  | \$ 0.01   | \$ 0.09          | \$ (0.08)                      |
| Diluted  | \$ 0.01   | \$ 0.09          | \$ (0.08)                      |

The following general discussions should be read in conjunction with the above table, the consolidated financial statements and the Notes thereto and other financial information appearing and referred to elsewhere in this report.



Additional detail relating to changes in operating revenues and operating expenses, and the quantification of specific factors affecting or causing such changes, is provided in the Domestic and International segment discussions below.

Operating revenues decreased by \$30.0 million primarily due to the following:

- decreased electricity and steam sales revenue due to lower fuel pass throughs at our Indian facilities and foreign exchange impacts in 2009, and
- decreased waste and service revenues and decreased recycled metal revenues at our existing energy-from-waste facilities in our Domestic segment, offset by
- increased electricity and steam sales in our Domestic segment due to acquired businesses and the transition of the Indianapolis and Kent facilities from Service Fee to Tip Fee contracts.

Operating expenses decreased by \$2.4 million primarily due to the following:

- decreased plant operating expense at our Indian facilities resulting primarily from lower fuel costs and foreign exchange impacts in 2009, offset by
- increased plant operating expenses at our existing energy-from-waste facilities resulting primarily from cost escalations, and
- increased plant operating expenses resulting from additional operating costs from new businesses acquired in the Domestic segment.

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Investment income decreased by \$0.6 million primarily due to lower interest rates on invested funds. Interest expense decreased by \$5.7 million primarily due to lower floating interest rates on the Term Loan Facility (as defined in the *Liquidity* section below).

Income tax expense decreased by \$8.9 million primarily due to lower pre-tax income resulting from decreased waste and service revenues and recycled metal revenue at our energy-from-waste facilities.

***Domestic Business Results of Operations Comparison of Results for the Three Months Ended March 31, 2009 vs. Results for the Three Months Ended March 31, 2008***

|                                       | <b>For the Three Months<br/>Ended March 31,<br/>2009</b> |                  | <b>2008</b> | <b>Increase<br/>(Decrease)<br/>2009 vs 2008</b> |
|---------------------------------------|--|------------------|-------------|---|
|                                       | <b>(Unaudited, in thousands)</b>                         |                  |             |   |
| Waste and service revenues            | \$ 205,352   | \$ 216,819       | \$          | (11,467)  |
| Electricity and steam sales           | 101,249  | 91,090           |             | 10,159  |
| Other operating revenues              | 6,572  | 15,375           |             | (8,803)   |
| <b>Total operating revenues</b>       | <b>313,173</b>   | <b>323,284</b>   |             | <b>(10,111)</b>                                 |
| Plant operating expenses              | 222,400  | 205,294          |             | 17,106  |
| Depreciation and amortization expense | 49,722   | 46,157           |             | 3,565   |
| Net interest expense on project debt  | 11,670   | 12,110           |             | (440)   |
| General and administrative expenses   | 19,493   | 19,618           |             | (125)   |
| Other operating expense               | 5,453  | 14,751           |             | (9,298)   |
| <b>Total operating expenses</b>       | <b>308,738</b>   | <b>297,930</b>   |             | <b>10,808</b>                                   |
| <b>Operating income</b>               | <b>\$ 4,435</b>  | <b>\$ 25,354</b> |             | <b>(20,919)</b>                                 |

*Operating Revenues*

Operating revenues for the domestic segment decreased by \$10.1 million as reflected in the comparison of existing business and new business in the chart below and the discussion of key variance drivers which follows (in millions):

|                            | <b>Domestic Segment<br/>Operating Revenue Variances</b> |                             |              |
|----------------------------|---|-----------------------------|--------------|
|                            | <b>Existing<br/>Business</b>                            | <b>New<br/>Business (A)</b> | <b>Total</b> |
| Waste and service revenues |   |                             |              |
| Service fee                | \$ (8.5)  | \$                          | \$ (8.5)     |
| Tip fee                    | 2.1   | 1.1                         | 3.2          |
| Recycled metal             | (6.2)   |                             | (6.2)        |

|                                  |           |    |     |           |
|----------------------------------|-----------|----|-----|-----------|
| Total waste and service revenues | (12.6)    |    | 1.1 | (11.5)    |
| Electricity and steam sales      | 4.1       |    | 6.1 | 10.2      |
| Other operating revenues         | (8.8)     |    |     | (8.8)     |
| Total operating revenues         | \$ (17.3) | \$ | 7.2 | \$ (10.1) |

(A) New Business is defined as businesses acquired after March 31, 2008.

Revenues from Service Fee arrangements decreased primarily due to the transition of the Indianapolis and Kent facilities from Service Fee to Tip Fee contracts and due to lower revenues earned explicitly to service project debt of \$4.2 million, partially offset by contractual escalations.

Revenues from Tip Fee arrangements for existing business increased primarily due to the transition of the Indianapolis and Kent facilities from Service Fee to Tip Fee contracts, offset by lower pricing and lower waste volumes, primarily at our transfer stations.

Recycled metal revenues was \$5.2 million for the quarter ended March 31, 2009 which decreased due to lower pricing, partially offset by increased recovered metal volume. During the second and third quarters of

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2008, we experienced historically high prices for recycled metal which declined significantly during the fourth quarter of 2008 as reflected in the table below (in millions):

| <b>Total Recycled Metal Revenues</b>  | <b>For the<br/>Quarters Ended</b> |             |
|---------------------------------------|-----------------------------------|-------------|
|                                       | <b>2008</b>                       | <b>2007</b> |
| March 31,                             | \$ 11.4                           | \$ 7.0      |
| June 30,                              | 19.0                              | 7.5         |
| September 30,                         | 17.3                              | 7.9         |
| December 31,                          | 5.9                               | 9.1         |
| Total for the Year Ended December 31, | \$ 53.6                           | \$ 31.5     |

Electricity and steam sales for existing business increased primarily due to new contracts at our Indianapolis and Kent facilities partially offset by lower energy pricing.

Other operating revenues for existing business decreased primarily due to the timing of construction activity.

*Operating Expenses*

Variances in plant operating expenses for the domestic segment are as follows (in millions):

|                                | <b>Domestic Segment</b>                  |                             |              |
|--------------------------------|--|-----------------------------|--------------|
|                                | <b>Plant Operating Expense Variances</b> |                             |              |
|                                | <b>Existing<br/>Business</b>             | <b>New<br/>Business (A)</b> | <b>Total</b> |
| Total plant operating expenses | \$ 4.8                                   | \$ 12.3                     | \$ 17.1      |

(A) New Business is defined as businesses acquired after March 31, 2008.

Existing business plant operating expenses increased by \$4.8 million primarily due to cost escalations and higher costs related to the transition of the Indianapolis and Kent facilities from Service Fee to Tip Fee contracts offset by the impact of lower energy related costs.

Depreciation and amortization expense increased by \$3.6 million primarily due to capital expenditures and new business.

Other operating expense decreased by \$9.3 million primarily due to timing of construction activity.

***International Business Results of Operations Comparison of Results for the Three Months Ended March 31, 2009 vs. Results for the Three Months Ended March 31, 2008***

|                                       | <b>For the Three Months<br/>Ended<br/>March 31,</b> |                 | <b>Increase<br/>(Decrease)</b> |
|---------------------------------------|---|-----------------|--------------------------------|
|                                       | <b>2009</b>   | <b>2008</b>     | <b>2009 vs 2008</b>            |
|                                       | <b>(Unaudited, in thousands)</b>                    |                 |                                |
| Waste and service revenues            | \$ 917  | \$ 804          | \$ 113                         |
| Electricity and steam sales           | 40,620  | 61,975          | (21,355)                       |
| <b>Total operating revenues</b>       | <b>41,537</b>                                       | <b>62,779</b>   | <b>(21,242)</b>                |
| Plant operating expenses              | 33,642  | 53,717          | (20,075)                       |
| Depreciation and amortization expense | 1,749   | 2,405           | (656)                          |
| Net interest expense on project debt  | 1,099   | 1,651           | (552)                          |
| General and administrative expenses   | 5,428   | 3,790           | 1,638                          |
| Other operating expense (income)      | 478   | (4,622)         | 5,100                          |
| <b>Total operating expenses</b>       | <b>42,396</b>                                       | <b>56,941</b>   | <b>(14,545)</b>                |
| <b>Operating income</b>               | <b>\$ (859)</b>                                     | <b>\$ 5,838</b> | <b>(6,697)</b>                 |

The decreases in revenues and plant operating expenses resulted primarily from lower fuel costs at our Indian facilities, which are a pass through at both facilities, and foreign exchange impacts in 2009, partially offset by increased demand from the electricity offtaker and resulting higher electricity generation.

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General and administrative expenses increased by \$1.6 million primarily due to additional business development spending, and normal wage and benefit escalations.

Other operating expense increased by \$5.1 million primarily due to insurance recoveries received during the three months ended March 31, 2008 and unfavorable foreign exchange impacts in 2009.

**LIQUIDITY AND CAPITAL RESOURCES**

Generating sufficient cash to invest in our business, meet our liquidity needs, pay down project debt, and pursue strategic opportunities remain important objectives of management. We derive our cash flows principally from our operations at our domestic and international projects, which allow us to satisfy project debt covenants and payments, and distribute cash. We typically receive cash distributions from our domestic projects on either a monthly or quarterly basis, whereas a material portion of cash from our international projects is received semi-annually, during the second and fourth quarters.

Our primary future cash requirements will be to fund capital expenditures to maintain our existing businesses, make debt service payments and grow our business through acquisitions and business development, both domestically and internationally. We will also seek to enhance our cash flow from renewals or replacement of existing contracts, from new contracts to expand existing facilities or operate additional facilities and by investing in new projects. See Management's Discussion and Analysis of Financial Condition Overview Acquisitions and Business Development above.

The frequency and predictability of our receipt of cash from projects differs, depending upon various factors, including whether restrictions on distributions exist in applicable project debt arrangements, whether a project is domestic or international, and whether a project has been able to operate at historical levels of production.

Additionally, as of March 31, 2009, we had available credit for liquidity of \$300 million under the Revolving Loan Facility (as defined below) and unrestricted cash of \$159.5 million.

Under our Revolving Loan Facility, we have pro rata funding commitments from a large consortium of banks, including a 6.8% pro rata commitment from Lehman Brothers Commercial Bank. Lehman Brothers Commercial Bank is a subsidiary of Lehman Brothers Holdings, Inc., which filed for bankruptcy protection in September 2008. We believe that neither the Lehman Brothers Holdings, Inc. bankruptcy, nor the ability of Lehman Brothers Commercial Bank (which is not currently part of such bankruptcy proceeding) to fund its pro rata share of any draw request we may make, will have a material effect on our liquidity or capital resources.

Our projected contractual obligations are consistent with amounts disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008. We believe that when combined with our other sources of liquidity, including our existing cash on hand and the Revolving Loan Facility, we will generate sufficient cash over at least the next twelve months to meet operational needs, make capital expenditures, invest in the business and service debt due.

**Sources and Uses of Cash Flow for the Three Months Ended March 31, 2009 and 2008:**

| <b>For the Three Months<br/>Ended March 31,</b> |             | <b>Increase<br/>(Decrease)</b> |
|---|-------------|--------------------------------|
| <b>2009</b>                                     | <b>2008</b> | <b>2009 vs 2008</b>            |
| <b>(Unaudited, in thousands)</b>                |             |                                |

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|  |             |             |          |
|--|-------------|-------------|----------|
| Net cash provided by operating activities                    | \$ 51,395   | \$ 49,706   | \$ 1,689 |
| Net cash used in investing activities                        | (34,720)    | (32,750)    | 1,970    |
| Net cash used in financing activities                        | (49,303)    | (42,237)    | 7,066    |
| Effect of exchange rate changes on cash and cash equivalents | (293)       | 269         | (562)    |
| Net decrease in cash and cash equivalents                    | \$ (32,921) | \$ (25,012) | 7,909    |

Net cash provided by operating activities for the three months ended March 31, 2009 was \$51.4 million, an increase of \$1.7 million from the prior year period. The increase was primarily due to the timing of working capital and reduced interest expense, offset by operating performance.

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Net cash used in investing activities for the three months ended March 31, 2009 was \$34.7 million, an increase of \$2.0 million from the prior year period. The increase was primarily comprised of higher cash outflows of:

\$6.2 million related to a loan issued for the Harrisburg energy-from-waste facility; and  
 \$4.6 million related to net investments in fixed maturities at our insurance subsidiary; and  
 \$3.5 million of property insurance proceeds received in the first quarter of 2008;

Offset by:

a decrease of \$12.2 million in purchases of property, plant and equipment primarily due to timing of maintenance capital expenditures in the three months ended March 31, 2009 and higher refurbishment expenditures in the three months ended March 31, 2008 for two California biomass facilities acquired in 2007.

Net cash used in financing activities for the three months ended March 31, 2009 was \$49.3 million, an increase of \$7.1 million from the prior year period. The increase was primarily related to:

\$11.8 million change in restricted funds held in trust; and  
 \$1.4 million increase in distributions to partners in noncontrolling interests in subsidiaries; and  
 a decrease of \$4.1 million in proceeds from borrowings on project debt;

Offset by:

a decrease of \$9.9 million in principal payment on project debt.

**Long-Term Debt**

Effective January 1, 2009, we adopted FSP No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) ( FSP APB 14-1 ). FSP APB 14-1 is effective for our \$373.8 million aggregate principal amount of 1.00% Senior Convertible Debentures ( Debentures ) and requires retrospective application for all periods presented. The FSP requires the issuer of convertible debt instruments with cash settlement features to separately account for the liability (\$127.5 million) and equity components (\$246.3 million) of the instrument. FSP APB 14-1 also requires an accretion of the resultant debt discount over the expected life of the Debentures. For additional information, see Note 1. Organization and Basis of Presentation of the Notes. Long-term debt is as follows (in thousands):

|   | March 31,<br>2009 | As of<br>December 31,<br>2008 |
|---|-------------------|-------------------------------|
| 1.00% Senior Convertible Debentures due 2027    | \$ 373,750        | \$ 373,750                    |
| Debt discount related to Convertible Debentures | (233,426)         | (235,016)                     |
| Senior Convertible Debentures, net              | 140,324           | 138,734                       |
| Term loan due 2014                              | 637,000           | 638,625                       |
| Other long-term debt                            | 462               | 512                           |
| Total   | 777,786           | 777,871                       |
| Less: current portion                           | (6,657)           | (6,922)                       |



|                      |            |            |
|----------------------|------------|------------|
| Total long-term debt | \$ 771,129 | \$ 770,949 |
|----------------------|------------|------------|

***Credit Agreement Financial Covenants***

The loan documentation under the Credit Facilities contains customary affirmative and negative covenants and financial covenants as discussed in Note 6. Long-Term Debt of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2008. As of March 31, 2009, we were in compliance with the covenants under the Credit Facilities.

The financial covenants of the Credit Facilities, which are measured on a trailing four quarter period basis, include the following:

maximum Covanta Energy leverage ratio of 4.00 to 1.00 for the four quarter period ended March 31, 2009, which measures Covanta Energy's principal amount of consolidated debt less certain restricted funds

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dedicated to repayment of project debt principal and construction costs ( Consolidated Adjusted Debt ) to its adjusted earnings before interest, taxes, depreciation and amortization, as calculated under the Credit Facilities ( Adjusted EBITDA ). The definition of Adjusted EBITDA in the Credit Facilities excludes certain non-cash charges. The maximum Covanta Energy leverage ratio allowed under the Credit Facilities adjusts in future periods as follows:

4.00 to 1.00 for each of the four quarter periods ended June 30 and September 30, 2009;

3.75 to 1.00 for each of the four quarter periods ended December 31, 2009, March 31, June 30 and September 30, 2010;

3.50 to 1.00 for each four quarter period thereafter;

maximum Covanta Energy capital expenditures incurred to maintain existing operating businesses of \$100 million per fiscal year, subject to adjustment due to an acquisition by Covanta Energy; and

minimum Covanta Energy interest coverage ratio of 3.00 to 1.00, which measures Covanta Energy's Adjusted EBITDA to its consolidated interest expense plus certain interest expense of ours, to the extent paid by Covanta Energy.

**Project Debt***Domestic Project Debt*

Financing for the energy-from-waste projects is generally accomplished through tax-exempt and taxable municipal revenue bonds issued by or on behalf of the municipal client. For such facilities that are owned by a subsidiary of ours, the municipal issuers of the bond loans the bond proceeds to our subsidiary to pay for facility construction. For such facilities, project-related debt is included as Project debt (short- and long-term) in our condensed consolidated financial statements. Generally, such project debt is secured by the revenues generated by the project and other project assets including the related facility. The only potential recourse to us with respect to project debt arises under the operating performance guarantees described below under *Other Commitments*. Certain subsidiaries had recourse liability for project debt which is recourse to Covanta ARC LLC, but is non-recourse to us, which as of March 31, 2009 aggregated to \$251.2 million.

*International Project Debt*

Financing for projects in which we have an ownership or operating interest is generally accomplished through commercial loans from local lenders or financing arranged through international banks, bonds issued to institutional investors and from multilateral lending institutions based in the United States. Such debt is generally secured by the revenues generated by the project and other project assets and is without recourse to us. Project debt relating to two international projects in India is included as Project debt (short- and long-term) in our condensed consolidated financial statements. In most projects, the instruments defining the rights of debt holders generally provide that the project subsidiary may not make distributions to its parent until periodic debt service obligations are satisfied and other financial covenants are complied with.

**Other Commitments**

Other commitments as of March 31, 2009 were as follows (in thousands):

|              | <b>Commitments Expiring by Period</b> |                  |
|--------------|---------------------------------------|------------------|
|              | <b>Less Than</b>                      | <b>More Than</b> |
| <b>Total</b> | <b>One Year</b>                       | <b>One Year</b>  |

|                             |            |           |            |
|-----------------------------|------------|-----------|------------|
| Letters of credit           | \$ 291,733 | \$ 38,582 | \$ 253,151 |
| Surety bonds                | 64,086     |           | 64,086     |
| Total other commitments net | \$ 355,819 | \$ 38,582 | \$ 317,237 |

The letters of credit were issued under various credit facilities (primarily the Funded L/C Facility) to secure our performance under various contractual undertakings related to our domestic and international projects, or to secure obligations under our insurance program. Each letter of credit relating to a project is required to be maintained in effect for the period specified in related project contracts, and generally may be drawn if it is not renewed prior to expiration of that period.

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We believe that we will be able to fully perform under our contracts to which these existing letters of credit relate and that it is unlikely that letters of credit would be drawn because of a default of our performance obligations. If any of these letters of credit were to be drawn by the beneficiary, the amount drawn would be immediately repayable by us to the issuing bank. If we do not immediately repay such amounts drawn under these letters of credit, unreimbursed amounts would be treated under the Credit Facilities as additional term loans in the case of letters of credit issued under the Funded L/C Facility, or as revolving loans in the case of letters of credit issued under the Revolving Loan Facility.

The surety bonds listed on the table above relate primarily to performance obligations (\$55.1 million) and support for closure obligations of various energy projects when such projects cease operating (\$9.0 million). Were these bonds to be drawn upon, we would have a contractual obligation to indemnify the surety company.

We have certain contingent obligations related to the Debentures. These are:

- holders may require us to repurchase their Debentures on February 1, 2012, February 1, 2017 and February 1, 2022;
- holders may require us to repurchase their Debentures, if a fundamental change occurs; and
- holders may exercise their conversion rights upon the occurrence of certain events, which would require us to pay the conversion settlement amount in cash and/or our common stock.

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, see Note 6. Changes in Capitalization of the Notes to the Consolidated Financial Statements included in our Audited Consolidated Financial Statements and accompanying Notes in our Annual Report on Form 10-K for the year ended December 31, 2008.

We have issued or are party to performance guarantees and related contractual support obligations undertaken pursuant to agreements to construct and operate certain domestic and international energy and waste facilities. For some projects, such performance guarantees include obligations to repay certain financial obligations if the project revenues are insufficient to do so, or to obtain financing for a project. With respect to our domestic and international businesses, we have issued guarantees to municipal clients and other parties that our subsidiaries will perform in accordance with contractual terms, including, where required, the payment of damages or other obligations. Additionally, damages payable under such guarantees on our energy-from-waste facilities could expose us to recourse liability on project debt. If we must perform under one or more of such guarantees, our liability for damages upon contract termination would be reduced by funds held in trust and proceeds from sales of the facilities securing the project debt and is presently not estimable. Depending upon the circumstances giving rise to such domestic and international damages, the contractual terms of the applicable contracts, and the contract counterparty's choice of remedy at the time a claim against a guarantee is made, the amounts owed pursuant to one or more of such guarantees could be material. To date, we have not incurred material liabilities under such performance guarantees, either on domestic or international projects.

## **Discussion of Critical Accounting Policies and Estimates**

In preparing our condensed consolidated financial statements in accordance with United States generally accepted accounting principles, we are required to use judgment in making estimates and assumptions that affect the amounts reported in our financial statements and related notes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. These estimates form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Many of our critical accounting policies are subject to significant judgments and uncertainties which could potentially result in materially different results under different conditions and assumptions. Future events rarely develop exactly

as forecast, and the best estimates routinely require adjustment. Except for the adoption of FSB 14-1 discussed below, management believes there have been no material changes during the three months ended March 31, 2009 to the items discussed in Discussion of Critical Accounting Policies in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended December 31, 2008.

Effective January 1, 2009, we adopted Financial Accounting Standards Board ( FASB ) Staff Position ( FSP ) No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon

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Conversion (Including Partial Cash Settlement) ( FSP APB 14-1 ). FSP APB 14-1 is effective for our 1.00% Senior Convertible Debentures ( Debentures ) and requires retrospective application for all periods presented. The FSP requires the issuer of convertible debt instruments with cash settlement features to separately account for the liability and equity components of the instrument. The debt component was recognized at the present value of its cash flows discounted using a 7.25% discount rate, our estimated borrowing rate at the date of the issuance of the Debentures for a similar debt instrument without the conversion feature. FSP APB 14-1 also requires an accretion of the resultant debt discount over the expected life of the Debentures from February 1, 2007 to February 1, 2027, which is the expected redemption date. The condensed consolidated income statements were retroactively modified compared to previously reported amounts. For additional information, see Note 1. Basis of Presentation of the Notes to the Condensed Consolidated Financial Statements.

**Recent Accounting Pronouncements**

See Note 2. Recent Accounting Pronouncements of the Notes for information related to new accounting pronouncements.

**Item 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

In the normal course of business, our subsidiaries are party to financial instruments that are subject to market risks arising from changes in interest rates, foreign currency exchange rates, and commodity prices. Our use of derivative instruments is very limited and we do not enter into derivative instruments for trading purposes.

Management believes there have been no material changes during the three months ended March 31, 2009 to the items discussed in Item 7A. Quantitative and Qualitative Disclosures About Market Risk in our Annual Report on Form 10-K for the year ended December 31, 2008.

**Item 4. *CONTROLS AND PROCEDURES***

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Covanta's disclosure controls and procedures, as required by Rule 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934 (the Exchange Act ) as of March 31, 2009. Our disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's ( SEC ) rules and forms.

Our Chief Executive Officer and Chief Financial Officer have concluded that, based on their review, our disclosure controls and procedures are effective to provide such reasonable assurance.

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must consider the benefits of controls relative to their costs. Inherent limitations within a control system include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. While the design of any system of controls is to provide reasonable assurance of the effectiveness of disclosure controls, such design is also based in part upon certain assumptions about the likelihood of future events, and such assumptions, while reasonable, may not take

into account all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and may not be prevented or detected.

**Changes in Internal Control over Financial Reporting**

There has not been any change in our system of internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

See Note 14. Commitments and Contingencies of the Notes to the Condensed Consolidated Financial Statements.

**Item 1A. RISK FACTORS**

There have been no material changes during the three months ended March 31, 2009 to the risk factors discussed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**Item 5. OTHER INFORMATION**

(a) None.

(b) Not applicable.

**Item 6. EXHIBITS**

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 31.1                      | Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002 by the Chief Executive Officer.  |
| 31.2                      | Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002 by the Chief Financial Officer.  |
| 32                        | Certification of periodic financial report pursuant to Section 906 of Sarbanes-Oxley Act of 2002 by the Chief Executive Officer and Chief Financial Officer. |



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COVANTA HOLDING CORPORATION  
(Registrant)

By: /s/ Mark A. Pytosh  
Mark A. Pytosh  
*Executive Vice President and Chief Financial Officer*

By: /s/ Thomas E. Bucks  
Thomas E. Bucks  
*Vice President and Chief Accounting Officer*

Date: April 22, 2009