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Covanta Holding Corp. (CVA)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to Covanta Holding Corporation's First Quarter 2020 Financial Results Conference Call and Webcast. An archived webcast will be available 2 hours after the end of the conference call and can be accessed through the Investor Relations section of the Covanta website at www.covanta.com. The transcript will also be archived on the company's website. Please also note today's event is being recorded.

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

Daniel Mannes

Vice President-Investor Relations, Covanta Holding Corp.

Thank you, Jamie, and good morning, everyone. Welcome to Covanta's first quarter 2020 conference call. Joining me on the call today will be Steve Jones, our President and CEO; and Brad Helgeson, our CFO. We will provide an operational and business update, review our financial results, and then take your question.

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

Now, onto the Safe Harbor and other preliminary notes. The following discussion may contain forward-looking statements and our actual results may differ materially from those expectations. Information regarding factors that could cause such differences can be found in the company's reports and registration statements filed with the SEC. The content of this conference call contains time-sensitive information that is only accurate as of the date of this live broadcast, May 8, 2020. We do not assume any obligation to update our forward-looking information unless required by law. Any redistribution, retransmission or rebroadcast of this call in any form without the express written consent of Covanta is prohibited.

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

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

Stephen J. Jones

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

Thanks, Dan, and good morning, everyone. I hope everyone is healthy and safe. For those using the web deck, let's begin on slide 3. We had a great start to the year. During the first quarter, we generated $97 million of adjusted EBITDA and $19 million of free cash flow, both showing strong growth, and processed 5.3 million tons of waste, a 2% improvement over last year driven primarily by improved plant availability. The first quarter highlighted our ability to drive higher waste prices given the secular trends of reduced disposal capacity in our market, and growing demand for landfill alternatives with same-store average tip fee price growth of nearly 5% in the quarter, continuing the trend that we demonstrated in 2019. This pricing improvement stemmed from tight waste disposal market of major contract that we repriced during 2019 at higher prevailing prices, as well as the escalators embedded in our contracts.

Our Covanta Environmental Solutions platform was a large contributor in the first quarter as we saw significant revenue growth in profiled waste at our Waste-to-Energy plant which was up 18%. And then our material processing facilities where revenue grew 7%. We revamped the CES sales and customer care team and systems in 2019 and these efforts clearly bore fruit in the first quarter.

While we can feel good about starting the year off on a strong note in Q1, the COVID-19 pandemic that emerged in mid-March significantly impacting our operations, market, customers and pulley, is now our overriding focus. How we navigate this period will tell the story for 2020 and I believe will demonstrate the strength of our company.

As I had discussed on our business update call a few weeks ago, we reacted decisively to mitigate the impact of COVID-19 pandemic on our employees, facilities, customers, and financials. As a result, our business continues to operate well in this challenging environment. At its core, Covanta operates critical infrastructure providing essential services for our host communities. And we've continued to do so with minimal operational disruption.

The majority of our waste and service revenue is stable and largely unaffected by the pandemic. This includes our long-term service fee contract with municipalities where we are relatively agnostic to waste volumes. And our tip fee revenues that are generated from processing residential waste which has remained strong.

We are seeing pressure on commercial MSW and profile waste volume which is largely generated from industrial and manufacturing sources given the widespread stay-at-home and similar mandates in our core region. However, given the location of our assets, our logistics and transfer station capabilities and the talent of our waste procurement team, we've been successful in backfilling any shortfall volumes to ensure consistent operations. I'll discuss this further in a few minutes.

Regarding commodity based revenue, things haven't changed too much since last quarter and while markets remain extremely challenging, the impact on us is manageable. Electricity prices are near historic lows and are expected to remain subdued in the near-term. Though natural gas futures have recently begun to move upward on the expectation of reduced drilling for oil and the potential reduction in associated gas, we are highly hedged for the remainder of 2020 and see limited remaining downside risk. As we look to 2021, we are already over 50% hedged on our exposed position at prices similar to our 2020 hedge levels. This activity is in line with our disciplined risk management strategy. While we are ultimately long on electricity, our goal remains to minimize near-term volatility.

In light of reduced economic activity during the COVID-19 pandemic, we have seen a reduction in demand for our scrap metal. That said, other sellers of scrap rely on the collections of metals from areas like auto scrapping and a slowdown in these activities is quickly reducing the supply of material. This supply response is helping to support prices even in this low-demand environment. Importantly, given the investments we've made in separating and upgrading our metal, we continue to find markets for our product.

Looking beyond the current situation, I want to remind you of the fundamental value proposition of Covanta. As a company, we're focused on leading the world in sustainable waste management and our business is levered to ongoing secular growth trends in waste disposal. This provides us the opportunity to drive incremental value from our critical asset while offering the potential for new investment opportunities.

We'll continue to invest in growth. But for the near term, this will be focused on the UK project and our first TAPS facility in Fairless Hills, Pennsylvania. These are the most strategic opportunities we have in front of us and offer the highest rates of returns on investment.

In the UK, our first three projects are in construction and we expect to begin seeing cash flow from the UK in 2022. As a brief update from our conference call a few weeks ago, the Earls Gate project in Scotland is now in the process of restarting construction activities. I'm proud of our success in UK to-date and excited about the opportunities ahead of us.

Supporting these initiatives is a flexible balance sheet, with no near-term maturities and ample liquidity. By lowering our dividend and focusing our growth investment, we're enabling a faster pathway to reducing our leverage, which we believe offers more value and less risk to all stakeholders while still offering an attractive shareholder payout.

Now, let's move to slide 4 to take a closer look at our waste revenue in this environment. While the waste bucket is well followed by investors, the current situation calls for a deeper dive on how the pandemic and economic shutdown are impacting Covanta specifically. Overall, our volume process will remain relatively steady with softness in certain waste streams translating to us at temporary pressure on tip fee prices. This is different than how the integrated waste collection and landfill companies experience this environment.

As a reminder in 2019, we generated about $1.4 billion in waste and service revenue. Of which, approximately 70% will see very little impact from COVID-19. As I mentioned earlier, this includes all of our long-term service fee contracts with municipalities where we are relatively agnostic to waste volumes and about half of our tip fee revenue, which is based on processing residential waste under long-term contract.

We had felt some downward pressure on roughly 30% of our waste revenue, including commercial MSW and profiled waste, which together represent the other half of our tip fee revenue and environmental services offered by Covanta's environmental solution. As our Waste-to-Energy plants are designed to run full, our goal is to procure sufficient additional waste to offset any declines in existing waste streams.

One of our first options here is to tap into our transfer station. In 2019, over 200,000 tons received at our transfer stations were sent to dispose to a third-party outlet. Where appropriate, we're now internalizing some of these tons. Second, we're going back to some of our key customers and asking for more waste. And then lastly, in some cases, we're simply casting a wider net to accept waste from additional haulers.

On the profile waste side, we have a diverse customer base that is balanced across areas including environmental services, chemicals, food and beverage, consumer products, manufacturing and healthcare. I'll note that we have very limited exposure to oil and gas. While overall profile waste volumes to our waste-to-energy plants were down in the 15% to 20% range in April, this has been particularly driven by our exposure to certain sectors like auto manufacturing while volume from many other sectors has shown limited impact.

Now, please turn to slide 5. Rather than try to guess when and how things will normalize, we can give you a sense for what we're seeing in the business today under current economic conditions. First, we estimate that backfilling shortfalls in commercial and industrial volumes with lower price alternative waste sources is currently reducing tip fee revenue by $5 million per month or an impact of $4 to $6 per ton on our overall average tip fee.

To be clear, this isn't a calendar year prediction but rather a current run rate that will evolve as the macro environment changes. Note that the majority of our existing commercial and industrial volumes are still largely unaffected. But on the portion where we do need to find replacement tons, the price delta can be significant depending on the location and waste type. As commercial activity improves, we anticipate these headwinds will abate but this is where we are today.

In addition, we're also seeing some impact from reduced volumes at our material processing facilities where environmental services revenue is currently running lower by 15% to 20%. However as compared to our Waste-to-Energy facilities, this business can respond by reducing costs such as labor, transportation and disposal. As a result, we estimate decremental margins on lower revenue of less than 50%.

Outside of waste revenue, we're seeing some impacts operationally. There are incremental costs of operating in this environment including areas like PPE and other supplies, disinfecting services and increased over time. Further, in light of some of the general challenges operating in this environment, it is inevitable we will see negative impacts on throughput and efficiency.

As previously announced, we expect to partially offset these items through proactive cost savings initiatives, including discretionary cost reductions, hiring freezes, temporary salary reductions, furloughs and reduced bonus. In total, we expect $15 million to $30 million in total cost savings in 2020. This discussion does not touch on the potential impact of the pandemic on commodity prices, but as usual, we are separately providing our outlook for commodity volumes, prices and revenue in the appendix to the presentation.

Fundamentally, this is a highly contracted and stable business where we generally have good visibility and for the majority of the business, this has not changed. With that, I'll hand the call over to Brad to discuss our financial results in greater detail.

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

Thanks, Steve, and good morning, everyone. I'll begin my review of our financial performance with revenue on slide 7. Total revenue for the quarter was $468 million, up $15 million or 3% from the first quarter 2019. Organic growth, excluding the impact of commodities, contributed $28 million driven by a strong waste price improvement, higher plant availability in the quarter, and additional revenue related to our new wholesale electricity load-serving contract in New Jersey.

Commodities had a significant negative impact as we saw a $12 million decline related to lower market prices for energy and metal. On a year-over-year basis, average power prices across PJM in the New England ISO were down approximately 40%, while the ferrous scrap HMS #1 index and the Old Cast high side scrap aluminum index were lower by 20% and 15% respectively.

Transactions reduced revenue by $4 million with the benefit of the start-up of the Manhattan Marine Transfer Station more than offset by asset divestitures. Long-term contract transitions represented a $3 million benefits to revenue, reflecting new contract at two of our plants on Long Island.

Now, moving on to slide 8. Adjusted EBITDA was $97 million in the quarter, a $13 million increase compared to Q1 2019. Excluding commodities, adjusted EBITDA improved by $21 million organically led by stronger waste prices, Waste-to-Energy plant production, and lower maintenance outage expense. Core business organic growth was over 20% in the first quarter.

The $12 million headwind from commodity prices that I just discussed translated directly from revenue to the adjusted EBITDA line. The net contribution from transactions was $2 million representing the benefit from the Manhattan MTS while long-term contract transitions at the two plants on Long Island contributed a $1 million to EBITDA.

Turning to slide 9, free cash flow was $19 million in the quarter compared to $6 million in Q1 last year. The $13 million increase in adjusted EBITDA was partially offset by higher maintenance capital expenditures in the quarter. In light of our maintenance capital plan for 2020, we expect this to be a recurring item in year-over-year comparisons throughout the year. During Q1 2019, we incurred cash cost in connection with the closure of our Warren facility and for severance, which did not reoccur in Q1 2020 providing a $7 million favorable comparison year-over-year. Working capital provided a modest benefit in the quarter largely consistent with Q1 last year.

Now please turn to slide 10 where I'll review our growth investment activity. As discussed during our recent business and capital allocation update call in April, we plan to focus growth investment primarily on our UK project and the start up of TAPS facility in 2020. We will be highly disciplined in making any additional discretionary investments this year which this outlook reflects.

During the first quarter, we invested $8 million in TAPS and we expect to spend about $15 million in total this year. The plant didn't start up in testing right now and some of our payments to our vendors will not be released until next year after the plant has met extended operating performance tests. We plan to invest a little over $30 million in this project in total.

Upon reaching financial close on the Newhurst project in the UK in the first quarter, we received both a premium from GIG to buy-in to the project and a recovery of development cost similar to Rookery but with smaller amounts involved given the relative size, ownership, and economics of the project.

With the amounts received for both project, we currently have approximately $22 million in our unconsolidated joint venture that can now be invested in project to construction. As you can see in our outlook presented here, we anticipate that these funds will effectively cover any planned spend for the UK projects in 2020 with little net new investment required from Covanta corporate fund.

Please turn to slide 11 where I'll provide an update on our balance sheet. At March 31, net debt was approximately $2.5 billion, up $41 million from yearend. Our consolidated leverage ratio was 6 times, down from 6.1 times at December 31. And our senior credit facility covenant ratio was 2.2 times, which is flat with yearend and substantially below the covenant limit of 4 times. Our available liquidity under our revolver was $425 million at March 31.

I'd like to take this opportunity to revisit the discussion around leverage from our call a few weeks ago. The revision to our dividend policy and focus of our growth investment plan will increase the cash flow that we retain over time, and thus accelerate the pace of de-leveraging all else being equal. While it's premature to lay out a timeline for when we will reach specific target especially given the current limits on business visibility, this shift in capital allocation policy represents a fundamental reprioritization of balance sheet improvement and puts the company firmly on a path, which we think is in the best interest of all stakeholders.

Now, before we turn it over to Q&A, I'd like to hand it back to Steve for some concluding comment. Steve?

Stephen J. Jones

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

Thanks, Brad. I want to take a moment and reiterate a few things. We've spoken a lot this morning about our various initiatives to manage through this environment. There is no crystal ball and we can't say when things will return to normal. What we can say is that business has a very high degree of resiliency and stability and we're also operating as normally as possible. We are a value partner to our clients and continue to provide the same high level of service as is expected from us.

Our initiatives to grow the business are unchanged and we remain focused on these opportunities. Waste-to-Energy investments take patience and perseverance, but as we saw with Dublin, they pay off handsomely. In the UK, we remain focused on growth with three facilities in construction and multiple others in development.

New development activities in the US are at an earlier stage, but as I've mentioned before, we're seeing more activity. For example, as you may have recently seen in the press, we're in negotiations with our client in Pasco County, Florida to support the potential expansion of their waste-to-energy plant. This will take time to play out, but it's a positive sign on the potential for domestic growth and of our strong position in the market.

As always, we appreciate your interest and support and I'd like to open the line for questions now. Operator, can we move on to the Q&A?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question today comes from Noah Kaye from Oppenheimer. Please go ahead with your question.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Hey. Good morning, and thanks for taking the questions and for providing all this detail. It's very helpful for modeling. If I could ask one more, that will help us. You called out some of the higher operating cost around the process inefficiencies and supplies, over time. If we just sort of take a look at April, how – what did that actually translate to in terms of increased plant operating and other expenses? What kind of run rate higher was that in terms of millions if you can quantify that?

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

A

Yeah. It's Brad. It's difficult to quantify that at the moment. We have a good view on just in our close process on revenue for April. We haven't fully closed the books. And also I think given the evolution of the rapidly evolving situation here, probably doesn't make sense for us to put too fine a point on the operating cost impact. I think we just wanted to make sure that people were – as they think about how this may impact us that they will think about those potential impact. But then of course our intention is to offset those impacts if not – more than what we incur additionally with the cost reduction initiative.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Okay. I appreciate that. It's sort of one missing feature. But I think you've giving us the pieces for the others. If I could just sort of try to simply capture those. Assuming no improvement in the business environment, you're basically looking at – if trends from today carry forward for the rest of the year, I just want to give a baseline here. Looking at something like $50 million a quarter, so $45 million lower EBITDA for the year from [ph] $50 million net (23:13), maybe $5 million or so from 100,000 volume, call it low single – mid single-digit million lower EBITDA from energy. Maybe high single-digits from environmental service to whatever the OpEx is and then you get back some of that with the savings program, right? So, I mean it kind of implies something like $40 million to $50 million EBITDA lock if we don't get any improvement. Is that a fair way to think about it based out of current trends?

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

A

It is. Yeah. You've covered all the major categories. And again, just to confirm what you said, that's assuming the environment that we're operating in at this moment remains as is through the rest of the year, but yeah.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

All right. That is extremely helpful. If I could sneak in one more. If you can just give us a quick update on Protos, imagining all kinds of processes are slowed because of the pandemic, but just any color there on expectations for that to move forward and into financial close?

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

A

Yes. So Protos, we're in the process now of finding an EPC, so engineering, procurement, construction contractor to build the plant for us. We're talking to several different entities at this point. And so we're working through that process. It will take us a few months to work through that and then we expect to get the financial close.

So it's still moving along the path. The original EPC contractor that we're going to use ran into some issues during the year pre-COVID. And so we had to pivot towards another set of EPC contractor. So we're working on that now.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

I appreciate that. Thanks for the update.

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

A

Sure.

Operator: Our next question comes from Tyler Brown from Raymond James. Please go ahead with your question.

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

Q

Hey, good morning, guys.

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

A

Good morning.

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

A

Good morning.

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

Q

Hey, so Steve, great color on waste pricing. I think we all understand maybe why prices jogging down to keep the burners full. However, my question is how contractually locked in are you in some of these new rates? Meaning, if you gave a hauler an advantageous enough deal to redirect tons to one of your plants, did you have to give them that rate for some duration or is that not the case? I guess my simple question is how quickly can waste pricing migrate back up?

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

A

Yeah. It's interest – Derek Veenhof and I were talking about this yesterday. Yeah, these are short-term deals. So, quite frankly we're already looking at some of these deals as the stay-at-home orders start to dissipate and waste is starting to come back into the market – commercial waste is starting to come back into the marketplace. We're starting to pivot now back to our, kind of, our normal flow – back to our normal customers that we get flow from. So, not – these don't really lock us in for any significant period of time.

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

Q

Okay. That's very helpful. And I know you guys probably won't get too granular like week-to-week, but has your un-contracted price to-date improved versus [ph] peak pain (26:24) or is that just too granular?

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

A

Let me say this, because I've heard this question with some of the other bigger waste – in greater waste companies. We're in the same general business as those guys. We're expecting a similar recovery. The low point for us, because, again, I've heard this question a few times, so let me deal with it, the low point for us was kind of Easter week. So, mid – early to mid-April when most of the stay-at-home and shelter-in-place orders were in full force.

Since that time, as the commercial industrial businesses have restarted, we've seen a stabilization and a modest improvement in volumes in both commercial waste and profile waste to our facilities. So, that's kind of the position we're in now. So, again, if you look at – mid-April was particularly challenging, but it's kind of moved up from there. And from a pricing standpoint, that's following that trend.

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

Q

Right. Okay. Right. Very, very helpful. And maybe my last one. So, Brad, I just want to make sure I have it all, but the $5 million a month impact on tip fee, is that basically 100% decremental because it's all priced? The 15% to 20% decline in environmental services, I think you said was that about a 50% decremental? And then, lastly, I think you're guiding down to some $5 million in service fee revenue. Is that a 100% decremental or just how do we think about all those?

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

A

Yeah. So, the first part, it is a 100% decremental that's just a net different price. On environmental services, yes. Steve said we actually expect the decremental to be probably less than 50%. If you want to use 50% of the rule of thumb, it's probably fine.

And then, on the service fee revenue, that's really just a function of the fact that we earn additional waste service fees under our service fee contract, and so Steve commented in the prepared remarks that we're relatively volume agnostic. We do see a very small impact to the extent that volumes are running a little lower. And that's really a function of the fact that under a number of these contracts, the municipalities bringing us primarily residential waste, but also some commercial. So, the volumes are running a bit lower on the service fee deals. That's not a 100% decremental, but it's pretty high.

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

Q

Okay. Okay. All right. Thank you, guys.

Operator: Our next question comes from Mario Cortellacci from Jefferies. Please go ahead with your question.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Hi, guys. Hope everyone is safe and well. Just kind of looking longer term and I think obviously from what you just said, things have more or less bottomed or stabilized, but kind of thinking a longer term, I guess, what is the mix shift – and commercial doesn't comeback as quickly or just kind of – is it a structural change in the business? Is there opportunities to get pricing on that lower priced spot business? I'm just trying to think theoretically about it longer term.

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

A

Yeah, I think it will. I mean if volumes comeback into the market, I think you'll see more of a stabilization on pricing. It depends on the region though. In some regions, I think we've got more pricing power. In other regions, less pricing power. So, it really is region specific but I think there will be – it will – the secular trends aren't going to change – aren't changing in the market. There is limit – more limited landfill capacity and we're still seeing customers who want to go to a non-landfill option and so that's been helping our business.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Great. And I don't know if you mentioned the – any update on the regulated medical waste part of your business, but any kind of update there would be great. And then, what is your end market exposure of late, I mean in terms of I guess large quantity versus small quantity hospitals, preventative care, things like that? Just any sense for the mix of that business. Thank you.

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

A

Yeah, we have three facilities that are permitted to accept regulated medical waste. And so, we believe we have the leading market position there, so we've been pleased with that. The third plant began to take shipments in the third quarter of 2018. And so these plants provide a secure path for regulated medical waste. It's actually been interesting during the pandemic. We had originally anticipated that regulated medical waste would ramp up. It ramped up in the first quarter. You saw that 42% figure that we've mentioned. But it actually with the doctors' offices closing and the slowdown in elective surgery, regular medical waste kind of slowed down also.

So, as we start to see doctors' offices opening, my doctor's office just sent me a note the other day, they're opening up, and then elective procedures will start up again here, I think you'll see a ramp-up in regulated medical waste. Because on top of all that, you've got the COVID-19 waste and how that's all playing in. So, we originally thought that would and you saw it in China, there was a lot of COVID-19 waste coming through the system. We haven't seen that come to us at this point because the other two things I mentioned, the doctors' offices and the elective surgeries are down. So, it's been kind of a mixed bag as we got into the COVID period.

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

A

And I'll just add a little more and Steve already touched on the trends, but I think it's probably useful to restate that we're not in the hospitals. We're not in the doctors' offices of course, we leave that to our partners including Stericycles. So, Steve described the general trends. But frankly for us we don't really see a difference, whether it's a small quantity or large quantity generator. For us what's relevant is, is it must incinerate material or not and that's just impacts on the market price for the material.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Great. Thank you so much.

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

A

Sure.

Operator: Our next question comes from Brian Lee from Goldman Sachs. Please go ahead with your question.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Good morning and thanks for taking the questions. I hope everyone is safe and well. Question on the pricing. I know there's been a lot of focus here and I appreciate the granular color on the $46 per ton impact here. You are stating that it's not on the entire 30% of the volume that's kind of in that blue part of the pie chart on page 4. So, could you help size kind of what impact or what part of that mix is actually seeing the pricing impacts right now?

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

A

Yeah. Hey, Brian. It's Brad. So, we intentionally kept this at a pretty high level to essentially give the market what we see as sort of a punchline and really not get into too much detail on specific volumes, specific markets, et cetera. I would tell you though that it is a minority of the 30% is actually showing up as lower volume. But in those instances, in many cases the price delta can be pretty significant. So the most obvious example would be profiled waste that we may need to backfill depending on the location with spot MSW. Of course, our average price on profiled waste is over $100 dollars a ton. So, that can be a – that could be a pretty steep delta. But, again, in the scheme of things even within the 30%, it's not a majority of that volume.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Fair enough. That helps. And then, just a second question here on the cost savings. I would imagine some of this is going to get phased in. But can you give us a sense of how much of that $15 million to $30 million is already flowing through as of today or as of the end of Q1 into Q2 and then what the cadence of achieving the rest of that cost savings is moving through the year?

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

A

Yes, so we started – I mean some of the things we've started were fairly quick out of the gates on. Furloughing and pay reductions started several weeks ago, so they're flowing through. Travel and entertainment and discretionary spending that was easy to shut off. So, if you take the midpoint of that $15 million to $30 million, it's coming in pretty evenly right now as we start to work through this COVID period. So it's not extremely lumpy. If I was modeling it, I'd make it pretty smooth through that period.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Thanks, guys.

Operator: Our next question comes from Jeff Silber from BMO Capital. Please go ahead with your question.

Jeffrey M. Silber
Analyst, BMO Capital Markets (United States)

Q

Thanks so much. You mentioned the negotiation going out with Pasco County, Florida. I wanted to focus on that a little bit. I'm not asking for specifics on that transaction or particular transaction, but do you really think there is possibility that you might see more domestic growth or is this maybe just a one-off?

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

A

No, we've got several discussions going on right now, Jeff. Interesting with Pasco County, there is a kickoff meeting today on the discussion. So that one has been in the press. So we figured we'd mention it. There's two, three others that we're actively talking to folks. And what's happening is, a lot of these folks are looking at their solid waste plan and seeing – depending on the location, seeing the need for additional disposal capacity in there municipalities or in their geographic areas. And so that's driving the business.

And we haven't been – at least for my tenure, we haven't been talking a lot about or have had a lot of opportunities in the US. It's been more outside the US. So we've been pleased with the fact that there seems to be a change in viewpoint and I think you're going to see more energy from waste now in the US, and really focused on expansions of some of the existing facilities that we have out there.

Jeffrey M. Silber
Analyst, BMO Capital Markets (United States)

Q

Okay. That's helpful. And I know this is a horrific crisis and I hate to ask this question, but do you think there are any "silver linings" for your business longer term? Will things change?

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

A

You know that's an interesting question. I think the – kind of – and I've had this from employees, that do things will change from an employee standpoint? I think we'll get more remote, there's a lot of articles out there about how the world is going to change. As it relates to the waste business, I don't see as much. We are seeing, quite frankly, some recycling program shutdowns which means that there's more waste coming through the waste stream and I think that'll continue.

And I think you'll see that continue even further which means there'll be more waste looking for a home. So, I think it'll tighten the market up a little bit is my sense, but as a general matter, this is a pretty stable and resilient business. I don't see a lot of issues from a drop off in waste. I think if anything, we'll see the same waste levels when we get back to whatever the new normal is or maybe an uptick.

Jeffrey M. Silber
Analyst, BMO Capital Markets (United States)

Q

Okay. Appreciate the color. Thanks so much.

Operator: And our next question comes from Michael Hoffman from Stifel. Please go ahead with your question.

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

Thank you, Steve, Brad, Dan, for taking the question and I echo, I'm glad to hear your employees are safe and you as well. You all had a terrific core business, incremental in 1Q. I mean, you came in at 75% incrementals. If you follow through with all this cost cutting, I'm not saying you're not, but as you follow through with it and the revs come back, is it possible the incremental on the recovery is better than that 75%?

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

Hey, Michael. It's Brad. I suppose it's possible. I mean it really depends on the pace of and the trajectory really of the recovery, which obviously we're not sort of wading into predicting. But your point is a valid one which is the one certainty of the numbers that we've laid out is the 15% to 30%. We're doing it, no matter what. And so depending on what the recovery looks like, I suppose that's possible.

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

Well, thought differently, you take out the midpoint, what is that, 22% something, and you add revenues faster than you would add costs?

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

Yeah, I think that's right. I think you're going to...

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

Okay.

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

...that's definitely a possibility.

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

Okay. Cool. And then I just want to make sure I understood your one comment, Steve, I got the business bottoms in the middle of April. It starts to kind of look like a swish, so it's steeped down short, gradual slow recovery. Did the blended average tip fee bottom as well or does – typically, pricings tend to have a longer tail before they level and then they take slower to recover?

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

Yeah, that was more of a volume comment. The data I've been looking has been more volume-based. I think the tip fee will fall a little bit after that, but I think it directionally all move in – will move in the same direction. I have been – so far, I've been pleased with the recovery, I have to say. And as we get more states pivoting away from the shelter and home – stay-at-home and shelter-in-place orders, I think we're going to see a faster recovery.

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

Q

Okay. And then it should be an interesting observation on tailing – tagging on the question of what's the silver lining. As Derek's team is out there trying to find volume, are there fewer third-party players to find it from because they are struggling in this environment?

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

A

We haven't seen that yet. I mean...

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

Q

Okay.

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

A

...and you've been around the waste industry a long time. There's still waste coming out. Commercial side is lower. The residential side, we don't have as good a visibility with some of the big guys who are the haulers, but there's still plenty of waste I think we're going to see that needs a home.

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

Q

Okay. Thank you very much.

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

A

Thanks, Michael.

Operator: And ladies and gentlemen, with that, I will be turning the conference back over to management for any closing remarks.

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

Sure. Thank you for joining us on the call this morning and for your continued interest in Covanta. As you heard today, we're navigating through a challenging environment but we remain focused on our long-term goals. I'm extremely thankful to our employees who are diligently performing in this environment. Our success as a company would not be possible without their continued outstanding effort. So, I want to thank them.

I remain excited about the company and our progress. And we look forward to virtually meeting with many of you over the coming months as we have an active shareholder engagement schedule planned. So, stay safe, be well, and have a good day. Thanks.

Operator: And ladies and gentlemen, with that, we'll conclude today's conference call. We do thank you for joining. You may now disconnect your lines.