31-Jul-2020

Covanta Holding Corp. (CVA)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

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

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

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

During their prepared remarks, Steve and Brad will be referencing certain slides that we prepared to supplement the audio portion of this call. Those slides can be accessed now or after the call 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, July 31, 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 expressed written consent of Covanta is prohibited.

The information presented includes non-GAAP financial measures. Because these measures are not calculated in accordance with the US GAAP, they should not be considered in isolation from our financial statements, which have been prepared in accordance with GAAP. For more information regarding definitions of our non-GAAP measures and how we use them, 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. For those using the web deck, let's begin on slide 3. As a company, we've worked very hard since the early days of COVID-19 to adjust our business to the realities of the current environment. And while it has not been without challenges, I'm very proud of the team and all we've accomplished.

We followed up on a strong first quarter performance by generating $96 million of adjusted EBITDA and $62 million of free cash flow in the second quarter. These are solid results considering the environment we are in and a clear indication of the underlying resiliency of our business model. We provide essential services with our critical infrastructure that are supported by long-term contracts. This combination provides the foundation of our business and leads to our durability and predictability.

As discussed in May, on our first quarter earnings call, we responded rapidly to the COVID-19 crisis, instituting new policies and procedures to ensure the safety of our employees, while also maintaining the continuity of our operations. This was no easy task. But during the second quarter, we experienced limited operational disruptions and were able to maintain a steady flow of waste to our facilities.

We also took immediate steps to reduce costs through several proactive measures, including eliminating all non-essential travel, significantly reducing discretionary spend, enacting a corporate hiring freeze, temporarily reducing administrative salaries and implementing a furlough program.

These efforts enabled us to manage costs even as we saw an increase in COVID-19-related expenses. As I sit here today, we're in an environment where the waste volumes have improved meaningfully from the initial weeks of the pandemic. Our operations are steady and we see limited near-term commodity volatility. The most visible area of improvement resides in the recovery of the waste markets. For the entirety of the quarter, we saw same-store average tip fee prices down less than 1% year-over-year.

However, that one number doesn't tell the entire story. As we anticipated, the majority of our waste stream remained steady and our team responded to the reduction in commercial and industrial waste by effectively sourcing replacement volumes of spot municipal solid waste for our plants from our transfer station network and new customers.

Over the course of the quarter, with modest improvements in waste flows as commercial and industrial activity picked up, we were able to reduce spot tons and improve our mix. The net result was that tip fee prices bottomed in April and improved slightly in May, before a more meaningful increase in June. In fact, June tip fee prices were actually higher year-over-year. Included in our tip fee volume is the profiled waste source to Covanta Environmental Solutions.

As noted in May some segments of our profiled waste stream were under significant pressure. Most notably, auto and the international waste. Profiled waste revenue bottomed in May with revenue 19% lower year-over-year. However, similar trends in municipal solid waste, we saw a return to positive year-over-year growth in June, and profiled waste revenue ended the quarter down 5% versus prior year.

The combination of better mix and improved pricing helped to partially offset lower volumes. One month doesn't make a trend, but we remain enthusiastic about our unique ability to provide comprehensive non-landfill solutions to commercial customers, and we have not seen a reduction in interest in this market. As manufacturing ramps back up, we have seen and expect to continue to experience a return of our typical volumes, which will help to further drive overall tip fee prices.

Outside of our waste to energy plants, Covanta Environmental Solutions continues to source waste for our fleet of material processing facilities. With the quarter or for the quarter, environmental services revenue was down by 17% year-over-year. But again, we saw improvement as we moved through the quarter. Similar to waste energy profiled waste, this business provide solutions to commercial and industrial customers and its production rate slowed so did waste volume.

However, many of our end markets, including chemical, consumer products and pharmaceuticals remain steady. One characteristic that makes this business a little different than the rest of Covanta is the higher level of variable costs. With lower revenue and inbound volumes, we were able to flex our costs, which significantly reduced the bottom-line impact.

These financial results highlight our ability to manage through this environment, and this is not by chance. Our operating teams reacted decisively to the changing environment to secure our facilities and adjust our protocols and procedures to ensure continued operation. Our facility is operating normally with no material disruptions. However, this environment does not create challenges for us and has increased our cost of operations in certain areas.

One area where we shifted our original plan for this year is maintenance, where we took tactical steps to manage risk. The most years, we spend between 55% and 60% of our total maintenance dollars during the first half of the year. This is by design as the spring shoulder period is an advantageous time to perform work given the seasonally lower waste flows, typically lower energy prices and more temperate conditions. With the onset of COVID-19 in March, we decided that in order to reduce the risk to our employees and ensure the availability of qualified contractors and necessary parts, we would selectively defer outages and reduce scope for the time being.

As the second quarter progressed, and we became more comfortable that our procedures were effective in mitigating the risk of virus transmission, we started to reschedule our outages with more of a tilt to the summer and the second half of the year.

Lastly, as I mentioned earlier, we took action to partially offset these impacts by reducing cost. We recently ended the salary reduction and furlough programs in early July as businesses beginning to normalize. However, we are keeping a tight rein on costs with limited discretionary and T&E spend through the balance of the year and our corporate hiring freeze remains in effect.

With that, I'll hand the call over to Brad to discuss our financial results in greater detail, before I close out with a discussion on our longer-term strategic initiatives.

Bradford J. Helgeson

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

Thanks, Steve. Good morning, everyone. I'll begin with an update on the financial impact of the COVID-19 pandemic on slide 4. During our first quarter earnings call in early May, we discussed the areas where the pandemic was impacting our business most significantly and provided a few specific financial data points at that time. As the market and operating environment have continued to evolve, it makes sense to update this commentary to the situation today.

As we've discussed, the economic slowdown has impacted volumes of both commercial MSW and profiled waste, which has required us to source replacement waste streams at lower prices, impacting our average tip fee. Early in the second quarter, we estimated the run-rate impact to be $4 to $6 per ton as an average across our tip fee plants. As waste volumes in our mix improved in May and June, the negative pressure on tip fees abated, and we estimate that the average impact for the quarter overall was approximately $3 per ton.

At the positive trajectory exiting the quarter, the impact is currently running at an estimated $1 to $2 per ton. Of course, further improvement over the balance of the year in commercial and industrial waste volumes and, therefore, our mix and average price will be dependent upon the pace of economic recovery.

Environmental services revenue was initially lower by 15% to 20% on a monthly basis and ended the quarter down approximately 15% overall due to COVID. However, while we had originally estimated this decline to come at a decremental margin of approximately 50%, the business was able to adjust variable costs even more effectively than anticipated, ultimately, limiting the impact on EBITDA. We estimate that COVID is currently impacting revenue by 10% to 15%. But looking forward, we're confident in our ability to continue to manage costs in response to further revenue pressure in this business.

In facility operations, as discussed last quarter, we're incurring higher costs for plant safety, including for personal protective equipment, and facility cleaning. In the second quarter, we incurred $3 million of these direct costs of operating in the pandemic, and we expect this to persist over the coming quarters and likely into 2021.

As Steve discussed, we adjusted our maintenance outage schedule in order to reduce risk in the initial weeks of the emerging pandemic, and as a result, now expect heavier outage activity than typical in the second half of the year, as we execute our full original scope of maintenance. Note that this represents more than a timing shift as performing rescheduled work in this environment is now more expensive, and you'll see that reflected in a higher revised estimated range for maintenance spend in 2020 in the appendix to the presentation.

Another consequence of maintenance deferrals is that we experienced an increase in unplanned downtime during the second quarter. That impact is reflected in our outlook for tons processed for the year. And is also a factor in the increased estimate for maintenance expenses that I just mentioned. Offsetting many of these impacts are the proactive cost reductions that we announced in April, which originally targeted at $15 million to $30 million. We realized a little over $10 million of these savings already in the second quarter.

The initial range contemplated our ability to flex in response to the evolving situation and as business conditions have improved, we're now unlikely to push towards the top of the range. You'll see that we have not reintroduced guidance for adjusted EBITDA and free cash flow for 2020. While the operating environment remains challenging, business conditions, particularly in the waste market have clearly improved. And we maintain a high degree of visibility on our business as expressed in the metrics we're providing.

However, the course of the pandemic and resulting policy responses and economic consequences will ultimately determine our overall results for the year. And we don't want to try to predict what is entirely out of our control.

I'll now turn to reviewing quarterly financial results beginning on slide 5. Total revenue in the quarter was $454 million, down $13 million, or 3% from the second quarter of 2019. Not surprisingly, the impact of COVID-19 on waste and service revenue as we've discussed was the primary driver here. Lower commodity market prices for recovered metals reduced revenue by $4 million on a year-over-year basis with the ferrous scrap HMS number one index and the old cap high side scrap aluminum index lower by 23% and 18%, respectively.

Realized market energy prices were essentially flat compared to last year. Asset divestitures reduced revenue by $4 million in the quarter, while long-term contract transitions added $2 million.

Now moving on to slide 6. Adjusted EBITDA was $96 million in the quarter, a $2 million increase compared to Q2 2019. Excluding commodities, adjusted EBITDA improved by $5 million as our cost reduction program and the deferral of certain plant maintenance outages more than offset the lower revenue in the quarter. Commodity prices were a net $3 million headwind on adjusted EBITDA, again, driven by lower metals prices.

Now turning to slide 7. Free cash flow was $62 million in the quarter compared to $21 million in Q2 2019. Higher adjusted EBITDA contributed $2 million year-over-year, while the impact of lower maintenance capital expenditures, including the impact of capital type expenditures at our service fee facilities was $4 million in the quarter on a comparative basis.

Clearly, the largest benefit to free cash flow in the quarter was working capital, which was driven both by reduced accounts receivable versus last year and increased accounts payable related to maintenance activity conducted late in the quarter.

We've now reported year-to-date free cash flow of $81 million, which reflects a much heavier [ph] weighing to (00:15:01) the first half than typical for Covanta, largely resulting from the significant working capital inflows in both the first and second quarters, much of which is timing related and will reverse in the second half. Further, our maintenance capital plan for the year calls for a $155 million to $165 million of spend. And to date, we've only spent $72 million or less than half of that, which is also not historically typical.

In summary, while we're not guiding free cash flow for the year, you should not extrapolate a full-year outlook based on the reported number for the first half.

Now, please turn to slide 8, where I'll review our growth investment activity. As discussed on our last quarterly call, we plan to focus growth investment in 2020 primarily on our UK projects and the start-up of the TAPS facility. We spent $8 million on TAPS in the first half and expect to spend about $15 million in total this year.

In the UK, we exercised an option to secure the land where the Protos project will be built. Covanta made this investment of $8 million in the second quarter, but will be reimbursed for its project development costs, including land acquisition by the partnership when the project reaches financial close.

I'll wrap up my comments by touching on the balance sheet. Please see slide 9. At June 30, net debt was approximately $2.5 billion, down $8 million from March 31. Our consolidated leverage ratio was 6 times, flat with

Q1, and the senior credit facility covenant ratio was 2.2 times, which is also flat and well below the covenant limit of 4 times.

Available liquidity under our revolver was over $450 million at June 30. Our balance sheet remains stable and provides more than ample liquidity as we navigate this challenging period. As a reminder, we have no material debt maturities for several years and no covenant constraints of any kind on our business plan either now or anticipated in the future.

Before we move to Q&A, I'd like to hand it back to Steve for some concluding comments. Steve?

Stephen J. Jones

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

Thanks, Brad. I want to take a moment to circle back and remind you of our fundamental proposition and growth initiatives. At our core, we're a sustainable provider of waste services, and all of our growth initiatives build of this foundation. The secular drivers we've discussed in the past including declining disposal availability in our core markets and growing demand for sustainable waste disposal remain in place.

We don't see these trends changing in any way with the pandemic, and they enable our primary domestic growth goal, which is to drive improvements in waste prices. Offering sustainable solutions to our customers requires us to be fully committed to sustainability for all of our stakeholders, including our host communities. A key facet of this is our investment program that drives productivity and improves our already low level of emissions. We have made many of these investments in the past, most visibly, our addition of a baghouse to the Essex County, New Jersey facility. Going forward, and as discussed in our sustainability report, we are committed to making further investments in our facilities, particularly those in environmentally burdened communities.

Another set of long-term opportunities that fits squarely within our sustainability goals is our metal recovery and ash reuse initiatives. Since 2012, we've increased non-ferrous metal recovery by 220%, which reduces ash disposal and land usage, recycles usable materials and reduces the need for metal mining. Looking forward, we expect to further increase our non-ferrous metal recovery both in our plants and via our total ash processing system, or TAPS.

At our first TAPS plant in Eastern PA, we continue to work through the testing and commissioning phase. Our current goals are to increase production, improve metal recovery and ensure reusability of the remaining aggregates. We will use the balance of the year to fully prove out its capabilities prior to full-scale operations.

We've long discussed our goal to grow our footprint in the UK market where there is significant need for new waste to energy infrastructure, and where the logic of this technology over landfill from an environmental and sustainability standpoint is well-recognized. During the last two years, we have seen tremendous success on the project development front, and the benefits of these investments are in view.

We're now in full construction of three facilities with initial financial contributions from projects occurring in 2022. Another project, Protos, is now in its final development phase with financial close expected late this year.

Lastly, before we move on to Q&A, I wanted to express my gratitude to the entire Covanta team. Our frontline operations personnel kept our facilities running as well as anyone could in an environment that no one envisioned six months ago. At the same time, our back office and administrative people transitioned to working from home without missing a beat. Instituting the payroll reduction and furlough programs was a painful decision, and I'm very pleased to end it. The shared sacrifice enabled the company to mitigate the financial impact of the pandemic and ensured the company emerged stronger. So thank you all for your ongoing efforts.

With that, I'd not now like to open the line for questions. Operator, can we move on to the Q&A.

QUESTION AND ANSWER SECTION

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

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

Thanks. Good morning. Appreciate your taking the questions. And I'm sure a lot folks really want to dive into the waste price and mix trends. So let me actually leave that aside for a second, and ask you about some of these longer-term strategic initiatives, and start maybe with just a little bit more color on TAPS. Where are you at in terms of proving out the process, demonstrating the reusability of the aggregate with customers? Just help us understand kind of what you're working through over the course of the year?

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

Yeah. Thanks, Noah. It's Steve Jones here. I was just out there last week, and actually, Dan and some of the folks, Brad were out there. We're in the process of processing ash, and we've made our first sale, the metal that we're reclaiming from the ash processing system. We've gone through that process, and we're producing aggregate and sand. And what we're doing now in the aggregate and sand, they're going through the various test protocols that are required in order to use that type of product in the construction products market.

So, all of this is coming along nicely. We are putting in a little more water capacity. Water is important in this type of process. And I'll say, overall, this is somewhat of an R&D project in that we're tweaking the composition of equipment as we figure out how to get even more metal out of the ash, and we've been successful from that standpoint. So, it's all working very well from my perspective.

What we need to do now is to start to ramp up on rates, and that's what I mentioned in my prepared remarks. As we go through the year – through the rest of the year, we want to ramp rates on how much ash we're processing. We'd like to get our first sale of aggregate, and we're talking to both asphalt companies in and around Pennsylvania, and New Jersey and cement companies.

Flowable fill concrete is an application for the aggregate and sand that we produce. So, all that – so all that's coming along nicely at this point. So I'm pretty pleased with where we stand, and we'll kind of ramp-up in volumes from here.

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

Okay. Great. Thanks for that color. Just in Protus – Protos rather – maybe help us understand, why did you buy the land? Presumably, that's a sign of conviction, project will go forward. And maybe what progress are you making in terms of finding a new EPC and driving that part of the process on?

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

A

Yeah. So our land option was going to expire, and so we felt and as we got closer to the expiration date, we looked at where the project returns were, where we were on the EPC. So good question, or a good facet to your question there. And we're comfortable enough to go forward with the land purchase. So that should give investors a pretty good indication of how we feel about this project.

On the EPC side, we're talking to two EPC providers now, both of them are reputable suppliers of engineering procurement construction services. So we feel good that one of those will be the winning party, and we'll be able to move forward with that. And the other thing that, we've just recently engaged is the lenders. So we've got the lending group kind of back together now, and starting to talk and so we're moving ahead with documentation on the lending side and trying to get the financial close. So we expect that will be later this year, but Protos and the land purchase is an indication Protos is moving along nicely.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Okay. Terrific. And last, I just wanted to touch on or unpack all the comments earlier around increased investments in some of the environmentally burdened communities. Can you just help us understand, what is the decision calculus on undertaking those investments? What's driving that? Does that portend any kind of increased maintenance, or CapEx beyond kind of normal levels? And what is the benefit to you?

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

A

It's interesting. Back in 2011, we developed an environmental justice policy and community outreach policy. We're one of the few companies that have that kind of policy. So we realize that, where we operate we've got people who are around us and we've got to be doing our best from an emissions standpoint. And so in our sustainability report, we had indicated that we were going to do a number of projects in environmental justice in overburdened communities.

And so, as that's become more in the news recently, we thought that as part of this earnings call, we make it clear that we're committed to that. We've been committed to being a good operator in and around the communities where we operate, and that we'd move – we're going to move forward with those commitments that we've made.

And again, they're in – you take a look at our sustainability report, and it's quite good, I think. That – in our maintenance numbers, all that's included there. When you make these types of investments, you do them for both emissions reasons, but they also have a productivity benefit. And so they all make sense from a number of different vantage points, and we'll continue to look at those investments to make those investments as we move through the next couple of years.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Okay. Perfect. Thanks very much. I'll jump back.

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

A

Thanks.

Operator: And the next question comes from Tyler Brown from Raymond James. Please go ahead.

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, Tyler.

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

A

Good morning, Tyler.

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

Q

Hey, Brad. So I know you guys elected to withhold guidance, and I totally get it, but it also feels like you've given us some bread crumbs here to kind of run with. So – and please stop me at any time, but I think the way that I'm thinking about it is there's kind of three big buckets of delta relative to your original guidance.

First, you've got lower waste revenues from tip and service fees. Secondly, you've got higher PPE costs, maybe lower metals and higher maintenance. And then three, you've got cost saves to the positive. So just to start, are those kind of the big deltas relative to the original guide?

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

A

Yeah. I think that gathers together the bread crumbs pretty well.

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

Q

Okay. So if we were to look at each of those buckets, and I know the tip fees are fluid, but based on what we know right now, does it feel that that waste bucket is maybe a $25 million drag, if I kind of sum it up to, again, versus the original guide? And that's between tip fees, service fees and maybe volume?

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

A

I mean, it depends on how you do the math for the rest of the year. But of course, the pieces to that are, we've been specific about revising our guidance for service fee revenue, we lowered that by $5 million. And we've lowered our outlook for plant production in tip fee volumes by about $100,000. So if you apply our average tip fee, that puts you in the ballpark of probably another $5 million. And then the big variable, I think, for the balance of the year is weighted average tip fee prices.

Of course, we were on plan in the first quarter, everything was normal, we ended up about $3 a ton negative to original plan in Q2. We're $1 to $2 now. So is that $1 to $2, is that what we see to the rest of the year? Do we see further improvement? Or does the pandemic take another turn for the worse? We'll have to see in the coming months. But those are definitely the pieces.

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

Q

Okay. Okay. That's helpful. And then I do want to come back, so you mentioned $3 million in PPE costs. First off, is that in maintenance expense?

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

A

No. No, in other operating costs.

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

Q

Okay. Okay. So you've got $3 million of PPE costs, assume that, that stays with us. It looks like you lowered non-tariffs a little bit, and you've got, obviously, this higher $15 million in maintenance. So that bucket feels like that's another, say $30 million drag versus, again, kind of the original guidance as well. Does that seem fair?

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

A

I think you're in the ballpark.

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

Q

Okay. And then you've got this positive $20 million on the cost offset. So maybe, I'm crazy, but if you use the breadcrumbs, it feels like maybe EBITDA is tracking $30 million to $35 million lower relative to the original guidance. If I was to, again, kind of follow those breadcrumbs?

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

A

Yeah. I think the way you've added up the data points make sense.

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

Q

Okay. I'm going to leave it at that, but I really appreciate the time.

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

A

Okay. Thanks.

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

A

Thanks.

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

Mario Cortellacci
Analyst, Jefferies LLC

Q

Hi, guys. Thank you for the time. I just kind of wanted to dive into that, the increased maintenance expense a little bit. It's gone up by about $15 million, and just wanted to see, I guess, what's driving that? Is there – you've obviously, pushed some expenses into the back half of the year. But I guess, do the actual increase, is that due to the friction and actually doing the maintenance, either social distancing or timing of shifts, or – are there any other pieces inside of that, that would be driving it outside of the – that are more COVID-related rather than you doing more work?

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

A

No. It's really, it's really – like you said Mario, it's the friction associated with doing this maintenance. Think about this, we are doing this maintenance at a later point in the year, particularly in the hot summer months. So we generally do this maintenance in the shoulder season, where it's cooler. So we're doing the maintenance in 60-degree weather, now we're doing it in 90-degree weather. And when you get inside a boiler, I think most investors would understand this, but if you get inside one of these boilers, it's already hot.

So there's less – there's more frequent change out of workers. You need more rest effectively. We're very concerned about heat stress. We've been doing a lot of safety context around heat stress as we've encountered some issues around that. So we've been really careful from that perspective. Contractors are a little more expensive in this environment, per diems, for example. We used to have maybe two contractors to a room, when they were traveling. Now, because of the pandemic, it's one contractor to a room. So it's that kind of friction, in a tougher climate, more frequent breaks, as you put it, that are driving up the cost. I think my view is, if you look going forward, this will – we'll get smarter at this, like a lot of things as the pandemic is going on. I think where our productivity is increasing, we're getting better at dealing with potential heat stress, for example. But there is a friction that's – that we're running into at this point.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Okay. So that's an – obviously, you're not guiding 2021. But as we get into next year, we should see either all of that or part of that come out of the expenses, as you either have better timing or [ph] you're going to have to (00:32:23) do it during the summer months, or is that the right way to think about it?

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

A

Yeah, because if you think about it next year, because we've figured out and I said this in my prepared remarks, we kind of figured out how to do maintenance in a COVID environment. We'll be doing these – doing the maintenance again back in the shoulder season. So we'll get back to doing maintenance in the normal period of when we did it. So you'll see this friction dissipate.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Okay. Great. And then just one on pricing, and I guess, just being a little more specific with it from a geographical standpoint. Obviously, the mix is hurting pricing. But I guess, could you break out the impact between maybe what that looks like in the north versus what that looks like in the south? And then in – and then also, what does pricing look like in those geographies on a like-for-like basis as well?

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

A

Hi, Mario. It's Brad. So I think the short answer to the question is that the business where this is impacted is our merchant business, which is almost entirely in the northeast along the Eastern seaboard.

So the tip fee business is a northeastern business. So what we're saying about that business as a whole is a kind of a regional comment I suppose. The business that we have in Florida in contrast is predominantly a service fee business, and I touched on the impact we're seeing there as well. But when Covanta talks about merchant waste prices, we're really talking about the Northeast.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Got it. Okay, understood. And then, have you guys provided what the end market exposure looks like for profiled waste? I'm just trying to get a sense for, I guess, which parts of that business are coming back faster than others. Obviously, you're seeing demand pick up and commercial and industrial businesses improving as things rebound from the pandemic. But have you guys provided the exposure for profiled waste, or could you?

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

A

I think – let's say, the areas that we got hit hardest on, and I mentioned this in my prepared remarks are international travel, which isn't coming back really at this point. And auto, and auto is starting to come back. So it's really auto is probably the biggest driver. We've been pretty steady in pharmaceuticals, chemicals, those types markets have been pretty steady, so – through the pandemic. It's auto, auto dropped off and now most of the auto manufacturers are back in production.

Mario Cortellacci
Analyst, Jefferies LLC

Q

Great. Thank you so much.

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

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

Q

Thanks, Steve, Brad and Dan. I was trying to be creative to figure out how to get one question to ask -- with five different questions in one. Now, it sounds like I can just keep asking them. Brad, would you update us on what the decremental now is for ES?

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

A

Yeah. Well, in the second quarter it was effectively zero. I mean, we were down about 15%. We estimate due to COVID in the quarter. We were down a little more than that year-over-year. Obviously, our plan had been to grow that business year-over-year. And we saw very little EBITDA impact in the quarter, frankly.

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

A

Yeah. It's interesting, Michael. The – we actually did – we talked about furloughs. We did a furlough in the administrative home office area, but the folks in CES did even further furloughs, so that we could flex our variable costs down. And so you saw that the impact we saw from the revenue line didn't really have much of an impact, didn't flow through to the EBITDA line.

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

Q

Could one get carried away and go, you did such a good job, that's volumes starting to recover, costs come back on slower, and there's margin tailwind in the second half?

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

A

Yeah, I think there is. Yeah.

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

Q

Okay.

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

A

I think the – we talked to Paul Stauder who runs that group. I think he's feeling pretty good about the second half of the year as things start to load back – the revenues load back on.

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

Q

Okay. And then on the volume side, can you frame for us the – where is the recovery of the percent that's under contract and the – what's the recovery of the percent that's under a spot – that was spot? How would you score that on a percent of recovery from the dip?

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

A

Yeah. Hey, Michael. It's Brad. We're probably not in a position to get too precise on the percentages, between one or the other. But sort of at a little bit of a higher level, spot volume was for us materially down in June. And that's what, Steve commented in his prepared remarks that on a year-over-year basis our average tip fee in June was actually up year-over-year, and a lot of that was, of course, the profiled waste coming back, contracted volume coming back, and spot getting kicked out in effect from the plants. I think there was some probably some one-time factors impacting June. For example, in the industrial area volume deliveries that were probably held back in April and May, sort of flooded when the doors opened in June. So, that should normalize over time. Also, with the increased downtime, we had for outages, that reduces the need for spot waste, which just naturally reduces the pressure from that on weighted average tip fee. So, yeah, that will sort of normalize, again, going forward at that we think the $1 to $2 net impact on where we thought we'd be originally.

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

Q

Okay. If I could tease it a little bit, are we better than halfway recovered on the contract side? Or are we still below – [ph] how about in halves (00:38:30) at least where are we relative to?

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

A

Yeah. I think, we are. I mean, simply just based on the difference between – out of the gates, we felt like we were hit by $4 to $6 per ton. Now it's $1, to $2. So, there was a dramatic improvement from when we spoke to you all in early May to now.

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

A

Yeah. We're seeing a pretty good improvement, Michael, from that perspective.

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

Q

Okay. I was just trying to get – I get we have to figure out the cadence but I'm just trying to figure out the cadence. Does $1 to $2 turn into $0 to $1 turns in itself plus $1 kind of $3, $4 1Q. And that's how to think.

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

A

We think half is the right way though, Michael. I mean, you had mentioned this last time. Is it a Nike Swoosh here? How is it moving up from where we are today?

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

Q

Right. Working capital, well, how do we think about that cadence of it rolling back off? Is it a heavy [indiscernible] (00:39:39), or is it going to come off relatively smoothly? How do I think about that?

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

A

Well, a big benefit we saw in the second – this is Brad – a big benefit we saw in the second quarter was growing accounts payable related to the fact that we did a lot of maintenance work later in the quarter, and just frankly, didn't get a chance to pay the bill. So – and that which is normal. It's just the way that the working capital moves around the sculpting of the spend.

So that specifically should reverse in the third quarter, this month, August. So, really then the question becomes what's the working capital position at the end of the year? And we're not really in a position I think anymore to predict that with a lot of precision. But net-net, you absolutely will see working capital, I think on balance as a negative across the second half.

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

A

I will say something along those lines on – because I saw some of the other waste companies were talking about credit risk and things around that, we saw a good receivable performance in the second quarter. And our days sales outstanding is right – pretty much right on top of where we were a year ago. So, we're not getting picked up on some people were worried and – some other companies about the receivable side. We're not worried at all. We've had strong receivable performance.

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

Q

So good cash collections still on plan...

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

A

Yes.

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

Q

...pay. This -- working capital is mostly, a payables issue, and would you expect that this is – without it being a number – a positive or a negative working capital for the year?

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

A

That's to be determined, yeah. I think it'll certainly be negative for the second half, where it ends up on balance positive or negative for 2020 TBD. But again, and Steve mentioned it, and I mentioned in my prepared remarks, and I think given the environment, it's definitely something we want to highlight. Accounts receivable was a component of the strength in Q2. Smaller of the two between AP and AR, but what it absolutely was the strength, which given the concerns that we have had and are natural for that side of the balance sheet in this environment. I think it's really good performance.

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

Q

Thank you for taking all of the questions at once. Appreciate it.

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

A

Sure.

Operator: Next question comes from Jeff Silber from BMO Capital Markets. Please go ahead.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

Thank you so much. I guess, I wanted to continue to the breadcrumb trail that Tyler started, and maybe that you guys elongated in the last answers to Michael. Everything that you've said, would it make sense that we would see negative free cash flow in the second half of this year?

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

A

It's possible.

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

A

Yeah, it's possible.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

Okay, great. And then just another cash flow question, I'm assuming you had some benefits from payroll tax deferral from the CARES Act. If you can just quantify that for us?

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

A

No, we didn't. We didn't avail ourselves of that.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

Okay. All right. That's good to know. And then, I guess, a bigger picture question, one of your competitors announced earlier this month the acquisition of [ph] hauler (00:42:59) I guess part of a vertical integration strategy. Is that something you guys might be considering over the next few years?

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

A

Yeah. We've looked at this over time, and I'm going to comment on their strategy, obviously, Jeff. But we've looked at this over time. We've found that we can get plenty of waste because of where our facilities are situated or geographically. So we haven't seen the need to get waste on wheels. Again, we can – we've shown through a lots of different periods of time that if we need to pull in more waste, we can do that. And we showed it during this pandemic, quite frankly. So I don't think you'll see us kind of moving in that direction. And quite frankly, we've got a slate of – we've got to slate – a full slate of investments in the UK. And even I have talked about them. With it – so a lot of our capital right now is really focused on UK investment, TAPS and then paying down debt. And that's not in that order, but they're all kind of in there together. So yes, so I don't – to answer your question, I don't think you'll see us putting wheels on the road.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

Okay. That's great. And just, if I could sneak in one more. I think last past quarter we talked a little bit about there was some press speculation about you guys getting or bidding for a new facility, and I think it was Pasco County, Florida. Can we get an update on that?

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

A

Yeah. So we're in a sole sourcing discussion right now with Pasco County. It'll take some time. So we're in the early stages of decide – to talking to them about what their expansion might look like. Like a lot of places, a lot of places, several places around the US, there's opportunities to expand these facilities as the municipalities look at their 10-year waste – solid waste plans, and Pasco County has been growing from a population standpoint. And so, are starting to think about what they want to do as the population has grown. And so, more to come on that, but it's kind of early in the discussions. But you will see, and there's a handful of these opportunities in the US. You will see us doing US projects here over the next several years as these municipalities come to grips with their future solid waste programs.

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

A

And then, Jeff, it's Brad. I'll just add a comment, just to properly calibrate expectations around these opportunities. So as Steve mentioned, the Pasco opportunity, because that one happened to have been in the press and it is indicative of the types of opportunities we're seeing in our portfolio, but these processes move very, very slowly by their nature. And so as to the expectations, people probably shouldn't expect us to have kind of quarterly updates on any of those situations.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.
Q

Okay. Fair enough. Thanks so much for taking my questions.

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

Sure.

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

Brian Lee
Analyst, Goldman Sachs & Co. LLC
Q

Hey, guys. Good morning.

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

Good morning.

Brian Lee
Analyst, Goldman Sachs & Co. LLC
Q

Thanks for taking the questions. I had a couple of follow-ups, maybe just first on the maintenance expense and OpEx. The $15 million to $20 million increase here, it sounds like it's mostly COVID-related. But on a net basis, I supposed it'd be higher just given the $15 million to $25 million in the cost reduction program is being reflected as part of the maintenance expense, and OpEx increase.

So I guess first question on that is the $15 million to $25 million in cost reduction, is that going to fall through all the maintenance expense on OpEx side? Or does it show up elsewhere in the P&L? And then secondly, how much of the $15 million to $25 million sort of sticks when things kind of normalize and you're not having to deal with some of these elevated expenses that you're dealing with right now?

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

Yeah. Hey, Brian. It's Brad. So to be clear, none of the now, $15 million to $25 million range on the cost reductions. None of that impacts the maintenance line. Really, you see that in the SG&A line and in other plant's operating expenses.

Now as far as projecting forward to next year or to when there's a normalized operating environment, the majority of that cost savings will unwind at that time. So it's really put in place as a shock absorber to the extent that business conditions worsen. So obviously, we put that in place for this year. I think that being said though, naturally, there are like many companies, there are probably some areas where we're going to be reassessing more generally, and fundamentally, where our cost structure should be, around things like travel and entertainment. I mean, that's sort of an easy one. I can't imagine sitting here today that we're going to be traveling next year as much as we have in the past.

And I think again, that's probably goes for just about everybody. And then, other discretionary expenditures that we've really tightened the reins on this year. Maybe that leads us to reassess some of those expenses going forward. So generally speaking, I would say that the $15 million to $25 million is one-time offsetting the benefits that hopefully are one-time this year. But I think they may open up some opportunities for us to reduce the cost structure in a more permanent way going forward.

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

Yeah. You're going to see us, me in particular, pushing on that because I think there are opportunities as we kind of re-envisioned, how you do your job. I think there's ways to get the cost stack down further on an ongoing basis.

Brian Lee
Analyst, Goldman Sachs & Co. LLC
Q

[indiscernible] (00:49:12) Okay. Great. That's clear. And then I might have missed this on the prepared remarks, but the increase in growth CapEx tied to international developments, can you give us a bit of a breakdown as to where that spend is focused here and are you indicating any type of acceleration in the timeline, or was this always sort of kind of the implicit plan and it's just now becoming more official in the CapEx guidance? Thanks, guys.

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

Yeah. So this is Brad. So the increase was essentially entirely the purchase of the land for the Protos project. That wasn't necessarily our plan to purchase it, when we did but just that we -based on the timeline of that project, the option to acquire that land was expiring in May, and so we had to make a decision. So while it doesn't indicate necessarily a change in the timeline of the project. We're still focused on getting that project financially closed and into construction later this year. It is indicative, and Steve made this comment earlier, it is indicative I think of our confidence in where that project sits, primarily with pulling together the EPC arrangements for construction.

Brian Lee
Analyst, Goldman Sachs & Co. LLC
Q

Okay. That's great. And is it typical that you buy the land or do you lease the land? Kind of what's typical in terms of some of the new developments that you approached in the past whether in the US or internationally?

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

It can go either way. I mean, you might enter into a long-term lease, 99 years, which is effectively buying the land, or you buy the land. So it all depends on the particular project.

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

And with this investment, ideally, if given the flexibility we probably would have just purchased it at financial close, because Covanta is going to be reimbursed for that investment by the project. Now, of course, we will be a part-owner in the project, but our partners will reimburse us.

So, again, perfect world, that's the way we would do it. But the circumstances around this required us to make a decision earlier and so, therefore, it shows up as an investment on Covanta's consolidated financials today.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Understood. Makes sense. Thanks, guys.

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

A

Thanks.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

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

Yeah. I'd like to thank, everybody, for joining us on the call this morning, and for your continued interest in Covanta. Stay safe, be well, and have a good day and also have a good weekend. Thanks. Thanks for joining us.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.